23-1177-cv

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

ARIZONA BEVERAGES USA, LLC,

Plaintiff-Appellee,

v.

HANOVER INSURANCE COMPANY,

Defendant-Appellant.

On Appeal from the United States District Court
for the Eastern District of New York

BRIEF FOR PLAINTIFF-APPELLEE

Amanda Peterson
Johnathan C. Lerner
LERNER, ARNOLD & WINSTON, LLP
Attorneys for Plaintiff-Appellee
286 Fifth Avenue, 12th Floor
New York, New York 10001
212-686-4655

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, the undersigned counsel for Plaintiff-Appellee ARIZONA BEVERAGES USA LLC (a private non-governmental party) certifies that there is no parent corporation or publicly-held corporation that owns more than 10% of its stock.

Dated: New York, New York
February 28, 2024

Respectfully submitted,

LERNER, ARNOLD & WINSTON, LLP
Attorneys for Plaintiff

\s\

Johnathan C. Lerner, Esq.
Amanda Peterson, Esq.
286 5th Avenue, 12th Floor
New York, New York 10001
(212) 686-4655

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

Cases

Rules

Other Authorities

COUNTERSTATEMENT OF THE ISSUE PRESENTED

1. Whether the District Court correctly concluded that the damages suffered by Plaintiff-Appellee Arizona Beverages USA, LLC ("Plaintiff" or "Arizona") were incurred during the applicable restoration period such that Defendant-Appellant Hanover Insurance Company ("Defendant" or "Hanover") is obliged to pay for same in accordance with the terms of the policy of insurance issued by Hanover to Arizona.

2. Whether, notwithstanding Defendant' Hanover's failure to question the issue below, the absence of any genuine issue of material fact permits entry of summary judgment in favor of Plaintiff Arizona.

3. Whether, to the extent that this Court disagrees with the District Court's analysis, the District Court's grant of summary judgment may be upheld on any alternative basis.

4. Whether the District Court correctly denied Defendant's motion for summary judgment because the loss was incurred during the applicable restoration period.

STATEMENT OF THE CASE

This is an appeal from a judgment of the District Court for the Eastern District of New York which concluded that Defendant-Appellant Hanover Insurance Company ("Defendant" or "Hanover") failed to pay Plaintiff-Appellee Arizona

Beverages USA, LLC ("Plaintiff" or "Arizona") for its losses in accordance with the terms of a policy of insurance issued by the Hanover to Arizona.[1] For good and valuable consideration, receipt of which is not in dispute, Hanover issued to Arizona a policy of insurance (the "Policy") whereby Hanover agreed to insure Arizona against all risks of physical loss and damage, relevantly including any business income and extra expenses that Arizona might incur as a result of the breakdown of Arizona's equipment. *See* R. at JA-92 *et seq.*; R. at JA-212-13. The Policy explicitly covers the sudden inability of computer equipment to function due to an "electrical circuitry impairment," as a form of "direct physical loss to covered equipment." *See* R. at JA-211. Arizona also maintained a credit agreement from JP Morgan Chase to support the cashflow of its business, which agreement required that an independent auditor provide annual certification of the completeness and accuracy of Arizona's financial statements. *See* R. at JA-989. The credit agreement further provided in relevant part that if Arizona failed to submit its financial statements in a timely

[1] In light of the fact that Hanover has not raised any issues on appeal relating to the amount of damages, facts and argument related thereto generally have been omitted from this brief. It suffices to say that Arizona negotiated and obtained significant reductions of the total amount charged and has in fact made payments associated with its audit in the amount of $552,573.25, consisting of $450,000 paid directly to its auditor, $16,118.25 to obtain an extension of the deadline from JP Morgan Chase, and $86,455 in overtime work to accomplish the additional work needed to complete the audit under the revised procedures. *See* R. at JA-1348, R. at JA-1079; R. at JA-901-02; R. at SPA-16. Two separate forensic accountants on behalf of Defendant have verified the reasonableness of these charges. *See* R. at JA-1363.

manner, Arizona would be in default under the agreement and JP Morgan Chase would be entitled to recall the entirety of the amount loaned to Arizona. *See* R. at JA-884-87; R. at JA-990-93. To repay the loan in full, Arizona would have needed to liquidate the company, causing significant financial losses and indeed the destruction of Arizona's business. *See* R. at JA-966-67. Arizona's audit process typically began in September or October of the year to be audited, with the provision of preliminary information regarding the third quarter provided so that the auditors could assess their audit approach. *See* R. at JA-780-81; R. at JA-790-91; R. at JA-1022-23.

On October 29, 2017, while the policy was in full force and effect, Arizona suffered a power surge that damaged multiple disc drives in a Raid Array Disk IO adaptor, thereby resulting in the catastrophic failure of Arizona's account operating system (the "Loss"). *See* R. at JA-1142; R. at JA-1160; R. at JA-1174-75. Arizona immediately began to attempt to repair the hardware and restore back-up data to resume its regular operations. *See* R. at JA-1162-68. Just a few days later, on November 3, 2017, Arizona was contacted by Deloitte to begin its annual audit, which typically began in or around early November. *See* R. at JA-786-88. On November 5, 2017, Arizona provided notice of a potential loss to its insurance broker, which Hanover concedes it received within two weeks thereafter. *See* R. at JA-800-01; R. at JA-40. Arizona also contacted Deloitte to advise them of the Loss

and related data issues, both immediately understanding this would impact the means, methods and manner of conducting the audit. *See* R. at 798-800. In other words, it was known at that time that Arizona would incur necessary extra expenses to complete its annual audit, the only question being how much.

Approximately three weeks later, Arizona was able to restore its hardware, though it could not restore its necessary software, firmware, operating systems and data, such that the equipment was functionally useless. *See* R. at JA-1177-80; R. at JA-1193-94. Arizona first had functioning software and applications on or about January 8, 2018, but Arizona's data for the years 2016 and 2017 were never recovered. *See* R. at JA-1180; R. at JA-1183. In particular, following the Loss, Arizona no longer had any balances, inventory information, open orders, information on orders to be shipped, packed, or fulfilled, nor any information relating to outstanding credits and debts. *See* R. at JA-814.

Beginning on or about November 29, 2017, Deloitte and Arizona entered into discussions as to a work around for Deloitte to conduct its audit in accordance with accepted accounting principles, given that the data typically used to evaluate and test Arizona's financial statements for the third quarter were unavailable. *See* R. at JA-1022. Throughout December 2017, Arizona and Deloitte met regularly to discuss how Deloitte might evaluate the transactional-level detail needed to complete an audit. *See* R. at JA-1024-26. As a result of the Loss, the revised audit procedures

required Deloitte to conduct an additional 2,200 hours of work for the 2017 audit above the work typically undertaken, as well as requiring Arizona to seek an extension from JP Morgan and incur internal overtime fees to meet the extended deadline. *See* R. at JA-1067-68. For the avoidance of doubt, Deloitte was not involved in any efforts to restore any lost data, and Hanover knew and knows that Deloitte did not participate in any data restoration efforts. *See* R. at JA-1091; R. at JA-177 ("Q: But the extra expenses for the audit were not related to the Data Restoration sublimit, correct? A: I mean, yeah, ac- — according to what we [] According to what we can assume from his — yeah, his report or his JT 4, whatever that status report was."); R. at JA-1347-48. Arizona sought indemnification from its insurer, *inter alia*, for the extra costs incurred to avoid being forced to sell assets at below-market costs, reduce its assets, or potentially close its doors in order to obtain enough capital to satisfy the loan in the event that JP Morgan Chase called it for non-compliance with the audit requirements resulting from the Loss. *See id.*; *see* R. at JA-1222; R. at JA-686-90; R. at JA-704-05; R. at JA-772-74; JA-890-92; JA-970. Arizona separately sought recovery for data restoration with regard to data for which Arizona hired consultants and incurred internal overtime expenses to recreate. *See* R. at JA-686-90; R. at 1347-48. It was at all points understood that the data restoration was separate and distinct from the enhanced audit procedure extra expense portion of the claim. *See id.*; *see also* R. at JA-1091.

On or about October 12, 2018, Arizona's insurance broker emailed Nicholas Tenan, who had been assigned as the adjuster for the loss by the Hartford Steam Company, who reinsured the Equipment Breakdown coverage under the Policy, to inquire about the status of the claim. *See* R. at JA-1220. Arizona's insurance broker email stated, "Please advise. We were at the insured's yesterday, and both the owner and the CEO were questioning about the claim. The increased cost of the audit with Deloitte on the extra expense component of the claim is a hot button." Within minutes, Mr. Tenan wrote a responsive email stating that:

> The increased costs will be included in the loss of business income, thus afforded coverage under the business income coverage and extra expense coverage embedded in the Equipment Breakdown. You can let them know it will be included in the claim.

See R. at JA-1219; R. at JA-705-06, JA-709, JA-711. The loss was thereafter reassigned to Joseph Tamres, who had conversations with Arizona regarding the audit requirements and the fact that Arizona had to retain lawyers to obtain audit deadline extensions approved by JP Morgan Chase. *See* R. at JA-1255. Mr. Tamres also reported that neither the legal fees to get the audit extensions nor the additional audit expenses incurred by Arizona as a result of the loss constituted data restoration under the Policy. *See* R. at JA-1285; R. at JA-1289; R. at JA-1292-93. Mr. Tamres stated that his understanding of extra expense is that the policy language is summarized to prevent loss of income. *See* R. at JA-1286. Moreover, Mr. Tamres

expressly admitted at deposition in this matter that if the audit fees incurred as a result of the Loss prevented a loss of income, they would constitute an extra expense under the Policy. *See id.* On or about February 6, 2019, Mr. Tamres had a conversation with Hanover's insurance adjuster, Mr. Mark Cullen, wherein Mr. Cullen indicated that the audit extra expenses should be covered under the Policy. *See* R. at JA-1293-95; R. at JA-1299-1300; R. at JA-1363. Mr. Tamres testified that Mr. Cullen had seen all of the audit expenses at that time and that as a result of this conversation, he hired forensic accountants to validate the amount of Arizona's damages under the extra expense provisions. *See* R. at JA-1299-1300; R. at JA-1363.

Notwithstanding the foregoing, Defendant refused to indemnify Plaintiff for the audit extra expenses. This litigation followed. Following the close of the discovery, each party sought leave to and did move for summary judgment. At the time of the motion practice, Defendant's only contentions in favor of its own motion and in opposition to Plaintiff's motion related to the issue of whether the loss was incurred during the period of restoration, with a particular focus on whether an audit constituted "usual business operations," and whether doctrines of estoppel or waiver applied.

The District Court thereafter entered an order and subsequent judgment in favor the Plaintiff. Notably, despite the mischaracterization provided by Defendant

in its initial brief before this Court, the District Court's decision had nothing to do with the alternative restoration period when "business is resumed at a new permanent location," *See* Defendant's Brief at 5, but instead turned upon "1) whether Plaintiff's annual audit is part of its 'usual business operations,' and, if so, (2) whether the Audit Expenses were incurred during the 'restoration period.'" *See* R. at SPA-5. The District Court first concluded that an annual audit, as part of the servicing of corporate debt, constituted a part of Plaintiff's "usual business operations," and that Defendant had the obligation in the first instance to include express language in the policy limiting Plaintiff's usual business operations to exclusively the sale of its products if that were truly the meaning intended by the Defendant. *See* R. at SPA-8-9. The District Court further concluded that Deloitte's enhanced audit procedures constituted a reasonable form of "repairing, replacing, or rebuilding," the relevant information such that the period of restoration did not conclude until the work was done. *See* R. at SPA-10-11. The District Court thus answered both questions in the affirmative and therefore entered judgment in Plaintiff's favor.

STANDARDS OF REVIEW AND APPLICABLE LAW

The Second Circuit will review a grant of summary judgment *de novo*, "with the view that summary judgment is appropriate when there is no genuine dispute as to any material fact and the moving party is 'entitled to judgment as a matter of law." *See Bartels v. Schwarz*, 643 F. App'x 54 (2d Cir. 2016). "Bald assertions or

conjecture unsupported by evidence are insufficient to overcome a motion for summary judgment." *Zdziebloski v. Town of E. Greenbush*, 336 F. Supp. 2d 194, 201 (N.D.N.Y. 2004) *citing Carey v. Crescenzi*, 923 F.2d 18, 21 (2nd Cir. 1991). "A party seeking to overturn the decision of a trial court may not ordinarily obtain review of an issue not raised below." *See Schmidt v. Polish People's Republic*, 742 F.2d 67, 70 (2d Cir. 1984). This Court may excuse procedural errors only to correct "manifest injustice." *See Provost v. City of Newburgh*, 262 F.3d 146, 162 (2nd Cir. 2001).

As a federal court in a diversity action, this Court is bound by the substantive laws of the state in which its district counterpart sits, specifically New York. *See, e.g.*, *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938). The policy at issue does not contain a choice of law provision, meaning that New York's center of gravity test determines the choice of law governing the contract. *See Auten v. Auten*, 124 N.E.2d 99 (1954); *Certain Underwriters of Lloyd's of London v. Foster Wheeler*, 36 A.D.3d 17, 22 (1st Dept. 2006). For insurance policies, the location of the principal insured risk typically determines the location that has the most significant relationship to the policy and whose law should therefore apply. *See Zurich Ins. Co. v. Shearson Lehman Hutton, Inc.*, 642 N.E.2d 1065, 1069 (1994). Here, the insured location was indisputably located in New York, such that New York law applies.

Under New York law, contracts "must be interpreted to give effect to the intent of the parties as expressed in the clear language of the contract." *Ment Bros. Iron Works Co., Inc. v. Interstate Fire & Casualty, Co.*, 702 F.3d 118, (2nd Cir. 2012), *quoting Mount Vernon Fire Ins. Co. v. Belize NY, Inc.*, 277 F.3d 232, 236 (2nd Cir. 2002) (internal citations omitted). "In determining a coverage dispute, [New York courts] look to the specific language used in the relevant policies, which must be interpreted according to common speech and consistent with the reasonable expectation of the average insured at the time of contracting, with any ambiguities construed against the insurer and in favor of the insured." *J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*, __ N.E.3d __, 2021 N.Y. Slip Op. 06528, 2021 WL 5492781 (Nov. 23, 2021) (internal quotations omitted). "[I]n order for the insurer to prevail, it must demonstrate not only that its interpretation is reasonable but that it is the only fair interpretation." *See City of New York v. Evanston ins. Co.*, 39 A.D.3d 153, (2nd Dept. 2007) *quoting Primavera v Rose & Kiernan*, 248 A.D.2d 842, 843, 670 N.Y.S.2d 223 (3rd Dept. 1998).

SUMMARY OF ARGUMENT

In this appeal, Hanover seeks to reverse the District Court's order awarding summary judgment to Arizona on the basis that, in Hanover's opinion, the District Court misinterpreted the policy of insurance issued by Hanover to Arizona, failed to follow binding precedent, and/or ignored a material question of fact requiring trial

by a jury. Hanover is in error for several reasons. Throughout its appellate brief, Hanover conflates the policy's requirement that damage be caused by an accident or electronic impairment to covered equipment with a requirement that the property damaged by the accident or electronic impairment should itself be covered equipment. The plain language of the policy contradicts this interpretation, providing coverage for damage to "property," rather than damage to "covered equipment." Moreover, even assuming that Hanover is correct about the date on which the period of restoration occurred, the extra expense loss would nevertheless be covered because the loss was incurred immediately upon the destruction of Arizona's property. From the moment that the property was destroyed, Arizona could not have avoided the extra expense, and the fact that the total thereof may not have been cognizable until after the audit was concluded does not alter this fact. Similarly, the purported contrary precedent cited by Hanover is inapposite to this dispute. Moreover, Hanover itself has admitted on multiple occasions, including in its most recent brief, that the policy covers the type of extra expense loss at issue. As to the issue of a question of material fact, Hanover appears to question only the meaning of terms of the Policy. Under binding precedent, unless Hanover has demonstrated that its own interpretation is the only reasonable interpretation of the Policy (which it has not), Arizona is entitled to judgment as a matter of law. Additionally, many of the issues identified by Hanover in this appeal were not raised

before the District Court, and are procedurally unavailable for consideration by this Court absent a showing of manifest injustice that Hanover has failed to make. Consequently, the judgment of the District Court should be affirmed in all aspects.

LEGAL ARGUMENT

POINT ONE

PLAINTIFF INCURRED ITS LOSS DURING THE APPLICABLE PERIOD OF RESTORATION

On this appeal, Hanover contends that the period of restoration concluded on January 8, 2018, the date that Arizona had obtained replacement hardware and software such that Arizona could sell its product. This, however, is not an accurate assessment of the policy, which defines the period of restoration as the "time it should reasonably take to resume your business to a similar level of service" and concluding on "the date the property should be rebuilt, repaired or replaced or the date business is resumed at a new permanent location." *See* R. at JA-160. As explained in greater detail hereinafter, Hanover's interpretation both requires a narrow interpretation of the meaning of "business" and "property" not justified by any text in the policy and incorrectly assumes that a loss does not occur until it is quantified. Consequently, Hanover's interpretation must be rejected, and the judgment of the District Court affirmed.

A. *Arizona's Property Covered Under The Extra Expense Provisions Includes Its Destroyed Data*

Even had Hanover not admitted coverage existed on multiple occasions, the plain language of the Policy at issue in this case confirms that the extra expense loss suffered by Arizona is covered under the Policy. The Policy states that the period of restoration means "[t]he time it should reasonably take to resume "your" "business" to a similar level of service starting from the date of a physical loss of or damage to property at a "covered location" that is caused by a covered peril and ending on the date: 1) the property should be rebuilt, repaired, or replaced; or 2) business is resumed at a new permanent location." *See* R. at JA-160. Hanover's conclusion that the restoration period concluded on January 8, 2018, relies upon several erroneous assumptions, most critically that Arizona was able to resume "its usual business operations" on the date on which it possessed a server with appropriate software because, according to Hanover, the server with appropriate software constituted adequate rebuilding, repair or replacement of the destroyed property.

In making this argument and recognizing that software constituted a critical component of the destroyed property, Hanover concedes that the information on the computer needed to be restored before the period of restoration could end. Hanover provides no explanation nor justification for its contention that this Court should distinguish between "software information" and "business information," both of

which are merely stored forms of data on a physical computer. Indeed, Hanover has engaged in a remarkable sleight of hand with this argument, improperly conflating the requirement that "direct physical loss or damage to property [be] caused by or resulting from an 'accident' or 'electronic circuitry impairment' to 'covered equipment'" with the time for the "property" in question to be replaced. Hanover asserts that the "property" in question is "covered equipment," but the Policy on its face makes no such statement – rather, it merely requires that physical damage occur to the property, as distinct from intangible forms of damage.

To the extent that the insurer desired a different result, it was incumbent upon the insurer, as the drafter of the policy, to expressly state, for instance, that "direct physical loss or damage to covered equipment caused by or resulting from an 'accident' or 'electronic circuitry impairment' to 'covered equipment'" would be covered. Having failed to do so, the insurer cannot belatedly impose this limitation upon the insured. As discussed in greater detail *infra*, insofar as the policy may be considered ambiguous in this regard, New York law requires that this Court adopt the insured's broader interpretation thereof. *See J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*, __ N.E.3d __, 2021 N.Y. Slip Op. 06528, 2021 WL 5492781 (Nov. 23, 2021) (internal quotations omitted).

Here, there is no dispute that the data, once destroyed, could not be rebuilt, repaired, or replaced in a traditional sense. New York courts have looked to the

theoretical period in which a repair could be made when an outside or intervening factor precludes the actual timely repair of the insured's property. *See SR Int'l Bus. Ins. Co. v. World Trade Ctr. Props., LLC*, 2005 U.S. Dist. LEXIS 13001 (S.D.N.Y. Oct. 17, 2005). Due to the impossibility of traditional repair, a viable interpretation of the Policy under this theory would be that the restoration period does not have a concluding date at all so long as Plaintiff continues to be impacted by the Loss in any way, as the theoretical period in which a repair could be effectuated is infinite. A better interpretation may be that the limitation imposed by the restoration period clause is excused due to the impossibility of performance. *See Kel Kim Corp. v. Central Mkts.*, 70 N.Y.2d 900, 902 (1987) (observing that impossibility excuses a party's performance when the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible). Alternatively, the term "replace" means, *inter alia*, "to restore to a former place or position," or "to put something new in place of." *See* "Replace," Merriam-Webster Dictionary, *available at* https://www.merriam-webster.com/dictionary/replace. The District Court adopted this latter interpretation, concluding that the replacement period would be properly measured by the length of time it took for Deloitte to work around the missing data, effectively replacing it through the location and analysis of other data that could be used to test Plaintiff's financial statements. *See* R. at SPA 7-10.

It must also be noted that the work done by Deloitte to enable the audit, though enabling an audit in accordance with generally accepted accounting principles, did not in fact restore Arizona's lost data, which remains permanently lost. *See* R. at JA-1091. Rather, Plaintiff provided and Deloitte analyzed additional types and forms of data because the standard books and records that would ordinarily have been reviewed no longer existed. *See* R. at JA-1024-26; JA-1067-68. The work-around procedure and its attendant expenses were necessary to avoid the cessation of Plaintiff's business in the event its loan was called by virtue of its failure to comply with the audit requirements thereof – to avoid the ultimate and permanent loss of business income. *See id.*; *see also* R. at JA-966-67. The timing of Arizona's acquisition of a new system therefore is irrelevant to Hanover's obligations resulting from the destroyed data. Consequently, under the plain terms of the agreement between the parties, the Defendant should be obligated to compensate Plaintiff for its extra expenses.

B. *Arizona's Losses Were Incurred Prior to January 8, 2018*

Perhaps the most ironic aspect of Hanover's claim before this Court is that Hanover's obligation would not change even if its interpretation were to be adopted. Under New York law, where an extra expense loss is sustained during the period of restoration, the causal link is sufficient to require the insurer to pay for the relevant expense notwithstanding the fact that it is realized or accounted for thereafter. *See*

National Union Fire Ins. Co. of Pittsburgh, Pa. v. TransCanada Energy USA, Inc., 153 A.D.3d 1153 (1st Dept. 2017), *affirming* 28 N.Y.S.3d 800 (Sup. Ct. N.Y. Cty. Mar. 2, 2016); *see also Eurospark Indus. v Underwriters at Lloyds*, 567 F. Supp. 2d 345, 371 (E.D.N.Y. 2008). Indeed, other jurisdictions that considered the matter have likewise concluded that so long as the loss is incurred during the period of restoration, coverage for a loss exists even if the realization of the loss occurs after the conclusion of such restoration period. *See High Country Arts & Craft Guild v Hartford Fire Ins. Co.*, 126 F3d 629, 632 (4th Cir. 1997); *Gates v State Auto. Mut. Ins. Co.*, 196 S.W.3d 761, 767 (Tenn. Ct. App. 2005). This makes logical sense – where a policy of insurance provides coverage for extra expenses during the period of restoration, the time at which the insured receives the invoice for the work done has little bearing on when the insured first acquired an obligation to make a payment, for all that the precise details thereof may have been subject to adjustment.

The same general rule should apply to the Plaintiff's work-around audit, which became necessary when it was determined that certain data had been permanently lost. Consider by way of analogy the case of a factory that makes custom goods using a particular machine that contains a custom widget. If the custom widget is destroyed as the result of an insured peril, and the machine becomes unusable, obviously insurance covers the cost to repair or replace the widget, or if such repair is not possible, to replace the machine such that the insured can continue

to conduct its business. If the factory had, at the time of loss, an open order that required its particular machine to complete, such that a replacement machine could not result in the precise product even though the insured would be able to continue operating generally, there would be little dispute that the factory would be entitled to the costs needed to fulfill that order or to the costs to cover a refund to the customer whose order could not be fulfilled under the policy's business income and extra expense protections. This would be true regardless of the timing with regard to the insured's acquisition of a replacement machine, as the loss was incurred when it was determined that a new machine would need to be acquired and that the new machine would be incapable of the precise function of the original machine. So, too, should the costs in this case be covered in full. Arizona had a financial obligation to comply with the audit provisions of its loan from J.P. Morgan Chase that existed at the time that its data was lost. *See* R. at JA-884-87; R. at JA-990-93; R. at JA-966-67. From the moment it was determined that the data could not be recovered, Arizona had an obligation to comply with whatever revised audit procedures were necessary to make up for the fact that the data had been destroyed. *See id.* Consequently, even if Hanover is correct in insisting on its improperly limited definition of business and period of restoration, Arizona's losses nevertheless were incurred during this shortened time period.

Hanover asserts that this conclusion is contrary to controlling precedent, specifically *Bernstein Liebhard LLP v. Sentinel Ins. Co. Ltd.*, 162 A.D.3d 605,606, 78 N.Y.S.3d 339 (1st Dept. 2018), *lv denied* 32 N.Y.3d 916 (2019). Here, again, Hanover misses the mark. In *Bernstein*, the Court concluded that prospective contingency fees could not be recovered as "resulting 'actual loss' of business income" following a necessary suspension of business after a covered loss where the parties agreed that "earned" fees were fees to which the insured became entitled during the applicable twelve month period. As noted by the Colorado District Court, the fact that the parties agreed that only those fees to which the insured became entitled during the period would be considered "earned" as required by the policy in *Bernstein* provides a significant limitation on the applicability of this precedent. *See EP Resorts, Inc. v Travelers Prop. Cas. Co. of Am.*, 2023 US Dist LEXIS 12812, No. 21-cv-00281-PAB-STV (D.Colo. Jan. 25, 2023). Prospective fees could not be quantified, and in that way resemble Arizona's own damages prior to January 8, 2018 in this case. This, however, is where the similarities end. The *Bernstein* Court expressly observed that the insured there "would have theoretically been entitled to coverage for such fees for services performed within 12 months of the fire or from such cases resolved within 12 months of the fire," but that the insured could not claim same because it had not presented the claim on that basis. In the same way, the insured here is entitled to recover for the loss actually incurred prior to the date

on which its equipment functioned once more, notwithstanding the fact that it could not quantify same until after the period closed. Given that the allegedly controlling precedent identified by Hanover is inapposite, the District Court committed no error in failing to consider the case as binding.

Further, it must be noted while Hanover now contends *Bernstein* is crucial precedent that was "ignored" by the District Court, *see* Defendant's Br. at 22 *et seq.*, Hanover failed to cite this case in its opposition to Arizona's motion before the District Court, or in either of its briefs in support of its own motion for summary judgment before the District Court. As such, its argument on this point has not been preserved for appeal and may be dispensed with on that basis. *See Schmidt v. Polish People's Republic*, 742 F.2d 67, 70 (2d Cir. 1984). Consequently, the District Court's decision must be affirmed.

C. The Extra Expense and Income Coverages Provisions Apply to Arizona's Loss

On appeal, Hanover argues for the first time that the Extra Expense and Income Coverage provisions do not apply to Arizona's loss because the provisions both reference losses "resulting from an 'accident' or 'electronic circuitry impairment' to 'covered equipment.'" *See* Hanover's Br. At 19-20. As an initial matter, and as noted above, Hanover waived this argument in its entirety by failing to raise it before the District Court. *See Schmidt v. Polish People's Republic*, 742 F.2d 67, 70 (2d Cir. 1984). Hanover provides no justification for this failure nor any

assertion as to why this Court should consider the argument in the first instance. As such, the Court is free to ignore this argument in its entirety. Nor can we ignore that two (2) representatives of Defendant have admitted the existence of coverage for Arizona's incurred audit related expenses arising from the Loss.

Even had the argument not been waived, or the coverage not admitted, its substantive merits are dubious at best. As noted above, the insurer on appeal improperly conflates the policy's requirements that property damage be caused by an issue with covered equipment with a purported but nonexistent requirement that the property damaged be covered equipment. The Policy provides no support for this interpretation. It is also at odds with the insurer's admission that insured's software was a necessary portion of the property that needed to be repaired before the period of restoration terminated, as well as the multiple instances in which the insurer's agents have previously admitted that the loss at issue in this litigation is a covered loss under the Policy as discussed *infra* at Point 1.D.

D. *Hanover Has Admitted Coverage For Arizona's Extra Expense Loss*

Even if the policy were not clear on its face, which Arizona contends it is, Arizona would nevertheless be entitled to recover because Hanover repeatedly has admitted that the loss for which Arizona seeks recovery in this litigation is a covered loss under the policy. "In a civil action the admissions by a party of any fact material to the issue are always competent evidence against him, wherever, whenever or to

whomsoever made." *Reed v. McCord*, 160 N.Y. 330, 341, 54 N.E. 737 (1899); *see also*, *e.g.*, *Yassin v. Blackman*, 188 A.D.3d 62, 67 (2nd Dept. 2020); Fed. R. Ev. Rule 801 (excluding party admissions from the definition of hearsay). An opposing party's statement is not hearsay if it is offered against the opposing party and was made by a person whom the party authorized to make a statement on the subject and/or was made by the party's agent or employee on a matter within the scope of their employment. Fed. R. Ev. Rule 801(d)(2)(C)-(D). During the adjustment of Arizona's claim, the first authorized representative to handle the claim on behalf of Hanover, Nicholas Tenan, while acting in the course of his employment as an adjuster for Hanover, replied to an email from Plaintiff's insurance broker regarding coverage for the extra expenses of the Deloitte audit by stating in no uncertain terms that the "increased costs will be included in the loss of business income, thus afforded coverage under the business income coverage and extra expense coverage embedded in the Equipment Breakdown." *See* R. at JA-1219; R. at JA-705-06, JA-709, JA-711. Mr. Tenan does not dispute that he wrote those words in response to the insured's question about whether the audit costs were covered and that the reasonable interpretation thereof is that the loss was covered. *See id.* At deposition in this matter, Mr. Tenan attempted to rationalize away these admissions as a result of "duress" that he purportedly placed upon himself; however, such post-hoc rationalizations do not provide sufficient justification for the Defendant to avoid

summary judgment. *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249-50, 106 S. Ct. 2505 (1986) ("If evidence is merely colorable or is not sufficiently probative, summary judgment may be granted."); R. at JA-707-08 ("Yes, those are my words under my self-duress in trying to update a client by way of Mr. Eisenberg as well as obviously his insured.").

Moreover, his statement is also consistent with the Defendant's conduct. Defendant did not initially deny Plaintiff's request for payment of extra expenses, but rather hired a forensic accountant to evaluate the reasonableness of the invoices charged by Deloitte in connection with the audit – an analysis that would be completely unnecessary if, in the Defendant's honest opinion, no portion of the extra expense should have been paid. *See* R. at JA-1299-1300; R. at JA-1363. Both the Defendant's statements and its behavior make clear that the loss is covered under the policy such that the Defendant had no legitimate basis on which to deny Plaintiff's claim. Mr. Tamres, a subsequent adjuster, admitted at deposition in this matter that if the audit fees incurred as a result of the Loss prevented a loss of income – which they did – then they would constitute an extra expense under the Policy. *See* R. at JA-1286. Similarly, Mr. Mark Cullen, Defendant's employee, also admitted that the audit extra expenses should be covered under the Policy. *See* R. at JA-1293-95; R. at JA-1299-1300; R. at JA-1363. Defendant's claim notes thus contain multiple admissions that the loss is in fact covered by the Policy,

demonstrating the pre-textual nature of Defendant's efforts to deny coverage for extra expense. *See id.* As such, Plaintiff is entitled to judgment as a matter of law on the issue of liability and the judgment of the District Court should be affirmed.

POINT TWO

NO QUESTION OF MATERIAL FACT PRECLUDES A GRANT OF SUMMARY JUDGMENT IN ARIZONA'S FAVOR

On appeal, Hanover contends for the first time that there is a question of material fact that precludes the entry of summary judgment in Arizona's favor. As noted *supra*, the Court need not consider this argument raised for the first time here because it was not properly preserved for appeal. Moreover, Hanover states that there is a question of material fact, indicating that the purported question relates to interpretation of the "restoration period." *See* Hanover's Br. at 29-31. However, none of the facts related to the Court's conclusion are in dispute. The parties agree that Arizona replaced its equipment and had functioning software installed on January 8, 2018, and that the audit and its extended procedures continued into October 2018. The parties' dispute is thus limited to a question of legal interpretation – given the aforementioned facts, does the period of restoration as set forth in the policy include the date upon which Arizona realized the loss for which it seeks recovery in this litigation? For the reasons set forth above, the District Court correctly concluded that the period includes the time at which Arizona's business

income loss and extra expense needed to conduct alternative audit procedures accrued.

To the extent that the Court concludes that there is any ambiguity with regard to this term, Arizona is entitled to summary judgment. This is because under New York law, for Hanover to prevail, it must prove that its interpretation is the only fair interpretation of the policy. *See City of New York v. Evanston ins. Co.*, 39 A.D.3d 153, (2nd Dept. 2007) *quoting Primavera v Rose & Kiernan*, 248 A.D.2d 842, 843, 670 N.Y.S.2d 223 (3rd Dept. 1998). In other words, if reasonable minds could differ as to the interpretation of this provision, as Hanover now contends, then Arizona is entitled to summary judgment on that basis as a matter of law. As such, Arizona respectfully requests that the Court affirm the judgment of the District Court.

POINT THREE

HANOVER WAIVED THE ARGUMENTS ASSERTED HERE BY FAILING TO RAISE THEM BEFORE THE DISTRICT COURT

On appeal, Hanover appears to have abandoned most of the arguments that it asserted in the District Court, which consisted primarily of the contention that Arizona's annual audit was not part of its usual business operations and its losses related thereto therefore could not be covered under the Policy. This choice makes sense, as the District Court thoroughly explained at length that "usual business operations" does not refer only to the sale of Arizona's products but "refers to activities undertaken on a regular basis that are essential to the company's continued

existence," which would include Arizona's annual audit. *See* R. at SPA-7-10. Indeed, Hanover is arguably collaterally estopped from asserting these issues, which were fully and fairly decided against Hanover previously in a case identified by the District Court. *See Fishbowl Solutions, Inc. v. Hanover Ins. Co.*, 2022 WL 16699749 (D. Minn. Nov. 3, 2022); *see also New England Systems, Inc. v. Citizens Ins. Co. of America*, 2022 WL 17585966 (D. Conn. Dec. 12, 2022).

However, while Hanover had good cause to think that it would not obtain a different result on appeal of this issue, as noted *supra*, a "party seeking to overturn the decision of a trial court may not ordinarily obtain review of an issue not raised below." *See Schmidt v. Polish People's Republic*, 742 F.2d 67, 70 (2d Cir. 1984). This Court may excuse procedural errors only to correct "manifest injustice." *See Provost v. City of Newburgh*, 262 F.3d 146, 162 (2nd Cir. 2001). In other words, Hanover was not free to set before this Court a completely different argument than the argument that it made to the District Court. Nevertheless, with the exception of that portion of its argument related to Hanover's belief that the period of restoration ended when the insured's physical equipment was replaced, Hanover has done so. Moreover, Hanover has chosen to do so without any explanation or elaboration as to how "manifest injustice" will result should it be forced to pay for a loss that it has admitted on multiple occasions is covered under the policy of insurance that it issued to Hanover. In the absence of any such explanation or justification, and given the

flaws identified *supra* with regard to the only viable portion of argument raised below, Hanover's appeal should be denied.

CONCLUSION

Wherefore, Arizona respectfully requests that the Court affirm the District Court's grant of summary judgment awarding Arizona judgment against Hanover in all aspects, affirm the District Court's denial of summary judgment to Hanover in all aspects, and enter judgment against Defendant in the amount of $552,573.25, together with interest thereon, and for such other and further relief as the Court may deem just and proper.

Dated: New York, New York
February 28, 2024

Respectfully submitted,

LERNER, ARNOLD & WINSTON, LLP
Attorneys for Plaintiff

\s\

Johnathan C. Lerner, Esq.
Amanda Peterson, Esq.
286 5th Avenue, 12th Floor
New York, New York 10001
(212) 686-4655

CERTIFICATE OF COMPLIANCE WITH FRAP 32(A)

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 6,658 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word in Times New Roman, 14 point font.

Dated: New York, New York
February 28, 2024

Respectfully submitted,

LERNER, ARNOLD & WINSTON, LLP
Attorneys for Plaintiff

\s\

Johnathan C. Lerner, Esq.
Amanda Peterson, Esq.
286 5th Avenue, 12th Floor
New York, New York 10001
(212) 686-4655