WIGGIN AND DANA *A Newsletter from the Insurance Practice Group at Wiggin and Dana LLP*

INSURANCE NEWS

DECEMBER 2016

We are pleased to share this latest issue of the Wiggin and Dana Insurance Practice Group Newsletter. We circulate this newsletter by e-mail periodically to bring to the attention of our colleagues in the insurance industry reports on recent developments, cases and legislative/regulatory actions of interest, and happenings at Wiggin and Dana. We welcome your comments and questions.

TIMOTHY A. DIEMAND
JOSEPH G. GRASSO
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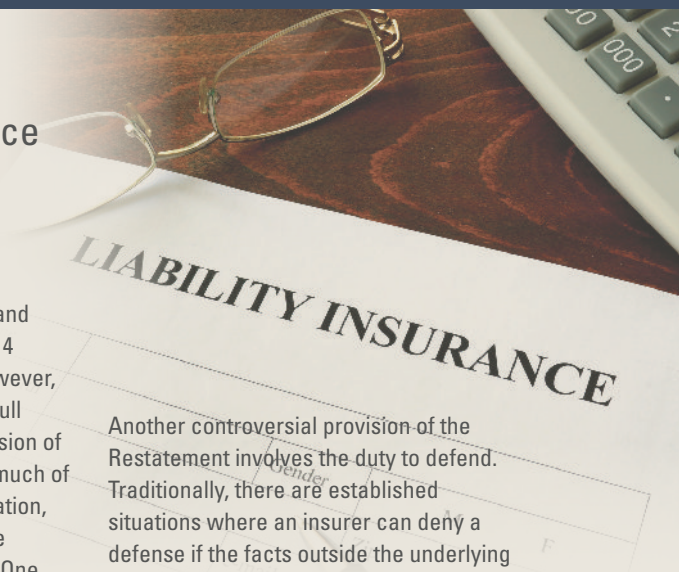
IN THIS ISSUE

Wiggin and Dana Expands to Florida

Wiggin and Dana proudly announces the expansion of our private client services practice and the opening of our new Florida office located at 231 Bradley Place, Suite 202, Palm Beach, FL 33480, with the addition of our new resident partner, Veronica Bauer.

This is the second new office for the firm in 2016, with our Washington, DC office opening in January.

We wish our colleagues, clients and friends all the best for the holiday season, and a happy and healthy new year.



Introduction to the Restatement of Liability Insurance
Underwriter Beware

In 2014, the American Law Institute (ALI) decided to publish the Restatement of Liability Insurance. After many meetings, conferences, comments, drafts, discussions and (some) controversy, the Restatement is expected to be published soon. This article describes the structure of the Restatement, how it has evolved, some of its contents, and its potential usefulness (or not). For those of us who attended law school and learned about the importance and influence of, for example, the Restatement of Torts or the Restatement of Contracts, the Restatement of Liability Insurance will not seem altogether familiar – This is not your grandfather's restatement of the law.

Traditionally, the ALI restatements, model codes, and principles projects have been quite influential in courts and legislatures. The word "traditionally" is used here with purpose because the ALI restatement projects synthesized the state of the law as it was created by statute and common law. Having law professors, judges, and practitioners distill the holdings and rulings from disparate courts was helpful to show what the law was, and this usefulness is evidenced by the sheer volume of citations to the venerable restatements in judicial opinions. More recently, however, ALI has changed its guidelines so that the reporters for restatement projects are not charged with distilling the law as it exists as their primary goal. Instead, reporters are now permitted to suggest "better" rules. This change from safely restating the law to advocating what the law should be may limit the future usefulness of the Restatement of Liability Insurance and ALI's similar contemporary projects.

In 2010, the ALI started with liability insurance as a "Principles Project" and approved Chapters 1 and 2 at the 2014 annual meeting. In October 2014, however, the document was changed to be a full restatement project. The current version of the Restatement has four chapters, much of which has been approved for publication, and the ALI has a timeline to approve the remainder in early 2017. Chapter One includes policy interpretation, waiver and estoppel, and misrepresentation. Chapter Two includes the duty to defend, the duty to settle, and cooperation. Chapter Three includes insuring clauses and exclusions, conditions, and limits, retentions and deductibles. Chapter Four includes enforceability and remedies.

While some portions of the Restatement will be familiar to those practicing as insurance professionals, there are other portions that are not summaries of majority law or the law in any state. With very few exceptions, the "better" rules advocated by the reporters appear to be pro-policyholder views of what they believe the law should be. For example, section 3 abandons the "plain meaning rule" of contract interpretation in favor of looking at extrinsic evidence of drafting history or contracting intent. The insurer has the burden to show that the policyholder's interpretation is unreasonable in light of the extrinsic ambiguous evidence available. On the opposite side, however, the drafters suggest that insurers are barred from using drafting history, state regulatory filings, other versions of the policy available on the market, custom and practice, and other extrinsic evidence. This is, no doubt, not the law as established by the majority of courts in the country.

Another controversial provision of the Restatement involves the duty to defend. Traditionally, there are established situations where an insurer can deny a defense if the facts outside the underlying complaint indisputably showed there is no coverage. Under section 13(3), the reporters would severely limit these situations to very specific instances, simply doing away with the decisions of many courts who have considered this issue over the years. For example, late notice, fraud, and failure to cooperate would not be valid bases for an insurer to deny a defense if the Restatement were followed by a court. The Restatement would impose on insurers the duty to make a settlement offer within limits even if there is no demand from the underlying plaintiff. Moreover, a failure to settle would expose insurers to the full amount of a judgment and other foreseeable damages, including punitive damages, even if the damages are excluded under the policy or are against public policy.

There are other provisions of the Restatement that are similarly outside the mainstream of established law. Insurers should be vigilant about policyholders citing the Restatement in briefs and about any court's inclination to adopt a portion of it. When the Restatement is cited in litigation, insurers would be wise to educate the court on how it is different from other restatements and that certain sections are both outside the established law and represent in some instances the reporter's opinion of what would make a "better" rule.

FROM
TheCOURTS

Florida Supreme Court Holds That When Concurrent Covered and Non-Covered Causes Lead to a Loss, the Loss is Covered

Sebo v. Am. Home Assurance Co., No. SC14-897 (Fla. Dec. 1, 2016).

The Florida Supreme Court recently ruled that when there are concurrent causes of loss to property only some of which are covered, all of the damages are covered. The court did leave open, however, the possibility that an insurer could still defeat a claim if it shows that an excluded risk prompted a chain of events causing damage. Prior to this decision, the Florida intermediate courts of appeals were split on this issue, but the concurrent cause doctrine is now the law across the state.

In this specific case, a jury had awarded the policyholder damages because his home was damaged due to water intrusion and wind from a hurricane, but also found the damages were caused by faulty construction – the first set of damages were covered under the policy at issue, the later were not. In reaching its decision, the court rejected the efficient proximate cause theory and held that applying it in this situation was not feasible because it would be impossible to determine whether the primary cause of damages was the covered peril of rain and wind or the excluded construction defects.

NOTE: As a result of this case, insurers should consider including anti-concurrent cause provisions in their policies if they wish to avoid the default application of this rule in Florida and other jurisdictions.

Delaware Court Holds Disgorgement is an Insurable Loss Under NY Law

TIAA-CREF Individual & Institutional Services, LLC v. Illinois National Ins. Co., No. N14C-05-178 JRJ CCLD (Del. Super. Ct. Oct. 20, 2016).

TIAA-CREF, a retirement service provider, was sued in Delaware in three class actions for allegedly delaying its clients' transfer and withdrawal requests. The defendant agreed to settle the allegations, including paying the alleged profits it earned through the alleged wrongful actions. The defendant then submitted the settlement/loss to its tower of professional liability insurers, all of whom denied the claim as an uninsurable loss. Applying New York law, the court held on summary judgment that there was "no conclusive link between the settlements in the underlying actions and wrongdoing by TIAA-CREF that would render the settlement agreements uninsurable disgorgement." Because the defendant did not admit any wrongdoing and did not face any claims by the SEC or other regulators, the court found cases cited by the insurers unpersuasive. The court held open for trial the question of whether consent of the insurers was needed before settlement. An appeal of this ruling is expected.

Pennsylvania Court Holds Faulty Workmanship Is Not An Occurrence

State Farm Fire & Cas. Ins. Co. v. Kim's Asia Construction, No. 2:15-cv-06619 (E.D. Pa. Oct. 5, 2016).

A Pennsylvania federal judge recently ruled in favor ofunderwriters by holding that

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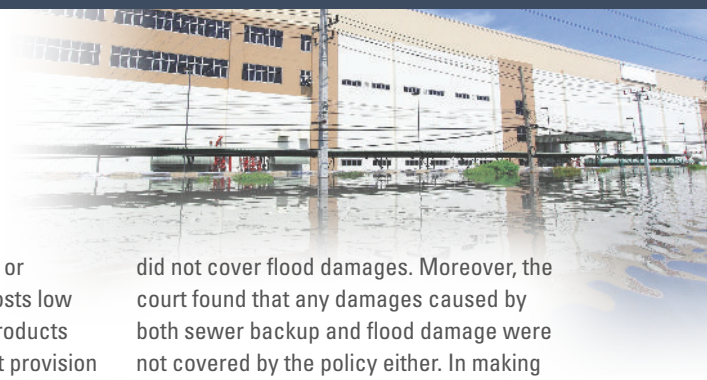

FROM
TheCOURTS CONTINUED

they do not have to defend or indemnify a contractor who was accused of negligently installing a faulty roof. The court held that faulty workmanship is not an "accident" that establishes an "occurrence." State Farm had been defending the contractor under an ROR but prevailed in this declaratory judgment action. The judge cited a 2006 decision by the Pennsylvania Supreme Court, *Kvaerner Metals v. Commercial Union Ins. Co.*, in rendering his decision that the term "accident" in general liability policies implies fortuity that was not present in this situation.

West Virginia Finds No Coverage for Intentional Acts, Even for Innocent Co-Insureds

Am. Nat'l Prop. & Cas. Co. v. Clendenen, No. 16-0290 (Sup. Ct. App. W.V. Nov. 17, 2016).

After two teenage girls confessed to killing a classmate and being sentenced to lengthy sentences, the estate of the deceased victim filed a civil suit against the girls and their parents. The claims against the parents alleged negligently failing to monitor their daughters' whereabouts and activities. The parents sough coverage under their homeowner's policies, which has an exclusion for intentional acts. The policies also had a separation of insureds provision. The parents argued that the intentional acts of one insured cannot be used against an innocent co-insured. Answering certified question from a federal judge, the West Virginia Supreme Court ruled that the intentional act exclusion was a bargained for term in the contract and should be enforced as written. The court recognized that "insurers exclude certain coverages which the insurer is either unable or unwilling to underwrite to keep costs low and accurately price insurance products for all policyholders" and that that provision must be enforced, even when it works to the detriment of innocent co-insureds.

New Jersey Court Rules Denial of Flood Coverage Not Done in Bad Faith

Carevel LLC v. Aspen American Insurance Co., case number 2:13-cv-7581, in the U.S. District Court for the District of New Jersey.

Carevel, LLC, owner of a commercial building damaged during Superstorm Sandy, brought a bad faith action against Aspen's American Insurance Company for its refusal to pay property damages. The policy in issue covered water damage if it was caused by backup from the sewer or drainage system but not for flood damages. Carevel filed two property loss notices forms, which contained invoices in the amount of $23,130 for remediation work and for the replacement of two boilers and a water heater. Aspen hired an independent investigator to review the property damage. The investigator concluded that the sewers and drains were backed up due to flooding. Citing the fact that Carevel had to replace overhead gates on the property, the investigators found, however, that "surge waters" not "backup" were responsible for the damages. In November, a New Jersey federal judge granted Aspen's motion for summary judgment on Carevel's claims for breach of contract, bad faith and violations of New Jersey's claims settlement law. In particular Judge William H. Walls ruled that Aspen did not act in bad faith when it denied coverage holding that the building's policy did not cover flood damages. Moreover, the court found that any damages caused by both sewer backup and flood damage were not covered by the policy either. In making its ruling, the court noted that while Aspen produced an expert report on the cause of the damages, Carevel never provided its own evidence refuting the investigator's conclusions. As such, the evidence produced by Aspen defeated the invoices produced by Carevel because the insured "failed to establish its prima facie case for breach of the policy and defendant has established that plaintiff's claimed losses fall within one of the policy's exclusions."

7th Circuit Permits Discovery in an Exception to the Four Corners Rule

Landmark Am. Ins. Co. v. Peter Hilger, No. 15-2566, 2016 U.S. App. LEXIS 17343 (7th Cir. Sept. 22, 2016).

The 7th Circuit Court of Appeals recently ruled that Illinois law permits an insurer to seek discovery of evidence outside the four corners of the underlying complaint, on the issue of whether the claimant qualifies as an insured. Hilger was sued in three separate suits accusing him of misrepresentations in premium finance loan transactions carried out by his company. Hilger sought coverage under a professional liability policy the Landmark had issued to a related party involved in the transactions. The district court had ruled that the underlying complaint alleged that Hilger was an independent contractor of the named insured and that reference to anything outside the complaint was inappropriate. The Court of Appeals explained that an insurer cannot look at evidence outside the underlying complaint when the insurer

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FROM
TheCOURTS CONTINUED

is not seeking a declaratory judgment of defending under a reservation of rights. But where the insurer is seeking a declaratory judgment, the limitation about whether the claimant is an insured does not apply. Evidence outside the underlying complaint is permitted so long as it does not go to an issue that must be decided in the underlying action. Here, the underlying action did not require an adjudication of whether Hilger was an independent contract or an insured, and discovery into those issues was permitted.

5th Circuit Rules that Payments Made as a Result of Fraudulent Email Are Not "Computer Fraud"

Apache Corp. v. Great Am. Ins. Co.,
No. 15-20499, 2016 U.S. Spp. LEXIS 18748 (5th Cir. Oct. 15, 2016).

A recuring pattern has emerged whereby companies have been convinced to send money to fraudsters. The typical scenario is that someone posing as a vendor contacts the company via email asking that future payments be made to a new bank account. In this case, $7 million of payments were made before Apache Corp. discovered the scheme, which consisted of an initial call from the imposters making the request, followed by a fraudulent email confirmation. Apache filed a claim under a crime protection policy seeking coverage for "computer fraud." Great American denied the claim because the loss did not arise directly from the use of a computer. After Apache prevailed in the federal district court, Great American appealed the ruling. The Court of Appeals vacated the district court ruling, finding that interpreting computer fraud to include any scheme in which a computer is used would "convert the computer-fraud provision to one for general fraud." The court reasoned that emails and other electronic communication are ubiquitous and hardly any form of communication that is not facilitated by computers. In this situation, the payment was authorized by Apache and that Apache failed to properly investigate the new fraudulent information, i.e., it paid legitimate invoices. The invoices, not the fraudulent email, were the reason the funds were transferred.

FROM
TheREGULATORS

NAIC Model Act on Data Security

The comment period for Version 2 of the NAIC Insurance Data Security Model Law recently closed. This revised version of the Model Act received a great deal of attention from insurers, brokers and industry trade groups. It is unclear at this time whether the NAIC will modify the draft and adopt a final version or if it will publish a new draft for additional comment. Like other model laws, each state would have to adopt it for it to become binding. Additional information can be found by **CLICKING HERE**.

New York Dept. of Financial Services Draft Regulation on Data Security

The New York Department of Financial Services has published a draft regulation on insurance data security. This far reaching regulation has been the subject of much discussion. Many comments to the draft regulation were submitted and Superintendent Maria Vullo has indicated that the DFS will carefully consider all comments when revising the draft and publishing a final regulation. The draft regulation was proposed to be effective on January 1, 2017. For a copy **CLICK HERE**.

About Wiggin and Dana's Insurance Practice Group

The Wiggin and Dana Insurance Practice Group provides insurers, reinsurers, brokers, other professionals and industry trade groups with effective and efficient representation. Our group members regularly advise clients in connection with coverage issues, defense and monitoring of complex claims, regulatory proceedings, policy wordings, internal business practices, and state and federal investigations. We represent clients in arbitrations and mediations as well as in the courts. We have broad experience in many substantive areas, including property, commercial general liability, inland and ocean marine, reinsurance, E&O, D&O and other professional liability, environmental, energy and aviation. A more detailed description of the Insurance Practice Group, and biographies of our attorneys, appear at www.wiggin.com.

About Wiggin and Dana LLP

Wiggin and Dana is a full service firm with more than 135 attorneys serving clients domestically and abroad from offices in Connecticut, New York, Philidelphia, Washington, DC and Palm Beach. For more information on the firm, visit our website at www.wiggin.com.

AttorneyNOTES

Michael Menapace has been participating on an ARIAS-U.S. task force looking into data security in the arbitration process and recently presented a related general session and chaired a breakout session at the Fall Conference in New York City.

Joe Grasso provided the annual "Legal Update" at the 2016 Meeting of the American Institute of Marine Underwriters on November 17th.

Wiggin and Dana's Insurance Practice Group was represented at the following conferences:

IUMI – Genoa – September 18-21
IMCC – Dublin – September 28-30
Tulane ALI – New Orleans – October 26-28
Ft. Lauderdale Mariners Seminar – November 1-2

Accolades &AWARDS

Department of the Year – Wiggin and Dana's Litigation Department Awarded by the Connecticut Law Tribune"

Michael Menapace received **SuperLawyer of the Year** recognition for Insurance Coverage.

Wiggin and Dana is pleased to announce that 24 attorneys have been selected for inclusion in the **2016 Connecticut Super Lawyers Magazine**, with 2 of them also listed as a **Top 50 Lawyer in Connecticut**, and 6 attorneys have been selected for inclusion in the **2016 New York Metro Super Lawyers Magazine**.

This Newsletter is a periodic newsletter designed to inform clients and others about recent developments in the law. Nothing in the Newsletter constitutes legal advice, which can only be obtained as a result of personal consultation with an attorney. The information published here is believed to be accurate at the time of publication, but is subject to change and does not purport to be a complete statement of all relevant issues. In certain jurisdictions this may constitute attorney advertising.

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