

INSURANCE COVERAGE OBSERVER

NEWS ON CONTEMPORARY ISSUES

Cozen O'Connor Successfully Defends Federal Insurance Company in First Phase of 9/11 World Trade Center Trial

On April 29, 2004, a jury in the U.S. Federal Court for the Southern District of New York decided that eleven out of fifteen insurers' property policies were based on a form that defined the WTC loss as only one occurrence, from an insurance coverage standpoint. Cozen O'Connor's core trial team of attorneys Tom McKay (Cherry Hill), Jay Levin (Philadelphia), Michael Hamilton (Philadelphia), and paralegal Marybeth Williams (Philadelphia), successfully represented Federal Insurance Company, the domestic insurer with the largest potential exposure in the phase of the \$3.55 billion WTC risk.

At the heart of this phase of the WTC litigation was a dispute about the terms of the insurance coverage under which 23 insurers wrote their property policies for their piece of the WTC complex. In July 2001, just two months before 9/11, a new owner, Larry Silverstein, had leased Towers 1, 2, 4 & 5 of the WTC complex. Silverstein was working with an insurance broker, Willis Group, Ltd. to procure insurance for his leased WTC properties. When Willis sent out its request for property coverage, it included one of its own policy forms --WilProp2000 -- for underwriting consideration. The WilProp2000 form included a definition of occurrence

While 23 insurers agreed to provide coverage for Silverstein's WTC complex, all but one of them issued only binders for their coverage before 9/11, not formal policies. Therefore, when 9/11 occurred, there was some dispute over the terms and conditions under which the binders were issued. Silverstein contended that the majority of the insurers issued binders under a policy form that The Travelers Insurance Company provided for its coverage binder. The Travelers form lacked a definition of occurrence, leaving open the door for the "two occurrence" challenge. Federal and a majority of the other insurers argued that they issued their binders based on the WilProp2000.

According to Cozen O'Connor's chairman and founder **Stephen A. Cozen**: "From our perspective, it was always clear that Federal Insurance bound its coverage on the WilProp2000. In fact, the Travelers form was never distributed to any of the other insurers before 9/11. And we are thrilled that this became obvious to the jury."

While a number of other insurers face involvement in further 9/11 coverage litigation related to the WTC Complex, Federal's involvement in this litigation has now ended. Federal's maximum

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Message from the Chair

Nearly twenty-eight years ago, **Bob Reeder** left a well-established firm to take a chance on an upstart 11-lawyer firm in Philadelphia headed by **Steve Cozen**. The rest, as they say, is history. Nearly twenty or so offices and 470 additional lawyers later, Bob will retire as Chairman of the Firm's Insurance Department on June 30, 2004. On that date, **Ann Thornton Field** will assume the role of department chair after service as vice chair the last two years.

There are but a handful of people with the breadth of knowledge and experience of insurance matters as **Bob Reeder**. Over his career, Bob has worked on virtually all lines of coverage issues as they emerged, from first party, D & O, professional liability and general liability claims. He has been a tireless advocate for the insurance industry, serving on many committees and trade organizations including service as Chairman of DRI's Insurance Law Committee and membership on DRI's Board of Directors.

More important than the long list of his professional accomplishments, in his various leadership capacities over the years, Bob has placed an indelible mark on the culture of the firm as it went through its startling growth over the past 25 years. In an ever-changing legal landscape, Bob has steadfastly upheld the highest values of his professional: honesty, forthrightness and fairness in dealings with his clients, his adversaries and the courts. And there has been no one at the firm more ready to come to the aid of a comrade in need than Bob. For those and many other things we offer Bob our heartfelt thanks.

So this summer, perhaps for the first time since his youth, Bob will spend the entire summer with his feet in the sand at play at his beloved New Jersey Shore, contemplating not just what he has accomplished but what he still plans to accomplish in other pursuits. Bob, good luck on your new adventures!

William P. Shelley, Chair

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Coming Up: Cozen O'Connor Seminars

Maritime Seminar: Developments In Maritime Law Including Reactions to 9/11 (June 17, 2004, New York)

This program will feature speakers from our New York, Chicago, San Francisco and Seattle offices. Registration is 8:30 a.m. followed by a series of substantive presentations from 9:00 a.m. through 12:30 p.m. The program will conclude with a "question and answer" session followed by lunch. This program is approved for NY Continuing Legal Education credits and approval is pending for PA Continuing Legal Education credits. If you are interested in attending, please contact Lori Scheetz at 1-800-523-2900 or lscheetz@cozen.com.

2004 Third Party Insurance Coverage Seminar (October 28, 2004, New York)

We will be holding our Insurance Coverage Seminar in New York City, at the Marriott Financial Center Hotel on October 28, 2004. More information to follow. Watch for your invitations in early Fall.

Annual Insurance Seminar (September 16, 2004, Seattle)

This morning seminar will take place at the Fairmont Olympic Hotel and offer 3.0 CE credits and 3.75 CLE credits for Washington and Oregon. Watch for your invitations later this summer, or contact Martha Painter (Seattle) at 206.340.1000 or mpainter@cozen.com for more information.

To suggest topics or for questions, please contact Helen Boyer, Co-Editor at 206.373.7204 or hboyer@cozen.com, Michael Hamilton, Co-Editor at 215.665.2751 or mhamilton@cozen.com or Marianne Gaul, Co-Editor at 973.286.1275 or mgaul@cozen.com. To obtain additional copies, permission to reprint articles, or to change mailing information, please contact Lori Scheetz 800.523.2900, or at lscheetz@cozen.com.

Comments in the Cozen O'Connor Insurance Law Observer are not intended to provide legal advice. Readers should not act or rely on information in the Observer without seeking specific legal advice from Cozen O'Connor on matters which concern them.



We are pleased to announce the opening of our 21st office in Houston, TX

Susan D. Noe
Deborah T. Busby
and
Brian J. Tagtmeier

join our firm as members in our International practice group of our Insurance Litigation department. All three attorneys were previously with the law firm of Fowler, Rodriguez & Chalos in Houston.

Joseph A. Ziemianski and Bryan P. Vezey

join our firm as members of the insurance coverage practice group of our Insurance Litigation department. Messrs. Ziemianski and Vezey were previously with the law firm of Beirne, Maynard & Parson in Houston.

The attorneys will continue to concentrate their practices in maritime defense and insurance coverage matters.

The Houston office is located at: 1 Houston Center 1221 McKinney, Suite 2900 Houston, TX 77010 800-448-8502 Telephone: 832-214-3900

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exposure has been set at its policy limit of \$254,300,700, instead of potentially twice that amount if the next phase of this litigation results in a two-occurrence ruling.

The Cozen O'Connor support team included attorneys Kevin Apollo, Kellyn Muller, Heather Buchanan, Lori Fox, Michael Metzger, Michael McCarty, Jacqueline Promislo and Terri Ackerman as well as paralegals Roland Paquette, Dominic Marano and Edward Benicoff.

California Clarifies The Ability of Successor Corporations to Obtain Coverage From Policies Issued to Predecessor Corporations

By John J. Dwyer

Over the past two decades, corporate America has witnessed a dizzying array of corporate mergers, acquisitions, divestitures, sales and spin-offs. While this frenetic level of activity may present opportunity for investment bankers and ripe fodder for commentary by financial analysts, it creates complex coverage problems for insurers trying to sort out who, if anyone, is entitled to obtain coverage under policies issued to corporations that have been bought, sold, merged with others, spun-off, acquired, partitioned or been involved in any number of corporate transactions. Recently, the California Supreme Court, in Henkel Corporation v. Hartford Accident and <u>Indemnity Company</u>,¹ clarified under what circumstances coverage from a policy issued to a corporation may pass to an acquiring corporation. In issuing its ruling, the California Supreme Court distinguished an earlier Ninth Circuit Court of Appeals case, Northern Insurance Co. of New York v. Allied Mutual Ins. Co.2 which had held that where liability passes as a matter of law to an acquiring corporation under the product-line exception to successor liability, the insurance coverage also passes as a matter of law

This note will discuss <u>Henkel</u> and <u>Northern Insurance</u> and provide some guidelines for future analysis of claims



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involving corporations that have been acquired or had their assets acquired by other corporations.

In Henkel, Union Carbide acquired Amchem No. 1 in 1977 by stock purchase and merger, making it a wholly owned subsidiary. Amchem No. 1 had two distinct product lines: agricultural chemicals and metallic chemicals. In 1979, Amchem No. 1 created its own subsidiary, Amchem No. 2, to which it spun-off its metallic chemicals product line. By resolution of its board of directors, Amchem No. 1 transferred "all of its right, title and interest ... in and to its domestic assets in its metal working business" to Amchem No. 2. The board of directors of the newly created Amchem No. 2 accepted the transfer.3 In 1980, Union Carbide sold all of the Amchem No. 2 stock to Henkel, which then merged with Amchem No. 2, leaving Henkel as the surviving corporation.4 In 1986, Union Carbide sold the stock of Amchem No. 1 to Rhone Poulenc, which later merged with Amchem No. 1 in 1992, leaving Rhone Poulenc as the surviving corporation. Sometime later, Henkel began to face liability arising from injuries sustained from Amchem No. 1's metallic chemicals product line prior to the company's purchase by Union Carbide in 1977. Henkel sought coverage for this liability under Amchem No. 1's pre-1977 policies.

In 1995, Henkel settled a suit with plaintiffs for \$7.65 million arising out of alleged exposure to metallic chemicals between 1959 and 1976. Henkel tendered its defense to Amchem No. 1's insurers during the exposure period and the insurers declined coverage. Henkel sued all of the insurers of Amchem No. 1 and added Rhone Poulenc as a necessary party. Henkel filed a motion for summary judgment arguing that the policies issued to Amchem No. 1, which no longer existed as an independent entity, should be available to Henkel. The trial court ruled that Rhone Poulenc and not Henkel was the corporate successor of Amchem No. 1 and that therefore it alone was entitled to protection of those liability policies. Henkel argued to the trial court that it was liable as a matter of law for Amchem No. 1's liabilities and as a result, it should be entitled to the benefits of Amchem No. 1's liability insurance. The trial

court disagreed, finding that Henkel had assumed Amchem No. 1's liability by contract and therefore the insurance would not follow as a matter of law.⁶

The Court of Appeals reversed, relying on Northern Insurance Co. of New York v. Allied Mutual Ins. Co., holding that the right of indemnity followed the liability rather than the policies themselves and even though the parties did not assign the insurance policies, the policies transferred to the successor corporation by operation of law.⁷

The Supreme Court of California granted the petitions for review and reversed the Court of Appeals.

The California Supreme Court first addressed Henkel's argument that liability was imposed upon it as a matter of law. The court explained there were three situations which the buyer of corporate assets could be liable for the torts of the predecessor, notwithstanding the purchaser's failure to assume liability by contract. The court wrote:

[T]he buyer of corporate assets may be liable as a corporate successor if [1] the transaction amounts to a consolidation or merger of the two corporations, [2] the purchasing corporation is a mere continuation of the seller, or [3] the transfer of assets to the purchaser is for the fraudulent purpose of escaping liability for the seller's debts.⁸

The court found that none of the circumstances existed because the original corporation was still available to be sued. Next, the court explained that in certain circumstances, the product line exception to successor liability may apply. That is, where one corporation acquires another's product line, it may be liable for injuries caused by the predecessor's defective products where there is a virtual destruction of the plaintiff's remedies against the original manufacturer which destruction of remedies is caused by the successor's acquisition of the business. The court found that there was not a destruction of remedies because Amchem No. 1 continued to exist after its 1979 sale of the metallic



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chemicals business. The court also noted that even if Amchem No. 1 had dissolved after it transferred its metallic chemical operation to Amchem No. 2, California law still permitted a plaintiff to assert a claim against Amchem No. 1's liability policy.¹⁰

The court commented that some statutes, notably the Comprehensive Environmental Response Compensation and Liability Act, 42 U.S.C. Section 9601 et seq. (CERCLA) allowed corporations to be liable for their predecessor's conduct without regard to contract, however, no such statute applied to the case before it. Because Henkel was not liable by operation of law but by assumption of contract, the court ruled that Henkel did not have access to Amchem No. 1's insurance coverage.

Henkel next argued that it was entitled to coverage because: (1) a "chose in action" may be assigned without an insurer's consent; and (2) the underlying injuries had been sustained prior to the transfer of liability, and thus there was no increased insured risk caused by transfer that would necessitate the need for the insurer's consent. The court rejected Henkel's arguments finding that the policies still required consent for assignment.¹¹

The court concluded that a chose in action or a cause of action for breach of the duty to defend or indemnify may be assigned against an insurance policy without an insurer's consent, however, that had not occurred. In order to be a "chose in action", an underlying action must be reduced to a sum certain due under the policy; the simple occurrence of an injury prior to a corporate transfer does not make a potential cause of action a "chose in action" to allow coverage for it to transfer without insurer consent. Similarly, the court stated that there was no claim for breach of the duty to defend or indemnify that would allow a transfer.

The court next addressed the argument that assignment without consent was allowed where there was no increase in risk to the insurer. The court explained that even assuming that demonstration of an increased insured risk is required to enforce an anti-assignment clause, an assignment of coverage would increase the insured risk

and thus be barred where, as in the case before it, claims against the predecessor corporation still could be made triggering the insurer's potential defense and indemnity obligations.¹³ The court further addressed the increase in risk:

Even assuming enforcement of the no consent clause requires a showing of additional burden or risk on the insurer, Henkel cannot prevail. An additional burden may arise whenever the predecessor corporation still exists or can be revived . . . [citations omitted] because of the ubiquitous potential for disputes over the existence and scope of the assignment. If both assignor and assignee were to claim the right to a defense, the insurer might effectively be forced to undertake the burden of defending both parties. In view of the potential for such increased burdens, it is reasonable to uphold the insurer's contractual right to accept or reject an assignment.¹⁴

The court further distinguished other circumstances that had allowed assignment of coverages. In other circumstances, courts had allowed assignments of coverages where at the time of the assignment, the claims had been reduced to judgments or at the time of the assignment, the insurers had breached their duty to defend.

In reaching its decision, the court emphasized that it was not overruling Northern Insurance but was reaching its decision based on the facts before it, namely that Henkel's liability was not imposed involuntarily by law, but assumed voluntarily by contract.¹⁵

In <u>Northern Insurance</u>, ¹⁶ the United States Court of Appeals for the Ninth Circuit allowed a predecessor's insurance coverage to pass to a corporation that had purchased certain assets absent insurer consent under the product-line exception where the subsequent corporation faced its predecessor's tort liability. There, plaintiffs filed suit complaining that their infant daughter was born with fetal alcohol syndrome because her mother consumed



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California Coolers during her pregnancy. The action was brought against the purchaser of California Cooler's assets. Brown-Forman Corporation purchased California Cooler pursuant to an asset purchase agreement after the underlying plaintiffs' daughter was born but before the underlying plaintiffs filed suit.¹⁷ The opinion contains minimal detail on the transaction, and it is unclear from it whether the transaction was a merger, although the California Court of Appeals, Second District, characterized the transaction as one.¹⁸ The asset purchase agreement excluded California Cooler's insurance policies.¹⁹

Relying on the product-line exception, the court held that although the policies were not assigned to Forman-Brown under the asset purchase agreement, their benefits passed to it as a matter of law.

California and Washington, like many other jurisdictions, apply a rule of product line successor liability. Under this theory, a purchaser of substantially all assets of a firm assumes, with some limitations, the obligations of product liability claims arising from the selling firm's pre-sale activities. Liability is transferred irrespective of any clauses to the contrary in the asset purchase agreement.²⁰

The court further noted that because the injury in question was a pre-sale injury, the rationale for honoring no assignment clauses within insurance policies vanished.²¹ The court believed that where a loss had occurred prior to a transfer, the characteristics of the successor had little or no importance, because the insurer was covering the risk it originally evaluated when it wrote the policies.²²

At least two other courts, <u>General Accident Ins. Co. v. Superior Court²³ and Quemteco, Inc. v. Pacific Auto Ins. Co.²⁴ have criticized or declined to follow <u>Northern Insurance</u>. In <u>General Accident</u>, the California Court of Appeals First District specifically disapproved of the reasoning of <u>Northern Insurance</u>, labeling "the crux of its holding, a paragraph devoid of authority" and concluding that the cases it cited did not stand for the propositions</u>

that the United States Court Appeals for the Ninth Circuit claimed. The <u>General Accident</u> court also noted that the decision failed to discuss California law and that it had not been followed in California and other jurisdictions. Although the <u>Henkel</u> Court declined to specifically overrule <u>Northern Insurance</u>, at this point, the impact of the <u>Northern Insurance</u> case has been severely restricted.

Today, an insurer may receive a claim from an entity that bears no semblance to the named insured on the policy declaration sheet, or may receive a claim from an entity who has the same name as the entity on the declaration sheet but is an entirely different corporation. When faced with claims by those who have a questionable affiliation with the original named insured, insurers must be vigilant to scrutinize the corporate genealogy of the entity seeking coverage. Entitlement to coverage may depend on transactions that took place over a decade ago, and may involve tracing numerous lines of corporate succession. However, the cost for not engaging in such a detailed analysis could be paying a claim for which the insurer has no liability or in a worst circumstance, paying multiple limits of liability to entities, some of whom are entitled to coverage and others who are not.

For more information, contact John J. Dwyer (Philadelphia) at 215.665.2006 or jdwyer@cozen.com.

New York Court of Appeals Reaffirms Uniform National Standard for Administration of Insolvent Insurance Companies

By Francine L. Semaya & William K. Broudy¹

New York's highest court, the Court of Appeals, has issued a unanimous decision in favor of National Colonial Insurance Company in Liquidation ("NCIC"), directing that a trust fund on deposit in New York be transferred to NCIC's liquidator in Kansas, NCIC's domiciliary state. The decision is significant for its reaffirmation of a uniform national system for the orderly administration of insolvent insurance companies.



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The decision² resolved competing claims between the NCIC liquidator and JPMorgan Chase Bank ("Chase"), the bank that held the trust (the "Trustee").

The matter arose from the liquidation of NCIC, a Kansas domestic stock property, casualty and fire insurance company. NCIC was declared insolvent by the Kansas Insurance Commissioner and was placed into liquidation pursuant to an order of the District Court of Shawnee County, Kansas (the "Kansas Liquidation Court") on or about July 16, 1993. The subject of the proceeding was a NCIC Trust Account, established by NCIC pursuant to Regulation 41 of the Rules and Regulations of the State of New York (11 NYCRR § 27.14).

The proceeding was commenced in 1994 by the Superintendent of Insurance of the State of New York (the "Superintendent") in Supreme Court, New York County, to take possession of the property and to conserve the assets of NCIC in New York. In particular, the Superintendent sought a conservation order to protect the assets of the NCIC Trust Account. Under Regulation 41, NCIC was required to establish the NCIC Trust Account in the amount of \$750,000 "for the protection of all United States policyholders and beneficiaries on policies written in states where the company does business as an unauthorized insurer . . . " (Regulation 41, section 27.14(j)(1)). A Conservation Order was entered by the Supreme Court, New York County on December 20, 1994, designating the Superintendent as Conservator of the NCIC Trust Account.

The NCIC Trust Account is governed by the terms of a Trust Agreement. The NCIC Trust Account under the terms of the Trust Agreement and in accordance with Regulation 41 (11 NYCRR § 27.14(j)(2)) was irrevocable for a period of at least five years. The Trust Agreement provides that the NCIC Trust Account shall be exclusively available for "payment of claims under American Policies", defined as policies "issued to a resident of or with respect to, property situated in a state in which [NCIC] is not licensed to do an insurance business," referred to as the "American Policyholders". In addition, the NCIC Trust Agreement provides that after

all claims made under American Policies are satisfied, the remaining funds, if any, should be used for the return of unearned premiums. Further, the express terms of the Trust Agreement provide that any funds remaining in the NCIC Trust Account be distributed to NCIC.

The Superintendent discovered that Chase had breached its duty as Trustee of the NCIC Trust Account and had unlawfully released the entire NCIC Trust Account balance to NCIC in June, 1992, prior to the company's seizure and liquidation by the Kansas Insurance Commissioner and well before the end of the five-year irrevocability period of the Trust. The Superintendent demanded that Chase replace \$750,000 into the NCIC Trust Account. Chase eventually acceded to the Superintendent's demand that the funds be restored to the NCIC Trust Account. Only under compulsion from the Department did Chase restore assets to the NCIC Trust Account.

After Chase restored the assets to the NCIC Trust Account, the Superintendent filed the proceeding to conserve the assets in the NCIC Trust Account and was designated as Conservator of the NCIC Trust Account, pending further order of the Court. The Conservation proceeding would have been commenced by the Superintendent as a matter of course to conserve NCIC assets in the New York Regulation 41 Trust Account, even if Chase had not improperly released the assets of the NCIC Trust Account. An affidavit of Chase, filed in the proceeding, acknowledged the demand by the Department to restore the funds and acknowledged that the funds were restored by "recrediting NCIC's account in the amount of \$750,000."

The Conservator's Petition that commenced the proceeding stated that the Liquidator and Chase had competing claims to the remainder of the NCIC Trust Account. Prior to the commencement of the Supreme Court, New York County proceeding, Chase had filed a timely Proof of Claim with NCIC's estate, which was received by NCIC's claims administrator on July 18, 1994. The Order of Conservation was issued by Supreme Court, New York County on December 14, 1994. In



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November, 1999, the Liquidator sent a written notice to Chase, advising Chase that the Liquidator would recommend that the Liquidation Court allow Chase's claim in the amount of \$750,000 (the initial principal amount of the assets in the NCIC Trust Account and the amount claimed by Chase in its Proof of Claim filed with the NCIC Liquidator). The notice also advised that Chase's claim would be assigned a Class IV distribution priority, would be deemed an unsecured claim of a general creditor and afforded Chase an opportunity to object to the Liquidator's determination of Chase's claim. Chase did not object or respond to the Liquidator in any way. Chase's claim against NCIC was properly filed with the Liquidator, was allowed by the Liquidator in accordance with Kansas Insurance Law and was approved by the Kansas Liquidation Court by order dated February 1, 2000 after notice and an opportunity to be heard were afforded to Chase. The approval of Chase's claim by the Kansas Liquidation Court constituted a finding that Chase had a claim against the assets of NCIC, and was premised on the fact that the assets of the NCIC Trust Account, the subject of Chase's claim, were assets of NCIC.

NCIC notified in excess of 84,000 potential claimants of the liquidation, including potential claimants in the states where NCIC did business as an unauthorized insurer. NCIC received in excess of 20,000 Proofs of Claims. No claims were made under the American Policies, the defined beneficiaries in the Trust Agreement. Chase was not a beneficiary of the NCIC Trust Account as defined in the Trust Agreement and did not have a secured claim to assets in the NCIC Trust Account. Under Kansas Insurance Law, which governs the NCIC Liquidation Proceeding, any remainder in the NCIC Trust Account is a part of the general assets of NCIC's estate. Accordingly, as a matter of law, the NCIC Trust Account was to be distributed to the Liquidator.

After it had been determined that there were no claims under the American Policies, the Conservator petitioned Supreme Court, New York County for an order directing distribution of the assets in the NCIC Trust Account. In the proceeding, NCIC argued that Chase not only violated the mandate of Regulation 41, but also breached its duty

as Trustee when it released the entire balance of the NCIC Trust Account only three years after the NCIC Trust Account had been established and before NCIC was placed into liquidation. The release of all the funds in the NCIC Trust Account deprived the American Policyholders of the security mandated by Regulation 41, the reason for the establishment of the NCIC Trust Account. In addition the approval by the Superintendent, required by both Regulation 41 and by the Trust Agreement, was not obtained by Chase prior to the release of the assets of the NCIC Trust Account.

NCIC advised the Court that but for Chase's improper release of the assets in the NCIC Trust Account, all the assets of the NCIC Trust Account, with interest, would have been available at all times for the NCIC American Policyholders and then the remainder, if any, for the Liquidator to recommend and the Liquidation Court to approve distributions to other policyholders and creditors of the NCIC estate. When Chase recredited the funds to NCIC, NCIC was made whole as to the principal held in the NCIC Trust Account and from that point on, Chase's only ownership interest in the funds was as an unsecured creditor of the NCIC estate.

The Supreme Court, New York County, ruled in favor of Chase, but, on NCIC's appeal, that ruling was unanimously reversed by the Appellate Division, First Department and the funds were directed to be distributed to the NCIC Liquidator in Kansas. The Appellate Division decision³ found that:

The Kansas court had and has jurisdiction over the proper disposition of this trust asset and the liquidator in that proceeding should determine distribution of such asset (KSA 40-3622[a], Insurance Law 7410). Chase's belatedly advanced claims to ownership, assuming that any remain viable, must be presented in the Kansas liquidation proceeding. The Kansas liquidation proceeding controls any distribution of the trust fund. Since Chase was afforded an opportunity to contest the Kansas determination which it did not exercise, Chase has been



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provided a full and fair opportunity to be heard in connection with its priority for distribution of such asset and such determination must be afforded full faith and credit.⁴

The Court of Appeals agreed to hear the case, pursuant to Chase's motion for leave to appeal.

In unanimously affirming the Appellate Division, the Court of Appeals stated that:

We find full faith inapplicable here, and instead rest our holding that Supreme Court lacked jurisdiction on the provisions of the UILA.⁵

The Court analyzed the Uniform Insurance Liquidation Act (UILA), adopted by New York, and found that Kansas is a reciprocal state with New York for UILA purposes. The Court held that:

In 1939, the National Conference of Commissioners on Uniform State Laws endeavored to resolve some of the complexities of liquidating an insolvent insurance company with assets in multiple states by approving the Uniform Insurers Liquidation Act (UILA). New York adopted the UILA in 1940 "with the main purpose in mind of providing a uniform system for the orderly and equitable administration of the assets and liabilities of defunct multistate insurers" (G.C. Murphy Co. v. Reserve Ins. Co., 54 NY2d 69, 77 [1981]; see Insurance Law §§ 7408-7415). As NCIC is a "defunct multistate insurer," any analysis of New York's authority to administer its assets must begin with the UILA.

Section 7410(b) of the UILA, entitled "Conduct of delinquency proceedings against insurers not domiciled in this state," sets forth the procedures that New York follows when assets of a non-domiciliary insolvent insurer are located both within and without New York, and when receivers have been appointed in New

York and the domiciliary state. This provision - and the UILA generally - recognizes the authority of the domiciliary state and its receiver over all the insolvent insurer's assets, including those located in New York.⁶

Noting that the NCIC Trust is a special deposit under both New York and Kansas insurance laws, made for the benefit of a specified group of policyholders, the Court addressed the role of the New York Conservator as follows:

Notwithstanding the appointment of the Kansas liquidator and the liquidation proceeding underway in Kansas, the New York conservator had authority under the UILA to "recover" the Regulation 41 trust fund and "liquidate" from it any claims made under the covered policies (see Insurance Law § 7410[b]). Jurisdiction over the trust did not rest exclusively with Kansas, as the Appellate Division determined; however, neither Chase nor NCIC was the holder or beneficiary of a policy protected under the trust. Accordingly, their claims to the trust remainder could not be adjudicated by the Supreme Court under the UILA's special deposit authority.⁷

Concluding that the UILA is silent regarding adjudication of competing claims of ownership of a trust remainder, the Court found that:

in order to promote the UILA's goal of orderly and equitable liquidation proceedings, the domiciliary state is the proper forum in which to adjudicate competing claims to the trust remainder.8

In so ruling, the Court accepted NCIC's argument that the New York courts do not have jurisdiction. The Court stated that:

By entertaining Chase's claim of ownership, [the] Supreme Court delayed the orderly administration of claims in Kansas. Once the



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conservator determined that there were no special deposit claims, [the] Supreme Court should have "promptly transferred" the trust remainder to the Kansas liquidator. While the highly unusual facts of this case, involving withdrawal of the settlor's deposit to the trust and its replacement by the trustee, may complicate the UILA's plan for efficient administration, they should not be allowed to override it.9

The Court made it clear that it was guided by the National Association of Insurance Commissioners' Insurers Rehabilitation and Liquidation Model Act in reaching its unanimous decision. In summarizing its findings the Court stated that:

This approach is consistent with the modern trend in insurance liquidation as evidenced by the Model Act. In 1994, the Model Act was revised in a manner that substantially curtails the ancillary receiver's authority. Specifically, the current version of the Model Act requires that, upon entry of a final order of liquidation, all special deposits "shall be delivered to the domiciliary liquidator" and held as a "general asset for the benefit of all creditors," and limits the ancillary receiver's authority to proceedings that "support" the domiciliary proceeding (see NAIC Model Laws, Regulations and Guidelines, 555-1, Insurers Rehabilitation and Liqudation Model Act, section 55). These changes were intended "to discourage the retention of special or statutory deposits by nondomicilairy states in the event of a multistate insolvency." Further, the "basic principle behind the amendments is that insurers should be rehabilitated or liquidated in their state of domicile pursuant to the laws of that state, and that the domiciliary commissioner is in the best position to carry out that function."10

Francine L. Semaya, Chair of Cozen O'Connor's Insurance Corporate and Regulatory Department, orally

argued the case before the Court in Albany. William K. Broudy was on the brief, with the assistance of Associate Gregg E. Englehardt. Chase was represented by inhouse counsel Eileen J. Berkman and the Superintendent as Conservator appeared by Jack Franceschetti of Steven R. Harris & Associates.

For more information, contact Francine L. Semaya or William K. Broudy in our New York office at 212.509.9400 or fsemaya@cozen.com or wbroudy@cozen.com.

Books & Resources

Punitive Damages

West's Handbook Series <u>Punitive Damages: A State-by-State Guide to Law and Practice</u> (2004) is now available, authored by **Lori Nugent, Richard Blatt and Rob Hammesfahr** (Chicago). The authors were assisted by **Ted Pannkoke, Beth Stroup, Keith Horton and Daniel Johnson**.

There have been a great many new legal developments recently as some \$160 billion (1.7% of US GNP) in punitive damages was awarded in reported verdicts excess of \$1 million in a single year. These awards disproportionally impact excess insurers, foreign insurers, and excess of loss reinsurers as well as claims involving vehicles, tobacco, asbestos and pharmaceutical and medical devices, professionals including accountants, lawyers and medical professionals, and global manufacturing, finance and tech businesses.

The book, in Chapter 8, contains two summary tables that are intended for use by claims departments of insurers. The first table summarizes the Law of Punitive Damages Recovery by state on (1) whether punitive damages are recoverable (yes in all states but Michigan, Nebraska, New Hampshire and Washington), (2) whether the conduct to obtain punitive damages must be done with malice (12 states), a strict standard (25 states), gross negligence (7 states), or other, and (3) the required burden of proof, i.e. clear and convincing (29 states),



Books and Resources continued from page 10

preponderance of evidence (20 states), and beyond reasonable doubt (1 state). A second table lists by state the insurability of directly assessed punitives (24 insurable, 20 not insurable and 6 undecided) and vicariously assessed punitives (33 insurable, 3 not insurable and 14 undecided).

The book was originally issued in 1988 and has been published nearly annually by West since 1991. It is available electronically on Westlaw. The authors have achieved wins in reversing or reducing punitive damage verdicts as salvage or rescue counsel in numerous cases, including a \$42 million reduction by the Arkansas Supreme Court. The punitive damages team also has wins in coverage disputes, including a summary judgment win in Illinois that \$124.5 million in punitive damages are not insurable, and a summary judgment win in Missouri that \$16 million in punitive damages are not insurable. For more information, contact Lori Nugent, Richard Blatt or Rob Hammesfahr in Chicago at 312.382.3100 or lnugent@cozen.com, rblatt@cozen.com, or rhammesfahr@cozen.com.

Regional White Papers

The Insurance Coverage Practice Group in Seattle has prepared white papers summarizing insurance coverage law in Washington, Oregon, Alaska, and Hawaii. *If you would like to have a copy of any of these papers, please contact Thomas Jones (Seattle) at 206.242.1242 or tjones@cozen.com.*

Pro Bono

Cozen O'Connor recently published its first annual Pro Bono Publico Observer, edited by **Rob Hawn** (West Conshohocken). The report describes the over 15,000 hours of pro bono legal work performed by Cozen O'Connor attorneys in 2003. Attorneys in the insurance coverage group contributed significantly to this firm-wide effort. The report also announces the first recipient of our annual Amicus Publico award, **Patrick J. O'Connor**, for

his leadership in creating policies and incentives for attorneys as well as his personal involvement in a death penalty appeal, all of which inspired a profound renewal of Cozen O'Connor's devotion to pro bono publico legal service. If you would like a copy of the report, please contact Lori Scheetz at 215.665.2123 or lscheetz@cozen.com.

Recent Victories

John Granger (Seattle), with the assistance of Ramona Hunter (Seattle), recently obtained a victory in the defense of a major first-party coverage and bad faith claim for a major property insurer, in the federal district court for the Western District of Washington. The claim involved the alleged theft of a Russian-made helicopter. The policyholder claimed ownership of the subject helicopter along with two additional helicopters. It also claimed that a representative of a buyer had stolen the helicopter during sale negotiations when it failed to pay off a major lien of nearly \$800,000 on the most valuable helicopter in addition to the base purchase price of \$120,000. The alleged lien was supposedly created when an individual lender provided the loan for much of the original purchase price and filed a security interest in the most valuable helicopter. The alleged thief was the original owner of the three helicopters and it was claimed that he had earlier sold the three helicopters to the policyholder for later resale to third parties. The alleged thief denied making the original sales and claimed he simply took back the helicopters after repaying the transportation costs for all three helicopters to the policyholder.

Fraud was suspected and an exam under oath taken and relevant documents demanded. Coverage was denied on the basis that the matter involved a contractual dispute and not a theft within the meaning of the policy. After the bad faith claim was filed, Cozen O'Connor counsel filed a counterclaim for declaratory relief and fully described the allegedly fraudulent portions of the transaction and allegedly fraudulent supporting documentation in the factual section of the counterclaim. After a series of



Recent Victories continued from page 11

depositions, the insurer moved for partial summary judgment on the bad faith claim on the basis that its actions were reasonable since ownership at best remained in dispute and the lien had been extinguished by the doctrine of merger when the collateral had been transferred to the debtor. The policyholder responded and sent the company a settlement demand letter while this motion was pending, demanding full payment and threatening that additional claims for the other two allegedly stolen helicopters would be filed if payment was not made immediately. The company refused to pay and demanded dismissal with prejudice. After extensive briefing Judge Thomas Zilly granted dismissal of the bad faith claim concluding the company's actions were reasonable because the policyholder could not prove its ownership. The insurer then brought a second summary judgment motion on the remaining issue of coverage and at the same time served a detailed motion for sanctions under FRCP 11 for both filing the suit without a reasonable basis in fact or law and filing a false supporting affidavit. An accompanying cover letter from Cozen O'Connor counsel for the insurer stated that if the claim was not voluntarily dismissed with prejudice within two weeks, the motion for sanctions would be filed with the court. The claim was voluntarily dismissed with prejudice and claims for the additional two helicopters were waived.

Chris Neal (Seattle) obtained summary judgment in an order issued February 6, 2004, by the Western District of Washington, for his client, a major domestic insurer, on a liability claim involving a physical altercation between two high school students on school property. The Court held that there was no occurrence, and hence no duty to defend or indemnify, where the insured injured the claimant by placing him into an extended headlock, causing the claimant to black out and fall to the floor, from which he then sustained a head injury. The Court held that the insured's intentional act was the uninterrupted cause of the claimant's injuries.

On February 6, **Jay Levin** and **Deborah Minkoff** (Philadelphia) received summary judgment for their

insurer client in a coverage case of first impression. The client had issued an excess general liability policy to a hospital in western Pennsylvania. By endorsement, the policy provided professional liability coverage on a claims-made basis, following form to the hospital's primary professional liability policy. The excess insurer asserted that it had no obligation under the policy for a serious medical malpractice claim against the hospital because the hospital did not report the claim to the excess carrier until after the policy expired. The hospital claimed coverage was due because the hospital reported the claim during the policy period to the primary carrier, so the excess carrier was not prejudiced, and because the hospital provided a loss run to the excess carrier during the policy period that would have listed the claim.

The excess insurer filed a declaratory judgment action on October 31, 2003, and filed for expedited disposition. The District Court for the Western District of Pennsylvania adopted every one of Jay's and Deborah's arguments, finding that there was no coverage for the underlying claim because the hospital failed to report the claim within the policy period. The court granted summary judgment on October 31, 2003, only 98 days after suit was filed. Deborah authored the summary judgment briefs (three briefs filed in 8 days), and Jay argued the cross-motions on less than an hour's notice when the judge moved the argument up two days. Valuable assistance in this highly expedited case was provided by John Salvucci, Rich Mason, June Gilson, Elena Park, and Joe Arnold (Philadelphia).

On March 17, 2004, **Jarrett Coleman** (Dallas) obtained summary judgment on behalf of a major domestic insurer in a matter involving an insured condominium association. The case was decided by the federal district court for the Northern District of Texas. The insured sought approximately \$500,000 in insurance policy benefits based on damages allegedly suffered at its buildings as a result of a severe hailstorm that occurred on May 5, 1995. In addition to seeking contractual benefits, the insured sought recovery of treble damages based on alleged violations by the insurer of Texas



Recent Victories continued from page 12

statutes and common law related to obligations of an insurance company to its insured in the event of a loss.

Among the defenses mounted by the company was that the insured failed to give it timely notice of the alleged hail damage loss, having first given the insurance company any notice of the loss in late 2001, more than six years after the hail damage allegedly occurred. In response, the insured argued that the policy's "notice" provision did not preclude coverage because: (a) the notice requirement was void because it violated the Texas Civil Practice and Remedies Code, (b) the policy notice requirement was ambiguous, and (c) the insurer waived compliance with the notice requirement by denying the condominium association's claim without asserting noncompliance with the notice requirement as reason for the denial.

U.S. District Judge John McBryde rejected each of the insured's arguments and granted the insurer's summary judgment motion finding the notice requirement did not violate Texas law, was not ambiguous and that the insurer had not waived the policy's condition precedent because it obtained a non-waiver agreement from the insured prior to denial. As a result of the finding of no coverage, all claims and causes of action were dismissed.

Bill Knowles and Jamie Clausen and Paralegal Tom Auer (Seattle) worked together to successfully defend a general contractor at trial. The plaintiffs claimed exposure to airborne fumes, odors, dust and smoke allegedly generated while the contractor remodeled an occupied public utilities building. Plaintiffs presented 23 witnesses, including five expert witnesses, over nine trial days. The defense presented two witnesses during one-half of a trial day. The jury deliberated 35 minutes before rendering a defense verdict in favor of the contractor, the painting sub-contractor, and all other unidentified contractors working on the building. The Cozen trial team was retained by two major domestic insurers to represent the general contractor.

Mike Partos (Los Angeles) obtained a dismissal of a \$503,000 claim made against two insureds of a large

commercial risks insurer. The insureds were based in Mexico and Spain. The clients were defendants in a Los Angeles Superior Court action filed by Union Pacific Railroad Company and Sea-Land Service, Inc., seeking damages arising from an intermodal container vard accident. The Court granted a motion to quash on the basis that it lacked personal jurisdiction over the defendants. Mike obtained this ruling over vigorous opposition by Union Pacific, who argued that one of our clients owned a subsidiary incorporated in California, and the other client made a significant portion of its yearly sales to a sister entity located in California. Mike established that the timing, intensity and relatedness of these and other alleged "minimum contacts" were insufficient to justify the imposition of jurisdiction over the foreign defendants.

Dan Hessel, with assistance from Kellyn Muller and Gaele McLaughlin Barthold (Philadelphia) obtained a J.N.O.V. in favor of the insured of a major domestic insurer in the Pennsylvania Superior Court. The judgment, including post-judgment interest, was in the neighborhood of \$6 million. The appeal from the judgment was won based on the argument that the trial court should have granted J.N.O.V. on the plaintiff's negligent-based products liability claim because the jury found that the product in question was not defective and there was no evidence that the insured was negligent in any other respect. Dan overcame many waiver and judicial estoppel arguments to obtain this proper result.

Noteworthy Events

Thomas Jones, John Soltys, John Granger and J.C. Ditzler (Seattle) have been selected by their peers as "Super Lawyers" for 2004. The notice will appear in Washington Law & Politics. The selection is made by surveying over 12,000 practicing attorneys in Washington State. The list represents 4% of attorneys licensed to practice in Washington.

See http://www.superlawyers.com/washington.asp for more information.

Peter Mintzer (Seattle) was named Litigator of the Year



Noteworthy Events continued from page 13

for 2003 for the Northwest region by Investors Underwriting Managers (Markel Corporation) as a result of victories in two policy rescission actions filed in federal court in Oregon.

Coverage Attorneys "In the Spotlight"

On June 21 and 22, 2004, Rob Hammesfahr (Chicago) will co-chair the American Conference Institute's 3rd National Comprehensive Guide to Reinsurance Claims and Collections, at the Mark Hotel in New York, NY. He will also speak on Reinsurance Update: New Claims, New Strategies and New Developments. Lori Nugent (Chicago) will also speak at the seminar, on the topic of Minimizing Exposure to Loss in Excess of Policy Limits and Extra-Contractual Obligations. CLE credit is available. For more information, contact www.AmericanConference.com or 1-888-ACI-2480.

Bill Knowles (Seattle) will be speaking in Seattle on July 21, 2004 at a National Business Institute seminar entitled Discovery in Washington Bad Faith Litigation. Bill will address the Rules of Discovery Impacting Bad Faith Litigation, Paper Discovery, Discovery Techniques For The Defense, and Depositions. CLE credit is available. *If you are interested, contact www.nbi-sems.com or 1-800-777-8707*.

Zac Chacon (Chicago) spoke April 16, 2004 at the ABA TIPS Property Insurance Law Committee Spring CLE Program in Pebble Beach, California. The program was on New Frontiers in First Party Property Insurance: Technology, Terrorism and Mega-Losses. Zac was on a panel discussing "Investigating the E-Business Loss." For more information, please contact Zac Chacon or Rob Hammesfahr at 312.382.3100 or zchacon@cozen.com or rhammesfahr@cozen.com.

Tom Jones (Seattle), Joe Gerber (Philadelphia), Zac Chacon (Chicago), Brian Walsh (New York), and Rob Hawn (West Conshohocken) have spoken on several occasions about the fundamentals of electronic discovery.

The electronic discovery program focuses on developing a sound litigation plan when responding to or propounding electronic discovery requests. The litigation strategy is broken into five categories: data preservation, data collection, data review, data protection, and data production. If you would like any materials pertaining to the fundamentals of electronic discovery, please contact Tom Jones in our Seattle office at 206.224.1242 or tjones@cozen.com.

ENDNOTES

California Clarifies The Ability of Successor Corporations to Obtain Coverage From Policies Issued to Predecessor Corporations

- 1. 29 Cal. 4th 934, 62 P. 3d 69, 129 Cal. Rptr. 2d 828 (2003).
- 2. 955 F. 3d 1353 (9th Cir. 1992).
- 3. 29 Cal. 4th at 938-39, 62 P. 3d at 71, 129 Cal. Rptr. 2d at 831.
- 4. Id.
- 5. Id. at 939-40, 62 P. 3d at 72-73, 129 Cal. Rptr. 2d at 831-32.
- 6. Id.
- 7. Id. citing <u>Northern Ins. Co. of New York v. Allied Mutual Ins. Co.</u>, 955 F.2d 1353, 1357 (9th Cir. 1992).
- 8. 29 Cal. 4th at 941, 62 P. 3d at 73, 129 Cal. Rptr. 2d at 833.
- 9. Id.
- 10. Id. citing <u>Penasquitos, Inc. v. Superior Court</u>, 53 Cal. 3d. 1180, 283 Cal. Rptr. 135, 812 P. 2d 154 (1991).
- 11. Id. at 835-36.
- 12. Id. <u>See also Quemteco, Inc. v. Pacific Auto Ins. Co.</u>, 24 Cal. App. 4th 494, 29 Cal. Rptr. 2d 627, 632 (Cal. Ct. App. 1994)



(holding that liability for pollution committed pre-transfer was not assignable without insurer consent as chosen action because at the time of asset sale, there could have been no assignment of the proceeds of the policies as there was no loss or injury or accrued right to collect the proceeds in existence - i.e., environmental damage was not assessed until long after asset sale).

- 13. 29 Cal. 4th at 945, 62 P. 3d at 75, 129 Cal. Rptr. 2d at 835-36.
- 14. 29 Cal. 4th at 945, 62 P. 3d at 75, 129 Cal. Rptr. 2d at 835-36.
- 15. Id. at 941, 62d P. 3d at 73, 129 Cal. Rptr. 2d at 833.
- 16. 955 F. 2d 1353 (9th Cir. 1992).
- 17. Id. at 1355-56.
- 18. Quemteco, Inc. v. Pacific Auto Ins. Co., 24 Cal. App. 4th 494, 29 Cal. Rptr. 2d 627, 630-31.
- 19. 955 F. 2d at 1357.
- 20. Id.
- 21. Id. at 1358.
- 22. Id.
- 23. 55 Cal. App. 4th 1444, 64 Cal. Rptr. 2d 781, 788 (Cal. Ct. App. 1997).
- 24. 24 Cal. App. 4th 494, 29 Cal. Rptr. 2d 627, 628 (Cal. Ct. App. 1994).

New York Court of Appeals Reaffirms Uniform National Standard for Administration of Insolvent Insurance Companies

1. Francine L. Semaya, Senior Member of Cozen O'Connor and Chair of it Insurance Corporate and Regulatory Department,

represented National Colonial Insurance Company in Liquidation in the case reviewed in this article. William K. Broudy, a Junior Member of Cozen O'Connor, was on the Court of Appeals Brief. The views expressed in this article do not necessarily reflect the views of Cozen O'Connor, any of its individual partners, counsel, or associates, or those of its clients

- Levin v. National Colonial Ins. Co., 1 N.Y. 3d 350, 806 N.E.
 2d 473, 774 N.Y.S. 2d 465, 2004 WL 303262 (N.Y.), 2004 N.Y.
 Slip Op. 00691, February 12, 2004. Page references are to 2004 WL 303262 (N.Y.).
- 3. <u>In re Conservation of the Trust Funds, etc., National Colonial Insurance Company</u>, 296 A.D. 2d 354, 745 N.Y.S. 2d 28 (App. Div. First Dept. 2002).
- 4. Id. at 745 N.Y.S. 2d 29, citation omitted.
- 5. <u>Levin v. National Colonial Ins. Co.</u>, footnote 7, page 5, referring to the Uniform Insurance Liquidation Act (UILA).
- 6. Id. at page 3.
- 7. Id. at page 4.
- 8. Id. at page 5.
- 9. Id. at page 5.
- 10. Id. at page 5.



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