PLUNKETT COONEY

Notice, Allocation, Computer Fraud Coverage Update

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Notice – Sixth Circuit (Tennessee Law)

First Horizon Nat'l Corp. v. Houston Cas. Co.
--- Fed. Appx ---, 2018 WL 3359555 (6th Cir. July 10, 2018)

The U.S. Court of Appeals for the Sixth Circuit ruled that a group of insurers was not obligated to pay $75 million to cover part of First Horizon National Corporation's and its wholly-owned subsidiary's (First Horizon's) False Claims Act settlement with the federal government because of First Horizon's insufficient notice of circumstances. In the underlying action, the U.S. Department of Justice (DOJ) alleged that First Horizon had knowingly originated and underwritten substandard mortgage loans insured by the government, in violation of the False Claims Act. First Horizon initially met with government officials in May 2013 regarding the alleged violations of the False Claims Act but did not inform its insurers of the DOJ's investigation until almost a year later. The appellate court held that "the question is whether a reasonable person would objectively expect the information presented in the [meeting] to give rise to a claim at some point in the future," which the appellate court found to be the case. The DOJ eventually made a written settlement offer, which the appellate court agreed was a claim defined as "any written demand for monetary, non-monetary[,] or injunctive relief." Though First Horizon notified the insurers of the claim in May 2014, the appellate court found that First Horizon failed to apprise the insurers of the significance of the claim or specifically to mention a $610 million settlement offer. Based on this insufficient notice, the appellate court found that the insurers had no duty to fund First Horizon's settlement. The appellate court, however, also affirmed the lower court's dismissal of the insurers' reverse bad-faith claim, finding that there was no showing that First Horizon acted in bad faith in bringing suit against the insurers.

Allocation – Delaware (Michigan Law)

Motors Liquidation Co. DIP Lenders Tr. v. Allstate Ins. Co.
No. 381, 2017, 2018 WL 3360976 (Del. July 10, 2018)

The Delaware Supreme Court affirmed a holding that, pursuant to Michigan law, *pro-rata* allocation applied to policies issued by excess insurers, OneBeacon Insurance Company (OneBeacon) and Continental Casualty Company (Continental), for pre–1972 asbestos claims for which General Motors (GM) sought coverage. In 2009, GM underwent bankruptcy reorganization and, as a result of that

proceeding, the rights to any proceeds from the policies were assigned to Motors Liquidation Company DIP Lenders Trust (Trust). The Trust sued a number of GM's excess insurers for coverage of the underlying asbestos claims. In June 2017, the trial court rejected the Trust's plea for an "all sums" allocation, under which insurers in a single triggered period may be liable for an entire loss up to the policy limits. Instead, the trial court found that OneBeacon's and Continental's obligations for asbestos claims under several excess policies they issued to GM in the late 1960s and early 1970s must be allocated pursuant to a "*pro-rata*" method, under which each insurer is assigned a proportional share based on the time its policies were on the risk. The Supreme Court affirmed the trial court's holding. In rejecting the "all sums" allocation adopted in the unpublished Michigan appellate court opinion in *Dow Corning Co. v. Continental Cas. Co., Inc.*, No. 200143, 1999 WL 33435067 (Mich. Ct. App. Oct. 12, 1999), the Supreme Court noted: "While Michigan will apply all sums allocation where there is policy language leading to that result, as in *Dow*, it applies *pro-rata* allocation to policy language like that contained in the policies involved in this case."

Computer Fraud Coverage – Second Circuit (New York Law)

Medidata Sols. Inc. v. Fed. Ins. Co.
--- Fed. Appx. ---, 2018 WL 3339245 (2d Cir. July 6, 2018)

The U.S. Court of Appeals for the Second Circuit affirmed a decision of the district court, finding that an insurance policy issued by Federal Insurance Company (Federal) to Medidata Solutions Inc. (Medidata) covered losses from a phishing scam perpetrated against Medidata. In September 2014, a Medidata employee received an email thought to be from the company's president, but in actuality it was a phishing scam asking the employee to transfer funds based on what was purported to be an acquisition. Based on the employee's correspondence, the employee received authorization to make the transfer (totaling almost $4.8 million) from other officers at Medidata. The transferred funds were never recovered. Federal refused to provide coverage under the computer fraud provision in the policy it issued to Medidata, saying that the same was not a "direct loss" from computer fraud as required by the policy's language. The District Court for the Southern District of New York disagreed, and this was upheld by the appellate court, which found that the loss still resulted directly from computer fraud even though there was no hacking or other compromise of the computer system. The appellate court reasoned that the fraudster's entry of data into the computer's system, and the use of a code that changed the appearance of the email to make it look authentic, constituted a computer fraud, giving rise to the loss. The appellate court also rejected the insurer's argument that the involvement of the employee (and the employees' independent authorization for the transfer) cut off the computer fraud as the "direct" loss, saying that because the employees thought they were acting under the authorization of their president, the causal relationship between the computer fraud and the loss was not severed.

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