AN UPDATE ON RECENT INSURANCE COVERAGE DECISIONS AND THEIR IMPACT ON THE CONSTRUCTION INDUSTRY:

THE POLICYHOLDERS' PERSPECTIVE

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The issue of whether extrinsic evidence is admissible to determine whether an insurer has a duty to defend is the subject of considerable dispute in Texas. Recently, the issue has received increased attention from the highest courts in the state, including the Supreme Court of Texas and the United States Court of Appeals for the Fifth Circuit. Soon, we may have a definitive answer as to whether there is any exception to the "eight corners" rule when the Supreme Court of Texas issues its decision on the questions certified by the Fifth Circuit in *BITCO General Insurance Corp. v. Monroe Guaranty Insurance Co*.[1]

A. Recent Developments

In 2020, the Supreme Court of Texas issued its opinion in *Richards v. State Farm Lloyds* ("*Richards*"), rejecting arguments that the eight-corners rule did not apply to insurance policies that did not include an obligation to defend claims even if they were "groundless, false or fraudulent"—*i.e.*, a "policy language" exception to the rule.[2] Shortly thereafter, in *Loya Insurance Company v. Avalos* ("*Avalos*"), the Supreme Court of Texas recognized a very narrow "collusive fraud" exception—the first time the Court ever adopted an exception to the "eight corners" rule.[3] In that case, the Court stated that an insurer can rely on extrinsic evidence if there is "conclusive evidence that groundless, false, or fraudulent claims against the insured have been manipulated by the insured's own hands in order to secure a defense and coverage where they would not otherwise exist."[4]

Prior to *Avalos*, the Supreme Court of Texas was presented with but declined on many opportunities to adopt (or reject) an exception to the eight-corners rule in evaluating the duty to defend. One of the exceptions that the Court recognized on several occasions was developed by the Fifth Circuit in *Northfield Insurance Co. v. Loving Home Care, Inc*., where the Fifth Circuit stated:

> [I]f the four corners of the petition allege facts stating a cause of action which potentially falls within the four corners of the policy's scope of coverage, resolving all doubts in favor of the insured, the insurer has a duty to defend. If all the facts alleged in the underlying petition fall outside the scope of coverage, then there is no duty to defend. However, in the unlikely situation that the Texas Supreme Court were to recognize an exception to the strict eight corners rule, we conclude any exception would only apply in 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

[1] 846 F. App'x 248 (5th Cir. 2021).

[2] *Richards*, 597 S.W.3d 492, 499–500 (Tex. 2020).

[3] *Avalos*, 610 S.W.3d 878 (Tex. 2020).

[4] *Id*. at 882.

> the merits of or engage the truth or falsity of any facts alleged in the underlying case.[5]

This exception became known and referred to colloquially as the "*Northfield* Exception."

In *Richards*, the Supreme Court of Texas specifically referred to the *Northfield* Exception (by name) and outlined the narrow circumstances under which courts have applied it in other cases. The Court, however, declined to express an opinion on the *Northfield* Exception, noting that it was only addressing the narrow question certified as to whether a "policy language" exception exists. While the Court recognized but expressly declined to analyze the *Northfield* Exception in *Richards*, it did not even mention the *Northfield* Exception in *Avalos*.

Considering these decisions, questions existed as to whether the *Northfield* Exception remained good law. It seemed peculiar that the Supreme Court of Texas did not discuss or even mention the *Northfield* Exception in *Avalos*, which was the first time the Court held that there are circumstances when extrinsic evidence is admissible in analyzing the duty to defend. Shortly after the *Avalos* ruling, The Northern District of Texas opined on the issue in *National Liability & Fire Insurance Company v. Young*, noting that, while the Supreme Court of Texas did not address the *Northfield* Exception in *Avalos*, that rule remained binding on Texas federal district courts: "Neither Texas case law nor a change in statutory authority has displaced the Fifth Circuit's *Northfield* [E]xception."[6]

B. *BITCO General Insurance Corporation v. Monroe Guaranty Insurance Co*., 846 F. App'x 248 (5th Cir. 2021)

On March 12, 2021, the Fifth Circuit again evaluated the *Northfield* Exception, this time putting the issue directly before the Supreme Court of Texas in *BITCO General Insurance Corporation v. Monroe Guaranty Insurance Co*.[7] Therein, the Fifth Circuit certified the following questions to the Supreme Court:

> 1. Is the exception to the eight-corners rule articulated in *Northfield* . . . 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?[8]

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[5] 363 F.3d 523, 531 (5th Cir. 2004) (emphasis in original).

[6] 459 F. Supp. 3d 796, 800 (N.D. Tex. 2020).

[7] 846 F. App'x 248 (5th Cir. 2021).

[8] *Id.* at 252.

The facts and issues in *BITCO* are representative of many common coverage disputes, especially in the construction industry. 5D Drilling & Pump Service Inc. ("5D") had commercial general liability insurance with BITCO General Insurance Corporation ("BITCO") for the policy period from October 6, 2013, to October 6, 2014, and with Monroe Guarantee Insurance Company ("Monroe") for the policy period from October 6, 2015, to October 6, 2016.[9] The Monroe policy, however, did not apply with respect to "any 'continuation, change or resumption' of property damage 'during or after the policy period' that was known 'prior to the policy period' 'in whole or in part.'"[10]

In "the summer of 2014," 5D was hired to drill a commercial irrigation well through the Edwards Aquifer.[11] 5D was later sued for breach of contract and negligence after it purportedly drilled the well with "unacceptable deviation" and then abandoned the well after it "stuck" the drill bit in the bore hole.[12] This allegedly rendered the "well practically useless for its intended/contracted for purpose."[13] 5D then purportedly "failed and refused to plug the well, retrieve the drill bit, and drill a new well."[14] 5D sought coverage for the lawsuit from both BITCO and Monroe. BITCO ultimately agreed to provide a defense, but Monroe refused, arguing that the "property damage" at issue did not occur during its policy period.[15] In fact, BITCO and Monroe stipulated that the drill bit was stuck in the bore hole "'during drilling' 'in or around November 2014.'"[16] BITCO subsequently filed a declaratory judgment action against Monroe and won summary judgment that Monroe owed a duty to defend.

On appeal to the Fifth Circuit, Monroe urged the court to consider the stipulation between it and BITCO regarding the date of the incident, even though that information was extrinsic evidence.[17] BITCO countered that Texas's eight-corners rule prohibited consideration of such evidence, and that, even if that evidence was evaluated, it did not establish that Monroe had no duty to defend.[18] In beginning its analysis, the Fifth Circuit recognized that, while the Supreme Court of Texas had never adopted the *Northfield* Exception, it had "favorably cited" the *Northfield* Exception in prior cases.[19] Thus, according to the Fifth Circuit, whether Texas law would permit a court to consider the undisputed date of an incident as relevant to determine whether a duty to

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[9] *See id.* at 249.

[10] *Id*.

[11] *Id.*

[12] *Id*.

[13] *Id*.

[14] *Id.*

[15] *Id.*

[16] *Id.*

[17] *Id*. at 250.

[18] *Id.*

[19] *Id*. at 251 (citing *Richards v. State Farm Lloyds*, 597 S.W.3d 492, 496–97 (Tex. 2020); *GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church*, 197 S.W.3d 305, 308–09 (Tex. 2006)).

defend exists under the scope of the *Northfield* Exception "is important because ascertaining the date of an occurrence is a frequently encountered 'gap' in third party pleadings."[20]

The Fifth Circuit noted that the "omitted date" of when damage or injury occurred can be a "key question" as it relates to whether the insurer has a duty to defend its insured in an underlying suit.[21] The Fifth Circuit recognized that it and some Texas federal courts had previously allowed the use of extrinsic evidence in certain circumstances to clarify the date of an occurrence or specific circumstances surrounding a loss.[22] The court further recognized that the two leading insurance treatise commentators have urged the allowance of extrinsic evidence in limited circumstances when evaluating the duty to defend.[23] As a result, the Fifth Circuit certified the above questions for a ruling from the Supreme Court of Texas.

C. *Certain Underwriters at Lloyd's, London v. Superior Natl'l Logistics, Ltd.*, No. 4:20-CV-00376, 2021 WL 707671 (S.D. Tex. Feb. 7, 2021)

In *Certain Underwriters at Lloyd's, London v. Superior Nationwide Logistics, Ltd.*, the Southern District ruled that an insurer could not rely on the *Northfield* Exception in an attempt to refuse to defend its insured.[24] Certain Underwriters at Lloyd's, London Subscribing to Certificate No. IRPI-GL-18-295 ("Underwriters") issued a CGL policy to Superior National Logistics, Ltd. ("Superior"), which was in effect for the policy period of March 8, 2019, to March 8, 2020.[25] Underwriters sought a declaration that they owed no duty to defend Superior in connection with an underlying lawsuit filed by Lazaveon Collins ("Collins"), wherein he alleged he was injured at a Superior facility located in Humble, Texas, on August 16, 2019.[26] Collins asserted that he was employed as a truck driver for MT Select and was picking up a load of pipes at the facility at the time of the incident. Collins alleged that the accident occurred because of the negligence of Superior's employee, who used unsafe loading procedures.[27] Collins further asserted that Superior

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[20] *Id.*

[21] *Id.*

[22] *Id*. (citing *Ooida Risk Retention Grp., Inc. v. Williams*, 579 F.3d 469, 476 (5th Cir. 2009) (examining extrinsic evidence to establish tandem driving of a commercial motor vehicle and, thus, the application of an exclusion that precluded the insurer's duty to defend); *Primrose Oper. Co. v. Nat'l Am. Ins. Co.*, 382 F.3d 546, 550 (5th Cir. 2004) (relying on extrinsic evidence (parties' stipulation) to determine whether pollution spills occurred during policy in evaluating duty to defend); *Century Sur. Co. v. Dewey Bellows Oper. Co.*, No. H-08-1901, 2009 WL 2900769, at *8 (S.D. Tex. Sept. 2, 2009) (concluding an exclusion applied and no duty to defend existed after examining extrinsic evidence within a counterclaim); *Boss Mgmt. Serv., Inc. v. Acceptance Ins. Co.*, No. H-06-2397, 2007 WL 2752700, at *11–12 (S.D. Tex. Sept. 17, 2007) (considering "occupancy certificates" as extrinsic evidence in evaluating the earliest date in which damage could have appeared).

[23] *Id*. at 251–52 (citing COUCH ON INS. § 200:22 (3d ed. 2020); 1 NEW APPLEMAN INSURANCE LAW PRACTICE GUIDE 11A.13 (2020)).

[24] No. 4:20-CV-00376, 2021 WL 707671, at *5 (S.D. Tex. Feb. 7, 2021), *report and recommendation adopted*, No. 4:20-CV-00376, 2021 WL 706762 (S.D. Tex. Feb. 23, 2021).

[25] *Id*. at *1.

[26] *Id*. at *2.

[27] *Id.*

was liable for the negligent actions of its employee, who was acting in the course and scope of his employment in furtherance of Superior's business.[28]

Superior sought coverage from Underwriters, who then filed a declaratory judgment action that it owed no duty to defend based, in part, on an exclusion added by the "Employees of Independent Contractors Endorsement."[29] Underwriters argued that they could rely on extrinsic evidence to establish that the exclusion applied.[30] That exclusion barred coverage for '"bodily injury,' . . . or any injury, loss or damage sustained by any employee of an independent contractor contracted by [Superior] or on [Superior's] behalf."[31] Collins had not alleged in the underlying lawsuit that MT Service was an independent contractor for Superior.[32] Apparently recognizing this predicament, Underwriters argued that the written Broker/Carrier Agreement between Superior and MT Select was admissible to the duty-to-defend analysis and established the requisite relationship between those two entities, sufficient to implicate the exclusion.

Specifically, because the endorsement stated that employees of Superior's independent contractors are excluded from coverage under the policy, Underwriters sought to introduce this extrinsic contract under the *Northfield* Exception.[33] The court declined, however, explaining that Underwriters could not show that it was "'initially impossible to discern whether coverage is potentially implicated.'"[34] The court ruled that Superior was able to show, from the face of the pleading, that the claims by Collins fell within the coverage of the policy.[35] In other words, it *was* possible to determine that coverage was implicated based on the factual allegations in the pleading alone, so any reference to extrinsic evidence was in violation of the Texas eight-corners rule.

D. Commentary

It is not unusual for Texas federal district courts and Texas state appellate courts to evaluate whether extrinsic evidence is admissible in determining the duty to defend. Without guidance from the Supreme Court of Texas, this has led to a number of inconsistent rulings. The adoption of the "collusive fraud" exception in *Avalos* was not a shock, especially given the facts and circumstances of the case. The very narrow exception to the eight-corners rule carved out in that case requires conclusive proof of collusion and insurance fraud by the insured and the third-party claimant. Given the unwillingness of the Supreme Court of Texas to adopt the *Northfield* Exception despite being presented with (many) opportunities to do so, and the omission of any reference at all to the existence of the *Northfield* Exception in *Avalos*, there was a question as to whether the exception

[28] *Id.*

[29] *Id.*

[30] *Id*. at *5.

[31] *Id.*

[32] *Id.*

[33] *Id.*

[34] *Id*. (quoting *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523, 531 (5th Cir. 2004)).

[35] *Id*. at *6.

still was good law. Presumably, the Fifth Circuit also recognized this development, finally putting the question squarely in front of the Supreme Court of Texas for a definitive answer on the issue.

It is impossible to predict how the Court will rule. Either way, the effects likely will be monumental for both sides of the insurance bar. While most standard insurance policies impose upon the insurer a duty to defend the insured against a suit in which covered damages are sought, the "eight corners" rule and contours surrounding that rule are a common law creation. Will the Supreme Court expressly adopt the *Northfield* Exception as originally developed by the Fifth Circuit? Will the Supreme Court of Texas adopt a modified or more limited exception? Will the Supreme Court of Texas outright reject the *Northfield* Exception in light of policy language that suggests the determination should be made based on what is "sought" by the claimant?

II. Standards and Evaluation of the Duty to Defend

There were multiple decisions issued in the past year analyzing the standards for determining when an insurer has a duty to defend.

A. *Siplast, Inc. v. Employers Mut. Cas. Co.*, No. 20-11076, --- F.4th ---, 2022 WL 99303 (5th Cir. Jan. 11, 2022)

The Fifth Circuit, in *Siplast, Inc. v. Employers Mutual Casualty Co.*, reiterated what insureds (and their coverage counsel) often must remind insurers: the Texas duty-to-defend standard is *very* broad and strongly favors the insured.[36] This time, the court did the reminding and explained, again, that if there is *any* possibility that the pleading supports a claim for potentially covered damages against an insured, an insurer *must* defend. If not, the insurer will be in breach of the insurance contract.

The underlying lawsuit was filed in New York state court (the "New York Lawsuit") by the Archdiocese of New York (the "Archdiocese") and other plaintiffs (together, the "Underlying Plaintiffs") against various parties, including roofing manufacturer Siplast, Inc. ("Siplast").[37] The New York Lawsuit stemmed from the Archdiocese's purchase, in 2012, of a roof membrane system from Siplast to be installed at a high school in the Bronx, New York. In conjunction with that sale, Siplast guaranteed that the roof membrane system would "'remain in a watertight condition for a period of 20 years, commencing with the date hereof; or SIPLAST will repair the Roof Membrane/System at its own expense' (the 'Siplast Guarantee')."[38]

In their pleading filed in the New York Suit Lawsuit, the Underlying Plaintiffs alleged that, in November 2016, school officials observed '"water damage in the ceiling tiles throughout the Premises after a rain storm' and 'notified both [the installing contractor] and Siplast of the water damage and potential leaks.'"[39] Siplast sent a contractor to attempt repairs, but they were unsuccessful. The high school continued to suffer from additional leaks and water damages.

[36] No. 20-11076, --- F.4th ---, 2022 WL 99303 (5th Cir. Jan. 11, 2022).

[37] 2022 WL 99303, at *1.

[38] *Id.*

[39] *Id.*

According to the court: "After continued communication, during which 'Siplast admitted that there were problems with the roof that needed to be addressed,' Siplast eventually informed the Archdiocese that 'its earlier repair attempts [were] temporary' and that Siplast 'would not honor the Siplast Guarantee with respect to any permanent improvements of the roof.'"[40]

In response to this communication, the Archdiocese retained a consultant who determined that there were significant issues with the workmanship of and the materials used in the construction of the entire roof membrane and system. The consultant concluded that, because the roofing membrane and system failed of its essential purpose, the only way to remediate the problem was to replace the "'existing, failed membrane and system with a new one'" at a cost of $5,000,000.[41] Thereafter, the Underlying Plaintiffs filed suit against Siplast and the installing contractor, asserting a cause of action against Siplast for Breach of the Guarantee.

Siplast sought coverage for the New York Lawsuit under its commercial general liability Siplast sought coverage for the New York Lawsuit under its commercial general liability insurance policy issued by Employers Mutual Casualty Company ("EMCC").[42] EMCC denied coverage. This denial prompted Siplast to file a declaratory judgment action against EMCC. EMCC subsequently filed a counterclaim and then a motion for summary judgment, arguing that there was no coverage because of the lack of allegations of "property damage" caused by an "occurrence."[43] EMCC also relied on the "Your Product/Your Work Exclusion" and the "Contractual Liability Exclusion."[44] The standard-form "Your Product/Your Work Exclusion" barred coverage for:

> The "Your Product/Your Work Exclusion" excluded coverage of "'[p]roperty damage' to 'your product' arising out of it or any part of it" or "'property damage' to 'your work' arising out of it or any part of it and included in the 'products-completed operations hazard.'" It defined "Your [P]roduct" as "[a]ny goods or products, other than real property, manufactured, sold, handled, distributed or disposed of by [you]" and "materials, parts or equipment furnished in connection with such goods and products." "Your [W]ork" was defined as "[w]ork or operations performed by you or on your behalf" and "[m]aterials, parts or equipment furnished in connection with such work or operations."[45]

[40] *Id.*

[41] *Id.*

[42] *Id*. at *2.

[43] *See id.*

[44] *Id.*

[45] *Id.*

The district court granted EMCC's motion for summary judgment, finding that while the complaint in the New York Lawsuit alleged property damage that was caused by an "occurrence," the Your Product/Your Work Exclusion barred coverage for that property damage.[46]

On appeal, the Fifth Circuit agreed with the district court's assessment that the dispute presented an "occurrence" as that term is understood under Texas law in the commercial general liability policy.[47] The Fifth Circuit disagreed, however, with the district court's evaluation of the Your Product/Your Work exclusion, simplifying the dispute as follows: "[T]his case can largely be reduced to a single question: does the Underlying Complaint contain allegations of damage to property other than Siplast's roof membrane as part of the cause of action against Siplast?"[48] Examining and comparing the holdings from *Wilshire Insurance Co. v. RJT Construction, LLC*[49] and *Building Specialties, Inc. v. Liberty Mutual Fire Insurance Co.*,[50] the court explained that, "[i]f the complaint alleges damage to and seeks damages for any property that is not the insured's product or directly subject to the insured's work [like in *RJT Construction*] . . . then the claim falls outside of a 'your product/your work' exclusion and the insurer has a duty to defend."[51] On the other hand, "if the complaint solely alleges facts and damage to the insured's own products, or solely seeks to recover the costs to repair the insured's work," like in *Building Specialties*, the Your Product/Your Work exclusion would preclude coverage and any duty to defend.[52]

The district court had found that the underlying complaint against Siplast mentioned that there was "damage to school property other than the Siplast roofing products."[53] Inexplicably, the district court then held that, "while the complaint *mentioned* said damage, the Archdiocese did not actually make 'a claim to recover from Siplast for any damage to the building caused by the leaky roof that is separate from the damage to Siplast's product.'"[54] Unsurprisingly, the Fifth Circuit found that this "reading of the Underlying Plaintiffs' complaint is overly narrow."[55] Continuing, the Fifth Circuit explained:

> The factual allegations raised by the complaint repeatedly point to damage to property other than Siplast's roof membrane system. The Underlying Complaint alleges that there was "water damage in the ceiling tiles throughout the [school] after a rain storm" and that Siplast recommended the Archdiocese "contact a designated Siplast roofing contractor to address the *damage* and leak." The complaint further alleges that "[d]espite the

[46] *Id.*

[47] *Id*. at *6

[48] *Id*. at *5.

[49] 581 F.3d 222 (5th Cir. 2009).

[50] 712 F. Supp. 2d 628 (S.D. Tex. 2010).

[51] 2022 WL 99303, at *4.

[52] *Id.*

[53] *Id*. at *5.

[54] *Id.*

[55] *Id.*

> work performed by Siplast's designated contractor, the School continued to suffer from additional leaks and *water damage.*" It then alleges that the installing contractor told the Archdiocese that "the leaks and *any damage created thereby* were the sole responsibility of Siplast under the Siplast Guarantee."[56]

Noting that in making the duty-to-defend determination, a court (and thus insurers) must consider '"any reasonable inferences that flow from the facts alleged,'"[57] the Fifth Circuit found that "[e]ach of these factual allegations contained within the Underlying Complaint creates an inference that the Underlying Plaintiffs asserted their cause of action based not only on damage to the roof membrane, but also on property damage to other parts of the school."[58] The court also found that reasonable inferences could be made from the factual allegations that the water damage to non-roof-membrane property was caused by the failure of Siplast's faulty roof membrane system.[59] Additionally, the court explained that the allegations that additional water damage occurred even after Siplast's designated contractor attempted repairs suggests that the additional water damage was caused by Siplast's failure to honor the Siplast Guarantee by timely and effectively repairing the roof membrane system.[60] Thus, because there were factual allegations that "clear[ly]" indicated that there was damage to property other than Siplast's roof membrane as part of the Underlying Plaintiffs' cause of action, the Your Product/Your Work Exclusion did not preclude the duty to defend.

EMCC also suggested that even to the extent that the Underlying Plaintiffs mentioned that there was "property damage," the Underlying Plaintiffs were not seeking damages for that "property damage." The court rejected this argument, noting that the pleading linked the alleged damage to the cause of action asserted by the Underlying Plaintiffs in their pleading.[61] The court explained:

> In their cause of action against Siplast, the Underlying Plaintiffs stated that they "repeat[,] reaffirm[,] and reallege each of the previous allegations as if fully set forth herein." The previous allegations that are incorporated into the cause of action by this language include the allegations of covered property damage to the school, which triggers EMCC's duty to defend. True, this type of reallegation language is common to the point of being boilerplate. However, that fact does not render the language invalid. Instead, this clause does exactly what it says it does—reincorporates all previous

[56] *Id*.

[57] *Id*. (quoting *Liberty Mut. Ins. Co. v. Graham*, 473 F.3d 596, 601 (5th Cir. 2006)).

[58] *Id.*

[59] *Id.*

[60] *Id*.

[61] *Id.*

> factual allegations, including those related to property damage to the school building that is covered by the policies at issue, into the cause of action.[62]

EMCC argued that the "incorporation" language was simply a "catch-all" boilerplate provision, or Mother Hubbard Clause, seeking "other and further relief," which courts have found do not trigger a duty to defend.[63] The Fifth Circuit found that this was not the case, as there was "no attempt here to use boilerplate language to locate invisible allegations lurking in the complaint's penumbras, or to create those allegations from whole cloth. Instead, the factual allegations of covered damage are explicitly included in the complaint."[64] The language in the pleading tied those factual allegations to the cause of action, which the court found was sufficient to trigger a duty to defend.[65]

The court also ruled that, when "[r]ead liberally, the Underlying Complaint . . . satisfies the requirement that the Underlying Plaintiffs seek damages that could be covered by the insurance policies."[66] Even though the section of the Underlying Complaint asserting the cause of action against Siplast did not specifically mention damage to non-roof property, the consultant hired by the Archdiocese estimated that replacing the roof membrane would cost approximately $5,000,000. In their cause of action against Siplast, however, the Underlying Plaintiffs sought damages from Siplast "*in excess* of $5,000,000," rather than limiting the alleged damages to the estimated cost of replacing the roof.[67] This damage request, according to the court, can be read to include compensation for the water damage to the school proper.[68]

Finally, the Fifth Circuit evaluated whether the Contractual Liability Exclusion precluded EMCC's duty to defend.[69] This exclusion states that insurance does not apply to "property damage" for which Siplast "is obligated to pay damages by reason of an assumption of liability in a contract or agreement."[70] The exclusion does not apply, however, to liability for damages "[t]hat the insured would have in the absence of the contract or agreement."[71] In evaluating that exception, the Fifth Circuit has held "the question 'is not whether the relevant duty is contractual; it is whether the contractual duty represents an *expansion* of liability.'"[72] In that regard, the Supreme Court of Texas has made clear that "assumption of liability" means that the insured has assumed a liability

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[62] *Id.*

[63] *Id*. at *6 (citing *Clemons v. State Farm Fire & Cas. Co.*, 879 S.W.2d 385, 393 (Tex. App.—Houston [14th Dist.] 1994, no writ); *Feed Store Inc. v. Reliance Ins. Co.*, 774 S.W.2d 73, 75 (Tex. App.—Houston [14th Dist.] 1989, writ denied)).

[64] *Id.*

[65] *Id.*

[66] *Id.*

[67] *Id*. (emphasis in original).

[68] *Id.*

[69] *Id*. at *8.

[70] *Id.*

[71] *Id.*

[72] *Id. (*quoting *Crownover v. Mid-Continent Cas. Co.*, 772 F.3d 197, 208 (5th Cir. 2014)).

for damages that exceeds the liability it would have under general law, or else those words would be meaningless.[73]

Thus, according to the Fifth Circuit, the operative question was whether, by providing the Siplast Guarantee, Siplast had "additional liability beyond that found at law."[74] The court held that Siplast did not, noting that it had "already determined that the Underlying Plaintiffs alleged that Siplast negligently provided a defective roof membrane, causing damage, including water damage to the school."[75] Absent the Siplast Guarantee, these allegations, if true, would render Siplast liable to repair the roof.[76] Thus, there was no expansion of liability. As a result, the court held that the duty to defend was implicated.[77]

B. Commentary on *Siplast*

In last year's paper, we wrote about the district court's opinion, commenting:

> The holdings from this case are a bit confusing. First, based on the Court's analysis, it appears that there was no dispute that interior portions of the building sustained water damage. As the interior of the building was not part of the Siplast's scope of work, it appears that this damage is the exact type of damage (resulting damage to property other than the work performed by the insured) that the Court recognizes is intended to be covered by a CGL policy. Interestingly, the Court then pivots and says that there are no allegations that the damages sought were separate and apart from the work that Siplast performed. Rather, the Court found that the allegations related solely to the damages associated with the defective roofing system, not for damages because of water staining of the interior. The court may have gone just a bit too far in its interpretation of the exclusions as it relates to the allegations in the pleading.

The Fifth Circuit apparently agreed. The primary takeaway from the Fifth Circuit's opinion is the reminder that all inferences must be read in favor of coverage (and thus the duty to defend the insured). Carriers seem to sometimes forget that the proverbial "tie" will always go to the insured. While not an earth-shattering opinion, it is nice to have the Fifth Circuit reaffirm certain bedrock principles of basic Texas insurance law—all of which support insureds in arguing for coverage in close cases.

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[73] *Id*. (citing *Ewing Constr. Co. v. Amerisure Ins. Co.*, 420 S.W.3d 30, 37 (Tex. 2014)).

[74] *Id.*

[75] *Id.*

[76] *Id*. (citing *Crownover*, 772 F.3d at 207–08 (holding that an express duty to repair did not expand an insured's obligations beyond those found at general law).

[77] The Fifth Circuit also rejected an argument asserted by EMCC for the first time on appeal that, Siplast had expanded its liability by guaranteeing that the roof would be watertight for 20 years

C. *Crum & Forster Spec. Ins. Co. v. Chemicals, Inc.,* No. CV H-20-3493, 2021 WL 3423111 (S.D. Tex. Aug. 5, 2021)

In *Crum & Forster Specialty Insurance Co. v. Chemicals, Inc.*, Judge Lee Rosenthal, Chief United States District Judge for the Southern District of Texas, issued an opinion holding that Crum & Forster Specialty Insurance Company ("Crum & Forster") owes a duty to defend under the commercial general liability policies it issued to Chemicals, Inc. ("Chemicals"), for underlying lawsuits alleging personal injuries from chemical exposures.[78]

The complaints filed in the underlying lawsuits contained allegations that the plaintiffs sustained injuries from exposures to toxic substances in aqueous film-forming foams that were designed, manufactured, and marketed by several defendants, including Chemicals.[79] These complaints also included allegations that the exposures to these substances occurred during the plaintiffs' employment as military or civilian firefighters.[80] The complaints, however, did not contain allegations regarding dates as to when the plaintiffs were exposed or when their symptoms first manifested.[81]

The Crum & Forster policy required that "bodily injury" first occur during the "policy period."[82] The policy also had a "Continuous or Progressive Damage or Injury" condition added by endorsement, which stated: "If the date cannot be determined upon which such 'bodily injury' . . . first occurred[,] . . . then . . . such 'bodily injury' . . . will be deemed to have occurred or existed . . . before the 'policy period'."[83] Based on this, the issue was whether this additional condition to coverage was met by the allegations in the complaints and, if so, whether the allegations triggered Crum & Forster's duty to defend.[84]

The court recognized that the "default" rule in Texas is that an insurer owes a duty to defend when the dates of loss are not alleged in a pleading but *potentially* could fall within the policy period and be determined in future proceedings.[85] Crum & Forster argued that the plain language of the policy superseded the "default" rule, asserting that, "An injury will be deemed to fall outside

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[78] No. CV H-20-3493, 2021 WL 3423111, at *1 (S.D. Tex. Aug. 5, 2021).

[79] *Id*. at *1

[80] *Id.*

[81] *Id.*

[82] *Id.*

[83] *Id*.

[84] *Id.*

[85] *Id*. (citing *See Lyda Swinerton Builders, Inc. v. Okla. Sur. Co.*, 903 F.3d 435, 447 (5th Cir. 2018); *Indian Harbor Ins. Co. v. KB Lone Star, Inc.*, No. H-11-CV-1846, 2012 WL 3866858, at *14 (S.D. Tex. Sept. 5, 2012) ("Texas courts have held that a carrier is obligated to defend when the underlying petitions are silent about the time of the damage.") (citing *Gehan Homes, Ltd. v. Employers Mut. Cas. Co.*, 146 S.W.3d 833, 845–46 (Tex. App.—Dallas 2004, pet. denied))).

the policy '[i]f the date cannot be determined upon which such "bodily injury" . . . first occurred or existed.'"[86] The court disagreed:

> Because Crum & Forster did not unambiguously reserve the right to unilaterally determine whether a date of loss can be determined, the Texas default rule applies. The policy stated only that the date can "be determined," not who must make the determination, or that it must be made with no evidence or opportunity to present it.[87]

Based on the allegations that the underlying plaintiffs were exposed to and potentially injured during the applicable policy periods, Crum & Forster could not meet its burden to show that the dates of damage could not be determined or that the allegations in the underlying pleadings were not within the scope of the policy.[88] Rather, the court found that the underlying complaints supported the potential for coverage, as the allegations created a reasonable inference that injury could have first occurred during the policy period.[89]

D. Commentary on *Chemicals*

As evidenced by the policy language in *Chemicals*, insurers have introduced (and will continue to introduce) manuscript language trying to shift the burden of proof of establishing an exclusion from the insurer to the insured. Hopefully, courts will continue to see through this tactic and continue to place the burden of establishing whether a limitation on coverage exists on the insurer—as required by Texas statute and extensive case law.

E. *Landry's Inc. v. Ins. Co. of the State of Pa.,* 4 F.4th 366 (5th Cir. 2021)

In *Landry's, Inc. v. Insurance Co. of the State of Pennsylvania*, the Fifth Circuit determined that the Insurance Company of the State of Pennsylvania ("ICSOP") had a duty to defend Landry's in an underlying data-breach lawsuit.[90] In the opinion, the Fifth Circuit addressed a developing area of law regarding insurance claims for data breach and cyber liability, finding coverage for the insured while also providing a rather memorable (and quotable) line in reaching its holding.

Landry's faced a lawsuit from its credit card processing company for losses arising out of a data breach that occurred at multiple Landry's-owned restaurants.[91] Landry's sought coverage under its commercial general liability policies issued by ICSOP and subsequently sued ICSOP

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[86] *Id.*

[87] *Id*. (citing *Pendergest-Holt v. Certain Underwriters at Lloyd's London*, 600 F.3d 562, 571 (5th Cir. 2010) ("[I]f an insurer 'wants the unilateral right to refuse a payment called for in the policy, the policy should clearly state that right.'").

[88] *Id*. at *2 (citing *Allied Prop. & Cas. Ins. Co. v. Clean N Go, LLC*, 290 F. Supp. 3d 619, 623 (E.D. Tex. 2017); *Indian Harbor Ins. Co. v. KB Lone Star, Inc.*, 2012 WL 3866858, at *14 (S.D. Tex. Sept. 5, 2012) (finding a duty to defend when the insurer "ha[d] not met its burden to establish as a matter of law that the property damage did not happen during the policy period")).

[89] *Id.*

[90] 4 F.4th 366, 372 (5th Cir. 2021).

[91] *Id*. at 367.

after it refused to defend.[92] The policy broadly obligated ICSOP to "pay those sums that [Landry's] becomes legally obligated to pay as damages because of 'personal and advertising injury'" and stated that ICSOP "will have the right and duty to defend [Landry's] against any 'suit' seeking those damages."[93] The policy defined "[p]ersonal and advertising injury" as "injury . . . arising out of" several offenses, including "[o]ral or written publication, in any manner, of material that violates a person's right of privacy."[94]

The district court found that "[n]one of the . . . 'personal and advertising injury' triggers were implicated by the allegations" because there were no allegations of a "publication" as contemplated by the policy.[95] Rather, because the underlying plaintiff asserted only that "[a] third party hacked into [the] credit card processing system and stole customers' credit card information," there was no allegation of "violat[ion] [of] a person's right of privacy" because the lawsuit involved the payment processor's contract claims, *not* the cardholders' privacy claims.[96]

In reversing, the Fifth Circuit rejected this narrow interpretation, explaining that "[t]he contractual text and structure suggest the parties intended the broadest possible definition of '[o]ral or written publication.'"[97] This means, according to the court, that "even merely 'exposing or presenting [information] to view'" will meet the "publication" requirement for coverage.[98] This is consistent with how courts have viewed the meaning of "publication" in the context of evaluating coverage for defamation claims.[99]

Turning to the next issue of whether the second component, "violat[ion] [of] a person's right of privacy," was satisfied, the court noted as follows:

> ICSOP urges us not to follow the plain text of the Policy and instead to alter it. In ICSOP's view, the Policy covers only *tort* damages "arising out of . . . the violation of a person's right of privacy." Thus, ICSOP suggests, it might defend Landry's if it were sued *in tort* by the individual customers who had their credit-card data hacked and fraudulently used. But ICSOP thinks it bears no obligation to defend Landry's in a *breach-of-contract* action brought by [the credit card processing company]. **Of course, the Policy contains none of these salami-slicing distinctions.**[100]

Relying on *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*, the Fifth Circuit reiterated that, under Texas law, the proper inquiry of whether a duty to defend exists focuses on the facts

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[92] Id. at 368.

[93] *Id.*

[94] *Id*. at 368.

[95] *Id.*

[96] *Id.*

[97] *Id*. at 369.

[98] *Id.*

[99] *See id*. at 370 (citing *Exxon Mobil Corp. v. Rincones*, 520 S.W.3d 572, 579 (Tex. 2017)).

[100] *Id*. at 371 (emphasis added).

alleged as opposed to the labels attached to the claims in the underlying suit.[101] As a result, the Fifth Circuit held that ICSOP had a duty to defend Landry's in the underlying lawsuit.

F. Commentary on *Landry's*

Much like the holding in *Siplast*, the court's decision in *Landry's* reiterates that, when evaluating the duty to defend, insurers should be cognizant that courts will broadly interpret the policy in favor of coverage. The insurer in *Landry's* proposed an interpretation of its policy language that was simply too cumbersome for the court's liking, prompting the very memorable quote. The direction from the court is clear: if the duty to defend is implicated under the plain language of the policy, provide a defense or risk a ruling of a breach of contract.

III. Loss During the Policy Period and "Continuation, Change or Resumption" Provision

Most liability insurance policies contain a provision that states that, if there is damage that begins during the policy period, coverage extends for any damage that continues, changes, or resumes after the expiration of the policy period. The United States District Court for the Southern District of Texas recently evaluated the meaning and scope of this language in a commercial excess policy.

A. *Colony Ins. Co. v. First Mercury Ins. Co.*, No. CV H-18-3429, 2020 WL 5658662 (S.D. Tex. Sept. 22, 2020).

In *Colony Insurance Co. v. First Mercury Insurance Co.*, the United States District Court for the Southern District of Texas evaluated the meaning and applicability of the "continuation, change or resumption" provision commonly found in liability insurance policies.[102] In that case, Cambridge Builders & Contractors, LLC ("Cambridge") contracted in 2012 to build an apartment complex for Archstone Memorial Heights Villages I LLC ("Archstone"). The final certificate of occupancy was issued on October 23, 2014. Cambridge had primary and excess insurance policies issued by First Mercury Insurance Company ("FMIC"), Colony Insurance Company ("Colony"), and Navigators Specialty Insurance Company ("Navigators") in effect during the time of construction, as follows:

Policy Period	Primary Insurer	Excess Insurer
2011 to 2012	FMIC	FMIC
2012 to 2013	FMIC	FMIC
2013 to 2014	Navigators	FMIC
2014 to 2015	Navigators	Colony

[101] *Id*. (citing *Lamar Homes, Inc. v. Mid-Continent Cas Co.*, 242 S.W.3d 1, 15–16 (Tex. 2007)).

[102] No. CV H-18-3429, 2020 WL 5658662, at *7 (S.D. Tex. Sept. 22, 2020).

Each primary policy provided up to $1 million per occurrence, while each excess policy provided up to $10 million in coverage.[103]

Archstone sued Cambridge in 2015, asserting that construction defects caused water damage to the complex's sheathing, framing, patio decks, stair landings, stucco system, masonry, windows, and roof. The damages were alleged to have occurred over time, spanning the term of multiple insurance policies. Navigators and FMIC participated in Cambridge's defense as primary insurers.[104]

Archstone demanded $8.25 million to resolve all claims against Cambridge.[105] Cambridge's own expert witnesses calculated that Cambridge was liable for over $2.7 million in repair costs. FMIC and Navigators each paid $500,000 toward the settlement out of the primary insurance layer. Colony determined that an additional $2 million would need to be paid from the excess layer to settle the case. Colony therefore requested that FMIC contribute additional money to the settlement, as it had issued the excess policies that were in effect when the damage to the complex began.[106]

Colony did '"not necessarily agree"' with the damage calculation by Cambridge's experts but explained to FMIC's counsel that the evidence showed that both excess insurers were obligated to indemnify Cambridge.[107] According to the court, "Colony warned [FMIC] that if [Colony] was forced to fund a settlement without [FMIC's] participation, Colony would seek reimbursement in a separate lawsuit."[108] FMIC denied coverage and refused to contribute to the settlement, stating that it was not '"provided any evidence or quantifying of any covered damage in the policy's term."'[109] Colony ultimately paid $1,925,000 toward the settlement, while FMIC paid nothing additional. Colony then filed suit, seeking reimbursement from FMIC for FMIC's pro rata share of the settlement.

After first rejecting FMIC's argument that Colony's right of subrogation was abrogated by the decision of the Supreme Court of Texas in *Mid-Continent Insurance Co. v. Liberty Mutual Insurance Co.*,[110] the court then evaluated whether the FMIC policies were implicated by the loss.[111]

The court noted that FMIC's excess insurance policies were only triggered if the concurrent primary insurance policies were exhausted. The parties did not dispute that there was one "occurrence" in the underlying case: Cambridge's failure to ensure proper construction of the

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[103] *Id*. at *1.

[104] *Id.*

[105] *Id*. at *2.

[106] *Id.*

[107] *Id.*

[108] *Id.*

[109] *Id.*

[110] *Id*. at *3 (citing *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d 765, 777 (Tex. 2007)).

[111] *Id*. at *5.

building.[112] FMIC argued, however, that Colony had not shown that the primary policies paid $1 million per occurrence to exhaust the primary layer. In evaluating this issue, the court explained that, because consecutive primary policies cover the loss, "when 'a single occurrence triggers more than one policy, covering different policy periods, . . . the insured's indemnity limit should be whatever limit applied at the single point in time during the coverage periods of the triggered policies when the insured's limit was highest.'"[113] This principle prohibits "stacking" policy limits to provide a loophole that would allow higher recovery for incidents lasting longer than one policy term. As such, '"[o]nce the applicable limit is identified, all insurers whose policies are triggered must allocate funding of the indemnity limit among themselves according to their subrogation rights."'[114]

Based on this, the court explained that "Colony, standing in the shoes of Cambridge, must (1) identify the highest limit of primary coverage and (2) show that this limit was paid by the insurer or insurers whose policies were triggered."[115] The parties agree that the highest limit of primary coverage that Cambridge contracted for was $1 million per occurrence. Because Colony showed that the $1 million primary limit was paid by a combination of the contribution of $500,000 by FMIC and Navigators, the court ruled that Colony met its burden to show that the primary layer was exhausted.

The next issue was whether there was damage during FMIC's policy period. Seeking to establish this, Colony produced emails from apartment complex personnel that describe leaks from a window, the roof, the night drop box, and an air conditioning unit between February of 2013 and October of 2014. The court concluded that, "[w]hile there [were] disputed fact questions as to how the damage occurred or when it began, these emails constitute some evidence that damage occurred during [FMIC's] excess policy period."[116]

FMIC asserted that, even if these emails showed losses during the 2013–2014 policy period, they did not show losses that exceeded $1 million.[117] According to the court, "[t]his is important because [FMIC's] excess policy is only triggered if covered losses exceed the $1 million limit of the primary layer."[118] In response, Colony pointed to the language in FMIC's policy that states an "'[i]njury or damage' which occurs during the Policy period . . . includes any continuation, change or resumption of that 'injury or damage' after the end of the Policy period."[119] Based on this language, the court explained that FMIC's "policy covers not only physical damage that occurred prior to November 7, 2014, but also any continuation of that damage that occurred

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[112] *Id.*

[113] *Id.* (quoting N. *Am. Specialty Ins. Co. v. Royal Surplus Lines Ins. Co.*, 541 F.3d 552, 557 (5th Cir. 2008)).

[114] Id. (quoting *Am. Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 855 (Tex. 1994)).

[115] *Id*. at *6.

[116] *Id.*

[117] *Id*. at *7.

[118] *Id.*

[119] *Id.*

after November 7, 2014."[120] Thus, the court found that "[t]he monetary requirement for coverage is therefore not restricted to physical damage that occurred during the 2013–14 policy term."[121] Instead, to show losses that exceed $1 million, the court found that "Colony may add together both the amount of any damage that occurred during the 2013–14 policy *plus* the amount of any loss that occurred after November 7, 2014, if the later damage extended from the 2013–14 damage and was caused by the same single occurrence."[122]

The court found that reports were produced that FMIC was on notice that experts found damage in 2016 and 2017 that could support a continuation or resumption of the damage reported during FMIC's 2013–2014 policy period:

> For example, experts opined that leaks through the night drop box, roof, air conditioner, windows, and drains caused stains, decay, cracks, and water damage. . . . Because the leaks came from the same places and resulted in the same types of damage as reported in the 2013–14 emails, these documents are enough to create a fact question as to how the damage occurred or when it began, which should be decided at trial. [citation omitted]. Colony has presented evidence that a fact issue exists as to coverage under [FMIC's] excess policies.[123]

B. Commentary

Many insurers seem to overlook or simply ignore the "continuation, change or resumption" language in the insuring agreement. Rather, insurers sometimes will entrench themselves in a position that they are only going to provide indemnity coverage for damage that occurred during its policy period. While it is true that, to trigger *defense* coverage under a commercial liability policy, the actual injury must occur during the policy period. The total amount of *indemnity* coverage for that damage, however, must be evaluated in light of any continuation, change, or resumption that goes beyond the policy period.

IV. The Adversarial Trial Requirement and Texas' No-Direct Action Rule

The Supreme Court of Texas' 2017 decision in *Great American Insurance Co. v. Hamel* provided guidance on the circumstances under which a judgment against an insured or a settlement between a third party and the insured would be binding on the insurer in a subsequent coverage suit.[124] Specifically, in *Hamel*, the Court clarified that any judgment rendered against a defendant insured without a fully adversarial trial will not be binding on the insurance company for the defendant insured.[125] The Court explained that a judgment does not bind an insurer unless, "at the time of the underlying trial or settlement, the insured bore an actual risk of liability for the damages

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[120] *Id.*

[121] *Id.*

[122] *Id*. (emphasis added).

[123] *Id.*

[124] 525 S.W.3d 655, 662–63 (Tex. 2017).

[125] *Id*. at 663, 666.

awarded or agreed upon, or had some other meaningful incentive to ensure that the judgment or settlement accurately reflects the plaintiff's damages and, thus, the defendant-insured's covered liability loss."[126] In *Turner v. Cincinnati Insurance Co.*, the Fifth Circuit evaluated how the "adversarial trial requirement" from Hamel interacts with the long-standing no-direct-action rule in Texas.[127]

A. *Turner v. Cincinnati Ins. Co.*, 9 F.4th 300 (5th Cir. 2021)

In *Turner*, six plaintiffs obtained a default judgment against an insured and subsequently filed a coverage action to collect on that judgment from the insurer.[128] The district court found that the plaintiffs lacked standing under Texas' no-direct-action rule to sue the insurer without either an adversarial judgment against the insured or a valid assignment from the insured.[129] In evaluating whether the default judgment against the insured satisfied the no-direct-action rule that would allow the plaintiffs to maintain their coverage suit directly against Cincinnati, the court focused on *Hamel*.[130]

The court explained that, from *Hamel* and cases that came before it, a general principle exists under Texas law that "an insurer that wrongfully refuses to defend its insured is barred from collaterally attacking a judgment or settlement between the insured and the plaintiff."[131] The Fifth Circuit postured the issues as follows:

> From the Texas Supreme Court's no-direct-action rule decisions, we know that "the general rule is that an injured party cannot sue the [insured-defendant's] insurer directly until the [insured-defendant's] liability has been finally determined by agreement or judgment." *See In re Essex* [*Ins. Co.*, 450 S.W.3d 524, 525 (Tex. 2014)] (ellipses omitted). Texas's highest court, though, has not decided a case involving the no-direct-action rule in the context of plaintiffs obtaining a judgment that is potentially insufficient. At the same time, the court decided each of the cases in the *Hamel* line — including *Hamel*, *Gandy*, *ATOFINA*, and *Block* — without any reference to the no-direct-action rule. We must determine whether there is any overlap.[132]

In *Landmark American Insurance Co. v. Eagle Supply & Manufacturing, L.P.*, a Texas court of appeals applied the no-direct-action rule and *Hamel* together, holding that two non-

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[126] *Id*. at 666.

[127] 9 F.4th 300 (5th Cir. 2021).

[128] 9 F.4th at 304.

[129] *Id*.

[130] *Id*. at 309–10.

[131] *Id*. at 310 (citing *Hamel*, 525 S.W.3d at 662–63; *Evanston Ins. Co. v. ATOFINA Petrochemicals, Inc.*, 256 S.W.3d 660, 671 (Tex. 2008), *Employers Cas. Co. v. Block*, 744 S.W.2d 940, 943 (Tex. 1988)).

[132] *Id*. at 311.

adversarial judgments did not satisfy the no-direct-action rule.[133] In that case, a third-party plaintiff sought to enforce two non-adversarial judgments against the insured-defendant's insurer. The court found that the policy's "no direct action" provision in the policy itself precluded the third-party plaintiff from pursuing the insurer directly.[134]

The *Landmark* court held that, "without a sufficient judgment against [the insured-defendant], [the third-party plaintiff] does not have a ripe claim under the no-direct-action rule to pursue a breach of contract claim as a judgment creditor against [the insurer]."[135] Thus, the *Landmark* court held that the judgments against the insured-defendant did not satisfy the no-direct-action rule because neither was "the result of a fully adversarial trial under *Hamel* and *Gandy*."[136]

The Fifth Circuit, however, declined to follow *Landmark*, explaining that Cincinnati's policy provision did *not* include language requiring an actual trial, but rather an "adjudication":

> No action shall be taken against us unless, as a condition precedent thereto, there shall have been full compliance with all of the terms of this policy and until the obligation of the "policy insureds" to pay shall have been finally determined, either by an adjudication against them or by written agreement of the "policy insureds," the claimant and us. Any person or organization or the legal representative thereof who has secured such judgment or written agreement shall thereafter be entitled to recover under this policy to the extent of the insurance afforded by this policy. Bankruptcy or insolvency of a "policy insured" or of a "policy insured's" estate shall not relieve us of any of our obligations hereunder.[137]

In reaching this decision, the Fifth Circuit explained that it was required to take the language of the no-direct-action provision literally. Thus, the court determined that the Supreme Court of Texas would hold as follows:

> First, the "general rule" applies, *i.e.*, a third-party plaintiff is barred from suing the defendant's insurer, when the third-party plaintiff has obtained neither a judgment nor agreement of any kind establishing the insured-defendant's liability.

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[133] 530 S.W.3d 761, 770–72 (Tex. App.—Eastland 2017, no pet.).

[134] *Id*. at 770. The provision at issue stated:

> No action will be taken against [Landmark] unless, as a condition precedent, the Insured is in full compliance with all of the terms of this policy and until the amount of the insured's obligations to pay shall have been finally determined, either by judgment against the insured after actual trial, or by written agreement of the insured, the claimant and the Company.

Id. It is also notable that, unlike in Hamel, the insurers in *Landmark* did not breach the duty to defend. *See id*. at 771 n.3.

[135] *Id.* at 772.

[136] *Id.*

[137] 9 F.4th at 311–12.

> Second, if the third-party plaintiffs obtain a judgment, then the court must look to the language of the no-action clause to determine whether it is the sort of judgment that satisfies the no-direct-action rule. For example, if the no-action clause contains an "actual trial" requirement, then the judgment must be sufficiently adversarial under *Hamel* . . . .[138]

The court held that the clause in Cincinnati's policy did not require an actual trial; rather, the plaintiffs must have obtained "an adjudication against" the insured before bringing an action directly against Cincinnati. Based on this, the court held that the default judgment was, under the circumstances before the court, sufficient to overcome the no-direct-action rule, but the default judgment was not sufficient to bind Cincinnati to the judgment under *Hamel*.[139] In fact, the court determined that the Cincinnati policy did not provide coverage.[140]

B. Commentary

In evaluating the "adversarial trial" issue, the first place to begin is in the policy language itself, as evidenced by the Fifth Circuit's opinion in *Turner*. But the *Turner* ruling adds another complex and esoteric rule when evaluating whether judgments against an insured bind an insurer. This issue is sure to foster disputes in the future.

V. Meaning of Primary Coverage in Evaluating Priority of Coverage of Insurance Policies

In September 2021, the First District Court of Appeals in Houston, in *National Union Fire Insurance Co. v. Exxon Mobil Corp.*, addressed issues regarding additional insured status and priority of coverage for Exxon Mobile Corporation ("Exxon") with respect to personal injury claims.[141] In doing so, the court addressed basic concepts regarding the meaning of commercial general liability insurance. Though seemingly innocuous, the analysis by the court is important for contractors that have potential risks for large construction projects.

A. *Nat'l Union Fire Ins. Co. v. Exxon Mobil Corp.*, No. 01-19-00852-CV, 2021 WL 4268898, at *1 (Tex. App.—Houston [1st Dist.] Sept. 21, 2021, pet. filed)

In January 2013, Kevin Roberts and Arturo Munoz, two employees of Savage Refinery Services, LLC ("Savage"), were working at Exxon's Baytown, Texas Refinery under the terms of a Standard Procurement Agreement No. 2088773 (the "Exxon-Savage Contract").[1] Exxon drafted the Exxon-Savage Contract, which required, among other things, that Savage obtain certain insurance coverage for Exxon as an additional insured.[142] The "Insurance" provision of the Exxon-Savage Contract obligated Savage to "carry and maintain in force at least . . . its normal and

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[138] *Id*. at 312.

[139] *Id.* at 313.

[140] *Id*. at 317.

[141] No. 01-19-00852-CV, 2021 WL 4268898 (Tex. App.—Houston [1st Dist.], Sept. 21, 2021, pet filed).

[142] *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Exxon Mobil Corp.*, No. 01-19-00852-CV, 2021 WL 4268898, at *1 (Tex. App.—Houston [1st Dist.] Sept. 21, 2021, pet. filed).

customary Commercial General Liability insurance coverage and policy limits or at least $2,000,000, whichever is greater."[143]

According to the underlying lawsuit, Roberts and Munoz were '"bolting and unbolting flanges on piping to coker drums . . . when hot water and steam exited a flange on piping' on one of the drums, 'causing injury to Roberts and Munoz.'"[144] Exxon sought coverage as an additional insured under "all of Savage's liability insurance carriers," including the following policies issued by National Union Fire Insurance Company of Pittsburgh, Pa. ("National Union"):

- AIG Europe Limited, formerly known as Chartis Europe Limited ("AIG Europe Limited"), Liability Policy No. CU001150b (the "AIG Policy");
- National Union Liability Policy No. 9725090 (the "National Union CGL Policy");
- National Union Liability Policy No. 13273101 (the "National Union Umbrella Policy"); and
- National Union Liability Policy No. 051769615 (the "other National Union Policy").[145]

AIG Europe Limited recognized Exxon's status as an additional insured and agreed to provide defense and indemnity coverage for Exxon up to the limit of the AIG Policy. That policy, however, had insufficient limits to satisfy the claims at issue and requirements under the Exxon-Savage Contract.[146] National Union denied coverage. This prompted Exxon to file a coverage lawsuit, alleging breach of contract and seeking a declaratory judgment against National Union. Specifically, Exxon sought declarations that

> it was "an additional insured under the liability policies in question"; that "[b]odily injury claims asserted against [Exxon] by Roberts and Munoz . . . [were] covered under the provisions of the policies issued by . . . National Union"; that ". . . National Union owe[d] and ha[d] owed coverage including a duty to defend and duty to indemnify [Exxon] against the bodily injury claims asserted by Roberts and Munoz"; and that ". . . National Union ha[d] not timely acknowledged [Exxon]'s additional insured status, correct priority of coverage, or otherwise provided coverage for defense and indemnity against the bodily injury claims of Roberts and Munoz . . . and [were] consequently liable to [Exxon] for interest damages under Texas Insurance Code, Chapter 542, subchapter b." Exxon requested attorney's fees and costs under the Uniform Declaratory Judgments Act . . . .[147]

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[143] *Id.*

[144] *Id.*

[145] *Id.* at *1–2.

[146] *Id*. at *2.

[147] *Id.*

In response, National Union asserted, in part, that the National Union CGL Policy and the AIG Policy "'satisfied any and all obligations—to the extent there were any—to Exxon' and that 'th[o]se policies provide[d] no coverage, or further coverage, to Exxon.'"[148] National Union also denied that Exxon was an additional insured under the National Union Umbrella Policy or that the National Union Umbrella Policy provided coverage.[149] Alternatively, National Union maintained that the National Union CGL Policy and all the other "primary" policies must be exhausted before the National Union Umbrella Policy would be triggered.[150]

Eventually, the parties moved for summary judgment. Exxon claimed that it was covered by the National Union Umbrella Policy based on its interpretation of Savage's obligation to cover Exxon as an additional insured on its "normal and customary Commercial General Liability insurance coverage and policy limits" under the Exxon-Savage Contract.[151] That interpretation relied on Exxon's position that the term "Commercial General Liability insurance," as referenced in the Exxon-Savage Contract, covers both primary and umbrella or excess insurance. In granting Exxon's summary-judgment motion against National Union on Exxon's breach of contract and declaratory judgment claims, the trial court implicitly adopted this interpretation.[152] The court of appeals disagreed, however, explaining that "there appears to be a near-consensus of understanding that 'commercial general liability insurance' refers to a form of primary policy or coverage and does not encompass umbrella or excess coverage."[153]

In reaching this decision, the court relied on an explanation by the Texas Department of Insurance:

> Commercial General Liability (CGL) insurance protects business owners against claims of liability for bodily injury, property damage, and personal and advertising injury . . . . Premises/operations coverage pays for bodily injury or property damage that occurs on your premises or as a result of your business operations. Products/completed operations coverage pays for bodily injury and property damage that occurs away from your business premises and is caused by your products or completed work.
>
> Excess liability insurance pays for covered losses that exceed your CGL policy's dollar limit.
>
> Umbrella liability insurance is excess liability insurance coverage above the limits of automobile liability and CGL policies. The umbrella policy also provides liability coverage for exposures not covered under the primary

[148] *Id*. at *3.

[149] *Id*.

[150] See *Id.*

[151] *Id*. at *7.

[152] *Id.*

[153] *Id.*

CGL insurance policies and not excluded by the umbrella liability insurance policy.[154]

The court of appeals recognized that Texas courts have routinely drawn a distinction between commercial general liability policies—*i.e.*, those providing primary coverage—from umbrella or excess policies.[155] The court further explained that Texas legal practitioners and other professionals understand "commercial general liability" in the same way, specifying that commercial general liability policies are primary policies distinct from umbrella or excess policies.[156] As such, the court found that the interpretation of "commercial general liability" proffered by Exxon deviated from the generally accepted understanding of the term, and, if adopted, would "disrupt the well-settled understanding of what constitutes commercial general liability insurance coverage reflected in these various authorities as well as in numerous other business agreements which, like the Exxon-Savage Contract, call for one party to provide insurance coverage for another."[157]

As a result, the court rejected Exxon's interpretation and concluded that the Exxon-Savage Contract provision requiring that Savage provide "'normal and customary Commercial General Liability Coverage'" to Exxon "had only one reasonable, certain, and definite meaning, creating an obligation for Savage to provide primary coverage to Exxon as an additional insured under a commercial general liability policy—but not any obligation to provide coverage under an umbrella

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[154] *Id*. at *8 (quoting Tex. Dep't of Ins., Commercial general liability insurance: What is commercial general liability insurance?, https://www.tdi.texas.gov/pubs/pc/pcgenliab.html (last updated Jan. 20, 2021) (emphasis omitted)).

[155] *Id*. (citing *Brown & Gay Eng'g, Inc. v. Olivares*, 461 S.W.3d 117, 119–20 (Tex. 2015) ("Brown & Gay was contractually responsible for furnishing the necessary equipment and personnel to perform its duties and was required to maintain insurance for the project, including workers' compensation, commercial general liability, business automobile liability, umbrella excess liability, and professional liability."); *In re Deepwater Horizon*, 470 S.W.3d 452, 462–63 (Tex. 2014) ("Triple S also agreed to carry $500,000 of commercial general liability (CGL) insurance, '[i]ncluding coverage for contractual liability insuring the indemnity agreement,' and $500,000 in excess insurance that followed the form of the CGL policy." (quoting *Evanston Ins. Co. v. ATOFINA Petrochems., Inc*., 256 S.W.3d 660 (Tex. 2008))); *Lennar Corp. v. Markel Am. Ins. Co.*, 413 S.W.3d 750, 752 (Tex. 2013) ("The trial court granted summary judgments for the insurers, and the court of appeals affirmed for all but two: American Dynasty Surplus Lines Insurance Company, which had provided Lennar a $1 million primary commercial general liability policy with an annual $1 million self-insured retention, and Markel American Insurance Company, which had provided a $25 million commercial umbrella policy . . . ."); *Zurich Am. Ins. Co. v. Nokia, Inc.*, 268 S.W.3d 487, 489 n.1 (Tex. 2008) ("National Union issued several commercial general liability insurance policies to Nokia, covering 1989–1993, as well as three umbrella policies for the period 1998–2001."); *Trinity Universal Ins. Co. v. Cellular One Grp.*, 268 S.W.3d 505, 505 (Tex. 2008) ("Cellular One tendered the defense of these suits to its insurer . . . from which Cellular One had purchased a number of commercial general liability policies and excess liability policies over a ten-year period."); *Fed. Ins. Co. v. Samsung Elecs. Am.*, 268 S.W.3d 506, 507 (Tex. 2008) ("Samsung tendered the defense of these cases to [its insurer], from which Samsung had purchased several commercial general liability insurance policies and excess liability policies over an eleven-year period."); *Daimler-Chrysler Ins. Co. v. Apple*, 265 S.W.3d 52, 64–65 (Tex. App.—Houston [1st Dist.] 2008) ("Here, the insurance policies exclude from coverage 'publication of material, if done by or at the direction of the insured with knowledge of its falsity,' as stated in the CGL policy . . . , and defamatory statements 'done at the direction of you with knowledge of its falsity,' as stated in the Umbrella policy."), *rev'd in part on other grounds sub nom. Chrysler Ins. Co. v. Greenspoint Dodge of Houston, Inc.*, 297 S.W.3d 248 (Tex. 2009)).

[156] *Id*. at *9 (citing various authorities).

[157] *Id.*

or excess policy to Exxon as an additional insured."[158] As a result, the court held that Exxon was an additional insured under the National Union CGL Policy, through its incorporation of the Exxon-Savage Contract, but not with respect to the National Union Umbrella Policy.[159]

B. Commentary

This case stands as a warning to general contractors and upstream subcontractors to carefully examine the contracts they have with subcontractors, suppliers, vendors, etc. as it relates to their requirement to provide insurance. If that obligation extends only to primary coverage, this may be insufficient to provide enough insurance against significant risks. Was the court harder on Exxon because it is Exxon? Unlikely. But it is unlikely that Exxon got any benefit of the doubt, given that it drafted the contract that imposed the obligation for its contractor to provide it with insurance. Even if it was not Exxon involved in the case, the argument that the language "normal and customary Commercial General Liability insurance coverage and policy limits" is meant to include umbrella/excess coverage seems to be a tenuous position, at best.

VI. Fifth Circuit Upholds No-Defense Excess Liability Policy

Staying in the theme of the differences between primary and excess coverage, the Fifth Circuit affirmed summary judgment for an excess insurer, holding that it did not have a duty to defend its insured in a wrongful death lawsuit.

A. *Tex. Disposal Sys., Inc. v. FCCI Ins. Co.*, 854 F. App'x 576 (5th Cir. 2021)

In *Texas Disposal Systems, Inc. v. FCCI Insurance Co.*, Texas Disposal Systems, Inc. ("TDS") sought coverage from its insurers for an accident caused by one of its employees.[160] The insurance tower for TDS was composed of four stacked liability insurance policies: primary insurance provided by FCCI Insurance Company ("FCCI"), followed by three separate excess policies, the final one issued by Arch Specialty Insurance Company ("Arch"). The total coverage available under the tower was $17 million.[161]

The first three insurers reached partial settlements with various plaintiffs that exhausted their limits. Once the settlements were paid, they tendered the remaining unsettled claims to Arch, and FCCI terminated its defense. The first three policies imposed a duty on the insurers to defend TDS, but the Arch policy granted Arch the *right*, but not duty, to defend.[162] TDS, however, believed that Arch had agreed to assume TDS's defense upon the exhaustion of the underlying policies. When Arch refused to defend, TDS sued FCCI and Arch for breach of contract, alleging

[158] *Id.*

[159] *Id.*

[160] 854 F. App'x 576 (5th Cir. 2021).

[161] *Id*. at 576.

[162] *Id*. at 576–77.

that FCCI had terminated its defense too early, and that Arch had improperly refused its defense obligation. The district court granted summary judgment for FCCI and Arch.[163]

In evaluating TDI's claim against Arch on appeal, the court noted that no dispute existed that the Arch policy imposed a duty to defend TDS.[164] Rather, TDS contended that, during the course of the underlying litigation, Arch had bound itself to assume TDS's defense, arguing: (1) that Arch and TDS somehow modified the Arch policy so as to impose a duty to defend upon Arch; or (2) that Arch invoked its contractual right to defend TDS and actually assumed the defense of TDS.[165]

The court rejected the first theory, explaining that a modification to an insurance policy requires "a meeting of the minds supported by consideration."'[166] There was no evidence of consideration. The court also found that Arch had not shown that it actually intended to assume the defense. According to the court,

> Arch could not assume the defense until "the total Limits of Liability of [the] underlying insurance . . . [were] exhausted solely by payment of loss." This condition was not satisfied until January 15, 2018, when the [other underlying excess policies] were exhausted [by settlement of certain settlements]—five days after Arch notified TDS that it was declining to exercise its right to assume TDS's defense.[167]

In response, TDS argued that Arch waived the condition on its right to defend.[168] But the court explained (and TDS conceded) that "an insurer can only waive policy provisions intended for the insurer's benefit."[169] The court noted that the condition at issue here did not benefit Arch; rather, it was a restriction on Arch's right to defend TDS.[170] The court ruled that the condition benefitted FCCI and the other insurers (and, indirectly, TDS as their policyholder), because "it served to keep Arch from meddling in their defense of TDS until their policy limits had been exhausted."[171] As a result, the Fifth Circuit affirmed summary judgment in favor of Arch that it had no duty to defend.

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[163] *Id*. at 577.

[164] *Id*. at 580.

[165] *Id.*

[166] *Id*. (citing *D2 Excavating, Inc. v. Thompson Thrift Constr., Inc.*, 973 F.3d 430, 435 (5th Cir. 2020) (quoting *Hathaway v. Gen. Mills, Inc.*, 711 S.W.2d 227, 228 (Tex. 1986))).

[167] *Id.*

[168] *Id.*

[169] *Id*. (citing RESTATEMENT OF LIAB. INS. § 5 cmt. a (AM. L. INST. 2019 & Oct. 2020 update) ("A party to a contract can waive only terms that benefit the waiving party.")).

[170] *Id.*

[171] Id.

B. Commentary

Though not an issue discussed at length in the opinion, this case shows the effect of having an excess policy that does not have language imposing upon an insurer a duty to defend. When facing multiple claims or a possible exposure that exceeds the primary limit of insurance, it is important to evaluate whether the excess policies or excess layers actually have a contractual provision that the excess insurer has a *duty* (not just a *right*) to defend, as the defense costs associated with these types of claims can be very significant. In the event that an insurer only has a *right* to defend but no duty, it is relatively safe to assume that the insurer will not incur the extra expense to defend the insured.

VII. Damage to and Resulting from Work Performed by a Subcontractor Sufficient to Implicate Coverage

A. *Tejas Spec. Group, Inc. v. United Spec. Ins. Co.*, No. 02-20-00085-CV, 2021 WL 2252742 (Tex. App.—Fort Worth, June 3, 2021, rule 53.7(f) motion granted)

In *Tejas Specialty Group, Inc. v. United Specialty Insurance Co.*, the Fort Worth Court of Appeals evaluated coverage with respect to a third-party claim brought against an insured contractor.[172] The third-party claim against Tejas Specialty Group, Inc. and Tejas Specialty Concrete Coatings, LLC (collectively, "Tejas") originated in the First Amended Third Party Petition of Icon Builders, LLC ("Icon") filed in the 55th District Court of Harris County. In that third-party petition, Icon alleged that Avenue Community Development Corporation ("ACDC") and Avenue Station, LP ("Avenue") (collectively, "Plaintiffs") had sued Icon, as general contractor, alleging breach of a construction contract, breach of express warranty, breach of performance bond, and negligence in the construction of Avenue Station, a multi-family affordable housing development in Houston, Texas (the "Project"), and that Icon was entitled to indemnity or contribution from Tejas if Icon was found liable to ACDC or Avenue for any work that Tejas had performed as a subcontractor on the Project.[173] In addition to Tejas, Icon sued five other subcontractors raising similar claims of indemnity or contribution.

Under the terms of its subcontract agreement with Icon, Tejas agreed to provide labor and materials to "install lightweight and gypsum" on the Project and to "water-proof[] the balconies."[174] The subcontract agreement contained no additional terms or details of the general contract. Icon alleged that the Project was substantially completed on March 9, 2017.[175] However, the third-party petition did not allege when any of Tejas' work, or any of the other subcontractor defendants' work, was performed, either before or after March 9, 2017.[176]

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[172] No. 02-20-00085-CV, 2021 WL 2252742 (Tex. App.—Fort Worth, June 3, 2021, rule 53.7(f) motion granted).

[173] *Id.* at *1.

[174] *Id.*

[175] *Id.*

[176] *Id.*

Tejas tendered the defense of the third-party petition filed by Icon to Tejas' commercial general liability insurer, United Specialty Insurance Company ("United").[177] The inception date for United's policy was October 1, 2017. United denied coverage, claiming, among other things, that Icon's claim was excluded under United's "Pre-Existing Injury or Damage Exclusion," which stated, in relevant part:

> This insurance does not apply to:
>
> 1. Any occurrence, incident or "suit" whether known or unknown to any officer of the Named Insured [*i.e.*, Tejas]:
>
> (a) which first occurred prior to inception date of this policy (or the retroactive date of this policy, if any); or
>
> (b) which is, or is alleged to be, in the process of occurring as of the inception date of the policy or the retroactive date of this policy, if any; even if the "occurrence" continues during this policy period.
>
> 2. Any damages arising out of or related to "bodily injury", "property damage" or "personal and advertising injury", which are known to any officer of any insured, which are in the process of settlement, adjustment or "suit" as of the inception date of this policy or the retroactive date of this policy, if any.
>
> We shall have no duty to defend any Insured or Additional insured against any loss, "occurrence", incident or "suit", or other proceeding alleging damages arising out of or related to "bodily injury", "property damage" or "personal injury" to which this endorsement applies.[178]

Tejas sued United, asserting breach of the duty to defend and the duty to indemnify. United again relied on its Pre-existing Injury of Damage Exclusion.[179] United took the position that the third-party petition included allegations that the work on the Project had been certified as substantially complete by March 9, 2017. Additionally, United asserted that the third-party petition and the Plaintiffs made allegations that problems existed with the construction and had been observed or made known "in the middle of 2017."[180] Because United's policy incepted on October 1, 2017, the work and resulting property damage would have occurred—according to United—before its policy was issued, thereby falling into the Pre-existing Injury of Damage Exclusion.

The Court of Appeals disagreed, explaining that, "[w]hile simplistically appealing, this position fails when tested against the rules of construction which apply to the eight-corners

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[177] *Id*. at *3.

[178] *Id*. at *3–4.

[179] *Id*. at *3.

[180] *Id*. at *9.

rule."[181] When construing the allegations in favor of Tejas and resolving all doubts about coverage in its favor, the court found that the exclusion did not apply because the work and property damage arising therefrom could have occurred after the inception date of the United policy.[182] In reaching this conclusion, the court explained that the allegations in the third-party petition were not just directed at the work by Tejas and property damages arising from that work; rather, the pleading named six subcontractors as third-party defendants.[183] Moreover, the subcontractors' contracts were signed in 2014, 2015, and 2016, and the third-party petition was filed on April 30, 2019.[184] Thus, the court concluded that an inference could be made that the work of all the subcontractors was performed and the property damage occurred between 2014 and April 30, 2019.[185] Further, the court explained that, because the third-party petition alleged neither that Tejas's work was performed during that period, nor when any property damage resulting from Tejas's work occurred, this left open the possibility that there could have been work performed and damage could have occurred *after* October 1, 2017.[186]

B. Commentary

The *Tejas* opinion reiterates the broad standard for defense under Texas law. The pleading by the claimant left open the *possibility* that both the work of the insured and the damage at issue *could have occurred* just after the policy incepted, meaning that the insurer could not meet its heavy burden to show that the exclusion applied.

VIII. The Meaning of the Term "Occurrence"

In last year's paper, we wrote about *LaTray v. Colony Ins. Co.* ("*Latray I*"), in which the Amarillo Court of Appeals held that a standard commercial general liability policy did not apply with respect to claims against an insured for damages resulting from the insured dumping materials following demolition of a building.[187] We commented that the analysis by the court was a bit confusing and suggested that the Supreme Court of Texas would potentially need to clarify the law concerning the "occurrence" requirement under Texas law. The Amarillo Court of Appeals, however, subsequently withdrew and superseded its opinion issued in *Latray I* and issued a new opinion on November 10, 2021 ("*Latray II*").[188]

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[181] *Id.*

[182] *Id.*

[183] *See id.* at *9, *11.

[184] *Id*. at *9.

[185] *Id.*

[186] *Id.*

[187] No. 07-19-00350-CV, 2021 WL 97204, at *4 (Tex. App.—Amarillo Jan. 11, 2021, no pet. h.) (slip op.).

[188] *LaTray v. Colony Ins. Co.*, 07-19-00350-CV, 2021 WL 5127520 (Tex. App.—Amarillo Nov. 4, 2021, no pet. h.) (mem. op.)

A. *LaTray v. Colony Ins. Co.*, 07-19-00350-CV, 2021 WL 5127520 (Tex. App.—Amarillo Nov. 4, 2021, no pet. h.) (mem. op.)

Latray II arose from an insurance coverage dispute stemming from the dumping by Clifton Boatright ("Boatright") of debris onto property owned by W.L. Roberts and others (hereafter "the Roberts").[189] The City of Kosse hired Boatright to demolish the town's old high school. Their agreement included Boatright's removal and disposal of the debris resulting from the demolition. David Garrett, a friend of Boatright's and a long-time tenant on the Roberts' property, asked Boatright if he could take some of the debris to use for purposes of erosion control.[190] Boatright testified that he mistakenly believed the property on which Garrett wished to place the debris belonged to Garrett when, in fact, the property belonged to the Roberts. Boatright never asked Garrett whether Garrett owned that property. Moreover, neither Garrett nor Boatright sought the Roberts' permission before placing the debris on the property. Further, neither sought a permit to dump the debris nor did either man consult an expert regarding erosion control.[191]

Garrett and Boatright subsequently took forty tons of debris from the demolition site and placed it on the Roberts' property.[192] In the process, they damaged fencing as they entered and exited the property, causing over $8,000 in property damages. When W.L. Roberts discovered the debris on his property, he filed suit against Boatright and others for illegal dumping and damage to his land, later obtaining a judgment against Boatright for $50,000, plus costs.[193] After the judgment became final, the court also issued a Turnover Order, thereby appointing Michelle Latray ("Latray") as a receiver, to take possession of non-exempt property for the purpose of liquidating that property for the benefit of Boatright's judgment creditors.[194]

After the judgment against Boatright was returned and the Turnover Order was issued, Latray submitted the judgment to Colony, who had issued a commercial general liability policy to Boatright prior to the demolition project. Colony denied coverage, prompting Latray to file a lawsuit. Colony filed a motion for summary judgment, relying primarily on the position "that because Boatright's actions were intentional, the policy did not cover Boatright's acts and thus, [Colony] had no duty to defend nor [*sic*] indemnify."[195] Latray filed a motion for partial summary judgment, arguing that, although Boatright's conduct was intentional, his alleged negligence was "accidental" because he was operating under the misconception that he had authority to dump the debris on the Roberts' property.[196] The trial court granted Colony's motion for summary judgment and denied Latray's motion for partial summary judgment.

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[189] *Id*. at *1.

[190] *Id.*

[191] *Id.*

[192] Id. at *2.

[193] *Id.*

[194] *Id.*

[195] *Id.*

[196] *Id.*

On appeal, the court explained that the "property damage" must have allegedly resulted from an "occurrence" as gleaned from the "eight corners" of the pleading and the policy.[197] The court relied heavily on *Curb v. Texas Farmers Insurance Co.*,[198] which is a 2005 unpublished opinion issued by the Eastland Court of Appeals.[199] In *Curb*, a high school student and his friends strung fishing line around the courtyard at school with the intent of luring and then making their friends trip over the line.[200] The students eventually forgot about the line, and the next night, a teacher left the building and tripped over the line and sustained injuries.[201] She sued the student and his father, who tendered the lawsuit to the father's homeowners' insurance carrier. The carrier denied coverage and coverage litigation ensued. The trial court found that there was no coverage because the conduct in question was intentional.[202] Because of that, there was no "accident" and, thus, no coverage for the damages alleged in the underlying pleading. On appeal, the appellate court agreed, finding liability did not arise as the result of an accident because the teacher had alleged that the student's acts were exactly what he intended to do.[203] To be accidental, according to the court, the "effect could not reasonably have been anticipated from the conduct that produced it, and the insured 'cannot be charged with the design of producing' the effect."[204] Thus, because the injury caused by the student was of the type that would "ordinarily follow" from his conduct "and the injuries could be 'reasonably anticipated from the use of the means, or an effect[,]'" the homeowners' insurer had no duty to defend the student.[205]

Moving to the present case, the court explained that the situation presented was similar to that in *Curb*. The policy defined the term "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions."[206] Though not defined, Texas courts have found that an injury is accidental if, "from the viewpoint of the insured, [it is] not the natural and probable consequence of the action or occurrence which produced the injury; or in other words, if the injury could not reasonably be anticipated by insured, or would not ordinarily follow from the action or occurrence which caused the injury."[207] Thus, the court found that two factors bear on the determination of whether an insured's action constitutes an accident: (1) the insured's intent and (2) the reasonably foreseeable effect of the insured's conduct.[208]

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[197] *Id*. at *3.

[198] No. 11–03–00406–CV, 2005 WL 1405744 (Tex. App.—Eastland June 9, 2005, no pet.).

[199] *Latray*, 2021 WL 5127520, at *4.

[200] *Id*. (citing *Curb*, 2005 WL 1405744, at *1).

[201] *Id.*

[202] *Id*. (citing *Curb*, 2005 WL 1405744, at *3).

[203] *Id*. (citing *Curb*, 2005 WL 1405744, at *3).

[204] *Id*. (citing *Curb*, 2005 WL 1405744, at *3).

[205] *Id*. (citing *Curb*, 2005 WL 1405744, at *4).

[206] *Id.*

[207] *Id*. (quoting *Lennar Corp. v. Great Am. Ins. Co.*, 200 S.W.3d 651, 663 (Tex. App.—Houston [14th Dist.] 2006, pet. denied) (citing *Mid-Century Ins. Co. v. Lindsey*, 997 S.W.2d 153, 155 (Tex. 1999)).

[208] *Id*. (citing *Lennar Corp*., 200 S.W.3d at 663).

Roberts alleged in his pleading that "Boatright clearly intended to move the debris to the Roberts' property and leave it there. Because the damage to the property was the very presence of the debris on the property, the damages were a reasonably foreseeable result of Boatright's intentional conduct."[209] The court further found that the damages sought by Robert "were of a type that ordinarily flowed from the conduct, not damages of an accidental nature."[210] Additionally, the court explained that, contrary to Latray's contention, the mere assertion of negligence is not sufficient to trigger a duty to defend as the focus of the analysis is on the factual allegations in the pleading as opposed to the legal theories asserted.[211] Thus, the court held that, as a matter of law, "the placement of the debris on the property was no accident and, therefore, no 'occurrence' under the terms of the policy."[212] Because there was no occurrence, there was no coverage with respect to the dumping of the debris.

In *Latray I*, the court did address the resulting damage to the fence caused while moving the debris.[213] Upon motion for rehearing, Latray contended that the result of the damaged fencing was not a reasonably foreseeable effect of placing the debris and, thus, the act of damaging the fencing constituted an "occurrence" under the policy. The court agreed, finding that, although the insured intended to use the dump truck and truck and trailer to move the debris onto the property, he did not intend to damage the fencing on the property.[214] As such, while the court found that there was an "occurrence" (at least with respect to the damage to the fence), the court then ruled that the policy's "auto" exclusion applied to bar coverage, thereby precluding the duty to defend.[215] The court ruled that this exclusion also precluded the duty to indemnify for any damage to the fence.[216]

B. Commentary

The ruling issued by the court on rehearing addresses an important principal about the duty to defend under Texas law. Specifically, an insurer must evaluate *all* the factual allegations in the pleading to determine if there is any possibility for coverage. In *Latray II*, the duty to defend was triggered because of resulting damage to a fence on the property. So, even though there was a finding that the dumping of the debris was not an accident, the insurer was obligated to defend against the *entire* suit because of the accidental damage to the fence.

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[209] *Id.*

[210] *Id.*

[211] *See id.*

[212] *Id.*

[213] *Latray I,* No. 07-19-00350-CV, 2021 WL 97204, at *4 (Tex. App.—Amarillo Jan. 11, 2021, no pet. h.) (slip op.).

[214] *Latray II*, 2021 WL 5127520, at *5.

[215] *Id*. at *6.

[216] *Id*. at *10.

IX. Commercial Property Insurance Claim for Resulting Water Loss

Disputes often arise as to the scope of coverage provided by an "all risks" commercial property policy when there is damage that results from either long-term issues or damage that results from faulty/defective work and/or materials by a third-party contractor.

A. *Axis Surplus Ins. Co. v. Mercer*, No. 3:21-CV-625-S, 2021 WL 6135324 (N.D. Tex. Dec. 29, 2021)

In *Axis Surplus Insurance Co. v. Mercer*, the Northern District of Texas evaluated the scope of coverage under an "all risks" policy for damage to an insured property caused by faulty workmanship of a roofing contractor.[217] Charles Mercer and Ofelia Mercer (the "Mercers") were the named insureds on a commercial property insurance policy issued by Axis Surplus Insurance Company ("Axis"). The policy provided coverage for Dakota Place Apartments, a multi-building apartment complex in Hurst, Texas, (the "Apartments"), and was in effect for the policy period from December 4, 2019, to December 4, 2020.[218]

The Mercers hired roofers to replace the roofs at the Apartments. After removing the whole roof on one building and part of the roof on another building, the roofers placed tarps over the open areas, securing them with wood blocks. An overnight rainstorm then damaged the interior of both buildings.[219] The Mercers sought coverage from Axis, who retained an investigator to examine the loss. The investigator concluded that the "tarps and wood-blocking were not utilized in a recognized waterproofing methodology."[220] The investigator also determined that some of the tarps had blown off during the storm, and the wood blocking "created a ponding area preventing water diversion and allow[ing] for additional water" to enter and damage the Apartments.[221] The Mercers did not dispute the investigator's conclusions about the cause of the loss to the Apartments.

The Axis policy provided coverage for "direct physical loss . . . or damage . . . caused by or resulting from any Covered Cause of Loss."[222] The term "Covered Causes of Loss" was defined as a "direct physical loss unless the loss is excluded or limited in this policy."[223] The policy also included various exclusions, including one that barred coverage "for loss of or damage to . . . [t]he interior of any building or structure . . . caused by or resulting from rain . . . whether driven by wind or not, unless . . . [t]he building or structure first sustains damage by a Covered Cause of Loss to its roof or walls through which the rain . . . enters."[224] In other words, the policy does not provide coverage for interior rain damage unless the roof or walls first experienced a "Covered

[217] No. 3:21-CV-625-S, 2021 WL 6135324 (N.D. Tex. Dec. 29, 2021).

[218] Id. at *1.

[219] *Id.*

[220] *Id.*

[221] *Id.*

[222] *Id.*

[223] *Id.*

[224] *Id.*

Cause of Loss."[225] Also excluded was any damage resulting from "'[f]aulty, inadequate or defective . . . [d]esign, specifications, workmanship, repair, construction, renovation, remodeling, grading, compaction; . . . [or m]aintenance;' unless such damage 'results in a Covered Cause of Loss.'"[226]

Axis denied coverage, asserting that the policy did not apply to the interior damage, that any restoration of coverage for interior rain is applicable only when there is damage to the Apartments' roof, and that the roofers' actions did not qualify as a Covered Cause of Loss. The court agreed, explaining first that any interior rain damage would be covered only if the "roofs or walls" were first "damaged" by a "Covered Cause of Loss."[227] The court held that the roofs were not damaged; rather, they were removed in order to be replaced. Thus, because there was no "damage" to the "roof or walls" before rain damaged the Apartments, the court ruled that the plain language of the exclusion precluded coverage for the loss.

Though the court stated that this alone was sufficient to support a denial of the claim, the court then explained that there is also no coverage because the damage resulted from "[f]aulty, inadequate or defective . . . workmanship."[228] The Mercers argued that removal of the roofs and waterproofing the exposed buildings was not "workmanship," but instead simply "negligence" in removing more of the roofs than they could replace in one day ultimately caused the damage.[229] Rejecting this argument, the court held that any damage resulting from "part of the construction process" related to "workmanship" as opposed to simply "negligence."[230] In doing so, the court ruled that the "meaning of faulty workmanship is broader than what is urged by the [Mercers]—it encompasses defects in the process of construction, not just a defect in the final product itself."[231] The court explained that the damage at issue occurred as roofers removed the roofs to replace them. The removal of existing roofs is, according to the court, "certainly an integral part of replacing a roof, as is waterproofing during construction."[232] As a result, the "faulty workmanship" exclusion was applicable.

The court also found that the exclusion for "[f]aulty, inadequate or defective . . . repair, construction, renovation, remodeling . . . [and m]aintenance" was implicated.[233] The court noted that the "plain, ordinary meaning" of the term "[r]epair" is "'to fix' or '[t]he process of restoring something that has been subjected to decay, waste, injury, or partial destruction, dilapidation, etc.'"[234] The term "renovation" is understood as the "restoration or development of a building

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[225] *Id.*

[226] *Id*. at *2.

[227] *Id*. at *3.

[228] *Id.*

[229] *Id.*

[230] *See id.* at *4.

[231] *Id.*

[232] *Id.*

[233] Id.

[234] *Id*. (quoting Repair, BLACK'S LAW DICTIONARY (11th ed. 2019)).

which is old or in a poor condition."[235] The term "remodeling" is understood to be "updat[ing] or restyl[ing] (a building, etc.), espe[cially] by carrying out extensive building work."[236] The term "construction" means "the . . . 'act of building.'"[237] Finally, the term "maintenance" is understood as "the care and work put into property to keep it operating and productive; general repair and upkeep."[238]

In light of these definitions, the court found that the removal and replacement of the roofs, as well as waterproofing performed while such a process was underway, fell under the plain meaning of the exclusion.[239] According to the court, if the roofs were in poor condition before the Mercers decided to have them replaced, then the project was a repair or renovation. On the other hand, if the new roofs were an upgrade from the old roofs, then the project was a renovation. Either way, it was construction and maintenance.[240]

B. Commentary

While an "all risks" policy provides broad coverage, insureds should be mindful that this does not mean that the policy provides a blanket of coverage for each claim. One common misunderstanding is that an "all risks" policy will cover water intrusion damages. Most policies require that the insured building or structure to first sustain a loss due to a specified cause (typically wind or hail) for the resulting water intrusion to implicate coverage. Without that first step in the chain, insureds will have difficulty in establishing a claim for coverage. Moreover, most "all risks" (and most commercial property policies in general) simply do not provide coverage for loss that results from faulty workmanship or faulty materials.

X. Bad Faith and Duty to Settle

The Supreme Court of Texas issued an important ruling on issues relating to bad faith, the duty to settle, and an insured's right of contribution from its insurer for amounts the insured paid towards a settlement.

A. *In Re Farmers Tex. County Mutual Ins. Co.*, 621 S.W.3d 261 (Tex. 2021)

In *In Re Farmers Texas County Mutual Insurance Co.*, the Supreme Court of Texas evaluated whether an insured can recover the amount of the insured's contribution towards a settlement when the insurer insisted that the insured make the contribution despite the fact that the demand and the settlement were within the policy limit.[241] In ruling for the insured, the Court held

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[235] *Id*. (quoting Renovation, OXFORD ENGLISH DICTIONARY (3rd ed. 2004)).

[236] *Id*. (quoting Remodeling, OXFORD ENGLISH DICTIONARY (3rd ed. 2004)).

[237] *Id*. (quoting Construction, BLACK'S LAW DICTIONARY (11th ed. 2019)).

[238] *Id*. (quoting Maintenance, BLACK'S LAW DICTIONARY (11th ed. 2019)).

[239] *Id.*

[240] Id.

[241] 621 S.W.3d 261, 271 (Tex. 2021).

that an insured can, under certain circumstances, seek to recover this type of contribution from its insurer under the theory of breach of contract.

The case arose from an automobile accident. The insured was sued wherein the underlying plaintiff sought damages of $1 million, which was twice the applicable limit of the insured's policy.[242] Two months prior to trial, the parties attended mediation, which resulted in the mediator proposing a settlement of $350,000.[243] The insurer countered with $250,000 and "suggested" or "ma[de] a demand" that the insured "contribute the additional $100,000 necessary to secure a release."[244] The underlying plaintiff rejected the insurer's $250,000 settlement offer and withdrew his own settlement offer, advising that he would now seek $2 million in damages. Before trial, the insured's personal counsel reopened settlement negotiations. The case ultimately settled for $350,000, with the insurer contributing $250,000 and the insured contributing $100,000 while retaining her rights to pursue recovery of that amount from the insurer.[245]

Although the Supreme Court of Texas held that there was no *Stowers* cause of action because the insured never faced potential liability in excess of the limit of insurance,[246] the Court did find that the insured had a viable cause of action for breach of the duty to indemnify against the insured for failing to pay the entire amount of the settlement.[247] The Court made it clear that it was not holding that the insured was entitled to recover the amount contributed towards the settlement; rather, the Court simply held that the insured had a viable cause of action for this recovery, which would need to be proven in additional litigation.[248]

B. *Millsap Waterproofing, Inc. v. U.S. Fire Ins. Co.*, No. 3:20-cv-00240, 2021 WL 6063620 (S.D. Tex. Dec. 21, 2021)

In *Millsap Waterproofing, Inc. v. United States Fire Insurance Co.*, United States Magistrate Judge Andrew M. Edison rejected arguments by an insured that an insurer breached the duty of good faith and fair dealing in handling third-party liability claim.[249] In *Millsap*, the insured was sued for its purported defective workmanship during repairs it made on certain units and buildings at a multi-family condominium complex located in Galveston, Texas.[250] The insured eventually settled the claim and then sought reimbursement for the settlement amounts it paid to resolve the underlying lawsuit.

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[242] *Id*. at 265.

[243] *Id.*

[244] *Id*.

[245] *Id.*

[246] *Id*. at 267.

[247] *Id*. at 270.

[248] *Id*. at 276.

[249] No. 3:20-cv-00240, 2021 WL 6063620 (S.D. Tex. Dec. 21, 2021).

[250] *Id*. at *1.

In analyzing whether the insurers were subject to claims for violation of the duty of good faith and fair dealing, the court was required to examine whether such claim for reimbursement of the settlement amounts constituted a first-party claim or a third-party claim.[251] Rejecting the insured's argument, the court explained that the Supreme Court of Texas has expressly held that "'[a] loss incurred in satisfaction of a settlement belongs to the third party and is not suffered directly by the insured,' and is, accordingly, not a first-party claim."[252] Because the insured's claim against the insurer was "clearly a third-party liability claim under Texas law," the court found that there is "no recognized duty of good faith and fair dealing."[253] Rather, the only recognized duty in this context is that imposed under the *Stowers* Doctrine.[254]

C. Commentary

Under Texas law, the scope of bad faith claims in the third-party liability context is extremely limited. Prior to the ruling in *In Re Farmers Tex. County Mutual Ins. Co.*, the only recognized claim was that outlined in *Stowers*. Even Texas Insurance Code claims against third-party liability insurers track the same requirements as those set forth in *Stowers*. But *In Re Farmers Tex. County Mutual Ins. Co.* provides a rather interesting angle for insureds. Specifically, the Supreme Court of Texas refused to recognize a *Stowers* claim under the facts of that case but *did* find that the insured could maintain an action against the insurer for breaching the duty to indemnify. Maybe this signals a possible thawing in how courts approach insurer actions and their conduct in handling third-party liability claims.

XI. Allocation and Time on the Risk

A. *Great Am. Lloyds Ins. Co. v. Vines-Herrin Custom Homes, L.L.C.*, 596 S.W.3d 370 (Tex. App.—Dallas 2020, pet. denied)

In *Great American Lloyds Insurance Co. v. Vines-Herrin Custom Homes, L.L.C.*, the Dallas Court of Appeals evaluated the proper method for allocation of an arbitration award between insurers.[255] The underlying arbitration was brought by a homeowner against its homebuilder, who was insured under a series of policies spanning multiple policy years. The insurers refused to provide the homebuilder with a defense. The arbitration ultimately resulted in an award of

[251] *Id*. at *2.

[252] *Id*. (quoting *Evanston Ins. Co. v. ATOFINA Petrochemicals, Inc.*, 256 S.W.3d 660, 674–75 (Tex. 2008)).

[253] *Id.*

[254] *See id*. at *3. Under Stowers, a duty to settle is triggered only where (1) the policy covers the claim, (2) the insured's liability is reasonably clear, (3) the claimant has made a proper settlement demand within policy limits, and (4) the demand's terms are such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to an excess judgment. *Id.* (citing *Pride Transp. v. Cont'l Cas. Co.*, 511 F. App'x 347, 354 (5th Cir. 2013)).

[255] *Great Am. Lloyds Ins. Co. v. Vines-Herrin Custom Homes, L.L.C.*, 596 S.W.3d 370, 375 (Tex. App.—Dallas 2020, pet. denied).

$2,487,507.77, which the insured assigned to the underlying claimant for it to pursue against the insurers.[256]

The court first found that, because the insurers had wrongfully refused to provide a defense, they were prohibited from challenging the total amount of the arbitration award.[257] The court then rejected "the notion that the Insurers may pay nothing at all if their insured does not establish a specific amount of damages attributable to each policy period."[258] While the court had previously held that the insurers "were not required to indemnify [the insured] for property damages [that] . . . occurred outside their respective policy periods,"[259] the court clarified that each insurer was required to indemnify the insured for any "property damages caused by occurrences" that occurred during the relevant policy periods.[260] Because there was evidence presented by the insured and the underlying claimant of damage that occurred in each policy period, the insurers were required to pay indemnity accordingly.[261]

Moving to the issue of allocation, the trial court applied a "time on the risk" allocation between the insurers to determine the amount of indemnification required from each insurer.[262] In doing so, the trial court allocated the total arbitration award on a pro-rata basis, based on the number of days each policy was implicated.[263] The court of appeals observed:

> In this case, the arbitrator rendered a final decision that [the underlying claimant] incurred $2,487,507.77 in actual damages from [the insured's] negligent construction of his home. At the arbitration and at the subsequent trial, [the underlying claimant and insured] established that these damages resulted from "separate occurrences, each of which caused damages in a single policy period." [citation omitted]. . . . But because the Insurers wrongfully refused to defend [the insured] or participate in the arbitration, they lost their opportunities to require that [the underlying claimant and insured] allocate an exact amount of damages to the relevant policy period or to request that the arbitrator do so. At the arbitration, [the underlying claimant's] burden was to prove and obtain damages for all of the problems at his home, regardless of the date of occurrence, and [the insured's] burden was to prove that its negligence was not the cause of any of the problems in question. Neither was required to meet the extra burden of proving exactly how much of the damage occurred on any particular day. Neither was

[256] *Id*. at 373.

[257] *Id*. at 375 (citing *Great Am. Ins. Co. v. Hamel*, 525 S.W.3d 655, 662–63 (Tex. 2017); *Evanston Ins. Co. v. ATOFINA Petrochemicals, Inc*., 256 S.W.3d 660, 670–74 (Tex. 2008)).

[258] *Id.*

[259] *Great Am. Lloyds Ins. Co. v. Vines-Herrin Custom Homes, L.L.C.*, No. 05-15-00230-CV, 2016 WL 4486656, at *7 (Tex. App.—Dallas Aug. 25, 2016, pet. denied).

[260] *Great Am. Lloyds Ins. Co. v. Vines-Herrin Custom Homes, L.L.C*., 596 S.W.3d at 375.

[261] *Id.* at 376.

[262] *Id*.

[263] *Id.*

> required to establish any sort of allocation among the absent insurers, and the arbitrator was not asked to make one. Consequently, this case presents a problem [of] how to apportion an established total amount of damages among the insurers whose policies were in effect during the time a portion of the loss was suffered by the insured.[264]

Under these circumstances, the court concluded that the trial court's allocation was proper. The underlying claimant and the insured offered evidence that damages occurred during each policy period and evidence of the total awarded by the arbitrator to compensate the underlying claimant for those damages. The trial court allocated the total loss on a pro-rata basis, allocating $872,057.32 of indemnification against one insurer for its single policy period and $1,615,450.45 of indemnification against the other insurer for its two policy periods, based on the number of days each policy was implicated.[265] The court concluded that, "'[i]n this way, each triggered insurer is responsible for a share of the total loss that is proportionate to its time on the risk.'"[266]

B. Commentary

This is an issue that insurers squabble about often at mediations. And this opinion still does not provide an overt adoption of the time-on-the-risk allocation method for determining how multiple insurers will allocate over the course of multiple policy periods. But an important takeaway from this case is that, once the insured establishes that there is damage that occurred during *an* applicable policy period, the insurers are on the hook for the damage and must then figure out how they will share.

XII. COVID-19 Decisions

Throughout 2021 and early 2022, insureds continued to face monumental challenges in recovering business income losses related to the COVID-19 pandemic. A recent case from the Fifth Circuit epitomizes these challenges.

A. *Terry Black's Barbecue, L.L.C. v. State Auto. Mut. Ins. Co.*, No. 21-50078, --- F.4th ---, 2022 WL 43170 (5th Cir. Jan. 5, 2022)

In *Terry Black's Barbecue, L.L.C. v. State Automobile Mutual Insurance Co.*,[267] the Fifth Circuit provided insurers with potent ammunition in rejecting COVID-19 claims, as the holding addresses one of the most common problems that policyholders have in establishing coverage: the existence of and ability to prove "direct physical loss of or damage to property."

The insureds, Terry Black's Barbecue, L.L.C. and Terry Black's Barbecue Dallas, L.L.C. (collectively, "TBB"), own and operate two barbecue dine-in restaurants in Austin, Texas, and

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[264] *Id*. at 377.

[265] *Id*.

[266] *Id*. (quoting *Crossmann Communities of N. Carolina, Inc. v. Harleysville Mut. Ins. Co.*, 717 S.E.2d 589, 602 (S.C. 2011)).

[267] *Terry Black's Barbecue, L.L.C. v. State Auto. Mut. Ins. Co.*, No. 21-50078, --- F.4th ---, 2022 WL 43170 (5th Cir. Jan. 5, 2022).

Dallas, Texas. The commercial property insurance policies issued by State Automobile Mutual Insurance Company ("State Auto") insure those restaurants against "all risks" and include a business income and extra expense coverage (the "BI/EE Coverage") component.[268] The BI/EE Coverage extends to "the actual loss of Business Income . . . sustain[ed] and Extra Expense . . . incur[red] due to the necessary suspension of [TBB's] operations during the period of restoration."[269] Importantly, however, to trigger coverage, the suspension of operations "must be caused by direct physical loss of or damage to property at the premises."[270] Each policy also has a "restaurant extension endorsement (the REE), which provides coverage for 'the suspension of [TBB's] operations at the described premises due to the order of a civil authority . . . resulting from the actual or alleged . . . exposure of the described premises to a contagious or infectious disease.'"[271]

As everyone is all too familiar, on March 19, 2020, the Governor of Texas issued an executive order in response to the COVID-19 pandemic, directing people to avoid eating or drinking at restaurants. The Governor encouraged restaurants to use drive-thru, pickup, and delivery options as opposed to dine-in services. In Travis County and Dallas County, civil authorities also prohibited in-person restaurant services and limited restaurants to providing take out, delivery, or drive-thru services. To comply with these orders, TBB suspended dine-in services, which allegedly caused it to suffer business income losses. TBB filed a claim with State Auto, seeking coverage for these losses under the BI/EE and REE provisions, but State Auto denied the claim, prompting TBB to file suit.[272] State Auto subsequently moved for a judgment on the pleadings pursuant to Rule 12(c), which the district court granted.[273]

On appeal, the Fifth Circuit found that the district court correctly determined TBB's losses are not covered by either the BI/EE or the REE provision.[274] The Court recognized that the Supreme Court of Texas has not yet "interpreted the policy language at issue or whether the relevant provisions cover business interruption losses due to civil authority orders suspending nonessential businesses during the COVID-19 pandemic."[275] Nevertheless, the Court looked to the interpretation of similar provisions under other circumstances for guidance.[276]

With respect to the BI/EE coverage, the Court concluded that TBB's suspension of dine-in services does not qualify as a direct physical loss of property under the BI/EE provision. Breaking down the provision word-for-word, the Court first evaluated the meaning of "physical," which it concluded requires there to be a "tangible alteration[] to property" under applicable Texas

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[268] *Id*. at *1.

[269] *Id.*

[270] *Id.*

[271] *Id.*

[272] *Id*. at *2.

[273] *Id.*

[274] *Id*. at *3.

[275] *Id*. at *2.

[276] *Id*. at *3.

law.[277] As to "loss," the Court found that, under Texas law, this "means a state of fact of being lost or destroyed, ruin or destruction."[278] The plain meaning of the term "loss," according to the Court, is also understood as "'perdition, ruin, destruction' or 'the being deprived of, or the failure to keep (a possession, appurtenance, right, quality, faculty, or the like).'"[279] Thus, in evaluating the "plain meaning" of the phrase "physical loss," the Court concluded that TBB's claim was not covered because TBB failed to allege any tangible alteration or deprivation of its property.[280] In other words, TBB could point to no physical or tangible destruction of its restaurants. The Court explained that, to the contrary, "TBB had ownership of, access to, and ability to use all physical parts of its restaurants at all times. And importantly, the prohibition on dine-in services did nothing to physically deprive TBB of any property at its restaurants."[281] In other words, "TBB's claimed loss is not about its property but about its inability to provide dine-in services. This economic loss, however, did not have any tangible effect on the property or restaurants."[282]

The Court specifically rejected TBB's arguments that the BI/EE provision does not require a tangible alteration and instead only requires that it be deprived of a "physical space" at the restaurants.[283] According to the Court:

> The phrase ["physical space"] appears nowhere in the policy and nonetheless provides no further definition of the phrase at issue here—physical loss of property. Even accepting TBB's argument, it still has not alleged that it was *deprived* of a physical space. TBB has always had access to the dining rooms in its restaurants. It was free to use that "physical space" in whatever manner it chose, except dine-in services. This limitation on the kind of services permitted to be offered at the restaurants is just not a deprivation of the physical space under any reading of the provision.[284]

The Court also rejected TBB's arguments that it lost the *use* of its dining rooms for their intended purpose amounts to a physical loss of property, noting that the unambiguous terms of the policy require a *loss of property*, not the loss of *use* of property.[285] Further, the Court rejected

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[277] *Id*. at *3–4 (citing *U.S. Metals, Inc. v. Liberty Mut. Group, Inc.*, 490 S.W.3d 20, 24–25 (Tex. 2015) (quoting BLACK'S LAW DICTIONARY 1331 (10th ed. 2014)). *See also N. Am. Shipbuilding, Inc. v. S. Marine & Aviation Underwriting, Inc.*, 930 S.W.2d 829, 833–34 (Tex. App.—Houston [1st Dist.] 1996, no writ) (interpreting "physical loss or damage" to mean there is "an initial satisfactory state that was changed by some external event into an unsatisfactory state"); *Great Am. Ins. Co. of N.Y. v. Compass Well Servs., LLC*, No. 02-19-00373, 2020 WL 7393321, at *14 (Tex. App.—Fort Worth Dec. 17, 2020, pet. filed) ("[A]n intangible or incorporeal loss that is unaccompanied by a distinct, demonstrable, physical alteration of the property is not considered a direct physical loss.").

[278] *Id*. at *4 (quoting *de Laurentis v. U.S. Servs. Auto. Ass'n*, 162 S.W.3d 714, 723 (Tex. App.—Houston [14th Dist.] 2005, pet. denied) (quoting BLACK'S LAW DICTIONARY 945 (6th ed. 1990)).

[279] *Id*. (quoting OXFORD ENG. DICTIONARY, OXFORD UNIV. PRESS (Dec. 2021)).

[280] *Id.*

[281] *Id.*

[282] *Id.*

[283] *Id*. at *5.

[284] *Id.* (emphasis in original).

[285] *Id*.

TBB's arguments that the BI/EE coverage was implicated because TBB lost the use of its restaurants for their "intended" purposes.[286] The Court reasoned:

> TBB's argument reads far more words into the provision than are actually there. A "physical loss of property" cannot mean something as broad as the "loss of use of property for its intended purpose." None of those words fall within the plain meaning of physical, loss, or property. And that phrase has an entirely different meaning from the language in the BI/EE provision. "Physical loss of property" is not synonymous with "loss of use of property for its intended purpose."[287]

The Court concluded the Supreme Court of Texas would interpret the requirement for a "direct physical loss of property" to require a tangible alteration or deprivation of property. Because the civil authority orders prohibiting dine-in services at restaurants did not *tangibly* alter TBB's restaurants, and because TBB failed to allege any other tangible alteration or deprivation of its property, the Court concluded that the policy does not provide coverage for TBB's losses.[288]

Moving to the REE coverage, the Court found that, because the civil authority orders did not "result from" TBB's exposure to COVID-19, the REE provision does not provide coverage.[289] According to the Court, the REE provision applies when the suspension of business operations is due to a civil authority order that results "from the actual or alleged exposure of the described premises to a contagious or infectious disease."[290] Because there was no actual or alleged exposure to a contagious disease at the restaurants, the REE coverage was not implicated.

In reaching this holding, the Court rejected TBB's arguments that coverage applied because it was following guidance from the Centers for Disease Control and Prevention advising individuals to social distance and take other precautions to prevent the spread of COVID-19. According to the Court, "from a common sense understanding of the onset of the pandemic, the civil authority orders were not caused, even tangentially, by TBB's alleged or actual exposure to a contagious disease."[291] Rather, the civil authority orders "resulted from" the global pandemic and the measures required to contain and prevent the spread of COVID-19.[292] Based on this, the Court concluded that the language in the orders established that the order were enacted to *avoid* exposure to COVID-19, not *because of* exposure to COVID-19.[293]

The Court also affirmed the dismissal of TBB's extra-contractual claims *and* affirmed the district court's denial of TBB's motion for leave to amend its pleading. The Court explained: "We

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[286] *Id.*

[287] *Id.*

[288] *Id.*

[289] *Id*. at *6.

[290] *Id.*

[291] *Id.*

[292] *Id.*

[293] *Id*.

perceive no set of facts in which TBB states a covered claim for its losses due to the suspension of dine-in services during the pandemic. We conclude amendment would be futile and the district court did not err in denying leave to amend."[294] Put differently, even if TBB re-plead its claim to allege the presence of COVID-19 in its restaurants, the result would not change.

B. *Graileys, Inc. v. Sentinel Ins. Co., Ltd.,* No. 3:20-cv-01181, 2021 WL 3524032 (N.D. Tex. Aug. 9, 2021)

Prior to the decision from the Fifth Circuit in *Terry Black's*, the Northern District of Texas in Dallas, in *Graileys, Inc. v. Sentinel Insurance Co., Ltd.*, granted an insurer's motion to dismiss an insured's COVID-19-realted business loss claim because of the lack of "direct physical loss."[295] The insured operated a wine club and made a claim under its policy with Sentinel Insurance Company ("Sentinel") for business losses resulting from COVID-19 after Dallas County issued an order closing all private clubs in the face of the pandemic.[296] Sentinel denied coverage, prompting the insured to file suit for breach of contract.[297] Sentinel responded by filing a motion to dismiss, asserting that the claim was not covered.

In evaluating the coverage issues, the court first rejected the insured's argument that the term "physical loss" was ambiguous. Moreover, the court explained that the meaning of "physical loss" required that there be more than an intangible or incorporeal loss; rather, the term required that there be a physical alteration of the property.[298] According to the court: "[the p]olicy requires physical loss. However, coronavirus 'does not cause physical damage to property, it causes people to get sick.'"[299] Because the insured was unable to establish that there was any nexus between any property damage and the presence of coronavirus or the Dallas County Order, the court found that the policy did not cover the loss.[300]

One unique twist presented by *Graileys* was that the policy issued by Sentinel had a "LIMITED FUNGI, BACTERIA OR VIRUS COVERAGE" (the "Virus Coverage Provision") added to its policy.[301] Contrary to its title, the Virus Coverage Provision actually modified the main coverage form, stating that the policy did *not* apply to any loss or damage caused directly or indirectly by a virus.[302] Accordingly, Sentinel based its motion to dismiss on the Virus Coverage Provision. In response, the insured argued that its losses were due to civil commotion, as opposed

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[294] *Id*. at *7.

[295] *Graileys, Inc. v. Sentinel Ins. Co., Ltd.*, No. 3:20-cv-01181, 2021 WL 3524032 (N.D. Tex. Aug. 9, 2021).

[296] *Id*. at *1.

[297] *Id.*

[298] *Id*. at *2.

[299] Id. at *3.

[300] *Id*.

[301] *Id*. at *1.

[302] *Id.*

to a virus, thereby placing the risk in the main coverage form as opposed to the Virus Coverage Provision.[303]

The insured asserted that, under the dictionary meaning of "civil" and "commotion," the civil authority orders that closed the insured's business qualified as a covered civil commotion.[304] Relying on the canon of contract interpretation *noscitur a sociis*, the court found that, because the policy listed the terms "riot or civil commotion" together, the meaning of the term "civil commotion" was required to be read in light of the meaning of "riot."[305] According to the court, the civil authority orders that caused the insured to close its business did not respond to either a riot or an analogous civil commotion; rather, the orders responded to a public health crisis. Finding that this was neither a "civil commotion" nor a civil authority order resulting from a Covered Cause of Loss, the court ruled that these provisions did not apply.[306]

C. Commentary

These cases demonstrate the difficulty insureds have in establishing coverage for COVID-19 related losses because of the requirement in most commercial property policies that there be a direct physical loss of or damage to the insured property. The Fifth Circuit's opinion in *Terry Black's* is no outlier; rather, the Fifth Circuit joins the Second, Sixth, Seventh, Eighth, Ninth, Tenth, and Eleventh Circuits, as well as a vast majority of federal district and state courts in Texas and other jurisdictions, in concluding that there is no coverage for COVID-19 related losses under the standard commercial property policy.[307] As other cases continue to work through the appellate process, insureds likely will not see any better success.

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[303] *Id*. at *3.

[304] *Id.*

[305] *Id.*

[306] *Id.*

[307] *See Santo's Italian Café LLC v. Acuity Ins. Co.*, 15 F.4th 398, 401 (6th Cir. 2021) ("Whether one sticks with the terms themselves (a 'direct physical loss of' property) or a thesaurus-rich paraphrase of them (an 'immediate' 'tangible' 'deprivation' of property), the conclusion is the same."); *Oral Surgeons, P.C. v. Cincinnati Ins. Co.*, 2 F.4th 1141, 1144 (8th Cir. 2021) ("[T]here must be some physicality to the loss or damage of property—*e.g.*, a physical alteration, physical contamination, or physical destruction."); *Mudpie, Inc. v. Travelers Cas. Ins. Co. of Am.*, 15 F.4th 885, 892 (9th Cir. 2021) (concluding "California courts would construe the phrase 'physical loss of or damage to' as requiring an insured to allege physical alteration of its property"); *Sandy Point Dental, P.C. v. Cincinnati Ins. Co.*, 20 F.4th 327 (7th Cir. 2021) (" '[D]irect physical loss' requires a physical alteration to property."); *Goodwill Indus. of Cent. Okla., Inc. v. Phila. Indem. Ins. Co.*, —— F.4th ——, ——, No. 21-6045, 2021 WL 6048858, at *3 (10th Cir. Dec. 21, 2021) ("[A] 'direct physical loss' requires an immediate and perceptible destruction or deprivation of property."); *10012 Holdings, Inc. v. Sentinel Ins. Co., Ltd.*, —— F.4th ——, ——, 2021 WL 6109961, at *4 (2d Cir. Dec. 27, 2021) (concluding "direct physical loss" does not extend to loss of use but requires physical damage). *Gilreath Fam. & Cosm. Dentistry, Inc. v. Cincinnati Ins. Co.*, No. 21-11046, 2021 WL 3870697, at *2 (11th Cir. Aug. 31, 2021).