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Insurance Law Alert

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"The team demonstrates extremely high intellect and provides highly practical advice."

– *Chambers USA* 2018 (quoting a client)

Applying Texas Law, Delaware Supreme Court Enforces Anti-Assignment Clause To Bar Coverage For Asbestos Liabilities

The Delaware Supreme Court ruled that Texas law governs an asbestos-related coverage dispute and that an anti-assignment clause precludes coverage for the losses at issue. *Travelers Indem. Co. v. CNH Indus. Am., LLC*, 2018 WL 3434562 (Del. July 16, 2018). (Click here for full article)

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The Ninth Circuit ruled that an insured stucco company is responsible for three deductible payments notwithstanding that there were 636 underlying claims alleging construction defects. *Probuilders Speciality Ins. Co. v. Yarbrough Plastering*, 2018 WL 3099434 (9th Cir. June 25, 2018). (Click here for full article)

Sixth Circuit Rules That Settlement Offer Is A "Claim" Under Claims-Made Policies

The Sixth Circuit affirmed a Tennessee district court decision holding that a settlement offer constituted a "claim" under a claims-made policy and that the policyholder's Notice of Circumstances was inadequate to preserve coverage. *First Horizon Nat'l Corp. v. Houston Cas. Co.*, 2018 WL 3359555 (6th Cir. July 10, 2018). (Click here for full article)

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The Second Circuit ruled that a two-year suit limitations clause in a property policy was unambiguous and enforceable as to the property owner's business income and extra expense claims. *Classic Laundry & Linen Corp. v. Travelers Cas. Ins. Co. of Am.*, 2018 WL 3147429 (2d Cir. June 26, 2018). (Click here for full article)

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A Minnesota federal district court ruled that a "Your Product" exclusion in a liability policy precludes coverage for property damage claims based on alleged defects in the windows installed in a building. *Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. Viracon, Inc.*, 2018 WL 3029054 (D. Minn. June 18, 2018). (Click here for full article)

Two Courts Hold That Pollution Exclusion Bars Coverage For Non-Traditional Environmental Claims

Federal district courts in Florida and Texas ruled that a pollution exclusion bars coverage for claims arising from non-traditional environmental contamination. *Colony Ins. Co. v. Great Am. Alliance Ins. Co.*, 2018 WL 3453975 (S.D. Fla. July 17, 2018); *Great American Insurance Co. v. Ace American Ins. Co.*, 2018 WL 3370620 (N.D. Tex. July 10, 2018).
(Click here for full article)

Fourth Circuit Seeks South Carolina Supreme Court Guidance On Scope Of Attorney-Client Privilege In Coverage Dispute

The Fourth Circuit has asked the South Carolina Supreme Court to address whether an insurance company waives attorney-client privilege by challenging allegations of bad faith failure to defend or indemnify. *In re Mt. Hawley Ins. Co.*, 2018 WL 3203033 (4th Cir. June 28, 2018). (Click here for full article)

Cyber Coverage Alert:

Two Federal Circuit Courts Rule That Fraudulent Wire Transfer Losses Are Covered By Liability Policy

The Second Circuit ruled that claims arising out of a fraudulent wire transfer are covered by a "computer fraud" provision in a policy. *Medidata Solutions Inc. v. Federal Ins. Co.*, 2018 WL 333924 (2d Cir. July 6, 2018).

A Metidata employee received an email purportedly sent from the company's president advising her to follow instructions to be received from an attorney regarding a potential corporate acquisition. That same day, a man who identified himself as an attorney called the employee and requested a wire transfer. The employee sought confirmation to make the transfer from Medidata's executives. Thereafter, a purported email from Medidata's president confirmed that the wire transfer should be made. On that basis, the wire transfer was made. It was later discovered that the emails were sent by imposters. Medidata sought coverage from Federal under provisions relating to computer fraud, funds transfer fraud and forgery. Federal denied coverage, and Medidata brought suit. A New York district court ruled that the policy provided coverage for the wire transfer losses pursuant to the computer fraud and funds transfer fraud provisions. *Medidata Solutions, Inc. v. Federal Ins. Co.*, 2017 WL 3268529 (S.D.N.Y. July 21, 2017) (discussed in our July/August 2017 Alert). In a summary order, the Second Circuit affirmed, ruling that the underlying claims were encompassed by the computer fraud provision.

The computer fraud provision provides coverage for 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 coverage was implicated under this provision because the thief embedded a computer code in the spoofed emails to mask their true origin and thus violated the integrity of the computer system. The court distinguished *Universal American Corp. v. National Union Fire Insurance Co. of Pittsburgh, PA,* 2015 WL 3885816 (N.Y. June 25, 2015) (discussed in our July/August 2015 Alert) on the basis that the fraud in that case was caused by an authorized user's submission of fraudulent medical claims into the computer system, whereas the present case involved fraud caused by unauthorized access.

The Second Circuit further held that Medidata sustained a "direct loss" as a result of the spoofing incident, rejecting Federal's assertion that the intervening actions by the Medidata employee in effectuating the wire transfer were sufficient to "sever the causal relationship between the spoofing attack and that losses incurred."

The Sixth Circuit also recently ruled that claims arising out of wire transfers initiated by fraudulent emails were covered by a "computer fraud" policy provision. *Am. Tooling Ctr., Inc. v. Travelers Cas. & Sur. Co. of Am.*, 2018 WL 3404708 (6th Cir. July 13, 2018).

ATC, a tool and die manufacturer, received a purported email from a vendor with whom ATC did business. The email in actuality was sent by an imposter using an email with a similar domain. The email instructed ATC to send invoice payments to a new bank account. In response, ATC wired approximately $800,000 to the account. ATC sought coverage for the loss from Travelers, which denied the claim. A Michigan district court ruled that Travelers owed no coverage, reasoning that ATC's loss was not directly caused by the use of a computer because of intervening steps that occurred internally at ATC between receipt of the fraudulent email and the eventual transfer of funds. *Am. Tooling Ctr., Inc. v. Travelers Cas. & Sur. Co. of Am.*, 2017 WL 3263356 (E.D. Mich. Aug.

1, 2017) (discussed in our September 2017 Alert). The Sixth Circuit reversed.

Travelers' policy covers the "direct loss of, or direct loss from damage to, Money, Securities and Other Property directly caused by Computer Fraud." Computer Fraud is defined as "[t]he use of any computer to fraudulently cause a transfer" of money or other property to a third party. The Sixth Circuit ruled that ATC suffered a "direct loss" of funds when it transferred the money to the impersonator. The court rejected the argument that there was no direct loss because ATC contractually owed money to its vendor. In addition, the Sixth Circuit ruled that the impersonator's conduct constituted "computer fraud" under the policy because the fraudulent emails and resulting wire transfer were implemented through the use of a computer. Finally, the court held that ATC's 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 distinguished *Interactive Communications International, Inc. v. Great American Insurance Co.*, 2018 WL 2149769 (11th Cir. May 10, 2018) (discussed in our May 2018 Alert), in which the Eleventh Circuit held that losses did not "result directly" from use of a computer because Georgia law construes "directly" to mean immediately and because there were intervening steps and a delay between the computer fraud and financial loss.

As discussed in previous Alerts, other federal circuit courts have rejected policyholder attempts to obtain coverage for cyber-related losses under computer fraud and similar policy provisions. Such decisions largely turn on whether the factual record establishes a sufficient connection between computer use and the loss-causing event. *See Taylor & Lieberman v. Fed. Ins. Corp.*, 2017 WL 929211 (9th Cir. Mar. 9, 2017) (coverage unavailable under computer fraud provision because sending an email, without more, does not constitute an unauthorized "entry into" a computer system) (discussed in our March 2017 Alert); *Apache Corp. v. Great Am. Ins. Co.*, 2016 WL 6090901 (5th Cir. Oct. 18, 2016) (computer fraud provision does not cover claims arising out of the transfer of funds to criminal accounts because a fraudulent email was only one part of a chain of events that caused the loss, and the loss therefore was not caused "directly" by computer use) (discussed in our November 2016 Alert).

Assignment Alert:

Applying Texas Law, Delaware Supreme Court Enforces Anti-Assignment Clause To Bar Coverage For Asbestos Liabilities

The Delaware Supreme Court ruled that Texas law governs an asbestos-related coverage dispute and that an anti-assignment clause precludes coverage for the losses at issue. *Travelers Indem. Co. v. CNH Indus. Am., LLC*, 2018 WL 3434562 (Del. July 16, 2018).

Tenneco, a Texas-based oil and gas company, acquired J.I. Case, a Wisconsin corporation. After the acquisition, Tenneco added Case to its insurance policies, which were part of a program that covered Tenneco and its wholly-owned subsidiaries located in various states. Thereafter, Case assigned certain assets and liabilities to CNH Industrial America, a Delaware company with its principal place of business in Wisconsin. CNH sued Travelers and other insurers for defense and indemnity for asbestos-related claims against it, claiming that insurance coverage was part of the assignment.

A Delaware superior court concluded that Wisconsin law governed the dispute, based largely on the insured's principal place of business. The court held that because Case, rather than Tenneco, was the relevant party, Wisconsin had the most significant relationship to the parties and the dispute. Applying Wisconsin law, the court held that the policies were validly assigned to CNH, notwithstanding Travelers' lack of consent. The Delaware Supreme Court reversed.

The Delaware Supreme Court ruled that when an insurance program covers risks across jurisdictions, the choice of law analysis should focus on the place of contracting, negotiation and performance of the contracts, as well as the location of the business of the parties involved. Applying these factors, the court held that Texas law governed the dispute because Tenneco (not Case) contracted with Travelers and because the contracts were negotiated and managed in Texas. In so ruling, the court noted that applying the law of the locations of each Tenneco subsidiary or claim would result in inconsistency and unpredictability in contract interpretation.

The Delaware Supreme Court also rejected CNH's assertion that applying Texas law violated Delaware public policy, stating that unlike in Texas, "[t]here is no established Delaware law that anti-assignment provisions in insurance contracts are against public policy."

Deductible Alert:

Finding Deductible Provision Ambiguous, Ninth Circuit Rules That Policyholder Does Not Owe Deductible For Each Construction Defect Claim

The Ninth Circuit ruled that an insured is responsible for paying three deductibles notwithstanding that the underlying claims alleged construction defects in 636 homes. *Probuilders Speciality Ins. Co. v. Yarbrough Plastering*, 2018 WL 3099434 (9th Cir. June 25, 2018).

ProBuilders insured Yarbrough, a drywall and stucco contractor, under liability policies that required the company to pay a separate deductible for "each and every claim . . . irrespective of the number of claims which may be joined in any one suit." During the policy periods, Yarbrough performed work on several large housing developments. Thereafter, 636 homeowners filed three lawsuits against the general contractor alleging construction defects. The contractor impleaded Yarbrough in three cross-complaints for indemnity. ProBuilders settled the claims against Yarbrough and then sought reimbursement based on the deductible provision. ProBuilders argued that Yarbrough owed a separate deductible for each of the 636 homes at issue in the underlying suits.

The court rejected this argument, finding that only three deductibles were due – one for each cross-complaint against Yarbrough. The court noted that the policy requires a separate deductible payment for each "claim," but emphasized that the policies did not specify whether the operative "claim" is the underlying homeowner's claim against the contractor or the contractor's claim against Yarbrough. Finding both constructions reasonable, the court deemed the policy ambiguous and interpreted the provision in Yarbrough's favor. In so ruling, the court found it irrelevant that Yarbrough would have been obligated to pay 636 deductibles if the homeowners had sued Yarbrough directly.

Coverage Alerts:

Sixth Circuit Rules That Settlement Offer Is A "Claim" Under Claims-Made Policies

The Sixth Circuit affirmed a Tennessee district court decision holding that a settlement offer constituted a "claim" under a claims-made policy and that the policyholder's Notice of Circumstances did not preserve coverage. *First Horizon Nat'l Corp. v. Houston Cas. Co.*, 2018 WL 3359555 (6th Cir. July 10, 2018).

In 2012, government agencies began investigating First Horizon for potential False Claims Act violations. First Horizon met with the agencies during 2013 and executed a tolling agreement in 2014, in which the Department of Justice ("DOJ") agreed to postpone filing an action against First Horizon in order to allow for settlement negotiations. In April 2014, the DOJ issued a "settlement offer" of $610 million to First Horizon, which was later confirmed via email.

In May 2014, First Horizon sent a Notice of Circumstances to its insurers, setting forth facts that might give rise to a claim under the 2013-2014 policy. The Notice of Circumstances did not disclose the DOJ settlement offer or the tolling agreement. In December 2014, the DOJ informed First Horizon that its investigation was nearly complete and that if it did not receive a settlement counteroffer, it would proceed with litigation. In February 2015, First Horizon notified its insurers of an upcoming meeting with the DOJ and its intention to make a $50 million settlement counteroffer. First Horizon ultimately settled with the government for $212.5 million and then sued its insurers for coverage.

The Sixth Circuit ruled that the DOJ's April 2014 settlement offer was a "claim," defined as "any written demand for monetary, non-monetary or injunctive relief." The court rejected First Horizon's assertion that the April 2014 offer was not a "demand" because it was not a forceful statement seeking money with a threat of consequences, holding that a communication can still be a demand even if it is phrased as a request.

Additionally, the Sixth Circuit held that First Horizon's Notice of Circumstances did not constitute sufficient notice under the policy, in part because it failed to mention the $610 million settlement offer. Finally, the court rejected First Horizon's assertion that the insurers were not prejudiced by this lack of specificity, noting that Tennessee law does not require an insurer to establish prejudice under such circumstances.

Second Circuit Rules That Business Expense Claims Are Barred By Suit Limitation Clause

The Second Circuit ruled that a two-year suit limitations clause in a property policy is unambiguous and enforceable as to the property owner's business income and extra expense claims. *Classic Laundry & Linen Corp. v. Travelers Cas. Ins. Co. of Am.*, 2018 WL 3147429 (2d Cir. June 26, 2018).

Travelers insured Classic Laundry under a first-party policy that covers property damage and business income loss or incurred extra expense resulting from a covered loss. The policy's limitation clause provides that a legal action must be "brought within 2 years after the date on which the direct physical loss or damage occurred."

When a fire damaged the covered property, Travelers paid for the damage, but denied coverage for business income and extra expense based on Classic Laundry's failure to timely return a sworn statement of loss. Nearly three years later, Classic Laundry sued Travelers. A New York federal district court dismissed the suit as untimely based on the suit limitations clause. The Second Circuit affirmed.

The Second Circuit ruled that the policy unambiguously requires a suit based on any claims for coverage – including lost income and extra expense – to be brought within two years of the loss-causing event. The court rejected Classic Laundry's assertion that the suit limitations clause applies only to property damage claims because business income and expense claims are often not ascertainable within a two-year period. The court deemed the two-year period reasonable and enforceable as to all loss under the policies.

Rejecting Argument That Windows Are "Real Property," Minnesota Court Rules That "Your Product" Exclusion Bars Coverage For Defective Product Claims

A Minnesota federal district court ruled that a "Your Product" exclusion in a liability policy precludes coverage for property damage claims based on alleged defects in the

windows installed in a building. *Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. Viracon, Inc.*, 2018 WL 3029054 (D. Minn. June 18, 2018).

Underlying suits against Viracon, a glass manufacturer, alleged that defects in the glass products used in two buildings caused damage to windows and to property within the buildings. National Union defended Viracon under a reservation of rights and sought a declaration of no coverage.

Ruling on National Union's summary judgment motion, the court rejected the insurer's assertion that the costs to repair or replace the allegedly defective windows is outside the scope of covered property damage. However, the court held that such damage was excluded by a "Your Product" exclusion. The exclusion bars coverage for property damage to "Your Product arising out of it or any part of it," but does not apply to "real property." Viracon argued that the exclusion did not apply because the windows, as attachments to the buildings, constitute "real property." The court disagreed, concluding that the windows were not real property and that the exclusion therefore applied.

Pollution Exclusion Alert:

Two Courts Hold That Pollution Exclusion Bars Coverage For Non-Traditional Environmental Claims

Federal district courts in Florida and Texas ruled that a pollution exclusion bars coverage for claims that arose from non-traditional environmental contamination.

In *Colony Insurance Co. v. Great American Alliance Ins. Co.*, 2018 WL 3453975 (S.D. Fla. July 17, 2018), the court ruled that insurers had no duty to defend or indemnify a homeowners association in a wrongful death suit arising out of carbon monoxide inhalation. According to the underlying complaint, carbon monoxide originating from a car in the unit's garage, seeped into the air conditioning vents and ducts, eventually reaching a second story residence. The insurers denied coverage based on an absolute pollution exclusion.

In ensuing litigation, the court granted the insurers' summary judgment motion, holding that under Florida law, a pollution exclusion applies to carbon monoxide claims. The court rejected the homeowners association's assertion that coverage was restored by an exception that applied to fumes originating from heating or cooling equipment. The court reasoned that a hypothetical scenario in which the carbon monoxide might have originated from the heating or cooling system did not create a potential for coverage since the underlying complaint listed a car as the only potential source of the toxic fumes. Further, the court held that the exception did not apply by virtue of the fact that the cooling or heating ducts were the conduit through which the fumes reached the residence.

A Texas federal district court also enforced an absolute pollution exclusion in a non-traditional context in *Great American Insurance Co. v. Ace American Insurance Co.*, 2018 WL 3370620 (N.D. Tex. July 10, 2018). There, the underlying claims arose out of the dispersal of rock fines (small particles of rock generated as part of the stone-crushing process at the insured's rock quarry) into an adjacent reservoir. The rock fines were supposed to be contained in settling ponds, but due to a pumping accident, were carried into a waterway that led to a reservoir. According to government agencies, the rock fines damaged the stream bed and required remediation by the quarry. The insurers denied coverage based on a pollution exclusion.

The court ruled that the rock fines were pollutants within the meaning of the exclusion, notwithstanding their "ordinary usefulness." In holding the pollution exclusion applicable, the court emphasized that the rock fines constituted waste material from the crushing process, and became contaminants when "discharged and dispersed where they did not belong." Rejecting the quarry's assertion that rock fines are a nonhazardous material, the court stated: "If they were indeed innocuous, the State of New Jersey would not have required remediation."

Privilege Alert:

Fourth Circuit Seeks South Carolina Supreme Court Guidance On Scope Of Attorney-Client Privilege In Coverage Dispute

The Fourth Circuit has asked the South Carolina Supreme Court to address whether an insurance company waives attorney-client privilege by challenging allegations of bad faith failure to defend or indemnify. *In re Mt. Hawley Ins. Co.*, 2018 WL 3203033 (4th Cir. June 28, 2018).

In a construction defect coverage dispute, the policyholder sought production of its insurer's claim files. The insurer argued that the files contained information protected by attorney-client privilege and produced the files in redacted form. The policyholder moved to compel, arguing that the insurer waived privilege. A South Carolina district court granted the motion to compel and ordered the insurer to produce the files for *in camera* inspection. The insurer sought a writ of mandamus from the Fourth Circuit to vacate the district court's order. The insurer argued that the district court erred in holding that the files were not protected by privilege because the insurer put them "at issue" by denying it had acted in bad faith and by asserting that it acted reasonably.

Emphasizing the lack of controlling South Carolina law as to the scope of the "at issue" exception to attorney-client privilege in the context of insurer bad faith claims, the Fourth Circuit certified the following question to the South Carolina Supreme Court: "Does South Carolina law support application of the 'at issue' exception to the attorney-client privilege such that a party may waive the privilege by denying liability in its answer?" We will keep you posted of any developments in this matter.

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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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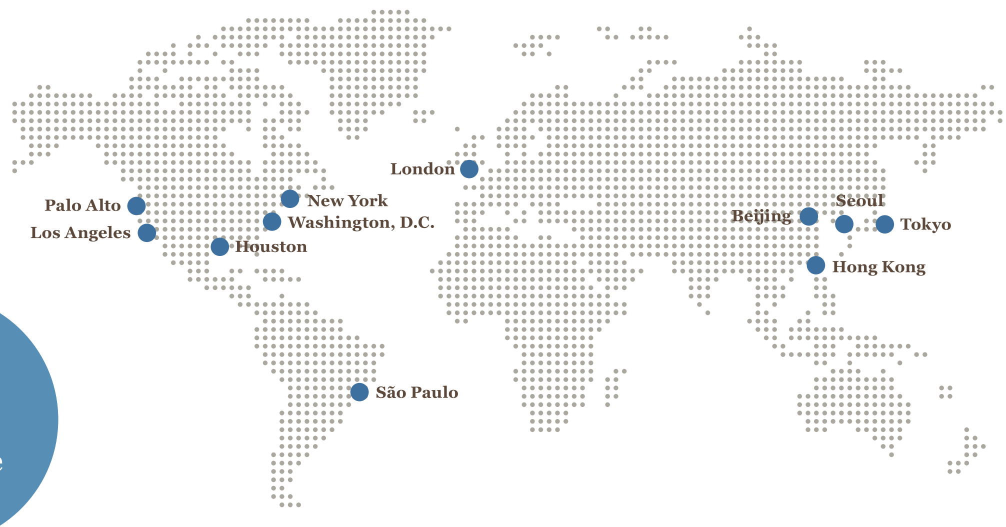

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