Simpson Thacher

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Applying New Jersey, Washington and Florida law, a New Jersey federal district court ruled that COVID-19-related coverage claims were barred by virus exclusions in the applicable policies. *Colby Rest. Grp., Inc. v. Utica National Ins. Grp.*, No. 1:20-cv-05927 (D.N.J. Mar. 12, 2021). (Click here for full article)

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A Nevada federal district court dismissed a casino's COVID-19-related coverage claims, finding that the complaint failed to allege "direct physical loss" and that in any event, coverage was barred by a contamination exclusion. *Circus Circus LV, LP v. AIG Specialty Ins. Co.*, 2021 WL 769660 (D. Nev. Feb. 26, 2021). (Click here for full article)

"[Simpson Thacher is] able to handle both direct insurance and reinsurance matters with equal flair, and also adept at handling the most complex of disputes regarding insurers' business practices."

– Chambers USA 2020

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A Delaware federal district court ruled that an excess D&O insurer had no duty to indemnify losses arising out of a lawsuit alleging that directors and officers of the insured company breached their fiduciary duties. *Calamos Asset Mgmt., Inc. v. Travelers Cas. & Sur. Co. of Am.*, 2021 WL 663056 (D. Del. Feb. 19, 2021). (Click here for full article)

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The Delaware Supreme Court ruled that an excess D&O insurer was obligated to fund the two underlying settlements, rejecting arguments that coverage was barred by public policy or contractual language. *RSUI Indem. Co. v. Murdock*, 2021 WL 803867 (Del. Mar. 3, 2021). (Click here for full article)

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The Nevada Supreme Court ruled that an insurer that defends under a reservation of rights is entitled to reimbursement of defense costs following a ruling that the insurer had no duty to defend. *Nautilus Ins. Co. v. Access Medical, LLC*, 2021 WL 936076 (Nev. Mar. 11, 2021). (Click here for full article)

Texas Court Rejects Coverage For Phishing-Related Loss, Finding That Policyholder Did Not "Hold" Lost Funds

A Texas federal district court granted insurers' summary judgment motion, ruling that losses incurred through a phishing scheme were not covered by commercial crime policies because the policyholder did not have ownership of the lost funds. *RealPage Inc. v. National Union Fire Ins. Co. of Pittsburgh*, PA, 2021 WL 718366 (N.D. Tex. Feb. 24, 2021). (Click here for full article)

COVID-19 Alerts:

As courts across the country continue to issue rulings in COVID-19-related coverage suits, some clear trends have emerged. The majority of courts continue to dismiss claims for coverage under business income and civil authority provisions based on the lack of "physical loss or damage" and/or a virus exclusion. A few courts, however, have permitted such claims to proceed based on the particular facts and policy language presented and interpretation of governing law. Several notable decisions are discussed below.

Liability Insurer Must Defend Restaurant Against Employees' Public Nuisance/Negligence Suit

An Illinois federal district court ruled that a general liability insurer was required to defend a restaurant against a suit brought by employees alleging public nuisance and negligence based on the restaurant's decision to remain open during the pandemic. *McDonald's Corp. v. Austin Mutual Ins. Co.*, No. 1:20-CV-05057 (N.D. Ill. Feb. 22, 2021).

Employees alleged that McDonald's remained open during the COVID-19 pandemic without enhanced health and safety protocols. The employees sought an injunction requiring McDonald's to provide adequate personal protective equipment, to enforce mask-wearing on premises and to monitor employees' COVID-19 infections, among other things. The insurer refused to defend, arguing that the suit did not seek "damages because of bodily injury," as required by the policy. The court disagreed.

The court ruled that under Illinois law, the costs of complying with a mandatory injunction can constitute "damages." The court further held that the underlying claims alleged damages "because of" bodily injury, explaining that "but for" the employees' COVID-19 infection and exposure, McDonald's would not have had to incur costs to comply with a mandatory injunction. In so ruling, the court rejected the insurer's contention that general liability policies cover only damages paid to a third-party, noting that this argument is "untethered to any language in the policy." Finally, the court ruled that the complaint alleged "bodily injury" for purposes of triggering the insurer's duty to defend because several employees had contracted the COVID-19 virus.

In Multi-District Litigation, Business Interruption Claims Survive, While Civil Authority And Contamination Claims Are Dismissed

An Illinois federal district court overseeing multi-district litigation denied an insurer's motion to dismiss claims seeking business interruption coverage, but granted the motion to dismiss claims under civil authority and contamination coverage provisions and a sue and labor clause. *In re: Society Ins. Co. COVID-19 Bus. Interruption Protection Ins. Litig.*, MDL No. 2964 (N.D. Ill. Feb. 22, 2021).

Restaurants and other hospitality businesses across several states sought coverage from Society Insurance for business losses incurred after the enactment of government-ordered restrictions designed to reduce the spread of COVID-19. The regulations required the policyholders to modify their standard business operations and to suspend in-person dining. Society denied coverage for the policyholders' lost revenue. In ensuing coverage litigation, Society moved to dismiss and for summary judgment, arguing that the policyholders failed to allege losses "caused by direct physical loss of or damage to covered property."

The court denied Society's motion to dismiss the claim for business interruption coverage. Society argued that the policyholders' business losses were caused by the shutdown orders, not the virus itself, and therefore, even assuming that COVID-19 qualified as a "direct physical loss," there would be no coverage because causation could not be established. Rejecting this argument, the court held that under Illinois, Wisconsin and Minnesota law, coverage under a business interruption provision requires only proximate causation between the business losses and the direct physical loss or damage. The court further held that a reasonable jury could find that COVID-19 proximately caused the policyholders' business interruptions.

As to the "direct physical loss" requirement, the court held that policyholders sufficiently alleged "direct physical loss" to withstand dismissal. The court explained that a reasonable jury could find that the restrictions on the policyholders' use of their premises constituted physical loss. In particular, the court reasoned that the government orders restricting the use of physical space at the insured premises could constitute "physical limit[s]."

However, the court dismissed the policyholders' claims for civil authority coverage because none of the government orders "prohibit[ed] access" to the insureds' premises. The court stated:

> [E]ven if the general public is prohibited from congregating in the covered premises, there is no allegation that employees are outright prohibited from accessing the premises—or from accessing the immediately surrounding areas, for that matter. Indeed, for some of the Plaintiffs, take-out customers and in-room dining guests may access the premises (and the immediately surrounding areas).

Claims for coverage under a contamination provision were also dismissed based on the absence of allegations alleging a suspension of operations, as required by the provision. Finally, the court dismissed a sue and labor coverage claim, holding that the sue and labor clause is not a coverage grant, but rather a mitigation condition with which policyholders must comply.

In another COVID-19-related coverage case governed by Texas law, *Derek Scott Williams PLLC v. Cincinnati Ins. Co.*, 2021 WL 767617 (N.D. Ill. Feb. 28, 2021), the court also dismissed a civil authority coverage claim but allowed a business interruption coverage claim to proceed, citing *In re: Society Ins. Co. COVID-19 Bus. Interruption Protection Ins. Litig*.

Georgia Court Dismisses Coverage Suit, Ruling That Complaint Fails To Allege Physical Loss Or Damage

A Georgia federal district court ruled that a childcare company was not entitled to business interruption or civil authority coverage for losses stemming from its cessation of operations during the state-mandated shutdown. *Lemontree Academy, LLC v. Utica Mutual Ins. Co.*, No. 3:20-cv-126 (M.D. Ga. Mar. 11, 2021).

The court rejected the policyholder's assertion that the COVID-19 virus caused "direct physical loss or damage" to property, emphasizing the absence of allegations that the virus was present on any insured structures. Further, the court held that even if the policyholder could prove that the virus was present at its facility, coverage would still be unavailable because the policyholder did not allege that the virus physically damaged or altered its property. While the policyholder did allege that its facility became uninhabitable, the court held that this "'omnipresent specter' of COVID-19 exposure is a threat experienced by 'every home, office, or business that welcomes individuals into an indoor setting across the globe' and is insufficient to trigger business income coverage under the terms of the policies."

The court also rejected the policyholder's claim under a civil authority provision, noting the absence of allegations of damage to "other property," a prerequisite to such coverage.

New Jersey Court Rules That Virus Exclusions Preclude Coverage For Restaurants' Business Losses

Applying New Jersey, Washington and Florida law, a New Jersey federal district court ruled that COVID-19-related coverage claims were barred by virus exclusions in the applicable policies. *Colby Rest. Grp., Inc. v. Utica National Ins. Grp.*, No. 1:20-cv-05927 (D.N.J. Mar. 12, 2021).

A restaurant group that operates food service businesses in several states sought business income, civil authority and extra expense

coverage for losses incurred during the pandemic-related shutdown. The court ruled that even assuming that coverage under these provisions was available, virus exclusions unambiguously barred coverage.

The policyholder argued that virus exclusions were intended to apply only in the event of actual contamination at the insured premises, and that because the insured property was not contaminated by COVID-19, the exclusions did not apply. Rejecting this assertion, the court noted that nothing in the exclusionary language requires actual contamination. Rather, the exclusions bar losses caused by "any virus . . . that induces or is capable of inducing physical distress, illness or disease." Further, the court declined to consider arguments based on an ISO Circular, explaining that consideration of such extrinsic evidence is appropriate only where language is ambiguous. Finally, the court rejected the policyholder's contention that the states' respective closure orders (rather than the virus itself) were the proximate cause of loss.

Nevada Court Rules That Casino's Business Losses Were Not Caused By "Direct Physical Loss" And Are Excluded By Contamination Clause

A Nevada federal district court dismissed a casino's COVID-19-related coverage claims, finding that the complaint failed to allege "direct physical loss" and that in any event, coverage was barred by a contamination exclusion. *Circus Circus LV, LP v. AIG Specialty Ins. Co.*, 2021 WL 769660 (D. Nev. Feb. 26, 2021).

Circus Circus filed suit after its insurer denied coverage for business losses incurred in the wake of a state-mandated shutdown. The court dismissed the suit, finding that the complaint did not allege "direct physical loss or damage," as required by the policy. The court reasoned that this undefined phrase requires a "distinct, demonstrable, physical alteration of the property" or a "physical change in the condition of the property" and does not encompass a temporary loss of use. The court noted that to the extent the complaint implied that objects and surfaces were contaminated by the COVID-19 virus, it would still fail to allege a physical alteration because such "surface-contamination is ephemeral."

In addition, the court ruled that coverage was barred by a contamination exclusion that applied to several enumerated pollutants and contaminants, including "bacteria, virus, or hazardous substances." In so ruling, the court distinguished Nevada Supreme Court precedent holding that a pollution exclusion was ambiguous as to whether it applied to carbon monoxide claims or was limited to traditional environmental contamination, explaining that the precedent involved a third-party policy and different exclusionary language.

D&O Coverage Alerts:

Three Delaware courts have recently addressed the scope of coverage available for breach of fiduciary duty claims against company executives and the proper application of an "uninsurability" defense.

Delaware Court Rules That Fiduciary Claims Are Not Covered "Securities Claims"

A Delaware federal district court ruled that an excess D&O insurer had no duty to indemnify losses arising out of a lawsuit alleging that directors and officers of the insured company breached their fiduciary duties. *Calamos Asset Mgmt., Inc. v. Travelers Cas. & Sur. Co. of Am.*, 2021 WL 663056 (D. Del. Feb. 19, 2021).

Travelers provided excess D&O coverage to Calamos. The policy covered loss resulting from a "Securities Claim," defined as "a claim . . . for: (1) any actual or alleged violation of any federal, state, local regulation,

statute or rule (whether statutory or common law) regulating securities, including but not limited to the purchase or sale of, or offer to purchase or sell, securities. . .” Calamos sought coverage under this provision for a shareholder suit alleging breach of fiduciary duty in connection with a company merger. Travelers denied coverage, arguing that the suit was not a covered “securities claim” under the policy. The court agreed and granted the insurer’s summary judgment motion.

The court held that even assuming that the fiduciary duty claims alleged a violation of common law, coverage would still be unavailable because the Delaware Supreme Court has ruled that claims for breach of fiduciary duties are not “securities claims.” *See In re Verizon Ins. Coverage Appeals*, 222 A.3d 566 (Del. Oct. 31, 2019) (discussed in our November 2019 Alert). Even though the policy at issue defined “rule” to include common law, whereas the policy in *Verizon* did not, the court deemed this distinction irrelevant because the phrase “regulating securities” imposes its own, distinct requirements. In particular, “regulations, rules or statutes that regulate securities are those specifically directed towards securities, such as the sale, or offer for sale, of securities.” The court held that breach of fiduciary duty claims do not meet this test because they do not depend on the involvement of a security and can involve a variety of claims arising from breach of trust or a special duty of care.

Applying Delaware Law Pursuant To Policy’s “Law Most Favorable” Clause, Delaware Court Rules That Settlement Funds Are Not Uninsurable Losses

A Delaware court rejected insurers’ “uninsurability defense,” ruling that Delaware law applied to the insurance dispute and that insurance for disgorgement or restitution is not prohibited as a matter of public policy. *Sycamore Partners Management, L.P. v. Endurance American Ins. Co.*, 2021 WL 761639 (Del. Super. Ct. Feb. 26, 2021).

The coverage dispute arose after a corporate transaction led to a bankruptcy filing by the acquired company. The bankruptcy estate sued the acquiring investment funds for fraudulent conveyance and breach of fiduciary duty, among other claims. The investment funds settled the claims for $120 million and then sought insurance coverage. The insurers denied the claim, arguing that the settlement was uninsurable as a matter of public policy because it represented disgorgement of or restitution for ill-gotten gains. The investment funds moved for judgment on the pleadings as to the insurability issue and the court granted the motion.

The coverage question turned primarily on whether a “law most favorable” policy clause constituted a choice of law provision. The provision excluded loss for “amounts which are uninsurable under the law most favorable to . . . insurability.” The court ruled that this clause constitutes a choice of law provision that allows the policyholder to select “any reasonable forum” for determining whether a loss is uninsurable. In addition, the court ruled that the provision was enforceable, rejecting the contention that it conflicts with the public policy of New York, which has a materially greater interest in the conflict than Delaware. The court explained that even absent the choice of law clause, New York would not be the “default” state because Delaware “takes a superseding interest in the merits of disputes involving insurance coverage for fiduciary mismanagement of Delaware organizations.”

Having determined that Delaware law governs the dispute, the court addressed whether the state has a public policy prohibiting insurance coverage for disgorgement or restitution payments. It held that it does not, noting the absence of clear legislation on this point.

Delaware Supreme Court Affirms D&O Coverage For Fiduciary and Securities Settlements, Rejecting Uninsurability Defense

The Delaware Supreme Court ruled that an excess D&O insurer was obligated to fund the two underlying settlements, rejecting arguments that coverage was barred by public policy or contractual language. *RSUI Indem. Co. v. Murdock*, 2021 WL 803867 (Del. Mar. 3, 2021).

Following a merger, shareholders of Dole Food Company filed suit, challenging the fairness of the transaction and alleging breach of fiduciary duty. After a nine-day trial, the court issued a Memorandum Opinion finding that Dole executives breached their duty of loyalty through intentional and fraudulent conduct. Dole ultimately settled the suit. Before the settlement was approved by the court, a second set of shareholders brought a federal securities action against Dole. Dole settled that action as well. In turn, several insurers sought a declaration that they had no duty to fund the settlements. A Delaware trial court entered judgment in favor of Dole. RSUI, a high-level excess insurer, appealed. The Delaware Supreme Court affirmed the trial court, rejecting each of RSUI's assertions.

First, the Delaware Supreme Court ruled that the trial court correctly applied Delaware law. RSUI argued that California law, which bars insurance coverage for willful acts, governed the dispute under the "most significant relationships" analysis because the negotiation and procurement of the policies occurred at Dole's headquarters in California, and the directors and officers lived and worked in California. RSUI further argued that Dole's incorporation in Delaware was "largely irrelevant." The court disagreed, observing that "in the vast majority of cases, Delaware law governs the duties of the directors and officers of [a] Delaware corporation to the corporation, its stockholders, and its investors." The court explained that Delaware statutory law permits Delaware corporations to provide broad indemnification to their executives and to purchase D&O policies to protect them where such indemnification is unavailable. Thus, "applying Delaware law to the D&O policies that actually cover those costs advances the relevant policies of the forum." However, the court noted the fact-specific nature of its ruling, acknowledging that the California contacts presented here "might be dispositive . . . [for] an insurance policy covering a different subject matter and insureds with a more tenuous connection to Delaware."

Second, the court ruled that Delaware public policy does not preclude coverage for fraudulent conduct. RSUI argued that because both underlying settlements were predicated on a judicial finding of fraud by Dole executives, Delaware public policy should bar their insurability. Rejecting "this invitation to void the Insureds' otherwise valid coverage," the court held that the policy's "expansive definition of covered losses, which on its face does not exclude losses occasioned by fraud," governs coverage. The court stated: "in the absence of clear guidance from the General Assembly to the contrary, we must reject RSUI's invitation to void its contractual obligations on public-policy grounds."

Third, the court concluded that a "Fraud/Profit Exclusion" did not bar coverage for the settlements. The exclusion applied to fraud or willful violation of law "if established by a final and non-appealable adjudication adverse to such Insured in the underlying action." The court ruled that the exclusion did not apply to the settlement of the second shareholder suit because there was no "adjudication of fraud." The court rejected RSUI's contention that the exclusion should apply because the settlement was based upon and attributable to the findings of fraud in the first stockholder action. The court noted that it need not address whether the settlement of the first shareholder action was subject to the exclusion because the settlement of the second action alone exhausted the underlying coverage limits.

Fourth, the Delaware Supreme Court ruled that the "larger settlement rule" (under which a loss is fully recoverable unless the insurer can show that the liability for non-covered conduct increased the insurer's liability), rather than a "relative exposure" rule (which weighs the relative exposure between covered and non-covered losses) governed the allocation of covered losses. The policy stated that:

> If in any Claim, the Insureds who are afforded coverage for such Claim incur Loss jointly with others . . . or incur an amount consisting of both Loss covered by this Policy and loss not covered by this Policy because such Claim includes both covered and uncovered matters, then the Insureds and the Insurer agree to use their best efforts to determine a fair and proper allocation of covered Loss. . . . In making such determination, the parties shall take into account the relative legal and financial exposures of the Insureds in connection with the defense and/or settlement of the Claim.

The trial court held that this provision governs only situations in which the parties work together to arrive at a "fair and proper allocation," and does not address the situation presented here, where the parties have failed to agree on allocation and seek judicial resolution. *See* February 2020 Alert. The Delaware Supreme Court agreed, and noted that RSUI failed to allege that the settlement represented a mixture of covered and non-covered losses or that a relative exposure theory would lead to a reduction in available coverage.

Defense Costs Alert:

Nevada Supreme Court Rules That Insurer Is Entitled To Defense Cost Reimbursement After No Duty To Defend Ruling

Answering a question certified by the Ninth Circuit, the Nevada Supreme Court ruled that an insurer that defends under a reservation of rights is entitled to reimbursement of defense costs following a ruling that the insurer had no duty to defend. *Nautilus Ins. Co. v. Access Medical, LLC*, 2021 WL 936076 (Nev. Mar. 11, 2021).

Nautilus defended its insured under a reservation of rights that referenced its right to seek reimbursement of defense costs. While the underlying litigation was pending, Nautilus sought a declaration that it had no duty to defend. A Nevada federal district court ruled in Nautilus' favor and closed the case. Thereafter, Nautilus sought reimbursement of defense costs, which the court denied.

On appeal, the Ninth Circuit noted the lack of clarity under Nevada law regarding an insurer's right to reimbursement of defense costs following a no duty to defend ruling. *See* July/August 2019 Alert. Therefore, the Ninth Circuit certified the following question of law to the Nevada Supreme Court:

> Is an insurer entitled to reimbursement of costs already expended in defense of its insureds where a determination has been made that the insurer owed no duty to defend and the insurer expressly reserved its right to seek reimbursement in writing after defense has been tendered but where the insurance policy contains no reservation of rights?

This month, the Nevada Supreme Court answered the question in the affirmative. As a preliminary matter, the court rejected the policyholder's contention that recovery under an "unjust enrichment" theory is unavailable where there is an express, written contract. Further, the court concluded that it is equitable for an insurer to receive restitution for payments that the policyholder was not entitled to in the first place, so long as the insurer has expressly reserved its right to such reimbursement.

The court rejected the assertion that reimbursement is tantamount to allowing the insurer to unilaterally amend the insurance contract, stating:

> when a court holds that there never was a duty to defend, it is holding that the claims were never even potentially covered by the policy. Therefore, when the insurer reserved its right to seek reimbursement, it was not extracting an amendment to a contract . . . . No contract governed its defense. In these circumstances, there is no reason it cannot reserve a right it has, not pursuant to the contract, but pursuant to the law of restitution.

As the court noted, this ruling accords with the law of California and the majority of other jurisdictions.

Cyber Alert:

Texas Court Rejects Coverage For Phishing-Related Loss, Finding That Policyholder Did Not "Hold" Lost Funds

A Texas federal district court granted insurers' summary judgment motion, ruling that losses incurred through a phishing scheme were not covered by commercial crime policies because the policyholder did not have ownership of the lost funds. *RealPage Inc. v. National Union Fire Ins. Co. of Pittsburgh, PA*, 2021 WL 718366 (N.D. Tex. Feb. 24, 2021).

RealPage provides online rent collection services for property managers and owners. RealPage contracted with Stripe, a software company, to facilitate its payment-processing services. Under the contract, Stripe processed payments from renters through its bank account before forwarding those payments to RealPage's clients. Any fees owed to RealPage were transferred in a separate transaction.

In May 2018, criminals used a targeted phishing scheme to access the Stripe dashboard and alter fund disbursement instructions. Through the scheme, the criminals diverted more than $10 million that was owed to RealPage's clients. Less than $4 million was recovered. RealPage ultimately reimbursed its clients for the unrecovered lost funds and then sought coverage under Computer Fraud and Funds Transfer Fraud provisions. The insurers denied coverage.

The policies expressly 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." The court held that that there was no coverage because RealPage did not "hold" the lost funds. The court reasoned that "hold" requires "possession" and does not encompass the mere "ability to direct property." Applying this definition, the court concluded that RealPage did not hold the client funds because those funds remained in Stripe's bank account until they were diverted to the criminals' accounts. While RealPage had authority to direct the transfer of funds, it had no rights to the funds and could not withdraw any funds. The court concluded that "[u]nder these circumstances, RealPage did not possess the funds in any manner; thus, RealPage did not hold the funds."

The court also rejected RealPage's assertion that Stripe served as its agent, noting that the facts did not support such a finding and that the contract expressly disclaimed an agency relationship. Finally, the court ruled that because RealPage did not "hold" the funds, it did not sustain a "direct loss" as required by the Computer Fraud and Funds Transfer Fraud provisions.

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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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