New Jersey Appellate Division Finds That War Exclusion Does Not Apply to Government-Backed Cyberattack

Merck is a pharmaceutical company with a global computer network. In 2017, malware known as NotPetya infected Merck's computer and network systems. The malware was introduced through a server in its Ukrainian office running accounting software that Merck used to transmit financial data to the Ukrainian government. The malware encrypted data and then sought a ransom payment for the decryption key. Over 40,000 machines in Merck's global network were infected creating massive disruption to Merck's operations. The malware quickly spread to at least 64 countries.

Merck sought coverage under its all-risks property insurance policies. The insurers' cyber consultant concluded with high confidence that the NotPetya cyberattack was orchestrated by actors working for or on behalf of the Russian Federation. As a result, most of Merck's insurers denied coverage, citing the "hostile or warlike" exclusion.

Merck sued and the trial court ruled that the hostile or warlike exclusion applied only to traditional forms of warfare and not cyberattacks. On appeal, the insurers argued that the word "hostile" had a meaning beyond traditional warfare and included any action that "reflects ill will or a desire to harm by the actor," as long as the actor was a government or sovereign power.

But the New Jersey Appellate Division didn't agree. "The exclusion of damages caused by hostile or warlike action by a government or sovereign power in times of war or peace," the court

reasoned, "requires the involvement of military action." The court added, "[t]he exclusion does not state the policy precluded coverage for damages arising out of a government action motivated by ill will."

The court agreed with the trial court that the plain language of the exclusion did not include a cyberattack on a non-military company that provided accounting software for commercial purposes to non-military consumers, no matter if the attack was instigated by a private actor or a "government or sovereign power."

The court also considered caselaw interpreting "war exclusions" and found that they "demonstrate a long and common understanding that terms similar to 'hostile or warlike action' by a sovereign power are intended to relate to actions clearly connected to war or, at least, to a military action or objective."

Thus, the court held that the hostile or warlike exclusion did not bar coverage for Merck's losses caused by the cyberattack.

The case is *Merck & Co. v. Ace Am. Ins. Co.*, No. A-1879-21 (N.J. App. Div. May 1, 2023).

Fourth Circuit Holds That a Search Warrant Is Not a "Claim" under Professional Liability Policy

A law firm partner represented another attorney in a federal racketeering investigation. The government later informed the partner that he was now the subject of an investigation and suggested that he stop representing the attorney due to nonwaivable conflicts of interest ("conflict letter"). A few months later, the government executed a search warrant on the partner's law firm and seized thousands of documents. It also sent a letter stating that the partner was the target of an ongoing criminal investigation ("target letter").

The partner and his law firm submitted a claim to their professional liability insurer for losses related to the search warrant and defense costs associated with the criminal investigation of the partner. The insurer denied coverage and the partner and his law firm sued.

The dispute centered on the meaning of "Claim," and specifically, whether there was "a written demand or written request for monetary damages or non-monetary relief."

Affirming the trial court, the Fourth Circuit ruled that there wasn't a "Claim."

The court explained that a search warrant is not a "Claim" because it doesn't seek relief against an insured and is not a written demand or request. The warrant application asked the court to grant law enforcement authorization to search and seize the law firm's files. But that authorization is not relief "against an Insured" because the government was not seeking redress or a benefit from the law firm. The target of a warrant is "not asked to say or to do anything" in response to the warrant. Instead, the warrant authorizes law enforcement to carry out the search and seizure regardless of any response by the target of the warrant.

The court also found that the insurer did not owe a defense for the criminal investigation because the government's conflict and target letters made no demand or request for relief against the insured. The conflict letter merely informed the partner of his ethical duties. Similarly, the target letter's request that the government be notified on how the partner intends to proceed was not a request for redress or benefit, like an injunction or specific performance.

The court rejected the insureds' characterization of the letters as "demands" and found that there was no coverage because there was no "Claim."

The case is *Brown, Goldstein, Levy LLP v. Federal Ins. Co.*, No. 22-1023 (4th Cir. May 18, 2023).

Sixth Circuit Finds No Duty to Defend in Kona Coffee Dispute

L&K Coffee roasts and sells coffee products throughout the United States. Coffee growers from the Kona region of the Island of Hawaii sued L&K and other coffee companies for "false designation of origin, false advertising, and unfair competition" in violation of the Lanham Act. Plaintiffs alleged that the defendants falsely designated the origin of the coffee they branded and distributed as "Kona" coffee even though most of the coffee beans were sourced from other regions of the world. Defendants' intentional mislabeling allegedly caused consumer confusion and mistaken purchases, damaging the reputation and goodwill of the Kona name because the defendants were ultimately passing off as authentic a product "of inferior quality."

L&K sought a defense under the personal and advertising injury coverage in its commercial general liability policies. L&K contended that two offenses within the definition of "personal and advertising injury" applied: (1) a publication that disparages a person's or organization's goods, products, or services, and (2) infringing upon another's slogan in the insured's advertisement.

The insurers denied coverage because the complaint alleged neither of these offenses but asserted false advertising, which was not covered.

L&K sued, and on summary judgment, the trial court ruled for the insurers. L&K appealed. The Sixth Circuit first considered if the complaint alleged disparagement. The court looked to Michigan law on disparagement and observed that it requires a company to make false, derogatory, or disparaging communications about a competitor's product. The court found that the complaint did not allege that L&K made a derogatory statement about plaintiffs' product but only that L&K falsely designated the origin of its own product. This was not disparagement.

L&K conceded that the complaint never used the term "disparagement," but argued that plaintiffs' claims should be interpreted as such. Plaintiffs alleged that defendants were selling run-of-the-mill coffee labeled as Kona coffee. A consumer who tries that inferior product thinking it is Kona coffee will conclude it is not worth a premium price. Because this would cause plaintiffs to lose sales, L&K argued that this asserted disparagement by implication.

The court disagreed. It was unsure if Michigan law even recognized a cause of action for disparagement by implication, but regardless, found such claim would be too remote to constitute disparagement because it involved merely false statements the insured made about its own product without comparison to another's product. Plaintiffs focused on the result of L&K's false labeling and not any false statement about plaintiff's products.

Although the court did not mention this, in reality, plaintiffs were alleging the opposite of disparagement. By trying to pass off their coffee as using Kona beans, they were holding Kona coffee in high esteem.

Turning to slogan infringement, the court found that the term "slogan" meant a motto or catch phrase. The complaint details why consumers desire Kona coffee, but "at bottom," the court explained, plaintiffs used the "Kona" descriptor as a source identifier of their coffee, not as a catch phrase. Nor did plaintiff claim any ownership over the phrase "Kona coffee." Thus, plaintiffs did not allege slogan infringement under the policy.

So the insurers had no duty to defend L&K in the suit.

The case is *L&K Coffee LLC v. LM Ins. Corp.*, No. 22-1727 (6th Cir. June 1, 2023).

Focusing on Conduct and Not Labels, 5th Circuit Finds No Coverage for Intentional Dumping of Wastewater into Public Sewers

An animal foodstuff maker in Mississippi, Gold Coast Commodities, Inc., was investigated by state regulators for intentionally dumping hot, greasy wastewater into the city sewer system. The city sued Gold Cost raising several claims. The foodstuff maker sought coverage from its insurer, Crum & Foster. Crum & Foster denied coverage because the underlying suit was based on intentional conduct and thus was not an "accident."

Gold Coast brought a declaratory judgment action in federal court. The district court granted the insurer's motion to dismiss. Gold Coast appealed.

In affirming the lower court's decision, the Fifth Circuit noted that, under Mississippi law, the focus for intentionality isn't on the consequences or damages that flow from the insured's act, but on the tortious act. The complaint contained repeated allegations that Gold Coast intentionally dumped its wastewater into public sewers.

Gold Coast argued that because the City advanced claims of negligence, the alleged wrongdoings could have been accidental. The court disagreed and focusing on the allegedly tortious conduct – not any particular legal theories or labels – reasoned that "negligence" is not a factual allegation, but a legal conclusion. The court said that "drive-by" or conclusory uses of the word "negligence" do not transform intentional conduct into accidental conduct constituting an "occurrence."

The overarching theme of the complaint was that Gold Coast deliberately dumped wastewater into public sewers. Because no occurrence was alleged in the complaint, Gold Coast wasn't entitled to a defense from Crum & Foster.

The case is *Gold Coast Commodities, Inc. v. Crum* (5th Cir. May 22, 2023).

Third Circuit Finds No Coverage in Fracking Dispute over Workmanship

U.S. Energy hired Superior Well Services to extract natural gas from its wells through hydraulic fracking. U.S. Energy accused Superior of damaging its wells during the fracking process. Superior notified its insurer, American Home, about the potential claim. American Home agreed to defend Superior under a reservation of rights. U.S. Energy later sued Superior in New York state court, claiming that Superior had damaged 97 of its wells.

The case went to trial and the jury found against Superior on the breach of contract claim and found that Superior had damaged 53 of the 97 wells. The jury's verdict form specified that Superior "fail[ed] to perform its contract with U.S. Energy in a workman like manner" and that this "failure" was "a substantial factor in causing damage to the U.S. Energy wells." The jury awarded U.S. Energy $6.16 million ($13.18 million after interest).

American Home then filed a declaratory judgment action, lost before the trial court, and appealed.

The Third Circuit reversed. Applying Pennsylvania law, the court held that "faulty workmanship" claims do not present the degree of fortuity contemplated by the ordinary definition of "accident" as used in the policy. The court rejected Superior's argument that phrasing of the jury verdict – "workman like manner" – was materially different than "faulty workmanship."

The court also rejected Superior's argument that an "underground resources and equipment coverage" (UREC) endorsement displaced the policy's "occurrence" requirement, noting that the endorsement incorporated the "occurrence" requirement by reference. It would

make little sense, the court explained, for the UREC endorsement to eliminate key terms of the policy.

The case is *Am. Home Assur. Co. v. Superior Well Servs., Inc.*, No. 22-1498 (3d Cir. May 31, 2023).

Royalty Dispute Over Logos Used on Apparel Not Causally Related to Advertising, Washington Federal Court Explains

Lucky Vintage sold clothing that displayed logos and artwork of "iconic local companies." Two such companies were a body shop and a cocktail lounge in Seattle. The companies entered into "Member Royalty Agreements" with Lucky Vintage, under which the companies licensed their logos and artwork to Lucky Vintage in return for royalties from the sale of clothing bearing their logos and artwork. The agreement also called for quarterly statements with sales and internet traffic statistics.

The two companies felt that Lucky Vintage did not make good on its promise and sought to represent a class of businesses in several states who also did not receive their royalty payments or quarterly statements.

Lucky Vintage turned to its commercial general liability insurer for a defense. The policy covered "personal and advertising injury" caused by an offense arising out of the insured's business. One of the covered offenses was "the use of another's advertising idea in your 'advertisement.'" But the insurer denied coverage because the suit did not allege a causal connection between Lucky Vintage's advertising and the relief being sought.

The court agreed with the insurer. The suit didn't allege that Lucky Vintage used plaintiffs' advertising idea without permission. Lucky Vintage had a valid license to market apparel

displaying plaintiffs' logos and artwork. Instead, plaintiffs alleged they were harmed because Lucky Vintage failed to remit the royalty payments and sales reports required under the licensing agreement. The alleged injury was caused not by Lucky Vintage's use of plaintiffs' logos and artwork, but a breach of the licensing agreement.

And that breach of the licensing agreement presented another reason why the claim was not covered. The policy had an exclusion for personal and advertising injury "[a]rising out of a breach of contract, except an implied contract to use another's advertising idea in [the insured's] 'advertisement.'" Lucky Vintage argued that this exclusion would not exonerate the insurer from defending because the suit asserted violations of Washington's Consumer Protection Act (CPA), which makes unlawful "[u]nfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce." Lucky Vintage argued that the CPA claim did not depend on plaintiffs' breach of contract claim because a party might be liable for unpaid royalties even with no licensing agreement. But the court wasn't buying it. It found that the CPA claim, as pleaded, arose out of the breach of the royalty agreement. Plaintiffs even cited the Member Royalty Agreements as a common factual question supporting class certification. The court also noted that Washington caselaw interprets the phrase "arising out of" to be broader than the phrases "caused by" or "resulting from."

The insurer thus had no duty to defend Lucky Vintage in the suit.

The case is *Lucky Vintage Brands LLC v. Ohio Sec. Ins. Co.*, No. C22-0417 TSZ (W.D. Wash. May 25, 2023).

Mississippi Appeals Court Rejects Insured's Claim That Reservation of Rights Letter Caused Him Emotional Distress, Finds Legitimate Coverage Question

Jerome Holloway was involved in an automobile wreck while driving a Dodge Ram 3500 pickup truck owned by his employer, Port City Connection LLC (Port City). At the time of the wreck, Holloway was on a personal trip with his then-girlfriend, Jacqueline Ward. Holloway was not acting within the scope of his employment.

Ward was injured in the wreck and sued Holloway for negligence. Holloway asserted that Ward's claims against him were covered by an insurance policy that National Fire & Marine Insurance Company (National Fire) had issued to Cassius Williams d/b/a Uncle Mervin's Transport (Williams). Port City was an independent contractor for Williams, and the Dodge Ram had been used to provide transportation services on behalf of Williams.

National Fire agreed to defend Holloway under a reservation of rights. National Fire later funded a settlement and secured a release of all claims against Holloway. But Holloway sued National Fire in Mississippi state court anyway, alleging "bad faith." He claimed to have suffered emotional distress because of National Fire's reservation of rights. The trial court granted summary judgment for National Fire.

The appeals court affirmed. The court held that National Fire had a legitimate basis for reserving its rights because the Dodge Ram was not being used for business purposes at the time of the accident and Holloway was not a permissive user under the policy. The court noted that National Fire never denied coverage but instead reserved rights and sought a judicial determination of coverage. It did not matter that Holloway had Port City's permission to use the truck. The policy made clear that permission for purposes of coverage had to come from Williams – to whom the policy was issued – not Port City.

For these reasons, the court affirmed the lower court's judgment.

The case is *Holloway v. Nat'l Fire & Marine Ins. Co.*, No. 2021-CA-01066-COA (Miss. Ct. App. May 9, 2023).

Rivkin Radler LLP
926 RXR Plaza, Uniondale NY 11556
www.rivkinradler.com
©2023 Rivkin Radler LLP. All Rights Reserved.