

Crime (Policy) Does Pay – Sixth Circuit Holds That Endorsement of Crime Policy Covers Losses from Hacker's Data Breach

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Cyber hacking, data breaches and privacy concerns have become commonplace headlines. While not always front page news, one study reported on 1,700 instances of computer hacking, cyber terrorism, and other data breaches in the past seven years, resulting in some 900 million compromised records. Another study of 49 breaches in 2011 reported that the average cost of a data breach (including detection, internal response, notification, post-notification cost and lost customers) was \$5.5 million. For businesses which have not yet purchased stand-alone cyber insurance policies, a recent federal appellate court case may provide the basis for coverage under other policies.

Providing policyholders with another method by which to receive data breach coverage, the Sixth Circuit Court of Appeals recently held that a computer fraud rider to a "Blanket Crime Policy" covered losses from a hacker's theft of customer credit card and checking account data. While most insurance companies have attempted to exclude cyber risks from many general liability and first-party property policies, this holding potentially adds crime policies to the list of policies that cover data breach costs, a list that, in addition to insurance-industry preferred cyber policies, also includes general liability, errors and omissions, media E&O and directors and officers policies.

In 2005, a hacker used the local wireless network at one of plaintiff DSW's stores to hack into its main computer system and download customer credit card and checking information, pertaining to over 1.4 million customers of 108 stores. The hacker used the credit card information to engage in fraudulent credit card transactions. Unsurprisingly, plaintiff incurred significant expenses as a result, paying over \$5.3 million for customer communications; public relations efforts; customer claims and lawsuits; attorneys' fees in connection with state and federal investigations; and, most significantly, fines imposed by Visa and Mastercard. Plaintiffs paid the two credit card companies over \$4 million as a result of the data breach and aftermath.

Plaintiff sought coverage from its insurer, defendant National Union Fire Insurance Company of Pittsburgh, PA ("National Union"). National Union denied coverage, asserting that the loss was excluded under the computer fraud rider because it was related to the theft of confidential customer information. Moreover, National Union asserted that plaintiff's loss did not qualify as a loss "resulting directly from . . . the theft of any Insured property by Computer Fraud," as required by the policy. The District Court in Ohio granted summary judgment to the policyholder for the amount of the loss plus interest, including the fines paid to Visa and Mastercard due to the data breach. The District Court rejected plaintiffs' bad faith claims. The Sixth Circuit affirmed the District Court opinion in its entirety.

In affirming the District Court, the Sixth Circuit found that a commonly used, broadly worded exclusion for proprietary and other confidential information did not apply to the loss in this case. The coverage exclusion provided that "Coverage does not apply to any loss of proprietary information, Trade Secrets, Confidential Processing Methods, or other confidential information of any kind." The Court agreed with the District Court's finding that even if the copying of customer information qualified as a "loss," it was not a loss of "proprietary information . . . or other confidential information of any kind." The Court interpreted the definition to include only "confidential information" of DSW's involving the way in which its business is operated. Moreover, the stolen credit card and checking account information was not proprietary because it was owned or held by many entities, including the customers, financial institutions, and merchants involved in the stream of commerce. The Court concluded that the term "other confidential information of any kind" did not mean all information belonging to anyone that is expected to be protected from unauthorized disclosure, because that interpretation "would swallow not only the other terms in [the] exclusion but also the coverage for computer fraud."

Secondly, the Court rejected the insurer's attempts to liken its policy to a traditional fidelity bond, which does not provide third party liability coverage. The Court noted that the terms of the policy, rather than its title, govern the coverage provided.

Finally, the Sixth Circuit agreed that, under Ohio law, the losses plaintiff suffered did result directly from the data breach as required by the terms of the policy. The Court found the phrase ambiguous, and further found that "resulting directly from" does not unambiguously mean that the data breach be the "sole" or "immediate" cause of the insured's loss, as defendant urged. Instead, the Court found that the language only required that the breach be the proximate cause of the loss.

This ruling represents a favorable outcome for policyholders that have been resistant to purchase cyber policies, as yet another commonly used policy has been held to cover data breach costs. At least in the Sixth Circuit, commonly used, broadly worded exclusions for proprietary and other confidential information will not exclude coverage for customer credit card and checking information, and a less exacting proximate cause standard will be applied in determining whether an insured's loss will be covered by crime policies.

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- **Joseph E. Clark**
Senior Counsel