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Harvard's Untimely Reporting Dooms Coverage for Affirmative Action Case, First Circuit Holds

Harvard bought a secondary excess policy from Zurich American Insurance Co. The Zurich policy followed form to a claims-first made policy that required the reporting of a claim to the insurer within ninety days of the end of the policy period. The Zurich policy was effective from November 1, 2014 through November 1, 2015.

In November 2014, an organization called Students for Fair Admissions sued Harvard for violating Title VI of the Civil Rights Act of 1964. Although Harvard notified its first-level carrier of the claim that month, it failed to notify Zurich of the suit until May 2017, well outside the policy's ninety-day notification window. Zurich denied coverage under the excess policy due to Harvard's late notice.

Harvard sued Zurich in federal court. The district court granted summary judgment to Zurich. Harvard appealed.

The First Circuit, applying Massachusetts law, affirmed. The court noted that under Massachusetts law, an insurer need not show prejudice when denying coverage for late notice under a claims-made policy. That Zurich may have had actual notice of the lawsuit was immaterial. Otherwise, the court would be eliminating the distinction between occurrence-based and claims-made policies.

The court also chided Harvard for attempting to change Massachusetts case law after filing in federal court. Whether this strict compliance rule contravened public policy, the court determined, would have been a question for the Massachusetts court to consider.

The case is *President and Fellows of Harvard College v. Zurich Am. Ins. Co.*, No. 22-1938 (1st Cir. Aug. 9, 2023).

Fifth Circuit Finds Rental Car Insurer Was Prejudiced by Insured's Failure to Notify – Awareness of Suit Irrelevant

Diaz, a Spanish citizen, traveled to Dallas and rented a car from Avis. The rental agreement included liability insurance coverage up to $30,000. Diaz also paid an extra premium for additional liability insurance ("ALI") of $2 million issued by ACE American Insurance Company. The ALI policy required prompt notice of any claim.

While driving the rental car, Diaz collided with another car. O'Donnell was a passenger in the other car and sustained brain injuries. Diaz cooperated with law enforcement and Avis at the accident scene. He later returned to Spain.

O'Donnell sued Diaz but had trouble serving him. O'Donnell proceeded against Avis, but Avis won on summary judgment. O'Donnell was eventually able to serve Diaz, but Diaz never appeared, and the court entered a default judgment against him for $2 million. Diaz never notified ACE.

O'Donnell obtained a turnover order in aid of collection of judgment under which he acquired Diaz's claims subject to all defenses. O'Donnell then sued Avis and ACE. The trial court determined that Avis and ACE were prejudiced by Diaz's failure to comply with the policy's notice requirements and awarded them summary judgment. O'Donnell appealed to the Fifth Circuit.

On appeal, O'Donnell contended that he was entitled to either the $30,000 under the rental agreement, or the $2 million under the ALI policy. The court determined that the ALI policy controlled and that any conflicting provisions in the rental agreement must yield to the ALI policy. So Diaz had to comply with the notice conditions in the ALI policy.

O'Donnell argued that Avis was Diaz's agent (because it sold Diaz the ALI policy) and that Avis's notice of the suit to ACE discharged the notice condition for Diaz. The court found no evidence of this and rejected O'Donnell's argument.

The dispute came down to whether ACE was prejudiced by Diaz's lack of notice. O'Donnell argued that ACE could not show prejudice because it had actual knowledge of the suit given Avis's participation in the suit. Examining Texas law, the court determined that ACE's actual knowledge was irrelevant. It didn't matter that Avis and ACE knew that Diaz had been sued. Under the ACE policy, Diaz had to give notice. Because he didn't, he breached a condition precedent and that breach prejudiced ACE because a default judgment had been entered.

Under Texas law, an insurer's duties to defend and provide coverage only arise once the insurer knows that the insured is subject to a default and expects the insurer to interpose a defense. There are many reasons, the court noted, why an insured may opt out of seeking a defense from its insurer, and "insurers need not subject themselves to gratuitous coverage and defense liability." For these reasons, the court affirmed the district court's judgment.

The case is *O'Donnell v. Avis Rent A Car Sys., L.L.C.,* No. 22-10997 (5th Cir. Aug. 15, 2023).

Seventh Circuit Emphasizes Difference Between a Condition and an Exclusion in Resolving Dispute Under Aircraft Policy

An aircraft insurance policy requires pilots to have a current FAA medical certificate. If a pilot lacks the certificate, but the crash is caused by mechanical failure, does the exclusion still apply? The Seventh Circuit said, "yes."

Jadair International held an aircraft insurance policy on a Cessna. The policy required pilots operating the aircraft to have certain minimum qualifications, including a Federal Aviation Administration medical certificate. The FAA requires pilots to get medical clearance showing they are fit to fly. The Cessna crashed due to mechanical failure. But the pilot didn't have a current FAA medical certificate at the time of the crash, as his previous certificate had expired.

Jadair submitted a claim under the policy, but the insurer denied coverage because the pilot lacked a medical certificate. Jadair then sued the insurer in federal court in Wisconsin. The district court awarded the insurer summary judgment.

On appeal before the Seventh Circuit, Jadair pointed to an endorsement that it claimed exempted the pilot from the medical certificate requirement. The medical certificate requirement was one of three requirements in Item Nine of the main body of the policy. Item Nine also expressly stated that there was no coverage if the pilot doesn't meet the three requirements. The Seventh Circuit considered this language to be an exclusion because it takes away coverage.

The endorsement similarly required the pilot to have an FAA medical certificate and other requirements but did not expressly say that there is no coverage if the pilot did not meet the requirements. Instead, it said, "there is no coverage if the pilot does not meet the qualifications or requirements specified below." It then listed things not found in Item Nine. Jadair argued that the

endorsement abrogated Item Nine's express provision that "there is no coverage" if the pilot lacks a medical certificate, but the Seventh Circuit disagreed.

The endorsement said that it "completes or changes" Item Nine. The court read the endorsement as supplementing, not supplanting, Item Nine and noted that it too required a valid medical certificate. The court also rejected Jadair's argument that the pilot had to satisfy only the extra requirements in the endorsement and not the medical certificate requirement. The court instead read the endorsement-specific requirements as other requirements on top of the medical certificate.

Jadair next argued that even if the medical certificate exclusion applies, the claim must be covered under Wisconsin Statute § 631.11(3):

> No failure of a condition prior to a loss and no breach of a promissory warranty constitutes grounds for rescission of, or affects an insurer's obligations under, an insurance policy unless it exists at the time of the loss and either increases the risk at the time of the loss or contributes to the loss.

Jadair argued that the insurer could not withhold coverage unless it could show that the pilot's failure to obtain medical certificates increased the insurer's risk or otherwise contributed to the accident. Jadair contended that the insurer could not show this because the crash resulted from mechanical failure, not the pilot's medical condition.

But the court found that the statute did not apply because the policy's medical certificate requirement was not a condition to coverage but an exclusion. The court explained the difference between conditions and exclusions. Conditions provide for the avoidance of liability for a covered loss if they are breached, while exclusions declare that there never was coverage for a particular loss in the first place. Because the medical certificate requirement was an exclusion and not a

condition, the Wisconsin statute did not apply. The Seventh Circuit thus affirmed summary judgment for the insurer.

The case is *Jadair Int'l, Inc. v. American Nat'l Prop. & Cas. Co*., No. 22-3053 (7th Cir. Aug. 9, 2023).

North Carolina Business Court Finds Single Occurrence and Pro Rata Allocation on Same Day in Hog Farming Coverage Case

Several North Carolina residents who lived near a farming operation sued Murphy Brown LLC. The suits made similar allegations – that Murphy Brown's hog farming operations had resulted in both physical invasions of their property and the loss of use and enjoyment of that property. Murphy Brown sued its insurers to recover what it paid to settle and defend the residents' suits.

In separate rulings, the court decided two major issues: number of occurrences and allocation. On number of occurrences, the question was whether the residents' suits involved multiple occurrences or a single occurrence. North Carolina courts apply a "cause" test to determine whether an injury involves one or multiple occurrences. They also use the "proximate cause" test. That test considers whether there was but one proximate, uninterrupted, and continuing cause that resulted in all of the injuries and damage.

Applying the "proximate cause" text, the court determined that the injuries all stemmed from central, uniform policies and procedures decided upon and implemented by Murphy Brown in operating their farms. Thus, all injuries arose from continuous or repeated exposure to substantially same conditions.

The court distinguished these facts from those considered by the North Carolina Supreme Court in *Gaston Cty. Dyeing Mach. Co. v. Northfield Ins. Co.,* 351 N.C. 293, 303 (2000). Gaston

involved rupture of a pressure vessel used in the manufacture of dyes for diagnostic medical imaging. Here, the court said, there was no sudden and one-time triggering event like the sudden rupture of machinery.

The court next applied pro rata allocation, relying on the North Carolina Supreme Court's decision last year in *Radiator Specialty Co. v. Arrowood Indem. Co.,* 383 N.C. 387 (2022). Radiator held that the "modern trend" is to apply pro rata allocation when limiting language like "during the policy period" exists, even when the policy refers to paying "all sums" arising out of certain liabilities.

The court also found that a "continuing coverage" provision did not support an all-sums allocation. That provision simply set forth "the unremarkable proposition that the policy in place when the injury occurs will cover all consequential damages, even those taking place after the policy period." The court might have ruled differently if the policies had a non-cumulation clause. But because the policies lacked such a clause, pro rata allocation was appropriate.

The case is *Murphy Brown, LLC v. Ace Am. Ins. Co*., 2023 NCBC 52 (N.C. Sup. Bus. Ct. Aug. 7, 2023).

Aircraft Exclusion in Policy Issued to Aircraft Charterer Does Not Render Coverage Illusory, Florida Federal District Court Rules

The claimant worked as a driver for a horse transportation company. He went to Blue Grass Airport in Lexington, Kentucky to pick up some horses and equipment from an aircraft chartered by Tex Sutton. The claimant loaded the horses and equipment into his tractor trailer, and upon leaving, collided with the aircraft's wing. The claimant was injured and sued Tex Sutton.

Tex Sutton sought a defense under its liability policies. Travelers, an excess insurer, filed a declaratory judgment action seeking a determination of no coverage based on an aircraft liability

exclusion. The exclusion barred coverage for "[d]amages arising out of the ownership, maintenance, use or entrustment to others of any aircraft owned or operated by or rented or loaned to any insured."

Tex Sutton did not dispute that the aircraft exclusion applied. Instead, it argued that the exclusion is so broad that it renders coverage illusory because Tex Sutton's entire business involves one thing — the use of an aircraft for the transportation of horses.

Tex Sutton argued that the exclusion swallowed up coverage because any claim for bodily injury would arise out of the use of an aircraft and thus be barred by the exclusion. But the court disagreed. To render coverage illusory, the exclusion must completely contradict the insuring provisions. Although broad, the court found that the aircraft exclusion did not swallow every claim under the insuring provision. It would not, for example, eliminate coverage for slips and falls at Tex Sutton's leased premises. As the court put it, "even though the Aircraft Liability Exclusion may take 'a nibble, or even a big bite, out of [coverage],' it does not swallow Tex Sutton's coverage whole."

The court also considered whether the common law illusory coverage doctrine applied. Coverage is considered illusory when an exclusion eliminates all, or virtually all, coverage in a policy. The court recognized that the aircraft liability exclusion negates a lot of coverage, but found that it did not negate all coverage. The court noted that Tex Sutton occupies leased premises at the airport. The aircraft liability exclusion "would not necessarily exclude claims based on premises liability, bodily injury or property damage sustained at Tex Sutton's offices, or injury resulting from trademark or tradename infringement, or defamation." Thus, under Florida law, the policy was not illusory.

The court awarded Travelers summary judgment.

The case is *Travelers Prop. Cas. Co. of Am. v. H.E. Sutton Forwarding Co*., LLC, No. 2:21-cv-719-JES-KCD (M.D. Fla. Aug. 24, 2023)

Home Depot Data Breach Resulted in "Property Damage," But Electronic Data Exclusion Bars Coverage, Ohio Federal Court Holds

Home Depot suffered a well-publicized data breach in which millions of customers' credit and debit card numbers were stolen. Banks cancelled their customers' payment cards and issued new cards. Home Depot settled the banks' suits for the cost of the replacement cards. Home Depot then sought to recoup the costs of the settlements from its insurers under its commercial general liability policies.

The insurers denied coverage for two reasons: (1) there wasn't "Property Damage," and (2) the electronic data exclusion applied. Home Depot then sued in federal court in Ohio (but the court determined that Georgia law governed the dispute).

The court first took up the property damage issue. The policies covered damages caused by the "loss of use of tangible property that is not physically injured," as long as the loss of use is caused by an "occurrence." The court found that the cancellation of the payment cards resulted in a loss of use of tangible property. It noted that the physical cards themselves served a purpose separate from the electronic data stored on the cards. That is, the numbers printed on the cards are useful for reminding cardholders of their card numbers, such as when purchasing items online. When the payment cards were cancelled, the numbers printed on the cards no longer reflected the cardholders' actual payment information and became useless. This was a loss of use.

But to qualify for coverage, the loss of use must have been caused by an "occurrence," defined as an "accident." The insurers argued that neither the data breach nor the cancellation of

the cards were accidents. The court disagreed. Viewing the conduct from the insured's perspective, the court found that Home Depot did not intend or expect the chain of events to occur. The court also rejected the insurers' argument that because the cards still functioned, the data breach did not cause the cancellation.

The court next considered the electronic data exclusion, which excluded property damage that "arise[s] out of the loss of, loss of use of, damage to, corruption of, inability to access, or inability to manipulate electronic data." The court again recounted the two uses of the payment cards. First, they store electronic data that can be transmitted through a card reader. Second, they contain printed information that allows the cardholder to enter when making online purchases. Home Depot conceded that the loss of use of the electronic data stored on the cards was not covered. But it contended that the loss of use of the physical numbers on the cards was covered.

The court disagreed with Home Depot. It found that the exclusion applied because the loss of use of the physical numbers on the cards arose out of the loss of use of electronic data. The physical numbers lost their use because the banks cancelled the cards. Once the physical numbers printed on the original cards no longer corresponded to the card holders' actual payment information, the numbers printed on the card could no longer be used to make purchases, rendering them useless. The cancellation, the court held, was "inextricably intertwined with electronic data."

The court noted that the use of electronic data was lost in two ways. First, when the card data was stolen in the data breach (it was no longer secure). Second, when the payment cards were canceled by the banks. It explained:

> The strings of numbers on the payment cards are not useful in and of themselves. Rather, they are useful only because they correspond to the cardholder's actual payment information. When the cards were cancelled, the electronic data, consisting of the old

> payment card numbers stored on computers, no longer corresponded to the cardholders' actual payment information and so became worthless. By extension, once the electronically stored payment information no longer matched the numbers printed on the card, the cards were useless. Thus, the loss of use of the physical card numbers arose out of the loss of use of the electronically stored card numbers.

The court held that the electronic data exclusion applied, and thus Home Depot's claim was not covered. Home Depot has appealed to the Sixth Circuit.

The case is *Home Depot, Inc. v. Steadfast Ins. Co.,* No. 1:21-cv-242 (D. Ohio Aug. 16, 2023).