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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

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| TENNECO AUTOMOTIVE INC., a Delaware corporation, TENNECO AUTOMOTIVE OPERATING COMPANY, INC., a Delaware corporation, WALKER MANUFACTURING COMPANY, a Delaware corporation, NEWPORT NEWS SHIPBUILDING INC., a Delaware corporation, NEWPORT NEWS SHIPBUILDING AND DRY DOCK COMPANY, a Virginia corporation, and PACTIV CORPORATION, a Delaware corporation, | : | **REDACTED – PUBLIC VERSION** |
| Plaintiffs, | : | |
| v. | : | **C.A. No. 18810-NC** |
| EL PASO CORPORATION, a Delaware corporation, EL PASO NATURAL GAS COMPANY, a Delaware corporation, EL PASO TENNESSEE PIPELINE CO., a Delaware corporation, and CERTAIN UNDERWRITERS AT LLOYD'S, LONDON and LONDON MARKET INSURANCE COMPANIES, foreign corporations, | : | |
| Defendants. | : | |

# MEMORANDUM OPINION

Date Submitted: July 18, 2002
Date Decided: August 26, 2004

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NOBLE, Vice Chancellor

The deconstruction of a conglomerate into separate entities to carry out its various businesses can present vexing questions as to historic insurance coverage, especially if one of the business lines suffers the bulk of the risk and the insurers' continuing ability to pay claims is in doubt. A 34-page insurance agreement was negotiated to address these concerns. As will be seen, it did not work well. After one of the surviving entities settled its claims with certain subscribing insurers and informed the other surviving entities that it had released and exhausted the coverage available to them from those insurers under the various policies, the other surviving entities, fearing that they had unjustly lost rights under the policies, brought this action. This is the Court's post-trial opinion.

## I.

Tenneco Inc. ("Old Tenneco") operated four businesses: energy (primarily natural gas transmission and marketing), automotive (ride and emission control components), packaging, and shipbuilding (including design, construction, repair, and overhaul). Old Tenneco decided to restructure. In late 1996, it spun off its automotive and packaging businesses to New Tenneco Inc. ("New Tenneco")[1] and its shipbuilding business to Plaintiff Newport News Shipbuilding Inc. ("Newport

[1] Subsequently, New Tenneco spun off the packaging business to Plaintiff Pactiv Corporation ("Pactiv") and, with only its automotive business remaining, renamed itself Tenneco Automotive Inc. ("Tenneco Automotive"). That entity is also a plaintiff in this action. Plaintiffs Walker Manufacturing Company and Tenneco Automotive Operating Company, Inc. are subsidiaries of Tenneco Automotive. References to Tenneco Automotive include them.

News").[2] Defendant El Paso Corporation ("El Paso") acquired the energy business when Old Tenneco (after the spin off of its other business lines) merged into one of El Paso's wholly-owned subsidiaries.[3]

Old Tenneco, as one would expect for a company of its size, had purchased numerous insurance policies to protect itself (and its subsidiaries)[4] from a wide range of risks. For example, between 1968 and 1993, Old Tenneco purchased more than $5 billion of insurance coverage. Defendants, Certain Underwriters at Lloyd's, London and London Market Insurance Companies (collectively, the "London Insurers"), provided a substantial portion of Old Tenneco's coverage.[5] These policies were regularly, but not exclusively, written on an occurrence basis, with per occurrence, and not aggregate, limits.[6]

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[2] Newport News, for purposes of this Memorandum Opinion, also includes Plaintiff Newport News Shipbuilding and Dry Dock Company. Newport News later merged into a subsidiary of Northrup Grumman Corporation. *See Tenneco Auto. Inc. v. El Paso Corp.*, 2002 WL 453930, at *4 (Del. Ch. Mar. 20, 2002). References to the "Plaintiffs" include Newport News and New Tenneco, or depending upon timing, Tenneco Automotive and Pactiv.

[3] "El Paso" also refers to the other El Paso defendants: El Paso Natural Gas Company and El Paso Tennessee Pipeline Co.

[4] A typical policy insured "TENNECO INCORPORATED AND ALL AFFILIATED AND SUBSIDIARY COMPANIES AS AT INCEPTION OF THIS POLICY AND/OR AS HEREAFTER CONSTITUTED, OWNED OR CONTROLLED." In some instances, corporate entities within the Tenneco family were excluded by endorsement.

[5] The nominal policy amounts for policies subscribed by the London Insurers totaled approximately $1.5 billion.

[6] The Plaintiffs note that such policies carry two distinct advantages. First, occurrence-based policies, as contrasted with claims-made policies, apply to events that happened during the policy period – even if the claims do not arise for many years, a trait especially helpful for environmental and product liability risks. Second, an occurrence-based limit will allow for multiple claims based on separate

El Paso acquired what was left of Old Tenneco as the result of an auction process followed by ten days of hectic and contentious negotiations. El Paso understood that it would be acquiring most of Old Tenneco's historic, primarily environmental, liability exposure.[7] In its solicitation of prospective bidders for the energy business, Old Tenneco supplied a proposed draft of a document to define the rights of the parties to insurance coverage following the spin off and the merger.[8] Under the terms of this draft, El Paso would have had no right to the historic insurance coverage; instead, the coverage would have accrued to the benefit of New Tenneco. The draft provided in part:

> 3.9 Environmental Insurance Coverage Claims. Notwithstanding anything to the contrary contained herein, from and after the Termination Time no Energy Covered Person [El Paso] shall have the right to coverage in respect of, or to make or pursue any, Environmental Insurance Coverage Claims under any of the Common Policies. Tenneco shall (and shall cause each of its respective Covered Persons over which it has direct or indirect legal or effective control to) assign to Industrial Company [New Tenneco] all of its right, title and interest in and to its Environmental Insurance Coverage claims under the Common Policies and to execute all such

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occurrences; with an aggregate limit, regardless of the number of claims, once that limit is reached, no further coverage remains.

[7] The entities that were spun off were not without exposure, however. For example, Tenneco Automotive is dealing with groundwater contamination from a degreasing solvent that was used at its sites in Georgia, Nebraska, and Arkansas. It also is confronted with claims based on exposure to asbestos from its products. Pactiv has given notice to the London Insurers for potential liability (actually, it has spent more than $4 million) associated with the environmental remediation of a former manufacturing facility in Michigan. Newport News has risks involving its oil tankers, which typically remain in service for decades, and site pollution liabilities based on its long-term ship repair and maintenance work.

[8] DX 41.

> further documents as Industrial Company may reasonably request in connection therewith.[9]

Liability for Old Tenneco's discontinued operations, which would be acquired by El Paso, was estimated to be at least $500 million.

During the negotiation process, El Paso also learned of Old Tenneco's earlier settlements with the London Insurers regarding PCB and "pipeline" environmental claims. For present purposes, the most important aspect was the prediction that additional funding from the London Insurers would likely be accompanied by a demand for a "global release" or a "policy buyback."[10]

The negotiations leading to the agreement supporting the merger were difficult. El Paso's outside counsel, who had substantial experience with complex mergers and acquisitions, described them as "the most unpleasant process I have been involved in in 25 years."[11] He further observed that the Old Tenneco drafts of the transaction documents "were the most one-sided documents" that he "had ever seen" in his years in practice.[12]

Of all the documents comprising the merger agreement, the important one, for purposes of this proceeding, is the Insurance Agreement.[13] El Paso chose to

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[9] *Id.* at 11-12.
[10] Zerhusen Dep. at 217.
[11] Tr. at 759.
[12] *Id.* at 756.
[13] DX 42. The transaction was governed by the Distribution Agreement. PX 39. The Insurance Agreement was one of several constituent agreements and Exhibit H to the Distribution Agreement.

fight for two changes in the Insurance Agreement.[14] First, it wanted access to the historic coverage because it was accepting significant future liability exposure for the environmental consequences of Old Tenneco's discontinued operations.[15] Second, once El Paso secured access to the environmental coverage, attention turned to Section 3.2(d). The initial draft of this provision, in substance, would have required El Paso to use its best efforts to obtain replacement coverage on terms and conditions no less favorable to the insureds, if El Paso's coverage efforts exhausted the existing coverage, but with no limit on the cost of such replacement coverage.[16] Thus, El Paso sought and obtained a cap on its potential liability for replacement or reinstatement of exhausted coverage. Initially, Old Tenneco proposed a cap in an amount equal to 600% of the premiums on the exhausted coverage; El Paso negotiated that down to 350%.[17]

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[14] Tr. at 762-68

[15] Accordingly, after Old Tenneco relented, Section 3.9 of the initial draft, quoted above, was stricken.

[16] That draft imposed the same obligations on New Tenneco or Newport News if either were the party that exhausted the coverage at issue.

[17] El Paso's due diligence with respect to Old Tenneco's historic insurance coverage was paltry at best. This can be attributed, in part, to the short period devoted to negotiations. El Paso also suggests that Old Tenneco was less than forthcoming in providing access to the numerous policies. Regardless, El Paso went forward without having carefully evaluated the existing coverage.

Before the merger, El Paso did not seek to determine the original premiums for the policies that were subject to Section 3.2(d). Thus, although it had obtained a cap and negotiated a lower multiple (350% instead of 600%), it did not have an accurate understanding of the potential liability that might be associated with Section 3.2(d). As its mergers and acquisitions counsel agreed, El Paso "wanted Tennessee Gas Pipeline so badly that it entered into the deal without having a clue as to what the maximum exposure would be." Tr. at 774.

Accordingly, the principal final terms of Section 3.2(d) were that El Paso, if it exhausted a particular policy, would (i) use its best efforts (ii) to obtain replacement or reinstatement coverage on terms no less favorable to the insured but (iii) subject to a cap on expenditures equal to 350% of the relevant policy premiums. The duty to seek to obtain replacement or reinstatement coverage was assumed by the party which exhausted the applicable coverage. Although it was conceivable that New Tenneco or Newport News would incur the obligation, because the greatest exposure likely to give rise to claims under the policies was accepted by Old Tenneco and, as a result of the merger, acquired by the El Paso subsidiary, it was most likely that El Paso would be the party which exhausted coverage under Section 3.2(d). El Paso agreed to the terms of Section 3.2(d) of the Insurance Agreement, which provided:

> 3.2 *Coverage Under Occurrence-Based Policies.*
> (d) *Policy Limits*. Any Energy Covered Person [Old Tenneco or El Paso], Industrial Covered Person [New Tenneco] or Shipbuilding

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El Paso eventually did attempt to gain a rough understanding of the commitment that it had made. It made this effort, however, in early 2000, more than three years after it acquired Old Tenneco. El Paso asked its insurance broker, which had also provided brokerage services to Old Tenneco, to estimate the premiums for the policies that would become the subject of this litigation. When that estimate came back, El Paso estimated a potential maximum exposure under Section 3.2(d) of less than $3,000,000. PX 151; PX 177. Unfortunately, the estimate provided by the broker was awful. Although the parties dispute in detail and at length the proper measure of the premiums attributable to the policies at issue under this provision, El Paso concedes that the attributable premiums, subject to certain relatively minor downward adjustments, would be $2,860,000. Even after generous adjustments, this would leave cumulative policy premiums at, perhaps, $2.5 million; with a 350% cap, El Paso's potential exposure would be at least $8.75 million. In contrast, the Plaintiffs calculate El Paso's exposure to be in excess of $80 million.

Covered Person [Newport News] entitled hereunder to make or pursue a claim for insurance coverage under an Occurrence-Based Policy may claim for such insurance as and to the extent that such insurance is available up to the full extent of the applicable limits of liability under such Occurrence-Based Policy. Notwithstanding the foregoing, each of Tenneco, Industrial Company and Shipbuilding Company shall, to the extent any of its respective Covered Persons shall have exhausted all or any portion of the limits of liability, if any, under any Occurrence-Based Policy, use its best efforts to either (i) obtain and comply in full with the conditions required to effect the reinstatement of the full limits of liability under such Occurrence-Based Policy for all claims which would be covered thereby absent such exhaustion (including any pending or known claims) and be responsible for and pay all costs and expenses, including the amount of any resultant increase in the premium charged in respect of such Occurrence-Based Policy or any renewal thereof, in connection therewith, or (ii) obtain and maintain in full force and effect a Policy in replacement of the limits of liability exhausted under the Occurrence-Based Policy for all claims which would be covered thereby absent such exhaustion (including any pending or known claims), and be responsible for and pay all costs and expenses in connection therewith, which Policy shall provide at least the same coverage, and contain terms and provisions which are no less favorable to the insured parties, as existed under the Occurrence-Based Policy in respect of which such replacement is obtained, provided, however, that no party hereto shall be required to expend more than an amount equal to 350% of the original premium paid with respect to the portion of the limits of liability under such Occurrence-Based Policy (determined on a pro rata basis) exhausted by such party's respective Covered Persons to obtain reinstatement or a replacement Policy as contemplated hereby, it being understood that each party hereto shall nonetheless be required to obtain the maximum amount of reinstatement or replacement coverage available for such 350% premium amount in accordance with the terms and provisions of clauses (i) or (ii) hereof, as applicable. If at any time a party (an "Impairing Party") hereto becomes aware (such party being deemed to be aware whenever any of the directors or executive officers of such party or any other member of its respective Group become aware) of a claim or potential claim against any of such Impairing Party's respective Covered Persons which claim is reasonably likely to exhaust (but has not yet exhausted) all or any portion of the aggregate limits of liability, if any, under any Occurrence-Based Policy (a "Potential Impairment"),

> such Impairing Party shall promptly provide notice of such Potential Impairment to the other parties hereto. Such Impairing Party shall have five business days after providing such notice to elect to, at that time, either secure reinstatement of the limits of liability under such Occurrence-Based Policy (to the extent provided for therein) or purchase a Policy in replacement of such limits of liability (in each case in accordance with the terms and provisions of the second preceding sentence) in respect of such Potential Impairment (but shall not be required to so elect at such time). If such Impairing Party does not timely elect to secure reinstatement or replacement coverage, then either or both of the other parties hereto may elect to reinstate the limits of liability under such Occurrence-Based Policy (to the extent provided for therein) and pay all expenses incurred in connection therewith, provided, however, that if such Potential Impairment actually occurs, the Impairing Party shall reimburse the other parties for any fees and expenses incurred by such parties in connection with such reinstatement.[18]

How to implement this provision is one of the perplexing questions posed by this litigation.[19]

The Plaintiffs, which, of course, had all been a part of Old Tenneco at one time, and El Paso knew, before the merger, that El Paso would be confronting substantial claims arising principally out of Old Tenneco's discontinued operations. Indeed, the proxy statement issued jointly by El Paso and Old Tenneco to secure approval of the restructuring described in some detail the environmental risks associated with Old Tenneco's business. These claims implicated Old Tenneco's historic coverage, including its coverage through the

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[18] PX 42.

[19] That application of Section 3.2(d) is difficult would come as no surprise to Newport News. Its insurance brokers were asked to review the Insurance Agreement before execution, and Newport News received the advice that Section 3.2(d) was "at best, unworkable." Tr. at 325. It does not appear that Newport News acted on this expression of concern or forwarded it to the other parties to the Insurance Agreement.

London Insurers. Because of Old Tenneco's experience in resolving its "pipeline" environmental insurance claims a few years earlier, which had resulted in the recovering from the London Insurers of approximately [redacted] the parties recognized that it could be expected that the London Insurers would require a release or policy "buyback" in order to resolve the coverage issues related to Old Tenneco's discontinued operations. Moreover, during the transition period leading up to and following the merger, representatives of New Tenneco encouraged El Paso to pursue coverage claims.

The insurance coverage provided to Old Tenneco by the London Insurers is evidenced by some 186 policies (the "Subject Policies") which are at issue in this proceeding.[20] These policies are all "excess" policies: there are other policies which absorb the first tier (and possibly other lower tiers) of risk. Unless a claim presents significant exposure, the Subject Policies would not be called upon by the insureds to defend or to pay any claim. As noted, because El Paso had accepted the liability for Old Tenneco's discontinued operations, principally liabilities arising out of existing or potential environmental claims, the policies had special significance for El Paso.

On November 14, 1997, less than a year after the merger, El Paso filed an insurance coverage action, captioned *Kern County Land Co. v. California Union*

[20] The Plaintiffs are insureds under the Subject Policies.

*Insurance Co.*[21] ("*Kern County*") in California against many carriers, including the London Insurers.

Representatives of El Paso traveled to London on a number of occasions in an effort to settle the coverage litigation with the London Insurers. During two of these visits, representatives of El Paso had dinner with David Zerhusen, then in-house counsel for Tenneco Management Company.[22] During the dinners, the status of the *Kern County* litigation was discussed, including the possibility that any settlement might result in policy buybacks. Mr. Zerhusen reviewed these discussions with in-house and outside counsel for New Tenneco. No representatives of New Tenneco who learned that El Paso was involved in negotiations that could lead to policy buybacks ever expressed any objections about this approach to El Paso.

The negotiations between El Paso and the London Insurers would consume almost two years. The London Insurers responded to El Paso's initial settlement entreaties with a demand for "a full policy buy-back of all claims in all London policies."[23] El Paso, emphasizing the per-occurrence nature of its available

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[21] California Superior Court, San Francisco County, Case No. 991097 (DX 82). Because of a similarity in issues between *Kern County* and litigation brought several years earlier by Old Tenneco in Louisiana regarding coverage of PCB claims, counsel for both New Tenneco and El Paso cooperated on matters of mutual interest through early 1998 with respect to both proceedings. At some point, the claims remaining from the Louisiana action were transferred for resolution in *Kern County*.

[22] One dinner was also attended by another of Tenneco Automotive's in-house attorneys, one who would soon become its general counsel.

[23] PX 49 at EP0007810.

coverage, offered a settlement of [redacted] in the fall of 1998. By March 2000, the London Insurers were proposing [redacted] as a compromise and El Paso had reduced its demand to [redacted]. Despite the gulf between them, they turned to drafting the other terms of the settlement agreement. El Paso's counsel prepared the initial draft. It provided a broad release by El Paso, which was defined to include the Plaintiffs.[24] That initial draft also provided the London Insurers with a broad indemnification against claims brought by "any person claiming to be insured under the Subject Insurance Policies."[25] Furthermore, it expressly addressed the question of policy exhaustion by providing that "all limits of liability under the Subject Insurance Policies, including (without limitation) all per-occurrence and aggregate limits of liability under the Subject Insurance

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[24] The term "El Paso" shall mean:

> (i) El Paso; its predecessors; all its past and present subsidiaries and the predecessors and successors of such subsidiaries; their past and present affiliates and joint ventures and their predecessors and successors; and all their past and present assigns;
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> (ii) any other entity that was in the past or is now affiliated with, related to or associated with El Paso, including any corporations that have been acquired by, merged into or combined with El Paso or its predecessors, or El Paso's past and present subsidiaries, affiliates, successors and assigns; and
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> (iii) any and all entities named as additional insureds, or otherwise insured or claimed to be insured under the Subject Insurance Policies . . .

PX 147 at EP015358. Thus, the defined term El Paso included the Plaintiffs both as prior affiliates of El Paso/Old Tenneco and as insureds under the policies.

[25] *Id.* at EP015361

Policies are exhausted."[26] Counsel for the London Insurers, in reviewing the draft, struck the provision regarding exhaustion because he "did not believe that the settlement agreement would exhaust limits."[27] El Paso's counsel then focused on the draft's definition of El Paso and the related indemnification and release provisions. He explained that El Paso could not release the claims of the Plaintiffs because it did not control them.[28] Nonetheless, counsel for the London Insurers informed El Paso "that the London Market expected that El Paso would release all the rights and the policies that it was authorized to release and would indemnify – give a full indemnity back to the London Market for any claims it couldn't release."[29]

El Paso and the London Insurers concluded their negotiations with the Confidential Settlement Agreement and Release (the "Settlement Agreement").[30] It was executed on behalf of the Lloyd's Underwriters on December 22, 2000, and the London Companies on March 1, 2001. Although El Paso had claimed damages in excess of [redacted], it settled for a payment of approximately [redacted] Under the Settlement Agreement, El Paso[31] released the listed London

[26] *Id.* at EP015365.
[27] Cosgrove Dep. Vol. II at 140.
[28] Osborne Dep. at 131.
[29] Cosgrove Dep. Vol. II at 132-33.
[30] PX 169.
[31] The definition of El Paso remained substantially as set forth in the draft, *i.e.*, it included the Plaintiffs. Specifically, it provides:

> The term "El Paso" shall mean:
>
> (i) El Paso Energy Corporation, formerly known as El Paso Natural Gas Company, its predecessors and successors, all its

Insurers[32] upon payment[33] from all remaining obligations under the Subject Policies.[34]

The Settlement Agreement resolved claims not only under historic Tenneco coverage, but also under separate El Paso coverage. As an indication of the relative amounts of coverage at issue, as between Old Tenneco and the other El Paso entities, a comparison of the limits of the policies at issue reveals that Old Tenneco accounted for approximately 52% of the policy limits addressed by the Settlement Agreement. Thus, one very rough measure of El Paso's recovery under the Old Tenneco policies would be 52% of the [redacted], or slightly less than [redacted].

El Paso was motivated, in part, to achieve a settlement by the deteriorating financial conditions of the London Insurance Market. El Paso, in accord with

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past and present subsidiaries and the predecessors and successors of such subsidiaries, its past and present affiliates and joint ventures and their predecessors and successors, and all its past, present and future assigns; and,

(ii) any other entity including any corporations, that have been acquired by, merged into or combined with El Paso, and,

(iii) any and all entities named as insureds, other insureds, or otherwise insured or claimed to be insured under the Subject Insurance Policies and those entities', subsidiaries', affiliates', and assigns' directors, officers, agents and employees;

*Id.* at 2. Thus, the defined term El Paso still included the Plaintiffs both as prior affiliates of El Paso/Old Tenneco and as insureds under the policies.

[32] The list is Attachment B to the Settlement Agreement.

[33] The respective payment obligations of the settling subscribers are listed on Attachment D to the Settlement Agreement.

[34] The Subject Policies are listed on Attachment A to the Settlement Agreement.

many insurance experts, recognized that assurance of a reduced payment might be a better bargain than an uncertain litigation effort subject to collection impairment.

Under the terms of the Settlement Agreement, El Paso agreed to release the settling London Insurers from any further liability under the Subject Policies and to indemnify them for any claims that might be brought under those policies. The Settlement Agreement provided in part:

> 4. **Release**
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> A. Release of London Market Insurers by El Paso. Upon El Paso's receipt of each London Market Insurer's allocated several share of the Settlement Amount, El Paso . . . shall be deemed to remise, release, covenant not to sue and forever discharge the following: (a) the London Market Insurer making such payment; . . . as follows: from and against all manner of action, causes of action, suits, debts, accounts, promises, warranties, damages (consequential or punitive), agreements, costs, expenses, claims or demands whatsoever, in law or in equity, whether presently known or unknown, asserted or unasserted, whether sounding in tort or contract, or arising under the statutes or administrative regulations of any jurisdiction, with respect to any and all past, present or future claims, of any type whatsoever, that El Paso ever had, now has, or hereafter may have: (1) for insurance coverage, including both defense costs and indemnification claims, with respect to the Subject Insurance Policies; or (2) arising out of or relating to any act, omission, representation, or conduct of any sort in connection with the Subject Insurance Policies.
>
> It is the intention of El Paso to reserve no rights or benefits whatsoever under or in connection with the Subject Insurance Policies with respect to any past, present or future claims and to assure the settling London Market Insurers their peace and freedom from such claims and from all assertions of rights in connection with such claims.

Upon El Paso's receipt of each London Market Insurer's allocated several share of the Settlement Amount, any and all rights, duties, responsibilities and obligations of such London Market Insurers created by or in connection with the Subject Insurance Policies are hereby terminated. As of the date of such payment, El Paso has no insurance coverage under the Subject Insurance Policies. This release is intended to operate as though the London Market Insurers that pay their allocated several share of the Settlement Amount had never subscribed to the Subject Insurance Policies.

This Release extends to all those Underwriters at Lloyd's that subscribed to any of the Subject Insurance Policies. . . .

This Release also extends to Equitas Reinsurance Limited and Equitas Limited. . . .

. . . .

6. **Indemnification**

El Paso shall defend, indemnify and hold harmless those London Market Insurers identified in Attachment B hereto that make the payment called for in Attachment D hereto, in respect of any and all claims arising under or relating in any way to the Subject Insurance Policies, including all claims, whether by direct action or otherwise, made by: . . . (b) any Person claiming to be insured, or otherwise entitled to rights, under the Subject Insurance Policies, (c) any Person who has made, will or can make a claim under the Subject Insurance Policies, and (d) any Person who has, or claims to have, acquired or been assigned the right to make a claim under the Subject Insurance Policies. The Parties acknowledge that this indemnification includes claims made by any Person over whom El Paso does not have control, including former subsidiaries, predecessors in interest, sellers or purchasers of assets, or any other Person who asserts rights to coverage under the Subject Insurance Policies. . . .

There was no specific agreement between El Paso and the London Insurers that "any limit in any policy ha[d] been exhausted."[35] Furthermore, the Settlement Agreement does not allocate proceeds to any particular policy or limits.[36]

On February 12, 2001, some 50 days after executing the Settlement Agreement, after receiving an initial [redacted] payment from the London Insurers, and after having purported to release many of the London Insurers, El Paso forwarded to New Tenneco and Newport News, with a copy to Pactiv, a "Notice of Impending Exhaustion of Occurrence-Based Excess Insurance Limits of Liability" (the "Notice"), which provided in part:

> Pursuant to the Insurance Agreement . . . notice is hereby given of the anticipated exhaustion and release of certain insurance policies originally issued to Tenneco Inc. El Paso . . . has made certain claims and filed a declaratory judgment action against historic insurers of El Paso Natural Gas, Tenneco and their predecessors relating to the substantial environmental liabilities of El Paso Natural Gas and of the former Tenneco Inc. that were retained by El Paso under the 1996 merger. Please be advised that as a result of this litigation, El Paso has entered into a settlement agreement with Lloyd's of London and the London Market Insurers ("London Market") that, among other things, *will result in the exhaustion and release of historic Tenneco Inc. insurance coverage* potentially

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[35] Cosgrove Dep. Vol. II at 159-60.

[36] The Settlement Agreement did not purport to resolve all claims under the Subject Policies. It did not address the continuing responsibility of the solvent London Insurers who did not join in the Settlement Agreement or the coverage that had been provided by the non-London Insurers. In addition, it did not address the status of certain insolvent London Insurers who may be funding coverage pursuant to some plan of arrangement. The Subject Policies still exist; there are subscribers liable for claims under the Subject Policies; and some coverage obligation under the Subject Policies remains. Whether any claim will ever be paid under the Subject Policies because of the unwillingness or inability of the remaining subscribers to pay is a different question.

available to El Paso as well as other insureds formerly related to Tenneco Inc.

As you may know, the London market and, in particular, Equitas are in the process of resolving their exposure to long-tailed liability under occurrence-based policies issued prior to the mid-1990s. There is a diminishing pool of assets from which insureds may be able to recover under the historic policies. The liquidity of the underwriting syndicates is questionable, and many are in schemes of arrangement for payment of debts to insureds. We understand that the London Market is not issuing any new coverage containing terms and conditions equivalent to those found in the historic policies.

Under the Insurance Agreement, El Paso is entitled to pursue insurance coverage issued to Tenneco Inc. with respect to the substantial environmental liabilities that face El Paso, to the full extent of the limits of liability under the historic policies. As part of the settlement of these claims, pre-1993 excess level insurance coverage issued by the London Market to Tenneco Inc. will be exhausted and released. Pursuant to Paragraph 3.1(d) of the Insurance Agreement, El Paso's only obligation is to attempt to reinstate the coverage, which is impossible given the London Market's current posture, or to obtain replacement insurance with the same coverage, terms and conditions as the original policies. This obligation, however, is limited to the expenditure of 350% of the original premiums paid with respect to the limits of liability being exhausted.

We have been unable to locate comprehensive records of the premiums paid for excess London Market coverage to which Industrial and Shipbuilding may have rights. Tenneco's historic brokers, Marsh, have advised us regarding the approximate cost, on a historic and average basis, for that coverage. Using this information, we believe that 350% of the total premiums with respect to the coverage being exhausted, for the period that predecessors of the Industrial and Shipbuilding companies were part of the Tenneco organization and prior to the institution of absolute pollution exclusions, would total less than $3,000,000.[37]

[37] PX 177 (emphasis added).

The Plaintiffs, after asking for a copy of the Settlement Agreement and being told that it was unavailable because it was confidential, filed this action and now seek a declaration as to their rights under the Insurance Agreement and the Settlement Agreement.[38]

El Paso and the London Insurers, shortly before trial, filed the following stipulation (the "Stipulation"):

> 1. The Confidential Settlement Agreement And Release (hereinafter "Agreement") dated December 22, 2000 by and between El Paso Corporation and Certain Underwriters at Lloyd's, London, and Certain London Market Insurance Companies does not release any rights or obligations of Tenneco Automotive, Inc., Pactiv Corporation or Newport News Shipbuilding, Inc. under the Subject Insurance policies as defined in the Agreement.[39]

**II.**

The Plaintiffs ask for a declaratory judgment to the effect that the Settlement Agreement did not impair their rights under the Subject Policies. They argue that the Insurance Agreement did not empower El Paso to erase their rights under the Subject Policies and that El Paso did not exhaust the individual coverages of the various policies. Alternatively, the Plaintiffs invoke Section 3.2(d) of the Insurance Agreement and seek an order requiring El Paso to purchase replacement or reinstatement insurance for the coverage which they lost by spending up to $80.33 million, which they claim is 350% of the original

[38] Initially, the Plaintiffs asked for a preliminary injunction against El Paso's entry into the Settlement Agreement. After litigation was commenced, the Plaintiffs learned that the Settlement Agreement had already been executed, and they abandoned their efforts to obtain interim injunctive relief.
[39] PX 205.

premiums spent to procure the Subject Policies. They also look to the Court for assistance in compelling El Paso to provide appropriate notice of actions which it may take with respect to Old Tenneco's historic insurance coverage. Finally, they petition for an award of attorneys' fees and expenses under a contractual provision which requires El Paso to indemnify them for any "indemnifiable loss" arising out of a breach of the Insurance Agreement by El Paso. "Indemnifiable loss" is defined to include reasonable attorneys' fees.

El Paso raises several arguments in its defense. First, it argues that it had (and used) the right to exhaust coverage (or, perhaps more accurately, to have coverage "deemed exhausted") under the Subject Policies. This, according to El Paso, is demonstrated not only by the terms of the governing documents but also by the parties' course of dealing. Second, it asserts that it need not procure replacement or reinstatement coverage because no coverage can now be obtained on "terms no less favorable to the insured," a condition to any duty to substitute coverage. Third, Tenneco Automotive and Pactiv are said to have acquiesced in El Paso's approach to the Insurance Agreement and its efforts with respect to the Settlement Agreement. Fourth, El Paso, after assuming for argument's sake that a premium calculation is necessary for purposes of replacement coverage, concludes that the maximum premium allocable to the Subject Policies would be approximately $2,800,000. Finally, El Paso questions the appropriateness of a declaratory judgment and its proper scope.

The London Insurers maintain that they have not avoided any obligations to the Plaintiffs. They also argue that certain policies issued directly to Newport News (and not to Old Tenneco) should not be part of any order that the Court might enter.

## III.

### A.

This is a case about contracts. The analytical framework for analyzing a contract is not debated.[40] At the outset, the Court reviews the contract language to determine if the intent of the parties can be determined from the express words which they chose or whether the contract is ambiguous.[41] Extrinsic evidence may not be employed to ascertain intent unless the contract is ambiguous, and, of course, extrinsic evidence may not be used to create that ambiguity.[42] A contract will be considered ambiguous if it is "reasonably or fairly susceptible of different interpretations or may have two or more different meanings."[43] If the contract language chosen by the parties is ambiguous, the Court will then consider objective extrinsic evidence including: "the overt statements and acts of the

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[40] The Insurance Agreement is governed by the laws of Delaware; the Settlement Agreement is governed by the laws of California. The parties have not identified any differences between the laws of the two states that are material to the Court's decision.

[41] *Supermex Trading Co., Ltd. v. Strategic Solutions Group, Inc.*, 1998 WL 229530, at *2-*3 (Del. Ch. May 1, 1998).

[42] *Eagle Indus., Inc. v. DeVilbiss Health Care, Inc.*, 702 A.2d 1228, 1233 (Del. 1997); *Cincinnati SMSA, L.P. v. Cincinnati Bell Cellular Sys. Co.*, 708 A.2d 989, 993 n.19 (Del. 1998).

[43] *Rhone-Poulenc Basic Chems. Co. v. Am. Motorists Ins. Co.*, 616 A.2d 1192, 1196 (Del. 1992).

parties, the business context, prior dealings between the parties, and other business customs and usage in the industry."[44]

B.

El Paso also invokes the principle of *contra proferentem* under which ambiguous terms will be construed against the drafter who was exclusively responsible for the terms chosen.[45] If the Court is able, by employing the doctrine of *contra proferentem*, to determine the intent of the parties to the contract, resort to extrinsic evidence is unnecessary.[46] Application of "the rule of contra proferentem is one of last resort. . . . [T]he justification for applying such rule pales in a situation, like the instant one, where the terms of an agreement resulted from a series of negotiations between experienced drafters. Where all parties to a contract are knowledgeable, there is no reason for imposing sanctions against the party who drafted the final provision."[47] Although many provisions of the Insurance Agreement are the same as those in the initial draft prepared by counsel for New Tenneco, the final product was the result of negotiations between sophisticated parties advised by sophisticated counsel. Indeed, El Paso made a conscious decision as to which terms it selected to negotiate. There is no evidence from which the Court can conclude that El Paso, if it had taken the time or had the

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[44] *Bell Atl. Meridian Sys. v. Octel Communications Corp.*, 1995 WL 707916, at *6 (Del. Ch. Nov. 28, 1995).
[45] *See, e.g., SI Mgmt., L.P. v. Wininger*, 707 A.2d 37, 43 (Del. 1998).
[46] *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392, 397 (Del. 1996).
[47] *E.I. du Pont de Nemours & Co. v. Shell Oil Co.*, 498 A.2d 1108, 1114 (Del. 1985) (citations omitted).

inclination, would not have been able to negotiate for other words or terms in the Insurance Agreement. Indeed, as this Court has recognized, the *contra proferentem* doctrine is typically applied in cases "involving an adhesion or otherwise standardized contract where the non-drafting party had little or no chance to provide input as to the language contained therein."[48] Accordingly, the doctrine of *contra proferentem* is of little help to the Court in its current efforts. Thus, "the meaning of the . . . provision[s at issue] should not turn on who drafted [the words], but rest on the interpretation of the words that is most reasonable in all of the circumstances."[49]

C.

Although these proceedings have emerged out of the contractual relationship established by the Insurance Agreement between the Plaintiffs and El Paso, it is necessary, first, to ascertain the consequences of the Settlement Agreement on the rights of the Plaintiffs.

Through the Settlement Agreement, El Paso purported to release not only its rights but also the Plaintiffs' rights to future coverage under the Subject Policies. The Plaintiffs argue, however, that the Insurance Agreement does not empower El Paso to release their rights.[50] Without such authority, the effort to

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[48] *Wilmington Firefighters Ass'n. Local 1590 v. City of Wilmington*, 2002 WL 418032, at *10 n.51 (Del. Ch. Mar. 12, 2002).

[49] *Id.*

[50] It appears that the London Insurers, even before entering into the Settlement Agreement, doubted El Paso's capacity to release the rights of the Plaintiffs. *See* Cosgrove Dep. Vol. II at 132-33. Of course, if El Paso is obligated under the

release the London Insurers on behalf of the Plaintiffs fails. Although El Paso in the Notice advised the Plaintiffs, and in its Answer asserted, that the rights of the Plaintiffs had been released through the Settlement Agreement,[51] it and the London Insurers have conceded in the Stipulation that El Paso, by the Settlement Agreement, did not release any rights of the Plaintiffs under the Subject Policies.

The concession that the Plaintiffs' rights under the Subject Policies were not released presents something of a quandary. If the Plaintiffs have rights to coverage under the Subject Policies and the London Insurers are indemnified by El Paso for any claim that the Plaintiffs might assert under the Subject Policies, has El Paso become the Plaintiffs' *de facto* insurer under the terms of the Subject Policies? El Paso's obligation, if any, to indemnify the London Insurers is not a topic of this litigation. However, it is a problem that looms behind El Paso's efforts to demonstrate both that it successfully limited the rights of the Plaintiffs under the Subject Policies as against the settling London Insurers and that it had the power to accomplish that result.

D.

The Court's inquiry, thus, turns to an assessment of how the Settlement Agreement may have affected the rights of the Plaintiffs under the Subject Policies if those rights were not released. El Paso contends that, as the result of its good

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Settlement Agreement to indemnify the London Insurers against claims of other insureds, such as the Plaintiffs, under the Subject Policies, this would not be a matter of much concern to the London Insurers.

[51] PX 177 at EP016850; PX 286 ¶ 40.

faith settlement efforts, it had the right to exhaust certain subscription and financial obligations of the London Insurers, with whom it settled, under the Subject Policies. The difficulty with El Paso's argument is a fundamental one. The Settlement Agreement does not speak of exhaustion or the grant of any other potential benefit to the settling London Insurers. The settling London Insurers obtained a release from El Paso, and that is all that can be fairly read from the Settlement Agreement.

The parties use the terms release, exhaustion, and deemed exhaustion. The concepts that these terms represent are important and at times may have been used imprecisely. Moreover, the meanings of these terms may, in some instances, vary with the circumstances, particularly here in the context of the London Insurance Market. The Subject Policies were not issued by one insurance company which had full responsibility for any claim (even if it shifted, for its purposes, some of the risk to a reinsurer). Instead, subscribers to those policies accepted the premium payments and took the risks. El Paso, for that reason, did not settle with one insurer; instead, the Settlement Agreement purports to release the "solvent and participating subscribers to the [Subject Policies]," which number approximately 184.[52] In general, a release is understood to be the abandonment of a claim,

[52] *See* Settlement Agreement, PX 169, Attach. B. By contrast, there are some 68 "insolvent and non-participating subscribers." *Id.*

whether actual or potential.[53] As to exhaustion, the former risk manager for Old Tenneco testified:

> I think "exhaustion" in insurance language has a very specific meaning. It means exhaustion of an aggregate. The term "exhaustion," as I understand it, does not refer to anything other than an aggregate. But it is possible for there to be an extra contractual release, not a term of the policy, which, for consideration, the insured may agree to release the insurer from future responsibilities under the policies.[54]

Thus, "exhaustion" of insurance coverage, for example, would occur when payments on an insured's claim reach policy limits. The phrase "deemed exhaustion" is one of convenience that is best described as an agreement to treat a subscriber's coverage obligation as fully paid even though the subscriber did not pay the maximum amount possible under the policy and the insured was not, in fact, paid the policy limits.[55] Here, these terms are employed by the parties in their efforts to describe the substance of the settlement which El Paso reached, not so much as to the policies as a whole, but with respect to the obligations of the various subscribers to the Subject Policies who constitute the settling London

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[53] 15 LEE R. RUSS & THOMAS F. SEGALLA, COUCH ON INSURANCE 3d § 216:3 (2001).

[54] Tr. at 226.

[55] One can debate the distinction between a release and a "deemed exhaustion" in these circumstances. If a release and a "deemed exhaustion" are the same, then El Paso's concession that the Settlement Agreement did not affect a release also would lead to the conclusion that it did not accomplish a "deemed exhaustion." If they are, as is the more likely outcome of this debate, different, then the Settlement Agreement, written in the language of release without any reference to exhaustion, deemed or otherwise, does not account for the concept of exhaustion and affords the Court no basis for imposing such limitations on the Plaintiffs' rights under the Subject Policies.

Insurers. It is important to recognize that "[t]here also is a distinction between a release and a 'settlement' or 'compromise,' the latter being agreements to terminate claims which are unliquidated or disputed in good faith."[56] In this instance, the Settlement Agreement includes a release running to the settling London Insurers, a release running to El Paso, a commitment to make certain payments, an indemnification provision for the benefit of the settling London Insurers, and a dispute resolution mechanism. Thus, it is broader than a mere one-way release. Whether it can be read, as a whole,[57] to exhaust in any manner the coverage obligations of the settling London Insurers is the question.

El Paso argues that the words chosen by El Paso and the London Insurers under the heading of "Release" accomplished something – in the nature of exhaustion – in addition to a release. It draws the substance of its argument from the third paragraph of Section 4(A) (captioned, "Release of London Market Insurers by El Paso") of the Settlement Agreement. There, the obligations of the settling London Insurers under the Subject Policies are "terminated," and, as a result, "El Paso [defined to include the Plaintiffs] has no insurance coverage under

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[56] 15 COUCH ON INSURANCE 3d § 216:4. This treatise follows with an apt observation:

> Distinctions as subtle as these are often missed in the practical world of litigation, and it is not uncommon to find the terminology confused in case opinions and other writings. For most practical purposes, it suffices to recognize that a "settlement" is generally a broader concept which may employ as components the devices of releases, covenants not to sue, or promises to discontinue a pending suit.

*Id.*

[57] *See, e.g., Kaiser Aluminum Corp.*, 681 A.2d at 395.

the Subject Insurance Policies." That language is not inconsistent with the concept of exhaustion, but it is also consistent with a carefully drafted release expressly setting forth its practical consequences. El Paso's argument, however, is undercut by the next three sentences in Section 4(A) – all of which begin with the words, "[t]his Release."[58] At best, from El Paso's standpoint, the language is ambiguous[59] – language that El Paso negotiated, but the extrinsic evidence does not lead to anything other than a release. El Paso knew how to incorporate exhaustion (or "deemed exhaustion" language) and did not. In addition, the drafters of the Settlement Agreement did not believe they were drafting a document to effect an "exhaustion." The early draft expressly provided for "exhaustion," but that concept was deleted during negotiations. Many of the Subject Policies had no aggregate limits[60] and there was no effort to allocate the payments to any policy. Finally, counsel for the London Insurers anticipated, from the perspective of his clients, a release, whether or not El Paso had authority, but with the backup protection of El Paso's indemnification. All of these factors support the conclusion that the parties used the release mechanism to settle El

[58] This is not a function of giving weight to the heading of the section even though the Settlement Agreement does not contain the familiar advice that headings are for convenience only. It is simply that if a drafter keeps repeating the word "release," maybe the reader should take him at his word.

[59] It is this ambiguity that allows, or perhaps requires, the Court to consider the extrinsic evidence.

[60] The parties debate at some length whether the Subject Policies can be characterized as without aggregates. Some may have aggregates and some may incorporate limits from a lower tier of coverage. It is clear, however, that many of the Subject Policies can fairly be said to have no aggregate limits.

Paso's claims and did not "exhaust" the various coverages. Thus, the Settlement Agreement, even when the focus is on a relatively narrow portion of the "release" provision, does not sustain the conclusion that the policies were "exhausted" or could be "deemed" to have been "exhausted."

To understand El Paso's argument better, a review of the Insurance Agreement may be helpful. By Section 5.1, El Paso was given responsibility for "Claims Administration" of any of its claims. "Claims Administration" is defined to include "the management, defense and settlement of claims." Under Section 3.2(d) of the Insurance Agreement, El Paso (or, for that matter, the Plaintiffs) could pursue a coverage claim "to the extent that such insurance is available up to the full extent of the applicable limits of liability." That section also acknowledges that El Paso's coverage efforts may "exhaust[] all or any portion of the limits of liability." Thus, the Insurance Agreement empowered El Paso to pursue coverage claims and to exhaust the limits of liability under the Subject Policies. There is, however, nothing in the Settlement Agreement to reflect that any such exhaustion (or "deemed exhaustion") of either all or any portion of the liability limits is what the London Insurers and El Paso agreed to under the Settlement Agreement.[61]

[61] The Settlement Agreement identifies the policies for which the settling London Insurers are released from liability. The Settlement Agreement does not reflect any particular payment under any particular policy and does not apply any particular payment against any particular policy limit.

El Paso points out that New Tenneco and Newport News should have been aware of the concept of "deemed exhaustion" because, in 1993, Tenneco agreed to a "deemed exhaustion" of certain of its policies issued by Travelers Indemnity Company Company and Continental Casualty Corporation.[62] That there can be a "deemed exhaustion" does not determine that either the Settlement Agreement effected a "deemed exhaustion" or that El Paso was authorized under the Insurance Agreement to agree to a "deemed exhaustion" that would, in effect, preclude the Plaintiffs from the benefits of those policy limits that El Paso would treat as "deemed exhausted." Indeed, the example cited by El Paso shows how to accomplish a "deemed exhaustion" if that is the intent of the parties to an agreement. Yet, El Paso, in its negotiations of the Settlement Agreement, did not follow the rubric which it has so vigorously brought to the Court's attention.

The Stipulation establishes that no rights of the Plaintiffs under the Subject Policies were released by the Settlement Agreement. Because all rights of the Plaintiffs to coverage to be provided by the subscribers to the Subject Policies were through those policies, it is equally clear that no rights of the Plaintiffs against the settling London Insurers were released either. Based on the language of the Settlement Agreement and the extrinsic evidence, there was no exhaustion,

[62] For example, one of those agreements provided: "All of the limits of liability (per occurrence, aggregate and otherwise) under the Policies are hereby deemed to be exhausted with respect to coverage for all Pipeline Environmental Claims . . ." PX 26 at 9; *see* DX 2 at 8. This settlement was for claims involving that portion of Old Tenneco which would ultimately become part of El Paso.

deemed or otherwise.[63] If the Plaintiffs' rights under the Subject Policies were not released and if the coverage (or any portion thereof) was not exhausted, whether deemed or otherwise, their rights under the Subject Policies were not impaired by the Settlement Agreement. In light of the Stipulation of El Paso and the London Insurers that the Plaintiffs' rights were not released and in light of the Court's finding that the Subject Policies were not "exhausted," the Court concludes that the Settlement Agreement, by its terms, did not impair the rights of the Plaintiffs under the Subject Policies.[64]

E.

El Paso next launches a multi-component argument relying upon notions of waiver, acquiescence, and estoppel. Perhaps it would be more accurate to characterize El Paso's argument as one supporting its interpretation of the

[63] The Court makes this finding as if the burdens of proof and persuasion were on the Plaintiffs.

[64] El Paso, as reflected in the Notice, believed that its resolution of claims against the settling London Insurers would deprive the Plaintiffs of any further benefit from the settling London Insurers under the Subject Policies. It obviously was cognizant of the Insurance Agreement: why else would it have endeavored to estimate its potential liability for procuring replacement insurance? It now concedes that it did not release the rights of the Plaintiffs. That begs the question: if it was somehow "exhausting" the available coverage from the settling London Insurers, why did El Paso not make that clear in the Settlement Agreement? Because of the language employed in the Settlement Agreement, it may be left with nothing more than an argument that a release is more than a release. The answer, to complete the circle, may be that El Paso, again as evidenced by the Notice and its Answer filed in this proceeding, thought that it had the authority at the time to release the Plaintiffs' rights (although this is at odds with the understanding of both its outside counsel who negotiated the Settlement Agreement and counsel for the London Insurers). The solving of this puzzle is not required to dispose of the matters before the Court.

Settlement Agreement and the Insurance Agreement in light of the conduct of New Tenneco.[65] El Paso points out: (i) New Tenneco knew that El Paso was pursuing (indeed, because it had acquired Old Tenneco's liabilities, it had to pursue) coverage claims; (ii) New Tenneco knew that El Paso had sued and was negotiating a settlement with the London Insurers; (iii) the London Insurers, particularly after earlier compromises with Old Tenneco, would be difficult to deal with; (iv) a successful negotiation could be expected to require policy buybacks; and (v) because of the nature of the claims and the London Insurers' liquidity problems, New Tenneco understood that El Paso would be required to compromise its claims, (*i.e.*, settle for less than the maximum coverage theoretically available).[66] It also notes that Old Tenneco, before its breakup, had negotiated insurance settlements along the lines that El Paso would follow in its compromise with the London Insurers. With this background, El Paso contends

[65] The facts which form the foundation of El Paso's acquiescence argument may also be viewed as additional extrinsic evidence demonstrating a course of conduct by some of the parties to the Insurance Agreement that would demonstrate their understanding of the Insurance Agreement and reflect their likely intentions for its implementation. While such evidence might well be helpful in understanding the Insurance Agreement, if it is ambiguous, with respect to the Settlement Agreement, it may tend to help with understanding El Paso's intentions, but it is of limited value in ascertaining the London Insurers' intentions. A small quantity of the extrinsic evidence, such as the expression by the London Insurers that policy buybacks would be necessary, may relate to the meaning of the Settlement Agreement. In light of the Court's conclusions, it is not necessary to reach the question as to whether the course of dealing between the Plaintiffs and El Paso provides help in understanding the Settlement Agreement, an agreement to which the Plaintiffs, of course, are not parties.

[66] For these purposes, New Tenneco includes both Tenneco Automotive and Pactiv, which by the time of the Settlement Agreement were separate entities. El Paso does not contend that this line of argument fairly reaches Newport News.

that New Tenneco acquiesced in the Settlement Agreement and the buyback of coverage (or, exhaustion of limits) from the settling London Insurers.

> Acquiescence, which conceptually is best viewed as a subset of waiver,[67]
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> > arises when a party complaining of an act (1) has full knowledge of his rights and all material facts and (2) remains inactive for a considerable time, or freely gives recognition to the act, or conducts himself in a manner inconsistent with any subsequent repudiation of the act, thereby leading the other party to believe that the act has been approved.[68]

The simple answer to El Paso's argument is that New Tenneco did not have sufficient knowledge before receipt of the Notice to be charged with acquiescence. Shortly after receipt of the Notice, this action was commenced. Such prompt action following acquisition of the necessary knowledge cannot form the basis of an acquiescence defense. However, something more than this simple answer is called for.

New Tenneco knew that El Paso would pursue the London Insurers, that it was negotiating with them, and that policy buybacks were likely. Whether that knowledge came from an appreciation of El Paso's predicament (large exposure desperately seeking covering), social conversations over dinner in London, or an understanding of the London Insurance Market's financial problems, New Tenneco did not know when a settlement would (if it could) be reached, what the precise terms would be, or how its interests might be specifically affected.

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[67] *Cantor Fitzgerald L.P. v. Cantor*, 724 A.2d 571, 584 n.44 (Del. Ch. 1998).

[68] DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 11-3 at 11-12 (2004).

Perhaps, it could have guessed accurately, but accurate guessing is not a substitute for the knowledge that is required before one can be deemed to have acquiesced.

El Paso has another prong to its acquiescence argument. In 1998, El Paso worked a settlement with Republic Insurance Company ("Republic") that was similar to the one reached with the London Insurers, although the settlement with Republic, at least to an extent, sought to allocate proceeds to particular policies and it purported expressly to exhaust coverage under one policy.[69] New Tenneco did not object to the settlement, and El Paso argues that, in the absence of an objection regarding that settlement, it was reasonable for it to proceed with the London Insurers on a similar basis. First, the Republic settlement involved a smaller aliquot of coverage than did the London Insurers' settlement. The failure to assert one's rights vigorously in a small matter will not generally preclude assertion of such rights in a separate and larger matter. Second, El Paso's disclosure of the terms of the Republic settlement was, at best, confusing.[70] Although, eventually, a complete copy was provided, the initial copy provided to New Tenneco contained substantial redactions and, in addition, El Paso's counsel represented that New Tenneco would be carved out of the release language. Thus, it is difficult to charge New Tenneco with the knowledge necessary to sustain a finding of acquiescence or waiver.

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[69] PX 47 at EP016666.
[70] *See* PX 52.

In sum, the course of conduct pursued by New Tenneco, with respect to both the Republic settlement and El Paso's efforts with the London Insurers, does not provide a basis for sustaining a defense of waiver or acquiescence. Furthermore, it does support an effort to give broader effect to the Settlement Agreement.

F.

Thus, the Court concludes that the Settlement Agreement did not release the Plaintiffs' rights under the Subject Policies; the Settlement Agreement did not exhaust (or cause the "deemed exhaustion") of limits of the Subject Policies; and New Tenneco did not waive its rights or acquiesce in El Paso's actions in such a fashion as to allow El Paso to achieve, in substance, a "deemed exhaustion" of limits of the Subject Policies.[71] In short, the Settlement Agreement, primarily by its express terms, did not adversely affect the rights of Plaintiffs, and the Plaintiffs are entitled to a declaratory judgment to that effect.[72]

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[71] Accordingly, it is not necessary to resolve whether El Paso would be obligated to obtain replacement or reinstatement insurance or what its maximum exposure under Section 3.2(d) of the Insurance Agreement would be.

[72] This conclusion is primarily the result of reading the Settlement Agreement, with less attention paid to the Insurance Agreement. It is, however, not an especially satisfying result. El Paso agreed to assume the liability for Old Tenneco's discontinued operations, but it did so with the expectation (and the expectation of the Plaintiffs) that it could rely upon the Subject Policies. Insurers do not regularly indemnify large historic environmental claims simply upon receipt of a demand for coverage. There are uncertainties. There are compromises. The wherewithal of the London Insurers was a legitimate concern to El Paso. Under these circumstances, it might have been a "fairer" allocation of the excess coverage under the Subject Policies if it had been dedicated to El Paso.

## IV.

El Paso contends that any "exhaustion" of limits would not result in harm to the Plaintiffs because they have no claims that would reach the levels of coverage afforded by the Subject Policies.[73] This is a version of the ripeness

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That, however, is not what the parties agreed to, and all of El Paso's arguments embroidered with threads of fairness cannot avoid that.

It is also not the Court's function to redraft agreements negotiated by sophisticated parties, aided by sophisticated counsel. The Insurance Agreement was negotiated in a rush. El Paso, because it took most of the exposure that would be covered by the Subject Policies (as excess coverage), had a compelling argument for access to that coverage, but the deal it negotiated left it with limited and restricted access to the coverage. Moreover, it accepted significant uncertainty with respect to the possibility of having to acquire replacement coverage. Significantly, for purposes of this Memorandum Opinion, it was not able to release the rights of the Plaintiffs.

The Settlement Agreement, conversely, was the culmination of protracted negotiations, but it functions as a release; indeed, it purports to release the rights of the Plaintiffs, something which El Paso could not do. No mention is made of exhaustion (or "deemed exhaustion"), and that should not be surprising because representatives of the London Insurers had doubts as to whether exhaustion was a concept applicable to the settlement that was being negotiated.

In short, El Paso traded a release and an indemnification obligation for [redacted] (or, if allocated to the Old Tenneco coverage, perhaps almost [redacted]). Maybe it could have (or should have) structured the settlement as an exhaustion of some type; it did not do so. With its concession that it did not cause a release of the Plaintiffs' rights, there is nothing belonging to the Plaintiffs that El Paso negotiated away.

One suspects that El Paso did not appreciate the potential expense of obtaining replacement coverage when it finalized the Settlement Agreement. With its estimate of the cost of replacement insurance at less than $3,000,000 (or less than [redacted] of what it would obtain from the London Insurers) its risks were manageable. Its after-the-fact recognition of the potential consequences of this miscalculation is a likely explanation for its changing strategies in this proceeding.

[73] If this is true, then the risks to which El Paso may be exposed through its indemnification obligation to the London Insurers would be small.

argument offered in support of the Defendants' motion to dismiss.[74] Now, as then, after El Paso gave notice that the Plaintiffs' rights under the Subject Polices had been released and exhausted by the Settlement Agreement, the Plaintiffs were prudent to pursue, and entitled to, a judicial determination of the effects of the Subject Policies. The judicial process may work better if there is a specific question about a specific claim. The application of the Settlement Agreement to these policies, however, does not depend on the presence of a specific coverage claim. The possibility, or likelihood, that the Plaintiffs have been or will be presented with claims implicating coverage under the Subject Policies is real and substantial.[75] Thus, as anticipated by the rejection of the Defendants' argument early in these proceedings that the Plaintiffs' declaratory judgment application is not ripe for resolution, the Plaintiffs' have satisfied the standards for pursuing a declaratory judgment action.[76]

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[74] *Tenneco Auto. Inc. v. El Paso Corp.*, 2001 WL 1641744 (Del. Ch. Nov. 29, 2001) ("*Tenneco I*").

[75] *See* note 7, *supra*.

[76] *See Stroud v. Milliken Enters., Inc.*, 552 A.2d 476, 479-80 (Del. 1989) (identifying the following factors: (1) that there is "a controversy involving the rights or other legal relations of the parties seeking declaratory relief;" (2) that there is "a controversy in which the claim of right or other legal interest is asserted against one who has an interest in contesting the claim;" (3) that the controversy is "between parties whose interests are real and adverse;" and (4) that "the issue involved in the controversy must be ripe for judicial determination."). The Defendants have not disputed that the first three of these factors have been satisfied.

## V.

El Paso argues that, because this is a declaratory judgment action, the Plaintiffs bear the burdens of proof and persuasion with respect to El Paso's affirmative defenses. This primarily arises in the context of whether the Subject Policies (or some element thereof) were exhausted and whether those policies were subject to aggregate limits.

This Court, has recognized that "[t]here is a split of authority as to whether a plaintiff seeking a declaratory judgment bears the burden of persuasion or whether the burden of persuasion rests with the party who would have borne that burden had it been brought as a conventional action, *i.e.*, the declaratory defendant."[77] Although this Court has observed that, as a general principal, "a plaintiff in a declaratory judgment action should always have the burden of going forward," it perceived no "hard and fast rule" that would control the question of who has the burden of persuasion.[78] Significantly, it noted that the burden of persuasion may be placed on the defendant in a declaratory judgment action involving insurance coverage.

From this uncertainty, I am guided by two principles. First, the use of the declaratory judgment process in a case such as this should not allow a litigant to shift burdens that it otherwise normally would have to carry. In a typical coverage

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[77] *Rhone-Poulenc Surfactants & Specialties, Inc. v. GAF Chems. Corp.*, 1993 WL 125512, at *3 (Del. Ch. Apr. 8, 1993).

[78] *Id.* *See* 10B WRIGHT, MILLER & KANE, FEDERAL PRACTICE AND PROCEDURE: CIVIL 3d § 2770; 12 MOORE'S FEDERAL PRACTICE § 57.62[2][c] (Matthew Bender 3d ed.).

case, the insured must demonstrate the existence of a policy and that the claims fall within the terms of the policy, but the insurer would bear the burden of proving any limits or exclusions.[79] Here, El Paso, which seeks in part to avoid becoming the Plaintiffs' *de facto* insurer as a consequence of its indemnification obligation to the London Insurers, relies upon its claim that it exhausted a substantial portion of the otherwise available coverage. That is not a burden which insureds seeking coverage, such as the Plaintiffs, normally would have to meet. Second, El Paso claims that its Settlement Agreement eliminated the obligation of some of the London Insurers to respond to the claims of the Plaintiffs under the Subject Policies. If that is so, it is reasonable to put on El Paso the burden of proving what it accomplished through the Settlement Agreement. Although the question may be less clear with respect to other issues, such as the presence of aggregate limits in some of the Subject Policies, the burden is still best assigned to El Paso because (i) it is part of the exhaustion issue and (ii) El Paso, in its role as "Old Tenneco," is the first-named insured on most of the policies. Accordingly, the burdens of proof and persuasion with respect to these contentions rest with El Paso. It should also be noted that the Court's conclusion with respect to whether the Settlement Agreement "exhausted" or should be "deemed to have exhausted" the Subject Policies would be the same if the burden of demonstrating the absence of exhaustion were imposed upon the Plaintiffs.

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[79] *See, e.g., State v. National Auto. Ins. Co.*, 290 A.2d 675, 678 (Del. Ch. 1972).

## VI.

A few words about the law of the case doctrine are appropriate.[80] During the course of ruling on the Defendants' motion to dismiss, the Court, in considering Section 3.2(d) of the Insurance Agreement, concluded that "under the policies [with 'Exhaustible Limits'] and the Insurance Agreement, El Paso had the authority to exhaust and, thus, to release the London Insurers from the liability on specific policies under which claims were paid without having received payment of the policy limits set forth in the specific policy."[81] There are two aspects arising out of the less than precise use of important terms,[82] which deserve mention. The first deals with release, but the parties have stipulated that the Plaintiffs' rights were not released. The second deals with exhaustion and addresses exhaustion of specific policies with aggregate limits and with payments less than the policy limits. As noted, "[the Court's ruling on the motion to dismiss] does not resolve the question . . . of El Paso's right to release [or exhaust] Exhaustible Limits policies which were not compromised as the result of specific claims."[83] The evidence before the Court demonstrates that the Settlement Agreement was not premised upon the allocation of specific payments to specific claims under specific policies. In short, the conclusion set forth in this Memorandum Opinion does not tread on the law of the case doctrine.

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[80] *See, e.g., Gannett Co., Inc. v. Kanaga*, 750 A.2d 1174, 1181-82 (Del. 2000).
[81] *Tenneco I*, 2001 WL 1641744, at *10.
[82] *See* note 56, *supra*.
[83] *Tenneco I*, 2001 WL 1641744, at *10 n.29.

## VII.

The parties stipulated as follows:

> The Settlement Agreement does not address, affect, or in any way impair policies issued to Tenneco Inc. that did not provide coverage for Tenneco Inc.'s energy operations, including policies issued solely to cover the operations of Newport News Shipbuilding and Dry Dock Company. These policies are not Subject to Insurance Policies under the Settlement Agreement.[84]

Newport News asks that the substance of the stipulation be included in the Court's final order in order to assure that the Settlement Agreement could not be invoked to impair its rights to policies issued directly to it (and not to Old Tenneco). The London Insurers oppose the request. In short, the London Insurers argue that the stipulation provides adequate assurance to Newport News and, thus, inclusion in the final order is not necessary. The London Insurers do not contend that the stipulation is in any way inaccurate. The Court concludes that Newport News is entitled to affirmative relief incorporating the terms of the Stipulation. The question before the Court, in a broad sense, is whether the Settlement Agreement limited the Plaintiffs' rights. If the parties thought that the question of whether or not the separate Newport News policies were Subject Policies under the Settlement Agreement was significant enough to include in the pretrial order, it is also significant enough to be memorialized in the Court's final order.

[84] Pretrial Order § B.19.

## VIII.

The Plaintiffs also seek a permanent injunction requiring El Paso to comply with the notice provisions of the Insurance Agreement. In light of the preceding exposition and its ramifications, the wisdom of timely notice should be apparent. This, however, is not a question committed to wisdom; it is a matter governed by Section 3.2(d) of the Insurance Agreement which provides in pertinent part:

> If at any time a party (an "Impairing Party") hereto becomes aware . . . of a claim or potential claim against any of such Impairing Party's respected Covered Persons which claim is reasonably likely to exhaust (but has not yet exhausted) all or any portion of the aggregate limits of liability, if any, under any Occurrence-Based Policy (a "Potential Impairment"), such Impairing Party shall promptly provide notice of such Potential Impairment to the other parties hereto.

In addition to receipt of the Notice some seven weeks after execution of the Settlement Agreement, the Plaintiffs point out that El Paso informed New Tenneco (but not Newport News) of its settlement with Republic after that settlement agreement was final. While a contractual requirement that one of the parties to the Insurance Agreement must give notice to the other parties of its potential for compromising their remaining coverage under any of the policies subject to the Insurance Agreement may make sense, the Plaintiffs' argument fails by the plain language of Section 3.2(d). That provision does not require notice of claims by an insured against its insurer – the set of claims at issue here. Instead, it only requires

notice of claims by third parties against the insureds. In short, El Paso breached no duty imposed by Section 3.2(d) to provide notice to the Plaintiffs.[85]

To the extent that the Plaintiffs rely upon Section 5.1(a) of the Insurance Agreement which requires El Paso to provide prompt notice to "[New Tenneco] of all actions taken by it with respect to the Claims Administration and Insurance Administration for the Occurrence-Based Policies," there is no requirement that the notice precede the taking of action and, indeed, the language suggests that it need only be provided promptly after the event. Perhaps, for example, the Notice could have been given in a more timely fashion, but it certainly does not suggest the need for permanent injunctive relief.

Accordingly, the Plaintiffs' application for permanent injunctive relief regarding El Paso's duty to provide notice of its actions under the Insurance Agreement is denied.

## IX.

The Plaintiffs seek an award of their attorneys' fees and expenses incurred in prosecuting this action. They rely only on the Distribution Agreement, of which the Insurance Agreement is a constituent agreement, which allows the prevailing party to recover its attorneys' fees and expenses in the event that the other party breaches the terms of the Distribution Agreement.

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[85] The environmental claims for which El Paso sought recovery from the London Insurers were known (or largely known) before the merger through which El Paso acquired responsibility for them.

Although the Plaintiffs initially presented an application for interim injunctive relief to prevent a breach of the Insurance Agreement, that effort ended when they learned that the Settlement Agreement had already been executed. This action, as framed by the Plaintiffs, is one for a declaratory judgment as to the consequences for the Plaintiffs of the Settlement Agreement.[86] Thus, it does not fall within the scope of the parties' agreement for an award of attorneys' fees and expenses, and the application, accordingly, is denied.[87]

## X.

Counsel are requested to confer and to submit a form of order, within ten days, to implement this Memorandum Opinion.

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[86] See Pretrial Order § D.1 at 27 (by Plaintiffs).

[87] Perhaps it should be noted in passing that the Court did not find that El Paso had breached the Insurance Agreement.