THARPE & HOWELL, LLP

BAD FAITH AND COVERAGE NEWSLETTER

AUGUST 2012 EDITION

This Newsletter is brought to you by Firm Partner Timothy D. Lake. Should you have any questions or comments about the articles presented, please feel free to contact Mr. Lake at (818) 205-9955, or via email to tlake@tharpe-howell.com . Please note also that Tharpe & Howell recently launched the *California Business Law Report*, an online forum which addresses the rapidly increasing convergence of business and law. To remain apprised of significant developments in the business community, please be sure to visit the forum at www.commercialcounselor.com.

HOW NOT TO SETTLE A WRONGFUL DEATH CLAIM!

The California Court of Appeals, Second District, Fifth Division recently held that a pre-litigation settlement of a wrongful death claim did not afford the tortfeasor any protection from a lawsuit by other heirs of the decedent that were unknown to the tortfeasor's liability insurer when the settlement was reached. This decision (which was subsequently ordered to be depublished) was in the case of *Moody v. Bedford, B226074,* rendered on January 9, 2012.

In this case, the mother of several minor children was killed in an auto accident. Also an heir was the decedent's adult daughter who was the half-sister of the minor children heirs. The decedent's adult daughter tendered a claim to the liability insurer of the auto driver that caused the accident. Due to the fact that liability was adverse to the tortfeasor driver, his auto insurer offered to settle the wrongful death claim for the policy limit of $100,000. After counsel for the decedent's adult daughter made representations to the tortfeasor's insurer that his client was the sole surviving heir, and provided a signed declaration from his client to that effect, a pre-litigation settlement was reached. The adult daughter claimant signed a standard release of all claims.

Following settlement, the minor surviving children of the decedent retained counsel and filed a wrongful death action against the tortfeasor. The defendant was successful on a motion for summary judgment which asserted the "one action rule" of *Cal. Code of Civ. Procedure, sec. 377.60.* The plaintiffs filed an appeal and the Court of Appeals reversed the granting of the motion on the ground that since the insurance claim by the decedent's adult daughter was not made in the context of an "action" commonly understood to only mean a civil lawsuit, the defendant was not entitled to the protection of *CCP sec. 377.60.* This left the defendant with no remaining policy limits and no defense to the wrongful death action. It also left the defendant's insurer with no further policy limits to protect its insured, and no means by which to seek indemnity from the claimants that had been paid the policy limits, other than an insurance fraud action against them under *Ins. Code sec. 1871.*

The Court of Appeal determined that the protection afforded to a tortfeasor under *CCP sec. 377.60* did not apply to a pre-litigation insurance claim. That statute provides that only one wrongful death action can be filed by all the heirs of a decedent. The plaintiffs in such an action must represent to the Court that all heirs are parties, either as plaintiffs or defendants; and the defendant in such an action may not be sued by other heirs in a separate action. [If that occurs, the defendant can seek indemnity from the heirs that filed the original action and the defendant can have the other wrongful death action dismissed.]

The Court suggested that liability insurers demand that wrongful death claimants file a civil lawsuit against their insureds in response to a policy limits demand. This would require the original claimants to join the surviving minor children of the decedent. If they had failed to do so, they would be subject to an indemnity action by the defendant tortfeasor under the “one action rule.”

The problem with this decision is that it does not address the duties of a liability insurer toward its insured when the insurer is faced with a policy limits settlement demand with a time limit attached. Any response by an insurer to such a settlement demand in the context of a pre-litigation insurance claim that is anything other than an unequivocal agreement to pay the policy limits is characterized as a rejection. The rejection is used as a basis by the claimant’s counsel to thereafter refuse to accept the policy limits and to assert that the policy limits no longer apply due to the insurer’s purported unreasonable refusal to offer the policy limits to protect its insured. The result is a judgment in excess of the policy limits, then an assignment from the insured to the judgment creditor of his bad faith rights against the insurer.

Obviously, *CCP sec. 377.60* could be amended to provide that a pre-litigation settlement affords the same protection as the settlement of a civil wrongful death action. A liability insurer faced with a pre-litigation settlement demand involving a wrongful death claim can retain the services of a genealogy expert that will provide a professional opinion as to all the surviving heirs. Such an expert is frequently retained when a decedent’s estate is being probated to ensure that all surviving heirs are accounted for in Court filings. One such genealogy expert service charges $7,800 for a detailed report that includes research of all public records, court and land records, wills and estate records, census records, etc., which is digitized and presented in the form of genealogy charts and other reports.

Given the fact that the plaintiffs in the *Moody v. Bedford* case were the surviving minor children of the decedent mother, their existence should have been easy to ascertain through the use of a reputable genealogy expert. While an amount of $5,000 to $8,000 may not seem that much of a claim expense when the available policy limits are $100,000, if the policy limits are $15,000, such an expense might be less attractive to a liability insurer.

Assuming a wrongful death claimant provides at least 30 days for a liability insurer to pay its policy limits to settle a pre-litigation claim, it may be possible for the insurer to “arrange” for the claimants to file a civil lawsuit against the insured. Provided the insured gives written consent, the insured could be provided defense counsel to immediately file responsive pleadings to place the action at issue. The insurer could then conclude a settlement with the plaintiff by release and dismissal and the insured would be afforded the protection of the “one action rule.” However, this would require the cooperation of the surviving heirs, their counsel (if they are represented), and the insured tortfeasor. Otherwise, this plan of action suggested by the Court would not be possible. Obviously, if the surviving claimants are not represented by counsel, it is difficult to understand how this “arrangement” would be possible unless the tortfeasor’s insurer also retained counsel for them to file a civil action against its own insured.

This article does not purport to provide an absolute solution as to how best to resolve a wrongful death pre-litigation, policy limits settlement demand. The most that can be offered are suggestions to possibly avoid the situation this particular liability insurer fell into by trusting the representations of counsel in the negotiation of a pre-litigation claim. Hopefully, more awareness of the problem and discussion of the need for solutions will lead to either a statutory change or acceptance among the bar as to how to best handle these claims for the protection of all concerned.

CYBER RISK ATTACKS AND AVAILABLE INSURANCE

Most of us are generally familiar with news reports of computer hacking by domestic or international terrorists or individuals with malicious intent. This article will provide a brief summary of the current insurance coverage available to businesses to protect themselves and their customers from losses due to computer hacking, or as the term has been coined, cyber risk.

Before summarizing the available insurance coverage, I should point out that there are a number of Federal and State statutes and regulations that pertain to cyber risks. *42 USCS 17932, 17953, 17937,* pertain to the duty to notify persons whose private or health information has been accessed by unauthorized persons. *17 USCS 1201* is with regard to a breach of technology measure designed to protect copyrighted material. *47 USCS 1001* has to do with the requirements of a company that has notice of interception of digital and other communications of its customers.

California, as have many states, enacted *Civ. Code secs. 1798.82, 1798.29* requiring notification to customers of security breaches encountered by companies. *Cal. Health & Safety Code sec. 1280.15* is similar to the Federal statute requiring companies to notify their customers when private health information has been accessed by unauthorized persons.

From a review of these statutes, it is apparent that companies face third party exposure when unauthorized persons either access private information stored in computers, or are threatened with such unauthorized access by persons attempting to extort money or other valuables. However, companies also face exposure to damage to their own business property, software, computers, money and detrimental publicity when confronted with cyber risks. A cyber attack may cause an unauthorized release of private information of customers and also cause damage to computer systems and the reputation of the insured company. Thus, cyber risks are somewhat unusual in that they involve both first and third party exposures resulting from one and the same event.

In order to address the need for insurance coverage for these first and third party exposures, a number of large domestic insurance companies have developed and marketed various forms of cyber risk policies. Some insurance companies have utilized one policy form to cover all of these risks, while others have attempted to target specific risks through the use of numerous endorsements allowing an insured to "tailor" the coverage to specific needs.

An example of a policy that utilizes numerous endorsements tailored to specific cyber risks is one that provides coverage for Crisis Fund Events, Cyber Extortion, Security Failure/Privacy Event Management, Specialty Professional Liability, Network Interruption, Media Content, Security and Privacy Liability and Cyber Extortion. A Crisis Event is defined as involving the death or incapacity or criminal indictment of a manager or key person, a bankruptcy announcement, return of a governmental grant, government litigation, accusation of a mass tort, or publication of an unfavorable news report. A covered loss includes expenses incurred to deal with such an event.

Under these numerous endorsements, coverage is afforded for threats to commit an intentional attack against a computer system to demand money or other valuable property from an insured company. A covered loss includes money paid to end such a threat and to investigate one. There are usually exclusions for fraud by an insured, misappropriation of a trade secret, patent, copyright, trademark, trade dress or other intellectual property, or for a governmental security threat.

Also covered is an insured's information the insured is legally responsible for such as personal identification information, non-public personal information, protected health information, trade secrets, designs, and other business information not available to the public. The policies cover expenses incurred by an insured to investigate a Security Failure or Privacy Event, public relations management firms, notification to holders of private information lost, and costs incurred to restore electronic data.

Network Interruption Insurance covers costs incurred within a specific period of time after the end of a Material Interruption of a computer system, net income that would have been earned, and continuing normal operating expenses, including payroll. Media Content Insurance pays for covered Loss due to an insured's Wrongful Act including judgments, settlements, and defense costs. Security and Privacy Liability Insurance provides coverage for a suit or Regulatory Action alleging a Security Failure or a Privacy Event.

These endorsements usually define a Privacy Event to mean any failure to protect Confidential Information, failure to disclose an event in violation of any Security Breach Notice Law, and violation of any statutes in connection with a Claim. This coverage is designed to address the exposure presented by a breach of any security breach notification statute referred to above. A Security Failure includes acts resulting from theft of a password or access code in violation of security policies.

A typical Cyber Extortion Insurance Endorsement pays for Loss in excess of a self insured retention amount an insured incurs resulting from a Security Threat. Loss means money paid by an insured to end a Security Threat, and costs to investigate same. A Security Threat means threats to commit an intentional attack against a computer system to demand money or items of value from an insured.

Under the current policy forms that attempt to combine most of the above endorsements into one policy that addresses both first party and third party exposures, the policies provide different sections or coverages to differentiate between first party and third party risks. One such policy divides the coverages among three such sections.

Under Coverage A – the policy affords coverage to pay sums the insured becomes legally obligated to pay as damages and regulatory fines by reason of an unauthorized access or potential access during the policy. Under Coverage B – the coverage indemnifies the insured for loss resulting from an unauthorized access during the policy. Coverage C pays damages resulting from an electronic media injury.

Another example of a cyber risk policy that combines third party liability and first party loss coverages is one that simply divides the coverage between these risks. Most of these policies attempt to address these same cyber risks, but each policy involves slightly different risks. Particular attention must be paid to the different exclusions, as some policies have exclusions that limit the coverage more than others.

Within the third party liability coverages one usually finds coverage for the failure to prevent unauthorized access to or use of data containing identity information, failure to prevent transmission of a computer virus not owned, or leased by an insured, failure to provide any authorized user with access to an insured's website or computer system, and failure to provide notification of an unauthorized access to or use of data containing private or confidential information if such notification is required by any Security Breach Notification Law.

Under the first party coverages, these policies cover costs incurred by an insured for public relations services to mitigate negative publicity due to any wrongful act. This does not include costs to notify of a wrongful act, costs to determine if a wrongful act occurred, compensation paid due to a wrongful act, costs to comply with any law or regulation, fines, or costs to replace or maintain a computer system.

Also covered are costs to determine whose information was accessed, to notify the affected persons, to provide one year of credit monitoring services, establishing a call center, other costs to comply with any breach notification law, and costs to provide identity fraud insurance to affected persons.

Some of the policies include Computer Program and Electronic Data Restoration Expenses, which are costs due to introduction of a computer virus into a computer system, damage to computer programs or data in a system due to unauthorized access by an insured or employee.

Also available is E-Commerce Extortion coverage, that covers a threat made to the insured to cause an insured to transfer money or property using a computer system, to sell or disclose customer information not publicly available, alter, damage or destroy any computer program, software or data, introduce a virus into a computer system, initiate an intentional attack on a computer system and threats made for the purpose of demanding money or property.

While the above coverages appear to be quite broad, the exclusions found in these "combined" policies can also provide broad limitations that should be compared carefully. A typical "combined" CyberRisk Policy does not apply to bodily injury, emotional distress, or fraud by an insured.

The wide variety and scope of Cyber Risk insurance, plus the fact that there are no standardized policies, makes coverage selection more difficult than D&O, professional liability or CGL policies. The key is an understanding of a particular insured's risks and then finding the policy that best addresses those risks.

TRUCKERS' COVERAGE FORM PRIMARY –EXCESS INSURANCE ISSUES

This article discusses how to determine primary-excess issues re a commercial Truckers Coverage form policy in California - which arise in the context of a claim involving an accident caused by the operator of a tractor towing trailers used for transporting goods or fuel. As you may know, approximately 60% of commercial tractors are "owner-operators" that lease their tractors back to companies that transport goods and fuel for hire. Such companies are regulated under the Federal Motor Carrier Safety Act and are known as "truckers" under a typical, standard, ISO Truckers Coverage form policy.

The "other insurance" issue arises because the tractor owner obtains a Truckers Coverage form policy that insures the risk of liability arising out of the use of his tractor as an "owned auto" in the Schedule of Autos You Own. The tractor is described using the VIN number of the tractor. Additionally, the "trucker for hire" that the tractor owner hauls freight for also obtains an identical Truckers Coverage form policy that insures that company's liability arising out of the operation of the tractor as a "hired" "auto" used in the business of the "trucker for hire."

Since both Truckers Coverage form policies have an identical "Other Insurance" provision, there is an understanding in the insurance community that these policies state that the insurance afforded to the transportation companies is primary for any covered "auto" while hired or borrowed by that insured and used in its business as a "trucker" and pursuant to operating rights granted to that insured by a public authority.

The intent of this industry-wide standard provision is to place the cost of the risk of loss on the transportation company that is earning money transporting goods for hire. Those companies make substantially more money than the owner-operator that is usually an individual that simply drives his tractor for a transportation company. Additionally, the Federal Government requires that the tractor bear the placards and Department of Transportation number of the transportation company under such a lease-back agreement

.

However, *Cal. Ins. Code sec. 11580.9(d)* makes the insurance primary that describes an "auto" as an "owned auto." This has been held to mean an auto policy in which the auto is described and rated by use of the VIN number of the auto. Thus, this Code section completely ignores the standard "other insurance" provisions of both policies and changes the result by making the policy issued to the owner-operator primary and the policy issued to the large, multi-national transportation company excess.

In recent litigation regarding this issue, the Court's tentative ruling citing *Wilshire Ins. Co., Inc. v. Sentry Select Ins. Co.* (2004) 124 Cal. App. 4th 27, 33, noted that the Legislature declared that Section 11580.9 of the Insurance Code expresses the "*total public policy* of this state" respecting the order in which two or more such liability insurance policies covering the same loss shall apply.

The Court's tentative ruling analyzed an argument that the definition of "automobile" set forth in *Insurance Code section 11580.06(d)* applies to *Insurance Code section 11580.9(d),* thus limiting *section 11580.9(d)* to self-propelled motor vehicles with neither more than nor less than four wheels. The Court summarized this argument as follows:

> The insurer for the owner-operator of the tractor argues that the "owned automobile" phrase in section (d) falls under the definition in *Insurance Code section 11580.06(d)* where "automobile" "means any self-propelled motor vehicle, with neither more than nor less than four wheels . . . thus, this insurer concludes that because the Tractor was 6-wheel then it is not an "automobile."

The Court's tentative ruling explained that there was no support for this argument, noting that several cases applied section (d) to tractor-trailers and that this interpretation would render *section 11580.9(d)* inapplicable to any tractor-trailer cases. The Court also noted that section *11580.9(h)* also uses the word "automobile" and concluded that it appeared that the Legislature did not appear to use the term "automobile" in *section 11580.9(d)* as narrowly as this insurer argued.

The Court felt that it did not have to consider the fact that the purpose of *11580.9(d)* was to insure that injured claimants would have insurance from the owner of an "auto" to compensate them, based on the concern that "non-owned" "auto" insurance may not have sufficient limits since it is optional coverage for private passenger "autos." Since commercial transportation companies are required by Federal statute to have at least $750,000 in liability coverage for non-owned tractors used in their business, the need to make the insurance issued to the tractor owner does not exist in a commercial setting.

From a claim management perspective, the application of *11580.9(d)* to commercial tractors that are leased back to transportation companies imposes a primary liability risk unexpected by insurers who issue policies to the owners of tractors. Based on the industry-wide, standard ISO Truckers Coverage form policies, the understanding of underwriters is that the insurance afforded to transportation companies will be primary, and that the insurance issued to tractor owners will be excess. The underwriting decisions as to pricing and whether to insure a tractor owner are based on the expectation that a policy issued to a tractor owner will not have to respond to damage or injury claims until the limits of coverage afforded to the transportation company the tractor owner works for are exhausted.

Most states will follow the "other insurance" provisions of the respective policies issued to the parties involved in a liability claim. *11580.9(d)* requires Courts to ignore the written lease-back agreements and the "other insurance" provisions of the parties' policies in favor of a statute that arguably was not intended to apply to a commercial trucking setting.

THARPE & HOWELL, LLP
www.tharpe-howell.com

15250 Ventura Blvd., 9th Floor
Sherman Oaks, CA 91403
Phone: (818) 205-9955

1226 State Street, 2nd Floor
Santa Barbara, CA 93101
Phone: (805) 962-4000

600 W. Santa Ana Blvd., Ste. 705
Santa Ana, CA 92701
Phone: (714) 437-4900

770 L Street, Suite 950
Sacramento, CA 95814
Phone: (916) 475-1600

225 Bush Street, 16th Floor
San Francisco, CA 94104
Phone: (415) 439-8840

11622 El Camino Real
San Diego, CA 92130
Phone: (858) 764-2577

6897 West Charleston Blvd.
Las Vegas, Nevada 89117
Phone: (702) 562-3301

955 South Virginia Street
Reno, Nevada 89502
Phone: (775) 324-1300

2415 East Camelback Rd. Suite 700
Phoenix, Arizona 85016
Phone: (602) 340-1234

2150 S. 1300 East, Suite 500
Salt Lake City, Utah 84106
Phone: (801) 337-3997

In The News

Firm Partner **Timothy D. Lake** recently joined the **Coverage Litigation Committee** of the Claims and Litigation Management Alliance ("CLM"); and has also been appointed to the **Insurance Coverage Committee of the California State Bar**! Mr. Lake is Chair of the Firm's Insurance Coverage and Bad Faith Practice Group, and represents nationally recognized insurance carriers on a broad range of coverage issues and related matters.

***

Tharpe & Howell recently launched the ***California Business Law Report*** – an online forum which continuously provides significant legal developments and practical advice for the business community. Please be sure to check it out at www.commercialcounselor.com!

This Newsletter has been brought to you by Firm Partner Timothy D. Lake. Should you have any questions or comments about the articles presented, please feel free to contact him at (818) 205-9955, or via email to tlake@tharpe-howell.com .

Tharpe & Howell has been part of the California, Arizona, and Nevada business communities for more than 35 years, providing clients with experience, judgment, and technical skills. We are committed to delivering and maintaining excellent client service and case personalized attention, and to be an integral member of each client's team.

This publication is designed to provide accurate and authoritative information regarding the subject matter covered. It is offered for information purposes only and does not constitute legal advice. Do not act or rely upon any of the resources and information contained herein without seeking professional legal advice.