

June 1, 2020

# When Wire Fraud and Money Laundering Constitute “Professional Services”

BY: Jason Taylor

In a somewhat counterintuitive decision, a Pennsylvania Superior Court recently affirmed a decision finding that wire fraud and money laundering could constitute “Professional Services” under a professional liability policy where two senior management members used their authority and their time on duty to engage in a criminal scheme to defraud a hotel.

In *Gemini Ins. Co. v. Meyer Jabara Hotels LLC*, 2020 WL 1649888 (Pa. Super. Ct. Apr. 3, 2020), a hotel management company provided two management-level employees to the Sheraton University City Hotel, owned by the University of Philadelphia, to run the hotel's operations. The two employees – general manager, Kenneth Kapikian, and a chief engineer, Dennis Gagliardi – created a fictitious entity called “Cold Wash,” which the men used to submit bogus invoices to the hotel for services that were never provided. The men also encouraged other vendors to inflate invoice amounts to receive “kickbacks.” Over six years, the scheme earned the men approximately \$3 million in fraudulent funds. Eventually, the scheme was unearthed and both men plead guilty to wire fraud and money laundering.

The University of Philadelphia demanded that the hotel management company pay almost \$5.5 million for the losses and damages arising from the criminal scheme. The hotel management company sought coverage for the claim under a professional liability policy issued by Gemini Insurance Company. Gemini agreed to defend the company under a reservation of rights and advanced money towards a settlement, while reserving the right to litigate its coverage defenses in a subsequent declaratory action, including the right to reimbursement of all amounts paid on behalf of the hotel management company.

In the ensuing coverage action, Gemini argued that coverage was barred by the policy's “Criminal Acts” Exclusion, which excluded coverage for claims arising out of the criminal acts of any “insured.” “Insured” in the policy was defined as “[t]he Named Insured listed on the Declarations Page including any partner, director, officer or full time, part time, temporary and leased employee of the Named Insured while rendering Professional Services on behalf of the Named Insured.” Thus, in order to bar coverage for the hotel court, the “Criminal Acts” Exclusion required that the criminal acts be committed by *any insured*. The trial court agreed with Gemini that the men qualified as “insureds,” and therefore, the “Criminal Acts” Exclusion barred coverage. The insured appealed.

On appeal, the Superior Court first affirmed the trial court's finding that Kapikian and Gagliardi were “employees” of the management company because the company controlled the work, hiring, firing and promotion of the men. The insured, however, argued that Kapikian and Gagliardi were not “insureds” as they were not “*rendering Professional Services on behalf of the Named Insured*” when they engaged in their fraudulent schemes. In other words, theft and fraud are not “professional services” and the criminal acts were not done “on behalf of” or in furtherance of the insured's business as it received no benefits from the fraudulent acts at all.

The Superior Court disagreed with the insured reasoning that “the underlying claim arose while [Kapikian and Gagliardi] were performing their management responsibilities.” According to the court, the men were hiring vendors, approving fraudulent invoices, creating fraudulent invoices, and approving those payments, all on behalf of the hotel. The Superior Court additionally adopted the lower court’s explanation that the policy language does not require criminal actions to be in the Named Insured *interest*. The Superior Court further explained that if criminal conduct committed by employees during the performance of management duties were to be deemed outside the scope of “professional services,” then the “Criminal Acts” Exclusion would be rendered superfluous. Based on this reasoning, the Superior Court concluded that the acts constituted the rendering of “professional services” on behalf of the management company, and therefore, Kapikian and Gagliardi were “insureds” under the language of the policy. As there was no question that the men’s acts were criminal – they pleaded guilty to wire fraud and money laundering – the “Criminal Acts” Exclusion of the policy barred coverage.