Fanning Harper Martinson Brandt & Kutchin

COVERAGE DEPARTMENT:
Jennifer Kelley
Direct Dial: 972-860-0304
jkelley@fhmbk.com
Kathryn Vaughan
Direct Dial: 972-860-0309
kvaughan@fhmbk.com
Mariam Shakir
Direct Dial: 972-860-0363
mshakir@fhmbk.com
Stephanie Pitel
Direct Dial: 972-860-0352
spitel@fhmbk.com

www.fhmbk.com

MARCH 2021 TEXAS INSURANCE LAW UPDATE

TEXAS SUPREME COURT HOLDS INSURER'S PROMPT PAYMENT OF AN APPRAISAL DID NOT BAR LIABILITY FOR FAILURE TO PAY A CLAIM WITHIN THE STATUTORY DEADLINE

In *Hinojos v. State Farm Lloyds*, 619 s.w.3D 651 (Tex. Mar. 19, 2021), the Supreme Court of Texas found that the insurer's prompt payment of an appraisal award did not bar liability under Chapter 542 of the Insurance Code even though there had been a partial payment of the claim within the statutory deadline.

In 2013, Hinojos made a claim for storm damage to their house caused by hail and wind. State Farm insured Hinojos and its initial inspection resulted in an estimate below the deductible. Hinojos disagreed with the inspection results and requested a second inspection. At the second inspection, the adjuster identified additional damage resulting in a payment to Hinojos of $1,995.11 After State Farm paid Hinojos for the damage less the depreciation and the policy deductible, the insured sued State Farm, accusing the insurance company of violating the Prompt Payment Act by delaying payment on the claim. Fifteen months later, State Farm invoked the policy's appraisal clause, resulting in appraisers valuing Hinojos's loss at a replacement cost of $38,270 and cash basis of $26,260. The appraisal resulted in State Farm tendering an additional

payment of $22,974.75 reflecting payment of the appraisal award inclusive of the prior payment made to Hinojos, the deductible and depreciation.

State Farm moved for summary judgment, arguing that timely payment of an appraisal award precluded prompt payment (or Chapter 542) damages. The trial court granted summary judgment and Hinojos appealed (notably *Barbara Technologies* had not yet been decided). The Court of Appeals affirmed State Farm's victory on the basis that "State Farm made a reasonable payment on Hinojos's claim within the sixty-day statutory limit…." The Supreme Court of Texas was not persuaded by this argument. The court ultimately found that State Farm was not relieved from liability for statutory interest for violation of TPPCA by payment of difference between appraisal award on Hinojos's claim and the amount it timely paid within statutory deadline, and that the TPPCA did not require that State Farm make only "reasonable" payments within the statutory deadline. This holding also explicitly highlights that an insurer's partial payment of a claim within the statutory deadline does not preclude it from liability for interest. "An insurer's acceptance and partial payment of the claim within the statutory deadline does not preclude liability for interest on amounts owed but unpaid when the statutory deadline expires."

THE FIFTH CIRCUIT CERTIFIES TWO QUESTIONS TO THE SUPREME COURT OF TEXAS TO DETERMINE IF THE NORTHFIELD EXCEPTION TO THE EIGHT CORNERS DOCTRINE IS PERMISSIBLE

In *Bitco Gen. Ins. Corp. v. Monroe Guar. Ins. Co.,* No. 19-51012, 2021 U.S. App. LEXIS 7394 (5th Cir. 2021), one year after the Supreme Court of Texas adopted the first formal exception to the "eight corners" rule, the Fifth Circuit has certified two questions asking the Supreme Court of Texas to examine whether extrinsic evidence can be considered to determine if the duty to defend in a general liability dispute has been triggered when the date of the damage is not alleged.

A farm hired a 5D Drilling and Pump Service Inc. ("5D") to drill an irrigation well through the Edwards Aquifer in the summer of 2014. In June of 2016, the farm sued 5D for abandoning the well with the drill head lodged in it after they deviated from the plan. 5D notified its two insurance companies from the relevant periods of time seeking defense. One company agreed to provide defense. However, the other company said that it had no duty to defend because the damage allegedly occurred outside their coverage window because the drill head became lodged in 2014 and their policy did not begin until October 2015.

The court acknowledged that the date, which can only be determined through extrinsic evidence, is the key to determining this issue. The court has certified the following two questions to obtain guidance from the Supreme Court of Texas on how to rule on this issue.

1. Is the exception to the eight-corners rule articulated in Northfield Ins. Co. v. Loving Home Care, Inc., 363 F.3d 523 (5th Cir. 2004), permissible under Texas law?

2. When applying such an exception, may a court consider extrinsic evidence of the date of an occurrence when (1) it is initially impossible to discern whether a duty to defend potentially exists from the eight-corners of the policy and pleadings alone; (2) the date goes solely to the issue of coverage and does not overlap with the merits of liability; and (3) the date does not engage the truth or falsity of any facts alleged in the third party pleadings?

This case could provide insurers with the long awaited answer to if the Northfield Exception is recognized by the Supreme Court of Texas. We will continue to monitor this case and provide you with updates as they arise.

THE LIMITED FLOOD ENDORSEMENT WAS FOUND BY THE FIFTH CIRCUIT TO NOT APPLY TO DAMAGES TO A BOAT DECK CAUSED DURING HURRICANE HARVEY

In *Playa Vista Conroe v. Ins. Co. of the West*, 989 F.3d 411 (5th Cir. 2021), the Fifth Circuit Court of Appeals addressed the application of the limited flood endorsement with respect to damages sustained during Hurricane Harvey, concluding it did not apply to preclude coverage.

Playa Vista Conroe is a condominium complex located on the north shore of Lake Conroe with twenty-two boat slips. Although Playa Vista Conroe sits just outside of Houston, it was not able to escape the unprecedented rainfall and flooding. In an effort to prevent Lake Conroe's Dam from overflowing, the San Jacinto River Authority authorized the release of 79,141 cubic feet of water per second (which the court likens to Niagra Fall's flow rate). This release of water damaged their boat docks and other various structures.

Playa Vista Conroe turned to its insurance carrier, Insurance Company of the West ("ICW"), to compensate them based on their policy. ICW denied the claim because the damage, "appear[ed] to be the result of Hurricane/Tropical Storm Harvey," and that Playa Vista Conroe's "policy d[id] not cover flooding caused by a hurricane or tropical storm." The policy contains a "limited coverage—flood endorsement": a 1.5 page document replacing the background flood provisions and a "specified flood exclusion": a 0.5 page document adding an additional site-specific flood exclusion for "BOAT SLIPS/DOCKS."

Playa Vista Conroe proceeded to file a notice and pre-litigation demand pursuant to Chapter 542A of the Texas Insurance Code alleging that ICW had improperly adjusted the claim so that they could deny paying Playa Vista Conroe what ICW had contractually agreed to cover. Playa

Vista Conroe eventually sued ICW for breach of contract and both parties moved for summary judgment

The district court granted Playa Vista Conroe's motion for summary judgment for the breach of contract claim but left the determination of damages and attorney's fees for trial. The parties then jointly agreed to a stipulation of $190,827.50 for Playa Vista Conroe's damages and $50,000.00 for its attorney's fees which was approved by the district court. ICW then attempted to argue that by agreeing to the stipulation, Playa Vista Conroe acknowledged that the incident fell within the Policy's exclusion for "[a]cts or decisions, including the failure to act or decide, of any person, organization or governmental body." ICW filed a motion to reconsider the final judgment which the district court promptly denied and ICW appealed.

The Fifth Circuit first analyzed whether or not Playa Vista Conroe met its burden of showing that the damages were covered in the absence of an exclusion. The policy stated that it would not cover damages for docks unless "a stated value is shown in Section E. . . . and/or a sub-limit of insurance is shown in Section A.1.a . . . in the Declarations or in an endorsement to this policy." In Section A.1.a. of the Policy, a $200,000.00 sublimit was included in coverage for boat slips, so Playa Vista Conroe was found to have met its burden.

Next, the court analyzed if ICW met its burden of showing an exclusion was applicable. The court recognized that the policy generally excludes damages caused by a flood unless the insured purchases separate flood coverage. Playa Vista Conroe purchased the separate flood coverage which renders the previous exclusion void. The court points to the fact that the exclusions in the separate flood policy closely mirror those in the primary policy as further evidence that ICW sought to replace the primary policy coverage and exclusions. The court then turned to the definitions provided in the policy for a "flood" to show that this provision also fails to exclude the damages. For the flood exclusion to be triggered, there must be "a general and temporary condition of partial or complete inundation of 2 or more acres of normally dry land areas or of 2 or more distinct parcels of land (at least one of which is your property) with water." The court reasons that the peculiar phrasing lends itself to only apply to things on dry land and since docks and boat slips are by nature in the water, the exclusion does not apply to them. The court made a point to address that even if the flood exclusions did apply, Playa Vista Conroe submitted sufficient paperwork, that was uncontested by ICW, proving that the damages were not caused by a flood, but rather the controlled release of water by the San Jacinto River Authority created a strong suction effect that whipped debris into the dock and boat slips.

ICW argued that the unique drafting of its policy was an attempt to shift the burden to prove coverage and no exception to the insured. The court was unpersuaded because ICW already conceded that the dock and boat slips were covered under the primary policy and they can no longer change their argument. ICW also argued that because Playa Vista Conroe signed the Stipulation, they agreed that the damage was caused by the decisions of a governmental body which would have triggered the previously unmentioned exclusion for "[a]cts or decisions, including the failure to act or decide, of any person, organization or governmental body."

However the court disagreed and disapproved of this tactic, concluding ICW waived the argument by not pleading it at summary judgment.

RELYING ON EXTRINSIC EVIDENCE, THE SOUTHERN DISTRICT OF TEXAS CONCLUDED AN ACCIDENT ON A BUS IN MEXICO DID NOT TRIGGER AN INSURER'S DUTY TO DEFEND OR INDEMNIFY DUE TO LOCATION OF THE ACCIDENT

In *Nat'l Liab. & Fire Ins. Co. v. Los Chavez Autobuses Inc.*, No. 4:20-cv-01302, 2021 U.S. Dist. LEXIS 44443 (S.D. Tex. 2021), the Southern District Court of Texas utilized extrinsic evidence related to the location of the accident to determine whether or not a commercial auto liability insurer owed a duty to defend or indemnify its insured in underlying state court litigation.

Los Chavez Autobuses Inc. ("Los Chavez") was issued a business auto insurance policy with National Liability & Fire Insurance Co. ("National Liability"). The policy required National Liability to "pay all sums" that the insured "legally must pay as damages . . . caused by an 'accident' and resulting from the ownership, maintenance or use of a covered 'auto.'"

In the underlying accident, a woman boarded a bus that was owned and operated by Autobuses El Refugio and Los Chavez in Matehuala, Mexico. It is alleged that the two entities are affiliated and frequently lease buses from each other. On the bus ride, the unknown driver sped over a speed bump in Matehuala causing the woman to hit her head on the ceiling of the bus and lose consciousness. The woman regained consciousness several hours later before reaching Laredo, Texas. The bus driver did not stop to get the woman medical care in Mexico. Once in the United States, Luis Perez, a driver for Los Chavez entered the bus to begin driving but the woman was still not taken for medical treatment until they reached their destination of Houston, Texas even though she allegedly experienced "bleeding from the head, confusion, fainting, [and] immobility."

National Liability sought declaratory judgment from the court that it had no duty to defend or indemnify because the accident is excluded from coverage because it happened in Mexico. The court began its duty to defend analysis by recognizing the *Northfield* exception to the eight-corners rule which states that the doctrine does not apply in the "very limited circumstances . . . when it is initially impossible to discern whether coverage is potentially implicated and when the extrinsic evidence goes solely to a fundamental issue of coverage which does not overlap with the merits of or engage the truth or falsity of any facts alleged in the underlying case." The court also noted that while the Texas Supreme Court has not expressly adopted this exception, they have cited to it with approval.

While the policy expressly denied coverage for accidents that occurred outside the United States, the operative documents did not state where the injury actually took place. Because it would be impossible to determine if coverage was triggered without additional evidence and because said

evidence would not overlap with the merits of the underlying claim, the court allowed extrinsic evidence. The court reasoned that since the record indisputably showed that the woman was injured initially in Mexico when the driver sped over the speed bumps, then National Liability's duty to defend had not been triggered.

The woman countered that National Liability must represent Los Chavez in the underlying suit because the injury stemmed from the drivers' negligence in not seeking medical care for her. The court rejected this argument because it was not the argument stated in the petition, and while creative, the argument failed the three part test adopted by the Texas Supreme Court for what constitutes an "accident." The "accident" of not seeking medical care did not (1) arise out of the inherent nature of the automobile, (2) arise within the natural territorial limits of the automobile without terminating the use, and (3) the automobile merely contributed to cause the condition which produced the injury but did not cause the injury itself. The Southern District thus found that National Liability had no duty to defend Los Chavez.

With regard to the duty to indemnify, the woman argued that the court must wait to decide the issue until after the underlying suit has been resolved. However, the court was unpersuaded that any facts could possibly be discovered that would turn an accident in Mexico into an accident covered under the policy. As such, the court found that National Liability had no duty to indemnify Los Chavez in the underlying suit

COVID-19 CIVIL MANDATES FOR BUSINESS CLOSURE FOUND BY EASTERN DISTRICT OF TEXAS NOT TO TRIGGER BUSINESS INTERRUPTION COVERAGE

In *Selery Fulfillment, Inc. v. Colony Ins. Co*., Civil Action No. 4:20-cv-853, 2021 U.S. Dist. LEXIS 47483 (E.D. Tex. 2021), the Eastern District Court of Texas found that the insured's business interruption claims and civil authority coverage should be dismissed because COVID-19 did not cause physical damage to their premises and because the civil authority orders were not based on physical damage or harm.

The 2020 COVID-19 pandemic disrupted many business owner's operations including Selery Fulfilment, Inc.'s ("Selery"). Selery provides services for eCommerce businesses through warehousing and personalized order fulfillment and was issued a CGL through Colony Insurance ("Colony"). Selery claimed that not only was its business adversely affected by the pandemic, but also that its business losses are covered under the insurance policy Colony issued. Selery brought suit when Colony denied this claim without investigating. In the suit, Selery alleged they should have been covered for (l) the damage to the Insured Premises by COVID-19; (2) business income loss and extra expenses resulting from the interruption of Selery's operation due to the damage to the Insured Premises by COVID-19; and (3) the business income loss and extra expenses Selery sustained as result of their inability to access and use the Insured Premises due to executive order. Colony sought a motion to dismiss the claim because it believed that physical, concrete damage was required under the Policy's provisions to trigger coverage.

The court disagreed with Selery's position and found that the Business Income provision does not cover Selery's claim. Selery made no claim that Covid-19 physically entered their premises but rather the civil orders prevented them from entering the premises. The court determined that without "direct physical loss of or damage to property" there could be no covered loss because "[i]t is too big of a leap to suggest that government orders that restrict access to property constitute 'property damage,' especially when the Policy insures Selery's commercial property location—not its entire business."

The court also disagreed with Selery's claim that the Civil Authority Provision should provide coverage because the Fifth Circuit has previously held that the provision "requires proof of a causal link between prior damage and civil authority action." Selery failed to allege that any property damage occurred at any place close to its facility and thus the court found that the "causal link" between property damage and the civil authority action is too attenuated to state a claim.

AUTO EXCLUSION FOUND BY SOUTHERN DISTRICT OF TEXAS TO BAR COVERAGE FOR WRONGFUL DEATH SUIT INVOLVING CHILD WHO DIED AFTER BEING LEFT ON A SCHOOL BUS

In *Scottsdale Ins. Co. v. Discovering Me Academy* LLC et al., 4:20-cv-02449 (S.D. Tex. Mar. 23, 2021), the Southern District Court determined that the "auto exclusion" in CGL policy precluded insurer's duties to defend and to indemnify in wrongful death suit arising out of a child's death. In *Scottsdale,* the underlying petition alleged that the child was left on the bus due to a teacher's negligent supervision and care and Discovering Me Academy not having in place a policy to confirm all children were off the bus. Both of these factors were alleged to have played a role in the child's death. Scottsdale insured Discovering Me Academy at the time of the accident through a CGL policy. When Discovering Me Academy was sued by the parents of the deceased child, Scottsdale determined that the accident was not covered because the policy excluded injuries from any auto vehicle use.

The Southern District Court of Texas ultimately found that Scottsdale had no duty to defend based on the auto exclusion, because (1) the accident must have arisen out of the inherent nature of the automobile, as such, (2) that the accident must have arisen within the natural territorial limits of an automobile, and the actual use must not have terminated, and (3) that the automobile must not merely contribute to cause the condition which produces the injury, but must itself produce the injury. The court determined that the child's death arose out of the use of the bus's inherent function or purpose, which was to transport the children and which had not been fulfilled as to the child left on the bus; that the accident occurred within the bus's natural territorial limits; and that the bus itself caused, rather than contributed to, the conditions that produced the injury.

The court also rejected Discovering Me Academy's argument that the underlying claims of negligence fell outside of the auto exclusion because under the test, which requires courts to examine whether the injuries, not whether a particular cause of action, arose out of the use of an auto. Finally, the court rejected Discovering Me Academy's argument that there was an independent cause of action. The court reasoned that under the "arising out of" phrase, the claim need only bear an incidental relationship to the described conduct for the exclusion to apply. The court also found that Scottsdale had no duty to indemnify Discovering Me Academy because the facts, as developed in the underlying action, would not alter the fact that the injury arose out of the use of the bus.

SOUTHERN DISTRICT CONCLUDES HOMEOWNERS' FAILURE TO PROVIDE EVIDENCE OF A COVERED LOSS DURING THE POLICY PERIOD AND TO SEPRATE COVERED DAMAGES FROM NON-COVERED DAMAGES PREVENTED RECOVERY UNDER THE POLICY

In *Henry v. Allstate Vehicle & Prop. Ins. Co*., No. 4:20-CV-310, 2021 U.S. Dist. LEXIS 55372 (S.D. Tex. 2021), the Southern District Court of Texas determined that the insured's failure to provide evidence of a covered loss occurring during the policy period and their failure to segregate the covered from non-covered damages barred them from recovery under their homeowners insurance policy.

The Henrys made a claim asserting that, in the spring of 2017, a pipe burst in their home's second-floor bathroom, causing damage to the first-floor kitchen. The Henrys submitted this claim to Allstate Insurance Company who issued their homeowner's insurance policy. Allstate denied the claim because the water damage did not seem to be sudden or accidental, but rather the result of ongoing water intrusion stemming from neglect of property maintenance. The Henrys then filed suit alleging breach of contract, Texas Deceptive Trade Practices Act violations, common law fraud, and violations of Chapters 541 and 542 of the Texas Insurance Code.

Allstate argued that it was entitled to summary judgment on the plaintiffs' breach of contract claim because the Henrys never submitted evidence that would allow a fact-finder to segregate the "covered" damages from "non-covered" damages. It also contended that the alleged damages did not arise from an accidental loss, but rather resulted from the lack of maintenance on their home.

The court ultimately agreed with Allstate's argument pointing to the Henrys' contradictory testimony about when the alleged damages occurred. The court also noted that there had been multiple claims of water damage to the property in the years prior and as such, it was impossible to separate the covered claims from the non-covered. Thus, the court found that the Henry's had not met their burden of proving that a covered loss occurred during the policy, entitling Allstate to summary judgment.