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Insurance Law Alert

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Tenth Circuit Rules That TCPA Damages And Injunctive Relief Are Uninsurable Penalties Under Colorado Law

The Tenth Circuit affirmed a Colorado district court decision holding that an insurer had no duty to defend or indemnify claims that DISH Network violated the Telephone Consumer Protection Act because relief under the statute constitutes an uninsurable penalty rather than covered damages. *Nat'l Union Fire Ins. Co. of Pittsburgh v. DISH Network, LLC*, 2021 WL 5066571 (10th Cir. Nov. 2, 2021). (Click here for full article)

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Sixth Circuit Rejects Coverage Claim Under Communicable Disease Provision

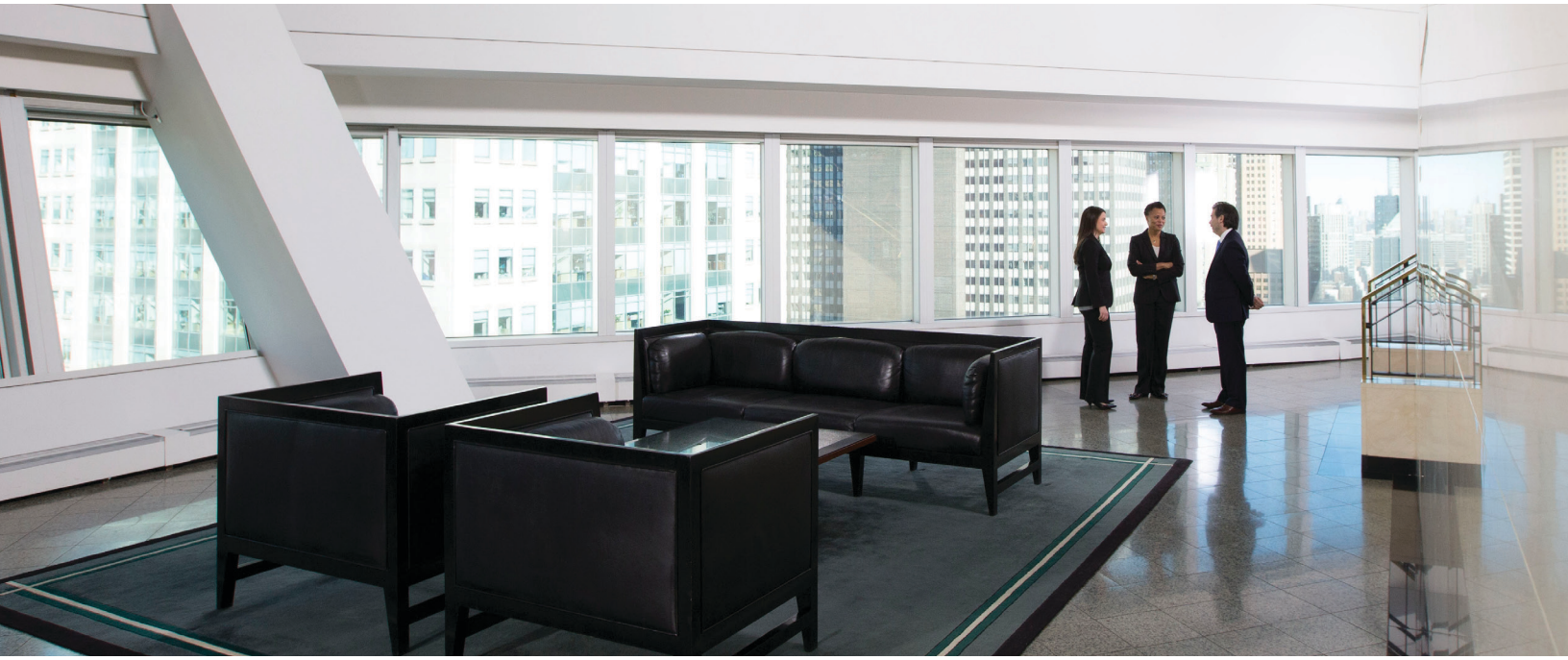
The Sixth Circuit ruled that a communicable disease and water-borne pathogen provision did not provide coverage for a policyholder's COVID-19-related business losses. *Dakota Girls, LLC v. Philadelphia Indem. Ins. Co.*, No. 21-3245 (6th Cir. Nov. 5, 2021). (Click here for full article)

California Appellate Court Affirms Dismissal Of Business Income And Civil Authority Coverage Claims

The first California appellate court held that a hotel operator was not entitled to insurance coverage for its COVID-19-related business losses. *The Inns by the Sea v. Cal. Mut. Ins. Co.*, 2021 WL 5298480 (Cal. Ct. App. 4th Dist. Nov. 15, 2021). (Click here for full article)

Missouri Jury Rules That Insurer Did Not Breach Contract By Denying Coverage For COVID-19 Claims

A Missouri jury found in an insurer's favor, finding that it did not breach an insurance policy by refusing to cover business losses incurred by the policyholder in the wake of government shutdown orders. *K.C. Hopps, Ltd. v. Cincinnati Ins. Co.*, No. 20-437 (W.D. Mo. Oct. 28, 2021). (Click here for full article)



D&O Alerts:

New York Court Of Appeals Rules That SEC Settlement Payment Is Not An Uninsurable Penalty

Reversing an intermediate appellate court decision, the New York Court of Appeals ruled that a $140 million settlement payment to the Securities and Exchange Commission ("SEC") was not an uninsurable penalty. *J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*, No. 61 (N.Y. Nov. 23, 2021).

The insurance dispute arose out of a settlement between the SEC and Bear Stearns & Co. Under the settlement, Bear Stearns agreed to pay $160 million as "disgorgement" and $90 million as a civil penalty in connection with deceptive trading claims. When Bear Stearns sought indemnification for $140 million of the disgorgement portion of the settlement (it did not seek coverage for $20 million of the payment), its insurers denied coverage on the basis that the disgorgement payment was uninsurable as a matter of public policy.

A New York trial court ruled that the disgorgement payment was a covered "loss" under the policy because it represented third-party gains. An appellate court reversed, ruling that the disgorgement payment was not a covered "loss," defined by the operative liability policy to exclude "fines or penalties imposed by law." (*See* September 2018 Alert). The appellate court relied on the United States Supreme Court's ruling in *Kokesh v. S.E.C.*, 137 S. Ct. 1635 (2017), which classified SEC disgorgement payments as penalties rather than losses in the context of a statute of limitations dispute.

This month, the New York Court of Appeals reversed, finding that the insurers failed to meet their burden of establishing that the $140 million payment was an excluded "penalty imposed by law." The court explained that a penalty is distinct from compensatory and punitive damages in that it is "not measured by the losses caused by the wrongdoing." Relying on the content of the communications between Bear Stearns and the SEC, including the valuations of investors' injuries, the court concluded that the record established that the payment "was calculated based on wrongfully obtained profits as a measure of the harm or damages caused by the alleged wrongdoing." The court contrasted the disgorgement payment from the $90 million penalty, "which was not derived from any estimate of harm or gain flowing from the improper trading practices."

Finally, the court rejected the appellate court's reasoning that the disgorgement payment must be considered a penalty under *Kokesh*. The court explained:

> *Kokesh* does not control here. Initially, the Supreme Court was not interpreting the term "penalty" in an insurance contract (much less one governed by New York law) and, as we have cautioned, the meaning of that term may vary based on context. Indeed, the Supreme Court has since clarified that SEC-ordered disgorgement is not always properly characterized as a penalty insofar as the SEC may seek "disgorgement" of a defendant's net gain for compensatory purposes as "equitable relief" in civil actions. Moreover, *Kokesh*—decided nearly two decades after the parties' executed the relevant insurance contracts—could not have informed the parties' understanding of the meaning of the term "penalty." (Citations omitted).

Virginia Court Rules That Bump Up Exclusion Does Not Bar Coverage For Underlying Settlements

A Virginia district court granted a policyholder's summary judgment motion, finding that a bump up exclusion did not unambiguously exclude coverage for underlying settlements and must therefore be construed narrowly in favor of coverage. *Towers Watson & Co. v. National Union Fire Ins. Co. of Pittsburgh, PA*, 2021 WL 4555188 (E.D. Va. Oct. 5, 2021).

Two suits were brought against the policyholder after it completed a corporate transaction. One suit alleged violations of the proxy solicitation rules of the Securities and Exchange Act and claimed that shareholders had received consideration lower than the true value of their shares based on omissions and misrepresentations in the proxy materials. The other, a consolidated shareholder derivative action, alleged breach of fiduciary duty based on the same factual allegations as the first suit. The insurers acknowledged that the actions were "Claims"

under the relevant policies and agreed to advance defense costs. However, they denied coverage for the underlying $90 million settlements, arguing that a bump up exclusion applied. The court disagreed and ruled in the policyholder's favor.

The exclusion 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 court concluded that ambiguity existed as to whether the transaction at issue, consummated through a merger, constituted an "acquisition" under the exclusion.

The 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." Moreover, the court explained that the structure of the transaction at issue—a "triangular merger involving a qualified stock purchase"—was "hardly comparable to the straightforward takeover of one company by another suggested by the Bump Up Exclusion." Finally, even though Virginia law governed the dispute, the court noted that Delaware corporate law recognizes a merger as a "distinct type of business combination, with procedural requirements and substantive law consequences dissimilar and distinct from other types of 'acquisition techniques' involving the transfer of stock or assets."

Coverage Alert:

Tenth Circuit Rules That TCPA Damages And Injunctive Relief Are Uninsurable Penalties Under Colorado Law

The Tenth Circuit affirmed a Colorado district court decision holding that an insurer had no duty to defend or indemnify claims that DISH Network violated the Telephone Consumer Protection Act ("TCPA") because relief under the statute constitutes an uninsurable penalty rather than covered damages. *Nat'l Union Fire Ins. Co. of Pittsburgh v. DISH Network, LLC*, 2021 WL 5066571 (10th Cir. Nov. 2, 2021).

The United States and several states sued DISH, alleging violations of the TCPA based on the company's solicitation calls to potential customers. The suits sought statutory damages and injunctive relief to prevent future violations. National Union sought a declaration that it had no duty to defend or indemnify the claims under its umbrella policies. A Colorado district court granted summary judgment to National Union and the Tenth Circuit affirmed.

The Tenth Circuit ruled that TCPA statutory damages are a "penalty" under Colorado law and thus uninsurable as a matter of Colorado public policy. In so ruling, the court relied on *ACE Am. Ins. Co. v. DISH Network, LLC* 883 F.3d 881 (10th Cir. 2018) (discussed in our March 2018 Alert), in which coverage for TCPA damages was similarly denied. The Tenth Circuit rejected DISH's assertion that *ACE* was abrogated by a Colorado Supreme Court decision which held that statutory relief for an unreasonable delay or denial of benefits is not a "penalty" for statute of limitations purposes and that the test for determining whether statutory relief is a "penalty" must be based on legislative intent rather than the common law test used in *ACE*.

In addition, the Tenth Circuit ruled that National Union had no duty to defend claims for prospective relief because its policies did not cover the costs of preventing future harms. The court expressly rejected DISH's contention that policy language covering expenses it was legally obligated to pay "by reason of liability imposed by law" encompassed the cost of preventing future harms.

Cyber Alert:

Reversing Trial Court, Ohio Appellate Court Rules That Ransomware Attack May Trigger Insurance Coverage

An Ohio appellate court ruled that a trial court erred in granting an insurer's summary judgment motion and that issues of fact existed as to whether a ransomware attack on the policyholder's computer system triggered coverage under a business owner's policy. *EMOI Services, LLC v. Owners Ins. Co.*, 2021 WL 5144828 (Ohio App. Ct. Nov. 5, 2021).

EMOI, a medical billing service provider, was the victim of a ransomware attack. EMOI ultimately paid the hacker and sought coverage from Owners. The insurer denied coverage, noting that a Data Compromise endorsement explicitly precluded coverage for ransomware payments and that an Electronic Equipment endorsement did not apply because it required "direct physical loss or damage." A trial court agreed and dismissed the suit. The trial court reasoned that there was no physical loss because even assuming that EMOI's software was damaged while it was encrypted by the hackers, it became fully functional once the ransom payment was made. The appellate court reversed.

The Electronic Equipment endorsement covered "direct physical loss of or damage to 'media.'" It defined "media" as "materials on which information is recorded such as film, magnetic tape, paper tape, disks, drums, and cards." It further stated that "media" includes "computer software and reproduction of data contained on covered media."

Viewing the evidence in a light most favorable to EMOI, the court ruled that the company's computer servers may be considered "media" under the policy 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." In particular, the court noted that the record established that portions of the software remained unusable even after decryption.

The court rejected Owners' contention that software and data "have no physical existence and thus are not susceptible to physical loss or damage." The court emphasized that the policy did not include the term "tangible" in referring to physical loss and deemed that omission significant. It also relied on *Nat'l Ink & Stitch, LLC v. State Farm Auto Prop. & Cas. Ins. Co.*, 435 F. Supp.3d 679 (D. Md. 2020) (discussed in our January 2020 Alert), in which the court ruled that the loss of data and impairment of a computer system resulting from a ransomware attack constituted direct physical loss where the policy listed "data" as a category of covered property and used the term "software" in a coverage provision heading.

Notice Alert:

Absent Prejudice, Insurer May Not Deny Coverage Under Claims-Made Policy Where Notice Was Late, But Within Policy Period, Says New Hampshire Court

Addressing a matter of first impression under New Hampshire law, a federal district court ruled that an insurer may not deny coverage under a claims-made policy where notice was late, but within the policy period, and the insurer did not suffer prejudice from the delay. *TRT Dev. Co., Inc. v. ACE Am. Ins. Co.*, 2021 WL 4777240 (D.N.H. Oct. 13, 2021).

A hotel discovered an oil leak near its fuel storage tank, and promptly contacted local authorities. However, the hotel did not notify its insurer until twenty-two days later, which was within the policy period, but not within the seven-day notice period applicable to a "storage tank incident." The insurer denied coverage based on the insured's failure to comply with the seven-day notice provision. In ensuing litigation, the court granted the hotel's summary judgment motion, predicting that the New Hampshire Supreme

Court would require an insurer to show prejudice where, as here, notice is late under a time-specific provision, but within the policy period.

The court distinguished cases in which insureds failed to provide notice under a claims-made policy within the policy period, explaining that prejudice is not required in those scenarios because doing so "effectively expands the policy's grant of coverage." In contrast, here "ACE had yet to 'close the books' on the Policy because the policy period was still in effect when the incident was reported" and thus "excusing late notice would not rewrite a fundamental term of the insurance contract and expand the scope of coverage."

As the court noted, decisions in other jurisdictions are mixed. While some courts have held that a claims-made insurer must establish prejudice when an insured notifies it of a claim within the policy period but outside a time period specified in the policy, others have refused to apply a notice-prejudice rule under such circumstances.

Filed-Rate Alert:

Wisconsin Court Rules That Filed-Rate Doctrine Bars All Claims Against Long-Term Care Insurer

Last month's Alert reported on a Washington Supreme Court decision holding that the filed-rate doctrine can bar suits against intermediaries who do not file rates. That decision emphasized the broad scope of the doctrine to any claim for which damages are based on a filed rate. This month, a Wisconsin district court applied the doctrine to bar class action claims alleging breach of contract, breach of the covenant of good faith and fair dealing and common law fraud. *French v. Northwestern Mut. Life Ins. Co.*, 2021 WL 5162646 (E.D. Wisc. Nov. 5, 2021).

The plaintiff class consisted of individuals who had purchased long-term care policies from Northwestern. The policy stated that it was "guaranteed renewable for life upon timely payments of premiums for the life of the Insured and can neither be cancelled nor have its terms, other than premiums, changed by the Company. Premiums may be changed by class." In 2016, Northwestern filed a request with the Texas Department of Insurance ("TDI") for an average premium rate increase of 86 percent. The TDI approved a 62 percent average rate increase and Northwestern subsequently implemented that increase in accordance with a plan provided to the TDI. Thereafter, plaintiffs sued, alleging that the substantial increase was part of a scheme to "drive policyholders off their plans" after many years of premium payments and thus relieve Northwestern of its duty to provide contractual benefits.

The court dismissed the suit, ruling that under Texas law, the filed-rate doctrine warranted dismissal of all claims. In particular, the court explained that the TDI's approval of Northwestern's rate increase, as well as its continued oversight of the implementation of rate increases, is precisely the type of regulatory conduct that triggers the filed-rate doctrine. The court rejected the plaintiffs' contention that the filed-rate doctrine does not apply where, as here, an insurer allegedly misled regulators about policy terms, noting that the "doctrine is not subject to equitable considerations." Similarly, the court held that even if the plaintiffs were not directly challenging the rates themselves, but rather Northwestern's allegedly illicit behavior that precipitated those rates, the filed-rate doctrine nonetheless applied.

COVID-19 Alerts:

Sixth Circuit Rejects Coverage Claim Under Communicable Disease Provision

The Sixth Circuit ruled that a communicable disease and water-borne pathogen provision did not provide coverage for a policyholder's COVID-19-related business losses. *Dakota*

Girls, LLC v. Philadelphia Indem. Ins. Co., No. 21-3245 (6th Cir. Nov. 5, 2021).

Dakota, a private preschool company, sought coverage for losses incurred during the government shutdown period under four policy provisions: (1) business and personal property; (2) business income; (3) civil authority; and (4) communicable disease and water-borne pathogens. An Ohio district court dismissed the suit and Dakota appealed. While the appeal was pending, the Sixth Circuit issued a decision foreclosing coverage under the first three provisions. *See Santo's Italian Café v. Acuity Ins. Co.*, 15 F.4th 398 (6th Cir. 2021) (discussed in our September 2021 Alert). The sole remaining issue in the present appeal was whether the communicable disease and water-borne pathogen provision provided coverage. The Sixth Circuit ruled that it did not.

The provision covered loss resulting from a government shutdown "due directly to an outbreak of a communicable disease or water-borne pathogen that causes an actual illness at the described premises." Dakota argued that this provision had "two distinct triggers" for coverage—either any communicable disease-related shutdown order (regardless of actual illness at insured premises), or an order due directly to a water-borne pathogen that causes an actual illness at the insured premises. The court deemed this interpretation unreasonable, noting that Dakota "never explains, much less convincingly so, why the drafters would have made one coverage trigger super-broad and the other super narrow." Instead, the court ruled that the provision required Dakota to plausibly plead an "actual illness" at the insured premises from either a communicable disease or water-borne pathogen. Because Dakota made no such allegations, the court held that there could be no coverage.

Alternatively, the Sixth Circuit held that even if Dakota alleged "actual illness," its claims would nonetheless fail because it did not plead that the statewide shutdown order was "due directly" to an outbreak at its schools.

In recent months, federal appellate courts in the Eighth, Ninth and Eleventh Circuits have similarly upheld district court dismissals of COVID-19 coverage suits. Appeals are currently pending in the First, Second, Fifth, Seventh and Tenth Circuits.

California Appellate Court Affirms Dismissal Of Business Income And Civil Authority Coverage Claims

The first California appellate court held that a hotel operator was not entitled to insurance coverage for its COVID-19-related business losses. *The Inns by the Sea v. Cal. Mut. Ins. Co.*, 2021 WL 5298480 (Cal. Ct. App. 4th Dist. Nov. 15, 2021).

The hotel operator sought coverage for business losses incurred after the state issued various shutdown orders aimed at slowing the spread of COVID-19. The insurer denied coverage based on the lack of "direct physical loss of or damage to" property. A trial court dismissed the claims and the appellate court affirmed.

The appellate court held that the complaint did not allege that the hotel's operations were suspended because of direct physical damage to insured property. The court noted that the complaint was "vague" as to the actual presence of the virus on insured property, but held that even assuming that the complaint alleged (or could be amended to allege) that infected individuals were present at insured property, there would be no coverage. The court explained that the hotel's losses were caused by shut down orders issued in response to viral presence throughout several counties—not because the virus was present at the insured premises. The court stated:

> The lack of causal connection between the alleged physical presence of the virus on Inn's premises and the suspension of Inn's operation can best be understood by considering what would have taken place if Inns had thoroughly sterilized its premises to remove any trace of the virus after the Orders were issued. In that case, Inns would *still* have continued to

> incur a suspension of operations because the orders would *still* have been in effect and the normal functioning of society *still* would have been curtailed. . . . '[T]he property did not change. The world around it did.' (Citations omitted).

The court distinguished cases in which the presence of asbestos or harmful fumes was held to constitute direct physical damage, noting that those cases involved property that was uninhabitable or unusable because of a physical force on the premises, not because of orders aimed at general surrounding conditions.

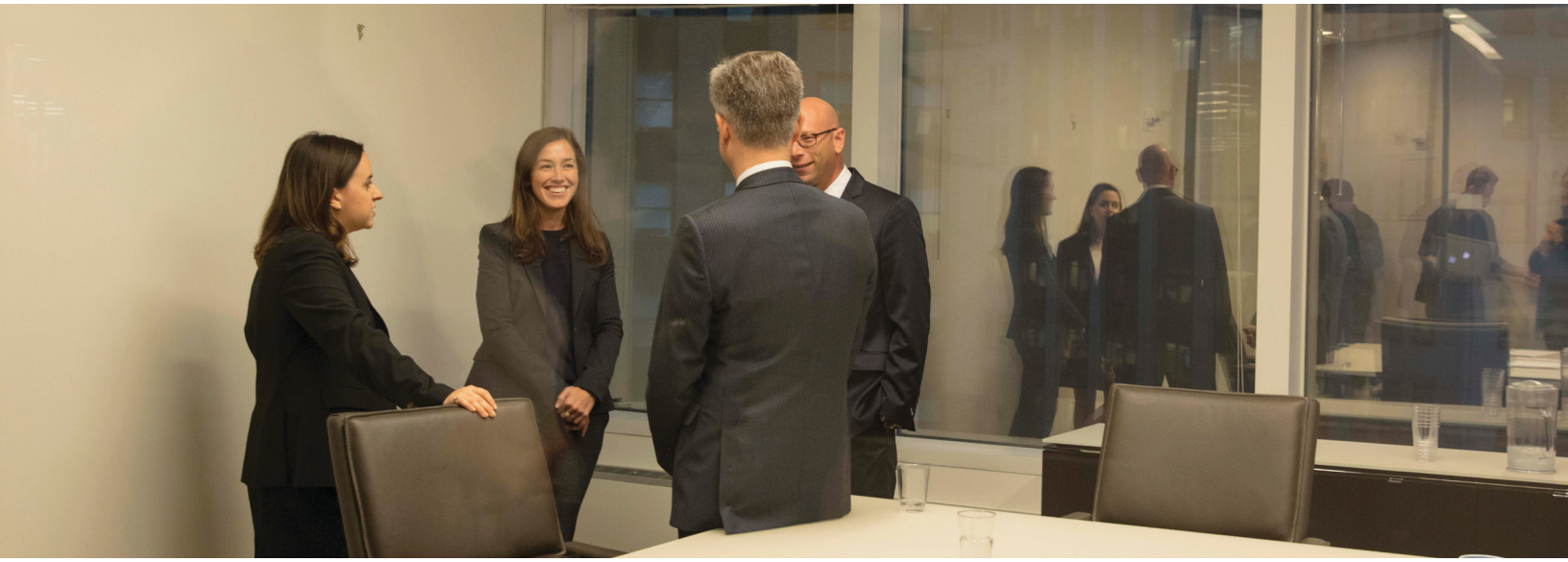
In addition, the court ruled that the hotel's operations were not suspended due to direct physical loss of insured property. A loss of use of property, standing alone, does not amount to a direct physical loss of property under common law or policy language, the court held.

The court expressly rejected the hotel's contention that the absence of a virus exclusion in the policy should be considered *prima facie* proof that the insurer intended to provide coverage for virus-related losses. The court explained that the absence of an exclusion cannot create ambiguity in otherwise clear policy language.

Finally, the court ruled that civil authority coverage was not available based on the absence of allegations of direct physical loss of or damage to property, other than the insured property. The court reasoned that the government orders were expressly issued to slow the spread of COVID-19, and not in response to any direct physical loss or damage at a particular location.

Missouri Jury Rules That Insurer Did Not Breach Contract By Denying Coverage For COVID-19 Claims

Our October 2021 Alert reported on a Missouri federal court decision that granted in part and denied in part an insurer's summary judgment motion in a suit seeking coverage for COVID-19-related business losses. *K.C. Hopps, Ltd. v. Cincinnati Ins. Co.*, 2021 WL 4302834 (W.D. Mo. Sept. 21, 2021). The court dismissed the policyholder's civil authority claims, but allowed the business income claims to proceed to trial, finding that there were issues of fact as to the existence of "direct physical damage" to insured property based on potential contamination of COVID-19. Last month, a jury found in the insurer's favor in this case, finding that it did not breach the policy by refusing to cover business losses incurred by the policyholder in the wake of government shutdown orders. *K.C. Hopps, Ltd. v. Cincinnati Ins. Co.*, No. 20-437 (W.D. Mo. Oct. 28, 2021).



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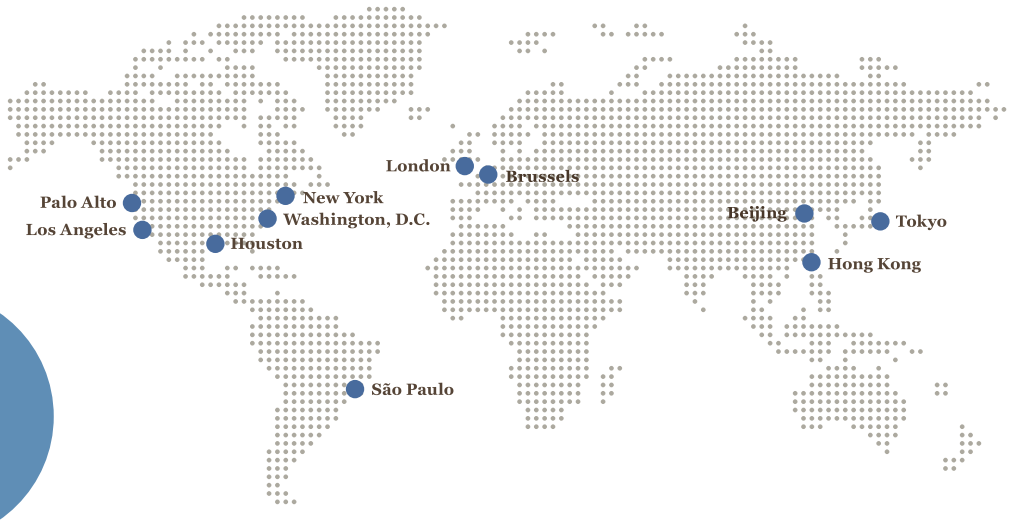

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