

## News & Alerts

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### **New York Court Rules Property Insurance Does Not Cover Losses From Counterfeit Check Scam**

Check scams are as old as checks themselves, but today's check fraud is quick moving, hard to detect – and likely not covered by the theft provisions of a typical business insurance policy. Unlike a burglar who may throw a brick through your window under cover of darkness, today's check scammer often involves his or her unsuspecting victim in the chain of events leading to the loss. Once involved, policy exclusions that prevent coverage for an insured's own actions can leave the insured empty-handed twice over – once from the criminal and again under the insurance policy.

Recent check scams have the feel of many day-to-day business transactions. A person presents a very realistic-looking check that is to cover a wire-transfer or cash payment to someone else. The victim deposits the check and then follows the instruction to move the cash on to the intended recipient. For instance, a check is presented to cover a down payment with a request that the funds be wired promptly to a third-party to meet a closing deadline. Days after the cash is sent over the wire from the victim's account, the check reaches the payees bank and is discovered to be fraudulent or counterfeit. At that point, the phony story is discovered, the bank wants the money and the victim is left "holding the bag."

As a New York law firm recently discovered, being the victim of a larceny does not mean that theft coverage in an insurance policy will be there to pay the loss. In *Martin, Shudt, Wallace, DiLorenzo & Johnson v. Travelers Indem. Co. of Conn.*, 2014 WL 460045 (N.D.N.Y. Feb. 5, 2014), the law firm received a cashier's check for \$95,000 as payment for money believed to be owed to one of its clients. The firm deposited the check, waited for the depository bank to make the funds available, and then wired all but a few hundred dollars of the payment to a third party as instructed by its client. It wasn't long before the firm learned that the check was forged, resulting in the bank taking the funds from the firm's account.

Even though the act was larceny and the law firm was the victim, the firm's property insurance would not cover the loss. The firm had a "Businessowners Property Coverage Special Form" that insured against "direct physical loss of or damage to Covered Property, ... including money or securities ... ." However, the policy excluded loss resulting from "[v]oluntary parting with any property by you or anyone else to whom you have entrusted the property."

The law firm (perhaps predictably, as lawyers are apt to do), sued the insurer claiming that the policy covered the loss from the crime. The firm argued that the parting was not voluntary because it was secured by false pretenses or fraud. It also alleged that the exclusion was ambiguous, because it did not clearly state whether property obtained by false pretenses or trickery were or were not covered. The reasonable interpretation, the firm argued, was that the exclusion only covered gifts, loans or bailments made purposely by the firm.

The Court was not swayed. First, the Court readily found that the exclusion, by its terms, broadly applied to *any* voluntary parting with property, regardless of origin. Next, the Court found that it was not reasonable for a policy to cover loss from a gift, loan or bailment – and as such the firm’s purported limitation of the exclusion to gifts, loans and bailments was unreasonable. Why would a policy need to exclude something that would be covered in the first place, the court reasoned.

The Court also rejected what likely was the common assumption of most insureds – that theft provisions in a policy should cover “thefts of all kinds.” Because the perpetrator’s conduct was larceny under New York law, the insured argued, the loss should be covered to be consistent with an insured’s reasonable expectations. The Court, however, found that there was no theft-specific coverage – only a definition of “covered loss” – and no definition of theft in the policy. The voluntary parting exclusion itself also did not carve out losses by theft for coverage. As a result, the Court ruling surmised that there was no basis for an insured to conclude that every theft would be covered.

Theft by elaborate schemes is a growing crime. Counterfeit checks, bogus wiring instructions, altered account numbers, cyber crime and other schemes take advantage of the clunky interface between new and old payment technologies. Businesses with frequent transactions cannot rely on property policies to provide coverage for losses from today’s scams. Better protection can be gained through commercial crime, cyber liability and other more robust insurance products now offered to cover specific risks. Even those policies, however, include limitation on coverage such as the “voluntary parting” exclusion that can carve out crime losses that many insureds’ wouldn’t consider to be insured. As a result, a business should not select a policy based on name alone. Rather, the details matters: a policy must be carefully matched to the specific risks that a business faces in its financial transactions.

*Chandra Lantz is a trial lawyer and member of Hirschler Fleischer’s Insurance Recovery Team and Construction & Suretyship Practice Group. She handles a variety of commercial business disputes, including insurance recovery and policyholder claims litigation. Chandra also dedicates a substantial portion of her practice to construction industry and real estate development advisory services and dispute resolution.*

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