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Computer Fraud under Commercial Crime Policy: Ransom Payment to Hacker Not Covered

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These days, the threat of a ransomware attack to companies, hospitals, municipalities and financial institutions looms large, and insurance options have evolved to include coverage for it. A recent decision from the Indiana Court of Appeals shows why, as it held a Computer Fraud provision of a Commercial Crime Policy did not extend to an insured that paid ransom monies to cybercriminals because no fraud was committed by the attackers.[1]

In the case, a hacker used ransomware to hijack G&G Oil Co. of Indiana's network servers and workstations. The hacker demanded payment in Bitcoin in return for providing passwords to G&G Oil for access to its computer system. G&G Oil paid the hacker over $34,000 to release the ransomware. After payment, G&G Oil submitted a claim to Continental Western Insurance Company seeking coverage for the ransomware attack and ensuing losses under the Commercial Crime Coverage Part of its insurance policy. Continental denied the claim arguing that G&G Oil's losses did not result directly from the use of a computer to fraudulently cause a transfer of G&G Oil's funds, as the Computer Fraud provision of the policy requires.

G&G Oil then brought suit seeking a judgment requiring

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A Whole New World: Covid-19 and the Surety

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Before March, 2020, the headwinds in the construction surety industry were, by today's standards, slight. Growth in the construction industry was so strong that contractors could not find enough labor and skilled workers to supply their workforces. For the surety industry, the zero-loss ratio approach to bonding was in full effect. The good times were rolling.

The March Madness that followed was of quite a different character from the 64-team college basketball tournament of yesteryear. In March 2020, no one filled out a bracket. Instead, construction companies scrambled to keep up with government directives on workplace safety and whether their projects were "essential," prepared notice of delay and force majeure letters, reviewed insurance policies, filled-out Paycheck Protection Program ("PPP") loan applications, and hastily planned for an uncertain future. The COVID-19 pandemic had dropped like a bomb.

April showers soon followed. AM Best revised its market segment outlook for the surety segment from "Stable" to "Negative." AM Best cited the new hurdles of increased disruption in supply chains, government restrictions on labor, inevitable mass project delays, and the contraction of new construction due to decreased private lending and reduced legislative support for public funding on infrastructure spending.

Since the surety industry is tied inextricably to the construction industry, the impacts of COVID-19 on construction necessarily affect the surety world with equal measure. This article briefly explores the impact of the COVID-19 pandemic on the surety industry both in the near-term, particularly from a claim handling perspective, and in the long term relating to underwriting and bonding practices.

Near-Term Challenges: Handling Claims

Heavy increases in performance and payment bond claims are expected due to COVID-19. In evaluating claims, sureties and their counsel should look foremost to the notice requirements of the bonded contract, which often contain strict notice timelines and other conditions precedent to contractor recovery for delays or disruptions. Major milestone dates in the COVID-19 timeline (including the effective dates of the national emergency declaration and any state or county-mandated closures) should be cross-referenced with the notice dates and the contractual timelines to ensure that timely notice was provided.

Since bond language does not typically address contractual defenses to work stoppage, such as unforeseeable delays and acts of God, the incorporated bonded contract must be analyzed. Sureties and their counsel should review the particulars of applicable Force Majeure clauses to determine if epidemics, pandemics, and/or government-ordered shutdowns qualify as events of force majeure. Sureties should also examine

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the contract language to determine if applicable force majeure events are compensable in time, money, or both.

Other contract provisions could also justify the contractor's delay or non-performance due to COVID-19, such as Change in Law provisions (where states have ordered work shutdowns), unit pricing cost schemes, the change order process, stoppage of work provisions for hazardous conditions, and Emergency clauses. For example, the AIA A201-2017 Emergency clause, Section 10.4, requires the contractor to take measures in an emergency situation that, in its discretion, will "prevent threatened damage, injury, or loss." Non-contractual, common law defenses to performance claims, such as impossibility of performance, frustration of commercial purpose, and impracticability of performance should also be evaluated. This "kitchen sink" approach to defending claims is more appropriate than ever since the legal consequences of COVID-19 are unprecedented and it remains unclear which legal theories will prevail.

Furthermore, sureties and their counsel should coordinate with their principals to review CGL and business interruption insurances that may apply to COVID-19 disruptions and which could be used to defray payment or performance bond claims. All insurance coverages should be exhausted as a means of mitigating risk.

Finally, sureties need to work closely with their principals to ensure that detailed records are maintained which account for all delays, damages, and disruptions from COVID-19. Sureties must communicate with the principal about the principal's real-time solutions for remobilization, maintaining adequate cash-flow, and implementing worker safety programs to minimize the risk of bond claims.

Long-Term Challenges: Underwriting and the Bonding Process

COVID-19 has not only upended our economic paradigm in the present, its after-shocks will be felt for the foreseeable future. Going forward, in underwriting bonds for principals, sureties must thoroughly review the principal's internal handling of the pandemic in order to analyze the principal's long-term financial condition and ability to absorb pandemic-related risk. Sureties should place a heightened emphasis on the principal's cash to debt ratio and access to lending. In a similar vein, sureties should examine the principal's use of PPP loans and other government relief programs to ensure compliance so that the principal does not risk rescission of aid or fines/penalties for failure to comply.

Sureties should also review the principal's plans for workplace safety measures, both in the field and at the home office. These include the use of masks, social distancing practices, and home office remote workspaces. Safety programs that reduce the risk of COVID-19 transmission will be necessary to comply with government mandates and jobsite safety requirements. Practically speaking, COVID-19 safety measures will also reduce the risk of jobsite infections, which could temporarily shut down a project, disrupt the labor on a project or at the home office, and impact the financial health of the principal. Sureties should work with principals to implement processes that meet the changing public health challenges of COVID-19. Principals should have an organized internal process for monitoring COVID-19 and developing solutions as the pandemic evolves or lingers. For example, in New York, principals should be proactively preparing for remobilizing in conjunction with maintaining compliance with the requirements of "New York Forward."

COVID-19 has also shed light on the need for the surety industry to look inward. For too long, tradition and inertia have hamstrung the surety industry from keeping pace with other industries in terms of technology. Remote working has highlighted the expedience and functionality of electronic documents, e-signatures, teleconferencing, and other remote technologies. Online notarizations have skyrocketed during the COVID-19 shutdown, and many industry professionals agree that online notarizations should continue into the future. Before COVID-19, twenty-three states had authorized remote online notarizations. Now, nineteen others have sanctioned emergency, short-term measures to enable remote online notarization. All states have enacted legislation authorizing the use of electronic signatures, teaching the surety industry that the cumbersome process of mailing back and forth wet-ink-signed documents, or gathering in a room to sign and notarize indemnity agreements, is obsolete. Use of remote technologies as a standard practice in the bonding process will not only help to bring the surety industry technologically up to speed, it will prepare it for expected COVID-19 persistence and any pandemic to come.

Conclusion

The magnitude of the COVID-19 effects is unprecedented in our lifetime. The pandemic has changed nearly everything about our world. Its influence on bond claim resolution and litigation will be no different. Claims litigation will be increasingly complex due to COVID-19, as sureties and their counsel navigate the labyrinth of insurance coverage, contractual defenses, common law doctrines, and government orders. As long as there is no widespread treatment or vaccination for COVID-19, its impacts will complicate the underwriting process. If nothing else, the construction industry's growth will see a pullback in the short term, as infrastructure spending takes a backseat to COVID-19 relief. The surety world will still turn. Just be sure to hang on! F&D

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Continental to indemnify it for the losses incurred as a result of the ransomware attack. Both G&G Oil and Continental moved for summary judgment, with Continental claiming that although G&G Oil's policy covered computer fraud, this situation was akin to an act of theft rather than fraud, and noting the exclusion in the policy for losses from a computer virus or hacking. The trial court agreed and granted Continental's motion for summary judgment, remarking that while the hacker's act was "devious, tortious and criminal, fraudulent it was not."

On appeal, the court reviewed the language of the policy, found it to be unambiguous, and enforced the language according to its terms, guided by the principle that the court "may not extend coverage beyond that provided by the unambiguous language" of the policy. The policy language at issue stated:

> Computer Fraud: We will pay for loss of or damages to "money", "securities" and "other property" resulting directly from the use of any computer to fraudulently cause a transfer of that property from inside the "premises" or "banking premises…"

The parties agreed that "fraud" was not defined in the policy, but disagreed on what the term "fraud" actually meant. The court determined that the word "fraud" was commonly understood as the "intentional perversion of truth in order to induce another to part with something of value or to surrender a legal right." Applying the plain meaning of "fraud" to this case, the court found that the hacker "did not use a computer to fraudulently cause G&G to purchase Bitcoin to pay as ransom," and "did not pervert the truth or engage in deception in order to induce G&G to purchase the Bitcoin." Even though the hacker's actions were illegal, the court concluded that coverage could not be provided because "there was no deception involved in the hijacker's demands for ransom in exchange for restoring G&G's access to its computers."

Commercial crime policy coverage for cyber-attacks based on computer fraud often turns on whether the insured's loss was a direct or indirect result of an obviously fraudulent action by the hacker. This case demonstrates that such coverage is unlikely to extend to the ordinary ransomware attack, as it lacks the necessary "fraud" component. A comforting result for the insurer, and a good reminder for the policy holder to obtain appropriate "cyber insurance." E&D

1 *G&G Oil Co. of Indiana v Cont'l W. Ins. Co.*, 2020 Ind. App. LEXIS 126 (March 31, 2020).

Moses Visits Surety Consultants

Beacon Consulting Group, Inc. President Dennis O'Neill and guest speaker "Moses" (E&D's Todd Braggins) pose together at Beacon's December 2019 Annual Corporate Meeting at the Omni Hotel in Boston. Moses brought forth the *"Surety Consultant's Ten Commandments."*

The Surety Consultant's Ten Commandments

1) Thou shalt not hide or delay bad news;
2) Thou shalt not commit the surety without authorization;
3) Thou shall work closely with the surety's counsel to maintain privilege;
4) Thou shall assume you will be asked to explain at your deposition or trial every email and text message you send;
5) Thou shalt not practice law;
6) Thou shall provide a realistic budget from the outset of the dispute;
7) Thou shall follow through on commitments made in interim reports and shall complete the entire assignment, including such exciting things as warranty and closeout documents;
8) Thou shall refuse work that you are too busy to perform and expert work that you are not qualified to perform;
9) Thou shall play the role of good cop, unless asked to be bad cop; and
10) Thou shalt not BS the client; "I don't know but I'll find out" is acceptable.

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Ernstrom & Dreste, LLP also publishes the ContrACT Construction Risk Management Reporter. If you would like to receive that publication as well, please contact Clara Onderdonk at conderdonk@ed-llp.com. Copies of ContrACT Construction Risk Management Reporter and The Fidelity and Surety Reporter can also be obtained at Ernstrom & Dreste, LLP's website (ernstromdreste.com).

FIRM NEWS

John Dreste participated as an attorney panelist for a webinar presented by AGC New York State entitled *"Contract Issues in the Age of COVID-19"* on April 1, 2020.

On March 20, 2020, Kevin Peartree co-presented the webinar *"Coronavirus Impact on the Construction Industry – Construction Contracts, Insurance and Workers Compensation"* for The Builders Exchange of Rochester.

Tim Boldt recently authored an article on *"Contract Negotiations During a Pandemic"* appearing in Southern Tier Builders Association's most recent *Building the Southern Tier* publication.

Tim Boldt and Kevin Peartree attended and were program presenters at the AGC Annual Convention in Las Vegas, Nevada March 9-12, 2020. Mr. Boldt's presentation topic was *"Subcontract Pitfalls That Could Bury Your Business."* Mr. Peartree's program was titled *"Become the Master of Your Contracts Using the New ConsensusDocs Master Subcontract Agreement."*

Todd Braggins, Brian Streicher and Matt Holmes attended the ABA Fidelity & Surety Law Mid-Winter Conference in New York City, January 29-31, 2020.

E&D Office Manager Clara Onderdonk was appointed to the Association of Legal Administrators' Chapter Resource Team which helps educate members on the policies, programs and initiatives of ALA, including providing support and resources to local chapters.