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Case No: 2007 Folio 1567

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
COMMERCIAL COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 20 May 2009

Before :

THE HON. MR JUSTICE TOMLINSON

- -

Between :

FLEXSYS AMERICA L.P.	**Claimant**
- and -	
XL INSURANCE COMPANY LIMITED	**Defendant**

- -
- -

Colin Wynter QC and Ben Lynch (instructed by **Messrs KSL Gates**) for the **Claimant**
Andrew Bartlett QC and Daniel Shapiro
(instructed by **Messrs Kennedys**) for the **Defendant**

Hearing dates: 23, 24, 25, 26 March 2009

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Judgment

Mr Justice Tomlinson :

1. This is a dispute concerning the ambit and extent of insurance coverage given by the Defendant to the Claimant during the period 1 July 2005 to 30 June 2006 pursuant to a Public and Products Liability Policy.

2. The Claimant, Flexsys America LP, a company incorporated in Ohio, is a subsidiary or associated company of Flexsys Holdings BV which is a global concern based in Belgium. Flexsys is a manufacturer, distributor and seller of various chemicals, including chemicals used in the manufacture of rubber products. Amongst the products that it produces and supplies are the products 6PPD[1] and 4-ADPA[2]. 6PPD is an anti-oxidant, anti-degradant, and anti-ozonant, and 4-ADPA is an essential component in the manufacture of 6PPD, which is a widely used product, particularly in the manufacture of rubber tyres. Flexsys carries out this manufacture, sale and distribution worldwide and has factories, offices and sale and distribution centres in many countries, including the UK, the US, Belgium, Brazil, France, Germany, Italy and Singapore. I shall hereafter refer to the parent group as "the Flexsys group" and to the Claimant, Flexsys America LP, the subsidiary and for present purposes the insured, as "Flexsys".

3. The Defendant, XL Insurance Co Ltd, is an English insurance company. It is part of the XL Capital group, formerly known as Winterthur. I shall refer to the Defendant as "XL". XL insured the Flexsys group for the period 1 July 2005 to 30 June 2006 pursuant to a Public and Products Liability Policy, to which I shall refer hereafter as "the Master Policy". The Master Policy is by express provision governed by English law. The Master Policy is part of a global insurance programme under which, in addition, various local policies were apparently issued in specific jurisdictions. However, save as to one specific policy to which I next turn, there are no details before the court as to the nature or number of such local policies.

4. Flexsys was insured by XL Select Insurance Company, a US company related to the Defendant, under a local Commercial Lines or Commercial and General Liability policy issued in Ohio for the period 1 July 2005 to 1 July 2006, to which I shall refer hereafter as "the local policy". The local policy provided a range of public and products liability cover.

5. Flexsys America LP was the US half of a joint venture which began in about May 1994 as a joint venture between Monsanto Company and Akzo Nobel. In September 1997 Monsanto spun off its chemicals business to form Solutia Inc. ("Solutia") and transferred its interest in Flexsys to Solutia at that time. In May 2007 Solutia purchased Axo Nobel's portion of the joint venture and is now the sole owner of Flexsys. On 25 April 2006 a Korean company, Korea Kumo Petrochemical Company Limited, to which I shall refer hereafter as "KKPC", filed a complaint ("the Original Complaint") in the District Court of the Central District of California (transferred initially to Ohio and then to the Northern District of California) making a range of allegations of improper and illegal conduct as against Flexsys and other companies. KKPC voluntarily amended the Original Complaint and filed a First Amended Complaint on 8 August 2006. Indeed the complaint has been amended some five

[1] Otherwise known as N-(1,3-Dimethylbutyl_-N'-Phenyl-P-Phenylenediamine)
[2] Otherwise known as 4-aminodiphenylamine

times. The First Amended Complaint was dismissed on or about 13 August 2007, although KKPC was granted leave to file an amended complaint. KKPC filed a Second Amended Complaint on or about 12 September 2007, which was dismissed in part on or about 11 March 2008. Again, however, KKPC was granted leave to file an amended complaint. KKPC filed a Third Amended Complaint on or about 18 April 2008.

6. On 4 December 2008 the Third Amended Complaint was dismissed without further leave to amend. It was dismissed "with prejudice" which as I understand it is the United States equivalent to the claim being struck out, with no permission to file a yet further amended complaint, save only for the claims under Californian State statutes which as I understand it could be reissued in a Californian State Court. That determination is in turn the subject of an appeal brought on 30 December 2008 before the United States Court of Appeals for the Ninth Circuit. That appeal is yet to be heard.

7. Flexsys has incurred legal costs in defending itself in the California proceedings. It is said that its costs to date are in excess of US$2 million.

8. Flexsys claimed indemnity from XL Select under the following provisions of the local policy. The local policy provided Flexsys with cover for "Personal and Advertising Injury", in Coverage B of the Policy. That provided:

> "COVERAGE B PERSONAL AND ADVERTISING INJURY LIABILITY
>
> 1. Insuring Agreement
>
> a. We will pay those sums that the insured becomes legally obligated to pay as damages because of 'personal and advertising injury' to which this insurance applies. …"

9. Clause B1.a. also sets out the duty to defend:

> "We will have the right and duty to defend the insured against any 'suit' seeking those damages. However, we will have no duty to defend the insured against any 'suit' seeking damages for 'personal and advertising injury' to which this insurance does not apply."

10. "Personal and Advertising Injury" is defined in Section VI clause 14 of the local policy as meaning:

> "… injury … arising out of one or more of the following offenses: …
>
> d. Oral or written publication, in any manner, of material that slanders or libels a person or organization or disparages a person's or organization's goods, products or services; …"

11. The cover provided under Clause B1.a. of the local policy is limited by Exclusions 2.a. and 2.b. which provide:

"2. Exclusions

This insurance does not apply to:

a. Knowing Violation of Rights of Another

'Personal and advertising injury' caused by or at the direction of the insured with the knowledge that the act would violate the rights of another and would inflict 'personal and advertising injury'.

b. Material Published With Knowledge of Falsity

'Personal and advertising injury' arising out of oral or written publication of material, if done by or at the direction of the insured with knowledge of its falsity'."

12. By Section III – Limits of Insurance, clauses 1 and 2.c. there is a General Aggregate Limit for Coverage B under the local policy. By Section III clause 4, there is also a limit for Personal and Advertising Injury "sustained by any one person or organization". In the Declarations both these limits are set at US$1 million. There is no deductible in respect of personal and advertising injury.

13. Payments in respect of defence costs were included within the limits: Supplementary Payments clause 1 as amended by an endorsement.

14. In the event, XL Select reached a settlement ("the Settlement") with Flexsys. By the Settlement XL Select agreed to pay to Flexsys the sum of US$408,251.60 which, when added to the US$591,748.44 already paid, totalled US$1 million, thus reaching both the specific, any one person or organisation, and the general aggregate limits. It was an express term of the Settlement that the Settlement was not to be construed as an admission by XL Select of the existence of insurance coverage in relation to KKPC's claim, and it was further agreed that XL Select expressly denied any liability with respect to the matters that were the subject of the complaint.

15. The local policy having thus been exhausted, Flexsys now seeks to recover the balance of its legal costs to date from XL under the Master Policy. It also claims declaratory relief as to its entitlement to be indemnified by XL in respect of its potential liability in damages to KKPC and its costs of defence, excess of the US$1 million payable to Flexsys pursuant to the Settlement and up to the US$25 million aggregate limit of indemnity under the Master Policy.

16. Flexsys relies on what is described in the Master Policy as a "Drop Down Clause". Flexsys says that in the circumstances which have occurred the Master Policy drops down in place of the local policy, subject to the terms and conditions of the local policy, but bringing with it its applicable higher limits of indemnity. Flexsys says that that is the purpose of such "umbrella" or master policies. The particular significance of the fact that, on its terms, this Master Policy drops down, if it does, on the terms of the local policy is that under the Master Policy the cover in respect of advertising injury is on very much more narrow terms than under the local policy. It is common ground that under the terms of the Master Policy Flexsys would have no claim,

because the relevant cover is in respect of legal liability for advertising injury arising out of Flexsys advertising its products or services. The claim brought by KKPC does not arise out of Flexsys advertising its products or services. The claim brought by KKPC alleges that Flexsys, with others, engaged in an unlawful conspiracy to monopolise the US market for 6PPD and to hamper KKPC competing fairly against it. Furthermore the Master Policy, which as I have already mentioned is expressly governed by English law, does not, like the local policy which it is common ground is governed by the law of Ohio, impose upon the insurer a "duty to defend". Under the Master Policy, as is traditional if not conventional under English policies, defence costs are recoverable only where incurred with the insurer's written consent.

17. The Master Policy covers Flexsys Holdings BV and/or Associated and/or Subsidiary Companies and/or Flexsys Rubber Chemicals Limited and/or Associated and/or Subsidiary Companies Flexsys America LP and/or Associated and/or Subsidiary Companies. It is a Public and Products Liability Insurance. The Master Policy limit of indemnity is US$25 million any one event. There is also an aggregate annual limit of US$25 million for product liability. Legal costs and expenses incurred in the USA are included within these limits. There is a worldwide excess of US$250,000 each claim up to a US$500,000 annual aggregate. However in relation to claims in the USA and Canada there is a separate excess of US$500,000 each claim up to a US$1 million annual aggregate. The excess does not form part of the limits of indemnity.

18. Further relevant provisions of the Master Policy are:

> "XL Insurance company Limited (herein called the Insurer) on the basis of any information provided in connection with a proposal made to the Insurer will subject to the terms of this Policy indemnify
>
> 1. the Insured
>
> …
>
> **Disputes**
>
> **Clause** Any dispute concerning the interpretation of the terms conditions limitations and/or exclusions contained herein is understood and agreed by both the Insured and the Insurer to be subject to English Law
>
> Each party agrees to submit to the jurisdiction of any court of competent jurisdiction within England …
>
> **Definitions** …
>
> 11. ***Advertising Injury*** shall mean injury arising out of

(a) oral or written publication of material that slanders or libels a person or organisation or disparages a person's or organisation's ***Products*** or services

(b) oral or written publications broadcast or telecast or the like of material that violates a persons rights of privacy

(c) privacy or unfair competition or idea misappropriation under an implied contract

(d) infringement of copyright or slogan

…

The Insurer will provide indemnity

1. up to the Limit of Indemnity against legal liability for compensation in respect of

(a) accidental ***Bodily Injury*** to any person

(b) accidental loss of or damage to ***Property***

(c) accidental obstruction nuisance or trespass

...

Extensions (each of which is subject otherwise to the terms of this Policy)

…

10. **Advertising Injury**

The ***Insurer*** will indemnify the Insured against legal liability for ***Advertising Injury*** arising out of advertising their ***Products*** or services

The indemnity will not apply to

(a) breach of contract other than misappropriation of advertising or advertising ideas under an implied contract

(b) the failure of ***Products*** or services to conform with advertised quality or performance

(c) the wrong description of the price of ***Products*** or services

(d) an offence committed by any Insured whose business is advertising broadcasting publishing or telecasting

(e) oral or written publication of material by or at the direction of the Insured with knowledge of its falsity

(f) oral or written publication of material which first took place prior to 1 January 2004

(g) other than as specified in (a) above liability assumed by virtue of an agreement or contract where such liability would not have attached in the absence of any agreement

…

Memoranda (each of which is subject otherwise to the terms of this Policy)

Memorandum A: Programme Clause

This Policy is a Master Policy for an International Public and ***Products*** Liability Programme where local policies each with a Limit of Indemnity have been issued in the countries forming part of this Programme

Any claims payments under the local policies shall be deducted from the total Limit of Indemnity under this Policy.

Should the Limit of Indemnity of this Policy be exhausted no further claim payments shall be made under the local policies

…

Memorandum C: Difference in Limits

With regard to Insured domiciled outside Great Britain, Northern Ireland, the Channel Islands or the Isle of Man the Insurer shall pay up to the Limit of Indemnity under this contract but only in respect of that part of the loss which exceeds the Limit of Indemnity of the policies issued locally and the total Limit of Indemnity under this contract shall be reduced by the amount of the Limit of Indemnity provided under the Local Policies.

…

Memorandum D: Difference in Conditions

This Policy will provide indemnity where the terms and Conditions hereon are broader than the local policy for an Insured company outside Great Britain Northern Ireland the

> Channel Islands or the Isle of Man in respect of claims made which are not recoverable under such local policies
>
> …
>
> **Memorandum E: Drop Down Clause**
>
> In the event of partial exhaustion of a local policy this Policy will pay in excess of the reduced underlying Limit of Indemnity
>
> In the event of total exhaustion of a local policy this Policy will continue in force as the underlying insurance subject to the terms Exceptions and Conditions of the particular local Policy."

19. Flexsys' case is straightforward. It says that the local policy is exhausted and under the second sentence of Memorandum E the Master Policy drops down to provide further cover on the terms of the local policy save only the specific and aggregate limits applicable thereunder. XL denies that the Master Policy operates in this way, effectively as an excess of loss cover in the event of exhaustion of the local policy by a single claim. It says that cover of that nature is in general available under Memorandum C, but not in the special case of a claim which is recoverable under the terms of the local policy but irrecoverable under the terms of the Master Policy. XL also says that in any event there is no liability under the terms of the local policy. It says that the claim which KKPC brings against Flexsys would not potentially or arguably give rise to a liability in Flexsys which would rank for indemnity under the local policy. It says that what is asserted is not "disparagement" and furthermore that what is asserted is expressly excluded from the cover given by the local policy as being "knowing violation of rights of another" or "material published with knowledge of falsity" – exclusions 2a and 2b.

Discussion and conclusions

20. Although Flexsys made submissions based on the purpose and function of "umbrella" or global master policies and drop down clauses, there was no expert evidence before the court dealing, even in general terms, with this type of cover. Flexsys had sought leave to introduce such evidence. I have not of course seen the terms of the report, apparently once revised, which it sought to introduce and I can only assume that since permission for its introduction was refused either it was unhelpful or it attempted to usurp the function of the court, or perhaps both. The parties did, at the court's direction, produce an agreed statement on drop down clauses. This points out that there is no single universally applied form of words and that there are a number of different clauses used in the London insurance market. Each clause must be looked at on its own merits. The agreed statement also points out that global master policies are a form of excess insurance. Global insurance policies are commonly offered as part of a global programme providing cover to multinational companies across the insured's chosen jurisdictions. The agreed statement contains the following paragraphs:

> "2. It is usual for insurance companies writing global master policies to have subsidiary or affiliate 'local insurance companies', each registered, licensed and domiciled in a

> different jurisdiction. It is common for some cover within global insurance programmes to be provided in certain jurisdictions through 'local policies' written by the insurer's local insurance company in the relevant jurisdiction. Such an arrangement of insurance involving a 'global Master Policy' and 'local policies' is referred to herein as a 'global insurance programme'. Where a local policy is issued, this is usually so that both insurer and insured can remain in compliance with local laws (e.g. where a jurisdiction requires a policy underwritten by an insurer domiciled within the jurisdiction).
>
> 3. The issuance of local policies may also benefit both insured and insurer through allowing differing local policies to be issued in particular jurisdictions reflecting the different requirements of the insured in a particular jurisdiction, and through improved claims-handling due to the knowledge of local laws and practice held by local employees.
>
> 4. Within global insurance programmes, local policies are usually issued on a primary basis with the global Master Policy providing cover in excess of local policies. Precisely what cover is provided by the global Master Policy in excess of the local policies depends on the terms of the master and local policies. It is also usual for there to be one aggregate limit of indemnity in the global Master Policy and for that to be expressed to be 'in the annual aggregate' across all jurisdictions and in excess of all primary policies within the programme."

21. There was appended to the agreed statement a two page extract from a paper published by the International Risk Management Institute Inc ("IRMI") in a CGL [Comprehensive and General Liability] and Umbrella Insurance Guide. I was later given the full paper. Its author is a senior research analyst at IRMI who is also a Chartered Property Casualty Underwriter. I will revert to this paper later.

22. It may be that umbrella or global master policies and the drop down clauses which they contain are so diverse in nature that it would be impossible to provide the court with any further impartial material by way of background. Flexsys also tendered in evidence two witness statements, one from a Mr Petrarca, who was at the time responsible for the treasury and insurance functions of the Flexsys group and one from a Mrs Noblet, one-time Group Treasurer and Insurance Manager of Flexsys NV. The witnesses were not themselves produced to give oral evidence and to submit to cross-examination. Mr Petrarca had no direct involvement in the obtaining of the policies under consideration and much of what he says concerning his subjective understanding of the intent of the Master and local policies is inadmissible as an aid to construction of them. Mrs Noblet joined Flexsys after these policies had been obtained – they were incidentally procured through specialist brokers Marsh both in London and, separately, in the USA. Mrs Noblet confirmed that often local policies were procured in order to meet local requirements.

23. I am not quite, like the court in *Brit Syndicates Limited v. Italaudit SPA* [2008] 2 All ER 1140, "asked to construe the policy in an almost complete vacuum" – see per Lord

Mance at page 1148. I also know for example that Flexsys had the benefit of two further excess layers of insurance above the Master Policy – US$25 million excess of US$25 million placed with Gerling and US$100 million excess of US$50 million placed with AIG. It was not however suggested that the underwriter of the XL Master Policy was aware of the existence of this further cover, still less of its terms. I am however without guidance from informed market professionals. I must assume that the topic of umbrella or global master policies and their associated drop down clauses is not one which lends itself to useful generalisation as to their purpose and function over and above the material which has been placed before the court. The task is therefore the familiar one of construing the language used in its context, both immediate and more broadly by way of background, so as to ascertain what the language used would signify to a properly informed observer – see per Aikens J in *Absalom v. TCRU Limited* [2005] 2 Lloyd's Rep. 735, whose helpful summary of the principles I gratefully paraphrase and adopt.

24. I approach the task therefore with no preconception as to how a drop down clause ought to be construed or as to the circumstances in which the dropped down cover ought to be available. It is obvious that the precise operation of a drop down clause will be dependent upon its terms. I would however note at the outset of the discussion that I am asked to determine the effect of this particular drop down clause in the context of a claim which should not I think be regarded as necessarily typical of those likely routinely to arise. Under both the local and the Master Policy the coverage in respect of liability for "advertising injury" is only a small part of much wider public and products liability coverage. Coverage in respect of this specific type of liability is achieved in the Master Policy only by Extension No. 10 (out of eleven such extensions) to the more broadly defined general liability, the subject of the cover. Furthermore this particular head of cover is under the Master Policy much more narrowly confined than under the local policy. As I have already pointed out, under the Master Policy it is confined to liability arising out of advertising by the insured of its products or services rather than extending to the publication of any material disparaging of the products or services of another. Whereas the broad scope of the cover afforded by the Master and the local policy is the same, with few other differences of any significance or materiality which either I or the parties have been able to discern, in relation to this particular, and relatively recondite, cover for "advertising injury" there is a marked difference. I am not therefore asked to determine how the Master Policy responds in a paradigm situation. In these circumstances reference to US$1 million being a very low limit for legal expenses cover for an operation in the United States rather misses the point. What is under discussion here is cover in a situation which comparison of the local and the Master Policy shows is the exception rather than the norm.

25. Furthermore, allied to the last point, whereas the Master Policy by Memorandum D deals specifically with the case where the terms and conditions of the Master Policy are broader than the local policy, no mention is made of the converse case where the terms and conditions of the Master Policy are narrower than those of the local policy. From this one would infer that ordinarily the Master Policy will not respond in circumstances where the underlying claim, although within the terms of the local policy, is outwith the terms of the Master Policy.

26. In the paradigm case of a single claim falling within the terms of both the local and the Master Policy giving rise to a liability in excess of the applicable limits under the local policy, cover for the excess, net of the appropriate deductible, up to the applicable limit of indemnity, will be available under the Master Policy Memorandum C, Difference in Limits. That cover is unavailable in the present case because of the difference in conditions. If cover were intended to be available in this situation, one would naturally expect it to be conferred by language similar in type, mutatis mutandis, to that employed in the Difference in Conditions provision, Memorandum D. One would expect some express reference to the applicability of the Master Policy cover notwithstanding its terms being more narrow than those of the local policy. I appreciate that it is the contention of Flexsys that that is indeed the effect of Memorandum E, but if that result is intended it is to my mind odd that language similar to that used in Memorandum D for broader terms and conditions is not likewise used in relation to narrower terms and conditions.

27. Moreover, if Flexsys is right that Memorandum E affords them cover in the present case, Extension 10, limiting cover for liability for advertising injury, is meaningless since in the event of a claim exhausting the local cover the Master Policy will drop down on the terms of the local policy and provide excess cover. Indeed the result contended for is in the present case the more odd still since Flexsys says that the Master Policy will continue in force as the underlying insurance subject to the terms, exceptions and conditions of the local policy, other than both the aggregate and the particular limits of liability. This brings about the doubly surprising consequence that (a) the Master Policy is responding to a claim which is not covered according to its terms and (b) although responding on terms of the local policy, the Master Policy is responding on terms more favourable than the local policy applies to a claim of that type, to which the local policy applies both a specific and a general aggregate limit of US$1 million in respect of a claim or claims brought by any one person or organisation. Indeed the result here is for a third reason odd in that it achieves "duty to defend" cover up to a limit of indemnity of US$25 million out of a Master Policy which (a) incorporates no reference to any such duty, (b) specifically provides that there is cover only for defence costs incurred with insurers' consent, and (c) does not cover the underlying claim.

28. Given the existence of the Difference in Limits and the Difference in Conditions Memoranda, C and D, it is I think unlikely that the language of the second sentence of Memorandum E is intended simply to secure excess cover for any claim which exhausts local limits, irrespective of whether the limit is particular or general and irrespective of whether the claim is one that would ordinarily rank for indemnity under the Master Policy. Furthermore I do not consider that the reaching of an event based particular limit would ordinarily be described as "total exhaustion of" a policy. I appreciate that in the present case there is the coincidence that the one claim exhausted both the event based specific limit and the general aggregate limit. However one must look for a construction of Memorandum E which will equally serve in the case where a local policy includes an event based specific limit which is lower than the aggregate limit.

29. It is common ground that the first sentence of Memorandum E deals with an ambiguity in Memorandum C. Where prior claims under the local policy have partially exhausted its aggregate, it is unclear on the wording of Memorandum C

whether a subsequent claim is covered under the Difference in Limits cover only to the extent to which it exceeds the underlying aggregate limit or rather to the extent that it exceeds the aggregate limit remaining unexhausted under the local policy. A simple example illustrates the problem. What is the effect of Memoranda C and E on a third claim for US$10 million where there have been two preceding claims, each of US$400,000, and each covered by and paid under the local policy, so that an aggregate of US$800,000 has been paid under the local policy? My example assumes that the third claim is within the scope of coverage of both the local policy and the Master Policy. The first and second claims have partially exhausted the local policy so that the first US$200,000 of the claim is covered by the remaining local policy cover. However if the first sentence of Memorandum E were not present, it would be unclear how much cover is available under the Master Policy. If the reference in Memorandum C to that part of the loss which exceeds the Limit of Indemnity of policies issued locally is construed as a reference to the limit stated in the local policy, US$1 million, there is a potential gap in the cover available. The gap is between the US$200,000 remaining local cover and the start of the Master Policy cover at US$1 million. There would be no cover in respect of US$800,000 of the third claim. The Master Policy excess of US$500,000 would then apply, before the Master Policy afforded a further US$8.5 million cover, resulting in a recovery of US$8.7 million. However if the reference to "Limit of Indemnity" is construed as meaning the remaining local limit of indemnity existing from time to time then the Master Policy will provide cover at that lower remaining limit of indemnity, on this example US$200,000, subject of course to the Master Policy excess. Thus after the Master Policy excess of US$500,000 has been applied, the Master Policy would on this hypothesis provide a further US$9.3 million of cover. The total cover would now be US$9.5 million, and the insured would bear the US$500,000 Master Policy excess. This compares with the position where the first sentence of Memorandum E is absent, where the insured recovers US$8.7 million, bearing US$1.3 million of the loss, being the US$800,000 gap in the local coverage plus the US$500,000 Master Policy excess. It is I think common ground that the first sentence of Memorandum E resolves this ambiguity in favour of the Master Policy providing cover at the lower remaining limit of indemnity.

30. Thus where the local policy has been partially exhausted, by definition by one or more prior claims, the Master Policy will attach at a reduced attachment point, always assuming that the terms of the Master Policy cover the subsequent loss. The first and second sentences of Memorandum E are introduced by the same phrase "in the event of … exhaustion of a local policy," that exhaustion being in the first place partial, in the second total. In the first sentence the partial exhaustion cannot be achieved by the claim which is immediately under consideration as potentially triggering the drop down. By definition, if the current claim only partially exhausts the local policy, there is no need for drop down.

31. If therefore the second sentence of Memorandum E comes into play when a single current claim exhausts the local policy, exhaustion is in that sentence being used in a rather different sense to that in which it is used in the first sentence. In the first sentence exhaustion is by payment of one or more prior claims. On this hypothesis in the second situation exhaustion could be achieved by the current claim, thereby simply converting the second sentence into a simple excess clause rather than a mechanism filling in a gap in cover previously offered by the local policy. It seems to

me more likely that the exhaustion spoken of in the second sentence is, consistently with that spoken of in the first sentence, an exhaustion achieved by one or more prior claims rather than by the instant claim which is the trigger for drop down. Looked at in this way, the second sentence, like the first, fills a gap. It provides a reinstatement of the local policy to be available to meet subsequent claims, i.e. claims subsequent to that or those which achieve total exhaustion of the local policy. It provides new cover from the ground up, but subject, as is logical, to the local terms, conditions and limits. It means that in the case of either partial or total exhaustion there is cover available from the ground up for the next claim. This may of course be a local statutory or regulatory requirement.

32. This construction is consistent with the two sentences of Memorandum E achieving broadly similar objectives. It is also consistent with the Master Policy "dropping down", a process which I understand as broadly involving the provision of cover by the Master Policy at a lower level or attachment point than is normal. Flexsys' construction on the other hand seeks to attribute to the second sentence of Memorandum E, although not to the first, a wholesale expansion of the cover available to meet a single claim which exceeds the local limit and which is outwith the terms of the Master Policy. XL's construction also has the advantage that it does not require the expression "subject to the terms, Exceptions and Conditions of the particular local Policy" to be read in the unnatural sense that it does not include the local limits of indemnity, whether specific or aggregate, which are as much terms and conditions of the local policy as are the other express provisions in the cover.

33. There is also I think a further anomaly in the Flexsys approach. On its construction the cover which "continues in force" as the dropped down cover is, although this is not spelled out, subject to the limits of indemnity of the Master Policy although otherwise subject to the terms, conditions and exceptions of the local policy. If the dropped down cover is subject to the Master Policy limit of indemnity it is difficult to see why it is not also subject to the Master Policy excess, which regulates the point at which the limit begins to be eroded. However if this were so, the purpose of the drop down cover in providing cover from the ground up would be severely compromised, since subsequent claims would need to exceed the applicable Master Policy excess before cover is available.

34. As Mr Andrew Bartlett QC, for XL, points out, there are potential anomalies on XL's construction too in consequence of the difference in cover between the master and the local policy. In relation to a subsequent claim not covered by the Master Policy but within the terms of the local policy, the local policy in the case of prior partial exhaustion will by definition pay less than US$1 million, with nothing available from the Master Policy. If the subsequent claim arises after total exhaustion, and reinstatement, the Master Policy as the reinstated local policy pays US$1 million. However this anomaly, which enures to the benefit of the insured, would be greater still on the approach of Flexsys. On Flexsys' approach, if the same subsequent claim, i.e. a claim covered by the local policy but not by the Master Policy, is for, say, US$10 million after prior partial exhaustion of the local policy by an earlier claim or claims, then the insured recovers the balance of US$1 million cover remaining unused under the local policy but nothing more under the Master Policy. If however the same claim arises after prior total exhaustion of the local policy, the insured recovers not US$1 million under the dropped down policy on local policy terms, but US$10

million, subject only to the excess point under the Master Policy. Thus the anomalies on XL's construction are much smaller in effect than those inherent in Flexsys' construction.

35. I do not agree with Flexsys that XL's construction makes no commercial sense and leaves Flexsys "uninsured" above US$1 million in circumstances where that limit can be expected to be quickly eroded. It is true that Flexsys is uninsured above US$1 million in certain limited circumstances, including the present circumstances. That is a consequence of the Master Policy being, in the particular respect under consideration, written on narrower terms than the local policy. However as I have already pointed out the case under consideration is the exception rather than the paradigm. The extent of cover purchased no doubt reflects its cost. The suggestion that it makes no commercial sense for Flexsys to choose to have only US$1 million worth of cover in certain limited circumstances is meaningless without a consideration of the cost of further cover and a balancing of that against the perception of the risk involved, an exercise which has not here been attempted.

36. Flexsys' reliance upon the excess layers above the XL cover was misconceived. Firstly the existence of those layers cannot affect the proper construction of the XL cover which was agreed without reference to them. Secondly however for the purposes of the excess layers it is the Master Policy which is in any event the primary policy, not the local policies. There is therefore no difficulty about those excess layer policies attaching at their stated attachment points.

37. I do not need to decide whether pursuant to the second sentence of Memorandum E the Master Policy drops down only once to replace any single local policy or whether multiple reinstatements of a single local policy are contemplated. On any view where there is more than one local policy there is the potential for the event of total exhaustion of a local policy to occur at least as many times as there are local policies. Whatever be the correct approach to the question whether a single local policy may be reinstated more than once, there is ample scope for claims which are covered by both a local and the Master Policy to reach the higher excess levels, as is indeed the case without reference to Memorandum E in any event.

38. Mr Colin Wynter QC, for Flexsys, attempted to make much of what he described as XL's "new standard wording". There was before the court a set of XL "Master Policies and Agreed Clauses" consisting of General Memoranda A to F in which Memorandum E was in the following form:

> "**Memorandum E: Drop Down Clause**
>
> In the event of partial exhaustion of a local policy this Policy will pay in excess of the reduced underlying Limit of Indemnity or in the event of total exhaustion of a local policy this Policy will continue in force as the underlying insurance subject to the terms Exceptions and Conditions of this Policy and not of the particular local Policy
>
> This Memorandum shall not apply in respect of any provisions in a local policy

(a) which would vary the period of validity or the territorial limits of this Policy

(b) which would vary the aggregate limit of indemnity under this Policy

(c) which provide for separate limits or sub-limits of indemnity for particular types of risk or for special local extensions of cover

(d) that require defence or any other costs to be insured in addition to the limit of indemnity where such costs are included in the limit of indemnity provided by this Policy

Any indemnity provided by this Memorandum shall not increase the Limit of Indemnity of this Policy in respect of an ***Event*** or change the period of insurance during which such ***Event*** is placed according to the terms conditions and exceptions of this policy"

There was no evidence as to the provenance or use of this form other than that it is an XL form. Mr Bartlett told me on instructions that it had been developed during about 2005 and that the first use of it which could be traced, in the sense of incorporation into a policy issued to an insured, was July 2006. Whilst Mr Wynter wished to characterise this as indicative that the standard form was changed, I cannot agree that the evidence, such as it is, goes so far. There is no evidence to the effect that the "new" clause supplanted the old. It is equally possible that both sets of clauses continued to be used, and indeed there may well have been other variants. In fact the production of this drop down clause in a form different from that under consideration demonstrated to my mind only two things. First, it demonstrates that a drop down clause cannot be approached with any *a priori* assumption as to the terms on which an umbrella or global Master Policy will drop down. Secondly, it demonstrates that a Master Policy continuing to serve as the underlying insurance but on its own terms rather than those of the underlying policy is not inherently inconsistent with the notion of a drop down clause, nor, presumably, is cover in such form commercially unrealistic or unsaleable.

39. I refer finally to the IRMI paper. I do not derive much assistance from this paper but I do note that of the various examples of drop down clauses provided none would provide excess cover in respect of a single claim which itself exhausts the primary policy. All of the examples given posit exhaustion by prior claims.

40. For all these reasons I conclude that, irrespective of the applicability of the local policy, Flexsys enjoys no cover under the XL policy in respect of the KKPC claim.

41. It follows that the question whether the terms of the local policy are apt to afford cover to Flexsys in respect of the legal expenses incurred in the California proceedings does not arise for decision. However in case the matter goes further and since I have heard contested evidence as to the law of Ohio by which this issue is governed I should set out briefly the conclusions which I have reached. I had the

benefit of detailed reports and oral evidence from two practitioners in Ohio, Mr Paul Rose and Mr Clifford Masch. Both had extensive experience of insurance coverage disputes. In their reports they referred to more than 130 authorities, all of which were made available to the court. I mean them no disrespect by indicating that it would be disproportionate for me to embark upon a lengthy treatment of the law of Ohio as they described it to me.

42. The allegations in the Third Amended Complaint, to which I shall refer hereafter as the "TAC", are wide ranging. Any attempt to summarise them will inevitably be incomplete. However Mr Wynter, in his written Opening Submissions for the trial, suggested that they could be briefly and compendiously summarised in the complaint that Flexsys and its various alleged co-conspirators (which include Akzo Nobel Chemicals International BV and Akzo Nobel Chemicals Inc):

> "… agreed to refuse to deal with KKPC and … sought to impede KKPC's entry into the US 6PPD market and constrain its growth by a variety of methods, including: the threat of litigation against KKPC; exerting control over the essential resource of 4-ADPA (a component of 6PPD); intimidating KKPC from entering into the United States 6PPD market; and intimidating KKPC's 6PPD customers and causing them to refuse to deal with KKPC, all in furtherance of the goals and purposes of the unlawful conspiracy …" (emphasis added)
>
> and
>
> "This matter arises from Defendants' efforts to monopolize the US 6PPD market and to organize a group boycott of KKPC as an independent supplier of 6PPD to US customers. Specifically, Flexsys has coerced, through threats and intimidation, the large tire manufacturers with facilities in the United States to either boycott KKPC altogether or to greatly reduce the amount of 6PPD that they purchase from KKPC. Moreover through its frequent efforts, Flexsys has attempted to gain monopoly power over the United States 6PPD market." (emphasis added)

It is obvious that much of this conduct, or the consequences of it, is not or are not appropriately characterised as "personal and advertising injury" as that is defined in the local policy. The question however is whether any part of the TAC can appropriately be so characterised. It is common ground that if only one claim in the TAC falls within the policy coverage, XL is by the law of Ohio compelled to provide a full defence for all claims contained therein.

43. It is also common ground that the element in the definition of "personal and advertising injury" in the local policy which is most likely to avail Flexsys is product disparagement. Whilst he did not I think make any concession, Mr Wynter recognised that unless he could demonstrate that the TAC made allegations of this nature, he was unlikely to be able to show that defence of the allegations made in the TAC attracts coverage.

44. However there is an additional hurdle which Flexsys must surmount, which is that the cover for product disparagement is itself qualified by Exclusions 2(a) and 2(b), which exclude from cover personal and advertising injury (a) caused by or at the direction of the insured with the knowledge that the act would violate the rights of another and inflict personal and advertising injury and (b) arising out of oral or written publication of material, if done by or at the direction of the insured with knowledge of its falsity. For present purposes these exclusions very severely curtail the ambit of the cover for product disparagement and trade libel. It is agreed that the elements of the common law claim of product disparagement in California are: (1) publication; (2) of a false and disparaging statement of fact about the product of the plaintiff; (3) made with either knowledge of a falsity or with reckless disregard of its truth or falsity; (4) with intent to harm the plaintiff's interests; and (5) specific damages. It is further agreed that trade libel under California law is defined to include intentional disparagement which results in pecuniary damage. The elements of trade libel are (1) a publication, (2) which induces another not to deal with the plaintiff, and (3) special damages. However, it is also common ground that claims of product disparagement, trade libel and defamation by libel and slander can be established under California law without proof of intent to cause injury or proof of actual knowledge that the offending statement is false. Disparagement of product can be established with proof of recklessness. Trade libel does not contain a requisite element of the publishing of a knowingly false statement or the element that it was intended to cause harm.

45. It is again common ground that I must look at the allegations in the TAC through the prism of Ohio law as it relates to the proper construction of the local policy for the purpose of determining the ambit of the coverage given. It is also agreed, as adumbrated above, that under established Ohio Supreme Court case law, when the allegations in a complaint filed against a policy holder arguably or potentially bring the claim within the indemnity coverage of the policy, the insurer is required to provide a defence of all claims, regardless of the outcome of the underlying action or the insurer's indemnity obligations to the insured. As is inherent in the foregoing, it is also agreed that the duty to defend based on the allegations presented in the complaint is a broader duty than the duty to indemnify. In part, as it seems to me, this is a consequence of the fact that in litigation in Ohio determination of the issue whether the insurer has a duty to defend routinely occurs long in advance of determination of the issue whether the insurer has a duty to indemnify. Having regard to the obvious vagaries of litigation, courts in Ohio are naturally reluctant to deny duty to defend coverage in all but clear cases, since denial of the existence of the broader duty to defend will, by operation of an issue estoppel, preclude later establishment of the more narrow duty to indemnify.

46. Thus the approach in Ohio is that whilst "the duty to defend may arise from the complaint alone if the allegations in the complaint unequivocally bring the action within the policy coverage … the duty to defend need not arise solely from the allegations in the complaint but may arise at a point subsequent to the filing of the complaint" – see *City of Willoughby Hills v Cincinnati Insurance Co* 9 Ohio St. 3d 177, 180 (1984). This approach is further informed by the adoption in Ohio of what are called "notice pleading" standards. This concept, adopted from the Federal Rules of Civil Procedure, requires only "a short and plain statement of the claim showing that the pleader is entitled to relief, and a demand for judgment for the relief to which he deems himself entitled" – see Ohio Rules of Civil Procedure Civ. R. 8(A).

Furthermore, by Civ. R. 15(B) a trial is no longer strictly limited to the issues raised in the pleadings. *City of Willoughby Hills* establishes the proposition that it must be determined whether "the underlying factual allegations in the complaint arguably or potentially fall within the [insurance] coverage". If they do, the duty to defend is made out. So too the duty is made out if "there is some doubt as to whether a theory of recovery within the policy coverage has been pleaded". Notwithstanding the apparent width of this approach, and the fact that "the scope of the allegations may encompass matters well outside the four corners of the pleadings" – see again *City of Willoughby Hills* – I detect no reluctance on the part of the courts of Ohio in plain and obvious cases to declare that the duty to defend is simply not made out. On the contrary, in *Motorists' Mutual Insurance Company v. National Dairy Herd Improvement Association* 141 Ohio App. 3d 269, 750 N.E. 2d 1169, I find the following in the judgment of the Court of Appeals of Ohio, Tenth District:

> "In determining whether a complaint states a claim that is potentially or arguably within policy coverage thereby triggering the insurer's duty to defend, we may consider matters 'outside the four corners of the pleadings'. *Willoughby Hills* … We will not, however, impose a duty to defend based on allegations outside the complaint, where the complaint does not state a claim that arguably triggers coverage. We agree with the following statement from *Leland Elctrosystems Inc v. Travelers Insurance Company* (July 10th, 1984), Montgomery App. 8580, unreported, 1984 WL 5371:
>
> > 'The inquiry into the insurer's duty to defend must naturally begin with a close scrutinization of the allegations of the disputed complaint. If such a review reveals claims which "potentially" or "arguably" fall within the purview of the policy, then, and only then, does *Willoughby Hills* dictate that a court look to extraneous matters to determine whether a defence is required of the insurer. On the other hand where a court reviews a complaint and concludes beyond a doubt that there are not arguably covered claims encompassed therein it need not stretch the allegations beyond reason to impose a duty on the insurer. To do so would effectively impose an absolute duty on the insurer to provide a defence to the insured regardless of the cause of action stated in the complaint. Even under the liberal notions of notice pleading it would be inherently unfair to require the insurer to provide a defence where the pleadings failed to notify, even arguably, that the insured is being sued on a claim covered by the policy'.
>
> Because we have determined that the allegations in the Agritronics complaint do not state a claim that potentially or arguably falls within the purview of the insurance policy, we need not look at extraneous matter developed during the course of discovery."

Mr Rose, the expert called by Flexsys, regarded this as an orthodox exposition of the proper approach. It is also I think common ground that in evaluating the TAC I can properly take into account that it is KKPC's fifth attempt to state its case. In such circumstances I do not I think need to be astute to search for yet further allegations which might more plausibly potentially rank for indemnity.

47. In my judgment this is a plain and obvious case where the duty to defend is simply not made out. The TAC alleges a series of intentional acts forming part of a conspiracy to exclude KKPC from the US market. It is a litany of allegedly improper conduct, carried out intentionally and with a clear intent to injure. Mr Wynter submits that the allegations involve publication of an allegedly false and disparaging statement of fact about KKPC's products made negligently or recklessly. However the words negligently and recklessly are nowhere used in the TAC. This is in my judgment unsurprising, since the five torts alleged are with one exception torts of intention. Mr Rose and Mr Masch included in their joint Memorandum the following passage:

> "2.6 The experts agree that the federal and California law claims in the Third Amended Complaint listed below contain the elements listed below, and they further agree that the listing of these elements is not a complete exposition of the nature of such claims.
>
> (a) **Violation of the Sherman Act, Section 1, conspiracy to restrain trade under 15 USC Section 1**. To state a claim under 15 USC, Section 1 for conspiracy to restrain trade, a Plaintiff must prove: (1) a contract, combination or conspiracy among two or more persons or distinct business entities; (2) by which the persons or entities intended to harm or restrain trade or commerce…: (3) which actually injures competition.
>
> (b) **Violation of the Sherman Act Section II, attempted monopolization under 15 USC Section 2**. To establish a claim for attempted monopolization under Section 2 of the Sherman Act, a plaintiff must prove: (1) that the defendant has engaged in predatory or anticompetitive conduct with, (2) a specific intent to monopolize, and (3) a dangerous probability of achieving monopoly power.
>
> (c) **Combination in Restraint of Trade under California Business and Professional Code §§ 16700, et seq.** In order to maintain a cause of action under the Cartwright Act for Combination in Restraint of Trade, a plaintiff must establish (1) the formation and operation of a conspiracy; (2) illegal acts done pursuant thereto; (3) purpose to unlawfully or unreasonably restrain trade; and (4) damages caused by such act.
>
> (d) **Unfair business practices under California Business and Professional Code §§ 17200**. To state a claim under Section 17200, a plaintiff need not plead and prove the elements of the tort of fraud. Instead, one need only show that members of the

> public are likely to be deceived. Allegations of actual deception, reasonable reliance and damages are unnecessary. Further, the statute authorizes courts to order restitution without individualized proof of deception, reliance, and injury if necessary to prevent the use or employment of an unfair practice. Because Section 17200's definition is disjunctive, the statute is violated where a defendant's act or practice is unlawful, unfair, or fraudulent, where it amounts to unfair, deceptive, untrue, or misleading advertising, or where it involved any act in violation of Section 17500. the statute imposes strict liability, and a showing of intent to injure is not necessary.
>
> (e) **Intentional interference with prospective economic advantage**. The elements of the tort of intentional interference with prospective economic advantage are: (1) an economic relationship between plaintiff and a third party, with the probability of future economic benefit to plaintiff; (2) defendant's knowledge of the relationship; (3) an intentional act by the defendant, designed to disrupt the relationship; (4) actual disruption of the relationship; and (5) economic harm to plaintiff proximately caused by the defendant's wrongful act."

In the section of the TAC dealing with unfair business practices KKPC repeats all its previous allegations of intentional misconduct and characterises that conduct as constituting additionally unlawful and/or unfair business acts or practices prohibited by California's Business and Professions Code Section 17200, resulting in substantial harm to KKPC.

48. All this notwithstanding, Mr Wynter submitted that since there are to be found in the Complaint allegations of acting wrongly, baselessly and improperly and unlawfully, allegations which looked at in isolation do not require or specify direct intent, so therefore it states or comprehends claims or at least one claim which is potentially or arguably within the policy coverage. What this amounts to in my judgment is a suggestion that it is here enough to establish the duty to defend to demonstrate that the allegations made, or which might be made, do not in themselves preclude an innocent mindset and thus commission of the tort by negligence or recklessness. I do not consider that this is the approach adopted by the Ohio courts but in any event I do not regard it as appropriate simply to isolate four adverbs out of their context and to enquire whether their use is consistent with an allegation of a non-intentional course of conduct. The whole thrust of the TAC at every point is that Flexsys has pursued a deliberate and concerted course of conduct designed to keep KKPC out of the market and to that end has told deliberate untruths to the effect that KKPC was guilty of patent infringement. What is alleged is commercial intimidation to maintain market share in the face of competition. The notion that such conduct could be characterised as simply negligent or reckless is in my view absurd. Such conduct is calculated and deliberate. It is in an attempt to convince the court of the deliberate nature of the conduct of Flexsys that KKPC recites at paragraph 23 of the TAC that in December 2005 the European Commission announced that it had found "firm and convincing evidence" of the existence of price fixing and other unlawful activities of an illegal

cartel, including Flexsys' role therein. Just as summarising the TAC is inherently incomplete, so too selective quotation necessarily runs the same risk, but I believe that the essence of the TAC emerges from the following paragraphs:

> "12. This matter arises from Defendants' efforts to monopolize the US 6PPD market and to organize a group boycott of KKPC as an independent supplier of 6PPD to US customers. Specifically, Flexsys has coerced, through threats and intimidation, the large tire manufacturers with facilities in the united States to either boycott KKPC altogether or to greatly reduced the amount of 6PPD that they purchase from KKPC. Moreover through its frequent efforts, Flexsys has attempted to gain monopoly power over the United states 6PPD market.
>
> …
>
> 27. Flexsys' aforesaid conspiracy and agreement with other rubber chemical producers resulted in it being allotted a significant share of the US 6PPD market. In order to preserve and expand upon these ill-gotten gains, Flexsys has sought to thwart the entry into the market of KKPC, a low-cost, independent provider of 6PPD. Most significantly, Flexsys has threatened KKPC's actual and potential US 6PPD customers to enlist their participation in a boycott of KKPC. Such customers included several tire manufacturers with facilities in the United States. Flexsys indicated to these customers that it would sever their existing supply of Flexsys 6PPD and other Rubber Chemicals if they purchased any portion of their 6PPD from KKPC for use in the United States. Flexsys also indicated to these customers that they would be subject to patent litigation if they did not join in the boycott of KKPC.
>
> …
>
> 30. Flexsys' ascendancy has been propelled by its efforts to coerce current and potential KKPC customers from purchasing 6PPD from KKPC. In September 2005, Michelin – a KKPC customer and US purchaser of 6PPD from KKPC – announced that it was halting even its small purchases of 6PPD from KKPC in the United states, in the face of continued threats by Flexsys.
>
> 31. In 2006, KKPC made a concerted effort to sell additional quantities of 6PPD in the United States. In response thereto, in or about July 2006, Flexsys issued a press release, directed at purchasers of Rubber Chemicals, purporting to describe the results of an action that Flexsys had brought before the United States International Trade Commission ('ITC Action') against KKPC, Sinorgchem and Sovereign Chemical Co. (the latter two are producers of 4-ADPA). In the ITC Action, the ITC specifically found that KKPC had not infringed Flexsys' patent

for PPD2 and declined to find that KKPC had infringed by purchasing 4-ADPA from Sinorgchem. Nonetheless, Flexsys' press release announced that it would continue to pursue KKPC as to any sales it made in the United States. In conjunction with the aforementioned press release, Flexsys informed major rubber chemicals purchased that they should refrain from purchasing 6PPD from KKPC as long as KKPC continued to manufacture 6PPD with 4-ADPA supplied by Sinorgchem. That statement was false. The ITC plainly rejected Flexsys' contention that KKPC somehow violated the law by manufacturing 6PPD with materials supplied by Sinorgchem. Flexsys' misleading and intimidating statements to customers that they should not purchase KKPC's 6PPD because of some alleged infringement was an impermissible continuation of its efforts to coerce customers from purchasing from KKPC, to allot customers to itself, and to foreclose KKPC from the United States 6PPD market.

…

35. Flexsys' threats of patent litigation are acts in furtherance of the unlawful group boycott. Flexsys has used these threats, which lack merit as to KKPC, to further the aims of the boycott and with the improper and unlawful objective and purpose of restraining KKPC's ability to compete in the US 6PPD market.

…

41. In furtherance of the goals and objectives of the aforesaid conspiracy to restrain trade, Defendants have wilfully engaged, and are illegally engaging, in a violation of Section 1 of the Sherman Act by (a) threatening KKPC's Rubber Chemicals customers and potential customers with refusals to deal and other adverse consequences if they continued to purchase 6PPD from KKPC for use in products sold in the United States; (b) threatening KKPC's Rubber Chemicals customers and potential customers with litigation if they continued to purchase 6PPD from KKPC for use in products sold in the United States and/or wrongly telling KKPC's customers and potential customers that they could not purchase 6PPD from KKPC as long as KKPC continued to manufacture 6PPD with 4-ADPA supplied by Sinorgchem; and (c) taking such actions to preserve the effects in the US 6PPD market of its unlawful conduct.

…

67. A valuable relationship existed between KKPC and Michelin, under which KKPC sold to Michelin significant quantities of 6PPD. Such relationship had been ongoing for several years and had regularly been renewed by the parties.

> Hence there was a probability of future economic benefit from its relationship to Michelin.
>
> …
>
> 69. Without legal justification, Flexsys engaged in wrongful conduct designed to disrupt this relationship by baselessly threatening Michelin with patent infringement and severance of supply if it continued to purchase 6PPD from KKPC and by taking other action to coerce Michelin into discontinuing its business with KKPC.
>
> …
>
> 72.Without legal justification, Flexsys engaged in wrongful conduct designed to disrupt the relationship by baselessly threatening Pirelli with patent infringement litigation and severance of supply if it purchased 6PPD from KKPC and by taking other action to coerce Pirelli into refusing to purchase 6PPD from KKPC. Flexsys' threats of severance of supplies to Pirelli severely damaged KKPC's relationship with Pirelli.
>
> …
>
> 74. Flexsys engaged in such conduct with the intent to interfere with or disrupt KKPC's business relationships and knew that its interference was certain or substantially certain to occur as a result of such conduct. Flexsys' conduct was malicious, oppressive, and fraudulent and without legal justification."

49. In my judgment the allegation made against Flexsys is not that it said things which turned out to be incorrect which conduct might therefore have occurred through mere negligence or recklessness but rather that Flexsys set out deliberately to injure KKPC by saying things about it and its products which it knew to be untrue. Liability in respect of such conduct is plainly excluded from the ambit of the local policy cover. The fact that XL Select paid out the limit of indemnity in settlement of the claim by Flexsys does not deter me from the conclusion that the duty to defend is not here made out. In Ohio an insurer can be liable in damages where it has denied coverage in circumstances characterised as bad faith. An insurer who is found not to have had reasonable justification for its understanding of the position is regarded as having acted in bad faith, and this failure can come about through incompetence, stupidity or mistake. The fact that in such circumstances XL Select chose to pay out a relatively modest limit of indemnity without admission of liability is not I think a particularly powerful indicator as to how an Ohio court would approach the matter. In *Snowden v. Hastings Mutual Insurance Co.* 177 Ohio App. 3d 209, 894 N.E. 2d 336 the plaintiff insured under a domestic policy including liability cover had an altercation with his neighbour. The neighbour Fares was allegedly injured and sued alleging intentional tort. In the context of the insurers' denial of a duty to defend the Court of Appeals of Ohio, Seventh District said:

> "13. Even though Fares' complaint characterises Snowden's action as both negligent and intentional, given the facts, Snowden's actions of slapping or shoving were clearly not negligent, but rather intentional. The mere insinuation of negligence in a civil complaint cannot transform what are essentially intentional torts into something accidental that might be covered by insurance."

This approach was followed by the Court of Appeals for the Eleventh District in *State Farm Fire and Casualty Company v. Totarella* 2003 WL 22236027.

50. There was an interesting debate between the experts as to whether a provision such as Exclusion 2a which, effectively, excludes liability for a tort involving direct intent would in Ohio be regarded as excluding liability where the insured appreciated that his conduct was substantially certain to cause harm. It will be recalled that in paragraph 74 of the TAC which I have set out above there is an allegation, in the context of the claim for intentional interference with prospective economic advantage, that Flexsys knew that in consequence of its conduct interference with KKPC's business relationships was certain or substantially certain. It seems to me on reflection that this debate was somewhat arid since the means of interference alleged against Flexsys was the use of the threat that those who dealt with KKPC would thereby expose themselves to patent infringement litigation. That threat was allegedly made by Flexsys deliberately misrepresenting the outcome of proceedings before the US International Trade Commission – see paragraph 31 of the TAC. It seems to me therefore that cover in respect of the conduct complained of in paragraph 74 of the TAC would be excluded by Exclusion 2b if not by Exclusion 2a. In the circumstances I see no reason to extend this judgment by lengthy discussion of the Ohio authorities. It suffices to say that the notion that an exclusion of cover for intentional injury might not be sufficient to preclude cover where there is a substantial certainty that harm will be caused derives from a line of cases dealing with specialised so-called "stop-gap" cover. This cover developed following the decision of the Supreme Court of Ohio in *Blankenship v. Cincinnati Milacron Chemicals* 69 Ohio St. 2d 608, 433 N.E. 2d 572 to the effect that a provision in the Ohio State Constitution hitherto thought to preclude actions in tort by employees against their employers did not preclude actions based upon an intentional tort. As a result of this, employers bought insurance policies covering the risk of liability to employees for injuries sustained in the course of their employment. Subsequently, a dispute arose as to whether insuring against intentional torts violated Ohio's public policy. The story is told in *Talbert v. Continental Casualty Co.* 157 Ohio App. 3d 469, 811 N.E. 2d 1169. The Supreme Court found in *Harasyn v. Normandy Metals* 49 Ohio St. 3d 173, 551 N.E. 2d 962 that there is a distinction between "direct intent" intentional torts and "substantially certain" intentional torts. Whilst it was against Ohio public policy to insure against the former, it was not against Ohio public policy to insure against the latter. In this manner it was ensured that the "stop-gap" policies were not devoid of all content. I am not sure that this reasoning transposes happily into the context of a commercial general liability policy which affords cover for negligence and recklessness across a broad spectrum of activity and where it is unnecessary to draw this somewhat artificial distinction in order to give content to the cover.

51. The wording in Exclusion 2a is in any event markedly different from the wordings considered in the line of authority to which I have just referred. Exclusion 2a does not in terms refer to intent. On the other hand I would characterise as "intentional" harm caused by or at the direction of the insured with the knowledge that the act in question would violate the rights of another and would inflict personal and advertising injury. So it seems in the context of an action by an employee against an employer the Supreme Court of Ohio treats as intended injuries which are known by the employer to be substantially certain to occur – see *Fyffe v. Jeno's Inc,* 59 Ohio St. 3d 115, 570 N.E. 2d 1108. I do not consider that Exclusion 2a would in Ohio be regarded as inapt to exclude coverage for harm which the insured knew was substantially certain to occur but as I have already explained I do not consider that the point in fact arises.

52. For all these reasons I have concluded that even it Flexsys has the benefit of dropped down cover on the terms of the local policy, still it affords it no right to an indemnity in respect of either the costs incurred in the California proceedings or in respect of its potential liability in damages to KKPC.

53. Flexsys is not entitled to the declaratory relief claimed.