RIVKIN RADLER LLP
ATTORNEYS AT LAW

June 2018 | Insurance Update | WWW.RIVKINRADLER.COM

11th Circuit: Computer Fraud Policy Did Not Cover Loss That Did Not Result "Directly" From Computer Fraud

The U.S. Court of Appeals for the Eleventh Circuit has ruled that a computer fraud insurance policy did not cover a loss involving the "use" of a computer where the loss did not result "directly" from the computer fraud.

The Case

The insured operated a computer network that allowed consumers to call the system to put money onto general-purpose reloadable debit cards issued by banks. Criminals discovered a vulnerability in the insured's computer system such that, by making simultaneous phone calls to the system, they could have multiple fraudulent transfers made to individual debit cards.

The fraud cost the insured $11.4 million, including $10.7 million redeemed on debit cards issued by Bancorp Bank. Believing the transactions to be legitimate, the insured wired funds to Bancorp to cover the purchasing power made available on the debit cards.

The insured sought coverage under a computer fraud insurance policy for the $10.7 million lost to Bancorp debit card holders who had fraudulently manipulated its computer system.

The U.S. District Court for the Northern District of Georgia granted the insurer's motion for summary judgment, and the insured appealed to the Eleventh Circuit.

The Eleventh Circuit's Decision

The circuit court affirmed.

The insurance policy provided coverage for "loss of, and loss from damage to, money, securities and other property resulting directly from the use of any computer to fraudulently cause a transfer of that property...."

The circuit court first decided that the callers to the insured's system had "used" the system as a means of accomplishing their fraud and that, accordingly, the fraud had been perpetrated through the "use of a[] computer" within the terms of the insured's insurance policy.

The court then considered whether the "loss of ... money" that the insured had suffered had resulted "directly" from the use of its computer system. The circuit court held that, for

purposes of the insured's policy, one thing resulted "directly" from another if it followed "straightaway, immediately, and without any intervention or interruption."

The circuit court reasoned that "several steps" typically intervened between the fraudulent manipulation of the insured's computer system and the insured's loss; namely, the insured's transfer of money to Bancorp to cover purchases made on the debit cards, debit card users making purchases from merchants, and Bancorp's transfer of funds to the merchants to cover the purchases.

The court determined that the loss occurred when Bancorp disbursed money to pay merchants for purchases made by cardholders. The "lack of immediacy" as well as the "presence of intermediate steps, acts, and actors" made it clear that the loss had not resulted "directly" from the initial fraud, and was not covered by the computer fraud policy, the circuit court concluded.

The case is *Interactive Communications Int'l, Inc. v. Great Am. Ins. Co.*, No. 17-11712 (11th Cir. May 10, 2018).

Fourth Circuit: No Coverage for Criminal Act

The U.S. Court of Appeals for the Fourth Circuit, affirming a district court's decision, has ruled that an insurer had no obligation either to defend or indemnify a defendant in a wrongful death action after he had been convicted of second degree murder.

The Case

After a jury convicted a University of Virginia senior of second degree murder, the victim's mother filed a multi-count wrongful death action against him, alleging four counts of negligence.

The defendant sought coverage for the lawsuit from the insurance company that had issued homeowners and excess liability insurance policies to his mother and stepfather.

The insurer asked a court to declare that it had no obligation to defend or indemnify the defendant, citing the "criminal act" exclusion in both of its policies. The insurer moved for summary judgment, arguing that because all of the factual allegations in the wrongful death action involved conduct that had been adjudicated as criminal, it had no obligation to either defend or indemnify the defendant.

The victim's mother contended that despite the defendant's conviction for second degree murder, whether he could have intended to harm her daughter was a highly contested fact given evidence of his extreme intoxication, and that summary judgment, therefore, was inappropriate.

The U.S. District Court for the District of Maryland ruled that the defendant's conviction for second degree murder was a criminal act and that the policies' exclusions for "any criminal act"

applied. It concluded that the insurer had no duty to defend or indemnify the defendant, and the dispute reached the Fourth Circuit.

The Fourth Circuit's Decision

The circuit court affirmed.

The circuit court agreed with the district court that the "unambiguous language" in the exclusions in the homeowners policy for personal injuries "resulting from any criminal" act and in the excess liability policy for injuries "arising out of any criminal" act entitled the insurer to summary judgment. The insurer was not required either to indemnify the defendant or provide him with a defense in the wrongful death action filed against him.

The case is *Love v. Chartis Prop. Cas. Co.*, No. 17-1467 (4th Cir. May 15, 2018).

Wisconsin: Supreme Court Finds No Coverage for Negligent Supervision Claim against Employer Stemming from Employee's Intentional Act

The Wisconsin Supreme Court has ruled that a business-owners liability insurance policy did not cover a negligent supervision claim arising out of an employee's intentional act of physically punching a customer in the face.

The Case

The owner of a convenience store was sued for negligent supervision by a customer who alleged that he had been punched in the face by the store's security guard. The owner's insurer asked the trial court to declare that its insurance policy did not provide coverage, arguing that there was no coverage for a negligent supervision claim based on an intentional assault.

The trial court ruled that the insurance policy did not provide coverage. It reasoned that punching somebody was "not a negligent act" and that the customer had not alleged any facts separate from the punch in the face to support a negligent supervision claim.

The court of appeals reversed in a split decision, holding that a reasonable insured would expect coverage for the negligent supervision claim alleged in the customer's complaint.

The dispute reached the Wisconsin Supreme Court.

There, the insurer argued that only an "occurrence" triggered coverage and that the court should reject the customer's attempt to "bootstrap negligence into the case" as a separate tortious act by alleging that the owner was negligent in training and supervising the security guard.

The Wisconsin Supreme Court's Decision

The court reversed and held that there was no coverage under the insurance policy.

In its decision, the court explained that the policy applied only to bodily injury caused by an "occurrence," defined in the policy as an accident.

Intentionally punching someone in the face was "not an accident under any definition," the court found.

Accordingly, it said, the negligent supervision claim against the owner could qualify as an occurrence only if facts existed showing that the owner's "own conduct accidentally caused" the customer's injuries. Because there were no facts in the customer's complaint alleging any specific separate acts by the owner that caused the customer's injuries, there was "no occurrence triggering coverage for the negligent supervision claim."

The court noted that the only specific assertion that the customer made in this regard was that the owner should have trained the security guard not to hit people.

The court concluded that when a negligent supervision claim was based entirely on an allegation that an employer should have trained an employee not to intentionally punch a customer in the face, no coverage existed.

The case is *Talley v. Mustafa*, No. 2015AP2356 (Wis. May 11, 2018).

California: Supreme Court Finds Coverage for Negligence Claim against Employer Stemming from Employee's Intentional Act

The California Supreme Court has ruled that a third party's suit against an employer for the negligent hiring, retention, and supervision of an employee who intentionally injured the third party alleged an "occurrence" under the employer's commercial general liability insurance policy.

The Case

A construction company that contracted with a California school district to manage a construction project at a middle school hired an assistant superintendent for the project. Several years later, a 13-year-old student at the school sued the construction company, alleging that the assistant superintendent had sexually abused her. The student asserted a claim against the construction company for negligently hiring, retaining, and supervising the assistant superintendent.

The construction company tendered the defense to its insurer. The insurer sought declaratory relief, contending that it had no obligation to defend or indemnify the construction company.

The district court ruled in favor of the insurer, and the construction company appealed to the U.S. Court of Appeals for the Ninth Circuit. The circuit court asked the California Supreme Court to answer the following question:

> When a third party sues an employer for the negligent hiring, retention, and supervision of an employee who intentionally injured that third party, does the suit allege an "occurrence" under the employer's commercial general liability policy?

The insurance policy defined "occurrence" as "an accident."

The California Supreme Court's Decision

The California Supreme Court said "yes" to the certified question.

In its decision, the court acknowledged that the assistant superintendent's alleged sexual misconduct was a willful act "beyond the scope of insurance coverage," but explained that a cause of action for negligent hiring, retention, or supervision sought "to impose liability on the employer, not the employee."

The court then ruled that the assistant superintendent's intentional conduct did "not preclude potential coverage" for the construction company. The construction company's negligent hiring, retention, and supervision "were independently tortious acts" that formed the basis of its claim against its insurer, the court reasoned.

The court concluded that, absent an applicable exclusion, employers legitimately could expect insurance coverage for claims of negligent hiring, retention, or supervision – even when an employee's conduct was deliberate – just as they did for other claims of negligence.

The case is *Liberty Surplus Ins. Corp. v. Ledesma & Meyer Constr. Co., Inc.*, No. S236765 (Cal. June 4, 2018).

Illinois: Appellate Court Decides Trigger for Malicious Prosecution Claim Was When Prosecution Began, Not at Exoneration

An appellate court in Illinois, affirming a trial court's decision, has ruled that an insurer had no duty to defend or indemnify its insured against a malicious prosecution claim where the prosecution began before the insurer had issued any insurance policy to its insured.

The Case

In February 2015, a private investigator was sued for malicious prosecution by a plaintiff who alleged that, in the late 1990s, the investigator and others "conspired to frame" him for a 1982 double murder.

The plaintiff alleged that he was indicted in March 1999 and pleaded guilty in September 1999 to the murder of one of the victims and the voluntary manslaughter of the second victim. In October 2013, prosecutors announced that they were re-investigating the murder case and, in October 2014, they asked that the charges against the plaintiff be vacated; he was released that day.

The investigator sought coverage for the lawsuit from the insurer that had issued annual insurance policies to him beginning in 2006. In particular, the investigator sought coverage under the 2014-2015 policy, which covered the time when the plaintiff was exonerated.

The insurer asked an Illinois state court to declare that it owed no duty to defend or indemnify the investigator in the plaintiff's lawsuit because the plaintiff did not assert any claim for "personal injury" caused by an "offense" committed during the policy periods. It pointed out that it was not the investigator's insurer at the time the plaintiff allegedly was framed or at the time of his guilty plea and conviction.

The investigator claimed that coverage was triggered when the "offense" of malicious prosecution was completed and that the malicious prosecution alleged by the plaintiff was not completed until his 2014 exoneration.

The trial court granted the insurer's motion for summary judgment, and the investigator appealed.

The Appellate Court's Decision

The appellate court affirmed, holding that the "trigger of coverage" for an underlying malicious prosecution claim was the date on which the underlying prosecution commenced, not the date of the exoneration.

In its decision, the appellate court rejected the investigator's contention that coverage only was triggered when all of the elements of the tort of malicious prosecution – including the plaintiff's exoneration – had been fulfilled.

According to the appellate court, the misconduct allegedly committed by the investigator was what led to the plaintiff's 1999 plea and conviction, and the plaintiff's 2014 exoneration was not part of any offense committed by the investigator. Because no offense by the investigator occurred during the 2014-2015 policy period, the insurer did not owe coverage for the plaintiff's action and was entitled to summary judgment, the appellate court concluded.

The case is *First Mercury Ins. Co. v. Ciolino*, No. 1-17-1532 (Ill. Ct. App. May 11, 2018).

California: District Court Finds No Coverage for Environmental Cleanup Costs Stemming from Consent Order

A federal district court in California has ruled that insurers did not have to defend or indemnify their insured for its costs to clean up a contaminated facility that the insured assumed under a consent order with a state agency.

The Case

Several years after the Alabama Department of Environmental Management ("ADEM") sent a notice of violation to the operator of a facility in Huntsville, Alabama alleging that its "release of chlorinated solvents and other volatile compounds represents a discharge of pollutant to waters of the State," the company entered into a consent order with the ADEM that provided that the company would "address environment conditions" at the Huntsville site.
The company sued its insurers, seeking to recover the costs associated with the cleanup. In response, the insurers argued that they had no duty to defend or indemnify the company because no lawsuit had been filed against the company.

The insurers moved for summary judgment.

The District Court's Decision

The district court granted summary judgment in favor of the insurers.
In its decision, the district court explained that the insurers' policies provided that the insurers had the right and duty to "defend any suit" against the company seeking damages on account of covered property damage and that they also could investigate and settle any "claim or suit" as they deemed expedient.

The district court then pointed out that no lawsuit had been filed against the company with respect to the Huntsville site and that the costs associated with the cleanup of the environmental contamination at the Huntsville site were incurred only after the company agreed to enter into a consent order to resolve the ADEM's investigation.

The district court, applying California law, reasoned that the duty to defend did not extend to "an administrative investigation or other proceeding against an insured related to alleged environmental contamination." Accordingly, the district court ruled that the insurers did not have a duty to defend the company.

The district court further concluded that the insurers did not have any duty to indemnify the company because its obligations under the consent order were not "damages," or money it was legally obligated to pay as ordered by a court.

The case is *Arrow Electronics, Inc. v. Aetna Casualty & Surety Co.*, No. CV 17-5247-JFW (JEMx) (C.D. Cal. May 15, 2018).

Georgia: District Court Decides That Pollution Exclusion Barred Coverage of Suit Seeking Damages for "Noxious Odors" Emanating from Holding Pond

A federal district court in Georgia has ruled that a pollution exclusion precluded coverage for a lawsuit against a company alleging property damage caused by noxious odors emanating from a holding pond.

The Case

Property owners near a holding pond used to store nutrient-rich water disposed of by poultry plants in Alabama sued the company that operated the pond for property damage allegedly caused by noxious odors emanating from the pond.

The company tendered the lawsuit to its insurer for defense and indemnification.

The insurer refused to defend the company in the property owners' action, contending that the property owners' claims were excluded by the policy's pollution exclusion.

The company sued its insurer, which moved for judgment on the pleadings.

The District Court's Decision

The district court granted the insurer's motion, ruling that the policy's pollution exclusion "clearly and unambiguously" excluded coverage for the claims asserted by the property owners against the company.

In its decision, the district court found that the alleged noxious odors "plainly" fell within the policy's unambiguous definition of "pollutants." The district court explained that the allegedly noxious odors were irritants or contaminants because the property owners alleged that the odors themselves were causing their injury.

Moreover, the district court added, the odors fell "neatly within a defined category of pollutants: "fumes."

The district court also decided that the alleged property damage arose "out of the . . . migration, release or escape" of the noxious odors within the meaning of the insurance policy because it occurred when they "emanate[d]" from the holding pond and "travel[ed]" onto the property owners' land. The district court also observed that the property owners identified the holding pond as the source of the odors and alleged that the company rented the land where the holding pond was located.

Thus, the district court concluded, the pollution exclusion, which excluded coverage when the injurious pollutants migrated, released, or escaped "from any premises, site or location ... rented" to the insured, "plainly applie[d]," and the pollution exclusion excluded coverage for the claims asserted by the property owners in their lawsuit.

The court also found that a fertilizer application endorsement to the policy did not yield coverage because the property owners were not alleging harm arising from the application of fertilizers, but from odors from the holding pond.

The case is *Recyc Systems Southeast, LLC v. Farmland Mut. Ins. Co.*, No. 4:17-CV-225 (CDL) (M.D. Ga. May 16, 2018).

RIVKIN RADLER
ATTORNEYS AT LAW

Rivkin Radler LLP
926 RXR Plaza, Uniondale NY 11556
www.rivkinradler.com