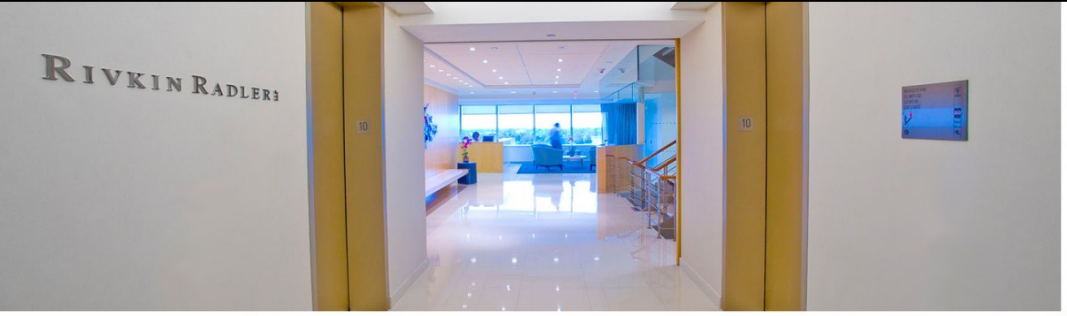

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Pollution Exclusion Bars Coverage for Criminal Proceeding Over Submission of Fraudulent Coal-Dust Samples, Sixth Circuit Affirms

The U.S. Court of Appeals for the Sixth Circuit affirmed an award of summary judgment in favor of an insurer, agreeing that the pollution exclusion bars coverage for claims by former coal company employees accused of conspiring to submit fraudulent coal-dust samples to federal regulators.

The Case

The Department of Labor's Mine Safety and Health Administration (MSHA) limits the concentration of coal dust that can be in the air in a mine. Coal companies are required to monitor and report their dust levels. High dust levels can put a halt to production and result in fines.

Armstrong Coal Company had a checkered history of compliance with MSHA regulations. In 2018, eight employees were indicted for conspiring to falsify coal-dust samples submitted to the MSHA. The employees sought a defense in the criminal case against them under Armstrong's directors, officers, and organization liability insurance policy ("D&O" policy).

The D&O insurer denied coverage based on the pollution exclusion. The exclusion applied to any claim "arising from, based upon, or attributable to" any discharge (or threat of discharge) of any "pollutant" or any "direction, request or voluntary decision" to test for or monitor any

"pollutant." The D&O insurer determined that coal dust was a "pollutant" and that the criminal proceedings arose from a direction to monitor and test for coal dust.

The employees sued the insurer for breach of contract and bad faith denial of their claim. All parties moved for summary judgment. Applying Kentucky law, the trial court held that the pollution exclusion applied, and absent a contractual obligation to provide coverage, the bad faith claim could not proceed.

The employees appealed on two grounds. First, that coal dust was not a pollutant. Second, that the criminal proceeding did not arise from any direction, request or voluntary decision to test for, abate, monitor, clean up, remove, contain, treat, detoxify or neutralize pollutants.

The Sixth Circuit's Decision

The Sixth Circuit affirmed.

The employees argued that the presence of coal dust in a mine, where it is supposed to be, is not a pollutant. Pointing to a Delaware trial court ruling, the employees contended that substances are not pollutants if they are used for their intended purposes, used in an appropriate confined space, or when they are disposed of properly. Because the coal dust never left the mine, the employees argued that it cannot be considered a pollutant.

The Sixth Circuit disagreed. It found that the parties already agreed on how to define "pollutant," so the definition crafted by the Delaware court did not apply. The Sixth Circuit noted that the issue is really whether coal dust is a contaminant or irritant. It rejected the employees' attempt to depart from the policy language and concluded that an ordinary person would consider coal dust to be a contaminant or irritant under these circumstances. It noted that "[h]ere, we do not have a substance that has caused damage outside its noxious capacity or a situation where the

substance's intended use caused an unusual reaction. Instead, we are dealing with a byproduct that has no intended purpose and that is regulated precisely because of its inherent ability to pollute, contaminate, and irritate."

The court next addressed the employees' "arising from" argument. The employees contended that the filing of criminal charges was not caused by Armstrong's duty to regulate coal dust. Instead, the prosecution was caused by a conspiracy to commit fraud.

Under Kentucky law, the phrase "arising from" does not require a direct proximate causal connection but instead merely requires some causal relation or connection. The court found that there was a causal connection between the criminal proceedings and a direction to test for and monitor coal dust. It explained that the MSHA, through its regulations, directed Armstrong and its employees to test for and monitor the level of atmospheric coal dust in the mines. Armstrong had to adhere to MSHA regulations, or face a shutdown or fines. Because of this, the employees "conspired to commit dust fraud by knowingly and willfully altering the company's required dust-sampling procedures, by circumventing the dust-sampling regulations, submitting false samples, and by making false statements on dust certification cards."

For a claim to arise from a direction to test for or monitor coal dust, the court emphasized, it need only have some causal connection to those regulatory requirements. Absent the MSHA's regulations, the employees would not have had to monitor or submit samples at all, and therefore would not have conspired to commit fraud. Thus, the court concluded that the criminal proceedings arose from a direction to test for or monitor a pollutant. The pollution exclusion therefore barred coverage for the criminal proceedings.

The Sixth Circuit also upheld dismissal of the employees' bad faith claim.

The case is *Barber v. Arch Ins. Co.,* No. 20-6307 (6th Cir. July 7, 2021). It is an unpublished decision and Sixth Circuit rules limit its citation.

Fifth Circuit Finds Insurer Has Duty to Defend Insured for a Data Breach Litigation Under Policy's Personal and Advertising Coverage

The Fifth Circuit, applying Texas law, held that an insurer had a duty to defend its insured in a data-breach litigation involving a hack of the insured's customers' credit card information.

The Case

The Plaintiff, Landry's, Inc. was a Houston-based company that operated retail properties. Paymentech, LLC, a branch of JPMorgan Chase Bank, processed Visa and MasterCard payments to those properties. In December 2015, Paymentech discovered credit-card problems at some of Landry's properties. Paymentech began an investigation, which uncovered a data breach that occurred across 14 Landry's locations between May 2014 and December 2015. Landry's own investigation discovered that the data breach involved the unauthorized installation of a program on its payment-processing devices. Over approximately a year and a half, the program retrieved personal information from millions of customers' credit cards. At least some of that credit-card information was used to make unauthorized charges. Visa and Mastercard assessed Paymentech a total of almost $20 million in penalties.

Paymentech and Landry's were parties to a Select Merchant Payment Card Processing Agreement (the "Paymentech Agreement"). In that agreement, Landry's was obligated to follow all Payment Brand Rules, comply with certain security guidelines, and indemnify Paymentech for any assessments, fines, or penalties stemming from any failure by Landry's to comply with the

Payment Brand Rules. However, Landry's refused to pay Paymentech for the losses assessed by Visa and Mastercard.

In May 2018, Paymentech sued Landry's in a federal court in Texas for breach of the Paymentech Agreement. Landry's sought coverage under its policy's personal and advertising injury coverage. The coverage applied to "injury . . . arising out of one or more of the following offenses: . . (d) [o]ral or written publication, in any manner, of material that slanders or libels a person or organization . . . ; (e) [o]ral or written publication, in any manner, of material that violates a person's right of privacy."

The insurer denied any duty to defend and indemnify. While funding its own defense against Paymentech, Landry's filed a separate action against the insurer for breach of contract and for a declaration regarding its duty to defend Landry's in the underlying litigation. The parties cross-moved for summary judgment. The district court denied Landry's motion, granted the insurer's motion, and dismissed all claims. Landry's appealed.

The Decision

The Fifth Circuit Court of Appeals reversed the district court, viewing the policy's "personal injury and advertising" coverage expansively. The court relied on dictionary definitions of "publications" that were "quite broad." The definitions included "[t]o expose to public view." The court concluded that the underlying complaint plainly alleged that Landry's published its customers' credit-card information – that is, "exposed it to view" – first when it was routed through the affected systems and second when the hackers used it for fraudulent purchases. The court also noted that the policy provision was broadly written to apply to a publication made "in any manner."

The court concluded that the "publication" involved an injury "arising out" the violation of a person's right to privacy. The court noted that the words "arising out of" "connote breadth." The court rejected the insurer's argument that it was not required to defend Landry's in a breach of contract action, as opposed to a tort action, stating that the policy contained no such "salami-slicing distinctions."

For these reasons, the court reversed the judgment of the district court, concluded that Landry's was entitled to summary judgment on liability, and remanded the case for further proceedings.

The case is *Landry's, Inc. v. Ins. Co. of the State of Pennsylvania.,* No. 19-20430 (5th Cir. July 21, 2021). The insurer has since filed a petition for en banc hearing before the entire Fifth Circuit, contending that the two-judge panel's overly broad interpretation of "publication" was erroneous with far-reaching consequences.

Warranty Exclusion Bars Directors & Officers Liability Coverage for Claim Involving Ponzi Scheme, Ohio Appellate Court Holds

An Ohio appellate court, applying Massachusetts law, ruled that a warranty exclusion barred Directors & Officers liability coverage for claims involving a Ponzi scheme.

The Case

Beginning in 2015, current and former employees of two companies, Downing Partners and a wholly owned subsidiary, 3si, alleged that they had been fraudulently induced into entering into employment agreements with, and investing in 3si and Downing. The current and former employees alleged that Shaut, an attorney licensed to practice law in the state of Ohio and others promised employment opportunities in exchange for significant personal investments in the

companies. According to the allegations, Shaut and the others had no intention of paying the current and prospective employees for their employment and used their investments to pay the salaries and benefits of other employees.

Shaut sought insurance coverage from 3si's Directors & Officers insurer, National Casualty Company (NCC). NCC asserted the policy's warranty exclusion. The warranty exclusion barred coverage based on a policy applicant's "intent to deceive" or "any misrepresentation or omission that materially affects either the acceptance of the risk or the hazard."

Shaut sued NCC in Ohio state court alleging that NCC breached the 2016-17 policy. He also sought a declaration that NCC was obligated to indemnify him for any judgments arising out of the Ponzi scheme. NCC moved for summary judgment. The trial court granted NCC's motion. Shaut appealed.

The Decision

The Ohio Court of Appeals affirmed.

The court first addressed the choice of law. Although Shaut was located in Ohio and all of his assets were there, the policy applications were executed in Massachusetts, 3si (the named insured) was located in Massachusetts, and the underlying suits were filed in Massachusetts. Therefore, the court applied Massachusetts law.

Turning to the merits, the court held that the relevant inquiry under the warranty exclusion was whether NCC would have issued the policy under materially different terms, or at all, had it known the true facts. The court agreed that 3si's omissions or statements in its policy application were material. The court noted that 3si represented that no claim had been brought against any proposed insured within the last five years, even though at the time of the application, two underlying lawsuits had been filed against Shaut, and 3si was named as defendant in another

lawsuit. The court also pointed to testimony by a policy underwriter that it would have evaluated the risk differently were it aware of these other claims, including by potentially increasing the policy premiums, adding an endorsement addressing the existing claims, or not issuing the policy at all.

Based on these facts, the court concluded that the trial court did not err when it found there was no issue of fact regarding application of the warranty exclusion.

The case is, *Shaut v. Nat'l Cas. Co.,* No. 110010 (Ohio Ct. App., July 22, 2021).

Delaware Court Finds No Coverage Under Directors and Officers Policies for Shareholder's Post-Merger Appraisal Action

A Delaware trial court held that an appraisal action filed by certain shareholders following a merger was not covered because it was not a claim "for a Wrongful Act" nor did it occur before the closing of the merger.

The Case

The plaintiff, Jarden, LLC, a Delaware corporation that was acquired in a merger in 2016, sought insurance coverage for the defense costs and pre-judgment and post-judgment interest it incurred in connection with an appraisal proceeding filed by the dissenting stockholders after the merger. The directors' and officers' insurance policies at issue provided a tower of corporate liability coverage for "Securities Claims" brought "for any Wrongful Acts" taking place before the Run-Off Date, which was the date the merger closed.

After the merger closed, several Jarden stockholders who voted against the merger filed appraisal petitions in the Delaware Court of Chancery. The appraisal petitioners alleged that the sales process leading up to the merger was flawed and unfair to Jarden's stockholders. After trial,

the Court of Chancery concluded that Jarden's fair value at the time of the merger was $48.31 per share, nearly $11 below the merger price. The court also held the petitioners were entitled to pre-judgment and post-judgment interest.

In March 2020, Jarden sued its insurers in Delaware state court seeking coverage for the interest award and defense costs that Jarden incurred in the Appraisal Action. The insurers moved to dismiss the complaint. The parties agreed that the word "for" in the policy provision "for any Wrongful Acts" meant "seeking redress or reprisal of."

The insurers argued that the Appraisal Action was not "for" a Wrongful Act because it did not "'seek redress in response to, or as requital of'" a Wrongful Act. The insurers further argued that, even if the Appraisal Action sought redress in response to a Wrongful Act, any such act was not one that occurred "before the Run-Off Date," as required under policies.

The Decision

The court granted the insurers' motion and dismissed the complaint. The court concluded an appraisal proceeding is not one that seeks redress or appraisal for any "act" of the insured corporation. The court observed that the only issue before the appraisal court is the value of the dissenting stockholders' shares on the date of the merger. The court emphasized that, in fact, as happened in the case, it is possible for the court to conclude that the value of the petitioner's shares was less than the negotiated deal process.

The court found it immaterial that the appraisal petitioners also challenged aspects of the process leading up to the merger's effectuation. The court noted that, in an appraisal proceeding, this evidence was only relevant to what weight, if any, accorded the negotiated merger price.

The court also accepted the insurers' argument that, even if the Appraisal Action was a claim "for" a Wrongful Act, it did not arise out of an act committed before the Run-Off date. The

court reasoned that, without the merger's execution, no appraisal right existed, and the dissenting stockholders would have no standing to pursue appraisal.

For these reasons, the court granted the insurers' motion and dismissed the complaint.

The case is *Jarden, LLC v. ACE Am. Ins. Co.,* C.A. No. N20C-03-112 (Sup. Ct., Del., July 30, 2021).

Connecticut Appeals Court Affirms That Emotional Injury Alone Is Not Bodily Injury Under Policy, Insurer Had No Duty to Defend

Affirming summary judgment for an insurer, the Appellate Court of Connecticut held that a complaint alleging emotional distress so severe that it could cause physical injury did not allege "bodily injury" as defined by a homeowner's policy, and therefore, the insurer had no obligation to defend.

The Case

A complaint was filed against the insured alleging that he had engaged in serial acts of surveillance, stalking, and harassment of a woman and her children. The insured tendered the claim to his homeowner's insurer for a defense.

The policy covered claims "for damages because of bodily injury." "Bodily injury" was defined as "physical injury, sickness or disease . . ." but did not include "mental injuries such as: emotional distress, mental anguish, humiliation, mental distress, or any similar injury unless it arises out of physical injury to the person claiming a mental injury."

The insurer denied coverage on the grounds that the complaint did not allege "bodily injury." The insured sued for breach of contract and sought a declaration on the duty to defend. The trial court awarded summary judgment in favor of the insurer, and the insured appealed.

The Appellate Court's Decision

The issue before the court was whether a claim for negligent infliction of emotional distress invoked the insurer's duty to defend.

Based on a plain reading of the policy, the court concluded that the policy covered only damages that result from bodily injury. Bodily injuries, including mental injuries that arise out of physical injuries and physical injuries that arise out of mental injuries, the court noted, are covered. But mental injuries alone do not trigger coverage.

Plaintiff alleged that she suffered "emotional distress so severe that it *could* cause physical illness." But the court said this did not allege that a bodily injury occurred. The complaint did not say that plaintiff actually experienced a physical injury, only that she suffered emotional injuries. Such an allegation is insufficient for coverage, the court explained, because the policy plainly did not cover purely mental injuries, such as emotional distress. The court further found that the policy cannot be read to provide coverage for mental injuries that are so severe that they could, but have not yet, resulted in bodily injury.

The court noted that plaintiff included the phrase "could cause physical illness" to meet the pleading requirements for a claim of negligent infliction of emotional distress, but that actual physical illness or injury is not necessary for such a claim. Therefore, this wording alone was insufficient to trigger the insurer's duty to defend because it did not establish that a physical injury had occurred.

The court also rejected the insured's argument that it should find coverage for purely mental injuries for public policy reasons. The court said that it was bound by the plain language of the policy and could not read it differently to account for public policy considerations.

The court affirmed summary judgment in the insurer's favor.

The case is *Warzecha v. USAA Cas. Ins. Co.,* No. AC 43984 (Conn. Ct. App. July 27, 2021).

Court Finds That Act of Handing Over Truck Keys Under Duress Is the Equivalent of False Arrest, Detention, or Imprisonment for Duty to Defend Purposes

An Indiana federal judge found that an insurer was required to defend a policyholder charged with causing the claimant emotional distress by forcefully demanding return of a vehicle. Because the claimant alleged that he handed over the keys under duress, the court found that this potentially stated a claim for "false arrest, detention, or imprisonment" under the "personal injury" coverage of the policy. The claimant was in his own home when he gave up the keys.

The Case

The claimant and the policyholder had been business partners, but the relationship soured. Intent on getting back a pickup truck provided to a former employee who now worked for the claimant, the policyholder paid a visit to claimant's home accompanied by an unknown male who claimant says was used for "muscle." In an "extremely loud, threatening, and intimidating manner," the policyholder demanded return of the pickup truck.

The claimant retreated to his home, but the policyholder and the "muscle" followed him in, demanding the truck's return. Fearing for the safety of his family, the claimant "gave the truck keys to [the policyholder] under duress." In his complaint, the claimant alleges that the policyholder's extreme and outrageous trespass was done intentionally and recklessly and caused damage and severe emotional distress to him, his wife, and small children.

The policyholder sought a defense from its insurer. After an investigation, the insurer denied coverage and sought a declaration from the court that it did not owe coverage. Both parties filed summary judgment motions.

The dispute concerned the "personal and advertising injury" definition under Coverage B of the policy. The policy covered "sums that the insured becomes legally obligated to pay as damages because of" injury arising from "false arrest, detention, or imprisonment." The policy also excluded coverage if the insured knowingly violated a person's rights.

The Decision

The policyholder argued that counts for trespass and emotional distress could be read to support a claim for false arrest, detention, or imprisonment. The complaint itself never used these words, but the court considered if the alleged conduct fell within the meaning of these legal offenses. Resorting to ordinary dictionaries, the court determined that the terms "arrest," "detention," and "imprisonment" all incorporated the concept of confinement or restraint.

The court next compared these terms to the meaning of duress – the claimant said he handed over the keys under duress – and found that forcible restraint and confinement were concepts embodied in that term as well.

The insurer pointed out that the policyholder maintained freedom of movement because he retreated into his house. The court acknowledged that this was one reasonable interpretation, but also found that once in the home, he was confined by the policyholder's trespass, conduct, and "muscle." The court found that these allegations potentially asserted a claim for "false arrest, detention, or imprisonment."

The court next found that the "knowing violation" exclusion did not apply. The policy excluded "personal and advertising injury caused by or at the direction of the insured with the knowledge that the act would violate the rights of another and would inflict personal and advertising injury." The insurer argued that the policyholder knowingly committed the acts that purportedly constituted false arrest, detention, or imprisonment.

The court found this was insufficient to enforce the exclusion, reasoning that the policyholder's knowledge could not be inferred from her allegedly "intentional" conduct, even though described to be "extreme" and "outrageous." The court noted that the covered offenses – false arrest, detention, or imprisonment – are intentional torts. For this, the court looked to civil jury instructions and caselaw (as opposed to ordinary dictionaries like it did before) and concluded that "[i]t would be a distortion of the policy to say it provides coverage for an intentional tort only to take coverage away for that same intentional tort when the insured acts knowingly and when the insurer's only basis for demonstrating knowledge comes from the fact that the insured acted intentionally." And whatever knowledge could be inferred from the complaint, according to the court, could not be read to establish that the policyholder knew its trespass or conduct would inflict injury. [Which begs the question: Why then, was "the muscle" brought along?]

Siding with the policyholder, the court ruled that the insurer was obligated to defend.

The case is *Westfield Ins. Co. v. SL Builders, LLC,* No. 3:19-CV-1026 DRL-MGG (N.D. Ind. July 28, 2021).