

MARCH | 2013



INSURANCE COVERAGE SECTION

# Newsletter

**SAVE THE  
DATE**

**FDCC  
ANNUAL  
Meeting**

**July 27-  
August 3,  
2013**

**Colorado  
Springs,  
Colorado**



Ronald J. Clark



I hope that the majority of you reading this edition of the Insurance Coverage Section newsletter were able to join us from (mostly) sunny San Antonio. If not, my condolences. If you were in San Antonio, and happened to see my exposed pasty white Oregon legs by the pool, again my condolences. We had a great time in San Antonio and our section presentation regarding Cyber Risks was well received.

Some interesting San Antonio facts I learned:

- San Antonio is the seventh largest U.S. City (third largest in Texas)
- San Antonio was originally settled in 1731 by sixteen Spanish families from the Canary Islands
- The famous River Walk stretches for 2.5 miles
- San Antonio is named after Saint Anthony of Padova, Italy
- The opening day of our Mid-Year meeting (Wednesday, March 6, 2013) was the 177<sup>th</sup> anniversary of the Battle of the Alamo, which occurred on March 6, 1836

Looking ahead to July, we have the Annual Meeting in Colorado Springs, CO (July 27 – August 3). The programs for that meeting are starting to take shape, and it looks like it will be another good one. Wherever this newsletter finds you, here's hoping that you are enjoying your life, your practice, and all of the small things which are too easily overlooked.

Take care,

Ron

## 2013 Insurance Industry Institute

### Institute Co-Chairs:

Kelly R. Dalmass, Helen Johnson Alford and Michael T. Glascott

The Federation will present its 2013 Insurance Industry Institute in New York City October 2 to October 4, 2013. The program, Managing Today's Issues, Developing Tomorrow's Solutions, will focus on emerging issues of interest to senior level insurance executives and will provide ample opportunity for networking. Defense counsel members are asked to bring a client to the "I-3" Institute.

The program will include a discussion of challenges faced by today's CEOs and CFOs and discuss issues involving daily decisions affecting overall costs and thoughts on responses which advance the objectives consistent with the company's mission. The program will also consider risk management, from an insurer's perspective, and will delve into issues driven by the company's bottom line.

Panel discussions including experts in various fields will discuss issues relating to the management of social media and the corporate image in cyberspace, emerging issues in social media and ethical issues that lawyers and insurance professionals face in today's digital world. We will also explore the latest advances, and use, of technology in corporate America, the insurance industry and law firms. Consideration will be given to the ethical issues and practical impediments to embracing such technological advancements. We will also consider emerging issues with regard to cyber risk and data breaches.

Another portion of the program, designed by our International members, will touch upon common threads and nuances of all these issues which have become so pervasive in our global economy.

We look forward to seeing you in New York in October 2013. Please remember that all defense counsel members are expected to bring a client. Registration is available online: [www.thefederation.org](http://www.thefederation.org)

July 28 – August 3  
2013

**ANNUAL Meeting 2013**  
Colorado Springs, California

October 2 - 4, 2013

**I-3 Insurance Symposium**  
New York, New York

March 1 – 8, 2014

**WINTER Meeting 2014**  
Marco Island, Florida

July 26 – August 2,  
2014

**ANNUAL Meeting 2014**  
Napa Valley, California

February 28 – March 7,  
2015

**WINTER Meeting 2015**  
San Juan, Puerto Rico

The citations link to a copy of the decision.

The summaries and analysis expressed in the Case Notes in this Newsletter are the views of the authors, and not necessarily of the Insurance Coverage Section officers. You should read each case yourself before citing it to any court.

## Harleysville Mutual Insurance Co. v. State

2012 WL 5870799 (S.C. Nov. 21, 2012)

**South Carolina Supreme Court upholds statute requiring builders' general liability policies to cover faulty workmanship.**

The South Carolina Supreme Court recently upheld a state law requiring builders' general liability policies to cover damages from faulty workmanship, but ruled that the statute cannot be applied retroactively to policies executed before the law's May 17, 2011 effective date.

Following an earlier South Carolina Supreme Court decision that a standard CGL policy does not cover property damage resulting from faulty workmanship, the South Carolina General Assembly passed Act No. 26, which expanded the definition of the term "occurrence" to include property damage or bodily injury resulting from faulty workmanship. The insurer benefiting from the favorable Supreme Court ruling challenged the new law on grounds that (1) the legislature did not have authority to pass a law overturning the Court's ruling due to the separation of powers doctrine, (2) the law unfairly targeted the insurance industry in violation of the equal protection clause of the state and federal constitution, and (3) the law violated its rights under the contract clauses of both the state and federal constitution.

The South Carolina Supreme Court noted that because it had reversed itself on the issue in a subsequent decision, the legislature had not retroactively overruled the Court's interpretation of a statute, and therefore held there was no violation of the separation of powers doctrine. The Supreme Court held that the legislature had a "rational basis" for enacting the legislation, noting that the insurance industry was already highly regulated, but that insurance coverage for construction liability itself lacked "clarity" and was the subject of "significant litigation, particularly with respect to whether construction defects constitute 'occurrence.'" Accordingly, it found no equal protection violation. Finally, while noting that it was generally within the legislature's power to define the term "occurrence," the Supreme Court held it would violate the contract clauses of both the federal and state constitutions to apply this definition retroactively as it would substantially impair pre-existing contracts by materially changing their terms. It thus held that the legislation applied only prospectively to contracts executed on or after the act's effective date of May 17, 2011.

**PPI Technology Services, L.P. v. Liberty Mutual Ins. Co.**

701 F.3d 1070 (5th Cir. 2012)

**Fifth Circuit concludes that merely alleging “property damage” does not trigger duty to defend.**

Liberty Mutual insured PPI, which was retained by third parties to assist in well-drilling operations. The third parties sued PPI after the well was drilled in the wrong location, alleging both economic and property damage. PPI sought defense and indemnification from Liberty Mutual. The Fifth Circuit concluded that, under Texas law, mere use of the phrase “property damage” and parroted policy language are not sufficient to trigger an insurer’s duty to defend. Assertions of property damage must be accompanied by facts illustrating specific harm or damage to tangible property.

Submitted by: Jeffrey R. Pilkington and Eric C. Reece

**Jamestown Insurance Co., RRG v. Reeder**

12-20437, 2013 WL 203382 (5th Cir. Jan. 17, 2013)

**Court of Appeals for the Fifth Circuit finds that thirty-one month delay in notifying insurer of judgment violates policy’s notice conditions.**

In 2004, the insured sued a number of business partners in a Texas state court (“the 2004 action”). In March 2006, the defendants in that action filed the first of multiple counterclaims against the insured. The case was subsequently tried, and the trial court entered its judgment in March of 2008, finding the insured liable. The insured appealed, and the Texas Supreme Court reversed, rendering a take-nothing judgment in the insured’s favor. During the pendency of the 2004 action, several entities affiliated with the insured filed separate claims against the defendants of the 2004 action in a neighboring Texas county. Subsequently, the defendants filed a third-party claim against the insured, alleging that he had committed fraud. In November 2010, the insured tendered the defense and indemnity of both actions to Jamestown, his commercial general liability carrier.

Thereafter, Jamestown sought a judicial declaration that it had no duty to defend or indemnify the insured. The district court granted Jamestown’s motion for summary judgment on the grounds that the counterclaims in the 2004 action and the third-party complaint in the second suit did not constitute an occurrence resulting in property damage. With regard to the claims of the third-party complaint, the Fifth Circuit agreed with the district court, finding that the third-party plaintiffs alleged intentional conduct and, therefore, the claims did not constitute an occurrence. In addition, the Court affirmed the district court’s ruling regarding the counterclaims of the first suit – albeit on alternate grounds. In so doing, the Court held that the insured’s 31-month delay in notifying Jamestown following the final judgment violated the policy’s notice conditions. While Texas law had not addressed questions regarding an insured’s failure to notify an insurer of an appealable final judgment, the Court made an “Erie guess,” and found that the delay was in fact prejudicial to Jamestown.

Submitted by: Jennifer Johnsen and Nick Farr, *Gallivan, White & Boyd, PA*

**Mountain States  
Mutual Casualty Co. v.  
Fitz-Gerald**

2013 CO 14; 2013 Colo.  
LEXIS 166 (2013).

**The Colorado Supreme  
Court found for insurers  
on the question of  
whether pollution  
exclusions apply to  
common, everyday  
waste products.**

On February 25, 2013, the Colorado Supreme Court found for insurers on the question of whether pollution exclusions apply to common everyday waste products. The insured, a restaurant, dumped cooking grease into the sewer system. The insurer found that the grease was a "pollutant." The trial court agreed with the insurer. The intermediate appellate court found for the policyholder. The court held that applying pollution exclusions to kitchen grease would lead to absurd, overbroad applications of the exclusion.

The Colorado Supreme Court reversed to find for the insurer. The decision is interesting on several levels. The Supreme Court did not dismiss the appellate court's concern about exclusions being overbroad: "we are mindful of the concerns expressed by the court of appeals...." But, the Supreme Court was persuaded by two factors. First, the disposal was huge; it created an eight-foot clog. Second, the restaurant's conduct violated a local ordinance. Ultimately, the court said that it was applying the exclusion "under the circumstances of this case." Of course, all decisions are under the circumstances of the presented case. But, the court seemed to be emphasizing the circumstances here.

This decision will not be the last word on the meaning of "pollutant," but it is an important victory for insurers.

Submitted by: Alan S. Rutkin, *Rivkin Radler LLP*

**Granite State Ins. Co.  
v. American Building  
Materials, Inc.**

2013 WL 28430 (11th  
Cir. Jan. 3, 2013).

**The Court of Appeals  
for the Eleventh Circuit  
holds under Florida  
and Massachusetts  
law that pollution  
exclusion in CGL  
policies excludes  
coverage for defective  
Chinese drywall.**

The U.S. Eleventh Circuit Court of Appeals recently held under either Florida or Massachusetts law that coverage for damages caused by defective Chinese drywall is excluded under CGL policies' pollution exclusions.

The insured was sued by a homebuilder for damages arising from defective gypsum drywall manufactured in China installed in homes, and the insured sought defense and indemnity from its CGL insurers. The insurers sought and obtained a declaratory judgment that they did not have a duty to defend or indemnify based on pollution exclusions in their policies. The insured appealed.

The Eleventh Circuit affirmed the district court's ruling that pollution exclusions preclude coverage for damage caused by Chinese drywall under either Florida or Massachusetts law. The Eleventh Circuit, relying on Florida and Massachusetts precedent, reasoned that the sulfide gas released by the Chinese drywall falls within the policies' definition of "pollutant" because it is a "gaseous . . . irritant or contaminant," and the alleged damage would not have occurred "but for the actual, alleged, or threatened discharge, dispersal, seepage, migration, release, or escape" of that pollutant.

**West Bend Mutual Insurance Co. v. Arbor Homes, LLC**

703 F.3d 1092 (7th Cir. 2013)

**United States Court of Appeal for the Seventh Circuit holds that plumbing contractor's insurer had no duty to defend homebuilder who took remedial action of plumbing contractor's negligence.**

After the completion of a new home construction, new homeowners discovered that raw sewage was being pumped into the crawl space due to the plumbing contractor's failure to connect the plumbing to the main sewer line. Defendant homebuilder paid \$65,000 for cleaning and repairs and also bought back the home, built a new home and paid all transactions costs for the homeowners to move into that new home. The homebuilder then filed suit against the plumbing contractor and sent a copy of the complaint to his insurer noting that the builder was an additional insured on the relevant insurance policies. Plaintiff insurer denied coverage claiming that the builder was not an additional insured under the policy and that the claim fell within a number of policy exclusions. Insurer then brought a declaratory judgment action seeking relief from their duty to defend or indemnify.

On appeal the Seventh Circuit examined only the "voluntary payments" exclusion, finding that coverage was properly denied because an insurance company must be given the right to protect its own interests under such a policy provision. Essentially the court found that a voluntary payment exclusion requires an insurer to consent to any obligations assumed by the insured. Ultimately, "[t]he builder's failure to obtain such consent prior to providing aid to the homeowners relieved the insurer of any obligations to pay for the damages cause by the plumber's negligence."

Michael O'Connell, Michelle Bibeau and Brian Doherty, *O'Connell, Attmore Morris, LLC*

**Forrest Construction, Inc. v. The Cincinnati Insurance Co.**

2013 WL 135372 (6th Cir. Jan. 11, 2013)

**The U.S. Sixth Circuit Court of Appeals holds that an insured does not have an obligation under Tennessee law to continue coverage negotiations with its insurer once an insurer denies coverage.**

A contractor sued its customers for nonpayment and was counter-sued for alleged defects in workmanship. The contractor tendered the counterclaim to its general liability insurer for defense and indemnity. The insurer denied coverage based on a "your work" exclusion. The denial letter advised the contractor that it could contact the insurer if it disagreed with the denial. The contractor subsequently defended itself against the counterclaim and was found liable for damages due to faulty construction.

The contractor sued its insurer for breach of contract and bad faith denial of coverage contending that the "your work" exclusion did not apply to damages attributable to subcontractors' faulty work. The parties cross-moved for summary judgment, and the court found that the insurer had breached its duty to defend. The insurer appealed arguing, in part, that the contractor should have advised it that subcontractors were involved and requested reconsideration of the denial. The Sixth Circuit held that an insurer severs an insured's responsibilities and obligations under the policy once it unequivocally denies coverage, and that inviting the insured to contact the insurer with additional information if it disagreed with the denial does not change the fact that the letter was unequivocal in its position.

**Dan D. Kohane**



**Tell us a bit about your background—legal and otherwise—and how you arrived at this point in your career.**

I started with Hurwitz & Fine, P.C. after my first year in law school as a law clerk, but wanted to do government/legislative work as a career. Soon after I started, the Love Canal litigation in Niagara Falls gained national publicity and our office was retained to represent one of the four defendants, the County of Niagara. Its liability carrier, Utica Mutual, had denied coverage based on the “sudden and accidental” pollution exclusion and we were hired by the policyholder to secure coverage.

My senior partner and mentor, Shelly Hurwitz, was known as a coverage guru, and brought me in to help him with legal research on the issue and I was soon knee deep in liability insurance and have never been able to pull my legs out of the muck and mire.

Shelly started teaching Insurance Law at the Buffalo Law School in about 1985 and within a couple of years, I was team teaching with him. When he retired from teaching and soon thereafter from the practice, because of illness, I took over the course and have been teaching 2nd and 3rd year law students for a quarter century or more.

I joined the FICC in 1989, as a nine year lawyer with my first meeting being at the Ritz Carlton Naples in the winter of 1990. I’ve not missed a meeting since, then, that may be 45 in a row. Other than my sponsors, who were lawyers from Rochester and Syracuse, I knew only one other FICC member when I joined, an in-house lawyer who was in my “class” coming in. It was an organization of strangers; it has become my family.

I chaired the Insurance Coverage Section from 96 – 98 (followed by Gale White), the P&O from 2002 – 2004 and was elected to the Board as a VP in 1997. Was President in 2006 – 2007.

Chris has been coming to meetings for 20 years and we were married four years ago on our beach in Ontario, Canada (where we live six months a year, with a 16 minute international commute to work). I have two married children, a daughter who is a graphic designer and a son who is a sales supervisor at GEICO. She has two daughters, one who is a chef and the other who is a financial analyst for a multi-national.

(Continued on Page 9)

**Dan D. Kohane**



**You have been a long-time member of the FDCC. Which meeting do you look back on as your favorite and why?**

Favorite meeting? Probably Boca in 2002 where Chris and I were convention chairs. It was the first FDCC meeting after 9/11 and after the Boca Anthrax scare. The warmth and fellowship of Federation friends were so apparent after such a tragic and horrible time for our nation. For most people, it was the first airline flight since 9/11, yet we filled the house. [Actually, it was the first meeting where we WERE the FDCC, the name change having taken effect at the conclusion of the previous meeting, from FICC to FDCC.]

**If you were not a lawyer, what do you imagine you would be doing and why?**

If I was not a lawyer, I probably would have gone into government or public service.

**If you had to give a one-sentence description of your practice, what would it be?**

I help clients who have "situations;" I love situations.

More descriptively, I provide coverage counseling, write coverage opinions, handle declaratory judgment actions and serve as a consultant, expert witness and counsel in insurance coverage and extra-contractual matters throughout New York state and around the country.

## Cyber-Related Losses: Are They Covered by Traditional Policies?

### Recent Legal Developments in Cyber Coverage

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Cyber risks present increasing challenges for businesses today given that use of computer systems and the internet are now key elements of the infrastructure of virtually every organization. These risks arise from malicious hacking, catastrophic weather events, electronic virus transmission, and human error. First-party losses may include network or website damage, data theft, data loss, or business interruption. Third-party losses may be attributable to internal or external transmission of private information, cyber security failure, regulatory enforcement actions based on non-compliance with data security laws, or class action data breach lawsuits.

In the privacy arena, states have promulgated regulations for the protection of personal information and have mandated specific requirements for the notification of customers in the event of a data breach. Compliance with these regulations requires thoughtful implementation by risk managers and technology experts. Investigation and mandatory notification costs associated with a breach can be significant.

In addition to implementing information technology controls, securing cyber-specific insurance may be a key tool for managing cyber risk. Many carriers are now offering a number of specialized cyber risk products, and the market for these products is growing. In determining insurance needs, companies should consider potential risks and seek appropriate risk management and insurance advice. As part of this evaluation, companies should examine their entire insurance program as more traditional policies, such as CGL, E&O, property, and crime policies, may provide coverage. Whether coverage is available under traditional business policies will depend on the policy wording, the allegations or facts of the underlying claim, and the applicable law. The law is evolving in the cyber coverage area, and we highlight some important cases below.

- ***Property: Ward Gen. Ins. Serv., Inc. v. Emp'rs Fire Ins. Co., 114 Cal. App. 4th 548 (2003)***

In *Ward*, the insured suffered a computer crash and a loss of data due to "human error." The insured sought recovery of costs to restore the data and attendant loss of business income under the Building and Personal Property Coverage Form of its first-party commercial insurance policy. The court held that data was not "tangible property" covered by the policy, which suggests that insureds may have difficulty demonstrating a loss of "tangible property" under these types of policies.

(Article continued on page 11)

## Cyber-Related Losses: Are They Covered by Traditional Policies?

- **Crime: *Retail Ventures, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 691 F.3d 821 (6th Cir. 2012).**

The insured, Retail Ventures, Inc., prevailed on appeal in its coverage claim seeking \$6.8 million in data breach losses under a computer fraud rider to a commercial crime policy. The court found that the loss resulted “directly from” the theft of insured property by computer fraud, and rejected application of the exclusion for losses of “proprietary information, trade secrets, confidential processing methods, or other confidential information of any kind.” It is important to note that not all crime policies have this type of rider/endorsement, and others exclude this type of coverage. Also, this type of coverage will only cover criminal acts. Note that data breaches often result from employee negligence.

- **E&O: *Eyeblander, Inc. v. Fed. Ins. Co.*, 613 F.3d 797 (8th Cir. 2010).**

An online marketing firm found coverage under its technology E&O policy when the firm’s online advertising caused a third-party internet user’s computer to be infected with spyware, resulting in computer damage and data loss. The court found that the insured’s acts were not intentionally wrongful, and as such, fell within the policy’s coverage. The court also found that the insured’s CGL policy covered the third party’s loss of use of his computer as this fell within the specific wording of the policy as a “loss of use of tangible property that is not physically injured.”

- **CGL: *Zurich Am. Ins. Co. et al. v. Sony Corp. of Am. et al.*, No. 651982/2011 (N.Y. Sup. Ct.)**

In this case, which is being closely monitored by insurance professionals and counsel, Zurich seeks a declaration that it is not obligated under a CGL policy to defend or indemnify Sony against claims relating to three separate breaches of Sony’s PlayStation network in which over 100 million customer records were improperly accessed. Over 50 class action lawsuits have been filed against Sony, with alleged damages in excess of \$170 million. A central issue being litigated is whether coverage is provided under Side B Personal and Advertising Injury coverage, *i.e.* whether the data breaches constituted “publication.” There have not yet been any rulings on the coverage issues, but this case may influence coverage claims going forward.

(Article continued on page 12)

## Cyber-Related Losses: Are They Covered by Traditional Policies?

Although not involving coverage under a standard business policy, a recent Seventh Circuit case highlights some interesting issues for businesses and their professional service providers, and further underscores the need to assess the risk of cyber-related losses and how those risks can be managed.

- ***Homeowners: Nationwide Ins. Co. v. Cent. Laborers' Pension Fund, 704 F.3d 522 (7th Cir. 2013)***

Here, certain pension funds retained the services of an accounting firm. To perform these services, the pension funds provided the firm with a CD containing the confidential personal information of 30,000 participants and beneficiaries of the pension funds. One of the firm's employee accountants took the disc home in her car, from which it was subsequently stolen. As a result of this theft, the pension funds incurred credit monitoring and insurance costs.

Interestingly, the funds elected to sue the accountant herself to recover the costs stemming from the loss of the CD. The accountant sought coverage for this potential liability under her homeowner's policy. In a declaratory judgment action filed by the homeowners' carrier against the insured accountant and the pension funds, the court held that the loss was not covered, based on the application of two exclusions: The policy did not cover property damage to property ...in the "care of" the insured. Also, the policy did not cover property damage arising out of or in connection with a "business"... engaged in by an "insured"... Accordingly, the court affirmed the lower court's judgment that the insurance company had no duty to defend or duty to indemnify the accountant.

This case illustrates one of the avenues a business could utilize to recover data breach losses caused by a third party – direct suit against the third party. Such a suit may not always cover the costs incurred (here, the accountant may not have the assets to cover the \$200,000 in damages). Other less costly options may be available to businesses seeking recompense. In a footnote, the Nationwide court noted that efforts made by the pension funds to recover from the accounting firm were pending, although it was unclear whether those efforts were of the legal variety. The funds' choice of suing the accountant invites speculation as to whether the pension funds had traditional policies that could potentially cover this loss.

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