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Insurance Law Alert

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A Michigan federal district court ruled that a policyholder is not entitled to coverage for losses arising from a wire transfer initiated by a fraudulent email. *American Tooling Center, Inc. v. Travelers Cas. & Sur. Co. of Am.*, 2017 WL 3263356 (E.D. Mich. Aug. 1, 2017). (Click here for full article)

California Appellate Court Rejects Policyholder's Attempt To "Electively Stack" Excess Policies

A California appellate court ruled that a policyholder is not entitled to electively stack excess policies issued in a single policy year, finding that the policyholder's elective vertical exhaustion approach is not supported by policy language or common law. *Montrose Chemical Corp. of Ca. v. Superior Court of the State of Ca.*, 2017 WL 3772568 (Ca. Ct. App. Aug. 31, 2017). (Click here for full article)

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The Eighth Circuit ruled that excess insurers have no obligation to indemnify a policyholder's underlying lump sum settlement of two underlying suits, only one of which was potentially covered by the policies. *UnitedHealth Grp. Inc. v. Executive Risk Specialty Ins. Co.*, 2017 WL 3910115 (8th Cir. Sept. 7, 2017). (Click here for full article)

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A Florida appellate court ruled that an insurer that denies coverage based on its determination that there is no covered loss cannot later assert that the insured failed to comply with the policy's conditions precedent. *Castro v. Homeowners Choice Prop. & Cas. Ins. Co.*, 2017 WL 3614102 (Ct. App. Fla. 2d Dist. Aug. 23, 2017). (Click here for full article)

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The Ninth Circuit ruled that an insurer is not obligated to defend a Telephone Consumer Protection Act suit against the Los Angeles Lakers based on a policy exclusion barring coverage for "right to privacy" claims. *Los Angeles Lakers, Inc. v. Federal Ins. Co.*, 2017 WL 3613340 (9th Cir. Aug. 23, 2017). (Click here for full article)

Fifth Circuit Rules That Pollution Exclusion Encompasses Asbestos Claims

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Pollution Exclusion May Not Bar Coverage For Claims Arising From Oil Leak, Says New Jersey Court

A New Jersey federal district court denied an insurer's summary judgment motion, finding that a pollution exclusion does not necessarily bar coverage for contamination claims stemming from an oil leak. *Benjamin v. State Farm Ins. Co.*, 2017 WL 3535023 (D.N.J. Aug. 17, 2017). (Click here for full article)

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Oregon Appellate Court Rules That Contribution Claims Are Barred By State Statute

The Court of Appeals of Oregon ruled that state statutory law precludes contribution claims between insurers for payments made in connection with underlying environmental claims. *Certain Underwriters at Lloyd's London v. Mass. Bonding & Ins. Co.*, 287 Or. App. 279 (Or. App. Aug. 16, 2017). (Click here for full article)

Computer Fraud Coverage Alert:

Michigan Court Rules That Fraudulent Wire Transfer Losses Are Not Covered By Liability Policy

As discussed in our July/August 2017 Alert, several courts have recently rejected policyholder attempts to obtain coverage for cyber-related losses under computer fraud and similar policy provisions. Last month, a Michigan federal district court followed suit, finding that a policyholder is not entitled to coverage for losses arising from a wire transfer initiated by a fraudulent email. *American Tooling Center, Inc. v. Travelers Cas. & Sur. Co. of Am.*, 2017 WL 3263356 (E.D. Mich. Aug. 1, 2017).

ATC, a tool and die manufacturer, outsources work to Shanghai, an overseas manufacturer. Shanghai receives payment after it sends an invoice to ATC and the invoice is verified by ATC. In 2015, ATC received an email purportedly sent by Shanghai (but in actuality sent by a third party using a similar domain), instructing ATC to send payment for several outstanding invoices to a new bank account. In response, ATC wired approximately $800,000 to the account without verifying the new instructions with Shanghai. ATC sought coverage for the loss from Travelers, which denied the claim. In ensuing litigation, a Michigan court ruled that the policy does not cover the losses.

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 "the use of any computer to fraudulently cause a transfer" of money or other property to a third party. The court held that ATC did not suffer a "direct loss" that was "directly caused" by "the use of any computer." The court reasoned that the loss was not "directly caused" by the fraudulent email because there were intervening events between receipt of the email and the transfer of funds. In particular, the court noted that ATC verified certain product milestones and authorized the wire transfer but failed to verify the new bank information. The court concluded that these intervening events preclude a finding of "direct" loss "directly caused" by the use of a computer.

Notably, a New York federal district court, faced with a similar factual record, recently concluded that claims arising out of losses caused by a fraudulent wire transfer were covered by "computer fraud" and "funds transfer fraud" provisions. *See Medidata Solutions, Inc. v. Federal Ins. Co.*, 2017 WL 3268529 (S.D.N.Y. July 21, 2017) (discussed in our July/August 2017 Alert).

Excess Alert:

California Appellate Court Rejects Policyholder's Attempt To "Electively Stack" Excess Policies

A California appellate court ruled that a policyholder may not electively stack excess policies issued in a single policy year, finding that the policyholder's elective vertical exhaustion approach is not supported by policy language or common law. *Montrose Chemical Corp. of Ca. v. Superior Court of the State of Ca.*, 2017 WL 3772568 (Ca. Ct. App. Aug. 31, 2017).

Montrose, a DDT manufacturer, purchased layers of primary and excess liability policies from various insurers over a twenty-six year period. The number of layers and policy limits of each layer varied from year to year. In seeking coverage for underlying claims against it from its excess insurers, Montrose argued that it could select any policy to indemnify its liabilities, and need only show it had sufficient liabilities to exhaust the underlying policies in that particular policy period in order to access excess policies for the same period (*i.e.*, vertical exhaustion).

In contrast, certain insurers argued that Montrose must exhaust all lower-lying excess policies in all triggered policy years (*i.e.*, horizontal exhaustion) before any particular excess policy could be reached. Ruling on cross-motions for summary judgment, a California trial court denied Montrose's motion and granted the insurers' motion. The trial court held that California law requires horizontal exhaustion unless policy language specifically provides otherwise, and that "other insurance" clauses in the excess policies preclude vertical exhaustion (even where excess policies explicitly referenced exhaustion of a particular underlying policy). The appellate court affirmed in part and reversed in part.

The appellate court ruled that Montrose's "elective stacking" is not supported by common law or policy language. In particular, the court deemed *State v. Continental Ins. Co.*, 55 Cal. 4th 186 (2012) (in which the court applied "all sums" allocation and allowed stacking) inapplicable, noting that both the policy language and legal issues presented in that case are distinguishable from the present case. The court expressly held that *Continental* does not stand for the proposition that insureds covered by multiple policies are entitled to select which policies to access "in the manner they deem most efficient and advantageous." Rather, the court explained, *Continental* reinforces the principle that policy language dictates issues of allocation and exhaustion. The court further held that here, policy language does not allow elective stacking because, among other things, many excess policies attach only upon exhaustion of all underlying insurance.

However, the appellate court ruled that the trial court erred in granting the insurers' summary judgment motion and holding that all underlying limits across years of damage must be exhausted before any excess policy is triggered. Highlighting the "tremendous variation among the terms of the excess policies," the appellate court held that it could not conclude, as a matter of law, that every excess policy requires horizontal exhaustion. Remanding the matter, the court noted that "the sequence in which policies may be accessed must be decided on a policy-by-policy basis, taking into account the relevant portions of each policy."

Settlement Alert:

Eighth Circuit Rules That Policyholder's Failure To Allocate Settlement Between Covered And Non-Covered Claims Is Fatal To Suit Against Insurers

The Eighth Circuit ruled that excess insurers have no obligation to indemnify a policyholder's lump sum settlement of two underlying suits, only one of which was potentially covered by the policies. *UnitedHealth Grp. Inc. v. Executive Risk Specialty Ins. Co.*, 2017 WL 3910115 (8th Cir. Sept. 7, 2017).

UnitedHealth settled two underlying suits with a single lump-sum settlement. Only one of the suits was potentially covered by UnitedHealth's excess liability policies. UnitedHealth sued its insurers seeking indemnity for the settlement and defense costs for one of the suits. A Minnesota federal district court ruled in the insurers' favor. The court held that UnitedHealth failed to meet its burden of allocating the settlement between potentially covered and non-covered claims. The Eighth Circuit affirmed.

Addressing this matter of first impression under Minnesota law, the court held that UnitedHealth bears the burden of allocating between covered and non-covered claims. The court further held that it is insufficient for UnitedHealth "to show simply that its $350 million settlement included a covered claim of an unspecified amount." Rather, it must allocate between potentially covered and non-covered claims "with enough specificity to permit a reasoned judgment about liability." The court concluded that UnitedHealth failed to meet this standard, explaining that evidence relating to pre-settlement rulings and expert testimony about the value of each suit failed to provide "more than a speculative basis" on which to allocate the settlement.

Coverage Alert:

Florida Appellate Court Rules That Insurer Cannot Assert Defense Based On Insured's Failure To Comply With Conditions Precedent After Blanket Coverage Denial

A Florida appellate court ruled that an insurer that denies coverage based on its determination that there is no covered loss cannot later assert that the insured failed to comply with the policy's conditions precedent. *Castro v. Homeowners Choice Prop. & Cas. Ins. Co.*, 2017 WL 3614102 (Ct. App. Fla. 2d Dist. Aug. 23, 2017).

Homeowners sought coverage for damage that appeared to be sinkhole-related. The property insurer retained an engineering firm to investigate the claim and subsequently denied coverage based on an earth movement exclusion. Prior to the denial, the insurer did not request examinations under oath ("EUO"), proof of loss or other documentation relating to the damage. Four years later, the homeowners asked the insurer to reconsider its denial based on an engineering report which found that the damage was caused by sinkhole activity. In response, the insurer requested EUOs and sworn proof of loss. After several unsuccessful attempts to schedule the EUOs, the homeowners brought suit. The insurer moved for summary judgment based on the homeowners' refusal to comply with its demands for EUOs and proof of loss. A Florida trial court granted the insurer's motion, finding that the claim had been "reopened" by the new information and that the insurer was entitled to seek compliance with the policy's conditions precedent. The appellate court reversed.

The court ruled that where, as here, an insurer investigates a claim and denies coverage based on a determination that no covered loss has occurred, it cannot later assert the insured's failure to comply with conditions precedent as a basis for summary judgment. The court rejected the insurer's assertion that the subsequent submission of an engineering report constituted a reopening of the claim "that somehow nullified its previous denial of coverage."

Arbitration Alert:

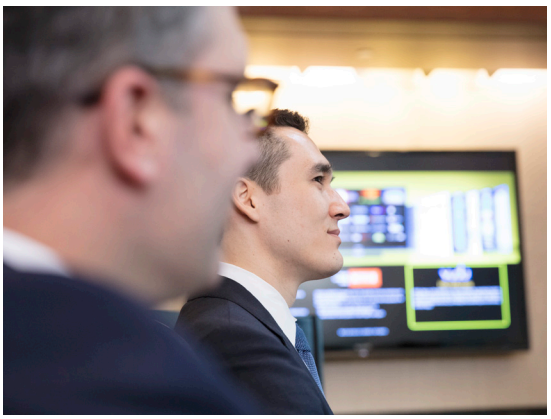
Connecticut Supreme Court Rules That Trial Court Improperly Vacated Arbitration Award

The Connecticut Supreme Court ruled that a trial court improperly vacated an arbitration award by substituting its own judgment for that of the arbitration panel. *Kellogg v. Middlesex Mutual Assurance Co.*, 2017 WL 3526616 (Conn. Aug. 1, 2017).

The dispute arose out of coverage for property damage under a "restorationist" insurance policy. Pursuant to the policy's appraisal provision, the parties arbitrated a loss valuation dispute. A three-member panel awarded the homeowner approximately $460,000, which reflected replacement/restoration costs less depreciation. The homeowner moved to vacate the award on the basis that it was defective under Connecticut

General Statutes § 52-418. The insurer moved to dismiss. Following a trial on both the motion to dismiss and the merits of the application to vacate, a Connecticut trial court denied the motion to dismiss and vacated the award. The court held that the award violated § 52-418 for two reasons: (1) it prejudiced the homeowner's "substantial monetary rights" because the award was too low, and (2) the award resulted from the panel's "manifest disregard" of the terms of the insurance policy. The Connecticut Supreme Court reversed.

Section 52-418(3) provides that an arbitration award shall be vacated if the arbitrators have been guilty of "any other action by which the rights of any party have been prejudiced." The Connecticut Supreme Court explained that this provision applies only to issues of



procedural errors in the arbitration process, and does not extend to the sufficiency of the monetary award. Because there was no claim that the panel committed any procedural errors, the trial court's decision to vacate based on its disagreement with the panel's loss valuation was erroneous.

The Connecticut Supreme Court also found error in the trial court's second basis for vacating. Section 52-418(a)(4) provides that an award should be vacated if the arbitrators have "exceeded their powers or so imperfectly executed them that a mutual, final and definite award upon the subject matter submitted was not made." The trial court had applied this provision based on its finding that the panel disregarded the insurance policy's depreciation clause. The Connecticut Supreme Court ruled, however, that interpretation of policy provisions is a task for the panel, not the court, and that in any event, the trial court misapplied state law in interpreting the depreciation provision.

TCPA Alert:

Ninth Circuit Rules That "Right To Privacy" Exclusion Relieves Insurer Of Duty To Defend TCPA Suit

The Ninth Circuit ruled that an insurer is not obligated to defend a Telephone Consumer Protection Act ("TCPA") suit against the Los Angeles Lakers based on a policy exclusion barring coverage for "right to privacy" claims. *Los Angeles Lakers, Inc. v. Federal Ins. Co.*, 2017 WL 3613340 (9th Cir. Aug. 23, 2017).

The underlying suit alleged that the Lakers violated the TCPA by sending automated text message responses to fans who had sent texts to the team during a game. Federal refused to defend the suit based on a policy exclusion for claims "based upon, arising from, or in consequence of . . . invasion of privacy." The Lakers filed suit, and a California district court dismissed the action based on the policy exclusion. The trial court reasoned that although the underlying suit did not allege any invasion of privacy claims, the exclusion applied because TCPA claims are "implicit" invasion of privacy claims. A divided panel of the Ninth Circuit affirmed.

Although the exclusion does not reference TCPA claims, the court ruled that TCPA claims fall within its scope as a matter of law. The court held that "invasion of privacy" encompasses intrusions upon one's seclusion or solitude and is not limited to invasions based on private content. In addition, relying on the legislative intent of the statute, the court concluded that a TCPA claim is inherently and solely an invasion of privacy claim. The court rejected the dissent's argument that common law privacy claims (which the underlying plaintiff expressly waived) are distinct from statutory TCPA claims and thus that the privacy exclusion does not necessarily bar coverage for the latter, which address more than just privacy concerns (*e.g.*, economic injury, public safety).

Pollution Exclusion Alerts:

Fifth Circuit Rules That Pollution Exclusion Encompasses Asbestos Claims

Addressing a matter of first impression under Texas law, the Fifth Circuit ruled that asbestos is a "pollutant" within the meaning of a pollution exclusion. *Longhorn Gasket & Supply Co. v. United States Fire Ins. Co.*, 2017 WL 3588304 (5th Cir. Aug. 18, 2017).

Longhorn, a manufacturer of asbestos-containing products, sued U.S. Fire Insurance Company, alleging breach of contract for failure to provide coverage. A Texas district court ruled that U.S. Fire was obligated to contribute to underlying defense and settlement costs. On appeal, U.S. Fire contested several district court rulings,

including its finding that the pollution exclusion was inapplicable. The Fifth Circuit reversed.

The Fifth Circuit concluded that asbestos is a "pollutant" and "irritant" within the meaning of the exclusion based on its harmful effects on the body and atmosphere. As the court noted, other jurisdictions have issued mixed decisions in this context. The court remanded the matter for a determination of whether the "sudden and accidental" exception to the exclusion applies.

Pollution Exclusion May Not Bar Coverage For Claims Arising From Oil Leak, Says New Jersey Court

A New Jersey federal district court denied an insurer's summary judgment motion, finding that a pollution exclusion does not necessarily bar coverage for contamination claims stemming from an oil leak. *Benjamin v. State Farm Ins. Co.*, 2017 WL 3535023 (D.N.J. Aug. 17, 2017).

Homeowners sought coverage for costs incurred in remediating contamination caused by a leak in an underground oil tank. The insurer denied coverage on several bases, including a pollution exclusion that bars coverage for loss caused by the discharge or escape of irritants, pollutants or contaminants, unless the loss was "sudden and accidental." In ensuing litigation, the court denied the insurer's summary judgment motion, finding that issues of fact exist as to whether the exclusion applies to the homeowners' claims.

The court held that New Jersey law limits the application of pollution exclusions to traditional environmental pollution claims. Here, because the claims arose out of small-scale and relatively contained contamination, the court held that the exclusion might not apply. Additionally, the court reasoned that under New Jersey law, the pollution exclusion includes an intent requirement as a matter of public policy. The court concluded that summary judgment was inappropriate where, as here, there were no allegations or evidence that the homeowners intended to pollute the property.

Punitive Damages Alert:

Texas Appellate Court Rules That Automobile Policy Does Not Cover Punitive Damages

Distinguishing prior case law, a Texas appellate court ruled that an automobile policy does not provide coverage for punitive damages. *Farmers Texas Cnty. Mutual Ins. Co. v. Zuniga*, 2017 WL 4014644 (Tex. Ct. App. Sept. 13, 2017).

In a coverage dispute arising out of an automobile accident, a Texas trial court ruled that a policy that covers "damages for bodily injury" requires the insurer to pay for punitive damages. The appellate court reversed. The appellate court distinguished cases involving policies that provide coverage for "all sums which the insured shall become legally obligated to pay as damages because of . . . bodily injury," explaining that such language provides broader coverage than the language at issue. Although at least one Texas appellate court has ruled that punitive damages are covered even in the absence of "all sums" language, the *Farmers* court deemed that ruling "dubious." In further support of its decision, the court emphasized the distinction between compensatory damages (which address costs associated with bodily injury) and punitive damages (which address public policy concerns).

Contribution Alert:

Oregon Appellate Court Rules That Contribution Claims Are Barred By State Statute

The Court of Appeals of Oregon ruled that state statutory law precludes contribution claims between insurers for payments made in connection with underlying environmental claims. *Certain Underwriters at Lloyd's London v. Mass. Bonding & Ins. Co.*, 287 Or. App. 279 (Or. App. Aug. 16, 2017).

Under 2013 amendments to the Oregon Environmental Cleanup Assistance Act, a contribution action is precluded unless the underlying environmental claims for which the insurer seeks contribution had become subject to "final judgment, after exhaustion of all appeals," prior to the effective date of the amendments. Or. Laws 2013, ch. 350 § 8(1)-(2). In the present case, the central issue in dispute was whether the underlying claims for which Lloyds sought contribution had become subject to final judgment prior to the effective date. An Oregon trial court ruled that final judgment had not been entered before the effective date and thus that Lloyd's contribution rights were extinguished. The appellate court affirmed.

Lloyds argued that the underlying action was not a single environmental claim, but rather two separate claims: one for defense and one for indemnity. Lloyds reasoned that because it did not appeal the underlying defense cost ruling (and only appealed the indemnity findings), there was a "final judgment" on the defense cost issue prior to the 2013 amendments. The court rejected this contention, explaining that:

> in determining whether there has been a final judgment after exhaustion of all appeals, it is not appropriate to examine the arguments raised on appeal to determine whether particular issues or claims were raised before the appellate court . . . . 'as long as an appeal is pending, finality does not attach piecemeal to the parts of a judgment or order that are not placed in direct controversy by the parties' assignments or arguments in the appeal; it attaches to the case as a whole after the appellate process is complete.'

Because an appeal from the environmental action judgment was pending when the 2013 amendments became effective, the court concluded that there was no final judgment and Lloyd's contribution claim is precluded.

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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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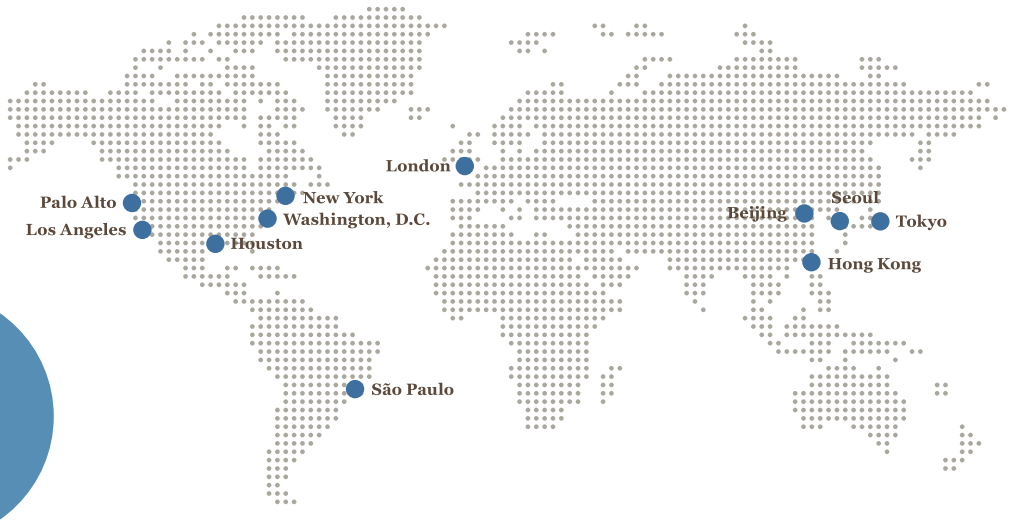

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