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The Weekly Update of Texas Insurance News

TEXAS INSURANCE LAW NEWSBRIEF

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TEXAS SUPREME COURT OPENLY RECOGNIZES EXCEPTION TO 8-CORNERS RULE

Since 2006, when the Supreme Court of Texas hinted that a narrow exception to the eight-corners rule might exist, debate has raged across state and federal courts in Texas whether the court's coy statements should be taken as tacit approval of the presumptive exception. Last Friday, in *Monroe Guaranty Ins. Co. v. BITCO Genal Ins. Corp.*, No. 21-0232, 2022 WL 413940 (Tex. Feb. 11, 2022), the high court finally resolved all doubts, openly declaring its approval of the following exception to the strict eight-corners rule:

"Today, we expressly approve the practice of considering extrinsic evidence in duty-to-defend cases to which *Avalos* does not apply. In doing so, we do not abandon the eight-corners rule. It remains the initial inquiry to be used to determine whether a duty to defend exists, and it will resolve coverage determinations in most cases. But if the underlying petition states a claim that could trigger the duty to defend, and the application of the eight-corners rule, due to a gap in the plaintiff's pleading, is not determinative of whether coverage exists, Texas law permits consideration of extrinsic evidence provided the evidence (1) goes solely to an issue of coverage and does not overlap with the merits of liability, (2) does not contradict facts alleged in the pleading, and (3) conclusively establishes the coverage fact to be proved."

The court made several refinements to the formulation of the exception that has circulated in court opinions since 2006:

First, it observed that the threshold for triggering the exception is best stated as, "…does the pleading contain the facts necessary to resolve the question of whether the claim is covered?" In stating this threshold, the court intentionally avoided the concept of "potentially," to avoid inviting litigants and courts to engage in the long-forbidden practices of reading facts into the pleadings and imagining factual scenarios which might trigger coverage.

Second, the court expressly chose to avoid the murky phrase, "*fundamental* coverage issue," used by many federal courts, to prevent battles over which types of coverage issues are "fundamental" and which are not.

Third, the court added a new requirement that the proffered evidence must *conclusively* establish "the coverage fact to be proved."

The court then went on to apply its newly refined rule to the case at hand. The extrinsic evidence at issue concerned the question of when the property damage, consisting of an improperly drilled well and a stuck drill bit, occurred and when the insured knew about it. Like many such pleadings filed in Texas courts, the petition was silent as to the dates of any of the acts or omissions alleged, leaving the two consecutive insurers, BITCO and Monroe, in disagreement as to who owed a duty to defend the insured.

Ordinarily, a petition mentioning no dates would be likely to trigger a duty to defend for both insurers, but in this case, both insurers knew *and stipulated* the date the drill bit became stuck in the well. However, the court held that this extrinsic evince could not be considered because it improperly overlapped with the merits, stating:

"In cases of continuing damage like the kind alleged here, evidence of the date of property damage overlaps with the merits. A dispute as to *when* property damage occurs also implicates *whether* property damage occurred on that date, forcing the insured to confess damages at a particular date to invoke coverage, when its position may very well be that no damage was sustained at all."

Thus, although the original exception posited by the Texas Supreme Court in 2006 is now openly enshrined in Texas law with a few refinements, the extrinsic evidence in this case was still disallowed.

Editor's Note: The court's ruling disallowing the date evidence has potentially far-reaching implications for a wide variety of long-tail claims involving allegations of ongoing damage. Historically, it has been extremely difficult for insurers to refuse their insureds a defense based on date-related grounds when the pleading is either silent, vague, or all-inclusive on when the coverage-triggering event might have occurred. This ruling gives with one hand and takes away with the other, openly approving the extrinsic evidence rule, but simultaneously holding that evidence of the date of damage or injury can never be used, at least in continuing-damage cases.

The silver lining is that situations like this one, where the specific date of the alleged occurrence was known and stipulated, tend to be the minority in continuing-damage cases. Quite often, under the Texas injury-in-fact rule, the date damage began and continued is extremely difficult, if not impossible, to conclusively prove by any means.

But the court's ruling begs the question of how many other types of extrinsic evidence will be banned. Its reasoning for disallowing this evidence could open the door for arguments that any facts about the loss itself must be disallowed because one of the insured's

defenses is to deny that any injury or damage was sustained at all.

GOLF CART IS NOT AN AUTO, TEXAS SUPREME COURT HOLDS

Last week, the Supreme Court of Texas addressed the seemingly pedestrian question of whether a golf cart is an "auto" within the meaning of an auto liability policy. In *Pharr-San Juan-Alamo Indep. Sch. Dist. v. Tex. Political Subdivisions Prop./Cas. Joint Self Ins. Fund,* No. 20-0033, 2021 WL 6881108 (Tex. Sept. 14, 2021) the claimant was injured after being thrown from a golf cart during a sudden turn, and the insured sought coverage for the claim under its auto liability policy. Coverage turned on whether a golf cart is an "auto" and therefore at least potentially covered under the policy, or something else, such as "mobile equipment," which is not covered.

Although the term "golf cart" did not appear in the insurance policy, the policy defined "auto" to mean "a land motor vehicle ... *designed for travel on public roads* but does not include mobile equipment." It went on to define "mobile equipment" as certain types of land vehicles, including "[b]ulldozers, farm machinery, forklifts and *other vehicles designed for use principally off public roads.*"

Extrinsic evidence was offered to show the golf cart in question was not street legal, was not used on public roads, and was only driven on sidewalks and private drives on school property. But the high court concluded none of this evidence was necessary, and coverage could be determined solely on the plain meaning of the term "golf cart," which was the term used in the petition to describe the vehicle. Notably, the court applied the "ordinary and generally accepted meaning" standard, typically used to determine the meaning of terms in contracts, to this term used not in a contract, but in a pleading. Looking to dictionary definitions and to uses of the term "golf cart" in the Texas Transportation Code, the court concluded a golf cart is not designed for use on public roads and therefore was not an "auto." The court rejected arguments that golf carts can be legally used on certain public roads under certain circumstances, noting that permission to be occasionally used on public roads is not the same as being "designed" for travel on public roads, as required by the policy.

Editor's Note: This ruling does not put to rest the question of whether a variety of "low-speed vehicles" or "neighborhood electric vehicles" which are similar to golf carts, but can be registered for use on certain low-speed public roads, and which require additional safety features to be registered, may qualify as "autos" for insurance purposes.

FEDERAL MAGISTRATE EXAMINES BURDENS OF PROOF AND RULES FOR INSURER IN MOLD CASE

Last week, a federal magistrate judge in San Antonio conducted a careful examination of burdens of proof under a homeowners policy and recommended granting summary judgment in favor of the insurer. *Buchholz v. Crestbrook Ins. Co.*, No. 1-20-CV-449-RP, 2022 WL 378442 (W.D. Tex. Feb. 8, 2022) involved homeowners who bought a 10,000-square foot home and $6.4 million in homeowners insurance, with an endorsement adding an additional $1.6 million in "Biological Deterioration" coverage.

After discovering mold behind the wall of the indoor basketball court, the plaintiffs undertook an investigation of the entire house and discovered numerous latent water leaks and resulting mold in various areas of the house, which led to six insurance claims being made. Five of the claims were associated with specific water leaks, and the insurer determined they were covered and paid about $750,000 for repairs and mold remediation. The sixth claim focused on mold growth throughout the house that was not directly associated with any known water leak and whose cause was mysterious.

An engineer agreed to by both parties undertook an investigation to determine the cause of the mold, and concluded the house had a design flaw: both an improperly designed HVAC system and various finishes used throughout the house were preventing a normal "vapor drive" cycle and causing humidity from outside the house to enter the building envelope and then, instead of evaporating as it normally would, to condense and promote mold growth inside wall cavities. The insurer denied the sixth claim on the ground that it was caused by design defect, faulty workmanship, inherent vice, or latent defect, leading to this lawsuit.

The critical dispute was who owed the burden to either prove coverage or prove an exclusion. The policy was an all-risk policy, covering "all risk of accidental direct physical loss… except for losses excluded…" However, the Biological Deterioration endorsement's coverage was limited to "a covered cause of loss [that] results in **Biological Deterioration or Damage** to property…" Both sides moved for summary judgment, each contending the other owed the initial burden of proof. Based on the all-risk wording, the homeowners contended the mold claim was covered unless the insurer proved a specific exclusion. But based on the "covered cause of loss" wording in the endorsement, the insurer contended the burden was reversed and the homeowners must prove the cause of the mold.

Significantly, the homeowners appear to have based their entire litigation strategy on the premise that it was the insurer's burden to prove an exclusion. They responded to discovery by refusing to answer questions about the cause of the mold and failed to comply with a court order requiring them to supplement that discovery answer. Their retained expert (not the same expert who had inspected the house before suit) opined the insurer had failed to prove its alleged exclusions but declined to give any opinion on the actual cause of the mold. And in their briefing, they continued to rely on the premise that the all-risk nature of the policy meant they only had to show there had been a direct physical loss in order to meet their initial burden. The magistrate judge disagreed and concluded that even though the policy was an all-risk policy, the Biological Deterioration endorsement shifted the burden of proof to the homeowners to prove a "covered cause of loss," and by declining to present any evidence of the cause of the mold, they had not met that burden. The magistrate judge recommended summary judgment be granted for the insurer on both breach of contract and all extra-contractual causes of action.

Editor's Note: A magistrate judge's report and recommendation is not yet law, and the parties have 14 days to file objections. However, magistrates' recommendations are usually adopted by the district judge.

FIFTH CIRCUIT COURT OF APPEALS REVERSES AND RENDERS JUDGMENT FOR INSURER THAT NAMED PERILS COVERAGE ONLY COVERS NAMED PERILS IN HURRICANE HARVEY CLAIM

In *Landmark American Insurance Company v. SCD Memorial Place II, L.L.C.*, No. 20-20389, 2022 WL 320316, (5th Cir., Feb. 3, 2022), the Court reviewed whether an insurance policy covered flood-related damage sustained by a building during Hurricane Harvey. The trial court determined that the policy provided coverage and granted summary judgment in favor of the insured. After consideration. The appellate court reversed and rendered judgment in favor of the insurer.

In 2016, Landmark issued an insurance policy to SCD that covered several properties and was effective from August 31, 2016, to September 7, 2017. The Landmark policy was a "deductible buy back policy." The deductible buy back policy may cover all or a portion of the deductible required by the primary policy, reducing the insured's out-of-pocket costs.

SCD's primary insurance policy was a "all risks" policy that covered "all risks of direct physical loss or damage including flood, earth movement, and equipment breakdown." The policy had a high deductible and thus, the insured purchased the separate Landmark policy to help cover the cost of that deductible. The "Insuring Clause" of the Landmark policy outlines the type of damage for which it would cover the deductible of the primary insurance policy. Specifically, Landmark agreed to indemnify the insured for damage "caused by any of such perils as are set forth in item 3 of the schedule, and which are also covered by ... the 'Primary Insurer(s).' "In August 2017, Hurricane Harvey made landfall. The parties agreed that Hurricane Harvey was a "Named Storm," as defined under the policies and also that it caused damage to one of SCD's insured properties.

Landmark argued that the policy covers the specified perils of "Windstorm or Hail" that are "associated with a Named Storm [here, Hurricane Harvey]" but not all perils associated with a Named Storm. In other words, it is a "named perils" rather than "all risks" policy, meaning it covers only the perils specified in the policy. SCD cited *Pan Am Equities, Inc. v. Lexington Insurance Company* for the proposition that Hurricane Harvey was a "Windstorm" and therefore the policy covers all perils associated it.

The Court agreed with Landmark because its interpretation aligned with "the plain meaning of the text of the policy." The Court noted that although "Windstorm" in another policy could include flood and hail damage, in the specific context of the Landmark policy, it is a specific peril "associated with a Named Storm." "Windstorm" did not expand the Landmark policy to include all the perils associated with Hurricane Harvey. The Court concluded that under its plain language, the Landmark policy does not apply to the type of damage that the SCD property sustained in connection with Hurricane Harvey. The Court reversed and rendered in favor of Landmark.

RELYING ON TERRY BLACK'S BARBECUE FEDERAL DISTRICT COURT DISMISSES INSURED'S COVID-19 BUSINESS INTERRUPTION COVERAGE

A federal district court in Dallas recently granted an insurer's motion to dismiss an insured's lawsuit alleging breach of contract and extra-contractual claims against the insurer after applying Fifth Circuit's ruling in *Terry Black's Barbecue*, a similar COVID-19-related coverage case. *Lamacar, Inc. v. The Cincinnati Cas. Co.*, No. 3:21-CV-1396-S, 2022 WL 227162 (N.D. Tex.—Dallas Jan. 26, 2022), involved a company that sells gift shop inventory to customers throughout the U.S., who filed a claim with its commercial property insurer seeking coverage under the policy's Business Income Loss from Dependent Properties Coverage. The policy also included coverage for the insured's loss of business income resulting from loss or damage to the property of its customers.

In April 2021, the insurer denied the claim, informing the insured that it had failed to provide evidence of direct physical loss or damage to dependent properties from a Covered Cause of Loss, as the policy required. The insured subsequently filed suit, alleging breach of contract and extra-contractual claims for violations of the Texas Insurance Code and breach of the duty of good faith and fair dealing. The insured alleged that the virus that causes COVID-19 physically damages property because, as the scientific studies it cited showed, the virus could "physically bond with, alter and contaminate" other materials, including the insured and its customers' property (i.e., the inventory sold to the gift shops, most of which were in hospitals). The insured also cited the lockdown orders from a local county judge stating the virus caused "property loss or damage due to its ability to attach to surfaces for prolonged periods of time." As result of the contaminated property, which caused the insured's customers to stop sales or go out of business, the insured's business fell by nearly 70%. In response, the insurer filed a motion to dismiss, restating that the insured had not provided evidence of a direct physical loss or damage to dependent properties from a Covered Cause of Loss.

The Court agreed with the insurer and emphasized the Fifth Circuit's ruling in *Terry Black's Barbecue*—in relevant part, that "physical loss of property . . . requires a tangible alteration or deprivation of property." Like the restaurant owner in *Terry Black's Barbecue*, the insured's customers had not experienced any loss of property that triggered coverage because "nothing physical ha[d] happened to their property." That is, coverage required a "loss of property, not the loss of use of property," and the insured was therefore required to allege in its complaint that it suffered a direct physical loss or damage to its property or the property of its customers. The insured's complaint did not so allege, and, after citing numerous cases reaching the same conclusion, the Court therefore granted the insurer's motion to dismiss as to the breach of contract claim. Because the insured's breach of contract claim was dismissed due to a lack of coverage, the Court also dismissed the insured's extra-contractual claims.

FEDERAL DISTRICT COURT IN DALLAS DENIES REMAND IN COVID-19 BUSINESS INTERRUPTION DISPUTE

A federal district court in Dallas recently denied an insured's motion for remand in a case alleging lost-business income at its restaurants during the COVID-19 pandemic. In *Boomerjacks Grill & Bar v. The Members, et al*, No. 3:21-CV-01022-X, 2022 WL 326620, (N.D. Tex.—Dallas, February 3, 2022) Boomerjacks is seeking coverage for alleged lost-business income at its restaurants during the COVID-19 pandemic. The plaintiff originally sued the defendants in the 95th Judicial District of Dallas, Texas. Subsequently, the defendants removed the case to federal court, asserting diversity jurisdiction. Plaintiff filed a motion to remand.

Plaintiff argued that the Court should remand the case for three reasons. First, that the defendants fail to satisfy amount-in-controversy requirement. Second, that the defendants failed to obtain the consent of an allegedly properly joined and served defendant. Third, the Court should remand under its discretionary authority to decline to hear declaratory-judgment cases involving issues of state law. On the first issue, although finding that that the initial-pleading amount under Texas Rule of Civil Procedure 47 should not govern in this case, the case clearly met the amount in controversy requirement based on the policy limits and value of the plaintiff's claim. On the second issue, the Court found that the party whose consent was at issue had not been properly served so their consent was unnecessary prior to removal. On the final issue, the Court found that Plaintiff's arguments for discretionary abstention were unpersuasive and did not meet the factors set out by the Fifth Circuit governing when a district court should decline to hear a declaratory-judgment case. The motion for remand was denied.

FEDERAL DISTRICT COURT GRANTS IN PART AND DENIES IN PART, INSURER'S MOTION FOR SUMMARY JUDGMENT ON INSURED'S EXTRA-CONTRACTUAL CLAIMS IN RESIDENTIAL PROPERTY COVERAGE DISPUTE

Recently, a federal court in San Antonio granted an insured's motion for summary judgment regarding the extra-contractual claims brought by an insured in a dispute arising from the insurer's denial of coverage under a homeowner's policy. *Jajou v. Safeco Ins. Co. of Indiana*, No. SA-20-CV-00839-XR, 2022 WL 220391 (S.D. Tex.—San Antonio Jan. 24, 2022) involved a claim for replacement of the roof at a residential property filed by the insured after a hailstorm damaged her property.

Upon filing of the claim, the adjuster and a ladder assist contractor inspected the property's exterior, roof, and attic-side of the roof decking, but not the interior, since the insured did not initially report any interior damages. The inspection revealed hailstorm damages to the copper standing seams on the roof and splintering in the roof decking from hail impacts; however, there were no roof leaks or damage to roof seams observed. Consequently, the insurer determined that the roof damage was cosmetic in nature and excluded under the insured's policy, which included a cosmetic damage exclusion.

The insurer informed the insured of its decision that the cosmetic damage exclusion precluded coverage. In response, the insured stated it spoke with several real estate appraisers, structural engineers, and construction professionals who all agreed that the roof had structural damage and was adamant about not settling for anything less than a new roof. The insured then sent the insurer a roofing agreement she signed with her contractor, with an estimated price of $250,803.08. The insurer reopened the claim and assigned an engineer to reinspect the roof. The engineer asked if he could use a drone to inspection the property, which would be much cheaper than hiring a lift to access the roof. The insurer obliged, and the property was reinspected.

In his report, the engineer concluded that no panels or panel seams on the roof were punctured or penetrated due to hail impacts, reiterating that the damage to the roof was cosmetic in nature. When the insurer relayed this information to the insured, she hired a public adjuster to inspect her property. The public adjuster, in turn, sent the insurer an estimate for $395,018.35 in repairs, including full replacement of the roof, and asked the insurer to reinspect the property. The insurer agreed only to reinspect the non-roofing items at the property.

The reinspection revealed additional damage to the property's exterior elevations and two items of personal property, so the insurer issued a payment to the insured for this damage, but not for the roofing system. The insured then filed suit, asserting claims for breach of contract, violations of the Texas Insurance Code and DTPA, and breach of the common law of good faith and fair dealing. A few months after removing the case to federal court, the insurer moved for summary judgment on all of the insured's extra-contractual claims.

The Court first noted that the insured's extra-contractual claims were based on two theories: (1) the insurer conducted an unreasonable, "outcome-oriented" investigation; and (2) the insurer affirmatively misrepresented the extent of coverage under the policy by failing to include a cosmetic-damage exclusion in her homeowners insurance quote. Next, the Court stated that the breach of the common law duty of good faith and fair dealing required proof that the insurer failed to settle the claim even though it "knew or should have known it was reasonably clear that the claim was covered," adding that evidence of a "bona fide dispute" about liability would not rise to the level of bad faith.

The insured argued the insurer acted unreasonably the not property inspecting the property's roof and attic, allowing the engineer to use a drone instead of a lift to inspect the property, and violating its own written policies for inspecting hailstorm damage claims. Relying on the claim file, the Court pointed out that the insurer had indeed inspected the roof and attic, the interior of the property was not inspected because the insured did not initially report any damages to the property's interior, the adjuster observed hail damage to the cooper standing seam, and the contractor showed the adjuster areas in the attic where decking had splintered due to hail strikes. Such evidence, the Court concluded, showed that the insurer reasonably inspected the property's roof and attic.

Next, the Court ruled that the use of a drone rather than a list to reinspect the property was not unreasonable because the engineer's report and accompanying photographs showed he examined the seams on the roof closely, and the decision to use a drone over a lift (which centered more on cost) was "not of such magnitude as to affirmatively cast doubt on [the insurer's] basis for denying [the insured's] claim for damage to her roof." Rather, the use of the drone merely showed a difference of opinion as to the best method for reinspecting the roof and was not evidence of an unreasonable investigation.

Finally, the insured cited a manual that she alleged the insurer used for guidance, arguing that the insurer did not take close-up photos of the hail damage and roof, did not bring a ladder during its initial inspection, and did not investigate the interior attic for water damage. The Court emphasized that the insured had failed to prove that the manual was used by the insurer in the process of adjusting her claim and, even if the insurer relied on it, the claim file showed that the insurer did inspect and photograph the roof and attic with the use of a latter. Further, there was no proof the manual was binding on the insurer or its adjuster and stated that "each claim should be handled on its own merits with all applicable forms and endorsements considered."

In addition to the claim file, which affirmatively disproved the insured's underlying reasons for claiming the insurer acted unreasonably, the Court also quickly disproved the insured's claim that the insurer never apprised her of the cosmetic damage exclusion when they provided the quote for the policy to her. In fact, the policy explicitly and clearly included the cosmetic damages exclusion when the insured purchased it, and the insured admitted that she had not read the policy during her deposition. Therefore, the insured's extra-contractual claims that relied on an alleged affirmative misrepresentation were dismissed.

The only extra-contractual claims left after dismissing the bad faith claim and the extra-contractual claims based on an affirmative misrepresentation were the insured's claim under the provisions of the Texas Insurance Code regarding prompt payment of claims and the alleged failure to make a coverage decision within a reasonable time, which the Court decided could proceed to trial.