ARIAS U.S.

QUARTERLY

What Arbitrators Want

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Workers' Compensation, New York Labor Law and RICO

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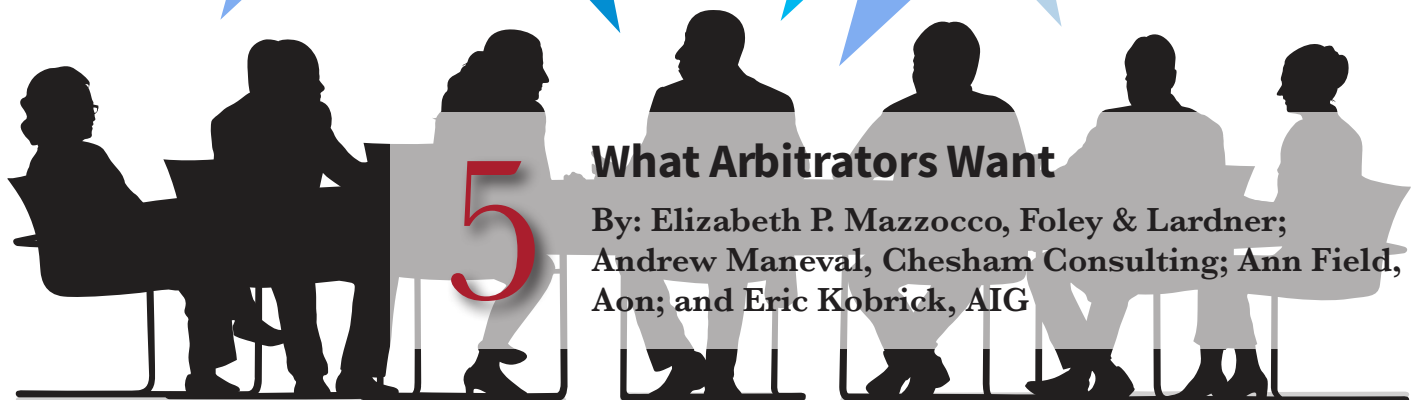

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EDITORIAL POLICY — ARIAS·U.S. welcomes manuscripts of original articles, book reviews, comments, and case notes from our members dealing with current and emerging issues in the field of insurance and reinsurance arbitration and dispute resolution. All contributions must be double-spaced electronic files in Microsoft Word or rich text format, with all references and footnotes numbered consecutively. The text supplied must contain all editorial revisions. Please include a brief biographical statement and a portrait style photograph in electronic form. The page limit for submissions is 5 single-spaced or 10 double-spaced pages. In the case of authors wishing to submit more lengthy articles, the *Quarterly* may require either a summary or an abridged version, which will be published in our hardcopy edition, with the entire article available online. Alternatively, the *Quarterly* may elect to publish as much of the article as can be contained in 5 printed pages, in which case the entire article will also be available on line. Manuscripts should be submitted as email attachments. Material accepted for publication becomes the property of ARIAS·U.S. No compensation is paid for published articles. Opinions and views expressed by the authors are not those of ARIAS·U.S., its Board of Directors, or its Editorial Board, nor should publication be deemed an endorsement of any views or positions contained therein.

Continued Celebrations of ARIAS' 30th Anniversary at Fall Conference

This issue of the Quarterly arrives as we are having our Fall Conference and our final celebration of the Society's 30th Anniversary year. From our Keynote Speaker, Frank Nutter, former President of the Reinsurance Association of America, to our special panel of some of the founding directors of ARIAS, we end our 30th year on a high note. Once again, we want to acknowledge our generous 30th Anniversary Sponsors, who will be recognized at the Fall Conference.

Also, a special thanks to the 2023-24 Board of Directors, four of whom will be stepping down at the Fall Conference. They include: Current Chair Marc Abrams; Past Chair Alysa Wakin; Peter Gentile; and Jonathan Rosen. If you attend the Fall Conference, please be sure to attend the Annual Meeting and Elections on Thursday afternoon, Nov. 14, 2024, to elect four new directors. If you are not attending (and even if you are), please make sure you send in your proxy for the vote on the slate of Directors for 2024-25.

Hopefully, by the time you read this, the ARIAS website has been refreshed. We kept the same look and feel, but cleaned up the website and made it more user-friendly. Let us know what you think. There will be more enhancements to the website as we move forward.

Enhanced Membership Benefits Continued

Speaking about enhancements, the ARIAS Board has voted to continue

the Enhanced Membership Benefits program into 2025 and beyond. The program provides Certified Arbitrators with a deep discount on all educational programs (other than the Spring and Fall Conference) and up to 10 employees of Corporate Members with free access to those same educational programs. Certified Arbitrators and employees of Corporate Members must use the applicable discount code when registering for a webinar, seminar or workshop. The discount code is the same for all educational events for the year, so if you have received the discount code, you can use it all year for all educational events. If you need the discount code, please contact me or info@arias-us.org. The 2025 discount code will be available after January 1, 2025 and will be distributed then.

The Board also approved the ARIAS·U.S. Diversity, Equity and Inclusion Statement, which you can find on the website. This statement acknowledges the Society's commitment to advancing diversity, equity and inclusion.

What Arbitrators Want, AI, and more in this issue of the Quarterly

This issue of the Quarterly features a roundtable discussion from an important Spring Conference panel. Titled, "What Arbitrators Want: A Roundtable Discussion of Arguments and Litigation Practices Arbitrators Find Persuasive… or Not," Elizabeth P. Mazzocco, Foley & Lardner; Andrew Maneval, Chesham Consulting; Ann Field, Aon; and Eric Kobrick, AIG present their views on what works and what doesn't when presenting a case to a panel of arbitrators. These three experienced arbitrators discuss the panel selection process, the role of position statements, opening statements at the organizational meeting, motions to compel and more.

Next, we have an article based on another presentation made at the New York City Bar on Directors and Officers Liability. Certified Arbitrator Alan "Willie" Borst, compiled the salient points raised in three panel presentations covering various aspects of Directors & Officers Liability and related issues arising from the SEC and artificial intelligence developments. Titled "Directors & Officers Liability Perspectives," the article truly provides some useful perspectives on these issues.

Direct insurance issues are important, of course, to direct insurance disputes and also to reinsurance disputes as those losses flow through to reinsurance contracts. In "Workers' Compensation, New York Labor Law and RICO," Frank DeMento and Howard Freeman from Transatlantic Reinsurance Company

provide us with an excellent refresher and update on the issues arising from workers' compensation and New York's unique labor law provisions that have generated substantial losses to insurers and reinsurers over the years and how RICO is being used in this context.

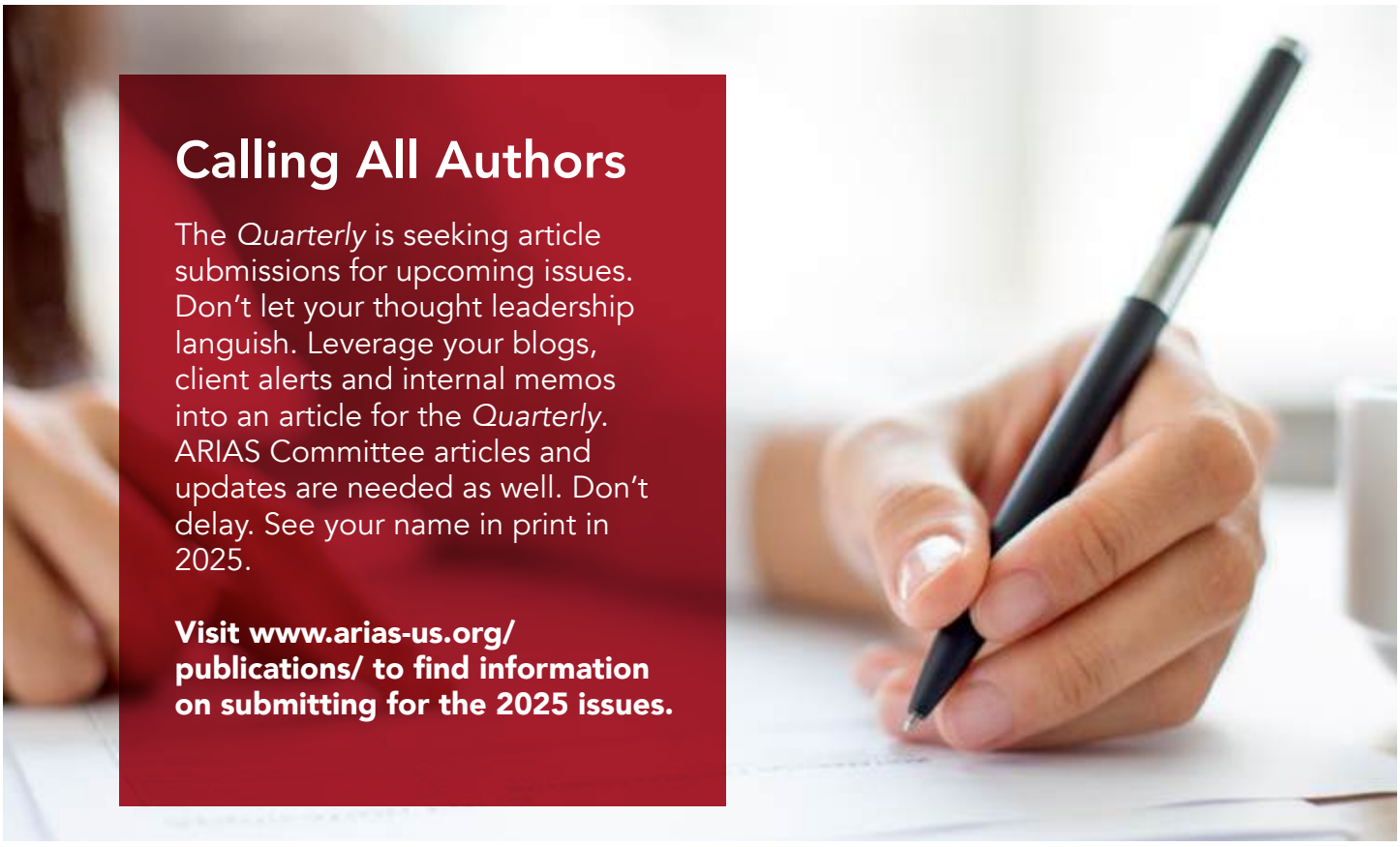
We then present yet another article from our Editorial Committee member Robert Hall of Hall Arbitrations. This time, Bob discusses developments in asbestos trusts in his article titled, "Insurers As Parties In Interest In Reorganization Asbestos Trusts." Whether insurers have a say in what happens with asbestos trusts is a very important issue to many insurers.

Frank DeMento is back again with a second article, this time with Bryan McCarthy of TransRe, covering issues arising from the use of Lithium batteries. In "Risks Associated With Lithium-ion Batteries," Frank and Bryan take us through the issues developing from the rising use of Lithium-ion batteries and what is being done to mitigate this potentially significant risk.

Finally, we have five new ARIAS Law Committee reports on cases practitioners and arbitrators should know about.

We hope you enjoy this issue of the Quarterly. We still need your contributions to future issues. The deadlines and requirements are on the ARIAS website under Publications. We welcome ARIAS committee reports, letters to the editor, original articles and repurposed articles from ARIAS CLE programs. If you are on a panel at the Fall Conference or have made a proposal for the Fall Conference that was not accepted, please turn your presentation or proposal into an article. Leverage your thought leadership and publish an article in the Quarterly. Your thought leadership should be published.

Larry P. Schiffer
Editor



What Arbitrators Want

A Roundtable Discussion of Arguments and Litigation Practices Arbitrators Find Persuasive . . . or Not

By: Elizabeth P. Mazzocco, Foley & Lardner; Andrew Maneval, Chesham Consulting; Ann Field, Aon; and Eric Kobrick, AIG

Editor's Note: *This article is a digest of the panel presentation made at the ARIAS·U.S. 2024 Spring Conference on May 1, 2024. The speakers were Elizabeth P. Mazzocco, Foley & Lardner; Andrew Maneval, Chesham Consulting; Ann Field, Aon; and Eric Kobrick, AIG.*

Mazzocco: As litigants and outside counsel we may find ourselves wondering what practices are most helpful and persuasive to the panel of industry professionals deciding our cases.

In this roundtable discussion I explore these questions with three experienced ARIAS·U.S. certified arbitrators.

Ann Field is an Executive Managing Director at Aon, serving as the Head of Client Services for North America and Head of Global Advocacy for the Americas. She has been ARIAS·U.S. certified since 2007 and has served as an arbitrator or umpire on over forty arbitrations.

Eric Kobrick is currently Senior Vice President, Deputy General Counsel and Head of International Insurance Legal at AIG. He has held a variety of senior legal roles in his over 25-year career at AIG as well as several roles in the over 25 years he has been involved with ARIAS, including serving as Chair of the Board of Directors. In addition, he has served as an arbitrator or umpire in nearly 50 arbitrations.

Andrew Maneval is a certified umpire and arbitrator, with experience in

over 175 industry arbitrations. He was previously an officer in various insurance and reinsurance companies in the Hartford Insurance Group, as well as a law partner at the Mound Cotton firm in New York.

Ann, what makes for a successful panel dynamic, and what advice do you have for parties in the panel-selection process to create the best panel dynamic for their objectives?

Field: I recommend hiring industry experts that really understand reinsurance, insurance, and/or contract law. I would put an emphasis or bold font on the word "industry experts." Often times having panel members who have sat in-house and can really appreciate what happens in an insurance or reinsurance company can be very persuasive on a panel. They understand custom and practice as well as the reality of what really happens inside of an insurance or reinsurance company.

Hiring industry experts that can understand and appreciate the actual issues at hand or be subject-matter experts for the line of business is a further benefit. Accordingly, if you have a property catastrophe treaty, for instance, ensuring that you have a party-appointed arbitrator that has experience with catastrophe treaties can go a long way. For your party-appointed arbitrators, you should be able to glean this from their resumes and/or any pre-appointment discussions with them.

In addition, you will want to ensure that your arbitrator is able to be an appropriate advocate. By that I mean ensuring they are well-matched with the demeanor or reputation of the opposing arbitrator, should that be an issue.

"Hiring industry experts that can understand and appreciate the actual issues at hand or be subject-matter experts for the line of business is a further benefit."

For your umpire, you want to ensure they too are experts in the industry. In addition, they should be good at managing the overall case, including managing the panel, and must be organized, professional, fair, unbiased, and capable of running (and sometimes controlling) a good hearing.

I believe there is quite a bit of this that already takes place. Parties and counsel tend to consider who the party-appointed arbitrator is and who would be a good advocate up against that party-appointed arbitrator. The same is true for the umpire selection. I know it can be a long process at times, but some of that is really determining who would be a good fit with the party arbitrators to ensure the panel is truly dynamic.

Mazzocco: Andrew, what role do position statements serve for you as an arbitrator, and what tips do you have for litigants to make them most useful for the panel?

Maneval: Position statements are very important for the umpire. In U.S. practice, at the outset of the case, the party-appointed arbitrators usually have been briefed on the claims and defenses in the arbitration. Umpires, however, have no such familiarity with the issues until they see the position statements. The position statements' "purpose" is to provide sufficient information for decision-making at the organizational meeting ("OM"), but they should also serve as an advocacy piece addressed to the umpire. The trick is to keep a position statement brief and focused enough to perform its formal purpose while also putting the umpire properly in mind of the submitting party's positions. That is a delicate balance.

As a practical matter, they should also provide the requisite input on what the panel will need to do at the OM, including dealing with issues such as confidentiality and ex parte communications, and setting a realistic and appropriate schedule. The latter can be influenced by such factors as motions

and third-party discovery, so to the extent possible these activities should be identified and justified.

Field: I agree with Andrew. I also find that position statements are a first impression regarding the demeanor of counsel both individually as well as how well they work together (or do not work together!).

Mazzocco: Eric, leading up to the OM there is often the question of whether litigants will deliver an oral statement at the meeting or stand on their position statements. Under what circumstances do you think it is useful to have oral statements, and what makes for an effective oral statement?

Kobrick: An effective oral statement will be clear and concise and will not simply rehash points from the position statements or address items that are premature (in the sense that there is no need for the panel to hear argument about them at this point in the proceeding). If a party is seeking immediate relief or intends to seek relief shortly after the OM, that should be flagged to the panel.

Also, given that position statements are usually submitted simultaneously so that a party does not have an opportunity to respond to the other party's arguments, if there is something worthy of response (i.e., something material), whether on a substantive or procedural issue, that should be addressed. Finally, if counsel has never appeared before the particular panelists (and the umpire, in particular), he or she may want to at least make a brief presentation to "break the ice" and provide the panel a sense of his or her presentation style.

Mazzocco: Ann, in the context of a motion to compel, what can litigants do to convince you that certain documents are relevant and necessary, and the other side should produce them?

Field: Be realistic, specific, and cost-efficient. Parties should be realistic with the request for documents to begin with and then be realistic with the expectation of documents based upon the issues and facts of the case. When parties go on a fishing expedition, it does not sit well with the panel and counsel can lose credibility early on in the arbitration process, which I suspect no attorney wants to do.

Regarding specificity, parties should be able to outline exactly why these documents are critical to the case and why the evidence cannot be secured in other ways such as in depositions.

Further, it is important to be cost-efficient. This is in line with having realistic expectations. Asking for overly burdensome or expensive-to-retain documents is not going to be persuasive to a panel. It is not just the photocopy expense; it is the internal business people's time to secure the documents being requested electronically or otherwise. The panel will need to make a cost-benefit analysis on whether the request is appropriate given the size of the case and the resource cost.

Mazzocco: What tips do you have for parties to best make use of their party-appointed arbitrator's experience and advice at various stages of the case before submitting pre-hearing briefs, which is when ex parte cutoff often commences?

Field: Litigants should speak at a high level with their party-appointed arbitrator regarding the approach and strategy they are taking. They should see if the party-arbitrator believes their approach is a good one given the panel, or if they have any other suggestions on what may be persuasive for the panel at hand.

> "Litigants should speak at a high level with their party-appointed arbitrator regarding the approach and strategy they are taking."

Mazzocco: Andrew, how do you use the pre-hearing briefs in preparation for the hearing, and what can parties do to make their brief as effective and

persuasive as possible to set themselves up well for the hearing?

Maneval: Most panels do not utilize post-hearing briefs, heightening the importance of the pre-hearing briefs. Usually, attorneys prepare slide presentations to accompany their closing arguments to the panel; hence, I will typically use both the pre-hearing briefs and the closing presentations in preparing for, and conducting, deliberations. Important cases and authorities should be linked to the briefs for easy access.

However, quite often it is the critical documents that most influence the outcomes of arbitrations, and these documents should also be linked in the briefs. This will allow the party-appointed arbitrator to call them up easily during deliberations and, presumably, they will be made more familiar and accessible to the umpire as well.

When critical evidence will be received solely via testimony, I often find it useful to have the briefs synopsize such testimony – although that "promise," once made in pre-hearing briefs, had better be kept at the hearing! While "concise" is generally a good practice, counsel should not be afraid to submit longer pre-hearing briefs: the briefs should always deal with each claim or defense presented by the party and, to the extent possible, all those put forward by the other party. Simply ignoring a claim or defense might unintentionally lend it some unwarranted credence.

Naturally, the pre-hearing briefs should be as specific as possible regarding the relief that party seeks and in what form it should be delivered.

Mazzocco: Do you ever permit the parties to submit a sur-reply in support of their pre-hearing briefs? If so, under what circumstances?

Maneval: I think the best practice is for the panel to receive initial pre-hearing briefs and then reply briefs, each pair of briefs to be submitted simultaneously by the parties. A sur-reply, then, would only be considered if some entirely new argument or material fact is raised for the first time in a reply brief. If there is an apparent attempt at a blatant "ambush," then the panel should certainly permit a sur-reply. However, this would constitute bad lawyering by the "ambushing" party and is not often seen. Good lawyering will ensure that however new, effective, and compelling the spin or the advocacy can be in a reply brief, a sufficient predicate for that point or allegation will already have been established in the initial briefs.

> "At the end of the day, be intellectually honest and do not attempt to defend the indefensible."

Mazzocco: Eric, what is the best way for litigants to deal with bad facts in their case?

Kobrick: There is no one way to deal with bad facts.

As a general matter, I would suggest that counsel be transparent with the panel and address the bad facts head on. Do not pretend that bad facts are not actually bad if they really are bad! Instead, argue that the bad facts really should not matter because they are irrelevant, are outweighed by other "good" facts, etc.

The key is to control the narrative, with a caveat. The caveat is that it is possible your adversary may not actually raise the bad facts or only raise them in passing, and you do not want to give the facts more prominence than they otherwise would have received. There may be instances where you should sit back and wait to see how your adversary deals with the facts and then react accordingly.

At the end of the day, be intellectually honest and do not attempt to defend the indefensible. The panel does not expect your case (or any case) to be perfect, and you will lose credibility with the panel if you pretend otherwise.

Mazzocco: Often reinsurance treaties will expressly free the panel from a strict application of the rules of law. In that case, to what extent is it persuasive for litigants to base arguments on formal rules such as the Federal Rules of Civil Procedure or Evidence?

Kobrick: The Federal Rules should be viewed as a guide; they are relevant but not determinative.

> "The Federal Rules should be viewed as a guide; they are relevant but not determinative."

It is perfectly appropriate for counsel to argue, for example, that if we were in federal court, a particular piece of evidence would not be admitted because it is hearsay, and while counsel understands that the panel is not obligated to follow the Federal Rules as it relates to hearsay, it should follow the rule in this instance.

The key is to argue the rationale behind the rule. Do not just say "objection, hearsay," or even worse, "objection, Rule 802!" Counsel should say something like "objection, hearsay, because the witness is testifying as to the truth of what is asserted in a statement that she heard from Jane Doe who heard it from John Doe, neither of whom were under oath, which does not make the statement sufficiently reliable and trustworthy that it should be considered by the panel."

Mazzocco: Ann, same question regarding citation to case law. And, is there any difference in the value of (re)insurance-specific case law or case law cited for general legal principles, such as contract interpretation principles?

Field: If case law is supportive then by all means use it but be sure to attach copies of the case law. Reinsurance case law is always helpful, but so is case law for contract interpretation or coverage on direct cases or other legal principles.

Mazzocco: Eric, we also often see treaties either requiring or permitting the panel to consider evidence of industry custom and practice. What advice do you have for litigants for how to best support a custom and practice argument?

Kobrick: To level-set, industry custom and practice evidence is different than evidence of the course of dealing between the parties on the issue, and it does not simply mean how your client did something.

At the same time, it does not mean that every company had to do something the exact same way. If the issue is, for example, how certain expenses are treated, the key is to present the custom and practice on this particular issue. And the strength of the argument will depend on how consistent the practice of treating the expenses was among companies that did business at or around the same time, in or around the same market or geography, and under the same or similar type of contract, among other possible factors.

For example, how companies in the London market treated expenses under reinsurance facultative certificates in the 1990s may not be particularly probative of how companies in the Bermuda market treated expenses under reinsurance treaties in the 2000s.

Mazzocco: Andrew, what are some tips for how parties can best address, or prepare witnesses to address, umpire or party-appointed arbitrator questions during the hearing?

Maneval: There are two kinds of questions: (a) simple clarifications of confusing or misstated points, and (b) probing, substantive questions.

To counsel and witnesses, the most important questions clearly are the substantive ones asked by the umpire (or neutral arbitrator). Typically, these questions will reflect or address concerns the decision-maker may have regarding a specific fact or issue, and one on which some further input could influence a particular outcome. These kinds of questions should always be carefully considered by counsel (and witnesses) and may warrant subsequent follow-up if the initial response seems not to satisfy the questioner or not to cover the waterfront. Often, by their questions, umpires are undertaking to signal counsel on what they consider to be the critical factor(s) in making an ultimate determination; it would be foolhardy for counsel to ignore or minimize such guidance.

Practitioners in arbitrations are very familiar with "probing" questions that party-appointed arbitrators sometimes

pose to the opposing party's witnesses. These can take the characteristics of a "second cross-examination." Except where there is a very inexperienced attorney representing a party (a rarity in our business), this is correctly considered to be a usurpation of counsel's proper role and function. Generally, counsel (and the umpire!) do not like to see this happen.

Sometimes it can be even more egregious, however, for example when one side would act to insert otherwise impermissible or objectionable questions by having them be advanced by a party-appointed arbitrator. This is an especially bad practice, and one that umpires should always be prepared to limit or prevent. When the "second cross-examination" has become particularly overt or "tactical," counsel should not feel abashed about asserting objections to a party-appointed arbitrator's questioning that breaches the rules in place or has otherwise crossed the line.

Mazzocco: Ann, how can litigants best educate the panel on the significance of key documents through witness testimony?

Field: First, be respected as the counsel throughout the whole hearing (starting with the OM and forward) so that the panel does not get frustrated or distracted because you have set the wrong tone with the panel. This will help with your credibility as the advocate and the panel will be listening because they hold you credible.

Second, set the stage in your pre-hearing briefs so that the panel is familiar with the documents and your position.

Third, be well prepared with your witness testimony. The order in which the documents are presented and the preparation of your witnesses all play important roles in this.

> "...expert evidence could help alleviate imbalances on the panel."

Fourth, ensure you have reference to these key documents and the testimony during your closing statement and/or your closing presentations.

Mazzocco: Andrew, what contribution does expert evidence (reports and testimony) provide in the panel's understanding of the case? What can litigants do to make their expert most useful to the panel?

Maneval: Occasionally, the need for expert evidence is obvious: technical or scientific matters involving engineering, medicine, aeronautics and the like. Other times, expert evidence may be fully appropriate for "technical adjacent" matters such as accounting, actuarial, and foreign law subjects.

But there are less obvious, but also appropriate, circumstances warranting expert evidence even on "industry" matters. For example, certain highly specialized lines of business (e.g., Reps and Warranties, financial guaranty, surety, or boiler & machinery coverages) might be outside of the panel members' experience and experts could help establish important context for (and understanding of) such coverages and their application to alleged losses.

To some extent, expert evidence could help alleviate imbalances on the panel. For example, if one arbitrator has been in claims her whole career, while the other arbitrator and the umpire have been underwriters, and the defense develops a potentially dispositive issue regarding certain claims practices, expert evidence could be used to prevent a party-appointed arbitrator from having an undue or excessive influence on the outcome of what might be a controversial issue with multiple reasonable interpretations. This can apply to alleged matters of "custom and practice" and "businesslike conduct" in the industry, notwithstanding panels' disinclination to receive such expert evidence in insurance and reinsurance matters. Parties should not necessarily be deterred from presenting fair, useful, or equalizing expert evidence based simply on this generalized disinclination.

Mazzocco: Eric, what are some overall best practices for an effective, persuasive closing argument, including both the presentation itself and any accompanying written material?

Kobrick: Tell a story that seamlessly weaves all the evidence together. It is that simple!

> “...the closing argument is critical, especially if there is no post-hearing briefing, in which case it will be the last chance to convince the panel of your position.”

Seriously, the closing argument is critical, especially if there is no post-hearing briefing, in which case it will be the last chance to convince the panel of your position. Hand out a power-point presentation of your argument at the outset so that the panel can easily follow along and will not be distracted by taking notes. Make sure you include citations to the record (documents and hearing or deposition testimony) for all factual assertions and have citations to cases or statutes for all legal assertions.

Keep the characterizations of the other party’s arguments to a minimum. Saying an argument is frivolous does not make it so, but showing the absence of any evidence to support the argument does.

Finally, make crystal clear the relief you are seeking. That sounds simple, but you would be surprised how often the parties treat this item as almost an afterthought and do not clearly address what they would like the panel to do!

Elizabeth Mazzocco is a trial lawyer with experience litigating a variety of complex commercial disputes in federal and state courts across the country. She has notable experience representing insurance and reinsurance companies in arbitrations involving life insurance and property/casualty insurance contracts.

Mazzocco is a member of the Insurance & Reinsurance and Business Litigation & Dispute Resolution Practice Groups.

Andrew Maneval is the President of Chesham Consulting, LLC, providing services as an Umpire, Arbitrator, and Mediator in the insurance/reinsurance and financial services industries; he also provides consulting and expert witness services in these fields.

Ann Field is an Executive Managing Director at Aon, serving as the Head of Client Services for North America and Head of Global Advocacy for the Americas. In her role, Field oversees over 100 Claim and Accounting Advocates, managing all premiums, claims, and accounting for Aon’s diverse segments and clients. Field has a diverse and extensive background in all lines of property and casualty business involving treaty and facultative reinsurance contracts dating from 1945 through 2023. Field is an ARIAS·US certified arbitrator and a licensed attorney with over twenty-five years of significant experience in reinsurance and insurance coverage issues, arbitration and litigation. ARIAS·US certified since 2007, Field has served as an arbitrator or umpire on more than forty arbitrations. She is also a Northwestern University trained and certified mediator. Field served on the ARIAS·U.S. Board of Directors from 2011 through 2017 and is currently the Chair of the ARIAS·U.S. Women’s Resource Committee. Field is a frequent speaker at various industry conferences. In 2015, 2016, and 2019 Intelligent Insurer honored Field as one of the “Top 100 Women In Reinsurance.”

Eric Kobrick is a Deputy General Counsel and Chief Reinsurance Legal Officer at American International Group, Inc. in New York. Kobrick joined AIG as Assistant General Counsel in 1997, was promoted to Associate General Counsel in 2001, assumed the additional title of Chief Reinsurance Legal Officer in 2005, and was promoted to Deputy General Counsel in 2009.

Directors & Officers Liability Perspectives[1]

By: Alan Borst

Editor's note: *Recently the author participated in a webinar where he moderated a panel that provided a primer on Directors & Officers ("D&O") liability. The panel gave an overview on D&O liability insurance based on sample policy forms prevalent in the industry. To the extent minor wordings may be different between carriers the basic concepts are largely the same. One should of course consult the particular form in force before making any coverage determination. The remarks during the presentation and in this article represent the presenters' views and not necessarily the views of their respective firms or companies.*

As a general product description, D&O liability insurance represents the "last line of defense" in a scheme of corporate fiduciary liability commencing with state statutory protections and the "Business Judgment Rule" passing through corporate by-laws including corporate indemnification and ending with D&O insurance itself. If the claim is cut short at any of the intermediate stages, there is no D&O claim. As a result, it is necessary to review D&O's responsibility under governing law in assessing any D&O claim.

There are two different standards of review when considering a business transaction (and by extension an insured's responsibility). These are the Business Judgement Rule ("BJR") and the Entire Fairness Doctrine. Under the Business Judgment Rule, the initial burden is on the plaintiff to challenge the transaction. There is the presumption that the corporation's board acted in good faith. Under the Entire Fairness

Doctrine, the burden of proof falls on the defendant to show that the majority of the directors who approved the transaction were unconflicted, or that the same parties were not on both sides of the transaction.

Directors generally owe the following fiduciary duties to their corporations: (1) the duty of care; (2) the duty of loyalty; and (3) the duty of obedience. As a rule, winning defense strategies are based on some version of the BJR even in federal cases based on the federal securities acts. The question to be resolved is did the board act reasonably and were they reasonably informed? To the extent they were not reasonably informed, did they act with *scienter* or were they reckless in not knowing the full truth. Remember, fully one-third of Section10b(5) securities class actions will be dismissed at the pleading stage, so this defense strategy will generally save more policy dollars than any given coverage strategy.

The standard D&O policy form is divided into three parts or three coverage sections, referred to as "sides" in the industry, which are set out below:

Corporate Indemnification?

Individual Directors and Officers Personal Assets	Corporate Protection	Corporate Protection
"Side A" Directors and Officers	"Side B" Corporate Indemnification of Directors and Officers Pursuant to By-Laws	"Side C" Corporate Entity Coverage?

We observe that Side A is limited to non-indemnifiable claims such as where the insured corporation either cannot (e.g., insolvency) or will not indemnity the claim. Side B is the much more frequent claim where the corporation is reimbursed for its indemnification of the Director. Side C is limited to securities claims and only reimburses the corporate entity.

The D&O policy typically defines "claim" in detail, as a written demand for monetary damages or non-monetary (injunctive) relief or a civil or criminal proceeding alleging a "Wrongful Act."[2] The takeaway is that the term "claim" can include correspondence and documents that fall short of a formal lawsuit. A letter, or even an email, may satisfy the claim definition. The first communication with the carrier may be of critical importance in determining the claims made date that will govern the policy period for (re)insurance purposes.

Is a subpoena a claim? Compare *Astellas US Holdings, Inc. v. Starr Indemnity & Liability Co.*[3] ("that [the insurance company] may have to cover plaintiffs' costs related to the subpoena — is not absurd, it is precisely what the policy intended") with *Patriarch Partners, LLC v. Axis Insurance Co.*[4] (SEC subpoena deemed "non-monetary relief" because it created a legal obligation upon the recipient to produce documents to a governmental agency). Even if the particular document in question does not constitute a claim, it may be regarded as a "notice of circumstance"[5] so long as it can reasonably be expected to give rise to a claim (against an insured).

Note the difference in some policies between "claims made" and "claims made and reported" language, which may make a difference under particular wordings. In the author's opinion, notice of claim leads to more (re)insurance disputes than any other single issue. For example, in *Heritage Bank of Commerce v. Zurich American Insurance Co.,*[6] the court held that a copy of the notice of claim sent to the primary carrier was ineffective against the excess carriers when sent to the underwriters — not the claims departments — of the excess carriers. This is especially true in cancel / re-write situations where new carriers are coming in and exiting in a tumultuous period of the corporate insured's lifespan.

Note the definition of insured person in the typical D&O policy includes a functional list that includes employees of the insured acting in the capacity of an insured:

Insured Person means any natural person:

1. who was, is, or becomes a duly elected or appointed director, officer, **Manager**, risk manager, or in-house general counsel, or any functional equivalent position, of the **Insured Organization**, or such natural person while serving in an **Outside Position**; 2. who was, is, or

becomes a shadow director of the **Insured Organization** pursuant to the United Kingdom Companies Act of 2006, or equivalent statute; or 3. not described in 1. who was, is, or becomes a full or part-time employee of the **Insured Organization**, with respect to: (i) a **Securities Claim**; or (ii) any other **Claim**, but only if such **Claim** is made and maintained against both such natural person and any natural person described in 1.

For D&O coverage to apply, the insured person must be acting in an insured capacity and no other capacity:

Wrongful Act means:

an actual or alleged error, misstatement, misleading statement, act, omission, neglect, or breach of duty committed or attempted: (i) by an **Insured Person** in his or her capacity as such; or (ii) by an **Insured Organization**, solely with respect to Insuring Agreement C; or 2. any matter claimed against an **Insured Person** solely because of his or her serving in such capacity. Solely with respect to determining whether a **Security Holder Derivative Action** that names the **Insured Organization** as a nominal defendant is a **Securities Claim** against such **Insured Organization** for purposes of Insuring Agreement C, any **Wrongful Act** as defined in 1.(i) will also be deemed to be a **Wrongful Act** of such **Insured Organization**; provided, this provision will only be deemed to create coverage for **Non-Monetary Resolution Fees** and **Nominal Defendant Expenses**. **Wrongful Act** does not include any conduct committed or attempted by any **Insured Person** in his or her capacity as a director, officer, manager, trustee, or employee of any entity other than the **Insured Organization** or **Outside Entity**, even if service in such capacity is with the knowledge and consent of, at the direction or request of, or part of the duties regularly assigned to such **Insured Person** by the **Insured Organization**.

Notably, when evaluating coverage of an insured person, one must ask: what was their position on the board? Are they being sued in their capacity as member of the board? Are they being sued as an owner, or dominant shareholder, or based on an incident outside their board capacity, or related to a position on a board not affiliated with the Inured?

In the past few years there has been an uptick in lawsuits relating to Special Purpose Acquisition Companies ("SPAC") and their resulting new entities referred to as "DeSpacs." Three potential towers of insurance coverage are applicable to these suits one for each of the pre-merger entities, *i.e.*, SPAC/DeSpac/ Private Company holding company—leading to questions of which tower(s) will respond. In each coverage determination, we must ask: what "hat" was the director or officer wearing at the time of the allegations?

Finally, after defining the loss by an insured person in an insured capacity we examine the "LOSS" definition itself to see if the loss incurred by the Insured is indemnifiable under the policy. Remember this is not a liability policy so not all loss for which the insured may be liable is covered. Notably we observe that only compensatory damages are covered, not restitution.[7] Punitive damages and civil fines are covered but only to the extent they are allowable under the jurisdiction with a substantial relationship to the **Insured**, the **Company** or to the **Claim.** It should be noted that a substantial number of states allow insurability, although there are significant exceptions (e.g., New York and California).

In addition, judgments, settlements and, of course, defense costs (which erode the limits available for compensatory loss) are covered under the D&O form. Note that from an excess carrier's or reinsurer's perspective a settlement which might ultimately fall within retentions or underlying coverages may impact their coverage due to the erosion of indemnity limits by defense costs and other professional fees.

So, what is <u>not</u> covered? We have a long list of exclusions in the typical D&O policy.[8] As a general matter these carve outs from coverage are just explicit statements of what does <u>not</u> constitute a compensatory loss. In other words, giving back what you took is not covered. Some of the more oft disputed of these carve outs in this category are the one for "bump up" (#5) and for disgorgement (#6), the latter of which has an exception for "33 Act" restitution (which would include stock buy backs as well). The reasoning behind the bump-up exclusions is that the particular type of restitution requested in a derivative suit is seeking return of the excess in value paid in a corporate merger. Recognizing coverage for this loss under the policy would be an invitation to overpay for corporate acquisitions. Note also the carveout for claims for excess compensation. These carveouts are straight-forward and largely self-explanatory.

Exclusions in the policy appear straight forward but can cause confusion in their application: There are generally exclusions for dishonesty, personal profit, bodily injury and property damage, ERISA, and Insured vs. Insured (commonly referred to as "I v I"). For an example of confusion that can be caused when multiple plaintiff/defendant parties are named and only one is an insured, *see Stoneburner v. RSUI Indem. Co.*[9] There, the insureds attempted to argue that at least some of the plaintiffs in the underlying suit were non-insureds such that they should receive a partial exemption from the absolute I v. I exclusion. They were, in effect, arguing for an allocation of the claim and partial indemnification of their defense costs. The court granted summary judgement to the carrier, however, finding that the entire lawsuit was a single claim and the court would not "carve apart causes of action which the underlying plaintiffs…have pleaded jointly."[10]

Notably, the dishonesty and personal profit exclusions require an adjudication, so the carrier usually fronts the defense up until the point of adjudication. A simple allegation will not suffice to avoid indemnification of defense expenses. (Having paid defense expenses, the insurer has a technical right of recoupment after an adjudication, but it is almost never asserted in practice. Keep in mind that the defendant insured may be in jail and or destitute so there may be no point in pursuing the recoupment).

Note this practice tip: the degree of intent required to trigger "34 Exchange Act" "scienter" is not the same as required to show intent under policy provisions. It is much lower. As a consequence, even a recklessness finding by an adjudicator may not be sufficient in and of itself to support a denial of coverage. It may be sufficient however to support a claim for contribution to a settlement (at mediation for example) by the defalcating insured.

As a rule, reasonable accommodations made to the insured to avoid litigation compel against taking strong coverage stances without a sound policy position to back them up. The exception to this is probably the "I. v. I exclusion," where the basis of the coverage denial should be generally ascertainable from the face of the complaint, and this without any showing of collusion on the part of the insured. Insurers and reinsurers (ultimately reviewing claims submissions) should resist the urge to interpret allegations of the underlying complaint as statements of fact. The vast majority of claims settlements are compromises where the insurer necessarily waives policy defenses for claims of criminality or underlying intentional fraud.

The second panel of the program focused on U.S. securities litigation and developments in Delaware corporate law The panel provided an overview of recent Delaware Chancery Court trends in regard to *In Re Caremark,* 698 A.2d 959, 971 (Del. Ch. 1996), Section 14(a) of the Exchange Act of 1934, and Delaware Code § 220. One apparent takeaway is that plaintiffs in securities cases can now use Section 220 demands under Delaware Law to strengthen their federal securities cases and use records thus obtained to draft complaints better able to withstand motions to dismiss. *See, e.g. Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019).

Next, the panel reviewed noteworthy federal and U.S. Supreme Court decisions in the securities class action arena. These included class certification cases, which remain a hotly contested area with the plaintiffs' bar scoring a major victory. In *Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System,* 141 S.Ct. 1951 (2021), plaintiff class members submitted evidence from 27

"Insurers and reinsurers (ultimately reviewing claims submissions) should resist the urge to interpret allegations of the underlying complaint as statements of fact."

evidence scholars who argued that defendants bear the burden to rebut the presumption of reliance by a preponderance of the evidence. To hold otherwise, the Court reasoned, would be to negate *Halliburton II's* holding that plaintiff need not directly prove price impact to support class certification under Rule 23.[11] Defendant issuers benefited from another part of the ruling as to what types of evidence a court may consider at the class certification stage. It is now black letter law that defendants in a securities-fraud class action bear the burden of persuasion to prove a lack of price impact by a preponderance of the evidence in order to defeat class certification.

On the other hand, the Second Circuit Court of Appeals reversed class certification in *Arkansas Teacher Retirement System*, 77 F.4th 74 (2d Cir. 2023), holding that the defendants had successfully severed the causal link between the back-end price drop and the front-end alleged misrepresentation. *But see, Ferris v. Wynn Resorts,* 462 F.Supp.3d 1101 (2020) (connection established between revelations and allegations). These cases are heavily fact specific, which indicates that large defense costs will result.

In an issue of first impression, on the issue of standing the Ninth Circuit Court of Appeals affirmed a district court ruling that both registered and unregistered shares were sufficiently traceable to the issuer's registration statement to permit the purchaser to sustain an action under Sections 11 and 12(a)(2) of the Securities Act of 1933. *Pirani v. Slack Techs., Inc.,* 13 F.4th 940 (9th Cir. 2021). On writ of *certiorari*, the Supreme Court reversed, holding that a plaintiff bringing a Section 11 claim must plead and ultimately prove that the securities held are traceable to the registration statement alleged to be false or misleading. Another pro-issuer decision by the Supreme Court is *Macquarie Infrastructure Corp. v Moab Partners, L.P.,* 144 S.Ct 885 (2024), in which the Court unanimously held that a failure to disclose information required by Item 303 of Regulation S-K cannot support a private claim under Rule 10b-5(b) in the absence of an otherwise misleading statement.

It remains to be seen whether the Ninth Circuit's pro-plaintiff decision in *E. Ohman Or Founder AB v. NVIDIA Corp.,* 81 F.4th 918 (9th Cir. 2023), will be upheld or modified by the Supreme Court. If the Court denies certiorari or affirms then the ruling upholding allegations of cryptocurrency financial fraud will stand. Defendants had moved to dismiss because the allegations were based on expert projections and not internal data.

Another pro-plaintiff decision in the District of Arizona on scheme liability opens new avenues for future securities litigation against D&Os under so-called "scheme" liability. Whereas Rule 10b-5(b) imposes liability against only those who "*make* any untrue statement of a material fact," subsections (a) and (c) make it unlawful "to employ any device, scheme, or artifice to defraud" or "to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." The court held that under "scheme" liability the defendant director or officer need not be a "maker" of a false statement in order to be liable for fraud. *Borteanu v. Nikola Corp.,* 20-cv-01797 (D. Ariz. Dec. 8, 2023).

The third panel of the program focused on the impact of artificial intelligence ("AI") on D&O risk. The panel addressed the growth and influence of AI and specifically its connection to evolving laws, regulations, and litigation.

One aspect of the AI presentation addressed the current laws and guidelines that are currently in existence today. This included In October 2022, the White House Office of Science and Technology's "Blueprint for an AI Bill of Rights,"[12] which was later followed in October 2023 with President Biden's Executive Order on "Safe, Secure, and Trustworthy Artificial Intelligence."[13] Federal regulation, such as the Federal Algorithmic Accountability Act proposed by Congress, has yet to gain traction. However, the executive branch continues to put out guidelines, such as the White House Office of Management Budget's memorandum on "Advancing Governance, Innovation, and Risk Management for Agency Use of Artificial Intelligence."[14] This established "new agency requirements and guidance for AI governance, innovation, and risk management, including through specific minimum risk management practices for uses of AI that impact the rights and safety of the public."

The panel also addressed some of the current litigations that have been filed that involve AI. There have been several lawsuits filed recently involving AI companies, such as *Divino Group LLC v. Google LLC*,[15] which alleged that YouTube LLC and parent Google LLC use artificial intelligence algorithms and manual reviews by employees to "discriminate[d] against plaintiffs based on their sexual or gender orientation, identity, and/or viewpoints by censor-

ing or otherwise interfering with certain videos that plaintiffs uploaded to YouTube." On July 5, 2023, the court dismissed the 4th Amended Complaint with prejudice.[16]

Another set of cases that were addressed were some early product liability cases related to AI and autonomous vehicles, such as *Cruz v. Raymond Talmadge d/b/a Calvary Coach*,[17] stemming from an incident when certain plaintiffs were either injured or killed when the bus that they were on struck an overpass, and *Nilsson v. General Motors LLC*,[18] which involved an injured motorcyclist who was struck by an autonomous vehicle when it swerved into his lane on a highway. In addition, there was discussion about current actions involving intellectual property disputes over AI, such as a case that challenged AI gathering certain images over copyright issues, *Andersen v. Stability AI Ltd.*,[19] where the court in October 2023 granted in part and denied in part the defendant's motion to dismiss. The court denied the motion to dismiss plaintiffs' claims for direct infringement, but dismissed the vicarious infringement claims, right of publicity claims, breach of contract claims and unfair competition claims. Also noted was the lawsuit that was brought by the New York Times in December 2023. *NY Times v. Microsoft Corp, Open AI*, [20] which is still pending.

The panel concluded by debating what sophisticated practitioners are doing with underwriting and claims inquiry checklists related to AI. They also gave predictions on how AI has its benefits, but also potential liability for companies that implement them, in particular with concerns on maintaining privacy and compensating for bias in the data. The developing law and related insurance coverage surrounding AI is continuing to unfold and it is unknown how it will be changing the world in 2024 and beyond.

Endnotes

1 This article is based on the Insurers' and Insureds' Perspectives on Current Issues in D&O Liability & Insurance 2024, May 10, 2024, New York City Bar. The author moderated the primer on D&O liability panel at this program. The moderators and panelists extend their thanks to the Insurance Law Committee of the New York City Bar Association for their sponsorship of this valuable annual event.

2 1. written demand for monetary damages or non-monetary relief (including a request to toll or waive the statute of limitations or for injunctive or declaratory relief) alleging a Wrongful Act which Claim shall be deemed first made upon the Insured's receipt of notice of such demand;

2. civil or criminal proceeding (other than an investigation), arbitration or any alternative dispute resolution proceeding alleging a Wrongful Act, including any appeal there from, which Claim shall be deemed first made upon the date of service upon or other receipt by an Insured of a complaint in any such proceeding, or on the date of the return of an indictment, information or similar document against an Insured in any such criminal proceeding;

- administrative or regulatory proceeding (other than an investigation) against an Insured Person or against an Insured Entity (but only to the extent such administrative or regulatory proceeding is continuously maintained against both an Insured Person and an Insured Entity) alleging a Wrongful Act, including any appeal there from, which Claim shall be deemed first made upon the date of service upon or other receipt by an Insured of a complaint in any such proceeding;
- civil, criminal, administrative or regulatory investigation of an Insured Person alleging a Wrongful Act, including any appeal there from, which Claim shall be deemed first made upon such Insured Person being identified by name in an order of investigation, subpoena, Wells Notice, target letter (within the meaning of Title 9, §11.151 of the United States

3 No. 17 CV 8220 (N.D. Ill., May 30, 2018).

4 No. 16-CV-2277 (VEC), 2017 U.S. Dist. LEXIS 155367 (S.D.N.Y. Sep. 22, 2017), *aff'd on other grounds*, No. 17-3022, 2018 U.S. App. LEXIS 34341 (2d Cir. Dec. 6, 2018).

5 Practical Considerations surrounding what constitutes a claim. Note the following regarding "circumstances":

> If, during the **Policy Period** or the Discovery Period (if applicable), the **Insureds** become aware of any circumstances which may reasonably be expected to give rise to a **Claim** against the **Insureds** and if, before the end of the Policy Period or the Discovery Period (if applicable), the **Insureds** give written notice to the Insurer of the circumstances and the reasons for anticipating such a **Claim**, with full particulars as to dates, persons and entities involved, potential claimants and the consequences which have resulted or may result from such **Wrongful Act**, then any Claim subsequently made against the Insureds and reported to the Insurer alleging, arising out of, based upon or attributable to such circumstances or alleging any Wrongful Act which is the same as or related to any Wrongful Act described in such notice will be considered to have been made at the time such notice of circumstances was given.

6 No. 21-CV-10086-RS, 2023 WL 25710 (N.D. Cal. Jan. 3, 2023).

7 Coverage based on the "Loss" Definition

> Under the D&O main form policy we have the following basic definitions:
>
> **Loss** means the amount which an **Insured** becomes legally obligated to pay as a result of any **Claim**, including:
>
> (A) compensatory damages;
>
> (B) punitive, exemplary or multiplied damages, if and to the extent such damages are insurable under the law of the jurisdiction most favorable to the insurability of such damages, provided such jurisdiction has a substantial relationship to the **Insured**, the Company, or to the **Claim** giving rise to such damages;
>
> (C) civil fines or civil penalties assessed against an **Insured Person**, including civil penalties assessed against an **Insured Person** pursuant to 15 U.S.C. §78dd-2(g)(2)(B) (the Foreign Corrupt Practices Act), if and to the extent such fines or penalties are insurable under the law of the jurisdiction in which such fines or penalties are assessed;
>
> (D) judgments, including pre-judgment and post-judgment interest;
>
> (E) settlements; and
>
> (F) D**efense Costs**

8 What is <u>not</u> covered – carveouts from the loss definition

> **Loss**, other than **Defense Expenses**, does not include:
>
> 1. any amount that an **Insured** is absolved from paying;
> 2. taxes, fines, or penalties; provided, **Loss** includes:
>
> a. civil penalties assessed against an **Insured Person** pursuant to the Foreign Corrupt Practices Act of 1977 §§ 15 U.S.C. 78dd-2(g)(2)(B) and 78ff(c)(2)(B) and the United Kingdom Bribery Act of 2010 (Eng.) § 11(1)(a); or
>
> a. taxes assessed against an **Insured Person** pursuant to applicable federal, provincial, or territorial statutory law imposing liability upon the **Insured Person** in his or her capacity as such where the **Insured Organization** has failed to deduct, withhold, or remit such amounts as required by law and is financially unable to do so;
>
> 3. any cost of complying with any order for, grant of, or agreement to provide, injunctive or non-monetary relief;
> 4. any cost incurred testing for, monitoring, cleaning up, removing, containing, treating, detoxifying, neutralizing, or assessing the effects of, any **Pollutant**;
> 5. any amount of damages, judgments, or settlements that represents, or is substantially equivalent to, an increase in the price or consideration paid, or proposed to be paid, for: (i) an actual or attempted acquisition of all, or substantially all, of the ownership interest in, or assets of, an entity; or (ii) merger with any entity;
> 6. disgorgement or other loss that is uninsurable under the law pursuant to which this **Policy** is construed; provided, the Company will not assert that any amount of a judgment or settlement in a **Securities Claim** for a violation of the Securities Act of 1933 §§ 11, 12, or 15 constitutes disgorgement or other uninsurable loss; or
> 7. the amount required to be repaid, returned, or refunded pursuant to Dodd-Frank § 954(b)(2), SOX § 304(a), or similar statute or regulation requiring the return of incentive-based compensation

9 598 F. Supp. 3d 1292 (D. Utah Apr. 12, 2022) (No coverage if one or several of the claimants are an "Insured").

10 *Id.* at 1300.

11 *Halliburton Co. v. Erica P. John Fund, Inc.* ("Halliburton II") 134 S. Ct. 2398 (2014).

12 www.whitehouse.gov>OSTP (Office of Science and Technology).

13 www.whitehouse.gov>briefing-room>presidential (October 30, 2023) "This order outlines the policy and principles of the Biden Administration to advance and govern AI safely and responsibly."

14 www.whitehouse.gov>wp-content>uploads Shalanda D. Young March 28, 2024.

15 No. 19-cv-04749-VKD, filed in 2019 in the Northern District of California.

16 *Divino Grp. LLC v. Google LLC*, No. 19-cv-04749-VKD, 2023 WL 4372701 (N.D. Cal. Jul. 5, 2023).

17 244 F. Supp. 3d 231 (D. Mass. 2017).

18 No. 18-cv-00471 (N.D. Cal. Jun. 26, 2018).

19 U.S. District Court for the Northern District of California, No. 3:23-cv-00201.

20 US District Court, Southern District of New York, No. 23-cv-11195.

Workers' Compensation, New York Labor Law and RICO

By: Frank DeMento and Howard Freeman

Recently, a Racketeer Influenced and Corrupt Organizations Act ("RICO') lawsuit was filed in a New York federal court in which a reinsurer and a managing general agent ("MGA") alleged that defendant medical professionals and attorneys exploited the New York State workers' compensation system by submitting fraudulent bills and medical records showing injuries and courses of treatment that were designed to result in "windfall tort claims" via New York's labor law.[1]

The Legal Landscape of New York Labor Law §240 Cases

New York Labor Law Section §240, a/k/a "the Scaffolding Law," is designed to protect workers from gravity-related falls. Although the intent of the law is to keep construction workers safe, the imposition of strict liability on defendants has had a significant financial impact on the construction and insurance industries due to a rise in nuclear verdicts. Nuclear verdicts are jury verdicts of $10M or more.[2] According to the U.S. Chamber of Commerce Institute for Legal Reform, New York State had 151 nuclear verdicts from 2010-19, ~30% of which were classified as premises liability matters.[3] New York Labor Law §240 is a "significant contributor" to these premises liability verdicts.[4]

The RICO lawsuit highlights the problems associated with the interplay of New York's workers' compensation and labor law claims. The nature of the New York workers' compensation law, which provides a low bar for recovery, has drawn alleged bad actors to the space, resulting in the RICO law-

suit. New York workers' compensation claims are extremely difficult to defend. In fact, it has been estimated that over 90% of New York workers' compensation claims are paid without contest.[5] The documentation of medical records and medical services provided under the New York workers' compensation cases are then used in New York labor law third-party claims to justify the necessity and validity of medical treatment rendered. The actions of the defendants in the RICO lawsuit invariably drives up the settlement values of these third-party claims.

The Alleged Fraudulent Enterprise

Roosevelt Road Re, LTD, a Bermuda-based reinsurer, and Tradesman Program Managers, LLC, Roosevelt's MGA, seek to recover money fraudulently obtained from Roosevelt, as well as costs incurred by Tradesman.[6] The RICO lawsuit alleges that the RICO defendants created claims and submitted fraudulent treatment records and billings to the New York State Workers' Compensation Board and Tradesman that were later used to prosecute third-party personal injury actions against labor law defendants.[7]

The allegations of the scheme follow a similar pattern:

- An unrecorded and/or unwitnessed and/or minor incident occurred, resulting in a workplace injury to the claimant;[8]
- Claimant immediately sought medical attention alleging a serious injury, yet was discharged with no evidence of serious injury and could return to work within several days;[9]
- Claimants were promptly sent to the RICO Defendant Workers' Compensation Law Firms and RICO Defendant Medical Providers, where they were diagnosed with a litany of injuries deemed to be causally related to the incident;[10]
- Imaging and other tests were regularly performed to the spine, regardless of the initial site of injury. These tests resulted in diagnoses of spine herniations, and bulges related to the alleged incident that the RICO defendants affirmed was related to the alleged incident;[11]
- This resulted in a purported trial of conservative treatment, including a physical therapy treatment plan. RICO defendant Physical Therapists recorded generic notes, which failed to state basic information that would be expected. This aspect of the claim was to "provide the semblance of conservative treatment."[12]
- RICO Defendant Medical Doctors would then find that conservative treatment had failed and that injections and/or surgery was needed.[13]

Analysis and Watch List

The doctors, physical therapists, and law firms listed in this RICO complaint are well known to those who handle New York labor law claims. This RICO lawsuit is an opportunity for the defense bar to combat the alleged nefarious actions of the RICO Defendants. There have been discussions on how to use the allegations in the RICO action in other cases involving RICO defendants. For example, there have been conversations as to whether to assert new affirmative defenses based on the RICO allegations, and suggestions on trial strategy as it relates to cross-examination and impeachment using topics underlying the RICO action.

> "This effort to push back against the RICO Defendants and others who would engage in similar tactics is not limited to labor law actions."

This effort to push back against the RICO Defendants and others who would engage in similar tactics is not limited to labor law actions. Many of the RICO Defendant Medical Providers and Physical Therapists are involved in non-labor law claims throughout New York. The insights and strategies developed may be suitable for use in other cases in which these actors play a role.

In addition to preventing the RICO Defendants from continuing to drive up the cost of workers' compensation and labor law claims, it is hoped this case will deter other medical doctors, physical therapists, and attorneys from participating in similar schemes.

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Endnotes

1 *Roosevelt Road Re, Ltd. v. John Hajjar, MD,* No. 1:24-cv-01549-NG-LB at 3, (E.D. N.Y. Mar. 1, 2024)

2 Nuclear Verdicts Trends, Causes and Solutions. U.S. Chamber of Commerce Institute for Legal Reform (2022).

3 Id. The report explains the data collection and methodology used to provide the statistics cited.

4 Id.

5 *Roosevelt Road Re, Ltd.,* 1:24-cv-01549-NG-LB at 11.

6 Id. at 3.

7 Id. at 50.

8 Id.

9 Id.

10 Id. at 52.

11 Id. at 53.

12 Id.

13 Id. at 63.

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Insurers As Parties In Interest In Reorganization Asbestos Trusts

By: Robert M. Hall

I. Introduction

Many companies that used asbestos (and other toxic substances) in their products have sought reorganization under Chapter 11 of the Bankruptcy Code due to litigation brought by those who were injured or who fear asbestos-related injury. Often, trusts funded by insurance proceeds are used to pay the claims of injured parties. Clearly, the relevant insurers have a vital interest in the terms of the trust but until a recent decision of the United States Supreme Court, insurers were limited in their ability of achieve a seat at the table when the terms of trust were hammered out. This article describes a major change in the interpretation of the Bankruptcy Code in Truck Insurance Exchange v. Kaiser Gypsum Co., No. 22-1079 (U.S. Jun. 6, 2024), which will significantly benefit those insurers unlucky enough to have insured companies that produced products containing asbestos or other toxic substances.

II. Relevant Bankruptcy Code Provisions

The Court described the legislative reaction to asbestos litigation:

> Congress responded to these challenges in § 524(g) of the Bankruptcy Code. This section allows a Chapter 11 debtor with substantial asbestos-related liability to establish and fund a trust that assumes the debtor's liability for "damages allegedly caused by the presence of, or exposure to, asbestos or asbestos-containing products." § 524(g)

(2)(B)(i) (1). Section 524(g) then channels all present and future claims into the trust by "enjoin[ing] entities from taking legal action for the purpose of directly or indirectly collecting, recovering, or receiving payment or recovery" for claims "to be paid in whole or in part by [the] trust.1

In this case, the trust was funded by insurance proceeds from Truck Insurance Exchange ("Truck") but the ability of Truck to have a seat at the table concerning the operation of the trust depended on whether it was an "interested party" under § 1109(b) of the Bankruptcy Code:

> A party in interest, including the debtor, the trustee, a creditor's committee, an equity security holders' committee, a creditor, and equity security holder or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter.

The issue in this case was whether Truck qualified as a "party in interest."

III. Ruling of the Court of Appeals

Truck was the primary insurer of Kaiser Gypsum Co. and its parent Hanson Permanente Cement (collectively "Kaiser"), which sold products containing asbestos. Truck provided liability coverage:

> (F)rom the 1960's through the 1980's. Under these policies, Truck must investigate and defend each covered asbestos personal-injury claim or suit asserted against the Debtors, "even if such claim or suit is groundless, false or fraudulent." Truck must also indemnify the Debtors for each such claim up to a per-claim limit, typically $500,000 per claim . . . without a maximum aggregate limit . . . .[2]

"A party in interest, including the debtor, the trustee, a creditor's committee, an equity security holders' committee, a creditor, and equity security holder or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter."

The Bankruptcy Court and the District Court ruled that Truck was not a "party in interest" and therefore lacked standing to contest the terms of the trust. The trust plan treated claims covered by insurance differently from those not covered. For the claims not covered by insurance, claimants were required to make disclosures designed to avoid fraud and duplication, but the claimants covered by insurance were not required to make the same disclosures. Truck objected to the plan on several bases including collusion, arguing that the trust undermined the obligation of the Debtors to assist in securing disclosures necessary to combat potential fraud.

The Court of Appeals ruled that Truck would not have standing as a party in interest if the trust was "insurance neutral":

> A plan is insurance neutral if it doesn't increase the insurer's pre-petition obligations or impair the insurer's pre-petition obligations or impair the insurer's pre-petition policy rights. Stated another way, a plan is insurance neutral if it "does not materially alter the quantum of liability that the insured [ ] would be called to absorb."[3]

The Court of Appeals ruled that the trust plan was insurance neutral and, therefore, Truck was not a party in interest:

> Because the Plan does not impair Truck's policy rights or otherwise alter Truck's quantum of liability but simply maintains Truck in its pre-petition status with all its coverage defenses intact, the Plan is insurance neutral. Accordingly, we hold that Truck, in its capacity as an insurer, is not a party in interest under §1109 (b) and therefore lacks standing to challenge he Plan in that capacity.[4]

IV. Ruling of the Supreme Court

The Court granted *certiorari* to determine whether an insurance company with financial responsibility for claims in a bankruptcy is a "party in interest" that has standing, among other things, to object to proposed plans and propose its own plan. Justice Sotomayor spoke for the Court in an 8 – 0 decision.

The Court flatly rejected the "insurance neutral" test: "This doctrine is conceptually wrong and makes little sense."[5] Applying the principles behind § 1109 (b), the Court held that Truck was a party in interest:

> Bankruptcy reorganization proceedings can affect an insurer's interests in myriad ways. A reorganization plan can impair an insurer's contractual right to control settlement or defend claims. A plan can abrogate an insurer's right to contribution from other insurance carriers. Or, as alleged here, a plan may be collusive, in violation of the debtor's duty to cooperate and assist, and impair the insurer's financial interests by inviting fraudulent claims. The list goes on. *See e.g.* Brief for American Property Casualty Insurance Association et al as *Amici Curiae* 16 – 17. ("For example, a plan that purports to maintain an insurer's coverage defenses could nonetheless allow claims at amounts far above their actual value and out of line with the claimants' injuries or the payment of claims for which little or no proof of injury is required.")[6]

As the Court noted: "Where a proposed plan 'allows a party to put its hands into other people's packets, the ones with the pockets are entitled to be fully heard and to have their legitimate objections addressed.'"[7]

Commentary

Truck Insurance Exchange appears to be a complete victory for insurers who find, to their chagrin, that they have insured parties alleged to have produced products that have caused mass toxic torts leading to a Chapter 11 reorganization. A finding of insurance non-neutrality of the plan in this case would have been a win for Truck. But the Court went further and rejected the insurer neutrality standard entirely. This decision will greatly increase the ability of insurers to enforce proper claim investigation and adjustment standards for reorganization trusts for those alleging injury from asbestos materials.

Robert Hall is an attorney, a former law firm partner, a former insurance and reinsurance executive and acts as an arbitrator and expert witness with respect to disputes involving insurers, reinsurers and self-insurers. He is a veteran of more than 200 arbitration panels and is certified as an arbitrator and umpire by ARIAS·US. Mr. Hall has authored over 100 articles, and they may be viewed at his website: robertmhalladr.com. The views expressed in this article are those of the author and do not reflect the views of his clients. Copyright by the author 2024.

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3 *Id.* at 83 quoting *In re Global Indus. Technologies, Inc.*, 645 F.3d 201 (3rd Cir. 2011).

4 *Id.* at 87.

5 *Slip op.* at 16.

6 *Id.* at 14.

7 *Id.* at 15, quoting *In re Global Indus. Technologies, Inc.*, 645 F.3d at 204.

Risks Associated With Lithium-ion Batteries

By: Frank DeMento and Bryan McCarthy

Archaeological discovery of the Baghdad Battery in the 1930's showed that humanity has relied on battery power for centuries.[1] But who would have thought a technology tracing back 2,000 years would present one of the more confounding challenges for insureds, insurers, and reinsurers in the year 2024? Yet that is exactly the case when it comes to the use, storage, and transportation of lithium-ion batteries and the products that they power. Fires caused by lithium-ion batteries have been increasing at an "alarming rate", and should be on the radar of insureds, insurers, and reinsurers.[2]

About lithium-ion batteries

Lithium-ion batteries dominate the market because they provide the most power per weight and have become the most widely used battery technology in industries from computing and automobiles to power generation and communications.[3] They are used in a wide-array of consumer and industrial products including cell phones, laptops, E-bikes, battery-powered tools, vaping devices, smart-luggage, and solar power backup storage.

Unfortunately, lithium-ion batteries are also plagued by the tendency to overheat and catch fire—or even explode.[4]The reason why these batteries present a fire risk that traditional batteries do not is because they combine high-energy materials and electrolytes—often flammable ones.[5] This can lead to a condition specific to lithium-ion batteries known as **thermal runaway**, which occurs when a cell, or a part of a cell, reaches elevated temperatures due to thermal failure, mechanical failure, internal/external short circuiting, or electrochemical abuse.[6] At elevated temperatures, the cell materials begin to decompose and release heat. Eventually, the self-heating rate of the cell is greater than the rate at which

heat can be dissipated to the surroundings. At this point, the cell temperature rises exponentially, and stability is ultimately lost. The loss of stability results in all remaining thermal and electrochemical energy being released to the surroundings. In many cases this leads to fire.

The proliferation of lithium-ion batteries and their tendency to overheat and cause fires creates significant challenges for many industries. The unfortunate results of thermal runaway impact waste operators and recycling facilities, ship operators, shipyards, and storage facilities. Because the lithium-ion batteries are commonly stored near flammable materials, these industries all present high-risk scenarios for lithium-ion battery fires. The impact of lithium-ion battery claims is not limited to these industries, however. All commercial and residential properties have some exposure.

> "The proliferation of lithium-ion batteries and their tendency to overheat and cause fires creates significant challenges for many industries."

Lithium-ion battery fires are also much more difficult to put out than traditional fires because they can keep flaring up again and again. The batteries get so hot that even when the original fire has been extinguished the battery itself must be monitored and kept cool for hours afterward.[7] Water-based fire extinguishers are not as effective against lithium-ion battery fires. They may help prevent the spread of the fire, but they will not extinguish the fire on the battery itself until all its energy has dissipated. And while special lithium-ion gel extinguishers do exist, they are not yet widely available.[8]

Impact on the insurance industry

The proliferation and wide-spread use of these batteries in so many diverse industries and varied consumer products presents an array of insurance-related losses and claims, which may implicate a variety of insurance policies and coverages, including:

- Property policies issued to cover homes and businesses
- Commercial general liability and umbrella policies
- Personal or business auto
- Cargo insurance
- Marine insurance

The frequency of these claims shows no sign of slowing. Marco Terruzzin, the chief commercial product officer at Swiss-based global energy storage company Energy Vault, believes the ever-increasing number of lithium-ion batteries in use means that fires caused by them are set to surge.[9] Steve Kerber, Vice President of Underwriters Laboratory's Fire Safety Research Institute states, "The more batteries that surround us, the more incidents we will see."[10] This trend will inevitably continue to be a strain on both insureds and insurers.

The numbers and trends are striking:

- The New York City Fire Department ("FDNY") has experienced a rapid increase in the frequency of fires involving e-bikes, e-scooters, and other battery-powered mobility devices. It has reached such a level of concern that the FDNY hosted an event last October to help educate the insurance industry about some of the dangers these batteries present.[11]
- In 2023 CNN reported that "the number of lithium-ion battery-based fires is growing with enormous frequency in both the United States and internationally."[12]
- A 2021 study estimated that lithium battery fires have cost waste

operators in the U.S. and Canada $1.2 Billion.[13]

- Fires and explosions—notably including those caused by lithium-ion batteries—were the most expensive cause of marine claims in 2021 accounting for 18% of $9.2 billion in total losses according to global ship insurer Allianz Global Corporate & Specialty (AGCS).[14]

Thoughts for 2024 and beyond

Active research is underway to try to mitigate the risks of thermal runaway and to make these batteries safer. University of Maryland researchers have developed a new technology that could increase energy storage within the battery while decreasing the risk of overheating and fires. The technology suppresses the growth and formation of lithium dendrites within the batteries.[15] Dendrites are magnetic microstructures that can form during the charging process and have been shown to cause battery failure, short circuits, and lead to fires.[16]

Several new products are being developed to help address thermal runaway and prevent or mitigate resulting fires. The Firechie Lith-Ex Extinguisher contains a new fire extinguishing agent aqueous vermiculite dispersion which cools the fire source while encapsulating the fuel source to create a thermal barrier against spread of the fire. In addition, fire blankets and suppression kits specifically designed for lithium batteries and smaller devices that carry them have been developed.[17]

Education will remain the most effective method to overcome the challenges caused by lithium-ion battery fires. Information and resources on the most effective ways to prevent such fires are readily available for distribution and discussion.[18] Recognizing of the risk is key to beginning the process of being prepared.

> “Education will remain the most effective method to overcome the challenges caused by lithium-ion battery fires.”

Ultimately, in response to a challenge that continues to grow in scope and scale, insureds, insurers, and reinsurers should remain diligent in their efforts to provide education about the risks of lithium-ion batteries, recognize companies and industries that face the risk of these claims, and be clear in determining and communicating the scope and nature of potential coverage afforded for these losses. With improved communication and dialogue, insureds and insurers can better identify the risks that these batteries present within a given company or industry, provide education to insured risk managers and employees about how to better manage these risks, and ensure that the proper and intended insurance coverage is secured to provide peace of mind.

In response to the increasing frequency of these fires, some insurers are applying greater underwriting scrutiny to lithium-ion battery risks, either making coverage more expensive or limiting coverage (even excluding it outright).[19]For example, many cargo insurers now specifically exclude lithium batteries or limit the size or volume of the batteries if they do cover them.[20] As a result, some marine cargo insureds are seeking capacity in the London market. Now more than ever, it is critical for insureds and their insurance carriers to discuss the need for coverage for lithium battery-related losses and to work together to design a mutually agreeable program that addresses these risks.

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Court Tackles Discoverability of Reinsurance Information/Work Product

On a discovery dispute between the plaintiff (insured) Bryce Corporation ("Bryce") and the defendant (insurer) XL Insurance America, Inc. ("XL"), the Court considered the discoverability of third-party and reinsurance information.

With respect to the discoverability of reinsurance information, the court held that *Fireman's Fund Ins. Co. v. Great Am. Ins. Co. of New York*, 284 F.R.D. 132 (S.D.N.Y. 2010), was controlling. The court rejected XL's reliance on *U.S. Fire Ins. Co. v. City of Warren*, 2:10-cv-13128, 2012 WL 1454008 (E.D. Mich. Apr. 26, 2012), which held that the reinsurance information at issue was not discoverable. The court noted that *Fireman's Fund* provided persuasive authority from the Second Circuit, and that *Warren* was distinguishable because there, the sole issue was the legal question of coverage. The court ordered, therefore, that "to the extent that the reinsurance information pertains specifically to the underlying policy and related claims at issue in this case, Defendant is directed to produce such information, absent any basis other than relevance for withholding or redacting the documents."

Also before the court was the issue of whether documents concerning loss reserves are work product. The court, however, deferred decision on this issue.

Case: *Bryce Corporation v. XL Insurance America, Inc.*, No. 1:23-cv-1814, 2023 WL 9004039 (S.D.N.Y. Nov. 28, 2023)

Issue Discussed: Discoverability of Reinsurance Information/ Work Product

Court: United States District Court for the Southern District of New York

Dated Decided: November 28, 2023

Issue Decided: Whether the defendant (insurer) is obligated to provide various items requested by the plaintiff (insured) in discovery including claims handling manuals, documentation in the possession of third parties, reinsurance information and documents related to loss reserves.

Submitted By: Polly Schiavone, Vice President, Swiss Reinsurance America Holding Corp.

Court Decides if Venezuelan Election Was Insurrection

This case arises from the intersection of geopolitics and insurance. CITGO, a U.S. subsidiary of a Venezuelan owned oil company, suffered a financial loss after it was unable to ship oil from Venezuela to Aruba. After the U.S. Government instituted sanctions against Venezuela due to Nicholas Maduro's refusal to yield power to Juan Guaidó, the parent company took the position that CITGO could not pay for the oil and had to return it to the Venezuelan government. Efforts were made through Guaidó to allow the cargo ship to sail, but those efforts were foiled by Venezuelan military vessels (supported by Maduro), and the oil was removed from the ship and returned to the parent company.

The policy at issue was governed by New York law. It contained an exclusion under the "Institute Cargo Clauses" for certain risks, including "capture[,] seizure[,] arrest[,] restraint[,] or detainment (piracy excepted), and the consequences thereof or any attempt thereat." But, pursuant to the "Institute War Clauses," the policy then provided coverage for losses arising from "capture[,] seizure arrest[,] restraint[,] or detainment, arising from" "war[,] civil war[,] revolution[,] rebellion[,] insurrection, or civil strife arising therefrom." CITGO contended that its losses arose from an "insurrection." The parties agreed on the definition of "insurrection" as "(1) a violent uprising by a group or movement (2) acting for the specific purpose of overthrowing the constituted government and seizing its powers." However, they disagreed on whether there was an insurrection.

In particular, the insurer argued that the government was not overthrown because Maduro, at all times, held the reins of power. Yet, the Court had to recognize Guaidó as Venezuela's legitimate president because the U.S. Government had done so. Faced with such circumstances, the Court determined that the term "insurrection" as used in the policy was ambiguous. Neither party offered any extrinsic evidence on the meaning of "insurrection" and how it should be interpreted in connection with the events that had taken place in Venezuela. Consequently, the Court construed the term in CITGO's favor and determined on summary judgment that Maduro's actions constituted an insurrection. This ruling did not finally resolve the issue of coverage. While the Court also found that CITGO owned the oil, there were unresolved factual issues as to whether the insurrection was the cause of CITGO's loss.

Case: *CITGO Petro. Corp. v. Starstone Ins. SE*, No. 1:21-cv-389-GHW, 2023 U.S. Dist. LEXIS 43911, 2023 WL 2525651 (S.D.N.Y. Mar. 15, 2023)

Issue Discussed: Other

Court: United States District Court for the Southern District of New York

Date Decided: March 15, 2023

Issue Decided: Whether events following Nicholas Maduro's refusal to yield power to Juan Guaidó after elections in Venezuela constituted an "insurrection" under the "Institute War Clauses" of the subject insurance policy.

Submitted By: Vincent J. Proto, Saiber, LLC

Court Looks at Securities Fraud Claim

This action involved a claim for securities fraud against Maiden Holdings and other defendants on the basis that Maiden Holdings understated the loss reserves on claims arising under policies issued by AmTrust. It appears that Maiden Holdings, in addition to handling the claims, reinsured AmTrust. The plaintiffs alleged that Maiden Holdings should have disclosed that "reserves were set by relying on estimated loss ratios that were lower than historical loss ratios for previous accident years."

The federal district court found that there was no evidence in the record that supported plaintiffs' claim. In particular, the court found that Maiden Holdings "engaged in a complex actuarial process that considered historical losses" and criticized the plaintiffs for making a "backward-looking challenge" to the reserving process that ignored the relevance of various other considerations apart from the mere fact that historical loss ratios were higher than the estimated loss ratios adopted by Maiden Holdings. As such, the court granted summary judgment to Maiden Holdings and the other defendants. This decision supports the proposition that an insurer or reinsurer cannot be faulted simply for setting reserves below historical loss ratios, provided that it engages in a thorough, professional process in setting those reserves.

Case: *Wigglesworth v. Maiden Holdings, Ltd.*, No. 1:19-cv-05296, 2023 U.S. Dist. LEXIS 225500, 2023 WL 8751243 (D.N.J. Dec. 19, 2023)

Issued Discussed: Other

Court: United States District Court for the District of New Jersey

Date Decided: December 19, 2023

Issued Decided: Whether the defendant's alleged failure to set reserves above historical loss ratios could support a claim for securities fraud.

Submitted By: Vincent J. Proto, Saiber LLC

Court Decides Whether Preclusive Effect of a Prior Arbitration Award Is Arbitrable

National Casualty Company and Nationwide Mutual Insurance Company (collectively, the "Reinsurers") entered into three reinsurance agreements (the "Reinsurance Agreements") with Continental Insurance Company ("CNA") in effect between 1969 and 1975. Each of the Reinsurance Agreements contained an arbitration clause providing that any dispute pertaining to the interpretation of the Reinsurance Agreements shall be submitted to final and binding arbitration.

In 2017 CNA initiated arbitration proceedings, pursuant to the arbitration clause in the Reinsurance Agreements, to adjudicate a dispute that had arisen with its Reinsurers over CNA's billing and allocation methodology and whether it was permissible under the "Loss Occurrence" definition set forth in the Reinsurance Agreements. CNA received two separate arbitration awards, each resolved in favor of the Reinsurers respectively, and each confirmed by a federal court order.

Thereafter, the CNA submitted certain additional billings to the Reinsurers, who, citing the same "Loss Occurrence" definition in the Reinsurance Agreements, refused to pay. The Reinsurers commenced a federal court action seeking declaratory judgment and injunctive relief, seeking to preclude CNA from compelling a second round of arbitration proceedings to once again litigate the interpretation of the "Loss Occurrence" definition. CNA moved to dismiss the Reinsurers' federal court action and compel arbitration of the parties' dispute.

The court considered the issue of whether the preclusive effect of a prior arbitration award is, itself, arbitrable. In doing so, the court noted that procedural questions that grow out of a dispute between parties and bear on the final disposition of such dispute are matters for an arbitrator to decide. The court found that the preclusive effect of a prior arbitration is not among the limited circumstances where contracting parties would have expected a court to decide the gateway matter of arbitrability; rather, the court found that the preclusive effect of a prior arbitral award is a defense subject itself to arbitration. The court noted that deciding on the preclusive effect of the prior arbitral awards would impermissibly require the court to delve into the merits of the claims. As such, the court granted CNA's motion to compel arbitration.

Further, the court considered whether to dismiss the declaratory judgment action or to stay that action pending the outcome of arbitration. Noting that all of the claims are subject to arbitration, the court held that it would not decide any matter unless and until a party were to seek confirmation of an arbitral award. The court therefore granted CNA's motion to dismiss.

Case: *Nat'l Cas. Co. v. Cont'l Ins. Co.*, No. 23 CV 3143, 2023 WL 7668793 (N.D. Ill. Nov. 15, 2023)

Issue Discussed: Preclusive Effect of Prior Arbitral Awards

Submitted by:
Rob DiUbaldo, a Shareholder in the New York and New Jersey offices of Carlton Fields, where he chairs the Firm's insurance and reinsurance practice and is a member of the Firm's Executive Committee.

Oliver Phillipson, an associate in the New York office. They handle a wide array of complex coverage, litigation and arbitration matters for insurers and reinsurers in both the P&C and life sectors.

Court Looks at Application of Direct Benefits Estoppel to Compel Non Signatory to Arbitration

Travelers Indemnity Company ("Travelers") entered into a reinsurance contract (the "Reinsurance Contract") with the Texas Rural Education Association Risk Management Cooperative ("TREA"), which in turn provided property insurance coverage to Grapeland Independent School District ("Grapeland").

The Reinsurance Contract contained an arbitration clause providing that any dispute between Travelers and TREA, "arising out of, or relating to the formation, interpretation, performance or breach" of the Reinsurance Contract shall be subject to arbitration.

Grapeland filed suit against, *inter alia*, Travelers and TREA over a dispute pertaining to the settlement of Grapeland's property damage claim arising out of damage it sustained during a hail- and windstorm. As against Travelers, Grapeland asserted claims for negligence, common law fraud, conspiracy to commit fraud, misrepresentation, violation of the Texas Unfair Compensation and Unfair Practices Act, and violation of the Texas Deceptive Trade Practices Act ("DTPA"). Travelers moved the trial court to either dismiss Grapeland's claims against it, or to stay the litigation, in favor of arbitration based on the arbitration clause in the Reinsurance Contract. The trial court denied Travelers' motion, and Travelers appealed.

On appeal, Travelers sought reversal of the trial court's decision and contended that, even though Grapeland was a nonparty to the Reinsurance Contract, the court should apply the doctrine of direct benefits estoppel and find that Grapeland's claims, insofar as they arise out of or relate to the Reinsurance Contract, were subject to arbitration because of the contract's arbitration clause. The appeals court disagreed and affirmed the trial court's denial of Travelers' motion.

The appeals court noted that direct benefits estoppel can be used to compel a party to arbitration, even where that party is a nonsignatory to the contract containing an arbitration provision. Direct benefits estoppel may apply when a nonsignatory party (i) seeks to derive a direct benefit from such contract through a lawsuit; or (ii) deliberately seeks and obtains substantial direct benefits from the contract itself. In view of Grapeland's claims against Travelers, the appeals court declined to apply direct benefits estoppel, finding that Grapeland's suit seeks damages arising out of an allegedly inappropriate settlement of its property damage claims under the policy issued by TREA, and not under the Reinsurance Contract. The appeals court found that Travelers putative liability arose out of its role as the adjuster of claims arising out of the TREA policy and sounded in tort or arose out of violations of the TDPA or the insurance code—non contract claims unrelated to Travelers obligations under the Reinsurance Contract. The appeals court therefore held that Grapeland's lawsuit was not subject to the arbitration clause and affirmed the judgment of the trial court.

Case: *Travelers Indem. Co. v. Grapeland Indep. Sch. Dist.*, No. 12-22-00311-CV, 2023 WL 3371072 (Tex. App. May 10, 2023)

Issue Discussed: Application of Direct Benefits Estoppel to Compel Non Signatory to Arbitration

Submitted by:
Rob DiUbaldo, a Shareholder in the New York and New Jersey offices of Carlton Fields, where he chairs the Firm's insurance and reinsurance practice and is a member of the Firm's Executive Committee.

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Stephen R. DiCenso

Stephen R. DiCenso is a Principal of Milliman, a Fellow of the Casualty Actuarial Society, and a Member of the American Academy of Actuaries. His career focus has been serving commercial and personal lines insurers, reinsurers, captives, public entity risk pools, runoff insurers, self-insured corporations, MGAs/insurtechs and state regulators.

DiCenso provides both traditional actuarial services of pricing and reserving but also additional services such as economic capital modeling, reinsurance arbitration/umpire services, due diligence, pro-forma financial support and risk-focused examinations across all lines of coverage. DiCenso recently completed terms of three years as President of the Connecticut Captive Insurance Association and the Workers Compensation Committee of the American Academy of Actuaries.

DiCenso currently serves on the AIRROC Education Committee and the ARIAS Arbitrator Services Committee.

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