POLICYHOLDER OBSERVER

MARCH 7, 2012

The Observer highlights significant developments in insurance recovery and risk management

Into the Data-Security Breach: Risks, Liability, and Insurance Recovery for Companies and Their Directors

By Marc S. Mayerson and Darren S. Teshima

This article is adapted from an article originally appearing in the February 3, 2012 edition of The Recorder*, and reprinted with permission.* *© 2012 ALM Properties, Inc. All rights reserved. Further duplication without permission is prohibited.*

At the same time as we begin to emerge from recent financial dislocations and economic turbulence—and as we face continued uncertainty in the Eurozone, election politics, and regional conflicts—businesses face increasing risks from technological failures, cyber-crime, and data-privacy violations.

According to a recent study by Lloyd's of London, cyber-risk—both malicious attacks and non-malicious ones—is approaching the top 10 of risks threatening businesses worldwide; in the U.S. malicious attacks were ranked in the top 5. Last year, hackers succeeded in attacking government networks in the U.S., India and Brazil. Data breach in various forms has struck major financial institutions, pharmaceutical companies, manufacturers, stock exchanges, defense manufacturers, electronics manufacturers, and Internet-based businesses. Stats from a year ago estimated that cybercrime was costing companies $114 billion, with $96 billion in the U.S. alone.

Against this backdrop, the Securities and Exchange Commission recently provided written guidance for registrants about the need to provide disclosure of the risk of cybersecurity breaches and companies' plans to mitigate that risk.

Please click here to read the entire article.

Orrick is currently pursuing first-party and third-party insurance claims for Sony arising out of last year's criminal cyber attacks on certain of Sony's online networks. Richard DeNatale, a partner in the San Francisco office, is leading the engagement.

Fifth Circuit's Expansive Reading of Contractual Liability Exclusion Serves as a Reminder That How Corporate Transactions Are Structured Can Affect Coverage

By Alison K. Roffi

The U.S. Court of Appeals for the Fifth Circuit recently reversed a decision from the U.S. District Court for the Western District of Texas, which found that an insurer was required to

To learn more about Orrick's Insurance practice, please visit us on the Web.

Contact a Team Member:

David Klein
Partner
Washington, D.C.
(202) 339-8629
dklein@orrick.com

Alex Lathrop
Partner
Washington, D.C.
(202) 339-8461
alathrop@orrick.com

defend the insured in an underlying lawsuit because the insured had assumed the "tort liability" of a third party through a purchase agreement. *Colony Nat. Ins. Co. v. Manitex, L.L.C.*, No. 11-50068, 2012 WL 555524 (5th Cir. Feb. 20, 2012). Applying Texas law, the Fifth Circuit focused on the distinction between "tort liability" and "contract liability" for an accident, in order to determine whether the purchase agreement between two parties constituted an "insured contract" for the purpose of a contractual liability exclusion in a general liability policy. The Fifth Circuit concluded that the insurer was not required to defend the insured based on the unambiguous language of the insurance contract because the insured did not assume its predecessor-in-interest's "tort liability" to trigger coverage.

Please click here to continue reading the article.

Massachusetts Federal Judge Dismisses Insurer's Misrepresentation Claims in $650M Suit on Coverage for Mortgage-Backed Securities

In a suit consolidating nine actions brought by Massachusetts Mutual Life Insurance Company (Mass Mutual) against various issuers of residential mortgage-backed securities, a federal district court in Massachusetts has dismissed claims that the issuers misrepresented facts concerning owner-occupancy bearing on the creditworthiness of the securitized loans. *See* February 14, 2012 Memorandum and Order, Massachusetts Mut. Life Ins. Co. v. Residential Funding Co., et al., C.A. No. 11-30035-MAP (D. Mass). U.S. District Judge Michael Ponsor found that most of the defendant issuers' of the offering documents "explicitly stated that all occupancy rates were based only on borrowers' representations," and that Massachusetts Mutual did not allege that the defendant issuers, including Credit Suisse, JP Morgan Chase and Goldman Sachs, had falsely reported the borrowers' representations. Therefore, he concluded that the defendants (with the exception of HSBC Bank USA) had sufficiently placed Massachusetts Mutual on notice of the possibility of borrower misrepresentation or fraud.

Update: Virginia Supreme Court Grants Rehearing in Global Warming Coverage Case

In our December 1, 2011 issue of the Observer, we provided commentary on the Virginia Supreme Court's recent decision denying coverage under a liability policy for an action in which the Alaskan Native Village of Kivalina alleged that AES and other companies were responsible for losses tied to global warming. (See Marc Mayerson, *No, Virginia, There is No Greenhouse-Gas Clause*.) On January 17, 2012, the Virginia Supreme Court granted the petition of AES for rehearing. Oral argument was scheduled for the February 2012 Session.

West Virginia Trial Court Finds that Pollution Exclusion Does Not Bar Coverage for Claims Against Coal Company, Rejecting Insurers' Argument That Policyholder's Core Product Is a "Pollutant"

A West Virginia trial court ordered that certain London market insurance companies and certain underwriters at Lloyd's of London who issued liability policies to Massey Energy Company must defend Massey against claims alleging that the coal company's operations caused the underlying plaintiffs to suffer bodily injury and property damage. *See* December 6, 2011 Order, Massey Energy Co. v. AIG Cas. Co., No. 09-C-59 (Boone Cnty. Cir. Ct.). The underlying claimants alleged that Massey's operations resulted in destabilization of various rock strata, resulting in contamination of the plaintiffs' well water. The London insurers moved for summary judgment that they had no duty to defend or indemnify Massey because the claims were barred by the pollution exclusion in the policy. The court denied the London insurers' motion for three reasons. First, the court reasoned that the term "pollution" cannot reasonably be interpreted to include the policyholder's core product—here, coal—because to do so would effectively render the coverage illusory. Second, the court found that London was bound by the insurance industry's representations to state insurance regulators that the pollution exclusion was only intended to apply to governmentally mandated environmental cleanups. Third, the West Virginia Insurance Commissioner permitted "absolute" pollution exclusions to be used in policies only if such a reduction in coverage was accompanied by a reduction in premium, and the London insurers failed to show that a reduced premium was charged for the policies at issue.

New York Appellate Court Rules That an Insurer Cannot Delay Issuance of a Disclaimer on a Ground Known by the Insurer While Investigating Other Potential Grounds for Denial

By statute, insurers who issue liability policies to New York policyholders must provide written notice of their grounds for denying coverage of an accident "as soon as is reasonably practicable." In 2004, the Appellate Division, First Department, carved out an exception to this rule, holding that an insurer was not required to provide written notice of denial of coverage on a ground it was aware of if the insurer was still conducting an investigation into other potential grounds for denial (*DiGuglielmo v. Travelers Prop. Cas.*, 6 A.D.3d 344 (1st Dep't 2004)). Last month, the First Department overruled the *DiGuglielmo* rule, finding it inconsistent with the text of New York's claims handling statute (Insurance Law § 3420[d][2]). In *George Campbell Painting v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA* (Index 116389/08), the Court ruled instead that New York law precludes an insurer from delaying issuance of a written disclaimer on a ground it is aware of while investigating other possible grounds for denial. Because the insurer had delayed notifying its policyholder that it intended to deny coverage, the court found that the insurer had waived its ground for denial and was required to pay its share of a settlement entered into by the insured.

Utah Supreme Court Holds that Insurer Cannot Seek Reimbursement of Amounts Paid in Excess of Policy Limits to Settle a Judgment Against Its Insured

In *United States Fidelity and Guaranty Co. v. United States Sports Specialty Association*, the Utah Supreme Court held that the insurer had no right to reimbursement of funds it paid in excess of its policy limits absent an express provision in the policy requiring such reimbursement. The case involved a personal injury action resulting in a jury verdict of $6.1 million against the policyholder. Although the insurers' policy limits were only $2 million, the insurer agreed to post a bond for the entire amount of the judgment after the policyholder contended that the insurer conducted its defense in bad faith and its refusal to post a bond for the entire amount of the judgment would cause further damage resulting from its bad faith. The insurer then participated in mediation with the underlying personal injury plaintiff and settled the judgment for $4.8 million. When the insurer sought reimbursement from its insured for the $2.8 million it paid in excess of policy limits, the Utah Supreme Court held that (1) the insurer did not have a claim for unjust enrichment where an express contract governs the relationship between the parties, and (2) it would be inconsistent with the bargained-for relationship between the parties for the insurer to seek reimbursement of money paid on behalf of its insured absent an express contractual provision allowing it.

Fourth Circuit Finds Coverage Under Commercial Package Insurance Policy For Defense Costs and Penalties Incurred in Wage-Hour Dispute

On February 24, 2012, the Fourth Circuit reversed a lower court's ruling that an insured school board was not entitled to coverage under a commercial package policy for defense and indemnity of overtime claims asserted by employees who alleged that they had improperly been deprived of overtime pay under the Fair Labor Standard Act. *See Republic Franklin Ins. Co. v. Albemarle County Sch. Bd.*, No. 10-1961 (4th Cir.). The policy covered "all 'loss' resulting from a 'claim' for a 'wrongful act.'" It defined "loss" as "any amount which an insurer is legally obligated to pay as damages" but not "operating costs. . .such as would be included in [the insured's] 'educational institution's budget." It defined "wrongful act" as including "any breach of duty." The insurer argued that there was no coverage for defense or indemnity claims because, among other things, the back wages due were in the nature of restitution, not damages constituting "loss." It argued that the FLSA violation was not a wrongful act, the Fourth Circuit ruled that violation of the FLSA was a breach of a legal duty and therefore, under explicit policy language, was a "wrongful act," and that while the policy provided no coverage for restitution of overtime pay, other costs incurred as a result of the wrongful act, including statutory liquidated damages and defense costs, were covered "losses."

The Home Insurance Company Proposes Interim Distribution

The liquidator of The Home Insurance Company ("The Home") recently proposed an interim distribution of 15% to policyholder claimants. The Home is an insolvent insurer that has been in liquidation since 2003. The bar date for claims to be submitted to The Home was June 13, 2004.