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Insurance Law Alert

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***– Chambers USA* 2022 (quoting a client)**

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Supreme Court Of Wisconsin Rules That Restaurants Are Not Entitled To Business Interruption Or Civil Authority Coverage For Pandemic-Related Losses

The Supreme Court of Wisconsin ruled that allegations of government shutdown orders and the physical presence of the COVID-19 virus at insured property were insufficient to state the "physical loss of or damage to" property required by the policy. *Colectivo Coffee Roasters, Inc. v. Soc'y Ins.*, 2022 WI 36 (June 1, 2022). (Click here for full article)

In Consolidated Appeal, New Jersey Appellate Court Affirms Dismissal Of Policyholders' COVID-19 Coverage Suits

A New Jersey appellate court held that insurers had no obligation to cover business losses incurred as a result of government orders aimed at slowing the spread of COVID-19. *MAC Prop. Grp. LLC v. Selective Fire & Cas. Ins. Co.*, 2022 WL 2196396 (N.J. App. Div. June 20, 2022). (Click here for full article)

Reversing Trial Court, Louisiana Appellate Court Rules That Restaurant's Pandemic-Related Business Losses Are Covered By All Risk Policy

A Louisiana appellate court ruled a trial court erred in refusing to issue a declaratory judgment in favor of a restaurant seeking insurance coverage for its COVID-19-related losses. *Cajun Conti LLC v. Certain Underwriters at Lloyd's, London*, 2022 WL 2154863 (La. Ct. App. June 15, 2022). (Click here for full article)

Defense Alert:

Fifth Circuit Rules That Duty To Defend Was Never Triggered Despite Insurer's Knowledge Of Underlying Suit

Affirming a Texas district court decision, the Fifth Circuit ruled that an insurer did not breach its duty to defend because the insured had never requested a defense or sought coverage. *Moreno v. Sentinel Ins. Co., Ltd.*, 35 F.4th 965 (5th Cir. June 2, 2022).

N.F. Painting was sued in connection with a worker's injury. N.F. Painting did not notify Sentinel of the suit or seek a defense and instead independently retained counsel. However, a co-defendant in the suit, also insured by Sentinel, did tender its defense to the insurer. More than two years later and after a judgment was entered against N.F. Painting, the underlying claimant, as third-party beneficiary to the policy, sued Sentinel, seeking to recover the judgment. The district court ruled that N.F. Painting was not entitled to coverage since it had failed to notify Sentinel of the suit or request a defense. The Fifth Circuit affirmed.

The Fifth Circuit ruled that Sentinel did not breach its duty to defend because its defense obligations were never triggered in the first place based on N.F. Painting's failure to tender defense. The court deemed it irrelevant that Sentinel received notice of the suit from another insured defendant, noting that "Texas law requires a request from the insured for whom a defense would be provided, not someone else, to trigger the duty to defend."

The court also deemed it irrelevant that N.F. Painting's attorney sent certain court documents to Sentinel in response to Sentinel's request for that material. The court observed that while the transmission of court papers may trigger the duty to defend "in the ordinary case," this was not an ordinary case based on the absence of any correspondence relating to Sentinel's defense. Likewise, the court held that a letter from Sentinel to N.F. Painting's counsel indicating that it would not provide a defense or indemnity did not support an inference that N.F. Painting had requested a defense in light of N.F. Painting's clear decision to hire its own counsel rather than seek coverage from Sentinel.

Finally, the court rejected the contention that N.F. Painting's non-compliance did not relieve Sentinel of its indemnity obligations absent a showing of prejudice. The court explained that where notice is "wholly lacking," prejudice is not required and that in any event, the issuance of a $1.6 million judgment against N.F. Painting without prior notice to Sentinel constituted prejudice as a matter of law.

Cyber Alerts:

Texas Appellate Court Rules That Voluntary Parting Exclusion Does Not Bar Coverage For Fraudulent Email Scam Losses

A Texas appellate court ruled that a voluntary parting exclusion does not bar coverage for losses stemming from an email impersonation scheme because it conflicts with a coverage endorsement in the policy. *Cent. Mut. Ins. Co. v. Reliance Prop. Mgmt., Inc.*, 2022 WL 1657031 (Tex. Ct. App. May 25, 2022).

Reliance was the victim of an email scam in which a fraudster impersonated a company employee and requested wire transfers. Central Mutual Insurance denied coverage for the loss, citing a voluntary parting exclusion, which applied to loss resulting from the "[v]oluntary parting with any property . . . if induced to do so by any fraudulent scheme, trick, device or false pretense." In a subsequent trial, a jury entered a special verdict finding, among other things, that Reliance's loss resulted from the voluntary parting of property induced by a fraudulent scheme. Nonetheless, the jury also found that Reliance was entitled to $25,000 based on Central's violation of its duty of faith and fair dealing. After a post-verdict hearing, the court awarded Reliance $220,000 for its principal

loss and $25,000 in damages for the violation of good faith. The appellate court affirmed in part and reversed in part.

The appellate court concluded that the voluntary parting exclusion could not be reconciled with an endorsement in the policy that provided coverage for various fraud-based crimes. The court noted that the endorsement expressly modified the "Causes of Loss" form in which the voluntary parting exclusion was located, followed by only a general statement that all other limitations or exclusions apply. As such, the appellate court ruled that the trial court correctly disregarded the jury's verdict response as to the voluntary parting exclusion. As discussed in our January 2019 and March 2020 Alerts, a few other courts have addressed application of a voluntary parting exclusion to cyber fraud-related losses, with one court enforcing the exclusion to bar coverage and the other deeming it ambiguous.

The appellate court also addressed a forgery provision that applied to the forgery or alteration of "checks, drafts, promissory notes, or similar written promises, orders or directions to pay a sum certain in 'money.'" The court concluded that this language was broad enough to encompass fraudulent emails and wire transfer instructions. This conclusion runs counter to the vast majority of decisions in this context; most courts have concluded that impersonated email messages and corresponding wire transfer instructions are not negotiable instruments within the meaning of a forgery provision.

Finally, the court reversed the $25,000 damage award, finding that the record was devoid of evidence to support a finding of bad faith.

Social Engineering Exclusion Bars Coverage For Policyholder's Email Scam Losses, Says Pennsylvania District Court

A Pennsylvania district court granted an insurer's summary judgment motion, finding that a policy exclusion for losses caused by computer-related activities barred coverage for cyber-related losses. *Constr. Fin. Admin. Servs. LLC v. Fed. Ins. Co.*, 2022 WL 2073824 (E.D. Pa. June 9, 2022).

Construction Financial was the victim of a fraudulent scheme involving impersonating emails, resulting in wire transfers to a hacker's account. In effectuating those transfers, a Construction Financial employee failed to follow a protocol designed to ensure legitimate invoice payments. When Construction Financial filed an insurance claim for its loss, Federal denied coverage on the basis of exclusions that applied to loss "based upon, arising from or in any consequence of any . . . unauthorized access to, or use or alteration of, any computer program, computer, computer system or communication facilities that are connected thereto."

In response, Construction Financial argued that the losses were proximately caused by the employee's negligence, not the unauthorized access to computers, and that under applicable North Carolina law, there is coverage when there is more than one cause of injury and only one of the causes is excluded. Rejecting this contention, the court held that the employee's failure to obtain the necessary documentation was not an independent cause of loss. The court stated:

> CFAS's lack of receipt of proper documentation could not have caused the injury in question (here, the fraudulently-induced money transfers) without the emails precipitated by the hacker's unauthorized access to [the] network. CFAS would not have sent the funds to the bank account included by the fraudster without first receiving the unauthorized emails. The existence of the loss did not depend on the existence (or lack thereof) of the documentation, but rather upon the unauthorized emails.

Additionally, the court noted that the exclusion contained particularly broad language that encompassed losses based upon, arising out of or "in consequence of any" computer-related losses.

Arbitration Alerts:

Arbitration Clause In Reinsurance Contract Does Not Require Original Insured To Arbitrate Claims Against Reinsurer, Texas Appellate Court Rules

A Texas appellate court ruled that an arbitration clause in a reinsurance contract was not binding on the original insured under the "direct benefits estoppel" doctrine. *Travelers Indem. Co. v. Alto ISD*, 2022 WL 1668859 (Tex. Ct. App. May 25, 2022).

Alto School District was insured under a property policy issued by Texas Rural Education Association ("TREA"). In turn, TREA obtained reinsurance for part of the underlying property risk from Travelers. When a dispute arose over the settlement of a claim, Alto sued TREA and Travelers, alleging negligence, common law fraud, misrepresentation and violation of state statutory law. Travelers moved to dismiss or stay, arguing that Alto was required to arbitrate the claims pursuant to an arbitration clause in the reinsurance contract even though Alto was a not a signatory to that agreement. A trial court disagreed and denied the motion, and the appellate court affirmed.

The appellate court rejected Travelers' assertion that Alto was required to arbitrate its claims against Travelers pursuant to a "direct benefits estoppel" theory, under which a non-signatory may be bound to an arbitration agreement if it seeks to derive a direct benefit from that agreement. The court explained that Alto's claims were not based solely on the reinsurance contract, and instead arose from general obligations imposed by state statutory and common law. In particular, the court reasoned that Alto's claims against Travelers stemmed from Travelers' role as adjuster of the insurance claims and sounded in tort and statutory law, rather than breach of contract. The court emphasized that direct benefits estoppel is not implicated "even if the claim refers to or relates to the contract or would not have arisen but for the contract's existence."

Reversing District Court, Eighth Circuit Rules That Challenge To Validity Of Contract Must Be Arbitrated

The Eighth Circuit granted a motion to compel arbitration, ruling that a challenge to the validity of a contract containing an arbitration clause should be resolved by an arbitration panel rather than a court. *Benchmark Ins. Co. v. SUNZ Ins. Co.*, 2022 WL 1916542 (8th Cir. June 6, 2022).

SUNZ Insurance Solutions, an affiliate of SUNZ, entered into Program Agreements with two Florida companies. The Program Agreements, which set forth the binding terms and conditions of workers compensation policies between the parties, contained an arbitration clause applicable to "any controversy or claim arising out of or relating in any way to this [Program] Agreement or the breach or alleged breach thereof." However, the first page of the Program Agreement stated that the insurance policy would prevail in the case of any conflict between the Program Agreement and insurance policy. In a subsequent lawsuit between SUNZ and several other entities, the two Florida companies filed crossclaims for breach of contract. The companies alleged

that the Program Agreements were void because they were never filed with state regulatory agencies. SUNZ moved to dismiss the crossclaims or alternatively compel arbitration. A Minnesota district court denied both motions.

The Eighth Circuit reversed, finding that the district court erred in refusing to compel arbitration. The court explained:

> The Policy cannot be read without the Program Agreement, which explicitly controls the administration of the Policy and only becomes binding and enforceable after its execution. While . . . the crossclaim alleges that SUNZ breached the Policy, it is the Program Agreement that drives the question of liability. And, under the Program Agreement both parties agreed to submit to arbitration any disagreement regarding its terms.

As the court noted, issues as to a contract's validity must be addressed by the arbitrator rather than the court, unless the challenge is to the arbitration clause itself, which was not the case here.

Coverage Alerts:

Eleventh Circuit Rules That Breach Of Contract Exclusion Unambiguously Bars Coverage For Underlying Suit

Affirming an Alabama district court decision, the Eleventh Circuit ruled that an insurer had no duty to defend or indemnify underlying losses based on a breach of contract exclusion. *Ala. Space Sci. Exhibit Comm'n v. Markel Am. Ins. Co.*, 2022 WL 1667904 (11th Cir. May 25, 2022).

The policyholder entered into an agreement to produce and fund a children's television show. When the policyholder stopped funding, the programming company filed an arbitration demand. Markel denied the producer's request for coverage based on an exclusion for claims for "any actual or alleged liability . . . under any written or express contract or agreement, except to the extent that [the policyholder] would have been liable in the absence of such contract or agreement." After the policyholder received an unfavorable arbitration award, it sued Markel, alleging breach of contract and bad faith. The district court granted Markel's summary judgment motion, and the Eleventh Circuit affirmed.

The policyholder argued that the lack of expansive language in the breach of contract exclusion (*e.g.*, "based upon, arising out of or in any way involving") as compared to other policy exclusions indicated that the breach of contract exclusion was meant to be construed narrowly. The court explained that even if construed narrowly, the exclusion still applied because the only basis for the damages awarded was the underlying written agreement. In addition, the policyholder contended that the "plethora of allegations of wrongdoing" in the Statement of Claim suggested potential tort liability, separate and apart from the breach of contract claims. The court rejected this assertion as well, explaining that the alleged facts did not support such independent causes of action.

Further, the court held that the exclusion applied despite the filing of a claim for breach of the implied duty of good faith and fair because a breach of the duty is a breach of contract and Alabama law does not recognize an independent tort arising out of a breach of contract. Finally, the court held that a *quantum meruit* claim was also subject to the breach of contract exclusion, emphasizing that when an express contract exists, there is no viable claim for *quantum meruit*.

Citing Policyholder's Reasonable Expectations, New Jersey Appellate Court Refuses To Enforce Policy Exclusion

A New Jersey appellate court ruled that although an exclusion in an automobile policy was unambiguous, it was nonetheless unenforceable because it was contrary to the policyholder's reasonable expectations. *Vega v. Travelers Ins. Co.*, 2022 WL 1436461 (N.J. App. Div. May 6, 2022).

The dispute arose when the policyholder sought coverage from St. Paul Protective Insurance Company for injuries sustained in an automobile accident. A St. Paul claims adjuster initially offered the $100,000 limit on the policy, but several months later rescinded the offer. The adjuster noted that the initial offer was based on a mistaken reading of the policy and that in fact, the policy provided a bodily injury limit of only $15,000 pursuant to an intra-family exclusion. In ensuing litigation, a New Jersey trial court deemed the exclusion ambiguous and contrary to New Jersey's public policy of compensating victims of car accidents. The appellate court affirmed.

Although the appellate court held that the exclusion was unambiguous, it deemed it unenforceable as contrary to the policyholder's reasonable expectations. In particular, the court explained that the declarations page indicated that the limit was $100,000 per person for bodily injury and that nothing on the declarations page referenced exclusions that would operate to reduce that limit. While the exclusion was included under a section entitled "Exclusions," the court concluded that it constituted a "hidden trap" that was "buried" in the thirty-eight page policy. Emphasizing that if an experienced adjuster initially believed the policy limit to be $100,000, a reasonable policyholder would likewise understand coverage to correspond with the limits listed on the declarations sheet, the court stated: "A clearly worded exclusion can still function as a hidden trap if the remainder of the policy, and particularly the declarations sheet, would lead a reasonable policyholder to expect different coverage."

First Circuit Certifies Coverage Question To Massachusetts Supreme Judicial Court

The First Circuit asked the highest court of Massachusetts to address whether the state recognizes a common law duty for insurers to cover the costs incurred by an insured to prevent imminent covered loss in the absence of a policy provision addressing such coverage. *Ken's Foods, Inc. v. Steadfast Ins. Co.*, 36 F.4th 37 (1st Cir. June 7, 2022).

The coverage dispute arose after Ken's Foods discovered an accidental discharge of wastewater at one of its facilities. The company immediately addressed the problem in cooperation with local authorities. According to Ken's Foods, without such measures, it would have been forced to suspend operations entirely or engage specialized contractors, either at a significantly larger cost. Steadfast refused to cover the cost of the prevention efforts, arguing that the policy covered only cleanup costs and business losses resulting from a suspension of operations.

In ensuing litigation, Ken's Foods conceded that the policy "on its face" did not cover such preventative costs, but argued that Massachusetts would nevertheless recognize a common law duty on the part of insurers to reimburse expenses incurred to prevent imminent covered loss. The district court disagreed and granted Steadfast's summary judgment motion.

On appeal, the First Circuit noted the absence of Supreme Judicial Court decisions on point. As the court observed, courts in other jurisdictions have reached conflicting conclusions, with some recognizing such a duty even absent guiding policy language, and others rejecting such an extra-contractual obligation. As such, the First Circuit asked the Massachusetts Supreme Judicial Court to address the following question of law:

> To what extent, if any, does Massachusetts recognize a common-law duty for insurers to cover costs incurred by an insured party to prevent imminent covered loss, even if those costs are not covered by the policy?

We will keep you apprised of any developments in this matter.

Direct Action Alert:

New Jersey Appellate Court Rules That Claimant Has Standing To Sue Insurer And Broker Under State Statutory Law

Reversing a trial court decision, a New Jersey appellate court ruled that a claimant was entitled to sue his attorney's malpractice insurer and an insurance broker under New Jersey's direct action statute. *D'Agostino v. Colony Ins. Co.*, 2022 WL 1553717 (N.J. App. Div. May 17, 2022).

D'Agostino retained an attorney to represent him in an employment matter. When the matter resulted in an unfavorable judgment, D'Agostino filed a legal malpractice action against his former attorney and was awarded $330,000 in damages. Unbeknownst to D'Agostino, the attorney was insured under a professional liability policy issued by Colony, which had refused to defend or indemnify the suit. When D'Agostino was not able to recover the judgment from the attorney, he filed a claim with the Lawyers' Fund for Client Protection. After the attorney died, D'Agostino discovered the existence of the Colony policy and sought reimbursement. When the broker informed him that Colony had previously denied coverage, D'Agostino sued, alleging wrongful denial of coverage and bad faith.

A trial court dismissed the suit, finding that D'Agostino lacked standing because he was not a third-party beneficiary of the policy nor an assignee of the rights to that policy. The appellate court reversed, ruling that D'Agostino had standing to file suit under N.J.S.A. 17:28-2, New Jersey's direct action statute. The appellate court acknowledged that Colony was entitled to assert several potential defenses to coverage, including that the claims were time-barred, but concluded that the statute provided a basis for standing against Colony.

The appellate court also held that D'Agostino stated a claim against the broker for negligent failure to procure appropriate professional liability coverage, noting that New Jersey recognizes the duty of care of brokers to "foreseeable third parties injured by the broker's negligence."

Filed-Rate Alert:

Second Circuit Upholds Dismissal Of Suit Stemming From Pandemic-Related Premium Reduction

Applying the filed-rate doctrine, the Second Circuit affirmed the dismissal of a putative class action suit stemming from an insurer's "Giveback Program," which provided premium reductions during the early months of the pandemic. *Grossman v. Geico Cas. Co.*, 2022 WL 1656593 (2d Cir. May 25, 2022).

The complaint, which asserted causes of action for breach of the covenant of good faith and fair dealing, unjust enrichment and violations of New York General Business Law, alleged that the insurer's premium reduction was inadequate, resulting in windfall profits to the insurer, and that advertising about the program was misleading.

The Second Circuit upheld the district court's dismissal of the suit based on the filed-rate doctrine. The court held that the doctrine squarely applied because the complaint sought a recalculation of rates that were approved by the New York Department of Financial Services, regardless of the nature of the causes of action in the complaint, the culpability of the insurer or the possibility of inequitable results.

COVID-19 Alerts:

Supreme Court Of Wisconsin Rules That Restaurants Are Not Entitled To Business Interruption Or Civil Authority Coverage For Pandemic-Related Losses

Reversing a lower court decision, the Supreme Court of Wisconsin ruled that allegations of government shutdown orders and the physical presence of the COVID-19 virus at insured property were insufficient to state the "physical loss of or damage to" property required by the policy. *Colectivo Coffee Roasters, Inc. v. Soc'y Ins.*, 2022 WI 36 (June 1, 2022).

Colectivo filed a class action complaint against Society seeking declaratory and injunctive relief and damages after the insurer denied coverage for lost income claims.

A circuit court denied Society's motion to dismiss, finding that the presence of the virus on insured property and the inability to use property for its intended purpose constituted allegations of physical loss or damage.

The Supreme Court of Wisconsin reversed, ruling that those allegations were insufficient to allege direct physical loss or damage. In particular, the court emphasized that viral presence does not alter property or require repair or remediation, and that while government orders might have restricted use of property, a loss of use is distinct from physical loss or damage. The court also rejected Colectivo's civil authority coverage claim for the additional reason that the government orders did not prohibit access to insured property.

Colectivo also sought coverage under a contamination provision that covered losses arising from a suspension in operations and that "results in an action by a public health or governmental authority that prohibits access to the [property] or production of [Colectivo's] product." Upholding Society's denial under this provision, the court noted that even assuming that the presence of COVID-19 constitutes "contamination," the coverage claim failed because the suspension in operations was caused by government orders rather than the virus itself.

In Consolidated Appeal, New Jersey Appellate Court Affirms Dismissal Of Policyholders' COVID-19 Coverage Suits

Ruling on six consolidated appeals, a New Jersey appellate court held that insurers had no obligation to cover business losses incurred as a result of government orders aimed at slowing the spread of COVID-19. *MAC Prop. Grp. LLC v. Selective Fire & Cas. Ins. Co.*, 2022 WL 2196396 (N.J. App. Div. June 20, 2022).

Various business owners sought coverage under property policies containing similar language. Each policy required "direct physical loss of or damage to" insured property. The court deemed this phrase unambiguous and requiring "a detrimental physical alteration of some kind" or "a physical loss of the insured property." The court concluded that the policyholders failed to satisfy this requirement, stating:

> [N]o plaintiff alleges the coronavirus was present on their properties or rendered their properties uninhabitable. Instead, plaintiffs' businesses were shut down or had their operations limited by the [Executive Orders]. Each plaintiff would have been able to continue functioning . . . without interruption had Governor Murphy not issued his [Executive Orders]. None of plaintiffs' premises required any repairs due to damage, nor needed to be relocated and then reopened.

The court also ruled that civil authority coverage was unavailable, reasoning that access to insured property was not "prohibited," as required by the policy. Additionally, there was no damage to nearby property; instead, the government orders were issued in order to slow the spread of the virus.

Finally, the court rejected the policyholders' regulatory estoppel arguments as without merit and ruled that for several policies, coverage was barred in any event by a virus exclusion.

Employing the same reasoning, another New Jersey appellate court affirmed a summary judgment ruling for an insurer on business income and civil authority coverage claims this month. *Rockleigh Country Club, LLC v. Hartford Ins. Grp.*, 2022 WL 2204374 (N.J. App. Div. June 21, 2022).

Reversing Trial Court, Louisiana Appellate Court Rules That Restaurant's Pandemic-Related Business Losses Are Covered By All Risk Policy

A Louisiana appellate court ruled a trial court erred in refusing to issue a declaratory judgment in favor of a restaurant seeking insurance coverage for its COVID-19-related

losses. *Cajun Conti LLC v. Certain Underwriters at Lloyd's, London*, 2022 WL 2154863 (La. Ct. App. June 15, 2022).

As discussed in our February 2021 Alert, the restaurant filed suit in March 2020, seeking coverage for business loss incurred after state and local orders restricted travel and dine-in eating in order to slow the spread of the virus. After a bench trial, the court issued a notice of judgment in the insurer's favor.

This month, the appellate court reversed, finding the policy ambiguous as to whether it provided coverage for the pandemic-related losses. In particular, the court held that "direct physical loss of or damage to property" could reasonably encompass a suspension of normal business operations, changes to capacity and operating protocols and constant decontamination efforts, among other things. In addition, the court deemed the "period of restoration" provision ambiguous, noting that the term "repair" could plausibly include the restaurant's cycle of cleaning and disinfection. In contrast, the overwhelming majority of courts across the country have concluded that a "period of restoration" provision indicates that actual, tangible destruction or alteration is necessary to trigger coverage.

In finding the policy ambiguous, the court emphasized several other factors, including that expert testimony indicated that there was an "overwhelming probability" that people present at the insured property were infected with the virus during the relevant time period and that the policy lacked a virus exclusion.

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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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