

A VICTORY FOR COMPUTER FRAUD POLICY HOLDERS: COURT FINDS INSURANCE COVERAGE FOR FRAUDULENT MONEY TRANSFER INSTRUCTIONS HOW TO PROTECT YOUR COMPANY

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A computer fraud policy holder recently won an important victory in the United States Court of Appeals for the Sixth Circuit in a case entitled, *American Tooling Center v. Travelers Casualty and Surety Co. of America*. If your business has suffered or suffers a loss due to fraudulent money transfer instructions and your insurance carrier denied your claim, *American Tooling Center* could be your ticket to getting your insurance carrier to cover the claim. Below highlights what you need to know and what steps you can take to keep your company protected.

I. Background.

American Tooling Center, Inc. ("ATC"), a tool and die manufacturer in Michigan, subcontracted out portions of its work to a Chinese company. Somehow, a third party imposter intercepted an e-mail from ATC to the Chinese company requesting invoices that needed to be paid. The imposter then e-mailed ATC, advising that due to an audit ATC should transfer money to a different bank account than it usually did. By the time ATC realized it had been conned, it had already transferred \$834,000 to the imposter.

Travelers, its insurance company, denied ATC's computer fraud coverage claim, and the U.S. District Court for the Eastern District of Michigan ruled that the denial was valid.

II. Key Arguments and Rulings on Appeal.

The appeals court surprisingly rejected all of Travelers' arguments. Below is what you need to know about Traveler's key arguments and the appeals court's rulings:

(1) Argument: ATC did not suffer a direct loss because the loss did not occur when ATC paid the imposter. Rather, the loss occurred when it subsequently paid its subcontractor, i.e. the loss was not direct.

Ruling: The appeals court stated that that argument was devoid of common sense.

(2) Argument: The imposter's conduct did not constitute computer fraud because there was no hacking or some other intrusion and control of the insured's computer.

Ruling: Because the policy did limit computer fraud to those actions, the appeals court held that the imposter's actions constituted computer fraud.

(3) Argument: ATC's loss was not directly caused by computer fraud because the direct cause was ATC transferring the money (Step 2) and not the fraudulent email (Step 1).

Ruling: The appeals court rejected that argument, stating that ATC had established that the computer fraud (Step 1) was the immediate cause of the loss (Step 2).



(4) Argument: There was no coverage for ATC's loss due to the insurance policy's exclusions, including as to "Exclusion G," which barred coverage for losses caused by the inputting of "Electronic Data" by an individual with authority to enter the "Insured's Computer System." Travelers' position was that because the individual at ATC who entered the wiring instructions had authority to do so, there was no coverage for the loss. Travelers had successfully made that argument in *Aqua Star (USA) Corp. v. Travelers Casualty and Surety Co. of America*, which was a case based on a very similar set of facts decided by the United States Court of Appeals for the Ninth Circuit.

Ruling: The appeals court pointed out that the policy's definition of "Electronic Data" excluded "instructions or directions to a Computer System." As such, Exclusion G did not apply.

Based on the foregoing, the appeals court held that there was coverage for ATC's loss. If other courts follow, *American Tooling Center* could change the landscape of computer fraud insurance litigation.

III. Key Factors to Consider When Purchasing Coverage for Computer Fraud.

ATC did achieve a victory against Travelers, but at what cost? In addition, as the ruling in *Aqua Star (USA) Corp.* demonstrates, victory was not assured.

To maximize coverage for computer fraud and minimize the need for litigation to obtain coverage, companies should do the following before purchasing insurance for computer fraud:

1. Read the terms of the proposed policy, especially the exclusions, very carefully;
2. Know how court(s) that could end up being the venue for a policy dispute have interpreted similar policy terms;
3. Evaluate which uncovered losses you are willing to live with; and
4. Determine whether any insurance company is willing to provide coverage not provided by the policy that you are considering purchasing, including fraudulent instruction insurance.

Only if you follow those steps then can you make an informed decision regarding the risks you are willing to take.

Joshua Bevitz is a partner in Newmeyer & Dillion's Walnut Creek office, and a member of the firm's Cybersecurity practice. As an experienced Insurance litigator, Josh advises his clients on proactive measures and potential pitfalls related to their cyber insurance policies. For questions on how you can protect your business, you can reach Joshua at joshua.bevitz@ndlf.com.

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