Emerging Issues in Insurance Law

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RECENT DEVELOPMENTS IN INSURANCE COVERAGE LAW

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While insurance coverage for Covid-19 dominated insurance coverage litigation in the first half of 2021, several other decisions addressed key issues in such emerging areas as ransomware, hacking, opioids, lead paint, biometrics, and directors and officers insurance. This article will not address the dozens of Covid-19 insurance decisions issued over the past six months, since the law is still developing. However, the other cases that have come down this year are essential reading for practitioners.

RSUI v. Murdock: D&O Insurance

In this case, an excess insurance company sought a declaration from the Delaware Superior Court that coverage under the policy was not available to fund the settlement of two lawsuits—a breach of fiduciary duty action and a federal securities action. The Superior Court ruled against the excess insurance company, entering judgment in favor of the policyholders. On appeal, the Supreme Court of Delaware addressed four questions: (1) whether the insurance policy, which insures a Delaware corporation but negotiated and issued in California, should be interpreted under Delaware law; (2) whether the policy, which purportedly covered the policyholder's fraud, is unenforceable as contrary to the public policy of Delaware; (3) whether a policy provision excluded fraudulent actions from coverage; and (4) whether the Superior Court properly applied the policy's allocation provision.

1. Choice of Law

To begin its choice of law analysis, the court noted that in circumstances where parties have not made an effective choice of law in their contract, Delaware courts have adopted the Restatement (Second) Conflict of Laws "most significant relationship test" for determining which state's law to apply. However, because the policy in this case insured risks in multiple jurisdictions, the court turned to Section 188 of the *Second Restatement* which addresses contract disputes more broadly. *See* Restatement (Second) of Conflict of Laws § 188.

The court's analysis under Section 188 considers contact factors such as: "the place of contracting; the place of negotiation of the contract; the place of performance; the location of the subject matter of the contract; and the domicile, residence, nationality, place of incorporation and place of business of the parties." *Murdock*, 248 A.3d at 897. In addition, the court weighed the importance of these contact factors in light of the choice of law considerations outlined by Section 6 of the Restatement (Second) Conflict of Laws. *Id*. Ultimately, in considering all of these factors, the most significant was the state of incorporation because the policy's subject matter was "Directors, Officers and corporate Liability." *Id*. at 900. Moreover, the existence of D&O insurance policies stem from Delaware law, which provides broad indemnification and advancement rights to D&Os, enhancing corporations ability to attract talented people. *See* 8 *Del. C.* § 145. Accordingly, the court agreed with the Superior Court's decision to apply Delaware law. *Id.* at 899.

2. Whether Fraud Provision is Unenforceable as Contrary to Public Policy

Applying Delaware law, and referring to the language of the policy, the court found that the respect for freedom of contract prevailed over any discernable Delaware public policy concerning fraud. *Murdock*, 248 A.3d at 903. Turning to Section 145 once more, the court reasoned that the Delaware General Assembly enacted the statute with the purpose of authorizing corporations to "afford their directors and officers broad indemnification and advancements rights and to purchase D&O insurance" for any liabilities that they could not indemnify. 8 *Del*. *C*. § 145. Section 145(a) limits the power of a corporation to indemnify director or officer conduct if they acted in good faith, while Section 145(g) authorizes corporations to secure insurance against liabilities that corporations do not have the power to indemnify. *Murdock*, 248 A.3d at 903. Read together, the court found that this implicitly means that corporations have statutory authority to obtain D&O insurance for liabilities arising from bad faith conduct. *Id*. Furthermore, the court noted that RSUI's public policy argument would lead to negative consequences in stockholder litigation because a blanket prohibition against insuring for losses based on D&O fraud, would leave many parties without a means of recovery. *Id*. at 904. Ultimately, the court chose to defer to the parties' contractual choices and to the legislature's prerogative in matters of public policy and affirm the Superior Court's ruling on the issue. *Id*.

3. Whether a Policy Provision Excluded Fraud

Applying traditional contract interpretation principles, the court also concluded that the Profit/Fraud Exclusion ("Exclusion") did not apply. *Id*. at 906 Crucial to the court's

analysis was the Exclusion's requirement that the adjudication of fraud must be "in the underlying action." *Id*. RSUI contended that "in the underlying action" was not meant to limit the Exclusion's application to follow-on collateral estoppel litigation for the same conduct. *Id*. The court rejected this argument, finding the proper interpretation of "the underlying litigation" in the settlement context to mean the litigation in connection with which the policyholder became legally obligated to pay on account of a claim. *Id*.

Importantly, the court noted that the Exclusion included language stipulating that only "fraudulent act[s] . . . established by a final and non-appealable adjudication adverse to [the] Insured in the underlying action" would be subject to the Exclusion. *Id*. 907. Without such a final and non-appealable adjudication, the Exclusion could not be triggered. The court noted that even though some findings in the Memorandum Opinion issued by the Superior Court might have been implicated in the resolution of the underlying matter had it not settled, these findings were inapposite to a determination of whether the was an actual adjudication. As a result, the court concluded that the Exclusion failed as to the policytholder's loss attributable to the underlying action. *Id*.

4. Whether Superior Court Applied Allocation Provision Properly

On the issue of allocation, RSUI argued that the Superior Court should have conducted a "relative exposure analysis," weighing the relative exposures between covered and non-covered losses under Section III.A of the policy ("Section III.A"). *Id.* at 908. The Superior Court declined to use this analysis and instead applied the

"larger settlement rule." *Id*. On appeal, RSUI contended that the Superior Court erred in choosing the larger settlement rule and that its excess insurance layer would not have been reached under a "relative exposure analysis," because "significant liability was placed on non-insured DFC, and liability was incurred for actions taken in uninsured capacities (Murdock as a controlling shareholder and Carter as General Counsel)." *Id*.

The court rejected RSUI's argument and agreed with the Superior Court's decision to use the "larger settlements rule" articulated by the Ninth Circuit Court of Appeals in *Nordstrom*, *Inc*. *v*. *Chubb & Sons*, *Inc*. According to the court,. several observations supported the use of the larger settlements rule in this case. First, Section III.A failed to establish an allocation methodology in the absence of an agreement between the parties. *Murdock*, 248 A.3d at 908. Second, when reading the contract as a whole, RSUI's argument favoring limitation of coverage, was inconsistent with other substantive provisions of the policy. *Id*. Specifically, policy language stating that, "The Policies cover all Loss that the Insured(s) become legally obligated to pay," seemed to imply complete indemnity. *Id* at 909. The court found that any type of *pro rata* or "relative exposure analysis," would run "contrary to the language of the Policies." *Id*. Coupled with these observations and without any argument from RSUI that the actions of DFC, Murdock or Carter in their uninsured capacities increased the amount of the Stockholder Action settlement, the court affirmed the Superior Court's Memorandum Opinion on Allocation. *Id*.

Citation: *RSUI Indem. Co. v. Murdock*, 248 A.3d 887 (Del. 2021) –

***Verto Med. Sols., L.L.C. v. Allied World Specialty Ins. Co.*, 996 F.3d 912 (8th Cir. 2021)**

In *Verto Medical Solutions, L.L.C. v. Allied World Specialty Insurance Co.*, 996 F.3d 912, 912–13 (8th Cir. 2021), the Eighth Circuit reversed the district court's dismissal of the policyholder's complaint and held that subsequent endorsements that purported to delete an exclusion rendered the policy ambiguous. The policyholder, Verto Medical Solutions L.L.C. ("Verto"), sought indemnity and defense under its D&O insurance policy issued by Allied World after a failed business deal. *Id.* at 913. Allied Word refused to provide either, and therefore, Verto filed suit for reimbursement. *Id.* The policy contained a standard contractual-liability exclusion barring coverage for liability arising out of a contract. *Id.* at 913-14. The policy also contained two endorsements relevant to the contractual-liability exclusion. The first, "Endorsement 11," deleted and replaced the contractual-liability with a new contractual-liability exclusion. *Id.* at 914. The second, "Endorsement 13," deleted the contractual-liability exclusion, among others, but did not replace it like Endorsement 11.

Allied World argued that coverage was clearly barred because Endorsement 11 applied to include a contractual-liability exclusion in the policy. *Id.* On the flip side, Verto argued the policy was ambiguous because both endorsements applied to the contractual-liability exclusion and contravened one another. *Id.* The Eight Circuit found that the policy was ambiguous because it was reasonably susceptible to different interpretations. *Id.* In light of the ambiguity, the court applied the *contra proferentem* rule and construed the policy against the insurance company and in favor

of coverage. *Id.* at 915. This decision reinforces the primacy of the doctrine of ambiguity as a fundamental interpretive principle of insurance coverage law.

***Motorists Mut. Ins. Co. v. Quest Pharms., Inc.*, No. 5:19-CV-00187-TBR, 2021 WL 1794754, at *6 (W.D. Ky. May 5, 2021)**

Turning to the opioid insurance coverage domain, insurance companies prevailed when the Western District of Kentucky granted summary judgment to Motorists Mutual Insurance Company, relieving it of the duty to defend or indemnity in numerous underlying litigations seeking damages caused by the opioid epidemic. In *Motorists Mutual Insurance Co. v. Quest Pharmaceuticals, Inc.*, No. 5:19-CV-00187-TBR, 2021 WL 1794754 (W.D. Ky. May 5, 2021), Quest Pharmaceuticals, Inc. ("Quest") sought coverage under its CGL policy issued by Motorists. *Id.* The policy provided that Motorists would pay "those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' . . . ." *Id.* at *1.

Motorists denied coverage on the basis that the complaints filed by various cities, counties, private health clinics, and health departments sought economic losses and not "damages because of bodily injury," as required by the policy. *Id.* at *3. Quest argued for a broad construction of the policy's "because of" language because the economic losses were a result of the bodily injury suffered by victims of the opioid epidemic. *Id.* Ultimately, the court agreed with Motorists and applied the reasoning of *Cincinnati Insurance Co. v. Richie Enterprises LLC*, No. 1:12-CV-00186-JHM, 2014 WL 3513211 (W.D. Ky. July 16, 2014), another opioid insurance case that analyzed the same issue and held that the underlying claims were purely economical and not

"because of bodily injury." *Id.* at *4. The court highlighted the fact that the underlying litigations against Quest did not require proof that bodily injury was suffered. *Id.* at *6. Rather, the allegations sounding in injury merely "put a human touch" on the plaintiffs' claims. *Id.* (internal quotation marks and citation omitted).

W*. Bend Mut. Ins. Co. v. Krishna Schaumburg Tan, Inc.*, 2021 IL 125978 (Ill. 2021)

In West Bend Mutual Ins. Co. v. Krishna Schaumburg Tan, Inc., 2021 IL 125978 (Ill. 2021), the Illinois Supreme Court found in favor of coverage for alleged violations of the Illinois Biometric Privacy Act ("BIPA"). The policyholder, Krishna Schaumburg Tan ("Krishna"), operated a tanning salon that sold tanning memberships. Id. at *1. As a requirement of the membership, customers were fingerprinted. Id. Krishna sought a defense and indemnity for a class action lawsuit against it that alleged violations of BIPA for the wrongful collection, use, storage and disclosure of biometric identifiers when Krishna provided customers' fingerprints to an out-of-state vendor. Id.

Krishna maintained two businessowners' liability policies issued by West Bend. Id. at *2. The policies provided coverage for "personal injury" or "advertising injury," which the policy defined, in pertinent part, as an "injury arising out of . . . "oral or written publication of material that violates a person's right of privacy. Id. The policies also contained an exclusion barring coverage for the "violation of a statute, ordinance or regulation . . . that prohibits or limits the sending, transmitting, communicating or distribution of material or information." Id. at *2-3.

West Bend filed a declaratory judgment and moved for summary judgment on the grounds that the claims did not fall within coverage for personal injury or advertising injury and, in the alternative, coverage was barred by the exclusion for violations of statute. Id. at *3. Krishna cross-moved for summary judgment on the ground that the complaint alleged a publication covered by the policies. Id. at *4. Both the trial and appellate courts applied the plain, ordinary meaning of the term "publication" and found that coverage for the disclosure of fingerprint information existed under the policies' Personal Injury and Advertising coverage parts. Id. On appeal, the state's highest court affirmed. Id.

The Supreme Court looked to several sources to discern the definition of "publication," an undefined term. Id. at *6-7. The ultimate definition adopted by the court defined "publication" as both a "communication to a single party and communication to the public at large." Id. at *7. Next, the court evaluated the meaning of the policies' "right of privacy" language and concluded that the complaint alleged a violation of privacy through Krishna's distribution of biometric identifiers. Id. Together, the court concluded that the disclosure of biometric identifiers to a single party constituted a publication that was alleged to be a violation of the right to privacy. For this reason, the complaint alleged a personal injury for which Krishna was entitled to coverage. Id. at *8.

Finally, the court addressed whether coverage was precluded by the exclusion for violation of statute. Applying the doctrine of ejusdem generis, whereby general words that follow a specific enumeration apply only to things of the same kind or class as

those specifically enumerated, the court held that the exclusion applied only to statutes that regulate methods of communication like telephone calls, faxes, and e-mails. Id. at *10. Unlike the statutes enumerated in the exclusion, BIPA does not regulate methods of communications, but rather it governs the collection, use, storage, and retention of biometric identifiers and information. Id. Therefore, the exclusion did not apply to bar coverage.

Certain Underwriters at Lloyd's of London v. NL Industries, Inc., Index. No. 650103/2014 (N.Y. Sup. Dec. 29. 2020)

On December 29, 2020, a New York court held that NL Industries, Inc. may pursue insurance coverage in connection with an underlying class action, arising out of NL Industries' paint products used in California residences.

There, a number of counties in California brought a public nuisance claim against NL Industries, among others, arguing NL Industries concealed the dangers of lead paint, had actual knowledge regarding the hazards of lead paint, and, notwithstanding, promoted its use in the interior of homes. The court agreed, and eventually the parties settled for $305 million – to which NL contributed $101.6 million.

Thereafter, NL Industries' insurers disclaimed coverage for the underlying settlement. The insurance companies argued, inter alia, that NL Industries was not entitled to coverage because it was held liable in the underlying action for promoting lead paint with the actual knowledge that it would cause harm. And, as such, argued that, in accordance with the language of the subject policies and the fortuity doctrine under New York law, coverage is not available for an 'expected or intended harm.'

The court disagreed. The court first looked to what conduct of NL Industries supported a finding of liability in the underlying action. In so doing, the court concluded that NL Industries: (1) must have known in the 1930's of the dangers of lead paint, (2) affirmatively promoted lead paint for interior residential use, but noted (3) the court in the underlying action did not specifically address whether NL Industries intended the damage as the result of its actions. The court held that "there is a distinction between knowledge of the risk of hazardous consequences of one's actions, and the intention to cause harm." For that reason, the court found the insurance companies failed to meet their burden to establish that NL Industries' conduct was unambiguously precluded by the 'expected or intended' exclusion, or otherwise precluded by the fortuity doctrine under New York law.

While NL Industries fared well in New York, a California court reached the exact opposite conclusion with respect to ConAgra Grocery Products Co. LLC's bid for coverage. ConAgra, like NL Industries, contributed $102 million toward the settlement of the underlying action. After tendering its claim for coverage, ConAgra's insurance companies disclaimed coverage. CASE CITE

Thereafter, the insurance companies filed suit, seeking to disclaim coverage on a number of grounds, including pursuant to California Insurance Code § 533. Ultimately, the parties filed competing motions for summary judgment. The court granted summary judgment in favor of the insurance companies. Specifically, the court held the insurance companies were entitled to summary judgment pursuant to California Insurance Code § 533, which provides that an "insurer is not liable for a loss

caused by the willful act of an insured." The court held that because ConAgra's predecessor was found to have intentionally promoted lead paint with knowledge that damage to children was at least highly probable, ConAgra knew the harmful consequences were substantially "certain to result" and, thus, coverage for such conduct is precluded by California Insurance Code § 533.

Thus, on the identical fact record, the two courts reached diametrically opposed conclusions as to coverage.

Target Corp. v. Ace Am. Ins. Co., Case No. 19-cv-2916 (WMW/DTS), 2021 WL 424468 (D. Minn. Feb. 8, 2021)

In December 2013, Target discovered that an unauthorized individual had breached its computer networks and stolen the payment card data and personal contact information of Target's customers. Following the data breach, several banks that issued the compromised payment cards cancelled and then reissued new payment cards to Target's customers impacted by the data breach.

Thereafter, the banks filed suit against Target for these costs. The banks and Target eventually settled the claims. Target tendered the bank claims to ACE, its insurance company, for coverage. ACE denied coverage, prompting Target to file suit against ACE.

At issue was whether Target's losses arose out of an 'occurrence' and resulted in Target's legal obligation to pay damages because of the 'loss of use' of "tangible property that is not physically injured." While it is generally known that general liability policies provide insurance coverage for claims because of property damage, it is less

widely understood that 'property damage' is defined in part as 'loss of use.' Target claimed that the credit cards issued by the banks had lost their use and needed to be destroyed and replaced by new cards.

The court disagreed and held that Target did not satisfy its burden to demonstrate that the data breach resulted in Target's legal obligation to pay damages because of the 'loss of use' of "tangible property that is not physically injured." Specifically, the court held that: (1) Minnesota law requires loss-of-use damages to have some connection to the value of the use of the now-damaged property when it previously was impaired; and (2) Target did not establish a connection between the damages incurred for settling claims related to replacing the payment cards and the value of the use of those cards, either to the payment-card holders or issuers.

Ultimately, the court found that the record was devoid of any evidence regarding the value of the use of the payments cards, which weighed heavily in the court's decision because the court determined that the connection between the claimed damages and the loss of use of the payment cards was insufficiently direct and, therefore, does not constitute loss-of-use damages.

G&G Oil Co. of Indiana, Inc. v. Contl. W. Ins. Co., 20S-PL-617, 2021 WL 1034982 (Ind. Mar. 18, 2021).

This case concerned a ransomware attack on G&G Oil's computer system. Specifically, the attack arose from a "malicious computer code that renders the victim's computer useless by blocking access to the programs and data." Id. at *1.

After consulting the FBI, G&G Oil paid the requested ransom with four bitcoins worth nearly $35,000 to regain access to its computer system.

G&G Oil's commercial crime policy provided coverage for loss or damage to "money," "securities" and "other property" "resulting directly from the use of any computer to fraudulently cause a transfer of that property from inside the "premises" or "banking premises":

> a. To a person (other than a "messenger") outside those "premises"; or
>
> b. To a place outside those "premises".

Id.

The court addressed two coverage issues: (1) whether the ransomware attack constitutes "fraudulent" conduct under the terms of the subject policy, and (2) whether the loss 'resulted directly from the use of a computer.'

Preliminarily, the court considered the insurance company's argument that since G&G Oil had not purchased coverage for computer hacking and computer virus in a separate part of the policy, G&G Oil's ransomware claim was "excluded". However, the Court disagreed, holding that G&G Oil's refusal to purchase such coverage was not dispositive. The Court concluded that the structure of the policy required that each coverage part had to be "read individually unless otherwise specified." Id. at *3.

The Indiana Supreme Court found that the policy language was unambiguous. The Court, however, rejected the lower courts' interpretation of the term 'fraud', ruling that

the construction was too narrow. Looking to multiple sources, including dictionary definitions, the Court found that the terms "fraudulently cause a transfer" can be reasonably understood from the standpoint of a reasonably intelligent policyholder "as simply 'to obtain by trick.'" Id. at *4. The Court relied on authority for the rule that the purpose of insurance is to insure.

However, in analyzing the parties' cross-motions, the court held that neither G&G Oil nor its insurance company were entitled to summary judgment. The court reasoned that not every ransomware attack was fraudulent, finding, for example, that: "if no safeguards were put in place, it is possible a hacker could enter company's servers unhindered and hold them hostage. There would be no trick there." Id. at *5. The Court found that the record was incomplete, and remanded the case and left G&G Oil to its proof.

The Court similarly held the insurance company was not entitled to summary judgment because it was unclear whether G&G Oil's computer systems were accessed and infiltrated by "trick", particularly since little was on the court record about the initiating events giving rise to the computer hack. In resolving this question in favor of G&G Oil, the non-moving party, the Court held the insurance company was not entitled to summary judgment on its cross-motion. Id.

Next, the Court examined whether G&G Oil's loss resulted directly from the use of a computer. On the one hand, G&G Oil argued that its loss resulted directly from the use of a computer, which would be covered under the policy. On the other hand, the insurance company argued G&G's voluntary transfer of bitcoin was an intervening

cause that severed the causal chain, such that the loss allegedly did not result "directly" from the use of a computer.

The lower courts agreed with the insurance company, holding that the loss did not result 'directly from the use of a computer.' Specifically, the lower court found that the voluntary payment of bitcoin by G&G Oil to satisfy the ransomware demand was an intervening cause of the loss. In reversing, the Indiana Supreme Court again looked to multiple sources, including dictionary definitions, and held that G&G Oil's claim satisfied the definition of "resulting directly from the use of a computer," in that G&G Oil's actions (i.e., the transfer of bitcoin) was "nearly the immediate result – without significant deviation – from the use of a computer." Id. at *6.

In so holding, the Court acknowledged G&G Oil's transfer of bitcoin was voluntary, but "only in the sense G&G Oil consciously made the payment." Id. The court found that under the facts, the payment "more closely resembled one made under duress," and was not so remote that the payment broke the causal chain. Id.

The Indiana Supreme Court decision is an important one for all policyholders, particularly given the drastic increase in ransomware attacks in recent years. Policyholders with traditional crime insurance policies should be encouraged by this decision, which is yet another example that policyholders should not accept a coverage denial at face value. Many insurance companies will attempt to apply an improperly narrow interpretation of the scope of insurance protection under their insurance policies.

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