

Invalid Payments Exclusion, Statute of Limitations Coverage Update

January 3, 2022

Invalid Payments Exclusion – Texas

Dillon Gage Inc. of Dallas v. Certain Underwriters at Lloyds

--- S.W.3d ---, No. 21-0312, 2021 WL 5750553 (Tex. Dec. 3, 2021)

The Texas Supreme Court answered two questions certified to it by the U.S. Court of Appeals for the Fifth Circuit relating to fraudulent payments accepted by a coin dealer. The high court found that an exclusion in the coin dealer's policy for losses "consequent upon" the acceptance of fraudulent checks applied to preclude coverage and that the United Parcel Service's (UPS) negligence in allowing a thief to reroute a shipment of coins from the coin dealer was not an independent cause of loss.

Certain Underwriters at Lloyds (Lloyds) issued an insurance policy to Dillon Gage Inc. (DGI) that contained an exclusion titled "Invalid Payments Exclusion Clause." The exclusion precluded coverage for "property losses 'consequent upon' handing over insured property 'to any third party' against payment by fraudulent check."

In January 2018, a thief opened an account with DGI pretending to be another customer, ordered over \$500,000 worth of coins and paid with a stolen check on which the thief forged the signature of the customer's wife. Upon provisional clearing of the check, DGI shipped the coins via UPS and unknowingly provided the tracking number to the thief. The thief rerouted the shipment and asked UPS to hold the coins at a facility for pickup; an action DGI had allegedly instructed UPS not to allow without DGI's consent. This scheme was attempted a second time, during which the customer discovered the identity theft and fraud. The bank dishonored the checks accepted by DGI.

DGI sought coverage for the loss of the coins from Lloyds based on the policy's coverage for "physical loss" of insured property "whilst being shipped via postal or courier transit." Following Lloyds denial of the bulk of the claim on the basis of the invalid payments exclusion, DGI commenced a breach of contract action against Lloyds in federal court. The district court found in Lloyd's favor, holding that the exclusion applied and that UPS's alleged negligence in, *inter alia*, allowing the package to be rerouted, was not an independent cause of loss for which there could be coverage.

On appeal, the appellate court certified to the Texas Supreme Court the questions of the meaning of "consequent upon" in the invalid payments exclusion and whether UPS's actions were an independent cause of loss. The Supreme Court found that the phrase "consequent upon" required only a finding of but-for causation, following the definitions of the phrase set forth in Black's Law Dictionary and other

dictionaries. The high court rejected DGI's argument that the phrase required a more stringent causal connection.

With respect to the second certified question, the Texas Supreme Court found that the use of the fraudulent check and UPS's actions in rerouting the package were sufficiently connected such that the acceptance of the fraudulent check (which was excluded) and the rerouting of the package (which could have been covered) concurrently caused DGI's losses: "UPS did not permit the thief to reroute Dillon Gage's shipments in a vacuum. Instead, the thief induced UPS's alleged negligence by using shipping information Dillon Gage provided against the thief's tender of the fraudulent check." Because the two constituted concurrent causes of loss, the exclusion precluded coverage for the entire claim.

Statute of Limitations – Fourth Circuit (North Carolina Law)

Skyline Restoration, Inc. v. Church Mut. Ins. Co.

--- F.4th ---, No. 20-1549, 2021 WL 5912171 (4th Cir. Dec. 15, 2021)

The U.S. Court of Appeals for the Fourth Circuit upheld the dismissal of an action brought by Skyline Restoration, Inc. (Skyline), as assignee of First Baptist Church, against Church Mutual Insurance Company (Church Mutual).

On Oct. 7, 2016, First Baptist Church sustained extensive damage from Hurricane Matthew. Skyline performed remediation services and, as part of the remediation contract, it was assigned First Baptist Church's rights to obtain proceeds under a policy issued by Church Mutual. After Skyline completed its work, it began attempting to collect payment, initially from First Baptist Church, then from Church Mutual. About two years later, as part of bankruptcy proceedings of First Baptist Church, Skyline was assigned the church's right to obtain the insurance proceeds for the remediation work. Skyline then instituted an action against Church Mutual, alleging breach of contract, unfair claim settlement practices under the Unfair and Deceptive Trade Practices Act (UDTPA) and seeking declaratory judgment.

The U.S. District Court for the Eastern District of North Carolina granted Church Mutual's motion to dismiss for failure to state a claim, reasoning that the declaratory judgment and breach of contract claims were time-barred under the applicable statute of limitations and the UDTPA claim was not assignable under North Carolina law.

The appellate court upheld the trial court's dismissal, noting that First Baptist's bankruptcy proceedings did not toll the three-year limitations period because "assuming that Skyline had a valid assignment with First Baptist, First Baptist's bankruptcy proceedings did not prohibit Skyline from timely filing a cause of action against Church Mutual under that assignment." Regarding when the limitations period began, the appellate court recognized that North Carolina General Statute § 1-52(12) and § 58-44-16 require

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a claim to be brought within three years from the date of the loss. While Section 58-44-16 was titled “Fire insurance policies; standard fire insurance policy provisions,” the appellate court noted that such title was “misleading” because it applied to policies insuring real property and to losses that are not fire related. Because Skyline instituted the action more than three years after the loss, its claims for declaratory judgment and breach of contract were time barred.

Further, the appellate court upheld dismissal of Skyline’s UDTPA claim, noting that it could not bring an independent UDTPA claim as a third-party claimant nor could it bring a UDTPA claim as an assignee of First Baptist Church, under North Carolina law.

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