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TEXAS INSURANCE LAW NEWSBRIEF

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FIFTH CIRCUIT EXAMINES CRIME-PROTECTION INSURANCE POLICY AND FINDS NO COVERAGE FOR LOSS CLAIMED UNDER "COMPUTER FRAUD" PROVISION

Last Tuesday, the Fifth Circuit analyzed coverage for a loss claimed under a "Computer Fraud" insurance provision and found that no coverage was afforded under the facts presented, and rendered judgment in favor of the insurer as a matter of law. In *Apache Corporation v. Great American Insurance Company*, 2016 WL 6090901 (5th Cir. October 18, 2016), an Apache employee received a call from a person claiming to be a vendor representative requesting a change to their bank account information for payments to Petrofac, the vendor. The Apache employee asked that they send the request on the Petrofac's letterhead. The criminals then set up a false email domain, "petrofacltd.com" which is very similar to Petrofac's actual domain – "petrofac.com" – and emailed the requested letter. The email and letter provided both old and new bank account information and requested that the change take effect immediately. The Apache employee called the phone number on the false letterhead to confirm the authenticity of the request and then another Apache employee implemented the change. Apache made transfers of almost $7 million before it learned of the fraud a month later.

Apache recouped a substantial portion of the money but sought coverage for loss in the amount of $2.4 million. Great American Insurance Company (GAIC) denied coverage and a lawsuit followed. The Computer Fraud policy provision provided coverage in relevant part for "*loss of… money resulting directly from the use of a computer to fraudulently cause a transfer of that property…*". The trial court granted summary judgment finding coverage for the loss and this appeal followed. The Fifth Circuit addressed the matter as one of first impression under Texas law, finding no Texas authority interpreting the provision. So making an *Erie-guess*, the court observed the Texas Supreme Court's policy preference for "uniformity when identical insurance provisions will necessarily be interpreted in various jurisdictions" then turned its analysis to decisions from other jurisdictions.

As a preliminary matter, the court agreed with the Ninth Circuit's observation that "[b]ecuase computers are used in almost every business transaction, reading this provision to cover all transfers that involve both a computer and fraud at some point in the transaction would convert this Crime Policy into a 'General Fraud' Policy essentially covering losses from all forms of fraud rather than a specified risk category." And after a detailed analysis of court decisions from other jurisdictions and, unpublished Texas court decisions addressing similar issues, the court determined that while a computer and emails were involved, under the facts presented it was the faulty verification and investigation process that caused the loss. Accordingly, the trial court's judgment was vacated and judgment was rendered for Great American Insurance Company.

COURT AFFIRMS SUMMARY JUDGMENT IN FAVOR OF INSURER, REJECTS INSURED'S EFFORTS TO REFORM POLICY BASED ON DISCOVERY RULE

Last Monday, the Fifth Circuit affirmed summary judgment in favor of an insurer, rejecting efforts to reform a policy by applying the discovery rule to overcome the insurer's statute of limitations defense. In *AIG Specialty Insurance Company v. Tesoro Corporation*, 2016 WL 6078247 (5th Cir. October 17, 2016), a refinery with a long history of environmental remediation efforts was sold in 2000, and the buyer secured a $100 million in pollution liability excess coverage. The buyer then sold the refinery and agreed to secure an endorsement to transfer the policy. The insurer did so, but the endorsement named Tesoro Corporation as the new named insured. The actual buyer, however, was Tesoro Refining.

The environmental issues at the refinery were much worse than represented and litigation between the buyer and seller followed from 2003-2007. As it neared settlement in 2007, the insurer was put on notice of a potential claim. The insurer responded with a reservation of rights, identifying Tesoro Corporation as the named insured and indicating that coverage would be afforded "only if the insured were legally obligated to pay for cleanup costs." The lawsuit between the buyer and seller settled in 2007, and in October 2009, the insurer received a formal demand for coverage of cleanup costs. The demand letter showed Tesoro Refining as the buyer. The investigation proceeded slowly and the parties eventually filed suit in 2012 with the insurer seeking a declaratory judgment that it owed no coverage to Tesoro Refining for cleanup costs and, with Tesoro Refining seeking to reform the policy. The trial court found that Tesoro Refining was not entitled to coverage as a third-party beneficiary and that their reformation claim was barred by Texas four-year statute of limitations because they should have discovered the alleged mistake in the mid-2000's. Summary judgment was granted in favor of the insurer and this appeal followed.

On appeal, the court agreed with Tesoro that mere receipt of a policy without protest, or without reading it, does not bar later claims for reformation. But due to the limitations defense and passage of time, the parties argued over application of the discovery rule which applies "only where 'the nature of the injury [is] inherently undiscoverable and… the injury itself [is] objectively verifiable." The court determined that Tesoro Refining presented no support for the position that the alleged mistake over which entity was covered was "inherently undiscoverable". To the contrary, "the mistake is evident from the face of the document" and as a result, Tesoro's reformation claim was time barred. Summary judgment in favor of the insurer was upheld.

[Editor's note: Chris Martin of our firm testified as an expert witness on the claims handling issues in this case for the carrier. We want to congratulate Scott Davis, David Timmins and the rest of their team from Gardere Wynne Sewell in Dallas on this significant victory.**]**

COURT FINDS INSURED'S FAILURE TO READ POLICY DOES NOT PRECLUDE AFFIRMATIVE MISREPRESENTATION CLAIMS AGAINST AGENT UNDER TEXAS INSURANCE CODE AND DTPA

Last Tuesday, the Houston Court of Appeals analyzed the impact of an insured's failure to read a policy and whether he could be deemed to know its contents so as to defeat affirmative misrepresentation claims against an agent under the Texas Insurance Code and DTPA. The court found that fact issues precluded summary judgment. In *Wyly v. Integrity Insurance Solutions*, 2016 WL 6108137 (Tex. App – Houston [14th Dist.] October 18, 2016), the insured sought insurance coverage for "all foreseeable loss" to an airplane in transit. The agent secured a policy from an insurer through a broker. But the policy contained an exclusion for "improper packing, preparation for shipment or loading by you or the shipper." The fuselage was damaged in transit by a tie strap securing the plane to the trailer because the tail was not properly supported. The claim was denied based on the improper packing or preparation for shipment exclusion.

The insured filed suit against the agent, broker and insurer. The trial court granted summary judgment in favor of all three but the insured only appealed the judgment as to the agent. On appeal, the court first examined whether there was an actionable misrepresentation of insurance coverage despite the exclusion. In doing so, the court agreed that "absent an affirmative misrepresentation, appellant's mistaken belief about the scope of coverage is not actionable under the DTPA or the Texas Insurance Code." The court found, however, that in this case the agent "did more than represent the policy provided 'full coverage' and there is no evidence that the appellant was aware of the exclusion." Accordingly, the court held that the trial court erred in finding there was no affirmative misrepresentation of insurance coverage.

The court then turned its focus to whether the insured's failure to read the policy served to preclude his claims. The court examined Texas case law finding in part that an insured is deemed to know the terms of an insurance policy issued to them despite the insured's failure to read the policy. And, the court carefully examined Texas case law to address the interplay between "failure to read" and "deemed to know" rules when affirmative misrepresentation claims are involved. The court concluded that: "Appellant's failure to read the policy does not preclude his claims under the DTPA or the Insurance Code. Because appellant's claims are for alleged violations under the DTPA and Insurance Code based on an affirmative misrepresentation of coverage, the trial court could not have properly granted summary judgment on the basis that appellant was deemed to know the contents of the policy." Accordingly, summary judgment in favor of the agent was reversed and remanded for further proceedings.

[Editor's Note: This case presents a careful and detailed analysis of the "failure to read" and "deemed to know" rules frequently applied in Texas, and how the narrow exception based on "affirmative misrepresentation" can be applied.**]**

COURT ENFORCES INSURANCE POLICY ARBITRATION PROVISION FOR CLAIMS AGAINST AGENCY AND AGENT

Last Monday, the Amarillo Court of Appeals enforced an insurance policy arbitration provision as applicable to the policyholder's claims under Texas Deceptive Trade Practices Act and, fiduciary duty claims against and agency and individual agent. In *Jody James Farms, JV v. The Altman Group, Inc*., 2016 WL 6092370 (Tex. App. – Amarillo, October 17, 2016), a crop insurer denied a claim in part due to untimely submission. The insured field suit and the insurer compelled arbitration under a policy provision mandating arbitration as the means to resolve "all disagreements" under the policy. The arbitrator ruled in favor of the insurer. The insured then filed suit against the agency and agent that secured the policy and they also moved to compel arbitration. The court agreed and the arbitrator found in favor of the agency and agent. The trial court entered an order in their favor and the insured appealed.

The Amarillo Court of Appeals analyzed case law addressing efforts to enforce arbitration provisions against non-signatories to the agreement. The court observed that the arbitration provision applied to all disagreements related to the policy and that the arbitrator had the authority to determine his ability to arbitrate claims against non-signatories to the agreement. In this case, the court determined the arbitrator properly exercised his authority and found that the trial court did not err in affirming the arbitration award. The court affirmed the trial court's judgment in favor of the agency and agent.

COURT FINDS TIMELY TENDER OF APPRAISAL AWARD PRECLUDES CONTRACTUAL AND EXTRA-CONTRACTUAL CLAIMS

Last Monday, a federal district court in the Sherman Division of the Eastern District of Texas granted summary judgment in favor of an insurer after finding that timely payment of an appraisal award precludes breach of contract and extra-contractual claims against the insurer. In *McEntyre v. State Farm Lloyds, Inc.*, 2016 WL 6071598 (E.D. Tex. October 17, 2016), the insurer initially found no wind or hail damage and advised the insured they would be unable to issue payment on the claim. After receiving a letter of representation, the insurer re-inspected the property and issued payment in the amount of $5,065.80 based on the re-inspection. The insured filed suit and invoked appraisal. And based on the appraisal award, State Farm tendered payment in the amount of $326.26 but inadvertently failed to enclose the check. The check was received two weeks later by overnight mail. State Farm then moved for summary judgment on all contractual and extra-contractual claims.

Judge Amos Mazzant examined Texas law analyzing the impact of payment of appraisal awards noting that the effect is to estop a party from contesting damages "leaving only the question of liability for the court." The court disagreed with the insured's ambiguity arguments and also found that the inadvertent two-week delay in delivering payment was a simple clerical error that did not create a fact issue on timely payment. Addressing the allegation that the appraisal process did not bar claims that the insurer unreasonably investigated and denied the claim initially, the court found having submitted their claim to appraisal, and with the insurer's payment of the award, the insured may no longer argue breach of contract. And, because the breach of contract claims fail, the extra-contractual claims under the common law, Texas Insurance Code and DTPA also fail. Summary judgment was granted in favor of State Farm on all claims.

[Editor's Note: We wish to congratulate Rhonda Thompson of the Thompson Coe firm in Dallas as well as the State Farm team for this great win on an increasingly important topic given the proliferation of appraisal awards over the last few years in the voluminous wind-hail litigation which continues in jurisdictions across Texas.**]**