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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

11th Circ. Deepens Divide On Ambiguous Policy Language

By **John Bonnie** (December 20, 2019, 3:18 PM EST)


John Bonnie

The U.S. Court of Appeals for the Eleventh Circuit's new opinion in Principle Solutions Group LLP v. Ironshore Indemnity Inc.[1] is perhaps less surprising for its finding of coverage for a cybertheft claim than for the path the majority traveled in reaching that conclusion. It's arguably more noteworthy what the majority did not say than what it did.

As addressed below, the majority opinion in Principle Solutions construed causation principles and the meaning of the term "directly" in the context of first-party insurance in a manner inconsistent both with Georgia law and the Eleventh Circuit's own recent but unpublished opinion in Interactive Communications International v. Great American Insurance Co.,[2] leaving policyholders and first-party insurers with confusing guidance respecting future disputes.

The dispute in Principle Solutions arose out of a phishing attack in which criminals impersonated a company director, advising the company controller of the need for a wire transfer that day as part of an alleged a corporate acquisition. According to the email, an attorney named Mark Leach would contact the controller to provide further instructions.

The controller confirmed by return email that she would work with Leach. Minutes later, an individual representing himself as Leach telephoned the controller and provided further instructions about the funds transfer, citing the company director's approval and urgent need for the transfer. The controller agreed to call Principle's bank, Wells Fargo, to confirm the ability to process an international wire in non-U.S. currency.

The controller got confirmation that Wells Fargo could make the transfer, and logged into an account to begin the wire process. She confirmed this by email to Leach who then emailed instructions for a $1.717 million transfer to a Chinese beneficiary at an address in China through a Chinese bank.

Leach followed up with a phone call to confirm her receipt of instructions. The controller's assistant then logged into Principle's Well Fargo account to create the wire order, and the controller approved it.

An email from Bryan Chu, a fraud consultant in Wells Fargo's fraud department, immediately warned the controller of potential fraud, and advised her that the transfer would require additional approval. The email included extensive warnings about imposter fraud, and Chu advised that he would be calling the controller.

The controller then called the fraud department rather than await the call from Chu, and spoke to someone else, who asked the controller to verify how the wire instructions had come from the company director. The controller spoke with Leach again, and obtained the requested information about the origins of the wire transfer request. The controller relayed the information back to the bank, and Wells Fargo released the funds. All of this happened in a span of two hours.

The fraud was discovered the next day, but the funds could not be recovered.

Principle sought coverage from Ironshore under a commercial crime policy covering losses that result directly from a fraudulent instruction directing a financial institution to debit one's transfer account and transfer, pay or deliver money or securities from that account.

The policy defined fraudulent instruction in part as "a computer ... telephone or other ... instruction initially received by you, which instruction purports to have been issued by an 'employee,' but which in fact was fraudulently issued by someone else without your or the 'employee''s knowledge or consent."

Ironshore denied coverage, contending that there was no fraudulent instruction directing Wells Fargo to debit Principle's account, since the initial email from the company director merely told the controller to await instructions from the lawyer, rather than providing her with transfer details.

Ironshore also contended that the loss did not result directly from any fraudulent instruction, given numerous intervening events which occurred after the director's purported email, and before the transfer actually occurred.

Coverage litigation ensued against Ironshore, and the parties filed cross motions for summary judgment. The U.S. District Court for the Northern District of Georgia concluded that the Ironshore policy language was ambiguous with respect to whether the fraudulent instruction must be the immediate cause of a loss or whether, as here, intervening events could interrupt the chain of causation and still be afforded coverage.

The district court's opinion relied on a similar finding by the U.S. District Court for the Southern District of Texas in Apache Corp. v. Great American Insurance Co.[3] Soon after the Georgia district court issued its decision in Principle Solutions, however, the U.S. Court of Appeals for the Fifth Circuit reversed Apache Corp., finding that the insured's fraud loss did not result directly from the use of a computer because the email which began the fraud was "but one step in Apache's multi-step, but flawed, process" causing the loss.

In light of this reversal, Ironshore asked the Georgia district court to reconsider its decision, but the motion was denied.

In the same time frame, another Georgia district court judge reached a quite different outcome, applying a policy similarly requiring a loss to result directly from fraud, in InComm Holdings Inc. v. Great American Insurance Co.[4] There, InComm operated a network allowing customers to put money onto reloadable debit cards by calling a 1-800 number, leading the caller to an interactive voice response, or IVR, system that used computers to process voice or telephone codes to obtain credit for chits purchased at retail stores.

Fraudsters discovered that they could redeem a single chit multiple times due to a glitch in the IVR system. InComm suffered losses of more than $11 million from the duplicate redemptions and sought coverage from Great American under a computer fraud policy. The district court in InComm found a lack of coverage on two bases, the second being that the loss did not result directly from the fraud as required by the policy.

The Eleventh Circuit affirmed in an unpublished opinion, Intractive Communications International v. Great American Insurance Co.,[5] and rejected InComm's contention that directly meant proximately, holding instead that the common, dictionary meaning of the term meant "straightaway, immediately, and without any intervention or interruption."

The appeals court held that while the fraudsters' manipulation of InComm's IVR system may have set into motion a chain of events that resulted in a loss, intervening actions between that manipulation and the loss broke the causal chain, such that the loss did not result directly from the initial fraud as required by the policy.

In appealing Principle Solutions to the Eleventh Circuit, Ironshore expressly relied upon the district court's judgment in InComm, which was then on appeal to the Eleventh Circuit. Ironshore furthermore relied upon the reversal of Apache by the Fifth Circuit.

Deciding Principle Solutions, the majority of the three judge Eleventh Circuit panel found no ambiguity either in the meaning of fraudulent instruction that "direct[ed] a financial institution to debit," or in the meaning of a loss resulting directly from such a fraudulent instruction. Without discussing, distinguishing or even citing InComm or Apache, the majority disagreed that the word "directly" in the policy required an immediate link between the fraudulent instruction and the loss.

Instead, citing what it contended was the ordinary meaning of the phrase "resulting directly from," the majority equated it with proximate causation, concluding that "directly" did not require an immediate link. Yet in InComm, another Eleventh Circuit panel held precisely the opposite and as Ironshore argued in Principle Solutions: that "directly" means "immediately," and does not mean "proximately."

In a further surprise, the Principle Solutions majority concluded that Principle's loss was proximately caused by the fraudulent instruction as a matter of law, because in its view, all of the acts occurring between the initial fraudulent email and the loss — including those of the alleged lawyer and Wells Fargo — were foreseeable, such that none could break the causal chain as a matter of law. The court invoked the exception to the rule that proximate cause is generally a fact question "where the evidence is clear and leads to only one reasonable conclusion."

Writing in dissent, the third member of the Eleventh Circuit panel concluded that the issue of causation was a fact issue that a jury needed to decide. Unlike the majority's determination that no unforeseen legal cause intervened between the company director's purported email and Principle's loss as a matter of law, the dissent noted that proximate cause is "undeniably a jury question" except "in plain and undisputed cases." While agreeing that proximate cause encompasses "natural and probable consequences," the dissent stated that such natural and probable consequences do not include those that are "merely possible."

Rejecting the majority's finding that all of the intervening acts and conduct between the initial email purportedly from the company director and the loss were foreseeable as a matter of law, the dissent identified eleven steps in the process — from the receipt of the initial director email to the loss — that potentially impacted whether Principle suffered a loss "resulting directly" from the fraud.

The dissent agreed that the controller's initial communications were a natural and probable consequence of the director's email, and that the director's email was the natural and probable consequence of the controller's approval of the wire transfer. The dissent stopped there, however, finding that whether the director's email proximately caused Principle's loss was a jury question.

In the view of the dissent, once Wells Fargo stepped in, the controller was no longer relying on the director's email, and once Wells Fargo placed a hold on the transfer, the link between the director's email and the loss was potentially short-circuited, given Principle's opportunity to prevent the loss.

In the dissent's view, a reasonable employee might have been led "to question the propriety of an unknown attorney providing international wire instructions for an American IT staffing company to pay over a million dollars to acquire a Chinese company" rather than calling Leach, "an unknown non-employee, to confirm the international wire instructions for an unspecified acquisition." In sum, a jury could determine that it was the controller's response to Wells Fargo's fraud investigation that directly caused the money to be released and Principle to suffer a loss, rather than the imposter director email.

Comment

The Eleventh Circuit's disregard of its prior decision in InComm, and the lack of even a mention of the decision are surprising and regrettable. If that holding could somehow be distinguished or harmonized with the decision reached in Principle Solutions, it was deserving of explanation. By omitting discussion of the court's own recent and facially contrary precedent in InComm, the Principle Solutions decision creates doubt about the controlling circuit authority, and presents inconsistent guidance to carriers and policyholders alike respecting the proper application of "resulting directly from" policy language.

The further lack of discussion by either the majority or the dissent about the trial court's reliance upon Apache, and the later reversal of that decision by the Fifth Circuit, is also unhelpful and equally

regrettable. The Apache trial court decision was a significant consideration in the district court's original order on summary judgment in Principle Solutions. While the Fifth Circuit's ultimate reversal of Apache was later addressed by the district court in Principle Solutions on motion for reconsideration to the district court by Ironshore, the court found the holding irrelevant because it addressed Texas rather than Georgia law.

Parties to insurance contract litigation are benefited by clear articulation of the law, and the bases on which cases are decided. Even a brief explanation by the Eleventh Circuit of how the Fifth Circuit's decision in Apache was no longer relevant or meaningful to the proper resolution of the issues in Principle Solutions would provide a useful road map for addressing similar issues in future coverage disputes.

If the decision of the majority and the dissent equating the term "directly" with "proximately" — despite the contrary decision in InComm equating "directly" with "immediately" — is not surprising enough, the majority's conclusion that proximate cause was shown as a matter of law is all the more so. With one of the three judges on the panel finding an issue for jury determination respecting proximate cause, and the acknowledged rarity in which proximate cause can be decided as a matter of law, the case shouts for rehearing en banc.

The full Eleventh Circuit should at the least consider the accuracy of the majority's finding of proximate cause as a matter of law, even if the recent and apparently contradictory holding in InComm continues to be disregarded.

The differing judgments about ambiguity by the district court and the appellate panel reveal the subjective and often unreliable task of determining whether insurance policy wording is ambiguous. The very same language the district court found ambiguous, the majority found unambiguous, while still deciding in favor of coverage. The dissent reached a third conclusion, finding a portion of the language ambiguous, and another part unambiguous.

The district court's initial path from citation of the policy language to a finding of ambiguity was a short one, while the Eleventh Circuit majority just as readily concluded that the same language was unambiguous. The inherently subjective nature of the ambiguity determination was revealed again just last year, when four federal judges — a district court judge and three appeals court judges — considered the same word in the same policy against the same undisputed facts, with two finding the word ambiguous, and two finding it unambiguous.[6] Pages of analysis in the Eleventh Circuit decision reveal hopeless disagreement about the meaning of certain words and the presence or absence of ambiguity.

With so many coverage disputes rising and falling on policy clarity or ambiguity, the process of deciding ambiguity is arguably on unreliable footing. This much is true: "almost any word or phrase may be rendered vague and ambiguous by dissection with a semantic scalpel."[7] A wholesale reconsideration of how an ambiguity analysis should be conducted is in order, with an identification of the necessary indices for an ultimate finding of ambiguity that does not simply hinge on summary, subjective conclusions.

John Bonnie is a partner at Weinberg Wheeler Hudgins Gunn & Dial LLC and a fellow of the American College of Coverage Counsel.

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[1] Principle Solutions Group LLP v. Ironshore Indemnity Inc., No. 17-11703 (11th Cir. December 9, 2019).

[2] Interactive Communications International v. Great American Insurance Co., 2018 WL 2149769 (11th Cir. May 10, 2018) .

[3] Apache Corp. v. Great Am. Insurance Co., 2015 WL 7709584, at *3 (S.D. Texas Aug. 7, 2015).

[4] InComm Holdings, Inc. v. Great Am. Ins. Co., 2017 WL 1021749 (N.D. Ga. Mar. 16, 2017).

[5] Intractive Communications Int'l v. Great Am. Ins. Co., 731 Fed. Apps. 929 (11th Cir. 2018).

[6] Jones v. Golden Rule Ins. Co., 748 Fed. Appx. 861 (11th Cir. 2018).

[7] Cole v. Richardson, 397 U.S. 238, 240, 90 S. Ct. 1099, 1101, 25 L. Ed. 2d 275, 276 (1970).

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