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The War Exclusion

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The War Exclusion in Property & Casualty Policies: When is a War a War?

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Merriam -Webster defines "war" as "a state of usually open and declared armed hostile conflict between states or nations".[1] When the insurance industry began developing war exclusions for insurance policies, no doubt it was that kind of "war" which was the focus of their attention.

War exclusions started becoming a prominent fixture in insurance policies around the time of the World Wars, however, they have been seen in some policies as far back as the Civil War.[2] The war exclusion has developed over the years to preclude coverage for loss or damage caused directly or indirectly by war and military action.[3] In terms of the exclusion, 'war and military action' also includes undeclared or civil wars and 'warlike action by a military force,' as well as insurrection, rebellion or revolution.[4]

Steven & Jordan Plitt described the war-risk exclusion as a "result"-oriented clause which requires that the injury be causally related to a military operation or act of warfare.[5] Therefore, analyzing the typical war-risk exclusion involves an analysis of the following constituent terms: (1) War; (2) War-Like Operations; (3) Military or Usurped Power; (4) Riot, Insurrection and Civil Commotion; and (5) Civil War.[6] These terms have always been left undefined by the

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[1] Dictionary by Merriam-Webster: America's On-line Dictionary, https://www.merriam-webster.com/dictionary/war, retrieved June, 2019

[2] Celebrezze, Bruce D. & Stewart, Elizabeth J. *War and Peace (The Abridged Version): Application of the War and Terrorism Exclusions*, American College of Coverage & Extracontractual Counsel, 5th Annual Meeting, Chicago, Il, May, 2017, unpublished paper, p. 4, citing, Pelletier, George A. *Life Insurance– Military Service– Military Exclusion Clauses and Death from Nonmilitary Causes,* 36 Notre Dame Law Rev. 4, 47-48 (1960)

[3] Celebrezze, et al., *supra*., n.1., p. 3.

[4] *Ibid*., at p 3.

[5] Plitt, Steven & Plitt, Jordan Ross, *Exclusions (general liability)—War-risk exclusions*, 2 PRACTICAL TOOLS FOR HANDLING INSURANCE CASES § 13:30 (Thomson Reuters, 2019). This article is referred to in this paper as "Plitt et al".

[6] *Ibid.,* p. 1.

policies and since they are exclusionary terms, the burden is on the insurers to prove causal connection between the constituent element and the loss.[7]

DEFINING THE TERMS

1. "War"?

The courts have taken two approaches in interpreting the term "war" and determining if the violence giving rise to the insured's claim qualifies as a "war". The first approach used by the courts applies a technical meaning to the term, meaning "war" is war in the legal sense and must be formally and constitutionally declared.[8] The second approach gives the term "war" an ordinary meaning.[9] The courts split on these approaches regarding World War II (between the attack on Pearl Harbor and Congress's formal declaration of war) and the military engagements in Korea and Vietnam.[10]

> Plitt et al brought some understanding to this question by giving the following analysis:[11]
>
> Where the destructive activity is performed by a defined group acting with the express purpose of ousting the existing government, the courts have enforced war, civil war, and insurrection exclusions. One commentator has concluded that these cases are "in irreconcilable conflict" due to their divergent opinions and holdings regarding the formal and informal requirements to establish that a state of "war" exists. The term "war" has been "defined almost always as the employment of force between governments or entities essentially like governments, at least *de facto*." War is often viewed as the method by which a "nation prosecutes its right by force." It has further been observed that "an undeclared *de facto* war may exist between sovereign states." However, no case has held that a terrorist act constitutes an act of war.

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7 *Ibid.*

8 *Ibid. at p.* 16, citing *Gladys Ching Pang* v. *Sun Life Assur. Co. of Canada*, 1945 WL 5596 (1945), where the court held that the war against Japan did not begin until it was formally and constitutionally declared by Congress.

9 *Ibid*., at p. 15 citing *Dole* v. *Merchants' Mut. Marine Ins. Co*., 51 Me. 465, 1863 WL 1315 (1863)

10 *Ibid,* at p. 2*,* endnotes 12-14 citing & analyzing multiple cases from those periods.

11 *Ibid,* p. 2. and endnote 16, citing 43 Am. Jur. 2d.§ 603 (2002).

Despite the use of the expression "war on terrorism", the standard war exclusion does not explicitly extend to acts of terrorism. This became dramatically apparent after the events of September 11, 2001. In the same article, Plitt *et al* tackled this issue by quoting another commentator, James Rizzo, on the difference between war and terrorism:

> War is defined as a "hostile intention by means of armed forces, carried on between nations, states or rulers, or between citizens in the same nation or state." Traditionally, war takes place between two or more sovereign powers for purposes of amassing empires, acquiring territory, or otherwise protecting national interests. Terrorism, on the other hand, is defined as "the unlawful use of force and violence against persons or property to intimidate or coerce a government, the civilian population, or any segment thereof, in furtherance of political or social objectives." "Terrorism uses unconventional means to exact the greatest amount of harm upon our citizens and the foundation of our society." *The combatant must have at least some incidence of sovereignty before their activity can be styled a war*. [12] (emphasis added)

In *Stanbery v. Aetna Life Ins. Co*., [13] a New Jersey court returned a judgment in favor of the insurer by holding a United States Army Captain who was killed on active duty in Korea in 1952 from a mine explosion while he was on a reconnaissance mission resulted from military service in time of war and thus was precluded from recovering under a war exclusion. After quoting numerous definitions of the term "war" from various sources, the court stated:

> The word "war" when used in a private contract or document should not be construed on a public or political basis, in a legalistic or technical sense, but should be given its ordinary, usual and realistic meaning, namely actual hostilities between the armed forces of two or more nations or states de facto or de jure. The conflict still raging in Korea is a war in the ordinary and usual meaning of the word, and it was such on March 27, 1952, when the insured met his untimely death. To hold otherwise and rule the Korean war is not a war seems to me inexplainable and absurd.[14]

The court continued:

> The purpose of such a clause is not insidious or difficult to understand. Military or naval service in time of war, whether in training or combat, is admittedly hazardous, fraught with incalculable danger. It is difficult to determine the scope of risks assumed by members of the armed forces in view of the methods of warfare, keeping in mind the possible

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[12] *Ibid*., at p. 2, endnote 23, quoting Rizzo, James *Tragedy's Aftermath: The Impact of 9/11 on the Insurance Industry*, 46 BOSTON B.J. 10, 12 (2002).

[13] *Stanberry v. Aetna Life Ins. Co.*, 26 N.J. Super 498 (Law. Div. 1953).

[14] Celebrezze, et al., supra, n. 2.

> devastation of present and future developments. An insurance company has the right to limit its liability to particular risks. If it will only assume risks which it feels can be calculated and clearly and plainly so states, this court will not increase such liability.[15]

2. "Warlike Operations"?

The district court in *Pan American World Airways, Inc. v. Aetna Casualty & Surety Co.*[16] found that the term "warlike operations" is "somewhat broader than war." Along with the district court in this case, Plitt et al give helpful insight in their article[17] into what qualifies as a "warlike operation" with the following analysis:[18]

> The nature of the "operation" that gave rise to the loss must be evaluated to determine its "warlike" character. The phrase "warlike operations" requires the operations to be conducted during wartime. As an example, if the loss occurs during routine military training exercises during wartime, it will qualify as a warlike operation. However, losses resulting from the same activity arising from peacetime training activities will not. Proximity to a theater of war may also be considered.

3. "Military or Usurped Power"?

Plitt *et a*l describe military or usurped power in the following way:[19]

> Military or usurped power has been defined as the power "exerted by invading foreign enemies or by an internal armed force in rebellion, 'sufficient to supplant the laws of the land and displace the constituted authorities.'" To constitute a "military or usurped power," the focus group must control a substantial territory with the trappings of states sufficient to constitute a "*de facto* government." Mere occupation at the sufferance of a government is insufficient to constitute a military or usurped power.

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15 *Id.*

16 *Pan Am. World Airways, Inc. v Aetna Cas. & Sur. Co.,* 505 F.2d 989 [2d Cir. 1974].

17 Plitt *et al supra*., n. 5.

18 *Ibid*., at pp. 2-3, endnote 28-32, where the following cases are cited in support of this statement: *United States* v. *Standard Oil Co. of New Jersey*, 178 F.2d 488, 492 (2d Cir. 1949) , judgment aff'd, 340 U.S. 54 (1950); *Panama Transport Co* v. *US,* 155 F. Supp. 699, (S.D. N.Y. 1957) , judgment aff'd, 253 F.2d 758, (2d Cir. 1958); *Eggena* v. *New York Life Ins. Co*., 18 N.W.2d 530, 534 (1945); *Airlift Intern., Inc.* v. *U.S.,* 335 F. Supp. 442, 447 (S.D. Fla. 1971).

19 *Ibid.,* at p. 3, endnote 35, citing *Pan Am. World Airways, Inc*., 368 F.Supp. at 1129–30

4. Riot, Insurrection, and Civil Commotion?

"Riots and civil commotion are purely 'domestic disturbances'.[20] They are "'essentially a kind of domestic disturbance' … 'such as occur among fellow citizens or within the limits of one community.'"[21] According to Plitts et al , for a disturbance to qualify as civil commotion, "the agents causing the disorder must gather together and cause a disturbance and tumult."[22] A "riot" has been defined a few different ways by the courts. One court defined "riot" as the "gathering of three or more persons" with the "common purpose" to do "an unlawful act [with the intent to use] force or violence."[23] An insurrection has been defined as a "rebellion or rising of citizens or subjects in resistance to their government."[24] Courts have used a two-prong test to determine whether a "insurrection" has taken place: (1) was there an identifiable "group or movement"; and (2) if so, did that group or movement have the requisite intent to overthrow the established government and assume at least *de facto* governmental control itself?[25]

5. Civil "War"?

"Insurrection" is not "civil war". "Civil war" requires a specific attempt to overthrow an established government.[26] In Plitts et al, several factors are identified for consideration in determining whether civil strife had reached "civil war" including: (1) the number of combatants involved; (2) the number of casualties, military, or civilian; (3) the nature and amount of arms deployed; (4) the size of territory occupied where delineation is possible; (5) the involvement of the population as a whole; (6) the duration and degree of continuity of the conflict; and (7) the extent of impairment of public order.[27]

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20 *Ibid*., endnote, 41, again citing *Pan Am. World Airways, Inc.,* 505 F.2d at 1019 .

21 *Ibid,* endnote 43, citing *Pan Am. World Airways, Inc.,* 505 F.2d at 1020.

22 *Ibid.,* p. 3, endnote 36, citing *Insurance Co. of North America* v. *Rosenberg*, 25 F.2d 635, 636 (C.C.A. 2d Cir. 1928).

23 *Ibid.*

24 *Ibid.,* endnote 61, citing Black's law Dictionary 808 (6thed, 1990).

25 *Ibid.,* p. 14, endnote 263, citing *Holiday Inns Inc. v. Aetna Ins. Co.,* 571 F. Supp. 1460, at1487–88.

26 *Ibid,* at p. 4, endnote 6, citing *Holiday Inns,* 571 F.Supp at 1466.

27 *Ibid.,* at p. 5, endnote 79, citing *Diamond Shamrock Chemicals Co.* v. *Aetna Cas. & Sur. Co.,* 609 A.2d 440, 473 (App. Div. 1992).

APPLYING "WAR" IN INSURANCE

In *Universal Cable Productions LLC v Atl. Specialty Ins. Co.*, a California federal district court granted summary judgment in favor of an insurance company based on a war exclusion.[28] According to the July 2016 complaint, Universal was filming for a show in Israel in summer 2014. During that time, the Islamist group, Hamas, started launching rockets from Gaza into Israel. That caused Universal to postpone filming and to move production out of Israel.

Universal claimed their insurance policy provided coverage for extra expenses incurred in cases of interruption, postponement or relocation of an insured production as a result of "imminent peril."[29] The insurer, Atlantic Specialty, cited exclusions for losses caused directly or indirectly by:

1. War, including undeclared or civil war; or

2. Warlike action by a military force, including action in hindering or defending against an actual or expected attack, by any government, sovereign or other authority using military personnel or other agents ....[30]

The District Court rejected Universal's argument that there was no "warlike action" because Hamas is not a sovereign or a quasi-sovereign.[31] Whether Hamas was a sovereign or a quasi-sovereign state did not matter in the end because the district court noted that Israel is a sovereign state and its actions "contributed to the situation that caused postponement and relocation of the production. . . . Thus, Israel, too, took warlike action using military force."[32]

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28 *Universal Cable Productions LLC v Atl. Specialty Ins. Co.*, 278 F. Supp. 3d 1165 (C.D. Cal. 2017).

29 The coverage read in part, ""We agree to pay to you such loss (as defined in Paragraph VII) not including loss of earnings or profit, as you sustain by reason of such extra expense you necessarily incur as a result of the interruption, postponement, cancellation, relocation, curtailment or abandonment of an Insured Production ..." Among the qualifications to coverage was the requirement that "[t]he loss must be a direct result of an unexpected, sudden or accidental occurrence entirely beyond your control to include[, among other things,] ... [i]mminent peril, defined as certain, immediate and impending danger of such probability and severity to persons or property that it would be unreasonable or unconscionable to ignore."

30 *Ibid.*

31 *Ibid.*

32 *Ibid.*

In July, 2019, the Ninth Circuit reversed the district court's interpretation of the relevant war-related exclusions.[33] Standing upon language in California Civil Code § 1644, insurance provisions are "understood in their ordinary and popular sense, rather than according to their strict legal meaning; unless used by the parties in a technical sense, or *unless a special meaning is given to them by usage, in which case the latter must be followed*."[34] The Ninth Circuit opined that failure to consider a term's meaning within "industry custom and practice" is reversible error under California law.[35] Universal's "unrebutted expert evidence demonstrating the customary usage of "war" and "warlike action by a military force" in the insurance context," was enough to supersede the ordinary, popular meanings of those terms at issue.[36] Specifically, "Universal's expert noted that 'if the policy does not contain a terrorism exclusion, there is a reasonable expectation that acts of terrorism by a known terrorist organization, regardless of however else they may be characterized, will be covered." [37]

The Ninth Circuit provided detailed analysis as to this customary usage of "war" and "warlike action by a military force."[38] It noted that *Pan Am. World Airways, Inc. v. Aetna Casualty & Surety Co.* and *Holiday Inns Inc .v. Aetna Ins. Co.* explicitly "refused to treat violent actions by Palestinian terrorist organizations targeting civilians as falling within the 'war' exclusion," and "rejected the argument that a 'common meaning' of war applies in the insurance context . . . ."[39] Quoting the Second Circuit in *Pan Am.*, "war is a course of hostility engaged in by entities that have *at least significant attributes of sovereignty*."[40] Thus the Ninth Circuit framed the

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33 *Universal Cable Productions LLC v Atl. Specialty Ins. Co.*, 929 F.3d 1143, 1153 (9th Cir. 2019) rev'g in part, 278 F. Supp. 3d 1165 (C.D. Cal. 2017).

34 *Ibid.* (emphasis in the original).

35 *Id.* (citation omitted).

36 *Id.* at 1154. Unrebutted indeed, as Atlantic did "not explicitly dispute that 'war' has a special meaning in the insurance industry requiring hostilities between de jure and de facto governments," but rather "focuse[d] on whether California law requires this special meaning." *Id.* at 1156.

37 *Id.* The Ninth Circuit explicitly rebuffs the district court's failure to consider this testimony. *Id.* at 1155.

38 *Id.* at 1154-61.

39 *Id.* at 1154 (citing *Pan Am. World Airways v. Aetna Cas. & Surety Co.*, 505 F.2d 989, 1012 (2d Cir. 1974); *Holiday Inns Inc. v Aetna Ins. Co.,* 571 F. Supp. 1460 (S.D.N.Y. 1983)).

40 *Id.* at 1155 (quoting *Pan Am.*, 505 F.2d at 1012 (emphasis added)). The Ninth Circuit also notes that George James Couch's leading insurance treatise recognizes that "'war' is defined as the employment of force between governments or entities essentially like governments, at least de facto," because "[w]ar is often viewed as the method by which a nation prosecutes its right by force." *Id.* (quoting 10A COUCH ON INSURANCE § 152:3 (3d ed.

appropriate question as "whether Hamas was acting as a de jure or de facto sovereign at the time of the 2014 hostilities."[41]

In answering that question, the Ninth Circuit focused on discussions within the *Pan Am.* and *Holiday Inns.* decisions, as well as further authorities outside of caselaw and precedent. Framing the discussion, the court noted that "[t]he United States, the European Union, Canada, Australia, and multiple other countries do not recognize Hamas as a legitimate authority in either Palestine or Gaza"; that "Hamas does not engage in formal relations on behalf of Palestine (or even Gaza);" "[t]he record does not indicate that Hamas controls Palestine's borders, airspace, or immigration," which is of particular importance when considering "Hamas' recognition of the Palestinian Authority's control over all governing functions."[42]

According to the Second Circuit in *Pan Am.*, "a terrorist group was not a de facto government because it was not acting on behalf of the recognized government."[43] The Southern District of New York articulated in *Holiday Inns* that status as a de facto government is not established merely by "occupy[ing] territory within the boundary of the sovereign state upon the consent of that state's de jure government," but such occupation must accompanied by "declarations of independence and sovereignty."[44] These authorities run in direct contravention to the facts confronted by the Ninth Circuit, where "the Palestinian Authority [was] the de jure government, and Hamas [] recognized the Palestinian Authority as the controlling government of Palestine."[45] Additionally, it was undisputed that

> Gaza is part of Palestine and not its own sovereign state. At most, Hamas exerted control over Gaza. Hamas never exercised actual control over all of Palestine and has agreed – at least in principle – not to disturb the Palestinian Authority, the de jure government of Palestine. Hamas has not declared itself independent from

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2017)). Another leading treatise provides that insurers seeking to invoke "sovereign act" and "war" exclusions "face[] steep factual, legal and political hurdles" due to caselaw such as *Pan Am.* and *Holiday Inns*. *Id.* (quoting 32-191 APPLEMAN ON INSURANCE LAW & PRACTICE ARCHIVE § 191.02 (2d ed. 2011)).

41 *Id.* at 1157.

42 *Ibid.* at 1157.

43 *Ibid.* (citing *Pan Am.*, 505 F.2d at 1012).

44 *Ibid.* (quoting *Holiday Inns*, 571 F. Supp. at 1158).

45 *Ibid.*

> Palestine. . . . [And that] Hamas agreed in June 2014 to cede any governing function it may have had to the Palestinian Authority.[46]

Thus, the Ninth Circuit concluded that Hamas was neither a de facto nor a de jure sovereign during the July 2014 conflict.[47]

With regard to the district court's application of the "warlike action by a military force" exclusion, the Ninth Circuit equated much the same analysis above. Relying upon the Second Circuit in *Pan Am.*, the Ninth Circuit distinguished "warlike operations" and "terrorist activity" by noting that

> [t]here is no warrant in the general understanding of English, in history, or in precedent for reading the phrase 'warlike operations' to encompass (1) the infliction of intentional violence by political groups (neither employed by nor representing governments) (2) upon civilian citizens of non-belligerent powers and their property (3) at places far removed from the locale or the subject of any warfare. ... This conclusion is merely reinforced when the evident and avowed purpose of the destructive action is not coercion or conquest in any sense, but the striking of spectacular blows for propaganda effects.[48]

Simply put, considering this and other authorities, the Ninth Circuit was unwilling to label the conduct at issue as anything but terrorist activity.[49]

Regarding causation, the Ninth Circuit ruled that the district court did not consider what the predominant cause of Universal's decision to relocate actually was, and Atlantic

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[46] *Ibid.* at 1158. Also, the Congressional Research Service had concluded in 2010 that "Hamas has a vested interest in separating its military and political factions." *Id.* (citing Jim Zanotti, Cong. Research Serv., *R41514, Hamas: Background and Issues for Congress*, at 18 (2010)).

[47] *Ibid.* The Ninth Circuit found additional support "by the executive branch's refusal to recognize Hamas as a de jure or de facto sovereign at the material time," since such a determination "is not a judicial, but is a political question, the determination of which by the legislative and executive departments of any government conclusively binds the judges." *Id.* at 1158-59 (quoting *Oetjen v. Cent. Leather Co.*, 246 U.S. 297, 302 (1918)). And the Secretary of State has designated Hamas a Foreign Terrorist Organization under 8 U.S.C. § 1189(a)(1) since 1997. *Id.* at 1159.

[48] *Ibid.* at 1160. Again citing Couch, "warlike operations" are normally considered "part of an armed conflict between combatants and usually do not include intentional violence against civilians by political groups," and ""the standard war exclusion does not explicitly extend to acts of terrorism," as "[t]errorists do not typically fit [the] profile" of "combatants" who "operate lawfully in accordance with the laws and customs of war." *Id.* at 1160 (quoting 10A COUCH ON INSURANCE §§ 152:3–4, 152:18 (3d ed. 2017)).

[49] *Ibid.* at 1160-61. The Ninth Circuit noted that the specific facts at issue, including that "Hamas [was] firing rockets into Israeli civilian centers," and that "the weapons Hamas used were unguided missiles and were likely used to injure and kill civilians because of their indiscriminate nature," were best construed as acts of terror. *Ibid.* at 1160-61.

provided no evidence that Israeli retaliation was the predominant cause of Universal's losses. As a result, the district court erred in holding that because Israel indirectly contributed to Hamas' conduct, Israel's conduct as a sovereign nation triggered the war exclusion in the policy.

For all of these reasons, Universal received coverage for its extra expenses which totaled almost $7 million.

According to Celebrezze *et al*,[50] the insurance industry widely concluded that the war exclusion was inapplicable to the events of September 11th, 2001 based on public policy considerations and decisions like *Pan Am. World Airways, Inc. v. Aetna Casualty & Surety Co.* and *Holiday Inns Inc. v. Aetna Ins. Co.*[51] Many commentators believed these cases demonstrated the difficulty that insurers would face in proving a causal link between terrorist activity and the elements of the exclusion.[52] Likely out of fear of backlash and other public policy considerations, there are no reported cases in which an insurer asserted the war exclusion to preclude coverage under its policies for any losses connected with the terrorist attacks of September 11th.[53]

However, not long after the attacks of September 11 insurers started including terrorism exclusions in some of their policies. Due to this increase in terrorism exclusions, Congress enacted a series of public acts designed to encourage the insurance market to cover events of terrorism.[54] The Federal Terrorism Risk Insurance Program essentially acts as a backstop for insurers.[55] The Terrorism Risk Insurance Act (TRIA) (H.R. 3210, Pub.L. 107–297) is a United States federal law signed in to law by President George W. Bush on November 26, 2002. The

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50 *Supra*. n. 2

51 *Pan Am.*, 505 F.2d 989; *Holiday Inns,* 571 F. Supp. 1460. We note that these are the cases that the Ninth Circuit in *Universal Cable* relied upon for the proposition that terrorist organizations do not fall within the "war" exclusion, as such organizations fail to qualify as sovereign or quasi-sovereign states. *See Universal Cable*, 929 F.3d at 1154-55.

52 Celebrezze et al, *supra*., n. 2.

53 *Ibid.at 22*

54 *Ibid. at 29*

55 *Ibid.*

Act created a federal "backstop" for insurance claims related to acts of terrorism. Celebrezze et al detailed the way the Program works, stating: [56]

> If there is a certified event of terrorism, the government will reimburse insurers after they pay a certain number of claims. The government will bear the costs of the Program, with some or all those costs being recouped later through premium taxes on property and casualty insurance.

The Program is silent as to cyberterrorism. However, according to Celebrezze et al, if a cyber event was certified as an act of terrorism under the Program, TRIA could provide coverage if the other terms of the policies were met.[57]

The ongoing litigation in *Mondelez International, Inc. v. Zurich American Insurance Co.* is interesting because Mondelez is asking the court to determine whether a claim for losses Mondelez suffered during the 2017 NotPetya attack is precluded by a "hostile or warlike action" exception in its Zurich all-risk property insurance policy. The NotPetya malware attack, which both the U.S. and British governments have blamed on Russian operatives, disabled infrastructure in Ukraine and compromised computer systems worldwide, according to Reuters. The virus infected two of Mondelez's servers in June 2017 and left about 1,700 servers and 24,000 laptops owned by the company "permanently dysfunctional," the complaint says.[58]

In *Mondelez*, Zurich denied coverage under a Property Insurance Policy issued to Mondelez (the "Zurich Policy"), which specifically provided coverage for "physical loss or damage to electronic data, programs, or software, including physical loss or damage caused by the malicious introduction of a machine code or instruction . . ." and "Actual Loss Sustained and EXTRA EXPENSE incurred by the Insured during the period of interruption directly resulting from the failure of the Insured's electronic data processing equipment or media to operate" resulting from malicious cyber damage.[59] Despite alleged public encouragement by Zurich to

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56 *Ibid.*

57 *Ibid.*

58 Embree, Dave *Insurer sued for denying coverage to snack food firm hit by malware attack*, Mondelez International v. Zurich American Insurance, 36 No. 11 Westlaw Journal Computer & Internet, Thomson Reuters, November 2, 2018

59 Mondelez Complaint, at ¶ 7-8, *Mondelez International, Inc. v. Zurich American Insurance Co.*, Case No. 2018L011008 (Cir. Ct. Ill. Oct 10, 2018) (*hereinafter* "Mondelez Complaint"). It was further alleged that Zurich "publicly and . . . in its non-public dealings with actual and prospective policyholders who were considering the

purchase additional coverage for malware attacks such as NotPetya, Zurich disclaimed coverage for the attack on the basis of the policy's "hostile or warlike action" and "terrorism"[60] exclusions.[61]

Those exclusions 3.B.2.a. and 3.B.2.f. cited by Zurich provide that "[t]his Policy excludes loss or damage directly or indirectly caused by or resulting from:

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a) hostile or warlike action in time of peace or war, including action in hindering, combating or defending against an actual, impending or expected attack by any:
   (i) government or sovereign power (de jure or de facto);
   (ii) military, naval or air force; or
   (iii) agent or authority of any party specified in i or ii above.

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f) terrorism, including action taken to prevent, defend against, respond to or retaliate against terrorism or suspected terrorism, except to the extent provided in the TERRORISM coverage of the Policy. However, if direct loss or damage by fire results from any of these acts (unless committed by or on behalf of the Insured), then this Policy covers only to the extent of the actual cash value of the resulting direct loss or damage by fire to property insured.

   This coverage exception for such resulting fire loss or damage does not apply to:
   (i) direct loss or damage by fire which results from any other applicable exclusion in the Policy, including the discharge, explosion or use of any nuclear device, weapon or material employing or involving nuclear fission, fusion or radioactive force, whether in time of peace or war and regardless of who commits the act.
   (ii) any coverage provided in the TIME ELEMENT section of this Policy or to any other coverages provided in this Policy.

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purchase or renewal of insurance coverage from Zurich, portrayed that NotPetya malware as a form of "ransomware" that merited the continued (if not increased) purchase of insurance coverage from Zurich." *Id.* at ¶ 12. Continuing, and in support of this allegation, Mondelez cites a statement given by Zurich's Group Chief Risk Officer on March 5, 2018, that

> Cybersecurity risks are also growing, both in their prevalence and in their disruptive potential. Attacks against business have almost doubled in five years, and incidents that would once have been considered extraordinary are becoming more and more commonplace. The financial impact of cybersecurity breaches is rising, and some of the largest costs in 2017 related to ransomware attacks, which accounted for 64% of all malicious emails. Notable examples included the WannaCry attack—which affected 300,000 computers across 150 countries—*and NotPetya, which caused quarterly losses of USD 300 million for a number of affected businesses.*

Ibid. at ¶ 12 (emphasis added).

[60] We note that Zurich "formally rescinded" its initial disclaimer only to "reassert" such disclaimer three months later, and at least with respect to Zurich's disclaimer on the basis of the "terrorism" exclusion, which was omitted from its initial disclaimer, there appear to be legitimate timeliness concerns. *Id.* at ¶ 22; *see also* Zurich Answer, at pp. 7-8, *Mondelez International, Inc. v. Zurich American Insurance Co.*, Case No. 2018L011008 (Cir. Ct. Ill. Oct 10, 2018) (*hereinafter* "Zurich Answer").

[61] Mondelez Complaint, at ¶ 13, 22.

> Any act which satisfies the definition of terrorism shall not be considered to be vandalism, malicious mischief, riot, civil commotion, or any other risk of physical loss or damage covered elsewhere in this Policy.
>
> If any act which satisfies the definition of terrorism also comes within the terms of item B2a of this EXCLUSIONS clause then item B2a applies in place of this item B2f exclusion.[62]

Interestingly, the language in exclusion 3.B.2.f the Zurich Policy appears to account for any apparent overlap between "hostile or warlike action" and acts of "terrorism" as it was discussed in *Universal Cable*, and the policy at issue in that case did not include a terrorism exclusion.[63]

This case will show if the courts take government attribution at face value as a basis for excluding damages from policy coverage since both the U.S. and British governments have blamed the attack on Russian operatives. However, some do not think the analysis will even make it this far. Brian Corcoran stated, "others have simply argued that NotPetya was not a "warlike" action for civil purposes, irrespective of the U.S. government's public statements, and that it might better fit the definition of what President Obama once called 'cyber vandalism.'"[64] If Mondelez wins this case, private industry may very well see "a new market in cyberattack insurance overnight."[65]

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62 *See* Zurich Answer, at 7-8.

63 Compare *Ibid.* ("If any act which satisfies the definition of terrorism also comes within the terms of item B2a of this EXCLUSIONS clause then item B2a applies in place of this item B2f exclusion."), with *Universal Cable,* 929 F.3d at 1160. Additionally, the Zurich Policy explicitly provided coverage for "physical loss or damage to electronic data, programs, or software, including physical loss or damage caused by the malicious introduction of a machine code or instruction . . ." and "Actual Loss Sustained and EXTRA EXPENSE incurred by the Insured during the period of interruption directly resulting from the failure of the Insured's electronic data processing equipment or media to operate" resulting from malicious cyber damage. Mondelez Complaint at ¶¶ 4-5. Considering that type of property damage was included, whose to say that Russian operatives did not cause such damage in a "hostile" manner as a sovereign power during a time of peace? *See also*, Michael Aylward, U.S. Courts Set Their Sights on the War Exclusion, ACCC (2019) (discussing potential usage of *Universal Cable* in cases like *Mondelez* involving potential "hostile acts" in the form of cyber-atacks) *available at*: https://coverage.memberclicks.net/assets/CommitteePagesSelectedPapers/ArticleOfMonth/ACCC_USCourtsSetTheirSightsOnTheWarExclusion_Aylward_2019-09.pdf

64 Corcoran, Brian *What Mondelez v. Zurich May Reveal About Cyber Insurance in the Age of Digital Conflict* (2019), https://www.lawfareblog.com/what-mondelez-v-zurich-may-reveal-about-cyber-insurance-age-digital-conflict (last visited May 30, 2019).

65 *Ibid.*

In his article entitled "War Risk Exclusions Threaten Cyber Coverage" April 1, 2019, published by *The Risk Management Society*, Joshua Gold raises interesting issues regarding war exclusions in the cyber insurance world:

> While the Mondelez case is being fought in the context of a property insurance policy, many cyber policies do contain war exclusions. Risk managers and brokers must consider what clarity and assurances can be obtained in the marketplace to minimize the risk that insurance companies will attempt to deny coverage for cyber claims where a state actor is allegedly involved in a hack, virus or other form of cyberattack. Additionally, the Mondelez case illustrates that, when a serious cyber loss occurs, policyholders can argue for coverage under business insurance policies like their property and crime insurance policies. Policyholders will not solely focus on stand-alone cyber insurance products when they face losses or claims to the exclusion of other lines of potentially applicable coverage.

Similarly, cyber insurers are fine-tuning war exclusions to more clearly limit or exclude claims for cyber terrorism. While definitions of cyber terrorism differ, they generally include acts perpetrated electronically by any party to cause harm, intimidate the public, or for political, religious or ideological purposes. Of course, cyber underwriters, understanding the risks of cyber-attacks, may craft policies to provide first- and third-party coverages for precisely that risk.[66]

Courts generally interpret "war" to require state action. An attack officially authorized and executed by a state is arguably an act of "war". However, if the cyber-attack simply emanates from another state, is it an act of war, a terrorist act or a criminal act? Michael E. Slipsky and Saad Gul, in their article entitled "Cyber Attack of Act of (Cyber) War February 4, 2019, published in the *Insurance Journal*, described the dilemma this way:

> These difficulties are compounded by hackers' ability to disguise the actual attack origination point by hijacking innocent third-party machines. Attribution necessarily requires inferences and surmises because hard evidence is rare. For instance, while the media widely attributed the Sony hack to North Korea, evidence for the connection was tenuous at best. The evidentiary issues are exacerbated given that the motivation of the attackers is not always clear. Take a hypothetical attack, apparently originating from China. Is it the work of individual hackers or an intelligence unit? Is the intention to injure the United States as a nation or to gain a

[66] LaCroix, Kevin, *War Exclusions and Cyber Attacks*, The D&O Diary, February 21, 2019, https://www.dandodiary.com/2019/02/articles/cyber-liability/guest-post-war-exclusions-cyber-attacks/ (last visited June 6, 2019).

> commercial advantage for a company? Were they acting under state orders or freelancing to make extra money?

Fred Kaplan, in his article *Death, Taxes, and Cyber Attacks*, April 16, 2019, published by *Slate*, raised the most interesting issue of all:

> As more cyberattacks appear to be directed by national governments or their proxies, what would be the point of having cyber insurance if such attacks are excluded from coverage? This is the question that many clients will ask themselves if Zurich wins this case. In other words, a victory for Zurich could spawn a strategic defeat.

Consider these same difficulties for physical attacks. The September 11 attacks on the World Trade Center and other locations have been generally attributed to Al-Qaeda. The redacted declassified report of the Senate Select Committee on Intelligence suggested evidence of Saudi Arabian government involvement[67]. How much "involvement" is necessary before the traditional "war exclusion" is triggered?

Although determining whether an event constitutes a "war" or "terrorism" may instinctively seem like common sense, making a legal determination of these issues has proven difficult. Not only do these legal determinations carry with them large monetary implications, but also social and political implications as well. The competing interests of the insurance industry to be able to understand and estimate the risk and the need for the public to be protected, especially in the event of catastrophic loss, makes the war exclusion extremely problematic and there will more than likely be coverage issues that will be at the center of the country's attention in the future.

[67] https://archive.org/details/declasspart4_201904/page/n1