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Dealing with an Extra Digit: Latest Developments in Excess Liability Insurance Coverage and "Bermuda Form" Arbitrations for Catastrophic Exposures

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Insurance Recovery

If you are the general counsel of a Fortune 500 company, you might be excused if you express bewilderment in response to reports about the successes of U.S. "tort reform." In the past 5-8 years, both the plaintiffs' bar and governmental authorities seem to have added an extra digit to many mass tort and product lability claims, demanding nine or even ten figures—and sometimes securing such sums—for personal injury or property damage claims that previously would have yielded eight- or nine-figure results. To be sure, the injuries and damage in some cases are very substantial. But tort valuations have exploded in many cases where there is scant proof of serious injury or devastating damage and no loss of life, and even where the science may favor the defense on quantum.

Faced with such exposures, companies understandably turn to their excess general liability insurance programs for coverage. But here, too, they often encounter substantial challenges:

- Excess general liability programs with limits required for these exposures commonly are written on versions of the so-called "Bermuda Form."
- Bermuda Form policies contain idiosyncratic terms and typically require mandatory arbitration outside the U.S. (in London, Bermuda, or Canada)—features that present unfamiliar territory, even for most highly-experienced U.S. coverage lawyers.
- And because such arbitrations are confidential and often involve non-American arbitrators (even though such policies typically are governed by New York substantive law), it can be difficult for policyholders and their counsel to predict how their coverage claims may fare.

Fortunately, recent developments in Bermuda Form claims and arbitrations have confirmed the availability of coverage under these policies for several, major components of loss that are common to many catastrophic tort scenarios. These developments also underscore the importance of certain, basic "best practices."

1. Coverage for Pollution-Related Damages and Defense Costs

Insurers generally have denied coverage for pollution-related damages and defense costs ever since stricter variants of standard-form pollution exclusions became a standard feature of general liability policies in the mid-1980s. But today, in response to the needs of policyholders in

sectors that face major environmental risks (e.g., energy, mining, rail, manufacturing, and construction), Bermuda Form and other excess liability policies commonly provide coverage for pollution-related exposures, via endorsements that restore coverage, in at least three circumstances:

- where the liability arises from the use of a product and thus, is a *product* liability, not a liability for *waste* or waste operations;
- where the insured becomes aware of an unintended and unexpected discharge, migration, or seepage of pollutants shortly after its commencement (e.g., within 30 days) and reports the matter to its insurers promptly (e.g., within 90 days)—temporal requirements that preserve coverage for accidental discharges while retaining the exclusion for long-tail liabilities; or
- where the insured causes an *intentional* discharge of pollutants in an "attempt" (whether successful or not) to mitigate or avoid a more catastrophic outcome from an *unintentional* discharge that already has occurred.

The coverage provided by such "Blended Pollution Exclusion" endorsements (sometimes referred to as a "Pollution Exclusion Amendment Endorsement with Named Peril, Product Pollution and Time Element Exceptions") can be worth an insurance policy's full limits—and indeed, hundreds of millions of dollars, in a catastrophe-level excess liability program where the endorsement appears in every policy layer—for policyholders with major environmental risks.

Every policyholder facing such risks should insist on such endorsements and should "sweat the details," with help from knowledgeable coverage counsel, over how they are worded and how they have fared in prior arbitrations. Insurers will not miss an opportunity to exploit gaps in language or ambiguities in coverage, which typically are not resolved in favor of policyholders in Bermuda Form arbitrations, as they typically are in American courts.

2. Environmental and Other Response Costs

Another defense that excess insurers occasionally advance—but that has not prevailed in Bermuda Form arbitrations—is the argument that, while a policy may cover pollution-related or product liability *damages*, it does not cover environmental or other *response costs* (i.e., legal, contractor, and other expenses that an insured incurs to assess, contain, or remediate property damage, or to alleviate physical injuries and suffering, caused by the policyholder's operations or product). The insurers' proposition is that their policies cover "Damages" and "Defense Costs" (which are defined terms in Bermuda Form policies), but not "response costs" (a term that appears nowhere in most policies).

This is a highly material issue. Today, for example, response costs alone commonly reach eight or nine figures in pollution-related cases arising from oil or chemical spills, train derailments, and industrial accidents. But an insurer's refusal to cover response costs generally fails for three reasons.

First, applicable environmental laws, regulations, and administrative orders generally impose strict liability for pollution-related releases, injury, and damage. A policyholder cannot wait to be sued, and have damages imposed in a final judgment or consent decree, before liability arises. If a policyholder delays, it not only risks greater damages, potential trebling, and fines and penalties—to the detriment of both itself and its insurers—it also forces authorities to incur such response costs (usually at higher cost) and to sue to recover them as damages. Arbitral tribunals accept this legal and practical reality and that responses costs are indeed damages.

Second, the definition of "Damages" in Bermuda Form and other excess policies is typically written expansively to encompass, in part, "*all forms* of compensatory damages, monetary damages and statutory damages, punitive or exemplary damages and costs of compliance with equitable relief, other than governmental (civil or criminal) fines or penalties" for which the insured is liable. This definition encompasses response costs.

Indeed, throughout the late 1980s, 1990s, and early 2000s, insurers in environmental coverage litigation across the U.S. argued that environmental response costs are not "damages" under commercial general liability policies that do *not* define the term. Their theory was that response costs are a form of restitution or mandatory injunctive relief (a remedy in equity)—not compensatory "damages" (a remedy at law). Courts nationwide overwhelmingly rejected that argument, in case after case, with a handful of exceptions. Perhaps in a nod to that reality, Bermuda Form policies eliminate the argument altogether by expressly including "costs of compliance with equitable relief" (and "all forms" of "statutory damages") within the scope of covered "Damages." This broad scope can be significant, as arbitral tribunals have held: it can extend coverage beyond environmental response costs to encompass, for example, costs incurred to house, clothe, feed, and attend to persons injured by an accident.

Third, while many coverage lawyers may consider "defense costs" to mean legal fees and related out-of-pocket costs, the standard Bermuda Form definition of the term is not so limited. In Bermuda Form policies, "Defense Costs" is typically defined to mean "reasonable legal costs *and other expenses* incurred by or on behalf of the Insured *in connection with the defense* of any actual or anticipated Claim, including"—and not necessarily limited to—"attorneys' fees and disbursements, law costs, premiums on attachment or appeal bonds, pre-judgment and post-judgment interest, expenses for experts and for investigation, adjustment, appraisal and settlement." Many response costs are such "other expenses" incurred "in connection with the defense" of actual and anticipated Claims. They are costs the insured incurs to address and reduce its liability, in connection with its effort to defend against actual or anticipated Claims. In fact, the only such costs that the standard Bermuda Form definition *excludes* are "the salaries, wages and benefits of the Insured's employees and the Insured's administrative expenses"—language that appears to acknowledge the breadth of "Defense Costs" coverage under the standard Bermuda Form definition, as such sums presumably are included in the definition as they do not fall within the limited items that are expressly excluded.

3. Compensatory Payments Without Releases or Formal Settlement Agreements

A third argument that some insurers have advanced, which arbitral tribunals have increasingly rebuffed, is the suggestion that there is no coverage for "Damages" under Bermuda Form (and similarly worded, high-level excess) policies absent a formal settlement agreement or release. The basis advanced for this argument is language in the standard Bermuda Form definition of "Damages" that states: "'Damages' means all forms of … damages and costs of compliance with equitable relief … which the Insured shall be obligated to pay *by reason of judgment or settlement* for liability on account of Personal Injury, Property Damage and/or Advertising Liability." The insurers' argument is that, absent an underlying adverse judgment or formal settlement, this italicized language is not satisfied, and accordingly, the often-large sums that a company pays to shelter, clothe, feed, and compensate victims from a mass tort scenario—i.e., before it is possible or practical to seek releases and when it generally would be inflammatory to request them—are not covered.

Fortunately for policyholders, this argument has not fared well. Tribunals have recognized that the term "settlement" is not defined, and nothing in the policy typically requires a *settlement*

agreement or a *release* as a condition for coverage of a "damages" payment. Nor do these policies typically require that a payment be a *final* payment to a claimant or tort victim, as opposed to *partial* compensation, to qualify for coverage: there is nothing in the standard policy language to preclude coverage for advance or partial payments that help claimants get back on their feet, potentially mitigating their damages, and nothing favors that harsh and counter-intuitive interpretation. Rather, as we have demonstrated in several cases over the years and as tribunals have appreciated, when read in the context of the "Damages" definition as a whole and its manifestly broad and intended reach, the phrase "by reason of judgment or settlement" is a phrase of coverage confirmation, not a phrase of coverage limitation: there are only two ways to resolve a legal liability—i.e., by judgment or settlement—and this language confirms that the insured is covered for "all forms" of damages or costs of compliance with equitable relief (other than governmental fines or penalties) *whether* the insured's liability arises "by reason of judgment *or* settlement."

4. *Best Practice #1*: Attorney-Assisted Renewals and Endorsement Reviews

While effective, high-limits coverage is available for many catastrophic risks, many policyholders fail to take full advantage of what the market has to offer for two reasons: (a) they fail to review policy wordings, with the assistance of both experienced counsel and brokers, in a timely manner during annual program renewals, to ensure that they are receiving the best available (or even market-standard) terms, and to flag and eliminate gaps and inconsistencies in coverage; and (b) they overlook opportunities to request endorsements that may clarify or expand coverage, often in circumstances that may have little to no impact on premiums.

Indeed, most major policyholders rely solely on their brokers to review and advise on policy terms and language, and the most experienced brokers have exceptional knowledge, market relationships, and judgment. But few, if any, brokers know how contested coverage issues play out in arbitral proceedings in cases under high-value insurance programs, or have detailed knowledge of the case law pertaining to key or common disputes. Just as one would not ask a coverage lawyer to price or place an insurance program, it makes little sense to ask a broker to review and optimize coverage terms and language. The best approach is a combined approach, with experienced counsel working behind the scenes to assist risk management and the underwriting team—an effort that costs peanuts relative to the value it can secure.

In fact, in virtually every instance where our team has been asked to review policy terms in advance of an annual renewal, we have identified inconsistencies and outright glitches in policy language—and areas where clarifications and enhancements can be secured by endorsement—even in circumstances where brokers have advised that the market would not be receptive. In some instances, we have secured enhancements by endorsement that unquestionably have helped to secure nine- and even ten-figure recoveries when major events have triggered that coverage.

5. *Best Practice #2*: Prompt, Comprehensive, and Careful Notice

Another major (and remarkably persistent) challenge that policyholders often create for themselves concerns the failure to give timely or effective notice of a potential claim. Such failings can have particularly dire consequences under Bermuda Form and other excess general liability policies, where the timing and effectiveness of notice can be a strict condition to

coverage and in the absence of which coverage may be forfeited. Our team has seen hundreds of millions of dollars of coverage prejudiced by defective notice practices over the years.

Three miscues are most common when it comes to a failure of notice: (a) the policyholder does not give the right kind of notice, or issues an incomplete form of notice, for the claim or occurrence in question; (b) the policyholder gives timely notice to its *broker*, but not to the *insurer*, or the broker fails to forward timely or properly framed notice to the insurer; or (c) the policyholder tries to "predict" how extensive its potential loss may be, or what types of coverage it may implicate, and does not provide notice to all relevant insurers or policies.

The first and second of these issues can be avoided by simply and promptly consulting coverage counsel, who are experienced with these policies and programs and what they require, and not relying solely on brokers. Indeed, the best-functioning coverage teams are integrated: they include coverage counsel, brokers, underlying defense counsel, and the policyholder's risk management professionals from promptly after the moment of loss. The third issue can be avoided by simply reminding oneself that the risk of a loss that exceeds initial expectations and indications is why one purchases insurance in the first place: why retain the risk, when you bought the peace of mind to transfer that risk to your insurers?

Conclusion

Bermuda Form and other excess general liability policies provide major protection for many of the corporate world's most serious risks. But they also contain traps for the unwary. The best practice is to consult experienced coverage counsel earlier than is typical for many companies—at the point of an annual policy renewal (during underwriting) and at the point of notice (before a claim is even submitted). Only then can a corporate policyholder have the level of protection it often thinks it has purchased and generally deserves.

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