

Your Coverage Advisor



Crime Coverage

By: Keven Drummond Eiber – keiber@brouse.com

Employee theft and fraud is a significant threat to all businesses. Brouse McDowell's Insurance Recovery Group has seen an increasing number of insurance claims for crime losses in recent years.

Smaller businesses, those with fewer than 100 employees, are particularly vulnerable. Businesses this size tend to take fewer preventative steps and also suffer disproportionately larger median losses.

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Are You the Next Target?

By: Lucas M. Blower – lblower@brouse.com

During the holidays, hackers stole the credit card information of up to 40 million customers of the retail giant, Target. According to Brian Krebs – the blogger who first reported the data-breach – stolen account information is already flooding underground markets.

If the holidays were busy for Target employees managing the public relations fallout, they were even busier for the plaintiffs' bar. The first class-action complaint was filed against Target within 24 hours after the hack became public. Dozens more followed.

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Crime Coverage

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In its 2012 Report to the Nations on Occupational Fraud & Abuse, the Association of Certified Fraud Examiners reported:

- **The average organization loses 5% of its revenues to fraud each year**
- **The median loss for small businesses was \$147,000**
- **The criminal activity lasted a median of 18 months before detection**
- **Billing schemes, check tampering and skimming were all very common methods of employee theft from smaller businesses**
- **Most theft and fraud schemes are discovered by an insider tip, and are discovered only rarely by an outside audit**
- **40 to 50 percent of victim companies do not recover any of their losses**

Typical first-party property insurance does not cover crime-related losses. Crime insurance fills this gap and provides coverage for losses that are the result of criminal acts committed by employees, such as theft, forgery, extortion, and fraud. A commercial crime policy typically provides several different types of crime coverage, such as: employee dishonesty coverage; forgery or alteration coverage; funds transfer fraud coverage; money and securities coverage; and money orders and counterfeit money coverage.

Crime policies most commonly provide “fidelity” coverage, also called employee theft coverage or employee dishonesty coverage, which insures against employee theft of the insured business’s property and employee theft of client property. The typical policy provides that the insurance company will pay for “the Insured’s direct loss of, or direct loss from damage to, Money Securities and Other Property directly caused by

Theft or Forgery committed by an Employee, whether identified or not, acting alone or in collusion with other persons.”

As with any type of insurance policy, the coverage is not all encompassing, but will be limited by the terms, conditions and exclusion in the policy. One of these is that the crime must be committed by an “employee.” An employee may be more narrowly or more broadly defined by the actual policy, which can vary, but one definition is “a natural person while in the regular service of the [insured company] in the ordinary course of such [insured company’s] business, whom such [insured company] compensates by Salary and has the right to govern and direct in the performance of such service, including any part-time or seasonal employee...” Employee typically will not include the owner of a business nor will it include employees of other companies to which certain functions are outsourced, such as payroll functions.

Another nuance to be aware of is that crime policies cover a business when an employee steals from the business itself. If an employee, in the course of his or her employment, steals from someone else, such as a customer, and the business is merely vicariously liable for the customers’ loss, a crime policy likely will not cover that loss. The one exception to this general rule is when the business is “legally liable” for the client or customer’s property. A business’s vicarious liability for its employee’s theft does not make it “legally liable” for the property that was stolen. When used in connection with crime insurance, “legally liable” connotes that the organization has a specific legal duty as to the property, not the employee’s conduct. Generally, this means that the business

had actual possession or custody of the client's property when the theft occurred. This issue often arises when there is theft of property from a customer's location. The issue also frequently arises when there is theft from the personal bank account of a company officer or executive. When theft of property belonging to anyone other than the business itself is at issue, the policy must be read very carefully.

Finally, the loss must be the result of a crime, which means there was actual theft or fraud which was deliberate or intentional. Crime policies generally do not provide coverage for losses that result from honest mistakes or simple mismanagement. Nor do they provide coverage when the cause of the loss is unknown. Where the only evidence of a loss is an inventory shortfall or accounting discrepancy, generally a crime policy will provide no coverage. However, where there is some evidence, even if it is circumstantial, that the loss is the result of employee crime, inventories and accounting records can and should be used to prove the amount of the loss.

Crime insurance policies are not as standardized as other types of insurance policies,

and they may contain many conditions regarding reporting the crime, both to law enforcement authorities and to the insurance company. Importantly, crime policies contain claim deadlines and the time for reporting a claim will begin to run upon "discovery" of the crime.

Typical first-party property insurance does not cover crime-related losses. Crime insurance fills this gap and provides coverage for losses that are the result of criminal acts committed by employees.

Although the time to make a claim does not begin to run based merely on unsupported suspicion of employee misconduct, a business easily can find itself up against a deadline before its investigation of such conduct has been completed. The concept of "discover" is that

a reasonable person would realize a theft had occurred, even if the exact details are not known. "Discovery" of a loss for insurance purposes occurs when the insured discovers facts showing that dishonest acts occurred and appreciates the significance of those facts.

No business is immune from loss due to employee dishonesty, and the ACEE Report to the Nations on Occupational Fraud & Abuse, which describes the most common types of employee crimes, their detection and prevention, is worth reading. Crime insurance is worth considering as one means of protection if your business does not already purchase it. If your business already does purchase this type of coverage, it is worth carefully reading the policy and discussing its terms and conditions, and the specifics of your business operations, with your broker. By familiarizing yourself with your crime policy, and understanding its terms and conditions, you will be better prepared, in the event your business suffers a crime loss, to maximize your potential recovery. ■





Coverage Conversations

By Gabrielle T. Kelly – gkelly@brouse.com

Q:

I was sued, so I retained defense counsel and resolved the lawsuit. I think my insurance would have covered the claim. Is it too late to provide notice and receive reimbursement from the insurance company?

A:

Although an insurance policy may require prompt notice, the specific facts of a case determine whether notice

was given in a reasonable time or notice was so untimely as to bar coverage. Even if it is determined that the policyholder's notice was late, most courts consider whether the insurance company was actually prejudiced by the late notice before finding coverage has been forfeited. A majority of courts place the burden on the insurance company to prove that the insured's notice was late and that it prejudiced the company. Other courts, including Ohio, have taken the approach that late notice gives rise to a presumption of prejudice to the insurance company, and the insured has the burden of proving that the insurance company was not prejudiced. There are only a few courts that have ruled that late notice alone relieves the insurance company of its obligation to pay.

Therefore, if you believe that you had a covered claim or you are unsure about a claim and have not yet informed your insurance company, consider taking the following steps:

- Don't assume that you are foreclosed from obtaining coverage because notice was not provided as soon as you learned of the lawsuit.
- Review the notice provisions in your policies carefully to determine the required timing and manner of notice.
- Send written correspondence to your insurance company notifying them of the claim and all policies that may potentially provide coverage.
- Gather documents regarding the nature of the lawsuit in case the insurance company requests additional information to evaluate the claim.
- Gather documents that explain the investigation process and litigation strategy that defense counsel used in handling the lawsuit.
- Because jurisdictions handle late notice differently, consider contacting experienced coverage counsel to determine the applicable law and the best method for pursuing reimbursement. ■



Are You the Next Target?

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Target is not alone. Hackers have stolen huge amounts of private data from companies as diverse as Wyndham Hotels, Yahoo!, and Sony. In Sony's case, the thieves acquired the personal information of 77 million subscribers to the PlayStation Network, a popular video gaming service.

The cost of a data-breach can be crippling. According to the Ponemon Institute – a research center studying information security policy – the average cost of a data-breach is \$188 per record and \$5.4 million total per breach.

With cyber-security breaches on the rise, businesses are looking to their insurers to mitigate their risk. But insurers are reluctant to pay under traditional insurance policies. For example, in *Zurich v. Sony*, a case pending before a trial court in New York, the insurer is arguing that a commercial general liability (“CGL”) policy does not cover losses resulting from a data-breach. Sony, the policyholder, disagrees. It argues that its CGL policy entitles it to a defense against the dozens of class-action lawsuits that cropped up after it was hacked in the spring of 2011. Policyholders and insurers alike will watch this case for guidance on whether CGL policies provide coverage against hackers.

Whatever the outcome in Zurich, it will bear only on an older, more traditional form of insurance. There are, however, newer policies that expressly protect against cyber threats. This cyber insurance goes by various names – such as Information Security Insurance or Data Breach Insurance – and the precise coverage varies across the policies. Generally, though, cyber insurance protects against the following risks:

- **Data Breach**
- **Regulatory Investigation**
- **Misappropriation of Intellectual Property**
- **Transmission of Malicious Code**
- **Data Recovery**
- **Business Interruption**
- **Extortion**

If your company collects sensitive data, you may want to purchase one of the various cyber policies. Work with your insurance broker to identify which policy is right for you. Your business will then be prepared if it is the hackers' next target. ■

Coverage for Consequential Damages Caused by Construction Defects:

Westfield Insurance Co. vs. Custom Agri Sys., Inc. – One Year Later



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Until recently, Ohio courts were split as to whether an insured's defective or faulty workmanship on a construction project would constitute an "occurrence" under a typical commercial general liability policy ("CGL"). Recently, the Ohio Supreme Court weighed in on the issue, holding that these types of claims "are not claims for 'property damage' caused by an 'occurrence' under a [CGL] policy." See *Westfield Ins. Co. v. Custom Agri Sys., Inc.*, 2012-Ohio-4712 ("Custom Agri"). Despite the broad wording of the Court's holding, the decision cannot be read to prohibit all claims in which defective construction is alleged.

Custom Agri's Narrow

Scope. Most commentators agree that the Ohio Supreme Court adopted the rule that construction defects are "occurrences" within the meaning of CGL policies, but only if property other than the policyholder's own work is damaged. Thus, the Court's opinion was consistent with prior Ohio decisions which had universally treated claims alleging such "consequential damages"

as alleging an "occurrence."

Some commentators and insurers, however, have asserted that the Court left open the question of whether consequential damages can satisfy the occurrence requirement.

Ohio Appellate Treatment of Custom Agri.

A little more than a year after the Ohio Supreme Court's decision in *Custom Agri*, only one Ohio appellate court has provided any further guidance. In

a recent case in the Tenth District, a subcontractor was hired to remove and reinstall air conditioning units, among other things. The subcontractor negligently reinstalled the units, damaging the units but causing no damage to other property. Relying upon *Custom Agri*, the appellate court identified the relevant question as "whether the claim in this case involves defective construction or workmanship."



Notwithstanding this broadly-phrased question, the court was careful to point out that the only damage at hand was to property within the subcontractor's contractual scope of work. Thus, as was the case in *Custom Agri*, the faulty work at hand did not cause damage to property other than the policyholder's own work.

On the Horizon. The battle regarding coverage for construction defects continues nationwide. *Custom Agri* and similar cases have been criticized by other state's high courts as the minority position that finds no support in the specific language of the policy. Conversely, the Sixth Circuit Court of Appeals recently held that defective construction does not constitute an occurrence under Kentucky law. Most notably, that court also found no occurrence

where the policyholder caused damage to the property of others that the policyholder was hired to "control." Such a distinction is inconsistent with prior Ohio decisions, of course, but perhaps illustrates the type of arguments Ohio policyholders can expect to face from their insurers when they make claims for construction defects.

Protect Yourself. Damages arising from construction defects can be significant, and many contractors still expect them to be covered by CGL policies.

Policyholders should consider retaining experienced coverage counsel to assist in the claim process. ■

Policyholders can protect themselves by doing the following:

- **Owners or general contractors should consider requiring a performance bond from downstream contractors in an amount that will protect them if there is defective workmanship.**
- **In the event of a claim, the policyholder should recognize that not all defective construction claims are barred, and carefully analyze whether the defective workmanship caused damage to property other than the policyholder's own work.**
- **The policyholder should analyze the potential applicability of any policy exclusions.**



Attorney Highlights

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HONORS AND APPOINTMENTS

Four Brouse McDowell Insurance Recovery attorneys have been designated as Certified Specialists in Insurance Law by the Ohio State Bar Association. Only 14 lawyers received this certification designation state-wide. Brouse McDowell's Certified Insurance Law Specialists are Paul A. Rose, Keven Drummond Eiber, Amanda M. Leffler, and Caroline L. Marks.



Caroline L. Marks has been appointed to the Ohio State Bar Association Insurance Coverage Specialty Board.

Amanda M. Leffler was recently named as Co-Chair of the firm's Litigation Practice Group. Amanda will share responsibilities of managing the firm's litigation practice, including its insurance recovery practice, with Keven Drummond Eiber.

Brouse McDowell has been included in the 2014 "Best Law Firms" rankings published in U.S. News and World Report. The firm received the highest possible, Metropolitan Tier 1, ranking in Akron for Insurance Law, as well as several other practice areas. The firm also received Metropolitan Tier 1 rankings in Cleveland for Corporate Law.

Five Brouse McDowell Insurance Coverage attorneys have been selected as 2014 Ohio Super Lawyers® and Rising Stars. Brouse Insurance Coverage attorneys listed in the 2014 Edition of Super Lawyers® are, Keven Drummond Eiber, Amanda M. Leffler, and Paul A. Rose. 2014 Rising Stars from Brouse's Insurance Recovery Practice Group are Kerri L. Keller, and Caroline L. Marks. Twenty-three Brouse attorneys were selected for these honors across all practice areas. Super Lawyers®, published by Law and Politics Media, Inc., represents only 5% of Ohio attorneys while Rising Stars represents less than 2.5% of attorneys under 40, or who have been practicing law ten years or less.

COMMUNITY INVOLVEMENT

Kerri L. Keller was recently elected Vice President of the Board of Directors for the Victim Assistance Program of Summit County.

Amanda M. Leffler recently joined the Board of Directors for United Disability Services.

ARTICLES

Paul A. Rose and Caroline L. Marks co-authored the article, "Ohio Supreme Court Case May Impact Significantly Coverage Case Settlements," published in the February 2014 issue of the Cleveland Metropolitan Bar Association Journal, Vol. 6, No.7.

