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Financial Institution Bond Did Not Cover Bank's Loss in Absence of "Financial Benefit" to Employee, Fifth Circuit Decides

The U.S. Court of Appeals for the Fifth Circuit has ruled that a financial institution bond did not cover a $7.77 million loss claimed by a bank where the bank failed to demonstrate that an employee who allegedly had caused the loss had received an "improper financial benefit" as a result.

The Case

In July 2009, Renasant Bank notified the insurance company that had issued it a financial institution bond of potential losses resulting from allegedly dishonest or fraudulent lending activities of a former employee. The bank apparently learned of these activities when it reviewed certain outstanding loans in late 2007, as the real estate market deteriorated.

According to the bank, in 2006, the employee approved two multi-million dollar real estate development loans that she knew were secured by less collateral (that is, by less land) than she initially had represented to the bank in obtaining the bank's authorization for the loans. The bank also claimed that the employee had knowingly allowed improper loan disbursements to the developers of the land, who had provided inadequate documentation verifying the legitimacy of those disbursements.

The bank submitted a formal claim to its insurer for approximately $7.77 million in alleged losses, consisting of the combined outstanding payoff amounts and accrued interest and penalties.

The insurer denied the claim, and the bank sued it for breach of contract.

In its complaint, the bank asserted that the employee had colluded with one or more of the developers by extending credit for projects that promised the developers substantial front-end profits in exchange for improper financial benefits, such as gifts, entertainment, and travel. The bank, however, did not demonstrate that the employee actually had received anything for her actions, other than commissions on the loans.

The U.S. District Court for the Northern District of Mississippi concluded that the bond did not cover the bank's alleged losses because the bank had not demonstrated that the employee had received "an improper financial benefit," as required and defined by the bond.

The bank appealed to the Fifth Circuit, asserting that the employee's commissions on the loans had been an "improper financial benefit" within the meaning of the bond because the employee had not earned the commissions in the "normal course" of her employment.

The Fifth Circuit's Decision

The circuit court affirmed.

In its decision, the circuit court explained that the bond provided that a "financial benefit" did not include "any employee benefits earned in the normal course of employment, including: salaries, commissions, fees, bonuses, promotions, awards, profit sharing or pensions." The circuit court then rejected the bank's contention that because the employee allegedly had obtained commissions through her dishonest and fraudulent acts, the commissions had not been "earned in the normal course," and therefore, counted as an improper financial benefit that triggered coverage under the bond.

The Fifth Circuit reasoned that the phrases "earned in the normal course" and "employee benefits" identified a general category: "employee benefits earned in the normal course." Commissions, the circuit court continued, were a specific example of "employee benefits earned in the normal course." The Fifth Circuit then concluded that increased commissions – even if resulting from acts of employee dishonesty – did not count as the type of financial benefit that triggered coverage under the bond.

The case is *Renasant Bank v. St. Paul Mercury Ins. Co.*, No. 17-60168 (5th Cir. Feb. 6, 2018).

In Coverage Suit Over Title Insurance Policy's Exclusion 3(a), Eighth Circuit Rules in Favor of Insurer

The U.S. Court of Appeals for the Eighth Circuit has vacated a $6 million judgment against a title insurer after finding that the district court had erred when it refused to permit the insurer to present a defense under Exclusion 3(a) of the policy.

The Case

National City Bank of the Midwest loaned money to a developer that planned to build a condominium development on the Lake of the Ozarks in Sunrise Beach, Missouri. Before construction was completed, the developer defaulted on the construction loan agreement and went bankrupt.

The bank sold its interest in the development to Captiva Lake Investments, LLC, which also became the successor-in-interest to the bank under a title insurance policy the bank previously had acquired.

Captiva filed a claim under the title insurance policy, seeking coverage for mechanics' liens that had been filed against the development.

The insurer agreed to defend Captiva, specifically reserving the right to deny coverage based on an exclusion in the policy – Exclusion 3(a) – that excluded coverage for loss or damage that arose by reason of liens "created, suffered, assumed or agreed to by the insured claimant."

Thereafter, the insurer asked the U.S. District Court for the Eastern District of Missouri to declare that the title insurance policy did not cover the mechanics' liens. It contended that Exclusion 3(a) excluded from coverage any loss or damage related to the liens that were filed against the development because the bank had "created, suffered, assumed or agreed to" the liens. Specifically, the insurer contended that the liens arose from the bank's intentional conduct – its improvidence in opening the loan and its failure to monitor the loan – and that, as a result, any loss or damage caused by the mechanics' liens were excluded from coverage under Exclusion 3(a).

The district court did not allow the insurer to present its Exclusion 3(a) defense that the bank had "created, suffered, assumed or agreed to" the mechanics' liens. The district court determined that, to sustain that defense, the insurer had to present evidence of intentional misconduct, breach of duty, or otherwise inequitable dealings by the bank but that the insurer had failed to present any such evidence. In the district court's opinion, the insurer's evidence showed "negligence, mismanagement, maybe downright stupidity or recklessness," but it did not show "some intentional wrongful act that was designed to do harm to somebody or something."

The jury found that the insurer had breached the title insurance policy and awarded more than $6 million in damages to Captiva.

The insurer appealed to the Eighth Circuit.

The Eighth Circuit's Decision

The Eighth Circuit vacated the judgment on the jury's award and remanded the case to the district court.

In its decision, the circuit court, applying Missouri law, ruled that Exclusion 3(a) could apply even if the insured bank had not engaged in intentional misconduct or inequitable dealings.

Title insurance, the circuit court said, "was not built to bear the risk of insufficient construction funding."

Accordingly, it concluded that the district court had erred when it required that the title insurer show that the bank had engaged in intentional misconduct or inequitable dealings, and thus, had erred when it had excluded evidence regarding the insurer's Exclusion 3(a) defense.

The case is *Captiva Lake Investments, LLC v. Fidelity National Title Ins. Co.*, Nos. 16-1854 and 6-1923 (8th Cir. Feb. 28, 2018).

Policy's "Coverage Territory" Limit Did Not Warrant Judgment on Pleadings for Insurer, California Appeals Court Concludes

An appellate court in California has ruled that a trial court should not have granted judgment on the pleadings to a commercial general liability insurance company on the basis of its policy's "coverage territory" provision where the possibility remained that the insured might be sued in the coverage territory.

The Case

Planet Bingo, LLC, designed a handheld electronic gaming device, had it manufactured by an independent contractor in California, and shipped it to a distributor in the United Kingdom. After the device started a fire, the distributor agreed to pay approximately $2.6 million for the damages.

The distributor demanded that Planet Bingo pay the full amount of the settlement, and indicated that it was going to sue Planet Bingo to recover this amount. Planet Bingo notified its commercial general liability insurance carrier of the claim.

The insurer denied coverage for the claim on the ground that the fire had not occurred in the "coverage territory," which the policy defined as:

> a. The United States of America (including its territories and possessions), Puerto Rico and Canada;
>
> ***
>
> c. All other parts of the world if the injury or damage arises out of:
>
> > Goods or products made or sold by you in the territory described in a. above . . . provided the insured's responsibility to pay damages is determined in a "suit" on the merits, in the territory described in a. above or in a settlement we agree to.

Planet Bingo then sued the insurer, asserting causes of action for breach of contract, bad faith, and declaratory relief.

The insurer moved for judgment on the pleadings. Among other things, it argued that there was no coverage because the fire had not taken place in the coverage territory and because a suit had not been filed in the United States or Canada.

The trial court granted judgment on the pleadings against Planet Bingo and in favor of the insurer, reasoning that the fire had occurred outside the "coverage territory" as defined in the policy.

Planet Bingo appealed.

The Appellate Court's Decision

The appellate court reversed, ruling that the trial court had erred by entering judgment on the pleadings against Planet Bingo.

Planet Bingo argued that the "coverage territory" definition was unenforceable because the clause requiring that a suit must be filed in the United States is an exclusion, and that the "exclusionary" language was not conspicuous, plain, and clear. The court disagreed that this language was tantamount to an exclusion or that it was not conspicuous, plain, and clear.

But the court accepted Planet Bingo's alternative argument. It agreed that there was at least a "potential for future coverage" under the insurance policy because, even though no suit had yet been filed against Planet Bingo in the United States or Canada, "it was not impossible that one might be filed later."

The appellate court found that the insurer did not have any duty to defend Planet Bingo in the absence of a lawsuit being filed but, it said, the fact that there was at least a potential for future coverage was relevant to whether Planet Bingo could state a cause of action for bad faith and for declaratory relief. The potential for coverage was "sufficient" to make the insurer's investigation and other claims-handling activities "subject to the implied covenant of good faith and fair dealing," the appellate court decided.

It concluded that the trial court had erred when it decided that there was no coverage and no duty to defend under any circumstances, and it ordered the trial court to enter a new order denying the insurer's motion for judgment on the pleadings with respect to the causes of action for breach of contract, bad faith, and declaratory relief.

The case is *Planet Bingo, LLC v. Burlington Ins. Co.*, No. E066690 (Cal. Ct. App. Feb. 14, 2018).

Tenth Circuit Rejects Insured's Bid for Coverage of Suit Seeking Statutory Damages and Injunctive Relief under TCPA

The U.S. Court of Appeals for the Tenth Circuit has ruled that an insurance company had no duty to defend and indemnify its insured in a lawsuit alleging that the insured's use of telemarketing phone calls violated the Telephone Consumer Protection Act.

The Case

In April 2009, the federal government and a number of state governments sued DISH Network, alleging violations of, among other things, the Telephone Consumer Protection Act ("TCPA"). The TCPA makes it "unlawful for any person [subject to a limited list of exceptions] . . . to initiate any telephone call to any residential telephone line using an artificial or prerecorded voice to deliver a message without the prior express consent of the called party."

Pursuant to the TCPA, the state plaintiffs sought statutory damages for willful violations, statutory damages for non-willful violations, and injunctive relief.

DISH notified its insurance company, which asked the U.S. District Court for the District of Colorado to declare that it did not have a duty to defend or indemnify DISH in the governments' action. The parties moved for summary judgment.

The district court ruled that the insurer had no duty to defend DISH, concluding that the statutory damages available under the TCPA were civil penalties, and therefore, were uninsurable under Colorado public policy. The district court also determined that the injunctive relief requested by the governments did not qualify as "damages" under the policies because it was "focused on preventing future violations [of the TCPA], not on remedying past violations."

DISH appealed to the Tenth Circuit.

The Tenth Circuit's Decision

The circuit court affirmed.

In its decision, the circuit court first ruled that the TCPA's statutory damages were penal under Colorado law and that, even if they otherwise were covered under the insurance policies, Colorado's public policy prohibited the insurability of such penalties and barred coverage. Therefore, the Tenth Circuit decided, the insurer had no duty to defend DISH on these claims.

The circuit court reached the same conclusion with respect to the governments' claim for equitable relief. It reasoned that, under the plain language of its policies, the insurer had to "indemnify damages arising from *past* injuries, not the cost of preventing future violations." Therefore, it found, the injunctive relief requested by the state governments did not constitute "damages" as defined by the insurance policies.

Finally, the Tenth Circuit rejected DISH's contention that the governments' request for "other ancillary relief to remedy injuries caused by DISH Network's violation of the TCPA" obligated the insurer to defend DISH. The circuit court concluded that it would "not interpret a boilerplate provision seeking 'other ancillary relief' so as to make it impossible for insurers to avoid a duty to defend," even when the asserted damages were "uninsured by the policy."

The case is *Ace American Ins. Co. v. Dish Network, LLC*, No. 17-1140 (10th Cir. Feb. 21, 2018).

Tenth Circuit Predicts New York's Top Court Would Find That Damage from Faulty Subcontractor Work Was an "Occurrence"

A divided panel of the U.S. Court of Appeals for the Tenth Circuit has predicted that the New York Court of Appeals would join what the Tenth Circuit characterized as the "clear trend among state supreme courts" holding that damage from faulty subcontractor work constituted an "occurrence" under a commercial general liability insurance policy.

The Case

In 2005, Black & Veatch Corporation ("B&V") contracted with American Electric Power Service Corporation ("AEP") to engineer, procure, and construct several jet bubbling reactors ("JBRs"), which eliminate contaminants from the exhaust emitted by coal-fired power plants. For at least seven of these JBRs, which were located at four different power plants in Ohio and Indiana, B&V subcontracted the engineering and construction of the internal components to Midwest Towers, Inc. ("MTI"). Allegedly, deficiencies in the components obtained by MTI and constructed by MTI's subcontractors caused internal components of the JBRs to deform, crack, and sometimes collapse.

After work on three of the JBRs was completed, and while construction of four others was ongoing, AEP alerted B&V to the property damage allegedly arising from MTI's negligent construction.

AEP and B&V reached a settlement under which B&V agreed to pay more than $225 million in costs associated with repairing and replacing the internal components of the seven JBRs.

B&V sought coverage under its commercial general liability insurance policy. The U.S. District Court for the District of Kansas, interpreting New York law, held that damage arising from construction defects was not an "occurrence" under the policy unless the damage occurred to something *other* than B&V's own work product. The district court ruled that because the damage had occurred only to B&V's own work product – the JBRs – arising from its subcontractor's allegedly faulty workmanship, the policy did not provide coverage

B&V appealed to the Tenth Circuit.

The Tenth Circuit's Decision

A divided Tenth Circuit reversed the district court's decision to deny coverage.

The circuit court predicted that New York's highest court, the New York Court of Appeals, would decide that B&V's damages constituted an "occurrence" under its insurance policy because they were accidental (that is, they were "unexpected and unintentional") and because they harmed a third party's property (that is, the JBRs).

The Tenth Circuit noted that the "Your Work" exclusion in the policy excluded coverage for property damage to the insured's own completed work, but it added that the policy also provided that the "Your Work" exclusion "does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor."

In the circuit court's opinion, it would be redundant to say the policy did not cover property damage to B&V's own work (as stated in the "Your Work" exclusion) if the definition of "occurrence" precluded coverage for such damages in the first instance. Similarly, the circuit court added, there would be no reason for the policy to state that it covered damages to the insured's work when "the damaged work . . . was performed . . . by a subcontractor" if the basic

insuring agreement did not encompass these damages.

The circuit court rejected the insurer's contention that B&V could not rely on the "subcontractor exception" because, as an exception to an exclusion, it could not create coverage that did not already exist under the policy's basic insuring agreement. The Tenth Circuit reasoned that the "subcontractor exception" did not create coverage – the policy's basic insuring agreement created coverage.

Accordingly, the Tenth Circuit concluded, the policy's definition of "occurrence" encompassed damage to B&V's own work arising from faulty subcontractor workmanship.

The case is *Black & Veatch Corp. v. Aspen Ins. (UK) Ltd.*, No. 16-3359 (10th Cir. Feb. 13, 2018).

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