

## Merck's War Exclusion Appeal Win May Shift Policy Language

By Abraham Gross

Law360 (May 3, 2023, 7:17 PM EDT) -- Following a New Jersey appeals court's decision affirming that war exclusions in Merck's insurance policies did not bar coverage from a cyberattack, attorneys for policyholders and insurers stressed that the ruling could potentially lead to an important shift in policy language.



A New Jersey appellate ruling affirming that a war exclusion in Merck's all-risk policies only barred coverage for physical warfare because it did not expressly include the word "cyber" could potentially lead to changes in policy language, insurance attorneys said. (iStockPhoto/Rawf8)

In an **opinion issued Monday**, the panel affirmed a **trial court's ruling** that the "hostile/warlike action" exclusion in the \$1.75 billion all-risk policies issued to Merck is not applicable to the multinational pharmaceutical company's claims stemming from the 2017 NotPetya cyberattack. The trial court made its determination from the bench in December 2021, finding that the exclusion precludes only a physical act of warfare instead of a malware hack.

The appellate panel's analysis of the case of first impression turned on the plain language of the property policies at issue, as many **policyholders had hoped**. The panel said that based on the policy's clear meaning, the exclusion for "damages caused by hostile or warlike action by a government or sovereign power in times of war or peace requires the involvement of military action."

"In considering the plain language of the exclusion, and the context and history of its application, we conclude the insurers did not demonstrate the exclusion applied under the circumstances of this case," the panel said.

The panel said that its ruling was based on the facts in the specific case, declining the request of insurers to specify what types of cyberattacks might fall under the hostile/warlike exclusion.

**Still, the panel's process of weighing the plain language of the policy, analysis of the war exclusion's historical application, and extensive briefing on the exclusion offered policyholders beyond New Jersey an important precedent, Roberta Anderson Sutton of Potomac Law Group, who represents policyholders, told Law360.**

**"The overarching takeaway here is that well-established fundamental tenets of insurance contract interpretation and construction have ruled the day," she said. "The insurer clearly bears the burden of establishing an exclusion applies."**

She added that **the premium increases**, reduced insurance capacity limits and other coverage limitations driven by proliferating malware attacks "has generally made the cyber insurance market a bloodbath for over two years. ... I think we're kind of at an inflection point here, where we're moving out of that and into better times again."

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, alleging that the carriers breached insurance contracts by refusing to cover losses from the June 2017 malware attack.

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. Merck and its insurers disputed whether the cyberattack could be attributed to a foreign government and thereby subject to the war exclusion.

The insurance companies argued that the malware hack was initiated by an instrument of the Russian government against Ukraine, while Merck had said the attack was not an act of war from a nation-state but a mere form of ransomware covered by the policy.

The decision by State Superior Court Judge Thomas J. Walsh, the first of its kind, held that the war exclusion at issue only barred traditional and physical warfare because it did not explicitly include the word "cyber." Judge Walsh's holding did not address the attribution of the cyberattack to a nation-state, another condition that must be proven for the exclusion to apply.

The Merck decision might accelerate insurers' efforts to clarify cyberinsurance coverage, as reflected by an **August 2022 bulletin** by Lloyd's of London directing its syndicates to include exclusions in all stand-alone cyber policies for state-backed cyberattacks that "significantly impair" a target nation's infrastructure.

Scott Seaman of Hinshaw & Culbertson LLP, who represents insurers, told Law360 that it is understandable that insurers like those at Lloyd's want to exclude coverage for government-sponsored cyberattacks since the harm they can inflict can potentially reach into the trillions of dollars.

He pointed to a **June 2022 report** issued by the U.S. Government Accountability Office, which warned that cyberattacks on critical infrastructure may "affect entire systems and result in catastrophic financial loss" beyond what can be covered by private insurance or government backstops.

"There are some losses — like pandemics and terrorism — that are capable of producing losses beyond which insurers can adequately calculate, control, or respond to without threat to their solvency," Seaman said in an email. "Large cyber events, particularly government-sponsored events, may fall into this category."

Practitioners following the case were closely watching whether the appeals court would find the exclusionary language ambiguous and then interpret the exclusion using the "reasonable expectation" of the insurer, a point raised by Merck's insurers on appeal. Instead, the appeals court ruled on the plain meaning of the exclusion without relying on the insurer's larger definition of a "hostile" action, said J. Andrew Moss, a partner with Reed Smith LLP who represents policyholders. Reed Smith filed an amicus brief supporting Merck on behalf of insurance consumer nonprofit United Policyholders.

It was crucial that the court relied on a plain language reading for an all-risk policy, as such policies are intended to cover a broad scope of risks and are widely used by more and less sophisticated clients alike, Moss said.

"It's important to recognize that the war exclusion, to the extent that businesses have similar coverage and face similar issues, is going to be construed narrowly under traditional contract interpretation roles and also construed in accordance with decades of precedent we have in applying the war exclusion," Moss told Law360.

"It's got to be faithful to the general principles of insurance policy construction, and just because the parties disagree on what the workable definition ought to be, doesn't make the term ambiguous," he said.

Walter Andrews, a partner at Hunton Andrews Kurth who represents policyholders, said that the panel's decision was a recognition that the application of war exclusions to cyberattacks failed to reflect the difficulties of applying old policy language to emergent risks, which would render the exclusion functionally dead.

Both the trial court and the appeals panel decisions highlighted the increasingly controversial issue of **how to attribute a cyberattack** for insurance purposes.

"The only way you can make it apply is to make it even broader, if war-like activity includes any kind of cyberattack without regard to whether we know who did it or why they did it," Andrews told Law360. "But then you don't have cyber coverage."

He added that some carriers, recognizing the difficulty of determining the identity of attackers and their motives, are already shifting away from categorical exclusions like a war exclusion altogether, instead mitigating risks through coverage limits and co-insurance.

The impact of the New Jersey panel's decision is likely to reverberate beyond the Garden State's borders in part because of the dearth of cases that have analyzed cyber-related policy language with as much depth, said Scott Godes, an attorney with Barnes & Thornburg LLP who represents policyholders.

"This is a well-reasoned decision that involves multiple amicus parties, and therefore any other court that will be looking at it, very likely, would see it as a persuasive interpretation and reasonable interpretation of the language," Godes told Law360.

Despite Merck's victory at the appellate level, experts cautioned that there was still a chance the case would be appealed to the New Jersey Supreme Court, given the coverage amounts involved and the broader policy language and interpretation issues at stake.

**Sutton said that the extent of legal proceedings that have taken place since the ransomware attack took place in 2017 underscored the importance of attention to proactive risk management, including by reviewing exclusions to cyber-related policies.**

**"It's so inexpensive, relatively, to find a good policy and negotiate it proactively," she said. "And then you're not paying lawyers and waiting for a decade to get your money when something happens, hopefully. You can certainly mitigate and minimize that risk."**

--Additional reporting by Emily Enfinger and Daniel Tay. Editing by Bruce Goldman.

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