

# Breach of Contract Exclusion, Theft of Funds, Duty to Defend Coverage Update

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*The e-POST*

## **Breach of Contract Exclusion – Ninth Circuit (California Law)**

***Office Depot, Inc. v. AIG Specialty Ins. Co.***

--- Fed. Appx. ---, 2020 WL 6690619 (9th Cir. Nov. 13, 2020)

The U.S. Court of Appeals for the Ninth Circuit upheld the district court's grant of summary judgment, dismissing a case in which Office Depot sought coverage from AIG Specialty Insurance Co. (AIG) for a lawsuit alleging that Office Depot had violated the California False Claims Act.

In March 2009, David Sherwin (Sherwin), a former account manager with Office Depot, filed a whistleblower complaint, alleging that the company had committed multiple violations of the California False Claims Act. Sherwin's suit alleged that Office Depot had offered steep discounts to hundreds of public entities participating in the U.S. Communities Government Purchasing Alliance, then would discontinue the discount and require the public entities to purchase more expensive products, and/or overbill them for the products.

Office Depot sought coverage from AIG under its 2007-2009 media liability policies, but AIG denied coverage. Office Depot settled the underlying lawsuit, then commenced a declaratory judgment action against AIG seeking defense and indemnity for the underlying lawsuit and the settlement.

Though the district court held that coverage for the underlying lawsuit was barred under a California statute prohibiting insurers from providing coverage for an insured's willful acts, the appellate court first rejected that finding and held that the alleged violations of the False Claims Act were not inherently willful acts. On remand, the district court held that coverage was precluded under the AIG policies because the policies exclude coverage for claims arising out of any breaches of contract. The appellate court agreed, noting that California law interprets the phrase "arising out of" broadly, requiring only a "minimal causal connection" or "incidental relationship" between the alleged injury and the alleged breach of contract. The appellate court specifically rejected Office Depot's argument that coverage should not be precluded because the underlying complaint also alleged fraud against Office Depot, as those allegations still arose out of Office Depot's alleged breaches of its contracts with the public entities. Though "noting the uncomfortable breadth of such contract exclusions," the appellate court

ultimately held “that the allegations in the Sherwin lawsuit are premised directly or indirectly on Office Depot's contractual obligations and, therefore, the lawsuit is precluded from coverage under the contract exclusion.”

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### **Theft of Funds or Accounts Exclusion – District of New Jersey (New Jersey Law)**

#### ***Authentic Title Servs. Inc. v. Greenwich Ins. Co.***

2:18-cv-04131, 2020 WL 6739880 (D.N.J. Nov. 17, 2020)

The U.S. District Court for the District of New Jersey held that Authentic Title Services, Inc. (Authentic) was not entitled to summary judgment in a dispute with its insurer, Greenwich Insurance Company (Greenwich), for losses stemming from a scam where Authentic was tricked into sending loan proceeds to a fraudster. Authentic filed a complaint against Greenwich for insurance coverage, breach of contract, and denial of legal representation under its Title Professional Liability Errors and Omissions insurance policy.

Greenwich moved for summary judgment, relying on a coverage exclusion in the policy that excluded claims “based on or arising out of ... the commingling, improper use, theft, stealing, conversion, embezzlement or misappropriation of funds or accounts.” Greenwich contended that the exclusion applied because Authentic's claim originated from a scam where it was tricked into transferring funds to a fraudulent account. Greenwich classified that scam as “theft,” “stealing,” “conversion,” or “misappropriation.” Authentic filed a cross-motion for summary judgment, arguing that the terms within that exclusion were ambiguous. Authentic claimed that any ambiguities must be resolved in its favor, and, thus, it was entitled to summary judgment and insurance coverage.

The district court found Authentic's arguments unpersuasive, holding that the terms within the exclusion were unambiguous, have an understood meaning, and are “clear as written.” In addition, the district court stated that the exclusion, and specifically the terms “theft,” “stealing,” “conversion,” or “misappropriation,” “undoubtedly apply” to the scam where Authentic was tricked into transferring funds to a fraudulent account. The district court, therefore, declined Authentic's “invitation to rewrite the policy ...,” granted Greenwich's motion for summary judgment, and denied Authentic's cross-motion for summary judgment.

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### **Duty to Defend – Delaware (Massachusetts Law)**

#### ***Indian Harbor Ins. Co. v. SharkNinja Operating LLC***

N20C-02-014-PRW, 2020 WL 6795965 (Del. Super. Ct. Nov. 19, 2020)

The Delaware Superior Court ruled that Indian Harbor Insurance Company (Indian Harbor) has to defend vacuum cleaner maker SharkNinja Operating LLC (SharkNinja) in a suit by iRobot Corporation (iRobot) for patent infringement and false advertising. In the underlying suit, iRobot accused SharkNinja of using iRobot's advertising ideas as its own and running a smear campaign against iRobot's Roomba product line. Specifically, iRobot asserted that SharkNinja promulgated false claims against the Roomba product line to the advantage of SharkNinja's "Shark IQ" vacuum.

SharkNinja sought a defense from Indian Harbor under its two commercial general liability policies. Indian Harbor determined there was no coverage, asserting that the claims did not include potentially covered personal and advertising injury. Indian Harbor's position was that the false advertising claim did not meet the definition of "personal and advertising injury" because it did not allege a "disparagement" of iRobot's products. Additionally, Indian Harbor asserted that the intellectual property infringement and the "failure to conform" exclusions applied to preclude coverage.

The superior court, however, disagreed with Indian Harbor and held that the policies extended coverage for the claims. The superior court explained that the policies included a broad definition of "personal and advertising injury" and that iRobot's allegations asserted "disparagement" and use of another's "advertising idea" under the plain meaning of those terms. The superior court also found the exclusions inapplicable, concluding that Indian Harbor's reliance on the "failure to conform" exclusion was misplaced given that the complaint specifically alleged that iRobot's products and pricing were discredited. The superior court ultimately held that the complaint met Massachusetts' standard of asserting "general allegations" that present the "possibility that the [personal and advertising injury] claim falls within insurance coverage" such that Indian Harbor's defense obligation was triggered.

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