Simpson Thacher

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Simpson Thacher Names Lynn K. Neuner Co-Chair of Global Litigation Department

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Five Federal Appellate Courts Affirm Dismissal Of COVID-19 Coverage Suits, Finding That Loss Of Use Is Not Direct Physical Loss Under Policy

The Second, Fifth, Sixth, Tenth and Eleventh Circuits recently ruled that policyholders were not entitled to coverage under property policies for business losses incurred in the wake of pandemic-related shut downs. *10012 Holdings, Inc. v. Sentinel Ins. Co.*, 21 F.4th 216 (2d Cir. 2021); *Terry Black's Barbecue, LLC v. State Auto. Mutual Ins. Co.*, 2022 WL 43170 (5th Cir. Jan. 5, 2022); *Estes v. Cincinnati Ins. Co.*, 2022 WL 108606 (6th Cir. Jan. 12, 2022); *Goodwill Indus. of Central Oklahoma, Inc. v. Philadelphia Indem. Ins. Co.*, 21 F.4th 704 (10th Cir. 2021); *Ascent Hospitality Management Co., LLC v. Employers Ins. Co. of Wausau*, 2022 WL 130722 (11th Cir. Jan. 14, 2022). (Click here for full article)

Indiana Appellate Court Rules That Loss Of Use Is Insufficient To Allege Direct Physical Loss Due To COVID-19 Under Property Policy

An Indiana appellate court ruled that policy language requiring "direct physical loss" did not encompass a claim for loss of use of the insured facilities during the COVID-19 pandemic. *Indiana Repertory Theatre v. Cincinnati Cas. Co.*, 2022 WL 30123 (Ind. Ct. App. Jan. 4, 2022). (Click here for full article)

New Jersey Court Declines To Dismiss COVID-19 Coverage Suit, Finding That Loss Of Use Of Casino May Satisfy Direct Physical Loss Requirement

A New Jersey trial court denied insurers' motion to dismiss a COVID-19-related coverage suit, ruling that a casino's inability to use its property for its intended purpose could satisfy the policies' physical loss requirement. *AC Ocean Walk, LLC v. American Guar. & Liab. Ins. Co.*, 2021 WL 6091224 (N.J. Super. Ct. Dec. 22, 2021).
(Click here for full article)

Absolute And Qualified Pollution Exclusions Bar Coverage For All Claims, Says New York Appellate Court

New York's Third Department ruled that pollution exclusions barred coverage for all underlying claims against a manufacturing company, rejecting the policyholder's assertion that some discharges were "sudden and accidental." *Tonoga, Inc. v. New Hampshire Ins. Co.*, 2022 WL 52903 (N.Y. App. Div. Jan. 6, 2022). (Click here for full article)

Reversing District Court, Fifth Circuit Rules That No "Claim" Was Made During Policy Period Despite News Coverage Putting Insurer On Notice

The Fifth Circuit ruled that no claim was made against the policyholder during the relevant policy period and therefore the insurer had no duty to defend. *Jordan v. Evanston Ins. Co.*, 2022 WL 141777 (5th Cir. Jan. 17, 2022). (Click here for full article)

Reinsurance Alert:

Declaring That *Bellefonte* Is No Longer The Law Of The Circuit, Second Circuit Rules That Defense Costs Are Not Subject To Reinsurance Policy Limits

The Second Circuit ruled that defense costs were not subject to limits set forth in facultative reinsurance certificates. *Global Reinsurance Corp. of Am. v. Century Indem. Co.*, 2021 WL 6122136 (2d Cir. Dec. 28, 2021).

Global issued facultative reinsurance certificates to Century that indemnified expenses Century incurred in connection with commercial liability policies issued to Caterpillar Tractor Company. When Century sought reinsurance payments from Global for amounts paid to Caterpillar, Global sought a declaration that the limits of the reinsurance certificates capped its obligations with respect to both losses and defense costs. In contrast, Century argued that the limits applied only to indemnity losses and that Century's defense costs were payable in addition to policy limits.

A New York district court, applying *Bellefonte Reins. Co. v. Aetna Cas. & Sur. Co.,* 903 F.2d 910 (2d Cir. 1990), ruled in Global's favor, finding that certificates' limits imposed a cap on both losses and defense costs. (*See* March 2020 Alert). On appeal, Century argued that defense costs were not subject to the limits because the reinsurance certificates followed form to Century's underlying policies to Caterpillar, under which defense costs were in addition to policy limits. In a certified question, the Second Circuit asked the New York Court of Appeals whether New York law imposes a presumption that reinsurance liability limits cap both loss and defense costs regardless of the terms of the underlying policy. The Court of Appeals answered the question in the negative, stating that ordinary rules of policy interpretation apply in such cases. Following remand by the Second Circuit, the district court reversed its prior decision. Last month, the Second Circuit affirmed that ruling.

The Second Circuit ruled that Global's reinsurance obligations were subject to the same terms as Century's underlying policies, including the payment of defense costs in addition to policy limits. The court explained that this result was supported by the unambiguous follow-form clause and expert testimony relating to industry custom and practice. In particular, the court emphasized that the follow-form clause specified that the reinsurance conformed "in all respects" to "all" terms and conditions of the underlying policies unless expressly stated otherwise. The court rejected Global's contention that a "Reinsurance Accepted" provision established an intent that the reinsurance contract would not be concurrent with the underlying Century policies as to whether defense costs would be subject to the certificates' limits.

The court noted that this conclusion was also supported by expert testimony regarding reinsurance industry custom and practice, which established that during the relevant time frame, "unless otherwise specifically stated, facultative reinsurance certificates covered investigation and defense expense in addition to limits of liability when the reinsured policy covered expense in addition to its limits of liability." The Second Circuit stated: "To the extent that *Bellefonte* and *Unigard* suggest a different result, we conclude that those decisions . . . are no longer valid law in our circuit."

Opioid Alerts:

Supreme Court Of Delaware Rules That Insurers Have No Duty To Defend Opioid Suits Against Pharmacy

Reversing a trial court decision, the Supreme Court of Delaware ruled that insurers were not obligated to defend Rite Aid in underlying opioid-related law suits brought by governmental entities because the suits do not seek damages because of or for personal injury. *ACE American Ins. Co. v. Rite Aid Corp.*, 2022 WL 90652 (Del. Jan. 10, 2022).

Ohio counties sued Rite Aid and others, alleging that it failed to maintain effective controls relating to the sale and distribution of opioids. The insurer denied coverage and in ensuing litigation a trial court ruled that the insurer had a duty to defend. (*See* October 2020 Alert). The trial court reasoned that at least some of the amounts sought by the counties were arguably because of personal injury because those costs were "at least in part grounded in medical care for the

personal injuries suffered by the counties' residents."

The Delaware Supreme Court reversed, emphasizing that the underlying complaints expressly disclaimed personal injury damages and sought purely economic damages stemming from the opioid crisis. The Court noted that although the counties' economic losses were "arguably linked to care for Ohio residents affected by the opioid epidemic," they were nonetheless outside the scope of coverage.

In so ruling, the court disagreed with the reasoning of *Acuity v. Masters Pharmaceutical, Inc.*, 2020 WL 34466532 (Ohio Ct. App. June 24, 2020) (discussed in our June 2020 Alert) and *Cincinnati Ins. Co. v. Discount Drug Mart, Inc.*, 2021 WL 6142648 (Ohio Ct. App. Dec. 30, 2021), discussed below.

Finding That Public Nuisance Claims Allege Damages Because Of Bodily Injury, Ohio Appellate Court Rules That Insurer Must Defend Drug Store In Opioid Litigation

An Ohio appellate court ruled that an insurer was obligated to defend public nuisance suits brought by government entities against a drug store, finding that the underlying complaints alleged damages because of bodily injury. *Cincinnati Ins. Co. v. Discount Drug Mart, Inc.*, 2021 WL 6142648 (Ohio Ct. App. Dec. 30, 2021).

The underlying complaints were nearly identical to those in *Rite Aid*, alleging that Drug Mart failed to adequately monitor suspicious opioid orders. An Ohio trial court ruled that the insurer had a duty to defend the suits because they alleged "damages" "because of" bodily injury caused by an "occurrence." The appellate court affirmed.

The appellate court held that the underlying claims alleged "damages" even though they sought only "forward-looking, equitable" relief. The court acknowledged that Ohio courts have generally deemed equitable relief to be outside the scope of covered "damages," but noted certain exceptions to this rule and concluded that the term "damages" was ambiguous. Construing this ambiguity in the policyholder's favor, the court ruled that "the payment of money into an abatement fund in this context, although an equitable remedy, arguably or potentially falls within the scope" of coverage.

In addition, the appellate court ruled that the claims sought damages "because of" bodily injury, even though the complaints expressly disclaimed damages for physical injury (either directly or derivatively). The court reasoned that the economic losses at issue were "because of" bodily injury because they were based on money spent on medical and treatment services provided to individuals who were addicted to opioids.

Finally, the court rejected the insurer's contention that the underlying claims did not allege an accidental "occurrence" because public nuisance requires a showing of intentional conduct. The court noted that Ohio law distinguishes between an intent to act and an intent to cause injury and explained that while the complaints alleged that Drug Mart intentionally marketed and distributed opioids, they did not allege that it intended to cause injury to individuals or to increase the counties' public service expenses.

Cyber Alerts:

War Exclusion Does Not Bar Coverage For Malware Claims, Says New Jersey Court

A New Jersey trial court granted a policyholder's summary judgment motion, ruling that a war exclusion in an all risk property policy did not bar coverage for claims arising out of a malware attack. *Merck & Co., Inc. v. ACE American Ins. Co.*, No. UNN-L-2682-18 (N.J. Super. Ct. Jan. 13, 2022).

Merck's computer systems were infected by a malware attack, resulting in alleged losses of more than $1.4 billion. Merck's insurers argued that the evidence established that

the Russian government was responsible for the cyberattack and therefore coverage was barred by an exclusion that applied to:

> Loss or damage caused by hostile or warlike action in time of peace or war, including action in hindering, combating, or defending against an actual, impending, or expected attack: a) by an government or sovereign power (de jure or de facto) or by any authority maintaining or using military, naval or air forces; b) or by military, naval, or air forces; c) or by an agent of such government, power, authority or forces.

Rejecting this assertion, the court noted that decisions interpreting war-related exclusions have construed "war" to mean the use of armed forces in conflicts between nations and have deemed such exclusions to be inapplicable to scenarios not directly linked to military conflict. In so ruling, the court noted that the exclusion did not include any language indicating that it was intended to encompass cyberattacks.

Fifth Circuit Affirms Coverage Denial For Phishing Loss, Finding That Policyholder Did Not "Hold" Lost Funds

Our March 2021 Alert reported on a Texas district court decision holding that losses incurred through a phishing scheme were not covered by a commercial crime policy because the policyholder never had ownership of the lost funds. Last month, the Fifth Circuit affirmed that holding, ruling that the policy was unambiguous and that there was no coverage as a matter of law. *RealPage, Inc. v. National Union Fire Ins. Co. of Pittsburgh, PA*, 21 F.4th 294 (5th Cir. 2021).

RealPage, a provider of online rent collection services, contracted with Stripe, a software company, to facilitate its payment-processing services. Under the contract, Stripe processed payments from renters through its bank account and then forwarded those payments to RealPage's clients. Criminals used a phishing scheme to access the Stripe dashboard and alter fund disbursement instructions. As a result, the criminals diverted more than $10 million. RealPage reimbursed its clients for the lost funds it was unable to recover and then sought insurance coverage. The insurers denied coverage and moved for summary judgment. The district court granted the motion and the Fifth Circuit affirmed.

The policy limited coverage to property "that you own or lease" or "that you hold for others whether or not you are legally liable for the loss of such property." RealPage conceded that it did not own or lease the funds that were designated for its property management clients, but argued that it "held" the funds for purposes of policy coverage. Rejecting this assertion, the Fifth Circuit explained:

> Essentially, RealPage provided routing instructions to Stripe, and Stripe effectuated the transactions and handled the funds transferred from tenants to property managers. Under any definition of "hold" that entails "keep[ing] in custody" or "possession," RealPage cannot claim a loss under National Union's policy because RealPage never "held" the funds intended for its property manager clients.

The court also rejected RealPage's contention that "hold" was ambiguous and could be interpreted to mean "control" over funds. Further, the court noted that even accepting RealPage's conflation of "hold" with "control," there would still be no coverage because all funds were deposited in pooled clearing accounts controlled by Stripe.

COVID-19 Alerts:

Five Federal Appellate Courts Affirm Dismissal Of COVID-19 Coverage Suits, Finding That Loss Of Use Is Not Direct Physical Loss Under Policy

The Second, Fifth, Sixth, Tenth and Eleventh Circuits recently ruled that policyholders were not entitled to coverage under property policies for business losses incurred in the wake of pandemic-related shut downs.

In *10012 Holdings, Inc. v. Sentinel Ins. Co.*, 21 F.4th 216 (2d Cir. 2021), the Second Circuit held that an art gallery's suspension of business operations in compliance with executive orders did not constitute physical damage for insurance coverage purposes under New York law. Additionally, the court held that civil authority coverage was unavailable because the executive orders did not result from direct physical loss to property in the vicinity of the insured premises, but rather from the pandemic itself and the risk it posed to human beings. Citing its decision in *10012 Holdings*, the Second Circuit also upheld dismissals of policyholders' COVID-19 coverage claims in *Kim-Chee LLC v. Philadelphia Indem. Ins. Co.*, 21-1082-cv (2d Cir. Jan. 28, 2022) and *Rye Ridge Corp. et al. v. Cincinnati Insurance Co.*, 2022 WL 120782 (2d Cir. Jan. 13, 2022).

In *Terry Black's Barbecue, LLC v. State Auto. Mutual Ins. Co.*, 2022 WL 43170 (5th Cir. Jan. 5, 2022), the Fifth Circuit, applying Texas law, ruled that losses stemming from the suspension of dine-in services at a restaurant were not covered by a property policy because there was no "direct physical loss" of covered property.

In compliance with government orders, the restaurant suspended its dine-in services. Thereafter, it sought coverage under business interruption and civil authority policy provisions. The insurer denied coverage, and in ensuing litigation a Texas district court dismissed the restaurant's complaint, ruling that physical loss required a "distinct, demonstrable, physical alteration of the property" and that loss of use of property did not satisfy that requirement. The Fifth Circuit affirmed.

Adopting the district court's interpretation of "physical loss," the Fifth Circuit stated: "Nothing happened to TBB's restaurants at all. In fact, TBB had ownership of, access to, and ability to use all physical parts of its restaurants at all times. And importantly, the prohibition on dine-in services did nothing to physically deprive TBB of any property at its restaurants."

The Fifth Circuit expressly rejected the restaurant's assertion that the loss of use of its dining rooms for their intended purpose amounted to a loss of "physical space" sufficient to implicate coverage. The court noted that the policy did not include the phrase "physical space" and that, in any event, the restaurant was not deprived of access to the dining rooms.

Finally, the court ruled that civil authority coverage was unavailable because that provision required the suspension of operations due to a civil authority order "resulting from" actual or alleged exposure to a disease. Declining to determine what standard of causation was required to meet "resulting from," the court held that the restaurant "failed to allege even a remote causal relationship between the civil authority orders and its restaurants' alleged or actual exposure to COVID-19." Rather, the orders were issued in response to the global pandemic in order to slow the spread of the virus.

In *Estes v. Cincinnati Ins. Co.*, 2022 WL 108606 (6th Cir. Jan. 12, 2022), the Sixth Circuit, applying Kentucky law, ruled that "physical loss" means that "a property owner has been tangibly deprived of the property or that the property has been tangibly destroyed." Ruling that the insured dental practice did not meet this standard, the court noted that "COVID-19 did not destroy its

dental offices, and the government shutdown orders did not dispossess it of them for a single day."

Applying similar reasoning, the Tenth and Eleventh Circuits held that government orders, which temporarily impeded the policyholders' ability to use property for its intended purpose, did not constitute a direct physical loss. In *Goodwill Indus. of Central Oklahoma, Inc. v. Philadelphia Indem. Ins. Co.*, 21 F.4th 704 (10th Cir. 2021), the Tenth Circuit, applying Oklahoma law, explained that allowing a loss of use to satisfy the "direct physical loss" policy requirement would ignore the word "physical." Likewise, in *Ascent Hospitality Management Co., LLC v. Employers Ins. Co. of Wausau*, 2022 WL 130722 (11th Cir. Jan. 14, 2022), the Eleventh Circuit, applying New York law, rejected the contention that physical loss includes more than actual physical damage, explaining that both physical loss and physical damage require "'an actual physical change to property that COVID-19 particles cannot cause' because a contaminated location can be immediately restored to its previous state by cleaning and disinfecting—no repair or replacement required."

Indiana Appellate Court Rules That Loss Of Use Is Insufficient To Allege Direct Physical Loss Due To COVID-19 Under Property Policy

An Indiana appellate court ruled that policy language requiring "direct physical loss" did not encompass a claim for loss of use of the insured facilities during the COVID-19 pandemic. *Indiana Repertory Theatre v. Cincinnati Cas. Co.*, 2022 WL 30123 (Ind. Ct. App. Jan. 4, 2022).

A theater sought coverage for business losses incurred in the wake of federal and local government shutdown orders. The insurer denied coverage based on the absence of direct physical loss or damage. An Indiana trial court dismissed the coverage suit and the appellate court affirmed, ruling that the policy was unambiguous and required physical alteration to the property. The court held that the theater's assertion that a loss of use of property was sufficient to allege physical loss was unreasonable and did not comport with other policy provisions, such as the "period of restoration" clause, which contemplated repair of property that had been physically altered or damaged.

New Jersey Court Declines To Dismiss COVID-19 Coverage Suit, Finding That Loss Of Use Of Casino May Satisfy Direct Physical Loss Requirement

A New Jersey trial court denied insurers' motion to dismiss a COVID-19-related coverage suit, finding that a casino's inability to use its property for its intended purpose could satisfy the policies' physical loss requirement. *AC Ocean Walk, LLC v. American Guar. & Liab. Ins. Co.*, 2021 WL 6091224 (N.J. Super. Ct. Dec. 22, 2021).

The casino alleged that COVID-19 presented an imminent threat to its facilities and employees, rendering the property unsafe. It further alleged that viral particles attach and adhere to surfaces and objects, which render physical changes to property. The court ruled that these allegations, accepted as true for purposes of a motion to dismiss, sufficiently stated a claim for physical damage to property. The court further stated that policy language requiring direct physical loss may be satisfied by demonstrating a loss of use of property for its intended purpose, whether or not the property has been altered by the COVID-19 virus.

In addition, the court ruled that a pollution exclusion in four applicable policies did not bar coverage for the casino's claims. In two policies, contaminant was defined to include a list of substances that did not include "virus," whereas a policy provision entitled "Contamination" did include "virus" in its definition. In two other policies, the pollution exclusion expressly excluded "virus." Nevertheless, relying on a body of New Jersey case law in which pollution exclusions have been construed as applying only to

traditional environmental contamination, the court ruled that the exclusions at issue did not bar coverage for COVID-19-related claims. The court noted that the provisions overwhelmingly referred to environmental and industrial pollution contaminants and stated: "Inserting the term 'virus' . . . does not change the substance of the exemption. When read as a whole, the exclusion remains applicable to more traditional environmental-related damages and as such will not fulfill the insured's reasonable expectations."

However, the court deemed a Biological or Chemical Substance Exclusion in one policy applicable to bar coverage, ruling that the COVID-19 virus was a "pathogenic" substance under the clear meaning of that provision.

Pollution Exclusion Alert:

Absolute And Qualified Pollution Exclusions Bar Coverage For All Claims, Says New York Appellate Court

New York's Third Department ruled that pollution exclusions barred coverage for all underlying claims against a manufacturing company, rejecting the policyholder's assertion that some discharges were "sudden and accidental." *Tonoga, Inc. v. New Hampshire Ins. Co.*, 2022 WL 52903 (N.Y. App. Div. Jan. 6, 2022).

After the policyholder's manufacturing site was declared a Superfund site, the policyholder entered into a consent agreement with the government to take certain remedial measures. Thereafter, numerous lawsuits were brought against the policyholder, alleging bodily injury and property damage stemming from pollution of water, soil and air at the site. The insurers refused to defend or indemnify the claims based on pollution exclusions in the relevant policies. A New York trial court ruled that the exclusions applied as a matter of law and that there was no duty to defend. The appellate court affirmed.

The appellate court ruled that an absolute pollution exclusion squarely applied. The court deemed it irrelevant that at the time the policy was issued, the harmful substances at issue were not known to have a detrimental effect on the environment. As to a qualified pollution exclusion in a different policy, the court ruled that the policyholder failed to allege that the discharges at issue were "sudden and accidental" so as to fall within the exception to the exclusion. In particular, the court explained that underlying allegations of "improper dumping" and "spilling" of harmful solutions did not sufficiently allege conduct that was "abrupt" or "unintentional." Rather, the court explained, the gravamen of the underlying complaints was that the policyholder dumped toxic substances over a period of many years as part of its routine practices. The court also rejected the policyholder's assertion that the "sudden and accidental" exception was met by underlying allegations that there were "likely" "other ways" in which the toxins were discharged into the environment.

Coverage Alert:

Reversing District Court, Fifth Circuit Rules That No "Claim" Was Made During Policy Period Despite News Coverage Putting Insurer On Notice

Disagreeing with a district court holding that "information received and recorded as a timely claim by the parties will be deemed a timely claim" under a claims-made policy, the Fifth Circuit ruled that no claim was made

against the policyholder during the relevant policy period and therefore the insurer had no duty to defend. *Jordan v. Evanston Ins. Co.*, 2022 WL 141777 (5th Cir. Jan. 17, 2022).

The insurance dispute arose out of injuries suffered by a child after ingesting small magnetic toys. During the relevant policy period, numerous news stories were published about the incident, which the manufacturer forwarded to its insurers. Upon receiving those media accounts, Evanston opened an internal "Claim/Occurrence" file. Months later, and after the policy period had ended, the toy company received a demand letter from the injured child's family, which it forwarded to its insurers. Evanston denied coverage.

In a declaratory judgment action, a Mississippi district court denied Evanston's summary judgment motion. The trial court sidestepped the question of whether the news constituted a "claim" against the toy manufacturer, and instead ruled that Evanston had effectively received notice of a claim, as evidenced by its internal files. The Fifth Circuit reversed, ruling that no claim was made against the toy manufacturer during the policy period and therefore the district court erred in finding that Evanston had received notice of a claim.

The Fifth Circuit concluded that the news articles did not constitute a claim because they did "not evidence an assertion of an existing right[,] any right to payment or to an equitable remedy." The court deemed it irrelevant that Evanston occasionally referred to the media reports as a "claim" in its internal files, explaining that awareness of an alleged injury is not sufficient to constitute a claim.

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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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