Simpson Thacher

The Insurance Disputes Law Review

December 2019

Simpson Thacher Litigation Partner Susannah Geltman and Counsel Summer Craig authored the United States chapter in the second edition of *The Insurance Disputes Law Review*. Published as part of *The Law Reviews* series, the book discusses important developments across more than fifteen jurisdictions in insurance disputes over the past year. The book features commentary on the global importance of and interest in the legal framework surrounding insurance, particularly in the developing area of disputes.

The full edition is available through the publisher's website and can be obtained here.

Susannah S. Geltman
+1-212-455-2762
sgeltman@stblaw.com

Summer Craig
+1-212-455-3881
scraig@stblaw.com

Inside the Second Edition

THE INSURANCE DISPUTES LAW REVIEW

SECOND EDITION

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This article was first published in October 2019
For further information please contact Nick.Barette@thelawreviews.co.uk

Editor
Joanna Page

THE LAWREVIEWS

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Published in the United Kingdom
by Law Business Research Ltd, London
Meridian House, 34-35 Farringdon Street, London, EC2A 4HL, UK

www.TheLawReviews.co.uk

ISBN 978-1-83862-070-7

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

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ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

ALLEN & OVERY LLP

AL TAMIMI & COMPANY

BECH-BRUUN LAW FIRM P/S

HOGAN LOVELLS STUDIO LEGALE

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PREFACE

This is now the second edition of *The Insurance Disputes Law Review*. I am delighted to be the editor of this excellent and succinct overview of recent developments in insurance disputes across 16 important insurance jurisdictions, including now the United States.

The first edition was very well received and demonstrated both the need and the very active interest, evident across the globe, in the legal frameworks for insurance and, in particular, in the insight that the developing disputes arena provides into this fascinating area.

Insurance is a vital part of the world's economy and critical to risk management in both the commercial and the private worlds. The law that has developed to govern the rights and obligations of those using this essential product can often be complex and challenging, with the legal system of each jurisdiction seeking to strike the right balance between the interests of insurer and insured and also the regulator who seeks to police the market. Perhaps more than any other area of law, insurance law can represent a fusion of traditional concepts that are almost unique to this area of law with entrepreneurial development, as insurers strive to create new products to adapt to our changing world. This makes for a fast-developing area, with many traps for the unwary. Further, as this indispensable book shows, even where the concepts are similar in most jurisdictions, they can be implemented and interpreted with very important differences in different jurisdictions.

To be as user-friendly as possible, each chapter follows the same format – first providing an overview of the key framework for dealing with disputes, and then giving an update of recent developments in disputes.

As editor, I have been impressed by the erudition of each author and the enthusiasm shown for this fascinating area. It has also been particularly interesting to note the trends that are developing in each jurisdiction. An evolving theme in almost every jurisdiction is the increase in protections for policyholders. Much of the special nature of insurance law has developed from an imbalance in knowledge between the policyholder (who had historically been blessed with much greater knowledge of the risk to be insured) and the insurer (who knew less and therefore had to rely on the duties of disclosure of the policyholder). With the increasing use of artificial intelligence to assess data and more detailed scope for analysis across risk portfolios, the balance of knowledge has shifted; it will often now be the insurer who is better placed to assess the risk. This shift has manifested itself in tighter rules requiring insurers to be specific in the questions to be answered by policyholders when they place insurance, and in remedies more targeted at the insurer if full information is not provided. Coupled with these trends, however, is the increasing desire by some jurisdictions to set limits on the questions that can be asked so that, for example in relation to healthcare insurance, policyholders are not denied insurance for historical matters. We can expect that this tussle

between the commercial imperative for insurers to price risk realistically and the need to balance consumer protection, government policy and privacy will increasingly be at the heart of insurance disputes.

It is also fascinating to see how global concerns around climate change and cyber risk are working their way through the legal systems, with jurisdictions, particularly the United States, leading the way in assessing how existing insurance products might respond to these risks.

No matter how carefully formulated, no legal system functions without effective mechanisms to hear and resolve disputes. Each chapter therefore also usefully considers the mechanisms for dispute resolution in each jurisdiction. Courts appear to remain the principal mechanism but arbitration and less formal mechanisms (such as the Financial Ombudsman in the United Kingdom) can be a significant force for efficiency and change when functioning properly. The increasing development of class action mechanisms, particularly among consumer bodies (e.g., in France and Germany) is likely to be an important factor.

I would like to express my gratitude to all the contributing practitioners represented in *The Insurance Disputes Law Review*. Their biographies are to be found in the first appendix and highlight the wealth of experience and learning that the contributors bring to this volume. I must also thank Russell Butland, who is a senior associate with my firm and a highly talented lawyer. He has done much of the hard work in this project, together with Frances Beddow, who has helped enormously in the research.

Finally, I would also like to thank the whole team at Law Business Research, who have excelled at bringing the project to fruition and in adding a professional look and more coherent finish to the contributions.

Joanna Page
Allen & Overy LLP
London
October 2019

Chapter 16

UNITED STATES

Susannah Geltman and Summer Craig[1]

I OVERVIEW

In the United States, insurance disputes are primarily governed by state law. Each state has its own statutory and common law applicable to insurance-related matters. Because the relevant law varies from state to state, practitioners must conduct a careful evaluation of potentially applicable law at the outset of an insurance dispute.

Most insurance disputes in the US are litigated in the first instance in state or federal trial courts. Disputes may also be subject to arbitration if the insurance contract contains an arbitration clause. Where an insurance contract requires the parties to arbitrate but applicable state statutory law prohibits insurance-related arbitration, courts will address whether state law supersedes or preempts federal law or treaties favouring arbitration.

US courts recently have addressed a number of significant insurance-related issues, including the proper allocation of losses arising from 'long-tail' liabilities between insurers and policyholders, coverage for disgorgement, malpractice claims by insurers against insurer-appointed counsel for policyholders and cyber insurance. Going forward, courts undoubtedly will continue to address the parameters of cyber-related coverage and issues related to long-tail claims. In addition, insurers may find themselves increasingly embroiled in coverage disputes arising out of climate change events.

II THE LEGAL FRAMEWORK

i Sources of insurance law and regulation

The regulation of insurance in the US is primarily performed by the states. In 1945, the US Congress passed the McCarran-Ferguson Act,[2] which provides that 'No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance.'[3] Under the McCarran-Ferguson Act, federal law preempts state insurance law only if it specifically relates to 'the business of insurance'.

The law of insurance in the US generally falls into one of two broad categories: (1) the regulation of entities that participate in the business of insurance; and (2) the regulation of

1 Susannah Geltman is a partner and Summer Craig is counsel at Simpson Thacher & Bartlett LLP. The authors would like to acknowledge Karen Cestari of Simpson Thacher & Bartlett LLP for her contribution to this chapter.

2 15 U.S.C. §§ 1011-15 (1945).

3 *Id.* § 1012(b).

the policyholder–insurer relationship. State law pertaining to the regulation of entities is generally comprised of statutes enacted by state legislatures and administrative regulations issued by state agencies, such as departments of insurance.

Each state also has statutory and common law applicable to the policyholder–insurer relationship. State statutes address a range of topics, including, among others, the disclosure obligations of the parties to an insurance contract, the nature of a policyholder's notice obligations and the circumstances in which a victim of tortious conduct may sue a tortfeasor's insurer directly. State common law is an important source of law for resolving disputes between policyholder and insurer. Practitioners must carefully assess potentially applicable law at the outset of a dispute, as insurance law (whether common law or statutory) varies by jurisdiction.

ii Insurable risk

In the US, the validity of an insurance contract ordinarily is premised on the existence of an insurable interest in the subject of the contract. An insurable interest may be defined as any lawful and substantial economic interest in the safety or preservation of the subject of the insurance free from loss, destruction or pecuniary damage.[4] The insurable interest doctrine was first adopted by courts[5] and has since been codified in state statutes.[6] The purpose of the insurable interest requirement, as articulated by courts and commentators, is to discourage wagering and the destruction of life and property and avoid economic waste.

iii Fora and dispute resolution mechanics

Litigation of insurance disputes

The US judicial system is comprised of two separate court systems. The US itself has a system comprised of federal courts and each of the 50 states has its own system comprised of state courts. Although there are important differences between federal and state courts, they share some key characteristics. Each judicial system has trial courts in which cases are originally filed and tried, a smaller number of intermediate appellate courts that hear appeals from the trial courts and a single appellate court of final review.

Unlike state courts, which include courts of general jurisdiction that can address most kinds of cases, federal courts principally have jurisdiction over two types of civil cases. First, federal courts may hear cases arising out of the US Constitution, federal laws or treaties.[7] Second, federal courts may address cases that fall under the federal 'diversity' statute, which generally authorises courts to hear controversies between citizens of different US states and controversies between citizens of the US and citizens of a foreign state.[8] For diversity jurisdiction to exist, there must be 'complete' diversity between litigants (i.e., no plaintiff shares a state of citizenship with any defendant) and the 'amount in controversy' must exceed US$75,000.

Most insurance disputes are litigated in the first instance in federal or state trial courts. Federal courts commonly exercise jurisdiction over insurance disputes under the diversity

4 *See generally* Steven Pitt *et al.*, Couch on Insurance § 41:1 (3rd ed. 2019).

5 *See, e.g.*, *Kramer v. Phoenix Life Ins. Co.*, 940 N.E.2d 535 (N.Y. 2010) (discussing common law origins and codification of New York insurable interest requirement).

6 *See, e.g.*, Cal. Ins. Code §§ 280, 281 (2019).

7 28 U.S.C. § 1331 (1980).

8 28 U.S.C. § 1332(a) (2011).

statute. In this context, an insurance company, like any other corporation, is deemed to be a citizen of both the state in which it is incorporated and the state in which it has its principal place of business.

An insurance action that is originally filed in state court may be 'removed' to federal court based on diversity of citizenship of the litigants. In the absence of diversity of citizenship or some other basis of federal court jurisdiction, insurance disputes are litigated in state courts. The venue is typically determined by the place of injury or residence of the parties, or may be dictated by a forum selection clause in the governing insurance contract. The law applied to the dispute may likewise be dictated by a choice-of-law clause in the insurance contract or, in the absence of such a clause, determined by a court based on relevant choice-of-law principles.

Arbitration of insurance disputes

Some insurance contracts contain arbitration clauses, which are usually strictly enforced. The Federal Arbitration Act (FAA)[9] and similar state statutes empower courts to enforce arbitration agreements by compelling the parties to arbitrate. If an insurance contract contains a broadly worded arbitration clause, virtually every dispute related to or arising out of the contract typically may be resolved by arbitrators rather than a court of law.

While all US states recognise the validity and enforceability of arbitration agreements in general, some states have made a statutory exception for arbitration clauses in insurance contracts. Complex legal issues may arise when an insurance contract obligates parties to arbitrate but applicable state statutory law prohibits the arbitration of insurance-related disputes. Although state laws that prohibit arbitration are generally preempted by the FAA, by virtue of the Supremacy Clause in the US Constitution, state anti-insurance arbitration statutes may be saved from preemption by the McCarran-Ferguson Act. As noted, the McCarran-Ferguson Act provides that state laws enacted 'for the purpose of regulating the business of insurance' do not yield to conflicting federal statutes unless a federal statute specifically relates to the business of insurance. Because the FAA does not specifically relate to insurance, courts have held that the FAA may be 'reverse preempted' by a state anti-insurance arbitration statute if the state statute has the purpose of regulating the business of insurance.[10] As discussed in Section IV, courts are split regarding whether the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention), an international treaty that mandates the enforcement of arbitration agreements, may be reverse preempted pursuant to the McCarran-Ferguson Act.

Where an insurance dispute is resolved through arbitration, the resulting award is generally considered to be binding, although there are grounds to vacate or modify an award under the FAA, similar state statutes and the New York Convention. The FAA describes four limited circumstances in which an arbitration award may be vacated by a court: (1) where the award was procured by corruption, fraud or undue means; (2) where there was evident partiality or corruption in the arbitrators; (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown or in refusing to hear evidence pertinent and material to the controversy; or if by any other misbehaviour the rights of any party have been prejudiced; or (4) where the arbitrators exceeded their powers or so

9 9 U.S.C. §§ 1-16 (1947).

10 *See, e.g.*, *Standard Life Ins. v. West*, 267 F.3d 821 (8th Cir. 2001) (Missouri statute's insurance arbitration bar reverse preempts FAA pursuant to McCarran-Ferguson Act).

imperfectly executed them that a mutual, final and definite award upon the subject matter submitted was not made.[11] One area of legal uncertainty is whether a court may vacate an award based on an arbitrator's 'manifest disregard' of the law. Although the manifest disregard standard is not listed in the FAA, some courts have ruled that an award may be vacated on this basis.

III RECENT CASES

US courts recently have addressed a number of significant insurance-related issues, including the proper allocation of long-tail losses between insurers and policyholders, coverage for disgorgement, malpractice claims by a defending insurers against insurer-selected counsel and cyber insurance.

i Unavailability exception to pro rata allocation

When injury or damage from long-tail liabilities, such as asbestos or environmental contamination, trigger coverage under more than one policy, courts are tasked with devising an appropriate method for allocating losses among multiple policies. The two primary methods of allocation recognised by US courts are: (1) finding each triggered policy to be jointly and severally liable for the entire loss (all sums); and (2) allocating the losses to each triggered policy on a pro rata basis. Pro rata allocation is based on the fact that some liability policies provide coverage only for losses occurring 'during the policy period'.

Under the pro rata allocation method, a policyholder generally must pay a share of its own long-tail liability costs for years when it had no policies in place. If an 'unavailability' exception is applied, however, the policyholder need not cover costs incurred during periods when insurance was unobtainable (either because it had not yet been offered by insurers or because the industry had adopted a pollution exclusion); instead, those costs are spread among the company's insurers.

The highest courts of two states – New York and New Jersey – recently addressed the question of whether an unavailability exception to pro rata allocation exists under their respective laws, and reached different conclusions. In *KeySpan Gas East Corp v. Munich Reinsurance America Inc*,[12] New York's highest court rejected an unavailability exception to pro rata allocation, holding that policyholders, not insurers, are responsible for damages that occurred during periods in which applicable insurance coverage was unavailable. The coverage dispute in *KeySpan* arose out of environmental contamination that took place over several decades. In declining to apply an unavailability exception, the court relied on policy language limiting coverage to losses that occurred during the policy period, explaining that there was no basis for exposing an insurer to risks beyond those contemplated by unambiguous policy language. The court also explained that the unavailability exception 'would effectively provide insurance coverage to policyholders for years in which no premiums were paid and in which insurers made the calculated choice not to accept premiums for the risk in question'.

By contrast, New Jersey's highest court affirmed the applicability of the unavailability exception in *Continental Insurance Company v. Honeywell International, Inc*.[13] The coverage dispute in that case arose from Honeywell's production of asbestos-containing products from

11 9 U.S.C. § 10(a) (2002).

12 96 N.E.3d 209 (N.Y. 2018).

13 188 A.3d 297 (N.J. 2018).

1940 until 2001. The policies from 1986 to 2001 contained exclusions for asbestos-related liabilities. The court held that the unavailability exception to pro rata allocation was a matter of established law in New Jersey and that, while the court '[would] not hesitate to revisit' this approach if it proved 'inefficient or unrealistic', this case 'does not present a compelling vehicle to reconsider our precedent on allocation'.

A third case that implicates the unavailability exception is currently pending in Connecticut's highest court: *RT Vanderbilt Co, Inc v. Hartford Accident & Indem Co*.[14]

ii Disgorgement

Delaware's highest court and a New York intermediate appellate court recently addressed the ongoing debate over whether policyholders are entitled to coverage for losses characterised as 'disgorgement' of wrongfully obtained funds.

The Delaware court ruled that class action settlement payments made by TIAA-CREF – a provider of investment counselling – was not uninsurable disgorgement under New York law. *In re: TIAA-CREF Ins Appeals*.[15] The court noted that New York public policy prohibits insurance coverage for disgorgement where 'payment is conclusively linked, in some fashion, to improperly acquired funds in the hands of the insured'. However, the court concluded that no conclusive showing of ill-gotten gains was made here. The court cited New York cases finding disgorgement uninsurable, explaining that those cases involved conclusive links between the insured's misconduct and the payment of funds, whereas here TIAA-CREF expressly denied any liability for its alleged failure to pay financial gains that had accrued in customers' accounts. Additionally, the court noted that New York cases finding disgorgement uninsurable involved claims brought by government or regulatory entities, whereas the claims against TIAA-CREF were brought in private civil actions.

Several months later, a New York appellate court ruled that no coverage existed for a policyholder's settlement payment to the US Securities and Exchange Commission (SEC) characterised as disgorgement. *JP Morgan Securities, Inc v. Vigilant Insurance Co*.[16] The court ruled that the disgorgement payment was not a covered 'loss', defined by the operative liability policy to exclude 'fines or penalties imposed by law', because the payment constituted an excluded penalty. The court relied on the US Supreme Court's ruling in *Kokesh v. SEC*,[17] which expressly held that 'SEC disgorgement constitutes a penalty.'

iii Malpractice actions by defending insurer against insurer-selected counsel for policyholder

Joining a majority of states to consider the issue, the South Carolina Supreme Court recently held that an insurer may pursue a legal malpractice claim against counsel it hired to defend its insured. In *Sentry Select Insurance Co v. Maybank Law Firm, LLC,*[18] the Court ruled that an insurer's malpractice action concerning a law firm's alleged mishandling of litigation regarding a car crash involving its insureds was viable, notwithstanding the absence of an attorney–client relationship between counsel and the insurer. The Court explained that although counsel owes a fiduciary duty only to the insured, the 'unique position' of

14 156 A.3d 539 (Conn. App. Ct. 2017), *review granted in part*, 171 A.3d 63 (Conn. 2017).

15 192 A.3d 554 (Del. 2018).

16 84 N.Y.S.3d 436 (N.Y. App. Div. 2018).

17 137 S. Ct. 1635 (2017).

18 826 S.E.2d 270 (S.C. 2019).

the insurer in this context militates in favour of allowing a malpractice claim. Limiting its holding, the Court emphasised that an insurer may recover damages for an attorney's breach of duty to an insured client only where the insurer proves that its claim for damages arose proximately as a result of the breach, and that there can be no liability if the interests of the client 'are the slightest bit inconsistent with the insurer's interest'.

Florida's highest court recently agreed to consider a defending insurer's right to sue its insured's counsel for malpractice in *Arch Insurance Co v. Kubicki Draper, LLP*.[19]

iv Cyber insurance: social engineering and spoofing

Policyholders often seek coverage for cyber-related losses under general liability or crime policies that address coverage for computer fraud. As illustrated by four recent cases, in determining whether coverage exists in this context, courts have confronted the question of whether the underlying computer fraud qualifies as a 'cause' of the losses at issue, particularly where policy language requires the loss to arise 'directly' out of use of a computer.[20] Three of these cases involved 'spoofing' claims, in which a communication is sent from an unknown source disguised as a source known to the recipient in an attempt to trick the recipient into transferring funds or disclosing sensitive information.

In *Interactive Communications International, Inc v. Great American Insurance Co*,[21] the Court of Appeals for the Eleventh Circuit recently ruled that a computer fraud policy does not cover losses caused by fraudulent debit card transactions because the losses did not result directly from computer fraud. Interactive Communications International (InComm) provided a service that allowed customers to fund prepaid debit cards using a computerised interactive telephone system. A vulnerability in InComm's processing centre allowed cardholders to add credit to their debit cards in multiples of the amount actually purchased, resulting in a loss of more than US$11 million to various debit card users.

The operative computer fraud policy covered losses 'resulting directly from the use of any computer to fraudulently cause a transfer of money, securities or other property'. The Court of Appeals for the Eleventh Circuit first held that 'directly' requires a consequence that follows 'straightaway, immediately, and without any intervention or interruption'. The Court concluded that, while the fraudsters' use of the company's computerised interactive telephone system constituted sufficient use of a computer, the company's loss did not result directly from that use. Rather, two intervening steps took place between the computer fraud and InComm's loss of funds: the transfer of funds onto debit cardholders' accounts and the purchase of goods by a debit cardholder. The Court rejected InComm's assertion that the loss was immediate because it occurred at the moment the funds were transferred to the debit cardholders' accounts.

Two other courts of appeals recently reached contrary conclusions. In *Medidata Solutions Inc v. Federal Insurance Co*,[22] the Second Circuit ruled that claims arising out of a wire transfer initiated by fraudulent emails or spoofing are covered by a computer fraud provision where the policyholder sustained a 'direct loss'. A Medidata employee received an email purportedly sent from Medidata's president advising her to follow a certain attorney's instructions in

19 No. SC19-673, 2019 WL 2386336 (Fla. Jun. 6, 2019).

20 Another important issue in this developing area of the law is whether computer fraud coverage applies solely to 'unauthorised' attacks on a policyholder's computer system (*e.g.*, hacking) or something more.

21 731 F.App'x 929 (11th Cir. 2018).

22 729 F.App'x 117 (2d Cir. 2018).

connection with a potential corporate acquisition. That same day, the employee received a call from a man who identified himself as that attorney and requested a wire transfer. Thereafter, the employee received an email, purportedly from Metadata's president, confirming that the transfer should be made. It was later discovered that the emails were sent from an unknown source and then altered to appear as if they were sent by Medidata's president.

The computer fraud provision under which Metadata sought coverage applied to loss arising from the fraudulent entry of data into a computer system or change to data elements of a computer system. The Second Circuit held that the hackers' attack constituted fraudulent entry of data into the computer system and that Medidata sustained a direct loss because the spoofed emails were the proximate cause of the company's losses. The Court explained that the intervening employee actions to effectuate the transfer were not sufficient to 'sever the causal relationship between the spoofing attack and the losses incurred'.

In *American Tooling Center Inc v. Travelers Casualty & Surety Co of America*,[23] the Sixth Circuit similarly ruled that claims arising out of wire transfers are covered by a computer fraud policy because the vendor-impersonation spoofing scheme resulted in a direct loss to the company and that the loss was directly caused by the alleged computer fraud. American Tooling, a tool and die manufacturer, received an email purportedly sent by a vendor, but in actuality sent by an imposter, instructing it to send payment for outstanding invoices to a new bank account. American Tooling wired approximately US$800,000 to the account without verifying the new instructions with the vendor.

The computer fraud provision covered the 'direct loss of, or direct loss from damage to, Money, Securities and other Property directly caused by Computer Fraud'. The court ruled that American Tooling had suffered a direct loss of funds when it transferred the money to the imposter, rejecting the insurer's argument that no such loss occurred because the insured contractually owed money to its vendor. The Sixth Circuit held that the loss was directly caused by computer fraud because the fraudulent email induced a series of internal actions that directly caused the transfer of money. The Court cited *Interactive Communications*, explaining that there were intervening steps and a time lapse between the computer fraud and the loss in that case whereas, in the present case, the loss occurred immediately upon the wire transfer, which was directly caused by the fraudulent email.

Finally, in *Aqua Star (USA) Corp v. Travelers Casualty & Surety Co of America*,[24] the Ninth Circuit ruled that crime policy exclusion barred coverage for losses stemming from a wire transfer initiated by a fraudulent email. The Court assumed, without deciding, that the losses were covered by a computer fraud provision, but that coverage was nonetheless barred by an exclusion that applied to 'loss or damage resulting directly or indirectly from the input of Electronic Data by a natural person having the authority to enter the Insured's Computer System'. The Court reasoned that the exclusion squarely applied because the employees that changed the payee information in the company's computers (albeit as a result of a fraudulent email) were authorised to enter the computer system and that the losses at issue were caused by the payment changes made by those authorised employees.

The causation issue addressed in these recent cases has been teed up for yet another federal appellate court in *Principle Solutions Group, LLC v. Ironshore Indemnity, Inc*.[25]

23 895 F.3d 455 (6th Cir. 2018).

24 719 F.App'x 701 (9th Cir. 2018).

25 No. 17-11703 (11th Cir.).

IV THE INTERNATIONAL ARENA

Complex jurisdictional issues may arise when an international insurance contract mandates arbitration of disputes but applicable state law prohibits such arbitration. In these circumstances, courts must address the interplay between governing state law and the New York Convention, which obligates the enforcement of foreign arbitration agreements. More specifically, such disputes require a determination of whether the New York Convention preempts state law such that arbitration is required, or conversely, whether state law reverse preempts the New York Convention pursuant to the McCarran-Ferguson Act, such that disputes may be litigated in a court of law.

Federal courts of appeals are divided on this critical issue of international insurance law. In a decision issued this year, the Court of Appeals for the Fifth Circuit ruled that an arbitration clause was enforceable notwithstanding a state statute banning insurance arbitration and a 'conformity-to-statute' clause in the insurance policy. In *McDonnel Grp, LLC v. Great Lakes Ins SE, UK Branch*,[26] the insurers argued that the dispute, relating to the scope of coverage under a builder's risk policy, was subject to arbitration pursuant to the policy's arbitration provision. However, the policyholder argued that the arbitration provision was invalid because (1) Louisiana statutory law expressly prohibits arbitration agreements in insurance policies covering property located within the state, and (2) the operative policy contains a conformity-to-statute provision stating that '[i]n the event any terms of this Policy are in conflict with the statutes of the jurisdiction where the Insured Property is located, such terms are amended to conform to such statutes.'

The Fifth Circuit ruled that reverse preemption under the McCarran-Ferguson Act did not apply. The Court reasoned that reverse preemption is limited to US federal legislation and does not encompass an international treaty such as the New York Convention. The Court therefore dismissed the coverage dispute in favour of arbitration.

The two other federal appellate courts that have addressed whether reverse preemption pursuant to the McCarran-Ferguson Act extends to international disputes involving the New York Convention have reached conflicting conclusions. Compare *Stephens v. Am Int'l Ins Co,*[27] with *ESAB Grp Inc v. Zurich Ins PLC*.[28]

V TRENDS AND OUTLOOK

i Third-party liability coverage

Asbestos and environmental coverage actions, along with products and construction defect coverage actions, remain the most significant in the complex third-party liability coverage space. In this context, future litigation is likely to continue to involve the proper method of allocating losses among multiple insurers and between insurers and policyholders. In fact, Ohio's highest court is poised to address the allocation of losses across numerous policy periods in *Lubrizol Advanced Materials v. National Union Fire Insurance Co of Pittsburgh, PA*.[29] In addition, given the continued proliferation of cases alleging widespread property damage or personal injury resulting from a policyholder's business or actions, courts are likely to be

26 923 F.3d 427 (5th Cir. 2019).

27 66 F.3d 41 (2d Cir. 1995).

28 685 F.3d 376 (4th Cir. 2012).

29 116 N.E.3d 151 (Ohio 2019).

faced with coverage disputes relating to the number of occurrences under general liability policies. Finally, as advancements in the fields of medicine, technology and science continue, litigation against companies whose products allegedly cause property damage or personal injury will continue to flood state and federal courts. Resulting coverage litigation is likely to require courts to address the applicability of pollution exclusions in non-traditional contexts (i.e., outside the traditional environmental contamination scenario). In recent years, courts have grappled with application of the pollution exclusion to novel contexts such as property damage caused by defective drywall and injuries caused by lead paint or by the release of carbon monoxide and other toxic fumes. These and other non-traditional contamination claims will continue to define the scope of a standard pollution exclusion across US jurisdictions.

ii Cyber breaches, data loss and computer fraud

Data breach incidents, cyberattacks and hacking activities designed to obtain financial gain or access to sensitive personal information continue to proliferate at an unprecedented rate. As such, courts undoubtedly will be called upon to address the parameters of both first-party property and third-party liability insurance coverage for myriad cyber-related claims. As discussed in Section III.iv, a small but growing body of case law is defining the scope of coverage for losses arising out of fraudulently induced wire transfers under computer fraud provisions. In the coming months and years, courts will continue to apply governing state law to decide whether various coverage or exclusionary provisions in general liability and crime policies encompass specific factual scenarios. Additionally, novel questions of law are likely to arise, such as whether cyber-related losses, including damage to software or other computer system components, constitutes covered 'property damage' under general liability or first-party policies; whether and under what circumstances hackers' intentional taking of sensitive data constitutes a publication of private information sufficient to trigger personal and advertising injury coverage; the timing and number of losses or occurrences under applicable policy language; and the scope of coverage under directors and officers policies for cyber-related claims against a company by its shareholders or by regulatory agencies. Furthermore, the applicability of certain exclusions, including those related to acts of war or terrorism, professional services or disputes based on contract, are likely to take centre stage in emerging cyber-coverage disputes.

iii Climate change

Climate change is an emerging concern for insurers, based on the increasing frequency of wildfires, storms, floods and other natural disasters.[30] As such, future litigation is likely to implicate the scope of coverage under both first-party property and third-party liability policies for the catastrophic losses – both physical and economic – associated with such natural disaster events.

With respect to first-party policies, disputes may involve interpretation of policy provisions relating to causation, particularly where losses are caused by a complex interaction of perils, such as wind, rain and storm surge. Given that property policies often provide coverage for certain perils while excluding others, future litigation arising from weather-related

30 Colin Dwyer, Footing The Bill For Climate Change: 'By The End of The Day, Someone Has to Pay', NPR (September 20, 2018), https://www.npr.org/2018/09/20/648700837/price-tag-of-natural-disasters-grows.

events are likely to implicate this issue. Indeed, complex issues of interrelated causation frequently took centre stage in prior coverage disputes arising out of Hurricane Katrina and other major storms to impact the US.

Other first-party issues that may become significant in disputes arising from natural disaster events include the extent of coverage for economic loss under business interruption expense income provisions. Emerging issues pertaining to calculation of damages involve interpretation of actual-cash-value (ACV) or replacement-cost clauses common to many property policies. Given the need to rebuild destroyed property and the escalating costs associated with weather-related property damage, parties are likely to litigate the meaning of phrases such as 'fair market value' and 'replacement cost, less depreciation'. In fact, the question of whether labour costs may be depreciated in calculating replacements costs has been a hot topic in recent years, resulting in divergent case law across US jurisdictions. See, for example, *Lammert v. Auto-Owners (Mut) Ins Co*[31] (policy language did not permit the insurer to depreciate labour costs in calculating ACV); *Henn v. Am Family Mut Ins Co*[32] (where a policy is silent on the issue, an insurer may consider the depreciation of labour costs in calculating ACV); *Shelter Mut Ins Co v. Goodner*[33] (state law prohibits including depreciation of labour costs in calculating ACV, even where a policy expressly permits such depreciation).

Coverage under third-party policies for damage caused by severe weather events are likely to be the source of litigation in coming years. In this context, a central issue for courts may be whether climate change or greenhouse gas emission claims give rise to a covered occurrence for purposes of liability coverage. The sole US court to address this issue thus far ruled that an insurer had no duty to defend or indemnify a policyholder for underlying nuisance claims relating to carbon dioxide and greenhouse gas emissions. In *AES Corp v. Steadfast Insurance Co*,[34] the court reasoned that the underlying claims did not allege an occurrence because the damage was not accidental, but rather the natural and foreseeable consequence of the policyholder's intentional emissions. Other courts may confront similar coverage claims arising out of policyholders' detrimental contributions to climate change. Outcomes are likely to depend on not only the particular factual scenario presented, but also policy language and applicable law. More specifically, future decisions are likely to turn, in part, on governing law relating to whether conduct may deemed an accidental occurrence if the resulting harm is expected or foreseeable, even if not intended.

Similar coverage disputes may arise in connection with pending cases against oil and gas industry giants, who face civil and regulatory litigation over their alleged role in global warming. Litigation has also been filed against the federal government and various state governments based on the alleged failure to safeguard the environment. To the extent that these defendants seek insurance coverage, complicated issues pertaining to justiciability, fortuity, actual property damage and trigger and allocation of coverage are likely to follow.

31 572 S.W.3d 170 (Tenn. 2019).

32 894 N.W.2d 179 (Neb. 2017).

33 477 S.W.3d 512 (Ark. 2015).

34 725 S.E.2d 532 (Va. 2012).

Appendix 1

ABOUT THE AUTHORS

SUSANNAH GELTMAN

Simpson Thacher & Bartlett LLP

Susannah Geltman is a partner in Simpson Thacher & Bartlett's litigation department, where she represents clients in a wide range of high-stakes, complex commercial litigation matters, including insurance and reinsurance coverage, securities, class action and shareholder derivative disputes. Her work involves the representation of corporations, financial institutions, private equity firms and national insurers, as well as boards of directors, board committees and executives. She has extensive trial and arbitration experience and also advises clients in internal investigations.

Susannah was recently honoured as the nationwide 'rising star' in litigation at the 2019 Euromoney Legal Media Group Americas Women in Business Law Awards and has been consistently named in *Benchmark Litigation*'s '40 & Under Hotlist', which honours the achievements of the nation's most accomplished legal partners under the age of 40.

Susannah joined the firm following her graduation, *cum laude*, in 2006 from Cornell Law School, where she served on the *Cornell Law Review*. She received her BA, *magna cum laude*, from Cornell University in 2003.

SUMMER CRAIG

Simpson Thacher & Bartlett LLP

Summer Craig is counsel in Simpson Thacher & Bartlett's litigation department. Summer represents clients in a variety of complex commercial litigation matters at both trial and appellate level, with particular emphasis in the areas of insurance and reinsurance.

Summer has authored numerous appellate briefs in high-profile insurance and reinsurance matters. Her appellate work has resulted in the affirmance of trial court decisions worth hundreds of millions of dollars and precedent-setting decisions by the New York Court of Appeals and the US Court of Appeals for the Second Circuit concerning allocation and non-cumulation clauses.

Summer has also served in a variety of capacities in trial-level cases, including discovery, dispositive motions, trial and helping to ensure appellate issues are properly preserved.

Summer received her JD in 2002 from Cornell Law School. She received her BA, *cum laude*, from Dartmouth College in 1997, where she graduated with high honours in history.

SIMPSON THACHER & BARTLETT LLP

425 Lexington Ave.
New York, NY 10017
United States
Tel: +1 212 455 2000
Fax: +1 212 455 2502
sgeltman@stblaw.com
scraig@stblaw.com
www.stblaw.com