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Year In Review: Insurance Developments In 2014

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2014 was a busy year for insurance practitioners, legislators and jurists. The year brought one of the first court decisions concerning the availability of insurance coverage for losses arising out of a data breach. It also came with clarification as to when an insurer may (and may not) rely on policy exclusions after wrongfully refusing to provide a defense. Courts also added breadth to instances where insurers must indemnify administrative response costs.

2014 also was not without its fair share of legislative and regulatory developments, such as the Flood Insurance Reform Act of 2014, which addressed the flood insurance cost increases that resulted from the Biggert-Waters Act. Likewise, the year saw the introduction and passage of legislation and regulation requiring minimum amounts of insurance for ride-sharing companies like Uber Technologies Inc. and Lyft Inc. Each of these developments, and more, is discussed in the annual recap below.

Litigation

Coverage for Data Breach Is No Game

A New York state judge issued one of the first court decisions regarding the availability of insurance coverage for losses due to a data breach. Zurich Am. Ins. Co. v. Sony Corp. of Am., No. 651982/2011 (N.Y. Sup. Ct. Feb. 21, 2014). In Sony, the trial court found that two insurance companies had no duty to defend Sony in cases arising out of a 2011 cyberattack on Sony's network that connects users to play video games. From an insurance standpoint, the critical issue was whether the claims brought against Sony following the breach involved "oral or written publication in any manner of material that violates a person's right to privacy," as required by the policy. The court decided that this language did not provide coverage for Sony because the "oral or written publication ... was perpetrated by the hackers" and not by Sony. The bottom line for the court was its conclusions that the policy required that the policyholder "perpetrate or commit the act" and that the policy "cannot be extended to include third party acts." Sony's appeal of this decision remains pending in the New York intermediate appellate court.

New York's High Court Descends From Its Earlier Decision in K2

The New York Court of Appeals also ranks among the courts making notable rulings in 2014. In K2 Investment Group LLC v. American Guarantee & Liability Insurance Co., 6 N.E.3d 1117 (N.Y. 2014) (K2 Investment II), New York's high court ruled that an insurer could enforce policy exclusions to escape liability even after the insurer breached the policy by failing to provide a defense. In doing so, the court took the rare step of vacating and reversing its own prior decision, where the court had reached the exact opposite conclusion. 993 N.E.2d 1249 (N.Y. 2013) (K2 Investment I) (holding that "when a liability insurer has breached its duty to defend its insured, the insurer may not later rely on policy exclusions to escape its duty to indemnify the insured for a judgment against him").

In K2 Investment II, the court determined that its earlier decision "fail[ed] to take account of a controlling precedent." The court reached this conclusion upon recognizing that its position in K2 Investment I was irreconcilable with its earlier holding in Servidone Constr. Corp. v. Sec. Ins. Co. of Hartford, 477 N.E.2d 441 (N.Y. 1985). Accordingly, faced with either overruling Servidone or following it, and having found no justification under New York law for overruling Servidone, the court followed the Servidone rule in K2 Investment II. It therefore concluded that the insurer in that case could rely on policy exclusions to escape its duty to indemnify even though the insurer had breached its duty to defend.

New York Court of Appeals Reminds Lower Courts That Statutory Standard Applies Only When Statute Applies

The New York high court also was busy in 2014 reconciling intermediate appellate decisions addressing when and under what circumstances an insurer has waived its ability to assert a late notice defense. The court resolved the conflict in KeySpan Gas East Corp. v. Munich Reinsurance America Inc., 15 N.E.3d 1194 (N.Y. 2014), in which it determined that several intermediate appellate court decisions on waiver of late notice defenses were wrongly decided insofar as they required insurers to disclaim coverage based on late notice of a claim "as soon as reasonably possible." The state high court found that the "as soon as reasonably possible" requirement relied upon by the intermediate appellate courts stems from New York Insurance Law § 3420(d)(2), which applies only to "insurance cases involving death and bodily injury claims arising out of a New York accident and brought under a New York liability policy." As the court explained, if the statute does not apply, the insurer's "delay in giving notice of disclaimer should be considered under common-law waiver and/or estoppel principles." The court concluded, therefore, that the lower court decisions finding an obligation to disclaim coverage based on late notice "as soon as reasonably possible" where § 3420(d)(2) did not apply were wrongly decided.

The KeySpan decision is an important clarification of New York law that can limit policyholders' ability to contend that insurers have waived their late notice defenses where the insurers failed to raise those defenses "as soon as reasonably possible." When the statute does not apply, policyholders will need to rely on common law waiver, which requires a voluntary and intentional relinquishment of a known right.

Contractual Liability Exclusions Are Not Big in Texas

The Supreme Court of Texas issued a much-anticipated decision concerning insurers' ability to rely on contractual liability exclusions. Ewing Constr. Co. v. Amerisure Ins. Co., 420 S.W.3d 30 (Tex. 2014). In Ewing Construction, the Texas high court rejected an insurer's attempt to rely on a contractual liability exclusion that operated to exclude coverage for liabilities stemming from damage to property. The insurer argued that the policyholder's liability arose "by reason of the assumption of liability in a contract or agreement" and therefore fell within the contractual liability exclusion. The court held, however, that the exclusion would apply only if "the insured has assumed a liability for damages that exceeds the liability it would have under general law." Analyzing the facts giving rise to the policyholder's liability, the court found that the liabilities arose from the insured contractor's failure to exercise ordinary care in connection with its work. Accordingly, the court concluded that the contractual liability exclusion would not apply in that case because the general contractor did not "enlarge its duty to exercise ordinary care in fulfilling its contract" by agreeing "to perform its construction work in a good and workmanlike manner."

When Excess Becomes the New Primary

2014 also brought several opinions concerning the availability of excess coverage when policyholders settle with underlying insurers for less than full policy limits. As one might expect, those opinions, issued by different judges in different jurisdictions, reach different conclusions. Compare Forest Labs. Inc. v. Arch Ins. Co., 116 A.D.3d 628 (N.Y. App. Div. 2014) (finding that excess coverage is unavailable when policyholder settled with underlying insurers for less than full policy limits where excess policy provided that it would pay "only after the insurers of the Underlying Policies shall have paid in legal currency the full amount of the Underlying Limit"), with Plantation Pipe Line Co. v. Highlands Ins. Co., 444 S.W.3d 307 (Tex. Ct. App. 2014) (finding that excess coverage is available when policyholder settled with underlying insurers for less than full policy limits where excess policy provided that it would pay "only after the Underlying Umbrella Insurers have paid or been held liable to pay the full amount of their respective ultimate net loss liability"). Consistent with prior opinions, these decisions demonstrate that the availability of excess coverage in these situations is highly dependent on the relevant policy provisions.

Coverage for Complying With Subpoena in Criminal Investigation

Although it came on the eve of 2014, a New York court's decision regarding coverage for costs to comply with subpoenas issued as part of a criminal investigation is too notable to pass over in our recap of this past year's decisions of significance. In Syracuse University v. National Union Fire Insurance Co., 112 A.D.3d 1379 (N.Y. App. Div. 2013), Syracuse University was served with six subpoenas for documents from the grand jury investigating sexual abuse allegations against an assistant basketball coach at the university. The New York appellate court found that Syracuse was covered for its costs in responding to the grand jury subpoenas because the subpoenas amounted to a "claim" under the policy.

Bad Faith Abound

The year also was not without its fair share of opinions on bad faith insurance issues. For instance, the Fourth Circuit held that a policyholder may recover damages under West Virginia law for "aggravation and inconvenience" resulting from its insurer's wrongful refusal to defend an underlying liability action. Graham v. Nat'l Union Fire Ins. Co., 556 Fed. App'x 193 (4th Cir. 2014). And, in a departure from prior case law, a Florida appellate court found that a policyholder has a viable bad faith claim as soon as it is determined that coverage is owed, even where the insurer has not breached the insurance contract. Cammarata v. State Farm Fla. Ins. Co. (Fla. Dist. Ct. App. Sept. 3, 2014). These decisions, along with many of the other bad faith decisions observed in 2014, illustrate that bad faith insurance law continues to evolve.

Superstorm Sandy: Still Wreaking Havoc

Even though it was the fall of 2012 when Superstorm Sandy ravaged the northeastern United States, insurance coverage litigation arising from Sandy continues in 2014. That ongoing litigation resulted in several significant decisions involving business interruption coverage in the past year. See, e.g., Newman Myers Kreines Gross Harris PCv. Great N. Ins. Co., 17 F. Supp. 3d 323 (S.D.N.Y. 2014) (finding that loss of power leading to closure of business office was not "direct physical loss or damage" necessary to establish business interruption coverage). In addition, more than 1,000 cases arising from Sandy and filed by property owners against insurance companies are now pending in consolidated litigation in federal court in the Eastern District of New York. The court has undertaken significant efforts to resolve these cases through mediation, including holding a training course tailored for Sandy mediators.

At least two of the Sandy cases pending in the consolidated litigation in the Eastern District involve apparently unscrupulous contractors engaged in adjusting claims arising from the tragedy. In a recent decision, the Eastern District of New York found "reprehensible gamesmanship by a professional engineering company that unjustly frustrated efforts by two homeowners to get fair consideration of their claims." In Re Hurricane Sandy Cases (E.D.N.Y. Nov. 7, 2014). More troubling was the court's finding that "evidence suggests that these unprincipled practices may be widespread." In particular, an engineering firm retained by one of the defendant insurers secretly rewrote its engineer's written report that Sandy had damaged beyond repair the property at issue. The rewritten report concluded that Sandy had not damaged the property and that long-term deterioration caused the defects in the home. Based on the rewritten report, the defendant insurer refused to pay for any structural damage to the property. The court found these practices "reprehensible" and "startling" and ordered the defendant insurers in all the Sandy cases to disclose any similar reports.

In addition, based at least in part on these practices, an insurance company, its consulting firms and its law firms were just hit with a class action complaint containing racketeering allegations. See Dweck v. Hartford Ins. Co. of the Midwest, No. 1:14-cv-6920 (E.D.N.Y.) (filed Nov. 25, 2014).

Stocking Stuffers

2014 also provided important insurance-related decisions in a variety of other areas. For instance, the Sixth Circuit held in William Beaumont Hospital v. Federal Insurance Co., 552 Fed. App'x 494 (6th Cir. 2014), that a hospital's insurer must pay for the settlement of antitrust class action claims brought by nurses against the hospital for allegedly keeping wages down after the court found that the settlement did not constitute disgorgement under the terms of the hospital's insurance policy.

In Executive Plaza LLC v. Peerless Insurance Co., 5 N.E.3d 989 (N.Y. 2014), the New York Court of Appeals refused to enforce a two-year suit limitation against a policyholder where doing so would require that the suit be filed before the loss was complete.

In PNC Financial Services Group Inc. v. Houston Casualty Co. (W.D. Pa. June 24, 2014), a Pennsylvania federal court held that an insurer must indemnify an insured bank for amounts paid as attorneys' fees and related costs incurred in settlement of class action claims.

In Louisiana Generating LLC v. Illinois Union Insurance Co., No. 10-516-JJB-SCR (M.D. La. Sept. 30, 2014), a Louisiana federal court held that a general liability insurer must indemnify its policyholder for civil penalties incurred pursuant to a consent decree with federal and state environmental agencies because the insurance policy's punitive damages exclusion did not apply since the court determined that civil penalties were not punitive.

In St. Paul Mercury Insurance Co. v. Michael S. Hahn (C.D. Cal. Oct. 8, 2014), a California federal district court ruled that an insurer must defend former directors and officers of a defunct bank who were sued by the Federal Deposit Insurance Corp. as the receiver for the defunct bank, rejecting the insurer's reliance on the "Insured v. Insured" exclusion and joining the majority of courts throughout the country that have held that the "Insured v. Insured" exclusion does not unambiguously exclude from coverage lawsuits by the FDIC.

And, last but certainly not least, in Gregory Packaging Inc. v. Travelers Property Casualty Co. of America (D.N.J. Nov. 25, 2014), a federal court in New Jersey recently held that contamination of a factory by ammonia gas constituted "direct physical loss of or damage to" property under a policy of commercial property insurance even though no structural damage or other alteration occurred to the insured property.

New Year's Resolutions for Courts in 2015

Finally, also notable is what 2014 did not bring. Several important cases remain pending in the courts, including Fluor Corp. v. Superior Court of Orange County, which presents the question of whether the Supreme Court of California will overturn its controversial decade-old decision in Henkel Corp. v. Hartford Accident & Indemnity Co., 29 Cal. 4th 934 (2003). In Henkel, the court disapproved of the transfer of insurance rights by operation of law in connection with a corporate transaction where the policies at issue contained a so-called no assignment clause. Henkel held that where liability is contractual, and does not arise by operation of law, insurance coverage likewise does not transfer by operation of law. Because Henkel had not obtained the insurer's consent, the court held under California law that the attempted contractual assignment was ineffective. At the beginning of the year, Fluor appeared in Law360's list of insurance cases to watch in 2014. Yet, as we near the end of 2014, insurers, policyholders and practitioners still wait in anticipation of a decision.

The Supreme Court of Pennsylvania also is poised to rule in a noteworthy case involving the interpretation of a "separation of insureds" provision that may have implications for additional insureds in Pennsylvania and elsewhere. Mut. Benefit Ins. Co. v. Politopoulos, 75 A.3d 528 (Pa. Super. Ct. 2013), appeal docketed 60 MAP 2014 (Pa. 2014).

And, as noted above, the Sony v. Zurich decision involving coverage for data breach losses remains on appeal in the New York intermediate courts.

Hopefully, adjudication of these and other significant pending issues is at the top of the courts' lists of New Year's resolutions for 2015.

Legislation and Regulation

In addition to important developments through court decisions, federal and state legislatures and regulators passed or implemented significant changes in 2014.

Ride Companies and Their Passengers Are Now Protected — In Some States

As the use of ride-sharing companies like Uber and Lyft continues to rise so does public criticism that such companies are not subject to the same rules and regulations that govern taxi companies and similar services. In response to both issues, several states passed legislation concerning, among other things, minimum amounts of insurance that must be obtained. For example, California passed a bill requiring that ride-sharing companies or their drivers maintain at least $100,000 of insurance protection. That coverage must apply as soon as the driver connects to the company's software, usually a smartphone application. The coverage must increase to $1 million once the driver agrees to pick up a passenger. The statute also provides that the driver’s personal auto policy will not apply while the driver is connected to the company’s software, unless the policy expressly provides otherwise.

Mopping Up Flood Insurance Cost Increases

Congress also passed insurance-related legislation in 2014 when it acted to address issues caused by the previously passed Biggert-Waters Act. The Biggert-Waters Act, among other things, caused increased flood insurance costs when it took effect in 2012. According to Sen. Joe Manchin, D-W.Va., the Flood Insurance Reform Act of 2014 eliminated those increases by suspending “insurance premium increases for grandfathered rates, all new subsidized policies initiated after enactment of Biggert-Waters, and all subsidized properties sold after enactment of Biggert-Waters.”

No Action Yet On Terrorism Risk Insurance Act

In contrast to its work on flood insurance, Congress has yet to act to extend the Terrorism Risk Insurance Act, which is again set to expire on Dec. 31, 2014. Congress enacted TRIA in November 2002 in response to the lack of capacity in the insurance market for coverage for terrorism losses following the Sept. 11 terrorist attacks. It has extended the law twice, but has yet to extend it beyond 2014. However, according to recent media reports, Congress looks set to extend the act for several years after a compromise between competing U.S. Senate and U.S. House views of the extension.

Federal Government Slaps MetLife With Unwanted SIFI Label

In September, the Financial Stability Oversight Council preliminarily designated MetLife Inc. as a systemically important financial institution. MetLife has challenged that designation, and the FSOC held a hearing in November. It has yet to issue a final decision. If the SIFI designation stands, MetLife will join American International Group Inc. and Prudential Financial Inc. as the only insurance companies subjected to the additional regulation by the Federal Reserve and additional capital requirements that come with the SIFI designation.

Capping the Use of Life Insurance Captives

In 2013, the New York Department of Financial Services issued a report documenting the use of captive insurance subsidiaries, or shadow insurance, as the DFS put it, and highlighting the risks of the use of shadow insurance as perceived by the DFS. The DFS recommended consideration of a national moratorium on approval of new “shadow insurance transactions” pending further investigation. While the DFS' recommendations were not adopted, the Executive Committee of the National Association of Insurance Commissioners adopted a framework in 2014, for some additional regulation in this area. According to the NAIC, the framework adopted by the NAIC’s Executive Committee “would not change the statutory reserve requirements; rather, it would change what types of assets or securities are needed to back those reserve liabilities.” It would also “require the ceding company to disclose the assets and securities used to support the reserves and hold a [Risk-Based Capital (RBC)] cushion if the captive does not file RBC.” However, much is still to be done before any regulations are in place. Going forward, “numerous groups will develop the details to create the framework for subsequent consideration by the entire NAIC membership.”

Governing Corporate Governance Practices

The NAIC did not limit its contributions to regulatory development to the captive arena described above. It also adopted a model act requiring insurers to provide additional information to state regulators about corporate governance practices. The required disclosure includes information about the company's "corporate governance framework and structure," the "policies and practices of its Board of Directors and significant committees," the "policies and practices directing Senior Management," and how the company ensures "an appropriate level of oversight to the critical risk areas impacting the insurer's business activities including risk management processes, the actuarial function, and investment, reinsurance and business strategy decision-making processes." According to a NAIC representative, the disclosure requirements "will ensure that state regulators have a comprehensive understanding of the corporate governance structure, policies and practices utilized by the insurer."

The Affordable Care Act: Experiencing Growing Pains

Finally, 2014 was the first year in which the ACA required individuals to maintain health insurance and in which the insurance exchanges were open for business. The law and its implementation continue to garner their fair share of press. That attention will undoubtedly continue as the U.S. Supreme Court hears argument in King v. Burwell, a case involving Internal Revenue Service regulations that permit federal subsidies in states where the federal government rather than the state government operates the insurance exchange. A decision in the case is expected in 2015.

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