Simpson Thacher

Insurance Law Alert

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"They [Simpson Thacher] substantively know the area extremely well and have encyclopedic knowledge of national laws as they litigate all over [the] country."

– Chambers USA 2019

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Florida Supreme Court To Decide Whether Insurer Has Standing To Bring Malpractice Suit Against Law Firm Retained To Represent Insured

The Florida Supreme Court agreed to hear an appeal relating to whether an insurer has standing to bring a malpractice suit against counsel it hired to represent the insured. *Arch Ins. Co. v. Kubicki Draper, LLP*, 2019 WL 2386336 (Fla. June 6, 2019). (Click here for full article)

As Data Breach Litigation Proliferates, Courts Address Scope Of Actionable Claims

Click here to read more about recent developments relating to the viability of data breach claims against insured entities.

South Carolina Supreme Court Adopts Case-Specific Approach To "At Issue" Waiver In Bad Faith Cases

The South Carolina Supreme Court ruled that an insurer does not automatically waive attorney-client privilege when it denies coverage and asserts good faith in the context of a bad faith claim; rather, privilege is waived only when the insurer's defense necessarily relies on information received from counsel. *In re: Mt. Hawley Ins. Co.*, 2019 WL 2441119 (S.C. June 12, 2019). (Click here for full article)

Duty To Defend Alert:

Insurers Must Defend Civil Rights Suit Stemming From Wrongful Acts That Preceded Policy Period, Says Fifth Circuit

The Fifth Circuit ruled that two insurers are obligated to defend a policyholder in a civil rights suit arising out of coerced confessions and fabricated evidence, notwithstanding that the arrests and convictions occurred before the relevant policies incepted. *Travelers Indem. Co. v. Mitchell*, 925 F.3d 236 (5th Cir. 2019).

Three men spent a collective 83 years in prison for a crime they did not commit. One died in prison, while the other two died shortly after their exoneration and release. Their estates filed a civil rights lawsuit against the County. Travelers and Scottsdale sought a declaration that they had no duty to defend the suit. A Mississippi district court granted the County's summary judgment motion, and the Fifth Circuit affirmed.

The Fifth Circuit ruled that injuries suffered by the decedents between 2005 and 2011 (while incarcerated and during the operative policy periods) triggered a duty to defend even though the wrongful causal acts (*i.e.*, arrest and conviction) occurred decades earlier. The Travelers policy covered "injury or damage that . . . happens while this agreement is in effect." The court reasoned that this language establishes a temporal requirement for injury only, not the causal event. The requirement was met, the court explained, because the civil rights suit alleges that the decedents suffered numerous incidents of physical and mental harm between 2005 and 2011.

The Fifth Circuit also held that a duty to defend was triggered under the Scottsdale policies, which covered "occurrences," defined as "an event . . . which results in personal injury, bodily injury or property damage sustained, during the policy period." The court deemed this language ambiguous as to whether it requires the "occurrence" or the bodily injury to take place during the policy period. Construing this ambiguity in favor of coverage, the court concluded that allegations of injuries during the policy periods trigger a duty to defend.

Importantly, the court noted that neither insurer's defense obligation was triggered by the ongoing false imprisonment alone. In this respect, the court emphasized that it was not applying a "continuous trigger" or "multiple trigger" theory. Rather, the court explained, the policies were triggered because the underlying complaint alleged "bodily injuries during the policy periods that were distinct from the convictions themselves."

D&O Alerts:

First Circuit Rules That SEC Enforcement Action And Related Proceedings Are A Single Claim "First Made" Prior To Policy Period

The First Circuit ruled that a D&O insurer had no duty to defend a Securities and Exchange Commission ("SEC") Enforcement Action and related subpoenas because the investigation was a single "claim" that was first made prior to the policy's inception. *BioChemics, Inc. v. AXIS Reins. Co.*, 924 F.3d 633 (1st Cir. 2019).

In May 2011, the SEC commenced an investigation by Formal Order targeting BioChemics and its officers, which included the issuance of subpoenas. At that time, the company was insured by Greenwich Insurance Company. Beginning November 2011, BioChemics became insured by AXIS Reinsurance. Shortly thereafter, the SEC served additional subpoenas under the same SEC matter number and caption as the initial Formal Order. In December 2012, the SEC filed an Enforcement Action against the company and several individuals. AXIS denied coverage, arguing that because the entire SEC investigation constituted a single "claim" first made in May 2011, it was outside the scope of policy coverage. A Massachusetts federal district court agreed, ruling that AXIS had no duty to defend. (*See* January 2015 Alert). The First Circuit affirmed.

The AXIS policy provides that all claims "arising from the same Wrongful Act . . . and all Interrelated Wrongful Acts shall be deemed one Claim and such Claim shall be deemed to be first made on the earlier date that: (1) any of the Claims is first made

against an Insured under this Policy or any prior policy . . . .” Based on this policy language, the First Circuit concluded that all SEC actions against BioChemics and its officers over the two-year period were part of a single “claim.” Additionally, the First Circuit held that the claim was “first made” in May 2011 (during the Greenwich policy period) and was not subject to coverage under the AXIS policy. Notably, the court deemed it irrelevant that some of the misrepresentations alleged in the SEC enforcement complaint took place during the AXIS policy period.

The First Circuit expressly rejected the assertion that the 2011 SEC Order, each individual subpoena issued thereafter, and the 2012 SEC action were each a separate “claim” under the policy rather than components of a single claim that encompassed the entire SEC investigation. Likewise, the court dismissed BioChemics’ contention that policy language was ambiguous or that the Interrelated Wrongful Acts provision applied only to limits of liability, not to availability of coverage.

Sixth Circuit Affirms Dismissal Of Breach Of Contract And Bad Faith Claims Against D&O Insurer

The Sixth Circuit ruled that four interrelated companies were not entitled to coverage under D&O policies because one company failed to timely report an underlying lawsuit and another made a material misrepresentation in the policy application. *US HF Cellular Commc’ns, LLC v. Scottsdale Ins. Co.*, 2019 WL 2323802 (6th Cir. May 31, 2019).

Four companies with overlapping ownership and executives were sued for allegedly committing several business-related torts. The companies sought coverage from Scottsdale, which the insurer denied. An Ohio district court granted Scottsdale’s summary judgment motion, ruling that coverage under one policy was unavailable based on the insured’s failure to timely report the underlying lawsuit and that coverage under a second policy was barred because of a material representation in the application. The Sixth Circuit affirmed.

Scottsdale issued three consecutive one-year policies, with the first inception date of July 31, 2013. The policies provide that “[t]he Insureds shall, as a condition precedent to their rights to payment under this Coverage Section only, give Insurer written notice of any Claim as soon as practicable, but in no event later than sixty (60) days after the end of the Policy Period.” The companies were sued in June 2015, but did not report the lawsuit to Scottsdale until January 2016, six months after the July 2014-July 2015 policy period had ended.

The Sixth Circuit ruled that the delay breached the condition precedent notice provision. The court rejected the companies’ assertion that the consecutive policies created a continuous three-year period of coverage and that the parties intended each renewal to “simply extend the expiration date of the earlier policies.” Instead, the court explained that the reporting requirements for each policy are distinct, indicating that “coverage under each policy is discrete and not continuous.”

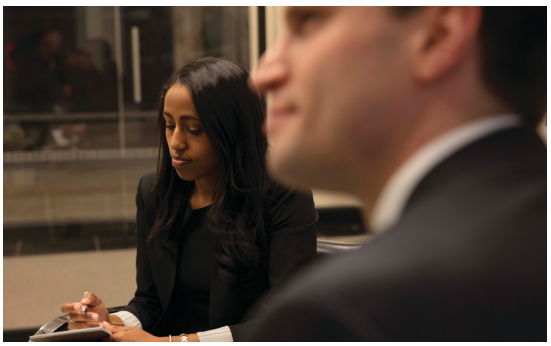
In addition, the court ruled that coverage under a second policy was barred because of a material misrepresentation in the application. The company answered “no” to a question concerning prior litigation, notwithstanding the existence of pending claims against it. The court held that the application question was unambiguous, the information asked was material and to the extent that a “nexus between that misrepresentation and the Claim” was required, such a nexus was established, given that the misrepresentation related to the very litigation for which the company later sought coverage.

Pollution Exclusion Alert:

Missouri Court Rules That Pollution Exclusion Precludes Coverage For Asbestos Exposure

A Missouri federal district court ruled that an insurer was not obligated to contribute to an underlying asbestos settlement, finding that coverage was barred by a pollution exclusion. *Zurich Am. Ins. Co. v. Ins. Co. of N. Am.*, 2019 WL 2184973 (E.D. Mo. May 21, 2019).

Zurich settled an asbestos claim on behalf of its insured and then sought contribution from Insurance Company of North America ("INA"). INA argued that it was not obligated to contribute towards the settlement based on a pollution exclusion. The court agreed and granted INA's motion to dismiss.



First, the court ruled that INA properly asserted the pollution exclusion as an affirmative defense. In its responsive pleading, INA stated that "the Underlying Claim is within an exclusion from coverage, including but not limited to asbestos exclusions." Zurich conceded that INA properly asserted the asbestos exclusion, which began in 1989, but argued that this statement was insufficient to assert an affirmative defense based on the pollution exclusion. The court disagreed. The court acknowledged that while this affirmative defense statement was not a "model of clarity," it adequately pled any and all asbestos-related exclusions, including the pollution exclusion.

Second, the court concluded that the pollution exclusion applied to the underlying asbestos claim, which alleged injury to a spouse of a worker who was exposed to asbestos during the course of his employment. The court rejected the contention that the pollution exclusion applies only to outdoor environmental contamination, noting that asbestos is unambiguously an irritant or contaminant. The court deemed it irrelevant that asbestos was not specifically identified in the exclusion, which refers to "smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases [and] waste materials."

Finally, the court rejected the contention that the pollution exclusion was inapplicable because the release of asbestos fibers occurred inside a building rather than "into the atmosphere," as required by the exclusion. The court explained that even accepting Zurich's interpretation of "atmosphere," any such requirement was met because the alleged contamination of the spouse occurred outside the confines of the factory, meaning that at some point, the asbestos fibers were released "into the atmosphere."

Coverage Alerts:

New Jersey Supreme Court Declares Stranger-Oriented Life Insurance Policy Void *Ab Initio*

The New Jersey Supreme Court ruled that a life insurance policy procured with the intent to benefit individuals with no insurable interest in the life of the insured is void *ab initio*. *Sun Life Assurance Co. of Canada v. Wells Fargo Bank, N.A.*, 2019 WL 2345444 (N.J. June 4, 2019).

In 2007, Sun Life issued a $5 million life insurance policy. The policy application listed a trust as the beneficiary, with the insured's grandson as a member of that trust. All other trust members were investors who were strangers to the insured and who paid most of the policy's premiums. About five weeks after the policy issuance, the grandson resigned as trustee and the trust agreement was modified to direct all policy benefits to the investors. Approximately two years later, the trust sold the policy. Eventually, Wells Fargo Bank obtained the policy in a bankruptcy settlement, and when the insured died, attempted to collect the proceeds. Sun Life sought a declaration that the policy was stranger-oriented life insurance ("STOLI") and therefore void *ab initio*. Wells Fargo

counterclaimed for breach of contract or a refund of the premiums it paid.

Noting a lack of dispositive New Jersey law relating to STOLI policies, the Third Circuit certified the following two questions of law to the New Jersey Supreme Court:

1. Does a life insurance policy that is procured with the intent to benefit persons without an insurable interest in the life of the insured violate the public policy of New Jersey, and if so, is that policy void *ab initio*?

2. If such a policy is void *ab initio*, is a later purchaser of the policy, who was not involved in the illegal conduct, entitled to a refund of any premium payments that they made on the policy?

The New Jersey Supreme Court answered the first question in the affirmative. It explained that where, as here, a life insurance policy is obtained for the purpose of directing financial benefits to strangers of the insured, the policy does violate the public policy of New Jersey and is therefore void *ab initio*. The court noted that even if the "insurable interest" requirement is met at the time the policy is procured, the policy is nonetheless void if the "plan from the start was to transfer the benefits to strangers." The court explained that "a number of considerations" should guide the STOLI inquiry, including the nature and timing of discussions between the original purchaser and the strangers and the reasons for transfer, among other things. In addition, the court held that an incontestability clause, which prevents insurers from contesting the validity of policies except based on non-payment of premiums, does not prohibit challenge to the validity of a STOLI policy.

As to the second question, the court held that a party "may be entitled" to a refund of premiums after a STOLI policy is voided, "depending on the circumstances." The court adopted a "fact-sensitive approach" to the premium question that focuses on equitable factors, including the party's level of culpability, its participation in or knowledge of the illicit scheme, and its failure to heed red flags.

As discussed in previous Alerts, courts in other jurisdictions have addressed whether and under what circumstances STOLI policies violate state law and/or public policy. *See* October 2016 Alert; October 2011 Alert; and December 2010 Alert.

Eighth Circuit Rules That Batch Clause Operates To Combine All Damage Occurring Across Multiple Policy Periods Into Single Occurrence

The Eighth Circuit ruled that a batch clause requires all damage that took place across multiple policy periods as a result of the same defective product to be deemed a single occurrence. *National Union Fire Ins. Co. of Pittsburgh, PA v. Donaldson Co., Inc.*, 2019 WL 2478044 (8th Cir. June 14, 2019).

Donaldson, a manufacturer of air ducts, was insured under consecutive general liability policies issued by AIG and consecutive follow form umbrella policies issued by Federal. A lawsuit against Donaldson alleged that a defect in two types of air ducts caused damage to truck engines. The suit ultimately settled for $6 million. AIG contributed approximately $3.5 million and Federal nearly $2.5 million. Thereafter, AIG sued Donaldson and Federal, seeking to recover its settlement payment.

A Minnesota district court issued a series of orders addressing various coverage issues. Among other things, the district court ruled that a batch clause in the AIG policies operated to combine all property damage arising from the same batch of products into one occurrence, even if the damage occurred across multiple policies periods. The district court further held that the occurrence took place when the policyholder was first notified of that damage. Finally, the district court ruled that there were two batches or "lots" of defective air ducts involved in the underlying settlement and therefore two occurrences. The Eighth Circuit affirmed.

The batch clause in the AIG policies provides that:

> all "bodily injury" or "property damage" arising out of and attributable directly or indirectly to the continuous, repeated or related exposure to substantially the same general conditions affecting one lot of goods or products . . . shall be deemed to result from a single "occurrence." Such "occurrence" will

> be deemed to occur with the first injury notified to [the insured] during the policy period.

The Eighth Circuit ruled that this clause unambiguously combines all property damage arising from the same "lot" of defective products, including damage that occurs across multiple policy periods, into one occurrence that takes place when Donaldson is first notified of that damage. The court rejected Federal's assertion that the batch clause only combines injuries that take place during an individual policy year.

In addition, the Eighth Circuit affirmed the district court's finding of two product "lots" based on Donaldson's manufacture of two distinct types of air ducts, each with its own product number, specifications, and base materials. The court rejected Donaldson's assertion that there were multiple lots over the years, based on changes in the particle size of the power form that was used in the product molds to manufacture the air ducts. The court explained that the "minor change in particle size had no bearing on whether a new type of unique product was formed."

Standing Alert:

Florida Supreme Court To Decide Whether Insurer Has Standing To Bring Malpractice Suit Against Law Firm Retained To Represent Insured

Our February 2019 Alert reported on a Florida appellate court decision dismissing an insurer's malpractice suit against counsel it hired to represent the insured. The appellate court ruled that the insurer lacked standing to assert such claims. *Arch Ins. Co. v. Kubicki Draper, LLP*, 266 So.3d 1210 (Fla. Dist. Ct. App. 2019). This month, the Florida Supreme Court agreed to hear the appeal. *Arch Ins. Co. v. Kubicki Draper, LLP*, 2019 WL 2386336 (Fla. June 6, 2019).

Arch Insurance Company hired counsel to defend its insured in an underlying action. After the suit settled for policy limits, Arch sued the law firm for professional negligence, claiming that the law firm's delay in asserting a statute of limitations defense resulted in an unnecessarily large settlement. A Florida trial court granted the law firm's summary judgment motion, finding that Arch lacked standing to sue and that there was no privity between Arch and law firm. The trial court acknowledged that some Florida district courts have recognized an insurer's right to bring a malpractice claim against an attorney retained to represent its insured, but deemed those decisions non-binding, unpersuasive and distinguishable.

A Florida appellate court affirmed, stating: "where nothing indicates that the law firm was in privity with the insurer, or that the insurer was an intended third-party beneficiary of the relationship between the law firm and the insured, we are unwilling to expand the field of privity exceptions to apply to this case."

We will keep you apprised of the Florida Supreme Court's decision in this matter.

Data Breach Alerts:

As Data Breach Litigation Proliferates, Courts Address Scope Of Actionable Claims

Litigation arising out of data breaches, hacking activities, and other incidents of computer fraud continues to proliferate. As a result, a body of case law is developing that addresses the scope of (1) actionable claims by consumers or other claimants arising out of cyber-related incidents; and (2) insurance coverage for such cyber-related losses. Prior Alerts have reported on the latter issue. *See* April and May 2019 Alerts; April, May and July/August 2018 Alerts; March, July/August and September 2017 Alerts; June 2016 Alert; March and July/August 2015 Alerts; and March 2014 Alert. Several recent noteworthy developments relating to the former issue—the viability of data breach claims against insured entities—are discussed below.

The Eighth Circuit dismissed a putative class action based on a data breach, finding that the plaintiff failed to allege actionable claims. *In re: SuperValu, Inc.*, 2019 WL 2306267 (8th Cir. May 31, 2019).

SuperValu, an operator of retail grocery stores, suffered two cyberattacks that compromised customers' credit and debit

card information. Customers brought putative class action suits, alleging negligence, breach of implied contract and unjust enrichment, among other claims. The suits were consolidated and dismissed by a Minnesota district court based on a lack of standing. The Eighth Circuit affirmed in part, ruling that with one exception, "no plaintiff had alleged a prospective injury in fact because, as pleaded, the likelihood of future identity theft was purely speculative." However, the Eighth Circuit ruled that named plaintiff David Holmes had standing because he adequately pled actual present injury based on an allegation of a single fraudulent charge on his credit card. *In re: SupreValu, Inc.*, 870 F.3d 763 (8th Cir. 2017)

On remand, the district court dismissed Holmes' suit for failure to state a claim. The Eighth Circuit affirmed, ruling that Holmes failed to allege negligence because Illinois law does not impose a common law or statutory duty on retailers to safeguard customers' credit or debit card information. The court also held that Holmes failed to allege consumer protection claims, noting the absence of alleged "actual damage." In this context, the court held that the expenditure of time monitoring a credit account and effort spent replacing a credit card do not constitute actual damage. Finally, the court dismissed the unjust enrichment and breach of implied contract claims, finding no factual support for such claims. The Eighth Circuit's dismissal of all class action claims alleging both present and future damage is significant in limiting the scope of actionable consumer-based data breach claims. The decision suggests that hacking-related claims must allege more than inconvenience or speculation about future pecuniary loss in order to survive dismissal motions.

Several other data breach suits have been filed in recent weeks, setting the stage for future rulings that define the scope of viable claims against insured entities.

The first of what may be a growing number of suits was also filed last month against First American Title Company. The suit comes in the wake of an announcement that a security flaw exposed approximately 885 million mortgage records containing customers' personal information. The putative class action alleges that the company ignored warnings from federal authorities relating to cybersecurity and failed to allocate adequate resources to ensuring data security. *See Gritz v. First Am. Fin. Corp.*, No. 8:19-cv-01009 (C.D. Cal. Compl. filed May 27, 2019).

In addition, two suits were filed this month against laboratory companies and a third party billing vendor, alleging harm incurred as the result of data breaches. In *Villarreal v. Am. Medical Collection Agency, Inc.*, No. 7:19-cv-05340 (S.D.N.Y. Compl. filed June 6, 2019), a putative class of patients alleged that LabCorp, a medical diagnostic testing facility, and its bill collection vendor failed to protect financial, medical and personal information even after being put on notice that hackers' had gained access to those records. A similar suit was filed in New Jersey against Quest Diagnostics and the same bill collection vendor after the company revealed that it was the victim of a data breach that compromised the banking information and medical data of nearly 12 million patients. The putative class action complaint in *Carbonneau v. Quest Diagnostics Inc.*, No. 2:19-cv-13472 (D.N.J. Compl. filed June 6, 2019) alleges breach of implied contract, negligence and violation of state consumer laws.

The viability of the claims alleged in these and other similar suits will likely be addressed in preliminary motion practice. Given that these suits allege harm based, in part, on the risk of future injury of identity theft and pecuniary loss it remains to be seen whether courts will reject such claims on standing grounds as the Eighth Circuit did in *In re: SuperValu, Inc.*

Privilege Alert:

South Carolina Supreme Court Adopts Case-Specific Approach To "At Issue" Waiver In Bad Faith Cases

The South Carolina Supreme Court ruled that an insurer does not automatically waive attorney-client privilege when it denies coverage and asserts good faith in the context of a bad faith claim; rather, privilege is waived only when the insurer's defense necessarily relies on information received from counsel. *In re: Mt. Hawley Ins. Co.*, 2019 WL 2441119 (S.C. June 12, 2019).

The discovery dispute arose out of an insured's bad faith claim against its insurer. When the insurer asserted that it had acted in good faith in denying coverage, the insured sought to discover the basis for the coverage denial. The insurer refused to produce certain documents on the basis of attorney-client privilege. A South Carolina district court ordered the documents to be submitted for an *in camera* inspection. The insurer sought a writ of mandamus from the Fourth Circuit to vacate the district court order. As reported in our July/August 2018 Alert, the Fourth Circuit certified the following question to the South Carolina Supreme Court: "Does South Carolina law support application of the 'at issue' exception to attorney-client privilege such that a party may waive the privilege by denying liability in its answer?"

The South Carolina Supreme Court answered the question in the negative, stating "we find little authority for the untenable proposition that the mere denial of liability in a pleading constitutes a waiver of the attorney-client privilege." Addressing the specific issue of whether asserting good faith in response to a bad faith claim operates as a waiver to privilege by placing privileged communications "at issue," the court endorsed a fact-specific "middle-ground" approach. The court adopted the analysis set forth in *State Farm Mutual Automobile Insurance Co. v. Lee*, 13 P.3d 1169 (Ariz. 2000). There, the court held that privilege is waived when an insurer asserts good faith based on its "subjective understanding of the law *as informed by counsel*—rather than defending exclusively on an objective reading of the disputed policy exclusions." (Emphasis in original).

The court acknowledged that insurers will likely confer with counsel in virtually all bad faith cases, and that "most if not all actions taken will be based on counsel's advice." The court cautioned: "This does not waive privilege." Rather, waiver occurs when an insurer "claims its actions were the result of its reasonable and good-faith belief that its conduct was permitted by law and its subjective belief based on . . . information and advice received from . . . lawyers." The court imposed an additional requirement that the party seeking waiver of attorney-client privilege make a *prima facie* showing of bad faith.

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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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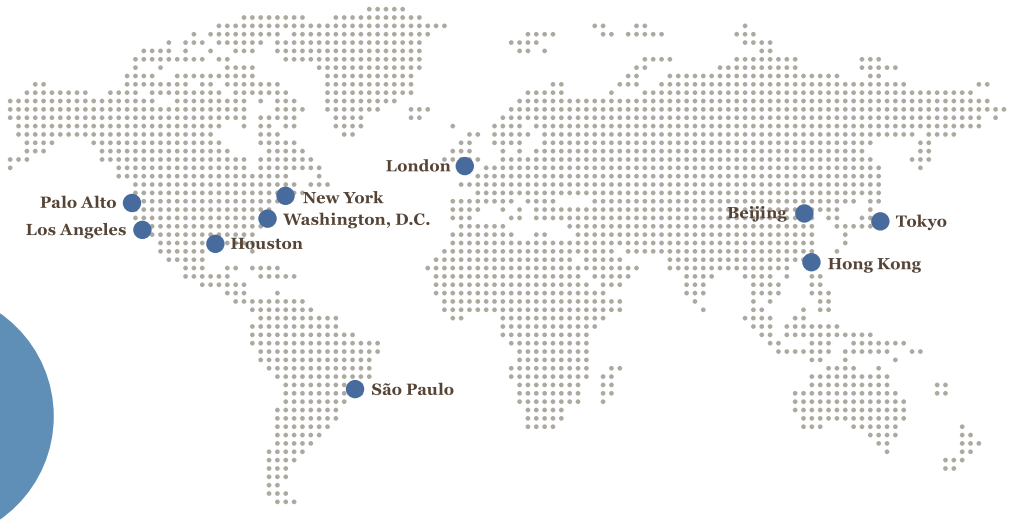

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