Insurance Cases to Watch in 2018

Law360

Courts across the country are primed to grapple with critical insurance issues in 2018, including whether email-based theft schemes trigger computer fraud coverage and whether policyholders must foot the bill for pollution claims in years insurance was unavailable for those risks.

Here, Law360 breaks down significant cases insurance attorneys will be tracking in 2018.

Medidata Solutions v. Federal Insurance Co., American Tooling Center v. Travelers

Both the Second and Sixth circuits are set to determine whether computer fraud insurance policies cover policyholders' losses from so-called "social engineering" schemes, in which criminals use fraudulent emails, phone calls and other deceptive communications to trick unwitting companies into wiring money to sham bank accounts. The appellate courts' decisions could provide key guidance on an issue that has divided courts across the country.

In the Second Circuit case, Federal Insurance Co. is seeking to reverse a New York federal court's ruling that it owes Medidata Solutions Inc. coverage for a $4.8 million loss it suffered when it was tricked into wiring money overseas by a fraudster posing as a Medidata executive.

Meanwhile, tool manufacturer American Tooling Center Inc. has asked the Sixth Circuit to overturn a Michigan federal court's decision and find that Travelers must cover $800,000 it lost when thieves posing as a vendor used fraudulent emails to deceive the company into wiring funds to a bogus bank account.

According to attorneys, the results of the two appeals could have serious financial implications for policyholders and insurers alike, given the rise of social engineering scams in recent years.

"Many businesses that have purchased cyber insurance mostly to cover a data breach) and crime insurance to cover first-party losses from computer fraud or funds transfer fraud) don't realize that in the

era of social engineering, their insurance coverage may be slipping between these two types of policies, costing them millions in losses," Stefan Dandelles, a partner at Kaufman Dolowich Voluck LLP, said in emailed remarks.

Given the relatively low volume of premiums collected by crime and fidelity insurance carriers, a pair of appellate decisions finding that computer fraud coverage applies to social engineering incidents could deal a huge blow to those insurers, said Matthew Jacobs, co-chair of Jenner & Block LLP's insurance recovery and counseling practice.

"We have a situation where this is an existential threat to crime and fidelity insurance companies," Jacobs said. "If they have to pay these claims, they will go out of business because the potential losses far exceed the total premiums collected for these policies, based on discussions I have had with brokers. That is why each of these cases is being litigated like it is World War III."

That said, Jacobs added he believes that policyholders would reasonably expect these types of policies to apply to email-based theft schemes.

"It is called computer fraud coverage, after all, and computers are being used to perpetrate the fraud," he said. "These insurers are splitting microscopic hairs by describing in extensive detail how email systems work to thread a needle and deny coverage for risks that were reasonably expected to be covered by policyholders."

The cases are Medidata Solutions Inc. v. Federal Insurance Co., case number 17-2492, in the U.S. Court of Appeals for the Second Circuit; and American Tooling Center v. Travelers, case number 17-2014, in the U.S. Court of Appeals for the Sixth Circuit.

KeySpan Gas East Corp. v. Munich Re

In another matter with potentially huge implications for the insurance industry, KeySpan Gas East Corp. has asked New York's highest court to reverse a state appellate panel's holding that Century Indemnity Co. doesn't have to cover the energy company's environmental cleanup costs for time periods when pollution liability coverage was unavailable in the marketplace.

KeySpan had sought indemnification from Century and other insurers for its costs to remediate

contamination that allegedly occurred at a pair of gas plants in Queens and Long Island between 1903 and 2012. Judge Saliann Scarpulla ruled in October 2014 that Century should cover KeySpan's cleanup costs for periods when such insurance was unavailable, which was the case for the years before 1953 and after 1986.

In reversing the lower court, a panel of New York's Appellate Division found in September 2016 that each of Century's policies generally provides coverage for accidents resulting in damages "during the policy period." No provisions in the policies require the carrier to cover damages outside the policy period when insurance is otherwise unavailable to the policyholder, the panel noted.

The case provides the first opportunity for the New York high court, known as the Court of Appeals, to weigh in on the so-called "unavailability exception" to the pro rata allocation formula, which arises in disputes involving coverage for environmental contamination, asbestos injury and other "long-tail" claims implicating many policy periods.

Attorneys who represent policyholders have expressed concerns that some companies could face financial ruin if forced to pick up the tab for long-tail claims in uninsured periods, while counsel for insurance companies have said insurers shouldn't be penalized for the decision to stop offering certain types of coverage.

"Pro rata allocation and allocation to the policyholder for periods when there is no insurance for any reason go together like peanut butter and jelly," said Hinshaw & Culbertson LLP partner Scott Seaman, who represents insurers. "There is no express policy language requiring the insurer to cover damages outside of the policy period when insurance is otherwise unavailable in the marketplace. The Appellate Division's refusal to rewrite the policy was cogent and consistent with the New York Court of Appeals' jurisprudence."

The case is KeySpan Gas East Corp. v. Munich Re, case number APL-2016-00236, in the New York Court of Appeals.

Pitzer College v. Indian Harbor Insurance Co.

Given the wild variation among different states' insurance laws, the outcome of a coverage dispute may hinge on which state's law is found to apply.

In a case that could affect multitudes of policyholders, the California Supreme Court is poised to decide whether the state's law applies to a college's pollution coverage dispute despite an insurance policy provision requiring the application of New York law, given the Golden State's rule that an insurer must prove it was prejudiced by a policyholder's late notice to deny coverage on that basis.

A California federal judge had rejected Claremont-based Pitzer College's bid for coverage of lead remediation costs under its policy with Indian Harbor Insurance Co. after applying New York law and finding that the college failed to provide timely notice of its claim or obtain the insurer's consent before making payments. Unlike California, New York does not have a "notice-prejudice rule" and allows an insurer to deny coverage based on late notice without showing it suffered prejudice.

Pitzer argued on appeal to the Ninth Circuit that, even though the Indian Harbor policy required the application of New York law to any coverage disputes, California law should still apply because the Golden State's notice-prejudice rule is a matter of "fundamental public policy" that overrides any contractual choice-of-law provision.

In January 2017, a panel of the Ninth Circuit found that there is no California precedent regarding whether the state's notice-prejudice rule is a fundamental public policy for the purposes of a choice-of-law analysis. As a result, the panel certified questions on the issue to the California Supreme Court, noting the "resolution of these questions will apply to insureds throughout the state."

"This can be significant for coverage disputes in California because the California rule could override the law of the state that would apply otherwise, even if the parties agreed to another state's law governing," said Hunton & Williams LLP partner Syed Ahmad.

The case is Pitzer College v. Indian Harbor Insurance Co., case number S239510, in the California Supreme Court.

Country Mutual Insurance Co. v. Vibram

Earlier this year, Massachusetts' highest court agreed to review a ruling that shoe maker Vibram Inc.'s insurance companies can't recoup the sums they paid to defend the company in a trademark dispute, in a case that raises multiple issues of first impression under the state's law.

Vibram USA Inc. has been locked in a battle with Country Mutual Insurance Co. and Maryland Casualty Co. over coverage for an underlying lawsuit alleging the company unlawfully obtained a trademark for a shoe named after the late Olympic marathon champion Abebe Bikila.

On Sept. 15, the Massachusetts Supreme Judicial Court granted a joint request for direct appellate review lodged by Vibram and the insurers, which had initially agreed to defend Vibram in the action by Bikila's family subject to a reservation of rights to later challenge coverage.

The state justices will take a second look both at Judge Mitchell H. Kaplan's determination that the Bikila suit didn't trigger Country Mutual's and Maryland Casualty's defense obligations, and the judge's subsequent holding that the insurers can't recoup defense costs they had already paid to Vibram. The dispute raises multiple issues previously untouched by Massachusetts courts, including whether an insurer has a right to recover defense costs paid under a unilateral reservation of rights.

Blank Rome LLP associate Omid Safa, who represents policyholders, said Judge Kaplan's denial of the insurers' request for recoupment was consistent with "well-established principles concerning the duty to defend."

"Allowing recoupment would fundamentally change the insurance contract and relegate the 'duty to defend' to a mere 'duty to advance' defense costs," Safa said. "Insurers charge higher premiums when selling 'duty to defend' policies precisely because that protection is superior. Recoupment efforts are an attempt at a 'bait and switch.'"

But Clark & Fox partner Michael Savett, who represents insurers, said that principles of fairness dictate that an insurer should have a right to recoupment if claims against its policyholder are ultimately found to be outside the scope of a policy's coverage.

"While the standard commercial insurance policy does not stipulate that policyholders may need to reimburse insurers for paid defense costs in the event of a finding of no coverage, as a matter of fairness the insured should not benefit from free representation when a lawsuit asserts claims that are not part of the risk underwritten by the insurer," Savett said.

The case is Country Mutual Insurance Co. v. Vibram Inc., case number SJC-12401, in the Massachusetts Supreme Judicial Court.

Office Depot v. AIG

Office Depot has asked the Ninth Circuit to upend a lower court's decision that a California law precluding coverage for willful acts means that American International Group Inc. doesn't have to cover its defense and settlement costs in a suit alleging it overbilled public agencies. Attorneys have told Law360 a decision in favor of the insurer could lead to widespread coverage denials for fraud-based claims.

The office supply giant is challenging U.S. District Judge Stephen V. Wilson's ruling accepting AIG's argument that California Insurance Code Section 533 — which precludes coverage for a policyholder's willful acts — applies to the entire underlying California False Claims Act action against the office supply giant, including allegations of reckless and negligent conduct.

Office Depot has asserted that Judge Wilson stretched Section 533 beyond its intended bounds, given that the company has not actually been found liable for any violations of the CFCA.

AIG, meanwhile, has countered that the district court's decision reflects sound public policy. In essence, the insurer argued, the supply company is seeking coverage for alleged acts that were intended to defraud the government.

The case has attracted the attention of concerned policyholder advocates. The nonprofit group United Policyholders argued in a November amicus brief that a ruling by the Ninth Circuit blessing Judge Wilson's rationale could lead to unfair coverage denials for claims premised on negligent, rather than deliberate, conduct.

"The court's ruling raises public policy concerns by restricting the availability of insurance for types of claims widely understood to be insurable, and drawing a false dichotomy between negligent acts that directly injure and speech or acts) that cause injury by inducing the reliance of others," attorneys for UP wrote in the brief. "Neither the district court nor [AIG] offer justification for such a sea change in California law."

The case is Office Depot Inc. v. AIG Specialty Insurance Co. et al., case number 17-55125, in the U.S. Court of Appeals for the Ninth Circuit.

–Editing by Katherine Rautenberg and Kelly Duncan.

*UP filed amicus curiae “friend of the court”) briefs in Medidata, Keyspan, Pitzer College, and Office Depot. See: http://www.uphelp.org/resources/amicus-briefs