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"They are tremendous writers and do a great job collaborating with co-counsel. They understand and are dedicated to the industry."

– *The Legal 500* (quoting a client)

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The Second Circuit affirmed a New York district court decision confirming and enforcing two foreign arbitration awards, rejecting plaintiff's assertion that it was not bound by the arbitration provision because it was a non-signatory to the agreement. *Generali Espana de Seguros Y Reaseguros, S.A. v. Speedier Shipping, Inc.*, 2023 U.S. App. LEXIS 11568 (2d Cir. May 11, 2023). (Click here for full article)

Supreme Court Ruling Means That Climate Change Litigation Will Proceed In State Courts And Insurers May Have To Focus On Requests For A Defense

Last month, the United States Supreme Court declined to hear several cases in which government entities sued oil, gas and coal companies seeking compensation for alleged greenhouse gas related environmental damage. To learn more about the potential insurance-related implications of this ruling, click here.

New Jersey Appellate Court Affirms That War Exclusion Does Not Bar Coverage For Malware Claims

HOLDING

A New Jersey appellate court affirmed a trial court decision granting a policyholder's motion for summary judgment, ruling that a war exclusion does not bar coverage for property damage claims arising out of a malware attack. *Merck & Co. v. Ace Am. Ins. Co.*, 2023 N.J. Super. LEXIS 43 (N.J. App. Div. May 1, 2023).

BACKGROUND

In 2017, a malware known as NotPetya infected Merck's global computer network systems. The infection allegedly resulted in disruptions to Merck's operations, including its manufacturing, sales, and research and development. When Merck submitted a notice of loss to its "all-risk" property insurers, they issued reservations of rights, raising a hostile/warlike action exclusion. The insurers noted that a cyber-consultant had concluded that the cyber-attack was "very likely orchestrated by actors working for or on behalf of the Russian federation." In ensuing litigation, a New Jersey trial court concluded that the hostile/warlike action exclusion did not apply. (*See* January 2022 Alert). This month, an appellate court affirmed.

DECISION

The hostile/warlike action exclusion 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 any 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[.]

While the insurers conceded that the term "warlike" might not apply, they contended that "hostile" encompassed "antagonistic" actions that "reflect ill will or a desire to harm," such as a malware attack by a government actor. Rejecting this contention, the court reasoned that the plain language of the exclusion "requires the involvement of military action."

COMMENTS

This ruling is a first of its kind in New Jersey. As such, the appellate court's decision was based largely on general principles of insurance policy interpretation relating to the narrow construction of exclusions in all-risk policies. The court appeared troubled that application of the exclusion here would preclude coverage for "a cyberattack on a non-combatant firm that provided accounting software updates to various non-combatant customers, all wholly outside the context of any armed conflict or military objective."

The decision does not establish a blanket rule that cyberattacks can never be subject to a war exclusion. The court declined to delineate the precise scope of when cyberattacks might be encompassed by the exclusion, giving rise to the possibility that a different fact pattern involving a cyberattack might fall within the scope of this or similar exclusionary language. The recent updates to war exclusions that have become more common in the market may make this case instructive rather than one of broad application.

Fourth Circuit Rules That Virginia District Court's Interpretation Of Bump Up Exclusion Was Improperly Narrow

HOLDING

The Fourth Circuit ruled that a Virginia district court's interpretation of a "bump up" exclusion in D&O policies was unreasonably narrow, vacating the decision and remanding the matter for further proceedings. *Towers Watson & Co. v. Nat'l Union Fire Ins. Co.*, 2023 U.S. App. LEXIS 11338 (4th Cir. May 9, 2023).

BACKGROUND

In 2015, Towers Watson and Willis Group Holdings executed a merger agreement that involved a "reverse triangular merger"—a transaction in which a newly created corporation and wholly owned subsidiary of Willis merged into Towers Watson and then disappeared, leaving Towers Watson as the surviving entity. Following the merger, Towers Watson shares were canceled and shareholders received the right to 2.649 shares of Willis stock for each cancelled share. The surviving Towers Watson entity then issued the remaining newly created shares to Willis, resulting in Towers Watson becoming a wholly owned subsidiary of Willis.

Thereafter, former Towers Watson shareholders filed class actions in Virginia District Court and in the Delaware Court of Chancery, alleging federal securities and state law claims based on an allegedly below-market valuation of Towers Watson shares. Both suits settled for a total of $90 million. The insurers funded Tower Watson's defense but denied indemnity based on a "bump up" exclusion that barred coverage for judgments or settlements stemming from a claim that "the price or consideration paid or proposed to be paid for the acquisition or completion of the acquisition of all or substantially all the ownership interest in or assets of an entity is inadequate."

The district court concluded that ambiguity existed as to whether the merger constituted an "acquisition" under the exclusion. As discussed in our November 2021 Alert, the district court reasoned that an acquisition is commonly associated with "the takeover of one company by another, with both companies surviving the transaction, as opposed to a merger, which contemplates the combination of two companies into a single entity, with shared ownership by the shareholders of both participating entities." Additionally, even though Virginia law governed the dispute, the district court noted that Delaware corporate law recognizes a merger as "distinct from other types of 'acquisition techniques' involving the transfer of stock or assets." The Fourth Circuit vacated the decision.

DECISION

The Fourth Circuit ruled that the district court erred in its interpretation of the term "acquisition." It explained that the "ordinary and accepted meaning" of "acquisition" contemplates the gaining of possession or control over something. The court concluded that as a result of the reverse triangular merger, another entity gained possession or control of all, or substantially all, of the ownership interest in and assets of Towers Watson. Rejecting the district court's interpretation, the Fourth Circuit stated that "nothing in the bump-up exclusion stipulates, or even hints, that the term 'acquisition' was intended to refer only to a particular form of acquisition . . . ."

Notably, the Fourth Circuit's decision did not resolve the ultimate question of whether the bump up exclusion bars coverage. In its original motion, Towers Watson posited two other arguments to explain why the exclusion did not apply: (1) that Towers Watson was not "an entity"; and (2) that the underlying settlements did not represent an effective increase in consideration for the original Towers Watson shares. The Fourth Circuit remanded the matter for resolution of those issues.

COMMENTS

In arguing against application of policy exclusions, insureds often seek to establish ambiguity in undefined terms and argue for narrow construction of such provisions. The Fourth Circuit's decision illustrates the limitations of such arguments. While ambiguous exclusionary terms may be subject to strict construction, courts are not free to rewrite clear and unambiguous policy language. Similarly, the ruling is also a reminder that ambiguity results from two "equally possible" and reasonable interpretations given the context of the disputed provision, and is not established merely because a term may have multiple dictionary definitions.

California Appellate Court Rules That Exclusion Does Not Relieve Insurer Of Duty To Defend

HOLDING

Reversing a trial court decision, a California appellate court ruled that an animal liability exclusion did not relieve the insurer of its duty to defend an underlying suit arising out of dog bite injuries. *Dua v. Stillwater Ins. Co.*, 2023 Cal. App. LEXIS 342 (Cal. Ct. App. May 5, 2023).

BACKGROUND

The underlying claimants sued Dua and her boyfriend Taylor for property damage and injuries allegedly arising out of an attack by Taylor's pit bulls that occurred on a public street. Dua was not present at the time of the incident, but the complaint alleged that Taylor and his dogs lived at Dua's home and that she knew that the dogs were dangerous. Dua's homeowner's insurer denied coverage on the basis of an animal liability exclusion, which applied to "any occurrence or damages caused by any animal, at any time, at any premises insured hereunder, or caused by, arising out of, or in any way related to any animal owned by or in the care, custody, or control of the insured, or any member of the insured's family or household."

Dua sued the insurer, alleging breach of contract and bad faith and seeking punitive damages. A trial court granted the insurer's summary judgment motion, concluding that the exclusion eliminated any possibility of coverage and therefore that the insurer had no duty to defend. The appellate court reversed and remanded for further proceedings.

DECISION

The appellate court noted that when Dua sought the insurer's defense, she informed the insurer that the dogs were not in her care, custody, or control, as required by the exclusion. Further, the appellate court found there was no evidence that the insurer had investigated the veracity of this allegation. The court explained that such extrinsic facts, whether "disputed or undisputed," give rise to a duty to defend if they create potential liability under the policy. The court concluded that the insurer improperly denied a defense without investigating facts alleged by the insured that would negate application of the exclusion.

COMMENTS

The decision illustrates the breadth of an insurer's duty to defend, particularly where an insurer's denial is based on a policy exclusion. In reversing the trial court decision, the appellate court emphasized that even if the policyholder cannot be found legally liable under the facts pled in the underlying complaint (and therefore not entitled to coverage under the policy), the insurer may still be obligated to defend the suit based on disputed extrinsic facts. In granting the insurer's summary judgment motion, the trial court had reasoned that if Dua lacked ownership, care, custody, or control of the dogs, then she could not be held liable for the underlying injuries (in which case, insurance coverage would not be an issue), whereas if she did have ownership, care, custody, or control, the exclusion would bar coverage. The appellate court rejected this reasoning, emphasizing that the contract required the insurer to defend "even if the suit is groundless, false, or fraudulent." Even if Dua could not be held liable, the insurer may still be required to defend her in the lawsuit.

Sixth Circuit Rules That Policyholder's Application Statements Eliminate Coverage for Underlying *Qui Tam* Action

HOLDING

Reversing an Ohio district court decision, the Sixth Circuit ruled that statements made in an insurance application triggered an exclusion that barred coverage for all underlying claims. *SHH Holdings, LLC v. Allied World Specialty Ins. Co.*, 2023 U.S. App. LEXIS 9570 (6th Cir. Apr. 21, 2023).

BACKGROUND

In 2016, a *qui tam* action was filed under seal, alleging that SHH violated the False Claims Act by providing unnecessary services to patients for the purpose of claiming higher Medicare reimbursement. The complaint also alleged that SHH retaliated against employees for internally reporting the allegedly fraudulent billing practices.

In 2017, the Department of Justice issued a Civil Investigation Demand to SHH, informing it that it was the subject of a False Claims Act investigation regarding fraudulent billing practices and also requesting information about certain employee terminations, including those of the relators of the *qui tam* action.

In 2019, SHH submitted an insurance application to Allied. Question 1 asked SHH to "provide full details of all inquiries, investigations, administrative charges, claims, and lawsuits filed within the last three (3) years against [SHH], any Subsidiary, any Executive, or other entity proposed for any coverage for which [SHH] is applying." SHH checked "none." Question 2 asked whether "[SHH], any Subsidiary, any Executive, or other entity proposed for coverage knew of any act, error or omission which could give rise to a claim, suit or action under any coverage part of the proposed policy." SHH checked "no." Finally,

the application included an "Application Exclusion," which stated that anything within the scope of Questions 1 and 2 would be excluded from the proposed coverage. Allied ultimately issued a policy in effect from 2019-2020.

In 2019, the *qui tam* action was partially unsealed and SHH received a copy of the complaint. It sought coverage for the costs of defending the retaliation allegations. Allied denied coverage, citing Questions 1 and 2 and the Application Exclusion. In ensuing litigation, an Ohio district court granted SHH's summary judgment motion. The Sixth Circuit reversed.

DECISION

The Sixth Circuit's decision turned on interpretation of Questions 1 and 2—and whether they called for disclosure of the Civil Investigation Demand. The district court had concluded that those Questions encompassed only "inquiries, investigations, administrative charges, claims and lawsuits" relevant to the liability coverage that the applicant was seeking—meaning "an inquiry or investigation that could implicate the eventual liability coverage." The district court then reasoned that the Questions did not encompass the fraudulent billing claims because SHH could not and did not intend to seek coverage for them and "did not encompass the retaliation claims because SHH did not have notice of the *qui tam* complaint at the time of the application."

Rejecting this reasoning, the Sixth Circuit ruled that the Questions were unambiguous and encompassed any inquiries for any investigations against SHH, not just inquires or investigations for which SHH could seek coverage under the policy at issue. The Sixth Circuit explained that the phrase "proposed for any coverage" applied to "any Subsidiary, any Executive or other entity"—and thus encompasses any inquiry or investigation targeting an insured entity, regardless of whether such inquiries would be subject to actual coverage. The court further held that it did not matter for the purposes of coverage whether SHH knew about the *qui tam* retaliation claim at the time of the application because the Application Exclusion required only that a claim fall within the scope of Questions 1 and 2 and exist at the time of the application.

COMMENTS

A notable element of the Sixth Circuit's decision was its refusal to find ambiguity in the Questions based on hypothetical fact patterns. The district court had reasoned that interpreting Question 1 to include any inquiry or investigation against an insured entity, even if unrelated to the applied-for policy, would create "strange results," and would impose a duty to disclose "unrelated and irrelevant matters," such as a local zoning citation or an executive's child custody proceedings. Rejecting this reasoning, the Sixth Circuit stated: "we are not persuaded that Question 1's scope is ambiguous simply because it sweeps broadly." Further, the Sixth Circuit explained that "a contract can be unambiguous when applied to some facts but not others."

Second Circuit Affirms That Non-Signatory Is Bound By Arbitration Agreement

HOLDING

The Second Circuit affirmed a New York district court decision confirming and enforcing two foreign arbitration awards, rejecting plaintiff's assertion that it was not bound by the arbitration provision because it was a non-signatory to the agreement. *Generali Espana de Seguros Y Reaseguros, S.A. v. Speedier Shipping, Inc.*, 2023 U.S. App. LEXIS 11568 (2d Cir. May 11, 2023).

BACKGROUND

Mabisa, a Spanish logistics company, was hired by a supplier of industrial transformers to arrange for transport of a transformer. Mabisa subcontracted the transportation to Wasa and Speedier, a New York freight company, to be performed jointly. The terms of transport were specified in a "Booking Note" signed by Mabisa and Wasa. While the Booking Note specified Speedier as the carrier and provided a signature line for Speedier, only Wasa signed the agreement.

When the transformer incurred damage during transit, the transformer supplier sued Mabisa in a Spanish court. The suit settled, and payment was made by Generali Espana, Mabisa's insurer. Thereafter, Mabisa and Generali Espana initiated an arbitration in London against Speedier and Wasa pursuant to an arbitration clause in the Booking Note. The panel issued an award finding Speedier and Wasa jointly liable. Speedier refused to pay, arguing that it had not been involved in the underlying shipping transaction and that Wasa had not adequately represented its interests during the arbitration proceedings. Generali Espana filed a petition in federal district court to enforce the award under the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards. A New York district court ruled in the insurer's favor, finding the arbitration award valid and enforceable against Speedier.

DECISION

Affirming the district court decision, the Second Circuit rejected Speedier's assertion that as a non-signatory to the Booking Note, it was not bound by the arbitration agreement. Applying English law (as specified in the Booking Note), the court ruled that the absence of a signature on a written agreement to arbitrate is not determinative as to the validity of that agreement. Further, the court emphasized that Speedier's decision to allow Wasa to represent it in the arbitration, without objection, rendered its subsequent challenge to the arbitration agreement unavailable under English law. Similarly, the court rejected Speedier's assertion that its lack of participation in the arbitration proceedings warranted vacatur, noting that Speedier received notice of the arbitration and chose not to participate directly in the proceedings.

COMMENTS

Decisions addressing whether and under what circumstances a non-signatory may be bound by an arbitration clause frequently turn on application of equitable doctrines, such as the "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. In the present case, which applied English law, the court analogized to the American law equitable doctrine of waiver, which precludes a party that participated in arbitration proceedings from raising a challenge as to arbitrability for the first time following an adverse result.

Supreme Court Ruling Means That Climate Change Litigation Will Proceed In State Courts And Insurers May Have To Focus On Requests For A Defense

Last month, the United States Supreme Court declined to hear several cases in which government entities sued oil, gas and coal companies seeking compensation for alleged greenhouse gas related environmental damage. *Suncor Energy, Inc. (U.S.A.) v. Bd. of Cnty. Comm'rs of Boulder Cnty.* (No. 21-1550); *BP P.L.C. v. Mayor & City Council Balt.* (No. 22-361); *Chevron Corp. v. San Mateo Cnty.*, (No. 22-495); *Sunoco LP v. City & Cnty. Of Honolulu*, (No. 22-523); *Shell Oil Prods. Co. v. Rhode Island* (No. 22-524).

The ruling means that the lawsuits will proceed in state, rather than federal courts. There are more than twenty such lawsuits pending in state courts across the country and substantially increased litigation activity is expected in the near term.

Plaintiffs in these suits claim to have compelling evidence of environmental damage legally caused by defendants. Some observers predict that the litigation will have "potentially enormous consequences for an entire sector of the global economy." U.S. climate change lawsuits are tracked by Columbia Law School here.

Given the anticipated expense of defending such actions, oil, gas, and coal companies are expected to renew efforts at the behest of the policyholder bar to seek coverage. Policyholders can be expected to revisit historical environmental coverage that some may have thought was finally settled. In addition to considering potential defense obligations, it is not too early for insurers to begin evaluating the available evidence which suggests that there will be strong policy defenses in response to any request for indemnification.

The landmark decision in this context is *AES Corp. v. Steadfast Ins. Co.*, 283 Va. 609, 725 S.E.2d 532 (Va. 2012). There, the Virginia Supreme Court ruled that an insurer did not owe a defense or indemnity under comprehensive general liability policies for global warming-related claims because the underlying complaint did not allege an "occurrence." The underlying complaint alleged that AES contributed to the excessive emission of carbon dioxide and other greenhouse gases. Steadfast argued that it owed no defense or indemnity because, among other things, the property damage at issue was a known and foreseeable consequence of the operation of fossil fuel-fired electricity plants rather than an "accident." In a summary ruling, a Virginia circuit court held that "Steadfast has no duty to defend AES in connection with the underlying [ ] litigation because no 'occurrence' as defined in the policies has been alleged in the underlying Complaint." *Steadfast Ins. Co. v. AES Corp.*, No. 2008-858 (Va. Cir. Ct. Arlington County Feb. 5, 2010). The Virginia Supreme Court affirmed, *AES Corp. v. Steadfast Ins. Co.*, 282 Va. 252, 715 S.E.2d 28 (2011), but subsequently withdrew its decision upon granting a motion to rehear the matter. On rehearing, the court again held that the claims did not allege an "occurrence." The court held that even if AES did not intend to cause the damage that occurred, "the gravamen of Kivalina's nuisance claim is that the damages it sustained were the natural and probable consequence of AES's intentional emissions."

Another climate change coverage suit is currently pending in Hawaii district court. In *Aloha Petroleum Ltd. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, No. 1:22-cv-00372 (D. Hawaii filed Aug. 10, 2022), a fossil fuel company alleges breach of contract and seeks declaratory relief against its insurer for failing to provide coverage in underlying climate change suits. In particular, the policyholder disputed the insurer's contention that a qualified pollution exclusion precludes coverage in the underlying actions.

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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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