Summer 2014

Perspectives
on Insurance Recovery

pillsbury

As our latest newsletter shows, the advice, guidance and litigative protection provided by experienced Insurance Recovery & Advisory professionals is as crucial to a company's business model and financial well-being as insurance itself. It's also as wide-ranging and varied. In this issue, we explore the great unknown of just what should be done in California to prepare for the "Big One," as well as examine a recent ruling in New York that may put insurers on the hook for more damages from Superstorm Sandy (written by Joseph D. Jean, one of the latest additions to our practice). After a look at what precautions should be taken for the next hurricane season, we step away from the natural disasters to ponder pending counter-measures taken by the insurance industry to exclude coverage of cyber attacks in conventional commercial insurance policies. We also take a closer look at some of the key differences between U.S. and English approaches to choice of law and forum clauses. We will also examine the peculiarities of English insurance law, which applies when policies prescribe English choice of law or forum.

Peter Gillon and Robert Wallan
Co-leaders, Insurance Recovery & Advisory

Article Highlights

California Quakes Should Shake Up Policyholder Complacency	1
Insurers May Be on the Hook for More Sandy Damages	3
Hurricane Season Is Here—Is Your Insurance Program Ready for the Next Storm?	4
An American Policyholder in London: English Choice of Law Clauses in United States Insurance Policies	6
Lion Oil Wins Dismissal of Insurer Lawsuit	8
Insurance Industry Poised to Introduce New Exclusions for Cyber Attacks This Year: What You Need to Know	8

California Quakes Should Shake Up Policyholder Complacency

by Robert L. Wallan, Kimberly L. Buffington and Alyson R. Parker

A version of this article was originally published in *Law360* on April 7, 2014.

Los Angeles residents didn't need to go to McDonald's for their "Shamrock Shake" on St. Patrick's Day, when a magnitude 4.4 earthquake shook L.A. County out of bed. Two weeks later, a magnitude 5.1 earthquake centered in Orange County, Calif., was followed by over a hundred aftershocks. The late March quakes flipped cars, crumbled walls, and caused rockslides, gas leaks, power outages and broken water mains near the epicenter. Authorities evacuated some hotels and residences, and other businesses were interrupted due to loss of power, structural damage or broken inventory.

The 2014 earthquakes serve as a resounding reminder to consider your earthquake insurance coverage needs.

California May Not Be Financially Prepared to Rebuild After the "Big One."

While many Golden State residents witnessed the televised trail of destruction following the March 11, 2011, earthquake in Fukushima, Japan, it seems that for many, a similar local disaster is unfathomable. The *Los Angeles Times* reports that five out of six homeowners currently have no coverage for losses resulting from a quake. These homeowners may not even be aware that most California homeowners' policies expressly exclude earthquake coverage. In California, where earthquakes are as inevitable as wildfires—though far more destructive—commercial earthquake insurance should be an integral part of

California Quakes Should Shake Up Policyholder Complacency

a long-term business plan. Still, many business owners choose not to add earthquake coverage.

The "Big Ones" in California Can Be Devastating.

On an early morning in April 1906, a magnitude 7.8 earthquake struck San Francisco. Over the next few days, fires erupted from burst gas mains, stoves and severed electrical wiring. The upheaval disconnected sources of water, leaving firemen helpless as they watched most of the city burn. The quake and fire left nearly three-fourths of San Francisco's population homeless, and destroyed many businesses.

Insurance companies were completely unprepared for the costly disaster and denied claims on the theory that the damage was caused by the uninsured earthquake, not by the subsequent devastating fires. For the most part, policyholders' lawyers successfully argued that the more significant losses were covered fire losses, not excluded earthquake losses. California's highest court agreed, adopting the rule that all losses caused by multiple events, such as earthquakes followed by fire, were covered even when one of those events was excluded. In response, insurers began to insert policy language to minimize their exposure to multi-causal events, a process that continues to this day.

Other major quakes have struck California in the last few decades. In 1971, a 6.6 earthquake hit north of Los Angeles in Sylmar, causing around $5 billion in property damage (measured in 2013 dollars). During the 1989 World Series, a 7.1 quake hit south of San Francisco, causing an estimated $14 billion in property damage. In January of 1994, a 6.7 earthquake struck Northridge, Calif., causing upwards of $20 billion in property damage—in just 15 seconds. Beyond property damages, all of these quakes produced other significant economic losses.

History also shows that the insurance industry will argue strenuously for the narrowest interpretation of coverage. After the Northridge earthquake in 1994, most insurance companies developed a scheme to exclude coverage for concurrent perils when one or more peril is excluded: so-called anti-concurrent causation (ACC) language. ACC language purports to exclude coverage for damage caused by an excluded peril, such as an earthquake, even if the loss is jointly caused by a covered peril, such as a fire. Most states enforce these clauses, which severely limit coverage. However, some states, like California, will not fully enforce ACC clauses.

When Will the Next "Big One" Occur?

Studies abound on earthquake prediction. Global Weather Oscillations Inc. recently published a report warning of a 75 percent chance of a 7 to 8 magnitude earthquake near Los Angeles within the next four months. The UC Berkeley Seismological Laboratory predicts that there will be a near-term significant earthquake from the Hayward Fault east of the San Francisco Bay, which runs under the campus.

Scientists and the media call the inevitable high-magnitude earthquake that will hit the southern part of the San Andreas Fault the "Big One." After the March 2014 Los Angeles earthquakes, however, seismologists are paying closer attention to the Puente Hills Fault, which runs directly underneath downtown Los Angeles and ends underneath Hollywood. Experts estimate that a quake in this fault could kill 3,000 to 18,000 people and cause up to $250 billion in damage. Human nature causes us to downplay the risk of an extremely severe event such as the predicted Big One, unless we have experienced a similar event previously. Californians appear to be in a state of collective denial on this risk, or perhaps they expect governmental protection.

Relying on Government Assistance in the Wake of a Natural Disaster is Risky.

Californians without earthquake insurance will likely hope to rely on the federal government for money to rebuild after a quake. But when the federal government helps out after a disaster, that help comes in the form of Federal Emergency Management Agency loans, which must be repaid. After Hurricane Katrina, many question the availability of government assistance and have very real concerns about delays in federal relief efforts.

Earthquakes Can Join With Other Disasters.

As illustrated by the disaster of 1906 and Fukushima, earthquakes can trigger other perils like fire, land movement, tsunami and water damage. Like Japan, much of coastal California is a tsunami zone. Policyholders should carefully review their property and earthquake policies to make sure they understand in advance the extent of coverage available.

While beyond the scope of this article, policyholders should also be aware that flood and other water-related losses also raise a number of serious coverage concerns under many policies.

Commercial Property Insurance Policies Generally Exclude Earthquake Coverage Unless Specifically Purchased.

Most general commercial property Insurance policies in California do not cover loss resulting from earthquake. Accordingly, business owners should consider supplementing their property insurance with a named-peril earthquake endorsement, or purchasing a separate earthquake coverage policy. A commercial earthquake insurance policy typically covers damage to buildings and business property, loss of business income, sprinkler leakage and betterment or repairs required by local ordinance or law caused by an earthquake.

continued on page 9

Insurers May Be on the Hook for More Sandy Damages

By Joseph D. Jean and Peter Gillon

A version of this article was originally published on Law360.com on April 24, 2014.

In the wake of Superstorm Sandy, property insurers have repeatedly denied coverage for business owners in lower Manhattan who suffered losses due to power outages, arguing that the outages occurred when Consolidated Edison Co. of New York Inc. intentionally cut off power to its networks to protect ConEd's facilities.

A recent decision from the Southern District of New York in *Johnson Gallagher Magliery LLC v. Charter Oak Fire Insurance Co.* considered coverage for a policyholder's losses caused by ConEd's Bowling Green Network outage. The court partially denied the insurer's summary judgment motion because the insurer did not demonstrate that the service interruption during ConEd's post-restoration period was excluded by the policy.

Johnson Gallagher is an important decision because it is the first to examine the circumstances of the Bowling Green Network shutdown and the implications that sequence of events may have on insurance coverage for policyholder business interruption losses arising from that Network.

The court broke down the insured's losses into three periods: (1) the preemptive shutdown just prior to the storm; (2) the period of restoration resulting from physical damage to ConEd's electrical systems caused by the storm; and (3) the further delays in reopening the plaintiff's building as a result of New York City building authority orders, and the testing of systems by the building owners.

Based on a very limited record, the district court concluded there was no coverage for the preemptive shutdown period due to lack of physical damage and that a broadly worded flood exclusion precluded coverage for the restoration period following Superstorm Sandy's damage to the Bowling Green Network's electrical systems.

But, importantly, the district court held that the water exclusion did not preclude coverage for the losses suffered during the post-restoration period because the loss during that period was not caused by water damage or the preemptive shutdown. Also significant is that the court did not consider damage to other ConEd networks (e.g., the widely reported fires and explosions at ConEd's 13th Street facility) or whether other aspects of the policy, such as sewer backup coverage, might apply. Presentation and consideration of these facts, as well as the particular circumstances of each policyholder's loss, could expand the possibility of insurance coverage for Superstorm Sandy-related losses.

The *Johnson Gallagher* decision is important for several reasons, most notably because it shows that insurers should not be able to avoid extended business interruption claims by asserting "flood" or other exclusions that relate to the period of loss and the time of restoration, but not to the extended period of indemnity that applies after the property is repaired or restored.

Policyholders should be careful to consider all aspects of their insurance coverage, as the facts and circumstances surrounding Superstorm Sandy demonstrated how catastrophic events have the potential to trigger various additional coverages, from extended period of indemnity to civil authority.

For instance, the court did not consider whether the ensuing loss provisions of the water exclusion applied following the widely reported fires and explosions that ensued after the water struck ConEd's facility. Thus, whenever there is a loss, every policyholder should carefully review their policies and all aspects of coverage—and retain experienced claims assistance—before submitting a claim, and most certainly after an insurer denies coverage.

Hurricane Season Is Here—Is Your Insurance Program Ready for the Next Storm?

By James P. Bobotek and Vincent E. Morgan

The challenges normally inherent in presenting business interruption and other economic claims were dramatically magnified with Sandy. A policy review before the next storm arrives will provide the opportunity to ensure that you understand the coverage you purchased before a loss occurs.

Last fall, Superstorm Sandy ripped across the East Coast, causing unprecedented damage to coastal and inland areas lying in its path. Making landfall near Atlantic City, N.J., the storm wreaked havoc from North Carolina to Connecticut, and as far inland as the Great Lakes. Sandy also caused tidal surges that inundated Lower Manhattan and flooded New York's airports, knocked out critical infrastructure, including power, rail and subway systems; and destroyed tens of thousands of homes. The storm caused at least $50 billion in physical damage, while tens of thousands of businesses that suffered little or no physical damage nonetheless experienced catastrophic business interruption losses. As is the case after any natural catastrophe, businesses affected by Superstorm Sandy promptly turned to their insurance carriers for help. Many insurance policyholders were taken aback by the significant obstacles insurers placed before them in responding to their property and business interruption insurance claims. Sandy was a wake-up call for policyholders in the Northeast, many of whom previously had perceived the risks associated with hurricane, flood and storm surge damage as inconsequential. Given that the National Oceanic and Atmospheric Administration and other organizations have predicted "extreme activity in the Atlantic" this hurricane season, with "more and stronger hurricanes" expected, there is no better time to review your property insurance coverage. The discussion below provides an overview of some insurance coverage-related issues facing commercial policyholders after a catastrophic storm.

Review Sub-limits and Deductibles for "Named Storm" and "Flood" Coverage.

Commercial policyholders should be aware of the distinction between coverage for "Flood" and "Named Storm" perils. This post-Sandy issue arises out of property insurers' attempts in recent years to limit their exposure to flood risks in Northeast coastal areas by reducing policy sub-limits and increasing deductibles. While many insurers restricted coverage for "Flood" perils in this fashion, in many cases they did not include similar limitations for "Named Storm" perils. Many policies categorize certain counties in New York, Connecticut and New Jersey as high-risk flood zones, but low-risk areas for Named Storm perils.

The assumption was that the likelihood of a "Named Storm" walloping the tri-state area was remote (despite a close call in 2011 from Hurricane Irene)—particularly in comparison to the likelihood of a "Flood" event. Yet, as Sandy hit businesses with a one-two punch of hurricane force winds and flooding, many insurers asserted applicability of the lower sub-limits and higher deductibles tied to Flood perils, instead of the more policyholder-friendly "Named Storm" sub-limits and deductibles. This has led to a significant number of disputes and, in cases in which policyholders are not aware of this distinction, loss of potentially significant coverage.

Beware of Concurrent Causation Language for Losses Involving Both Covered and Non-Covered Perils.

Superstorm Sandy has compelled policyholders and insurers alike to scrutinize policy language and case law for guidance on the extent to which a loss is covered when caused concurrently or sequentially by perils that are covered (such as Named Storm, fire or wind-driven rain) and also by perils that are expressly excluded or sublimited (such as flood or pollution). Whether coverage exists for a loss in such a situation varies from jurisdiction to jurisdiction because courts have not yet developed a uniform approach in determining whether or not coverage is available in these situations. Some courts apply the broad doctrine of "concurrent causation," whereby coverage will be available if any one of the multiple causes of loss is a covered peril. Other courts apply the "efficient proximate cause" theory, whereby the fact finder looks at the circumstances of the loss to determine which cause was the dominant or efficient cause (which may or may not be the initiating event in the chain of events). The analysis of causation in each case requires a careful and searching inquiry into the circumstances of the loss, and is highly fact-specific.

The causation analysis may also depend on whether a policy includes "anti-concurrent causation" (ACC) wording. Insurance companies have attempted to eliminate the need for courts to search for the efficient proximate cause, or even to consider multiple causes, by incorporating ACC clauses into certain exclusions in property policies. These clauses attempt to preclude any claim that involves the particular excluded peril, even if it is only one of multiple causes of the loss. Such clauses were challenged following Hurricane Katrina and other recent catastrophes. Because some courts have upheld their application, some states have recently introduced legislation to prohibit them or, at a minimum, to provide an express warning in the policy of their inclusion.

Identify Challenges of Proving Contingent Business Interruption Loss.

Although many companies have experienced loss due to "Contingent Business Interruption" (CBI)—that is, the adverse economic impact on the insured resulting from damage to the property of its customers and suppliers—proving CBI loss can present significant challenges. Policies usually offer little guidance on the proof required to establish that a loss of business is attributable to the impact of a covered peril on a policyholder's customers or suppliers. For example, with Sandy, retailers in Lower Manhattan suffered major losses because their customers were affected; however, as a condition to payment under CBI provisions, many insurers required these policyholders to prove exactly which customers were affected by the storm—a burden that is challenging to meet, and, in the opinion of most experts, highly unreasonable. Requiring policyholders to overcome such evidentiary burdens as a condition to coverage is almost certainly contrary to the reasonable expectations of the commercial insured.

In the best of circumstances, proving losses due to damage to a supplier is difficult for policyholders. The insured typically does not have access to the suppliers' records, suppliers may fail to document their damages or repairs, and suppliers often have commercial reasons for not disclosing the cause or magnitude of their losses. The same is true of customers. In the case of gasoline station operators, for example, who were unable to secure adequate supplies due to flooding and closure of tank farms and distribution facilities, insurers are requiring proof of damage to facilities of suppliers, who are generally reluctant to disclose information about their operations.

Review Civil Authority, Ingress/Egress, and Service Interruption Coverage Language

After a catastrophic storm, commercial policyholders may benefit from having Civil Authority, Ingress/Egress and Service Interruption insurance coverage. However, it is important to review these coverages and understand their potential limitations and restrictions.

Civil Authority provisions provide coverage for an insured's business interruption losses resulting from orders of civil authority, such as evacuation orders, curfews, highway closures, and the like, which prevent or impair access to the insured's property. However, many Civil Authority coverage provisions contain limitations and restrictions that can make it challenging to establish when Civil Authority coverage begins. For instance, most policies require that

continued on page 10

Another Blow to the Restitution/ Disgorgement Defense

In recent years, purchasers of D&O and professional liability insurance have been stunned to learn that their carriers are denying coverage for a wide range of claims on the theory that their policies do not cover loss that could be characterized as restitutionary in nature or where a judgment or settlement requires the insured to "disgorge" a sum of monies. This "restitution/disgorgement defense" usually rests on standard policy language defining covered "Loss" to exclude amounts that are uninsurable as a matter of law, and the argument that applicable State law does not enforce rights to coverage for restitution or disgorgement of ill-gotten gains. In many instances, insurers assert this defense even when there is no case or statute on point. The defense may also include a secondary argument that when a policyholder is ordered to return monies it has obtained unlawfully, there is no basis for coverage because the insured has suffered no economic loss. This argument was articulated most forcefully in an opinion by Judge Richard Posner in *Level 3 Communications, Inc. v. Federal Insurance Co.*, 272 F/3d 908 (7th Cir. 2001). Insurers have attempted to use the defense to escape liability for matters otherwise expressly covered, such as insider trading claims, bankruptcy trustee fraudulent transfer claims, and even standard securities fraud claims.

Although it is far too early to administer last rites to the restitution/disgorgement defense, a compelling opinion penned by Judge Paul Magnuson of the District of Minnesota, in *US Bank v. Indian Harbor Insur. Co.*, along with other recent court rulings, suggests that its expanding use has been severely curtailed. Applying Delaware law, the court flatly rejected insurers' arguments that the defense precluded coverage under a professional liability policy for amounts the insured bank agreed to reimburse customers in a settlement over claims the bank charged excessive overdraft fees.

To read the full article, go to **http://goo.gl/5TMR7x** or scan the QR code below with your mobile phone.

An American Policyholder in London: English Choice of Law Clauses in U.S. Insurance Policies

By Raymond L. Sweigart and Jeffrey A. Kiburtz

It is not uncommon for insurance policies issued to companies based in the United States, particularly large commercial and excess policies brokered on the London Market, to contain choice of law and forum clauses specifying that the law of England and Wales governs and that any legal proceedings shall be brought in the English courts. This article will look at some of the key differences between the U.S. and English law approaches.

Bad Faith Claims

The primary goal of "bad faith" law in the insurance arena is to provide insurance companies with an additional incentive to promptly pay meritorious claims. The vast majority of U.S. states recognize some form of bad faith law. In those states with meaningful bad faith law, the incentive is provided through remedies such as attorneys' fees, prejudgment interest at higher-than-market rates and punitive damages that become available to an insured when its insurer unreasonably refuses to pay a justified claim.

There is no bad faith under English law as that is understood in the United States. While the parties must deal with each other in "utmost good faith" at the time of formation, this doctrine does not generally extend past formation to require the insurer to handle claims fairly. Whether the lack of an English bad faith law ultimately is significant is debatable, though, as one of the most valuable bad faith remedies often is the ability to recover attorneys' fees incurred pursuing coverage. But since England does not follow the "American Rule" under which each side pays its own attorneys, an insured that successfully pursues coverage can often recover its attorneys' fees. Moreover, unlike states in which attorneys' fees are recoverable only when the insurer acted unreasonably, fees can be recovered in England even when the insurer took a reasonable position which turned out to be erroneous. While that may be positive, the counterpoint is that the insured, if unsuccessful, can end up paying the insurer's attorneys' fees.

Insurability of Punitive Damages

Many states limit or prohibit coverage for punitive damages as a matter of public policy. A significant number of states do, however, recognize that insurance is available for punitive damages awarded vicariously. Other states permit insurance to cover punitive damages

Under English law, the *Court of Appeal in Lancashire County Council v. MMI* (1997) held that such insurance was not per se contrary to public policy in English law. This could be perceived as a significant benefit to English law, given potential limitations in the United States. It should be noted, however, that many of the situations under which punitive damages may be awarded in the United States can give rise to other arguments against coverage whether under U.S. or English law (e.g., arguments about the nature of the insured's conduct).

Contract Interpretation/ Resolution of Ambiguities

Like U.S. law, English contract law seeks to give effect to the parties' mutual intent at the time of contracting. It would be a mistake, however, to conclude that there is no meaningful difference between English and American law in this regard.

Among the most significant is the treatment of disputes involving a word or phrase that is subject to two or more interpretations, both of which are reasonable. Stateside, rules of contract interpretation require a court to adopt any reasonable interpretation resulting in coverage without regard to whether that interpretation is "better" or "more reasonable" than a coverage-limiting interpretation. By contrast, insurers often argue that English law permits the arbiter to choose which interpretation is "more reasonable" under the circumstances, taking into account the information which reasonably would have been available to the parties at the time of contracting. It does not matter, therefore, what information the parties actually had or what was actually said about the meaning the parties ascribed to words or phrases, just what would have been theoretically available to them, or at least so it is argued. If this argument is accepted, it is possible that an insurer's coverage-limiting interpretation of ambiguous language will be accepted even if there is an equally if not more reasonable interpretation of the plain language that would favor coverage.

Scope of Discovery

There is generally no "discovery" in English legal proceedings as that is understood in the United States. Parties to English litigation are required to give "standard disclosure" under which they are to produce only those documents (including electronically stored information) on which they rely as well as documents which may adversely affect their case or support another party's case. The rules also require that documents be preserved, and that a reasonable search be made for potentially relevant documents.

U.S.-style depositions generally are not permitted in English proceedings. If oral evidence is to be used at trial, it must be disclosed in written format in a "witness statement." Witness statements set out the facts to be introduced orally at trial, and are usually exchanged several weeks before the trial. Then, the witnesses may be cross-examined by the other party's lawyer at trial based on their witness statements.

This more limited approach to "discovery" could be perceived as inhibiting the "search for truth" or a sensible way to avoid excessive expense and resulting injustice. Either way, it is a significant difference that ought to be considered when analyzing an English law and forum clause.

Coverage When Underlying Case is Settled

The overwhelming majority of cases brought in the United States are settled before reaching a final judgment. One would expect, therefore, that a company's insurer would be willing to pay settlements that are reasonable in amount and involve payment on account of alleged liability coming within the scope of coverage. For example, when a life sciences company purchases large amounts of coverage to pay for bodily injury claims brought against it, it reasonably expects that coverage would be available in connection with settlements to resolve bodily injury claims.

This may not be the case under English law. In *AstraZeneca Ins. Co. Ltd. v. XL Insurance (Bermuda) Ltd. and ACE Bermuda Ins. Ltd. (2013),* AstraZeneca's captive insurer paid nearly $126 million in defense costs and settlements related to product liability suits. AstraZeneca obtained a complete defense verdict on the only case it tried. Since there was no judicial determination that AstraZeneca had "actual legal liability" to the underlying claimants, the excess insurer argued that, in effect, AstraZeneca had to litigate the underlying plaintiffs' case against itself to obtain coverage. The English courts agreed, holding that AstraZeneca could not recover defense costs or the settlements in the absence of a showing that it had "actual legal liability" to plaintiffs.

While U.S. insurers may sometimes assert the same position, the vast majority of states which have considered the issue have rejected such arguments. For example, the courts in Illinois have repeatedly recognized that it is patently unfair to

continued on page 10

Lion Oil Wins Dismissal of Insurer Lawsuit

As mentioned in: Arkansas Business - January 27, 2014

U.S. District Court Judge Aleta Trauger ruled that a lawsuit filed by National Union Fire Insurance Co. and a dozen other insurers against Lion Oil Co. in Tennessee will be stayed while Lion Oil's case against the insurers in Arkansas can go forward.

Pillsbury is representing Lion Oil in an $80 million insurance coverage claim against the insurers. The rupture of a pipeline run by ExxonMobil Pipeline Co. in 2012 cut off Lion Oil's El Dorado, Arkansas refinery from access to crude oil from the Gulf of Mexico for more than seven months. Lion Oil suffered financial losses due to lost earnings and spill-related expenses.

The insurers filed a suit in Tennessee seeking a declaratory judgment that they were not required to cover Lion's business-interruption losses. Lion Oil later sued the insurers arguing that the case belonged in Arkansas where the refinery is located and where Lion employs hundreds of workers.

Siding with Lion Oil, Judge Trauger wrote, "[T]he court finds that deference to the Arkansas Coercive Action is warranted, notwithstanding the fact that the Insurers 'raced to the courthouse' to file this action before Lion Oil could react to the underlying claim denial."

Led by litigation partner Geoffrey Greeves, the Washington, D.C.-based team includes insurance partner Peter Gillon and litigation associates Ashley Joyner and Vernon Thompson. Houston-based litigation partner Vincent Morgan is also assisting on the case.

Insurance Industry Poised to Introduce New Exclusions for Cyber Attacks This Year: What You Need to Know

By Rene L. Siemens and Matthew M. Brady

Last year has been called the "Year of the Mega Breach" because it saw an explosion of cyber-attacks and other data security breaches that affected literally hundreds of millions more people than were affected during the previous year. The cost of a data breach can be astounding. While organizations turn to technological safeguards to prevent cyber threats, insurance is a key asset for mitigating cyber losses when they happen.

The insurance industry has taken the position that data security breaches are not generally covered under conventional commercial insurance policies and is marketing specialized "cyber policies" to cover these losses. Many courts have rejected the insurance industry's position that there is no coverage under existing policies, finding that data security breaches are at least partly covered under a variety of kinds of insurance including commercial general liability (CGL) policies.

Insurance companies have responded by inserting into their policies an ad hoc assortment of exclusions intended to limit coverage for data security breaches and other privacy claims. These exclusions have had mixed success in accomplishing that goal. Now, the Insurance Services Office (ISO) has proposed a new set of exclusions for use by the insurance industry that are intended to broadly exclude coverage for data security breaches. It is expected that the new ISO exclusions will start appearing in CGL policies later this year.

Standard CGL policies cover liability for bodily injury and property damage (Coverage A) and for so-called "personal and advertising injury" (Coverage B). "Personal and advertising injury" coverage requires a "publication" of material that invades someone's right of privacy. The scope of Coverage B is at the center of disputes between policyholders and insurers about whether privacy claims are covered under CGL policies, but many courts have found that this coverage applies to a variety of data breach and other privacy claims, although the case law is not uniform.

ISO recently submitted to state insurance regulators for their approval a set of proposed exclusions that seek once and for all to broadly exclude coverage for data breaches from CGL policies. The new exclusions will start being introduced by endorsement this summer. The new endorsement is entitled "Exclusion—Access or Disclosure of Confidential or Personal Information and Data-Related Liability—With Limited Bodily Injury Exception."

This endorsement adds the following language to both Coverages A and B:

> *This insurance does not apply to [d] amages arising out of:*
>
> > *(1) Any access to or disclosure of any person's or organizations confidential or personal information, including patents, trade secrets, processing methods, customer lists, financial information, credit card information, health information or any other type of nonpublic information.*

Significantly, the explanatory memorandum that ISO has submitted to state regulators acknowledges that this revision "may be considered a reduction in personal and advertising injury coverage" to the extent that access to or disclosure of confidential or personal information results in publication that violates a person's right of privacy.

The endorsement also includes the following additional exclusionary language in Coverage A:

> *This insurance does not apply to [d] amages arising out of:*
>
> *(2) The loss or loss of use of, damage to, corruption of, inability to access, or inability to manipulate electronic data.*

Finally, the endorsement provides that

> *This exclusion applies even if damages are claimed for notification costs, credit monitoring expenses, forensic expenses, public relations expenses or any other loss, cost or expense incurred by you or others arising out of that which is described in Paragraph (1) or (2) above.*

It is worth noting that these exclusions contain several exceptions. For example, the ISO endorsement contains an express exception for "damages because of bodily injury arising out of loss of, loss of use of, damage to, corruption of, inability to access or inability to manipulate electronic data." With that said, ISO has also drafted an optional endorsement (CG 21 07) which eliminates this exception. So it remains to be seen what the scope of coverage will be for bodily injury resulting for example from cyber attacks on critical infrastructure.

This exclusion may not be the silver bullet the insurance industry seeks in other respects, as well. For example, the new language does not seem to apply to privacy claims that do not involve the "accessing" of any confidential information, e.g., illegal phone recording claims, junk fax and phone call claims, and claims arising out of the loss of hard drives and other media containing confidential information. Further, these exclusions do not appear to apply to property damage or bodily injury claims resulting from all cyber attacks, but only to attacks that damage or deny access to data.

As mentioned previously, policyholders should expect to see these exclusions added to their policies soon. While the courts may ultimately end up deciding what they mean, the insurance industry's ongoing attempt to limit coverage under conventional insurance policies for data security and privacy claims will no doubt give policyholders further reason to assess the scope of their current insurance coverage, and consider whether now is the time to buy specialty cyber insurance. Policyholders should bear in mind that even cyber insurance policies contain many exclusions and other limitations on coverage, but the good news is that they tend to be highly negotiable with the help of an experienced broker or attorney. ■ ■ ■

California Quakes Should Shake Up Policyholder Complacency

(cont. from page 2)

California Compels Insurers to Provide Earthquake Insurance to Homeowners.

All California homeowners' insurers have an obligation to offer their policyholders earthquake insurance at least every other year. The California Earthquake Authority (CEA), a publicly managed organization of most private homeowners' insurers, provides a standard residential earthquake insurance policy.

While coverage will ultimately depend on the specific characteristics of the property and the exact form purchased, the CEA policy usually covers: (1) damage to the property up to the limit on the homeowner's residential policy with a 10 or 15 percent deductible for the structure; (2) loss of most personal property up to $100,000, with a 10 or 15 percent deductible that may be waived depending on the amount of the total loss; (3) living expenses or loss-of-use costs, like replacement housing, restaurant meals and laundry expenses, or the expense of moving to another permanent home (up to $25,000, without deductible); and (4) some coverage for building code upgrades and emergency repairs.

Conclusion

Earthquake insurance can be costly—but earthquake damage to property could be catastrophic. Business and homeowners can and should plan ahead. ■ ■ ■

Hurricane Season Is Here– Is Your Insurance Program Ready for the Next Storm?

(cont. from page 5)

the governmental order be the result of physical damage "of the type insured," and not just a preventive or general public safety measure. Some policies require that the physical damage be within a limited distance of the insured's location. Also, in the case of Sandy, insurers have resisted this coverage by arguing that while there were numerous orders affecting business, the orders were not the direct result of physical damage, but rather to prevent harm to public health and safety. In some cases, insurers have claimed that the insured has not demonstrated the orders were the result of physical damage to property of the type insured, within a certain distance of the insured's premises. Likewise, insurers have argued that the orders did not totally prevent or prohibit access.

In addition to orders of Civil Authority that restrict access to an insured property, storm-related physical damage may limit an insured's ability, or the ability of its customers or employees, to enter or exit its property. Ingress/Egress coverage typically insures business interruption losses incurred when access to or from an insured's premises is "physically prevented" by the loss or damage. Even if a governmental authority does not issue an evacuation order, storm or flood damage may limit access to a business or property and result in business loss. Ingress/Egress clauses, which can extend business interruption coverage where property damage "in the vicinity" (such as flooding, downed power lines, road closures, snow, or fire) restricts access to insured premises.

When utility services to insured premises are interrupted, Service Interruption coverage may be available to cover damage to property (e.g., spoiling of refrigerated food or medicine) and loss of income or extra expense. The coverage for such interruption can be substantial, including payroll incurred when the company is closed, loss from event cancellation, extra expense, contractual penalties and lost profits. Post-Sandy disputes have arisen under this coverage, particularly with regard to whether the coverage applies to loss of power caused by damage to electrical equipment away from an insured's premises. Service Interruption coverage generally requires damage to the property of a utility supplier used by the insured, and sometimes includes requirements that the damage occur within a specified distance to the insured property, or even on the insured property. Service Interruption coverage would typically apply to power outages where overhead power lines downed by a storm or physical disruption to a transformer or generating station prevent a manufacturing plant or hotel from operating normally.

Conclusion

After striking heavily populated areas and wreaking unprecedented destruction, Superstorm Sandy left a legacy that will have lasting repercussions for the field of insurance coverage. Major disputes with insurers, including some already in the courts, will challenge conventional wisdom regarding Flood and Named Storm coverage. In one sense, we have all been here before– numerous issues raised and litigated with respect to Hurricane Katrina and other catastrophes are emerging again. As in every catastrophe, however, the unique aspects of Sandy have presented new challenges and opportunities to maximize coverage. One point on which all those knowledgeable about these nuances agree is that the challenges normally inherent in presenting business interruption and other economic claims were dramatically magnified with Sandy. A review of your policy before the next storm arrives will provide the opportunity to ensure that you understand the coverage you purchased before a loss occurs.

An American Policyholder in London: English Choice of Law Clauses in U.S. Insurance Policies

(cont. from page 7)

require an insured to prove a claim against itself and that coverage is available when an insured settles "in reasonable anticipation of potential liability." *Federal Ins. Co. v. Binney & Smith, Inc., 393 Ill.App.3d 277, 288, 332 Ill.*Dec. 448 (2009).

Strict Compliance with Covenants/Conditions

The typical insurance policy imposes upon an insured several obligations, most commonly the obligation to provide notice of claims, cooperate to some degree with the insurer at the time of the claim and not enter into settlements without the insurer's consent. Depending on the particular duty and state, many—but not all—of these obligations do not require strict compliance, and an insurer cannot deny coverage under the U.S. approach on grounds of purported non-compliance unless it demonstrates that it has suffered actual prejudice as a result of the non-compliance.

By contrast, under English law, compliance with claims notification provisions often requires strict compliance (if the provision in question is considered a "condition precedent," and not a "bare condition"), and an insurer can deny coverage even in the absence of any prejudice. Similar results can be found with respect to consent to settlement and cooperation clauses, i.e., that the insurer can deny coverage outright even in the absence of prejudice.

An insured's pre-inception disclosures to the insurer also may be scrutinized more strictly under English law. That is, formation issues are governed by the doctrine of "utmost good faith," which

Prior Planning Prevents Poor Performance

By David L. Beck
Posted on Pillsbury's ***Gravel2Gavel*** *blog*
March 3, 2014

You'd be surprised at how often we find mistakes at the beginning of projects that, if not caught, would put most of a client's insurance coverage at risk. Clients frequently ask us to review their controlled insurance programs (often referred to as "CIPs" or "Wrap-Ups") before implementing them. Brokers do much of the heavy lifting in structuring these programs, but many of our clients like to have coverage attorneys review them for some nuances that lawyers who litigate coverage issues will pick out. The issues get pretty esoteric, but some esoteric issues can be worth a lot of money. Lately, I've been seeing one particular type of exclusion in Wrap-Ups that, if it remained and were enforced, could jeopardize much of the coverage the client thought they were buying a "Cross-Suits" exclusion.

Under a Wrap-Up, the owner (under an "Owner Controlled Insurance Program, or OCIP) or general contractor (under a Contractor Controlled Insurance Program, or CCIP) and all contractors and subcontractors of every tier are named insureds under certain project insurance, typically general liability and worker's compensation. When properly administered, a Wrap-Up program can increase project savings, reduce litigation, provide more complete coverage for completed operations, increase Minority and Women Business Enterprise participation, among other benefits.

But Cross-Suits Exclusions are children of a different type of insurance set-up, a more traditional program where individual contractors and subcontractors buy their own insurance and where some are required to make others additional insureds. This exclusion precludes coverage for claims brought by one insured against another insured. A typical Cross-Suits Exclusion provides: "This insurance does not apply to...Suits brought by one insured against another insured." These would, for example, avoid the "moral hazard" of a parent company suing its own subsidiary to trigger liability coverage.

But in a Wrap-Up, this doesn't make any sense. Remember, in a Wrap-Up, the owner, general contractor and all subcontractors are all named insureds. So a Cross-Suits exclusion would bar coverage for any liability the general contractor may have to the owner for losses arising from its or its subcontractors' negligence. That's a significant part of the coverage that an owner would want its contractor to have on a GL policy. If a Cross-Suits exclusion remained and were enforced, the only liabilities covered would be to third parties—parties that have nothing to do with the project.

A similar limitation is created when a Cross-Suits Exclusion is included in a CCIP. Although in that circumstance there may be coverage for a contractor's liability to the owner (if the owner is not a named insured), contractors will not be able to trigger coverage for their own losses arising from the negligence of another contractor/subcontractor on the project. For example, the general contractor will not be able to trigger the Wrap-Up program for losses it incurs as a result of its subcontractors' negligence.

This is just an example of an exclusion that plainly doesn't belong in a Wrap-Up program, but that we've seen almost inserted in them recently. Make sure to have a reputable broker review your programs before implementing them and consider investing a small amount to have a coverage attorney review it. Prior planning prevents poor performance.

arguably imposes a duty to voluntarily disclose all material facts to permit the insurer to accurately assess the actual risk being undertaken. Failure to meet this standard can result in the policy being found void ab initio. While there are disclosure obligations under U.S. law, they are generally perceived as being less stringent.

Conclusion

Just as it is often remarked that the United States and Great Britain are two countries separated by a common language, the similarities and joint roots of their common law systems should not lull one into thinking that the choice of law and forum as between the two is mere "boilerplate" without meaningful significance.

Pillsbury Office Locations

Abu Dhabi	Palm Beach
Austin	Sacramento
Beijing	San Diego
Houston	San Diego North County
London	San Francisco
Los Angeles	Shanghai
Nashville Operations	Silicon Valley
New York	Tokyo
Northern Virginia	Washington, DC

Pillsbury Winthrop Shaw Pittman LLP
Perspectives on Insurance Recovery
1540 Broadway
New York, NY 10036-4039

Our Insurance Recovery & Advisory Team

Pillsbury's Insurance Recovery team consists of more than 30 attorneys across the United States. The team's partners and counsel are listed below.

Peter M. Gillon, Co-leader
+1.202.663.9249
peter.gillon@pillsburylaw.com

Robert L. Wallan, Co-leader
+1.213.488.7163
robert.wallan@pillsburylaw.com

James P. Bobotek
+1.202.663.8930
james.bobotek@pillsburylaw.com

Mariah Brandt
+1.213.488.7234
mariah.brandt@pillsburylaw.com

Kimberly L. Buffington
+1.213.488.7169
kimberly.buffington@pillsburylaw.com

David T. Dekker
+1.202.663.9384
david.dekker@pillsburylaw.com

Geoffrey J. Greeves
+1.202.663.9228
geoffrey.greeves@pillsburylaw.com

Joseph D. Jean
+1.212.858.1038
joseph.jean@illsburylaw.com

Melissa C. Lesmes
+1.202.663.9385
melissa.lesmes@pllsburylaw.com

Vince Morgan
+1.713.276.7625
vince.morgan@pillsburylaw.com

René L. Siemens
+1.213.488.7277
rene.siemens@pillsburylaw.com

Raymond L. Sweigart
+1.703.770.7795
raymond.sweigart@pillsburylaw.com