

6th Circ. Revives Bank's \$32M Ponzi Settlement Coverage Suit

By **Hope Patti**

Law360 (February 2, 2024, 4:21 PM EST) -- A bank can seek coverage for a \$32 million settlement it paid to resolve a bankruptcy suit alleging it allowed a Ponzi scheme to continue so it could recover loans to the company running the scheme, the Sixth Circuit ruled, reversing a win for a pair of AIG insurers.



A Sixth Circuit panel says that Huntington National Bank's claim for coverage in a suit involving a Ponzi scheme is insurable under Ohio law since the settlement payment was not akin to punitive damages or intended to punish an intentional bad act. (iStock.com/syahrir maulana)

Huntington National Bank's claim for coverage is insurable under Ohio law since the settlement payment was not akin to punitive damages or intended to punish an intentional bad act, which are the only categories of uninsurable claims, a three-judge panel held in an **opinion** Thursday.

The panel also held that the bank's claim is not barred by an exclusion for claims based on "unrepaid, unrecoverable, or outstanding credit" in its bankers professional liability policy issued by AIG Specialty Insurance Co. or its excess policy issued by National Union Fire Insurance Co. of Pittsburgh, Pa.

The court remanded the case for consideration of any remaining claims.

The coverage dispute stems from loans that Huntington extended to Cyberco Holdings Inc. between September 2002 and October 2004, according to court filings.

The bank initially issued a \$9 million loan to Cyberco in 2002, based on representations made by the company's chair and chief executive, Barton Watson, that the company was a computer services business that needed capital, according to the ruling. Cyberco represented that it needed loans to purchase computer equipment from Teleservices Group Inc., which Watson claimed was a vendor but was actually a "paper company" that was created to perpetuate the scheme, the panel said.

After noticing discrepancies in Cyberco's reporting in 2003, the Huntington team managing the company's account asked the bank's security department to look into Watson and the company. The security department discovered that Watson was being investigated by the FBI and had previously confessed to and served time for fraud-related crimes, but security did not report the findings to the team responsible for Cyberco, according to the ruling.

Cyberco gradually repaid its loan between May and October 2004, the ruling said. Later that year, the FBI raided Cyberco's offices, and Watson died by suicide, the panel said.

The bankruptcy trustee of Cyberco and Teleservices later filed suits against Huntington, alleging that the bank "put its desire to be repaid ahead of its concerns that Watson was committing fraud and, by doing so, perpetuated the Ponzi scheme to its benefit and other lenders' detriment," the panel said. Both complaints included allegations of fraudulent transfers and sought to recover those transfers from Huntington, according to court filings.

After years of litigation, the Sixth Circuit determined that the trustee could recover the transfers actually paid to Huntington, although it could not recover all the transfers into Cyberco's Huntington account. The bank settled with the trustee for \$32 million in 2018.

The insurers maintained that Huntington was not entitled to coverage throughout the proceedings and also denied the bank's claim for \$15 million after the settlement, according to court filings.

Huntington sued the insurers for breach of contract and bad faith in January 2020.

In December 2022, U.S. District Judge James L. Graham **granted summary judgment** in favor of the insurers, finding that the settlement was not covered under the policies. The court held that the settlement was a repayment of transfers the bank received from Cyberco and Teleservices and that because those transfers were fraudulent, Huntington's acceptance of the payments constituted the wrongful taking of money and was thus uninsurable.

"Ohio law demonstrates that for insurance coverage to be uninsurable under the law, the damages claimed must be based on an intent to injure, malice, ill will, or other similar culpability," U.S. Circuit Judge Julia Smith Gibbons said in the panel's opinion.

The insurers, however, have not shown that Huntington committed any intentionally malicious act, the panel said.

The bank's "acceptance of loan repayments, even while lacking a legitimate belief that Teleservices's transfers to Cyberco's account were merely Cyberco's receivables, was a step or two removed from any intentionally malicious act," Judge Gibbons added.

Moreover, the policy exclusion based on Huntington's performance of lending acts does not apply because it is open to more than one reasonable interpretation, and ambiguity must be resolved in the insured's favor, the panel said.

The exclusion states that the insurers will not pay for a loss in connection with a claim made against Huntington for the principal and/or interest of any unrepaid, unrecoverable or outstanding credit.

Representatives of the parties declined to comment.

U.S. Circuit Judges Karen Nelson Moore, Julia Smith Gibbons and Jane Branstetter Stranch sat on the panel for the Sixth Circuit.

Huntington National Bank is represented by Benjamin L. Mesches and Barry I. Buchman of Haynes and Boone LLP and by Michael H. Carpenter, Timothy R. Bricker and Jennifer A.L. Battle of Carpenter Lipps LLP.

AIG Specialty Insurance Co. and National Union Fire Insurance Co. of Pittsburgh, Pa. are represented by R. Reeves Anderson, Suneeta Hazra, Rachel L. Ryan and Devin M. Adams of Arnold & Porter Kaye Scholer LLP.

The case is Huntington National Bank v. AIG Specialty Insurance Co. et al., case number 23-3039, in the U.S. Court of Appeals for the Sixth Circuit.

--Additional reporting by Daniel Tay. Editing by Khalid Adad.