Simpson Thacher

Insurance Law Alert

February 2022

In This Issue

Texas Supreme Court Adopts Exception To Eight-Corners Rule

The Texas Supreme Court ruled that courts may look to certain information outside the allegations in the complaint and the insurance policy in evaluating whether an insurer has a duty to defend. *Monroe Guaranty Ins. Co. v. BITCO Gen. Ins. Corp.*, 2022 WL 413940 (Tex. Feb. 11, 2022). (Click here for full article)

Ninth Circuit Rules That Computer Fraud And Funds Transfer Fraud Provisions May Cover Email Phishing Loss

The Ninth Circuit ruled that a California district court erred by dismissing Computer Fraud and Funds Transfer Fraud coverage claims arising out of an email phishing scheme. *Ernst and Haas Management Co., Inc. v. Hiscox, Inc.*, 23 F.4th 1195 (9th Cir. 2022). (Click here for full article)

"Market leader for insurer representation, offering unmatched ability in handling bet-the-company litigation and arbitration proceedings."

–Chambers New York 2021

New York Court Rules That Four Underlying Actions Arose Out Of "Related" Wrongful Actions And Were Therefore Subject To A Single Per-Claim Limit

A New York district court ruled that four separate lawsuits against a law firm arose out of related wrongful actions and were therefore subject to a single $1 million per-claim limit. *Lonstein Law Office, P.C. v. Evanston Ins. Co.*, 2022 WL 311391 (S.D.N.Y. Feb. 2, 2022). (Click here for full article)

Michigan Court Of Appeals And Sixth Circuit Affirm Dismissals Of Restaurants' COVID-19 Coverage Suits

A Michigan appellate court and the Sixth Circuit affirmed dismissals of suits seeking coverage for losses incurred in the wake of government closure orders under commercial property policies. *Gavrilides Management Co., LLC v. Michigan Ins. Co.*, 2022 WL 301555 (Mich. Ct. App. Feb. 1, 2022); *Brown Jug, Inc. v. Cincinnati Ins. Co.*, 2022 WL 538221 (6th Cir. Feb. 23, 2022). (Click here for full article)

New Jersey Court Dismisses Law Firm's COVID-19 Claims Against Insurers

A New Jersey trial court granted insurers' motion to dismiss a complaint seeking coverage under business interruption and civil authority provisions of an all risk policy. *Fleming Ruvoldt PLLC v. Sentinel Ins. Co.*, 2022 WL 401883 (N.J. Super. Ct. Feb. 1, 2022). (Click here for full article)

Two Courts Reach Opposite Conclusions As To Application Of Pollution Exclusion To Injuries Stemming From Tank Explosions

The Supreme Court of Mississippi ruled that a pollution exclusion is ambiguous and does not bar coverage for injuries arising out of an explosion caused by flammable substances, *Omega Protein, Inc. v. Evanston Ins. Co.*, 2022 WL 178171 (Miss. Jan. 20, 2022), whereas a Washington district court held that a pollution exclusion barred coverage for claims arising out of a tank explosion, *Country Mutual Ins. Co. v. Jackson*, 2022 WL 187808 (E.D. Wash. Jan. 20, 2022). (Click here for full article)

Duty To Defend Alert:

Texas Supreme Court Adopts Exception To Eight-Corners Rule

The Texas Supreme Court ruled that courts may look to certain information outside the allegations in the complaint and the insurance policy in evaluating whether an insurer has a duty to defend. *Monroe Guaranty Ins. Co. v. BITCO Gen. Ins. Corp.*, 2022 WL 413940 (Tex. Feb. 11, 2022).

The coverage dispute arose out of a negligence lawsuit against a drilling company. The company tendered defense of the suit to two insurers, Monroe and BITCO. BITCO agreed to defend under a reservation of rights, but Monroe refused, arguing it had no duty to defend because the property damage did not occur during its policy period. BITCO sued, seeking a declaration that Monroe was obligated to defend the suit. The parties stipulated that the property damage occurred during BITCO's policy period. A Texas district court determined that it could not consider the stipulation related to the timing of the property damage and therefore granted BITCO's summary judgment motion.

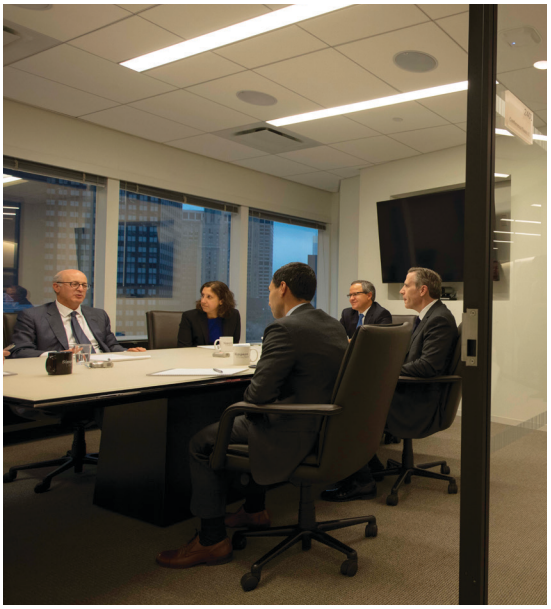
On appeal, the Fifth Circuit asked the Texas Supreme Court to address two issues of law: (1) whether exceptions to the eight-corners rule, as set forth in *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523 (5th Cir. 2004), are permissible under Texas law; and (2) whether a court may consider evidence of a stipulated date related to the underlying occurrence in determining an insurer's duty to defend. (*See* April 2021 Alert). In *Northfield*, the Fifth Circuit agreed to consider extrinsic evidence in evaluating an insurer's duty to defend "when it is initially impossible to discern whether coverage is potentially implicated," and "when the extrinsic evidence goes solely to a fundamental issue of coverage which does not overlap with the merits of or engage the truth or falsity of any facts alleged in the underlying case."

Answering the first certified question in the affirmative, the Texas Supreme Court ruled that courts may consider extrinsic evidence under a standard similar to that set forth in *Northfield*. More specifically, the court held that:

> [I]f the underlying petition states a claim that could trigger the duty to defend, and the application of the eight-corners rule, due to a gap in the plaintiff's pleading, is not determinative of whether coverage exists, Texas law permits consideration of extrinsic evidence provided the evidence (1) goes solely to an issue of coverage and does not overlap with the merits of liability, (2) does not contradict facts alleged in the pleading, and (3) conclusively establishes the coverage fact to be proved.

Notwithstanding this exception, the court emphasized that the eight-corners rule remains the "initial inquiry" to determine an insurer's defense obligations.

As to the second question, the court held that a court may consider extrinsic evidence of the date of an occurrence so long as it meets the aforementioned requirements. The court concluded that here, the extrinsic evidence did not satisfy the test because the date of occurrence stipulation overlapped with the merits of the underlying case. The court explained: "A dispute as to when property damage occurs also implicates whether property damage occurred on that date, forcing the insured to confess damages at a particular date to invoke coverage, when its position may very well be that no damage was sustained at all."



Cyber Alert:

Ninth Circuit Rules That Computer Fraud And Funds Transfer Fraud Provisions May Cover Email Phishing Loss

The Ninth Circuit ruled that a California district court erred by dismissing Computer Fraud and Funds Transfer Fraud coverage claims arising out of an email phishing scheme. *Ernst and Haas Management Co., Inc. v. Hiscox, Inc.*, 23 F.4th 1195 (9th Cir. 2022).

The coverage dispute arose after an employee of the insured management company wired payments to a fraudulent actor who had presented himself as her supervisor in spoofed emails. Hiscox denied coverage, arguing that the loss was caused by the intervening actions of the employee and not "directly" by computer fraud, as required by the Computer Fraud provision. The insurer also argued that coverage under a Funds Transfer Fraud provision was unavailable because the loss did not result directly from "fraudulent instructions." A California district court agreed and dismissed the coverage suit. The Ninth Circuit reversed.

The Ninth Circuit ruled that the Computer Fraud provision covered the company's loss because it "resulted directly" from use of a computer to fraudulently cause a transfer of property, notwithstanding the employee's actions in effectuating the transfer. The court relied on *American Tooling Center, Inc. v. Travelers Cas. & Sur. Co. of Am.*, 895 F.3d 455 (6th Cir. 2018) (discussed in our July/August 2018 Alert), in which the Sixth Circuit ruled that fraudulently induced wire transfers were a "direct loss" and that the insured company's multi-step authorization process did not qualify as an intervening action sufficient to break the causal chain. The court distinguished Ninth Circuit precedent that held there was no coverage for losses stemming from an authorized user's embezzlement of funds, deeming that factual scenario "materially different" from fraudulently-induced wire transfer losses.

In addition, the Ninth Circuit ruled that coverage was available under a Funds Transfer Fraud provision, which applied to "loss of Money and Securities resulting from a Fraudulent Instruction directing a financial institution to transfer, pay or deliver Money and Securities." The court emphasized that the policy defined "instruction" to include an instruction "initially received by You which purports to have been transmitted by an Employee but which was in fact fraudulently transmitted by someone else." As the court noted, the Eleventh Circuit, faced with nearly identical policy language, reached the same conclusion in *Principle Solutions Group, LLC v. Ironshore Indemity*, 944 F.3d 886 (11th Cir. 2019) (discussed in our December 2019 Alert).

Coverage Alert:

New York Court Rules That Four Underlying Actions Arose Out Of "Related" Wrongful Actions And Were Therefore Subject To A Single Per-Claim Limit

A New York district court ruled that four separate lawsuits against a law firm arose out of related wrongful actions and were therefore subject to a single $1 million per-claim limit. *Lonstein Law Office, P.C. v. Evanston Ins. Co.*, 2022 WL 311391 (S.D.N.Y. Feb. 2, 2022).

A law firm was retained by DirecTV to identify and bring claims against businesses or individuals who had illegally acquired DirecTV services. Various businesses brought lawsuits against the law firm and DirecTV, asserting claims of fraud, federal statutory violations and other causes of action. The suits alleged that the law firm participated in a scheme in which DirecTV would induce businesses to sign up for a non-commercial DirecTV package, after which the law firm would threaten litigation and extort large sums of money in order to avoid prosecution for failing to obtain a commercial account. In turn, the law firm sued Evanston, alleging breach of contract and bad faith based on the insurer's refusal to pay the full aggregate limits rather than a single $1 million per-claim limit. The court dismissed the complaint.

The policy included a "related claims" provision that stated that "[m]ore than One Claim arising out of a Single Wrongful Act . . . or a series of related Wrongful Acts . . . shall be considered a single Claim." The court held that the provision was

unambiguous and that the four underlying actions were "related" under the policy. More specifically, the court explained that each lawsuit arose from the law firm's actions in representing DirecTV and involved "nearly identical and overlapping allegations" of a scheme to extort money from small business owners using the same misrepresentations. The court deemed it irrelevant that the allegations in each action presented distinct facts, occurred at different times and involved different claimants. Further, the court emphasized that the policy provision did not require claims to be based on the same legal theories in order to be "related."

COVID-19 Alerts:

Michigan Court Of Appeals And Sixth Circuit Affirm Dismissals Of Restaurants' COVID-19 Coverage Suits

A Michigan appellate court affirmed a trial court's dismissal of a suit seeking coverage for losses incurred in the wake of government closure orders under a commercial property policy. *Gavrilides Management Co., LLC v. Michigan Ins. Co.*, 2022 WL 301555 (Mich. Ct. App. Feb. 1, 2022).

The appellate court ruled that the insurers properly denied coverage based on the restaurant's failure to allege direct physical loss or damage to property. The court explained that even assuming that loss or damage need not be permanent to qualify as "direct physical loss of or damage to" property, there would still be no coverage because "physical" requires the loss or damage to "have some manner of tangible and measurable presence or effect in, on, or to the premises." The court emphasized that the complaint did not allege that the restaurant was contaminated with the virus and that even if it did, such contamination would likely constitute an "indirect" loss rather than a "direct physical loss." The court also held that a civil authority provision was inapplicable because there were no allegations of damage to nearby property, which was required under that coverage provision.

Additionally, the court held that coverage was barred by two provisions: an exclusionary clause that applied to loss or damage caused directly or indirectly by "enforcement of any ordinance or law" and a virus exclusion. As to the first exclusion, the court held that the executive orders constituted ordinances or laws within the meaning of the policy, and as to the virus exclusion, the court deemed it irrelevant that the provision did not include phrases such as "directly or indirectly" or "regardless of any other cause."

Citing the appellate court's decision in *Gavrilides*, the Sixth Circuit affirmed the dismissal of restaurants' business loss claims and predicted that the Michigan Supreme Court would rule that allegations of loss of use of property due to government shutdown orders are not sufficient to allege "direct physical loss." *Brown Jug, Inc. v. Cincinnati Ins. Co.*, 2022 WL 538221 (6th Cir. Feb. 23, 2022). The court noted that general, conclusory allegations that the virus "impaired some unidentified property in some unidentified manner" are not sufficient to withstand a motion to dismiss and that allegations of harm to individuals are not the same as harm to property. In addition, the court explained that allegations that viral particles were present on surfaces and were capable of spreading the virus do not allege actual harm to property because such particles can be eliminated with cleaning. Finally, the court ruled that there could be no civil authority coverage because (1) the complaints failed to allege more than conclusory statements of loss to other property, and (2) the shutdown orders did not prohibit access to insured property and in fact encouraged businesses to remain operational for takeout or delivery service.

New Jersey Court Dismisses Law Firm's COVID-19 Claims Against Insurers

A New Jersey trial court granted insurers' motion to dismiss a complaint seeking coverage under business interruption and civil authority provisions of an all risk policy. *Fleming Ruvoldt PLLC v. Sentinel Ins. Co.*, 2022 WL 401883 (N.J. Super. Ct. Feb. 1, 2022). The court found that the law firm's financial losses were caused by government shutdown orders, rather than "physical loss" or "physical damage" as required under the policy. In so ruling, the court rejected the notion that a loss of use of property could constitute direct physical loss. The court further noted that even if the virus was

physically present at the covered property, it would be insufficient to meet the "physical damage" requirement. Moreover, the court held that civil authority coverage was unavailable because the government orders did not "completely prohibit" the law firm from accessing its property. Finally, the court ruled that a virus exclusion was unambiguous and barred coverage for all claims.

Pollution Exclusion Alert:

Two Courts Reach Opposite Conclusions As To Application Of Pollution Exclusion To Injuries Stemming From Tank Explosions

The Supreme Court of Mississippi ruled that a pollution exclusion is ambiguous and does not bar coverage for injuries arising out of an explosion caused by flammable substances. *Omega Protein, Inc. v. Evanston Ins. Co.*, 2022 WL 178171 (Miss. Jan. 20, 2022).

The injuries arose while contractors were working on a storage tank containing stickwater, a liquid composed of water, fish oil and fish solids—the byproducts of fish oil production. During welding and grinding of the metal tank, an explosion occurred, killing one person and injuring others. The explosion was allegedly caused by the "extremely flammable" gases inside the tank. Evanston sought a declaration that coverage under its excess policy was barred by a pollution exclusion that applied to loss "arising out of or contributed to in any way by the actual, alleged or threatened discharge, dispersal, release, migration, escape, or seepage of pollutants."

The court ruled that the pollution exclusion is ambiguous because the undefined terms "irritant" and "contaminant" in the definition of "pollutant" are susceptible of more than one reasonable interpretation. In particular, the court noted that a substance can be an irritant or contaminant "at its core and by its very nature" regardless of where it exists, or conversely, may only be an irritant or contaminant when it comes into contact with something else. Construing this ambiguity in favor of coverage, the court ruled that the exclusion did not apply.

In contrast, a Washington district court granted an insurer's summary judgment motion, finding that a pollution exclusion barred coverage for claims arising out of a tank explosion. *Country Mutual Ins. Co. v. Jackson*, 2022 WL 187808 (E.D. Wash. Jan. 20, 2022).

During the transport of several items to be recycled, a metal tank that was believed to be harmless exploded. The pressurized tank contained poisonous chlorine gas, and the accident resulted in the death of one individual and injuries to several others. The insurer defended the resulting lawsuits under a reservation of rights and later sought a declaration that it had no further duty to defend. The court granted the motion, ruling that the pollution exclusion precluded coverage for all claims.

The policyholder conceded that the injuries arose from a "pollutant" but argued that coverage nonetheless existed under Washington's efficient proximate cause analysis. In particular, the policyholder claimed that the initial peril of the underlying injuries was the tortfeasor's negligence in failing to inspect the cylinder, which is a covered peril under the policy. Under state law, if the initial event is a covered peril, "then there is coverage under the policy regardless [of] whether subsequent events within the chain, which may be causes-in-fact of the loss, are excluded by the policy." The court rejected this argument, explaining that it "need not consider the efficient cause of the injuries because the initial peril—negligent identification of a metal cylinder for recycling or disposal—fits within the 'pollution exclusion' and is an uncovered peril." The court further noted that "general negligence in this context is not an independent peril distinct from the pollution exclusion."

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.

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

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

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

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

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

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

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

Joshua Polster
+1-212-455-2266
joshua.polster@stblaw.com

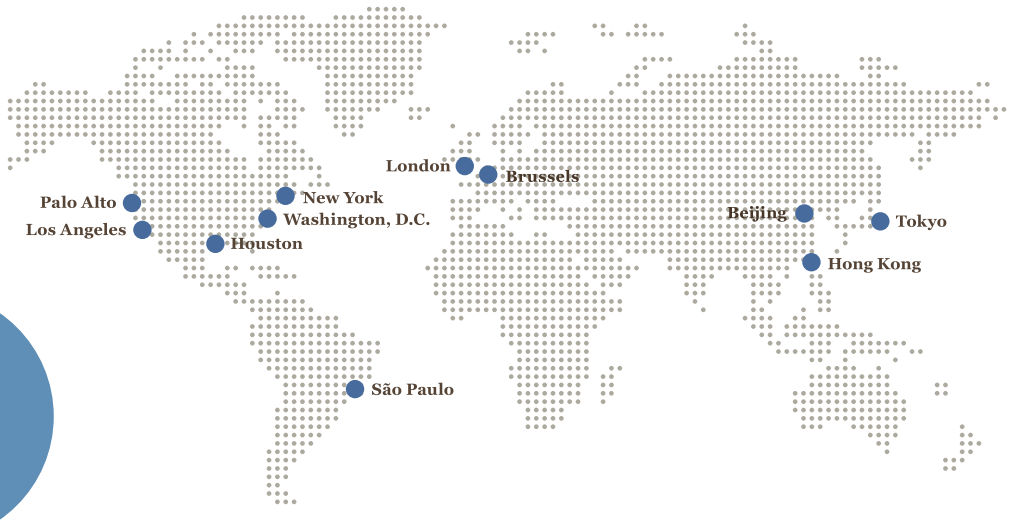
Summer Craig
+1-212-455-3881
scraig@stblaw.com

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

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

Isaac M. Rethy
+1-212-455-3869
irethy@stblaw.com

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

Brussels
Square de Meeus 1, Floor 7
B-1000 Brussels
Belgium
+32-472-99-42-26

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

ASIA

Beijing
3901 China World Tower A
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

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