Simpson Thacher

Insurance Law Alert

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The Tenth Circuit and Georgia Court of Appeals ruled that an insurer was estopped from denying coverage based on its delay in reserving its rights. *Interstate Fire & Cas. Co. v. Apartment Management Consultants LLC*, 2020 WL 5049018 (10th Cir. Aug. 27, 2020); *Penn-America Ins. Co. v. Morgan Fleet Services Inc.*, 2020 WL 4726544 (Ga. Ct. App. Aug. 14, 2020). (Click here for full article)

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"[Simpson Thacher's] expertise ranges from direct insurance coverage of virtually all kinds, through to reinsurance matters and cases relating to insurance companies' business practices."

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The Eleventh Circuit ruled that each alleged theft of gas at a filling station constituted a separate occurrence subject to a separate deductible, notwithstanding that all thefts occurred due to the same computer malfunction. *Port Consolidated, Inc. v. International Ins. Co. of Hannover, PLC*, 2020 WL 5372281 (11th Cir. Sept. 8, 2020). (Click here for full article)

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An Illinois appellate court ruled that a general liability insurer had no duty to defend an engineering firm against a suit seeking damages for personal injuries allegedly caused by contaminated water, reasoning that the underlying claims did not allege accidental conduct. *General Casualty Co. of Wisconsin v. Burke Engineering Corp.*, 2020 WL 5514189 (Ill. Ct. App. Sept. 14, 2020). (Click here for full article)

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A California federal district court predicted that the California Supreme Court would decline to impose tort liability for a breach of the covenant of good faith and fair dealing in the reinsurance context. *California Capital Ins. Co. v. Maiden Reinsurance North America, Inc.*, 2020 WL 4018796 (C.D. Cal. July 16, 2020). (Click here for full article)

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Addressing a matter of first impression under New York law, a New York appellate court ruled that a bankruptcy exception to an "insured v. insured" exclusion applied to claims brought by a creditor trust against the bankrupt company's director and officers. *Westchester Fire Ins. Co. v. Schorsch*, 2020 WL 4905056 (N.Y. App. Div. 1st Dep't Aug. 20, 2020). (Click here for full article)

STB News Alerts

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COVID-19 Alert:

Growing Number Of Courts Dismiss Policyholders' Claims For Business Interruption Coverage

In recent weeks, courts in Florida, California, Michigan and Illinois have issued decisions in coverage cases involving alleged COVID-19-related losses, all of which resolved the disputes in the insurers' favor.

Two Florida federal district courts dismissed coverage claims for business losses arising out of government orders aimed at reducing the spread of COVID-19. In *Martinez v. Allied Ins. Co. of Am.*, 2020 WL 5240218 (M.D. Fla. Sept. 2, 2020), the court ruled that a virus exclusion expressly excluded such coverage. In ruling on the insurer's motion to dismiss, the court accepted as true the policyholder's allegation that his business incurred losses as a result of government orders that limited his ability to provide dental services during the pandemic. The court concluded that coverage was nonetheless unavailable based on an exclusion for loss or damage caused "directly or indirectly" by "[a]ny virus, bacterium or other microorganism that induces or is capable of inducing physical distress, illness or disease."

In *Malaube, LLC v. Greenwich Ins. Co.*, 2020 WL 5051581 (S.D. Fla. Aug. 26, 2020), the court dismissed a restaurant's COVID-19-related coverage claims based on a lack of "physical loss or damage" to property. The restaurant alleged that state emergency orders limited its use of its facilities, resulting in significant business losses. The court deemed this allegation insufficient to satisfy the "physical loss or damage" requirement, rejecting contentions that physical loss does not require structural alteration and may encompass loss of use. Emphasizing the absence of allegations of physical harm or the presence of COVID-19 on the premises, the court noted that "the restaurant merely suffered economic losses—not anything tangible, actual, or physical." Finally, the court held that even accepting the restaurant's argument that physical loss or damage could include property that is substantially unusable, coverage would still be unavailable because the restaurant continued to operate takeout and delivery services during the relevant time period.

Four federal district courts in California likewise rejected policyholders' claims for coverage based on COVID-19-related losses. In *10E, LLC v. Travelers Indem. Co. of Conn.*, 2020 WL 5359653 (C.D. Cal. Sep. 8, 2020), the court dismissed a restaurant's suit seeking coverage for COVID-19-related losses, finding that the complaint failed to allege "direct physical loss of or damage to property," as required by the policy's civil authority provision. The court reasoned that losses arising from an inability to use property do not constitute direct physical loss of or damage to property; physical loss or damage requires a "distinct, demonstrable, physical alteration." The court declined to address the applicability of a virus exclusion or whether the government orders "prohibit[ed] access" to the covered property, as required by the civil authority provision.

Finding the analysis and holding in *10E, LLC* persuasive and applicable, another California district court dismissed a suit seeking coverage for lost income allegedly caused by COVID-19-related government orders. *Pappy's Barber Shops, Inc. v. Famers Group, Inc.*, 2020 WL 5500221 (S.D. Cal. Sept. 11, 2020). In addition to ruling that the policyholder's complaint failed to allege "direct physical loss" as required by the business income, extra expense and civil authority provisions, the court also concluded that the government orders did not "prohibit access" to the insured property, a prerequisite to civil authority coverage. In so ruling, the court distinguished between a prohibition on the operation of business and a prohibition on access to a place of business.

A third California court dismissed a retailer's coverage suit. *Mudpie, Inc. v. Travelers Cas. Ins. Co. of Am.*, 2020 WL 5525171 (N.D. Cal. Sept. 14, 2020). Mudpie alleged that its compliance with government closure

orders resulted in substantial business losses because its storefront became "useless and/or uninhabitable." It sought coverage under civil authority, business income and extra expense provisions. Travelers denied coverage based on the lack of requisite "direct physical loss of or damage to" property and a virus exclusion, arguing that "direct physical loss" requires a "distinct, demonstrable, physical alteration of the property." The court rejected this interpretation, explaining that "direct physical loss of" property (as distinguished from "direct physical loss to" property) contemplates the "permanent dispossession of something." Nonetheless, the court ruled that Mudpie did not suffer direct physical loss of property because it was not permanently dispossessed of its storefront or inventory.

Additionally, the court rejected Mudpie's assertion that loss of functionality or access to property constitutes a direct physical loss of property. In so ruling, the court distinguished cases frequently cited by policyholders in this context, *see, e.g., Gregory Packing, Inc. v. Travelers Prop. Cas. Co. of Am.*, 2014 WL 6675934 (D.N.J. Nov. 25, 2014), emphasizing that decisions that equated loss of use with physical loss involved an "intervening physical force which 'made the premises uninhabitable or entirely unusable.'" The court noted that its conclusion was supported by a policy provision excluding coverage for "loss or damage caused by or resulting from . . . loss of use or loss of market." The court also distinguished *Studio 417, Inc. v. Cincinnati Ins. Co.*, 2020 WL 4962385 (W.D. Mo. Aug. 12, 2020) (discussed in last month's Alert), which, unlike the present case, involved allegations that COVID-19 particles were present on and caused damage to property.

Finally, the court held that civil authority coverage was unavailable because Mudpie failed to "establish the 'requisite causal link between damage to adjacent property and denial of access' to its store." The court explained that the government orders were preventative in nature, and were not based on any alleged damage to adjacent property.

In *Plan Check Downtown III, LLC v. AmGuard Ins. Co.*, No. 2:20-cv-06954 (C.D. Cal. Sept. 15, 2020), the court dismissed with prejudice a restaurant's complaint against its property insurer seeking business interruption coverage, rejecting the assertion that "physical loss of or damage to property" could include changes in what activities can occur in the restaurant's space. Reasoning that this interpretation would be a "major expansion of insurance coverage," the court sided with the "[w]eight of California law" in holding that some tangible alteration is required in order to satisfy the "physical loss of or damage to" requirement for coverage. AmGuard Insurance, Co. is represented by Simpson Thacher in this matter.

A Michigan federal district court similarly dismissed COVID-19 coverage claims in *Turek Enterprises, Inc. v. State Farm Mutual Auto. Ins. Co.*, 2020 WL 5258484 (E.D. Mich. Sept. 3, 2020). A chiropractic office, suing State Farm on behalf of itself and all others similarly situated, sought coverage for business losses incurred in the wake of government-mandated closures and restrictions. The policyholder did not allege that the virus was present on the covered premises, but asserted that it lost income when it suspended operations in compliance with government orders. State Farm denied coverage based on the lack of "direct physical loss." The court ruled that the undefined term "direct physical loss" was unambiguous, required tangible damage and did not encompass loss of use of property. The court distinguished *Studio 417*, which involved allegations that COVID-19 particles were present on and caused damage to property and different policy language ("accidental physical loss or accidental physical damage").

Additionally, the court rejected the policyholder's assertion that it sustained tangible loss because of alleged deterioration during the several months that its business was suspended, including the expiration of medication and depreciation of assets.

Finally, the court ruled that even if the policyholder had alleged direct physical loss, coverage would still be precluded by a virus exclusion. In so ruling, the court rejected the policyholder's contention that the government orders, rather than the virus, were the proximate cause of the alleged losses. The court stated: "Plaintiff's position essentially disregards the Anti-Concurrent Causation Clause, which extends the Virus Exclusion to all losses where a virus is part of the causal chain." The court also noted that actual viral contamination was not required by the exclusion, emphasizing that the exclusionary language applies to any "[v]irus, bacteria or other microorganism that induces or is capable of inducing physical distress, illness, or disease."

Citing to several of the aforementioned rulings, An Illinois federal district court dismissed a dentist's suit seeking business interruption and civil authority coverage. *Sandy Point Dental, PC v. The Cincinnati Ins. Co.*, No. 20 CV 2160 (N.D. Ill. Sept. 21, 2020). The court deemed the absence of allegations of "demonstrable physical alternation to the property" fatal to its coverage claims given the policy's "direct physical loss" requirement. Further, the court noted that civil authority coverage was unavailable for the independent reason that access to the insured premises was never "prohibited."

Property Policy Alert:

Cleaning Expenses Do Not Satisfy "Direct Physical Loss" Requirement, Says Eleventh Circuit

In a decision that reaffirms the reasoning and holdings in the aforementioned COVID-19 coverage cases, the Eleventh Circuit ruled that a restaurant was not entitled to coverage for cleaning expenses or lost revenue related to nearby construction because it failed to allege "direct physical loss" as required by the policy. *Mama Jo's Inc. v. Sparta Ins. Co.*, 2020 WL 4782369 (11th Cir. Aug. 18, 2020).

Mama Jo's restaurant sought coverage under an all-risk policy issued by Sparta for losses arising from nearby road construction. The restaurant claimed that dust and debris generated by the construction migrated into the restaurant, which necessitated daily cleaning. Although the restaurant did not cease operations during construction, it asserted that customer traffic decreased during the period of construction. Sparta denied the claim, citing a lack of requisite "direct physical loss." In ensuing litigation, the restaurant identified additional categories of damage, including its roof systems, awning, audio and lighting systems and HVAC repairs. It relied on three experts to establish causation between the newly-claimed damages and the construction.

A Florida district court granted Sparta's motion to preclude the expert testimony, finding that their methodologies were "unreliable or nonexistent, and that their testimony was speculative." Absent that testimony, the court concluded that Mama Jo's could not establish causation between the construction and the newly-claimed damages. The district court also ruled that the claim for cleaning was properly denied, stating that "property that must be cleaned, but is not damaged, has not sustained a 'direct physical loss.'" Additionally, the court ruled that the loss stemming from lower-than-expected sales was not covered because the restaurant did not suffer a "necessary 'suspension'" of its operations as a result of a "direct physical loss," as required by the business income loss provision. The Eleventh Circuit affirmed.

The Eleventh Circuit rejected the restaurant's assertion that direct physical loss encompasses property that is uninhabitable or unusable, noting that under Florida law, physical loss contemplates an "actual change in insured property." With respect to the business loss claim, the Eleventh Circuit held that even assuming the restaurant had established a "suspension" of its operations because it closed down sections of the premises for cleaning, the claim nonetheless failed due to a lack of requisite direct physical loss.

Estoppel Alert:

Two Courts Rule That Delayed Reservation Of Rights Results In Waiver Of Coverage Defense

The Tenth Circuit ruled that an insurer was obligated to indemnify a punitive damages award notwithstanding a punitive damages exclusion, finding that the insurer was estopped from denying coverage based on its delay in reserving its rights. *Interstate Fire & Cas. Co. v. Apartment Management Consultants LLC*, 2020 WL 5049018 (10th Cir. Aug. 27, 2020).

An apartment tenant sued her landlord and its management company (the "Defendants") after sustaining carbon monoxide injuries. The suit sought compensatory and punitive damages. Interstate, the Defendants' primary and excess insurer, assumed the defense of this suit. Approximately eighteen months later (and one month after Defendants' summary judgment motion was denied in the underlying suit), Interstate sought to reserve its right to disclaim coverage for punitive damages based on a punitive damages exclusion in the primary policy. The Defendants argued that Interstate was estopped from relying on the exclusion based on its unconditional assumption of the defense and delay in reserving its rights. A Wyoming federal district court agreed and granted the Defendants' summary judgment motion. The Tenth Circuit affirmed.

The Tenth Circuit emphasized that Interstate was on notice that the underlying suit sought punitive damages, but failed to reserve its right to deny coverage on that basis until eleven days before the trial commenced. In addition, the court noted the failure of insurer-appointed counsel to "mount a full-bore assault on the claims for punitive damages under Wyoming law, which creates significant obstacles for obtaining a punitive damages award." The court concluded that these actions resulted in prejudice to the Defendants.

Further, the court ruled that coverage was triggered under Interstate's excess policy, which followed form to the primary policy. The court reasoned that Interstate was "legally obligated to pay" the punitive damages award under the primary policy by virtue of equitable estoppel. As such, the excess policy, which applied to sums that that the insured "becomes legally obligated to pay as damages after the primary policy of insurance has been exhausted," was triggered. Refusing to enforce the punitive damages exclusion, the court stated:

> Allowing a retrograde application of the Primary Policy's punitive damages exclusion to cancel the clear coverage obligations of the Excess Policy to pay [the Defendants'] "ultimate net loss" above the Primary Policy's aggregate limit would be inconsistent with the provisions of the Excess Policy that explicitly agreed to provide such coverage.

The Court of Appeals of Georgia similarly granted summary judgment to policyholders, finding that an insurer was estopped from seeking to void the policy based on misrepresentations because of a delay in issuing a reservation of rights. *Penn-America Ins. Co. v. Morgan Fleet Services Inc.*, 2020 WL 4726544 (Ga. Ct. App. Aug. 14, 2020).

A bus driver sued Morgan Fleet Services ("MFS") after she was injured exiting a bus that had caught fire. Penn-America, MFS's insurer, notified outside counsel that it would defend under a reservation of rights and that a "letter w[ould] be forwarded shortly." Six months later, Penn-America issued an email reserving its right to withdraw from the defense in the future and to "assert additional defenses to any claims for coverage in the future as may be necessary or appropriate." The letter also noted that in its policy application, MFS identified its business as seat cover installation and failed to indicate its bus inspection services, the conduct upon

which the underlying lawsuit was based. Penn-America therefore expressly reserved its right to rescind or void the policy based on that misrepresentation.

In ensuing litigation, Penn-America and MFS cross-moved for summary judgment. Penn-America sought to void the policy and MFS argued that Penn-America was estopped from asserting non-coverage based on its assumption of the defense without effective notification of its reservation of rights. A Georgia trial court ruled in MFS's favor and the appellate court affirmed.

The appellate court concluded that Penn-America's reservation of rights was insufficient to avoid waiver. The court explained that shortly after it agreed to defend, Penn-America noted (in an email to outside counsel) that it "was aware of and investigating the potential for non-coverage" based on the inconsistencies between the application information and the allegations in the underlying complaint as to the nature of MFS's business. The court reasoned that this email was "only a statement of future intent" to send a reservation of rights at a later date and was thus not "an actual reservation of rights." Moreover, the court emphasized that the actual reservation of rights was not sent until six months later. As a result, the court concluded that Penn-America waived the defense of non-coverage.

Filed-Rate Doctrine Alert:

Invoking Filed-Rate Doctrine, Third Circuit Dismisses Force-Placed Insurance Claims Against Mortgage Company

Affirming a New Jersey federal district court decision, the Third Circuit ruled that force-placed insurance claims alleging fraud, unjust enrichment and violations of state and federal statutes were barred by the filed-rate doctrine. *Leo v. Nationstar Mortgage LLC of Delaware*, 964 F.3d 213 (3d Cir. 2020).

Borrowers alleged that Nationstar, their reverse mortgage lender, colluded with an insurance company and agent to receive kickbacks on force-placed insurance policies. They claimed that the insurer inflated the rate filed with state regulators in order to return a portion of the profits to Nationstar to induce Nationstar's continued business. The complaint alleged violations of state and federal law, as well as unjust enrichment, breach of contract and the implied covenant of good faith and fair dealing.

The Third Circuit ruled that the filed-rate doctrine blocks these claims because the complaint sought damages based on an alleged overcharge of a rate that was filed with regulatory agencies. The court stated: "we reiterate that the filed-rate doctrine brooks no distinction between, on one hand, challenging a filed rate as unreasonable and, on the other hand, challenging an overcharge fraudulently included in a filed rate." As discussed in previous Alerts, several other courts have dismissed suits against mortgage service providers based on the filed-rate doctrine and have declined to create a fraud exception to the doctrine. *See* October 2018 Alert; September 2015 Alert; May 2011 Alert; October 2010 Alert.

Number Of Occurrences Alert:

Eleventh Circuit Rules That Each Alleged Act Of Theft Constitutes A Separate Occurrence For Purpose Of Applying Deductibles

The Eleventh Circuit ruled that each alleged theft of gas at a filling station constituted a separate occurrence subject to a separate deductible, notwithstanding that all thefts occurred due to the same computer malfunction. *Port Consolidated, Inc. v. International Ins. Co. of Hannover, PLC*, 2020 WL 5372281 (11th Cir. Sept. 8, 2020).

Port Consolidated, Inc., a fuel distribution company, operates a cardlock facility in which only authorized customers with preexisting contractual relationships can pump gasoline and diesel fuel. Customers use "CFN" cards at the filling station and can request restrictions on the cards, such as limits on the gallons of fuel or frequency of transactions. Such restrictions are "pegged" to the CFN card so that the facility's computer system can

enforce them. Port discovered an incorrectly programmed setting on its fuel pumps that failed to enforce a fuel limitation request by Allied Trucking, one of its customers. The incorrect setting allowed Allied's drivers to exceed the 75-gallon limit that should have been in place by up to an extra 100 gallons, despite Allied only being invoiced for 75 gallons per transaction. According to Port, Allied's drivers engaged in thousands of fuel transactions and intentionally exploited the error to steal fuel. When Allied refused to pay the difference, Port sought coverage under a general liability policy issued by Hannover.

In the ensuing coverage dispute, Hannover argued that each alleged theft was a separate occurrence that did not exceed the $1000 deductible in the policy. A Florida district court agreed and granted Hannover's summary judgment motion. The Eleventh Circuit affirmed, rejecting Port's assertion that all of its losses should be construed as a single occurrence pursuant to a definition included in policy endorsements. The term "occurrence" is not defined in the general definitions section of the policy, but in three sections of a supplemental coverage endorsement, it is defined to include "a series" of unauthorized actions or uses. Port argued that the supplemental coverage definitions should be applied to the policy as a whole, or alternatively, established ambiguity. Dismissing these arguments, the court concluded that under Florida law, the undefined term "occurrence" is unambiguous and is determined by "the immediate injury-producing act." Further, the court emphasized that each alleged theft was an act "separated and distinguishable in 'time and space.'" Because no single fuel theft exceeded the $1000 deductible, the court concluded that Port was not entitled to coverage under the policy.

Excess Alert:

Excess Insurer May Not Challenge Payment Decisions Of Underlying Insurers, Says Ninth Circuit

Reversing a district court decision, the Ninth Circuit dismissed an "improper exhaustion" claim, ruling that an excess insurer may not challenge the payment decisions of underlying insurers absent a showing of fraud or bad faith, or the reservation of such a right in the governing policy. *AXIS Reinsurance Co. v. Northrop Grumman Corp.*, 2020 WL 5509743 (9th Cir. Sept. 14, 2020).

Two lawsuits were filed against Northrop alleging ERISA violations, one by the Department of Labor ("DOL" action) and the other on behalf of the ERISA plan ("Grabek" action). Northrop settled both actions and then sought coverage from insurers in its multi-layered program of insurance. AXIS provided secondary excess coverage that "dropped down" when the combined $30 million limit of the underlying policies was exhausted for "covered loss" under those policies. National Union, a primary insurer, and CNA, a first-level excess insurer, both determined that the DOL settlement fell within coverage of their policies and therefore indemnified the settlement payment. Because CNA's partial payment did not fully exhaust its liability limit, AXIS was not required to pay any portion of the DOL settlement. However, because the DOL exhausted National Union's primary coverage, CNA covered the Grabek settlement as primary insurer. That payment exhausted CNA's liability limits. Therefore, AXIS was called upon to pay the remainder of the Grabek settlement—approximately $9.7 million.

AXIS did not contest coverage of the Grabek settlement under its policy, but sought reimbursement of the DOL settlement on the basis that the payments made for that settlement by National Union and CNA were not for "covered loss." In particular, AXIS argued that the DOL settlement payment constituted disgorgement, which is uninsurable under California law and an "uncovered loss" under the underlying policies. AXIS filed a declaratory judgment action against Northrop, seeking reimbursement of its payment. A California

district court ruled in AXIS's favor, endorsing AXIS's "improper erosion" theory of recovery.

The Ninth Circuit reversed, finding no basis in case law or policy language for the improper erosion theory. Further, the Ninth Circuit reasoned that allowing excess insurers to contest the soundness of underlying insurers' payment decisions "would undermine the confidence of both insureds and insurers in the dependability of settlements" and "introduce a host of inefficiencies into the insurance industry."

Importantly, the court noted that an excess insurer remains free to contest claims submitted to it during the claims adjustment process, even if an underlying carrier has determined that the same claim constitutes a "covered loss." Additionally, excess carriers may dispute payments on the basis of alleged fraud or bad faith. However, absent a specific contractual provision, an excess insurer "may not second-guess other insurers' payments of earlier claims without first showing that those payment were motivated by fraud or bad faith."

Coverage Alert:

Finding No Allegations Of "Accidental" Conduct, Illinois Appellate Court Rules That Insurer Has No Duty To Defend Engineering Firm In Contaminated Water Suit

An Illinois appellate court ruled that a general liability insurer had no duty to defend an engineering firm against a suit seeking damages for personal injuries allegedly caused by contaminated water, reasoning that the underlying claims did not allege any accidental conduct. *General Casualty Co. of Wisconsin v. Burke Engineering Corp.*, 2020 WL 5514189 (Ill. Ct. App. Sept. 14, 2020).

Burke provided water engineering and consultation services to the Village of Crestwood. When residents discovered that their drinking water was drawn from a contaminated well, rather that Lake Michigan, as represented by Crestwood officials, they brought suit. The complaint alleged claims for statutory and common law fraud, civil conspiracy and negligence. All of the claims against Burke were dismissed, except for civil conspiracy to commit fraud. Burke's professional liability insurer agreed to defend, but General Casualty, Burke's general liability insurer, denied coverage. General Casualty argued that the underlying claims alleged only intentional conduct, which did not constitute an "occurrence" under the policy. An Illinois trial court agreed and granted General Casualty's summary judgment motion. The appellate court affirmed.

Crestwood residents, as assignees of Burke's rights under the policy, argued that the underlying allegations potentially fell within the scope of coverage because the complaint alleged that Burke was negligent in breaching its fiduciary duty to inform the public about the contaminated water. Although that count was dismissed, the residents claimed that recovery was still possible because amended complaints preserved negligence claims for appeal and because they intended to amend the complaint to allege negligence based on statutory violations. Rejecting these assertions, the court explained that the factual allegations in the complaint included only intentional conduct on the part of Burke and did not allege any "unforeseen occurrence." Additionally, the court held that any potential negligence cause of action would be irrelevant, explaining that a "court looks at the actual factual allegations, not the label."

Finally, the court rejected the residents' contention that facts outside the complaint triggered General Casualty's duty to defend. The court held that correspondence between General Casualty and Burke did not establish the insurer's acknowledgement of coverage. Further, the insurer's supposed knowledge that the residents intended to pursue common law negligence claims on appeal was insufficient to trigger its defense obligations.

Reinsurance Alert:

California Court Rules That Reinsureds May Not Recover Tort Damages For Breach Of Good Faith And Fair Dealing

A California federal district court predicted that the California Supreme Court would decline to impose tort liability for a breach of the covenant of good faith and fair dealing in the reinsurance context. *California Capital Ins. Co. v. Maiden Reinsurance North America, Inc.*, 2020 WL 4018796 (C.D. Cal. July 16, 2020).

California Capital sued its reinsurer, Maiden, alleging breach of contract and the covenant of good faith and fair dealing. California Capital alleged that Maiden refused to pay valid claims and demanded return of previous payments for covered claims, among other things. Maiden moved to dismiss the breach of good faith cause of action on the basis that reinsureds may not recover tort damages for such claims under California law. The court agreed and dismissed the cause of action to the extent it sought to recover tort (rather than contractual) damages.

Although the California Supreme Court has strictly limited tort recovery for the breach of the duty of good faith and fair dealing for contract-based disputes, it has allowed such recovery in the context of insurance disputes. California Capital asserted that "because reinsurance is a form of insurance, tort remedies should be available in the reinsurance context." Rejecting this contention, the court emphasized the distinction between the policyholder-insurer relationship and the reinsured-reinsurer relationship. In particular, the court reasoned that a breach of a reinsurance contract does not violate the same social policies as a breach of an insurance contract because insurance contracts are typically "marked by elements of adhesion and unequal bargaining power," whereas reinsurance contracts are not. Further, the court explained that reinsurers do not have the same fiduciary duties that insurers do.

The also court dismissed California Capital's claims for attorneys' fees and statutory penalties, finding them unsupported by law and the allegations in the complaint. However, the court declined to strike the breach of the covenant of good faith and fair dealing cause of action to the extent it seeks contractual damages. The court reasoned that the bad faith conduct alleged in the complaint went beyond mere contractual breaches sufficient to withstand a motion to dismiss.

D&O Alert:

New York Appellate Court Rules That Bankruptcy Exception To "Insured v. Insured" Exclusion Restores Coverage For Claims Brought By Creditor Trust

Addressing a matter of first impression under New York law, a New York appellate court ruled that a bankruptcy exception to an "insured v. insured" exclusion applied to claims brought by a creditor trust against the bankrupt company's director and officers. *Westchester Fire Ins. Co. v. Schorsch*, 2020 WL 4905056 (N.Y. App. Div. 1st Dep't Aug. 20, 2020).

In the wake of a financial scandal and a stock price plummet, RCS Capital Corp. negotiated a restructuring support agreement ("RSA") with its unsecured creditors and thereafter filed for bankruptcy. The RSA provided for the creation of a Creditor Trust to pursue the bankruptcy estate's legal claims on behalf of the unsecured creditors. When the Creditor Trust initiated claims against RCS Capital's directors and officers, Westchester Fire denied coverage on the basis of an insured v. insured exclusion, which bars coverage for "any Claim made against an Insured Person . . . by, on behalf of, or at the direction of the Company or Insured Person." The policy defines "Insured Person" as "any past, present, or future director or officer." The defendant insureds argued that coverage was restored by an exception to the exclusion, which applies to claims "brought by the Bankruptcy Trustee or Examiner of the Company or any assignee of such Trustee or Examiner, or any Receiver, Conservator, Rehabilitator, or Liquidator or comparable authority of the Company." A New York trial court deemed the language ambiguous and construed it in favor of coverage. *See* May 2019 Alert. The appellate court affirmed.

The appellate court held that the policy was ambiguous as to whether the Creditor Trust was a "comparable authority" under the exception to the exclusion. The court reasoned that

> by including the undefined and open-ended phrase "comparable authority" into the D&O policy's bankruptcy exception, the parties created a broadly applicable exception with no clear limiting principles other than that there should be no coverage where the D&O claims are prosecuted by the DIP or by individuals acting as proxies for the board or the company.

However, the appellate court vacated the lower court's grant of summary judgment to the defendant insureds on their claim for breach of contract as to coverage and its issuance of a declaration of coverage. The appellate court ruled that, although Westchester Fire was obligated to advance defense costs, material issues of fact remain as to the ultimate issue of coverage, including whether the individual defendant insureds engaged in wrongdoing in their personal, rather than official capacities, and whether the remedy sought in the Creditor Trust action constitutes uninsurable disgorgement payments.

STB News Alerts

Bryce Friedman was quoted in an article by *The Wall Street Journal* titled, "Insurance Firms Gain Early Lead in Coronavirus Legal Fight With Businesses." The article highlighted that, as courts begin to address the flurry of COVID-19 business-interruption coverage disputes, U.S. property insurers have recently won more judicial rulings than policyholders. In discussing trends in the early decisions, Bryce noted, "[t]he initial decisions indicate, on the whole, these cases can ultimately be resolved consistent with insurers' underwriting intent as reflected in the language of the policies." Bryce was also quoted in a *Reuters* article on the recent decision by the Judicial Panel on Multidistrict Litigation rejecting petitions for a nationwide, multi-district litigation proceeding to determine whether businesses that shut down in response to COVID-19 are entitled to insurance coverage based on claims of property damage or loss as a result of rules issued by civil authority. Bryce noted that this decision may mean that judges who were awaiting a decision on a potential MDL will move ahead to issue decisions on pending motions in individual cases quickly and that upcoming decisions will likely clarify the viability of policyholders' suits.

Mary Beth Forshaw and Lynn Neuner are among the six Simpson Thacher partners named among this year's "Top 250 Women in Litigation" by *Euromoney's Benchmark Litigation*. The feature honors the accomplishments of America's leading female litigators who have participated in some of the most impactful litigation matters in recent history and who have earned the respect of their peers and clients. *Benchmark* selects its honorees through extensive research, client feedback surveys and one-on-one interviews. In addition to being named to the "Top 250 Women in Litigation" list, Lynn was also recognized as a "Top 10 Female Litigator" in the United States.

Susannah Geltman and Craig Waldman were named to *Benchmark Litigation's* fifth annual "40 & Under Hot List." The feature honors the most notable up-and-coming litigation attorneys in the U.S. under the age of 40 and is based on extensive research and feedback from peers and clients.

Simpson Thacher

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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