10 Cases in 45 Minutes

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MAJOR INSURANCE DEVELOPMENTS OF 2019

Robert Chesler and Nicholas Insua

In the early 1980's, when insurance coverage litigation was in its infancy, most practitioners expected that courts would quickly resolve the key issues. No one expected that they would still be debating basic coverage issues in 2019. This past year did not see any decisions addressing truly novel issues. Rather, with the exception of cyber insurance, the year's decisions shed clarity on existing issues with which coverage litigators long have grappled.

Cyber Insurance

The Eleventh Circuit, applying Georgia law, held that a phishing loss constituted a direct loss resulting from a fraudulent transfer. *Principle Solutions Group LLC v. Ironshore Indemnity Inc.,* 944 F.3d 886 (11th Cir. 2019). The meaning of 'direct' has long been a source of contention.

Principle Solutions concerned a classic phishing case. The company's controller received a message supposedly from the company's managing director, advising her to wire $1,700,000 pursuant to instructions that the controller would receive from an attorney. The purported attorney then contacted the controller and gave her instructions to wire the money to a bank in China. The transferring bank, Wells Fargo, asked for verification that the wire transfer was legitimate, which the controller confirmed. Wells Fargo then released the funds. The next day, the managing director told the controller that he never gave the instruction.

Ironshore first argued that the phishing loss did not constitute a covered fraudulent transfer pursuant to the insurance policy, an argument that the court found was unpersuasive. Ironshore next asserted that the loss was not 'direct' as required by the fraudulent transfer coverage because there was no "immediate link between the instruction and the loss." Id. Again the court disagreed. It found that the Georgia standard was proximate cause, which included "all of the natural and probable consequences" of the act "unless there is a *sufficient and independent* intervening cause." (Cite omitted) (Emphasis in original.) Id. The court held that the intervening acts between the initial message and the wiring of the money were not sufficient to break the causal chain.

Principle Solutions is the third circuit court decision to find coverage for phishing losses under a business crime policy.

Illusory Coverage

Policyholders often assert to a court that if it adopts the policy interpretation proffered by the insurance company, it would render coverage illusory, but the case law shows that this assertion has met with only limited success. However, cases from 2019 may breathe new life into this argument.

Crum & Forster Specialty Ins. Co. v. DVO, Inc., 939 F.3d 852 (7th Cir. 2019) concerned a professional liability policy issued to a company that had contracted to design and build an 'aerobic digester,' designed to convert cow manure to electricity. After an accident, the insurance company denied coverage on the basis of a breach of contract exclusion. Since the underlying claim arose from DVO's breach of contract, the insurance company asserted the application of the exclusion.

The trial court agreed, but the Seventh Circuit reversed. The court found that all of DVO's work was performed pursuant to a contract, and to enforce the breach of contract exclusion would render the coverage illusory.

In *Starr Surplus Lines Ins. Co. v. Star Roofing,* No. CA-CV18-0642, 2019 WL 5617575 (Ariz. Ct. App. Oct. 31, 2019), Starr issued a policy to a roofing company. An employee of the building's tenant passed out from roofing fumes and broke her arm. The insurance company denied coverage on the basis of the pollution exclusion, and the court's decision centered on its holding that the absolute pollution exclusion only applied to traditional environmental pollution. However, the court also addressed illusory coverage: "The scope of interpretation requested by Starr Surplus would result in illusory coverage for the ordinary commercial business activities of the insured…." Id. at *35. See also, *McGraw-Hill Education v. Illinois National Insurance Co.*, Case No. 655708/16, 2019 WL 6869010 (Ill App. Div. 1st Dept., Dec. 17, 2019) (applying fortuity defense to copyright infringement coverage "would render that portion of the policy illusory.") Id. at *1.

Bad Faith

Bad faith is another cause of action often pressed by policyholders with only mixed success. However, two decisions from 2019 may provide a roadmap to policyholders on such claims.

In *Yahoo! Inc. v. National Union Fire Ins. Co. of Pittsburgh, PA*, No. 5:17-cv-00489 (N.D. Cal. May 17, 2019), National Union moved for judgment as a matter of law on Yahoo's bad faith claim. To oppose, Yahoo relied on such evidence as (1) National Union's denial letter cited to an exclusion not found in the policy, (2) National Union used an incomplete copy of the policy to determine coverage, (3) National Union did not construe "the allegations of the underlying suits in a manner that would favor a finding of coverage," (4) National Union did not reconsider its coverage position, and (5) National Union did not conduct a thorough investigation, among others. Id. at *3.

The court found that the jury could rule for National Union and find that its "coverage decisions were not unreasonable." However, it also found that "there is a legally sufficient evidentiary basis for a jury to find that National Union acted or failed to act without proper cause." As a result, the court denied National Union's motion.

Prucker v. American Economy Ins. Co., No. CV186013630S, 2019 WL 2880369 (Conn. Sup. Ct. May 31, 2019) involved a homeowners' claim of deteriorating conditions in its basement walls caused by a contaminant in the concrete, apparently a common complaint. The insured brought causes of action in bad faith, and pursuant to the Connecticut Unfair Trade Practices Act ("CUTPA") and the Connecticut Unfair Insurance Practices Act ("CUIPA"). The insurance company moved to strike these counts.

The court allowed the bad faith claim to remain because the insured alleged that the insurance company "knew of and chose to ignore the rulings by state and federal courts in Connecticut that similar damage should be covered under similar policy language." Id. at *4. The court stated that this essentially alleged that the insurance company had no reasonable basis to deny coverage. The court found that if these decisions were confirmed by the Connecticut Supreme Court and Harleysville knew that its coverage position was incorrect, a bad faith claim was plausible.

The CUTPA and CUIPA counts required by statute a general business practice of unfair trade practices by the insurance company. The plaintiff alleged the insurance company's "systematic and uniform denial" of similar claims, and pointed to a putative class action on the same issue. The court found that the plaintiff had alleged a sufficient general business practice, and denied the insurance company's motion to strike. Id. at *7.

Yahoo and *Prucker* indicate that courts will look to evidence of claims handling practices in determining bad faith. This could be a fertile field for policyholders.

War Risk Exclusion

The war risk exclusion has received much attention with respect to cyber-attacks of late. *Universal Cable Productions, LLC v Atlantic Specialty Ins. Co*., 929 F.3d 1143 (9th Cir. 2019) concerned a more traditional conflict – that between Israel and Hamas in Gaza. Universal was filming near Gaza and had to move and cease production because of the outbreak of fighting between the parties. This resulted in a business interruption loss. The insurance policy had two war risk exclusions upon which the insurance company relied to deny coverage. The district court held that the conflict was a war within the ordinary understanding of that term and denied coverage, and the Ninth Circuit reversed.

First, the court rejected the application of contra proferentem, because of Universal's broker's role in drafting the insurance policy. The court next rejected the district court's reliance on the 'ordinary understanding' rule. It cited to the California Civil Code, which stated that the ordinary meaning applied to policy terms *"unless a special meaning is given to them by usage, in which case the latter must be followed."* (Emphasis in court's decision.) Id. at 1153. The court then found that in the insurance context, 'war' was understood only to be a conflict between two sovereign states. It therefore held that since neither Hamas nor Gaza were sovereign states, the exclusions did not apply.

War and terrorism exclusions have become much broader in many policies. Policyholders and their brokers or consultants should review them carefully and see if they need to be scaled back.

Late Notice

Late notice is a crucial issue on which jurisdictions differ dispositively. A majority of states hold that late notice of a claim will only foreclose coverage under a general liability policy if the late notice has prejudiced the insurance company – although states differ on what constitutes prejudice. A minority of states hold that late notice of a claim will foreclose coverage as a matter of law.

Pitzer College v. Indian Harbor Ins. Co., 447 P.3d 669 (Cal. 2019) concerned a California insured suing in California on an insurance policy that contained a New York choice of law provision. Pitzer gave late notice of an environmental claim to Indian Harbor, which denied coverage on the basis of late notice. Under California law, late notice will only foreclose coverage if the insurance company can demonstrate substantial prejudice, while under New York law, with respect to the insurance policies at issue, late notice is fatal to coverage. Pitzer argued that the court should not enforce the choice of law provision because the prejudice rule constituted California fundamental public policy. The Ninth Circuit certified the case to the California Supreme Court.

The California Supreme Court held that even in the absence of a legislative pronouncement, the prejudice rule was a fundamental public policy of California that overrode the contractual choice of law provision. The court relied on several factors. Id. at 99.

Asbestos Insurance Coverage

Apocryphally, someone once asked a Lloyd's representative what would be the next asbestos, and he replied – asbestos. The Connecticut Supreme Court's decision in *R.T. Vanderbilt v.Hartford Acc. & Indem. Co.,* 216 A.3d 629 (Conn. 2019) reflects the persistence of asbestos in the insurance (and other) contexts. The court addressed four important issues.

Most importantly, the court confirmed that Connecticut was a continuous trigger state. Under that rule, the insurance company on the risk when the first exposure to asbestos exposed, and insurance companies continued on the risk until manifestation of an asbestos illness. The court affirmed the lower court's refusal to permit expert testimony by an insurance company to establish that in fact, an asbestos injury does not take place until the final cellular mutation that caused the disease to develop.

The court also adopted the 'unavailability rule,' holding that the insurance company and not the insured was responsible for those years on the risk when insurance coverage was not available in the marketplace. The court ruled that indoor exposure to asbestos was not

pollution, adopting, as in *Starr Surplus,* the rule that the pollution exclusion only applied to traditional environmental pollution. The court then granted a significant victory to insurance companies, holding that an 'occupational disease' exclusion applied not only to the insured's only employees but to any employee. Since almost all asbestos claimants suffered exposure in the course of their employment, this holding practically vitiates coverage under any policy containing such an exclusion.

Assignment

Ever since the decision by the California Supreme Court in *Henkel Corp. v. Hartford Acc. & Ind. Co*., 62 P.3d 69 (Cal. 2003), insurance companies have carefully reviewed claims by successor companies under their predecessors' policies to see if the parties had properly assigned the policies. In *The Premcor Refining Group, Inc. v. ACE Ins. Co. of Illinois,* No. 5-18-0210, 2019 Ill. App. (5th) 180210-u (Ill. App. Ct. 5th Dist., Aug. 12, 2019), the successor corporation failed to do so.

Premcor purchased assets from Apex. As a result, Premcor found itself subject to environmental litigation stemming from those assets. Premcor sought coverage under the Apex policies in place when the contamination occurred. The insurance companies denied coverage, asserting that the asset purchase agreement ("APA") had not assigned those policies to Premcor. Moreover, Apex intervened, joining the insurance companies and denying that it had assigned the policies to Premcor.

The court ruled that the APA did not include an assignment of those policies in dispute. It found that while the APA did specifically assign certain policies, it did not assign the earlier policies. The court stated, "a valid assignment must describe the subject of the assignment with sufficient particularity." Id. at *4. In some similar disputes, successor companies have argued that a general assignment of contractual rights includes rights under insurance policies. Query whether such an argument would survive the Premcor test of 'sufficient particularity.' See also, *PCS Nitrogen, Inc. v. Continental Casualty Co.*, N. 5699 (S. Car. App. 2019) (court held that company was not a successor and did not receive an assignment).

Loss of Use

The definition of property damage in a general liability policy includes 'loss of use of tangible property that is not physically injured.' Many policyholders do not realize how broad this coverage is. In *Thee Sombrero, Inc. v. Scottsdale Ins. Co.*, 28 Cal. App. 5th 729 (Cal. App. Ct. 2019), the court stretched this coverage probably as far as it can go.

After a shooting, the city canceled Thee Sombrero's nightclub license, although the club could still be used as a banquet hall. The Sombrero sued the security company at the night club. That company defaulted, and Thee Sombrero sued the company's insurance company

directly. The trial court dismissed the claim, finding that the loss was not for property damage but for economic loss.

The appellate court reversed. It held that Thee Sombrero suffered the loss of use of the property as a nightclub, which was an element of the definition of property damage. The court then found that the proper measure of damages was the loss in value of the property.

Relationship Back

Under claims-made policies, and particularly D&O policies, a later claim can relate back to a prior claim and be covered under the policy in place at the time of the earlier claim. This 'relationship back' doctrine has produced a large and bewildering morass of case law. *Emmis Communications Corp. v. Illinois National Ins. Co*., 323 F. Supp. 3d 1012. (S.D. Ind. 2018) may help both policyholders and insurance companies navigate their way on this issue.

Emmis has both an unusual fact pattern and procedural history. The relationship back doctrine can aid either the policyholder or the insurance company depending on the circumstances. However, it is more frequently used by insurance companies to argue that a latter claim relates back to an earlier claim that the policyholder did not report, thereby foreclosing coverage for the latter claim because of late notice.

In *Emmis*, the insurance company sought to relate the later action back to the prior one. The district court disagreed and ruled in favor of the policyholder. At first, the Seventh Circuit reversed. However, it then granted a petition for rehearing, withdrew its prior opinion, and adopted the decision of the district court. The district court had adopted a relation back standard of "operative facts…that is, facts that form the basis of the causes of action asserted in the lawsuits." Id. at 1027. The court found that the related facts relied upon by the insurance company were just "window dressing," and held that the actions were not related.

D&O Issues

Delaware courts were active in addressing D&O issues in 2019, issuing five important decisions.

The Delaware Supreme Court handed a victory to insurance companies in *In re Verizon Insurance Coverage Appeals*, No. 558, 560, 561, 2018, 2019 WL 5616263 (Del. Sup. Ct. Oct. 31, 2019). Verizon had spun off a company, which quickly entered bankruptcy. The bankruptcy trustee sued Verizon, alleging violation of fraudulent transfer statutes, payment of unlawful dividends in violation of Delaware corporate statutes, and common law counts of breach of fiduciary duty, promoter liability, and unjust enrichment. While Verizon successfully defended the suit, it incurred $48 million in attorneys' fees. Verizon sought coverage under its D&O policy, which defined a security claim in relevant part as a claim

"alleging a violation of any federal, state, local or foreign regulation, rule or statute regulating securities." Id. at *1.

The trial court held that the definition of 'security claim' was ambiguous and that contra proferentem applied, and found coverage. The Delaware Supreme Court reversed, holding that the definition was unambiguous. It found that the broad definition of "regulations, rules or statutes" enunciated by the lower court "would encompass a variety of non-security related claims." Id. at *3.

In *Conduent State Healthcare, LLC v. AIG Specialty Ins. Co*., No. N18C-12-074, 2019 WL 3337216 (Del. Super. Ct. June 24, 2019), the insured received a civil investigation demand ("CID") from the Texas attorney general demanding documents. The insurance company sought partial summary judgment, arguing that the CID was only a request for information and not a 'claim' under the insurance policy. The court denied the motion, holding that the demand for documents was a claim because it was a demand for non-monetary relief.

In *IDT Corp. v. U.S. Specialty Ins. Co*. No. N18C-03-032, 2019 WL 413692 (Del. Super. Ct. Jan. 31, 2019), the court held that the insurance company had to defend the chairman of the board of the corporation. The insurance company asserted that the underlying complaint did not allege a 'wrongful act' necessary to trigger coverage against the chairman. The court found that the definition of 'wrongful act' was unambiguous It held that 'wrongful act' had a broad meaning not limited to the breach of fiduciary duty, and found coverage.

However, the court also held that the corporate spin-off that was the basis of the claim was not a securities claim, so that the corporation itself did not have coverage. It found that a security claim had to be brought by a subsidiary, and that, following a spin-off, the former subsidiary that sued IDT was no longer a subsidiary, despite its central role.

In *Arch Ins. Co. v. Murdock*, No. N16C-01-104, 2019 WL 2005750 (Del. Super. Ct. May 7, 2019), the court held that settlement payments by the company to its shareholders were not an excluded 'increase in the consideration paid' but a covered loss.

In *Solera Holdings v. XL Specialty Ins. Co*., No. N18C-08-315, 2019 WL 4733431 (Del. Super. Ct. Sept. 26, 2019, the court faced the novel issue of whether an appraisal action constituted a covered securities claim, and held that it did.

Conclusion

Insurance law is state law, which means that the parties can litigate each issue fifty times. Hopefully, this year's decisions will be normative and help to reduce future litigation on these issues. However, if the past is any indicator, we can expect that we have not heard the last word.

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