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Causes of Action over Property Insurance Coverage

By Jason L. Shaw

Rarely do lawyers have the benefit of a decision that is a primer on permissible causes of action arising from property insurance coverage disputes. *Kings Infiniti v. Zurich American Ins.*, 43 Misc.3d 1207(A) (Sup. Ct. Kings Cty. April 3, 2014), is one of those decisions. Justice Carolyn Demarest clearly and concisely addressed each issue raised by the defendants (collectively, Zurich) who successfully obtained a dismissal on a CPLR 3211 motion of several of the causes of action in the plaintiffs' amended complaint. However, a Court of Appeals decision, decided while the *Infiniti* motion was under submission, may allow the plaintiff to revive its case.

Hurricane Sandy Damage

The plaintiffs were three commonly owned car dealerships and service centers, all of which in October 2012 suffered extensive damages, alleged to be in the seven figures, from Hurricane Sandy. They had served an amended complaint containing 10 causes of action against the two Zurich defendants arising from what was essentially a breach of an insurance contract claim.

Prior to the loss, the Infiniti car dealer plaintiffs had had a relatively long relationship with Zurich. The latter first underwrote the properties in 2004, and had sent its employees to inspect the properties at the time of the underwriting. The plaintiffs alleged that Zurich would annually review coverage and make recommendations to the plaintiffs.

Most of the plaintiffs' dealership properties were in an area of Brooklyn that the New York City Office of Emergency Management listed in a category as having the highest risk of flooding. The plaintiffs alleged that in February 2012, Zurich conducted its annual review, but did not recommend the purchase of flood insurance for the dealerships and service centers, even though Zurich had been insuring the plaintiffs'automobile inventory, stored at a location apparently

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Cyberattacks Push Companies To Specialty Insurance Policies

By Travis Wall

Standard insurance policies are not designed to address losses from data breaches. Although some insureds have been successful in obtaining coverage for cyberattacks under traditional policies, that window is closing. As insurers refine coverage defenses and expand exclusions for cyber events, business will have to turn to specialty cyber policies for protection against data theft or loss.

Background

Commercial general liability (CGL) policies have two basic coverage types. Coverage A addresses "property damage" and "bodily injury." Coverage B applies to "personal injury" offenses, such as publications that invade rights of privacy. Because data breaches typically do not involve property damage or bodily injury, policyholders rely primarily on the personal injury prong.

Among other requirements, personal injury coverage applies only to claims arising from a "publication" of information. Data theft through hacking does not appear to involve a "publication" as that term is commonly understood. Courts will not presume a publication

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outside of the designated flood zone, under a separate policy from the one at issue in the *Infiniti* case. This separate policy did contain flood coverage. Most property insurance policies exclude from coverage damage and loss caused by flooding. The federal government has a national flood insurance program and is considered the sole provider of flood insurance coverage.

Two weeks after the Oct. 29, 2012 hurricane, the plaintiffs contacted Zurich and requested a copy of the policy. The amended complaint alleged that the copy of the policy Zurich faxed to them in response did not include the pages containing the flood exclusion language. Nevertheless, Zurich claimed that its policy excluded coverage for losses caused "directly or indirectly" by flooding. When Zurich ultimately denied coverage, relying on the flood exclusion, the certified copy of the policy it sent the plaintiffs with its denial letter contained the exclusionary language. The plaintiffs asserted in their complaint that Zurich, even before the loss, had never provided them with a copy of the policy containing the flood exclusion.

Declaratory Judgment

The first cause of action of the amended complaint sought a declaratory judgment as to which version of the policy controlled: the version Zurich had faxed to the plaintiffs, or the defendant's certified copy. Zurich moved to dismiss the declaratory judgment cause of action, asserting that it was essentially duplicative of the plaintiffs' breach of contract claims.

The court stated the general rule that when a declaratory judgment action merely asks for the same determination as a breach of contract cause of action, a court may appropriately dismiss the declaratory judgment action. However, Justice Demarest determined that because an insurer can bring a declaratory judgment action against its insured on a coverage question, an insured ought to be able to bring one against its insurer.

Moreover, because the declaratory judgment cause of action asked for a specific determination of whether the exclusion applies, and, unlike the breach of contract claims, did not seek damages, the declaratory judgment action was not merely duplicative or redundant of the contract breach claims. Therefore, it would survive the motion to dismiss.

Zurich may have thrown in its request for the dismissal of the declaratory judgment cause of action, or perhaps there was a strategy behind it. If the *Infiniti* case went to trial, judicial economy would provide a compelling reason for a bifurcated trial to try the issue of coverage first. It would take days of court time and tens of thousands of dollars of attorney fees and valuation proof to establish property and business losses. Before incurring such expense, the *Infiniti* plaintiffs would want to know whether they were, at the outset, in or out of court because of the one-paragraph policy flood exclusion. Likewise, one would think Zurich's interest would be the same, but perhaps not.

Assembling and presenting proof of property and business losses takes countless hours and often involves mind-numbing tedium. Proof of damages is frequently controlled by multiple insurance policy provisions. The opportunities for defense counsel to punch holes in a plaintiff's damage presentation are many, and defense counsel doubtless knows that a plaintiff who must prove both coverage and covered damages is frequently more agreeable to settlement.

The plaintiffs' victory on their declaratory judgment cause of action was fleeting, as the remainder of the court's decision involved dismissing their claims. There is no separate cause of action for a "breach of the implied covenant of good faith and fair dealings." To say it differently:

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CASE NOTES

Insurer Is Not Barred From Relying on Policy Exclusions to Disclaim Indemnity to an Insured

On Feb. 18, 2014, in *K2 Inv. Group, LLC v. American Guar. & Liab. Ins. Co., 6* N.E.3d 1117, 22 N.Y.3d 578 (N.Y. 2014) (hereafter "*K2 – II*"), the Court of Appeals of New York vacated its prior decision and reversed the Appellate Division's Order in *K2 Inc. Group, LLC v. American Guar. & Liability Ins. Co.*, 21 N.Y.3d 384 (2013) (hereafter "*K2 – I*"), holding that its ruling in *K2 – I* was irreconcilable with an earlier, established decision: *Servidone Const. Corp. v. Security Ins. Co. of Hartford*, 64 N.Y.2d 419 (1985).

In the *K2 – II* decision, the Court of Appeals thus affirmed the proposition that an insurer is not barred from relying on policy exclusions to disclaim indemnity to an insured where the insurer earlier breached a contractual duty to defend the insured in a personal injury action.

Background and the *K2 – I* Decision

Legal malpractice claims were brought against American Guarantee's insured, Jeffrey Daniels, whom American Guarantee refused to defend (it is now conceded that this denial of the duty to defend by American Guarantee was wrongful). Daniels later suffered a default judgment and assigned his rights against American Guarantee to the plaintiffs who had originally brought claims against him. These plaintiffs then brought suit against American Guarantee, seeking to enforce an indemnity obligation on the default judgment. American Guarantee responded that the loss was not covered pursuant to two exclusions in the policy.

In *K2 – I*, the Court of Appeals affirmed an order granting summary judgment to plaintiffs, holding that American Guarantee's breach of its duty to defend Daniels barred it from then relying on policy exclusions to disclaim an obligation to indemnify the judgment. In making this determination, the Court of Appeals relied on *Lang v. Hanover Ins. Co.*, 3 N.Y.3d 350, 356 (2004) to conclude that an insurance company that has disclaimed its duty to defend may litigate only the validity of its disclaimer, and cannot challenge the liability or damages determination underlying the judgment.

The *K2 – II* Decision

In *K2 – II*, the Court of Appeals determined that *K2 – I* failed to take into account controlling precedent: *Servidone Const. Corp. v. Security Ins. Co. of Hartford*, 64 N.Y.2d 419 (1985). In *Servidone*, an insurer relied on policy exclusions in defending against a suit for indemnification, and the Court of Appeals examined the following question:

> Where an insurer breaches a contractual duty to defend its insured in a personal injury action, and the insured thereafter concludes a reasonable settlement with the injured party, is the insurer liable to indemnify the insured even if coverage is disputed?

64 N.Y.2d at 421.

In *Servidone,* the Court of Appeals answered "no" to this question, concluding that an insurer is not barred from relying on policy exclusions to deny indemnity even after breaching the duty to defend.

The Court of Appeals carried this *Servidone* proposition forward in *K2 – II*, holding that even though there was a settlement in *Servidone*, and a judgment in the instant underlying proceedings, this distinction was not persuasive. "A liability insurer's duty to indemnify its insured does not depend on whether the insured settles or loses the case." Instead, the issue in the instant matter, as it was in *Servidone*, was "whether the insurer may rely on policy exclusions that do not depend on facts established in the underlying litigation." In *K2 – II*, the Court of Appeals answered this in the affirmative.

The Court of Appeals also examined its reliance on *Lang* in the *K2 – I* decision, and concluded that *Lang* was distinguishable. In *Lang*, the Court of Appeals decided that "a judgment is a statutory condition precedent to a direct suit against the tortfeasor's insurer," but did not consider any defense based on policy exclusions at that time. Here, the insurer did present a defense to indemnification based on policy exclusions. Thus, in *K2 – II*, the Court of Appeals held that the application of *Servidone* is not limited, and may be applied to cases in which a defense is predicated on either non-coverage or on an exclusion.

Last, in the second part of its decision, the Court of Appeals determined that even though American Guarantee was not barred from relying on policy exclusions, the applicability of such exclusions presented a question of fact sufficient to defeat summary judgment. — **Brian M. Oubre,** White and Williams

NY Refuses to Impose 'As Soon As Reasonably Possible' Requirement on All Insurer Disclaimers

The New York Court of Appeals, applying New York law, has held that an insurer is not required to disclaim coverage for environmental contamination claims on late notice grounds "as soon as reasonably possible," a standard drawn from a statute only applicable to death and bodily injury claims arising out of New York accidents and brought under New York liability policies. *KeySpan Gas East Corp. v. Munich Reinsurance America, Inc., et al.*, No. 110 (N.Y. June 10, 2014).

The policyholder, an electrical power and natural gas utility, had

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been engaged in ongoing negotiations with state regulatory actors over a number of years concerning the cleanup of seven manufactured gas plant sites. Several claims had been asserted against the policyholder relating to contamination emanating from the sites, and the policyholder began proactively investigating and remediating its sites. However, the policyholder did not notify its insurers of the potential for liability until many years later. Upon receiving notice, the insurers issued timely reservation of rights letters expressly reserving the right to deny coverage on late notice grounds and requesting more information from the policyholder.

In a subsequent coverage action between the policyholder and its excess insurers, the insurers included late notice as an affirmative defense in their answers. The insurers then sought summary judgment on the grounds of late notice. The trial court found as a matter of law that the policyholder's notice was late as to one site, but held that genuine disputes of material fact remained as to the other sites. The trial court specifically rejected the policyholder's contention that the insurers had waived the late-notice defense for each of the sites because they did not immediately disclaim coverage on that basis.

On cross-appeals of the trial court's ruling, the intermediate appellate court held that the policyholder's notices at two sites were late as a matter of law. However, the court ruled that summary judgment was premature because material issues of fact remained as to whether the insurers had waived their rights to disclaim based on late notice. The intermediate appellate court stated that there would be a wavier if the insurers had not met an "obligation to issue a written notice of disclaimer on the ground of late notice as soon as reasonably possible after first learning of the accident or of grounds for disclaimer of liability."

The New York high court reversed, holding that the intermediate appellate court erred in holding that the insurers had an "obligation" to disclaim coverage "as soon as reasonably possible." The court observed that the lower court had essentially recited the language of New York Insurance Law § 3420(d), which applies only to cases involving death and bodily injury claims arising out of a New York accident and brought under a New York liability policy. The court held that the environmental contamination claims in this case did not fall within the scope of the statute and that the courts should not extend the statute's prompt disclaimer requirement beyond the limits set by the Legislature. The court remanded the case to the intermediate appellate court to determine if, under the common law doctrine of waiver, there were triable issues of fact as to whether the insurers had clearly manifested an intent to abandon their late notice defense.

In this case, the New York Court of Appeals agreed that the court below erred by judicially supplanting long-standing common law rules governing insurers' denials of coverage with a standard the Legislature chose to apply in limited circumstances in New York Insurance Law § 3420(d). Insurance Law § 3420(d) applies only to claims brought under a policy issued or delivered in New York regarding disclaimer of liability or coverage for death or bodily injury arising out of an accident occurring in New York. By imposing this standard here and stating that "a jury could determine that the insurers possessed sufficient knowledge to require that they meet the obligation to issue a written notice of disclaimer on the ground of late notice as soon as reasonably possible after first learning of the accident or of grounds for disclaimer of liability," the court below misapprehended and overlooked settled New York law. *Long Is. Light. Co. v Allianz Underwriters Ins. Co.*, 104 AD3d 581, 581-82 [1st Dept. 2013].

New York law does not require an "as soon as reasonably possible" standard for insurer coverage disclaimers outside the circumstances governed by Insurance Law § 3420(d), and there is no need or proper basis on which to alter New York law governing coverage disclaimers to impose the unique standards of § 3420(d) as a matter of general application. Essentially, the New York high court concluded that the common law principles of waiver and estoppel provide familiar and adequate constraints on insurers' coverage decisions, and that there was no basis on which to disturb existing New York precedent to impose a new timeliness requirement on all insurer disclaimers. — **Laura A. Foggan**, **Parker Lavin** and **Jennifer A. Williams**, Wiley Rein

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simply because a data loss occurred. In a recent case, tapes containing confidential employee information fell out of a delivery truck. An unknown person then retrieved them, but there was no evidence that employee information was publicly disclosed or improperly used.

A Connecticut appellate court rejected the argument that the data loss, in and of itself, constituted a "publication." The mere potential for disclosure was not enough — there had to be evidence that confidential information on the tapes was actually published. *See Recall Total Information Management Inc. v. Federal Ins. Co.*, 147 Conn. App. 450 (2014).

Zurich v. Sony

Some courts have held not only that there must be a publication, but that the insured must publish information giving rise to the claim. In March 2014, a New York state judge denied coverage on this basis in the hotly contested *Zurich v. Sony* insurance litigation.

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Insurer's Conduct When No Bad Faith Is Pleaded

By Robert E. Smith

In what has commonly become known as the *Koken* decision, the Pennsylvania Supreme Court held that the Pennsylvania Insurance Department "does not possess the authority to require mandatory binding arbitration for UM and UIM disputes." Prior to *Koken*, captioned as *Insurance Federation of PA v. Department of Insurance*, 585 Pa. 630, 889 A2d. 550 (2005), uninsured and underinsured claims were usually arbitrated before three-person panels with very limited appellate rights. Now, most of these claims are being litigated and many procedural and evidentiary issues are working their way through the courts.

Complaints filed to recover UM/UIM coverage range from simple single-count complaints alleging that the plaintiff was injured by the negligence of an uninsured or underinsured motorist and is entitled to recover UM/UIM coverage, to those also including claims for breach of contract or statutory bad faith pursuant to 42 Pa. C.S.A. § 8371. The inclusion of a statutory bad-faith claim provides a basis for the plaintiff to argue for a broad scope of discovery regarding the insurer's conduct and evaluation of the claim. However, the insurer may file a motion to sever and stay the bad-faith claim and argue for a more restricted scope of discovery.

The purpose of this article is to discuss some arguments relating to whether discovery of information relating to the insurer's conduct and claim handling is relevant in a UM/UIM claim pleaded as a breach of contract action without a statutory bad-faith claim. Relevant evidence "means evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence," according to Pa.R.E. 401.

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Breach of Contract

UM/UIM claims pleaded as a breach of contract often include allegations that the carrier failed to properly investigate, evaluate and handle the claim, and may be followed by broad discovery requests focused upon the insurer's conduct. Typical discovery requests focusing upon the insurer's conduct may include: the insurer's evaluation of demands and basis for any settlement offers; procedures followed to determine if and when a claim would be paid; reserves; claim manuals; claims logs; and depositions of adjusters.

Even if such information is deemed relevant, other objections may apply to such discovery requests, including work product and privilege. However, this article is limited to the threshold inquiry of relevance. Also, for purposes of this discussion, it is assumed that there is no dispute as to coverage or the terms of the applicable insurance contract.

As a starting point, below is a sample insuring agreement with respect to UM/UIM coverage:

> We will pay compensatory damages which an 'insured' is legally entitled to recover from the owner or operator of an 'uninsured or underinsured motor vehicle' because of 'bodily injury': (1) sustained by an 'insured'; and (2) caused by an accident.

Based upon such language, it would appear that the central issue in a UM/UIM claim is the amount of compensatory damages the plaintiff proves that he or she is legally entitled to recover from the alleged uninsured or underinsured motorist who caused the accident. If so, the insurance carrier has a strong argument that its conduct in handling and evaluating the claim, apart from any factual information obtained relating to liability and damages, is not relevant and therefore not discoverable. In response, the plaintiff may argue that the insurer's failure to pay the amount of UM/UIM coverage demanded amounts to a breach of the insurance contract and that evidence of the insurer's conduct is relevant and necessary to establish that breach and is therefore discoverable.

These arguments give rise to questions as to whether a plaintiff must prove a breach of contract by the insurer in order to recover UM/UIM benefits and, if so, what is the nature of the breach that must be proven? The answers to these questions may have a significant impact on defining the relevant scope of discovery in a litigated UM/UIM claim where no bad faith is pleaded. Appellate case law addressing these issues is sparse.

Case Law

In *Stepanovich v. McGraw*, 2013 Pa.Super. 275, 78 A.3d 1147 (2013), the Pennsylvania Superior Court recently commented upon the nature of a litigated UIM claim presented as a breach of contract action. In *Stepanovich*, the plaintiff filed a single lawsuit against both the driver he claimed caused his injuries, and against State Farm to recover UIM coverage. The claim against State Farm was labeled as a breach of contract and, in a footnote, the court commented as follows:

> Although Stepanovich's claim for underinsured motorist benefits is labeled as breach of contract ... the contract is not technically breached until there has been a determination of liability and an award of damages in excess of the tortfeasor's liability limits. A UIM action represents a disagreement over third-party liability and/or the extent of damages. The insurance contract requires this disagreement be resolved through a lawsuit.

If a UIM action represents, as the comments above suggest, a "disagreement over third-party liability and/or extent of damage," the argument exists that discovery requests focused upon the insurer's conduct in handling the claim, such as evaluations of demands and offers,

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The *Sony* dispute arose from a massive data breach. In April 2011, hackers broke into Sony networks and stole personal information involving over 100 million users. Sony was named in numerous class actions, which the company tendered to its insurers. One of those insurers, Zurich, filed a declaratory relief action in New York state court seeking a declaration that it had no duty to defend.

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Sony argued that the unauthorized collection and use of personal information necessarily constituted a "publication" that violates privacy rights. The company cited authority holding that there could be a publication even though the people who accessed or stole personal information never disseminated it. *See, e.g., Lenscrafters Inc. v. Liberty Mut. Fire Ins. Co.*, 2005 U.S. Dist. LEXIS 47185 (N.D. Cal, Jan. 20, 2005) (insured's improper use of private medical information to sell products to customers).

The insurers countered that Sony's authorities all involved situations in which the insured misappropriated information. Because Sony did not misappropriate any personal information — rather, third-party hackers stole it — there was no personal injury coverage as a matter of law. The insurers relied primarily on the New York Court of Appeals decision in *Columbia v. Continental Ins. Co.*, 83 N.Y.2d 618, 634 N.E.2d 946 (1994). There, Columbia County sought coverage for environmental contamination under a personal injury endorsement. Upholding a dismissal in the insurer's favor, the court of appeals interpreted personal injury coverage to reach only the insured's "purposeful acts," and not indirect, incremental harm from environmental pollution.

Columbia was an environmental case, but other courts have applied

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In New York, there is no independent, extra-contractual, tort cause of action for an insurance company's bad-faith behavior in refusing to pay a claim. Nevertheless, an insurer's breach of the implied covenant of good faith and fair dealings in handling a claim may give rise to a claim for consequential damages beyond the policy limits.

The New York Court of Appeals determined this significant extension of an insurer's liability in *Bi-Economy Mkt. v. Harleysville Ins. Co of New York*, 10 N.Y.3d (2008). In *Panasia Estates v. Hudson Ins.*, 10 N.Y.3d 200 (2008), the court held that even policy language excluding payment of consequential losses would not preclude a claim for consequential damages if the insurer acted in bad faith when settling a claim.

The *Infiniti* plaintiffs could have alleged bad faith within its breach of contract causes of action and claimed resulting consequential damages. However, as pointed out by Judge Demarest, the amended complaint contained no allegations of consequential damages beyond those covered under the insurance contract, and therefore the *Infiniti* plaintiffs' cause of action for bad faith should properly be dismissed.

Unfair Practices Claim

The next cause of action to fall was the claim under § 2601(a) of the Insurance Law, which prohibits insurers from engaging in a general business practice of "unfair claim settlement practices." One of the specifically enumerated unfair practices in § 2601(a) was "knowingly misrepresenting to claimants pertinent facts or policy provisions relating to coverages at issue." Insurance Law section 2601(a)(1). The *Infiniti* plaintiffs claimed Zurich had

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reserves, claims manuals and the general process that the insurer followed to evaluate the claim, would be irrelevant and therefore beyond the permissible scope of discovery. Assuming that to be true, factual information obtained by the insurer relating to the issues of liability and damages would still be relevant and discoverable. Such information often includes medical records, police reports, witness statements, damage photos and repair estimates. In essence, if evidence of the insurer's conduct is irrelevant to a claim for UM/UIM coverage, the scope of discovery in such claims would be similar to a typical third-party automobile negligence claim. Such a position would appear consistent with the plaintiff's burden of proof in a UM/UIM claim to establish the amount of compensatory damages he or she is legally entitled to recover from the alleged uninsured or underinsured motorist.

A counterargument is that plaintiffs are permitted to introduce evidence of the insurer's conduct to prove a breach of the insurance contract. However, as the court in *Stepanovich* noted, the contract is "not technically breached until there has been a determination of liability and an award of damages in excess of the tortfeasor's liability limits."

Conclusion

Like many issues in the era of post-*Koken* UM/UIM claims, the law regarding the proper scope of discovery in a UM/UIM action is evolving. While that can make practicing in this area challenging, it also makes it interesting.

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the purposeful acts rationale outside the pollution context. In *Butts v. Royal Vendors Inc.*, 202 W. Va. 448, 504 S.E.2d 911 (1998), the West Virginia Supreme Court concluded that personal injury coverage applied only where the insured itself had published material invading privacy rights.

The *Sony* trial judge sided with the insurers, concluding that personal injury coverage applied only to Sony's own publications. And the judge rejected the argument that Sony's negligent failure to prevent hacking constituted a publication.

Coverage for Data Breaches

Traditional liability policies have other conditions and exclusions that may limit their effectiveness in reimbursing companies for losses from data breaches. Liability polices do not compensate for first-party losses, such as forensic costs or business interruption losses. In addition, insurers have expanded policy exclusions for losses arising from cyber risks. These exclusions already have found their way into many CGL, errors and omissions, and directors and officers policies.

Now the Insurance Services Office Inc., the entity that publishes the standard ISO forms, is getting into the act. In late 2013, the ISO filed data breach exclusionary endorsements for CGL policies. Effective May 1, these forms broadly exclude all "property damage," "bodily injury" or "personal injury" liability arising out of the access to or disclosure of any person's or organization's confidential or personal information.

As insurers clamp down on coverage for cyber events and expand exclusionary language, companies will have to consider cyber insurance for protection against data breaches. Unlike standard policies, there are no ISO forms for cyber insurance. Each insurer has unique provisions.

Because minor differences in language could have significant repercussions, insureds must scrutinize policies carefully to determine exactly what they cover. Below are some factors companies should consider when buying a cyber policy.

1. What Damages or Expenses Does the Policy Cover?

This is a basic question, but the answer may not be straightforward with cyber policies. Standard commercial liability policies tend to have broad coverage provisions. A wide variety of damages could be covered, provided they derive from property damage, bodily injury, or personal injury offenses as broadly defined.

As insurers clamp down on coverage for cyber events and expand exclusionary language, companies will have to consider cyber insurance for protection against data breaches.

Cyber policies are different. They compartmentalize losses into discrete categories, and then include separate coverage parts for each type of loss. Thus, there could be separate coverage provisions, limits, and premium requirements for breach notification costs, forensic costs to identify and repair a data breach, business interruption losses, expenses to fund media campaigns, defending third-party lawsuits, and responding to regulatory inquiries.

2. What Type of Information Loss Does the Policy Cover?

Not all data breaches involve consumer information. Hackers could steal corporate trade secrets or employee information. The policy language should be broad enough to cover all relevant data.

3. Does the Policy Apply to Data Losses Involving Third-Party Vendors?

Cyber policies will define what computer systems and networks the policies cover. When a data breach occurs, these definitions will be critical in determining coverage. Companies that rely upon third-party vendors for data management should ensure that the policies cover losses involving outside entities.

4. Does the Policy Require the Data Breach to Begin During a Specified Period?

Some cyber policies require the data breach to begin during a specified period, while others cover data breaches a policyholder discovers during the relevant period. This distinction could be significant, since companies may not be aware of a data breach for weeks, months, or even years.

5. Does the Policy Require the Policyholder to Maintain and Update Its Computer Systems?

Insurers have tightened underwriting requirements for cyber policies. Representations that the insured makes in the underwriting process could impact coverage. An insurer, for example, might attempt to rescind a policy if an insured made material misrepresentations about its data management.

Some cyber policies have exclusions or conditions requiring policyholders to implement certain data security measures. Thus, depending upon policy language, coverage could be excluded where a company failed to encrypt sensitive data on laptops or thumb drives, failed to require strong passwords or the periodic changing of passwords, or failed to install software patches.

Conclusion

As the cyber insurance landscape changes, specialty cyber policies will become more prevalent. When purchasing this insurance, companies must carefully analyze the cyber risks they face and buy policies specifically tailored to those risks.

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Hurricane Sandy

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misrepresented that they had flood insurance. However, the court quickly dispatched this statutory cause of action because New York does not recognize a private cause of action under Insurance Law § 2601. Enforcement of § 2601 is reserved to what used to be the Insurance Department and what is now the Department of Financial Services.

The plaintiffs attempted to keep the § 2601 cause of action alive by relying on legislation introduced in the Assembly which would, if enacted, have created a private cause of action under § 2601 in circumstances of a natural disaster such as Sandy. The proposed law would have allowed for the award of attorney fees and punitive damages. Of course many bills are proposed in Albany and many never see the light of day. Recognizing this, the court rejected proposed legislation as the basis for allowing the § 2601 cause of action to remain in the complaint. Moreover, as Zurich pointed out, even if such legislation were enacted in 2014, there was a question whether it would apply retroactively to a 2013 lawsuit.

The *Infiniti* plaintiffs also alleged causes of action for fraud and breach of fiduciary duty, both of which sought punitive damages in the prayer for relief. The purported fraud was that Zurich falsely represented that it was an expert in insurance coverage and would "procure insurance coverage to protect" the plaintiffs. The alleged fiduciary duty breach was Zurich's failure to advise the plaintiffs of insurance coverage they would need to protect themselves. The court said the plaintiffs, significantly, had omitted any allegation that they had asked Zurich to provide flood coverage, and that Zurich had failed to follow through on the request. The *Infiniti* court found these general allegations insufficient to sustain either cause of action.

The fraud, the fiduciary duty breach, the breach of the implied covenant of good faith, and the alleged violation of § 2601 all were the plaintiffs' basis for requesting punitive damages and an award of attorney fees. The court pointed out that punitive damages are not recoverable in New York absent an allegation of "a high degree of moral turpitude or such wanton dishonesty as to imply a criminal indifference to civil obligations. … " Moreover this conduct must be aimed at the public as a whole and not just at the individual insured. The complaint failed to make these allegations against Zurich.

Attorney Fees

The *Infiniti* court dismissed the claim for attorney fees, stating the well-established principle that absent a statute, rule, or contractual provision allowing for the award of attorney fees, such an award cannot be had in New York. Although an insurer that seeks a declaratory judgment to relieve itself improperly of its coverage obligation will be required to pay the insured's attorney fees incurred in defending such an action, the same rule does not apply in a declaratory judgment action brought by an insured seeking a determination of coverage.

When the dust settled on the motion to dismiss, the *Infiniti* plaintiffs were left with what they probably should have started with — a breach of contract claim with alleged damages to real estate, inventory, personal property, and business income. The big issue will be to determine the parties' insurance contract when the renewal policy was issued effective July 1, 2013. If the prior policies issued by Zurich to the plaintiffs had contained the flood exclusionary language that the plaintiffs alleged was absent from the renewal policy, it would be reasonable to assume that the plaintiffs' insurance premiums would have increased substantially for the 2013 renewal policy because of the greatly increased coverage. If the prior policies had not excluded flood damage, then Infiniti has a better argument about the 2013 renewal policy. It does not appear that the complaint alleged that the prior Zurich policies contained flood damage coverage.

Insurance Broker Decision

The Feb. 25, 2014, Court of Appeals case of *Voss v. The Netherlands Ins.*, _NY3_ (2014), decided while the *Infiniti* motion was under submission, may provide some hope to the *Infiniti* plaintiffs. In *Voss*, the Court of Appeals, in a 4-3 decision, held that there may be a "special relationship" created between an insurance broker and an insured if there is proof of an extended course of dealings that would put an insurance agent on notice that his/her advice was being sought and relied upon. In *Voss*, the insured alleged that her broker had negligently secured inadequate business interruption insurance. The Court of Appeals reversed the appellate division and determined that the *Voss* plaintiff had provided sufficient proof of a special relationship to avoid the broker's summary judgment motion.

If a special relationship can be created between a broker and an insured client, the *Infiniti* plaintiffs could allege a special relationship with their own insurer, which held itself out to plaintiffs as knowledgeable about the coverage required and upon whom the plaintiffs relied over the years. To make such a claim, the *Infiniti* plaintiffs will now have to seek leave to serve a second amended complaint, this time alleging a special relationship and a claim of negligence against Zurich.

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