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Texas Court of Appeals Finds Fraud Exclusion Irreconcilable with Forgery Endorsement

BY: Jeremy S. Macklin

With phishing scams and other cybercrimes on the rise, insurers are offering products that protect insureds who fall victim to scams. In *Cent. Mut. Ins. Co. v. Reliance Prop. Mgmt.*, No. 05-21-00071-CV, 2022 Tex. App. LEXIS 3521 (Tex. App. May 25, 2022), the Texas Court of Appeals was tasked with interpreting an endorsement extending coverage for fraud-based crimes in the context of a policy form exclusion for losses caused by fraud. This recent decision underscores the importance of narrowly tailoring policy language to effectuate the intended coverage.

Reliance Property Management (“RPM”) purchased a commercial lines insurance policy from Central Mutual Insurance. The policy’s commercial property coverage part—specifically the “Buildings and Personal Property Coverage Form”—was subject to a Voluntary Parting Exclusion, which provided that Central Mutual “will not pay for the loss or damage caused by the [. . .] voluntary parting with any property by you or anyone else to whom you have entrusted the property if induced to do so by any fraudulent scheme, trick, device or false pretense.” RPM purchased a Premier Plus endorsement to the policy that added coverage, in relevant part, for “Forgery or Alteration,” “Computer and Funds Transfer and Fraud,” and “Fraudulent Impersonation.” The endorsement stated that Central Mutual “will pay for the loss resulting directly from ‘forgery’ or alteration of checks, drafts, promissory notes, or similar written promises, orders or directions to pay some certain in ‘money’ that are made or drawn upon you; or [. . .] by one acting as your agent.”

RPM is a small property management company with three employees: Robert Grunnah (“Grunnah”), the owner and president; Debbie Molitor (“Molitor”), the secretary and bookkeeper; and Alex Lilley, the property manager. On May 18, 2017, Molitor received a fraudulent email from “Fake Robert” asking if she could make wire transfers. Over the course of the following week, “Fake Robert” sent instructions to Molitor and RPM’s bank officers at BB&T Bank to authorize Molitor to make wire transfers for RPM. After further communications, “Fake Robert” instructed Molitor to transfer \$220,000 to Hong Kong from RPM’s account. The following day, Molitor received additional requests for transfers, so she called Grunnah only to find he knew nothing of the requests or the previous transfer. They immediately contacted the bank and attempted to stop the payment but were unable to do so. RPM then filed a claim for the loss of \$220,000, Central Mutual denied coverage, and this legal battle ensued.

Central Mutual denied coverage by relying on the Voluntary Parting Exclusion, arguing that the exclusion unambiguously applies to losses resulting from the voluntary parting with property if induced to do so by a fraudulent scheme. In arguing that the Voluntary Parting Exclusion applied to coverage added by the Premier Plus endorsement, Central Mutual pointed to the following general language found at the end of the endorsement: “All other Limitations, Conditions and Exclusions apply.” RPM insisted its claim was covered under the Premier Plus endorsement, arguing that the endorsement specifically modifies the Causes of Loss form and adds coverage for losses resulting from forgery of orders or directions to pay a sum certain of money.

The Court of Appeals sided with RPM. The Court of Appeals began its analysis by reiterating Texas law on policy interpretation: endorsements cannot be read apart from the main policy, and added provisions will only supersede the previous terms to the extent they are truly in conflict. In other words, the policy and endorsements should be construed together unless they are so much in conflict that they cannot be reconciled. Applying Texas law to the coverage dispute before it, the Court of Appeals found that the Voluntary Parting Exclusion cannot be reconciled with the Premier Plus endorsement's express coverage for loss from fraud-based crimes, such that the Premier Plus endorsement's language controlled.