

GETTING THE
DEAL THROUGH 

Insurance Litigation 2015

Contributing editor

Barry R Ostrager

Simpson Thacher & Bartlett LLP

Publisher
Gideon Robertson
gideon.roberton@lbresearch.com

Subscriptions
Sophie Pallier
subscriptions@gettingthedealthrough.com

Business development managers
Alan Lee
alan.lee@lbresearch.com

Adam Sargent
adam.sargent@lbresearch.com

Dan White
dan.white@lbresearch.com



Published by
Law Business Research Ltd
87 Lancaster Road
London, W11 1QQ, UK
Tel: +44 20 3708 4199
Fax: +44 20 7229 6910

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First published 2014
Second edition
ISSN 2055-236X

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Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112



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Japan

Keitaro Oshimo

Nagashima Ohno & Tsunematsu

Preliminary and jurisdictional considerations in insurance litigation

1 In what fora are insurance disputes litigated?

Judicial remedy pertaining to insurance disputes is pursued through court, arbitration or alternative dispute resolution proceedings. If the relevant insurance policy contains a forum selection clause, the dispute would be brought to the battleground as agreed. Commercial policies the holders of which are enterprises often state that any dispute over the sums payable by the insurance company shall be resolved and determined by agreement of two neutral adjusters as selected by the policyholder and the insurance company respectively, or an independent third party as selected by the two adjusters if they fail to reach agreement on the sums payable by the insurance company. The clause is not considered to be an 'arbitration agreement' in that neither the agreed decision of the two adjusters nor the decision of the independent third party is final and conclusive, and hence, despite the frequency with which we see such clause in commercial policies, the clause is said to be rarely used. The standard D&O insurance and some other commercial policies contain a forum selection clause, which sets forth that courts in Japan shall have jurisdiction over any lawsuit pertaining to this insurance contract. The clause is intended to exclude foreign jurisdictions in such instance where directors or officers of foreign subsidiaries or other offices are covered as the insured persons under a D&O policy issued for Japan-based multinational corporations. In the area of consumer-instigated disputes, typically in the life insurance industry, they are often brought to alternative dispute resolution proceedings sponsored by the insurance industry. If the ADR panel issues a recommendation for settlement after hearing the allegations of both sides, the insurance company must follow the recommendation and settle the dispute in principle.

2 When do insurance-related causes of action accrue?

Typically, insurance-related causes of action accrue on the occurrence of the insured event as specified in the insurance policies. If the insurance policies set forth the insurer's liability-attaching-point differently, the right of the policyholder shall accrue in accordance with the policy language.

3 What preliminary procedural and strategic considerations should be evaluated in insurance litigation?

Given the uncertainty inherent in most lawsuits, it would always merit consideration for both parties to discuss, on a 'without prejudice' basis, the matter in question to reach an amicable resolution before instigating a lawsuit. Insurers especially would need to show good faith in the course of such discussion so as not to be accused of wrongful denial of claims. Wrongful denial could expose the insurer to a tort liability or an administrative sanction imposed by the insurance regulators or both. If the dispute is over the scope of coverage or interpretation of policy language of commercial policies, it would be useful for the policyholders to ask the views of the insurance broker that mediated the execution of the insurance contract. Due consideration should be given to whether or not it may be feasible to proceed with fully fledged adversarial proceedings given the availability of replacing insurance cover or the existence of other insurance policies issued by the insurer.

4 What remedies or damages may apply?

Typically, the policyholders would attempt to prove and recover the insured sum within the limits of insurance, which are set on each occurrence or an aggregate basis in the relevant clauses in the insurance policies or declarations attached to the policies. Punitive damages are generally not awarded or enforceable by courts in Japan.

Interpretation of insurance contracts

5 What rules govern interpretation of insurance policies?

There is no statutory set of rules on the construction of contracts. Generally speaking, we follow the black letter, and as long as the contract language is complete and clear, the wording of the contract, or the ordinary meaning assigned to the wording, will govern. No provision in a contract should be construed in isolation but in harmony with other terms and conditions set forth in the contract. If the language is not so certain or if the contract does not address the issue in question, we also consider the expectations of the parties, so long as they are objectively reasonable and in line with the purpose or context of the contract, which may be supported by legitimate evidence on the factual background surrounding the parties at the time of execution of the contract. In insurance contracts, the language is often not the product of negotiation between the parties, but is authored unilaterally by the insurer and offered to their customers on a 'take it or leave it' basis. Moreover, the entire policy provisions often are not disclosed to the customers before execution of the insurance contracts. Such circumstances would support courts' decisions to construe the insurance contracts in favour of aggrieved policy holders. As regards the burden of proof, the policyholder must show that the insuring agreement covers the alleged claim, and the insurer bears the burden of proving that the exclusion clauses would apply in order to deny its liability under the policy by virtue of the exclusion clauses. If the circumstances warrant it, the court would construe exclusion clauses strictly.

6 When is an insurance policy provision ambiguous and how are such ambiguities resolved?

As indicated in question 5, the policyholders do not necessarily have to first establish ambiguity in the insurance contracts prior to relying on evidence about the factual background or otherwise in pursuit of policy construction in their favour. Moreover, policy language that seems to be ambiguous in isolation is often not so ambiguous if it is viewed alongside the entire agreement or the objective or context of the contract.

Notice to insurance companies

7 What are the mechanics of providing notice?

As for 'claims-made' policies, the insurance is called on at the time when the relevant claim is made in accordance with the claim provisions contained in the policy (see question 8.) The policies set formal notification procedures to be followed by the policyholder in respect of details of such underlying claim made against the policyholder. As for 'occurrence-based' policies, which are more prevalent in the industry, the insurer's liability is attached on the 'occurrence' of the insured event. The policies nonetheless impose notification obligations on the side of the policyholders, and failure to make due notice could expose the policyholder to a reduction of insurance benefits otherwise payable under the policy (see questions 9 and 10). The Insurance Law (Law No. 56, 2008) also simply states that

when policyholders or beneficiaries become aware of the occurrence of the insured event, they shall notify it to the insurer without delay. It seems that the rationale for the notification obligations is to enable the insurer to provide guidance to minimise the loss; conduct incident examination swiftly so as to ensure the timely payment of the insurance benefits; and perform timely capture claims for such purposes as accounting, reserving and evaluation of the book of business.

8 What are a policyholder's notice obligations for a claims-made policy?

As for 'occurrence-based' policies, the link between an insured event, such as bodily injury or an accident, and the relevant insurance policy is solely the physical facts of such insured event. Failure to notify on the side of the policyholders does not change this. As for claims-made policies, the link is the claim first made by the underlying plaintiff against the policyholder for compensation for the damage allegedly suffered. Failure to notify by the policyholders does not change this. However, if the policy states that the claim must be notified to the insurer during the policy period, it means that the policyholder must fulfil the notice obligation to link the claim to the relevant policy.

9 When is notice untimely?

There is not authoritative ruling or guidance on when is notice untimely, but the Supreme Court case mentioned in question 10 suggests that a mere failure to meet the notice period as set forth in the policy, say, 60 days from the day of the occurrence, would not deprive the policyholders of a right to recover the insured benefit in full.

10 What are the consequences of late notice?

The Supreme Court decision (20 February 1987, Minshu 41-1-159) indicates that the insurer has to demonstrate prejudice in order to deny all or any part of benefits payable under the policy were it not for failure to make due notification. Namely, an insurer may deny coverage if it has successfully demonstrated 'extraordinary bad faith' on the part of the policyholder in respect of the late notice in breach of the agreed policy wording. Otherwise, the insurer may reduce its claim payment obligation only to the extent of the actual damage suffered due to the late notice and only after successfully demonstrating the actual damage. The court in this case suggested that 'extraordinary bad faith' could be established if the insurer demonstrated intent of the policyholder or beneficiary to deceive the insurer to pay insurance benefits. If such intention did exist, the insurer could terminate the policy retroactively pursuant to a termination clause regardless of whether or not the notification is made to the insurer.

Insurer's duty to defend

11 What is the scope of an insurer's duty to defend?

Unless the policy explicitly states that the insurer assumes the position to defend, it is the insured who shall defend against claims and the insurer will only indemnify the insured against the defence costs. A liability insurer shall indemnify policyholders from expenses incurred by them to defend a claim made against them in accordance with the terms of liability insurance policies. If the insurer owes the duty to defend, the defence expenses will be paid within or outside the limit of the insurance as agreed in the insurance contract.

12 What are the consequences of an insurer's failure to defend?

If the insurer owes the duty to defend, the insurance policy specifically sets forth the scope of such duty or right to investigate, defend and settle any claims as long as the claim is covered by the insurance policy. The insurance policy, however, is unlikely to set forth the consequence of an insurer's failure to defend. Under the general theory of contract and tort laws, the aggrieved policyholder would be able to recover damage with a reasonable connection to the negligence of the insurer. Reasonable expenses borne by the policyholder to defend the claim could be recoverable from the negligent insurer by virtue of such general theory even when the relevant insurance policy is silent on the consequence of an insurer's failure to defend.

Standard commercial general liability policies

13 What constitutes bodily injury under a standard CGL policy?

Typically, 'bodily injury' is defined to mean 'bodily injury, sickness or disease sustained by a person, including death resulting from any of these at any time'. It may follow to clarify that 'bodily injury includes mental anguish, mental injury and death as a result of physical injury to that person'. If the insurance policy addresses 'advertising injury' or 'personal injury' as well, the bodily injury definition also clarifies that 'bodily injury does not include any injury included in advertising injury or personal injury'. The definitions mentioned above would suffice if a manifest injury is caused by an accident instantly. However, if a disorder is caused gradually due to exposure to a harmful substance for quite a long time, it is not clear whether a bodily injury means the gradual micro-level change of cells or the manifestation of the disorder. We do not have established rules to determine what constitutes bodily injury in this instance. Needless to say, the issue relates to how to determine its 'occurrence' as well.

14 What constitutes property damage under a standard CGL policy?

Typically, 'property damage' is defined to mean

(a) physical injury to tangible property, including all resulting loss of use of that property (and all such loss of use shall be deemed to occur at the time of the physical injury that caused it); or (b) loss of use of tangible property that is not physically injured (and all such loss of use shall be deemed to occur at the time of the 'occurrence' that caused it).

15 What constitutes an occurrence under a standard CGL policy?

Typically, 'occurrence' is defined to mean 'an accident, including continuous or repeated exposure to substantially the same general harmful conditions'. A variety is 'an accident, or continuous or repeated exposure to substantially the same general harmful conditions'. With respect to 'advertising injury' and 'personal injury', 'occurrence' is defined to mean 'an offence committed by an insured resulting in 'advertising injury' or 'personal injury'. In a standard Japanese-language CGL policy, 'occurrence' is not defined.

16 How is the number of covered occurrences determined?

If the relevant insurance policy specifies the manner of counting the number of occurrences, we follow this specific provision. For instance, if in respect of limits of liability, the policy sets forth that the occurrence limit is the most the insurer shall pay for loss resulting from any one occurrence regardless of the number of the insured, the number of claims made against any insured or the number of persons making claims, such provision would govern the manner of counting, or integrating, occurrences for the purpose of the occurrence limit. A standard Japanese-language CGL policy does not define occurrence or offer the manner of counting occurrences. As indicated in question 5, where several construction is reasonably possible, the parties would be allowed to count the number of occurrences in light of 'reasonable expectations', taking into account such background facts as expected frequency and sums of the insured events against the sum of the occurrence limit and the aggregate limit.

17 What event or events trigger insurance coverage?

As indicated in question 7, the 'trigger' to call on the insurance policy is occurrence in the case of 'occurrence-based' policies. In the case of claims-made policies, the 'trigger' is a claim against the insured person lodged by an underlying plaintiff.

18 How is insurance coverage allocated across multiple insurance policies?

The allocation would follow the 'other insurance' clauses in the relevant insurance policy. Typically, such clause sets forth explicitly the manner in which the policy shall contribute with any other collectible insurance that covers a claim covered under the policy. If the policy is written as excess, the 'other insurance' clauses or other documents as attached to the policy form, such as the declarations, clarify the order of application or the manner of liability sharing among the multiple policies, for instance, by way of showing the attaching point and the cap of each of the layers assumed by excess liability insurers. In the unlikely event that the insurance policy does not contain such clauses, section 20 of the Insurance Act (Law No. 56 of

Update and trends

The amendment to the Companies Act (No. 86 of 2005), which passed the Diet and was publicised on 27 June 2014, includes expansion of the scope of D&O derivative lawsuits. Namely, the amendment will introduce 'multiple-layered derivative lawsuits' under which eligible shareholders of the summit company will be able to instigate a derivative lawsuit to pursue the liability of directors and officers of its major subsidiaries 100 per cent owned, directly or indirectly, by the summit company. To meet the eligibility to instigate a 'multiple-layered derivative lawsuit' as the plaintiff, a shareholder must:

- hold at least 1 per cent equity stake in the summit company, which is measured in terms of either:
 - the number of voting rights held by the shareholder against the number of all voting rights; or
 - the number of issued shares held by the shareholder against all issued shares, excluding the number of treasury stocks; and

- hold such 1 per cent or more status for at least six months through to the date of the instigation of the lawsuit so long as the summit company is a public company.

A 'major subsidiary' means a *kabushiki kaisha*, that is a stock company incorporated as such in Japan, the book value of which exceeds 20 per cent of the total assets of the summit company. Directors and officers of foreign subsidiaries of the summit company will not be subject to the 'multiple-layered derivative lawsuits' under the amended Companies Act. The amendment will be enforced on 1 May 2015.

2008) provides that if a risk is covered by policies issued by multiple insurers, the insured person may recover from any such policies up to their full insured sum, up to the full amount of the loss. Once the payment is made by one insurer, the allocation will be made among the multiple insurers on a pro rata basis.

First-party property insurance

19 What is the general scope of first-party property coverage?

As regards comprehensive insurance for moveables, for example, this offers indemnification of physical injury and any extraordinary expenses resulting from the loss of use, including destruction and clean-up expenses.

20 How is property valued under first-party insurance policies?

Typically, the relevant policy states that unless otherwise specifically agreed by way of endorsement attached to the policy, the insurer shall determine the sum of recoverable compensation based on the value of the insured property at the place and time of the occurrence of the property damage and if the property injury can be repaired to the state of the property immediately before the injury, the expense required for such repair work shall be the sum of recoverable compensation. In case of automobile insurance, an endorsement to apply the standard secondary market price of a vehicle equivalent to the insured automobile is attached to the insurance policy automatically. Section 18 of the Insurance Law states that the recoverable sum shall be determined based on the value of the insured property at the place and time of the occurrence of the damage; and the recoverable sum shall follow the agreed value of the insured property if there is such agreement, but if the agreed sum materially exceeds the actual value, the recoverable sum shall be determined in light of the actual value. In theory, if such agreed valuation of the insured property at the time of execution of the insurance contract by far exceeds its actual value, it would cast doubt over whether or not such contract constitutes a lawful and valid insurance contract.

Directors' and officers' insurance

21 What is the scope of D&O coverage?

A standard D&O insurance policy offers indemnification in respect of the sums the insured persons become legally obliged to pay as damages in connection with their business conduct, including omission, in the capacity of directors or other similar positions and reasonable defence expenses, only if the underlying claim is made against the insured persons during the policy period. The recoverable sum does not include any taxes, fines, administrative penalties, or punitive or exemplary damage, if any, charged to the insured persons. The policy does not extend to the directors' liability determined to be owed to their employer as the result of shareholder lawsuits. However, the directors can buy endorsement to extend the cover to such liability owed to the employer at their cost. If the directors win the shareholder lawsuit, it is not the endorsement but the policy that will cover their defence expenses.

22 What issues are commonly litigated in the context of D&O policies?

Typically, a dispute is over the application of exclusions. For instance, the exclusion provisions state that the insurer will not cover if the underlying claim is made against a director due to his or her action with actual or constructive knowledge about the resulting violation of laws. Then the argument would centre on what set of background facts would suffice to establish the constructive knowledge. The exclusion provisions also state that the insurer will not extend cover to all directors broadly in respect of a series of claims if any director is aware, or could reasonably be expected to be aware, of facts showing the likelihood of a threatening claim against him or her prior to the date of commencement of the policy period. Application of the exclusion in some cases could make the D&O policy almost meaningless to protect the directors, and it would provoke strong arguments against it. We do not have established rules on the construction of these exclusions.

NAGASHIMA OHNO & TSUNEMATSU

Keitaro Oshimo

keitaro_oshimo@noandt.com

Kioicho Building, 3-12 Kioicho
Chiyoda-ku
Tokyo 102 0094
Japan

Tel: +81 3 3288 7000
Fax: +81 3 5213 7800
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Insurance Litigation
ISSN 2055-236X



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