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## Third Circuit Court of Appeals Addresses Mutual Mistake

In *Illinois National Ins. Co. v. Wyndham Worldwide Operations*, 2011 U.S. App. LEXIS 15894 (3d Cir. Aug. 3, 2011), the United States Court of Appeals for the Third Circuit had occasion to consider whether the doctrine of mutual mistake allows for reformation of an insurance policy against a party that was not part of the insurance procurement process.

Illinois National had issued several years of successive aircraft

fleet insurance policies to Jet Aviation, an aircraft maintenance and charter services company. While the policies were negotiated exclusively between Illinois National and Jet Aviation, the policies extended coverage to certain qualifying Jet Aviation clients, but only when Jet Aviation managed the client's aircraft and aircraft usage. In the fifth year of the program, Jet Aviation and Illinois National negotiated a

*Cont. p. 2*

## First Circuit Addresses Meaning of "You" As Used In General Liability Policy

In its recent decision in *Wright-Ryan Constr., Inc. v. AIG Ins. Co. of Can.*, 2011 U.S. App. LEXIS 15502 (1st Cir. July 27, 2011), the United States Court of Appeals for the First Circuit, applying Maine law, had occasion to consider whether the term "you" as used in a general liability policy is limited to the policy's named insured, or whether it includes additional insureds.

This issue in *Wright-Ryan* arose out of a priority of coverage dispute involving two primary

policies under which *Wright-Ryan* qualified as an insured. The first policy, issued by Acadia Insurance Company, was issued directly to *Wright-Ryan*. The second policy, issued by AIG to a subcontractor of *Wright-Ryan's*, provided additional insured coverage to *Wright-Ryan* on a primary and non-contributory basis for all liability "arising out of [the subcontractor's] premises or operations." *Wright-Ryan* was sued in a bodily injury lawsuit brought by an employee of the

*Cont. p. 4*

## Reformation as to Non-Party (cont.)

Third Judicial Circuit



revised managed aircraft endorsement, which was the endorsement extending coverage to third parties such as Wyndham. While Jet Aviation and Illinois National intended for the endorsement to provide broader coverage for entities affiliated with Jet Aviation, the actual wording of the endorsement also had the unintended effect of providing broad coverage to clients of Jet Aviation, such as Wyndham, even when using aircraft without Jet Aviation's management. Wyndham was not aware of the change to the endorsement when issued.

During the period of the policy with the revised endorsement, a Wyndham employee rented a Cessna aircraft from a company other than Jet Aviation. The aircraft subsequently crashed, resulting in the death of five people on the ground. While Jet Aviation had no involvement with the involved plane, the wording of the revised management aircraft endorsement nevertheless would have provided liability coverage to Wyndham for the matter. Illinois National subsequently brought a declaratory judgment action against Wyndham arguing, among other things, that the policy should be reformed to reflect the mutual intent of Illinois National and Jet Aviation. Wyndham argued, and the United States District Court for the District of New Jersey agreed, that because Wyndham was not

involved "in the negotiation and drafting" of the policy, the standard for reformation would not be one of mutual mistake, but rather the more stringent standard of unilateral mistake under which a party's own negligence cannot serve as a basis for reformation.

In a majority panel decision, however, the Third Circuit concluded that notwithstanding the fact that Wyndham did not participate in the underwriting process, "[r]eformation on the basis of mutual mistake can be granted even when it is to the disadvantage of a third party." In light of the testimony from Illinois National and Jet Aviation that their mutual intent was to limit coverage for non-owned aircraft to aircraft used by or at the direction of Jet Aviation, the Third Circuit held that the lower court erred by analyzing Illinois National's claim under the unilateral mistake standard rather than the less severe standard of mutual mistake. Accordingly, the Third Circuit remanded the matter for further evaluation of Illinois National's and Jet Aviation's intent, as well as Wyndham's argument that reformation, even in light of a mutual mistake, would be inequitable under the circumstances.

## Florida Court Holds Pollution Exclusion Applies to Millings

In its seminal decision *Deni Associates of Florida, Inc. v. State Farm Fire & Casualty Insurance Co.*, 711 So. 2d 1135 (Fla. 1998), the Florida Supreme Court held that the terms “irritants” and “contaminants” as used in an absolute pollution exclusion, are not ambiguous, and that the exclusion is not restricted to matters traditionally thought of as industrial or environmental pollution. The United States Court of Appeals for the Eleventh Circuit, in a matter involving Florida law, recently had occasion to address the *Deni* decision in *Markel Int'l Ins. Co. v. Florida West Covered RV & Boat Storage, LLC*, 2011 U.S. App. LEXIS 16552 (11<sup>th</sup> Cir. Aug. 11, 2011), a case involving the issue of whether millings resulting from road work constituted “contaminants” or “irritants” for the purpose of the pollution exclusion.

The insured, Florida West, was sued by an individual claiming to have suffered severe bacterial poisoning as a result of being required to wade through retained flood waters at the insured’s facility. Plaintiff claimed that the water had been contaminated by millings from nearby roadwork, and that these millings specifically were the source of his bacterial poisoning. The insurer, Markel, denied coverage based on the policy’s pollution exclusion, as well as another exclusion not relevant to the appeal. The federal district court

held in favor of Markel, relying in large part on the decision in *Deni*.

On appeal, Florida West argued that the lower court erred by failing to consider whether “millings are irritants or contaminants under environmental regulations” and by failing to consider case law from other jurisdictions. Florida West also argued that the underlying plaintiff’s injuries were not caused by the millings, but rather by bacteria. The Eleventh Circuit rejected each of these contentions. The court stated that based on the holding in *Deni*, the lower court properly relied on a standard dictionary to define the term “irritant” as anything that causes an “irritating effect”; it was not necessary to look to environmental regulations to further limit this term. The court further agreed that plaintiff alleged that his injuries resulted from the millings, since the underlying complaint alleged that:

... he contracted bacterial poisoning and infection from millings, which Florida West allowed to mix with flood water. We agree with the district court that “[w]hile millings may not inflict injury under normal circumstances, millings are alleged to have produced bacterial poisoning and infection, which certainly are ‘irritating effects.’” Thus, under the facts alleged in [the underlying] complaint, the millings constituted a pollutant.




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Florida courts continue to broadly construe the pollution exclusion.

## 1<sup>st</sup> Circuit Addresses “You” (cont.)

subcontractor. Wright-Ryan tendered the matter to the subcontractor and to AIG directly, but when neither responded, Acadia defended the matter directly and ultimately settled the case. Acadia and Wright-Ryan then commenced a declaratory judgment action against AIG to recover the settlement amount as well as Wright-Ryan’s defense costs.

The Maine federal district court concluded that Wright-Ryan qualified as an additional insured under the AIG policy, but that the AIG policy was excess to the Acadia policy. Looking to the policies’ other insurance clauses, the First Circuit disagreed. Both policies contained the following excess other insurance provision:

This insurance is excess over:

*(1) Any of the other insurance, whether primary, excess, contingent, or on any other basis . . . (a) That is . . . coverage for "your work"; . . .*

*(2) Any other primary insurance available to you covering liability for damages arising out of the premises or operations for which you have been added as an additional insured by attachment of an endorsement.*

*When this insurance is excess, we will have no duty . . . to defend the insured against any "suit" if any other insurer has a duty to defend the insured against that "suit".*

The First Circuit focused on the word “you” as used in these provisions. Acadia and Wright-Ryan argued that the AIG policy could not be considered excess over the Acadia policy since the word “you” in the AIG policy was limited to that policy’s named insured. As such, they argued that the excess other insurance provision in the AIG

policy should not even be considered in terms of the coverage afforded to Wright-Ryan. AIG, however, argued that the word “you” as used in its policy should be read to include additional insureds, in which case the AIG policy would be excess to any other policy providing coverage for Wright-Ryan’s work. The court rejected AIG’s contention, noting that the first page of each policy expressly stated that “[t]hroughout this policy the words ‘you’ and ‘your’ refer to the Named Insured shown in the Declarations, and any other person or organization qualifying as a Named Insured under this policy.” Further, Section II. of the policies, titled “WHO IS AN INSURED” extended coverage to certain individuals and entities not otherwise identified in the policies’ declarations, such as officers, employees and newly acquired organizations. Absent from Section II. was any reference to additional insureds. Thus, held the court:

Reading these provisions together, we find the definition of “you” to be unambiguous: it refers solely to a person or organization listed as a Named Insured in the policy Declarations or “qualifying as Named Insured” by virtue of being newly formed or acquired by a Named Insured.

Applying this definition to the AIG and Acadia policies, the court concluded that the AIG policy could not be considered excess to the Acadia policy, since the word “you” in the AIG policy referred not to Wright-Ryan, but rather to the subcontractor. On the other hand, because the word “you” in the Acadia policy referred solely to Wright-Ryan, the coverage afforded under Acadia policy necessarily was excess to the coverage afforded to Wright-Ryan under the AIG policy.

*... we find the definition of “you” to be unambiguous: it refers solely to a person or organization listed as a Named Insured in the policy Declarations ...*

## Fifth Circuit Holds Underlying Settlement Did Not Result In Exhaustion

In *Citigroup Inc. v. Federal Ins. Co.*, 2011 U.S. App. LEXIS 16316 (5th Cir. Aug. 8, 2011), the United States Court of Appeals for the Fifth Circuit, applying Texas law, considered whether a settlement between an insured and a primary layer insurer for an amount less than the policy's limits could be considered exhaustion of that policy for the purpose of triggering excess policies in the insured's tower of coverage.

Citigroup, as successor to Associates First Capital Corporation, sought coverage under a \$200 million tower of directors and officers coverage for underlying consumer lending practices claims. While Citigroup provided timely notice of the claims, it later settled the matters without the consent of its insurers, prompting an initial denial of coverage from each of the insurers in the tower. Citigroup's primary insurer, Lloyd's, later changed its coverage determination and agreed to a \$15 million settlement with Citigroup, notwithstanding the fact that the policy had a \$50 million limit of liability. The remaining insurers maintained their denial of coverage, resulting in coverage litigation.

The Fifth Circuit considered whether the lower court properly granted summary judgment to the insurers on the basis that there was no exhaustion of the primary Lloyd's policy. Citing to New York law, Citigroup argued that if an excess policy ambiguously defines "exhaustion," then settlement with an underlying insurer, even if for an amount less than full policy limits, necessarily constitutes exhaustion for the purpose of determining excess layer attachment. The court disagreed that there was any ambiguity, holding that each excess policy plainly defined when and under what circumstances underlying insurance would be considered exhausted. Specifically, each policy required payment of the "full" or "total" amount of underlying limits. As such, the court held that Citigroup's settlement with Lloyd's, for an amount less than the full policy limits of that policy, could not be considered exhaustion for the purpose of triggering Citigroup's excess insurance policies.



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## **Nevada Supreme Court Adopts Notice Prejudice Rule**

In *Las Vegas Metropolitan Police Dep't. v. Coregis Ins. Co.*, 2011 Nev. LEXIS 52 (Aug. 4, 2011), the Supreme Court of Nevada addressed whether an insurer must be prejudiced in order to disclaim coverage based on late notice, and if so, which party has the burden of demonstrating prejudice or the lack thereof.

The insured, Las Vegas Metropolitan Police Department, was named as a defendant in an underlying civil rights lawsuit. The Department did not give notice to Coregis of its potential liability until ten years after the incident giving rise to the litigation. Coregis denied coverage for the matter on the basis of the insured's late notice. In subsequent coverage litigation, the lower court granted summary judgment in favor of Coregis, concluding that the Department's notice was late and that Coregis was prejudiced as a result.

On appeal, the Supreme Court of Nevada initially concluded that there was a genuine issue of material fact as to whether the Department's notice was late, since there was a question as to which of the policy's notice requirements applied. More significantly, the court addressed which standard should apply for late notice disputes under Nevada law. Citing to what it considered the "majority rule," the court held that an insurer must be prejudiced in order to deny coverage based on late notice and that it is the insurer's burden to demonstrate prejudice. Prejudice, explained the court, exists "where the delay materially impairs an insurer's ability to contest its liability to an insured or the liability of the insured to a third party." The court further noted that prejudice is necessarily an issue of fact.

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