23-1177

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 AND SPECIAL APPENDIX FOR DEFENDANT-APPELLANT

JEREMIAH L. O'LEARY, ESQ.
ROBERT M. WOLF, ESQ.
FINAZZO COSSOLINI O'LEARY MEOLA & HAGER, LLC
Attorneys for Defendant-Appellant
5 Penn Plaza, 23rd Floor
New York, New York 10001
(646) 378-2033

-and-

67 East Park Place, Suite 901
Morristown, New Jersey 07960
(973) 343-4960
jeremiah.oleary@finazzolaw.com
robert.wolf@finazzolaw.com

F.R.A.P. 26.1 DISCLOSURE STATEMENT

Defendant-Appellant The Hanover Insurance Company ("Hanover"), incorrectly sued as Hanover Insurance Company, by its undersigned counsel, certifies pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, in order to enable the Judges of the Court of Appeals to evaluate possible disqualification or recusal, that it is a wholly owned subsidiary of Opus Investment Management, Inc., which is a wholly owned subsidiary of The Hanover Insurance Group, Inc., a publicly traded company.

Dated: New York, New York
November 29, 2023

FINAZZO COSSOLINI O'LEARY MEOLA & HAGER, LLC

By: */s/ Robert M. Wolf*
JEREMIAH L. O'LEARY, ESQ.
ROBERT M. WOLF, ESQ.
5 Penn Plaza, 23rd Floor
New York, New York 10001
(646) 378-2033
- and -
67 East Park Place, Suite 901
Morristown, New Jersey 07960
(973) 343-4960
jeremiah.oleary@finazzolaw.com
robert.wolf@finazzolaw.com
Attorneys for Plaintiff-Appellant
The Hanover Insurance Company

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Basis for District Court's Subject Matter Jurisdiction

The district court had subject matter jurisdiction over this matter pursuant to 28 U.S.C. § 1332 because it is an action between citizens of different states and the amount in controversy exceeds the sum of $75,000, exclusive of interest and costs.

Plaintiff-Appellee Arizona Beverages USA LLC ("Arizona") is a limited liability company organized under New York law and has its principal place of business in New York. Consequently, Arizona is a citizen of New York. Hanover is a corporation organized under New Hampshire law with its principal place of business in Massachusetts. Hanover is a citizen of New Hampshire and Massachusetts for diversity purposes. There is complete diversity of citizenship between the parties, satisfying the diversity requirement of 28 U.S.C. § 1332.

Arizona sought damages against Hanover in the amount of $552,573.25, plus interest and costs. The amount in controversy exceeds $75,000, exclusive of interest and costs, satisfying the amount in controversy requirement of 28 U.S.C. § 1332.

Basis for Court of Appeals Jurisdiction

This Court has appellate jurisdiction pursuant to 28 U.S.C. § 1291 to review "all final decisions of the district courts." This appeal is from a final judgment and order of the United States District Court for the Eastern District of New York granting Arizona's motion for summary judgment against Hanover, denying

Hanover's motion for summary judgment against Arizona and directing the clerk to close the case. Therefore, this Court has appellate jurisdiction over this matter.

The Appeal is Timely

Hanover filed its Notice of Appeal pursuant to Fed. R. App. P. 4 within 30 days of entry of judgment. The Notice of Appeal was filed on August 16, 2023 and appealed from the district court's Memorandum and Order dated July 17, 2023, a Judgment entered by the clerk of the court on the same date closing the case and "any and all orders, including but not limited to orders entering a monetary judgment against Hanover, pertaining thereto." Therefore, this appeal is timely.

The Requirement of a Final Order or Judgment is Satisfied

The district court's Memorandum and Order, entered on July 17, 2023, resolved all issues in the case. The Judgment, also dated July 17, 2023, was entered pursuant to the district court's directive that the clerk enter Judgment and close the case. A later revised Judgment dated August 30, 2023 memorialized the quantum of the Judgment as reflected in the Memorandum and Order. This appeal is from a final order or judgment and, therefore, the 28 U.S.C. § 1291 requirement that there be a final order or judgment disposing of all claims of all parties is satisfied.

STATEMENT OF ISSUES PRESENTED

1. Was the court below correct in rewriting the Policy's terms to extend the "restoration period" beyond the date on which the damaged computer system –

the "covered equipment" – was replaced and Arizona's "usual business operations at a 'covered location'" were restored "to a similar level of service"?

2. Did the lower court commit reversible error in ignoring controlling precedent and relying on non-binding case law involving different policy language and coverage provisions to arrive at its summary judgment decision?

3. Did the district court impermissibly decide a genuine issue of material fact in concluding that the Deloitte independent audit "falls squarely" within Arizona's "usual business operations occurring at [Arizona's headquarters]" and parlaying that erroneous fact finding into a determination on summary judgment that the "restoration period" continued until the audit was completed?

4. Was the court below correct in denying Hanover's summary judgment motion given the incontrovertible fact that the damaged "covered equipment", Arizona's computer system, was replaced on January 8, 2018 and, therefore, all of the claimed "extra expense" was incurred outside the "restoration period"?

STATEMENT OF THE CASE

The Loss and Claim Adjustment

This is a first-party property insurance coverage action arising from the "electronic circuitry impairment" of a computer system that resulted in the loss of data on October 29, 2017 (the "Incident"). Hanover paid Arizona the $250,000 "Data Restoration" limit that was available under the Equipment Breakdown

Coverage Part within the commercial output insurance policy that Hanover issued to Arizona (the "Policy"). Hanover did not pay Arizona for claimed "Extra Expense" under the "Income Coverages", including enhanced outside audit fees, Arizona employee overtime and bank legal fees, which were incurred after the computer system, the "covered equipment" under the Equipment Breakdown Coverage Part, was replaced on January 8, 2018 and, therefore, outside the "restoration period" and not recoverable under the Policy.

Procedural History

Arizona brought this action by filing a Summons and Complaint styled *Arizona Beverages USA LLC v. Hanover Insurance Company*, in Supreme Court of the State of New York, County of Nassau, Index No. 614971/2019, on October 28, 2019. JA-22. The Complaint contained a single count alleging that Hanover breached the Policy by not paying Arizona's claimed "Extra Expense". *Id.* On March 25, 2020, Hanover filed a Notice of Removal with the Eastern District of New York removing all proceedings to that court on the basis of diversity of citizenship pursuant to 28 U.S.C. §1332. JA-11. The case was assigned Civil Action No. 20-1537. *Id.* Hanover filed its Answer and Affirmative Defenses on April 3, 2020. JA-32. After the conclusion of discovery and a pre-motion conference, the parties filed motions for summary judgment. JA-75 – JA-1437.

Disposition Below

On July 17, 2023, the Hon. Gary R. Brown, U.S.D.J., issued his Memorandum and Order, Slip Copy at 2023 WL 4564872, granting Arizona's motion and denying Hanover's motion for summary judgment. JA-1438 – JA-1451.

The district court found the pertinent terms of the Policy to be unambiguous. However, it chose to expand the definition of "restoration period" beyond the words used in the Equipment Breakdown Coverage Part and in doing so incorrectly granted Arizona summary judgment for the claimed "Extra Expense" allegedly incurred after its computer system was replaced and its "usual business operations at a 'covered location'" (the Policy definition of "business") resumed. The court also mistakenly denied Hanover's motion for summary judgment seeking, as the Policy required, to hold recoverable "Extra Expense" to expenses "necessarily incurred during the restoration period" to avoid or reduce the interruption of Arizona's "usual business operations at a 'covered location'".

The Policy provided that the "restoration period" would end when "the property should be rebuilt, repaired, or replaced" or when "business is resumed at a new permanent location." The court inexplicably employed the alternative "restoration period" end date, when "business is resumed at a new permanent location", as a license to expand the unambiguous Policy definition of "restoration period" to include coverage for "Extra Expense" incurred after Arizona had resumed

its "usual business operations" at its headquarters. To the court below, even though the property damage at issue, an "electronic circuitry impairment" to "covered equipment" (the computer system), had been remedied nine months earlier on January 8, 2018 when the replacement system was brought on-line, the "restoration period" extended for an additional more than nine months until Deloitte completed its audit on October 24, 2018.

In reaching this conclusion, the court overrode controlling New York precedent defining the period of restoration as when with due diligence and dispatch physically damaged covered property should be repaired, replaced or rebuilt. To the lower court, because some historical data was lost and could not be and will never be restored, rebuilt or replaced, the phrase "business is resumed at a new permanent location" in the "restoration period" definition allowed it to rewrite the Policy and extend the end of the "restoration period" to a third party's completion of an outside audit. And, while Deloitte could not engage in the business of data restoration as an auditor rendering an outside opinion on Arizona's financial statements, the district court found Deloitte's enhanced audit to be "creating a functional simulacrum of the lost data" and "a reasonable form of 'repairing, replacing, or rebuilding' the lost data" and concluded that the completion of the audit, not the date on which the computer system – the "covered equipment" – was replaced, should mark the end of the "restoration period".

The district court's analysis is inherently flawed because it conflates "data" with "covered equipment", which are separately defined terms in the Policy, and because it is the repair, replacement or rebuilding of "covered equipment", not "data", that delimits the end of the "restoration period" during which "Extra Expense" may be incurred. Arizona was paid the separate "Data Restoration" sublimit under the Policy and the costs of data restoration are not "Extra Expense". If "covered equipment" were "data", there would be no purpose in the Policy providing separate "Data Restoration" coverage through a Coverage Extension.

Detailed Recitation of Pertinent Facts

A. The Policy.

Hanover issued Policy No. RHY 9560593 05 to Arizona for the period May 31, 2017 to May 31, 2018. JA-93 – JA-232. The Policy includes a Commercial Output Program Property Coverage Part, a Commercial Output Program Income Coverage Part and an Equipment Breakdown Coverage Part (Including Electronic Circuitry Impairment) – Commercial Output Policy, which states that "[c]overage provided under this coverage part is also subject to the 'terms' and conditions in the Commercial Output Program – Property Coverage Part." JA-209. The Property Coverage Part states: "Refer to Definitions for words and phrases that have special meaning. These words and phrases are shown in quotation marks or bold type." JA-65.

The Definitions section defines "business" and "restoration period". With regard to "business", the Definitions state: "'Business' means the usual business operations occurring at 'covered locations'…." JA-65. As to the "restoration period", the Definitions state:

> 26."Restoration period" means:
>
> a. The 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.

JA-160.

The Equipment Breakdown Coverage Part adds two Additional Definitions. It separately defines the terms "covered equipment" and "data" as follows:

> **4.** The definition of "covered equipment" as described in the Commercial Output Program – Property Coverage Part is deleted and replaced by the following:
>
> **a.** "Covered equipment", unless otherwise specified in the "schedule", means covered property:
>
> **(1)** that generates, transmits or utilizes energy; or
>
> **(2)** which, during normal usage, operates under vacuum or pressure, other than the weight of its contents.
>
> "Covered equipment" may utilize conventional design and technology or new or newly commercialized design and technology.

* * *

5. "Data" means information or instructions stored in digital code capable of being processed by machinery.

JA-209 – JA-210.

Incorporating these Definitions and Additional Definitions, the Equipment Breakdown Coverage Part includes "**5. Income Coverages**" premised on the following statement: "**a. Coverage** – If a 'limit' is indicated on the 'schedule', 'we' provide the coverages described below during the 'restoration period' when 'your' 'business' is necessarily wholly or partially interrupted as a result of an 'accident' or 'electronic circuitry impairment' to 'covered equipment'." JA-212. It states under "**d. Extra Expense**":

> "We" cover only the extra expenses that are necessary during the "restoration period" that "you" would not have incurred if there had been no direct physical loss or damage to property caused by or resulting from an "accident" or "electronic circuitry impairment" to "covered equipment".
>
> "We" cover any extra expense to avoid or reduce the interruption of "business" and continue operating at a "covered location", replacement location, or a temporary location. This includes expenses to relocate and costs to outfit and operate a replacement or temporary location.
>
> "We" will also cover any extra expense to reduce the interruption of "business" if it is not possible for "you" to continue operating during the "restoration period".
>
> To the extent that they reduce a loss otherwise payable under this Coverage Part, "we" will cover any extra expenses to:
>
> **(1)** repair, replace, or restore any property; and

(2) research, replace, or restore information on damaged "valuable papers".

JA-213.

Separate from the coverages provided for direct physical loss or damage caused by or resulting from an "electronic circuitry impairment" to "covered equipment" and "Extra Expense" necessarily incurred during the "restoration period" to avoid or reduce the interruption of business associated with such physical loss or damage, the Equipment Breakdown Coverage Part includes a Coverage Extension, limited to $250,000, for the cost of "Data Restoration", the "reasonable and necessary costs to research, replace and restore lost 'data'". JA-211 – JA-212; JA-119. Unlike the "Extra Expense" coverage, the "Data Restoration" coverage is not tied to the "restoration period". Hanover paid Arizona the "Data Restoration" limit and only "Extra Expense", not the costs of "Data Restoration", is at issue in this litigation.

B. Arizona's Witnesses' Testimony About the Loss.

According to the testimony of Arizona's witnesses, its "usual 'business' operations occurring at 'covered locations'" – producing, selling and delivering beverage products to customers – resumed within a matter of days or weeks after the October 29, 2017 "electronic circuitry impairment" of the "covered equipment", Arizona's legacy "JBA" information management system. Disc drives were restored

within days, Arizona's ordinary accounting functions resumed within weeks and its systems were fully able to handle its business functions in a manner similar to as existed prior to the Incident no later than the "go live" date of its new, replacement "SAP" computer system on January 8, 2018.

a. Joseph DeBella

Arizona's Chief Information Officer, Joseph DeBella, testified that "JBA" was a computer system that had been used for many years in connection with Arizona's business operations. JA-328 – JA-329. At the time of the Incident, Arizona was preparing to convert from "JBA" to a new system called "SAP", with a "go-live" target date of January 8, 2018. JA-330 – JA-331. DeBella testified that as the result of Arizona's efforts after the Incident, "JBA" was running on November 2, 2017, but could not take orders and ship until November 6 or 7, 2017. JA-333. He further stated that invoicing was functional within another week or two and cash application took about three weeks to be brought back online in the November-December time frame. JA-333 – JA-334. Arizona's systems were fully able to handle its business functions in a manner similar to as existed prior to the Incident on January 8, 2018 when the "SAP" computer system went "live". JA-332.

b. Patricia Catalina

Arizona's Executive Vice President for Finance, Patricia Catalina ("Catalina"), testified that she oversees the financial reporting for Arizona and

related entities, manages a team that handles the companies' accounting, accounts receivable and accounts payable functions, and assists with some of the operational activities of the sales and production planning departments. JA-235 – JA-236. In 2017, the "JBA" computer system housed some of Arizona's financial and other business information and maintained its general ledger. JA-237. The system was being phase out. As of October 29, 2017, the date of the Incident, "JBA" was being transitioned to a new "SAP" platform with a "go-live" date of January 8, 2018. JA-238 – JA-239. The change-over to the new computer system occurred on January 8, 2018. *Id.*

Catalina testified that Arizona's auditors, Deloitte & Touche LLP ("Deloitte"), originally issued an engagement letter which estimated the cost of the fiscal year 2017 audit in the amount of $265,000. JA-252 – JA-255; *see also* JA-275 – JA-288. For months after the Incident, extending to mid to late March 2018, Deloitte developed a plan to conduct a modified audit. JA-265 – JA-266; JA-267; JA-268 – JA-269; JA-270; JA-272; JA-302; JA-308; JA-309 – JA-311. Catalina acknowledged that the Deloitte audit costs claimed as "Extra Expense" represented $450,000 in charges above the $265,000 original estimate. JA-904 – JA-910. The incremental Deloitte fee was for audit work performed after the new "SAP" computer system went "live" on January 8, 2018. JA-1422 – JA-1434.

Catalina testified that the internal overtime claimed as "Extra Expense" was

to assist Deloitte's auditors for the period after May 31, 2018 and through submission of final draft financial statements to the auditor on or about September 30, 2018. JA-272 – JA-274; JA-312 – JA-316. In connection with Arizona's claim for lender attorneys' fees as "Extra Expense", Catalina identified three invoices, dated April 30, 2018, August 29, 2018, and October 24, 2018, for legal services not rendered until April, August and October 2018, respectively. These invoices were issued in connection with the preparation of amendments to Arizona's loan documents to extend three times the deadline for submission of audited financial statements, with a portion of the last invoice unrelated to the claimed extra expenses. JA-240 – JA-246; JA-317 – JA-323.

c. Jennifer Castaldo

Jennifer Castaldo, the Deloitte Audit Managing Director responsible for Arizona's audit, testified that, other than inventory counts, the audit procedures used to opine on Arizona's financial statements do not begin until the company's books are closed for the year. JA-341 – JA-344. Castaldo added that Arizona's audited financial statements are usually required by its lender by the end of May, and therefore, "our typical audit would run from March to the end of May in order to make that bank requirement." JA-344. The enhanced audit that was developed as a result of the Incident did not begin until after mid-April 2018, well after Arizona's new computer system went "live" on January 8, 2018. JA-347 – JA-353.

Castaldo identified a spreadsheet that she described as a Deloitte "budget to actual results from the December 31, 2017 audit." JA-354 – JA-355; JA-362 – JA-363; *see also* JA-1422 – JA-1434. The line-by-line time entries by the Deloitte team members reflect only 53 line items in November-December 2017 (of which only 28 highlighted entries indicate time recorded) and 859 line items after January 8, 2018. The total billable value of Deloitte's time spent on and prior to January 8, 2018 was $109,813.75, less than half of the original retainer estimate of $265,000 set forth in Deloitte's November 3, 2017 retainer letter (JA-276 – JA-288), and did not include the claimed $450,000 in "additional expenses arising from the delayed audit", reflected in time entries made after the "restoration period" ended.

SUMMARY OF THE ARGUMENT

The Equipment Breakdown Coverage Form plainly provided that the "restoration period" for an "Extra Expense" claim terminated on the date the "covered equipment", in this case Arizona's computer system, was "rebuilt, repaired, or replaced." The system was undeniably replaced on January 8, 2018 and, therefore, any "Extra Expense" incurred after that date were not recoverable under the Policy. The Policy separately defined "data" and "covered equipment" and only "Extra Expense" resulting from direct physical loss or damage to "covered equipment" were potentially compensable under the Policy.

The Equipment Breakdown Coverage Form contained a Coverage Extension

for "Data Restoration" limited to $250,000. Hanover paid Arizona the Policy limit for "Data Restoration" for the "reasonable and necessary costs to research, replace and restore lost 'data'", and owes Arizona nothing more. The "Data Restoration" Coverage Extension was not part of the "Extra Expense" Coverage and the task of recreating "data" did not extend the "restoration period" under the "Extra Expense" Coverage. Thus, the district court impermissibly and erroneously rewrote the Policy when it concluded that Deloitte's modified audit procedures "constituted a reasonable form of 'repairing, replacing, or rebuilding' the lost data" and, for that reason, extended the "restoration period" until the audit was completed on October 24, 2018. Repair or replacement of "covered equipment", not "data", was the terminus date for the "restoration period" under the Policy.

The lower court also committed reversible error in ignoring controlling New York and Second Circuit authorities and relying on distinguishable, non-binding case law involving different policy language and coverage provisions to support its opinion that Arizona's "usual business operations occurring at 'covered locations'" (the Policy definition of "business") may be broadly interpreted to include the work of independent auditor Deloitte. The court relied on inapposite case law broadly defining "business" to justify an extension of the "restoration period" to the conclusion of Deloitte's audit. Binding case law holds, consistent with the definition of "restoration period" in the Policy, that the "restoration period" ends when

damaged "covered property" is "rebuilt, repaired, or replaced" or the business is resumed at a replacement location.

In positing that Arizona's "business" was not resumed "to a similar level of service" until after the audit was finished because the audit "falls squarely" within Arizona's "usual business operations occurring at [Arizona's headquarters]", the district court also violated Rule 56 by deciding a genuine issue of material fact on summary judgment. Hanover has never acknowledged and there is no testimony from Arizona or Deloitte to support the notion that Deloitte's annual independent audit of Arizona's financial condition was part of Arizona's "usual business operations occurring at" its headquarters location. For this separate reason, the court below erred in granting Arizona's motion for summary judgment.

Finally, the district court denied Hanover's motion for summary judgment in the face of the incontrovertible fact that the damaged "covered equipment", Arizona's computer system, was replaced on January 8, 2018, which under a straightforward reading of the Policy marked the end of the "restoration period" for purposes of the "Extra Expense" coverage. It is beyond dispute that all of the audit-related "Extra Expense" claimed by Arizona was incurred after January 8, 2018. Consequently, the court below should have granted Hanover summary judgment dismissing Arizona's Complaint on the basis that "Extra Expense" incurred beyond the "restoration period" is not recoverable under the Policy.

LEGAL ARGUMENT

STANDARD OF REVIEW

Each issue set forth in the arguments that follow presents a question of law and, therefore, is subject to *de novo* review. *McBride v. BIC Consumer Prod. Mfg. Co., Inc.*, 583 F.3d 92, 96 (2d Cir. 2009) (the court reviews *de novo* a district court's grant of summary judgment, "construing all the evidence in the light most favorable to the non-movant and drawing all reasonable inferences in that party's favor").

POINT I

THE COURT BELOW ERRED IN REWRITING THE POLICY TO EXTEND THE "RESTORATION PERIOD" BEYOND THE DATE ON WHICH THE DAMAGED COMPUTER SYSTEM – THE "COVERED EQUIPMENT" UNDER THE POLICY – WAS REPLACED AND ARIZONA'S "USUAL BUSINESS OPERATIONS AT A 'COVERED LOCATION'" WERE RESTORED "TO A SIMILAR LEVEL OF SERVICE".

The court below found the Policy's terms to be unambiguous and acknowledged that its provisions "must be given their plain and ordinary meaning." Although it further recognized that "courts should refrain from rewriting the agreement" when, as here, its terms are clear, it ignored this maxim and impermissibly rewrote the Policy by extending the "restoration period" more than nine months beyond the date on which the "covered equipment" – Arizona's damaged computer system – was replaced and its "usual business operations at a 'covered location'" were restored "to a similar level of service" on January 8, 2018.

To arrive as this conclusion, the district court opined that Deloitte was engaged in data restoration, which it found to be "repairing, replacing or rebuilding" property, and that Arizona's usual business operations were not restored until this modified audit process was completed. This finding was flawed first because Arizona's broker and claim advocate made it clear that "Deloitte is prohibited in being involved with Data Restoration" and that "[t]heir function is only to audit and render an opinion on the data presented to them." JA-1379. Arizona's "Data Restoration" was handled by a different accountant, Robin Berger, not Deloitte. JA-1224. Second, it was contrary to the Equipment Breakdown Coverage Part, which defines "data" and "covered equipment" as two separate things, with the cost of researching, replacing and restoring lost "data" compensable under the "Data Restoration" Coverage Extension and the cost of repairing, replacing or rebuilding "covered equipment" damaged as a result of an "electronic circuitry impairment" compensable under the "Property Damage" Coverage.

The "Extra Expense" coverage provision ties to the "Property Damage" Coverage for direct physical loss or damage caused by or resulting from an "electronic circuitry impairment" to "covered equipment", not the "Data Restoration" Coverage Extension for loss of "data". The Equipment Breakdown Coverage Part contains Additional Definitions that separately define: (1) "covered equipment" as "covered property… that generates, transmits or utilizes energy"; and

(2) "data" as "information or instructions stored in digital code capable of being processed by machinery." JA-209 – JA-210. It defines "electronic circuitry impairment" as "a fortuitous event involving 'electronic circuitry' within 'covered equipment' that causes the 'covered equipment' to suddenly lose its ability to function as it had been functioning immediately before such event." JA-210.

Under Coverage, the Equipment Breakdown Coverage Part states:

> **Property Damage** – "We" cover direct physical loss to covered property caused by or resulting from an "accident" or "electronic circuitry impairment" to "covered equipment" at "covered locations". "We" will consider "electronic circuitry impairment" to be direct physical loss to "covered equipment".

JA-211. Under Coverage Extensions, the Equipment Breakdown Coverage Part separately provides for "Data Restoration", which is described as "'your' reasonable and necessary cost to research, replace and restore lost 'data'" and is not tied to any "restoration period". JA-211 – JA-212.

Further, Income Coverages, which are tied to the "restoration period", are described in the Equipment Breakdown Coverage Part as follows:

> **a. Coverage** – If a "limit" is indicated on the "schedule", "we" provide the coverages described below during the "restoration period" when "your" "business" is necessarily wholly or partially interrupted as a result of an "accident" or "electronic circuitry impairment" to "covered equipment".
>
> * * *
>
> **d. Extra Expense** – "We" cover only the extra expenses that are necessary during the "restoration period" that "you" would not have

> incurred if there had been no direct physical loss or damage to property caused by or resulting from an "accident" or "electronic circuitry impairment" to "covered equipment".
>
> "We" cover any extra expenses to avoid or reduce the interruption of "business" and continue operating at a "covered location", replacement location, or a temporary location….

JA-212 – JA-213.

Hanover paid Arizona the Policy limit of $250,000 for the costs of "Data Restoration", which were incurred months after Arizona's computer system was replaced on January 8, 2018 and were invoiced by Berger, an accountant not associated with Deloitte. However, Hanover did not pay Arizona for the costs of the enhanced Deloitte audit and associated employee overtime and legal fees, all of which were incurred after the "restoration period" ended on January 8, 2018 and, therefore, were not recoverable "Extra Expense" under the Equipment Breakdown Coverage Part.

In opining that the "restoration period" extended to October 24, 2018 because Deloitte spent more than nine months after January 8, 2018 effectively restoring data needed for the audit, the court below failed to appreciate the fact that the Policy plainly distinguishes between, and separately defines, "covered equipment" and "data", with "Extra Expenses" incurred because of physical loss or damage to "covered equipment" tied to the "restoration period" applicable to the Income Coverages, and the limited Coverage Extension for "Data Restoration" costs not tied

to a "restoration period". Further, in characterizing the Deloitte audit as "creating a functional simulacrum of the lost data" and as "a reasonable form of 'repairing, replacing, or rebuilding' the lost data", the lower court ignored the record evidence, including the statement of Arizona's broker, that Deloitte, as an auditor, cannot engage in "Data Restoration" and the fact that Berger, not Deloitte, performed "Data Restoration".

The Policy provided separate "Data Restoration" coverage, which was fully paid and is not at issue, and "Extra Expense" coverage. The "Data Restoration" coverage was limited to $250,000 but was not restricted to the "restoration period". In contrast, the "Extra Expense" coverage was expressly confined only to extra expenses "necessary during the 'restoration period'" to "avoid or reduce the interruption of 'business' and continue operating…" after a loss to "covered equipment". The "restoration period" ended no later than January 8, 2018 when Arizona's computer system, the "covered equipment", was replaced with a new system and Arizona's operations at its corporate headquarters were "restored to a similar level of service". What Deloitte or anyone else may have been doing to "restore data" after January 8, 2018 did not extend the "restoration period" and the lower court erred in holding otherwise.

POINT II

THE LOWER COURT ERRED IN IGNORING CONTROLLING PRECEDENT AND RELYING ON NON-BINDING OPINIONS INVOLVING DIFFERENT COVERAGE PROVISIONS TO SUPPORT ITS SUMMARY JUDGMENT DECISION.

A. Controlling New York Time Element Case Law.

Absent unique facts, where an insurance policy provides for time element coverage (a term that encompasses business interruption and extra expense coverages), New York courts have strictly adhered to the time limitations provided in the policy for such losses. They consistently hold that a time element loss is compensable only when it occurs within the "period of liability" or "period of restoration" applicable to that coverage.

In *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), the court narrowly interpreted a lost business income provision to only provide for compensation for losses actually incurred within the controlling "period of liability". A fire damaged a law firm's office, and the firm brought suit to recover business income losses under its insurance policy. *Id.* The policy limited the insurer's liability to "any resulting 'actual loss' of business income due to the necessary suspension of operations as a result of a covered cause of loss that would have been 'earned' during the 12 months after the fire." *Id.* Both parties agreed "earned" meant "becomes entitled to." *Id.*

The plaintiff sought prospective contingency fee proceeds "it would have

otherwise received in cases that it did not acquire because of a suspension of advertising allegedly due to the fire." *Id.* The court held that these fees were not recoverable under the policy because they "would not have been 'earned' by [the] plaintiff at the time, within the 12-month cutoff after the fire." *Id.* The court reasoned that "[l]ost fees from prospective clients that" the plaintiff did not realize due to the fire were not covered under the policy, but instead, coverage was limited to fees earned for services actually performed for new clients within the 12-month period following the fire "that resolved within 12 months of the fire." *Id.*

In *Royal Indem. Co. v. Retail Br. Al., Inc.*, 33 A.D.3d 392, 822 N.Y.S.2d 268 (1st Dept. 2006), *lv denied*, 8 N.Y.3d 813 (2007), *lv denied*, 11 N.Y.3d 705 (2008), the court also considered a lost business income provision, and affirmed the trial court's ruling that coverage for the insured's loss of business income due to the destruction of the World Trade Center was strictly confined to "the time needed to reopen the subject store." The court held that the policy did not provide business interruption coverage beyond the date of the store's reopening. *Id.* at 269. Similarly, in *Retail Brand All., Inc. v. Factory Mut. Ins. Co.*, 489 F. Supp. 2d 326, 329 (S.D.N.Y. 2007), the court held that coverage for business interruption losses which include extra expense coverage, "do not extend into the indefinite future but are limited by the Period of Liability clause". *Id.* at 329.

Here, under controlling New York precedent and the plain terms of the Policy,

"Extra Expense" coverage was confined to the "restoration period", which was to be measured by "[t]he time it should reasonably take to resume [Plaintiff's] 'business' to a similar level of service" ending "on the date the property should be rebuilt, repaired, or replaced," or alternatively, on "the date business is resumed at a new permanent location." Arizona's "usual business operations occurring at 'covered locations'" resumed on January 8, 2018 to a "similar level of service" when the "covered equipment", Arizona's computer system, was replaced. JA-238 – JA-239; JA-332. Business was never "resumed at a new permanent location", making the alternative "period of restoration" end date inapplicable.

B. The Non-Binding Cases Cited by The Court Below Are Inapposite.

Ignoring the binding New York case law discussed above, the lower court relied on two non-precedential opinions that were issued in other jurisdictions interpreting different policy language to conclude that the "restoration period" extended until Deloitte completed its annual audit on October 24, 2018 and did not end when the "covered equipment" was replaced on January 8, 2018. Both cases, which involved Data Breach Coverage Forms containing "impairment" language not found in the subject Policy, are inapposite.

In *Fishbowl Solutions, Inc. v. Hanover Ins. Co.*, 2022 WL 16699749 (D. Minn. Nov. 3, 2022), a bad actor gained access to the email account of the insured's senior staff accountant and, by impersonating the accountant, duped customers into

redirecting payments to accounts controlled by the wrongdoer. The subject Data Breach Coverage Form insured loss of business income and extra expense during the period of restoration directly resulting from a data breach "which results in an actual impairment or denial of service of 'business operations' during the policy period." Rejecting the argument that the policy's definition of "business operations" ("usual and regular business activities") should be read narrowly to mean only income-generating activities, and focusing on the inclusion of the words "actual impairment", the court concluded that it was "plausible that an insured could experience an impairment of "business operations" unrelated to income generation". *Id.* at *5.

The Data Breach Coverage Form further stated that "[t]he Period of Restoration ends either when ''business operations' are restored' or 60 days after the impairment or denial of 'business operations' first occurs, whichever is earlier." *Id.* at *7. Granting summary judgment to the insured, the *Fishbowl Solutions* court found that there had been an "impairment" of the policyholder's "business operations", which it distinguished from business interruption coverage provisions requiring losses arising from a "necessary interruption" or "interruption" of business, and that the loss claimed occurred within the "period of restoration" as defined by the Data Breach Coverage Form. *Id.* at *7 & *9-10.

In *New England Systems, Inc. v. Citizens Ins. Co. of America*, 2022 WL

17585966 (D. Conn. Dec. 12, 2022), the insured, an IT and cybersecurity firm, also submitted a claim under a Data Breach Coverage Form, claiming that as a result of a data breach, a bad actor or actors had gained access to some of its customers' computer systems and unleashed a virus and malware that encrypted the clients' data. *Id.* at *3. The data breach also impacted one of plaintiff's own systems, but the server was restored about a week after the breach occurred. *Id.* The event allegedly resulted in the loss of business income from some of the clients affected by the data breach, including loss of monthly service agreements, cancelled or lost projects and lost subscriptions. *Id.* at *4.

The Data Breach Coverage Form in *New England Systems* contained the same language that was at issue in *Fishbowl Solutions*, including the requirement that the actual loss of business income resulting from a data breach occur during the "period of restoration", that it first be discovered during the "policy period" and that the data breach result in "an actual impairment or denial of service of 'business operations' during the 'policy period.'" *Id.* at *2. The "period of restoration", as in *Fishbowl Solutions*, was defined to end "on the earlier of 'the date 'business operations' are restored, with due diligence and dispatch, to the condition that would have existed had there been no impairment or denial,' or sixty days 'after the date the actual impairment or denial of 'business operations' first occurs." *Id.*

Notably, the court in *New England Systems* partially granted and partially

denied the defendant insurer's motion for summary judgment, finding there to be issues of fact as to whether the insured suffered business interruption losses as a result of the data breach that affected its systems but no disputed issues of fact that would preclude a dismissal of plaintiff's bad faith claim. Because the data breach did not result in the "denial of service" of business operations, the court found "the operative question [to be] whether the data breach 'result[ed] in an actual impairment… of business operations.'" *New England Systems*, 2022 WL 17585966, at *7. The court applied a broad definition of "impairment" – an "inability to function at full capacity" -- and left for the jury the question of whether, and to what extent, the insured had suffered an "impairment" and whether the losses, if any, occurred during the Data Breach Coverage Form's restoration period. *Id.* at *7-9.

In the present matter, the lower court seemingly failed to appreciate the fact that the cases on which it relied involved business interruption claims, not extra expense claims, and the application of different and broader policy language than at issue here.[1] *Fishbowl Solutions* and *New England Systems* rested on Data Breach Coverage Form language focused on the "impairment" rather than the "interruption" of the insured's business. And in those cases the terminus for the "period of restoration" was, unlike the current matter, also tied to impairment: the restoration

[1] *Fishbowl Solutions* and *New England Systems* were decided after the motions in this matter were fully briefed. Because there was no oral argument, Hanover did not have the opportunity below to distinguish those decisions.

of the business operations "to the condition that would have existed had there been no impairment or denial," or "sixty days after the date the actual impairment or denial of 'business operations' first occurs." *New England Systems*, 2022 WL 17585966, at *2.

The district court's reliance on non-binding authority is also problematic because it failed to analyze or distinguish *Bernstein Liebhard*, *supra*, 162 A.D.3d 605, *Royal Indemnity*, *supra*, 33 A.D.3d 392, and *Retail Brand Alliance*, *supra*, 489 F. Supp. 2d 326, precedential cases which stand for the proposition that time element coverage applies only to losses within the specified "period of restoration", the time before damaged "covered equipment" or "covered property" should be rebuilt, repaired or replaced. *See*, *e.g.*, *Best Payphones, Inc. v. Dobrin*, 410 F. Supp. 3d 457, 475 (E.D.N.Y. 2019) (magistrate erred in "relying on non-binding and out-of-circuit precedent" rather than analyzing or distinguishing binding cases); *Rubenstein on Behalf of Jefferies Fin. Grp. Inc. v. Adamany*, 2021 WL 5782359, at *4 (2d Cir. Dec. 7, 2021) ("reliance on non-binding and out-of-circuit authority problematic because" it conflicted with Second Circuit opinions). Rather than confronting controlling New York cases, the lower court erroneously relied on non-binding, inapposite opinions under a Data Breach Coverage Form to justify its award of summary judgment to Arizona.

POINT III

THE DISTRICT COURT IMPERMISSIBLY DECIDED A GENUINE ISSUE OF MATERIAL FACT AND PARLAYED THAT IMPROPER FINDING OF FACT INTO A DETERMINATION ON SUMMARY JUDGMENT THAT THE "RESTORATION PERIOD" CONTINUED UNTIL THE AUDIT WAS COMPLETED.

The lower court also improperly decided a genuine issue of material fact in concluding that the Deloitte audit "falls squarely" with Arizona's "usual business operations occurring at [Arizona's headquarters]" and parlaying that erroneous finding of fact into a determination on summary judgment that the "restoration period" continued until the Deloitte audit was completed. In deciding a question of material fact, the district court violated Rule 56 and, for this additional reason, its summary judgment decision should be reversed.

Summary judgment is appropriate if there is no genuine dispute as to any material fact and the moving party is entitled to judgment as a matter of law. *Bartels v. Incorporated Village of Lloyd Harbor*, 97 F. Supp. 3d 198, 211 (E.D.N.Y. 2015), *aff'd sub nom. Bartels v. Schwarz*, 643 Fed. App'x 54 (2d Cir. 2016), citing *Gonzalez v. City of Schenectady*, 728 F.3d 149, 154 (2d Cir. 2013); *see* Fed. R. Civ. P. 56(a). "A fact is material if it might affect the outcome of the suit under governing law, and an issue of fact is genuine if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Ramos v. Baldor Specialty Foods, Inc.*, 687 F.3d 554, 558 (2d Cir. 2012) (internal quotation mark and citation omitted); *see also*

Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986). The court's role on a motion for summary judgment is not to resolve issues of fact. *Pinto v. Allstate Ins. Co.*, 221 F.3d 394, 398 (2d Cir. 2000).

The district court's role was to identify whether any issues of material fact existed, not to decide any genuine issues of material fact, yet that is precisely what it did in finding that the "restoration period" did not end with the replacement of the "covered equipment" – Arizona's computer system – on January 8, 2018, but continued until Deloitte completed its outside audit, which it described as the "functional simulacrum of the lost data", on October 24, 2018. The lower court made this determination while ignoring the fact that coverage under the Equipment Breakdown Coverage Part rests on an "accident" or "electronic circuitry impairment" that causes loss or damage to "covered equipment", not loss or damage to "data", and that the "restoration period" ends when the "covered equipment" is rebuilt, repaired or replaced. Further, even if Deloitte was engaged in "Data Restoration", which Arizona's broker stated it was not permitted to do, the Policy's separate "Data Restoration" coverage, unlike its "Extra Expense" coverage, was not tied to the "restoration period". Consequently, the completion of "data restoration" could not be an end point for the "restoration period".

The lower court's findings of fact in favor of Arizona and award of summary judgment to Arizona violated the tenet of Rule 56 that a court may not decide

genuine issues of material fact on a summary judgment motion. For this additional reason, the judgment below should be reversed.

POINT IV

THE COURT BELOW SHOULD HAVE GRANTED HANOVER SUMMARY JUDGMENT DISMISSING ARIZONA'S COMPLAINT BECAUSE THE DAMAGED "COVERED EQUIPMENT", ARIZONA'S COMPUTER SYSTEM, WAS REPLACED ON JANUARY 8, 2018 AND THE CLAIMED "EXTRA EXPENSE" WAS INCURRED OUTSIDE THE "RESTORATION PERIOD".

The district court should have granted Hanover summary judgment on the basis of the indisputable fact that the "covered equipment", Arizona's computer system, was replaced on January 8, 2018 and, on the plain language of the Policy, the "restoration period" ended on that date. Since the claimed "Extra Expense" costs were all incurred after January 8, 2018, those expenses were not recoverable under the Policy and Hanover should have been awarded summary judgment dismissing Arizona's breach of contract claim as a matter of law.

The Equipment Breakdown Coverage Part provided "Income Coverages", including "Extra Expense" coverage, "during the 'restoration period' when 'your' 'business' is necessarily wholly or partially interrupted as a result of an 'accident' or 'electronic circuitry impairment' to 'covered equipment'". JA-212. It defined "covered equipment" to mean "covered property… that generates, transmits or utilizes energy…." JA-209 – JA-210. The Equipment Breakdown Coverage Part separately defined "data" to mean "information and instructions stored in digital

code capable of being processed by machinery" and provided separate coverage, limited to $250,000, for "Data Restoration". JA-210 – JA-212; JA-119. Unlike the "Extra Expense" coverage, the "Data Restoration" coverage, for the "reasonable and necessary costs to research, replace and restore lost 'data'", was not tied to the "restoration period" and the "Extra Expense" coverage associated with damaged "covered equipment". Therefore, the completion of "Data Restoration" was not an end point for the "restoration period".

Because the claimed audit and audit-related expenses were all incurred after January 8, 2018, those costs are not recoverable "Extra Expense" under the Equipment Breakdown Coverage Part. And, if they constituted data restoration costs, Hanover already paid the limit of the "Data Restoration" Coverage Extension and owes nothing more. Hanover did not breach the Policy when it failed to pay Arizona's claimed audit and audit-related expenses and, for this reason, the court below should have granted Hanover's motion for summary judgment.

CONCLUSION

For all of the foregoing reasons, it is respectfully submitted that this Court should reverse the decision of the court below granting Arizona summary judgment, award Hanover summary judgment dismissing Arizona's Complaint, and grant Hanover such other and further relief as the Court deems just and appropriate.

Dated: New York, New York
November 29, 2023

FINAZZO COSSOLINI O'LEARY MEOLA & HAGER, LLC

By: */s/ Robert M. Wolf*
JEREMIAH L. O'LEARY, ESQ.
ROBERT M. WOLF, ESQ.
5 Penn Plaza, 23rd Floor
New York, New York 10001
(646) 378-2033
- and -
67 East Park Place, Suite 901
Morristown, New Jersey 07960
(973) 343-4960
jeremiah.oleary@finazzolaw.com
robert.wolf@finazzolaw.com
Attorneys for Plaintiff-Appellant
The Hanover Insurance Company

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Dated: New York, New York
November 29, 2023

FINAZZO COSSOLINI O'LEARY MEOLA & HAGER, LLC

By: */s/ Robert M. Wolf*

JEREMIAH L. O'LEARY, ESQ.
ROBERT M. WOLF, ESQ.
5 Penn Plaza, 23rd Floor
New York, New York 10001
(646) 378-2033
- and -
67 East Park Place, Suite 901
Morristown, New Jersey 07960
(973) 343-4960
jeremiah.oleary@finazzolaw.com
robert.wolf@finazzolaw.com
Attorneys for Plaintiff-Appellant
The Hanover Insurance Company

SPECIAL APPENDIX

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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

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ARIZONA BEVERAGES USA, LLC,

Plaintiff,

- against -

HANOVER INSURANCE COMPANY,

Defendant.

----------X

MEMORANDUM AND ORDER

Civil Action
No. 20-1537 (GRB)(LGD)

GARY R. BROWN, United States District Judge:

Reportedly, Arizona Beverages sells more than $3 billion in drinks and related products every year.[1] In the absence of cashflow, that river of beverages would quickly run dry. This undeniable proposition helps resolve the pending motions for summary judgment in this business interruption coverage dispute.

Factual Background

The following facts, except where otherwise stated, are largely undisputed. Arizona Beverages USA, LLC ("Plaintiff"), one of the largest private companies in the nation,[2] maintained commercial insurance with one of the nation's oldest insurers, Hanover Insurance Company ("Defendant").[3] This dispute emanates from a policy that insured Plaintiff against certain losses and extra expenses it might incur as a result of a covered loss (the "Policy"). Docket Entry ("DE") 35-2 ¶ 3.

As part of its business operations, Plaintiff entered into a credit agreement with JP Morgan Chase, N.A. ("Chase") wherein Chase provided a credit line for Plaintiff to maintain its cashflow

[1] *Arizona Beverage*, FORBES, https://www.forbes.com/companies/arizona-beverage/?sh=53fb0ff64574 (last visited July 12, 2023).
[2] *Id.*
[3] *Our history*, THE HANOVER INSURANCE GROUP, https://www hanover.com/why-hanover/about-our-company/our-history (last visited July 12, 2023).

(the "Credit Agreement"). *Id.* ¶ 7. Pursuant to the Credit Agreement, Plaintiff is required to undertake an independent audit of its financial position every year, to be completed by May 31 of the following year. *Id.* ¶ 8. The May 31 deadline could be extended by purchasing additional time periods. *See id.* ¶ 30. Failure to complete the audit would render Plaintiff in default of the Credit Agreement, which would allow Chase to demand immediate repayment. *Id.* ¶ 9. Such a repayment demand would likely require liquidation of Plaintiff. *Id.* ¶ 10.

On October 29, 2017, Plaintiff suffered a power surge at its corporate headquarters, which damaged multiple disc drives, resulting in a catastrophic failure of Plaintiff's account operating system (the "Loss"). *Id.* ¶ 12. Plaintiff was unable to access its computer software and applications, including account balances, receivables, inventory, and order information. *Id.* ¶¶ 19-20. Plaintiff acted swiftly to repair the hardware and restore the backup data, and, by January 8, 2018, had regained software functionality as to its present period operations. *Id.* ¶ 13; DE 32-1 ¶ 19. The data and functions for 2016 and 2017, however, were never recovered, which included the data used by Plaintiff's auditor to complete its annual audit. DE 35-2 ¶¶ 20, 24.

Days after the Loss, Plaintiff's auditor, Deloitte and Touche LLP ("Deloitte"), contacted Plaintiff to commence its annual audit for 2017 (the "Audit"). *Id.* ¶ 14. At the time, Deloitte was unaware of the Loss and provided Plaintiff with an engagement letter, quoting Plaintiff $265,000 to complete the Audit. *Id.* ¶ 16; DE 22 ¶ 14, Ex. A. A few days later, Plaintiff's Executive Vice President, Patricia Catalina, contacted Deloitte to inform them of the Loss and Plaintiff's efforts to recover the relevant lost data. DE 35-2 ¶ 16. But since Plaintiff was unable to recover the data typically used by Deloitte to evaluate and test Plaintiff's financial statements for the third quarter, Deloitte had to dramatically revise its normal audit procedures in accordance with accepted accounting principles. *Id.* ¶ 23, Ex. G at 28-32, 96:11 ("[W]e had to change everything.").

As a result, Plaintiff incurred substantial additional costs in completing the Audit. The revised audit procedures required Deloitte to conduct an additional 2,200 hours of work above the original quote. *Id.* ¶ 23, Ex. G at 71:21-72:1. Deloitte billed Plaintiff $450,000 for these additional efforts after negotiations. *Id.* ¶ 24.[4] In utilizing the revised procedures, Plaintiff's employees worked overtime to assist Deloitte, incurring $86,455 in overtime wages. *Id.* ¶ 30. And since the Audit could not be completed by the May 31 deadline set forth in the Credit Agreement, Plaintiff had to purchase deadline extensions with Chase to complete the Audit at a cost of $16,188.25. *Id.*

As to the Loss, Defendant reimbursed Plaintiff $250,000, the sublimit for data restoration under the Policy. *Id.* ¶ 29. Plaintiff sought coverage and reimbursement from Defendant under the Policy for the additional audit expenses, totaling $552,573.25 (the "Audit Expenses"). *Id.* ¶ 28. Concerning the Audit Expenses, Plaintiff sought coverage pursuant to the "extra expense" provisions of the Policy, which state, in pertinent part:

> **EXTRA EXPENSE**
>
> "We" cover only the extra expenses that are necessary during the "restoration period" that "you" would not have incurred if there had been no direct physical loss or damage to property caused by or resulting from a covered peril.
>
> "We" cover any extra expense to avoid or reduce the interruption of "business" and continue operating at a "covered location", replacement location, or a temporary location. This includes expenses to relocate and costs to outfit and operate a replacement or temporary location.

Id. ¶ 6; DE 32-2 at 100. The Policy defines "restoration period," as relevant here:

> "Restoration period" means:
>
> 1. The time it should reasonably take to resume "your" "business" to a similar level of service beginning . . .

[4] Defendant engaged with two forensic accountants, who both determined that Deloitte's additional audit fee of $590,000 was reasonable. DE 35-2 ¶ 47. Deloitte originally quoted Plaintiff $1,500,000 for the Audit. *Id.* ¶ 24.

> b. for extra expenses, immediately following the direct physical loss of or damage to property at a "covered location" that is caused by a covered peril.
>
> The "restoration period" ends on the date the property should be rebuilt, repaired, or replaced or the date business is resumed at a new permanent location

Id. at 106. The Policy defines "business" as "the usual business operations occurring at 'covered locations.'" *Id.* at 66. Defendant took inconsistent positions regarding coverage, but ultimately denied Plaintiff's claim for reimbursement for the Audit Expenses.

Around October 12, 2018, Defendant's adjuster, Nicholas Tenan, emailed Plaintiff's insurance broker, informing him that "[t]he increased costs [of the Audit] 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." *Id.* ¶¶ 27, 34. But at his deposition, Tenan testified that this email was "worded incorrectly" due to "self-duress" and "pressure" that he put on himself in not providing an update to his client sooner and that he actually "made no formal decision" on Plaintiff's claim at the time. DE 36-1 ¶ 34.

Soon thereafter, Plaintiff's claim was reassigned to Joseph Tamres, who testified that if the Audit Expenses were incurred to prevent a loss of income during the period of restoration, then it would be covered under the Policy. *Id.* ¶¶ 35, 43; DE 35-2 ¶ 43. And, on February 6, 2019, in the context of whether an exclusion under the Policy applied, Mark Cullen, another adjuster for Defendant, told Tamres that he believed that the Audit Expenses should be covered under the Policy. DE 35-2 ¶ 47, Ex. J at 71:17-72:2.

But, on March 6, 2019, Defendant issued a payment notice and summary to Plaintiff, which provided the remaining reimbursements from the Loss but denied reimbursement for the Audit

Expenses. DE 35-2 ¶ 51, Ex. O at 2. Specifically, the notice stated that "any and all of the additional expenses the insured has incurred due to the loss of data totaling $957,573.03 was the direct result of the data restoration event and exceeds the policy limit of $250,000." *Id.* In response, Plaintiff's broker informed Defendant that "[h]ad the audit financials not been presented to the [Plaintiff's] bank by the deadline, the bank would have called the loan. The insured would have to start liquidating assets and sell inventory below to repay the loan. These additional expenses prevented a significant business income loss." *Id.* ¶ 55. Nevertheless, Defendant denied coverage as to the Audit Expenses. *Id.* ¶ 56.

This suit followed.

Procedural History

Plaintiff commenced this action against Defendant on October 28, 2019, in Nassau County Supreme Court, alleging breach of contract. DE 1-2 at 8. Defendant subsequently removed the suit to this Court on March 25, 2020. DE 1. After the close of discovery, the parties both requested a pre-motion conference seeking leave to file motions for partial summary judgment. On March 21, 2022, the Court held a pre-motion conference and set a briefing schedule. This opinion follows.

Discussion

There are two issues at the core of this case: (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." Based on the undisputed facts, both questions are answered in the affirmative.

Standard of Review

This motion for summary judgment is decided under the oft-repeated and well understood standard for review of such matters, as discussed in *Bartels v. Inc. Vill. of Lloyd Harbor*, 97 F.

Supp. 3d 198, 211 (E.D.N.Y. 2015), *aff'd sub nom. Bartels v. Schwarz*, 643 Fed. App'x. 54 (2d Cir. 2016), which discussion is incorporated by reference herein.

Principles of Insurance Policy Interpretation

Under New York law, "an insurance contract is interpreted to give effect to the intent of the parties as expressed in the clear language of the contract." *10012 Holdings, Inc. v. Sentinel Ins. Co., Ltd.*, 21 F.4th 216, 220 (2d Cir. 2021) (quoting *Parks Real Est. Purchasing Grp. v. St. Paul Fire & Marine Ins. Co.*, 472 F.3d 33, 42 (2d Cir. 2006)). As such, New York law treats an insurance policy as a contract and construes it in accordance with general contract principles. *Scottsdale Ins. Co. v. Long Beach Polar Bear Club City of Long Beach*, No. 20-CV-3026 (JMA)(AYS), 2022 WL 1748618, at *3 (E.D.N.Y. Mar. 18, 2022) (citing *Cont'l Ins. Co. v. Atl. Cas. Ins. Co.*, 603 F.3d 169, 180 (2d Cir. 2010)). "The policy must . . . be construed in favor of the insured, and ambiguities, if any, are to be resolved in the insured's favor and against the insurer." *10012 Holdings, Inc.*, 21 F.4th at 220 (quoting *U.S. Fid. & Guar. Co. v. Annunziata*, 67 N.Y.2d 229, 232 (1986)). "But '[w]here the provisions of [a] policy are clear and unambiguous, they must be given their plain and ordinary meaning, and courts should refrain from rewriting the agreement.'" *Id.* (quoting *U.S. Fid. & Guar. Co.*, 67 N.Y.2d at 232).

Thus, "the initial question for the court on a motion for summary judgment with respect to a contract claim is whether the contract is unambiguous with respect to the question disputed by the parties." *Law Debenture Trust Co. of New York v. Maverick Tube Corp.*, 595 F.3d 458, 465 (2d Cir. 2010). A court will find language in an insurance contract ambiguous if "reasonable minds could differ as to its meaning." *Duane Reade, Inc. v. St. Paul Fire & Marine Ins. Co.*, 600 F.3d 190, 201 (2d Cir. 2010) (quoting *Haber v. St. Paul Guardian Ins. Co.*, 137 F.3d 691, 695 (2d

Cir. 1998)). "In other words, ambiguity is present where the contractual language at issue is 'reasonably susceptible to more than one reading.'" *Id.* (citation omitted).

Here, a plain reading of the Policy and relevant provisions reveal no such ambiguity, and the parties agree. *See* DE 35-2 at 9; DE 32-16 at 15. The Policy covers "extra expenses that are necessary during the 'restoration period' that [Plaintiff] would not have incurred if there had been no [Loss]," including "any extra expense to avoid or reduce the interruption of 'business' and continue operating at [Plaintiff's headquarters]." DE 32-2 at 100. The Policy defines "restoration period" as beginning "immediately following" the Loss and ending "on the date the property should be rebuilt, repaired, or replaced," while defining "business" as "usual business operations occurring at [Plaintiff's headquarters]." *Id.* at 66, 106. These provisions suggest that if the Audit was part of Plaintiff's usual business operations and the Audit Expenses were incurred during the restoration period, then the Policy provides coverage. Therefore, the Court finds that the relevant Policy provisions are unambiguous and will give them their "plain and ordinary meaning." *See 10012 Holdings, Inc.*, 21 F.4th at 220.

"Usual Business Operations"

Whether the Audit Expenses and the resulting provision of continued cashflow for operations were part of Plaintiff's "usual business operations" is fairly self-evident. From the perspective of any business—let alone a multi-billion, international company such as Plaintiff—the plain and ordinary meaning of "usual business operations" refers to activities undertaken on a regular basis that are essential to the company's continued existence. *See Fishbowl Sols., Inc. v. Hanover Ins. Co.*, No. 21-CV-0794 (SRN)(DJF), 2022 WL 16699749, at *6 (D. Minn. Nov. 3, 2022) (holding that a company's "usual and regular business activities" is broad and covers "all business activities performed with a certain frequency and consistency" and "makes no distinction

based on the type of business activity"). Such activities may take on many forms, including activities to increase profits, expand brand recognition, and monitor staffing needs. *See, e.g.*, *New England Sys., Inc. v. Citizens Ins. Co. of Am.*, No. 20-CV-01743 (SVN), 2022 WL 17585966, at *8 (D. Conn. Dec. 12, 2022) (finding that a plaintiff company's "business operations may have been impaired under the Policy if Plaintiff was unable to function at full capacity because it needed to dedicate its employees to client remediation work as a result of the data breach."). It may also include managing financial obligations such as maintaining cashflow, servicing debt, and filing tax returns. *See Vissa v. Williamson*, 276 A.D. 662, 664 (App. Div. 1950), *aff'd,* 302 N.Y. 750 (1951) ("[B]usiness operations . . . may fairly be said to embrace many activities.").

Thus, Plaintiff's annual audit falls squarely within its usual business operations. Ordinarily, Plaintiff's audit procedure begins in September or October of the year that is being audited. DE 35-2 ¶ 11. Plaintiff provides the auditor with preliminary financial information for the third quarter along with year-to-date numbers and inventory levels so the auditor can assess their audit approach. *Id.* Plaintiff also prepares for physical observations of its inventory by the auditor, which begins around November of the year being audited. *Id.* And in anticipation of the physical inspections, Plaintiff provides the auditor with additional financial information and interim balances of accounts receivable so that the auditor can determine how many selections it would make for confirmation related balances. *Id.*

To maintain cashflow and continue the day-to-day operations of the company, Plaintiff relies on its Credit Agreement with Chase. As such, Plaintiff is bound to the terms and conditions of that agreement, which includes a requirement that Plaintiff complete an annual audit. Failure to complete the annual audit would render Plaintiff in default, thereby giving Chase the opportunity to demand immediate repayment of the full outstanding balance, potentially requiring liquidation

of Plaintiff's inventory and receivables, and the company shuttered. Thus, completing its annual audit represents a vital part of Plaintiff's operations, ranking alongside the importation of tea leaves.[5]

Defendant argues that Plaintiff is in the business of "producing, marketing, selling and distributing beverage products," not auditing. DE 32-16 at 1; DE 34 at 7. But Defendant construes the Policy too narrowly and fails to recognize that Plaintiff's operations involve more than its end products. Indeed, for Plaintiff's products to end up on the shelves of retail stores, there are countless other aspects of Plaintiff's company that must operate simultaneously that may not be directly related to production but are indirectly vital to it. The continued receipt of operating funds from Chase is one of them. To be sure, had Defendant intended to limit the definition of "business" and "usual business operations" to solely activities directly arising out of "producing, marketing, selling and distributing beverage products," Defendant could have expressly drafted that language in the Policy. *See Fishbowl Sols., Inc.*, 2022 WL 16699749, at *5 ("If Hanover wanted to restrict 'business operations' to include only the 'income-generating' subset of Fishbowl's 'usual and regular business activities,' it had the responsibility as drafter to write the governing contractual definition accordingly."); *Nat'l Union Fire Ins. Co. of Pittsburgh, Pennsylvania v. TransCanada Energy USA, Inc.*, 52 Misc. 3d 455, 461 (N.Y. Sup. Ct. 2016), *aff'd sub nom. Nat'l Union Fire Ins. Co. v. TransCanada Energy USA, Inc.*, 153 A.D.3d 1153 (1st Dep't 2017) ("The best evidence of what the parties to an agreement intended is the language of the agreement itself, especially where, as here, the parties to the insurance policy were sophisticated entities.") (citation omitted).

Additionally, Defendant's argument that Plaintiff's annual audit is completed by an independent entity and therefore constitutes something other than Plaintiff's operations fails to

[5] *FAQS*, ARIZONA BEVERAGES USA, https://drinkarizona.com/pages/faqs ("Our tea comes from all main tea-growing countries such as China and India.") (last accessed July 12, 2023).

carry the day. Indeed, Plaintiff's audit *must* be completed by an independent entity. DE 35-2 ¶ 25. Moreover, while Plaintiff retains Deloitte annually to conduct the audit, its employees work closely with Deloitte to ensure its proper completion through diligent and accurate record keeping, precise inventory counts and accounts receivable, and other assistance, sometimes requiring Plaintiff's internal employees to work overtime. Thus, it is ultimately irrelevant whether Deloitte is "independent" of Plaintiff as Plaintiff devotes significant time and resources to completing its annual audit.

Therefore, the Court finds that Plaintiff's annual audit is part of its "usual business operations" as defined by the Policy.

"Restoration Period"

The Policy defines "restoration period" as the "time it should reasonably take to resume [Plaintiff's] 'business' to a similar level of service." DE 32-2 at 106. It further explains that for "extra expenses, [the restoration period commences] immediately following the [Loss]." *Id.* The Policy provides two alternative end dates. First is the "date the property should be rebuilt, repaired, or replaced." *Id.* Alternatively, the period ends on the "date business is resumed at a new permanent location." *Id.* Here, the "restoration period" began on October 29, 2017, the date of the Loss. The parties diverge, however, as to the appropriate end date. Defendant contends that the "restoration period" ended on January 8, 2018, when Plaintiff regained software functionality for its present operations but the historical data for 2016 and 2017 had not been restored. DE 36-1 at 12. Plaintiff argues that since the relevant Audit data proved unrecoverable, the property was *never* "rebuilt, repaired, or replaced." DE 35-1 at 10. And because it was impossible to restore the lost data, the proper end date of the restoration period should be measured by the length of time it took Deloitte to work around the missing data from the Loss. *Id.* Thus, Plaintiff concludes that

the "restoration period" continued until October 24, 2018, when Deloitte completed the Audit. *Id.*; DE 35-8 at 146:20-22. This argument proves more persuasive.

The Policy clearly anticipates alternative means of restoration in circumstances in which property proves unrecoverable. One example is the express term provision that extends the "restoration period" until "the date business is resumed at a new permanent location." DE 32-2 at 106. Thus, as here, the impossibility of restoration does not extend the period indefinitely, rather the Policy expressly anticipates alternative means of a "work-around." This concept is buttressed by the well-settled proposition that insurance policies are to be construed "in light of 'common speech' and the reasonable expectations of a businessperson." *See U.S. Fid. & Guar. Co. v. Fendi Adele S.R.L.*, 823 F.3d 146, 152 (2d Cir. 2016) (citations omitted).

Deloitte's enhanced Audit procedures constituted a reasonable form of "repairing, replacing, or rebuilding" the lost data to satisfy acceptable accounting principles. Deloitte had to analyze additional types and forms of data to form its opinion, including, for example, conducting a proof of cash from the transactions that went through Plaintiff's bank accounts, which meant every transaction was identified, documented, and assigned a financial statement assertation. DE 35-8 at 92:14-20; *see also id.* 131:19-29 ("I now have to convert cash basis accounting to accrual basis accounting for this Audit Opinion."); DE 35-10 at 30-32 (discussing proposing to create a new entire manual ledger since Plaintiff could not provide general ledger transactional details). Indeed, Deloitte could only audit certain sections of Plaintiff's financial statements for which it had "concrete support." DE 35-8 at 135:6-7; *id.* at 113–14 (discussing importance of disaggregating Plaintiff's inventory balances so that each part had a certain level of detail and supporting documentation behind it for validation). "Everything had to be reviewed, second

partner reviewed, [and] national office[6] reviewed by the partner who signed off on the plan for each one of those items . . . . Those approaches were being developed as information was being provided." *Id.* at 146:11-17. Thus, while the missing 2017 data was never recovered, Deloitte created a functional simulacrum of the lost data throughout its modified Audit process, ultimately finalizing its repair on October 24, 2018, when it completed the Audit.

Even accepting Defendant's position that the use of "should be" in the provision means the theoretical time—not the actual time—it should take to repair, rebuild, or replace the property, the result remains the same. *See* DE 32-16 at 14. There is no evidence that Plaintiff or Deloitte were dilatory in replicating the lost data. In fact, the evidence is to the contrary. Plaintiff was particularly motivated to complete the Audit as it was critical to its ongoing loan agreement with Chase and Plaintiff had already missed the May 31 deadline, incurring attorneys' fees and costs to extend that deadline. Meanwhile, Deloitte had worked diligently to complete the Audit using its modified procedures. *See, e.g.*, DE 35-8 at 108:22-25 (acknowledging correspondence regarding the Audit taken place around 11:00 p.m. on a Sunday night); *id.* at 108:1 ("We never stopped working."); *id.* at 231:19-20 ("[Deloitte's] additional work concluded upon their issuance of their [Audit] Opinion."). Therefore, given the plain and ordinary meaning of the Policy and the reasonable expectations of the parties, the "restoration period" began on October 29, 2017, the date of Loss, and ended on October 24, 2018, the date of the Audit's completion.

For the avoidance of doubt, to the extent that the definition of "restoration period" is ambiguous, Plaintiff, as the insured, still prevails. Where a contract is ambiguous, "New York follows the well-established *contra proferentem* principle which requires that equivocal contract provisions are generally to be construed against the drafter." *Judd Burstein, P.C. v. Long*, 180 F.

[6] Deloitte's national office "manages the firm's structure and consults on problematic, very high-level accounting questions of individual teams." DE 35-8 at 231:3-6.

Supp. 3d 308, 312 (S.D.N.Y. 2016) (quoting *McCarthy v. Am. Int'l Grp., Inc.*, 283 F.3d 121, 124 (2d Cir. 2002)). Defendant 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, 156 (2d Dep't 2007) (citation omitted) (emphasis added).

Defendant's view, that the restoration period ended on January 8, 2018, when Plaintiff regained software functionality, seems anything but a fair and reasonable interpretation of the Policy. The Policy defines the "restoration period" as "[t]he time it should reasonably take to resume 'your' [usual business operations] to a similar level of service . . . [ending] on the date the property should be rebuilt, repaired, or replaced . . . ." DE 32-2 at 106. The Loss caused a catastrophic disruption of Plaintiff's software and operating systems. While Plaintiff restored some functionality, the relevant audit data for 2017 was never recovered, thereby preventing Deloitte from discharging its responsibilities. As such, Plaintiff was unable to service its debt obligations until Deloitte developed and completed its modified procedures. Thus, Plaintiff's usual business operations were not resumed to a similar level of service until October 24, 2018, when the Audit was completed. Such a reading of the Policy is a fair and reasonable one. Indeed, one "purpose of the business interruption insurance is to . . . compensate an insured for losses stemming from an interruption of normal business operations . . . by placing the insured in the position that it would have occupied if there had been no interruption." *Nat'l Union Fire*, 52 Misc. 3d 455 at 466 (cleaned up).

Turning to the remaining relevant provisions of the Policy, extra expenses will be covered if they are "necessary during the 'restoration period" that Plaintiff "would not have incurred if there had been no [Loss]." DE 32-2 at 100. The Policy also covers extra expenses incurred to "avoid or reduce the interruption of 'business' and continue operating at [Plaintiff's

headquarters]." *Id.* Given their plain and ordinary meaning, these provisions further support coverage of the extra expenses Plaintiff incurred to avoid the interruption of its usual business operations but for the Loss.

Here, the Audit Expenses fall squarely within the "extra expense" provisions of the Policy. First, the Audit Expenses were incurred to avoid the interruption of its usual business operations. As discussed above, Plaintiff's annual audit is included in its usual business operations and the Audit Expenses were incurred to prevent a grave financial threat, to wit: a potential liquidation of the company, thus "avoid[ing] the interruption" of Plaintiff's business. And second, but for the Loss, Plaintiff would not have incurred the Audit Expenses. Indeed, the sole cause for these additional expenses was because the financial records necessary to complete the Audit were destroyed in the Loss.

Therefore, the Audit Expenses are covered under the Policy, and Defendant's remaining arguments are unavailing as contrary to the express terms of the Policy and applicable case law.

Conclusion

For the reasons set forth above, Defendant's motion for summary judgment is DENIED, and Plaintiff's motion for summary judgment is GRANTED. The Clerk of Court is respectfully directed to enter judgment for Plaintiff and close the case.

SO ORDERED.

Dated: Central Islip, New York
July 17, 2023

/s/ Gary R. Brown
GARY R. BROWN
United States District Judge

SPA-15

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

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ARIZONA BEVERAGES USA, LLC,

Plaintiff,

- against -

HANOVER INSURANCE COMPANY,

Defendant.

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JUDGMENT
CV 20-1537 (GRB) (LGD)

A Memorandum and Order of Honorable Gary R. Brown, United States District Judge, having been filed on July 17, 2023, denying Defendant's motion for summary judgment, granting Plaintiff's motion for summary judgment, and respectfully directing the Clerk of Court to enter judgment for Plaintiff and close this case, it is

ORDERED AND ADJUDGED that judgment is entered in favor of Plaintiff Arizona Beverages USA LLC, and against Defendant Hanover Insurance Company; that Defendant's motion for summary judgment is denied; that Plaintiff's motion for summary judgment is granted; and the case is closed.

Dated: July 17, 2023
Central Islip, New York

BRENNA B. MAHONEY
CLERK OF COURT

BY: /S/ JAMES J. TORITTO
DEPUTY CLERK

SPA-16

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

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ARIZONA BEVERAGES USA LLC,

Plaintiff,

-against-

HANOVER INSURANCE COMPANY,

Defendant.

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Docket No.: 20 CV 01537 (GRB/SIL)

~~PROPOSED~~ **JUDGMENT**

THIS MATTER having been brought before the Court on Plaintiff ARIZONA BEVERAGES USA LLC's (hereinafter "Plaintiff") motion for summary judgment against Defendant, and upon the parties cross-motions for summary judgment pursuant to Fed. R. Civ. Pro. 56 filed in accordance with the Court's Order dated March 21, 2022 and the Court having reviewed both parties submissions and rendered a Memorandum and Order dated July 17, 2023, which granted Plaintiff's motion for summary judgment and denied Defendant's motion; and for good cause shown;

IT IS on this 30th, day of August, 2023,

ORDERED that judgment herein shall be entered against the Defendant, Hanover Insurance Company and in favor of Plaintiff, Arizona Beverages USA, LLC, in the principal amount of $552,573.25, plus prejudgment interest in the amount of $217,184.00,[1] for a total amount of $769,757.25; and it is further

[1] Pursuant to CPLR §§ 5001 and 5004, the amount of prejudgment interest is calculated at 9% per annum from earliest ascertainable date the cause of action existed. Here, the Court found in its Memorandum and Order dated July 17, 2023 that Defendant denied coverage for Plaintiff's audit expenses on March 6, 2019. *See* ECF Doc. No. 38 at pp. 4-5. Therefore, prejudgment interest is calculated from March 6, 2019 until the date of this Court's Memorandum and Order dated July 17, 2023 which is a total of 1,594 days. Plaintiff's principal amount of damages multiplied by 9% equals $49,731.59 of interest per annum. $49,731.59 divided by 365 days in a year equals a daily interest rate of $136.25. The daily interest rate of $136.25 multiplied by 1,594 days that have passed totals $217,184.00.

ORDERED that Defendant is responsible to pay post judgment interest to Plaintiff which continues to accrue at $81.45[2] per day from the date of this Court's Memorandum and Order dated July 17, 2023 until the date this Judgment is satisfied; and it is further;

ORDERED that a copy of this Order shall be deemed served on Defendant upon the electronic filing of this Order of Judgment by the Court.

SO ORDERED

/s/Gary R. Brown

Hon. Gary R. Brown, U.S.D.J.

Dated: August 30, 2023

[2] The post-judgment interest rate is the weekly average one-year constant maturity Treasury yield for the calendar week preceding the date of the entry of judgment which would by July 10, 2023 – the week proceeding this Court's Memorandum and Order dated July 17, 2023. On July 10, 2023 the weekly average one-year constant maturity Treasury yield was 5.38%. *See* https://home.treasury.gov/resource-center/data-chart-center/interest-rates/TextView?type=daily_treasury_yield_curve&field_tdr_date_value=2023. Plaintiff's principal amount of damages multiplied by 5.38% equals $29,728.44 of interest per annum. $29,728.44 divided by 365 days in a year equals a daily interest rate of $81.45.