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August 2017 | Insurance Update | WWW.RIVKINRADLER.COM

Insurance Did Not Cover Loss Suffered by Company That Transferred Funds to Wrong Bank Account after Receiving Fraudulent Emails

A federal district court in Michigan has ruled that a company that received fraudulent emails and then transferred funds to a bank account it believed to be its vendor's could not recover its loss under the computer fraud provision of its insurance policy.

The Case

After receiving emails that appeared to be from one of its vendors, American Tooling Center, Inc. ("ATC") authorized payments to a bank account that it believed belonged to the vendor. The emails were fraudulent, however, and the payments ATC sent to the bank account were received by a third party, not ATC's vendor.

ATC contended that it suffered a loss covered under the computer fraud provision of its insurance policy. ATC's insurer argued that ATC's loss had not been a "direct loss" that had been "directly caused by the use of a computer" as required by the policy.

ATC sued, and the parties moved for summary judgment.

The District Court's Decision

The district court granted summary judgment in favor of the insurer.

In its decision, the district court found that the fraudulent emails received by ATC had not "directly" or immediately caused the transfer of funds from ATC's bank account. It reasoned that the fraudulent emails had been used to impersonate a vendor and dupe ATC into making a transfer of funds, but it ruled that those emails did not constitute the "use of any computer to fraudulently cause a transfer."

As the district court observed, there had been no infiltration or "hacking" of ATC's computer system. Indeed, the district court stated, the emails themselves had not directly caused the transfer of funds; rather, ATC had authorized the transfer based on the information it had received in the emails.

In other words, the district court said, there were "intervening events" between ATC's receipt of the fraudulent emails and its transfer of funds – including ATC's authorization of the transfers and its initiation of the transfers without verifying bank account information. The case is *American Tooling Center, Inc. v. Travelers Casualty and Surety Co. of America*, No. 16-12108 (E.D. Mich. Aug. 1, 2017).

Rivkin Comment

In a similar case, a federal district court in New York recently reached a different result, but under different policy language. *See Medidata Solutions, Inc. v. Federal Ins. Co.*, No. 15-CV-907 (S.D.N.Y. July 21, 2017). There, an employee was tricked into sending over $4.7 million by wire transfer to an imposter, after receiving a spoof email that appeared to come from the company's president. The court found coverage under the Computer Fraud clause of the policy, which applied to the "fraudulent: (a) entry of Data into or deletion of Data from a Computer System" or "(b) change to Data elements or program logic of a Computer System, which is kept in machine readable format." The court held that the thief fraudulently entered and changed data in Medidata's computer system by altering the "From" field of the email and by entering computer code that changed the hacker's email address to that of Medidata's president.

The court also found coverage under the Funds Transfer Fraud clause. The insurer argued that the coverage did not apply because the wire transfer was voluntary and made with Medidata's knowledge or consent. The court disagreed, reasoning that the fact that the employee pressed the send button on the bank transfer did not transform the bank wire into a valid transaction. Larceny by trick, the court added, is still larceny.

Professional Services Exclusion Precluded Coverage of Additional Insured in Pipeline Explosion Case

An appellate court in California, affirming a trial court's decision, has ruled that a professional services exclusion in an umbrella policy precluded coverage for claims stemming from a pipeline explosion.

The Case

When an excavator operated by Mountain Cascade, Inc. ("MCI"), a contractor for East Bay Municipal Utility District, punctured a high-pressured petroleum line owned by Kinder Morgan, Inc., gasoline was released into the pipe trench and was ignited by the welding activities of Matamoros Pipelines, Inc., a subcontractor working for MCI. The resulting explosion and fire killed five employees and seriously injured four other employees.

Following the explosion, California's Division of Occupational Safety and Health, ("Cal/OSHA") investigated and concluded that the primary cause of the accident was the failure to properly mark the petroleum pipeline. Cal/OSHA issued two citations to Kinder Morgan due to the

failure of its employees to mark the location of the petroleum pipeline prior to the excavation activities to install the water line.

Kinder Morgan and Comforce Corporation, a staffing company that supplied temporary employees to Kinder Morgan, were sued.

Kinder Morgan settled. Its excess insurer contended that Kinder Morgan was covered as an additional insured under Comforce's umbrella policy and sought to recover defense costs and settlement payments from Comforce's umbrella insurer. Comforce's insurer contended that its umbrella policy excluded damages arising from professional services.

A California trial court ruled that the professional service exclusion in Comforce's umbrella policy precluded coverage for the claims against Kinder Morgan, and Kinder Morgan's excess insurer appealed.

The Appellate Court's Decision

The appellate court affirmed.

In its decision, the appellate court rejected Kinder Morgan's excess insurer's argument that the professional liability exclusion in Comforce's umbrella policy was "ill-defined" and should not be enforced.

The appellate court then pointed out that California courts had defined "professional services" as those "arising out of a vocation, calling, occupation, or employment involving specialized knowledge, labor, or skill" where the labor or skill involved was "predominantly mental or intellectual, rather than physical or manual." The appellate court added that it was a "broader definition" than a "profession" such as medicine, law, or engineering.

Here, the appellate court noted, the lawsuits against Kinder Morgan and Comforce alleged that severe personal injuries and deaths arose from the failure to properly locate and mark the underground pipelines. The appellate court decided that the activities involved in owning and operating a pipeline, including mapping and marking underground installations, were "clearly analogous" to other skilled services that have been held to be "professional services."

Accordingly, the appellate court concluded, the basic occurrence that had caused the injuries – the failure to mark the pipeline – was excluded from coverage by the professional services exclusion in Comforce's umbrella policy.

The case is *Energy Ins. Mutual Ltd. v. Ace American Ins. Co.*, No. A140656 (Cal. Ct. App. July 11, 2017).

Professional Services Exclusion Applied to "Any" Insured, Barring Coverage of Ponzi Scheme Losses

The U.S. Court of Appeals for the Eleventh Circuit has ruled that a professional services exclusion precluded coverage of losses stemming from a Ponzi scheme.

The Case

After a Ponzi scheme orchestrated by Scott Rothstein through his law firm, Rothstein Rosenfeldt Adler ("RRA") came to light, Gibraltar Private Bank and Trust Company, at which RRA had maintained accounts, and certain of Gibraltar's executives were sued by plaintiffs seeking to recover losses caused by Rothstein's scheme.

The Gibraltar defendants requested that their insurance carriers extend coverage under Gibraltar's executive and organization liability insurance policies toward a joint settlement of the claims. The insurers denied coverage, and Gibraltar and its executives began settlement discussions without the insurance companies. The parties eventually reached a settlement, which included Gibraltar and the executives assigning their policy rights to the bankruptcy trustees of RRA and of other entities that lost money in the Ponzi scheme.

After the assignments, the trustees unsuccessfully demanded coverage. The trustees then sued the insurers for breach of contract and bad faith.

The insurers argued that a "professional services exclusion" in their policies barred coverage. The U.S. District Court for the Southern District of Florida agreed, reasoning that the plain language of the exclusion barred coverage because some of the insured executives at Gibraltar had provided professional banking services directly to RRA.

The district court dismissed the trustees' lawsuit and the trustees appealed to the Eleventh Circuit. The trustees contended that the exclusion should be read to bar coverage only as to the claims against those insured executives who had directly provided professional services to RRA. Therefore, they argued, the district court had erred because claims against executives who were merely responsible for internal managerial banking functions, such as complying with federal reporting regulations, were not exempt from coverage.

The Eleventh Circuit Decision

The Eleventh Circuit affirmed.

In its decision, the circuit court explained that the professional services exclusion twice used the phrase "any insured," once in referring to the claim made and once in referring to the professional services rendered. According to the circuit court, the phrase "any insured" in the professional services exclusion "unambiguously" expressed a contractual intent to create "joint obligations."

The Eleventh Circuit added that the policies did not contain a severability clause. Accordingly, it concluded, the policy language was fatal to the trustees' argument.

The case is *Stettin v. National Union Fire Ins. Co. of Pittsburgh, Pa.*, No. 15-14716 (11th Cir. July 5, 2017).

Total Pollution Exclusion Precluded Coverage of Injuries Allegedly Caused by Chlorine Gas, and Did Not Make Coverage Illusory

A Pennsylvania appellate court has affirmed a trial court's decision that a total pollution exclusion precluded coverage for injuries allegedly sustained following a release of chlorine gas – and that the "potentially wide" pollution exclusion did not render coverage illusory.

The Case

A number of individuals alleging that they had been injured when chlorine gas was released by a neighboring scrap metal recycling facility sued the owners of the property.

The property owners' insurance carrier asserted that the policy's total pollution exclusion precluded coverage for the alleged release of the chlorine gas. The insurer filed a declaratory judgment action and moved for summary judgment.

In response, the property owners argued that chlorine was not a pollutant and that, if the exclusion were enforced, it would render coverage illusory.

The trial court ruled in favor of the insurers, and the property owners appealed.

The Appellate Court's Decision

The appellate court affirmed.

In its decision, the appellate court first found no genuine issue of material fact regarding the classification of chlorine as a pollutant under the policy.

Then, the appellate court ruled that the pollution exclusion did not render coverage illusory. The appellate court explained that insurance coverage was considered "illusory" where the insured purchased "no effective protection." By contrast, the appellate court added, an insurance policy was not illusory if it provided coverage for some acts, even if it had a "potentially wide exclusion."

Here, the appellate court decided there were "many types of incidents that could occur" on the insured property that would not be excluded by the policy's total pollution exclusion. For example, where a customer or invitee suffered a slip and fall on the property due to an irregular physical condition of the property's surface area due to poor maintenance or where a customer or invitee was on the premises while the insured was doing demolition work on a vehicle and the customer or invitee was injured by that process.

Accordingly, the appellate court concluded that the total pollution exclusion would not bar "almost all claims" made under the policy and that, even assuming that the pollution exclusion

was potentially wide, coverage still was not illusory because the policy would provide coverage under other reasonably expected sets of circumstances.

The case is *Atlantic Casualty Ins. Co. v. Zymblosky*, No. 1167 MDA 2016 (Pa. Super. Ct. July 17, 2017).

Faulty Workmanship Was Not an Occurrence, Tenth Circuit Rules

The U.S. Court of Appeals for the Tenth Circuit has affirmed a district court's decision granting summary judgment to two insurance companies, ruling that insured contractors' allegedly faulty workmanship was not an occurrence under the insurance policies.

The Case

George and Janis Fleming hired Timbersmith, Inc., to build a home for them in Utah. The Flemings asserted that LC Builders, Inc., working with Timbersmith, had incorrectly framed the house, and that both Timbersmith and LC Builders ultimately abandoned the project before construction had been completed.

The Flemings filed a lawsuit against LC Builders and an arbitration action against Timbersmith, asserting various claims for negligence and breach of contract. The Flemings prevailed in both actions and were awarded $1,113,780.63 against LC Builders and $1,109,642.50 against Timbersmith. The owners of both companies filed for bankruptcy before satisfying the judgments against them.

The Flemings sued the insurers for LC Builders and Timbersmith, seeking to recover the judgments. The district court granted summary judgment in favor of the insurers, and the Flemings appealed to the Tenth Circuit.

The Tenth Circuit's Decision

The Tenth Circuit affirmed.

In its decision, the circuit court explained that both insurers' policies covered "property damage" caused by an "occurrence," defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." It then pointed out that, under applicable Utah law, the "natural results of an insured's negligent and unworkmanlike construction" did not constitute an occurrence. Faulty workmanship, according to the Tenth Circuit, was not an insurable "fortuitous event."

Given that the Flemings had alleged only that faulty construction by LC Builders and Timbersmith had caused damage to their own work, the circuit court concluded that the district court had properly ruled in favor of the insurance companies.

The case is *Auto-Owners Ins. Co. v. Fleming*, No. 16-4118 (10th Cir. July 13, 2017).

"Clearly" No Coverage for TCPA Claim, Colorado District Court Rules

A federal district court in Colorado has ruled that an insurer had no duty to defend its insured in a case under the federal Telephone Consumer Protection Act ("TCPA") stemming from an unsolicited fax.

The Case

Heska Corporation was sued by a plaintiff who sought to recover under the TCPA on a class-action basis for an unsolicited fax he allegedly had received.

Heska's insurance carrier denied coverage and sought a declaratory judgment. The insurer moved for summary judgment.

The District Court's Decision

The district court granted the insurer's motion.

In its decision, the district court ruled that exclusions "clearly" removed the TCPA claim from coverage.

For example, the district court continued, the unsolicited-communications exclusion indicated that the insurer would not cover any claims for damages "arising out of unsolicited communications by or on behalf of the insured." In the district court's opinion, the plain meaning of "unsolicited communication" was "no mystery," meaning "any communication not requested by the recipient."

The district court stated that there could be "no reasonable disagreement" that the TCPA claim was "not only excluded from coverage" under Heska's policies, but was "clearly contemplated" by the insurer as a situation under which it would not provide coverage.

Accordingly, it concluded that the insurer had no duty to defend Heska in the TCPA case.

The case is *Phoenix Ins. Co. v. Heska Corp.*, No. 15-CV-2435-MSK-KMT (D. Colo. July 26, 2017).

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