PLUNKETT COONEY

Allocation and Trigger of Coverage, Electronic Equipment Endorsement Coverage Update

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Allocation and Trigger of Coverage – North Carolina

Radiator Specialty Co. v. Arrowood Indem. Co. et al.
--- S.E.2d ---, 2022 WL 17726535 (N.C. Dec. 16, 2022)

The Supreme Court of North Carolina held that an "exposure trigger" applied to underlying claims of benzene exposure; that the insurers' obligations to defend and/or indemnify their insured for such claims were subject to pro rata allocation; and that certain umbrella policies were subject to vertical exhaustion only, and not horizontal exhaustion.

Radiator Specialty Company (RSC) manufactured cleaners, degreasers and other automotive and plumbing products. Because some of its products contained benzene, RSC was named in hundreds of personal injury lawsuits over several years alleging bodily injury stemming from exposure to benzene. During the pertinent time period, RSC had "purchased more than one-hundred standard-form product liability policies from twenty-five insurers," according to pleadings in the case.

RSC sought coverage from its insurers for the personal injury lawsuits and filed a declaratory judgment lawsuit against those insurers. The insurers sought summary judgment, and the trial court held that an exposure trigger was appropriate in the context of benzene exposure, pro rata allocation applied, plus one of the umbrella policies was subject to horizontal exhaustion with respect to the duty to defend and vertical exhaustion with respect to the duty to indemnify.

On petitions for discretionary review, the Supreme Court affirmed in part and reversed in part. First, the Supreme Court affirmed the lower courts' holdings that an exposure trigger was appropriate for determining coverage for alleged benzene exposure because "benzene causes bodily injury upon exposure" even if that injury does not manifest as cancer or some other illness until years later. The Supreme Court, therefore, rejected one insurer's argument that a manifestation trigger should be applied.

Second, the high court held that the insurers' duties to defend and indemnify were subject to pro rata allocation, rejecting RSC's argument that an "all sums" approach should apply. The Supreme Court noted that "the modern trend is to apply pro rata allocation when limiting language like 'during the policy period' exists, even when the policy contains a reference to paying 'all sums' arising out of

certain liabilities." Because benzene exposure causes bodily injury at the time of the exposure, according to the Supreme Court, and because the policies at issue did not contain non-cumulation clauses, the "all sums" approach adopted in other cases was not appropriate for "benzene-related injury."

Finally, the Supreme Court held that vertical exhaustion applied to the duty to defend under one insurer's umbrella policies. The high court reversed the findings of the trial court and appellate court, which found the insurer had a duty to defend under the umbrella policies only after "horizontal exhaustion of all other available policies" from other policy periods. Where the policies in question required the insurer to defend when "[n]o other valid and collectible insurance is available to the insured for damages covered by this policy," in addition to requiring such defense where other available coverage was exhausted, the insurer was required to defend under the umbrella policies because the underlying policies contained "pre-existing damage" exclusions precluding coverage under those policies. Because no other "valid and collectible" insurance was available, the umbrella policies' defense provisions applied, notwithstanding whether horizontal exhaustion had occurred.

By: Stephanie Brochert

Electronic Equipment Endorsement – Ohio

EMOI Servs., L.L.C. v. Owners Ins. Co.
--- N.E.3d ---, 2022 WL 17905839 (Ohio Dec. 27, 2022)

Owners Insurance Co. (Owners) insured EMOI Services, LLC (EMOI), a computer software company, under a businessowners insurance policy. In September 2019, EMOI was the target of a ransomware attack where a hacker illegally gained access to EMOI's computer systems and encrypted files that it used for its software and database systems.

As a result of the attack, when a new file was open, a ransom note appeared, which notified the user that the filers were unavailable but could be restored by a decryption key that the hacker would provide in exchange for three bitcoins, which totaled approximately $35,000. EMOI decided to pay the ransom, after determining the timing and financial feasibility of recovering the files through a third-party service. Upon paying the ransom, a majority of the files were returned to normal, and there was no hardware or equipment damage as a result of the ransomware attack. Shortly thereafter, EMOI upgraded its software systems to protect itself from future attacks.

EMOI filed an insurance claim with Owners for payment of the ransom and the costs associated with investigating and remediating the attack, as well as for upgrading its security system. Owners determined that the policy did not cover EMOI's loss and denied the claim. Owners noted that the

electronic equipment endorsement covered direct physical loss of or damage to "media," defined in the policy as "materials on which information is recorded such as film, magnetic tape, paper tape, disks, drums, and cards," including "computer software and reproduction of data contained on covered media." As such, Owners denied the claim under the electronic equipment endorsement because there was no "direct physical loss to the 'media.'"

As a result of the denial, EMOI filed a lawsuit against Owners, alleging that Owners breached the insurance contract by denying coverage under the electronic equipment endorsement, and did so in bad faith. Owners counterclaimed for declaratory judgment, arguing that "no coverage, payment or indemnity is owed" to EMOI under the policy. Owners then filed a motion for summary judgment. The trial court granted Owners' motion, reasoning that "this is a data compromise situation, rather than a situation involving physical damage to electronic equipment." EMOI appealed the trial court's decision, and the appellate court reversed, finding genuine issues of material fact where "the language of the electronic-equipment endorsement potentially applied to EMOI's claim if EMOI could prove that its media, i.e., its software, was in fact damaged by the encryption." Owners appealed to the Supreme Court of Ohio.

The Supreme Court held that the language in the electronic equipment endorsement was clear and unambiguous in that there must be "direct physical loss of, or direct physical damage to, electronic equipment or media before the endorsement is applicable." The Supreme Court held that because the ransomware attack did not cause "direct physical loss of or damage to" the software (which is intangible and cannot experience direct physical loss or direct physical damage), the electronic equipment endorsement did not apply, and Owners was not responsible for covering the loss. As such, the Supreme Court reversed the decision of the lower court and reinstated the trial court's grant of summary judgment in Owner's favor.

By: Danielle Chidiac

Reservation of Rights Letter – Fourth Circuit (South Carolina Law)

Stoneledge at Lake Keowee Owners' Ass'n, Inc. v. Cincinnati Ins. Co. et al.
No. 19-2009, 2022 WL 17592121 (4th Cir. Dec. 13, 2022)

The U.S. Court of Appeals for the Fourth Circuit upheld the federal district court's decision granting summary judgment in favor of the plaintiff Stoneledge at Lake Keowee Owners' Association (Stoneledge) and against Cincinnati Insurance Company (Cincinnati) and Builders Mutual Insurance Company (Builders) in a case in which Stoneledge sought damages arising out of a construction-defect lawsuit. The appellate court ruled that Cincinnati's and Builders' reservation of rights letters issued to their insured, Marick Home Builders LLC (Marick), failed to provide a basis for denial of

coverage.

Stoneledge manages a community of 80 townhomes on a lake in South Carolina. As part of a construction project, Stoneledge used the services of the insured general contractor Marick and Marick's managing member, Rick Thoennes (Thoennes), to build 47 of the 80 townhomes. In 2009, Stoneledge filed suit against Marick and Thoennes seeking damages for water intrusion resulting from construction defects. After Marick notified his two insurers, Cincinnati and Builders, it received three reservation of rights letters from them.

Stoneledge prevailed at trial, becoming a judgment creditor of the insureds. Eventually, Stoneledge was awarded approximately $1.6 million against Marick and Thoennes. In 2014, Stoneledge brought a declaratory judgment action against Cincinnati in state court. It was subsequently removed to federal court and Builders was added to the lawsuit. The district court granted Stoneledge summary judgment on the ground that the insurers failed to reserve the right to contest coverage.

Applying the rationale of a South Carolina Supreme Court decision, the federal appellate court affirmed the district court's decision. The binding case law required reservation of rights letters to provide sufficient information to allow the insured to understand the reasons the insurer believes the policy may not provide coverage. Generic denials of coverage, coupled with furnishing the policy or a copy of the policy provisions, is not sufficient. The appellate court held that although the Builders letter referenced certain policy exclusions and summarized the general nature of those exclusions, stating a policy exclusion without more did not constitute a sufficient reservation of rights letter. The appellate court acknowledged that the Cincinnati letter was a closer question because it stated that "[i]t is doubtful that the claim alleges the happening of an 'occurrence' or that the 'claim alleges 'property damage' within the policy definition,' and if there is no 'occurrence' or 'property damage' as defined by the policy, there is 'no coverage.'" However, the letter was devoid of any explanation for why Cincinnati found doubt that there was an occurrence or property damage, and, therefore, the letter was, at best, ambiguous and thus insufficient.

By: Joshua LaBar