Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Insurance Cases To Watch In 2012

By **Dietrich Knauth**

Law360, New York (January 01, 2012, 12:00 AM ET) -- While the U.S. Supreme Court's review of the Patient Protection and Affordable Care Act will grab national headlines in 2012, insurance attorneys are also keeping their eye on a range of other coverage cases, including disputes over natural disasters, data breaches, and directors and officers coverage for government investigations.

For corporate attorneys, coverage for government oversight is going to be a key issue in 2012. Courts have reached conflicting rulings on whether or not D&O insurers must pay for the costs of preparing for investigations by agencies like the Securities and Exchange and Commission, leaving the area ripe for further litigation.

"I think the area that is going to be the most active in the next year is really going to be around SEC and CFTC and other state and federal investigations," said Steven Gilford of Proskauer Rose LLP. "It's driving the D&O markets and is really causing a lot of concern and focus."

Florida et al. v. Department of Health and Human Services

The Supreme Court's review of state challenges to the 2010 Patient Protection and Affordable Care Act will be by far the most important case for the health insurance industry. Twenty-six states, including Florida, have claimed in court that Congress can't require individuals to buy health insurance under the commerce clause of the Constitution.

Insurance industry groups have argued to the Supreme Court that the individual mandate is an integral part of the law and can't be severed. The law will force insurers to expand coverage of sick people by limiting insurers' ability to deny coverage for patients with preexisting conditions, bringing additional costs that will become unbearable unless healthy people are required to buy insurance as well, the industry groups say.

“This clearly will be the biggest case in 2012,” said Bart Reuter, a partner in Foley & Lardner LLP's insurance group. “It would be a devastating result for the health industry if the court ruled that the individual mandate is unconstitutional but the rest of the law could stand.”

The divisive law has led to a split between federal appeals courts. The Eleventh Circuit is the lone federal appeals court to have struck down the health care law's individual mandate, while the Sixth Circuit and D.C. Circuit have upheld the law, finding that Congress has the authority to regulate the purchase or nonpurchase of insurance because it is an economic activity that substantially affects interstate commerce.

Meanwhile, the Fourth Circuit dismissed two other challenges to President Barack Obama's health care overhaul, ruling the plaintiffs did not have standing to sue. It found that no suits to challenge the individual mandate or the penalty could be brought until the mandate takes effect in 2014.

The Supreme Court has scheduled over five hours of oral arguments across two days in March, and is expected to rule later in 2012.

The cases are National Federation of Independent Business et al. v. Sebelius et al., case number 11-393; U.S. Department of Health and Human Services et al. v. Florida et al., case number 11-398; and Florida et al. v. Department of Health and Human Services et al., case number 11-400, in the U.S. Supreme Court.

Sony Hacking Coverage Litigation

Sony Corp. found itself in hot water with customers in April after hackers accessed account data for more than 100 million users of Sony's PlayStation Network, Sony Entertainment Online and Sony Pictures. Seeking to avoid coming to Sony's defense in a wave of hacking-related consumer class actions, insurers led by Zurich American Insurance Co. have sued Sony in New York state court, saying that the data breach isn't covered by their commercial general liability policies.

Sony estimated that the attack would cost the company $178 million by March 2012, in addition to potential settlements or judgments in class actions brought by customers whose personal data was stolen. Sony faces roughly 60 complaints that have been consolidated in California federal court.

The case will likely test the limits of whether 'personal and advertising injury' coverage in typical CGL policies will extend to data breach claims, attorneys said.

Coverage for data breaches is an area of intense dispute, especially as companies begin purchasing coverage under separate data breach and cybersecurity policies, according to attorneys.

“Five to 10 years ago, nobody was writing cybersecurity or Internet-oriented policies,” Gilford said. “Now these policies are out there, but I don't think they've been tested.”

Unless they have separate cyber coverage, most policyholders will seek data breach coverage under their CGL policies' personal-and-advertising-injury clauses. Most such clauses include coverage for injuries resulting from “oral or written publication” of information that violates a right to privacy.

Whether an unintentional release of information counts as publication in this context is the hardest-fought question in many cyber coverage disputes, according to David Attisani, co-chairman of Choate Hall & Stewart LLP's insurance and reinsurance group.

“If a policyholder can publish something unintentionally, that will really open up the floodgates for more and more lawsuits like that,” Attisani said.

The case is Zurich American Insurance Co. et al. v. Sony Corp. of America et al., case number 652982/2011, in the Supreme Court of the State of New York, County of New York.

D&O Litigation

While no single case stands out as a must-watch battle in the D&O arena, attorneys are gearing up for an active year in D&O litigation as companies continue to lawyer up to fend off oversight and investigations from Congress, agencies like the U.S. Securities and Exchange Commission, and state regulators.

Policyholders are likely to continue to fight their insurers over D&O coverage for company responses to official investigations. While some important decisions on the issue were reached in 2011, the issues will spread to courts in other jurisdictions in 2012, as insurance law can vary greatly from state to state, attorneys said.

One closely watched decision from the past year was the Second Circuit's July ruling in MBIA Inc. v. Federal Insurance Co., in which the appeals court ruled that MBIA's D&O insurers must cover costs related to government investigations and derivative lawsuits over alleged accounting misstatements. But in October, the Eleventh Circuit reached a decision in favor of insurers in a similar case brought by Office Depot Inc., which sought D&O coverage after receiving letters from the SEC informing the company of a potential probe.

Another issue likely to see more litigation is the question of whether the insurer or insured gets to choose defense attorneys in a case in which insurers decide to defend a client under a reservation of rights. In such cases, where the insurer intends to eventually dispute coverage, allowing insurers to choose the defense team could present a conflict of interest, according to Reuter.

“I think we're going to get more decisions in 2012 from appellate courts on the issue of who gets to control the defense,” Reuter said.

Marc Mayerson of Orrick Herrington & Sutcliffe LLP agreed, saying that fights over control of the defense and questions about how to manage litigation costs in insurer-funded defenses would likely increase.

The insurance industry could solve most of the related litigation by clearly spelling out the rules of defense in their policies, but insurers seem reluctant to do so, perhaps because language that limits an insured's defense options would put the insurer at a competitive disadvantage, Mayerson said.

Disaster Coverage

When disaster strikes, insurance litigation is never far behind — and 2011 saw more than its fair share of natural disasters in the U.S. and globally, according to insurance industry and government reports.

Most of the insurance disputes over coverage for global disasters like massive flooding in Thailand and the Japanese tsunami and earthquake will start to hit U.S. courts in 2012, attorneys said.

“There's a lag in those kinds of cases,” Mayerson said. “It's very complex and difficult to put together the claim. I would be surprised if any cases had yet been filed, but that is something you could expect to see by next year.”

Losses from the Thailand flooding are expected to reach $13 billion, according to an estimate from JLT Re, the reinsurance brokerage arm of Jardine Lloyd Thompson PLC. U.S. businesses, like electronics and tech companies that rely on Thai companies for important supplies, will be harmed as well.

And while large-scale international disasters got much of the press, the U.S. also suffered record-setting economic losses due to weather-related disasters in 2011.

The National Climatic Data Center announced in October that 11 separate weather- or climate-related disasters had each caused at least $1 billion in economic losses, breaking an annual record dating back to 1980. The record for total federal disaster declarations was also broken in September, when the U.S. pushed past 81 for the year, according to the Insurance Information Institute.

Insurers paid nearly $25 billion in direct coverage for U.S. natural catastrophes in the first nine months of 2011 alone, according to the Insurance Information Institute.

Fluor Corp. v. Hartford Accident & Indemnity Co.

A case that could make waves in California in 2012 is Fluor Corp. v. Hartford Accident & Indemnity Co., which deals with coverage for environmental liabilities incurred by a predecessor company.

A favorable ruling for the policyholder could overturn a 2003 California Supreme Court decision that established the current California case law on enforceability of anti-assignment clauses in liability insurance policies, according to Brook Roberts of Latham & Watkins, who represents Fluor.

The 2003 case, Henkel Corp. v. Hartford Accident & Indemnity Co., ended in a win for insurers, with a ruling that the transfer of assets and liabilities to a successor did not automatically transfer the predecessor corporation’s insurance benefits.

Fluor was initially dismissed by an appeals court that refused to hear the case because of the Henkel decision. But on Nov. 16, the California Supreme Court unanimously granted a petition for review and ordered the lower court to show cause as to why Fluor should not be granted coverage for asbestos liabilities under policies granted to its predecessor.

The order indicates that the Supreme Court wants the court of appeals to hear the case on its merits, and likely means that the Supreme Court will take up the case after its been fully briefed in the lower court, Roberts said.

According to Roberts, the Henkel court overlooked an obscure part of California's insurance law, Insurance Code Section 520, which actually addresses the question of succession. In its ruling on the Henkel case, the Supreme Court applied common law.

“This has major significance for policyholders and insurance carriers in California,” Roberts said. “What's at stake is, is Henkel good law anymore? And I don't think it is.”

The decision could quickly move back to the Supreme Court and will have ramifications for other states that haven't considered the succession issue and for states that have considered it and rely on Henkel, according to Roberts.

--Editing by Cara Salvatore.