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FEBRUARY 2021 TEXAS INSURANCE LAW UPDATE

NORTHERN DISTRICT OF TEXAS CONCLUDES EXTRINSIC EVIDENCE PERTAINING TO EMPLOYEE STATUS FELL WITHIN NORTHFIELD EXCEPTION BECAUSE AN "EMPLOYEE" FOR PURPOSES OF COVERAGE DID NOT ESTABLISH "EMPLOYEE" STATUS IN UNDERLYING LAWSUIT

In *Canal Ins. Co. v. Greenland Trucking, LLC*, CA No. 3:20-CV-2970-G, 2021 U.S. Dist. LEXIS 24212, (N.D. Tex. February 9, 2021), the Northern District of Texas concluded insurer's declaratory judgment action survived a motion to dismiss based on use of extrinsic evidence.

Canal Insurance Company ("Canal") issued a commercial automobile policy ("Canal's policy") to Greenland Trucking, LLC ("Greenland") for the period September 28, 2019 to September 28, 2020. Canal's policy included a 2011 Volvo truck ("Volvo") as a covered "auto." On December 10, 2019, Yohannes Meharana ("Meharana") was driving the Volvo which became involved in a motor vehicle accident while Simon Yitbarek ("Yitbarek") was riding as a passenger in the Volvo. Yitbarek filed a lawsuit against Meharena, alleging that he suffered injuries because Meharana was negligently driving the Volvo, and also sued Greenland, the alleged lessee of the Volvo along with Maekel Habtemariam ("Habtemariam"), the alleged owner of the Volvo (the "Underlying Lawsuit"). Specifically, Yitbarek brought a claim of negligence against Meharana and claims for respondeat superior, negligence, and gross negligence against Greenland and

Habetemariam. Yitbarek alleged that Meharana was operating Greenland's and/or Habtemariam's tractor-trailer combination in furtherance of Greenland's and/or Habtemariam's business, and was operating the Volvo while under dispatch from Greenland and/or Habtemariam.

Canal commenced a declaratory judgment action against Greenland, seeking a declaration that it owed no duty to defend or indemnify Greenland in the Underlying Lawsuit, based on the Employee Indemnification and Employer's Liability exclusion and Fellow Employee exclusion in Canal's policy. Specifically, Canal's policy excluded coverage for "bodily injury" to an "employee" of the "insured" arising out of and in the course of 1) employment by the "insured," or 2) performing the duties related to the conduct of the insured's business. Furthermore, Canal's policy excluded coverage for "bodily injury" to any fellow "employee" of the "insured" arising out of and in the course of the fellow "employee's" employment or while performing duties related to the conduct of the insured's business. Moreover, the term "employee" was defined as any individual who is in the course of his or employment or contractual duties on behalf of any insured directly affects commercial motor vehicle safety. The term included but was not limited to a driver of a commercial motor vehicle (including an independent contractor while in the course of operating a commercial motor vehicle), co-driver (including an independent contractor).

Yitbarek moved to dismiss the declaratory judgment action, arguing that the eight-corners rule prohibited Canal from pursuing a claim based on facts that went beyond the allegations in the Underlying Lawsuit. Canal argued that extrinsic evidence exception to the eight corners rule applied. The Northern District of Texas ruled against Yitbarek and allowed Canal's declaratory judgment action to continue.

In deciding whether the extrinsic evidence exception applied, the court analyzed the two-part test in *Northfield*,[1] noting that the first requirement, that is—the pleadings do not contain facts necessary to resolve the question of insurance coverage, was satisfied inasmuch as there were no allegations as to Yitbarek's employment status in the Underlying Lawsuit. The court next considered whether the extrinsic evidence solely impacted a fundamental issue of coverage without affecting the merits of the allegations. The court noted that the meaning of "employee" under the Policy was different than the meaning of "employee" for purposes of vicarious liability. According to the court, one was a question of contract interpretation, and the other a matter of tort liability. Thus, the Court concluded that Canal's declaratory judgment fell within the extrinsic evidence exception.

Next, the court looked at the allegations in the underlying lawsuit. In the complaint in the Underlying Lawsuit Yitbarek alleged that he was a passenger in the Volvo at the time of the accident, that Meharana was operating the Volvo in the performance of his work duties on behalf of Greenland and/or Habtemariam at the time of accident, that Habtemariam owned the Volvo yet leased it to Greenland with a driver or drivers. Relying on judicial experiences and common sense, the court concluded that Yitbarek was in the Volvo on the day of the accident because he

[1] *Northfield Insurance Company v. Loving Home Care, Inc.*, 363 F.3d 523 (5th Cir.2004).

was employed to do so, just as Meharana. The court further reasoned that the petition's continued use of the phrase "Greenland and/or Habtemariam" suggests that Yitbarek was an employee of Habtemariam on lease to Greenland. Moreover, the language in Canal's insurance policy suggested that injuries to leased workers, such as Yitbarek, were excluded under Canal's policy. As such, considering that Canal's declaratory judgment action alleged that the employee based exclusions applied to both the duty to defend and the duty to indemnify, the declaratory judgment complaint survived the Rule12(b))(6) scrutiny and Yitbarek's motion to dismiss Canal's declaratory judgment action was denied.

NORTHERN DISTRICT OF TEXAS CONCLUDES TEMPRATURE/HUMDITY EXCLUSION PRECLUDES COVERAGE EVEN WHEN A CONCURRENT CAUSE IS A COVERED CAUSE

In *Methodist Hosps. of Dallas v. Affiliated FM Ins. Co.*, CA No. 3:20-CV-1504-B, 2021 U.S. Dist. LEXIS 34114* (N.D. Tex. February 24, 2021), the Northern District of Texas held that the Temperature/Humidity Exclusion in a property insurance policy applied to exclude coverage for loss of use of surgical stock.

Affiliated FM Insurance Company ("AFM") issued a property insurance policy to Methodist Hospitals of Dallas (Methodist) for the period October 1, 2017 to October 1, 2018. AFM's policy also covered Methodist Dallas Medical Center ("MDMC"). AFM's policy covered property against all risks of physical loss or damage. AFM's policy excluded loss or damage that was directly or indirectly caused by or resulted from certain enumerated events, regardless of any other cause or event, whether or not insured under AFM'S policy contributed concurrently or in any other sequence to the loss or damage ("Group 1 exclusions"). Moreover, AFM's policy also excluded loss or damage caused by or resulting from: 1) changes in temperature, or 2) changes in relative humidity, all whether atmospheric or not, except as provided by the Change of Temperature and Off-Service Interruption coverages in the AFM's policy ("Temperature/Humidity Exclusion" or the "Exclusion" or "Group II Exclusions").

Around September 7, 2018, a thunderstorm led to multiple power surges at MDMC, causing two chillers at MDMC to shut down for four hours. The chillers helped cool the operating rooms, emergency departments, and other patient care areas. However, following the power surge, these areas had a rapid rise in temperature and moisture as air handlers pulled hot and humid air into the building, leaving chillers unable to cool the air. This led to high humidity in the operating rooms and other patient care areas. Moisture accumulated on the ceiling, floor, cabinets and other surfaces of the rooms that were affected. Moisture also accumulated on paper-packaged surgical and other supplies, leaving them unfit for use. Methodist filed a claim under AFM's policy for the loss to its surgical stock, seeking over $8,000,000 to replace the items. AFM, however, denied coverage based on the Temperature/Humidity Exclusion. Following the court's permission, both parties moved for summary judgment on the issue of whether coverage for Methodist's loss of surgical stock was precluded by the Temperature/Humidity Exclusion of AFM's policy.

AFM argued that the Exclusion applied as it unambiguously excluded coverage for any loss that was directly caused by a change in temperature or humidity, without any exception. However, MDMC argued that 1) the Exclusion must be interpreted narrowly against AFM, and 2) the Exclusion requires that a change in temperature and humidity be the *sole* cause of the loss because the policy did not include anti-concurrent causation language. Methodist therefore contended that because the thunderstorm and the power surge caused the change in temperature and humidity at MDMC, the change in temperature and humidity was not the sole cause of the loss of surgical stock, rendering the Exclusion inapplicable.

Relying on the concurrent-causation doctrine,[2] the Northern District held that the loss squarely fell within the Temperature/Humidity Exclusion and found in favor of AFM. In reaching its decision, the Northern District found that the concurrent-causation doctrine applied with respect to the Group II exclusions because it lacked anti-concurrent causation language. As such, under the Temperature/Humidity Exclusion, AFM was not required to cover any losses caused in part by a change in temperature, so long as any other cause of the loss was inseparable from the change in temperature or humidity. Furthermore, the court found that simply because Methodist interpreted the exclusion to preclude damage "solely" caused by or resulting from change in temperature or humidity does not render the exclusion ambiguous. Instead, the court held that the Temperature/Humidity Exclusion applied to losses that were an effect, consequence, or outcome of a change in temperature or relative humidity, and there was no ambiguity in this language. The court held that nothing in the Exclusion's language indicates that it was intended to apply only where an excluded event is the sole cause of the loss. Instead, the rise in temperature and humidity was not only one of multiple events, but one of multiple related and interdependent events in the chain of causation that resulted in Methodist's loss of surgical stock. As such, based on the concurrent-causation doctrine, regardless of whether the events that occurred earlier in chain of causation than the change in temperature and humidity are covered events, because the change in temperature and humidity is *not* a covered event, the Exclusion is triggered. The court further declined to grant summary judgment as to the applicability of any exceptions to the Exclusion after noting that Methodist did not present any arguments as to applicability of any such exceptions.

[2] Under the concurrent-causation doctrine, when excluded and covered events combine to cause a loss and the two causes cannot be separated, concurrent causation exists and the exclusion is triggered, relieving the insurer of any duty to provide coverage.

SOUTHERN DISTRICT OF TEXAS DISMISSES BREACH OF CONTRACT AND EXTRA-CONTRACTUAL CLAIMS AFTER CAREFUL ANALYSIS OF CAUSATION EVIDENCE

In *Farris v. State Farm Lloyds*, CA No. H-19-3872, U.S. Dist. LEXIS 21311*, (S.D. Tex. February, 4, 2021), the Southern District of Texas addressed an insured's breach of contract and extra-contractual claim against the insurer.

In *Farris*, State Far Lloyds ("State Farm") issued an insurance policy to Dustin Farris ("Farris") that provided coverage for Plaintiff's residence in Montgomery, Texas (the "Property") from June 28, 2017 to June 28, 2018. The Policy included a $2,534.00 wind/hail deductible and $1,267.00 deductible for other insured losses.

Plaintiff filed a claim with State Farm on February 18, 2019 for damage to the Property from a wind and hail storm on March 18, 2018. On March 8, 2019, State Farm adjuster inspected the property and found no wind or hail damage on the roof, yet noted a potential hail mark on a mercury light fixture. The adjuster also found interior water damage in the laundry room and nursery, yet concluded that the damages were not from any storm-related roof damage. After a second inspection by State Farm confirmed its findings, State Farm estimated the costs of repairs to be below the deductible. Plaintiff then filed suit, alleging that the estimate damage to the Property was $30,536.00, bringing claims of breach of contract and extra-contractual claims, including bad faith claims, violation of Prompt Payment Act and fraud, against State Farm. State Farm moved for summary judgment. The Southern District of Texas granted State Farm's motion and dismissed all of Plaintiff's claims.

As for Plaintiff's breach of contract claim, in reaching its decision, the *Farris* court relied on Plaintiff's causation expert Neil Hall's opinions in his report based on the different affected areas of the Property including the laundry room, nursery, roof and garage roof. As for the laundry room, Hall concluded that the damage to the wall of laundry room resulted from rainwater dripping off the forward edge of R-panels of the roof, which did not extend beyond the face of the veneer on the side of the house or far enough past the wall to prevent rainwater dripping off the edge from traveling to the opening. As such, the damage to the laundry room was not caused by the wind or hail storm on March 18, 2018 but rather from the roof panels being improperly sized and not extending far enough to prevent rainwater from dripping off the edge of the roof into the opening behind the veneer. Also, with regard to the nursery, Hall noted that based on weather data, the damage took place on or about August 11, 2018, a date outside State Farm's policy period. Hall noted that Plaintiff claimed to have first noticed the leak shortly after June or July of 2018, yet later testified that he claimed this date as he was under the wrong impression that he filed his claim with State Farm in June or July of 2018. Because Plaintiff actually filed the claim in February 18, 2019, he would have noticed the leak after and closer in time to August 11, 2018. As such Hall testified that he had no conclusive opinion regarding the cause of the water damage to the ceiling in the nursery. Therefore, the court found that Plaintiff failed to raise any issue of material fact that the damage to the nursery was caused by the March 18, 2018 wind/hail storm. Moreover, with regard to the roof, the Southern District found that the

Cosmetic Damage Endorsement excluded coverage. The Cosmetic Damage Endorsement excluded coverage for damage to a metal roof that is a loss that altered physical appearance of the metal roof covering but did not result in the penetration of water through the metal roof covering or did not result in the failure of the metal roof covering to perform its intended function of keeping out the elements over an extended period of time. Because Hall opined that the hail hit the ridge cap of the metal roof, it did not create any penetrations or water intrusion and Plaintiff admitted there were no areas of the roof found to be punctured by hail, the Cosmetic Damage Endorsement precluded coverage for any damage to the roof. As for the roof of the garage, Hall reported that two silicone-covered holes in the R-panel roof over the attached garage were the result of relocating two screws in metal roof, not any damage from March 18, 2018. Therefore, finding that Plaintiff's causation evidence failed to raise any genuine issues of material facts that the damage to the Property was above the deductible, the Southern District granted summary judgment in favor of State Farm and dismissed Plaintiff's breach of contract claims.

As for Plaintiff's bad faith claims, the court noted that Plaintiff claimed he was forced to appear for a deposition, respond to discovery requests, allow multiple experts and adjuster to access the Property for inspection, and engage legal representatives to try to obtain policy benefits improperly withheld. However, these alleged injuries all stemmed from State Farm's denial of Plaintiff's claim or additional benefits under State Farm's Policy, and Plaintiff failed to establish any right to receive benefits under the policy or present an injury independent of the right to benefits. The court further noted that Hall's opinions were consistent with those of State Farm's expert such that both concluded that there was no covered wind or hail damage in excess of State Farm's policy's deductible. Moreover, even if the parties' experts differed in opinion, the court held that same will only indicate a bona fide coverage dispute, yet will not constitute bad faith. There was no evidence that State Farm's opinions could not be reasonably relied upon by State Farm or that State Farm was biased against Farris in processing his claim. The court also found that State Farm did not violate the Prompt Payment of Claims Act as it notified Plaintiff of its claim decision within 15 days after conducting an inspection of the Property. Finally, Plaintiffs' fraud claim was similarly dismissed. Plaintiff argued that the State Farm adjuster stated that unless there were holes in the roof, there would be no coverage under State Farm's policy and the dents on the ridge cap of the roof were cosmetic damage. However, there was no evidence that State Farm's adjuster knew these statements were false when he made them or that Plaintiff relied on them in any way, all of which were fatal for Plaintiff's fraud claim against State Farm.

NORTHERN DISTRICT OF TEXAS DISMISSES INSURED'S CLAIMS BUT GRANTS A SECOND CHANCE TO REPLEAD

In *Vandelay Hospitality Grp. LP v. Cincinnati Ins. Co.*, CA No. 3:20-CV-1248-D, 2021 U.S. Dist. LEXIS 24032, (N. D. Tex. February 9, 2021), the Northern District of Texas dismissed insured's claim for the second time for failure to plead plausible claims, yet granted a second opportunity to replead.

In *Vandelay Hospitality Grp. LP v. Cincinnati Ins. Co.*, CA No. 3:30-CV-1348-D, 2020 U.S. Dist. LEXIS 185581, (N.D. Tex. October 7, 2020), the Cincinnati Insurance Company ("Cincinnati") issued an "all risk" commercial property insurance to Vandelay Hospitality Group LLC d/b/a Hudson House ("Vandelay"). Vandelay filed a lawsuit against Cincinnati, seeking recovery for alleged losses to three of its restaurants caused by the COVID-19 pandemic. Specifically Vandelay brought claims of breach of contract, violation of Prompt Payment Act, and violations of the Texas Insurance Code. Vandelay also sought declarations from the court that (1) Cincinnati's policy was an all-risk commercial property insurance policy and provided coverage for business income losses and extra expenses; (2) that the forced closures of the Vandelay's restaurants was a prohibition of access to its own premises and covered as defined in the Policy; (3) that Vandelay sustained direct loss to property because of the pandemic as well as related state and local orders; and (4) that the ongoing lost business income is due to the necessary suspension of Vandelay's business operations.

However, the Northern District of Texas granted Cincinnati's motion to dismiss Vandelay's complaint, finding that Vandelay had failed to plead a plausible breach of contract claim in its state-court first amended petition. Even though Vandelay acknowledged in its response to Cincinnati's motion that it must show that its properties plausibly sustained direct physical loss or damage, the Court found that the allegations in Vandelay's amended petition, rather than its acknowledgment in its response to Cincinnati's motion, determine whether Vandelay has pleaded a plausible claim. As such, finding that the allegations in Vandelay's first amended petition were mere factual and legal conclusions, the Court dismissed Vandelay's breach of contract claim. The court had also dismissed Vandelay's claim for violation of the Prompt Payment Act, as it found that Vandelay failed to plausibly plead that Cincinnati owed any benefits under the policy. Likewise, Vandelay's claims for violations of Texas Insurance Code were also dismissed as the court found that it failed to plausibly plead that it is entitled to policy benefits. Vandelay's declaratory judgment claims for the same reasons the court dismissed Vandelay's breach of contract claim. The court had further held that even if Vandelay's breach of contract claim was plausible, the declaratory judgment claim would still be dismissed because it overlapped with the allegations in the breach of contract claim and had to be resolved in the context of the breach of contract claim. However, acknowledging that Vandelay first amended its complaint under Texas pleading rules, which applied prior to removal of the case to Northern District, the court gave an opportunity to Vandelay to replead under federal pleading standards within 28 days, considering that Vandelay did not state it cannot or will not cure it defects pleading.

Following the Northern District's October 7, 2020 decision, Vandelay filed its second amended claim and Cincinnati again moved to dismiss Vandelay's second amended complaint for failure to state a claim on which relief may be granted. Vandelay's second amended complaint alleged that the COVID-19 was present in its restaurants and infected the premises. The court, however, found that even assuming Vandelay sufficiently pleaded that COVID-19 was the source of damages to its restaurants, Vandelay did not adequately plead that the presence of COVID-19 caused any distinct, demonstrable physical alteration of the restaurants that would trigger coverage under Cincinnati's policy. As such, the court again dismissed Vandelay's breach of contract claims. With regard to Vandelay's claim for violation of the Prompt Payment

Act and the Texas Insurance Code, the Northern District again found that Vandelay failed to plausibly plead that Cincinnati owed any benefits under its policy, which again warranted dismissal of said claims. Vandelay's declaratory judgment claims were also dismissed, as the court found that Vandelay was seeking declarations that "track[ed]" its breach of contract claims. Nevertheless, the Northern District granted Vandelay yet another opportunity to amend its complaint, after considering that Vandelay did not state that it cannot or is unwilling to cure the defects in its pleadings. The court granted Vandelay 28 days to file a third amended complaint, while also permitting Cincinnati to move anew to dismiss on proper basis again if Vandelay files a third amended complaint.

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