ZELLE LLP

LONESTAR LOWDOWN

Dedicated to Texas First-Party Property Claims

The Zelle Lonestar Lowdown | Wednesday, July 10, 2024 | ISSUE 15

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.

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INSIDE THIS ISSUE

Upcoming Events

You don't want to miss this!

August 27 - 28 , 2024 – Seth Jackson, a partner in Zelle's Boston, MA office, will present "Code Enforcement Coverage in Commercial Cases" at the PLRB 2024 Central Regional Adjusters Conference on August 27 - 28, 2024, in St. Louis, MO.

August 27 - 28 , 2024 – Jessica Port, a senior associate in Zelle's Washington, D.C. office, will present "In Defense of the Insurance Adjuster: How to Navigate Written and Implied Duties" at the PLRB 2024 Central Regional Adjusters Conference on August 27 - 28, 2024, in St. Louis, MO.

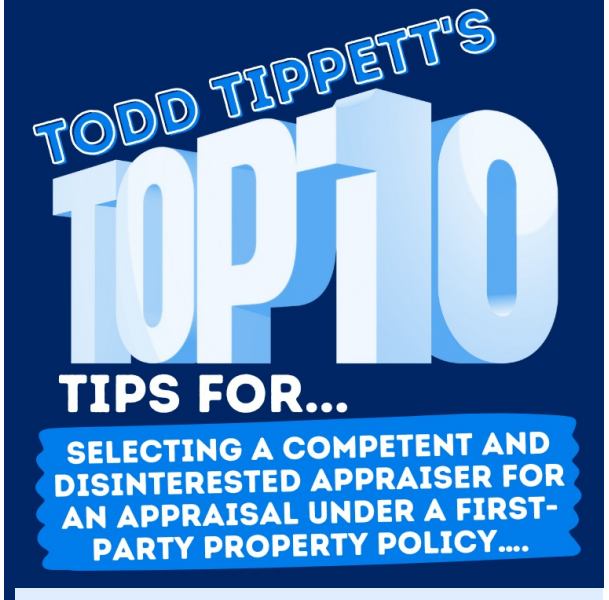
Chapter 542 Interest and Tolling During Periods of Delay Caused by the Policyholder

by **Ashley Pedigo**

The Texas Prompt Payment of Claims Act (TPPCA), found in Chapter 542/542A of the Texas Insurance Code, mandates deadlines for insurers to process and pay claims. It grants insured individuals the right to recover actual damages, penalty interest, and attorney's fees if insurers fail to adhere to specified timelines, such as acknowledging receipt of claims and paying claims promptly upon acceptance. The Act aims to discourage insurer delays and abuse without requiring proof of bad faith by insurers. However, it does not clearly address situations where delays in claim processing are caused by insureds, leaving unresolved questions about whether insurers should be penalized for such delays. Judicial interpretations vary, with some courts suggesting that interest accrual may be halted during periods of delay attributable to insureds, underscoring the complexity and ongoing debate surrounding the Act's application.

Read the full article here!

News From the Trenches



1. The selected appraiser should have proper training or experience in evaluating and/or estimating property damage losses.

2. The selected appraiser should not be an adjuster (whether public or independent) previously involved with the investigation or adjustment of the claim.

3. The selected appraiser should not be a contractor that will be or intends to be involved in the repair of the damage at issue.

4. The selected appraiser should agree to charge a reasonable hourly fee.

5. The selected appraiser should agree that his or her fee will not be based on a contingency or percentage of the outcome for the appraisal.

6. The selected appraiser must agree to work independently of the insured, carrier and attorneys (if any) involved in the appraisal.

7. In Texas, the selected appraiser should agree to only determine the amount of loss and avoid making coverage or liability decisions that will impact the outcome of the appraisal.

8. The selected appraiser should not receive a significant percentage of its total income from the retaining party.

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

10. The selected appraiser should agree to use best efforts to help resolve the disputed claim through the appraisal process and agree to avoid creating issues that will require litigation after the appraisal process is complete.

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.

Beryl Is Coming

by **Steven Badger**

Well, obviously the big news from the trenches this week is Beryl striking the Houston area. Preliminary weather data indicates maximum sustained winds of around 70 mph and gusts approaching 100 miles per hour.

And that presents a really interesting scenario….

With some exceptions of course, the wind speeds were not high enough to cause obvious severe damage to most structures. But they were high enough to create an argument for damage. Which means that storm chasing contractors, public adjusters, and lawyers will be trolling Houston area neighborhoods looking for claims, with some of the less scrupulous ones telling everyone that they have “wind uplift damage” and that any interior water damage was the result of a “storm created opening”.

Essentially, we will be fighting about the same issues we fought about after Harvey.

Speaking of Harvey, what did we see in those matters? Yes, of course there were legitimate damage claims. And those got paid. But we also saw a whole lot of claims involving reported “non-visible” damage. We also saw claims involving reported damage that was not repaired after Ike and claims including every maintenance item the structure needed regardless of cause.

So what does all this mean for Beryl claims?

These will be the key issues…..

- **Is there really any damage?**
  As is often the case, the main dispute will be over the existence of physical loss or damage. Did the shingles uplift? Was there a storm-created opening? All the usual issues.

- **Is it flood or wind?**
  Another issue we see in these rain-intensive storms. Fortunately, for inland claims these are usually pretty easy to figure out. Did the water come from the ground or through the roof?

- **When did the damage occur?**
  There are lots of properties in Houston that collected on Ike claims and collected on Harvey claims. They might also have submitted a claim and collected from the recent May 16, 2024, derecho. And in many of these claims no repair work was done. A lot of people collected on their claims or lawsuits and went to Disney World. There must be an effort to identify new versus old damage. Insurance companies should always ask their insureds whether they submitted claims for prior storm events and if the reported damage was repaired after those storms.

- **How do we allocate between old damage and new damage?**
  This issue will implicate the Texas concurrent causation doctrine. Under Texas law, it is the insured’s burden to separate covered versus non-covered damage and allocate its damages between the multiple causes. There is nothing wrong with an insurance company holding the insured to its burden to conduct this allocation. Of course, the insurance company must also conduct its own reasonable investigation of the issue. But in the end, the burden lies with the insured.

- **When is appraisal appropriate?**
  Given all of these issues, there is no question that certain public adjusters and policyholder attorneys (we all know who they are) will sign up anyone who will execute a contract, submit a claim, and then just dump it in appraisal hoping for an award. We will thereafter have to litigate when the damage included in the award actually occurred and in some situations the cause of the damage. Insurance companies should make certain they make an effort prior to going into appraisal to obtain clarity as to the scope of the appraisal process.

We are all going to be very busy for the next few years thanks to Beryl.

And it's only the second week of July. Yikes!

Texas Appellate Court Confirms COVID Does Not Cause Physical Loss or Damage

by **Shannon O'Malley**

While the Fifth Circuit and numerous Texas federal district courts have determined that COVID-19 does not cause physical loss or damage under Texas law, no Texas *state* appellate court has addressed this question – until now.

On Wednesday, July 3, 2024, the first Texas Appellate Court issued an opinion confirming under Texas law that the virus that causes COVID-19 does not cause physical loss of or damage to property to trigger coverage for lost income arising from the pandemic. In Julio & Sons Co. v. Cont'l Cas. Co., No. 05-23-00116-CV, 2024 WL 3287598, at 9 (Tex. App. July 3, 2024), the Dallas Court of Appeals determined as a matter of law that “business income losses resulting from the COVID-19 pandemic are not covered under property insurance policies requiring a direct physical loss of or damage to property.”

The well-reasoned opinion affirmed the underlying court's summary judgment and addressed the factual and legal arguments raised by the plaintiffs (and many other plaintiff-insureds across the country). First, the court discussed the meaning of "direct physical loss of or damage to property" under Texas law. Citing both pre-COVID Texas Supreme Court jurisprudence, as well as the Fifth Circuit's analysis of COVID claims, the court held that an "intangible or incorporate loss that is unaccompanied by a distinct, demonstrable, physical alteration of property is not considered a direct physical loss." *Id.* Based on this, the court found that COVID-19 does not cause physical loss or damage to property under Texas law.

The court considered the scientific expert evidence presented by the insureds in the attempt to demonstrate physical loss or damage to property. The experts opined that the presence of the virus on a surface created fomites and adsorbed on property. They also admitted, though, that the virus's attachment to property could be deactivated or removed with manual cleaning and disinfecting, and that fomites deactivate on their own over time. The court found that the experts' affidavits did not create more than a scintilla of evidence to create a genuine issue of material fact. The court recognized the reality of these opinions, which applied to COVID-19 *and viruses generally*. The court noted that to ignore the expert's "concession regarding the similarity between COVID-19 and other viruses and conclude that fomites cause physical damage to or loss of property would result in any airborne virus, such as the common cold, triggering coverage. If such were the case, property everywhere would be in a constant state of damage or loss." *Id.* at 14.

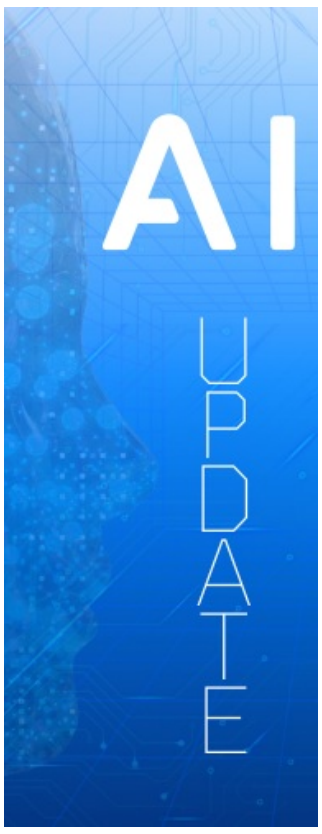
The court further recognized that "a property has not experienced 'physical loss' or 'physical damage' when all that is required from the property owner is cleaning the surfaces or simply waiting several days for the alleged physical alteration to resolve itself." *Id.* Based on this analysis and the numerous other courts' opinions concerning COVID-19's effect on property, the court concluded that the virus does not cause physical loss of or damage to property and affirmed summary judgment on that basis.

But the court did not stop there. It also affirmed summary judgment on the basis that the insureds failed to meet their burden on causation. The insureds' business interruption coverage only covered losses "resulting from interruption of business caused by direct physical loss of or damage to covered property." *Id.* at 18. The court found there was no evidence that the insureds' losses were *caused by* direct physical loss or damage to property. Instead, the losses were due to two independent reasons – the discontinued on-premises dining because of government mandates and the financial struggles at certain locations because of the pandemic.

Essentially, the court recognized that the driving force behind the insureds' lost income was not the condition of the property, but government closure of the businesses to slow the spread of the disease and financial troubles from the pandemic at large. In reaching its decision, the court rejected the insureds' attempt to "create a fact issue by relying on executive orders indicating in-person dining was closed because of physical loss of or damage to property." *Id.* at 20. While some orders stated "they were necessary because 'the virus is physically causing property damage due to its proclivity to attach to surfaces for prolonged periods of time,'" the court recognized that the focus of the orders was to protect human life: "The overall purpose of the Dallas County order was to slow the spread of the virus to protect people, not property." *Id.* The court further recognized that the insureds' business did slow when it was mandated to close, except for takeout, but once the orders were lifted, the business re-opened to the public without any change to the property itself. Accordingly, the court found the insureds failed to present evidence demonstrating its business loss was caused by direct physical loss of or damage to property.

The court further addressed specific coverages raised by the insureds including civil authority and ingress/egress coverage. Because these coverages all required physical loss of or damage to property, the court rejected the insureds' arguments.

Ultimately, this opinion adopts the analysis presented to date by the Fifth Circuit and other Texas federal district courts. While it is likely to be appealed to the Texas Supreme Court, it is unlikely that Court will alter the decision. After all, Texas courts are "mindful of and persuaded by other courts' interpretations of similar or identical policy language" because Texas courts "'strive for uniformity in construing insurance provisions.'" *Id.* at 17 (quoting *RSUI Indem. Co. v. The Lynd Co.*, 466 S.W.3d 113, 118 (Tex. 2015)).



AI Update

What is Explainable Artificial Intelligence (XAI)?

by **Jennifer Gibbs**

Imagine submitting a loan application and receiving a denial based on the lending institution's underwriting software program that utilizes artificial intelligence. One of the first questions the denied applicant might ask is what criteria the AI program relied upon in generating the denial, and what steps the applicant might take to later receive an approval. However, if the AI software is not explainable, the applicant might never receive an answer – not because the lending institution doesn't want to provide the answer, but because the programmer of the AI system itself cannot understand why the program issued a denial. To the extent the software program's use generates biased outcomes, this "unexplainable AI" could become a real problem – especially for those business entities that are prohibited by law from issuing denials based upon certain criteria, such as race, gender, or sex.

The Supreme Court recently recognized the use of unexplainable AI:

And when AI algorithms make a decision, "even the researchers and programmers creating them don't really understand why the models they have built make the decisions they make." Are such decisions equally expressive as the decisions made by humans? Should we at least think about this?

See Moody v. NetChoice, LLC, No. 22-277, 2024 WL 3237685, at *5 (U.S. July 1, 2024) (J. Alito concurring opinion) (citing T. Xu, AI Makes Decisions We Don't Understand—That's a Problem, (Jul. 19, 2021),).

Not everyone agrees that this characteristic of AI is problematic: "Not being well understood by its own creator is a

strange phenomenon of AI, but it's also the reason for its power and success — using AI methods, people can create something that's self-training and able to perform certain calculations beyond people's capabilities." T. Xu, AI Makes Decisions We Don't Understand—That's a Problem, (Jul. 19, 2021),

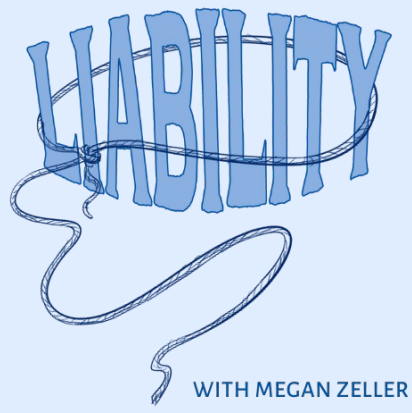
This phenomenon of an AI system, good or bad, has given rise to the development of XAI - a version of artificial intelligence that is able to document how specific outcomes are generated in a manner that ordinary humans can understand. The goal of XAI is to make sure that artificial intelligence programs are transparent regarding both the purpose they serve and how they work. There are several techniques that are commonly used to make AI systems more explainable, such as rule-based systems, decision trees, model distillation, and counterfactual analysis.

Others caution that the current field of explainable AI is littered with false promises because explaining a model to an AI researcher may be very different from explaining it to a layperson or businessperson and could ultimately enable unethical uses of AI.

Regardless of the challenges, there is an increasing need to ensure that AI-driven outcomes should be explainable– which means developing responsible XAI products to increase trust and transparency during this time of rapid technological transformation.

Lassoing Liability

with Megan Zeller



Courts in Texas Continue to Find that the MCS-90 Endorsement is Applicable Only in a Duty to Indemnify Analysis

More often than not, large-scale third-party liability claims result in plaintiffs identifying as many liability defendants as possible, even if some defendants only have tenuous connections to the claim. One of the main issues insurers deal with in these scenarios is whether their insured is actually liable based on the facts as alleged in the petition as well as under the terms of the applicable policy. An important caveat to this is when a policy contains an MCS-90 endorsement, which causes an insurer to be liable for any resulting liability from the negligent use of a motor vehicle by an insured, **even if** the vehicle used was not covered by the insurance policy. However, while the MCS-90 endorsement is extremely important, it plays more of a role in a duty to indemnify analysis rather than an initial duty to defend analysis. The Northern District of Texas, Abilene Division, recently upheld this position in *Lancer Insurance Company v. L&Y Trucking LLC.*

Here, an insurance coverage dispute arose from a commercial car crash involving a freightliner tractor hauling a trailer. In Plaintiff's Original Petition, Plaintiff alleged that the tractor was owned or leased by TLA Trucking, and that the various defendants had engaged the services of Reinaldo La O Baute to drive the freightliner. Although Plaintiff also sued L&Y Trucking, the Petition provided scant detail regarding the extent of L&Y's alleged liability.

At the time of the crash, L&Y Trucking was insured by Lancer, which had issued a commercial insurance policy to L&Y Trucking covering a policy period of December 5, 2019 to December 5, 2020. The policy defined an "insured" as follows:

> a. You for any covered "auto"
>
> b. Anyone else while using with your permission a covered "auto" you own, hire or borrow except
>
> > (1) The owner or any "employee", agent or driver of the owner, or anyone else from whom you hire or borrow a covered "auto" ....
>
> c. The owner or anyone else from whom you hire or borrow a covered "auto" that is a "trailer" while the "trailer" is connected to another covered "auto" that is a power unit, or, it not connected, is being used exclusively in your business.
>
> d. The lessor of a covered "auto" that is not a "trailer" or any "employee", agent or driver of the lessor while the "auto" is leased to you under a written agreement if the written agreement between the lessor and you does not require the lessor to hold you harmless and then only when the leased "auto" is used in your business as a "motor carrier" for hire.
>
> e. Anyone liable for the conduct of an "insured" described above but only to the extent of that liability.

***

Under the terms of the Policy, the covered autos are defined as "[o]nly those 'autos' described in Item Three of the Declarations for which a premium charge is shown." However, the policy only listed two covered autos, and did not include the freightliner that La O Baute was allegedly driving during the time of the loss. Moreover, La O Baute was not listed as an insured by the policy.

Importantly, the policy also contained an MCS-90 endorsement, which provided:

> In consideration of the premium stated in the policy to which the endorsement is attached, the insurer (the company) agrees to pay, within the limits of liability described herein, any final judgment recovered against the insured for public liability resulting from negligence in the operation, maintenance or use of motor vehicles subject to the financial responsibility requirements of Sections 29 and 30 of the Motor Carrier Act of 1980 **regardless of ... whether or not such negligence occurs on any route or in any territory authorized to be served by the insured or elsewhere** .... However, all terms, conditions, and limitations in the policy to which the endorsement is attached shall remain in full force and effect as binding between the insured and the company.

***

As a result of Plaintiff's suit, Lancer filed a complaint seeking declaratory judgment as to three points: (1) its duty to defend in the underlying lawsuit; (2) its duty to indemnify in the underlying lawsuit; and (3) whether the MCS-90 endorsement creates a payment obligation in the underlying lawsuit.

The Court found that Lancer did not have a duty to defend because, based on the facts pled in the Petition, La O Baute was not driving a covered auto within the meaning of the policy. Accordingly, because he was not driving a covered auto, he was not an "insured," and therefore no coverage exists.

More importantly, the Court found that the MCS-90 endorsement did not confer a duty to defend upon Lancer. As the Court stated:

> The MCS-90 endorsement likewise does not confer a duty to defend. MCS-90 endorsements have been read to create a "suretyship, which is triggered when the policy to which it is attached **provides no coverage to the insured**." *Canal Ins. Co. v. XMEX Transport, LLC* , 126 F. Supp. 3d 820, 826 (W.D. Tex. 2015) (internal quotation marks omitted); *see also State Nat'l Ins. Co. v. BranRich, Inc.* , No. 4:09-CV-443-Y, 2012 WL 13027998, at *4 (N.D. Tex. Dec. 4, 2012).

In other words, the MCS-90 endorsement might create liability, but it cannot create coverage out of nothing. *See Canal Ins. Co.*, 126 F. Supp. 3d at 826. Instead, the Court found that "[t]he obligation that the MCS-90 endorsement confers is more akin to the duty to indemnify . . . So even when considering the MCS-90 endorsement, there is not a duty to defend." As such, the MCS-90 endorsement could only be considered under a duty to indemnify analysis, which the Court found unripe since no judgement had been made against the named defendants.

Although insurers should always consider how the MCS-90 endorsement impacts liability in trucking liability claims, the endorsement continues to play a limited role in a duty to defend. Nonetheless, it is important for insurers to consider how this endorsement impacts indemnity as part of their initial coverage assessment, particularly in a post-*Copart* world.

Laur v. Safeco – Where the Actual Facts Matter to Determine Coverage, As Opposed to The Insured's Characterization of Those Facts

by David Winter

When insureds suffer a loss for which they seek coverage under a property policy, they will often attempt to characterize the loss in a manner to avoid the application of policy exclusions. *Laur v. Safeco Insurance Company of Indiana*, 2024 WL 2991196 (5th Cir. June 14, 2024), provides a good example of what a court is supposed to do to determine whether coverage exists – determine the actual facts at issue and then apply the terms of the policy to those facts, regardless of how the facts are characterized.

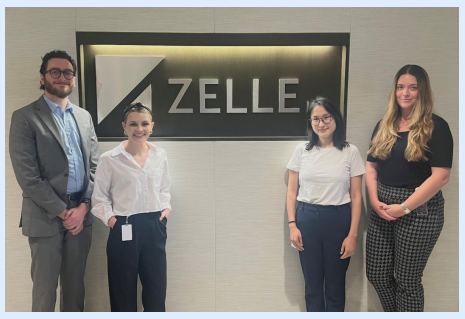
In *Laur*, the insured's basement suffered water damage when an underground frozen irrigation line ruptured in the backyard of the insured's property due to freezing conditions. The water from the ruptured line then ran at ground level into the basement.

Safeco denied coverage for Laurs' claim based on the following exclusions:

> **BUILDING PROPERTY LOSSES WE DO NOT COVER**
>
> We do not cover loss caused directly or indirectly by any of the following excluded perils. Such loss is excluded regardless of the cause of the loss or any other cause or event contributing concurrently or in any sequence to the loss. These exclusions apply whether or not the loss event results in widespread damage or affects a substantial area.
>
> **...**
>
> 2. Freezing, thawing, pressure or weight of water, ice or snow whether driven by wind or not, to a swimming pool, hot tub or spa, including their filtration and circulation systems, fence, landscape sprinkler system, pavement, patio, foundation, retaining wall, bulkhead, pier, wharf or dock;
>
> **...**
>
> However, we do insure from any loss from items 1. through 5. unless the resulting loss is itself excluded under Property Losses We Do Not Cover in this Section.
>
> **...**
>
> 9. Water Damage, meaning:
>
> a. (1) Flood, surface water, waves, tidal water, overflow of a body of water, or spray from any of these, whether or not driven by wind, including hurricane or similar storm; and
> (2) release of water held by a dam, levee or dike or by a water or flood control device;
> b. water below the surface of the ground, including that which exerts pressure on, or seeps or leaks through a building, wall, bulkhead, sidewalk, driveway, foundation, swimming pool, hot tub or spa, including their filtration and circulation systems, or other structure;
> c. water which escapes or overflows from sewers or drains off the [r]esidence [p]remises;
> d. water which backs up, overflows or discharges, for any reason, from within a sump pump, sump pump well, or any other system designed to remove water which is drained from the foundation area;
>
> Water includes any water borne materials.
>
> This exclusion applies whether caused by or resulting from human or animal forces or any act of nature.
>
> Direct loss by fire, explosion or theft resulting from water damage is covered.

Spotlight

Zelle Dallas Office 2024 Summer Law Clerks



(left to right) Nicholas Smetzer, Anna Kuhlman, Grace Zuo, Katherine Jakeway

"Working at Zelle this summer has been an amazing opportunity to immerse myself in the practice of contract and insurance law. Drafting motions, writing research memos, and working with policies firsthand has shown me just how fascinating and intricate insurance litigation can be, and having the privilege of working on real cases with such a fantastic team has made each day rewarding." - Nicholas Smetzer

"I have genuinely loved every day working at Zelle. Insurance law is fascinating, with nuances and intricacies I would have never expected. I have learned something different from each assignment I have been given, and I love feeling like my work actually 'matters.' I feel so grateful to work for and learn from such knowledgeable, talented attorneys. Thank you, Zelle and everyone here, for such an incredible summer!" -Anna Kuhlman

"What I love most about Zelle is the incredible people and the firm's unique culture. From my very first day, I felt warmly welcomed and supported by everyone here. The attorneys at Zelle are not only top-notch professionals but also genuinely kind and wonderful individuals. The firm's close-knit, family-like atmosphere has been truly inspiring. The friendships and professional relationships I have built here are invaluable, and the encouragement I have received has motived me to grow both professionally and personally. Zelle is more than a workplace for me – it is a place I feel valued and at home." - Grace Zuo

"Clerking at Zelle is a fantastic experience. I love that I work on projects for real cases. Moreover, I have learned so

The trial court granted summary judgment to Safeco. On appeal, the Laurs argued that Exclusion 2 did not preclude coverage for the damage to their basement because the damage "was a 'resulting loss' of the 'freezing ... to a ... landscape sprinkler system,'" rather than a loss directly flowing from the burst pipe. Further, as to Exclusion 9, the Laurs argued that the district court erred in finding 1) that a landscape sprinkler system is not a "water or flood control device," 2) that Safeco failed to offer evidence that the damaging water was either "below the surface of the ground" or "surface water" as those terms are used in Exclusion 9, and 3) the basement was not damaged by a "flood."

The Fifth Circuit found that Exclusion 9 applied to the Laurs' claim because, based on the plain language of the exclusion at issue, the water originated below the surface of the ground, the water traveled along the ground surface (making it surface water), and/or that the damage resulted from a "flood."

With respect to flood, the Laurs argued that the water that damaged their property was not "flood" water because it did not come from a well-defined body of water. However, the court distinguished between a loss caused by a "flood" – which includes floods caused by human acts - and "flood water." In particular, the court found:

> The fact that "flood" is not "flood *water*," as with other enumerated categories of peril, suggests that the Policy excludes from coverage damage caused by the *act* of flooding—irrespective of the source of flooding. *See In re Davenport*, 522 S.W.3d 452, 457 (Tex. 2017) (citation omitted) ("Courts may not rewrite the parties' contract, nor should courts add to its language."). Along that theme, the Laurs' reading of "flood" as employed in Exclusion 9(a)(1) renders the clause "overflow from a body of water" superfluous. *See id.* (citation omitted) ("The Court must read contractual provisions so none of the terms of the agreement are rendered meaningless or superfluous."). Taken together, the Policy's terms indicate that a "flood" is distinct from an "overflow from a body of water," and that both work to exclude coverage whether "caused by or resulting from human or animal forces or any act of nature." Given that [the expert], and even the Laurs, characterize their loss as resulting from a flood of their basement, the Laurs' loss is excluded from coverage on this additional basis under Exclusion 9(a)(1).

Id. at *5.

Ultimately, the court noted that it was sympathetic to the Laurs' predicament but found that the facts as presented on summary judgment supported application of the exclusion. In doing so, the court looked through the Laurs' characterization of their loss and looked to the actual facts presented to determine coverage. This is exactly how courts should examine whether coverage exists under Texas law.

much about the fascinating world of insurance law by getting experience on real matters. I am also sincerely grateful for all the knowledgeable and kind attorneys in the Dallas office who selflessly give time out of their days to help my fellow clerks and I to learn. The other summer clerks in the office are also one of my favorite parts of this summer, and I am so happy to come in to work and learn beside them every day. This summer has been a great one, and I'm incredibly appreciative for everyone on the Zelle team."- Katherine Jakeway

Barron v. Century Surety Co., No. 1:22-CV-00144-MAC-ZJH – Three Decisions Demonstrating First-Party Coverage Litigation in Texas

by **Lindsey Bruning**

U.S. Magistrate Judge Zack Hawthorn of the United States District Court for the Eastern District of Texas recently issued three back-to-back decisions in a first-party case involving alleged freeze damage to a commercial property resulting from Winter Storm Uri—rejecting an unreliable expert opinion, holding an insured to its burden under Texas law, and appropriately recommending dismissal of a statutory bad faith action where there is only a *bona fide* dispute.

Barron v. Century Surety Co. involves alleged damage to a commercial property in Southeast Texas resulting from the February 2021 freeze. 2024 WL 2822745, *1 (E.D. Tex. Apr. 23, 2024). Barron filed a claim for damages to the property, including the metal roof, plumbing, and interior. *Id.* Upon investigation, Century partially accepted coverage for interior water damage, but declined coverage for the metal roof based upon its adjuster's and expert engineer's evaluations, both of whom concluded that the roof was not damaged by the storm, but had sustained damage due to "foot traffic." *Id.* To that end, Century relied upon policy exclusions for faulty, inadequate or defective workmanship, repair, and/or maintenance. *Id.*

Disagreeing with Century's coverage determination, Barron initiated the lawsuit. During litigation, Barron designated Phil Spotts as an expert on damages and bad faith. *Id.* at *2. Spotts provided an estimate totaling $370,020.81 for repairs to alleged damages to the property and rendered an opinion that Century's claim investigation and adjustment were conducted in bad faith. *Id.* Barron also designated engineer Joshua Reeves as its expert on causation, who opined that "the damages to the metal panels were caused by environmental forces from the February 2021 winter storm." *Id.* Conversely, Century designated engineers with Envista Forensics and MKA International, Inc. to provide opinions on causation for the alleged roof damage—both opining that the roof damage was *not* caused by the weight of snow and ice, but by foot traffic. *Id.*

On the September 1, 2023 motion deadline, Century filed a Motion to Exclude Plaintiff's Expert Witnesses, and both parties filed competing Motions for Summary Judgment, all of which were decided in April and May of this year.

Motion to Exclude Plaintiff's Expert Witnesses

Century moved to exclude Barron's expert witnesses, Phil Spotts and Joshua Reeves. On April 23, 2024, Magistrate Judge Zack Hawthorn issued an Order Granting in Part and Denying in Part Century's Motion to Exclude. *Barron v. Century Surety Co.,* No. 1:22-CV-00144-MAC-ZJH, 2024 WL 2822745 (E.D. Tex. Apr. 23, 2024). Therein, the Court considered the admissibility of the expert testimony based on FRE 702 and *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579, 588-89 (1993). Specifically, the Court considered the following factors: (1) whether the witness is qualified as an expert based upon his knowledge, skill, experience, training, or education; (2) whether the proffered testimony is relevant, i.e. whether it will help the trier of fact to understand the evidence or to determine a fact in issue; and (3) whether the expert's testimony is reliable. *Id.* at *2-3.

Upon the parties' agreement that a pending appraisal would supplant any determination of damages, the Court denied as moot the challenge to Spotts' opinion on damages. *Id.* at *4-5. The Court did, however, consider Spotts' qualifications, the relevance of his report, and the reliability of his methodology with regard to his ***bad faith*** report. *Id.* at *5. Ultimately, the Court agreed that Spotts is qualified to render an opinion on bad faith based on his experience, knowledge, and skill. *Id.* The Court further agreed that Spotts' opinion is relevant to the issues presented in the case – to Barron's claims for breach of contract, statutory bad faith, and Prompt Payment of Claims Act—holding that whether Century properly adjusted Barron's claim in good faith is central to resolution of these claims. *Id.*

However, the Court determined that Spotts' expert report on bad faith was not reliable and therefore not admissible. *Id.* In so holding, the Court reasoned that Spotts failed to explain the specific sources upon which he relied in reaching his conclusions, thereby failing to demonstrate a reliable methodology. *Id.* at *6. Further, the Court found that Spotts' only analysis of Century's behavior was conclusory and failed to explain *how* Century's behavior fell below the applicable standard(s), stating: "Spotts' conclusory statement on Century's claim investigation and adjustment amounts to him stating 'it is so' without explaining *how* Century's behavior fails to meet the vague standards of insurance adjusting he cites." *Id.* at *6. Because there was "too great an analytical gap between the data and the opinion proffered," Spotts' opinions were not sufficiently reliable and accordingly excluded. *Id.* at *7.

The Court denied Century's Motion to Exclude Barron's causation expert, engineer Joshua Reeves, however. *Id.* at *8. The Court found that Reeves had demonstrated his qualifications and experience in engineering such that he is qualified to testify regarding the cause of damage to Barron's building, and further, that his opinions were directly relevant to the issues in litigation—the *cause* of damage to the property. *Id.* The Court also agreed that Reeves' opinions were based upon reliable engineering methodology, including a step-by-step analysis of various potential causes of the damage along with engineering analysis based upon his personal observations and inspections. *Id.* at *9. Ultimately, the Court held that Century's objections to Reeves' opinions "pertain to the weight of the evidence, not its admissibility," and accordingly declined to exclude them. *Id*.

The Court's decision on Century's Motion to Exclude was thorough, well-reasoned, and appropriately applied the standards laid out in FRE 702 and *Daubert.*

Report and Recommendation Granting in Part and Denying in Part Century's Motion for Summary Judgment

Two weeks after issuing the decision on Century's Motion to Exclude Plaintiff's Expert Witnesses, Magistrate Judge Hawthorn issued his Report and Recommendation on Century's Motion for Summary Judgment. Century sought summary judgment on all of Barron's claims – for breach of contract, statutory bad faith, the Prompt Payment of Claims Act. *Barron v. Century Surety Co.*, No. 1:22-CV-00144-MAC-ZJH, 2024 WL 2807224 (E.D. Tex. May 9, 2024).

Upon consideration, Magistrate Judge Hawthorn recommended that the District Court deny Century's Motion for Summary Judgment on Barron's breach of contract claims, finding that there exists a genuine dispute of material fact as to the cause of damage to the roof of Barron's building. *Id.* at *5. Specifically, the Court found that Century had failed to meet its burden to conclusively establish that the alleged damage to the roofing was caused by "foot traffic," or that "foot traffic" is an excluded cause of loss under the policy. *Id.* at *4. Magistrate Judge Hawthorn further recommended that the District Court deny summary judgment on Barron's claims under the Texas Prompt Payment of Claims Act, because its breach of contract claim survived. *Id.* at *6-7.

However, Magistrate Judge Hawthorn appropriately recommended the District Court ***GRANT*** Century's Motion for Summary Judgment on Barron's statutory bad faith claims. *Id.* at *5-6. In its analysis, the Court confirmed Texas law that a *bona fide* dispute is insufficient to sustain a claim for statutory bad faith, stating: "If the insurer has a reasonable basis to deny or delay payment of a claim, even if that basis is eventually determined by the fact finder to be erroneous, the insurer is not liable for the tort of bad faith." *Id.* at *5. The Court noted that Barron failed to introduce any evidence establishing that Century had no reasonable basis for the partial denial. *Id.* To the contrary, Barron merely established a "dispute between experts about causation," with Century having relied on its adjusters and two separate, independent engineering experts, all of whom reached the same conclusion—that "the damage to the roof was not caused by snow and ice." *Id.* The Court noted even if ultimately proven incorrect at trial, "Century's reliance on the conclusions of its experts as the basis for denying coverage was reasonable and does not indicate bad faith." *Id.*

Magistrate Judge Hawthorn's report and recommendations should be a reminder to policyholders and insurers, alike—despite constant allegations, statutory and common law bad faith is rarely found.

Report and Recommendation Denying Plaintiff Barron's Partial Motion for Summary Judgment

Just a week later, on May 15, 2024, Magistrate Judge Hawthorn issued his Report and Recommendation on Barron's Motion for Summary Judgment, recommending that the motion be denied "because Barron has failed to satisfy his summary judgment burden regarding the applicability of [Century's] asserted affirmative defenses." *Barron v. Century Surety Co.*, No. 1:22-CV-00144-MAC-ZJH, 2024 WL 2809184 (E.D. Tex. May 15, 2024).

Barron moved for summary judgment on certain affirmative defenses, which were based upon policy exclusions. *Id.* at *3. In its analysis, the Court began by explaining the burden shifting framework for coverage disputes under Texas law:

> The insured has the initial burden of establishing coverage under the terms of the policy. If the insured meets the initial burden, the burden shifts to the insurer, who has the burden to plead and prove that the loss falls within an exclusion to the policy's coverage. If the insurer successfully proves that an exclusion applies, "the burden shifts back to the insured to show that an exception to the exclusion brings the claim back within coverage."

Id. at *4 (citing *JAW The Pointe, L.L.C. v. Lexington Ins. Co*., 460 S.W.3d 597, 603 (Tex. 2015)).

The Court confirmed that Barron met the initial burden, finding that it had provided sufficient proof that the property sustained "physical loss" during the policy period, triggering potential coverage under the 'all-risks' policy. *Id.* As such, the burden shifted to Century to prove the applicability of an exclusion. *Id.*

But the Court held that Century had provided evidence through its adjuster and experts supporting the applicability of the claimed policy exclusions. *Id.* at *5. And further, that Barron had failed to establish that the applicability of the exclusions was not supported by evidence. *Id.* Rather, the Court found that Barron had simply highlighted potential weaknesses in Century's coverage analysis, ultimately confirming that the exclusions/affirmative defenses were, in fact, supported by evidence "based on three adjusters' inspections of [the property]." *Id.* The Court further noted that Barron did not support its contentions "with any evidence showing that the reports were improperly or erroneously made, or that Century's reliance on the reports in denying coverage was improper." *Id.*

Because Barron failed to meet his summary judgment burden regarding the applicability of Century's exclusions/affirmative defenses, Judge Hawthorn recommended summary judgment be denied in its entirety. *Id.*

Objections to the Magistrate Judge's Reports and Recommendations

On July 3, 2024, Barron filed Objections to the Magistrate Judge's Reports and Recommendations on both parties' cross-motions for summary judgment. With regard to dismissal of the statutory bad faith claims, Barron argues that the Court's finding that Century failed to establish any policy exclusion for the alleged "foot traffic" is inconsistent with its holding on the statutory bad faith claims – i.e. Barron argues that there can be no *"bona fide"* dispute if there is no applicable exclusion to coverage. Barron further objected to the Magistrate Judge's report and recommendation to deny its Motion for Summary Judgment, based on a limited objection regarding the collapse exclusion in the policy.

Despite Barron's objections, Magistrate Judge Hawthorn applied comprehensive and thoughtful analysis to the issues at hand. As such, we anticipate that his recommendations will be adopted by the District Court.

For more information on any of the topics covered in this issue, or for any questions in general, feel free to reach out to any of our attorneys. Visit our website for contact information for all Zelle attorneys at zellelaw.com/attorneys.

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