THOMSON REUTERS
Westlaw®

Major insurance coverage developments of 2019

By Robert D. Chesler, Esq., and Nicholas M. Insua, Esq., *Anderson Kill*

FEBRUARY 21, 2020

In the early 1980s, 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, except for those involving cyber insurance, the year's decisions brought clarity to existing issues with which litigators long have grappled.

CYBER INSURANCE

The 11th U.S. Circuit Court of Appeals, applying Georgia law, held that a phishing loss constituted a direct loss resulting from a fraudulent transfer. *Principle Sols. Grp. LLC v. Ironshore Indemnity Inc.*, 944 F.3d 886 (11th Cir. 2019). The meaning of "direct" has long been a source of contention.

> Except for cyber insurance, the year's decisions brought clarity to existing issues with which coverage litigators long have grappled.

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 $1.7 million 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 provided.

Wells Fargo then released the funds. The next day, the managing director told the controller that he never gave the instruction.

Ironshore, which was the insurer, first argued that the phishing loss did not constitute a covered fraudulent transfer pursuant to the insurance policy. The court found this argument unpersuasive.

Ironshore next asserted that the loss was not "direct" as required for coverage because there was no "immediate link between the instruction and the loss." Again, the court disagreed.

It found that the Georgia standard is proximate cause, which includes "all of the natural and probable consequences" of an act "unless there is a *sufficient and independent* intervening cause." (Citation omitted, emphasis in original.)

The court held that the intervening acts between the initial message and the wiring of the money did not break the causal chain.

Principle Solutions is the third federal appeals 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. While case law overall shows that this assertion has met with only limited success, some cases from 2019 may breathe new life into this argument.

Crum & Forster Specialty Insurance Co. v. DVO Inc., 939 F.3d 852 (7th Cir. 2019), concerned a professional liability policy issued to DVO, a company that had contracted to design and build an "anaerobic digester" — a machine that converts cow manure into electricity.

The company later sued DVO for breach of contract, alleging that DVO did not properly design the digester and that it suffered substantial losses as a result. The insurer relied on a breach-of-contract exclusion in the policy to seek a declaration that no coverage was owed.

The trial court agreed, but the 7th U.S. Circuit Court of Appeals reversed. The court found that all of DVO's work for the company was performed pursuant to a contract, and it decided that enforcing the breach-of-contract exclusion would render the coverage illusory.

In *Starr Surplus Lines Insurance Co. v. Star Roofing Inc.*, No. 18-0642, 2019 WL 5617575 (Ariz. Ct. App. Oct. 31, 2019), Starr issued a policy to a roofing company. An employee of a building's tenant passed out from roofing fumes and broke her arm.

The insurance company denied coverage based on a pollution exclusion, and the court decided that the absolute pollution exclusion applied only to traditional environmental pollution.

The court also addressed illusory coverage as follows: "The scope of interpretation requested by Starr Surplus would result in illusory coverage for the ordinary commercial business activities of the insured. ..." See also *McGraw-Hill Education v. Illinois National Insurance Co.*, 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.")

BAD FAITH

Bad faith is another cause of action policyholders often assert, and these claims have met with only mixed success. However, two decisions from 2019 may provide a road map for policyholders for such claims.

> 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.

In *Yahoo Inc. v. National Union Fire Insurance Co. of Pittsburgh*, No. 17-cv-489, 2019 WL 5540611 (N.D. Cal. May 9, 2019), National Union moved for judgment as a matter of law on Yahoo's bad-faith claim.

To oppose the motion, Yahoo presented evidence that (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. *Yahoo Inc. v. Nat. Union Fire Ins. Co. of Pittsburgh*, No. 17-cv-489, 2019 WL 5540609 (N.D. Cal. May 12, 2019).

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 Insurance Co., No. CV186013630S, 2019 WL 2880369 (Conn. Super. Ct. May 31, 2019), involved a homeowner's claim of deteriorating conditions in the home's basement walls caused by a contaminant in the concrete, apparently a common complaint.

The insured brought causes of action for bad faith and violations of the Connecticut Unfair Trade Practices Act and the Connecticut Unfair Insurance Practices Act. 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."

According to the court, the insured essentially alleged that the insurance company had no reasonable basis to deny coverage.

The CUTPA and CUIPA counts required 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 met that requirement 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.

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

WAR RISK EXCLUSION

The war risk exclusion has received much attention with respect to cyberattacks of late. *Universal Cable Productions LLC v. Atlantic Specialty Insurance Co.*, 929 F.3d 1143 (9th Cir. 2019), concerned a more traditional conflict — the one between Israel and Hamas in Gaza.

Universal was filming near Gaza when it had to move and cease production because of an outbreak in fighting. 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 U.S. District Court for the Central District of California held that the conflict was a war within the ordinary understanding of that term and denied coverage. The 9th U.S. Circuit Court of Appeals reversed.

First, the appeals court declined to apply the doctrine 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 says the ordinary meaning applies 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.)

The court then found that in the insurance context, "war" is understood only to be a conflict between two sovereign states. It therefore held that since neither Hamas nor Gaza are 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.

Most states hold that late notice of a claim will foreclose coverage under a general liability policy only if the late notice prejudices the insurer, although states differ on what constitutes prejudice.

A minority of states hold that late notice forecloses coverage as a matter of law.

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.

Pitzer College v. Indian Harbor Insurance 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 based on the late notice.

Under California law, late notice forecloses coverage only if the insurer can demonstrate substantial prejudice. Under New York law, with respect to the insurance policies at issue, late notice was 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 9th Circuit certified the case to the California Supreme Court.

The state's highest 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.

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 Co. v. Hartford Accident & Indemnity 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 is a continuous trigger state. Under that rule, the insurance company on the risk when the first exposure to asbestos occurs is liable, along with insurance companies that continued on the risk until manifestation of an asbestos illness or death.

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 is 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 applies only 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 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 Accident & Indemnity 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 *Premcor Refining Group Inc. v. ACE Insurance Co. of Illinois*, No. 5-18-0210, 2019 WL 3814598 (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 had not assigned those policies to Premcor. 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 the 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." In some similar disputes, successor companies have argued

that a general assignment of contractual rights includes rights under insurance policies.

It is an open question whether such a general assignment would survive the *Premcor* test of "sufficient particularity." See also *PCS Nitrogen Inc. v. Continental Casualty Co.*, No. 2016-001140, 2019 WL 6884913 (S.C. Ct. App. Dec. 18, 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.

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 Insurance Co.*, 28 Cal. App. 5th 729 (Cal. App. Ct. 2018), 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. Thee Sombrero sued the security company at the nightclub.

That company defaulted, and Thee Sombrero sued the company's insurer directly. The trial court dismissed the claim, finding that the claim 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 Insurance 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 U.S. District Court for the Southern District of Indiana disagreed and ruled in favor of the policyholder. At first, the 7th U.S. Circuit Court of Appeals reversed.

However, it then granted a petition for rehearing, withdrew its prior opinion and adopted the District Court's decision.

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." 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*, Nos. 558, 560, 561, 2018, 2019 WL 5616263 (Del. Oct. 31, 2019).

Verizon had spun off a company that 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 attorney 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."

The trial court found there was coverage, holding that the definition of "security claim" was ambiguous and that contra proferentem applied. 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."

In *Conduent State Healthcare LLC v. AIG Specialty Insurance Co.*, No. N18C-12-074, 2019 WL 2612829 (Del. Super. Ct. June 24, 2019), the insured received a civil investigation

demand 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 Insurance 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 the term had a broad meaning not limited to the breach of fiduciary duty and found there was coverage.

However, the court also held that the corporate spinoff 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 spinoff, the former subsidiary that sued IDT was no longer a subsidiary, despite its central role.

In *Arch Insurance 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 instead were a covered loss.

In *Solera Holdings Inc. v. XL Specialty Insurance 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.

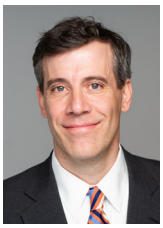
CONCLUSION

Insurance law is state law, which means that the parties can litigate each issue 50 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.

This article first appeared in the February 21, 2020, edition of Westlaw Journal Insurance coverage.

ABOUT THE AUTHORS



Robert D. Chesler (L) and **Nicholas M. Insua** (R) are shareholders in the Newark, New Jersey, office of **Anderson Kill**, where they represent policyholders in insurance coverage disputes. Chesler represents policyholders with a broad variety of coverage claims against their insurers and advises companies with respect to their insurance programs. Insua represents policyholder clients with respect to catastrophic first-party property damage and business interruption claims, D&O and E&O claims, and general liability claims, among others.