2022 Insurance & Professional Liability Seminar

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AVANT-GARDE – YOU BE THE CRITIC

Roundtable Discussion

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CASE UPDATES AND DEVELOPMENTS

Thank you for joining us for our roundtable discussion, Avant-Garde – You Be the Critic! We hope you find it fun and beneficial.

Below we provide some additional information about cases we will discuss in the roundtable, as well as some other cases decided over the last few years.

A. Status of Covid-Related Claims Seeking Business Income Losses

No discussion of recent coverage developments would be complete without discussion of the trend of decisions addressing the flood of claims seeking business income, extra expense, and civil authority coverages under property policies for government-ordered shutdowns related to COVID-19. Though the volume of court filings for these claims has tapered off in the last year, new suits continue to be filed. Based on data compiled for the Covid Coverage Litigation Tracker, well over 2,000 cases have been filed. *https://cclt.law.upenn.edu/.* Approximately 200 cases are up on appeal.

On the whole, trial courts have ruled there is no coverage for losses due to shutdowns pursuant to government mandates, finding that there is no physical loss or damage as required by policy language. In a number of cases courts have also enforced virus exclusions. For cases in which courts ruled on the merits, nearly 70% of cases filed in state courts were dismissed with prejudice; in federal court, 80% of cases were dismissed with prejudice.

This data was compiled on the Covid Coverage Litigation Tracker, which we encourage you to check out if you are interested in these claims.

B. Broker Liability

In addition to the coverage suits filed seeking coverage for COVID-related losses, insureds have also filed suits against brokers/agents for alleged failures to purchase coverage that would cover such losses. We discuss four recent decisions addressing broker liability:

- *BSD-360, LLC v. Philadelphia Indemnity Ins. Co.*, 2022 U.S. Dist. LEXIS 7804; 2022 WL 138075 (W.D. Pa.);
- *St. Charles Surgical Hosp., LLC v. Hub Int'l, Ltd.*, 535 F. Supp. 3d 588 (E.D. La. 2021);
- *VCS, LLC v. Mt. Hawley Ins. Co.*, 534 F. Supp. 3d 635 (E.D. La. 2021);
- *Soundview Cinemas Inc. v. Great American Ins. Group*, 142 N.Y.S.3d 724 (2021).

a. *BSD-360, LLC*

In the *BSD-360* case, the insured was a daycare and preschool which claimed COVID-related losses. While the school was closed pursuant to government mandate, it also alleged that about the time of the issuance of the mandate it was advised by one of the parents that they were positive for COVID-19. The insured sought business income and extra expense coverage under its property policy, which was denied. It filed suit against the insurer and also against its broker, Specht, asserting claims of negligence and negligent misrepresentation.

The insured alleged that it had requested that the broker "secure coverage as broad as possible" and specifically asked Specht whether business income coverage would be afforded if it were "shut down for any reason," to which Specht replied, "absolutely." The insured also argued that Specht did not adequately communicate the scope of the policy provisions. The court found that no plausible claim was alleged against Specht, noting that under Pennsylvania law a broker has no obligation to advise about the type or amount of coverage available, obtain total coverage, or explain the policy. The court also found that the broker's assurance ("absolutely") that the insured would have coverage in the event of a shutdown for any reason did not support a claim. "[T]his cannot be a breach of Specht's duty. [The insured] cannot plausibly claim that it reasonably relied on Specht's assurance that the insurance policy here would cover [the insured] if it 'was shut down for any reason.'" It also held that brokers are not obliged to explain "clearly worded and unambiguous policy language." Finally, it held that the exclamation of "absolutely" amounted to puffery, not a negligent misrepresentation.

b. *St. Charles Surgical Hospital, LLC*

The court in the *St. Charles* case reached a different conclusion for a claim by a hospital alleging that its broker failed to advise it about the availability of pandemic coverage. The court noted that, while under Louisiana law such a claim is normally actionable only under limited circumstances, in some instances courts have recognized that a broker or agent may owe a broader duty. The hospital alleged that HUB and the agent "held themselves out to be more than agents who merely procured requested insurance." The complaint quoted statements on HUB's website:

- "We understand your need to protect all areas of liability and exposures. . ."
- "Our team will work with you to develop integrated business insurance, risk management and employee benefits solutions that help improve the performance of your organization and: . . . protect your people, property and profits. . ."
- "Our healthcare systems and hospital insurance specialists will help you manage your total cost of risk with solutions to address: Patient and worker safety, including slips, trips and falls, needle sticks, and infection control."
- "Let us be your partner in risk management."
- "Our healthcare system and hospital insurance specialists will help you: Identify potential gaps and deficiencies in your existing programs."

The complaint also looked at statements on social media, including a statement that "Our practice group consults, designs risk management programs, and brokers insurance transactions on our client's behalf." The hospital also alleged that it "relied on [the agent] to understand its business and to advise it of the coverage needed." Based on these allegations, the court found there was a possibility of recovery against the broker and allowed the claim to proceed.

c. *VCS, LLC*

The *VCS* case also applied Louisiana law. An insured hotel was denied coverage on COVID-related claims and for an unrelated water damage claim caused by a hotel guest setting off the sprinkler system. The hotel alleged that both Marsh and ARI (a wholesale broker) acted as their brokers, advising and recommending insurance coverage. The motion before the court was to remand the case to state court, but the court was required to delve into the allegations to address the motion.

The hotel alleged that it relied on the representations on Marsh's and ARI's websites. For instance, it pointed to ARI's website, alleging that it "held itself out as advisors of hotel business income insurance" but failed to advise about virus-related coverage. The court held that the complaint sufficiently alleged that ARI owed a heightened duty and that it breached that duty.

d. *Soundview Cinemas, Inc.*

The *Soundview Cinemas* court granted the brokers' motion to dismiss, finding the allegations insufficient, stating:

> The Insurance Brokers' motion is granted. Plaintiff does not allege that it made any inquiries about specific insurance coverage that might apply to these unprecedented times, and certainly does not allege that it inquired about coverage for pandemic-related government closures. Mr. Desner's vague assertion that he asked if Soundview was sufficiently insured for known and unknown business risks does not suffice to allege that a specific request was made to the Insurance Brokers for coverage that was not provided in the Policy. And even assuming, *arguendo*, that Mr. Desner's long-term friendship with Mr. Schuster of Five Star gave rise to a special relationship, Plaintiff has not plausibly alleged that the Insurance Brokers breached their duty by failing to direct Plaintiff to obtain additional coverage. Indeed, Plaintiff does not allege that any such insurance coverage for pandemic-related government closures existed prior to March 2020.

C. Capacity – An Insured, Or Not?

An insured attorney sued by his client for sexual misconduct was successful in obtaining summary judgment compelling his malpractice insurer to defend him. *Spurling v. Westport Insurance Corp*., 2021 U.S. Dist. LEXIS 229940; 2021 WL 5702161 (D. Maine).

Mr. Spurling was retained on a family law matter. Early in the representation, the client met with Spurling in his office to pay the remainder of the retainer. As described by the court:

> Doe met Spurling at Spurling Law Offices and she paid the remainder of Spurling's retainer.

> Spurling then brought Doe to a nearby restaurant, where he encouraged her to order food and drinks as they discussed her legal needs and the legal services Spurling could provide. At the restaurant, Doe "became severely impaired and lost all conscious awareness of herself and her surroundings." Soon thereafter, she regained consciousness in Spurling's offices to find him naked and on top of her attempting to engage in vaginal intercourse. Spurling stopped trying to engage in intercourse after Doe started vomiting. He then gave her an open bottle of water containing, as she described it, "something that did not taste like water."
>
> While Doe "remained in a twilight state—alternating between long periods of total unawareness and fragmentary periods of addled consciousness," Spurling drove Doe to his home, where he insisted that she take off her clothes. Spurling then "engage[d] in sexual touching, sexual contact, and/or sexual acts with [the client's] body," and withheld her clothes from her before returning her to her family after 7:00 a.m. the next day.

The suit against Spurling included claims of sexual assault and professional misconduct.

The summary judgment motion presented two issues to the court: 1) whether Spurling qualified as an insured, and 2) whether the allegations in the complaint triggered a duty to defend.

Westport relied on its policy language—"in the rendition of professional services to others"—to argue that the claims against Spurling arose from sexual assault and false imprisonment that did not occur while Spurling was providing professional services. Westport argued that the allegations of malpractice were merely artful pleading and conclusory language, and a duty to defend is based on the facts alleged. The court concluded that the complaint alleged that beginning at the meeting in Spurling's office, he breached his professional responsibilities and ethical duties. "The [] meeting was part and parcel of the attorney-client relationship and [the client] had a right to expect that Spurling would not breach his professional responsibilities. Instead, the facts allege that Spurling violated multiple rules of professional conduct during the meeting." Quoting another case, the court also observed, "we think it at least arguable … that a lawyer's honoring of ethical duties, arising as they do out of the attorney-client relationship, is itself a 'legal service' the lawyer provides to his clients." It noted that the claims of malpractice and breach of fiduciary duty were alleged in addition to the claims sexual assault and false imprisonment.

In evaluating whether the complaint allegations triggered coverage, the court stated:

> Under the Rules of Professional Conduct, Spurling owed [the client] a duty to honor his ethical obligations to her. The facts allege that he breached this duty by engaging in representation with [the client] despite his personal desire to engage in a sexual relationship with her, exploited the communications they had regarding her legal case to put her in a heightened position of vulnerability, and convened with her under the guise of conducting a professional meeting. A jury could determine that, because Spurling took Doe to a restaurant and encouraged her to drink to the point of intoxication, he was professionally negligent. A jury could conclude that Spurling and Doe were engaged in an attorney-client relationship on July 9, initially met to discuss the rendering of legal services, and that Spurling then committed one or more violations of the Maine Rules of Professional Conduct during and after this meeting.

> These actions would constitute "act[s], circumstance[s], or breach[es] of duty [that occurred] in the rendition of PROFESSIONAL SERVICES," as the term wrongful acts is defined in the Policy.

D. Conflict of Law; D&O Claims

A decision by the Supreme Court of Delaware is likely to have far-reaching implications for D&O claims, given the prevalence of incorporating in Delaware. *RSUI Indem. Co. v. Murdock*, 248 A.3d 887 (Del. 2020). We may find that courts in other jurisdictions will adopt Delaware's analysis of conflict of laws.

The D&O policy was issued to Dole Food Company, Inc., a Delaware corporation. Dole's principal place of business was in California. The policy was negotiated in California and was issued to the California location. David Murdock, a director and CEO of Dole, took the company privage through a merger transaction in which Murdock acquired all of Dole's stock not already owned by him. After the merger, stockholders filed suit, challenging the transaction and alleging breach of fiduciary duty by Murdock and others. The trial court concluded that Murdock had breached the duty of loyalty "through a series of intentional, unfair, and fraudulent actions" that drove down the stock price and impaired the corporation's negotiating position. A federal security class action was also filed by stockholders who had sold their stock prior to the merger. All of the lawsuits were settled.

RSUI and other excess insurers sought declaratory relief, contending they owed no coverage for the settlements. The trial court held that RSUI owed the limits of its policy. RSUI appealed. One issue on appeal was whether the trial court erred in applying Delaware law. RSUI favored California law as it may have precluded coverage for the alleged willful acts.

Delaware applies the "most significant relationship" test for conflict of laws questions. The issue, as argued by RSUI, was whether the trial court placed "undue emphasis" on the state of incorporation, creating "an unprecedented and inflexible rule under which the insured's state of incorporation is the dispositive factor in choice of law for D&O policies." It argued that, under prior case law, the location of the principal place of business should weigh more heavily. The Supreme Court rejected these arguments, agreeing with the analysis of the trial court.

The Supreme Court agreed with the following proposition:

> When the insured risk is the directors' and officers' honesty and fidelity to the corporation – and we would add to its stockholders and investors – and the choice of law is between headquarters or state of incorporation, the state of incorporation has the most significant interest.

The court noted the following aspects of Delaware's corporations statutes as significant to its decision: it is the statutes which provide the authority for the purchase of D&O coverage, which reflect the intent to minimize risks of serving as a director or officer; these laws govern the scope and entitlement to indemnification and advancement; and, its statutes govern the duties of officers and directors. "These factors suggest that the state of incorporation is the center of gravity of the typical D&O policy." The court held that Delaware had the most significant contacts.

As this analysis was conducted under the framework set forth in Sections 188 and 193 of the Restatement (Second) Conflict of Laws, and because of the court's emphasis on the public policy as reflected in the incorporation statutes, we may see other courts start to place more emphasis on the state of incorporation for conflict of laws analysis involving D&O policies.

See also Stillwater Mining Co. v. Nat'l Union Fire Ins. Co., 2021 Del. Super. LEXIS 720, 2021 WL 6068046 (applying the above analysis in a coverage action involving the question whether a stock appraisal lawsuit was a "Securities Claim" as defined by the policy).

E. Privilege – Coverage Opinions and Draft RORs

When an insurer seeks a coverage opinion or assistance from outside counsel, it is important to always be mindful and take steps to protect the attorney-client privilege, as insureds may later seek to obtain those communications. Protection of these communications continues to be the subject of litigation, with policyholders arguing that because analysis of coverage is a usual part of the claims handling process and coverage opinions are obtained in the normal course of claims handling, they should be discoverable. Generally, courts protect the privilege. Courts will look to the substance to assess whether the opinion is primarily legal analysis (as opposed to investigation of the claim, for example) and whether the purpose is to provide legal services or advice.

But, there are cases in which courts hold that opinions and draft reservation of rights letters prepared by attorneys are discoverable. Often these decisions are driven by the particular facts of a case, as was a recent decision by the Supreme Court of Mississippi. *Travelers Prop. Cas.Co. v. 100 Renaissance, LLC* 308. So.3d 847 (Miss. 2020). The matter was before the Supreme Court on an interlocutory appeal after the trial court ordered the production of written communications between in-house counsel and the claims handler in a bad faith action in which the policyholder, 100 Renaissance, LLC, sought to recover for damage to a flagpole caused by a hit-and-run driver under the uninsured motorist coverage.

Travelers initially denied coverage on the basis that the flagpole was not a "covered auto" and was not within the definition of "property damage." Counsel for the policyholder disputed this conclusion, citing a Mississippi statute which he contended compelled coverage for "all sums for which the uninsured driver is liable." The claims handler sought guidance from in-house counsel and then responded, once again denying coverage. This correspondence referenced the Mississippi law. At her deposition, the claims handler could not explain the position and repeatedly stated that she was not an attorney and could not explain how the law affected the coverage afforded. Based on this testimony, the policyholder sought communications with the in-house counsel. After in-camera review, the court ruled that the privilege was waived.

(After the deposition, Travelers paid the claim – which was less than $3,000 – but the policyholder continued to pursue its bad faith claim.)

The Supreme Court affirmed the trial court ruling, holding that Travelers had waived the privilege by placing in issue the attorney-client relationship. "Generally, it may be expected that the person who signs the letter has personal knowledge of the matters set forth in the letter. But [the claims handler's] testimony clearly evidenced that she did not have the personal knowledge of either the applicable law

or Traveler's reasons to deny the claim." The court concluded that, based on the deposition testimony, the letter must have been prepared by someone other than the claims handler, likely the in-house counsel. The court cited the following discussion:

> But as *our* cases have shown, a litigant's affirmative disavowal of express reliance on the privileged communication is not enough to prevent a finding of waiver. When a litigant seeks to establish its mental state by asserting that it acted after investigating the law and reaching a well-founded belief that the law permitted the action it took, then the extent of its investigation and the basis for its subjective evaluation are called into question. Thus, the advice received from counsel as part of its investigation and evaluation is not only relevant but, on an issue such as this, inextricably intertwined with the court's truth-seeking functions. ***A litigant cannot assert a defense based on the contention that it acted reasonably because of what it did to educate itself about the law, when its investigation of and knowledge about the law included information it obtained from its lawyer, and then use the privilege to preclude the other party from ascertaining what it actually learned and knew.***

Quoting *State Farm Mut. Auto. Ins. Co. v. Lee*, 13 P.3d 1169 (Ariz. 2000) (emphasis added by Mississippi court). The court noted the following legal principle: "if the claims handler relied *substantially*, if not *wholly*, on in-house counsel to prepare her denial letter, the reasoning of in-house counsel should be discoverable."

F. Failure to Cooperate

Hot off the presses is an unpublished decision addressing the question of whether the invocation of Fifth Amendment rights and refusal of an insured to provide testimony may constitute a breach of the duty to cooperate. *Link v. Link*, 2022 Wisc. App. LEXIS 75, 2022 WL 28822. Mr. Link sought coverage under his homeowner's policy for two lawsuits, one by his wife and a second by other women, both alleging that he had posted photographs of them along with sexually suggestive and degrading captions about them on a members-only fetish website. His insurer afforded him a defense under reservation in both actions; it intervened in both actions, asserting a crossclaim for declaratory judgment. The insurer served discovery requests to which Mr. Link did not respond based on an assertion of Fifth Amendment protection against self-incrimination. The insurer then sought summary judgment in both cases asserting a breach of the duty to cooperate under the policy. Both trial courts granted summary judgment in favor of the insurer.

The policy had a concealment clause which stated:

> We do not provide coverage to an 'insured' who, whether before or after a loss, has … [c]oncealed or misrepresented any fact upon which we rely, if the concealment or misrepresentation is material and is made with intent to deceive.

The policy also had a cooperation clause which provided that the insured must "cooperate with [the company] in the investigation, settlement or defense of any claim or suit, and stated that there was "no duty to provide coverage" if the failure to cooperate was prejudicial to the insured.

The Wisconsin Court of Appeals quoted a prior decision to distinguish the rights against self-incrimination and contractual duties:

> The fifth amendment protects a defendant only when it is the state that is the questioner; the state can use the answers in a criminal prosecution. Fear of self-incrimination does not exempt one from contractual duties. Constitutional immunity has no application to a private examination arising out of a contractual relationship.

Quoting *State Farm Fire & Cas. Ins. Co. v. Walker*, 459 N.W.2d 605 (Wis. App. 1990). Responding to Link's arguments about the peril he faced, the court concluded, "it makes little sense to require most insureds to cooperate in the typical coverage investigation while allowing those accused of more egregious, and potentially criminal, acts to invoke privilege and still receive coverage." The court found the information requested to be material (e.g., whether first publication was prior to policy period and knowledge of falsity) and also held that the insured's failure to respond inhibited the insurer's ability to evaluate coverage which prejudiced it.

G. Recouping Defense Costs

In a case of first impression, the Nevada Supreme Court recognized an insurer's right to recoup defense expenses in *Nautilus Ins. Co. v. Access Med., LLC*, 482 P.3d 683 (2021). As Nevada law provided no guidance on the issue, the question was certified to the Supreme Court by the Federal District Court handling the coverage suit. The coverage court found that the underlying complaint did not trigger a duty to defend and granted declaratory relief in Nautilus' favor; this decision was affirmed by the Ninth Circuit Court of Appeals. Nautilus then sought recovery of defense expenses incurred on behalf of the insured.

The insured – who was sued by a former business partner – sought coverage under Personal and Advertising Injury coverage, asserting that the underlying complaint alleged defamation. Nautilus originally denied coverage but ultimately provided a defense subject to expressly "reserv[ing] the right to disclaim coverage, withdraw from defense, and obtain a reimbursement of defense fees if a court determined that no potential for coverage existed for the claims."

The Supreme Court recognized the right to recover under an unjust enrichment theory. The insured argued that Nautilus could not assert unjust enrichment because a contract existed. The Supreme Court rejected this view because the court had determined that the duty to defend was not triggered. "Therefore, the contract between the parties does not apply to the instant dispute and the existence of that contract does not foreclose an unjust enrichment claim." The court looked to general contract principles and noted that a party who performs a disputed obligation and who does not actually have a duty to perform is entitled to reimbursement.

The Supreme Court also rejected the argument that, when a policy does not set forth a right of reimbursement, recognizing such a right effectively allows an insurer to unilaterally modify the contract. The court stated:

> [W]hen a court holds that there never was a duty to defend, it is holding that the claims

were never even potentially covered by the policy. Therefore, when the insured reserved its right to seek reimbursement, it was not extracting an amendment to the contract that would otherwise govern its defense. No contract governed its defense. In these circumstances, there is no reason it cannot reserve a right it has, not pursuant to the contract, but pursuant to the law of restitution.

H. D&O Claim; "Penalty Imposed By Law"

The insured, Bear Stearns Company, was a securities broker. The SEC undertook an investigation of Bear Stearns, alleging it facilitated late trading and deceptieve market timing practices. Ultimately, Bear Stearns settled the SEC claim, paying $160 MM for "disgorgement" and $90 MM for a "civil money penalty." Both amounts were deposited into a fund to compensate investors harmed by Bear Stearns. Per the settlement, the $90 MM payment was deemed ineligible to offset amounts owed to private litigants and Bear Stearns was required to treat the payment as a penalty for tax purposes.

Bear Stearns sought coverage for the disgorgement payment and the issue was whether it was a "penalty imposed by law" which was excepted from the policy definition of "loss." Bear Stearns argued that it the disgorgement payment was compensatory in nature because it was "derived from estimates of client gain and investor harm."

The court noted that New York law distinguishes between penalties and compensatory remedies. It found that at the time of contracting, the parties "would likewise have understood the term 'penalty' to refer to non-compensatory, purely punitive monetary sanctions." Based on evidence of the negotiations and the calculations leading to the $140 MM payment, the court found that "Bear Stearns demonstrated that the $140 million disgorgement payment was calculated based on wrongfully obtained profits and as a measure of the harm or damages caused by the alleged wrongdoing that Bear Stearns was accused of facilitating." The court also found that because the payment was placed into the fund to compensate injured parties, it was compensatory. Though the $90 MM was also placed into this fund, the court distinguished it because the agreement specifically required that Bear Stearns treat it as a penalty.