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"If you have a major issue, an exceptionally high value or critical claim, Simpson is where you turn."

– The Legal 500
(quoting a client)

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In a pair of decisions, a North Carolina trial court ruled that underlying nuisance claims stemming from hog farm operations arose out of a single accident for insurance coverage purposes and that pro rata allocation was the appropriate method for determining each insurer's liability. *Murphy-Brown, LLC v. ACE American Ins. Co.*, 2023 NCBC LEXIS 93 (N.C. Super. Ct. Aug. 7, 2023); *Murphy-Brown, LLC v. ACE American Ins. Co.*, 2023 NCBC LEXIS 94 (N.C. Super. Ct. Aug. 7, 2023). (Click here for full article)

Policy Exclusions Do Not Bar Coverage For Opioid-Related Claims Against Pharmaceutical Distributor, Says North Carolina Court

A North Carolina district court granted a policyholder's summary judgment motion, ruling that contract and professional service exclusions in a claims-made policy did not bar coverage for underlying opioid-related claims. *North Carolina Mutual Wholesale Drug Co. v. Federal Ins. Co.*, 2023 U.S. Dist. LEXIS 147248 (M.D.N.C. Aug. 17, 2023). (Click here for full article)

Ninth Circuit Seeks Guidance From Alaska Supreme Court About Applicability Of Pollution Exclusion To Carbon Monoxide Claims

The Ninth Circuit asked the Alaska Supreme Court to decide whether a pollution exclusion bars coverage for claims arising out of carbon monoxide poisoning, a matter of first impression under Alaska law. *Estate of Wheeler v. Garrison Prop. & Cas. Ins. Co.*, 2023 U.S. App. LEXIS 23648 (9th Cir. Sept. 6, 2023). (Click here for full article)

Hawaii District Court Certifies Climate Change Coverage Question To Hawaii Supreme Court

HOLDING

A Hawaii district court asked the Hawaii Supreme Court to decide whether reckless conduct can be a covered "occurrence" under an insurance policy and whether greenhouse gases are pollutants within the meaning of a pollution exclusion. *Aloha Petroleum, Ltd. v. National Union Fire Ins. Co. of Pittsburgh, PA,* 2023 U.S. Dist. LEXIS 156211 (D. Haw. Sept. 5, 2023).

BACKGROUND

Two lawsuits against Aloha Petroleum and twenty other fossil fuel entities alleged that the defendants knew that their products created greenhouse gas pollution that resulted in harmful climate change and tangible harm to the plaintiff communities, but nonetheless continued to promote fossil fuel use. In this coverage action, Aloha Petroleum seeks a declaration that AIG has a duty to defend the underlying suits.

DECISION

The court explained that AIG's defense obligations turned on resolution of two issues: (1) whether the reckless conduct alleged in the complaint could constitute an "occurrence" under the operative policies; and (2) whether greenhouse gases are "pollutants" (defined as "gaseous" "irritant[s] or contaminant[s], including smoke, vapor soot, fumes acids, alkalis, chemicals and waste") for purposes of applying a pollution exclusion.

With respect to the first issue, Aloha Petroleum argued that an insured may engage in conduct that is reckless, while still lacking intent or expectation of injury, such that a covered "occurrence" (defined in part as an "accident") may be found. In contrast, AIG asserted that recklessness cannot be an "accident" because recklessness generally requires a risk of foreseeable harm that is disregarded by the tortfeasor.

As to application of the pollution exclusion, the court framed the central questions as whether the pollution exclusion applies only to "traditional environmental pollution" under Hawaii law, and if so, whether the production of greenhouse gases constitutes such "traditional environmental pollution."

COMMENTS

Because this dispute relates to AIG's duty to defend, the court's analysis will turn on a comparison of the allegations in the underlying complaint with the policy language. Here, the underlying suits expressly allege that the defendants had knowledge about the resulting harm of their products but continued to wrongfully market them. Such allegations arguably contravene any categorization of Aloha Petroleum's conduct as "accidental."

With respect to the pollution exclusion, even under a very narrow reading of the provision, it would seem incongruous to find that the release of harmful gases into the atmosphere does not fall within the scope of the plain language of the exclusion, particularly in light of a 2007 Supreme Court decision finding that greenhouse gases are "pollutants" under a provision of the Clean Air Act.

We will keep you posted on the Hawaii Supreme Court's ruling in this matter.

Noting Possible Distinction Between Acquisition And Merger Transactions, Delaware Court Deems Bump-Up Exclusion Ambiguous

HOLDING

A Delaware trial court granted a policyholder's motion for partial summary judgment, ruling that a bump-up exclusion was ambiguous and must be construed narrowly in favor of coverage. *Viacom Inc. v. U.S. Specialty Ins. Co.*, 2023 Del. Super. LEXIS 728 (Del. Super. Ct. Aug. 10, 2023).

BACKGROUND

In 2019, Viacom merged with CBS Corp. Pursuant to the merger agreement, Viacom ceased to exist as a corporation and all "assets, rights, privileges, powers and franchises" of Viacom vested in the surviving corporation, CBS. Additionally, all Viacom shares were converted into CBS common stock. Following this transaction, Viacom stockholders brought several lawsuits alleging breach of fiduciary duty against Viacom executives. In 2023, the suits were settled for approximately $122 million.

Viacom's D&O insurers denied coverage for the settlement, arguing that coverage was barred by a bump-up provision which stated that covered loss did not include: "[A]ny amount representing the amount by which the price of or consideration paid or proposed to be paid for the acquisition or completion of the acquisition of all or substantially all of the ownership interest in, or assets of, an entity, including a Company, was inadequate or effectively increased."

The court concluded that the exclusion was ambiguous with respect to the undefined term "acquisition" and therefore deemed it inapplicable.

DECISION

The court's ruling as to ambiguity turned primarily on its finding that merger and acquisition could be two distinct business transactions. The court noted that the language in other policy provisions relating specifically to mergers tracked the "acquisition" language contained in the bump-up exclusion, but also contained explicit reference to "or the merger or consolidation of the Company into or with another entity." The court reasoned that the absence of such references to merger in the bump-up exclusion raised doubt as to whether it was intended to apply only to acquisition transactions.

The court acknowledged that one reasonable interpretation of the exclusion was that it applied to the Viacom-CBS merger because that transaction resulted in CBS's acquisition of all Viacom's assets, rights, privileges and franchises, as well as an ownership interest in Viacom's subsidiaries. However, the court held that an equally plausible reading of the exclusion was that it applied exclusively to acquisitions, and not to merger transactions, such as the one at issue here. Having deemed the provision ambiguous, the court construed it in favor of coverage.

COMMENTS

As reported in our May 2023 Alert, the Fourth Circuit reached a contrary conclusion in *Towers Watson & Co. v. National Union Fire Ins. Co. of Pittsburgh, PA*, 67 F.4th 648 (4th Cir. 2023). There, the Fourth Circuit reasoned that the "ordinary and accepted meaning" of "acquisition" contemplates the gaining of possession or control over something and therefore encompassed the transaction at issue—a reverse triangular merger. 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." The *Viacom* court distinguished *Towers Watson* based on its application of Virginia, rather than Delaware, law.

Illinois Court Dismisses Some, But Not All, Causes Of Action Against Insurer Alleging Racial Discrimination In Claims Handling Practices Based On Artificial Intelligence Algorithms

HOLDING

An Illinois district court granted in part and denied in part an insurer's motion to dismiss a putative class action law suit alleging racial discrimination in claims handling practices based on the insurer's use of algorithmic decision-making tools. *Huskey v. State Farm Fire & Cas. Co.*, 2023 U.S. Dist. LEXIS 160629 (N.D. Ill. Sept. 11, 2023).

BACKGROUND

Black homeowners alleged that State Farm's use of certain algorithmic tools in its claims handling process resulted in discriminatory treatment. More specifically, Black homeowners alleged that State Farm took longer to process their claims, required additional paperwork and communication, and ultimately provided less coverage. The complaint alleged that these racial disparities stem from State Farm's use of "machine-learning algorithms," which consider race as one of many factors in predicting fraud and determining whether claims should be paid. The plaintiff homeowners alleged disparate impact race discrimination in violation of the Fair Housing Act ("FHA"), and also sought injunctive and declaratory relief, damages and attorneys' fees.

DECISION

The court dismissed two of the three FHA claims. Section 3604(a) of the FHA makes it unlawful to refuse to sell or rent, or otherwise make unavailable, a dwelling to any person because of race. The court ruled that plaintiffs' claims were not within the scope of this provision because the complaint did not allege actual unavailability of the homes, but rather only a lack of habitability and diminution in property value due to damage not being promptly covered by State Farm. Similarly, the court ruled that plaintiffs' allegations did not state a viable claim under Section 3605 of the FHA, which prohibits any "entity whose business includes engaging in residential real estate-related transactions" from discriminating based on race. Relying on a Seventh Circuit decision holding that insurers are not "entities who engage in covered transactions under [Section] 3605," the court dismissed the claim.

However, the court declined to dismiss a claim under Section 3604(b), which prohibits discrimination "in the terms, conditions, or privileges of sale or rental of a dwelling, or in the provision of services or facilities in connection therewith, because of race." The court explained that under the broad language of this provision, property insurance—in particular, claims handling operations—could plausibly constitute a service in connection with the sale of a home. Having reached that conclusion, the court addressed whether plaintiffs adequately alleged disparate impact. The court ruled that they did, based on the following three factors: (1) allegations of statistical disparities among a large cross section of insured homeowners, (2) State Farm's utilization of algorithmic decision-making tools to automate claim processing, and (3) a purported causal connection between the policy and statistical racial disparities.

Additionally, the court declined to dismiss the suit based on the doctrine of reverse-preemption. State Farm argued that the federal FHA claims were reversed-preempted by Illinois state law under the McCarran-Ferguson Act, which holds that federal laws of general application may not displace state laws that specifically relate to the business of insurance. State Farm argued that Illinois statutes relating to claims handling procedures

conflict with the FHA and therefore reverse preempt the federal statute. Rejecting this assertion, the court held that there was no conflict between state and federal law in this context and that application of the FHA would not disrupt Illinois's insurance-related administrative regime.

COMMENTS

Claims based on an insurance company's use of computers to assist human decision-making are not new. However, claims are likely to proliferate in the near term as the perceived consequences of the use of such tools become more obvious to consumers, employees or other individuals. With respect to the FHA, *Huskey* emphasized that "disparate-impact liability must have limits" and should not be based solely on a showing of statistical disparity; instead, such claims require "careful examination" of the company policies at issue and the existence (or lack thereof) of a causal connection between the policies and any statistical disparities.

North Carolina Court Finds That Nuisance Claims Arise From A Single Accident And Are Subject To Pro Rata Allocation Across Multiple Policy Periods

HOLDING

In a pair of decisions, a North Carolina trial court ruled that underlying nuisance claims stemming from hog farm operations arose out of a single accident for insurance coverage purposes and that pro rata allocation was the appropriate method for determining each insurer's liability. *Murphy-Brown, LLC v. ACE American Ins. Co.*, 2023 NCBC LEXIS 93 (N.C. Super. Ct. Aug. 7, 2023); *Murphy-Brown, LLC v. ACE American Ins. Co.*, 2023 NCBC LEXIS 94 (N.C. Super. Ct. Aug. 7, 2023).

BACKGROUND

Property owners sued a hog farm operator, alleging physical invasion and loss of use and enjoyment of property due to odor, dust, noise, pests and traffic stemming from the hog farm operations at multiple sites. According to the underlying complaint, the property owners suffered repeated exposure to conditions over an extended period of time, during which multiple insurance policies were in place. In two summary judgment motions, the court was asked to determine whether the claims in the underlying suits arose out of one accident or multiple accidents under business automobile policies, and whether allocation among various liability insurers should be based on pro rata time on the risk or an "all sums" method.

DECISION

The hog farm operator and a primary automobile insurer argued that there was only one "accident" under the operative policies because the alleged damages arose from the "centralized policies and procedures regarding the operation" of the farms, including their trucking operations. Conversely, excess insurers asserted that the underlying claims arose from 89 accidents, based on the operation of 89 separate farms and the accompanying trucks serving those farms. The operative language provided coverage for injuries or damage caused by an "accident" resulting from the ownership, maintenance or use of a covered automobile, and further stated that "[a]ll 'bodily injury,' 'property damage,' and 'covered pollution cost or expense' resulting from continuous or repeated exposure to substantially the same conditions will be considered as resulting from one 'accident.'"

Applying a proximate cause-based test, the court concluded that the alleged injuries and damages stemmed from a single accident. In so ruling, the court emphasized that the

injuries did not differ materially among the various farm sites and that conditions were "essentially the same in all material respects." More specifically, the court noted the existence of a centralized trucking operation, as outlined in a standard manual utilized by the hog farm operator.

With respect to allocation of indemnity costs, the court concluded that policy language indicated that liability among multiple insurers that issued policies during the period of alleged damage should be based on a pro rata time on the risk methodology. In particular, the policies limited recovery to bodily injury or property damage (or in the case of auto policies, accidents) that occurred "during the policy period."

The hog farm operator argued that "all sums" allocation should apply, under which it may recover the entirety of any loss from any single insurer that provided coverage during the ongoing period of damages. The hog farm operator relied on a "Continuing Coverage" provision included in certain policies, which stated that bodily injury or property damage that occurs during the policy period "includes any continuation, change or resumption of that bodily injury or property damage after the policy period." Rejecting this assertion, the court reasoned that the Continuing Coverage provision did not establish an obligation on the part of the insurer to be liable for "all sums" arising from liability during any policy period. Rather, the court held that the provision sets forth the "unremarkable" principle that a policy in effect when the damage occurs will cover all consequential damages, even those occurring after the policy period.

COMMENTS

The court's allocation ruling is notable in several respects. First, the court rejected the notion that a policy's inclusion of both "all sums" and "during the policy period" language creates ambiguity that should be construed in the policyholder's favor. Second, the court emphasized the "modern trend" of courts across jurisdictions in applying pro rata allocation, noting that "all sums" allocation represented an "outdated view" of relevant policy language. Finally, the court's refusal to construe the Continuing Coverage provision as a mandate for "all sums" allocation is a significant ruling for insurers in this context, as it draws a clear line between that type of policy clause and a non-cumulation clause, which has been a basis for applying "all sums" allocation in other cases, such as *In re Viking Pump*, 27 N.Y.3d 244 (2016), which the court expressly distinguished.

Policy Exclusions Do Not Bar Coverage For Opioid-Related Claims Against Pharmaceutical Distributor, Says North Carolina Court

HOLDING

A North Carolina district court granted a policyholder's summary judgment motion, ruling that contract and professional service exclusions in a claims-made policy did not bar coverage for underlying opioid-related claims. *North Carolina Mutual Wholesale Drug Co. v. Federal Ins. Co.*, 2023 U.S. Dist. LEXIS 147248 (M.D.N.C. Aug. 17, 2023).

BACKGROUND

Mutual Drug, a wholesale company that sold products to retail pharmacies, was sued in numerous lawsuits brought by municipalities, hospitals and individuals. The complaints alleged that Mutual Drug failed to monitor or investigate suspicious orders by pharmacies for prescription opioids, in violation of federal and state law and in breach of common law duties among other things. Chubb refused to indemnify Mutual Drug for its defense costs and liabilities on the basis of policy exclusions relating to contract and professional services. The court ruled that neither provision applied to the underlying claims.

DECISION

The contract exclusion applied to any claim "based upon, arising from or in consequence of any liability in connection with any oral or written contract or agreement." Chubb argued that this provision barred coverage because the underlying claims arose from liability in connection with Mutual Drug's wholesale distribution contracts with independent pharmacies. Rejecting this contention, the court held that the underlying claims arose from common law or regulatory duties, rather than those contracts. The court acknowledged the breadth of the exclusion, but explained that "[t]he fact that the claims arise out of the insured's business and that the insured uses contracts in its business is not enough."

Likewise, the court ruled that the professional services exclusion was inapplicable. While the policy defined "professional services" as "services which are performed for others for a fee," the court concluded that none of Mutual Drug's services could be categorized as "professional" regardless of whether it charged fees to independent pharmacies. In particular, the court explained that Mutual Drug's commercial distribution of tangible commodities does not constitute a professional service, "or indeed any service[ ] at all." The court rejected Chubb's contention that by conducting compliance reviews in connection with the sale of pharmaceutical products, it engaged in "services," emphasizing that those reviews were undertaken in compliance with federal, state, and local regulations for the sale of pharmaceuticals and not in exchange for a separate fee from customers.

COMMENTS

In the emerging area of opioid coverage litigation, most decisions have turned on whether the underlying claims alleged a covered "occurrence" (as opposed to knowing or intentional conduct) and/or covered "bodily injury" (as opposed to purely economic damages incurred by municipalities or other entities). The decision in this case addresses somewhat different issues of coverage in this context and illustrates the limits some courts may impose in construing certain policy exclusions.

Ninth Circuit Seeks Guidance From Alaska Supreme Court About Applicability Of Pollution Exclusion To Carbon Monoxide Claims

HOLDING

The Ninth Circuit asked the Alaska Supreme Court to decide whether a pollution exclusion bars coverage for claims arising out of carbon monoxide poisoning, a matter of first impression under Alaska law. *Estate of Wheeler v. Garrison Prop. & Cas. Ins. Co.*, 2023 U.S. App. LEXIS 23648 (9th Cir. Sept. 6, 2023).

BACKGROUND

The coverage dispute arose after a young man died from carbon monoxide poisoning while living in the home of the policyholders. When the decedent's estate sued the homeowners, the homeowners filed an insurance claim. The insurer denied coverage on the basis of a pollution exclusion that applied to bodily injury or property damage "[a]rising out of the actual, alleged, or threatened discharge, dispersal, release, escape, seepage or migration of 'pollutants' however caused and whenever occurring." The policy defined pollutants as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste."

The decedent's estate, as assignees of the homeowners, sued the insurer, seeking a declaration of coverage and an award of damages. An Alaska district court granted the insurer's summary judgment motion, finding that the suit fell within the scope of the pollution exclusion.

DECISION

The Ninth Circuit noted the history of extensive litigation and conflicting decisions across jurisdictions as to the scope of a pollution exclusion—both in general and in the context of carbon monoxide claims. Expressing uncertainty as to how the Alaska Supreme Court would rule on this outcome-determinative issue, the Ninth Circuit certified the following question: "Does a total pollution exclusion in a homeowners' insurance policy exclude coverage of claims arising from carbon monoxide exposure?"

COMMENTS

Courts that have declined to apply a pollution exclusion to carbon monoxide claims have generally reasoned that such exclusions are intended to apply only to "traditional environmental pollution," meaning claims of outdoor air, water or ground contamination by industrial polluters, rather than discrete, isolated incidents of injury or damage caused by the release of an indoor pollutant. In contrast, a significant number of courts have concluded that the exclusion bars coverage for such claims, reasoning that carbon monoxide is a pollutant and that the exclusion, by its plain terms, applies unambiguously. Those decisions appear to be the better reasoned ones, as the language of the exclusion itself lacks reference to any "traditional" or outdoor requirement and absent ambiguity, consideration of legislative history or other extrinsic evidence is not warranted.

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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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