Simpson Thacher

Insurance Law Alert

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The Supreme Court of Texas ruled that an insured vs. insured exclusion bars coverage for claims asserted against a former director by an insurance company standing in the shoes of the insured company. *Great American Ins. Co. v. Primo*, 2017 WL 749870 (Tex. Feb. 24, 2017). (Click here for full article)

Ninth Circuit Rejects Coverage Under Computer Fraud Provision For Fraudulent Wire Transfer Claims

The Ninth Circuit ruled that an insurer does not owe coverage under a computer fraud provision for losses arising out of wire transfers that occurred as a result of fraudulent emails. *Taylor & Lieberman v. Fed. Ins. Corp.*, 2017 WL 929211 (9th Cir. Mar. 9, 2017). (Click here for full article)

Georgia Court Rules That Computer Fraud Provision Does Not Encompass Fraudulent Debit Card Transactions

A Georgia federal district court ruled that losses caused by fraudulent debit card transactions are not covered by a computer fraud provision. *InComm Holdings, Inc. v. Great Am. Ins. Co.*, 2017 WL 1021749 (N.D. Ga. Mar. 16, 2017). (Click here for full article)

Insurer May Depreciate Labor Costs In Calculating Actual Cash Value, Rules Nebraska Supreme Court

The Nebraska Supreme Court ruled that where a policy is silent on the issue, an insurer may consider the depreciation of labor costs in determining the actual cash value of a covered loss. *Henn v. American Family Mutual Ins. Co.*, 295 Neb. 859 (Neb. Feb. 17, 2017). (Click here for full article)

Insurer Not Bound By Consent Judgment Executed By Underlying Parties, Says West Virginia Supreme Court

The West Virginia Supreme Court ruled that an insurer is not bound by a consent judgment executed by opposing parties in an underlying suit in conjunction with a covenant not to execute and an assignment of claims against the insurer. *Penn-America Ins. Co. v. Beecher*, 2017 WL 878716 (W. Va. Mar. 1, 2017). (Click here for full article)

"Simpson Thacher has many litigators who are very experienced in handling complex, multi-faceted litigation involving novel issues."

***–Benchmark 2017,* quoting a client**

Oregon Court Rules That Pollution Exclusion Bars Coverage For Carbon Monoxide Claims

Ruling on a matter of first impression under Oregon law, an Oregon federal district court ruled that a pollution exclusion unambiguously bars coverage for claims alleging injury caused by carbon monoxide. *Colony Ins. Co. v. Victory Constr. LLC*, 2017 WL 960024 (D. Or. Mar. 9, 2017). (Click here for full article)

Connecticut Appellate Court Addresses Allocation Issues In Asbestos-Injury Context

A Connecticut appellate court addressed the proper allocation of defense and indemnity for long-term asbestos-related injury claims, resolving several matters of first impression under Connecticut law. *R.T. Vanderbilt Co., Inc. v. Hartford Accident and Indem. Co.*, 2017 WL 810704 (Conn. App. Ct. Mar. 7, 2017). (Click here for full article)

Applying Cause-Based Approach, Ohio Court Rules That Sale of Defective Products Constitutes Multiple Occurrences

An Ohio federal district court ruled that injuries allegedly caused by defective torches and/or improper fuel arose out of multiple occurrences, not a single decision to sell those products. *Big Lots Stores, Inc. v. American Guarantee & Liability Ins. Co.*, No. 2:14-cv-02635 (S.D. Ohio Mar. 2, 2017). (Click here for full article)

STB News Alerts:

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D&O Alert:

Texas Supreme Court Rejects Narrow Construction Of Insured vs. Insured Exclusion

Reversing an appellate court decision, the Supreme Court of Texas ruled that an insured vs. insured exclusion bars coverage for claims asserted against a former director by an insurance company standing in the shoes of the insured company. *Great American Ins. Co. v. Primo*, 2017 WL 749870 (Tex. Feb. 24, 2017).

Robert Primo served as a director of Briar Green, a non-profit organization. After Primo resigned, Briar Green allegedly discovered that he had misappropriated funds and sought coverage for those losses from Travelers, its fidelity insurer. Travelers paid the claim in exchange for a written assignment of Briar Green's rights and claims against Primo. Travelers, standing in the shoes of Briar Green, then sued Primo to recover the funds. Thereafter, Primo sued Great American, Briar Green's D&O insurer, seeking reimbursement of the costs he incurred in the Travelers suit. Great American argued that coverage was barred by the insured vs. insured exclusion, which applies to claims against an insured made by Briar Green "or … any person or entity which succeeds to the interests of [Briar Green]." A Texas trial court agreed that the exclusion applied. An intermediate appellate court reversed, reasoning that the exclusion did not apply because Travelers was not Briar Green's "successor." The appellate court held that Texas common law requires a "successor" to acquire the rights of another entity and "maintain[ ] the character of the place taken." The Texas Supreme Court reversed.

The Texas Supreme Court ruled that the appellate court erred in applying a corporate-based "successor" analysis given the absence of that term in the exclusion. As the Texas Supreme Court emphasized, the exclusion does not use the term "successor" or "successor-in-interest." Rather, it requires that the party bringing suit "succeed" to the interests of Briar Green. Further, the Texas Supreme Court reasoned that applying the plain meaning of "succeeds" (falls heir to, inherits or comes into possession of) comports with the purpose of the exclusion – to prevent collusive suits between organizations and their officers.

Computer Fraud Coverage Alerts:

Ninth Circuit Rejects Coverage Under Computer Fraud Provision For Fraudulent Wire Transfer Claims

As discussed in previous Alerts, courts have rejected policyholder attempts to obtain coverage for cyber-related losses under computer fraud and other similar policy provisions. In *Apache Corp. v. Great American Ins. Co.*, 2016 WL 6090901 (5th Cir. Oct. 18, 2016), the Fifth Circuit ruled that a 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. *See* November 2016 Alert. Similarly, in *Universal Am. Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 2015 WL 3885816 (N.Y. June 25, 2015), the New York Court of Appeals ruled that coverage for the "fraudulent entry" of data is limited to losses caused by unauthorized access into the policyholder's computer system and does not encompass losses caused by an authorized user's submission of fraudulent information into the computer system. *See* July/August 2015 Alert.

This month, the Ninth Circuit, applying similar reasoning, ruled that an insurer does not owe coverage for losses arising out of wire transfers that occurred as a result of fraudulent emails. *Taylor & Lieberman v. Fed. Ins. Corp.*, 2017 WL 929211 (9th

Cir. Mar. 9, 2017). The court reasoned that coverage was not available under a computer fraud provision because "sending an email, without more" does not constitute an unauthorized "entry into" a computer system, as required by the coverage grant. The court explained that the emails that instructed the policyholder to effectuate the wire transfers do not amount to trespass into a computer system. The court also held that the fraudulent emails are not an "introduction of instructions" that "propogate[d] themselves" through the computer system, explaining that those policy terms refer to malicious computer codes and other similar intrusions.

In addition, the court ruled that there is no coverage under a forgery provision that protects against loss "resulting from Forgery or alteration of a Financial Instrument by a Third Party." The court rejected the policyholder's contention that under the "last antecedent rule," the words "financial instrument" only limit coverage for an alteration, and that a forgery need not be of a financial instrument. Instead, the court concluded that under a "natural reading of the policy," forgery coverage extends only to forgery of a financial instrument (and not to a fraudulent email). Finally, the court ruled that there is no funds transfer fraud coverage because that provision requires transfers to be made "without an Insured Organization's knowledge or consent." Here, the policyholder knew about the wire transfers and in fact directed the transfer of funds after receiving the fraudulent emails.

Georgia Court Rules That Computer Fraud Provision Does Not Encompass Fraudulent Debit Card Transactions

A Georgia federal district court ruled that losses caused by fraudulent debit card transactions are not covered by a computer fraud provision. *InComm Holdings, Inc. v. Great Am. Ins. Co.*, 2017 WL 1021749 (N.D. Ga. Mar. 16, 2017).

InComm provides a service that allows customers to load funds onto prepaid debit cards issued by banks. Cardholders can purchase "chits" from retailers to add funds onto the cards. InComm processes such requests by using an Interactive Voice Response System (*i.e.*, telephone) as well as Application Processing Servers (computer servers that process the requested transactions). A vulnerability in InComm's processing center allowed cardholders to add credit to their debit cards in multiples of the amount actually purchased. Before InComm discovered this flaw, unauthorized redemptions caused InComm to transmit more than $11 million to various debit card issuers. InComm sought coverage from Great American for these losses, which the insurer denied. In ensuing coverage litigation, the court agreed with Great American that the policy's computer fraud provision does not encompass the losses at issue.

The computer fraud provision covers losses "resulting directly from the use of any computer to fraudulently cause a transfer" of money, securities or other property. The court found that the underlying transfers were not caused by "use of a computer" because they were caused directly by the automated telephone system. Although a computer processing system was also involved in the transactions, the court deemed that involvement insufficient to constitute use of a computer. The court stated: "A person 'uses' a computer where he takes, holds or employs it to accomplish something. That a computer was somehow involved in a loss does not establish that the wrongdoer 'used' a computer to cause the loss. To hold so would unreasonably expand the scope of the Computer Fraud Provision." Additionally, the court held that even if a computer was used, the losses did not "result directly" from computer use because they "occurred only after InComm wired money to [a bank], after the cardholder used his card to pay for a transaction, and after [the bank] paid the seller for the cardholder's transaction." In so ruling, the court relied on *Apache Corp. v. Great American Ins. Co.*, 2016 WL 6090901 (5th Cir. Oct. 18, 2016), in which the court, considering an identical computer fraud provision, denied coverage for wire transfers made at the direction of fraudulent emails.

Property Insurance Alert:

Insurer May Depreciate Labor Costs In Calculating Actual Cash Value, Rules Nebraska Supreme Court

As discussed in our January and February 2016 Alerts, courts disagree as to whether labor costs can be depreciated for the purposes of calculating actual cash value ("ACV") under a property policy. The Arkansas Supreme Court has ruled that state law prohibits the depreciation of labor costs, even where the policy expressly allows for such depreciation, whereas the Minnesota Supreme Court has ruled that the question of depreciation should be left to the trier of fact. Last month, the Nebraska Supreme Court weighed in, ruling that where a policy is silent on the issue, an insurer may consider the depreciation of labor costs in determining the ACV of a covered loss. *Henn v. American Family Mutual Ins. Co.*, 295 Neb. 859 (Neb. Feb. 17, 2017).

Although Nebraska courts have used various approaches to calculate ACV, the Nebraska Supreme Court noted that all approaches are based on the principle that "actual cash value is the value of the property in its depreciated condition." Therefore, the court concluded that:

> The unambiguous definition of actual cash value is a depreciation of the whole. As such, the insured is not underindemnified by receiving the depreciated amount of both materials and labor. We agree with American Family that a payment of actual cash value that included the full costs of labor would amount to a prepayment of unearned benefits.

In so ruling, the court noted that allowing consideration of depreciated labor costs is consistent with Nebraska's "broad evidence rule," which allows "all relevant facts and circumstances to be considered."

Settlement Alert:

Insurer Not Bound By Consent Judgment Executed By Underlying Parties, Says West Virginia Supreme Court

The West Virginia Supreme Court ruled that an insurer is not bound by a consent judgment executed by opposing parties in an underlying suit in conjunction with a covenant not to execute and an assignment of claims against the insurer. *Penn-America Ins. Co. v. Beecher*, 2017 WL 878716 (W. Va. Mar. 1, 2017).

After sustaining injuries in a timbering accident, Osborne sued his employer (H&H Logging) as well as the owner and lessor of the land on which the accident occurred (Heartwood and Allegheny). H&H tendered the suit to its insurer, Penn-America, which denied coverage based on a policy exclusion. Thereafter, H&H retained counsel at its own expense. Heartwood and Allegheny were defended by Liberty Mutual, Allegheny's insurer. Although Heartwood and Allegheny discovered that their timber contract with H&H required H&H to defend and indemnify them for job-related accidents, they did not forward that information to or request indemnity from Penn-America. Prior to trial, the parties reached a settlement containing three components: (1) a consent judgment in which Heartwood and Allegheny agreed to a $1 million judgment against them; (2) a covenant not to execute the judgment; and (3) an assignment to Osborne of all claims Heartwood and Allegheny might have against Penn-America. Pursuant to the settlement, Osborne dismissed his claims against Heartwood and Allegheny and sued Penn-America. A West Virginia circuit court granted Osborne's summary judgment motion and ordered Penn-America to pay the $1 million consent judgment (which represented its policy limits). The West Virginia Supreme Court reversed.

The West Virginia Supreme Court ruled that the consent judgment was not binding on Penn-America because it was not a party to the settlement or the lawsuit in which the consent judgment was entered. In so ruling, the court noted the lack of factual support for the $1 million judgment as a "fair and reasonable valuation" of Osborne's injuries. The court rejected the argument

that Penn-America should nonetheless be bound by that amount because it did not exceed policy limits. Additionally, the court ruled that the assignment of claims was void because it was based on false factual bases. In particular, the assignment was expressly based on the assertion that Heartwood and Allegheny were without insurance coverage and that the consent judgment was necessary to protect their assets, when, in fact, they were provided coverage and a defense by Liberty Mutual. Finally, the court noted the symptoms of fraud and collusion in this case: an unreasonable judgment amount and concealment of the settlement from Penn-America.

Pollution Exclusion Alert:

Oregon Court Rules That Pollution Exclusion Bars Coverage For Carbon Monoxide Claims

Ruling on a matter of first impression under Oregon law, an Oregon federal district court ruled that a pollution exclusion unambiguously bars coverage for claims alleging injury caused by carbon monoxide. *Colony Ins. Co. v. Victory Constr. LLC*, 2017 WL 960024 (D. Or. Mar. 9, 2017).

Lawsuits filed against Victory Construction alleged negligence and failure to warn in connection with the installation of a swimming pool heater. The complaints alleged that as a result of Victory's negligence, excessive carbon monoxide entered a home, causing injury to its residents. Colony Insurance denied coverage based on a pollution exclusion. Ruling on the parties' cross-motions for summary judgment, the court held that the pollution exclusion bars coverage and that Colony has no duty to defend or indemnify the claims.

Predicting that the Oregon Supreme Court would apply a pollution exclusion to preclude coverage for carbon monoxide claims, the court rejected three assertions made by Victory. First, the court held that exclusion is not limited to traditional environmental pollution based on the "plain meaning" of the terms of the exclusion, without resort to extrinsic evidence. In so ruling, the court expressly disagreed with the Nevada Supreme Court's ruling in *Century Surety Co. v. Casino West, Inc.*, 329 P.3d 614 (Nev. 2014) (discussed in our June 2014 Alert). Second, the court ruled that Victory's reasonable expectations were irrelevant to interpretation of the pollution exclusion, noting that the Oregon Supreme Court has not expressly adopted a reasonable expectations doctrine and that state statutory law (requiring insurance contracts to be interpreted according to their terms and conditions) appears to be inconsistent with the doctrine. Finally, the court concluded that the exclusion was unambiguous on its face, rejecting Victory's assertion of ambiguity based on conflicting case law.

As discussed in previous Alerts, other courts have likewise concluded that carbon monoxide injury claims fall squarely within the scope of a standard pollution exclusion. *See* March 2016 Alert, June 2013 Alert, Sept. 2012 Alert.

Allocation Alert:

Connecticut Appellate Court Addresses Allocation Issues In Asbestos-Injury Context

A Connecticut appellate court addressed the proper allocation of defense and indemnity for long-term asbestos-related injury claims, resolving several matters of first impression under Connecticut law. *R.T. Vanderbilt Co., Inc. v. Hartford Accident and Indem. Co.*, 2017 WL 810704 (Conn. App. Ct. Mar. 7, 2017).

The coverage dispute arose from thousands of underlying asbestos-related personal injury lawsuits against Vanderbilt. In this interlocutory appeal, Vanderbilt and approximately thirty insurance companies sought declarations regarding their respective obligations as to the underlying claims. Among other things, the parties challenged the trial court's allocation and policy exclusion rulings. Reversing in part and affirming in part, the appellate court ruled as follows:

Trigger: The court rejected Vanderbilt's contention that Connecticut law has definitively endorsed a continuous trigger

for long-tail asbestos injury claims. Rather, the court held that trigger remains an "open question" in Connecticut. The court also rejected Vanderbilt's assertion that trigger presents a question of fact that requires expert testimony. Instead, the court concluded that trigger must be determined by the court as a matter of law and that the trial court properly excluded scientific/medical testimony in this context. Turning to the substantive issue at hand, the court ruled that a continuous trigger governs asbestos-related claims, under which "every policy in effect, beginning at the time of initial exposure and extending through the latency period and up to the manifestation of asbestos related disease, is on the risk for defense and liability costs."

Unavailability of Insurance: The court addressed whether Vanderbilt should be responsible for costs prorated to periods in which it was uninsured not by choice, but because insurance coverage was unavailable. The insurers argued that Connecticut law does not recognize an unavailability rule, and that even if it does, an equitable exception existed because Vanderbilt "continue[d] to place allegedly harmful products into the stream of commerce during a time when no coverage [was] available for losses attributed to those products." The court rejected both contentions. First, the court endorsed an unavailability rule under Connecticut law, but held that the trial court misapplied the rule. In particular, the appellate court found error in the trial court's reasoning that occurrence-based insurance was available from 1993 through 2007 based on the limited availability of claims-made coverage. The appellate court also noted a lack of factual support for the finding that Vanderbilt could have obtained coverage during this time frame, but chose not to. Second, the court declined to rule on whether Connecticut would adopt an equitable exception to this rule, instead finding that even if such an exception existed, the factual record did not support its application because Vanderbilt had a good faith belief that its talc did not contain asbestos during the relevant period of no insurance.

Excess and Umbrella Coverage: The court ruled that an allocation agreement among primary insurers was enforceable against umbrella and excess insurers that were not parties to the allocation agreement. The court noted that while potentially collusive or bad faith agreements may be challenged by excess insurers, the factual record did not suggest any such impropriety. The court also ruled that Continental's umbrella policies were unambiguous and that language obligating Continental to defend "an occurrence not covered in whole or in part by underlying insurance" does not create a defense obligation when primary coverage was available and has been exhausted.

Pollution Exclusion: The court held that a standard pollution exclusion is ambiguous as to whether it applies only to traditional environmental contamination or "more broadly to circumstances such as the release of asbestos dust and similar toxic industrial products within a building when used as intended." However, the court noted that to the extent that the factual record establishes traditional environmental contamination (*e.g.*, the outdoor dumping of silica waste onto neighboring properties), the exclusion may apply.

Occupational Disease Exclusions: Addressing a matter of first impression in Connecticut and nationally, the court ruled that occupational disease exclusions are not limited to claims brought by a policyholder's own employees. Rather, the exclusion also bars claims brought by complainants who developed occupational disease while using the policyholder's products in the course of working for another employer. The court reasoned that although the term "occupational disease" may be used in workers' compensation law, "it does not follow that the term applies only to workers' compensation claims brought against one's own employer."

Number of Occurrences Alert:

Applying Cause-Based Approach, Ohio Court Rules That Sale of Defective Products Constitutes Multiple Occurrences

An Ohio federal district court ruled that injuries allegedly caused by defective torches and/or improper fuel arose out of multiple occurrences, not a single decision to sell those products. *Big Lots Stores, Inc. v. American Guarantee & Liability Ins. Co.*, No. 2:14-cv-02635 (S.D. Ohio Mar. 2, 2017).

The coverage dispute arose out of lawsuits filed against Big Lots alleging personal injuries caused by tabletop torches sold in combination with a particular fuel. Some underlying complaints alleged that Big Lots was involved in the design and manufacture of the torches while others alleged only that Big Lots sold and distributed the torches. In one case, a Texas court ruled that Big Lots was a non-manufacturing seller of the torches. In the present suit, American Guarantee disputed its coverage obligations under umbrella policies issued to Big Lots. More specifically, the parties disagree as to whether Big Lots' primary policy has been exhausted – an issue that depends on whether the underlying claims allege a single occurrence or multiple occurrences.

Applying a cause-oriented analysis under Ohio law, the court concluded that the torch claims constituted multiple occurrences. The court reasoned that there was not "but one proximate, uninterrupted and continuing cause which resulted in all of the injuries," as required by the cause test. The court rejected Big Lots' contention that its single "chain of business decisions" led to the underlying injuries. The court distinguished single occurrence-product defect cases on the basis that, in those cases, the policyholder was the manufacturer (rather than the seller). Here, in contrast, each sale of a torch presented a "new exposure" and a separate "act from which liability arose." The court also distinguished "failure to warn" cases, in which courts have found that numerous injuries arise from a single occurrence.

STB News Alerts:

Mary Beth Forshaw and Elisa Alcabes edited *Getting the Deal Through: Insurance Litigation*, a publication that provides expert advice and insight into contentious insurance issues, and co-authored its chapter on United States law.

The 18th edition of the *Handbook on Insurance Coverage Disputes* has recently been released. The *Handbook*, co-authored by retired Simpson Thacher partner and acting New York State Supreme Court Justice Barry R. Ostrager, and edited by Elisa Alcabes and Karen Cestari, discusses thousands of insurance and reinsurance-related decisions issued over the past decade, including the most recent and significant rulings by state supreme courts.

Simpson Thacher

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

David J. Woll
+1-212-455-3136
dwoll@stblaw.com

Mary Beth Forshaw
+1-212-455-2846
mforshaw@stblaw.com

Andrew T. Frankel
+1-212-455-3073
afrankel@stblaw.com

Lynn K. Neuner
+1-212-455-2696
lneuner@stblaw.com

Chet A. Kronenberg
+1-310-407-7557
ckronenberg@stblaw.com

Bryce L. Friedman
+1-212-455-2235
bfriedman@stblaw.com

Michael D. Kibler
+1-310-407-7515
mkibler@stblaw.com

Michael J. Garvey
+1-212-455-7358
mgarvey@stblaw.com

Tyler B. Robinson
+44-(0)20-7275-6118
trobinson@stblaw.com

George S. Wang
+1-212-455-2228
gwang@stblaw.com

Deborah L. Stein
+1-310-407-7525
dstein@stblaw.com

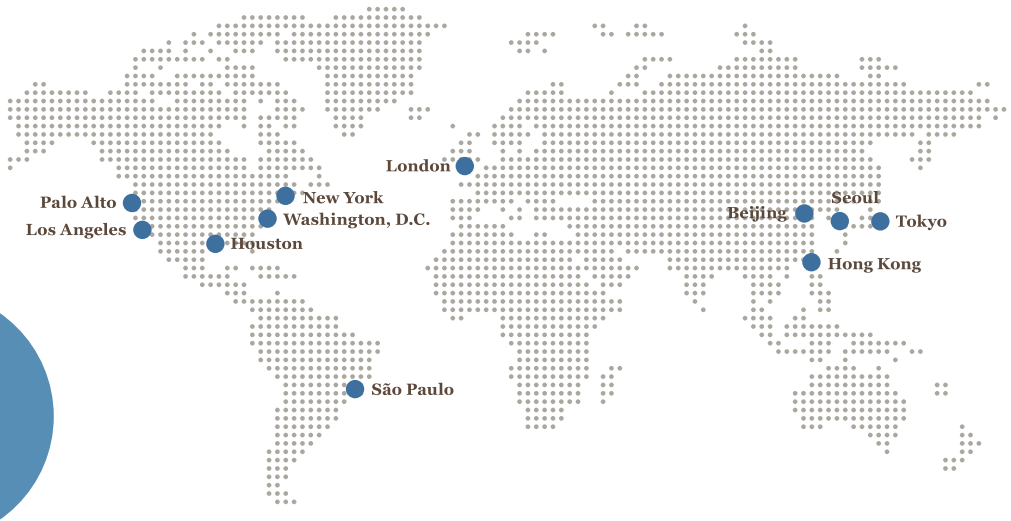
Craig S. Waldman
+1-212-455-2881
cwaldman@stblaw.com

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

Elisa Alcabes
+1-212-455-3133
ealcabes@stblaw.com

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

This edition of the Insurance Law Alert was prepared by Mary Beth Forshaw mforshaw@stblaw.com /+1-212-455-2846 and Bryce L. Friedman bfriedman@stblaw.com /+1-212-455-2235 with contributions by Karen Cestari kcestari@stblaw.com.



Simpson Thacher Worldwide

UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
600 Travis Street, Suite 5400
Houston, TX 77002
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
900 G Street, NW
Washington, D.C. 20001
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3901 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
25th Floor, West Tower
Mirae Asset Center 1
26 Eulji-ro 5-gil, Jung-gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino
Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000