Simpson Thacher

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Following an emerging trend, the Ninth Circuit ruled that a statutory violation exclusion barred coverage for all underlying claims, including non-statutory claims. *Big 5 Sporting Goods Corp. v. Zurich Am. Ins. Co.*, 2015 WL 8057228 (9th Cir. Dec. 7. 2015) (unpublished decision). (click here for full article)

"Simpson Thacher & Bartlett is an elite firm that has demonstrated expertise in handling high-stakes matters."

–Chambers USA 2015, quoting a client

Illinois Appellate Court Rules That Insurer Has Duty to Defend Nuisance Suit

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A Rhode Island federal district court ruled that tax liens on residents' property are insured property and that an insurer is obligated to indemnify losses caused by erroneous tax bills. *Pfeiffer v. Am. Alt. Ins. Corp.*, 2015 WL 7016319 (D.R.I. Nov. 12, 2015). (click here for full article)

Application of Wrongful Acts Exclusion Turns on Policyholder's Subjective Knowledge, Says Sixth Circuit

The Sixth Circuit ruled that a wrongful acts exclusion was ambiguous and should be construed to require subjective knowledge on the part of the policyholder that a prior wrongful act would result in a claim. *Maxum Indem. Co. v. Drive West Ins. Svs., Inc.*, 2015 WL 7292722 (6th Cir. Nov. 18, 2015) (unpublished decision). (click here for full article)

Tenth Circuit Rules That Excess Insurers Are Not Required to "Drop Down" for Insolvent Primary Insurer

Addressing a matter of first impression under Oklahoma law, the Tenth Circuit ruled that excess and umbrella carriers did not have to "drop down" in the place of an insolvent primary insurer to defend or indemnify a policyholder in underlying asbestos litigation. *Canal Ins. Co. v. Montello, Inc.*, 2015 WL 7597429 (10th Cir. Nov. 27, 2015). (click here for full article)

Georgia Appellate Court Addresses Notice Requirement in Excess Policies

A Georgia appellate court found that notice was untimely as a matter of law, but that policy language required the insurer to establish prejudice, which presented a disputed issue of fact. *Plantation Pipe Line Co. v. Stonewall Ins. Co.*, 2015 WL 7306254 (Ga. Ct. App. Nov. 20, 2015). (click here for full article)

New York Court Rules That Multi-Dog, Multi-Victim Attack Constitutes One Occurrence

A New York federal district court declined to apply New York's "unfortunate event test" to determine the number of occurrences, finding that applicable policy language established the intent to aggregate multiple incidents into one occurrence. *Verlus v. Liberty Mut. Ins. Co.*, 2015 WL 7170484 (S.D.N.Y. Nov. 12, 2015). (click here for full article)

Texas Supreme Court Rules That Incorporation of Defective Component Is Not Physical Injury to Property

The Texas Supreme Court ruled that the installation of defective flanges in diesel units, without more, did not constitute physical injury under a general liability policy. *U.S. Metals, Inc. v. Liberty Mut. Grp., Inc.*, 2015 WL 7792557 (Tex. Dec. 4, 2015). (click here for full article)

Iowa Court Defines Scope of Physical Damage Under Property Policy

An Iowa federal district court ruled that the threat of flooding and alleged loss of use of office space did not establish physical damage for purposes of coverage under a property policy. *The Phoenix Ins. Co. v. Infogroup, Inc.*, 2015 WL 7755976 (S.D. Iowa Nov. 30, 2015). (click here for full article)

Coverage Alerts:

Ninth Circuit Rules That Statutory Violation Exclusion Bars Coverage For All Underlying Claims

Applying an exclusion for statutory violations, the Ninth Circuit barred coverage for all underlying claims, including non-statutory claims. *Big 5 Sporting Goods Corp. v. Zurich Am. Ins. Co.*, 2015 WL 8057228 (9th Cir. Dec. 7. 2015) (unpublished decision). This follows a growing trend reported on in our April and May 2014 and January 2015 Alerts.

Several class action suits were filed against Big 5 Sporting Goods, alleging the violation of plaintiffs' privacy rights by obtaining and publishing consumers' ZIP codes during credit card transactions. The complaints alleged violations of the Song-Beverly Act and the common law right to privacy. A California federal district court ruled that the insurers had no duty to defend or indemnify the suits based on the policies' Statutory Violation Exclusion, which barred coverage for injury "arising directly or indirectly out of any action or omission that violates or is alleged to violate any statute … ." The Ninth Circuit affirmed.

The court rejected Big 5's argument that insurers were obligated to defend because the suits contained common law and California constitutional right to privacy claims, separate and apart from the Song-Beverly Act violations. The court explained that "in garden variety ZIP code cases like these, such extra Song-Beverly Act privacy claims simply do not exist." The court further dismissed Big 5's attempt to obtain coverage by framing some of the underlying claims as based in negligence. The court stated, "a rose by any other name is still a rose, so a ZIP Code case by under any other label remains a ZIP Code case." A Wisconsin appellate court employed the same reasoning and ruled that a similarly-worded TCPA exclusion barred coverage for both statutory and common law conversion claims. *See State Farm Fire & Cas. Co. v. Easy PC Solutions, LLC*, 2015 WL 8215533 (Wis. Ct. App. Dec. 9, 2015).

Other courts have denied coverage for ZIP code-related privacy claims on the basis that they do not allege a covered advertising injury. *See, e.g., OneBeacon Am. Ins. Co. v. Urban Outfitters, Inc.*, 2015 WL 5333845 (3d Cir. Sept. 15, 2015) (discussed in our October 2015 Alert).

Illinois Appellate Court Rules That Insurer Has Duty to Defend Nuisance Suit

An Illinois appellate court ruled that an insurer was obligated to defend its insured in an underlying nuisance suit. *Country Mut. Ins. Co. v. Bible Pork, Inc.*, 2015 WL 7424845 (Ill. App. Ct. Nov. 20, 2015).

Bible Pork, operator of a hog factory facility, was sued by a group of property owners. Plaintiffs alleged that the facility was a source of "disagreeable noises, odors, dust particles, surface water contamination, and loss of property values which would interfere with their lives and render the facility a public and private nuisance." Bible Pork provided notice of the suit to its insurer, Country Mutual, which denied coverage. In ensuing litigation, an Illinois trial court ruled that Country Mutual was obligated to defend the suit. An appellate court affirmed on the basis of several significant holdings relating to an insurer's duty to defend nuisance suits.

First, the appellate court ruled that the nuisance suit sought "damages" as required by the policies. Country Mutual argued that the suit did not seek damages because it requested only equitable relief in the form of a declaratory judgment. The court disagreed, explaining that the suit could be construed to seek damages because, in addition to equitable relief, it asked for "other relief deemed appropriate." According to the court,

this phrase was sufficient to establish a claim for damages. Second, the court concluded that the complaint alleged an "occurrence" and that the "expected or intended injury" exclusion did not apply. The court reasoned that the focus of the occurrence inquiry is whether the insured intended the resulting injury, not whether the insured's acts were performed intentionally. Here, because Bible Pork sought and was granted regulatory approval prior to construction of the hog factory, the court held that it could not be considered to have expected or intended to cause injury to the underlying plaintiffs. Finally, the court ruled that the pollution exclusion did not relieve Country Mutual of its duty to defend because it was ambiguous as to whether it applied to non-traditional pollution emissions. In so ruling, the court relied on *Country Mut. Ins. Co. v. Hilltop View, LLC*, 998 N.E.2d 950 (Ill. App. Ct. 2013) (discussed in our December 2013 Alert), in which an Illinois appellate court ruled that a pollution exclusion did not bar coverage for nuisance claims based on the emanation of foul odors from a hog farm.

Rhode Island Court Rules That Tax Liens Are Insured Property

A Rhode Island federal district court ruled that tax liens on residents' property are insured property and that an insurer is obligated to indemnify losses caused by erroneous tax bills. *Pfeiffer v. Am. Alt. Ins. Corp.*, 2015 WL 7016319 (D.R.I. Nov. 12, 2015).

The Central Coventry Fire District in Rhode Island has authority to tax the businesses and residents within its geographical region in order to fund fire-fighting and rescue services. Under local law, the tax bills are a lien on the taxed property. In 2010, the tax collector made several errors in calculating the District's budget, resulting in a significant shortfall for that fiscal year. The mistakes went unreported and were repeated the following year, further compounding the shortfall. Thereafter, a special master was appointed to oversee the District's finances. The special master made a claim to the District's insurer seeking coverage for the losses incurred in the two tax billing cycles. The insurer denied the claim.

The policy covered the "[f]ailure of any 'employee' to faithfully perform his or her duties as prescribed by law, when such failure has as its direct and immediate result a loss of your covered property." The term "covered property" was defined as property "that you own or hold; or for which you are legally liable." The crux of the parties' dispute was whether the budget shortfall constituted "covered property." The court held that it did. The court reasoned that the tax liens could be considered property that the District "owned or for which it was legally liable" because, under governing local law, the District was charged with the responsibility of assessing taxes and those taxes constituted "a lien on the real estate, due and owing until collected." In so ruling, the court rejected the insurer's argument that the loss was a speculative projection, or "monies not due the District" because of the accounting errors.

Application of Wrongful Acts Exclusion Turns on Policyholder's Subjective Knowledge, Says Sixth Circuit

Reversing an Ohio federal district court decision, the Sixth Circuit ruled that a wrongful acts exclusion was ambiguous and should be construed to require subjective knowledge on the part of the policyholder that a prior wrongful act would result in a claim. *Maxum Indem. Co. v. Drive West Ins. Svs., Inc.*, 2015 WL 7292722 (6th Cir. Nov. 18, 2015) (unpublished decision).

Starting in 2011, Mulberry, a wholesale insurance broker, issued quotes and binders for insurance coverage to National Condo & Apartment Insurance Group ("NCAIG"). NCAIG later learned that the quotes and binders were fraudulent. Later that year, Mulberry and NCAIG received

cease-and-desist letters informing them that the quotes and binders were not authorized. Mulberry also received a notice from the Illinois Department of Insurance, indicating that certain binders of insurance purportedly issued by Mulberry might not be legally valid.

Sometime later, several property owners sued NCAIG when they learned their insurance was not valid. NCAIG demanded indemnification from Mulberry. Mulberry, in turn, sought coverage under an errors and omissions policy issued by Maxum in 2012. Maxum denied coverage based on an exclusion that applied to "[a]ny claim arising out of or resulting from any 'wrongful act' ... [y]ou had knowledge of or information related to, prior to the first inception date of ... coverage with us, and which may result in a 'claim.'" In coverage litigation, an Ohio district court ruled that the exclusion barred coverage because the underlying claims arose from wrongful conduct "of which Mulberry had related information" prior to the policy's March 2012 inception date. The Sixth Circuit reversed.

Applying California law, the Sixth Circuit ruled that the exclusion was ambiguous and must therefore be construed in favor of coverage. Maxum argued that the exclusion applied to "all claims where the insured simply had information prior to the coverage period relating to a 'wrongful act' that resulted in a claim." Under this interpretation, the exclusion would bar coverage. In contrast, NCAIG contended that the exclusion encompassed "only those claims arising from wrongful acts that [Mulberry] subjectively believed, prior to inception of the Policy, would result in claims." Finding both interpretations reasonable, the court endorsed the latter view, and held that Maxum had not established such subjective knowledge on the part of Mulberry. Although Mulberry had received several cease-and-desist letters from insurers and a notice from the Department of Insurance prior to the policy inception date, the court held that these notices did not establish subjective awareness of potential litigation. In reaching this conclusion, the court emphasized that none of the correspondence included demands for relief or threatened litigation. The court therefore reversed the trial court's summary judgment ruling in Maxum's favor and granted NCAIG's summary judgment motion on the breach of the duty to defend and indemnify under the policy.

Excess Alerts:

Tenth Circuit Rules That Excess Insurers Are Not Required to "Drop Down" for Insolvent Primary Insurer

Addressing a matter of first impression under Oklahoma law, the Tenth Circuit ruled that excess and umbrella carriers did not have to "drop down" in the place of an insolvent primary insurer to defend or indemnify a policyholder in underlying asbestos litigation. *Canal Ins. Co. v. Montello, Inc.*, 2015 WL 7597429 (10th Cir. Nov. 27, 2015).

Home Insurance Company provided primary insurance for Montello, a distributor of asbestos-containing products. Home became insolvent before any claims were paid on Montello's behalf. When it became apparent that Home would be unable to fulfill its contractual obligations, Montello sought defense and indemnity from its excess and umbrella insurers. Because underlying limits had not been paid, the excess and umbrella insurers sought a ruling that they had no duty to defend or indemnify Montello. An Oklahoma federal district court ruled in the excess insurers' favor, predicting that Oklahoma would follow the majority of jurisdictions to find that an excess insurer is not obligated to assume an insolvent primary insurer's defense or indemnity obligations, absent policy language indicating the intent to do so. *Canal Ins. Co. v. Montello, Inc.*, 2013 WL 6732658 (N.D. Okla. Dec. 19, 2013)

(discussed in our January 2014 Alert). The Tenth Circuit affirmed.

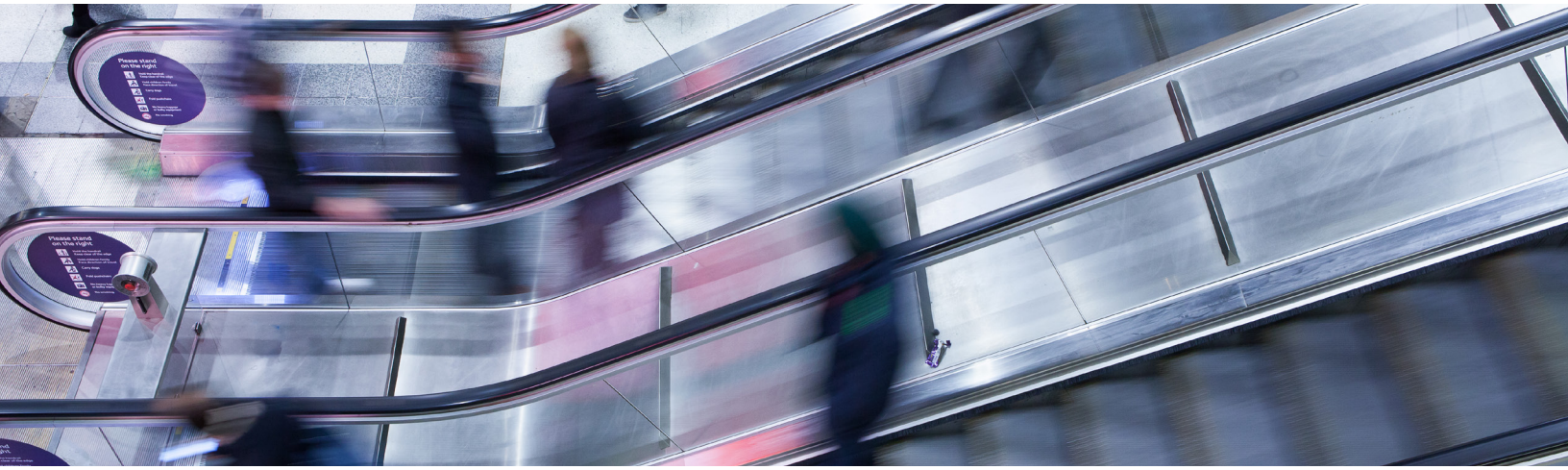
Ruling that excess and umbrella insurers had no duty to "drop down" to provide defense or indemnity, the Tenth Circuit rejected Montello's argument that Home's insolvency was an "occurrence" covered by the excess policies. The court similarly rejected the argument that a primary insurer's inability to pay a loss is equivalent to exhaustion by payment of loss. The Tenth Circuit also dismissed Montello's attempt to obtain coverage pursuant to various other policy provisions, including an "other insurance" clause, finding it inapplicable to the case at bar. Finally, the court rejected Montello's suggestion that the "reasonable expectations" doctrine provided a basis for finding coverage, finding that policy language was unambiguous, and that in any event, a reasonable insured would not have understood excess and umbrella policies to provide coverage insuring the solvency of the primary insurer.

Georgia Appellate Court Addresses Notice Requirement in Excess Policies

A Georgia appellate court issued a mixed ruling on an excess insurer's late notice defense, finding that notice was untimely as a matter of law, but that policy language required the insurer to establish prejudice, which presented a disputed issue of fact. *Plantation Pipe Line Co. v. Stonewall Ins. Co.*, 2015 WL 7306254 (Ga. Ct. App. Nov. 20, 2015).

The coverage dispute arose from a leak in one of Plantation's pipelines. The leak was discovered and immediately repaired in 1976. More than thirty years later, in 2007, contaminated soil traced to the 1976 leak was discovered at the site. Plantation then sent notice to its primary insurer and three excess carriers. Three years later, in 2010, when Plantation discovered the existence of the Stonewall policy through a search conducted by Plantation's former counsel, it notified Stonewall that its policy was likely to be implicated by third-party claims arising from the contamination. Stonewall denied coverage on several bases, including late notice. Ruling on cross-motions for summary judgment, a Georgia trial court ruled that Plantation forfeited coverage under the Stonewall policy by failing to give timely notice. The appellate court affirmed in part and reversed in part.

The appellate court affirmed the trial court's ruling that Plantation's notice was untimely as a matter of law. The appellate court rejected Plantation's arguments that (1) it did not reasonably believe that its losses would reach the $2 million attachment point of the Stonewall policy before 2010; and (2) notice was reasonably prompt under the circumstances. As to the first point, the court explained that the factual record established that Plantation knew as early as 2008 that its costs would likely exceed $2 million, evidenced by the fact that Plantation notified other excess carriers at that time. As to the second point, the court held that even assuming that an insured's inability to locate a policy could constitute an excuse for late notice (an issue the court declined to reach), there was "no evidence that the policy could not have been … discovered any earlier."



However, the appellate court parted ways with the trial court on the issue of prejudice. It explained that if a policy makes prompt notice an express condition precedent to coverage, an insurer is not required to establish prejudice. Conversely, where a notice provision does not contain explicit "condition precedent" language, an insurer must demonstrate prejudice as a result of the untimely notice. The court ruled that the trial court erred in concluding that general introductory policy language requiring both parties to adhere to contract provisions was a "condition precedent" clause. The appellate court further ruled that Stonewall failed to establish prejudice as a matter of law, notwithstanding the more than two-year delay in providing notice. The court explained that although Stonewall was entitled to timely investigate claims, an excess insurer is "not necessarily … entitled to an opportunity to investigate in the early days following an occurrence that gives rise to an insured's liability, as a primary carrier may be." In this respect, the decision highlights the distinction between the events that typically trigger an insured's obligation to provide notice to a primary insurer (*i.e.*, knowledge of an occurrence giving rise to liability) and the events that trigger notice obligations under excess policies (*i.e.*, assessment regarding likelihood that exposure will exceed primary limits). The appellate court noted that although Stonewall may succeed in establishing prejudice as a matter of fact based on "particularized evidence of harm," its "bare assertion" that it was deprived of an opportunity to investigate during the two-year delay was insufficient to establish prejudice as a matter of law.

Number of Occurrences Alert:

New York Court Rules That Multi-Dog, Multi-Victim Attack Constitutes One Occurrence

Our October 2015 Alert reported on a Second Circuit decision holding that under New York's "unfortunate event" test, a series of closely-related automobile accidents within a short time span constitute three separate "accidents" for purposes of policy coverage. *Itzkowitz v. Nat'l Liab. & Fire Ins. Co.*, 2015 WL 5332109 (2d Cir. Sept. 15, 2015), as amended (Sept. 22, 2015). There, the court rejected the insurer's contention that the policy language at issue (providing that all injury and damage "resulting from continuous or repeated exposure to substantially the same conditions will be considered as resulting from one 'accident'") evidenced an intent to aggregate separate accidents into a single occurrence. In a decision issued last month, a New York federal district court, faced with nearly identical policy language, reached the opposite conclusion and held that policy language established the intent to aggregate multiple incidents into one occurrence. *Verlus v. Liberty Mutual Ins. Co.*, 2015 WL 7170484 (S.D.N.Y. Nov. 12, 2015).

Verlus arose from an attack by two dogs on two pedestrians, Jean and Joanne, who were walking down the street at the same time. One dog attacked Jean, while the other attacked Joanne. After less than a minute, Joanne escaped to higher ground, at which point the dog that had been attacking her joined the other dog in attacking Jean. The pedestrians successfully sued the dogs' owners for their injuries. The pedestrians then received a payment from the dog-owners' insurer (Liberty Mutual) that fell far short of the judgment awarded in the tort litigation. Liberty Mutual argued that the sum paid was the maximum allowed for a single occurrence under the dog-owners' policy. The pedestrians sought a declaration that the dog attack constituted three separate occurrences under the policy (the attack on Jean, the attack on Joanne, and the attack on Jean by the dog that was originally attacking Joanne).

The court noted that New York applies the "unfortunate event" test to determine the number of occurrences unless policy language

evidences the parties' intent to aggregate separate events into one occurrence. The court held that the language before it (stating that "continuous or repeated exposure to substantially the same general harmful conditions shall be considered to be the result of one occurrence") evidences such intent. Therefore, the court declined to apply the unfortunate event test and instead held that the proper inquiry was "whether the underlying attacks emanated from the same location at a substantially similar time." Applying this standard, the court concluded that the attacks constituted a single occurrence because the pedestrians were walking close together, the dogs approached from the same direction at the same time, and the incident lasted for a short three to four minute period.

"Physical Loss" Alerts:

Texas Supreme Court Rules That Incorporation of Defective Component Is Not Physical Injury to Property

Answering questions certified by the Fifth Circuit, the Texas Supreme Court ruled that the installation of defective flanges in diesel units, without more, does not constitute physical injury under a general liability policy. *U.S. Metals, Inc. v. Liberty Mut. Grp., Inc.*, 2015 WL 7792557 (Tex. Dec. 4, 2015).

U.S. Metals sold flanges to ExxonMobil for use in diesel units. After the flanges were installed, ExxonMobil discovered that they were defective. The process of replacing the flanges required the destruction of several components of the diesel units. U.S. Metals agreed to pay ExxonMobil for the costs of replacing the flanges as well as the loss of use of the diesel units during the process, and then sought indemnification from Liberty Mutual under a general liability policy. Liberty Mutual denied coverage. In ensuing litigation, a Texas federal district court ruled in Liberty Mutual's favor. On appeal, the Fifth Circuit certified four questions relating to interpretation of several policy provisions. The questions presented two central issues: (1) did the mere installation of the faulty flanges cause "physical injury" to the diesel units when the only harm at that point was the risk of leaks?; and (2) is property "restored to use" by replacing a faulty component when the property must be altered, damaged and repaired in the process?

The Texas Supreme Court ruled that physical injury requires harm that is tangible and manifest. Therefore, incorporating a defective component into a larger product is not, in and of itself, physical injury, even though there may be intangible injury, such as diminution in value or increased risk of damage. However, the Court ruled that physical injury occurred when components were cut and destroyed in order to replace the faulty flanges. The Court distinguished between, on the one hand, the units considered as organic wholes, and, on the other hand, the particular components of the units. The Court found that "Exclusion M" of the policy barred

coverage for physical injury to the units considered as organic wholes. Exclusion M precludes coverage for impaired property that can be "restored to use." The Court found that the diesel units were impaired property that could be (and actually were) restored to use. Exclusion M did not apply, however, to those particular components of the units (*e.g.* the insulation and gaskets) that were not restored to use but destroyed and replaced. The policy therefore covered the cost of replacing such components.

The Court acknowledged the "perverse aspect" of the decision, noting that had ExxonMobil been negligent in failing to test the flanges, and had damage resulted, the policy would have provided coverage. However, the Court emphasized that coverage

issues are dictated by policy language, not by "what coverage should be available."

Iowa Court Defines Scope of Physical Damage Under Property Policy

An Iowa federal district court ruled that the threat of flooding and alleged loss of use of office space did not constitute physical damage for purposes of coverage under a property policy. *The Phoenix Ins. Co. v. Infogroup, Inc.*, 2015 WL 7755976 (S.D. Iowa Nov. 30, 2015).

Faced with threats of Missouri River flooding, a policyholder relocated its business and then sought compensation for its relocation costs and associated expenses from its insurer, Phoenix Insurance. Phoenix initially advanced some money, but later brought suit seeking a declaration that it had no coverage obligation. The parties disputed several aspects of coverage, including whether the policyholder established "direct physical loss or damage," a prerequisite for coverage under the Extra Expense Clause ("EEC"). The policyholder argued that it sustained physical loss in two respects: (1) the "loss of use" of its office due to the threat of flooding; and (2) physical loss at various times after it relocated its office. The court rejected both contentions.

First, the court held that physical loss or damage "generally requires some sort of physical invasion, however minor." The court therefore reasoned that the policyholder's loss of use of its office space due to a threatened event (rather than actual, existing damage) did not constitute a physical loss. The court further held that the factual record did not establish a loss of use of the property because the policyholder continued to house employees and equipment at its original office during the relevant time frame. Second, the court ruled that to the extent the policyholder suffered physical losses after relocation, those losses were not covered by the EEC because there was no causal relationship between the covered physical losses and the policyholder's decision to relocate (*i.e.*, that the physical damage caused the policyholder to incur moving expenses). No causal relationship existed here because all alleged physical losses occurred after the policyholder had already relocated. In emphasizing the causal relationship requirement, the court cited to *United Airlines, Inc. v. Ins. Co. of the State of Pa.*, 385 F. Supp.2d 343 (S.D.N.Y. 2005), in which the court rejected a claim for $1.2 billion in business interruption coverage following the World Trade Center attack because the amount of recovery sought, based on the total shutdown of U.S. aviation system, bore no relation to the actual property damage suffered by the policyholder at its World Trade Center ticket counter. *See* December 2012 Alert.

Simpson Thacher

Simpson Thacher has been an international leader in the practice of insurance and reinsurance law for more than a quarter of a century. Our insurance litigation team practices worldwide.

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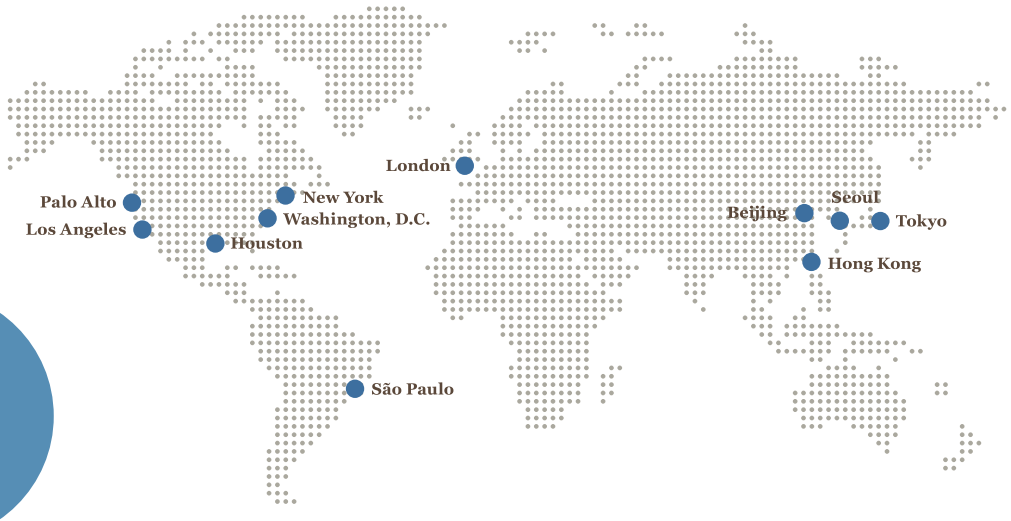

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