

NotPetya Triggers War Exclusion, Insurers Tell NJ Panel

By Josh Liberatore

Law360 (February 8, 2023, 7:29 PM EST) -- Property policies' war exclusions were designed to apply to any type of nation-state attack, including cyber events, insurers told a New Jersey appellate panel Wednesday in a battle over whether Merck has coverage for \$1.4 billion in losses stemming from the 2017 NotPetya cyberattack.

During oral arguments in a case of first impression over whether insurers, including Chubb and AIG units, may rely on a traditional wartime exclusion to deny Merck & Co.'s bid for cyberattack coverage, a three-judge panel for New Jersey's Appellate Division mostly sat back and let attorneys do the talking.

Judge Heidi W. Currier was the only judge to speak during the roughly hourlong session, and she mainly limited her questions to clarifying the sides' positions and understanding the history behind the exclusion in question.

The appeal turns on whether insurers can use a policy exclusion that applies to any "hostile or warlike action" to avoid covering damages Merck sustained in NotPetya, a 2017 cyberattack believed by most Western nations to have been carried out by the Russian government.

James E. Rocab III, an attorney at Steptoe & Johnson LLP who represents AIG, argued that the exclusion was tailor-made to apply to any act of war launched by a nation-state, including a cyberattack. NotPetya was a piece of malware launched by Russia to cripple the Ukrainian government and its core businesses, Rocab said, classifying Merck's losses from the attack as "collateral damage."

"This is precisely the kind of situation that 'hostile and warlike actions in a time of peace or war' was designed to address," Rocab said, referring to language from the exclusion.

Judge Currier asked Rocab whether the exclusion has ever "been previously used to exclude coverage for cyberattacks."

"Not to our knowledge," Rocab responded. "But also not to our knowledge has there been a situation such as NotPetya," which was "in the middle of the Russia-Ukraine conflict."

"Cyberattacks are clearly weapons of war nowadays," he said. "Cyber is a battlefield."

Mark W. Mosier, an attorney at Covington & Burling LLP who represents Merck, argued that the war

exclusion should only apply to traditional forms of warfare based on its plain language.

There's a key difference between the terms "war" and "cyberwar," he said, noting that the exclusion in Merck's policy only mentions the former.

"The dictionary definition today of war still talks about the deployment of armed force against an enemy," Mosier said. "The same dictionary defines cyberwar as a use of computers against an organization."

In August 2018, Merck dragged 15 insurers, including Chubb, AIG, Zurich and Liberty Mutual, and eight reinsurers, including Hannover Re, Munich Re and Generali, to court in Union County, New Jersey. The pharmaceutical company alleged that the carriers breached their "all-risk" property policies by refusing to cover its losses from NotPetya, a piece of malware that spread in June 2017 after being introduced via an update to accounting software. Many of the carriers have since been dismissed from the case.

According to the suit, the malware infection spread to 40,000 Merck computers, caused more than \$1.4 billion in losses and hurt Merck's revenues.

In a ruling made public in January 2022, New Jersey Superior Court Judge Thomas J. Walsh granted Merck's motion for partial summary judgment, holding that the war exclusion didn't explicitly include the word "cyber" and therefore only barred coverage for acts of traditional, physical warfare.

Judge Walsh's ruling sent shockwaves throughout the insurance industry, with carrier-side attorneys and insurer groups warning of the potential marketplace ramifications of the court's holding. A reversal would also result in a spotlight on the increasingly controversial issue of how to attribute a cyberattack for insurance purposes, attorneys say.

On Wednesday, Laura Foggan, an attorney at Crowell & Moring LLP, spoke on behalf of the American Property Casualty Insurance Association, which filed an amicus brief in the case. Foggan echoed the concerns of the broader insurance industry, arguing that it's unreasonable for a court to expect carriers to list every action they don't intend to cover in a "categorical exclusion" like the one at issue in the Merck case.

"Refusing to enforce the plain terms of this exclusion would put into doubt the application of other categorical exclusions when we face a new or innovative fact scenario," Foggan said, referring to the newness of cyberattacks. "That uncertainty would threaten the insurance market."

However, Mosier argued that even if the exclusion could theoretically apply to acts of cyberwar in some circumstances, the NotPetya attack doesn't meet that bar.

"Even if you could have a cyberattack amount to an act of war, putting malware in an accounting software and interrupting a business's operations is not that," he said.

Potentially tipping her hand at which way she's leaning, Judge Currier seemed to lend some approval to Mosier's contention that NotPetya shouldn't trigger the exclusion since over 80% of Merck's losses from the attack happened in the U.S., not in Ukraine.

"How was it then a warlike action if so much of the damage occurred in the U.S.?" she said.

Judges Heidi W. Currier, Jessica R. Mayer and Catherine I. Enright sat on the appellate panel.

Merck is represented by Craig A. Domalewski and Russell L. Hewit of Dughi Hewit & Domalewski PC and William P. Skinner, Anna P. Engh, Mark W. Mosier, Mark D. Herman, Timothy D. Greszler and Alexis N. Dyschkant of Covington & Burling LLP.

The insurers are represented by attorneys with Finazzo Cossolini O'Leary Meola & Hager LLC; Crowell & Moring LLP; Mound Cotton Wollan & Greengrass LLP; DLA Piper; Zelle LLP; Steptoe & Johnson LLP; and Mendes & Mount LLP.

The case is Merck & Co Inc. et al. v. Ace American Insurance Co. et al., case number A-001879-21-T02, in the Superior Court of New Jersey, Appellate Division.

--Additional reporting by Daniel Tay. Editing by Emma Brauer.