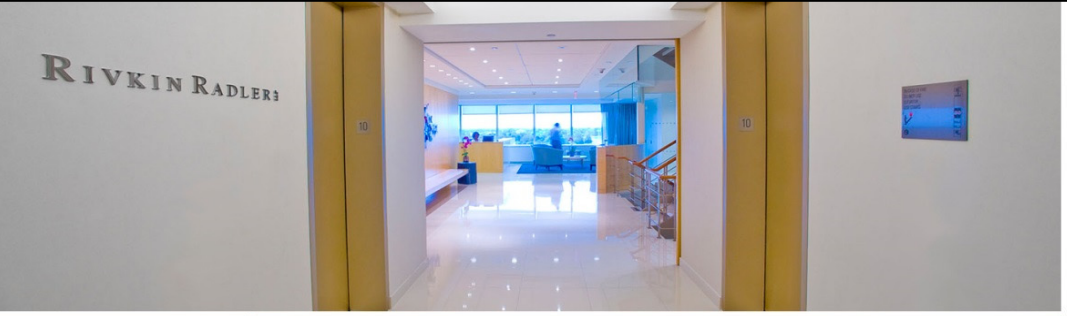

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Ninth Circuit Rules That Convention Trumps State Law: Compels Arbitration

In a case of first impression in the circuit, the Ninth Circuit Court of Appeals ruled the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "Convention") is self-executing, and therefore, not subject to reverse preemption by the McCarran-Ferguson Act. Therefore, a Washington state statute prohibiting the enforcement of arbitration clauses in insurance policies must give way to a foreign insurer's right to arbitrate.

The Case

A domestic company purchased insurance for a Texas townhome complex through Lloyd's, London. Under the terms of the policy, disputes were to be resolved through arbitration in New York.

In August 2017, the townhome complex was damaged by Hurricane Harvey. The insured submitted a claim under the policy, but there was a dispute over the amount of the deductible. The insured sued Lloyd's in federal court in Washington. Lloyd's moved to stay the suit and compel arbitration. Lloyd's argued that under the Convention, the United States committed to enforce arbitration agreements between foreign and domestic entities.

The insured conceded that the arbitration clause fell within the Convention's scope, but argued that the McCarran-Ferguson Act reverse preempts the Convention, such that Washington law controls. As Washington law prohibits the enforcement of arbitration clauses in insurance contracts, it argued that Lloyd's request to arbitrate should be denied.

The district found that it was required to enforce the arbitration clause under the Convention but certified its order for interlocutory review.

The Ninth Circuit's Decision

Generally, the Supremacy Clause mandates that a federal law will preempt a conflicting state law. But the McCarran-Ferguson Act provides that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance."

In determining whether the McCarran-Ferguson Act reverse-preempts the Convention, the issue boiled down to whether the Convention was self-executing. A treaty is self-executing and has automatic force as domestic law when no further action from Congress is required for the treaty to take effect.

The insurer argued that the Convention is a self-executing treaty, and thus, not an "Act of Congress." Therefore, the insurer argued, the Convention preempts Washington state law.

The policyholder argued that the Convention is not self-executing and is enforceable as domestic law only through the Convention Act. Because the Convention Act does not specifically relate to the business of insurance, the policyholders argued that it is reverse preempted by the Washington statute that voids arbitration clauses in insurance policies.

Based on a textual analysis and the Convention's drafting history, the Ninth Circuit concluded that the Convention is self-executing and that it alone requires enforcement of the parties' arbitration agreement. The Ninth Circuit disagreed with a 1995 decision from the Second Circuit that found the Convention was not self-executing. The Ninth Circuit explained that the Second Circuit, who issued its decision more than 25 years ago, did not have the benefit of more recent Supreme Court guidance, and therefore, "did not undertake an analysis of the Convention's

text, drafting and negotiation history, or the views of the executive." The court further noted that two other circuit courts – the 4th and 5th Circuits – also found that the Convention required enforcement of arbitration clauses, although they did not specifically address whether the Convention was self-executing.

Because the Ninth Circuit found that the Convention is self-executing and not an act of Congress, it was not subject to reverse preemption by the McCarran-Ferguson Act. It upheld the district court's order compelling arbitration.

The policyholder has indicated its intention to file a petition for writ of certiorari with the Supreme Court.

The case is *CLMS Mgmt. Servs. Ltd. Partnership v. Amwins Brokerage of Georgia, LLC*, No. 20-35428 (9th Cir. Aug. 12, 2021).

Eleventh Circuit Becomes Second Federal Appellate Court to Side with Insurers in COVID-19 Business Interruption Claim

As the second federal appellate court to decide whether business interruption claims due to the pandemic are covered, the Eleventh Circuit ruled that a dentist's lost income claim resulting from shelter-in-place orders was not covered because there was no "direct physical loss or damage" to property.

The Case

On CDC guidance, and in accordance with Georgia shelter-in-place orders, a dental practice canceled its elective and non-urgent dental visits. As these procedures made up the majority of its business, the dental practice lost a substantial part of its income. The dental practice filed a

business interruption claim with its insurer under the "Business Income," "Extra Expense," and "Civil Authority" provisions.

The Business Income and Extra Expense provisions covered income that the dental practice lost due to the necessary suspension of its operations and for extra expenses that it sustained during that suspension. For there to be coverage, however, the suspension and expenses must have resulted from a "direct 'loss' to property" at the dental office and the "loss" must have been the result of a "Covered Cause of Loss," defined as a "direct loss" not excluded or limited under the policy.

The Civil Authority provision applies when a Covered Cause of Loss causes damage to property other than Covered Property, which essentially entails damage to property off the dental practice's premises.

The insurer determined that the dental practice had not asserted any physical loss or damage to property, either at or off the dental practice's premises, and thus denied the claim. The dental practice sued on behalf of itself and similarly situated dental practices, alleging that the insurer had breached the policy. The district court dismissed the complaint, holding that the complaint failed to state that any direct physical loss or damage to property had occurred.

The dental practice appealed.

The 11th Circuit's Decision

The Eleventh Circuit recognized that the "Business Income" and "Extra Expense" provisions apply only if the pandemic and shelter-in-place order caused direct "accidental physical loss" or "damage" to the dental practice's property. Looking to Georgia law, the court observed that "direct physical loss or damage" requires an actual change in insured property that either makes the property "unsatisfactory for future use" or requires that repairs be made.

The court found that the dental practice alleged nothing that could qualify as physical loss or damage. The court explained that the shelter-in-place order did not damage or change the property in a way that required repair or precluded future use for dental procedures. In fact, the property was still used for emergency dental procedures.

The court acknowledged that the dental office was an enclosed space where viral particles tend to linger, and where patients and staff must interact with each other in close quarters. But even so, the court said, "we do not see how the presence of those particles would cause physical damage or loss to the property."

The court also rejected the dental practice's claim under the "Civil Authority" provision. That coverage was contingent on a "Covered Cause of Loss" damaging property off the business premises. The court found that the allegations about off-premises property were no different than those at the dental office. There was no allegation of physical loss or damage in either case.

Because the dental practice had failed to state a claim for coverage, the court affirmed the district court's dismissal of the dental practice's action against the insurer.

The case is *Gilreath Family Cosmetic Dentistry, Inc. v. Cincinnati Ins. Co.,* No. 21-11046 (11th Cir. Aug. 31, 2021).

Ninth Circuit Upholds Insurer's Right to Reimbursement of Defense Costs

Reversing the district court, the U.S. Court of Appeals for the Ninth Circuit applying Nevada substantive law, found that an insurer who defended under a reservation of rights was entitled to seek reimbursement of defense costs where it was determined that the insurer had no duty to defend.

The Case

In July 2019, the Ninth Circuit affirmed the lower court's ruling that an insurer had no duty to defend an insured in an underlying state court litigation. But the Ninth Circuit was unsure if the insurer was entitled to reimbursement of defense costs under Nevada law, so it certified a question to the Nevada Supreme Court. The Nevada high court instructed that an insurer is entitled to reimbursement if a court determines that: (1) an insurer never owed a duty to defend; (2) the insurer expressly reserved its right to seek reimbursement in writing after defense was tendered; and (3) the policyholder accepted the defense from the insurer.

Although these conditions were met, the district court denied the insurer's request for reimbursement on the basis that it did not raise a damages claim in its declaratory judgment complaint.

The Ninth Circuit's Decision

The Ninth Circuit reversed.

Under Rule 54(c) of the Federal Rules of Civil Procedure, district courts may "grant the relief to which each party is entitled, even if the party has not demanded that relief in its pleadings."

The Declaratory Judgment Act (28 U.S.C. § 2202) addresses further relief and provides that "[f]urther necessary or proper relief based on a declaratory judgment or decree may be granted, after reasonable notice and hearing, against any adverse party whose rights have been determined by such judgment."

The court held that Nevada substantive law entitled the insurer to reimbursement and that § 2202 provided the procedural vehicle to obtain that reimbursement. Also, the Declaratory

Judgment Act imposes no stringent pleading requirement under § 2202, but only reasonable notice and hearing.

The Ninth Circuit determined that there was reasonable notice. The insurer expressly stated in writing that it was providing a defense subject to a reservation of the right to seek reimbursement of defense costs. In its declaratory judgment complaint, the insurer asked for "such other and further relief as this Court may deem just and proper." And during the district court action, the insurer alerted the policyholder that it would file another motion seeking reimbursement of all defense fees and costs incurred in defending the insureds in the underlying action after the district court granted its declaratory relief. Plus, the insurer never disavowed a claim for damages. Taken together, the court found that the insurer provided reasonable notice.

As § 2202 permits additional hearings after a court grants declaratory relief, the Ninth Circuit remanded the case to the district court to determine how much the insurer was entitled to be reimbursed.

The case is *Nautilus Ins. Co. v. Access Med., LLC*, Nos. 17-16265, 17-16272, and 17-16273 (9th Cir. Aug. 9, 2021). This decision is unpublished.

Eighth Circuit Finds That Violation of Statutes Exclusion Bars Coverage for Claim Under Fair Debt Collection Practices Act

Affirming summary judgment in favor of an insurer, the Eighth Circuit ruled that a collections firm was not entitled to coverage for a wrongful garnishment claim alleged to violate the Fair Debt Collection Practices Act because the policy's Violation of Statutes exclusion applied. That exclusion barred Personal and Advertising Injury coverage for any potential liability arising

directly or indirectly from conduct that was alleged to violate a statute that prohibits or limits the communication of material or information.

The Case

A debt collections firm obtained a default judgment on a debt owed by "Charlene Williams." The firm served a notice of intent to garnish wages on Williams's employer. Williams contacted the firm and informed it that she was not the debtor against whom it had a default judgment. Despite this information, the firm proceeded to garnish her wages for six weeks. After Williams proved that the firm had the wrong "Charlene Williams," the firm returned the funds.

Williams then sued the firm under several theories of liability, including violations of the Fair Debt Collection Practices Act (FDCPA). Williams alleged that she suffered emotional distress, humiliation, and interference with the use and enjoyment of her property.

The collections firm sought coverage under its commercial umbrella liability policy. The insurer denied the claim. After the collections firm settled with Williams, it filed a declaratory judgment action against the insurer in federal court in North Dakota seeking its defense costs and settlement payment.

The district court held that any "bodily injury" that Williams suffered was not caused by an "occurrence" and was otherwise barred by the "expected or intended injury" exclusion.

The policy's Personal and Advertising Injury coverage was implicated to the extent that Williams asserted malicious prosecution, defamation, and publication of material that violates a person's right of privacy. But the court found that the exclusion for Distribution of Materials in Violation of Statutes applied. It therefore awarded summary judgment in the insurer's favor.

The collections firm appealed.

The Eighth Circuit's Decision

On appeal, the Eighth Circuit first addressed whether any "bodily injury" or "personal and advertising injury" were caused by an "occurrence."

For claims involving "bodily injury," the policy defined "occurrence" as "an accident . . . that results in 'bodily injury.'" The court held that the complaint plainly alleged that Williams's emotional distress was caused by an intentional act. Williams did not allege that she sustained emotional injury because of the collections firm's mistake about her identity. Rather, her injury was because the firm contacted her employer about an alleged debt, ignored her when she informed the firm of its mistake, and garnished her wages for six weeks. The court found that the firm's mistaken belief about its rights did not transform its conscious actions into accidents.

The court next turned to the Personal and Advertising Injury coverage. There, "occurrence" was defined as an "offense that results in 'personal and advertising injury.'" The court concluded that Williams's complaint asserted offenses within the policy's coverage; namely, defamation and publication of material that violates a person's right of privacy.

It then turned to the Violation of Statutes exclusion, which stated that the policy does not cover:

> Any liability arising directly or indirectly out of any action or omission that violates or is alleged to violate:
>
> (a) The Telephone Consumer Protection Act (TCPA), . . . ;
>
> (b) The CAN-SPAM Act of 2003, . . . ; or
>
> (c) Any statute, ordinance or regulation, other than the TCPA or CAN-SPAM Act of 2003, that prohibits or limits the sending, transmitting, communicating or distribution of material or information.

The collections firm urged a narrow construction of the exclusion. Because the FDCPA does not limit communication in the same way as the other statutes mentioned in the exclusion, the firm argued that the exclusion did not apply. Applying a literal reading, the firm suggested, would exclude coverage for a major source of potential liability for a debt collections firm.

The Eighth Circuit disagreed. It found that the exclusion was unambiguous and enforced it as written.

The firm next argued that even if the policy excluded coverage for the injury caused by the alleged FDCPA violations, it did not exclude coverage for the injury caused by the alleged intentional torts because the FDCPA violations did not cause the firm to invade Williams's privacy, defame her, or maliciously prosecute her. But the court rejected this argument too, finding that the Violation of Statutes exclusion broadly barred coverage for not only statutory liability, but any liability arising directly or indirectly out of any action or omission that violates or is alleged to violate the FDCPA. The court found that all of the conduct underlying the FDCPA claim was the same conduct underlying the other claims. Because any potential liability arose either directly or indirectly from conduct that was alleged to violate the FDCPA, the Violation of Statutes exclusion applied.

The Eighth Circuit affirmed the district court's judgment in favor of the insurer.

The case is *Rodenburg LLP v Certain Underwriters at Lloyd's of London,* No. 20-2521 (8th Cir. Aug. 25, 2021).

Fifth Circuit Finds Two Lawsuits Alleging Misrepresentations by Trade School Constituted a Single Claim First Made Before the Policy Period

Applying Texas law, the Fifth Circuit upheld the insurer's denial of coverage because two lawsuits alleging misrepresentations by a trade school constituted a single claim "first made" before the policy period.

The Case

ATI Acquisition Company ("ATI"), a company with trade schools in several Texas counties, was the subject of multiple similar lawsuits brought by former students. The lawsuits alleged that ATI misrepresented the quality and results of its programs through its website, promotional materials, and admissions representatives, and that ATI pressured its admissions representatives to increase enrollment by engaging in aggressive and misleading sales techniques. The first lawsuit, brought by lead plaintiff Nelson, was filed in June 2010. The second lawsuit, brought by lead plaintiff Bartlett, was filed in October 2011.

ATI sought coverage from its liability insurer. ATI's policy covered any "claim" "first made" against ATI during the "policy period" (basically, all of 2011) for a "wrongful act." The policy also provided that "all 'claims' based upon or arising out of the same 'wrongful act' or any 'interrelated wrongful acts' shall be considered a single 'claim.'" The insurer denied coverage because the Nelson and Bartlett lawsuits were based upon the same wrongful acts or interrelated wrongful acts, meaning that the two lawsuits constituted a single claim first made against ATI prior to the policy period.

After obtaining a default judgment in state court against ATI, six plaintiffs filed a coverage action in Texas state court to collect on that judgment from ATI's insurer, who in turn removed the coverage action to federal court.

A federal district court in Texas granted the insurer summary judgment. The court held that plaintiffs lacked standing to sue the insurer without either an adversarial judgment against the entities or a valid assignment. Additionally, the district court held that plaintiffs' claims against ATI fell outside the scope of coverage because the Nelson and Bartlett lawsuits were "sufficiently related to constitute a single claim under the policy's provisions," which was first made against ATI prior to the policy period. Plaintiffs appealed.

The Decision

The Fifth Circuit disagreed with the district court that plaintiffs lacked standing, but agreed that plaintiffs' claims were outside the scope of coverage.

The insurance policy at issue contained a no-direct-action provision that required an "adjudication against" the insured before a third-party plaintiff could sue the insurer. The court held that plaintiffs' default judgment against ATI was an adjudication that satisfied the no-action clause, and therefore, the no-direct-action rule did not bar the coverage suit.

Nonetheless, the Fifth Circuit held that the insurer had no duty to indemnify ATI for the underlying claims because they were a "single claim" first made against ATI before the policy period. The court held that the district court properly compared the complaints in the Nelson and Bartlett actions and concluded that they were based on at least one common "wrongful act" or "interrelated wrongful act." The court noted that although the lawsuits involved different plaintiffs in different cities who attended different schools, ATI's alleged role in creating and maintaining a high-pressure sales culture was a fact common to both lawsuits and integral to the claims presented.

The court rejected plaintiffs' argument that the district court improperly considered unsworn pleadings from the underlying actions in its duty-to-indemnify inquiry. The court

reasoned: "we are not concerned with the accuracy of the *facts* in the complaints filed in the two different lawsuits. Instead, the similarity of the *allegations* is our inquiry. The pleadings that began the two state-court suits are *the* evidence of relatedness." (emphasis in original). The court added that consideration of extrinsic complaints filed in other proceedings is common in insurance litigation and is proper summary judgment evidence in an insurance coverage dispute.

Accordingly, the Fifth Circuit affirmed the district court's grant of summary judgment to the insurer.

The case is *Turner v. Cincinnati Ins. Co.*, No. 20-50548 (5th Cir. Aug. 13, 2021).

Fifth Circuit Applies "Particular Part" Property Damage Exclusion to Claim Involving a Faulty Well

The Fifth Circuit, applying Texas Law, held that a "particular part" property damage exclusion barred coverage for a claim involving a shallow oil well. It rejected an argument that the exclusion applied only to the insured's active negligence.

The Case

McBride Operating, LLC hired ETOPSI Oil & Gas LLC as a consultant for the design and construction of a new injection well. But once constructed, this well was approximately 200 feet too shallow to reach the desired subterranean geological formation. Efforts to expand the well's depth were unsuccessful and the well was considered valueless.

At the time that ETOPSI designed McBride's well, Kinsale Insurance Company provided ETOPSI with insurance coverage under a general liability policy. After McBride filed its case against ETOPSI in Texas state court, Kinsale filed a declaratory judgment action in Texas federal court

seeking a ruling that its liability policy did not provide coverage. The parties cross-moved for summary judgment.

Kinsale argued that there was no "property damage" as required by the insuring agreement, and to the extent that McBride and ETOPSI established coverage in the first instance, coverage was barred by an exclusion for "property damage to . . . [t]hat particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the 'property damage' arises out of those operations."

The district court ruled in favor of Kinsale. The court concluded that there was "property damage" because the petition did not allege mere economic damages, but rather that EPTOPSI's well deprived McBride of the use of property due to the valueless well. But the court rejected McBride's argument that the exclusion required "action" and did not apply when the underlying claim alleges only "inaction" – that is, ETOPSI's failure to run pipe to a greater depth. The court noted that the underlying petition alleged that ETOPSI agreed to provide McBride with a functioning well, that it failed to do so, and that this damaged its property. McBride appealed.

The Decision

The Fifth Circuit affirmed the district court's order. The Fifth Circuit did not address whether there was "property damage," but proceeded right to the "particular part" exclusion.

Applying the exclusion, the court held that the well's defects, which prevented it from working as intended, arose from ETOPSI's operation, that is, how ETOPSI designed and oversaw the construction of the well. For that reason, the court agreed with the district court that the "particular part" exclusion barred coverage and held that Kinsale had no duty to defend or indemnify.

The case is *Kinsale Ins. Co. v. McBride Operating L.L.C.*, No. 20-40588 (5th Cir. 2021 Aug 10, 2021)(unpublished).

Texas Federal Court Applies Pollution Exclusion to Claim Involving Contaminated Stormwater Runoff

A Texas federal court held that a pollution exclusion in a commercial general liability policy barred coverage for a claim alleging that contaminated stormwater runoff reached nearby properties.

The Case

The insured, Copart of Connecticut, Inc. operated a machine salvage junkyard and vehicle wash facilities in South Carolina. In 2016, six neighboring landowners sued Copart, alleging that Copart altered the normal course of stormwater runoff over its property, resulting in discharge of sediment and hazardous materials onto plaintiffs' properties. The landowners asserted claims under the Resource Conservation and Recovery Act, the Clean Water Act, the South Carolina Pollution Control Act, and common law claims under South Carolina law.

Copart's insurers sought a declaration in Texas federal court that they had no duty to defend or indemnify Copart in connection with the underlying lawsuit. The policies at issue contained a pollution exclusion, which provided that the insurance did not apply to bodily injury or property damages which would not have occurred in whole or part but for "the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of 'pollutants' at any time."

The insurers argued that the pollution exclusions in the policies unambiguously precluded coverage because the sediment that flowed off Copart's property was a "pollutant."

The Decision

The court, applying Texas law, granted summary judgment to the insurer. The court found that the pollution exclusion was unambiguous, and thus, the question before the court was whether what allegedly caused plaintiffs' injuries arose out of a discharge, dispersal, release or escape of pollutants. The court held that it was clear that the underlying plaintiffs alleged damages caused by pollutants in the water being released onto their properties.

The court rejected Copart's reliance on cases from other jurisdictions holding that pollution exclusions did not apply to stormwater or natural sediment in stormwater runoff. The court reasoned that the complaint could not be read to allege damages only from water, as opposed to polluted water. The court noted that the allegations in the complaint make clear the origin of damages was the flow of stormwater laden with soil, sediment, and harmful chemicals.

For these reasons, the district court granted the insurer's motion for summary judgment.

The case is *Liberty Mut. Fire Ins. Co. v. Copart of Conn., Inc.*, 3:19-cv-2748-E (N.D. Tex. Aug. 20, 2021).