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– *New York Law Journal* 2018

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A Connecticut appellate court ruled that an insurer's equitable subrogation claim against alleged tortfeasors was not subject to two statutes of limitations applicable to the underlying negligence claims. *Gov't Employees Ins. Co. v. Barros*, No. 184 Conn. App. 395 (Aug. 28, 2018). (Click here for full article)

Hurricane Alert:

Business Interruption Coverage In The Wake Of Florence

As North and South Carolina and other coastal states grapple with the devastation caused by Hurricane (turned Tropical Storm) Florence, affected companies will likely seek business interruption coverage to alleviate their losses. Business interruption coverage generally applies to losses an insured sustains due to the necessary suspension of operations as a result of a covered peril. The suspension of business operations may be due to physical damage to the business itself, a civil authority order preventing the business from operating, or damage to a third-party supplier of goods or services that the business relies on.

In order for business interruption coverage to apply, the insured typically must establish that it was necessary to suspend its business operations. Some courts interpret a suspension of operations to include either a partial or complete interruption of business. *See Prudential LMI Commercial v. Colleton Enterprises, Inc.*, 976 F.2d 727 (4th Cir. 1992); *Fountainbleau 2006, LLC v. United States Fire Ins. Co.*, 2010 WL 11597704 (N.D. Ga. Dec. 21, 2010). Other courts, however, have interpreted suspension to require a complete cessation of activity, such that losses arising from reduced hours of operation, for example, are not covered. *See Quality Oilfield Prods., Inc. v. Michigan Mut. Ins. Co.*, 971 S.W.2d 635, 638 (Tex. App. 1998). Additionally, policy language often requires that the suspension of business was due to a "direct physical loss or damage to" covered property. *Fountainbleau*, 2010 WL 11597704; *Ne. Georgia Heart Ctr., P.C. v. Phoenix Ins. Co.*, 2014 WL 12480022 (N.D. Ga. May 23, 2014).

Storm-related business losses may also implicate civil authority provisions, which provide coverage when a civil authority order prohibits access to the insured's premises due to direct physical loss or damage to property. *Assurance Co. of Am. v. BBB Serv. Co.*, 265 Ga. App. 35 (2002). For coverage under civil authority provisions, courts generally require a complete denial of access to the covered property. *See Paradies Shops, Inc. v. Hartford Fire Ins. Co.*, 2004 WL 5704715 (N.D. Ga. Dec. 15, 2004) (finding an order grounding all flights after September 11th was not an order that specifically prohibited access to stores in airports); *Abner, Herrman & Brock, Inc. v. Great N. Ins. Co.*, 308 F. Supp. 2d 331 (S.D.N.Y. 2004) (concluding that traffic restrictions which merely made it difficult for customers to access the covered property were insufficient to implicate business interruption indemnity); *730 Bienville Partners, Ltd. v. Assurance Co. of Am.*, 2002 WL 31996014 (E.D. La. Sept. 30, 2002) (finding no coverage where the FAA prohibited flights into the affected city but there was no order prohibiting access to the insured's hotel).

Furthermore, civil authority coverage is generally available only when the order was made because property was actually damaged; a mere threat of damage is insufficient. *See Assurance Co. of Am.*, 265 Ga. App. 35; *Paradies Shops, Inc.*, 2004 WL 5704715. Moreover, courts typically require a sufficient causal nexus between the civil order and the property damage in order to find coverage under a civil authority provision. *Dickie Brennan & Co. v. Lexington Ins. Co.*, 636 F.3d 683 (5th Cir. 2011); *S. Texas Med. Clinics, P.A. v. CNA Fin. Corp.*, 2008 WL 450012 (S.D. Tex. Feb. 15, 2008).

Policyholders may also seek coverage for storm-related losses under a contingent business interruption ("CBI") policy provision. CBI coverage applies to losses incurred by policyholders as a result of damage to the property of a third-party that supplies goods or services to the policyholder's business. Many CBI provisions require the third party to be a direct supplier to the policyholder. In such cases, the existence of an intermediate entity in the supply chain would preclude CBI coverage even where an indirect supplier sustains property damage that prevents the transfer of goods or services. *See Millennium Inorganic Chemicals Ltd. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 744 F.3d 279 (4th Cir. 2014).

Finally, issues relating to the proper measure of recovery are often raised in the context of business interruption coverage disputes. More specifically, courts have addressed the appropriate measure of recovery for business interruption losses as well as the standard of proof for establishing lost profits. Although specific policy language and governing law may be outcome determinative in any given case, courts have generally held that business interruption recovery should reflect what the insured business would have earned if no interruption had occurred. *Prudential LMI Commercial*, 976 F.2d 727. Thus, courts

typically look to the earnings of the business prior to the interruption in calculating lost income recovery. In terms of the appropriate standard of proof, courts have emphasized that lost profit damages must be established with "reasonable certainty" and cannot be based on hypothetical or speculative forecasts. *Blis Day Spa, LLC v. Hartford Ins. Grp.*, 427 F. Supp. 2d 621 (W.D.N.C. 2006).

Significantly, the Fourth Circuit has held that an insured may not claim as a source of expected earnings (or operational expenses) a source that would not itself have come into being but for the interrupting peril. *Prudential LMI Commercial*, 976 F.2d 727 (finding that motel could not claim that if it was not damaged, it would have been able to profit from the influx of temporary residents and relief workers that the hurricane brought to the area).

The Fifth Circuit, addressing business interruption claims in the wake of Hurricane Katrina, reached the same conclusion. *Consol. Cos., Inc. v. Lexington Ins. Co.*, 2010 WL 3223137 (5th Cir. Aug. 17, 2010) (holding that calculation of lost profits must be based on a scenario in which the hurricane did not strike at all, not on a scenario in which the hurricane struck, but did not damage the policyholder's facilities) (Louisiana law) (discussed in our October 2010 Alert); *Catlin Syndicate Ltd. v. Imperial Palace of Miss. Inc.*, 600 F.3d 511 (5th Cir. 2010) (Mississippi law) (discussed in our May 2010 Alert); *Finger Furniture Co. v. Commonwealth Ins. Co.*, 404 F.3d 312 (5th Cir. 2005) (Texas law). Addressing a related recovery issue, the Fifth Circuit has also held that the amount of "charges and expenses" to which a policyholder is entitled under business interruption coverage must be offset by income earned by the policyholder during the relevant time frame. *Consol. Cos., Inc.*, 2010 WL 3223137.

We will keep you apprised of important developments in coverage actions that arise in this context.

Disgorgement Alert:

New York And Delaware Courts Address Whether Disgorgement Payments Are Covered Under Liability Policies

The Delaware Supreme Court ruled that class action settlement payments were not uninsurable disgorgement under New York law. *In re: TIAA-CREF Ins. Appeals*, 2018 WL 3620873 (Del. July 30, 2018).

TIAA-CREF, a company that provides counseling for retirement accounts, pensions and other investments, was named as a defendant in three class action suits that alleged failure to pay financial gains that had accrued in customers' accounts. TIAA-CREF settled the actions and sought reimbursement of defense costs and settlement payments from its liability and excess insurers. The insurers denied coverage and argued, among other things, that the settlement payments were uninsurable disgorgement under New York law. A Delaware state court disagreed. *See* November 2016 Alert. The Delaware Supreme Court affirmed the ruling.

The Delaware Supreme 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 such showing of ill-gotten gains was made here. The court distinguished 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. Additionally, the court noted that the 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.

In a case involving payments to the Securities and Exchange Commission ("SEC"), a New York appellate court recently ruled that a policyholder was not entitled to coverage for a portion of a payment that expressly represented disgorgement. *J.P. Morgan Sec., Inc. v. Vigilant Ins. Co.*, 2018 WL 4494692 (N.Y. App. Div. 1st Dep't Sept. 20, 2018).

The insurance dispute arose out of a settlement between the SEC and Bear Stearns & Co. Under the settlement, Bear Stearns agreed to pay $160 million as "disgorgement" and $90 million as a civil penalty in connection with deceptive trading claims. When Bear Stearns sought indemnification for the disgorgement portion of the settlement, its insurers denied coverage.

A New York trial court ruled that the disgorgement payment was a covered "loss" under the policy because it represented third-party gains. This month, the appellate court reversed.

The appellate 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." The appellate court ruled that the insurers were entitled summary judgment because the disgorgement payment constituted an excluded penalty. The court relied on the United States Supreme Court's ruling in *Kokesh v. S.E.C.*, 137 S. Ct. 1635 (2017), which expressly held that "SEC disgorgement constitutes a penalty." Although *Kokesh* was decided in the context of a statute of limitations dispute, the New York appellate court held that "[t]he Supreme Court's rationale as to the nature of disgorgement . . . applies with equal force to the issue of whether the disgorgement paid by Bear Stearns, even if representing third party gains, was a 'Loss' within the meaning of the policy."

Asbestos Alert:

Department Of Justice Files Statement Of Interest Regarding Fraud And Mismanagement Of Asbestos Trust

In recent years, a lack of transparency has led to escalating concerns relating to fraud and mismanagement of asbestos trusts. Such problems were highlighted in *In re Garlock Sealing Techs., LLC*, 504 B.R. 71 (Bankr. W.D.N.C. 2014), a matter specifically referenced in the Department of Justice's ("DOJ") Statement of Interest (and discussed in our February 2014 Alert).

This month, the DOJ filed a Statement of Interest in *In re Kaiser Gypsum Co.*, No. 16-31602 (Bankr. W.D.N.C. 2016), relating to the management and transparency of asbestos trusts created under 11 U.S.C. § 524(g) of the Bankruptcy Code. The Statement of Interest emphasizes the need for accountability and proper administration of asbestos trusts in order to protect against fraud and abuse. Further, the DOJ states that the government will object to any proposed plan of reorganization that lacks sufficient protections. Although no formal reorganization plan has been approved in the matter, the DOJ indicated that it has filed the Statement of Interest proactively, in order to give the parties time to address its concerns.

The Statement of Interest sets forth several provisions that the DOJ expects to be included in the plan, including the following: provisions to prevent excessive legal fees and administrative costs, provisions to avoid conflicts of interests among members of the Trust Advisory Committee, and provisions

that preclude payment to claimants who are unable to establish exposure to the defendants' products.

The Statement also implicitly addresses the DOJ's standing to be involved in *In re Kaiser Gypsum Co*., emphasizing that the federal government is entitled to reimbursement of Medicare payments to trust claimants. The DOJ states:

> The United States has a strong interest in ensuring that the trust operates in a transparent manner and complies with its obligations under the (Medicare) statute; that claimants are informed of their potential obligation to reimburse the Medicare program; that the trust's assets are preserved to the greatest extent possible to pay the claims of legitimate asbestos victims; and that trust assets are not dissipated through payment of fraudulent claims, excessive professional fees, or mismanagement.

Restatement Alert:

Ohio Rejects ALI's Restatement Of Law, Liability Insurance

In May 2018, the American Law Institute published the first Restatement of the Law of Liability Insurance, a work that has been criticized in some quarters for failing to restate existing law.

In an unprecedented move, Ohio expressly rejected the Restatement, deeming it not authoritative under Ohio law and against Ohio public policy. *See* Ohio Rev. Code Ann. § 3901.82. The legislation states that the Restatement of the Law of Liability Insurance "does not constitute the public policy of this state and is not an appropriate subject of notice."

It remains to be seen whether additional states will follow suit, and whether the new Ohio legislation will face any judicial challenges. We will keep you posted on this and other related matters.

Defense Costs Alert:

Applying Tennessee Law, Delaware Court Rules That Insurer Is Entitled To Reimbursement Of Defense Costs

A Delaware state court ruled that, under Tennessee law, an insurer has a right to reimbursement of defense costs following a judicial determination that there was no duty to defend, where the insurer preserved such a claim. *Catlin Specialty Ins. Co. v. CBL & Assocs. Props., Inc.*, 2018 WL 3805868 (Del. Super. Ct. Aug. 9, 2018).

When CBL was sued in a class action, it sought defense and indemnity from Catlin. Catlin agreed to advance defense costs but expressly reserved its right to seek reimbursement of those costs in the event it was determined that Catlin had no duty to defend. In a subsequent declaratory judgment action, a Delaware court ruled that Catlin had no duty to defend the class action. Catlin then sought reimbursement, arguing that CBL was unjustly enriched by the defense. The court agreed and ruled in the insurer's favor.

Although the Tennessee Supreme Court had not addressed the issue, the Delaware court concluded that an insurer's right to reimbursement based on unjust enrichment was supported by Tennessee case law. In particular, the court concluded that reimbursement is proper where it is determined that the insurer had no duty to defend, the insurer expressly reserved its right to reimbursement, the policy is silent as to reimbursement and the policyholder accepted the defense notwithstanding the reservation. The court rejected CBL's contention that there was no unjust enrichment because Catlin's offer to defend served its own interests in that it provided protection against the risk of an adverse coverage decision.

The court also rejected CBL's assertion that an insurer's right to reimbursement "has lost favor in recent years." The court noted that the recently-formulated Restatement of the Law on Liability Insurance reflects this purported shift, but explained that the Restatement is "mere persuasive authority" rather than controlling law until a court has

adopted it and that Tennessee courts have not expressly endorsed the new Restatement.

Finally, the court granted Catlin's request for pre-judgment interest, finding that Tennessee statutory law permits the imposition of pre-judgment interest based on equitable factors. The court deemed the accrual date for pre-judgment interest the date upon which the court ruled that Catlin had no duty to defend.

Privacy Alert:

Law Firm Not Entitled To Coverage For Violation Of Privacy Claims, Says Fourth Circuit

The Fourth Circuit ruled that an insurer had no duty to defend a law firm in class action suits alleging violation of federal privacy laws. *Hartford Cas. Ins. Co. v. Ted A. Greve & Assocs.*, 2018 WL 3752235 (4th Cir. Aug. 7, 2018).

Greve, a personal injury law firm, was sued in two class action suits alleging violations of the Driver's Privacy Protection Act. The complaints alleged that Greve obtained plaintiffs' names and addresses from accident reports maintained by the State of North Carolina and that the firm used that information to mail legal advertisements. Hartford, Greve's liability insurer, refused to defend on the basis of two policy provisions. A North Carolina federal district court agreed and entered judgment on the pleadings in Hartford's favor. The Fourth Circuit affirmed.

Hartford's policy provided coverage for personal and advertising injury (which includes violations of the right to privacy), but expressly excluded coverage for (1) injury arising out of the violation of a person's right to privacy created by a state or federal law, unless liability would exist even in the absence of the statute, and (2) injury arising directly or indirectly from a statute, ordinance or regulation that prohibits or limits the sharing of information. The court ruled that both exclusions squarely applied here. The court rejected Greve's assertion that the underlying plaintiffs could potentially state a claim for invasion of privacy under North Carolina common law, separate and apart from the statutory violation. Although North Carolina recognizes a privacy tort based on an intrusion upon a person's seclusion/solitude, the facts alleged in the underlying suits did not allege such conduct. The court reasoned that seclusion/solitude privacy claims typically encompass physical invasions, such as wiretapping or trespass. Here, however, the alleged invasion was the taking of information that was available as a matter of public record. Thus, the court concluded that the underlying allegations did not fall within the exception to the exclusion, and Hartford had no duty to defend or indemnify the claims.

Occurrence Alert:

Kentucky Supreme Court Rules That Intentional Acts, Even If Based On Mistaken Beliefs, Are Not Covered Occurrences

The Supreme Court of Kentucky ruled that a mining company's unauthorized removal of minerals from an adjacent farm based on its mistaken beliefs regarding property lines was not a covered occurrence under a liability policy. *Am. Mining Ins. Co. v. Peters Farms, LLC*, No. 2018 WL 3913781 (Ky. Aug. 16, 2018).

Ikerd Mining removed more than 20,000 tons of coal from land owned by Peters Farms. The vast majority of that coal was wrongfully mined based on Ikerd's mistaken belief as to the location of Peters' property line. Peters sued Ikerd and Ikerd's insurer, American Mining, for trespass and conversion. American Mining argued that there was no occurrence under its policy because Ikerd's mining was intentional. A Kentucky trial court ruled that the damage to Peters' property was

caused by accident, and thus constituted a covered occurrence. The trial court further held that coverage was available under a products-completed operations hazard ("PCOH") clause. An intermediate appellate court affirmed.

The Kentucky Supreme Court reversed, holding that Ikerd's conduct could not be deemed accidental in light of Ikerd's intent and control. As to intent, the court explained that while it may not have been Ikerd's intent to mine Peters' coal specifically, Ikerd did intend to mine and sell the coal it extracted. In other words, although Ikerd's trespass might have been innocent rather than willful, the relevant inquiry for coverage purposes is whether Ikerd intended to act. With respect to control, the court concluded that Ikerd had complete control over its employees who extracted the coal and, indeed, directed them to excavate coal from Peters' property for several months. Thus, the court ruled that Peters' property damage was not caused by a covered occurrence. Additionally, the court reversed the PCOH ruling, explaining that because the PCOH clause creates an exception to a policy exclusion, it cannot be invoked where, as here, there was no initial grant of coverage in the first place.

Expected Or Intended Alert:

Supreme Judicial Court Of Maine Says That Lower Court Erred In Finding That School Assault Injuries Were Not Expected Or Intended

Vacating a lower court decision, the Supreme Judicial Court of Maine ruled that injuries resulting from an attack on a high school student were expected and intended and thus excluded from coverage under a liability policy. *Vermont Mut. Ins. Co. v. Ben-Ami*, 2018 ME 125 (Aug. 21, 2018).

The factual record established that two students, Francoeur and Ben-Ami, engaged in a verbal dispute during a school event and that Francoeur later planned an attack on Ben-Ami. On the day of the assault, Francoeur approached Ben-Ami from behind in a classroom and struck him multiple times in the face. Ben-Ami sustained a broken jaw and other serious injuries.

The central issue in dispute was whether coverage under Francoeur's homeowner's policy was barred by an exclusion for "bodily injury . . . [w]hich is expected or intended by the insured." Under Maine law, this exclusionary language has been deemed ambiguous as to whether it requires an objective standard or rather a subjective perspective based on the insured's personal beliefs and intent. Resolving this ambiguity in favor of the insured, Maine courts have interpreted the exclusion to mean "bodily injury that the insured in fact *subjectively wanted* ('intended') to be a result of his [or her] conduct or in fact subjective foresaw as practically certain ('expected') to be a result of his [or her] conduct." Applying this legal standard, the lower court concluded that the exclusion did not apply. The trial court reasoned that Francouer did not consider the consequences of his actions and did not subjectively intend the extent of injuries that he caused.

The Supreme Judicial Court of Maine vacated the decision, holding that the lower court's findings regarding Francouer's expectation and intent were factually inconsistent with the account of the attack. More specifically, the Supreme Judicial Court of Maine ruled that in light of the premeditated nature of the assault, the ambush tactic and magnitude of the injuries, "the evidence compelled the court to find, at the very least, that Francoeur must have subjectively foreseen as practically certain (*i.e.*, expected) that his deliberately violent conduct would result in bodily injury to Ben-Ami."

Significantly, the court declined to adopt a bright line rule that physical assaults categorically fall within an expected or intended exclusion as a matter of law. Although Maine has recognized that some actions invoke the exclusion as a matter of law (*e.g.*, sexual assault, murder, armed robbery), the court reasoned that a physical altercation is qualitatively different than those types of conduct.

Coverage Alert:

Nevada Court Rules That Losses Arising From Employee Theft Are Not Covered By Crime Policy

A Nevada federal district court ruled that a night club was not entitled to coverage under a commercial crime policy for losses arising from a theft scheme orchestrated by employees. *CP Food & Beverage, Inc. v. U.S. Fire Ins. Co.*, 2018 WL 3993408 (D. Nev. Aug. 6, 2018).

CP operated a club where patrons could purchase "funny money" to tip waitresses or pay dancers who, in turn, gave the funny money back to CP in exchange for cash. After receiving multiple complaints, CP discovered that certain employees were overcharging customers' credit cards and keeping the profits for themselves. CP paid chargebacks to customers' credit cards and incurred substantial expenses in investigating and resolving the theft with both law enforcement and defrauded customers. CP sought coverage from U.S. Fire, which denied coverage on the basis that CP's losses did not "result[ ] directly from theft" as required by the policy. In ensuing litigation, the court granted U.S. Fire's summary judgment motion.

Addressing this matter of first impression under Nevada law, the court ruled that "direct means direct," such that a loss is covered only if CP sustained a direct theft of its own property. The court rejected a proximate causation standard, explaining that "[i]f proximate cause were sufficient, that would render the word 'directly' superfluous." Applying the "direct means direct" standard, the court concluded that there was no coverage because the employees stole money from the customers, not CP, and because CP's losses were incurred indirectly through its restitution/disgorgement to customers and law enforcement. The court also held that CP's investigative expenses did not result "directly" from the theft because CP undertook the investigation to demonstrate to law enforcement that the club owners were not involved in the scheme.

Advertising Injury Alert:

Massachusetts Supreme Judicial Court Rules That Celebrity's Name Is "Advertising Idea" For Purposes Of Advertising Injury Coverage

The Supreme Judicial Court of Massachusetts ruled that a company's use of famed marathon runner Abebe Bikila's name to advertise its running shoes constituted use of another's "advertising idea" for purposes of coverage under an advertising injury clause. *Holyoke Mut. Ins. Co. in Salem v. Vibram USA, Inc.*, 2018 WL 4344538 (Mass. Sept. 12, 2018).

The family of famed barefoot marathon runner Abebe Bikila sued Vibram, alleging improper use of the name Bikila to advertise Vibram's running shoes. Vibram tendered defense to its insurers, who denied coverage on the basis that there was no covered advertising injury. More specifically, the insurers argued that the underlying claims did not allege "use of another's advertising idea" in Vibram's advertisements, as required by the policy. A Massachusetts trial court agreed and granted the insurers' summary judgment motion. In so ruling, the trial court found that the underlying complaint asserted only that Vibram's advertisements implicated a "personality right" (rather than an "advertising idea"), which is excluded from coverage pursuant to an intellectual property exclusion. The Supreme Judicial Court granted an application for direct review and reversed.

Ruling on this matter of first impression under Massachusetts law, the Supreme Judicial Court ruled that Bikila's name constituted an "advertising idea" because his family had used his name to promote their own commercial and educational ventures. The court stated: "we conclude that the complaint reasonably may be interpreted as

claiming that the Bikila family intentionally created a connection between their family name and Abebe Bikila's legacy and desirable qualities for purposes of using 'Bikila,' and everything it conveyed, to attract customers to their running-related commercial ventures." The court noted that other jurisdictions have interpreted "advertising idea" broadly to include a wide array of concepts that are implemented in connection with marketing and sales.

Statute Of Limitations Alert:

Insurer's Equitable Subrogation Claim Not Subject To Statute Of Limitations, Says Connecticut Appellate Court

A Connecticut appellate court ruled that an insurer's equitable subrogation claim against an alleged tortfeasor was not subject to two statutes of limitations applicable to the underlying negligence claims. *Gov't Employees Ins. Co. v. Barros*, 184 Conn. App. 395 (Aug. 28, 2018).

An automobile insurer paid the policy limit for bodily injury to its policyholder after a car accident. More than three years after the accident, the insurer brought an equitable subrogation claim against the other driver. The driver argued that the claim was barred by two statutes of limitations applicable to the underlying claims for negligent operation of a motor vehicle. A Connecticut trial court disagreed and entered judgment in the insurer's favor. The appellate court affirmed.

The appellate court ruled that equitable subrogation claims are not subject to statutes of limitations, but rather may be barred by a defense of laches, which applies only if there has been an unreasonable and prejudicial delay in bringing suit. The court further held that the driver waived a defense of laches, and that even if he had not, there was no evidence of an unreasonable delay or prejudice. The court also rejected the driver's contention that the statutes of limitations for the underlying tort claims should apply to the equitable subrogation claim because the insurer "stands in the shoes" of the policyholder.

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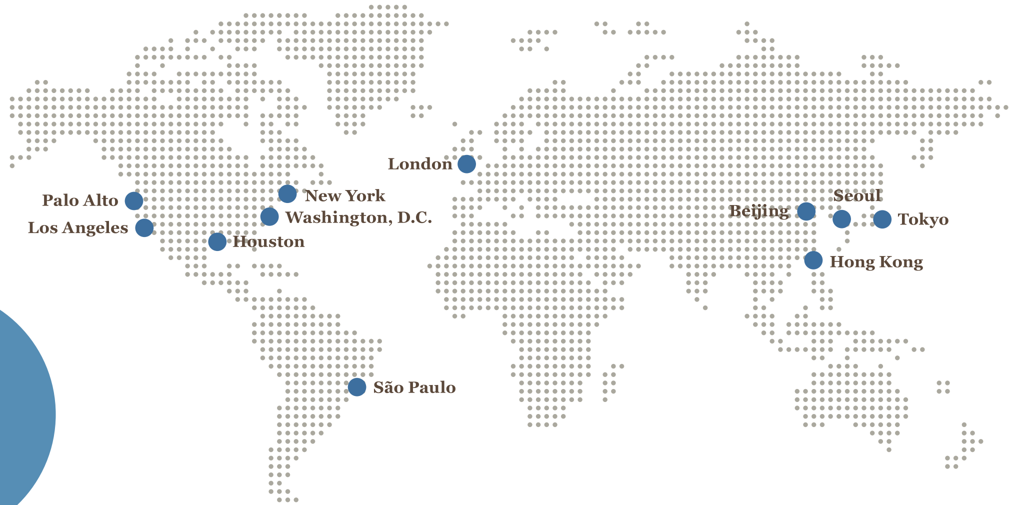

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