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Insurance Law Alert

December 2019

In This Issue

Eleventh Circuit Rules That Crime Policy Covers Email Phishing Scheme Resulting In Fraudulent Wire Transfer

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Rejecting Policy Renewal-Continuous Coverage Argument, Ohio Appellate Court Says Late Notice Bars Coverage

An Ohio appellate court ruled that an insurer had no duty to defend or indemnify underlying claims based on the policyholder's failure to comply with the notice provision in the claims-made policy. *ISCO Indus., Inc. v. Great American Ins. Co.*, 2019 WL 6353709 (Ohio. App. Ct. Nov. 27, 2019). (Click here for full article)

Illinois Supreme Court Rules That For Purposes Of Policy Coverage, Offense Of Malicious Prosecution Occurs At Time Of Prosecution, Not Exoneration

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A Massachusetts federal district court ruled that a total pollution exclusion bars coverage for damage caused by a gasoline spill, rejecting the policyholder's assertion that another policy provision, which grants coverage for certain fuel spills, creates ambiguity as to the pollution exclusion. *Performance Trans., Inc. v. General Star Indem. Co.*, 2019 WL 6307227 (D. Mass. Nov. 25, 2019). (Click here for full article)

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A Massachusetts court refused to dismiss coverage claims brought by a motel that was sued for sex trafficking, finding that the claims were potentially covered acts of negligence, even though the complaint alleged only intentional conduct. *Ricchio v. Bigal, Inc.*, 2019 WL 6253275 (D. Mass. Nov. 22, 2019). (Click here for full article)

Alabama Supreme Court Rules That Insurer's Contribution Claim Does Not Trigger "At Issue" Privilege Waiver

The Supreme Court of Alabama ruled that an insurer does not waive privilege as to settlement-related documents by seeking contribution for settlement costs, even though such contribution depends, in part, on the reasonableness of the settlement. *Ex parte Dow Corning Alabama, Inc.*, 2019 WL 6337291 (Ala. Nov. 27, 2019). (Click here for full article)

Cyber Coverage Alert:

Eleventh Circuit Rules That Crime Policy Covers Email Phishing Scheme Resulting In Fraudulent Wire Transfer

The Eleventh Circuit ruled that a "fraudulent instruction" provision of a commercial crime policy covered loss stemming from an email phishing scheme. *Principle Solutions Grp., LLC v. Ironshore Indem., Inc.*, 2019 WL 6691509 (11th Cir. Dec. 9, 2019).

A hacker posing as a Principle Solutions executive sent an email to the company controller. The email stated that the company had been secretly working on a corporate acquisition that would involve a $1.7 million wire transfer to a specific account. The email instructed the employee to await further information from an attorney. Several minutes later, someone purporting to be that attorney sent detailed instructions regarding the wire transfer. The employee then provided necessary information to Wells Fargo in order to effectuate the transfer, including a confirmatory phone call. It was later discovered that the emails were fraudulent. The money was never recovered.

Principle sought coverage under a provision for "loss resulting directly from a fraudulent instruction directing a financial institution to . . . transfer, pay or deliver money or securities." When the insurer denied coverage, Principle sued for breach of contract. A Georgia district court ruled in Principle's favor and the Eleventh Circuit affirmed.

The insurer argued that it had no obligation to provide coverage because the loss did not involve a "fraudulent instruction," defined as "an electronic or written instruction initially received by [Principle], which instruction purports to have been issued *by an employee*, but which in fact was fraudulently issued by someone else without [Principle's] or the employee's knowledge or consent" (emphasis added). The insurer argued that this provision did not apply because the wiring instructions were not sent by a hacker purporting to be the Principle executive (the first email), but rather came from the fraudster pretending to be the attorney (the second email). The court rejected this contention, noting that the two emails, considered together, constituted a "fraudulent instruction."

The court also rejected the insurer's assertion that the loss did not "result directly" from the fraudulent instruction. The insurer argued that "directly" requires an "immediate" link between the fraudulent instruction and loss, and that several intervening steps occurred between the fraudulent email and the actual wire transfer, including the confirmation phone call with Wells Fargo. Dismissing this argument, the court held that "resulting directly from" requires proximate causation (not immediacy), and that the employee's interactions with the impersonating attorney and with Wells Fargo did not constitute intervening acts sufficient to break the causal chain. The court also rejected the contention that proximate causation was a question for a jury, finding that under the factual record presented, the only reasonable conclusion was that the loss "resulted directly from" the fraudulent instruction.

Notably, in another cyber coverage case also governed by Georgia law, the Eleventh Circuit declined to endorse a "proximate cause" interpretation of the policy term "resulting directly," and instead held that it requires a consequence that follows "straightaway, immediately, and without intervention or interruption." As discussed in our May 2018 Alert, when it considered that case, *Interactive Communications International, Inc. v. Great Am. Ins. Co.*, 2018 WL 2149769 (11th Cir. May 10, 2018), the Eleventh Circuit held that financial losses did not "result directly" from computer fraud because of a time lapse and intervening steps between the fraud and the loss.

Numerous courts, interpreting specific policy provisions in accordance with governing jurisdictional law, have reached different conclusions as to whether coverage is available for wire transfer losses initiated by fraudulent emails. Such decisions turn largely on whether the factual record establishes a sufficient connection between computer use and the loss-causing event. *See* July/August 2018 Alert; March 2017 Alert; November 2016 Alert.

Notice Alert:

Rejecting Policy Renewal-Continuous Coverage Argument, Ohio Appellate Court Says Late Notice Bars Coverage

An Ohio appellate court ruled that an insurer had no duty to defend or indemnify underlying claims based on the policyholder's failure to comply with the notice provision in the claims-made policy. *ISCO Indus., Inc. v. Great American Ins. Co.*, 2019 WL 6353709 (Ohio. App. Ct. Nov. 27, 2019).

Great American issued three consecutive one-year policies to ISCO from March 19, 2013 through March 19, 2016. ISCO was sued in Canada in February 2014, but did not notify Great American of the lawsuit until August 2015. Great American denied coverage based on ISCO's failure to comply with the "condition precedent" notice provision, which requires notice to be given during the policy period or "as soon as practicable from the date [of] . . . knowledge of the Claim, and in no event later than ninety (90) days after the end of the Policy Period." After the coverage denial, ISCO sued Great American, alleging breach of contract. An Ohio trial court dismissed ISCO's suit, and the appellate court affirmed.

The appellate court rejected ISCO's assertion that the notice provision was ambiguous by virtue of ISCO's annual renewal of the policy. ISCO relied on Ohio case law holding that renewals of consecutive claims-made policies created an expectation of continuous coverage, such that notice would not be deemed untimely so long as it was reported within a "reasonable time." In those cases, the courts expressed concerns about a "trap wherein claims spanning the renewal are denied." The court distinguished those decisions, explaining that the policy in one case included a renewal clause that was ambiguous about the timing of claim reporting and continuous coverage, and in the other case, there was a factual issue as to the timing of notice. The court emphasized that where, as here, a notice provision requires claims to be reported within a specific time frame, it must be enforced as written.

Courts in several other jurisdictions have rejected similar "seamless coverage" arguments based on back-to-back policy renewals of claims-made policies. *See* June and March 2019 Alerts; March and February 2015 Alerts. However, at least two courts have ruled that consecutive claims-made policies create continuous coverage for notice purposes. *See* December 2016 Alert; November 2010 Alert.

Trigger Alert:

Illinois Supreme Court Rules That For Purposes Of Policy Coverage, Offense Of Malicious Prosecution Occurs At Time Of Prosecution, Not Exoneration

The Supreme Court of Illinois ruled that primary and excess liability insurers had no duty to indemnify a malicious prosecution claim, finding that the operative "occurrence" for triggering coverage was the original prosecution, not the later exoneration. *Sanders v. Illinois Union Ins. Co.*, 2019 WL 6199651 (Ill. Nov. 21, 2019).

Following his prosecution in 1994, Rodell Sanders spent 20 years in prison for crimes he did not commit. After his exoneration, he sued Chicago Heights for malicious prosecution. The City's insurers disclaimed coverage on the basis that there was no "occurrence" during the policy period. The insurers argued that the operative event for coverage purposes was the 1994 prosecution, and that Sanders' exoneration in 2014 did not trigger coverage under the 2011-2014 policy period.

An Illinois trial court granted the insurers' motion to dismiss. The trial court acknowledged that a requisite element of malicious prosecution is exoneration, but reasoned that coverage under the policies turns on an "act and injury during the policy period, rather than the accrual of a completed cause of action." A split appellate panel reversed. The appellate court reasoned that because the policy expressly covered the "offense" of malicious prosecution, the operative trigger for coverage was the "completed cause of action" (*i.e.,* exoneration).

The Illinois Supreme Court reversed, ruling that malicious prosecution occurs, for insurance coverage purposes, at the time of prosecution. The court explained that the prosecution itself was the operative "offensive conduct" and that nothing in the policy required all of the elements of the tort to be satisfied in order to trigger coverage. The court stated: "If we were to deem exoneration the trigger for coverage of a malicious prosecution claim, liability could be shifted to a policy period in which none of the acts or omissions giving rise to the claim occurred. That would violate the intent of the parties to an occurrence-based policy."

As discussed in our June 2019 Alert, the Fifth Circuit ruled that insurers were obligated to defend a suit arising out of wrongful imprisonment, notwithstanding that the arrests and convictions occurred before the relevant policies incepted. *Travelers Indem. Co. v. Mitchell*, 925 F.3d 236 (5th Cir. 2019). There, the court reasoned that injuries suffered by the underlying plaintiffs while incarcerated (and during the operative policy periods) triggered a duty to defend even though the wrongful causal acts (*i.e.*, arrest and conviction) occurred decades earlier. Importantly, the Fifth Circuit noted that the duty to defend was not triggered by the ongoing false imprisonment alone and that it was not applying a "continuous trigger." Rather, the court explained that the policies were triggered because the underlying complaint alleged bodily injuries during the policy periods that were distinct from the original convictions.

Pollution Exclusion Alerts:

Other Policy Provisions Do Not Create Ambiguity In Pollution Exclusion, Says Massachusetts Court

A Massachusetts federal district court ruled that a total pollution exclusion bars coverage for damage caused by a gasoline spill, rejecting the policyholder's assertion that another policy provision, which grants coverage for certain fuel spills, creates ambiguity as to the pollution exclusion. *Performance Trans., Inc. v. General Star Indem. Co.*, 2019 WL 6307227 (D. Mass. Nov. 25, 2019).

The coverage dispute arose out of a car accident in which a tanker truck drove off the road and overturned, discharging more than 4,000 gallons of gasoline and diesel fuel onto the pavement and into a nearby reservoir. The trucking company's insurer denied coverage based on a total pollution exclusion, which excludes "loss, costs or expenses, arising out of, resulting from, caused by or contributed to by the . . . discharge, dispersal, seepage, migration, release or escape of pollutants."

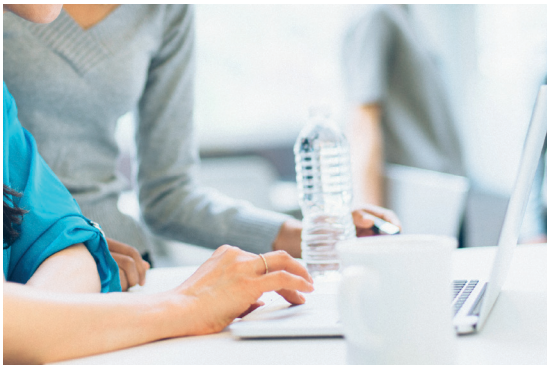
The insured asserted that the policy was ambiguous and that application of the total pollution exclusion would improperly render a "Special Hazards and Fluids Limitation Endorsement" superfluous. That endorsement bars coverage for certain spills, but provides an exception for spills that result from the overturning of a vehicle. The insured argued that by including this exception, the insurer agreed to provide coverage for loss caused by spills resulting from overturned trucks.

Rejecting this contention, the court explained that Massachusetts law "flatly reject[s] the concept that, because [one exclusion]

excludes certain possible coverage and then provides for an exception, that exception creates an ambiguity, or an objectively reasonable expectation of coverage, when it is confronted with another explicit exclusion."

Arizona Appellate Court Limits Application Of Pollution Exclusion To Claims Arising Out Of Traditional Environmental Contamination

An Arizona appellate court ruled that a pollution exclusion did not bar coverage for personal injury claims arising out of exposure to hazardous fumes released during construction because the underlying factual scenario did not constitute "traditional environmental pollution." *Starr Surplus Lines Ins. Co. v. Star Roofing, Inc.*, 2019 WL 5617575 (Ariz. Ct. App. Oct. 31, 2019).



A woman suffered bodily injury after passing out and falling in a building's parking lot. Her injuries were allegedly caused by inhaling toxic fumes that were released during the course of roofing work. Star Roofing tendered the claim to its liability insurer, which agreed to defend under a reservation of rights. In ensuing litigation, a trial court ruled that a pollution exclusion did not apply to the underlying claims. The trial court relied on Arizona precedent, which has limited application of pollution exclusions to "traditional environmental pollution." The appellate court affirmed.

The appellate court acknowledged that the roofing materials "may be classified as hazardous substances under state and federal statutes and should not be handled without the use of protective equipment due to their caustic nature." The court also noted that inhalation of the chemicals can cause "irritation to the respiratory tract, mucous membranes, dizziness, blurred vision, and headaches." Notwithstanding these facts, the court held that the pollution exclusion did not apply because the overall scenario did not constitute a traditional environmental event. The court declined to overturn, limit or re-examine Arizona precedent despite the insurer's assertion that Arizona law follows the "minority" position in this context.

Coverage Alert:

Insurer Must Defend Sex Trafficking Claims Against Motel, Says Massachusetts Court

A Massachusetts court refused to dismiss coverage claims brought by a motel that was sued for sex trafficking, finding that the claims were potentially covered acts of negligence, even though the complaint alleged only intentional conduct. *Ricchio v. Bigal, Inc.*, 2019 WL 6253275 (D. Mass. Nov. 22, 2019).

A motel and two of its employees were sued for alleged violations of federal sex trafficking statutes. The complaint alleged that the motel and employees were aware of and profited from the kidnapping, abuse and forced prostitution of a woman being held captive at the motel. Peerless, the motel's insurer, intervened in the matter, seeking a declaration that it had no duty to defend or indemnify the claims.

The court ruled that Peerless had a duty to defend because the underlying claims were potentially within the scope of "Personal Injury" coverage, defined to include damages caused by "false imprisonment." The court ruled that the insurer's defense obligation was not negated by an exclusion for injury "arising out of a criminal act committed by or at the direction of the insured." The court explained that the underlying claims alleged that the motel and employees violated the civil (rather than criminal) provision of the sex trafficking statutes. The civil provision requires that one "knowingly benefit . . . from participation in a venture which that person knew or should have known has engaged in an act in violation [of the statute]." Interpreting the phrase "knew or should have known" to include negligence, the court concluded that the motel

and employees could be held civilly liable without having engaged in criminal conduct.

The court acknowledged that all of the underlying allegations against the motel and employees were "cast in terms of intentional, not negligent conduct." Nonetheless, the court deemed coverage possible. The court stated: "Each [underlying] claim[ ] includes allegations of criminal conduct by the [employees], but the complaint is 'reasonably susceptible' to an interpretation finding only negligence."

As discussed in our July/August 2019 Alert, in a similar matter, the Third Circuit found no coverage for a sex trafficking suit against a hotel. The court reasoned that all underlying allegations were encompassed by an assault and battery exclusion, even those alleging negligence, because all alleged injuries arose out of assault. *See Nautilus Ins. Co. v. Motel Mgmt. Servs., Inc.*, 2019 WL 3283221 (3d Cir. July 22, 2019). Sex trafficking suits against hotels have increased in recent months, and a number of courts have denied motions to dismiss such suits, setting the stage for emerging coverage litigation in this context.

Privilege Alert:

Alabama Supreme Court Rules That Insurer's Contribution Claim Does Not Trigger "At Issue" Privilege Waiver

The Supreme Court of Alabama ruled that an insurer does not waive privilege as to settlement-related documents by seeking contribution for settlement costs, even though such contribution depends, in part, on the reasonableness of the settlement. *Ex parte Dow Corning Alabama, Inc.*, 2019 WL 6337291 (Ala. Nov. 27, 2019).

Dow Corning and its insurers settled a personal injury suit brought by an Alabama Electric employee who was injured while working at a Dow facility. Alabama Electric and its own insurer, National Trust, had refused to participate in the defense or settlement. Following settlement, Alabama Electric and National Trust sued Dow and its insurers, seeking a declaration that they owed no defense or indemnity. The Dow insurers counterclaimed, seeking contribution for the defense and settlement costs. In that action, Alabama Electric and National Trust sought production of documents relating to the underlying settlement, including reports and evaluations from counsel. The Dow insurers moved for a protective order on the grounds that the requested documents were subject to attorney-client privilege and work-product protection. An Alabama trial court denied the Dow insurers' motion for a protective order. The Alabama Supreme Court granted a writ of mandamus and directed the trial court to vacate its order requiring production of the requested information.

The privileged status of documents may be waived if the party asserting privilege has placed the content of those materials "at issue" in the litigation. Alabama Electric and National Trust argued that by seeking contribution for the settlement—a claim that requires a showing of the settlement's reasonableness—the Dow insurers placed the otherwise privileged settlement documents at issue. They further contended that the reports and recommendations of counsel, relating to liability exposure and potential verdict range, were relevant to evaluating the reasonableness of the settlement.

The Alabama Supreme Court disagreed. The court held that reasonableness is judged by an objective standard, such that the subjective advice of counsel is unnecessary in the reasonableness evaluation. The court further explained that non-privileged materials generated in the course of the underlying personal injury claim would be sufficient to determine Dow's potential liability and the reasonableness of the settlement.

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Simpson Thacher sends warm season's greetings and best wishes for a wonderful new year.

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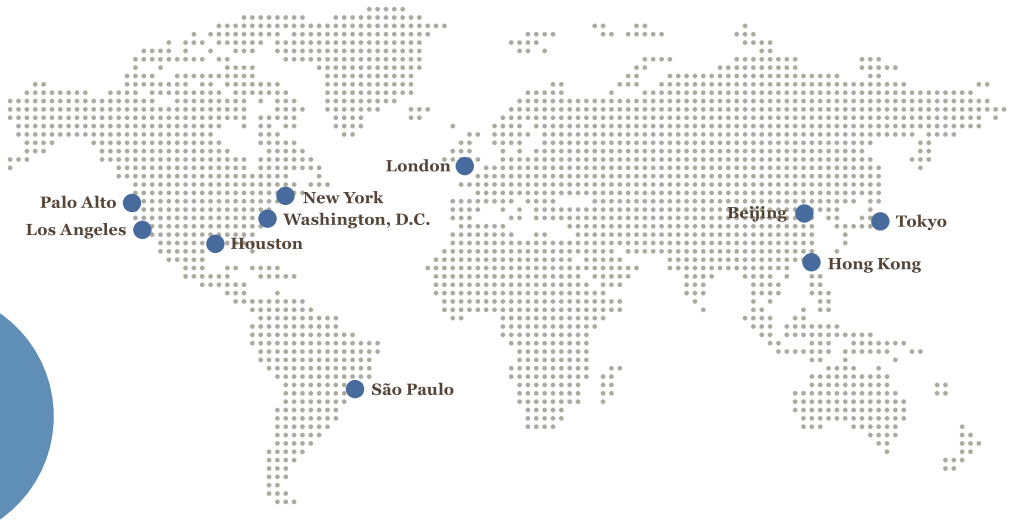

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