ZELLE LLP

LONESTAR LOWDOWN

Dedicated to Texas First-Party Property Claims

The Zelle Lonestar Lowdown | Thursday, June 13, 2024 | ISSUE 14

Welcome to The Zelle Lonestar Lowdown, our monthly newsletter bringing you relevant and up-to-date news concerning Texas first-party property insurance law. If you are interested in more information on any of the topics below, please reach out to the author directly. As you all know, Zelle attorneys are always interested in talking about the issues arising in our industry. If there are any topics or issues you would like to see in the Lonestar Lowdown moving forward, please reach out to our editors: Shannon O'Malley, Todd Tippett, and Steve Badger.

INSIDE THIS ISSUE

Upcoming Events

You don't want to miss this!

June 25 - 26, 2024 – Seth Jackson, a partner in Zelle's Boston, MA office, will present "Code Enforcement Coverage in Commercial Cases" at the PLRB 2024 Western Regional Adjusters Conference on June 25 - 26, 2024, in Anaheim, CA.

June 25 - 26, 2024 – Jessica Port, a senior associate in Zelle's Washington, DC office, will present "In Defense of the Insurance Adjuster: How to Navigate Written and Implied Duties" at the PLRB 2024 Western Regional Adjusters Conference on June 25 - 26, 2024, in Anaheim, CA.

Texas Prompt Payment of Claims Act: When Are Insurance Code Chapter 542 Penalties Not Owed?

by **Eric Bowers** and **Austin J. Taylor**

There are a litany of deadlines an insurer must be mindful of, and this is especially true in Texas, which imposes a number of statutorily prescribed deadlines during the claim adjustment process. The Texas Prompt Payment of Claims Act ("TPPCA") codified under Chapter 542, Subchapter B, of the Texas Insurance Code, imposes procedural deadlines on insurance companies during the claim adjustment process. Although some of the TPPCA's deadlines are straight forward, several of these deadlines are far more nebulous when an insurer has not yet received all of the information that it has *reasonably* requested from the claimant/insured in its investigation, such as an outstanding request for information ("RFI") or proof of loss ("POL").

In this article, Eric Bowers and Austin Taylor examine the state of Texas law on this issue and provide best practices for staying on the right side these murky deadlines.

Read the full article here!

1. A Contractor cannot serve as a Public Adjuster unless he or she is licensed as a Public Adjuster.

2. A Contractor, even if licensed as a Public Adjuster, cannot serve as both the Public Adjuster and the Contractor retained to make repairs. Texas law does not allow a Contractor to serve in this dual capacity role.

3. A Contractor cannot advertise that it is an "insurance claim specialist" or will "handle your insurance claim".

4. A Contractor cannot evaluate and discuss liability for coverage under the applicable policy with the carrier's adjustment team.

5. A Contractor cannot demand appraisal.

6. A Contractor cannot negotiate the settlement or resolution of the claim.

7. A Contractor can assess the scope of damage and provide an estimate to repair or replace the damage.

8. A Contractor can provide its opinion as to the cause and date of loss.

9. A Contractor can advise of any work completed that would warrant a supplement in a revised estimate.

10. A Contractor cannot waive, absorb, rebate, or in any other way help the insured avoid payment of any applicable deductible.

Sources: **TDI Bulletin** and **NTRCA Bulletin**

Feel free to contact **Todd M. Tippett** at 214-749-4261 or **ttippett@zellelaw.com** if you would like to discuss these Tips in more detail.

News From the Trenches

by **Steven Badger**

The big news from the trenches this month is obviously the Texas Supreme Court's decision last week in the Stonewater Roofing matter. Available here. The case involved an argument by Stonewater Roofing that the Texas Public Adjuster Licensing Act was an unconstitutional restraint on its free speech rights. Stonewater Roofing filed a lawsuit against the Texas Department of Insurance ("TDI") asking that the courts declare the Act to be unconstitutional. What would that mean? It would mean that anyone -- literally anyone -- could act as a public adjuster on behalf of Texas property owners in the insurance claims process.

Imagine the feeding frenzy that would have created. Wow.

The insurance industry trade groups (ICT, APCIA, and NAMIC) retained Zelle to draft an amicus curiae brief in support of the TDI's position. We focused not on the constitutional issues, but instead on the real-world ramifications of the relief Stonewater was requesting. Available here. It's pretty apparent that the court read the brief and understood the debacle that was sure to follow if Stonewater obtained the relief it was seeking.

Fortunately, the Texas Supreme Court got to the right result and our public adjuster licensing statute remains intact. Ironically, Stonewater actually did us a favor in that now we have strong Texas Supreme Court authority discussing what contractors can and cannot do. Take a look at Todd Tippett's Top Ten list in today's Lowdown for our interpretation of the do's and don'ts. And be sure to see the two bulletins linked in Todd's List. Also see Shannon O'Malley's case summary taking a deeper dive into the Court's analysis.

Otherwise, the other interesting breaking news is the FBI's issuance of a Bulletin seeking information on "victims" harmed by McClenny Moseley. Here is a link: https://forms.fbi.gov/MMAInvestigation I've really tried recently to stay off the "dump on MMA" bandwagon. The whole story is just plain sad. It will undoubtedly be an episode of American Greed one day. But with that said, wow! How does a law firm handling weather claims behave so poorly that they end up the subject of an FBI investigation? Very sad.

Finally, I've said it before and I'll say it again now -- the traditional "get paid ACV and find a contractor to fix your damage" first-party insurance claims model is changing. Every week I am receiving inquiries about managed repair programs, preferred contractor programs, invocation of the right to repair, and pure indemnity insurance coverage. Insurance companies are tired of writing checks to fund all types of things other than fixing what is alleged to be damaged. And I can't blame them. What is wrong with money only being used to fix damage? And that's it. This change is coming and those who get behind it will be able to adapt to the new way things are going to be done in the first-party claims world.

Oh yeah. One more thing. Yesterday was my 60th Birthday. Wow. Where did the time go? Thanks to all of my industry friends who continue to make this job fun and rewarding for me every single day, even at this "mature" age.

Steve

Texas Supreme Court Corrals Contractors

by **Shannon O'Malley**

The vast majority of states in the US have laws that regulate the roles of public adjusters in order to ensure they are qualified and to avoid conflicts of interest. In June 2003, Texas joined those states and enacted Section 4102.001 of the Texas Insurance Code, defining the profession of public adjuster as follows:

> (A) a person who, for direct, indirect, or any other compensation:
> (i) acts on behalf of an insured in negotiating for or effecting the settlement of a claim or claims for loss or damage under any policy of insurance covering real or personal property; or
> (ii) on behalf of any other public insurance adjuster, investigates, settles, or adjusts or advises or assists an insured with a claim or claims for loss or damage under any policy of insurance

covering real or personal property; or

(B) a person who advertises, solicits business, or holds himself or herself out to the public as an adjuster of claims for loss or damage under any policy of insurance covering real or personal property.

The law requires the public adjuster to be licensed. And it specifically prohibits a contractor, even if licensed as a public insurance adjuster, to "act as a public adjuster or advertise to adjust claims for any property for which the contractor is providing or may provide contracting services[.]" Tex. Ins. Code §§ 4102.163(a); 4102.158. "In other words, a person may not serve in a dual role—as both contractor and adjuster—in connection with property subject to an insurance claim or falsely advertise an ability to do so. A person violating the statute is subject to administrative, criminal, and civil penalties." *Texas Dep't of Ins. v. Stonewater Roofing Co*., No. 22-0427, 2024 WL 2869414, at *2 (Tex. June 7, 2024).

Despite the twenty-plus years the law has been in effect, recently, a contractor challenged its constitutionality, claiming it infringed on the contractor's First Amendment rights and the Fourteenth Amendment's fair notice requirements. In *Texas Dep't of Ins. v. Stonewater Roofing Co*., No. 22-0427, 2024 WL 2869414 (Tex. June 7, 2024), roofing contractor, Stonewater Roofing, filed a declaratory judgment action against the Texas Department of Insurance in response to a complaint that its actions violated the Texas public adjuster laws. In particular, Stonewater advertised that it had "extensive experience in facilitating settlement of insurance claims." *Id.* at *6. Stonewater's website described it as an insurance specialist and a "Leader In Insurance Claim Approval" with a system to help its "customers settle their insurance claims as quickly, painlessly and comprehensively as possible." *Id.* Moreover, Stonewater's contract with clients specifically authorized Stonewater "to negotiate on [the customer's] behalf with [the] insurance company and upon insurance approval to do the work." *Id.*

These statements and the contract were challenged as violations of the Texas Insurance Code. Stonewater argued that the public adjuster laws infringed on its free speech rights and were void for vagueness. The Texas Supreme Court stepped in and definitively determined the public adjuster laws were constitutional and clear. First, the Court determined that while free speech is "one of 'our most cherished liberties,'" the government has a "freer hand in regulating commerce and conduct; such laws generally do not offend the First Amendment and are often upheld under rational-basis review." *Id.* at *10-11. Based on that, the Court had "little trouble concluding that sections 4102.051(a) and 4102.163(a) do not regulate speech protected by the First Amendment." *Id.* at *11-12.

The Court found section 4102.051(a)'s licensing requirement prescribes what a person must do, rather than infringed on protected expression. As with other regulated professions, the Court found "the State may permissibly require a license to engage in the profession [and] may permissibly prohibit false commercial speech about the same." *Id.*at *12. Similarly, the court found the dual-capacity prohibition affected business actions rather than constraining speech. "Section 4102.163(a) dictates what a contractor *may not do*: undertake a business engagement giving rise to a conflict of interest. Regulated persons are permitted to provide either contracting services or adjusting services but not both types of services for the same property on the same claim….Like the licensing requirement, the dual-capacity prohibition circumscribes nonexpressive commercial activity." *Id.* at * 13 (emphasis in original).

Nonexpressive commercial activity is not protected by the First Amendment. "'The First Amendment does not prevent restrictions direct at commerce or conduct from imposing incidental burdens on speech,' and professionals are no exception to this rule." *Nat'l Inst. of Fam. & Life Advocs. v. Becerra*, 585 U.S. 755, 769, 138 S.Ct. 2361, 201 L.Ed.2d 835 (2018) (citations omitted) (*quoting Sorrell v. IMS Health Inc*., 564 U.S. 552, 567, 131 S.Ct. 2653, 180 L.Ed.2d 544 (2011). The Court recognized that a public adjuster's role is to act as an agent of the insured – to represent the insured to the insurance carrier. "As defined, the profession's actuating activity and dominant focus is employment in a representative (or agency) capacity." *Stonewater* at *13. And a person's status as an agent and work, including negotiating on behalf of an insured, is part of the person's role. The speech necessary to negotiate for the insured are "incidental to the nonexpressive commercial activities delimiting the profession." *Id.* at *17. In other words, if the person is speaking or advertising as part of the person's role as the insured's agent, it is not protected by the First Amendment but instead is part of a regulated commercial representative relationship. Given this, the Court determined the statute did not impermissibly infringe on the First Amended.

Next, the Court addressed whether the laws were too vague under the Fourteenth Amendment's Due Process clause. The Court explained that "a vague statute offends due process in two ways. First, it fails to give fair notice of what conduct may be punished, forcing ordinary people to guess at the statute's meaning. Second, the statute's language is so unclear that it invites arbitrary or discriminatory enforcement." *Id.* at *22. The Court determined that the Texas public adjuster laws pass muster under both circumstances.

The Court found fair notice because "[d]ue process is satisfied so long as the prohibition is 'set out in terms that the ordinary person exercising ordinary common sense can sufficiently understand and comply with.'" *Id.* at 23. The ordinary person standard here is contractors and public adjusters. The Court noted that the statute does *not* prohibit contractors like Stonewater to discuss repairs that are subject to an insurance claim. Specifically, contractors "may 'discuss' and 'answer questions about' topics like 'the amount of damage to the consumer's home,' 'the appropriate replacement,' 'reasonable cost of replacement,' 'estimate for a consumer's claim,' 'the scope of work in [a] repair estimate,' or 'supplements and clarifications concerning the revised estimate.'" *Id.* at

24. Essentially contractors can share their knowledge and experience to discuss repairs.

What the statute expressly prohibits is communications that evidence a prohibited engagement – *i.e.* if the contractor is acting in the role of public adjuster and communicating in a manner that is limited to a licensed public adjuster. Thus, the Court found that Stonewater's advertisement and contract discussing its ability to "negotiate" with the insurance company "on the consumer's behalf" and perform work "upon insurance approval" fell under the public adjuster bucket, rather than simply repair assessment. The Court determined there was fair notice given the language of the statute.

Ultimately, the Court determined that Stonewater's website and contract violated the Texas public adjuster laws because "the messaging, which is the sum of its parts, describes conduct an ordinary industry participant exercising common sense would understand to violate section 4102.051(a)'s prohibition on an unlicensed person acting, advertising, or holding itself out as an insurance adjuster." *Id.* at 26.

This clear-cut opinion should be a warning to those contractors who hold themselves out as insurance experts who can negotiate with carriers to get the most out of a claim. There is a clear conflict of interest when a contractor both negotiates a claim and tries to do the work – the contractor is encouraged to make the claim as

large as possible. Keeping the roles between public adjusters and contractors separate maintains a semblance of fairness to the process and encourages contractors to bid work at accurate pricing.

AI Update

Shallowfake and Deepfake Technology: Coming Soon to a Claim Near You

by **Jennifer Gibbs**

As the claims adjustment process becomes more automated, the potential for fraud using shallowfake and deepfake technology has also increased. “Shallowfake” technology involves manipulating existing documents and images using editing software, whereas “deepfake” technology is a form of artificial intelligence that can be used to create convincing - yet completely fake - images, documents, sounds, and videos.

Scott Clayton, Zurich's head of fraud reports a significant increase in claim photos that have been manipulated with shallowfake technology. In what has been predicted to be the “latest big scam” to affect the insurance industry, fraudulent actors have been finding vehicles classified as total losses on salvage sites, and then manipulating images with digital editing tools by placing a different license plate on the vehicle and filing a false insurance claim. Notably, this scam does not require sophisticated artificial intelligence technology, but can be perpetrated using widely available editing software such as Photoshop.

In response to this growing threat, insurers are expected to rely upon digital forensics companies to identify and prevent this type of fraudulent activity. One such company, Envista Forensics, has a number of interesting videos on LInkedIn by Lars Daniel illustrating how both shallowfake and generative AI technology can be used to manipulate photos and other evidence to support an insurance claim.

With the development of sophisticated technology aimed at preventing the use of shallowfakes, it is only a matter of time before this type of fraud becomes obsolete. However, this latest scam highlights the need for insurers to continue to stay educated regarding technological advancements to combat fraud utilizing shallowfake and deepfake technologies.

Lassoing Liability

with Megan Zeller

The Fifth Circuit Deals a Blow to Insureds in Bitcoin Disputes

In an unpublished but nonetheless extremely important case, the Fifth Circuit recently found that the theft of Bitcoin does not constitute an “occurrence” because it is an intentional act. In *Nationwide Mutual Ins. Co. v. Choi*, appellants challenged a summary judgment motion granted by the Southern District of Texas, Houston Division, which found that an insurer had no obligation to provide coverage under a homeowner policy and personal-umbrella policy. 2024 WL 2131515 (5th Cir. May 13, 2024). The Fifth Circuit affirmed the lower court’s position.

The Fifth Circuit – as well as Texas – has long-held that in order for an act to qualify as an occurrence, there must be an accident, which is considered “a fortuitous, unexpected, and unintended event.” *Lamar Homes, Inc. v Mid-Continent Cas. Co.*, 242 SW3d 1, 8 (Tex. 2007). As a result, the basis of any duty to defend claim rests on a complaint alleging an occurrence (or accident) that resulted in some kind of property damage or bodily injury. In this case, appellants failed to successfully show that a malware attack was an accident.

According to the underlying complaint, appellants Choi and Ng worked together in August 2020 to steal approximately 1,400 Bitcoin through a malware attack, which was worth more than $80 million at the time. The complaint alleged civil conspiracy, conversion, civil theft, and unjust enrichment. While Choi and Ng argued – rather weakly – that the malware attack resulted from alleged negligent conduct, the Southern District was not persuaded and found that a malware attack**,** based on the facts pled in the complaint, was not an accident. Choi and Ng also argued that unjust enrichment did not require proof of an intentional act, and therefore was an “occurrence.” Once again, the Southern District found that, based on the underlying complaint, the facts alleged showed that Choi and Ng’s unjust enrichment was motivated and planned. As a result, the Southern District granted the insurer’s summary judgment.

In a short and succinct ruling, the Fifth Circuit affirmed the Southern District’s position. The Fifth Circuit specifically rejected that a malware attack, as alleged in the underlying complaint, “should be interpreted as claiming negligence.”

Although this case is relatively straightforward, it is nonetheless highly relevant to the ever-evolving world of crypto-currency and cyber threats. Based on *Choi*, insurers should successfully be able to counter any duty to defend claims involving crypto-currency theft in the future.

Expert Affidavits with Nothing More Than Conclusory, Subjective Opinions Do Not Create a Fact Issue Sufficient to Defeat Summary Judgment

By: **David B. Winter**

In response to a motion for summary judgment, plaintiffs often attempt to create a fact issue by arguing that the experts at issue disagree on a material fact that makes summary judgment inappropriate. This requires that the plaintiff provide an affidavit from their expert that sets forth the expert's opinions and the factual basis for such opinions.

As recently discussed by the United States Court of Appeals for the Fifth Circuit, an affidavit that merely sets forth conclusory, subjective opinions is not sufficient to create a fact issue. In *Smiley Team II, Inc. v. General Star Insurance Co* ., Smiley Team suffered damage to its building from Hurricane Harvey in August 2017 and then again when the building was struck by a vehicle.[1] The insurance policy precluded coverage for pre-existing wear and tear or damage caused by a windstorms or hail. Accordingly, General Star paid Smiley Team for the damaged it attributed to the vehicle impact and denied coverage for claimed roof damage asserting that such damage was not the result of the collision.

In response to General Star's summary-judgment motion, Smiley Team attached an affidavit from its expert which stated:

> I estimate the car colliding with the Property September 14, 2017 only and no preexisting event or its damages caused all damages identified in my estimate, including damages to the roof ... I implement reliable methodology in my testimony in this case because (1) I examined the property for which I facilitated my estimate on the amount of loss the September 14, 2017 car collision with the Property caused to the Property and (2) my estimate entailed I estimated the September 14, 2017 car collision caused covered damages to the property including damages to the roof ... totaling $94,103.22 based on the condition and state of covered damages I observed and my education, training and professional experience as an Estimator. Additionally, I considered all evidence regarding this claim, the identified damages, alternative causes of loss and the insurance company's expert's opinions before forming my own opinion.[2]

The trial court found that this affidavit was insufficient to create a fact issue and granted summary judgment for General Star.

On appeal, the Fifth Circuit agreed with the trial court finding:

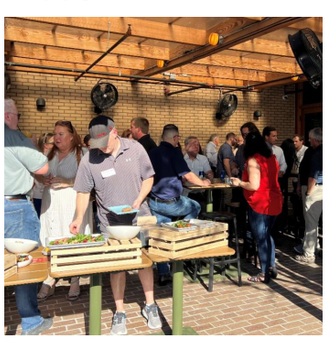
> Plaintiff's expert's affidavit makes conclusory statements and naked assertions that the roof damage was caused by the vehicle collision. He provides no supporting factual evidence or methodology for how he arrived at the conclusion that the roof damage was caused by the vehicle collision. Such a self-serving affidavit is not sufficient to defeat summary judgment. "We have held that the district court may inquire into the reliability and foundation of any expert's opinion to determine its admissibility." *Orthopedic & Sports Inj. Clinic v. Wang Lab'ys, Inc*., 922 F.2d 220, 224-25 (5th Cir. 1991). However, when such an affidavit is conclusory in fashion, "[w]e have recognized that there is a [certain level] below which [it] must not sink if it is to provide the basis for a genuine issue of material fact." Id. "Without more than credentials and a subjective opinion, an expert's testimony that 'it is so' is not admissible." *Id*. at 225 (quoting *Viterbo v. Dow Chem. Co*., 826 F.2d 420, 424 (5th Cir. 1987)).[3]

While this unpublished decision does not create new law, it does reemphasize the importance of counsel to make sure that their opposition has properly supported any summary-judgment evidence. An expert's affidavit must have more than just credentials and conclusions, it must provide some analysis or support to create a genuine issue of material fact. As in *Smiley Team*, a party's and or its counsel's failure to provide a sufficient affidavit can result in summary judgment against that party.

[1] No. 23-40129, 2024 WL 2796652 (5th Cir. May 31, 2024) (unpublished).
[2] *Smiley Team II, Inc. v. General Star Ins. Co* ., No. 3:21-cv-103, 2022 WL 18909496, at *3 (S.D. Tex. Oct. 28, 2022).
[3] 2024 WL 2796652.

Spotlight:

Thank you to everyone who attended the Zelle LLP and J.S. Held Sip, Snack & Socialize Happy Hour last week in Dallas!



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