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UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

PINNACLE PROCESSING GROUP,
INC.,

Plaintiff,

v.

HARTFORD CASUALTY INSURANCE
COMPANY, a foreign insurer,

Defendant.

CASE NO. C10-1126-RSM

ORDER ON CROSS MOTIONS FOR
SUMMARY JUDGMENT

I. INTRODUCTION

This matter comes before the Court upon Defendant’s Motion for Summary Judgment (Dkt. # 22); Plaintiff’s Motion for Partial Summary Judgment (Dkt. # 37); and Defendant’s Motion for Protective Order (Dkt. # 20). For the reasons set forth below, Defendant’s Motion is GRANTED, Plaintiff’s Motion is DENIED, and the Motion for Protective Order is DENIED.

II. BACKGROUND

A. Credit Card Processing, Generally

Plaintiff Pinnacle Processing Group, Inc. (“PPG”) is a Washington corporation whose primary business is to process credit card transactions for merchants. PPG is an Independent Sales Organization (“ISO”) as that term is understood in the credit card industry and it contracts with a “merchant bank” called Merrick Bank. Pursuant to PPG’s ISO Agreement with Merrick Bank, PPG is responsible for marketing credit card processing services to merchants and assisting them in obtaining the equipment and software necessary to access those services. Thus, PPG utilizes independent sales agents to enter into agreements with individual merchants who wish to offer their customers the ability to pay for goods and services with bank cards. Upon entering into an agreement with PPG, the merchant is sold or leased a credit card terminal through which its customers may swipe credit cards to make purchases.

Once a merchant has entered into an agreement with PPG and set up its credit card terminal, its customers may use credit cards to pay for goods and services at their place of business. When a customer swipes a credit card at the merchant’s credit card terminal, data passes through the terminal to the bank that issued the credit card – the “issuing bank.” The issuing bank returns an electronic message indicating whether there are sufficient funds or there is sufficient available credit to cover the cost of the transaction. If there is money available on the card, the transaction is approved, and the merchant’s sale to the customer is consummated.

At the end of each day, the merchant’s account is settled: Merrick Bank deposits funds into the merchant’s bank account in an amount equal to the sum of all of the credit card transactions processed in that day. Merrick Bank, in turn, is reimbursed by the banks that issue

1 the credit cards. The banks that issue the cards pay Merrick Bank by debiting their customers'
2 accounts.

3 In certain situations, money must be refunded from the merchant to the customer. When
4 this happens, the transaction is reversed in what is termed a “chargeback.” A chargeback can
5 occur when a customer returns an item to the merchant, when there is an error in the transaction
6 or in processing the transaction, or as a result of fraud. When a chargeback occurs, funds are
7 either returned to the customer’s issuing bank or the charged amount is never posted against the
8 customer’s account at the issuing bank. The merchant must then enable the same amount of
9 funds to be debited from its account. If there is a chargeback and the merchant cannot cover the
10 amount of the refund, or has disappeared, one of the processing entities will generally end up
11 covering the loss. In this case, the entity that bears the risk in the case of chargeback losses is
12 PPG.

13 Pursuant to PPG’s ISO Agreement with Merrick Bank, PPG is required to establish a
14 \$250,000 “reserve account” (the “ISO Reserve Account”) with Merrick Bank as security for the
15 satisfaction of chargeback credits that do not get reimbursed by merchants. Dkt. No. 39, ¶7.7.
16 Merrick Bank is the sole and exclusive owner of the ISO Reserve Account and is authorized to
17 withdraw amounts from the account to cover its losses incurred through unreimbursed
18 chargebacks:

19 Merrick may withdraw from the ISO Reserve Account from time to time amounts
20 equal to any losses suffered or incurred by Merrick, or reasonably expected by
21 Merrick to be suffered or incurred, in connection with (i) Merchant chargebacks,
22 other Merchant acts, omissions, activity or fines, charges or other assessments
23 made by any Association based upon any Merchant activity... (ii) any other
24 amount payable by ISO to Merrick pursuant to the terms of this Agreement, and
25 (iii) ISO’s acts, omissions or activity, or finds, charges or other assessments made
26 by any Association based on ISO activity.

1 *Id.* When Merrick withdraws from the reserve account, PPG is required to replenish those funds
2 within two days. *Id.*

3 **B. The Fraud Alleged in this Case**

4 In 2008 and 2009, PPG sustained chargeback losses in the sum of \$360,823.56 as a result
5 of fraudulent credit card transactions processed through PPG's computer system by several retail
6 merchants with whom PPG had established business relationships. One of those merchants was
7 Kirakosyan Jewelers. Kirakosyan Jewelers requested merchant services from PPG for the
8 purpose of selling watches, jewelry and accessories for an average price of \$500 and an
9 estimated monthly credit card volume in the amount of \$50,000. PPG accepted and activated
10 Kirakosyan's merchant account in September 2008.

11 Kirakosyan Jewelers processed credit card transactions within the contracted limits until
12 December 2008. Between December 8 and December 17, 2008, however, it processed \$228,000
13 worth of credit card transactions. PPG's staff verified each of these transactions by having
14 telephone conversations with the merchant, the customers, and sometimes with the issuing bank.
15 Each of the transactions was processed after the legitimacy and capacity of the cardholder
16 customer was established. Nonetheless, on January 6, 2009, Kirakosyan Jewelers ran 23
17 requests for refunds for a total amount of \$228,044. PPG attempted to freeze the refund
18 requests, but was ultimately obligated to process them when the cardholders submitted written
19 requests to the issuing banks for the refunds.¹ When PPG attempted to electronically recover
20 these refund credits from the Kirakosyan bank account, they were dishonored. As a result,
21 Merrick deducted \$228,044 from PPG's reserve account to cover the cost of refunding the
22 issuing banks that had extended refunds to their customers. PPG replaced the funds in the

23 ¹ It is believed that the customers in this case were working together with Kirakosyan Jewelers to
24 perpetuate the fraud. Dkt. # 23-1, p. 39.

1 reserve account within two days pursuant to its contractual obligations. The additional
2 approximately \$132,000 in losses were incurred by other merchants in a substantially similar
3 manner.

4 **C. The Insurance Policy**

5 PPG is covered by a policy of insurance that it purchased from Defendant Hartford
6 Casualty Insurance (“Hartford”). The policy was effective for the policy period 7/29/08 –
7 7/12/09, and consisted of the “Spectrum Policy Declarations,” the “Special Property Coverage
8 Form,” and a “Financial Services Stretch” endorsement.

9 The Special Property Coverage Form provides:

10 **Additional Coverages ...Money and Securities...** We will pay for loss of
11 “money” and “securities” used in your business while at a bank or savings
12 institution, within your living quarters of the living quarters of your partners or
13 any employee having use and custody of the property, at the “scheduled
14 premises”, or in transit between any of these places, resulting directly from: (a)
15 “Theft”; (b) Disappearance; or (c) Destruction.

16 ...

17 The most we will pay for loss in any one occurrence is: (a) The limit shown in the
18 Declarations...

19 Dkt. No. 23-4, p. 12-13. The Spectrum Policy Declarations provide “NO COVERAGE” for
20 Money and Securities. Therefore, PPG is not covered for a loss of “money” or “securities”
21 under the Special Property Coverage Form.

22 PPG, however, purchased additional insurance for computer fraud. Pursuant to the
23 Financial Services Stretch Endorsement:

24 **Computer Fraud** The following Additional Coverage is added: We will pay up
to \$5,000 in any one occurrence for physical loss of or physical damage to
“money”, “securities”, and other property having intrinsic value resulting directly
from computer fraud. Computer fraud means any act of stealing property
following and directly related to the use of any computer to fraudulently cause a
transfer of that property from inside your premises or from a banking institution
or similar safe depository, to a person (other than a “messenger”) outside those
premises or to a place outside those premises.

1 *Id.* at 33.

2 Other relevant provisions of PPG’s insurance policy are as follows:

3 **EXCLUSIONS**...We will not pay for physical loss or physical damage caused by
4 or resulting from:... **Dishonesty:** Dishonest or criminal acts by you ... or anyone
5 to whom you entrust the property for any purpose. **False Pretense:** Voluntarily
6 parting with any property by you or anyone else to whom you have entrusted the
7 property if induced to do so by any fraudulent scheme, trick, device or false
8 pretense.

9 *Id.* at 22-23.

10 **PROPERTY DEFINITIONS** ... “Money” means: a. Currency, coins and bank
11 notes whether or not in current use... “Securities” means negotiable and
12 nonnegotiable instruments or contracts representing either “money” or other
13 property and includes: a. Tokens, tickets except Lottery Tickets, revenue and
14 other non-postage stamps whether or not in current use; and b. Evidence of debt
15 issued in connection with credit or charge cards, which are not of your own issue;
16 but does not include “money.”

17 *Id.* at 24-25.

18 In late 2009, PPG submitted claims under the Computer Fraud endorsement to Hartford
19 for the losses caused by the fraudulent credit card transactions. Hartford reviewed and denied
20 the claims. This lawsuit ensued.

21 In its motion for summary judgment, Hartford argues that PPG’s losses did not result
22 from computer fraud because they are not directly related to the use of a computer; that PPG’s
23 claim is an “economic loss” not covered by the policy; and that the exclusions for dishonesty and
24 false pretense bar coverage. *See generally* Dkt. No. 22. Even if there were coverage, Hartford
argues that the PPG’s claim is limited to \$5,000 per occurrence and subject to a \$250 deductible
and is limited or barred by the two-year contractual limitation for bringing suit. *Id.*

PPG argues in its motion for partial summary judgment that PPG’s losses were in fact
directly related to use of a computer. PPG directs the Court to the definition of “Securities” in
the Hartford insurance policy as including “evidences of debt issued in connection with credit or

1 charge cards, which are not of your own issue.” Dkt. No. 37, p. 11, citing Dkt. No. 39, p. 25.
2 Under PPG’s analysis, the “losses suffered by PPG resulted from fraudulent acts which followed
3 and were directly related to the use of a computer because a request for a fraudulent electronic
4 refund credit is clearly evidence of debt.” Dkt. No. 37, p. 12. PPG also contends that ambiguity
5 in the policy requires that the Court construe the terms in its favor. Finally, PPG argues that it
6 does not have to suffer a loss of its own funds in order to secure coverage for computer fraud for
7 the manner in which it sustained the losses. *Id.* at 13.

8 **III. DISCUSSION**

9 **A. Standard**

10 Summary judgment is appropriate where “the movant shows that there is no genuine
11 issue as to any material fact and that the movant is entitled to judgment as a matter of law.”
12 FRCP 56(c); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247 (1986). In ruling on summary
13 judgment, a court does not weigh evidence to determine the truth of the matter, but “only
14 determine[s] whether there is a genuine issue for trial.” *Crane v. Conoco, Inc.*, 41 F.3d 547, 549
15 (9th Cir. 1994) (*citing O’Melveny & Meyers*, 969 F.2d at 747). Material facts are those which
16 might affect the outcome of the suit under governing law. *Anderson*, 477 U.S. at 248.

17 The Court must draw all reasonable inferences in favor of the non-moving party. *See*
18 *F.D.I.C. v. O’Melveny & Meyers*, 969 F.2d 744, 747 (9th Cir. 1992), rev’d on other grounds, 512
19 U.S. 79 (1994). However, the nonmoving party must make a “sufficient showing on an essential
20 element of her case with respect to which she has the burden of proof” to survive summary
21 judgment. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). Further, “[t]he mere existence of
22 a scintilla of evidence in support of the plaintiff’s position will be insufficient; there must be
23 evidence on which the jury could reasonably find for the plaintiff.” *Id.*

1 Where policy language is clear and unambiguous, Washington courts enforce the
2 provisions written “and do not modify the policy or create ambiguity where none exists.” *Pub.*
3 *Util. Dist. No. 1 v. Int'l Ins. Co.*, 124 Wash.2d 789, 797 (1994). Ambiguity exists if the policy is
4 susceptible to more than one reasonable interpretation, *Transcon. Ins. Co. v. Wash. Pub. Util.*
5 *Dists'. Util. Sys.*, 111 Wash.2d 452, 456-57 (1988), and any ambiguity is interpreted in favor of
6 the insured, *Sears v. Grange Ins. Ass'n*, 111 Wash.2d 636, 638 (1988). Finally, definitions set
7 forth in an insurance policy must be applied and undefined terms are given “their plain, ordinary,
8 and popular meaning, as defined in standard English dictionaries.” *Overton v. Consolidated Ins.*
9 *Co.*, 145 Wash.2d 417, 427-428 (2002).

10 **B. Analysis**

11 1. Cross Motions for Summary Judgment

12 Both parties seek a judicial determination of whether coverage for PPG’s losses exist
13 under PPG’s insurance policy with Hartford. The parties do not dispute that, if PPG’s losses are
14 covered, they are covered under the Computer Fraud clause of the Financial Services Stretch
15 endorsement. The Computer Fraud clause provides coverage for “physical loss of or physical
16 damage to ‘money’, ‘securities’, and other property having intrinsic value resulting directly from
17 computer fraud.” Dkt. No. 23-4, p. 33. “Computer fraud” is defined as “any act of stealing
18 property following and directly related to the use of any computer to fraudulently cause a
19 transfer of that property from inside your premises or from a banking institution or similar safe
20 depository, to a person (other than a “messenger”) outside those premises or to a place outside
21 those premises.” *Id.*

22 “Direct means without any intervening agency or step: without any intruding or diverting
23 factor.” *Moeller v. Farmers Ins. Co. of Washington*, 155 Wash.App. 133, 143 (2010) (citing
24 Webster's Third New Int'l Dictionary 640 (1976)). “Commentators generally agree with this

1 definition.” *Id.* (citing 11 Lee R. Russ, *Couch on Insurance*, § 156:21 (3d ed. 1998) (Supp.
2 2009)). Here, PPG’s loss was not direct. PPG did not suffer a loss until (1) Merrick Bank was
3 unable to recover the chargeback funds from the merchant banks; (2) Merrick Bank deducted
4 funds from PPG’s Reserve Account; and, finally, (3) PPG fulfilled its contractual obligation to
5 replace those deducted funds. To interpret the term “directly” as potentially applying to such an
6 attenuated chain of events would be to “create ambiguity where none exists.” *Pub. Util. Dist.*
7 *No. 1,124 Wash.2d at 797*. Moreover, such an interpretation would render the use of the word
8 “directly” in the insurance policy superfluous: there would be no difference between the phrase
9 “resulting from computer fraud,” and “resulting directly from computer fraud.” Accordingly, the
10 Court gives the term “direct” its plain meaning and, in so doing, determines as a matter of law
11 that that PPG’s losses are not covered under the policy.

12 Indeed, several courts that have examined this issue have determined that where a loss
13 must “directly” result from a specified occurrence, the insured’s obligation to reimburse a third
14 party for losses that result from that specified occurrence, does not give rise to coverage. In
15 *Lynch Properties, Inc. v. Potomac insurance Company of Illinois*, a corporation’s employee
16 embezzled money from one of its clients. 962 F.Supp. 956, 959 (N.D. Tex. 1996), *aff’d*, 140
17 F.3d 622 (5th Cir. 1998). The corporation transferred its own funds to cover its client’s loss and
18 then filed a claim with its insurance company. *Id.* The corporation’s insurance policy provided
19 “[w]e will pay for loss of ...Covered Property resulting directly from the Covered Cause of
20 Loss.” *Id.* at 961. “Covered Cause of Loss” was defined as “employee dishonesty.” *Id.* The
21 Court held that the words “resulting directly from” unambiguously limited coverage to the
22 insured’s direct losses and adopted the insurance company’s interpretation that “[s]ince the direct
23 result of [the employee’s] embezzlement was a loss to [the client’s] personal funds, and the
24

1 indirect result was Lynch’s replacement of those lost funds... [the corporation] cannot recover
2 under the policy.” *Id.* at 962-63. The same analysis is appropriate here: since the direct result of
3 the purported computer fraud was a loss to Merrick Bank, and the indirect result was PPG’s
4 replacement of those lost funds, PPG cannot recover under the policy.

5 Several other courts interpreting similar contract language have reached the same result.
6 *See Vons Companies, Inc. v. Federal Ins. Co.*, 212 F.3d 489, 492-93 (9th Cir. 2000) (“We hold
7 that ‘direct’ means ‘direct’ and that in the absence of a third party claims clause, Vons’s policy
8 did not provide indemnity for vicarious liability for tortious acts of its employees.”); *Methodist*
9 *Health System Foundation, Inc. v. Hartford Fire Ins. Co.*, 2011 WL 2607107, at *3 (E.D. La.
10 July 1, 2011) (also relying on *Lynch* and interpreting identical computer fraud provision as that at
11 issue here as precluding coverage because “only Tremont suffered losses ‘resulting directly
12 from’ the Madoff ponzi scheme; Plaintiff was too far removed from the Madoff scheme in order
13 to recover under a ‘direct loss’ provision because Plaintiff invested in Meridian, who invested in
14 Tremont..”); *Finkel v. St. Paul Fire and Marine Ins. Co.*, 2002 WL 1359672, 5 (D. Conn. 2002)
15 (“That the insured may be liable to a third party for a loss of money resulting from employee
16 dishonesty does not transform a policy covering the insured against a direct loss into one
17 indemnifying against liability.”) (internal citation omitted).

18 PPG argues that it suffered a loss – in that it incurred a debt – as soon as the fraudulent
19 requests for refunds were issued. The computer fraud provision covers physical losses of both
20 “money” and “securities.” Dkt. No. 23-4, p. 33. The definition of “securities” includes
21 “[e]vidence of debt issued in connection with credit or charge cards, which are not of your own
22 issue.” Thus, argues PPG, “the losses suffered by [PPG] resulted from fraudulent acts which
23 followed and were directly related to the use of a computer because a request for a fraudulent
24

1 | electronic refund credit is clearly evidence of debt.” Dkt. # 37. The Court is not persuaded by
2 | this argument. The computer fraud provision by its express terms covers the physical *loss* of
3 | securities, or, “evidence of debt.” To construe the provision as simultaneously covering any *gain*
4 | of a debt to another – which is essentially what PPG argues – would be to read the terms of the
5 | policy as providing coverage for exactly the opposite of that which it purports to cover.

6 | Rather, PPG’s loss resulted directly from its contractual obligation to cover any
7 | chargeback losses incurred by Merrick Bank, not from computer fraud. PPG’s loss was only
8 | indirectly caused by the purported computer fraud. There is no coverage for PPG under the
9 | computer fraud provision of its insurance contract with Merrick. Because the Court has
10 | determined that there is no coverage for PPG as a matter of law, it declines to address the other
11 | bases for denial of coverage in this order. Hartford’s motion for summary judgment is
12 | GRANTED and PPG’s motion for partial summary judgment is DENIED.

13 | 2. Motion to Strike

14 | In its reply to PPG’s motion for summary judgment, Hartford moves to strike from the
15 | Declaration of Eric Zubel “the testimonial references and the attached exhibit 1 pertaining to
16 | Hartford Casualty’s alleged internet advertising.” Dkt. # 34, pp. 8-9. Because the Court did not
17 | rely on these materials in rendering its decision on the parties’ cross motions for summary
18 | judgment, the motion is MOOT.

19 | 3. Motion for Protective Order

20 | Hartford moves for a protective order under Fed. R. Civ. P. 26(c)(1) regarding a 30(b)(6)
21 | deposition notice issued by PPG. A motion for a protective order “must include a certification
22 | that the movant has in good faith conferred or attempted to confer with other affected parties in
23 | an effort to resolve the dispute without court action.” Fed. R. Civ. P. 26(c)(1). “A good faith
24 | effort to confer requires a face-to-face meeting or a telephone conference.” Local Rule CR

1 26(c)(1). Hartford did not include a certification that it conferred with PPG in a face-to-face
2 meeting or by telephone prior to bringing its motion. Accordingly, the motion is DENIED.

3 4. Motion to Continue Trial and Related Dates

4 Before the Court is Plaintiff's unopposed Motion to Continue Trial and Related Dates
5 (Dkt. # 43). The trial is currently set for December 5, 2011, only slightly more than a month
6 away. To allow the parties ample time to prepare for trial, the Court GRANTS Plaintiff's motion.
7 The parties are directed to confer regarding the amount of time necessary to complete discovery
8 and prepare for trial and submit a joint revised scheduling order to the Court within fourteen (14)
9 days of the date of this Order.

10 **IV. CONCLUSION**

11 Having considered the parties' motions, the responses and replies thereto, all declarations
12 and attached exhibits, and the remainder of the record, the Court hereby finds and ORDERS:

13 (1) Defendant's Motion for Summary Judgment (Dkt. # 22) is GRANTED. The motion
14 to strike contained therein is moot.

15 (2) Plaintiff's Motion for Partial Summary Judgment (Dkt. # 37) is DENIED.

16 (3) Defendant's Motion for Protective Order (Dkt. # 20) is DENIED.

17 (4) Plaintiff's Motion to Continue Trial and Related Dates (Dkt. # 43) is GRANTED.

18
19 Dated this 4th day of November 2011.

20
21 

22 RICARDO S. MARTINEZ
23 UNITED STATES DISTRICT JUDGE
24