Simpson Thacher

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The Supreme Judicial Court of Massachusetts ruled that a policyholder is not entitled to indemnification for costs it incurred in order to prevent imminent covered loss, finding no contractual or common law basis for such an obligation. *Ken's Foods, Inc. v. Steadfast Ins. Co.*, 491 Mass. 200 (Jan. 6, 2023). (Click here for full article)

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Illinois Court Addresses Scope Of Coverage For BIPA Claims Under Excess And Umbrella Policies

An Illinois district court ruled that exclusions in excess and umbrella policies did not negate the insurer's duty to defend a suit alleging violations of the Biometric Information Privacy Act, but that the duty to defend did not arise until the policyholder exhausted primary policy limits. *Thermoflex Waukegan, LLC v. Mitsui Sumitomo Ins. USA, Inc.*, 2023 WL 319235 (N.D. Ill. Jan. 19, 2023). (Click here for full article)

Maryland Supreme Court Rules That Allegations Of Actual Presence Of Virus On Insured Property Do Not Constitute Direct Physical Loss Or Damage To Property

The Maryland Supreme Court ruled that an all-risk property policy did not provide coverage for business losses stemming from the presence of the COVID-19 virus on insured property and the resulting loss of functional use of that property. *Tapestry, Inc. v. Factory Mutual Ins. Co.*, 2022 WL 17685594 (Md. Dec. 15, 2022). (Click here for full article)

Applying Colorado Law, Tenth Circuit Affirms That COVID-19 Did Not Impose Physical Loss Or Damage To Restaurant

The Tenth Circuit ruled that a restaurant's pandemic-related business losses were not the result of direct physical loss or damage, as required by the relevant policy. *Sagome, Inc. v. Cincinnati Ins. Co.*, 2023 WL 18796 (10th Cir. Jan. 3, 2023). (Click here for full article)

Ruling On Consolidated Appeals, Third Circuit Affirms Dismissals Of Business Interruption Claims Based On Lack Of Physical Loss Or Damage

The Third Circuit rejected fourteen consolidated appeals of district court dismissals of lawsuits seeking coverage for business interruption losses incurred in the wake of the virus and its related government closure orders. *Wilson v. USI Ins. Svs LLC*, 2023 WL 116809 (3d Cir. Jan. 6, 2023). (Click here for full article)

New York Appellate Court Affirms That Communicable Disease Exclusion Does Not Bar Coverage For Pandemic-Related Business Losses

A New York appellate court affirmed a New York trial court decision denying an insurer's motion to dismiss a COVID-19-related coverage suit based on a communicable disease exclusion. *Tina Turner Musical LLC v. Chubb Ins. Co. of Europe SE*, 2022 WL 17419269 (N.Y. App. Div. 1st Dep't Dec. 6, 2022). (Click here for full article)

Cyber Alert:

Ohio Supreme Court Rules That Ransomware Losses Are Not Covered By Business Owners' Policy

The Ohio Supreme Court ruled that an insurance policy that requires "direct physical loss of or damage to" property does not cover losses stemming from a ransomware attack. *EMOI Services, L.L.C. v. Owners Ins. Co.*, 2022 WL 17905839 (Dec. 27, 2022).

EMOI was the victim of a ransomware attack. The company ultimately paid the hacker and sought coverage from Owners, which denied coverage based on an Electronic Equipment endorsement that required "direct physical loss or damage." A trial court dismissed the suit, reasoning that there was no physical loss, and additionally, even assuming that EMOI's software was damaged while it was encrypted by the hackers, most system files became fully functional once the ransom payment was made.

An intermediate appellate court reversed, ruling that issues of fact existed as to whether the attack resulted in direct physical loss. (*See* November 2021 Alert). The appellate court noted that the Electronic Equipment endorsement covered "direct physical loss of or damage to 'media'" and that "media" was defined as "materials on which information is recorded such as film, magnetic tape, paper tape, disks, drums, and cards." The policy further stated that "media" included "computer software and reproduction of data contained on covered media." Viewing the evidence in a light most favorable to EMOI, the appellate court ruled that the company's computer servers may be considered "media" because they "constituted materials on which EMOI's information was recorded." Additionally, the court ruled that EMOI had raised an issue of fact as to whether its software incurred "direct physical damage" because the record established that portions of the software remained unusable even after decryption.

The Ohio Supreme Court reversed and reinstated the trial court's grant of summary judgment in the insurer's favor. The court held that under the "clear and unambiguous" language of the Electronic Equipment endorsement, there must be direct physical loss of or damage to property, which does not include damage to software. Although the term "computer software" was included within the definition of "media," the court explained that "it is included only insofar as the software is 'contained on covered media' . . . [which] means media that has a physical existence." As the court emphasized, all examples of media in the definition of that term were of a physical nature ("film, magnetic tape paper tape, disks, drums, and cards"). The court stated: "[T]he policy requires that there must be direct physical loss or physical damage of the covered media containing the computer software for the software to be covered under the policy." Because EMOI did not incur damage to its physical media, any loss or damage to software was not covered. Rejecting the notion that software itself could sustain direct physical loss or damage, the court explained that software is "essentially nothing more than a set of instructions" and lacks a "physical existence."

Opioid Alert:

Citing Lack Of Damages "Because Of Bodily Injury," Sixth Circuit Rules That Insurers Have No Duty To Defend Or Indemnify Opioid Claims

The Sixth Circuit affirmed a Kentucky district court holding that insurers have no duty to defend or indemnify a pharmaceutical company in underlying opioid litigation because the claims failed to allege damages "because of" bodily injury. *Westfield National Ins. Co. v Quest Pharmaceuticals, Inc.*, 2023 WL 179766 (6th Cir. Jan. 13, 2023).

Quest, a wholesale distributor of pharmaceutical products, was sued in numerous lawsuits brought by cities and other government agencies, alleging misconduct

that contributed to a nationwide epidemic of opioid abuse. The underlying suits sought damages for economic costs incurred by the local and state governments in response to the epidemic. Quest's insurers denied coverage, arguing that the suits did not seek damages "because of" bodily injury, as required by the policies. In ensuing litigation, a Kentucky district court granted the insurers' summary judgment motion. (*See* May 2021 Alert). This month, the Sixth Circuit affirmed.

Addressing this matter of first impression under Kentucky law, the Sixth Circuit concluded that claims seeking compensation for losses incurred by government agencies in addressing the opioid crisis were not damages "because of" bodily injury. The court reasoned that "because of" requires a connection between the damages sought in the underlying suits and particular individual bodily injury, which was not present here. As the court noted, the Supreme Courts of Ohio and Delaware have employed similar reasoning in finding that insurers were not obligated to defend underlying opioid suits.

Finally, the Sixth Circuit held that even assuming that the policy language could be considered ambiguous and therefore construed in accordance with the insured's reasonable expectations, an insured could not reasonably expect coverage for the underlying suits. The court explained that the policies used the terms "because of bodily injury" and "for bodily injury" interchangeably in various provisions and that both phrases suggest that coverage would extend only to "claims requiring proof of an actual bodily injury, not all claims tangentially related to bodily injuries."

Allocation Alerts:

Sixth Circuit Rules That Ohio's All Sums Allocation Permits Insurers To Seek Equitable Contribution From Insured

Affirming an Ohio district court decision, the Sixth Circuit ruled that insurers that have been targeted by a policyholder for indemnification under all sums allocation may later seek contribution from policies that would result in payments by the policyholder. *Chemical Solvents, Inc. v. Greenwich Ins. Co.*, 2023 WL 179772 (6th Cir. Jan. 13, 2022).

After Chemical Solvents settled an underlying bodily injury lawsuit, it sought indemnification from two of the numerous insurers that issued policies during the relevant time frame. More specifically, Chemical Solvents turned to Greenwich for reimbursement under two policies and Illinois National for coverage under one policy. The insurers then worked out for themselves an allocation of liability for which each policy was responsible. Under that arrangement, Illinois National contributed funding from other policies it had issued to Chemical Solvents (but which had not been targeted by Chemical Solvents for indemnification). One of those other policies was reinsured by Alembic, a group captive insurer that was partially owned by Chemical Solvents. As a result, Chemical Solvents ended up responsible for a large portion of what Alembic owed to National Illinois.

Chemical Solvents sued the insurers, arguing that it was impermissible under Ohio's all sums allocation to reallocate costs in a way that would trigger Alembic's policies (and consequently, require payments by Chemical Solvents). The district court ruled in the insurers' favor and the Sixth Circuit affirmed. The Sixth Circuit rejected Chemical Solvents' contention that all sums allocation prohibits a policyholder from bearing financial responsibility. Rather, the doctrine promotes economy for the insured by shifting the burden of calculating relative liability to the insurers, "but doesn't absolve the insured of all financial burden."

The court distinguished decisions from other jurisdictions in which courts refused to allow contribution from the insured for uninsured or self-insured periods, explaining:

> [T]he insurers didn't seek contribution from Chemical Solvents. They sought it from Illinois National. No jurisdiction has prohibited contribution whenever an insured will face financial consequences down the line. And given that Ohio hasn't established this exception at all, we have no basis for creating such a sweeping exception out of whole cloth.

North Carolina Supreme Court Rules On Trigger, Allocation And Exhaustion In Long-Tail Benzene Bodily Injury Suits

The North Carolina Supreme Court ruled that insurers' coverage obligations were triggered when an underlying claimant was exposed to benzene, that defense and indemnity costs must be allocated among multiple insurers on a pro rata basis, and that vertical exhaustion applied for determining when umbrella or excess policies were implicated. *Radiator Specialty Co. v. Arrowood Indem. Co.*, 2022 WL 17726535 (N.C. Dec. 16, 2022).

Radiator was named in hundreds of suits seeking damages for bodily injuries allegedly caused by exposure to benzene. The underlying claimants alleged that as a result of exposure to Radiator's benzene-containing products over many years, they developed progressive diseases. Addressing the scope of liability coverage for these claims, the North Carolina Supreme Court issued the following rulings related to trigger, allocation and exhaustion.

Trigger: The court held that "a claimant's period of exposure to benzene is the appropriate reference point in determining which policies provide coverage for a given benzene-related injury." Ruling that exposure to benzene constitutes the injury-in-fact, the court explained that an "attempt to redefine 'injury-in-fact' as death, disease, or some other physical manifestation of the harm confuses the injury with its consequences. . . . [C]ancer is a manifestation of the injury that occurs upon benzene exposure that creates a compensable claim. It is not the injury itself." Emphasizing the fact-intensive nature of its holding, the court noted that in other contexts (such as asbestos or environmental contamination), a multiple-trigger theory might be appropriate if, for example, new, distinct injury or damage occurs over multiple policy periods.

Allocation: The court ruled that insurers' costs must be allocated on a pro rata time-on-the-risk basis. Rejecting Radiator's "all sums" argument, the court explained that any references to "all sums" in the policies were limited by language referring to injuries that occurred "during the policy period." The court noted that in other contexts, courts have endorsed an all sums approach when faced with similar "during the policy period" language, but distinguished those cases based on either a different factual record or the inclusion of other relevant policy provisions.

Exhaustion: The court ruled that policy language in a particular umbrella policy required vertical exhaustion (under which a policyholder may obtain coverage from an excess policy once the limits of the primary policies directly beneath it within the same policy period are exhausted) for purposes of the umbrella insurer's duty to defend. The trial court had adopted a hybrid approach, applying horizontal exhaustion to the duty to defend and vertical exhaustion to the duty to indemnify, and the intermediate appellate court affirmed. Reversing, the North Carolina Supreme Court ruled that policy language justified vertical exhaustion for the duty to defend. In particular, the policy stated that the insurer had the right and duty to defend when: "a. The applicable limits of insurance of the 'underlying insurance' and other insurance have been used up in the payment of judgments or settlements; or b. No other valid and collectible insurance is available to the insured for damages covered by this policy." The court concluded that under section b, the umbrella insurer's duty to defend is triggered so long as no other valid insurance was available for damages covered by the policy, which was the case here because the policies covering the same periods as the umbrella policy did not cover the benzene actions.

Coverage Alert:

Insurer Has No Contractual Or Common Law Duty To Indemnify Costs Incurred By Policyholder To Prevent Imminent Covered Loss, Says Supreme Judicial Court Of Massachusetts

The Supreme Judicial Court of Massachusetts ruled that a policyholder is not entitled to indemnification for costs it incurred in order to prevent imminent covered loss, finding no contractual or common law basis for such an obligation. *Ken's Foods, Inc. v. Steadfast Ins. Co.*, 491 Mass. 200 (Jan. 6, 2023).

The dispute arose after the policyholder's wastewater treatment system malfunctioned, resulting in contamination of a nearby water source. The policyholder took necessary remediation and also implemented a temporary system in order to allow it to continue operating its business. The insurer reimbursed the policyholder for the costs of removing the wastewater that had escaped and of preventing more waste from overflowing pursuant to a policy provision for "reasonable and necessary" cleanup costs for a pollution event. However, the insurer argued it was not obligated to cover the mitigation costs incurred in order to avoid suspending its operations.

Addressing this matter of first impression under Massachusetts law, the Supreme Judicial Court ruled that neither the operative insurance policy nor common law required the insurer to cover such costs. A mitigation provision covered losses resulting from a pollution event that caused a "suspension of operations," which was defined as a "necessary partial or complete suspension of 'operations' . . . as a direct result of a 'cleanup' required by a 'governmental authority.'" The court emphasized that there was no suspension of operations here; to the contrary, the policyholder avoided a suspension by implementing the temporary wastewater system for which it sought reimbursement.

Additionally, the court declined to impose a common law obligation to reimburse the policyholder's mitigation expenses. The court noted that other jurisdictions are divided on this issue, but concluded that it need not answer whether such a duty exists "abstractly" under Massachusetts law because here, the specific policy language was unambiguous. The court stated: "A common law doctrine cannot displace the clear provisions of the [p]olicy, . . . particularly when the [p]olicy directly addresses and circumscribes the applicability of the doctrine." (Citation omitted). In refusing to impose a common law duty, the court noted that the contracting parties were sophisticated commercial entities that were "capable of, and responsible for, their own contractual risk allocation."

Finally, the court noted that a maintenance exclusion further indicated that the parties did not intend to insure the mitigation costs at issue. The exclusion applied to upgrade or improvement costs, even if required by government authority or incurred as a result of covered cleanup costs. The court reasoned that the temporary treatment process utilized by the policyholder in order to continue its business operations appeared to fall within the scope of this exclusion.

BIPA Alert:

Illinois Court Addresses Scope Of Coverage For BIPA Claims Under Excess And Umbrella Policies

An Illinois district court ruled that exclusions in excess and umbrella policies did not negate the insurer's duty to defend a suit alleging violations of the Biometric Information Privacy Act ("BIPA"), but that the duty to defend did not arise until the policyholder exhausted primary policy limits. *Thermoflex Waukegan, LLC v. Mitsui Sumitomo Ins. USA, Inc.*, 2023 WL 319235 (N.D. Ill. Jan. 19, 2023).

The underlying suit against Thermoflex alleged BIPA violations based on the company's policy of requiring workers to scan handprint data, which was then transmitted to a third party. In a previous ruling in this case, an Illinois district court ruled that there was no coverage under general liability policies issued by Mitsui based on an "Access or Disclosure Exclusion." In the present ruling, the court addressed whether coverage was available under two provisions in excess and umbrella policies issued by Mitsui, and whether certain exclusions in those policies applied.

As a preliminary matter, the court ruled that coverage was unavailable under a provision that is triggered only when underlying insurance provides coverage in the first place. The court refused to reconsider the prior ruling that the Access or Disclosure Exclusion in the general liability policy applied, and therefore concluded that excess and umbrella coverage under a provision that was predicated on underlying general liability coverage was unavailable.

However, the court concluded that the BIPA claims triggered coverage under a separate provision that applied to "personal and advertising injury coverage (defined to include injury arising out of the publication of material that violates a person's right to privacy) and which did not require coverage under an underlying liability policy. Mitsui argued that three exclusions barred coverage under that provision, but the court disagreed.

First, the court declined to apply a Statutory Violations Exclusion, which applied to alleged violations of the TCPA, the CAN-SPAM Act of 2003, the Fair Credit Reporting Act, the Fair and Accurate Credit Transaction Act, and "any other federal, state, or local law, regulation, statute, or ordinance that restricts, prohibits, or otherwise pertains to the collecting, communicating, recording, printing, transmitting, sending, disposal, or distribution of material or information." Applying the reasoning set forth in *W. Bend Mutual Ins. Co. v. Krishna Schaumburg Tan, Inc.*, 2021 IL 125978 (Ill. 2021) (discussed in our May 2021 Alert) and *Citizens Ins. Co. of Am. v. Wynndalco Enters., LLC*, 2022 WL 952534 (N.D. Ill. Mar. 30, 2022) (discussed in our April 2022 Alert), the court ruled that the catchall provision in the exclusion did not encompass alleged BIPA violations. The court acknowledged that the exclusion in *Krishna* was narrower in scope than the one at issue here, but nonetheless agreed with the *Wynndalco* decision that interpreting the catchall provision to include BIPA claims would "swallow up large swaths" of coverage. Ultimately deeming the exclusion ambiguous, the court construed it in favor of coverage.

Additionally, the court declined to apply a Data Breach Exclusion that applied to damages arising out of the "disclosure of or access to private or confidential information." The court acknowledged that the language of the exclusion "tracks closely with the Access or Disclosure Exclusion" that was held to bar general liability coverage in the court's previous ruling, but concluded that "reading the exclusion in its entirety suggests that it was not intended to bar coverage beyond data breach liability." More specifically, the court reasoned that language in the exclusion

referring to computer applications and software suggested that it was focused on damages resulting from a data breach, or at a minimum, ambiguous in its scope.

A third exclusion precluded coverage for damages arising out of "other employment-related practices, policies, acts, or omissions directed towards that person." The court rejected Mitsui's contention that the BIPA claims, which arose out of a policy requiring employees to use a biometric time tracking system, fell within the scope of the exclusion. Citing *Citizens*, the court concluded that the phrase "directed towards that person," together with an enumerated list of examples that pertained to actions taken against a specific individual (*e.g.*, harassment, demotion, discipline), indicated that the exclusion was not intended to apply to a company-wide policy that affected all workers in the same way.

Finally, the court ruled that even though none of the exclusions precluded coverage of the underlying claims, that Mitsui had no present duty to defend because Thermoflex had not exhausted primary coverage. In so ruling, the court took judicial notice of a ruling in another case holding that a different primary insurer owed Thermoflex a duty to defend the underlying suit. Applying the principle of horizontal exhaustion (under which all primary policies must be exhausted before excess coverage is implicated), the court held that Mitsui had no present duty to defend.

COVID-19 Alerts:

Maryland Supreme Court Rules That Allegations Of Actual Presence Of Virus On Insured Property Do Not Constitute Direct Physical Loss Or Damage To Property

The Maryland Supreme Court ruled that an all-risk property policy did not provide coverage for business losses stemming from the presence of the COVID-19 virus on insured property and the resulting loss of functional use of that property. *Tapestry, Inc. v. Factory Mutual Ins. Co.*, 2022 WL 17685594 (Md. Dec. 15, 2022).

The court answered the following certified question in the negative:

> When a first-party, all-risk property insurance policy covers "all risks of physical loss or damage" to insured property from any cause unless excluded, is coverage triggered when a toxic, noxious, or hazardous substance—such as Coronavirus or COVID-19—is physically present in the indoor air of that property; is also present on, adheres to, and can later be dislodged from physical items on the property; and causes a loss, either in whole or in part, of the functional use of the property?

The court explained that absent tangible, concrete and material harm to property, or a deprivation of the possession of property, the physical loss or damage requirement is not met by the presence of viral particles. In so ruling, the court declined to consider the absence of a viral exclusion in the relevant policies, stating: "We do not think the availability on the insurance market of a broader virus exclusion undermines the unambiguous language employed in the Policies."

Applying Colorado Law, Tenth Circuit Affirms That COVID-19 Did Not Impose Physical Loss Or Damage To Restaurant

The Tenth Circuit ruled that a restaurant's pandemic-related business losses were not the result of direct physical loss or damage, as required by the relevant policy. *Sagome, Inc. v. Cincinnati Ins. Co.*, 2023 WL 18796 (10th Cir. Jan. 3, 2023).

The court noted that the question of whether COVID-19 causes direct physical loss or damage under a property policy is an open question under Colorado law, but joined the consensus among other federal circuit courts in ruling that it does not. In particular, the Tenth Circuit rejected the restaurant's assertion that there is physical loss or damage because the virus itself is physical. The court explained: "For coverage, the loss or damage itself must be physical, not simply stem from something physical." In addition, employing similar reasoning to many other courts in this context, the court noted that the policy's "period of restoration" clause, which references restoration and repair, reinforces the conclusion that there was no physical loss or damage because the operative event that allowed the business to reopen was the

change in government orders rather than any specific repair or restoration.

Importantly, the court distinguished a decision in which the Colorado Supreme Court ruled that a church sustained direct physical loss or damage when it was required to close as a result of gasoline vapors. There, the court reasoned that the accumulation of gasoline around and under the church was so severe as to render it uninhabitable. The court explained that a complete dispossession of property due to gas accumulation is qualitatively different from the presence of COVID-19, which did not render the restaurant uninhabitable. As the court noted, the restaurant continued to use its property even after the initial shutdown orders were issued.

Ruling On Consolidated Appeals, Third Circuit Affirms Dismissals Of Business Interruption Claims Based On Lack Of Physical Loss Or Damage

The Third Circuit rejected fourteen consolidated appeals of district court dismissals of lawsuits seeking coverage for business interruption losses incurred in the wake of the virus and its related government closure orders. *Wilson v. USI Ins. Svs LLC*, 2023 WL 116809 (3d Cir. Jan. 6, 2023). Business owners in Pennsylvania, New Jersey, New York, Maryland and Delaware argued that the loss of use of their properties during the pandemic constituted the requisite direct physical loss of or damage to property under their insurance policies. Rejecting these assertions, the court stated: "the businesses lost the ability to use their properties for their intended business purposes because the governors of the states in which they operate issued orders closing or limiting the activities of nonessential businesses, not because there was anything wrong with their properties." Because the court found no coverage under the operative policy provisions, it did not address whether virus or "ordinance or law" exclusions barred coverage.

New York Appellate Court Affirms That Communicable Disease Exclusion Does Not Bar Coverage For Pandemic-Related Business Losses

Our December 2021 Alert reported on a New York trial court decision denying an insurer's motion to dismiss a COVID-19-related coverage suit based on its finding that a communicable disease exclusion did not bar coverage. *Tina Turner Musical LLC v. Chubb Ins. Co. of Europe SE*, 2021 WL 5818352 (N.Y. Sup. Ct. Dec. 6, 2021). Last month, an appellate court affirmed the decision. *Tina Turner Musical LLC v. Chubb Ins. Co. of Europe SE*, 2022 WL 17419269 (N.Y. App. Div. 1st Dep't Dec. 6, 2022).

The sole issue before the appellate court was whether coverage was barred by an exclusion that applied to "any loss directly or indirectly arising out of, contributed to by, or resulting from . . . any communicable disease or threat or fear of communicable disease" which leads to: . . . "the imposition of quarantine or restriction in movement of people or animals by any national or international body or agency" [or] . . . "any travel advisory or warning being issued by a national or international body or agency." The trial court ruled that this provision did not apply because the policyholder's losses stemmed from an order issued by the New York Governor rather than a national or international authority.

Affirming the decision, the appellate court rejected the insurer's contention that the exclusion encompassed losses caused by communicable diseases "that were of such a systemic nature as to lead to quarantine or travel advisory orders by a national or international body or agency" in general, even where, as here, the specific losses at issue arose from an order issued by a governor. Rather, giving the exclusion "a strict and narrow construction" and resolving any ambiguities against the insurer, the appellate court explained that the exclusion was limited to losses resulting from orders issued by a national or international body or agency.

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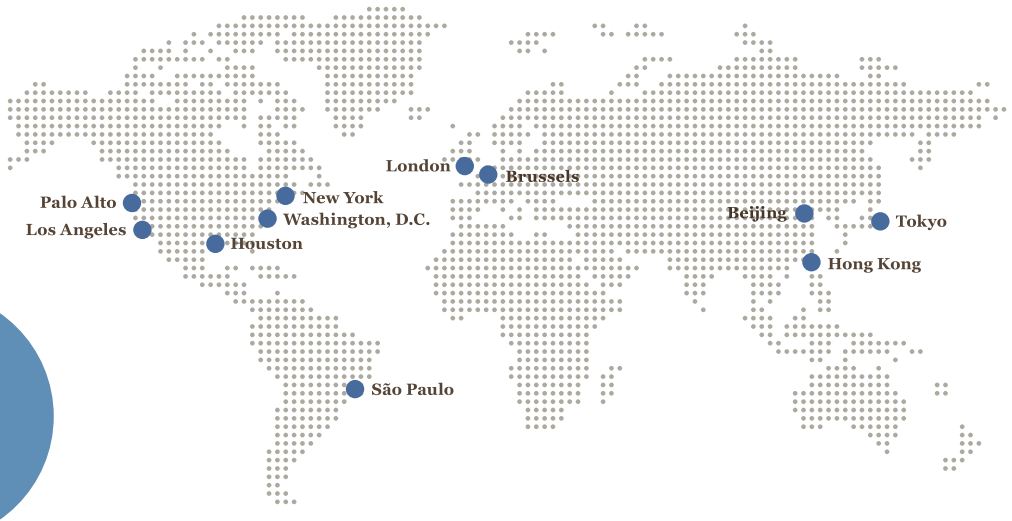

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