The Commercial Law Connection

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CONNECTING PEOPLE, IDEAS AND OPPORTUNITIES

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Message from the Chair

Dawn R. Tezino, Esq., Chair

Greetings! It is both an honor and a privilege to be elected Chair of the Commercial Law Section for 2011-2012. We look forward to celebrating our 25th Annual Corporate Counsel Conference in Miami, Florida on February 23-25, 2012 at the Doral Golf Resort & Spa. Our theme for the 25th Annual Conference is "Celebrating the Past and Embracing Our Future: 25 Years of Excellence." In keeping with the tradition of providing "an excellent opportunity for general counsel, in-house counsel and chief executive officers of major corporations to meet and network with talented attorneys from the Commercial Law Section," the Conference will feature new and unique opportunities to network with conference attendees. This year's conference will be particularly memorable because three General Counsels have agreed to serve as Honorary Chairs of the Conference: Jeffrey J. Gearhart, Executive VP, General Counsel and Corporate Secretary, Wal-Mart Stores, Inc., Michele Coleman Mayes, Executive VP and General Counsel, Allstate Insurance Company and Roderick A. Palmore, Executive VP, General Counsel & Chief Compliance and Risk Management Officer, General Mills, Inc. In addition, the three Honorary Chairs have agreed to participate on a panel moderated by Vernon Baker, Senior VP, General Counsel, Meritor, Inc. We are honored to have these General

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Government Winning in the Corporate Tax Shelter Fight

*By Del Wright, Esq.**

Recently, the U.S. government has secured victories in three high-profile, multi-million dollar tax cases. The facts of each case are different, but demonstrate some of the traps for the unwary general counsel when presented with a "too good to be true" tax-motivated transaction.

The first of the trio, *Southgate Master Fund LLC v. United States*,[1] involved a "Distresses Asset Debt" ("DAD") structure. A thorough analysis of the DAD structure is beyond the scope of this article, but it generally worked as follows:

> U.S. taxpayer (partnership created by a company or individual taxpayer) acquires distressed debt, *i.e.,* debt that is valued at some small portion of its face amount, say 20 cents on the dollar. Later, the partnership dissolves and the U.S. taxpayer claims as a loss the $0.80 difference between the face amount ($1.00) and the acquisition price ($0.20). The transaction is structured to allocate that loss to a particular partner (often one who has roughly $0.80 of income).

The DAD structure in *Southgate* was used to generate over $1 billion in paper losses, and one of the partners in Southgate claimed approximately $200 million of deductions based on those losses. The IRS challenged the transaction and won in the district court,[2] and the Fifth Circuit Court of Appeals upheld the district court's decision. The Fifth Circuit found part of the transaction valid (the acquisition of the distressed debt), but concluded that the partnership structure used was a sham, thus the allocation of deductions would not be respected.

An interesting and instructive side note to *Southgate* is that the both courts rejected the IRS' attempt to impose penalties of the parties. Initially, the IRS determined that four penalties apply to the taxpayer:

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Meet and Greet Reception with President, Daryl Parks in Houston, Texas

By Dawn R. Tezino, Esq.

On November 16, 2011, a meet and greet reception with NBA President, Daryl Parks, was held at Hotel ZaZa in Houston, Texas. The reception was sponsored by Attorney Ricky Anderson. There was a host of NBA and NBA Commercial Law Section ("NBA-CLS") attendees present at the well-attended event. Most notably, there were two NBA-CLS Executive Committee members in attendance at the reception, Dawn R. Tezino, Chair of the NBA-CLS and DeMonica Gladney. NBA Past President, Algenita Scott Davis was also present to welcome President Parks. The NBA-CLS salutes President Parks for all his hard work with his various NBA initiatives this year and wishes him continued success.

Chair's Message... *continued from page 1*

Counsels discuss their respective paths to their positions and also share their perspectives on the future of diversity in the legal profession.

In honor of 25 years of excellence, the Commercial Law Section is also pleased to announce that it will present a special viewing of a commemorative video highlighting the rich heritage of the Conference and the pioneering spirit of the Section's beloved visionary and founder, Cora T. Walker. There will also be a special tribute to all the past Commercial Law Section Chairs for their dedication to the Section. Additionally, I am extremely proud to announce that the Section will launch its "Diversity Empowerment Scholarship Award" to help strengthen its commitment to diversity and prime the diversity pipeline. The scholarship award will be given to three diverse law school students in the Florida area, who will be considered based on their economic need, involvement in the community and diversity related organizations, and their leadership and academic achievement.

We have expanded our conference programming for 2012 to include Corporate Dine-Arounds on the first day of the conference. The Corporate Dine-Arounds will allow our conference attendees the unique opportunity to continue networking and interacting in a casual atmosphere at one of several nearby Miami restaurants. The Conference will again include the Law Firm Networking Expo, combined with the traditional interviewing format as an additional opportunity to network. During the Expo every attorney in attendance has the extraordinary opportunity to showcase their individual skills and their firm's expertise while networking with in-house and corporate attendees. Our Judicial Panel will feature a number of politically and geographically diverse judges speaking on a variety of interesting topics. Additionally, we will have nine substantive CLE's featuring highly sought after and experienced practitioners.

Thank you again for allowing me to serve as the Chair of the Commercial Law Section. It is a privilege for me to have the opportunity to share my voice, expertise, and be an advocate for diversity in the legal profession.

I look forward to seeing you in Miami!

Ten Tips for Maximizing your Insurance Recovery under Commercial General Liability Insurance Policies

*By Kenneth E. Sharprson, Esq.**

Our economy would not be able to function without liability insurance, which provides essential protection to policyholders, and thus to the public, for a diverse range of problems. The standard Commercial General Liability (CGL) insurance policy is purchased by virtually every business organization in the United States--including large and small corporations, lending institutions, partnerships, and proprietorships. Although the CGL policy is most often referred to as liability insurance, it is 'litigation insurance' as well, protecting the policyholder from the expense of defending suits brought against it.[1] Courts specifically have noted the broad scope of coverage intended by CGL policies.[2] The purpose is both to compensate victims and to protect policyholders, even if they engaged in tortious conduct.[3] In short, CGL coverage exists whenever someone imposes, or attempts to impose, legal liability upon a policyholder, unless a specific exclusion applies.[4]

When a claim arises and a policyholder seeks coverage, the insurance company however all too often denies the claim, sometimes without a legitimate basis, leaving the policyholder exposed to liability.[5] Even when faced with a denial, policyholders can recover the insurance proceeds to which they are entitled if they know how to persist with their claim.

Here are ten tips for maximizing your insurance recovery and, when necessary, getting your insurance company to pay a disputed claim:

1

1. Don't Forget The Purpose Of Insurance

It seems obvious, but corporate risk managers sometimes forget: *the purpose of insurance is to insure.*[6] Policyholders of all sizes tend to underestimate risk and fail to focus on what will happen if they actually need to file claims for a serious disaster or liability. The result is underinsurance. When it comes to insurance, risk managers sometimes are more interested in cost-cutting than risk-transfer. A risk manager, whose job is to buy insurance for the corporation, is sometimes under pressure to self-insure, which looks deceptively cheap in comparison to the cost of purchasing real insurance.[7] Corporate financial officers often fail to appreciate that the hidden costs of self-insurance can be hefty including a loss of coverage for an insurance loss.[8] The real reason for buying insurance gets lost in the shuffle of corporate profits. Think loss prevention. Think risk transfer before losses happen. Remember risk transfer after losses happen.

2

2. Locating Insurance Policies

It is essential that policyholders prepare for an insurance claim – and possible dispute – before it happens. Catalog your insurance policies and insurance related documents. The policyholder may lose millions of dollars if it cannot demonstrate during an insurance coverage dispute that it owned a specific policy providing coverage during a particular period of time.[9]

If the policyholder's insurance policies are not already catalogued and safely filed away, the time to do so is now. Locate all insurance policies, including old ones.[10] Old insurance policies are extremely valuable because they tend to provide insurance coverage for any damage or injury that took place during the policy period, no matter when the damage or injury is discovered.[11] If a particular policy cannot be found, secondary sources may be used to demonstrate that the policy was purchased. The search for insurance policies should include a review of:

- ✓ internal accounting records and outside accountants' files for evidence of premium payments.
- ✓ legal records and lawyers files, paying special attention to claims files.
- ✓ known insurance policies for references to other policies.
- ✓ insurance policies of other parties also facing potential liability in the same matter.
- ✓ records of affiliated or predecessor companies.
- ✓ Workers' compensation records to determine if an insurance company defended the worker's compensation claim, since workers' compensation and liability insurance are often purchased from the same insurance company.
- ✓ if possible, records of companies which would have required submission of a certificate of insurance from your company before engaging in business with it, for instance, railroad company records or state and federal government records.

There are several companies, known as insurance archaeologists, which specialize in locating old insurance policies on a cost-effective basis.[12] And never forget, despite repeated insurance company arguments to the contrary, that insurance companies should have copies of the insurance policies purchased from them.

3

3. After A Loss Occurs. . . Think Insurance

Whenever a lawsuit or claim letter arrives in the company law department, or whenever the company suffers a significant financial loss (property damage, business interruption, theft, etc.), someone should ask whether that loss is covered by insurance. This mantra should be posted in every in-house lawyer's office. Lawsuits by present and former employees frequently are covered by a company's workers' compensation and employers' liability policies. Almost as frequently, however, these cases or losses are

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California Courts Struggle to Clarify Arbitration Landscape Following AT&T Mobility Decision

By Robert C. Rodriguez, Esq. and Christian S. Scott, Esq.**

As many are aware by now, the United States Supreme Court recently held that the Federal Arbitration Act ("FAA") preempted California state contract law, which California courts had routinely relied on to invalidate arbitration agreements that included class action waiver provisions.[1] Although *AT&T Mobility* involved a consumer contract, the Supreme Court's analysis provided hope to many employers seeking to enforce employment agreements that contain class action waivers. However, the Plaintiffs' bar has been very vocal in asserting that *AT&T Mobility* should be limited to consumer contracts. That issue remains to be decided, and the only thing that remains clear is that the *AT&T Mobility* decision did not put to rest the issue of arbitration clauses or class action waivers in the employment or consumer law context.

AT&T Mobility v. Concepcion

In *AT&T Mobility v. Concepcion*, the Plaintiffs brought an action in federal court alleging that AT&T had engaged in false advertising and fraud by charging a sales tax on cell phones it advertised as free.[2] The action was later consolidated into a class action. AT&T moved to compel binding arbitration with the Concepcions because its contract with them contained an arbitration clause with a class action waiver. Both the District Court and the Ninth Circuit Court of Appeals denied AT&T's motion to compel arbitration, relying on the California Supreme Court's decision in *Discover Bank v. Superior Court*,[3] which invalidated arbitration clauses in consumer contracts as "unconscionable" when the provisions did not allow for class actions.[4]

The Supreme Court in *AT&T Mobility* held that by routinely disallowing the arbitration of matters, which the FAA expressly encouraged and favored, California's *Discover Bank* rule "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[5] However, the Court also noted that courts are still free to invalidate arbitration agreements under the FAA by applying "generally applicable contract defenses," including grounds such as fraud, duress, or unconscionability, but not "defenses that apply only to arbitration or derive their meaning from the fact than an agreement to arbitrate is at issue."[6]

The New Battlefield Following *AT&T Mobility*?

On November 23, 2011, a California Court of Appeal (Second Appellate District) refused to enforce a sales contract's arbitration provisions.[7] The court held that the sales contract terms were unconscionable.[8]

Plaintiff Sanchez alleged that in connection with his purchase of a used Mercedes-Benz vehicle, the selling dealership charged him $3,700 to have the vehicle certified as eligible for a lower interest rate.[9] Sanchez further contended that the charge was actually for an undisclosed and optional extended warranty.[10] Sanchez filed a class action alleging violations of a number of California's consumer protection laws. The dealership moved to compel arbitration of the matter.[11] The trial court denied the motion, stating that the Consumer Legal Remedies Act (CLRA) expressly provides for class actions and declares the right to a class action to be unwaivable.[12] Because the arbitration agreement included a "poison pill" clause holding that if the class action waiver was deemed invalid the entire agreement was invalid, the court ruled that the entire arbitration agreement was unenforceable.[13]

The appellate court took a different approach, and did not address whether the class action waiver was unenforceable. Rather, it concluded that the arbitration provision as a whole was unconscionable, even after the Supreme Court's ruling in *AT&T Mobility.* The *Sanchez* court applied the conscionability analysis the California Supreme Court set forth in *Armendariz v. Foundation Health Psychcare Servs., Inc.*,[14] and held that the arbitration provision was procedurally unconscionable because it was "adhesive and satisfies the elements of oppression and surprise", and was substantively unconscionable because "it contains terms that are one-sided in favor of the car dealer to the detriment of the buyer."[15] The court ultimately found the sales contract "permeated with unconscionability and unenforceable."[16]

Of significance, the *Sanchez* court held that *AT&T Mobility* does not preclude the application of well established contract law principles used to determine whether an arbitration provision is valid. Specifically, while *AT&T Mobility* disapproved the *Discover Bank* rule, "[w]ith the exception of the *Discover Bank* rule, the Court acknowledged that the doctrine of unconscionability is still a basis for invalidating arbitration provisions."[17] As such, the *Sanchez* court found *AT&T Mobility* inapplicable to its case, which did not hinge on a class action waiver or "involve a judicially imposed procedure that conflicts with the arbitration provision and the purposes of the Federal Arbitration Act (FAA)"[18] The court reasoned that it was simply applying an unconscionability analysis that pre-dated and survived the *AT&T Mobility* ruling.

In finding the arbitration agreement invalid, the *Sanchez* court took particular offense to numerous contract provisions that seemed to benefit only the car dealership defendant and not its consumers, such as offering arbitration appeal rights only as to those issues the car dealer would be likely to appeal (e.g. excessive monetary judgments), conditioning an arbitration

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Government Winning... *continued from page 1*

1. a 40 percent penalty for a gross valuation misstatem0ent (Section 6662(b)(3) and (h));
2. a 20 percent penalty for substantial valuation misstatement (Section 6662(b)(3);
3. a 20 percent penalty for substantial understatement of income tax (Section 6662(b)(2); and
4. a 20 percent penalty for negligence or disregard of rules and regulations (Section 6662(b)(1)).[3]

The trial court, however, disagreed with the Service and found that the taxpayer had reasonable cause for, and acted in good faith with respect to, its tax positions. The Fifth Circuit affirmed the trial court's decision to disallow the penalties, noting, however, that the issue was close.[4] Southgate argued persuasively that it relied reasonably on two tax opinions (one by an accounting firm and one by a law firm) that concluded it was "more likely than not the IRS would uphold" the tax positions.[5] A close reading of *Southgate* may be instructive, if for no other reason, than to identify what steps companies should take to defend successfully against the imposition of penalties.

The second case, *Pritired 1, LLC & Principal Life Insurance Co. v. United States,*[6] involved the use of what is known as a "foreign tax credit generator" by the Principal Financial Group ("Principal") and Citibank. In *Pritired*, a district court disallowed $20 million in foreign tax credits claimed by Principal.

In the transaction at issue, both Citibank and Principal contributed funds to a newly-created entity, Pritired 1, LLC ("Pritired"), a limited liability company taxed for U.S. purposes as a partnership. *Pritired* invested $300 million into SAS, a subsidiary of two French banks. The French banks then invested an addition $900 million with SAS.

SAS invested the $1.2 billion in a portfolio of securities, and paid French tax on the earnings from that portfolio. SAS also entered into a swap with Pritired, and under the swap, Pritired paid SAS a floating rate minus the French tax attributed to (and paid by) SAS on the income from the entire $1.2 billion portfolio. As a result of the swap, Pritired claimed (for U.S. tax purposes) that it was entitled to claim as a foreign tax credit the entire amount of foreign taxes paid by SAS. Pritired's parent, Principal, then sought to use those foreign tax credits to offset other income.

The court held for the IRS on three grounds. First, the court found that Principal's "investment" was really debt, and observed that other than the tax benefits, there was no "upside potential" to the investment.[7] Second, the court determined that the transaction lacked either an objective or subjective business purpose, and was primarily structured to generate foreign tax credits.[8] Lastly, the court held that the IRS could disregard the partnership under the partnership anti-abuse regulations, allowing the IRS to effectively unwind the transaction.[9]

The last case, *WFC Holding Corp. v. United States,* involved Wells Fargo's use of a so-called "underwater lease transaction." In the transaction at issue, Wells Fargo sold (i) stock worth $430 million and (ii) underwater leases[10] worth negative $426 million for $4 million. Wells Fargo later claimed a capital loss of roughly $425 million on the sale. The court concluded that the transaction was actually a sham tax shelter that Wells Fargo had purchased from an accounting firm (for $3 million!) and that it had no business purpose other than tax avoidance.[11]

Each of the above cases involves a "technical" tax shelter, i.e., a transaction whose tax benefits are arguably supported by a technical reading of the tax law.[12] Because technical tax shelters arguably follow the law, they often are accompanied by tax opinions providing comfort to the client that the transaction follows the law. As a practical matter, however, those tax opinions may serve a more important role – protection against penalties, which proved valuable in Southgate.

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[1] No. 09-11166 (5th Cir. Sept. 30, 2011).
[2] *Southgate Master Fund, LLC v. United States*, 651 F. Supp. 2d 596 (N.D. Tex 2009).
[3] There is no stacking of penalties, so the maximum penalty is either 20 percent or 40 percent of the underpayment of tax. See Treas. Reg. § 1.6662-2(c).
[4] 651 F. Supp. 2d at 663-664
[5] *Id*.
[6] 108 A.F.T.R.2d (RIA) 6605 (S.D. IA 2011).
[7] *Id*.
[8] *Id*.
[9] Penalties were not discussed in the *Pritired* case.
[10] An underwater lease is one in which the obligations on the part of the lessor exceed the projected rent. For example, if the lessor has to pay $1,000 for the property, but only earns $300 in rent, the lease would be "underwater" by $700.
[11] *Id*.
[12] According to Eric Solomon, former Deputy Assistant Secretary in the Office of Tax Policy at the U.S. Treasury Department, a technical tax shelter is, "a tax-engineered transaction normally with little business purpose except to save taxes with minimal risk or profit potential often designed to create a tax loss without an economic loss or in some cases to make income nontaxable." See remarks of Eric Solomon, Tax Policy Center – Tax Analysts Form on Tax Shelters, Washington, D.C., February 11, 2005.

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handled as though they were uninsured. Don't let this happen to your company.

In addition to the various types of insurance purchased by the company or any of its predecessors, risk managers and executives should also analyze other sources of insurance which may potentially cover a claim. Such sources may include contractual indemnitor or other company's insurance policies which may list the company as a named insured under a vendor endorsement or pursuant to a contractual coverage endorsement. With respect to environmental matters, for example, a company alleged to have generated waste at a Superfund site should look to not only its own liability insurance but also the liability insurance of the transporter of the alleged waste and the owner of the site.

4

4. Give Notice Early And Often

Some policies require notice be given within a specified time. Others require notice be given "as soon as practicable." But every liability policy includes some provision that requires the insured to provide the carrier with notice of certain events. A delay of even a few days can prevent you from recovering anything, though the insurance company must typically show that it was actually prejudiced by the delay.[13] Have your broker give notice **in writing** to **every** insurance company that sold you insurance, even if you cannot locate your policies. Have your broker give notice even if you are not sure a particular policy applies. Have your broker give notice even if the extent of your loss is not yet known. Finally, give notice under policies sold to other parties which could potentially cover any of your losses, particularly where you are listed as a named insured. Because most policies have timely notice provisions, if you fail to give notice promptly, you give the insurance company an argument against coverage that is easily avoided – by giving notice early.[14]

5

5. Insurance Expertise Should Not Be Limited To Risk Management

Both lawyers and risk managers are in the business of assessing risks. Both want to protect their company from a hostile outside environment--they are natural allies. Thus, while your company's risk management department is obviously an important and central part of your company's base of insurance knowledge, it should not be the only department in which insurance knowledge resides. Likewise, your legal department, including any regularly retained outside counsel, should have a ready working knowledge of your company's insurance program. Lacking the expertise and often failing to work as a team causes risk managers and in-house lawyers to overlook the availability of insurance, thus exposing the company to losses that could have been avoided due to insurance coverage.

6

6. Keep In Contact With The Insurance Company

No matter how contentious the relationship between the policyholder and the insurance company becomes during an insurance coverage dispute, the policyholder should keep in regular contact with the insurance company. The policyholder should establish a system of periodic reports to keep the insurance company informed of what is happening and of the status of each claim. In particular, if engaged in settlement negotiations with a party suing the company, the policyholder should keep the insurance company informed of all progress and should forward proposed settlement agreements to the insurance company before agreeing to them while making sure that no privileged information is disclosed in situations where the insurance company has denied coverage or taken a position adverse to the policyholder.

7

7. Seek Help From The State

If the insurance company continues to turn a deaf ear, plead your case to your state insurance department.[15] Most states have a consumer complaint hotline that should be able to tell you your rights and what to do next. Some states, such as Texas and Missouri, employ consumer advocates to agitate on a policyholder's behalf, a service that could save thousands of dollars in legal fees. Do not be afraid to use all of your resources.

8

8. Don't Take No For An Answer

Insurance companies routinely deny claims, even if the grounds for denial are highly questionable from a policyholder's point of view.[16] The practicalities and economics of denying insurance coverage and denying insurance claims weigh very heavily in favor of insurance companies.[17] As one commentator notes:

> Insurance is all about betting against negative consequences and the insurance business model is unique in that profits depend upon goods and services not being provided.[18]

Insurance is a product that is promised but often never delivered. It is a defective product, and the courts ought to treat it as such.[19] Insurance companies win simply by saying "no."[20] The Supreme Court of Delaware also noted this phenomenon with respect to insurance policies:

> Insurance is different. Once insured files a claim, the insurer has a strong incentive to conserve its financial resources balanced against the effect on its reputation of a 'hard-ball' approach. Insurance contracts are also unique in another respect. Unlike other contracts, the insured has no ability to 'cover' if the insurer refuses without justification to pay a claim. Insurance contracts are like many other contracts in that one party (the insured) renders performance first (by paying premiums) and then awaits the counter-performance in the event of a claim. Insurance is different, however, if the insurer breaches by refusing to render the counter-performance. In a typical contract, the non-breaching party can

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> replace the performance of the breaching party by paying the then-prevailing market price for the counter-performance. With insurance this is simply not possible. This feature of insurance contracts distinguishes them from other contracts and justifies the availability of punitive damages for breach in limited circumstances.[21]

"Delay and deny" strategies favor the insurance company.[22] Thus, if you do not challenge an insurance company's unwarranted denial, the matter will end there and the policyholder loses the insurance benefits from lack of persistence.[23] There is no downside, however, to challenging a denial of insurance coverage. Make your insurance company spell out the basis for the denial. Most state insurance regulations demand this. Read your policy to see if it says what the insurance company says it does; and then read it again to see if any other provisions alter the insurance company's interpretation. Write back explaining your position and why "No" is unacceptable. Unfortunately, the difference between coverage and non-coverage often directly reflects the determination and persistence of the individual policyholder.[24]

9. Always Respond To Insurance Company Requests

The flip side of never accepting "No" from the insurance company is that you have a duty *not* to say "No" to the insurance company when they request cooperation and information – unless you have a specific reason for withholding information, in which case you should spell out the reason for your refusal. Most liability policies contain a standard cooperation clause that provides that the policyholder will cooperate with the carrier in the investigation, settlement, or defense of a claim or suit.[25] The purpose of such provisions is to permit the insurance company to present a complete defense of its policyholder and to prevent collusion between the policyholder and a claimant.[26] Unreasonable requests, however, should be challenged, and you do not necessarily have to fulfill every request exactly as the insurance company presents it.[27] Specifically, the policyholder should be careful be about sharing privileged information in circumstances where doing so might constitute a waiver of the privilege and cause more harm in the long run.[28] In most circumstances, however, cooperation with the insurance company is best because a simple denial of all or most requests by the insurance company may provide a basis for denying your claim.[29]

10. Hire Only The Most Experienced Attorneys

Unlike breach of other contracts, breach of an insurance policy does not involve a third party vying for what the insurance company has already promised to sell to the policyholder — the policyholder's insurance coverage. Rather, the insurance company merely wants to hold onto the policyholder's money for as long as it can.[30] Policyholders should therefore seek out lawyers who have the same degree of insurance coverage litigation experience and knowledge about this product as the insurance companies. Lawyers with the proper expertise in insurance coverage litigation can give the policyholder a realistic idea of the prospects for recovery, the anticipated legal fees, and how long it may take before a decision or settlement is reached.[31] In addition, insurance coverage disputes, like any other species of legal dispute, are fraught with unique pitfalls which a policyholder should know about before it is too late.[32] For instance, insurance coverage dispute arbitration is an idea which sounds great -- but arbitration as stipulated in insurance contracts is a field slanted in favor of the insurance company.[33] Conversely, non-binding mediation is an excellent vehicle to maintain dialogue, narrow the issues, and speed along the litigation towards settlement. A knowledgeable and aggressive litigation force is the single most effective tool to expedite the litigation process and achieve substantial settlements.

CONCLUSION

Until a claim is denied, the policyholder and insurance company may share an amicable, if not harmonious, relationship. A policyholder which finds itself in the midst of an insurance coverage dispute is often taken completely by surprise. Policyholders must be prepared and know what to do if a claim for insurance coverage is denied. The proper legal advice can help the policyholder decide whether it should talk or litigate, settle or go to trial, and can provide guidance in shaping an appropriate settlement or negotiation strategy. In the end, the policyholder who understands the long-standing traditions of insurance, and rules of insurance coverage, is in a much better position than the policyholder who does not.

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[1] Liability insurance is "litigation insurance". *See International Paper Co. v. Continental Casualty Ins. Co.,* 35 N.Y.2d 322, 361 N.Y.S.2d 873, 320 N.E.2d 619 (1974); *National Grange Mut. Ins. Co. v. Continental Casualty Ins. Co.,* 650 F. Supp. 1404, 1407 (S.D.N.Y. 1986); *Technicon Electronics Corp. v. American Home Assur. Co.,* 74 N.Y.2d 66, 542 N.E.2d 1048, 544 N.Y.S.2d 531 (N.Y. Ct. App. Westchester County) (No. 08811/85); *Boeing Co. v. Aetna Casualty & Sur. Co.,* 113 Wash. 2d 869, 784 P.2d 507 (W.D. Wash. 1990) (No. C86-352WD).

[2] See Marla Jo Aspinwall, Note, The Applicability of General Liability Insurance to Hazardous Waste Disposal, 57 S. Cal. L. Rev. 745, 757 (1984). "The very title 'Comprehensive General Liability Insurance' suggests the expectation of maximum coverage." Id.

[3] "The primary duty of the [insurance company] claim

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representative is to deliver the promise to pay. Therefore, the [insurance company] claim representative's chief task is to seek and find coverage, not to seek and find coverage controversies or to deny or dispute claims." James J. Markham et al., The Claims Environment, 13 (1st ed. 1993).

[4] The contractual rule of thumb enunciated by courts is that they narrowly construe exclusions and thus maintain the expected broad coverage of the CGL policy. Typical exclusions are: Contractual; Automobile; Aircraft; Transportation of Mobile Equipment; Watercraft; War; Liquor Liability; Workers Compensation; Employers' Liability; Care, Custody or Control; Alienated Premises; Design Error; Injury to Product; Injury to Completed Work; Pollution; Sistership; Explosion; Collapse and Underground Damage; and Water Damage. See generally 1B Appleman, Insurance Law and Practice §§ 371 et seq. (1983). See also Jeffrey W. Stempel, Law of Insurance Contract Disputes §14.06 (2d ed. 1999 & Supp. 2002) (discussing different CGL triggers utilized by courts).

[5] In selling the insurance policy to the policyholder, the insurance company promises to provide the policyholder with legal representation, at the insurance company's expense, if a third party makes a claim for injury or damage allegedly caused by the policyholder and also promises to pay for any settlement or adverse judgment entered against the policyholder in such claim or lawsuit.

[6] Having a simple resolve and understanding of the purpose of insurance can make many issues that may arise when a policyholder is subjected to a claim less problematic. The protagonist in the movie Ghost Dog: The Way Of The Samurai explains, "[t]here is something to be learned from a rainstorm. When meeting with a sudden shower, you try not to get wet and run quickly along the road. But doing such things as passing under the eaves of houses, you still get wet. When you are resolved from the beginning, you will not be perplexed, though you still get the same soaking. This understanding extends to everything." quoting Yamamoto Tsunetomo, The Hagakure: A code to the way of samurai.

[7] Two issues surface with regularity in litigation over self-insurance. The first involves the duty of a self-insured to its excess insurance company to settle a claim. The second issue concerns whether a policyholder can avoid periods of non-insurance in cases involving insurance claims for continuous injury over long periods of time--such as asbestos and pollution claims. See, e.g. *World Omni Financial Corp. v. ACE Capital Re, Inc.,* No. 02 Civ. 04765 (RO), 2002 WL 31016669 (S.D.N.Y. Sept. 6, 2002), vacated on other grounds by, 64 Fed. Appx. 809 (2d Cir. 2003). In this case, World Omni's risk management department created a captive insurer, JCJ, to act as its direct insurer because World Omni could not get direct insurance from ACE Overseas. ACE Overseas was apparently not licensed to provide direct insurance coverage. JCJ issued World Omni a direct insurance policy covering approximately $160,000,000 of its potential lease losses and ACE Overseas reinsured the portfolio of automobile leases. When a claim arose, myriad issues followed that almost caused World Omni to lose out on insurance coverage because of the business decision to "creatively" insure the risk.

[8] Even the insurance industry agrees with this statement. In its insurance training manual, Liberty Mutual states that "the supposed advantages of self-insurance cost-wise are largely illusory. . . . Where self-insurance plans are not soundly conceived under ideal conditions, they may easily amount to nothing better than non-insurance, a gamble." Liberty Mutual Insurance Company, Insurance Principles for Risk Control Lesson 1 Overview 14 (undated).

[9] Sheila Mulrennan, Insurance Archaeology: Unearthing Unexpected Assets To Cover Unexpected Liabilities , 577 PLI/Lit 57 (1998) ("For a Fortune 500 manufacturer facing a multi-million dollar cleanup tab affecting several dozen sites around the U.S., insurance archaeologists located $170 million in previously unknown insurance coverage. The policies, dating back to the 1950s, were spread among seven predecessor companies of the current client. As a result, this manufacturer was able to advance a successful settlement strategy by targeting and prioritizing the numerous liability policies written by more than 60 insurance companies over a 40-year period."); Jerold Oshinsky & Judith H. Howard, The Coverage Lawyer as Indiana Jones: Finding Lost Insurance Coverage, Envtl. Hazards, July 1990, at 1 (outlining some of the steps counsel should undertake to find lost insurance coverage for their clients).

[10] Even musical artists recognize the importance of keeping track of their insurance policies. Lil Wayne notes that he keeps his "Insurance papers in the safe, money in the ceiling . . . ." Lil Wayne, We Come and See About It on The Drought Is Over Pt. 4 (Universal Distribution 2007).

[11] In certain environmental and asbestos claims, due to the latency period between the cause of loss and the manifestation of injury, claims may be presented under occurrence-based policies issued many decades earlier.

[12] See Julianne Kurdila and Elise Rindfleisch, Funding Opportunities For Brownfield Redevelopment, 34 B.C. Envtl. Aff. L. Rev. 479 (2007), citing Jack Fersko & Ann M. Waeger, Environmental Insurance in Brownfield Transactions: Issues and Answers, in Brownfields: A Comprehensive Guide to Redeveloping Contaminated Property 165, 165 (Todd S. Davis ed., 2d ed. 2002) ("Some use the phrase "insurance archeology" to describe the systematic recovery and analysis of old policies to determine coverage.")

[13] There is a small minority of states that hold that "late" notice can effect a complete forfeiture of insurance coverage without a demonstration of prejudice to the insurance company. See Couch § 193:32. General Rule That Prejudice Immaterial, at n. 58 citing cases.

[14] State statutes and case law vary as to the effect of a policyholder's untimely notice of a claim on the insurance company's liability under the policy.

[15] One concern is in this context is that most state insurance commissioners come from the insurance industry and leave their government office in order to return to the industry (by accepting an offer of high-level employment with an insurance company at a much higher salary). Insurance companies can play a hand in determining who the insurance department should single out

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for regulatory scrutiny. Thus, when insurance companies want their way, they usually get it. The "revolving door" at the top at state insurance departments widens the information imbalance between the insurance companies and its policyholders by seriously questioning whether protecting policyholders' or a potential employer is the primary concern of the state insurance department. See, e.g., Robert H. Gettlin, An Elder Statesman Moves On, BEST'S REV. P/C ed., Sept. 1997, at 16:

> Insurance commissioners live in two worlds. They're charged with protecting consumer interests, but they're also responsible for maintaining a healthy insurance market and keeping profitable companies in the state. Commissioners tack back and forth between these twin duties. A state regulator may promote one role over the other, but can never fully escape the natural tensions of the job.

[16] The unbalanced relationship between the insurance company and policyholder and profitability of delay make it is easy to see why the insurance company almost always denies or delays payment of claims and "runs for cover rather than coverage." *Sandoz, Inc. v. Employer's Liability Assur. Corp., 554 F.Supp. 257, 258 (D.C.N.J. 1983)*.

[17] A basic, fundamental principle of insurance economics and of contracts in general is that breach of contract is profitable. A successful breach of contract claim brings the victim of the breach only the benefit of the original bargain. The victim of the breach is out the time, trouble and costs (including legal expenses) of pursuing the perpetrator of the breach. "Just say 'No'" has an especially sweet sound to anyone (including insurance companies) who does not want to live up to their word.

[18] Jonathan Kellerman, The Health Insurance Mafia, Wall St. J., http://online.wsj.com/article/SB120813453964211685.html, April 14, 2008.

[19] An insurance policy is a product, not a mere contract right. Courts and insurance companies have referred to insurance policies as products. See, e.g., *U.S. Healthcare v. Blue Cross,* 898 F.2d 914, 917 (3d Cir. 1990); *Omega Nat'l Ins. Co. v. Marquardt,* 799 P.2d 235 (Wash. 1990) (upholding state insurance commissioner's rule aimed at "banishing certain offensive insurance products from the state marketplace" because the policies were "inherently unfair to insurance purchasers"); *State Farm Mut. Auto. Ins. Co. v. Wyoming Ins. Dep't,* 793 P.2d 1008, 1016 (Wyo. 1990) (insurance policyholders are "purchasers of the product"); *New Mexico Life Ins. Guar. Ass'n v. Quinn & Co.,* 809 P.2d 1278, 1284 (N.M. 1991); *National Claims Assoc. v. Division of Employment,* 786 P.2d 495, 498 (Colo. Ct. App. 1989); *C & J Fertilizer, Inc. v. Allied Mut. Ins. Co.,* 227 N.W.2d 169, 178 (Iowa 1975); *Batton v Tennessee Farmers Mut. Ins. Co.,* 736 P.2d 2, 5-6 (Ariz. 1987) (en banc).

Because insurance policies are products, courts have also recognized implied warranties in the sale of an insurance policy. See, e.g., *Carper v. State Farm Mut. Ins. Co.,* 758 F.2d 337 (8th Cir. 1985) (theory of implied warranty for a particular purpose focuses on the circumstances present at the time the insurance policy is sold. The Supreme Court of Arizona has held that selling an insurance policy is no different than selling a product. Batton, above. The recognition of an implied warranty of fitness in the sale of an insurance policy was summarized by a Missouri court as follows:

> Although implied warranties of fitness for intended purpose have traditionally been attached only to sales of tangible products, there is no reason why they should not be attached to "sales of promises" as well. Whether a product is tangible or intangible, its creator ordinarily has reason to know of the purposes for which the buyer intends to use it, and buyers ordinarily rely on the creator's skill or judgment in furnishing it.

Estrin Constr. Co. v. Aetna Cas. & Sur. Co., 612 S.W.2d 413, 424 n.10 (Mo. Ct. App. 1981), (quoting from W. David Slawson, Standard Form Contracts and Democratic Control of Lawmaking Power, 84 HARV. L. REV. 529, 546-47 (1971)).

[20] When an insurance company denies a claim, most policyholders simply give up. See Ray Bourhis, So, You Thought You Had Disability Insurance?, http://www.disability-insurance-help.com/consumers.htm(explaining that. . ."policyholders simply give up or under-settle for nickels on [the] dollar because they are too ill or injured to deal with the insurance onslaught.") Insurance companies win by default, even when a policyholder's claim for coverage is valid.

[21] *E.J. Dupont de Nemours & Co. v. Pressman,* 679 A.2d 436, 447 (Del. 1996).

[22] Insurance claims handling and insurance coverage litigation are often said to operate at four speeds: slow, very slow, stop and reverse. Moreover, claim inflation during the delay is offset by the interest the insurance company earns. George M. McCabe and Robert Witt, Investment Income and Claim Costs Inflation in Insurance, CPCU J., June 1987, at 117.

[23] "Insurance float – money we temporarily hold in our insurance operations that does not belong to us – funds $66 billion of our investments. This float is "free" as long as insurance underwriting breaks even, meaning that the premiums we receive equal the losses and expenses we incur." Warren Buffett, Berkshire Hathaway, Inc., 2011 letter to Shareholders; "Simply put, the float is money we hold that is not ours, but which we get to invest." Warren Buffett, billionaire CEO of Berkshire Hathaway, Inc., explaining one of the benefits of "float" in a 2007 letter to shareholders of Berkshire Hathaway.

[24] Persistence will better the odds that a policyholder will recover especially since "our system of legal remedies for breach of contract . . . has shown a marked solicitude for men who do not keep their promises." E. Allan Farnsworth, Legal Remedies for Breach of Contract, 70 COLUM. L. REV. 1145, 1216 (Nov. 1970).

[25] Christopher W. Martin, Ethical Issues In Insurance Litigation, 861 PLI/Lit 263, 304 (2011) ("Because most insurance policies require an insured to cooperate, the refusal to consent to the carrier's defense or the refusal to consent to a settlement may be unreasonable and violate the insured's obligations under the policy.")

[26] Under New York law, a policyholder's failure to cooperate with an investigation by an insurance company constitutes a material breach of the insurance contract and is a defense to a suit on the policy. *Stradford v. Zurich Ins. Co.,* No. 02 Civ.3628, 2002 WL 31819215, at *4 (S.D.N.Y. 2002); *In re U.S.A. Electronics, Inc. v. Aetna Cas. & Surety Co.,* 120 B.R. 637, 643 (E.D.N.Y. 1990).

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Member Spotlights

Vickie E. Turner - Named Lawyer of the Year

Vickie E. Turner was recently named the *Best Lawyers'* 2012 San Diego Product Liability Litigation - Defendants Lawyer of the Year. *Best Lawyers* compiles its lists of outstanding attorneys by conducting exhaustive peer-review surveys in which thousands of leading lawyers confidentially evaluate their professional peers. The current, 18th edition of *The Best Lawyers in America* (2012) is based on more than 3.9 million detailed evaluations of lawyers by other lawyers.

Only a single lawyer in each specialty in each community is recognized with the honor as the "Lawyer of the Year." The lawyers being honored as "Lawyers of the Year" have received particularly high ratings in the publication's surveys by earning a high level of respect among their peers for their abilities, professionalism, and integrity.

Brian K. Telfair - Wins in the Fourth Circuit Court of Appeals

Very recently, Executive Committee member, Brian K. Telfair, successfully argued before the Fourth Circuit Court of Appeals. In *A Society Without a Name, For People Without a Home, Millennium Future-Present v. Virginia, (ASWAN v. Virginia)*, the Court affirmed the district court's dismissal of all claims brought by a coalition of homeless and formerly homeless people. The Court determined that the group had failed to make its case. The case involved challenges to various steps taken by Virginia Commonwealth University ("VCU") and the City of Richmond, Virginia (Richmond) to relocate services away from downtown Richmond.

The Society alleged that Richmond, VCU and the Commonwealth of Virginia conspired to establish homeless shelter, the Conrad Center, at a site removed from Richmond, Virginia's downtown community for the purpose of reducing the presence of the homeless population in the downtown area by providing services for them in a remote location. The Society claimed that the relocation of homeless services to the Conrad Center violated the Americans with Disabilities Act (ADA), the Equal Protection Clause of the Fourteenth Amendment and the Fair Housing Act (FHA). According to the Society, the relocation was rooted in class, race and disability prejudice.

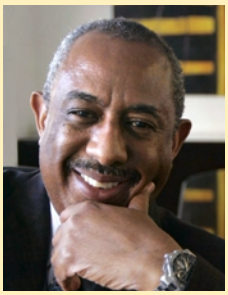
The Court noted that the Society's conspiracy claim failed because the Society almost entirely pled conclusory allegations unsupported by any concrete facts. The Court found that the Society's ADA and FHA claims were both time-barred, and that, regardless of filing limitations, the Society failed to state a FHA claim upon which relief could be granted. The panel ruling was divided. The Hon. Ronald Lee Gilman (senior Sixth Circuit judge sitting by designation) wrote the lead opinion affirming the district court's dismissal of all claims. The Hon. Diana Motz wrote a separate opinion concurring in Judge Gilman's opinion except with respect to analysis of the Society's ADA claim against VCU (which Judge Motz would have allowed to proceed). The Hon. James A. Wynn, Jr. Wynn wrote a separate opinion concurring in Judge Gilman's opinion except with respect to analysis of whether various claims were barred by the statute of limitations (the majority said yes and Judge Wynn said no).

David B. Cade - Appointed Assistant Secretary at Boeing

NBA-CLS Immediate Past Chair David B. Cade was appointed recently as an Assistant Secretary at The Boeing Company where he is Senior Counsel in the Law Department. Boeing is the world's leading aerospace company and the largest manufacturer of commercial jetliners and military aircraft combined. Additionally, Boeing designs and manufactures rotorcraft, electronic and defense systems, missiles, satellites, launch vehicles and advanced information and communication systems. David currently serves as Program Counsel to Boeing's Missiles and Unmanned Airborne Systems (MUAS), a division of Boeing Military Aircraft, located in St. Louis, Missouri. MUAS develops, manufactures, and integrates Boeing and non-Boeing weapons onto various platforms and provides precision strike and autonomous unmanned intelligence, surveillance and reconnaissance capability to military and government customers on a global basis.

Among other things, David's responsibilities include providing legal counsel to the MUAS Vice President, Functional Directors, Contracts and Supplier Management personnel on general legal issues, including those concerning compliance with federal procurement laws and regulations, general organization transactional matters, conflict of interest and disputes as well as acquisition law matters relating to the prime contracts and subcontracts supporting the missile division's five programs (Cruise Missile Systems, Direct Attack, Terminal Missile Defense, Insitu and Unmanned Airborne Systems). David's new assignment includes subsidiary maintenance and management, mergers, acquisitions, divestitures and joint ventures within MUAS. Boeing products within the MUAS portfolio include Joint Direct Attack Munition (Boeing JDAM), Small Diameter Bomb (SDB), Harpoon, Aegis Standard Missile-3 (SM-3) Kinetic Warhead, Patriot Advanced Capability-3 (PAC-3 Patriot Missile) Seeker, A-160 Hummingbird, ScanEagle®, Integrator™. MUAS programs are located in Bingen, WA; Huntington Beach, CA; Huntsville, AL; Mesa, AZ; Puget Sound, WA; and St. Charles, MO.

Member Spotlights



Lafayette & Kumagai LLP Wins 2011 Minority-Owned Law Firm Client Service Award

Gary T. Lafayette of Lafayette & Kumagai LLP is pleased to report that his firm recently received the 2011 the Minority-Owned Law Firm Client Service Award from the California Minority Counsel Program ("CMCP"). CMCP presents this award each year to the minority-owned law firm that has best demonstrated outstanding client service.

The CMCP seeks to promote and sustain diversity and inclusion in California's legal profession by developing professional opportunities for attorneys of color and providing business, legal and lay communities access to their talent. To recognize the organizations which capture the spirit of the CMCP mission, CMCP annually bestows three awards: The John Essex and Guy Rounsaville In-House Counsel Diversity Award; The Drucilla Stender Ramey Law Firm Award and the Minority-Owned Law Firm Client Service Award. These awards reflect CMCP's long standing tradition of honoring those dedicated to the furtherance of CMCP's mission. The awards were presented at the Awards Luncheon during the 2011 CMCP Annual Conference in Los Angeles, California.

Tillman J. Breckenridge - Joins Reed Smith LLP

Tillman J. Breckenridge has joined Reed Smith LLP as counsel in the Appellate Group, and leads the appellate practice for the Washington, D.C. and Virginia regions. Tillman's practice covers a diverse array of appellate litigation matters at all levels. He has represented companies, organizations, individuals, and foreign, state and local governments before the United States Supreme Court and various federal and state appellate courts. Additionally, Tillman has been a lecturer at DePaul University on the subjects of Constitutional Civil Liberties and First Amendment law.

Prior to Reed Smith, Tillman was a member of the Supreme Court and Appellate practice at the
Washington, D.C. office of Fulbright & Jaworski, LLP. He previously worked at the Los Angeles office of Greines Martin Stein & Richland, LLP, and in 2006 and 2007 was named a Southern California Super Lawyers Rising Star – Appellate. His appellate practice has included matters spanning numerous substantive legal fields, including constitutional, patent, tax, administrative, and myriad others.

Tillman earned his J.D. from the University of Virginia School of Law in 2001. He is admitted to practice in the District of Columbia, California and Illinois, and before the U.S. Supreme Court and the U.S. Courts of Appeals for the Third, Fourth, Seventh, Ninth, District of Columbia, and Federal Circuits.

Joseph M. Drayton - Successfully Defends Pier 1 Imports in a Patent Infringement Trial

Recently, Joseph M. Drayton successfully defended Pier 1 Imports in a patent infringement trial. Mr. Drayton and his mentor and friend, Alan M. Fisch, won a jury trial in a major patent litigation in the United States District Court for the Eastern District of Texas. Mr. Drayton defended Pier 1 Imports and the gift card system of Stored Value Solutions ("SVS"), a prepaid card processing company, in a matter brought by Alexsam, a non-practicing entity (patent troll). Mr. Drayton examined six of the twelve live trial witnesses including cross-examination of plaintiff's technical and financial expert. He gave closing argument before an all women jury. In this specific litigation, Messrs. Drayton and Fisch defended against patent infringement claims where the plaintiff was seeking $26 million in past damages and an additional $12 million in future damages from Pier 1. The case was the first line of defense for SVS as its business systems are used by Pier 1 and hundreds of other clients and were a significant part of the plaintiff's infringement case. Instead of settling the litigation, Pier 1 remained steadfast in defense despite Alexsam's successful suit against another company, IDT, making similar claims earlier in the year.

Joseph Drayton is an experienced trial attorney, who last year was named among the National Bar Association's Nation's Best Advocates: 40 Lawyers Under 40 (2010). Mr. Drayton's practice background includes a broad range of intellectual property, complex commercial and antitrust matters. He practices before both state and federal courts, as well as the International Trade Commission. Mr. Drayton also counsels clients in all aspects of intellectual property acquisition, transfer, protection and enforcement. He is the Chair of the Intellectual Property Litigation Committee of the American Bar Association's Section of Litigation

Mr. Drayton is a life member of the NBA and a member of the NBA's Convention and Meeting Committee. Mr. Drayton is also the President of the Metropolitan Black Bar Association of New York City, an affiliate chapter of the NBA. Mr. Drayton is a life member of Omega Psi Phi Fraternity, Inc., and board member of the Practicing Attorneys For Law Students, Inc., a New York based non-profit organization aimed at improving the professional experience of law students and young lawyers.

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Generally, policyholders "may forfeit their right to recover under an insurance policy if they fail to abide by provisions in the policy requiring them to cooperate with the insurer's investigation of their claim." *Tran v. State Farm Fire and Casualty Company,* 961 P.2d 358, 363 (Wash. 1998).

[27] Be wary of the types of requests because insurance companies often engage in post-loss underwriting. A superb definition of post-loss underwriting (also known as "post-claim underwriting") is expressed in a popular legal novel:

> THINGS PICK UP A BIT on Tuesday, partly because I'm getting tired of wasting time, partly because the witnesses either know little or can't remember much. I start with Everett Lufkin, Vice President of Claims, a man who'll not utter a single syllable unless it's in response to a direct question. I make him look at some documents, and halfway through the morning he finally admits it's company policy to do what is known as "post-claim underwriting," an odious but not illegal practice. When a claim is filed by an insured, the initial handler orders all medical records for the preceding five years. In our case, Great Benefit obtained records from the Black family physician who had treated Donny Ray for a nasty flu five years earlier. Dot did not list the flu on the application. The flu had nothing to do with the leukemia, but Great Benefit based one of its early denials on the fact that the flu was a preexisting condition.
>
> John Grisham, The Rainmaker 295 (1995).

[28] Christopher Mickus and Patrick Frye, Access To Insureds' Privileged Communications Via Cooperation Clauses, 39-SPG Brief 18 (Spring 2010) ("The insured can satisfy its cooperation duty by providing nonprivileged information while withholding privileged communications."); The "Common interest" doctrine may permit disclosure without forfeiting protection of attorney-client privilege. *North River Ins. Co. v. Philadelphia Reinsurance Corp.,* 797 F. Supp. 363, 367 (D.N.J. 1992) (no common interest if insurance company has reserved its rights).

[29] A policyholder is typically relieved of the duty to cooperate, when an insurance company initially denies a claim (even if it later accepts to defend or indemnify). *See Higgins Ave. LLC v. Fidelity Nat'l Title Ins. Co. of NY,* 18 Misc.3d 1103(A), 856 N.Y.S.2d 24, 2007 WL 4439245 (N.Y. Sup. Ct. 2007). By contrast, under Massachusetts law, without breaching the duty to cooperate, a policyholder may refuse to allow an insurance company to defend and control a suit under a reservation of rights. *Three Sons,0000 Inc. v. Phoenix Ins. Co.,* 357 Mass. 271, 276 (1970) (holding that the insurance company had a duty to defend the policyholder without a reservation of rights or claim of nonwaiver so long as it insisted on retaining control of the defense).

[30] Insurance companies, like any other contract breaching entity, should be punished: "Repudiators of fair and solemn and binding promises are commercial sinners. If they are unrepentant, courts should hold them to the full consequences of their sins." *Lagerbef Trading Co. v. American Paper Products Co. of Indiana,* 291 F. 947 (7th Cir.), cert. denied, 263 US. 708 (1923).

[31] Indeed, the hostile environment of litigation extends to insurance disputes. See A. Michael Barker, Preparing the Defense in Fire Loss Litigation, FOR THE DEFENSE, Jan. 1992, at 2 ("Good defense, whether exercised on a football field or a battleground of war, requires adherence to the same basic principles.") (Mr. Barker regularly represents insurance companies); John G. Aicher, Developing CGL Coverage Defenses for CERCLA Remediation, 60 DEF. COUNS. J. 559 (1993); Memorandum of Law of CNA in Support of Motion to Strike Amended Counterclaims, Cross-Claims and Third-Party Complaint of General Battery at 1, Continental Casualty Co. v. General Battery Corp., (Del. Super. Ct. 1996) (No. 93 C011-088-WCC) ("Legal wars are fought with words but they are wars nonetheless."); Liberty Mutual has been sanctioned for being a "major league team" in the game of "hardball litigation." *See Adolph Coors Co. v. American Ins. Co.,* 164 F.R.D. 507, 509 (D. Colo. 1993).

[32] Sandoz, Inc, 554 F.Supp. at 258 (stating in order to avoid paying claims "insurance companies can be seen scurrying about the courts of this country in search of ways to avoid honoring their policies.").

[33] "Too many policyholders . . . get stuck dealing with unanticipated claim disputes that must be resolved confidentially under arbitration provisions they may never have read or may not even have realized were included in the policy language." John G. Nevius and Peter Halprin" Arbitration of Insurance Coverage Disputes: A Policyholder's Definitive Survival Guide," The John Liner Review (Fall 2010); *See, e.g., World Omni Fin. Corp. v. Ace Capital Re Inc.,* 64 Fed Appx. 809, 812 (2d Cir. 2003) (holding that if a party asserts claims or seeks to enforce rights under an agreement containing an arbitration provision, it has to arbitrate those claims whether or not it is a signatory to that agreement. It is estopped from denying arbitrability); In arguing against mandatory arbitration, one commentator explains that "one of the main complaints of the men who signed the Declaration of Independence: [was] that King George III deprived the colonists of their right to trial by jury." Eugene R. Anderson, Stop Mandatory Arbitration, 40-DEC Trial 12 (2004).

YOUR VOICE

If you have comments concerning the NBA-CLS newsletter, or if you are an NBA-CLS member who wants to submit an article for publication consideration, please contact Jean-Marie Sylla, Jr., Esq. at jmsylla@gmail.com.

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California Courts Struggle... *continued from page 4*

appeal on pre-paying onerous filing fees, and exempting certain issues from arbitration that only the dealership would want exempted (e.g. the right to repossess a vehicle).[19] In addition, the court reaffirmed the following contract principles that arbitration clauses cannot be couched in small font sizes; and that sales contracts should not be issued on a "take it or leave it" basis offering no negotiation; and companies should allow the customer a sufficient opportunity to review the contract.[20]

Employment Law Matters

Although *AT&T Mobility* arose in the consumer context, many felt it had wide-ranging implications for employment law as well, particularly as it pertained to employers trying to compel binding arbitration as a means to prevent class action lawsuits. However, it appears unsettled whether *AT&T Mobility* has this far-reaching potential.

By the time *AT&T Mobility* was decided, the California Supreme Court had already strongly suggested that class action waivers contained in employment arbitration agreements may be unconscionable, but directed that trial courts must evaluate such waivers against certain factors, including the modest size of the potential individual recovery, the potential for retaliation, and whether absent class members would otherwise know their legal rights.[21] What was left unclear was whether *Gentry* was also struck down along with *Discover Bank* in the Court's *AT&T Mobility* opinion.

In the first published California appellate court opinion on this issue following *AT&T Mobility*, California's Second Appellate District Court of Appeal issued a decision regarding the enforceability of arbitration agreements limiting employees' rights to assert class actions.[22] The arbitration agreement used by defendant Ralphs expressly barred class actions.[23] The trial court held that this agreement was unconscionable under *Gentry* and refused to enforce the arbitration agreement.[24]

A key issue on appeal in *Brown* was whether *AT&T Mobility* struck down the *Gentry* rule along with the *Discover Bank* rule. However, the *Brown* court refused to definitely answer this question, instead ruling that the plaintiff had failed to make a sufficient evidentiary showing under *Gentry* that the class action waiver was unconscionable, so the point was moot. The court did imply however that it believed it lacked the power to deem invalid the California Supreme Court's decision in *Gentry* absent a ruling by the California State Supreme Court.[25]

Furthermore, the *Brown* court held that *AT&T* does not preclude employees from pursuing a representative action under California's Private Attorney General Act (PAGA),[26] and that any arbitration agreement provision waiving the right to maintain a PAGA claim would be unenforceable. The court reasoned that unlike in the typical class action context seeking monetary relief for the class members, PAGA claims are essentially public enforcement actions of Labor Code provisions with 75 percent of any recovery flowing to the Labor and Workforce Development Agency.[27] As such, the *Brown* court appears to have opened the door to a new line of attacks on arbitration agreements.

Lewis v UBS Financial Services, Inc.

At least one California Federal district court has weighed in on the issue of whether the *Gentry* rule survived the *AT&T Mobility* decision.[28] In *Lewis v. UBS Financial Services, Inc.*,[29] plaintiff, a former UBS Financial Advisor, filed a class action against the company alleging violations of the California Labor Code and California's Unfair Competition Law (UCL).[30] The action stemmed from UBS' alleged practice of structuring employee bonuses as "loans" that were only forgiven if the employee remained with the company a certain amount of years.[31] Lewis' employment contract contained an arbitration provision and a class action waiver, which UBS sought to enforce.[32] Plaintiff argued that under the *Discover Bank* and *Gentry* rules, the class action waiver and arbitration provision were invalid.[33] Plaintiff further argued that even if *AT&T Mobility* struck down the *Discover Bank* rule, it left the *Gentry* case untouched.

The court disagreed, saying "*[AT&T Mobility]* cannot be read so narrowly" and that "like *Discover Bank*, *Gentry* advances a rule of enforceability that applies specifically to arbitration provisions, as opposed to a general rule of contract interpretation. As such, *[AT&T Mobility]* effectively overrules *Gentry*.[34]

Aftermath and Conclusion

The *Sanchez* ruling may reflect where the battle lines will be drawn following the *AT&T Mobility* decision, namely on whether the arbitration provisions or class action waivers in dispute survive good old-fashioned unconscionability analysis. As with any case by case approach, some contracts will be validated while others will fail the test. Because the courts will now be looking closely at consumer and employment contracts rather than simply finding them to be unenforceable, companies are well advised to take a much closer look at their sales as well as employment contracts with an eye towards whether they will survive judicial scrutiny on the issue of conscionability in the post- *AT&T Mobility* landscape. Terms that favor one side to the detriment of the other, such as those involved in the *Sanchez* opinion, will likely need to be modified.
Also, it remains unclear whether *Gentry* remains good law following the *AT&T Mobility* decision, so we will have to wait and see how that issue plays out in the courts. One thing is certain, the fight over the enforcement of arbitration agreements and class action waivers is sure to wage on in California, and across the country.

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California Courts Struggle... *continued from page 15*

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[1] *See AT&T Mobility LLC v. Concepcion,* 131 S. Ct. 1740 (2011).
[2] *Id.*
[3] 36 Cal. 4th 148 (2005)
[4] *Id.*
[5] *AT&T Mobility*, supra, 131 S.Ct. at 1748.
[6] *Id.* at 1746.
[7] *Sanchez v. Valencia Holding Company, LLC,* No. 228027, 2011 Cal.App. LEXIS 1467 (November 23, 2011).
[8] *Id.*
[9] *Id.* at 3.
[10] *Id.*
[11] *Id.* at 8.
[12] *Id.* citing Civ. Code, §§ 1781, 1751.
[13] *Id.*
[14] 24 Cal.4th 83 (2000).
[15] *Id.* at 31-33.
[16] *Id.*
[17] *Id.* at 20-21.
[18] *Id.* citing 9 U.S.C. §§ 1–16.
[19] *Id.*
[20] *Id.* at 28-32.
[21] *See Gentry v. Superior Court*, 42 Cal. 4th 443 (2007).
[22] *See Brown v. Ralphs Grocery Co.*, 197 Cal.App. 4th 489 (2011).
[23] *Id.*
[24] *Id.*
[25] *Id.* at 498.
[26] *Id.*
[27] *Id.* at 501-502.
[28] *See Lewis v. UBS Financial Services, Inc.,* No. C 10-04867, 2011 U.S. Dist. LEXIS 116433 (N.D. Cal. September 30, 2011).
[29] *Id.*
[30] *Id.*
[31] *Id.*
[32] *Id.*
[33] *Id.*
[34] *Id.* at 14.

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January 18-22, 2012
Mid-Winter Meeting Co-Sponsored: Judicial Council, Small Firms/Solo Practitioners'/ Young Lawyers Division
Sonesta Maho Beach Resort & Casino
St. Marteen

February 23-25, 2012
Commercial Law Section's Corporate Counsel Conference
Doral Golf Resort & Spa
Miami, Florida

March 2012
Annual Day on the Hill
Washington, D.C.

March 7, 2012
National Black Law Students Association 44th Annual Convention
Washington, D.C.

April 19-22, 2012
Mid-Year Conference & Gertrude E. Rush Award Dinner
Tampa, Florida

June 1-20, 2012
International Affiliates Meeting
Morocco

July 14-19, 2012
87th Annual Convention & Exhibits
Las Vegas, Nevada

July – August 2013
88th Annual Convention & Exhibits
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Highlights from the NBA 86th Annual Convention - CLS Reception

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