

Fifth Circuit Rules That Policyholder Is Not Entitled To Recover Under Crime Policy

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Our [July/August 2016 Alert](#) reported on a Texas federal district court decision holding that a commercial crime policy did not provide coverage for losses arising out of a Ponzi scheme because the policyholder did not “own” the funds for which it sought indemnification. *Cooper Indus., Ltd. v. National Union Fire Ins. Co. of Pittsburgh, PA*, 2016 WL 3405295 (S.D. Tex. June 21, 2016). Last month, the Fifth Circuit affirmed. *Cooper Indus., Ltd. v. National Union Fire Ins. Co. of Pittsburgh, PA*, 876 F.3d 119 (5th Cir. 2017).

Cooper invested approximately \$175 million in Westridge Capital Management, a registered investment advisor. Unbeknownst to Cooper, Westridge was part of a Ponzi scheme orchestrated by individuals who owned a controlling share of Westridge, as well as two other related entities (WGTC, a registered broker-dealer, and WGTI, an unregulated entity utilized to facilitate investments into WGTC). Before the scheme was discovered, Cooper recouped its principal investment plus earnings in Westridge’s equity fund. However, Cooper did not redeem its investment in Westridge’s bond fund. Cooper sought coverage from National Union for lost principal investments, earnings and interest. National Union denied coverage, and Cooper brought suit, claiming losses of nearly \$20 million.

The Fifth Circuit affirmed the district court’s ruling that the policy does not provide coverage because Cooper did not “own” the funds for which it sought recovery, as required by the policy. The court reasoned that when Cooper loaned the money to WGTI in exchange for promissory notes, it no longer had an ownership interest in the property. The court declined to interpret “own” as encompassing both legal and equitable ownership, noting that no Texas court “has held that a party continues to ‘own’ funds it was fraudulently induced to loan to someone else.”

The court also concluded that Cooper did not suffer a “loss” under the policy when it loaned the bond-fund principal to WGTI. Cooper argued that a loss “occurs at the moment a borrower fraudulently induces a loan.” The court disagreed, finding that even where a loan is fraudulently induced (and is thus voidable), ownership of the funds passes to the borrower (here, WGTI) and the loss does not occur until the funds are stolen. Finally, the court noted that Cooper’s substantial profit on its equity fund investment “belies any argument that it sustained a ‘loss’ when it funded the loan.”

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