Your Coverage Advisor

Recovering Your Attorneys' Fees in an Insurance Coverage Case

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A denial of insurance coverage has immediate and sometimes severe consequences for a policyholder. A wrongful denial by the insurer leaves the policyholder to fend for itself, requiring the policyholder to cover the attorneys' fees associated with defending actions brought against the policyholder by third parties, as well as the cost of the loss.

Adding insult to injury, the policyholder then must incur attorneys' fees and costs in prosecuting a coverage action against its insurer in order to obtain the insurance coverage for which it paid. The total cost when an insurer wrongfully denies coverage can place substantial financial strain upon a policyholder.

In Ohio, however, policyholders have a powerful weapon available to them to fight against insurers that deny covered claims: policyholders may recover from their insurers the costs and attorneys' fees incurred in successfully prosecuting coverage actions, even in the absence of bad faith. Ohio generally follows the American Rule with regard to the

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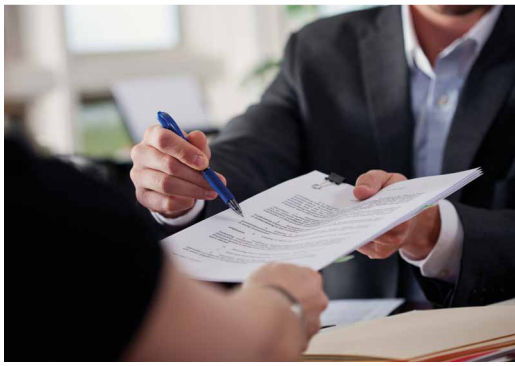

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recovery of attorneys' fees in civil actions – a prevailing party in a civil suit generally may not recover its fees and costs associated with the litigation. In the context of insurance coverage cases, however, Ohio recognizes two exceptions to the general rule.

BREACH OF CONTRACT EXCEPTION

An insurance policy is a contract and most disputes between policyholders and insurance companies present possible claims for breach-of-contract. Actions for breach of insurance contracts differ from other breach-of-contract actions, however, in certain important respects. One difference recognized by the Ohio Supreme Court is that Ohio law requires an award of attorneys' fees to a policyholder that prevails against its insurer in a breach-of-contract action, Motorists Mutual Insurance Company v. Trainor (1973), 33 Ohio St. 2d 4; Allen v. Standard Oil Co. (1982), 2 Ohio St.3d 122, 126.

The rationale for allowing recovery of attorneys' fees under these circumstances is that "the insured must be put in a position as good as that which he would have occupied if the insurer had performed its duty," Allen, supra. This basis for recovering attorneys' fees is significant in that it does not require the policyholder to demonstrate any impropriety on the insurer's part - the insurer's good or bad faith in reaching its coverage decision is irrelevant.

> "Policyholders have a powerful weapon available to them...[and] may recover from their insurers the costs and attorneys' fees incurred in successfully prosecuting coverage actions..."

BAD FAITH EXCEPTION

Policyholders may also recover the attorneys' fees incurred in prosecuting a bad faith action. Contrary to the claim of some insurers, in order to recover its attorneys' fees as compensatory damages, a policyholder is not required to prove the existence of any additional compensatory damages separate and distinct from those fees. Therefore, the fact that a jury may not award any additional damages will not preclude a policyholder from recovering its attorneys' fees as compensatory damages. Nor is a policyholder required to prove actual malice in order to recover its attorneys' fees.

DECLARATORY JUDGMENT ACTIONS

In 1999, the Ohio Declaratory Judgment Act was amended by enacting 2721.16, which provides, "A court of record shall not award attorney's fees to any party on a claim for declaratory relief," except in narrow circumstances that typically would not include insurance coverage actions. Because insurance coverage actions typically include claims for declaratory relief, insurers sometimes will argue that this amendment nullifies the right of policyholders to recover their attorneys' fees when they prevail against their insurers in coverage disputes. These arguments have been rejected by Ohio courts. See e.g. Cremeans v. Nationwide Mut. Fire Ins. Co. (7th Dist. 2000), 2000-Ohio-2612; National Eng. & Contr. Co. v. U.S. Fidelity & Guar. Co. (10th Dist. 2004), 2004-Ohio-2503 at 23; Judge Richard Markus, Trial Handbook for Ohio Lawyers 34.19 (statutory change does not affect recovery of attorneys' fees in for breach of insurance contract).

When a policyholder has a claim for breach of contract or anticipatory breach of contract, in addition to the

claim for declaratory relief, the policyholder will still be able to recover attorneys' fees if the policyholder prevails on the contract claim. The reason for this is simple. On its face, 2721.16 applies only to claims for declaratory relief and does not purport to modify the Ohio Supreme Court's decisions in Trainor and Allen.

The pronouncements from the Ohio Supreme Court are unequivocal. Because this feature of Ohio law is not widely known or understood, however, from time to time lower courts, particularly federal courts, fail to properly apply this law. Policyholders can greatly enhance their prospects of recovering these fees and costs by properly raising and advocating this issue, such as by citing to controlling law discussed above.

Policyholders and their counsel maintain a strong argument that policyholders are entitled to attorneys' fees, even in the absence of insurer bad faith, when insurers breach their policies of insurance. As a result, policyholders are wise to assert breach-of-contract claims, or anticipatory breach-of-contract claims, whenever appropriate to do so, and to request attorneys' fees in conjunction with those claims. ■

Sony's Second Data Breach: Insurance against Cyber Risks after Zurich v. Sony.

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The Guardians of Peace, a group of hackers who, according to the FBI, have ties to the government of North Korea, are believed to be the ones that recently infiltrated Sony's computer network, bringing the company to an electronic standstill. The hack reportedly was in retaliation over The Interview, a movie produced by Sony Pictures that depicts the assassination of the North Korean dictator, Kim Jong Un. The cyber-terrorists not only paralyzed Sony's computers for days, but they also made off with 100 terabytes of data from Sony's servers. Soon after the attack, the hackers began leaking stolen information on the internet.

Predictably, lawsuits followed. According to CNN, at least four class action lawsuits were filed against Sony in response to the cyber-attack between December 15-19, 2014. At this point, estimates vary as to how many plaintiffs may be part of these class actions. But at least one of the complaints alleges that the information of over 47,000 past and present Sony employees was posted online.

With potentially huge liabilities looming, Sony is very likely reviewing its insurance policies to determine whether it might have coverage against the hack. This is a familiar position for the company.

In April 2011, Sony was the victim of another enormous data-breach, compromising millions of user accounts from its PlayStation video game network. Sony later made a claim to its insurers under its commercial general liability ("CGL") policies, arguing that it was entitled to a defense against the dozens of class-action lawsuits that cropped up after it was hacked. Its insurer denied the claim, and brought suit

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against Sony in New York for a declaration that there was no coverage.

In early 2014, the New York court ruled against Sony. In its opinion, given on the record, the court analogized the data-breach to letting information out of a secure box. The Court concluded that CGL policies provide coverage only where the policyholder opens the box through its negligence. But because Sony was the victim of third-party hackers - who criminally got in the box, "opened it up and ... took the information" - the Court concluded there was no coverage under the policy. Zurich v. Sony, No. 651982/2011, Hr'g Tr. 77 (N.Y. S.Ct. Feb. 21, 2014).

The Zurich decision is currently on appeal. But whatever the outcome, its impact will be limited in light of new policy language designed to exclude losses for data-breaches. ISO, which drafts form policy language for insurers, has prepared a mandatory endorsement to its standard CGL policies that excludes injuries "arising out of any access to or disclosure of any person's or organization's confidential or personal information..."

Though there is no standard cyber-risk policy currently available, in general, policyholders can purchase insurance that protects against the following risks:

- **Data Breach**
- **Regulatory Investigation**
- **Misappropriation of Intellectual Property**
- **Transmission of Malicious Code**
- **Data Recovery**
- **Business Interruption**
- **Extortion**

Cyber insurance is filling the gap. But policyholders should know that some cyber policies contain provisions that may defeat the purpose for obtaining coverage in the first place. For example, some policies may over-restrict the coverage territory, such that they apply only to claims made in the United States. The internet is international, so in order to truly protect against all risks, the policyholder needs coverage against claims no matter where they are made.

Further, some policies contain exclusions for "failure of security," which require the policyholder to maintain certain minimum levels of data security, or else forfeit coverage. Depending on how broadly these provisions are worded, they may make the insurance hardly worth the cost. After all, the main reason to buy cyber insurance is to protect against the risk that the policyholder's security measures will fail, either through negligence or otherwise.

If your company collects sensitive data, as most companies do, at least with respect to their employees, you may want to purchase one of the various cyber policies. Work with your insurance broker to identify which policy is right for you. ■

Policyholders Should be Aware of the Impact of "Presumptive Intent" on Coverage

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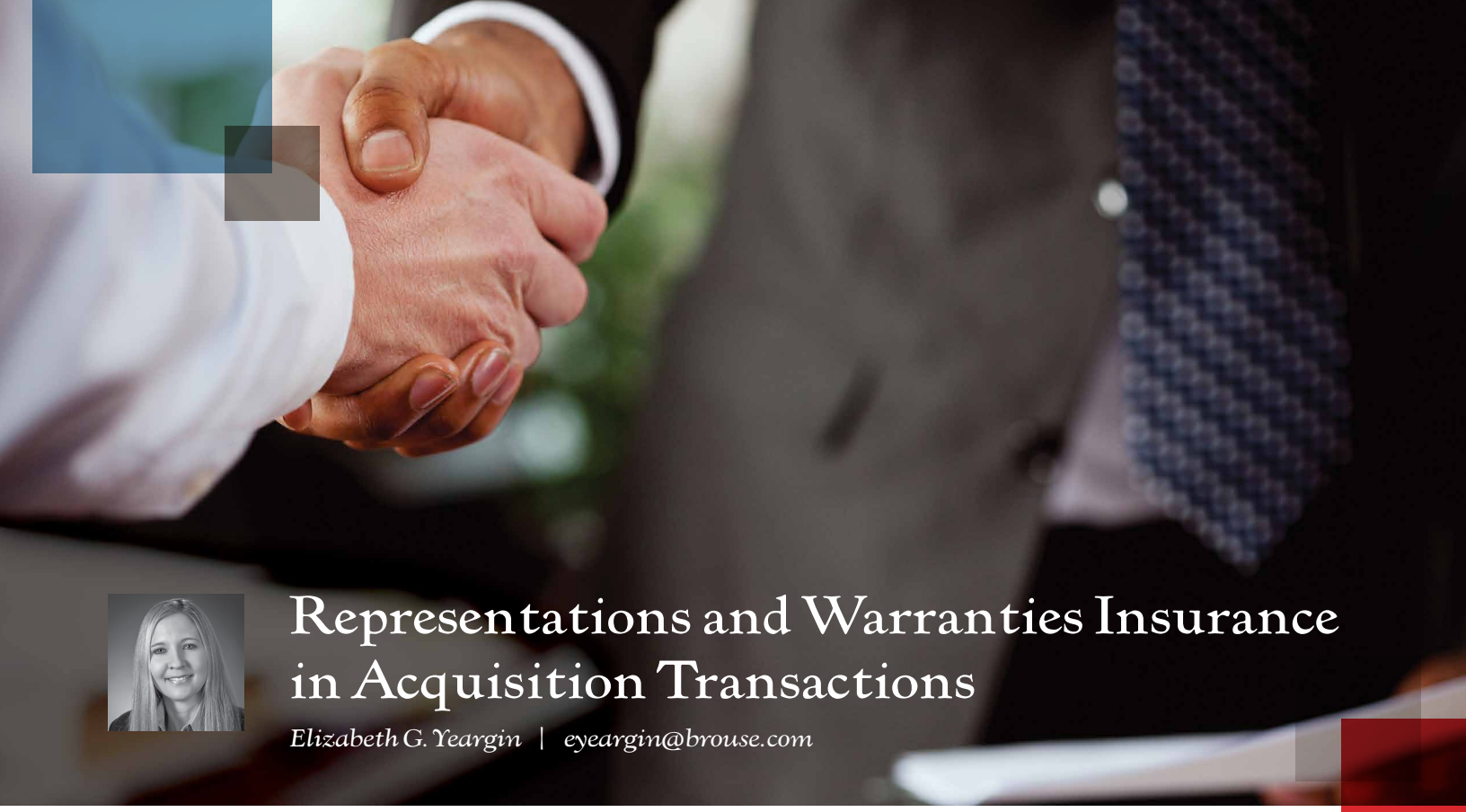
Under Section 2745.01 of the Ohio Revised Code, an employer's intentional tort liability is limited to the rare situation where it acts with "deliberate intent" to injure the employee. Proving deliberate intent, however, is extremely difficult. Consequently, employees increasingly rely upon R.C. 2745.01(C), sometimes called the "equipment safety guard" provision, which provides that an employer's deliberate removal of an equipment safety guard creates a rebuttable presumption that the employer intended to cause injury. It essentially allows a court to assume the employer intended to injure the employee even if no direct proof of deliberate intent exists — requiring the employer to then disprove intent.

Recently, in *Liberty Mutual Fire Insurance Co v. Ivex Protective Packaging,* the Southern District of Ohio addressed whether a claim under R.C. 2745.01(C) was covered by an employer's insurance policy that specifically excluded bodily injuries "intentionally caused or aggravated" by an employer-insured. The coverage dispute stemmed from an underlying lawsuit involving an Ohio manufacturing plant employee who was seriously injured when a machine malfunctioned due to the lack of proper safety guards. The employee sued Ivex, his employer, alleging that Ivex intentionally caused his injuries by removing the safety guards. The parties eventually settled and agreed that Ivex's liability was limited to a disputed violation of R.C. 2745.01(C).

Ivex requested defense and indemnity from Liberty Mutual under the terms of its Workers Compensation and Employer Liability Insurance Policy. Liberty Mutual denied coverage and filed a coverage action seeking a declaratory judgment that it had no duty to defend or indemnify Ivex because the policy specifically excluded bodily injury "intentionally caused or aggravated" by Ivex. Ivex disputed this conclusion relying on the Ohio Court of Appeals' decision in *Hoyle v. DTJ Enterprises* that presumptive intent under R.C. 2745.01(C) does not constitute an "intentional act" and was therefore covered under the employer's insurance policy.

The Southern District of Ohio agreed with Liberty Mutual on the coverage issue and granted partial summary judgment in its favor. The Southern District distinguished the case before it from *Hoyle* on the purported basis that *Hoyle* involved policy language and provisions that were not included in Ivex's policy. The court then determined that a violation of R.C. 2745.01(C) constituted a "tortious act with the intent to injure another" and, therefore, was excluded from coverage under that specific policy. The Court did, however, determine that Liberty Mutual had a duty to defend Ivex in the underlying tort action because of the legal uncertainty regarding the interpretation of presumptive intent under R.C. 2745.01(C).

The *Ivex* court, like other federal courts before it, misunderstood or misapplied Ohio law, resulting in inconsistency and unpredictability for policyholders facing potential claims of injury under R.C. 2745.01(C), at least before Ohio federal courts. The decision improperly distinguished *Hoyle* which considered an analogous policy provision and, in so doing, rendered Ivex's coverage for employment-related torts completely illusory, a result disfavored under Ohio law. Until the Ohio Supreme Court has an opportunity to conclusively settle this issue, employers should be aware of this uncertainty and mindful that employee claims brought under R.C. 2745.01(C) *may* result in denial of coverage under certain policy wording, and should work with their insurance broker to ensure that their policies contain the most advantageous policy language. ■



Representations and Warranties Insurance in Acquisition Transactions

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In negotiating the terms of an acquisition transaction, parties spend considerable time and legal expense negotiating the language of their representations and warranties in a purchase agreement and the corresponding indemnification and liability sections. Most importantly, the seller makes contractual representations and warranties to the buyer regarding fundamental facts about the seller's business.

The allocation of risk between the parties for breaches of these representations and warranties and the ability to recover for such breaches are often the most hotly disputed facets of a deal. Buyers want safeguards against post-closing liabilities related to a seller's breach; sellers would prefer to sleep at night knowing that their obligations with regard to the transaction have come to a definitive end. Structuring an acquisition in conjunction with a representations and warranties insurance policy can accelerate the discussions by eliminating such extensive debates over the related indemnification and liability provisions.

A representations and warranties policy can be purchased in the name of either the buyer or the seller. Buyer-side representations and warranties insurance is more prevalent in M&A transactions. Because this insurance can be used as security or a supplement for the seller's indemnification obligations under the purchase agreement, or in some cases enables the parties to delete indemnification altogether, representations and warranties insurance is attractive to sellers and is often used in the bidding process or in an auction by a purchaser to enhance its offer to acquire a target company. In some cases, a buyer is able to reduce the escrow or maximum indemnity in a manner so attractive to a seller that the money expended by a buyer on the policy's premium is counterbalanced by a seller's willingness to substantially reduce the overall purchase price. Representations and warranties insurance is also attractive to a purchaser because it is first-party insurance and entitles a buyer to direct payment by the insurance company to cover its losses. Another important purpose

served by representations and warranties insurance is that it aids in the continuity of business for the surviving company. In many cases, shareholders who served in management of the target company remain employed by the purchaser post-closing. Representations and warranties insurance can eliminate a potentially hostile work environment where the buyer seeks indemnification claims, which often result in litigation, from such management members who are now employees of the buyer.

For a seller, the use of a representations and warranties insurance policy can be an attractive way to structure a business deal. Unlike buyer-side insurance, a seller-side policy is written as third-party coverage in which the insurer provides defense to the seller for claims made by the purchaser for breaches of the seller's representations and warranties. Possibly the biggest advantage of a representations and warranties insurance policy is that it provides the seller assurance that after closing, he/she will not be saddled with contingent liabilities or a holdback of the purchase price. Therefore, a seller is able to distribute all or most of the proceeds of a transaction to its shareholders. Another scenario in which representations and warranties insurance is attractive to a seller involves the situation in which there are multiple shareholders and the purchase agreement provides for joint and several liability. In such a situation, one shareholder with less knowledge and control over the target company could be responsible for the entire potential risk when his/her interest in the overall consideration paid for the target company is small. A representations and warranties insurance policy can protect such shareholders from this type of unbalanced liability.

However, a representations and warranties insurance policy is not a fit for every transaction and should be evaluated in light of the size of the deal and the potential risks involved. It is important to note that policies do include exclusions, such as knowledge of breach or fraud by the insured, purchase price adjustments, environmental violations known to the insured at closing, and criminal activity. Further, representations and warranties insurance has historically been expensive, although prices have gone down in recent years. Today, a policy is generally priced as a percentage of the policy's coverage. A one-time premium of 2.0% to 3.5% of the policy limit is common. The insurance also typically carries a deductible which is typically between 1-2% of the purchase price for a transaction.

> "The allocation of risk between the parties for breaches of these representations and warranties and the ability to recover for such breaches are often the most hotly disputed facets of a deal."

If a party to a transaction is interested in exploring representations and warranties insurance, it is best to talk with an insurance provider early in the negotiation process. Oftentimes the insurer requires an additional due diligence process (which is conducted at a cost to the parties) before providing a quotation for insurance, so it is best to consider whether insurance is right for the transaction as soon as possible. ■

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Attorney Highlights

Gabrielle T. Kelly was certified as a specialist in Insurance Coverage Law by the Ohio State Bar Association.

Christopher J. Carney, Keven Drummond Eiber, Amanda M. Leffler, Caroline L. Marks and Paul A. Rose were listed as 2015 Super Lawyers® *Ohio Super Lawyer through a peer- and achievement-based review conducted by the research team at Super Lawyers, a service of Thompson Reuters legal division.*

Lucas M. Blower, Kerri L. Keller, Alexandra V. Dattilo and Gabrielle T. Kelly were named 2015 Ohio Super Lawyers® Rising Stars™ *Ohio Super Lawyer through a peer- and achievement-based review conducted by the research team at Super Lawyers, a service of Thompson Reuters legal division.*

Keven Drummond Eiber and Amanda M. Leffler were named in the Top 25: 2015 Women Cleveland Super Lawyers Top List and Top 50: 2015 Women Ohio Super Lawyers Top List.

Lucas M. Blower was elected as a Partner of the firm.

Kerri L. Keller recently hosted a Federal Bar Association webinar on January 14 entitled, The Federal Declaratory Judgment Act: Overview of 28 U.S.C. 2201 and Recent Court Decisions.

Caroline L. Marks & Alexandra V. Dattilo were published in the Insurance Coverage Law Bulletin's January issue entitled, "The Impact of Bad-Faith Arguments on Forum Battles."

Keven Drummond Eiber and Paul A. Rose will be speaking at the ABA's Annual Coverage Conference in Tucson, Arizona.

Kerri L. Keller was elected as Vice Chair of the Victim Assistance Program Board of Directors.