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Fifth Circuit Upholds Denial of Claim Seeking Recovery for Phishing Losses

The U.S. Court of Appeals for the Fifth Circuit ruled that a commercial crime insurer was entitled to summary judgment in a suit by the victim of a phishing scheme because the insured never "held" the diverted funds.

The Case

First, some quick background on the insured's business. The insured, RealPage, partners with online payment processors in collecting rents and sending them to property managers. Using RealPage's online platform, tenants submit bank account and credit card information, which RealPage then transmits to third-party processors.

In this case, Stripe was the third-party processor. Based on information and instructions received from RealPage, Stripe withdrew funds from the tenant's bank account or credit card account and deposited them into Stripe's own accounts with Wells Fargo. Stripe kept a fraction for itself as a transaction fee and designated a percentage for RealPage as its transaction fee. The balance was then transmitted to property managers' bank accounts within a few days.

Now for the phishing scheme. In April 2018, a RealPage employee got a fake email that appeared to be from Stripe. The employee clicked on the link and entered login credentials. Using this information, the crooks changed RealPage's payment instructions and diverted over $10 million to the crooks' bank accounts.

RealPage and Stripe managed to reverse some disbursements after learning of the fraud but ultimately lost about $6 million. RealPage reimbursed its property manager clients whose funds were stolen and then sought recovery under its commercial crime policy with National Union ($5 million limit) and its excess fidelity and crime policy with Beazley.

The commercial crime policy covered property that the insured (1) owns or leases, or (2) that the insured holds for others whether or not the insured was legally liable for the loss of such property. National Union paid RealPage about $ 1 million – the amount Stripe had designated as RealPage's transaction fees – because RealPage owned these funds. But National Union and Beazley denied coverage for the sums to be paid to the property managers because RealPage did not own or lease those funds, nor did it ever hold them. Only Stripe "held" the funds.

RealPage sued its insurers in federal court in Texas. RealPage argued that because it controlled Stripe's disbursement of the funds, RealPage "held" the funds. But the district court found that RealPage never actually possessed the funds intended for the property managers, and therefore did not hold the funds. It found that the theft was not covered and awarded the insurers summary judgment. RealPage appealed.

The Fifth Circuit's Decision

Applying Texas law, the Fifth Circuit first acknowledged a rule of contract construction – that it must give effect to all words and provisions in the insurance policy – and treated the term "hold" as being distinct from, but related to, the terms "own" and "lease." The court next looked to legal dictionaries for the meaning of "hold" in the context of financial transactions of this sort. The court concluded that "hold" in this context meant to "possess or occupy" or "to keep in custody or under an obligation."

The court found that RealPage never possessed or kept the disputed funds in its custody. The transactions between tenants, Stripe, and RealPage's property manager clients were structured so that once the tenants entered their bank or credit card account information into RealPage's online portal, RealPage transmitted that information to Stripe for processing and did not save it. Stripe drafted funds directly from the tenant's account and disbursed the funds to the appropriate property manager. RealPage was not involved beyond providing tenants' and property managers' account information. The court noted that “when money changed hands, RealPage's fingers never touched it.” RealPage provided routing instructions to Stripe. Stripe transferred all the funds. RealPage never “held” the funds intended for the property managers.

RealPage argued that “control” rather than “possession” is the proper definition of “hold” in this context. The Fifth Circuit disagreed, finding that the dictionary definitions that RealPage cited did not show that “hold” equated with “control.” And even if “hold” could mean “control,” RealPage failed to show that it ultimately controlled the funds designated for the property managers. All funds were processed through Stripe using Stripe’s bank accounts. RealPage had no right to draw funds from those accounts.

RealPage advanced two other arguments that the court also rejected.

First, it argued that it held the funds in bailment for the property managers. But because RealPage never possessed any of the funds, it could not satisfy the elements of a bailment.

Second, it argued that Stripe was its agent. But the services agreement between RealPage and Stripe expressly disclaimed any agency relationship and RealPage produced no evidence to show that an agency relationship existed or that it controlled Stripe’s payment processing beyond giving Stripe routing instructions.

Because the court found that RealPage never held the funds at issue, it found no coverage under the policies and affirmed the district court's award of summary judgment for the insurers.

The case is *RealPage, Inc. v. Nat'l Union Fire Ins. Co.,* No. 21-10299 (5th Cir. Dec. 22, 2021).

Sixth Circuit Affirms That Insured's Notice of Pond Closure Claim Was Too Late

The U.S. Court of Appeals for the Sixth Circuit held that a metal parts manufacturer failed to timely notify its insurer of a claim involving the cleanup and closure of its wastewater treatment ponds, having notified its insurer more than two years after entering into a consent order.

The Case

The insured, Canton Drop Forge, made metal parts for the energy, aerospace, and transportation industries. Oils used in the manufacturing process were directed to man-made wastewater treatment ponds. This allowed Canton to skim off the oils on top and dispose of them. Over time, oil accumulated at the base and sides of the ponds and in surrounding soils.

In August 2012, a federal EPA inspector informed Canton that it would need to close the ponds. Canton sought to enroll the ponds in Ohio's Voluntary Action Program so that it could clean up the ponds without federal enforcement. But in January 2013, EPA formally notified Canton that its ponds violated state and federal regulations. EPA asserted that Canton ignored if the oils on the bottom and sides of the ponds were hazardous waste and that Canton failed to obtain permits required for surface impoundments of hazardous waste.

Over the next 18 months, Canton negotiated with the federal EPA and Ohio EPA. In September 2014, Canton agreed to pay a civil penalty and close the ponds. The Ohio EPA determined that Canton had successfully completed its pond closures in August 2016.

In November 2016, Canton sought recovery of its pond closure costs under its primary and excess insurance policies. The insurer, who issued both policies, denied coverage on several grounds and Canton sued. The district court ruled for the insurer for several reasons. Canton appealed.

The Sixth Circuit's Decision

The Sixth Circuit addressed only a single issue – late notice.

The policies required Canton to give notice of an occurrence "as soon as practicable."

Under Ohio law, the court noted than an insurer may deny coverage for late notice when the insurer is prejudiced by the insured's unreasonable delay. Prejudice arises when delayed notice causes an insurer to lose options to protect its interests, leaving it to deal with the decisions made by the insured. An unreasonable delay leads to a rebuttable presumption of prejudice.

Applying these rules, the Sixth Circuit concluded that Canton's notice to its insurer was untimely. Canton was aware by 2012 that its ponds would need to be closed. And in 2014, federal and state agencies formally ordered Canton to remediate and close them. Yet Canton kept its insurer in the dark until November 2016, after Canton had already negotiated its liability and spent $5 million on the cleanup. The court found that this delay was unreasonable as a matter of law.

The court also found that the delay prejudiced the insurer because it denied the insurer the opportunity to negotiate Canton's liability and the cost of cleanup. The court rejected Canton's argument that the insurer would not have done anything differently as speculative.

The court held that notice was late under both the primary policy, and the excess policy, which attached at $1 million. Canton did not notify the insurer until after it had spent $5 million. The court reasoned that Canton knew it was spending these sums and had no excuse not to notify its insurer sooner. It affirmed the district court's judgment for the insurer.

The case is *Canton Drop Forge, Inc. v. Travelers Cas. & Sur. Co.,* No. 21-3349 (6th Cir. Dec. 14, 2021) (this case is unpublished and citation may be limited).

Louisiana Court of Appeals Enforces Employee Exclusions Despite Existence of Independent Contractor Agreement

The Louisiana Court of Appeals found that an insurer rightfully denied coverage under the employee exclusions of a business automobile policy, where the undisputed facts showed that the injured claimant lacked the right of supervision and control. The court looked to the totality of factors, and not just an independent contractor agreement, in assessing whether an employer-employee relationship existed.

The Case

Claimant was a passenger in an 18-wheeler truck owned by the insured, Circle L Trucking. Claimant had recently been hired as a helper to assist the driver load and unload the contents of the trailer. Claimant alleged that the driver failed to control his speed, causing the truck to hydroplane and roll off the road, resulting in serious injuries to claimant. Claimant filed a direct action against Circle L and its business auto insurer, asserting theories of negligence, *respondeat superior,* and agency.

The insurer denied coverage because claimant was an employee of Circle L, and therefore, excluded from coverage. The insurer relied on exclusions for workers' compensation, employer's liability, and fellow employees. It moved for summary judgment.

Claimant opposed the motion because he was an independent contractor, not an employee of Circle L. The trial court disagreed and awarded the insurer summary judgment. Claimant appealed.

Appellate Court's Decision

The Louisiana Court of Appeals affirmed based on the policy's employee exclusions.

The court focused on the nature of the relationship between claimant and Circle L. Claimant began his relationship with Circle L about two weeks before the accident. His role was a helper, in which he loaded and unloaded a trailer at the direction of the driver. Claimant testified at his deposition that he believed he worked for Circle L.

The driver, however, testified that claimant was a contract laborer and not an employee of Circle L. The driver testified that both he and claimant signed independent contractor agreements and that neither were employees. He added that Circle L had no employees because everyone signed independent contractor agreements. He also testified that a helper was free to accept or decline work on any given day that it was offered, but conceded that a helper who did not do what was asked would be terminated.

The independent contractor agreement provided that claimant is not an employee of Circle L, that Circle L would pay claimant a fixed sum per day but would not withhold taxes, provide any employee benefits, or extend workers' compensation coverage to claimant.

Relying on Louisiana Supreme Court precedent, the court looked to several factors to determine whether a worker is an employee or independent contractor. The appellate court observed that the principal test in determining whether someone is an independent contractor is the degree of control over the work reserved by the employer. But the court recognized that it is necessary to consider the totality of factors in determining whether an employer-employee relationship exists.

The court held that claimant was not an independent contractor because, among other reasons, he lacked the right of supervision and control. The independent contractor agreement

did not call for specific work to be performed according to claimant's own methods or for a specific time. The court noted that this lack of independence and the lack of the right of supervision and control was undisputed. Therefore, despite the independent contractor agreement, the uncontested facts demonstrated that claimant was working as an employee of Circle L and that the employee exclusions applied.

The case is *Ellis v. Circle l Trucking, LLC,* No 2021 CA 0457 (La. Ct. App. Dec. 30, 2021).

Court Holds that Pennsylvania's Late Notice Rule Bars Coverage for Opioid Claim

A federal court in Alabama held that a pharmaceutical manufacturer's claim for excess coverage for opioid lawsuits was barred as untimely because it did not report the loss to its insurer until 2.5 years after being served with the first complaint.

The Case

The insured, KVK-Tech Inc., manufactured and distributed generic pharmaceutical products including prescription opioid medications. On August 17, 2017, the first of many opioid lawsuits were filed against KVK in Alabama state court. After removal, the cases were transferred to the multi-district litigation in the Northern District of Ohio.

KVK had two primary claims-made products liability policies with Ironshore Specialty Insurance Company, in effect from July 22, 2016 through August 21, 2017 and from August 21, 2017 through August 21, 2018. KVK also had claims-made excess liability policies with Navigators Specialty Insurance Company for the same period. The Navigators policies followed form to the Ironshore policies.

KVK notified Ironshore of the first opioid suit on August 24, 2017. Ironshore provided KVK with a defense. KVK notified certain other excess insurers of the opioid suits on June 25, 2019 but did not notify Navigators until January 27, 2020. Navigators denied coverage based on late notice.

KVK filed a complaint for declaratory judgment and breach of contract against Navigators in Alabama state court. The case was removed to federal court. Navigators moved for judgment on the pleadings.

The Decision

The court granted Navigators' motion. Applying Pennsylvania law (where the policies were delivered), the court ruled that Navigators did not have to cover the opioid suits because KVK did not notify Navigators of the loss during either the policy period or the applicable extended reporting period. Under the insuring agreement, KVK had 30 days after the policy expired to report the claim to Navigators. The policy expired on August 21, 2018, but KVK did not report the suit to Navigators until January 27, 2020.

Aside from the reporting requirement in the insuring agreement, the court found that KVK also violated the notice requirement in the policy's conditions. Under the conditions section, notice was to be given "as soon as practicable." The court determined that KVK's notice to Navigators in January 2020 was not as soon as practical given that KVK notified its other excess insurers of the opioid lawsuits six months earlier.

The court also rejected KVK's argument that breach of the notice condition barred coverage only if Navigators was prejudiced by the delay. The court observed that Pennsylvania law does not require an insurer to show prejudice when the relevant notice provision is contained in a claims-made and reported policy like the one at issue.

Thus, the court granted Navigator's motion and held that it did not have to provide insurance coverage to KVK for the opioid lawsuits.

The case is *KVK-Tech, Inc. v. Navigators Specialty Ins. Co.*, 21-cv-286-KD-N (S.D. Ala. Dec. 23, 2021).

Washington Court Applies Asbestos Exclusion to School Construction Project Claim

A federal court sitting in the State of Washington, rejected the insured's efficient proximate cause theory and enforced an asbestos exclusion involving a claim over negligent disbursement of asbestos-contained in a school's pipe system.

The Case

A school district hired Chas. H. Beresford Co., Inc. for a project at an elementary school. The project called for the replacement of flooring throughout the school and upgrades to the school bathrooms. Beresford did the flooring work and subcontracted the bathroom work to Cobra Construction Company.

The school district sued Beresford, alleging that while performing the bathroom work, Cobra "improperly and negligently disturbed asbestos containing materials ('ACM') in the bathroom wall cavities" of the school, damaging the school by causing the release, discharge, and dispersal of asbestos throughout the building. The school district alleged that Beresford breached its contract by causing or allowing the asbestos disturbance and property damage.

Beresford had a liability policy with Charter Oak Fire Insurance Company, which contained an asbestos exclusion. The exclusion barred coverage for "bodily injury" or "property damage "arising out of the actual or alleged presence or actual, alleged or threatened dispersal of

asbestos." Beresford also had an excess liability policy issued by Travelers, which contained a similar asbestos exclusion.

Charter Oak and Travelers filed a declaratory judgment action in federal court. The insurers moved for partial summary judgment as to claims related to asbestos contamination. Beresford sought to avoid the asbestos exclusion by relying on Washington state's "efficient proximate cause rule," which provides coverage "where a covered peril sets in motion a causal chain, the last link of which is an uncovered peril." Beresford characterized the underlying action as alleging "initial negligent installation of plumbing" that merely caused asbestos damage. It argued that the asbestos exclusion was inapplicable.

The Decision

The court granted the insurers' motion. The court rejected Beresford's framing of the underlying action as one for negligent construction rather than an asbestos release. The court determined that the underlying action alleged a single event, that is, when Cobra improperly stripped hard fittings containing ACM and dropped them to the bottom of the wall cavities.

The court further noted, that even if it were to apply an efficient proximate cause analysis, it would still find that the asbestos exclusion barred coverage because the initial peril was Cobra's asbestos disbursement, not wall damage, negligent construction, or negligent installation of plumbing. The court noted that no one alleged that the damage to the walls from discarded hard fittings caused the asbestos damage. Rather, the asbestos was in the hard fittings.

The court granted the insurers' motion and concluded that the policies did not cover damages arising out of the discharge or dispersal of asbestos, asbestos fibers, or asbestos containing materials.

The case is *Charter Oak Fire Ins. Co. v. Chas. H. Beresford Co.*, C21-93RSM (W.D. Wash. Dec. 14, 2021).

North Carolina Trial Court Finds that Separate Damage Incidents Arose from Same Windstorm, Only One Deductible Applies

A North Carolina trial court held that damage to a policyholder's roof over several days arose from the same underlying windstorm, and therefore, constituted a single occurrence. The court also found that a first-party property insurer could not recover contribution from a third-party liability insurer because the policies did not insure the same risks.

The Case

Under a services agreement, Logipia USA provided warehouse space and transportation services for Hyosung USA's products. The agreement required Logipia to maintain a warehouseman's liability insurance policy but allowed Hyosung to maintain its own property insurance on its inventory. Logipia purchased third-party liability insurance from Hartford Fire Insurance Company. Hyosung purchased first-party property insurance with Travelers Property Casualty Company of America.

On April 19, 2019, large portions of the warehouse's roof became detached during a windstorm. Water entered the warehouse, damaging Hyosung products. Plastic sheeting was hung from the ceiling as a temporary repair to prevent additional damage. On April 26, 2019, the plastic sheeting failed and allegedly activated the warehouse's sprinkler system, causing further water damage to Hyosung's products.

Following the incidents, Hyosung sought reimbursement from Logipia under the services agreement, but Logipia refused to pay. Hyosung also submitted a claim to Travelers for

reimbursement under the property policy. Travelers refused to reimburse Hyosung fully for the loss because (i) the "other insurance" provision in its policy required Hyosung to recover those sums from Hartford and (ii) each incident was a separate "occurrence" caused by a windstorm, subjecting Hyosung's claims to a windstorm deductible of $1.55 million for each incident.

Hyosung sued Travelers, Hartford, and Logipia in North Carolina state court and then moved for summary judgment.

In its first motion, Hyosung argued that the Hartford policy was not "other insurance" under the Travelers policy. Hyosung contended that the Travelers and Hartford policies covered separate interests and risks. Hartford agreed with Hyosung, contending that the Travelers policy's "other insurance" provision applied only to first-party property damage policies insuring Hyosung, not to third-party liability policies like the Hartford policy. Travelers countered that both the Travelers and Hartford policies provide coverage when Hyosung's products suffer direct physical loss from a covered cause of loss and that the first-party property/third-party liability distinction was irrelevant.

In its second motion, Hyosung argued that the incidents comprised a single "occurrence" subject to a single windstorm deductible under the Travelers policy. Travelers responded that the two incidents were separate and distinct "occurrences," and therefore, Travelers properly deducted two $1.55 million windstorm deductibles from its payment to Hyosung.

The Decision

The court granted Hyosung's motions.

The court noted a lack of North Carolina appellate case law on the "other insurance" provision and looked to Fourth Circuit case law for guidance. Based on these cases and secondary authorities, the court noted that first-party property insurance and third-party liability insurance

do not insure the same interest. The court found that "[w]hile each policy provides coverage for damage to the same property, each policy protects a separate insured from a separate risk – Hyosung got first-dollar protection if its property is damaged whereas Logipia got coverage if it is legally obligated to pay damages resulting from loss to that same Property."

Turning to whether there was a single "occurrence" or two "occurrences," the court noted that North Carolina courts apply a "cause" test rather than an "effects" test. Under North Carolina law, where "all subsequent damages flow from [a] single event, there is but a single occurrence[.]" Applying this test, the court found that the hole in the warehouse's roof that allowed wind and rain to damage Hyosung's products during the first incident was the same hole in the warehouse's roof that allowed wind and rain to damage Hyosung's products in the second incident. The court further found that the fact that both incidents took place one week apart was immaterial because both incidents were caused by the same April 19 windstorm.

For these reasons, the court granted Hyosung's motions for summary judgment and entered judgment directing Travelers to pay to Hyosung the $1.55 million that Travelers deducted from its payment to Hyosung for the second incident.

The case is *Hyosung USA Inc. v. Travelers Prop. Cas. Co. of Am.*, 19-CV-23974 (N.C. Sup. Ct., Mecklenburg Cty., Dec 16, 2021).

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