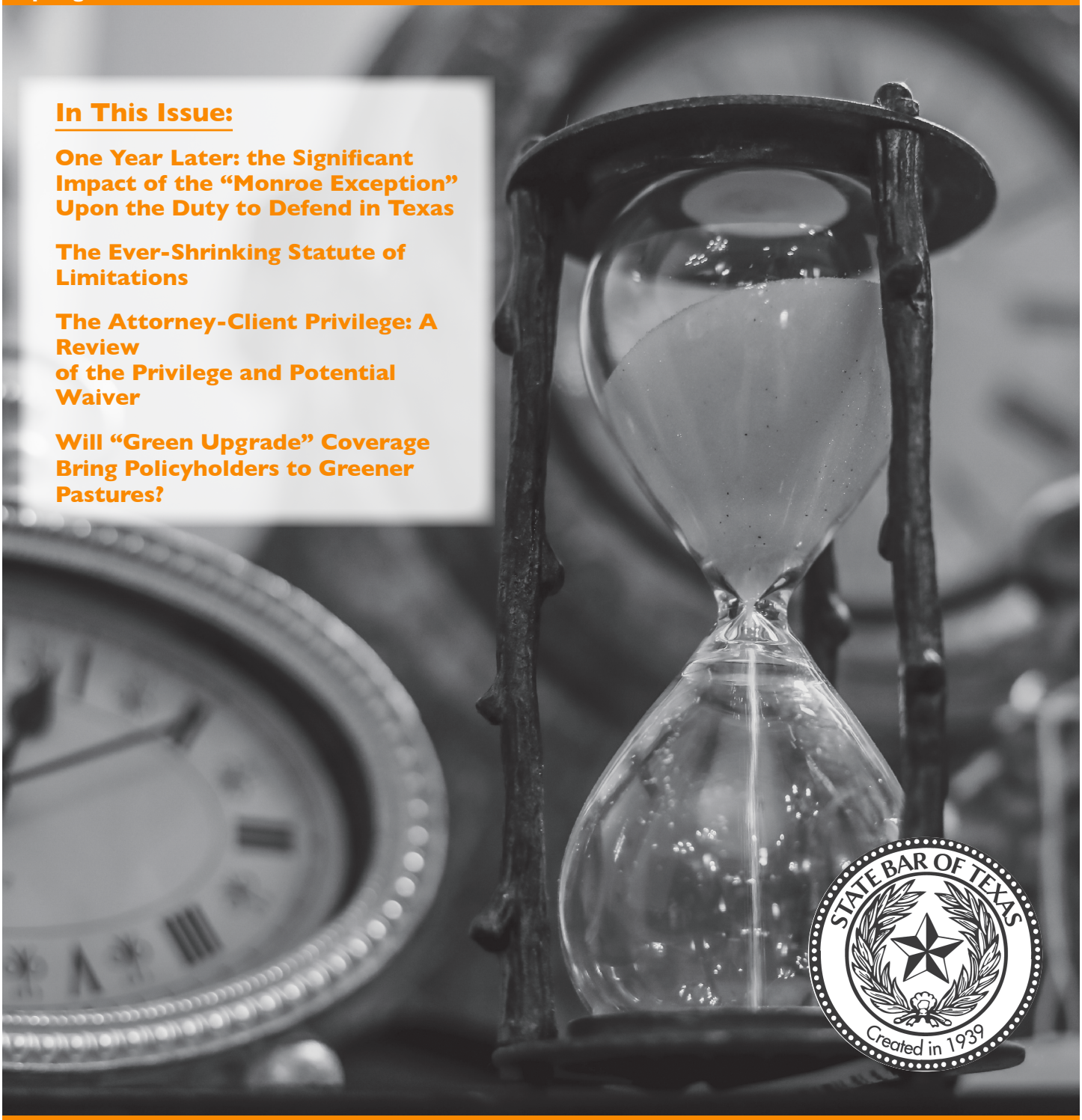
Journal of Texas Insurance Law

Spring/Summer 2023 Volume 20 Number 1



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Official publication of the Insurance Law Section of the State Bar of Texas

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Journal of Texas Insurance Law
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The Journal of Texas Insurance Law is published by the Insurance Law Section of the State Bar of Texas. The purpose of the ***Journal*** is to provide Section members with current legal articles and analysis regarding recent developments in all aspects of Texas insurance law and convey news of Section activities and other events pertaining to this area of law.

Anyone interested in submitting a manuscript for publication should contact Jason C. McLaurin, Editor In Chief, at (713) 461-6500 or by email at jmclaurin@mdlawtex.com. Manuscripts for publication must be typed and double-spaced with endnotes. Replies to articles published in the ***Journal*** are welcome.

Journal of Texas Insurance Law

SPRING/SUMMER 2023 • VOLUME 20, NUMBER 1

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Mission Statement

The Insurance Law Section serves to promote the understanding and development of Texas insurance law by providing high quality educational resources to the bench, bar, and public and by promoting collegiality among those with an interest in insurance law.

NOTICE – OPT IN FOR PAPER JOURNAL

This notice is to inform the membership that the Insurance Section of the State Bar of Texas is discontinuing widespread circulation of the paper version of the Journal of Texas Insurance Law and transitioning to an electronic version, effective immediately. This decision has been made after careful consideration and analysis of the benefits and costs associated with both formats and feedback from the membership.

However, we understand that there are a number of members of the Insurance Section that wish to continue receiving a paper copy of the Journal of Texas Insurance Law. We are thus offering those members the option to continue to receive a paper version of the Journal.

For those members that wish to continue receiving a paper copy of the Journal, please send an email to admin@insurancelawsection.org. Please put the words PAPER JOURNAL in the subject line of your email and indicate in your email that you wish to continue receiving a paper version of the Journal.

Thank you for your understanding and continued support. We look forward to delivering even more engaging and informative content to you via the Journal.

Sincerely,

Jason McLaurin

COMMENTS

FROM THE EDITOR

By Jason C. McLaurin
McLaurin Law, PLLC

This issue of the *Journal* discusses a wide range of topics to assist practitioners in connection with evolving insurance doctrines over the last year. First, Rob Witmeyer and Brian Waters provide insight into the way courts have been applying the "Monroe Exception's" in their duty-to-defend analyses since the Texas Supreme Court's holding in *Monroe*. Next, Clare Pace Rogers and Michel Le discuss potential changes relating to the statute of limitations applicable to insurance causes of action. Christina Culver and Megan Tilton then discuss issues relating to attorney-client privilege—and the potential for waiver of that privilege—in the context of insurance claims handling and litigation. Finally, John Wood brings insight into the future of coverage in a world where property owners, either voluntarily or involuntarily, are required to have additional coverage for "green" advancements and updates in connection with their insured property.

Our next edition is still currently receiving submissions, but we expect to have articles discussing uninsured motorist coverage and concurrent causation.

Thanks to the authors and to the Managing Editors, Chris Avery, Matthew Paradowski, and Darin Brooks for their invaluable assistance, as well as the work performed by all of the associate editors that contributed to the publishing of this Journal.

Jason C. McLaurin
Editor In Chief

COMMENTS

FROM THE CHAIR

By Stephen A. Melendi, Chair

By the time you receive this issue of the Journal of Texas Insurance law, I will be the Immediate Past Chair of the Insurance Law Section. Rest assured that the Section's new Officers and Council Members are already hard at work to ensure that the Insurance Law Section continues its work to fulfil its Mission of promoting collegiality and educating the bench, bar, and public about Texas insurance law.

Throughout the past year, the Council has worked tirelessly to fulfil the Section's mission. The Council has put on several webinars, hosted happy hours throughout the state, and again conducted the Texas Insurance Law Student Writing Competition, which allows students at all ten accredited Texas law schools to submit articles on insurance-related topics and compete for scholarships. This work culminated in the annual Advanced Insurance Law Course that was held at the Hyatt Hill Country Resort & Spa in San Antonio May 31 - June 2, 2023. By all accounts, the seminar was a huge success, including, of course, the Casino Night event on June 1. In addition to the Council, I would like to thank all of the speakers who make this event such a success; everyone who attended; and all the sponsors who make this event possible.

Finally, I would like to thank my fellow Officers and Council Members of the Section, both those who are currently on the Council and those who I served with over the past decade of my involvement with the Section. I look forward to watching the Section continue to grow and work to fulfil its Mission of promoting collegiality and educating the bench, bar, and public about Texas insurance law.

Sincerely,

Stephen A. Melendi
Chair of the Insurance Law Section of the State Bar of Texas

By Robert J. Witmeyer & Brian E. Waters

ONE YEAR LATER: THE SIGNIFICANT IMPACT OF THE "MONROE EXCEPTION" UPON THE DUTY TO DEFEND IN TEXAS

A little over one year ago, the Texas Supreme Court decided that extrinsic evidence may be used to determine an insurer's obligation to defend an insured when the insurance policy and pleading are insufficient to make that determination. This ruling significantly alters Texas law, as many Texas courts previously refused to consider any documents beyond the policy and petition. With the Court's new approach, Texas courts will be allowed to examine extrinsic evidence under certain rules.

This article will examine a brief history of the Texas duty to defend standard. Next, it will discuss the *Monroe*[1] and *Pharr*[2] decisions. Then, it will review how courts have applied the *Monroe* exception over the past year. And finally, this article will analyze the duty to defend standard going forward, as well as other significant issues that will likely be subject to future coverage disputes.

I. Discussion of the Duty-to-Defend Standard

The duty to defend generally requires a liability insurer "to defend its insured against claims or suits seeking damages covered by the policy."[3] The duty to defend is a creature of contract arising from a liability insurer's agreement to defend its insured from those claims or suits.[4] Over fifty years ago, the Texas Supreme Court held that the duty to defend depends not "on what the facts are or what might finally be determined to be the facts," but rather "only on what the facts are alleged to be."[5] To determine whether the duty existed, Texas courts considered only the allegations made within the petition in the underlying lawsuit and the terms of the insurance policy, "without reference to the truth or falsity of such allegations and without reference to what the parties know or believe the true facts to be, or without reference to a legal determination thereof."[6]

Under this "eight-corners" rule, the insurer has a duty to defend if the underlying petition alleges facts that fall within the scope of the insurance policy's coverage.[7] Prior to *Monroe*, Texas courts applied this rule liberally in favor of the insured by resolving "all doubts regarding the duty to defend in favor of the duty," and by recognizing the duty if the petition alleges facts that "*potentially* support a covered claim."[8] As the Fifth Circuit bluntly put it to insurers, "[w]hen in doubt, defend."[9]

II. Prior Case Law on Extrinsic Evidence

A small dent in the inflexible eight-corners rule occurred at the Texas Supreme Court two years prior to *Monroe*. In *Loya Insurance Co. v. Avalos*[10], the Court recognized a narrow exception to the eight-corners rule for the first time by allowing courts to consider evidence that the insured colluded with the plaintiff in the underlying suit to fraudulently create coverage that otherwise would not exist.[11]

The *Avalos* decision raised the prospect of the Court approving a broader exception. In *Northfield Ins. Co. v. Loving Home Care, Inc.*[12], the Fifth Circuit predicted that if the Texas Supreme Court were to recognize such an exception to the eight-corners rule, it would apply only "when it is initially impossible to discern whether coverage is potentially implicated and when the extrinsic evidence goes solely to a fundamental issue of coverage which does not overlap with the merits of or engage the truth or falsity of any facts alleged in the underlying case" ("*Northfield* exception").[13] The Court later acknowledged the *Northfield* exception without adopting or rejecting it in *GuideOne*.[14]

In the ensuing years, Texas state and federal courts have disagreed on the validity of the *Northfield* exception. Some courts rejected extrinsic evidence altogether;[15] but other courts considered extrinsic evidence under *Northfield* or similar standards.[16]

Prior to *Monroe*, the Court never directly addressed the so-called "*Northfield* exception," although the Court twice acknowledged its widespread use.[17] In *Avalos* and *Richards*, the Fifth Circuit did not certify the appropriateness of the *Northfield* exception. Most recently, in *Richards v. State Farm Lloyds*, the Court concluded its opinion with the following statement:

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Robert J. Witmeyer is a Shareholder in the Dallas office of Cooper & Scully, P.C. He focuses his practice on insurance coverage and extra-contractual litigation. Rob represents clients in a variety of insurance coverage disputes, including those involving advertising injuries, construction defects, environmental accidents, liquor liability, professional liability, property damage, trucking accidents, and uninsured motorists' claims.

> As noted above, it is often the case that the petition states a claim that could trigger the duty to defend, but the petition is silent on facts necessary to determine coverage. In such cases, some courts often allow extrinsic evidence on coverage issues that do not overlap with the merits in order to determine whether the claim is for losses covered by the policy. The Fifth Circuit did not ask for our opinion on that practice, so we express none. We also reserve comment on whether other policy language or other factual scenarios may justify the use of extrinsic evidence to determine whether an insurer must defend a lawsuit against its insured. The varied circumstances under which such arguments for the consideration of evidence may arise are beyond imagination.[18]

This changed with *Monroe*.

III. Discussion of *Monroe*

In *Monroe*, the Fifth Circuit placed the *Northfield* exception squarely before the Court. Specifically, the Fifth Circuit certified the following questions:

> 1. Is the exception to the eight-corners rule articulated in *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523 (5th Cir. 2004), permissible under Texas law?
>
> 2. When applying such an exception, may a court consider extrinsic evidence of the date of an occurrence when (1) it is initially impossible to discern whether a duty to defend potentially exists from the eight corners of the policy and pleadings alone; and (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?[19]

Thus, with *Monroe*, the Fifth Circuit directly asked the Court for its opinion on the practice of using extrinsic evidence, and the Court provided an answer despite ultimately concluding that the new extrinsic evidence exception did not apply.

A. Procedural Background

The *Monroe* coverage litigation arose out of the insured drilling company allegedly causing damage to an aquifer. Specifically, the property owner hired the insured drilling company ("5D") to drill a 3600-foot-deep commercial irrigation well through the Edwards Aquifer. The property owner sued 5D for breach of contract and negligence after 5D allegedly drilled with an unacceptable deviation, stuck the drill bit in the borehole, abandoned the well, and failed to case the well—allowing detritus to fall down the bore and fill up the well.[20]

The property owner contracted with 5D "in the summer of 2014."[21] The underlying pleading was silent on the date that the property damage occurred. However, the two carriers in the coverage suit stipulated that the drill bit became stuck "in November 2014."[22] The carrier for the 2015–16 policy period ("Monroe") refused to defend because the alleged property damage occurred outside its policy period. The carrier for the 2014–2015 policy period ("BITCO") defended under a reservation of rights.[23]

BITCO sued Monroe in the Western District of Texas, seeking a declaration that Monroe owed a duty to defend 5D. BITCO argued that even though it stipulated to the date that the drill bit became stuck, such extrinsic evidence could not be considered under Texas's eight-corners rule. The federal court agreed, holding that (1) the allegations in the underlying petition potentially triggered coverage; (2) the stipulation did not conclusively defeat coverage under the Monroe policy; (3) the stipulation could not be considered in any event because it overlapped with the merits of the underlying lawsuit; and (4) even if the stipulation could be considered to establish the first date of property damage, it did not conclusively establish that 5D *knew* that the property damage occurred before Monroe's policy period.[24]

Monroe appealed. The Fifth Circuit concluded that the question whether the court could consider extrinsic evidence—"the stipulated date the drill bit became stuck"—was "[k]ey to deciding this case."[25] The Fifth Circuit then certified its two questions to the Texas Supreme Court.

B. Factual Background

The Texas Supreme Court started its opinion by discussing the lack of specific dates in the underlying petition. The property owner's petition did not detail when 5D's negligent acts allegedly occurred or even when 5D began or stopped the work.[26] But the petition did allege that the insured was negligent in various respects: (1) the insured drilled the well in a way that "deviates in an unacceptable fashion from vertical"; (2) the insured "'stuck' the drilling bit in the bore hole, rendering the well practically useless for its intended/contracted for purpose"; (3) the insured "failed and refused to plug the well, retrieve the drill bit, and drill a new well"; and (4) the insured "failed to case the well through the Del Rio clay, allowing detritus to slough off the clay, falling down the bore and filling up the well."[27]

Similarly, the pleading alleged that the property owner's land

was damaged in different ways but was silent as to when any of the alleged damage occurred.[28] More specifically, the petition alleged that 5D "damaged [the property owner]'s property by lodging a drill bit and part of a bottom hole assembly in the aquifer under [his] property, damaging the aquifer and damaging the free flow of water in the aquifer."[29] And while the petition made clear that the insured's failure to case the well allowed detritus to fall down it, the petition did not say when this occurred or when 5D or Jones learned about it.[30]

The Court laid out the basis for Monroe's coverage position. The Monroe policy limited the scope of the duty to defend to cover property damage only if it "occurs during the policy period."[31] The Monroe policy also provided that Monroe will have no duty to defend 5D against any suit "to which this insurance does not apply." Further, coverage applies only if, "[p]rior to the policy period, no insured . . . knew that the . . . 'property damage' had occurred, in whole or in part."[32] Moreover, if the insured "knew, prior to the policy period, that the . . . 'property damage' occurred, then any continuation, change or resumption of such . . . 'property damage' during or after the policy period will be deemed to have been known prior to the policy period."[33]

Based upon the policy language, Monroe argued it had no duty to defend because the stipulation of the drill bit becoming stuck in November 2014 proved that property damage occurred during BITCO's policy period.[34] As a result, Monroe asserted that its policy deemed all property damage to have been known during BITCO's policy period, which was before Monroe's policy became effective in October 2015.[35]

C. The New *Monroe* Exception

Next, the Court articulated its newly minted "Monroe exception" for extrinsic evidence. In cases where *Avalos* does not apply (*i.e.*, no evidence of fraud), the Court instructed that the eight-corners rule would be the initial inquiry to determine whether a duty to defend exists.[36] The Court explained that the eight-corners rule would resolve coverage determinations in most cases.[37] However:

> [I]f the underlying petition states a claim that could trigger the duty to defend, and the application of the eight-corners rule, due to a gap in the plaintiff's pleading, is not determinative of whether coverage exists, Texas law permits consideration of extrinsic evidence provided the evidence (1) goes solely to an issue of coverage and does not overlap with the merits of liability, (2) does not contradict facts alleged in the pleading, and (3) conclusively establishes the coverage fact to be proved.[38]

The Court then explained how this new exception is different from the *Northfield* exception. First, *Northfield* applies only if it is initially impossible to discern from the pleadings and policy "whether coverage is *potentially* implicated."[39] The Court rejected this limitation because it was concerned that this could invite courts to improperly "read facts into the pleadings" or "imagine factual scenarios which might trigger coverage."[40] Instead, the Court adopted the following inquiry: does the pleading contain the facts necessary to resolve the question of whether the claim is covered?[41]

The second difference from the new exception when compared to the *Northfield* exception relates to the types of extrinsic evidence that may be considered. *Northfield* required that the extrinsic evidence go to a "fundamental" coverage issue, such as: (1) whether the person sued has been excluded by name or description from any coverage, (2) whether the property in suit is included in or has been expressly excluded from any coverage, and (3) whether the policy exists.[42] But the Court determined that "the rationale for considering extrinsic evidence is sound regardless of whether the coverage issue in dispute meets *Northfield*'s 'fundamental' qualifier."[43] As a result, the Court determined that the better approach is to eliminate the "fundamental" requirement altogether.[44]

Third, the Court determined that, unlike *Northfield*, Texas law requires that the proffered extrinsic evidence must conclusively establish the coverage fact at issue.[45] The coverage fact need not be the subject of a stipulation, as other forms of proof may suffice.[46] However, "extrinsic evidence may not be considered if there would remain a genuine issue of material fact as to the coverage fact to be proved."[47]

Before moving on to the second certified question, the Court articulated policy reasons for adopting its new rule. The Court stated:

> [C]onsideration of extrinsic evidence under these standards advances our dual goals of effectuating the parties' agreement as written, while protecting the insured's interests in defending against the third party's claims. A contrary rule that ignores conclusively proven facts showing the absence of coverage would create a windfall for the insured, requiring coverage for which the insured neither bargained nor paid. Such a windfall would come at the expense of all consumers of insurance, who ultimately shoulder the expense of the insurer's increased defense costs through higher premiums.[48]

D. The Second Certified Question – Finding the Newly Minted Exception Does Not Apply

The Court next tackled the second certified question. The second certified question asked whether a Texas court may consider extrinsic evidence of the date of an occurrence.[49] The Court stated that "[b]ecause we do not categorically limit the types of potentially coverage-determinative facts that may be proven by extrinsic evidence, evidence of the date of an occurrence may be considered if it meets the other requirements described above."[50]

The Court held that the stipulation involving the date of the occurrence agreed to by BITCO and Monroe (but not the insured) did not pass the new exception because the extrinsic evidence overlapped with the merits and did not go solely to the issue of coverage.[51] The Court explained its basis for rejecting Monroe's argument that the stipulation relieved Monroe of a duty to defend because the stipulation established that property damage occurred in November 2014:

> Yet in the underlying case, the insured likely would have sought to prove the sticking of the drill bit was not the cause of any damage. And to obtain coverage in the face of Monroe's refusal, the insured would necessarily argue that some of plaintiff's alleged damages (e.g., the sloughing of material into the well) occurred after November 2014. This would undermine its liability defense, which is best served by asserting there was no damage either in November or anytime thereafter.[52]

The Court concluded that "[b]ecause the use of the stipulation in the manner urged by Monroe would overlap with the merits of liability in these ways, it cannot be considered in determining whether Monroe owes a duty to defend."[53]

IV. Making Sense Out of *Monroe*

The Court's unanimous opinion fundamentally alters over fifty years of insurance coverage law by adopting an extrinsic evidence exception that applies far beyond cases of collusion. The Court likely wanted to provide some clarity and guidance on the use of extrinsic evidence after repeatedly being able to avoid deciding the issue. However, coverage attorneys are now testing the boundaries of the new exception and particularly the meaning of the Court's analysis as to the second certified question.

While the Court stated that extrinsic evidence could be used to establish the date of an occurrence, the Court ultimately rejected Monroe's attempted use of extrinsic evidence. With the stipulation, Monroe appeared to try to establish: (1) the date of the occurrence (sticking of the drill bit) was when property damage also occurred; (2) the insured's knowledge of the existence of property damage prior to the Monroe policy period; (3) the insuring agreement known loss language deemed that all of the property damage occurred prior to the inception of the Monroe policy period; and (4) the Monroe policy did not provide coverage due to the property damage occurring during the BITCO policy period and not during the Monroe policy.

Arguably, the Court could have determined that the known loss language was not triggered. Indeed the Court stated that the petition alleged that the claimant's property suffered damage "in different ways." If the petition alleged the claimant's property suffered different types of "property damage," the known loss provisions may not apply as the newest "property damage" would not be the "continuation, change or resumption of *such* [*i.e.*, prior] 'property damage.'"[54]

Instead, the Court took a different approach. The Court determined that the drill bit becoming stuck was the occurrence, *i.e.*, the insured's alleged defective work. And the date of the occurrence could not be used against the insured to establish that property damage occurred on the same date and that the known loss language applied. These two sentences from the Court's opinion will likely be the subject of future coverage disputes:

> In cases of continuing damage like the kind alleged here, evidence of the date of property damage overlaps with the merits. A dispute as to *when* property damage occurs also implicates *whether* property damage occurred on that date, forcing the insured to confess damages at a particular date to invoke coverage, when its position may very well be that no damage was sustained at all.[55]

Fortunately, the Court provided context for these two sentences. The Court rejected Monroe's attempt to use the insurers' stipulation against the insured to escape the duty to defend. The Court observed that the insured would seek to prove in the underlying case that the drill bit getting stuck caused no property damage. But to obtain coverage from Monroe, the insured would have to argue that the plaintiff suffered damage and some of the damage occurred after the inception of the Monroe policy period. According to the Court, "[t]his would undermine [the insured's] liability defense, which is best served by asserting there was no damage either in November [2014] or anytime thereafter."[56]

It is important to note that the stipulation was between two carriers. The insured—who would obviously be impacted by any ruling on coverage—was not part of the stipulation.

Further, the stipulation involved the date of alleged faulty workmanship. As a result, the existence of faulty workmanship and the date of such faulty workmanship were conclusive facts. But the existence of property damage caused by the faulty workmanship, much less the date of property damage, was not a conclusive fact. While the claimant alleged property damage, it was not established that any property damage actually occurred. Thus, to eliminate coverage, the insurer tried to use conclusive evidence regarding the date of faulty workmanship to establish that the faulty workmanship caused property damage at a certain time point to eliminate coverage. The Court did not permit the usage, as it would intrude on the merits of the case and damage the insured's liability defense by forcing it "to confess damages" (*i.e.*, acknowledge property damage caused by its faulty workmanship) to trigger coverage under the Monroe policy. Ultimately, the Court's rejection of an insurer trying to use a stipulation against its insured in this manner is not surprising.[57]

V. The Second Extrinsic Evidence Opinion - *Pharr*

On the same day that it issued the *Monroe* decision, the Court issued another opinion involving the use of extrinsic evidence to determine an insurer's duty to defend. The Court determined once again that the *Monroe* exception did not apply, but for a different reason: the duty to defend could be determined based upon the eight corners of the petition and policy.

The Pharr-San Juan-Alamo Independent School District ("School District") obtained automobile liability insurance from the Texas Political Subdivisions Property/Casualty Joint Self Insurance Fund ("Insurance Fund").[58] The insurance policy required the Insurance Fund to indemnify the School District by paying "all sums" the School District "legally must pay as damages because of bodily injury or property damage to which this self-insurance applies," if those damages are "caused by an accident and result[ ] from the ownership, maintenance or use of a covered auto."[59] The policy defined "auto" as "a land motor vehicle . . . designed for travel on public roads but does not include mobile equipment."[60] And, the policy defined "mobile equipment" to mean certain types of "land vehicles," including "[b]ulldozers, farm machinery, forklifts and other vehicles designed for use principally off public roads."[61]

The coverage dispute arose when Lorena Flores, acting as next friend of her minor daughter Alexis, sued the School District and its employee, Cristoval DeLaGarza, Jr. ("DeLaGarza").[62] Flores alleged in her petition that Alexis "was severely injured after being thrown from a golf cart."[63] More specifically, Flores alleged that DeLaGarza, while acting within the course and scope of his employment with the School District, "recklessly and negligently operated" the "golf cart" when "he suddenly, and without warning, turned the golf cart abruptly, thereby throwing Alexis Flores ("Flores") from the vehicle."[64] The underlying petition did not provide any additional details about the accident or the golf cart.[65]

The School District requested that the Insurance Fund defend it against Flores's claims and indemnify it against any resulting liability.[66] The Insurance Fund refused, asserting that the policy did not provide coverage because a golf cart did not qualify as an "auto" under the policy as it was not designed for travel on public roads; instead, it qualified as "mobile equipment," which was not covered under the policy.[67] The Insurance Fund ultimately filed a declaratory judgment lawsuit seeking a ruling that it had no duty to defend the School District.[68]

Relying upon the exception set forth in *Monroe*, the Court determined that it need not resort to extrinsic evidence because the Insurance Fund's duty to defend could be determined by the eight corners of the petition and insurance policy.[69] Applying the eight-corners rule, the Court concluded that the Insurance Fund had no duty to defend the School District against the plaintiff's claims because the petition alleged that the minor was "thrown from a golf cart" and did not include an allegation that the minor was thrown from a "vehicle designed for travel on public roads," *i.e.*, an "auto."[70] As a result, there was not a "gap" as to coverage in the underlying lawsuit.[71] Therefore, the duty to defend analysis started and ended with the eight-corners rule.[72]

VI. Cases considering the *Monroe* Exception

As of the date of this article, neither the Texas Supreme Court nor any state intermediate appellate courts have considered the *Monroe* exception since the Texas Supreme Court issued the *Monroe* and *Pharr* opinions in February of last year. However, each of the four federal district courts in Texas have meaningfully analyzed the exception on at least one occasion. Five of those nine cases are from the Southern District, and two are from the Northern District. The Western and Eastern Districts have each analyzed the *Monroe* exception once.[73]

A. Cases declining to apply the *Monroe* Exception

In five of the nine cases that have grappled with the *Monroe* exception, the courts determined that it did not apply because the proffered extrinsic evidence did not meet the requirements set forth in *Monroe*.

The Southern District reached that conclusion in *Everest National Insurance Co. v. Megasand Enterprises, Inc.*[74] There, Megasand sought a defense for three lawsuits alleging that Megasand negligently discharged materials into certain waterways, reducing the capacity of those waterways and contributing to flooding.[75] The initial complaints alleged that "runoff dust, sand, construction materials, and other

products produced and/or used by Defendants" caused the alleged damages.[76] However, the amended live pleadings referred only to "materials and substances produced and/or used and/or maintained by some Defendants."[77] On summary judgment, Everest argued that it owed no duty to defend Megasand due to the policy's Pollution Exclusion.[78] Everest sought to introduce the initial pleadings as evidence, presumably believing that their description of the discharged materials more clearly implicated the exclusion.[79] Applying *Monroe*, the magistrate refused the extrinsic evidence because it was clear from the live amended pleadings what the underlying plaintiffs alleged entered the waterways, *i.e.*, there was no factual gap in the pleadings to fill.[80]

In *Allstate Fire & Casualty Insurance Co. v. Hurtado*, the auto policy covered the vehicle at issue only if the vehicle's primary usage was not to carry property for a fee.[81] The underlying pleadings sufficiently alleged that the insured was carrying property for a fee at the time of the accident but not that carrying property for a fee was the vehicle's primary usage.[82] Relying on *Monroe*, the insurer sought to introduce deposition testimony of the insured driver establishing that he used the van to carry property for a fee on a daily basis on 250 out of 365 days of the year and that the van did not have seating for passengers.[83] The Southern District magistrate judge held that this evidence met the first and second *Monroe* factors—that it did not overlap with the merits of liability and that it did not contradict the underlying pleadings—but the court nevertheless refused the evidence because it failed the third factor.[84] The court explained, "[t]he extrinsic evidence is consistent with Hurtado using the Van primarily to carry items for a fee. But the evidence fails to *conclusively* establish that Hurtado had no other more important or main use for the Van."[85]

In *Knife River Corp. South. v. Zurich American Insurance Co.*, Knife River sought defense and indemnity as an additional insured under the insurance policy of its subcontractor, AWP.[86] The underlying lawsuit stemmed from a single-car accident that occurred on a stretch of road where AWP and another contractor were performing construction as subcontractors of Knife River.[87] The underlying plaintiffs alleged that Knife River and the subcontractors collectively "were negligent with respect to [the] road work ... [leading] to the accident causing [the driver's] personal injuries," including that the defendants failed to place proper warning signage during the construction work.[88] In turn, AWP's insurer filed a motion to dismiss the coverage lawsuit arguing that the anti-indemnity act prohibited KRC's additional-insured claim because KRC sought defense and indemnity for its own negligence.[89] In response, Knife River offered its contract with AWP to show that AWP assumed all responsibility for signage related to the construction.[90] The Northern District ruled that the contract did not meet the requirements of the *Monroe* exception "because the provisions [of the contract] overlap with liability determinations."[91]

In *Certain Underwriters at Lloyd's, London v. Keystone Development, LLC*, Underwriters filed a lawsuit in the Northern District seeking a declaration that it had no duty to defend Keystone in a lawsuit brought by a condominium owners association alleging defects and resulting property damage related to the condominiums that Keystone built.[92] Underwriters relied on two exclusions – one barring coverage for projects exceeding twenty-five units and one barring coverage for projects exceeding three stories or thirty-six feet.[93] Interestingly, the court moved for summary judgment against Underwriters *sua sponte*, presumably based on its view that the pleadings stated claims potentially within coverage and did not trigger the asserted exclusions.[94] In response, Underwriters offered the master deed for the project to establish that it included thirty-nine units and offered other evidence to show that the condominiums exceeded thirty-six feet in height.[95]

Analyzing the Texas Supreme Court's holdings in *Monroe*, and particularly *Pharr*, the court rejected the evidence, finding that the pleadings contained no informational gaps regarding either exclusion.[96] The court found no gap as to whether the project exceeded twenty-five units because the pleadings clearly alleged that the condominiums consisted of two *separate* projects—one twenty-four unit project and one fifteen unit project.[97] The court's decision regarding the height exclusion was more interesting because, while the pleadings alleged that the buildings were three stories, they were silent as to the height in feet.[98] The height exclusion excluded coverage for buildings exceeding three stories or thirty-six feet, in the disjunctive—meaning the existence of either condition barred coverage.[99] The court held that there was no informational gap because the pleadings addressed at least part of the exclusion by alleging the number of stories.

In *Allied Property & Casualty Insurance Co. v. Armadillo Distribution Enterprises, Inc.*, the United States District Court for the Eastern District of Texas analyzed whether it could consider pre-suit correspondence between the insured and the plaintiff in the underlying action to determine the insurer's duty to defend an intellectual property infringement lawsuit.[100] Notably, the underlying lawsuit was filed five days before the insurer issued the applicable policy.[101] The insurer offered the pre-suit correspondence to prove its defenses that the loss did not occur during the policy period and that the Known Loss Doctrine and the policy's Knowing Violation of Rights of Another exclusion precluded coverage.[102] The insurer did not argue the *Monroe* exception to the Eight Corners Rule, but the court analyzed the exception *sua sponte*.[103] The court determined that the extrinsic evidence did not meet the exception because the live pleadings, along with the incorporated exhibits, stated a potentially covered claim.[104] As the court put it, "there is no 'gap' in Gibson's complaint that necessitates the use of extrinsic evidence to determine coverage," even though the proffered evidence presumably disproved or at least contradicted the coverage facts stated in the pleadings.[105]

In summary, one court has declined to consider extrinsic evidence because it overlapped with the merits of the underlying litigation (the contractor agreement in *Knife River* allocating responsibility for posting warning signs in the construction zone), and another court rejected proffered extrinsic evidence because it did not conclusively establish the coverage fact at issue (testimony from the insured driver offered to establish that the vehicle was primarily used to carry property for a fee). The remaining three courts declined to apply the *Monroe* exception after determining that there was no informational gap in the coverage facts stated in the underlying pleadings.

B. Cases applying the *Monroe* Exception to Allow Extrinsic Evidence

On the other hand, Texas federal courts have now applied the *Monroe* exception on four occasions to consider extrinsic evidence when determining the insurer's duty to defend. Three of those cases come from the Southern District and one from the Western District.

In *Drawbridge Energy US Ventures, LLC v. Federal Insurance Co.*, Drawbridge sought defense under a claims-made Directors and Officers policy issued by Federal.[106] In the underlying lawsuit, Molopo Energy Limited sought to void a transaction with Drawbridge because the transaction lacked required approval by Molopo's shareholders.[107] Federal denied coverage.[108] It argued that, under the policy's "Related Claim" provision, the lawsuit related back to a demand letter that Drawbridge received prior to the inception of the policy.[109] The Southern District court determined that the letter satisfied the *Monroe* requirements for extrinsic evidence.[110] The court found a gap in the underlying pleadings because "[t]he underlying pleadings are silent as to whether a related claim was made prior to the inception of the policy period."[111] The court also found that the letter went solely to an issue of coverage and did not overlap with the merits of liability, it did not contradict facts alleged in the pleadings; and it conclusively established the coverage fact at issue—namely, that the claim was first made prior to the policy period.[112]

In *Progressive Commercial Cas. Ins. Co. v. Xpress Transp. Logistics, LLC*, the Southern District admitted extrinsic evidence to show that the truck involved in an accident was not the covered auto identified in the declarations and therefore was not covered by the policy.[113] Relying on *Monroe*, the court noted that identification of the truck did not contradict the underlying pleadings and conclusively determined Progressive's defense and indemnity obligations.[114]

In *National Liability & Fire Insurance v. Turimex, LLC*, the business auto-insurer denied defense and indemnity to Turimex, a tour bus operator, for a lawsuit brought by a Turimex passenger for injuries sustained when a Turimex bus crashed on its way from Houston to Cuernavaca, Mexico.[115] The underlying pleadings were silent as to where the accident occurred.[116] The insurer offered the claim notice, an email from the underlying plaintiff's counsel and a Mexican news report to show that the accident occurred in Mexico, which was not within the coverage territory of the policy.[117] The Southern District magistrate judge allowed the evidence because the issue of where the accident occurred went solely to coverage and not the merits; the evidence did not contradict the pleadings because the pleadings did not state the location of the accident; and the evidence was conclusive of whether the accident occurred within the policy's coverage territory.[118]

In *Xavier Benites v. Western World Insurance Co.*, the balcony of Benites's Port Aransas condominium collapsed and caused injuries to several renters.[119] The renters sued Benites and the condominium owners association, and Benites sought defense from Western World Insurance under a policy issued to the condominium owners association.[120] Western denied coverage, and Benites sued it.[121] Coverage under the Western policy extended to each individual owner, "but only with respect to liability arising out of the ownership, maintenance or repair of that portion of the premises which is not reserved for that unit owner's exclusive use or occupancy."[122] On summary judgment, the Western District magistrate judge applied *Monroe* to allow the use of condominium bylaws and declarations to show that the balcony was reserved for Benites's exclusive use and, therefore, fell outside the policy's coverage.[123]

In each of the four cases where the courts applied *Monroe* to admit extrinsic evidence, the courts used the extrinsic evidence to find that insurer did not owe a defense. Importantly, before *Monroe*, the gaps in the pleadings in those cases would have been filled, not with extrinsic evidence, but with a presumption in favor of the insured and the duty to defend.

VII. Four Takeaways regarding the *Monroe* Exception

A. The duty to defend standard in Texas is now less friendly to insureds.

The eight-corners rule generally helps insureds because insurers are at the mercy of the allegations of the lawsuit. Moreover, Texas courts liberally construe factual allegations in favor of the insured. Now, insurers may use extrinsic evidence, assuming the three elements of the *Monroe* exception are satisfied. More importantly, a petition that alleges a claim that could trigger coverage does not automatically trigger a duty to defend anymore. A petition alleging a claim that *could* trigger the duty to defend is merely the first step now in the duty-to-defend analysis. If there is such a claim, but there is a gap in coverage contained within the petition, a party may use extrinsic evidence, assuming the three *Monroe* elements are satisfied.[124]

B. How high is the conclusive extrinsic evidence standard?

Many disputes will likely involve the third *Monroe* element. The Court stated that that the proffered extrinsic evidence "must conclusively establish the coverage fact at issue." The Court further stated that forms of proof other than a stipulation may suffice. However, the "extrinsic evidence may not be considered if there would remain a genuine issue of material fact as to the coverage fact to be proved."[125]

The Court appears to require the party offering extrinsic evidence to satisfy the summary judgment standard. [126] Presumably, if the party offering extrinsic evidence carries its burden, then the burden shifts to the non-movant to present to the court any issue that would preclude the use of extrinsic evidence.[127] However, where reasonable minds could not draw differing inferences or conclusions from undisputed coverage facts, there should be no genuine issue of material fact.[128]

Again, the Court did not reject the Monroe stipulation due to this element. Instead, the Court concluded that the evidence overlapped on the merits and was flawed for reasons discussed above.

C. Will insurers take the Court up on the opportunity to create different rules?

In *Richards* and *Monroe*, the Court made clear that an insurer's defense obligation is a "creature of contract," which means it can be modified. In fact, the Court expressly stated in *Monroe* that an insurer could modify its defense obligations by contract if an insurer is unhappy with the new exception.[129] It remains to be seen whether insurers will take this opportunity to amend their policies by adding new provisions, such as the use of the "true facts" to determine the duty to defend, even if the facts overlap with the merits of the underlying case.

Under current law, the extrinsic evidence cannot overlap with the merits of the underlying lawsuit, unless it meets the narrow *Avalos* collusion exception. While insureds would presumably argue that extrinsic evidence that overlaps with the merits in future cases is not allowed, insurers could preempt this argument by modifying their defense obligations by contract. However, because *Pine Oak* instructs that extrinsic evidence is not limited to insurers,[130] insurers may be reticent to rewrite policies to give insureds the ability to bring forward extrinsic evidence in favor of coverage.

D. Using extrinsic evidence for when the property damage occurred will be hotly contested.

The prospect of using extrinsic evidence to establish when the property damage occurred when the pleadings are silent is a potential game-changer. For example, if an automobile runs over a pedestrian, can the insurer use the incident date from the police report to establish when the bodily injury happened if the petition does not allege an incident date? Presumably, the answer could be "yes" under *Monroe*.

Can evidence of the date of when property damage happened ever be used? Even conclusive evidence of when property damage that first occurred may not be considered if the merits of liability involve this issue. For example, suppose the petition in *VRV Development L.P. v. Mid-Continent Casualty Co.*[131] did not allege when the retaining wall collapsed. An insurer that issued a policy after the collapse would likely attempt to use extrinsic evidence to show that the collapse occurred prior to time the insurer got on the risk.

Property damage claims involving continuing injury could present various problems. What if there is conclusive evidence that the insured did not start the work until after the insurer's policy expired? Or, what if the insurer issued a broad *Montrose* exclusion[132] referencing when work completed prior to the time the insurer issued its first policy, and it is undisputed that the insured completed its work prior to that time? Some will no doubt contend that extrinsic evidence can never be used to establish the date of property damage in continuing injury cases by referencing broad language contained within *Monroe*.

These examples are just the tip of the iceberg. There are countless scenarios that will trigger coverage disputes over the propriety of the use of extrinsic evidence to establish when property damage may have occurred.

VII. Conclusion

The duty to defend standard is arguably less favorable to insureds as parties are permitted to use extrinsic evidence when there is doubt and a gap in coverage, assuming the evidence: (1) goes solely to an issue of coverage and does not overlap with the merits of liability, (2) does not contradict facts alleged in the pleading, and (3) conclusively establishes the coverage fact to be proved. Continued coverage litigation will likely focus on elements (1) and (3) as litigants will dispute whether the proffered extrinsic evidence overlaps with the merits or conclusively establishes a coverage fact. It remains to be seen if insurers will accept the Court's invitation to restrict their defense obligations further by modifying insurance contracts in a manner that permits even more extrinsic evidence. Although many questions remain, one thing is clear—Texas is not a strict eight-corners state.

1 *Monroe Guar. Ins. Co. v. BITCO Gen. Ins. Corp.*, 640 S.W.3d 195, 197 (Tex. 2022).

2 *Pharr-San Juan-Alamo Indep. Sch. Dist. v. Texas Pol. Subdivi-*

sions Prop./Cas. Joint Self Ins. Fund, 642 S.W.3d 466 (Tex. 2022).

3 *Loya Ins. Co. v. Avalos*, 610 S.W.3d 878, 880–81 (Tex. 2020).

4 *Richards v. State Farm Lloyds*, 597 S.W.3d 492, 498 (Tex. 2020).

5 *Heyden Newport Chem. Corp. v. S. Gen. Ins. Co.*, 387 S.W.2d 22, 25 (Tex. 1965).

6 *Id.* at 24.

7 *King v. Dallas Fire Ins. Co.*, 85 S.W.3d 185, 187 (Tex. 2002).

8 *id; See GuideOne Elite Ins. Co. v. Fielder Road Baptist Church*, 197 S.W.3d 305, 310 (Tex. 2006) (emphasis in original).

9 *Gore Design Completions, Ltd. v. Hartford Fire Ins. Co.*, 538 F.3d 365, 369 (5th Cir. 2008).

10 610 S.W.3d 878, 879 (Tex. 2020).

11 *Id* at 881–82.

12 363 F.3d 523 (5th Cir. 2004).

13 *Id*. at 531.

14 197 S.W.3d at 308.

15 *See, e.g., AIX Specialty Ins. Co. v. Shiwach*, No. 05-18-01050-CV, 2019 WL 6888515, at *7 (Tex. App.—Dallas Dec. 18, 2019, pet. denied).

16 *See, e.g., Nabors Drilling Techs. USA Inc. v. Deepwell Energy Servs. LLC*, 2021 WL 4924758 at *15–16 (S.D. Tex. Oct. 21, 2021);*Weingarten Realty Mgmt. Co. v. Liberty Mut. Fire Ins. Co.*, 343 S.W.3d 859, 865 (Tex. App.—Houston [14th Dist.] 2011, pet. denied).

17 *Zurich Am. Ins. Co. v. Nokia, Inc.*, 268 S.W.3d 487, 497 (Tex. 2008); *GuideOne*, 197 S.W.3d at 308–09.

18 *Richards*, 597 S.W.3d at 500 (citations omitted).

19 *Bitco Gen. Ins. Corp. v. Monroe Guar. Ins. Co.*, 846 F. App'x 248, 252 (5th Cir. 2021).

20 *Bitco Gen. Ins. Corp. v. Monroe Guar. Ins. Co.*, No. SA18CV00325FBESC, 2019 WL 3459248, at *4 (W.D. Tex. July 31, 2019), *report and recommendation adopted* No. SA-18-CA-325-FB, 2019 WL 11838850 (W.D. Tex. Sept. 27, 2019).

21 *Id.* at *5.

22 *Id.* at *6.

23 *Id.* at *2.

24 *Id.* at *5–*7.

25 846 F. App'x 248, 248 (5th Cir. 2021).

26 *Monroe*, 640 S.W.3d at 197.

27 *Id*.

28 *Id*.

29 *Id*.

30 *Id*.

31 *Id*. at 197–98.

32 *Id.* at 198.

33 *Id.*

34 *Id.*

35 *Id.*

36 *Id.* at 201.

37 *Id.*

38 *Id.* at 201-02.

39 363 F.3d at 531 (emphasis added).

40 *Monroe*, 640 S.W.3d at 202 (quoting *Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. Merchs. Fast Motor Lines, Inc.*, 939 S.W.2d 139, 142 (Tex. 1997)).

41 *Id.* at 202.

42 363 F.3d at 530 (citing *Westport*, 267 F. Supp. 2d at 621).

43 *Monroe*, 640 S.W.3d at 203–04.

44 *Id.* at 203.

45 *Id.*

46 *Id.*

47 *Id.*

48 *Id.*

49*Id.* Notably, the Court focused on the word "occurrence" instead of the term "property damage."

50 *Id.* at 204.

51 *Id.*

52 *Id.*

53 *Id.* The district court engaged in a slightly different analysis, noting that although the extrinsic evidence demonstrated that the drill bit became stuck in the borehole prior to the policy period, "it [did] not show that 5D *knew* that the drill bit became stuck in the borehole prior to the policy period." *Bitco,* No. SA18CV00325FBESC, 2019 WL 3459248, at *7. Further, the court found that the stipulation could not be considered because it overlapped with the merits of the underlying lawsuit. The court observed that "[f]or example, the alleged failure to case the well constitutes negligence only if it was the legal cause of the alleged damage to [the] property." *Id.* To answer this question, the court in the underlying lawsuit would have to determine, among other things, when the well should have been cased, when the debris fell down the borehole and filled up the well, and when the Edwards Aquifer was damaged. As the court stated, "the date on which the drill bit became stuck in the borehole is likely relevant to these issues." *Id.*

54 *Monroe*, 640 S.W.3d at 198 (emphasis added).

55 *Id.* at 204.

56 *Id.*

57 Again, there was no stipulation regarding when the different damages occurred, if at all. The case may have turned out differently if the insured was also involved in the stipulation or the stipulation involved date of physical injury to the property. The case could have also turned out different if there was a conclusive fact that the aquifer was damaged on a specific date. With

none of these conclusive facts, Monroe did not prevail.

58 *Pharr*, 642 S.W.3d at 468.

59 *Id.*

60 *Id.*

61 *Id.*

62 *Id.*

63 *Id.*

64 *Id.*

65 *Id.*

66 *Id.*

67 *Id.* at 468–69.

68 *Id.* at 469.

69 *Id.*

70 *Id.*

71 *Id.*

72 *Id.*

73 In addition to the nine cases that include a substantive review of the *Monroe* exception, the courts in *Allstate Vehicle & Property Insurance Company v. Crawford* and *Mt. Hawley Insurance Company v. J2 Resources LLC* acknowledged the exception but did not apply it, analyze it, or discuss any arguments about it from the parties. *Allstate Vehicle & Prop. Ins. Co. v. Crawford*, No. 3:21-CV-2806-K, 2022 WL 2790650, at *3 (N.D. Tex. July 16, 2022); *Mt. Hawley Ins. Co. v. J2 Res. LLC*, No. 4:20-CV-2540, 2022 WL 1785483, at *5, n.2 (S.D. Tex. June 1, 2022). Those courts determined that the insurers owned no duty to defend without resorting to extrinsic evidence. *Id.*

74 No. 4:20-CV-1265, 2022 WL 6246854, at *3 (S.D. Tex. Aug. 5, 2022), *report and recommendation adopted,* 2022 WL 6225838 (S.D. Tex. Oct. 7, 2022).

75 *Id.* at *1.

76 *Id.*

77 *Id.*

78 *Id.* at *2.

79 *Id.* at *3.

80 *Id.* at *4.

81 No. 4:21-CV-3686, 2022 WL 4390644, at *3 (S.D. Tex. Aug. 31, 2022), *report and recommendation adopted,* 2022 WL 4389704 (S.D. Tex. Sept. 22, 2022).

82 *Id.* at *1–*2.

83 *Id.* at *6.

84 *Id.* at *5–*6.

85 *Id.* at *6.

86 No. 3:21-CV-1344-B, 2022 WL 686625, at *1 (N.D. Tex. Mar. 8, 2022).

87 *Id.*

88 *Id.*

89 *Id.*

90 *Id.* at *6.

91 *Id.* at *8.

92 No. 3:21-CV-336-L, 2022 WL 6202129, at *1 (N.D. Tex. Oct. 7, 2022).

93 *Id.* at *3–*4.

94 *Id.* at *1.

95 *Id.* at *3–*4.

96 *Id.*

97 *Id.* at *3.

98 *Id.* at *4.

99 *Id.* at *4–*5.

100 No. 4:21-CV-00617-ALM, 2022 WL 3568482 (E.D. Tex. Aug. 18, 2022).

101 *Id.* at *2.

102 *Id.* at *9–*12

103 *Id.* at *6.

104 *Id.* at *5.

105 *Id.*

106 No. 4:20-CV-03570, 2022 WL 991989, at *1–*2 (S.D. Tex. Apr. 1, 2022).

107 *Id.*

108 *Id.*

109 *Id.* at *2.

110 *Id.* at *6.

111 *Id.* at *5.

112 *Id.* at *5.

113 No. CV H-21-2683, 2022 WL 6779078, at *7–*8 (S.D. Tex. Oct. 11, 2022).

114 *Id.* at *8.

115 No. 4:21-CV-3967, 2022 WL 16838038, at *1 (S.D. Tex. Oct. 20, 2022), *report and recommendation adopted sub nom.* 2022 WL 16836342 (S.D. Tex. Nov. 9, 2022).

116 *Id.* at *2.

117 *Id.*

118 *Id.* at *3–*4.

119 No. 1:21-CV-1093-RP, 2022 WL 2820669, at *1 (W.D. Tex. July 18, 2022), *report and recommendation adopted sub nom.*, 2022 WL 18034649 (W.D. Tex. Oct. 18, 2022).

120 *Id.* at *1–*2.

121 *Id.* at *2.

122 *Id.* at *1 (emphasis added).

123 *Id.* at *4–*6.

124 Extrinsic evidence is available to both insureds and insurers. In *Pine Oak*, the insured argued that a different rule should apply when a party was trying to use extrinsic evidence to create

coverage than when extrinsic evidence was being used to defeat coverage. 279 S.W.3d at 655. The Court held that "[t]his distinction is not legally significant." *Id*

125 *Monroe*, 640 S.W.3d at 203.

126 See Tex. R. Civ. P. 166a(c) (stating a court may enter summary judgment if "there is no genuine issue as to any material fact"). The Court cited *Avalos* and *Heyden Newport* in support of this proposition. *Heyden Newport*, decided in 1965, instructs insurers to resolve doubts in the insured's favor. *Heyden Newport Chem. Corp. v. S. Gen. Ins. Co.*, 387 S.W.2d 22, 24 (Tex. 1965). *Avalos* requires insurers to show conclusive proof of collusive fraud to negate the duty to defend. *See* 610 S.W.3d at 879. The invocation of summary judgment-standard language may be a signal to courts and practitioners what it means to conclusively establish a coverage fact at issue.

127 *Phan Son Van v. Pena*, 990 S.W.2d 751, 753 (Tex. 1999).

128 *See, e.g., Comm'l Standard Ins. Co. v. Davis,* 137 S.W.2d 1, 2 (Tex. 1940).

129 *Monroe*, 640 S.W.3d at 203 & n 12.

130 *Pine Oak*, 279 S.W.3d at 655.

131 630 F.3d 451 (5th Cir. 2011).

132 "*Montrose*" is a reference to the California Supreme Court's decision in *Montrose Chemical Corp. v. Admiral Insurance Co.*, 913 P.2d 878, 906 (Cal. 1995), in which the court held that coverage is not precluded for damage that the insured knew existed at the time it purchased the policy, as long as the policyholder's liability for that property damage was still contingent. Although the original *Montrose*-endorsement (now incorporated into the standard CGL policy's grant of coverage) contains a knowledge element, some *Montrose* exclusions have come to encompass other types of provisions that establish the first occurrence of property damage as the end date for continuous or progressive property damage claims, even without knowledge by the insured.

By: Clare Pace Rodgers & Michelle C. Le

THE EVER-SHRINKING STATUTE OF LIMITATIONS

In Texas, the statute of limitations on first-party insurance cases has evolved into a difficult time limit for insureds aggrieved by their insurance companies. A liberal four-year statute of limitations has effectively been reduced, bit by bit, to one year and ten months from the date of loss. Insureds now must work quickly to address their claims, allowing inspections and re-inspections of property at the request of the insurance carrier, while also minding the clock, to preserve their right to challenge the carrier's ultimate decision.

Concerningly, the shortening of the limitations period is not a product of legislative action but of judicial action. These opinions concern the notice requirements under Chapter 542A, specifically section 542A.007, which allows for the limitation of attorney's fees for failure to provide notice sixty days prior to filing suit.

Historically, the notice requirement was excused in the case of an impending statute of limitations, but recently courts have determined that insureds must show more than impending limitations instead, they must prove "impracticability." The authors were unable to find any case where a court found "impracticability" and ruled against the carrier. In this paper, we review the history of the statute of limitations as well as the new precedent concerning presuit notice in insurance cases, to effectively educate attorneys in this practice area on how to avoid financial harm to their clients.

In the recent past, insureds had four years to bring breach of contract, fraud, and breach of fiduciary duty claims and two years from the date the cause of action accrues to bring claims related to violations of the Texas Insurance Code. Over the years, the four-year breach of contract statute has been reconfigured to allow insurance companies to contract for shorter periods as long as the limit is no less than two years and one day from the date the cause of action accrues. Accrual of the cause of action has always been a question of law, but courts were given leeway in interpreting the law in conjunction with questions of fact determined on a case-by-case basis.[1] In recent years, a number of events have been found to potentially give rise to accrual of a cause of action against an insurer, including date of denial, date of final payment, or date of file closure.

The common law provides four-year statute of limitations for breach of contract, common law fraud, and breach of fiduciary duty claims, which has been codified in the Texas Civil Practices and Remedies Code.[2] However, with first-party insurance claims, this period has been shortened to allow insurance companies to contractually limit the four-year limitations period within their policies so long as it is not shorter than two years.[3] The Texas Civil Practices and Remedies Code, section 16.070(a), states "a person may not enter a stipulation, contract, or agreement that purports to limit the time in which to bring suit on the stipulation, contract, or agreement to a period shorter than two years. A stipulation, contract, or agreement that establishes a limitations period that is shorter than two years is void in this state." Therefore, if the policy provides less than two years to bring a claim, the Texas Civil Practices and Remedies code renders the provision void, which then reverts the limitations period back to four years.[4]

Prior to the Texas Supreme Court's decision in *Murray v. San Jacinto Agency, Inc.*, which held that the statute of limitations on a breach of contract claim begins to run when the insurance company wrongfully denies coverage, the Court applied the general rule that the statute of limitations accrues when facts come into existence that authorize the claimant to seek a judicial remedy.[5] In the case of the common law duty of good faith and fair dealing, prior to *Murray*, the Texas Supreme Court held that the running of that statute of limitations did not begin until the underlying insurance contract dispute was resolved.[6] However, the *Murray* Court modified that ruling three years later to hold that the general rule for determining when a cause of action has accrued in all claims made by an insured is the date coverage is denied.[7]

Since the general rule was established, there has been much litigation concerning what constitutes a "denial." Recently, the majority of federal district courts have found that "the action accrues when the insurance company sends a letter to the insured detailing its decision to deny the claim *or its decision to pay the claim with payment included which the insured disagrees with*, as long as the insurance company never changes its position on the claim."[8] It appears, therefore, that the insurance company control over the accrual date.[9]

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Moreover this interpretation of the statute could lead to situations where the insurance company may delay the claim to a point where an insured misses the limitations period such as when a claim is in appraisal.

Similarly, if an insured chooses to bring a cause of action under the Texas Deceptive Trade Practices Act ("DTPA"), then it must bring it "within two years after the date on which the false, misleading, or deceptive act or practice occurred or within two years after the consumer discovered or in the exercise of reasonable diligence should have discovered the occurrence of the false, misleading, or deceptive act or practice."[10] Texas courts have interpreted the additional time period as a so called "discovery rule," which allows an extension only when a "Plaintiff's injury is both inherently undiscoverable and objectively verifiable."[11] Because this is an exception to the rule, the standard is rarely met. Further, the statute provides that the time period is only extended for an additional 180 days "if the plaintiff proves that failure timely to commence the action was caused by the defendant's knowingly engaging in conduct solely calculated to induce the plaintiff to refrain from or postpone the commencement of the action."[12] Courts have interpreted this to mean that the plaintiff must prove that defendant's conduct was done knowingly.[13]

The Texas Insurance Code has similar statutory language and interpretations as the DTPA.[14] However, this two-year-and-one-day approach has been shortened by recent case authority discussing pre-suit notice. Particularly, the pre-suit notice provision has taken on a new meaning through recent opinions centering on the word "impracticable."

The Texas Insurance Code requires an insured to provide pre-suit notice to the insurance carrier more than sixty days prior to filing suit. Failure to provide notice may result in abatement of the suit or the denial of attorney's fees. However, the code provides that an insured is not required to provide notice if there is an impending statute of limitations. The statute states in relevant part:

> A presuit notice under Subsection (a) is not required if giving notice is *impracticable* because: (1) the claimant has a reasonable basis for believing there is insufficient time to give presuit notice before the limitations period will expire; or (2) the action is asserted as a counter claim.[15]

Prior to the 2017 adoption of 542A of the Texas Insurance Code, neither side debated the term "impracticable." Under Chapter 542, which predated 542A, if an insured failed to give pre-suit notice then the only remedy was abatement. In 2017, the Texas Legislature chose to stiffen the penalty for failing to provide pre-suit notice under certain subsets of claims by including the denial of attorney's fees for failure to provide pre-suit notice. The notice provision itself remained unchanged but with higher stakes, and litigation became more frequent, centered on the single term "impracticable." Black's Law defines the word impracticable as:

> A fact or circumstance that excuses a party from performing an act. For performance to be truly impracticable, the duty must become much more difficult or much more expensive to perform, and this difficulty or expense must have been unanticipated. The doctrine by which such a fact or circumstance excuses performance.[16]

The inclusion of the attorney's fees bar in capitalize 542A upped the stakes for both parties, and the result has been a handful of cases that question whether an insured can rest solely on an impending statute of limitations to show "impracticability."

However, what qualifies as "something more" is currently unanswered by courts. Though we don't know what fact scenario merits impracticability, we can consider scenarios that did not. In *Hvlavinka Equipment Company*, the court considered the following facts:

1. August 25, 2017 - plaintiffs' property was damaged by Hurricane Harvey;
2. December 18, 2018 - defendant's adjuster provided an updated estimate for damages but plaintiff still disagreed with the amount;
3. November 24, 2019 – plaintiff hired counsel and invoked appraisal;
4. COVID delays appraisal on both sides;
5. December 17, 2020 - plaintiff filed suit while the appraisal process ongoing without pre-suit notice.

Though plaintiff's counsel argued the impracticability of providing a demand while participating in the appraisal process—because the appraisal takes the estimating work out of the insured's hands—he court focused its analysis on the eleven month gap between Nationwide's denial and plaintiff hiring an attorney.

> While there was a delay in receiving an estimate of repairs caused by the pandemic, Plaintiff waited until November 2019 to hire counsel and begin the appraisal process creating an unaccounted for eleven-month gap of time…. As such, Plaintiff reasonably could have begun the appraisal process in early 2019 (and does not provide a reason why it did not do so), leaving ample time to provide pre-suit notice and file a lawsuit if a settlement was not reached even if the appraisal process occurred as slowly as it did[17]

Given that the presuit notice requirement is to "discourage litigation and encourage settlements of consumer complaints,"[18] and the purpose of the appraisal provision is to resolve the dispute,[19] these writers suggest it seems impracticable that the insured would provide notice to their carrier of their claims when the claims were being reviewed and appraised by independent parties.

Another factual scenario to consider is addressed in *Tadeo v. Great Northern Ins. Company*:

1. plaintiffs' attorney fails to provide notice presuit and defendant challenges attorney's fees;

2. attorney states that it was not hired prior to the sixty-first day and claims impracticability because client did not have counsel;

3. court identifies that notice may be sent by a non-attorney; therefore, plaintiff or its representatives could have provided notice prior to hiring attorney;

4. court granted defendant's motion to deny attorney's fees.

The court held that "[a] finding of impracticability, however, ought to be reserved for those instances in which presuit notice genuinely cannot be provided; a plaintiff should not be allowed to skirt the important requirements of the Texas Insurance Code by engaging in dilatory tactics."[20] This quote from *Tadeo* has led to more extreme results.

One such example is the case of *Pemberton v. Unitrin Preferred Insurance Co.*, which involved the following pertinent facts:

1. plaintiff's insurance policy shortened the period of limitations to two years and one day from the date of first denial;

2. plaintiff engaged with insurance carrier for almost two years to try and resolve the claim. After the final denial, plaintiff sought counsel and quickly provided notice fifty-three days prior to filing suit based on shorted limitation period in insurance policy;

3. defendant moved to deny attorney's fees;

4. plaintiff identified correspondence provided by plaintiff, prior to hiring an attorney, that met requirements of 542A notice with the exception of the provision requiring a party to identify attorney fees incurred (the argument being that a party cannot provide accounting of incurred attorney's fees prior to them being incurred);

5. court granted defendant's motion and found that plaintiffs' notice was insufficient for failure to include attorney's fees.

In this case, the court considered the language in *Tadeo* and focused on plaintiff's delay in first submitting the claim.[21] The court noted that the delay in the original submission of the claim indicated that plaintiff "did not have clean hands."[22] The court observed that after defendant's initial claim decision, plaintiff "engaged in continued dialogue with Unitrin," which resulted in a new claims decision, and plaintiff's counsel "moved with alacrity in filing the pre-suit notice . . . the fact remains that almost six years has passed between the incident giving rise to the claim and the filing of the lawsuit."[23] Therefore, the court considered the pre-claim actions of the insured as the basis for finding that the insured had engaged in dilatory tactics that prevented the insured being able to show that it had given notice in a practicable manner.

Presuit notice is an important part of our jurisprudence and echoed not only through insurance law, but multiple other facets of civil litigation. It is important that parties try and work out their differences pre-litigation, and encouraging those discussions should be in the best interest of our legislature and courts. But, the practical result of the pertinent case authority has led to a challenging dynamic for insureds. Property owners are now required to know the notice requirements, meet the notice requirements, and comply with all requirements prior to obtaining legal counsel, in conjunction with actively pursuing their insurance claims.

Another example is the case of *Perrett v. Allstate Insurance Co.*, where the insured's attorney sent pre-suit notice on the same date as filing the lawsuit because of an impending statute of limitations.[24] The insurance carrier moved for abatement and the Court abated the case because the pre-suit notice did not include the statement "that a copy of the notice was provided to the claimant."[25] In other words, an attorney, capable of reading the statute did not send sufficient notice.

Last, we consider the one opinion that rejected an insurance carrier's request to deny attorney's fees based on insufficient notice. In *Mount Canaan Missionary Baptist Church v. Westchester Surplus Lines Insurance Co.*, notice was provided within the time period, but the defendant argued that the notice was insufficient for failing to provide the specific allegations and a statement that the notice was provided to the claimant.[26] The court thoroughly reviewed the statutory language regarding Section 542A.,[27] and the court noted that the request to deny attorney's fees falls under section 542A.007(d).[28] Pursuant to the plain terms of the statute, insufficient notice is not grounds for denying attorney's fees unless the notice does not include a "specific amount alleged to be owed."[29] Therefore, the argument that the notice did not contain one of the other provisions, *i.e.*, attorney's fees, alleged violations, etc., was irrelevant as long as the notice provided the "specific amount alleged to be owed."[30] This is an understandably plain reading of the statute that allows notice to be sent by an insured, their attorney, or other representative.[31]

Unfortunately, the result is currently muddy without definitive guidance from the Fifth Circuit or the Texas Supreme Court as to the intent and purpose of section 542A.003. It is, therefore important, for all practitioners to be aware of this trend toward shortened limitations period.

1 *See Provident Life & Acc. Ins. Co. v. Knott*, 128 S.W.3d 211, 222 (Tex. 2003).

2 *See* Tex. Civ. Prac. & Rem. Ann. Code § 16.004.

3 *See id.* § 16.070(a); *Port Arthur Towing Co. v. Mission Ins. Co.*, 623 F.2d 367, 370 (5th Cir. 1980).

4 *See Duster v. Aetna Ins. Co.*, 668 S.W.2d 806, 807 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd) (holding that because the policy failed to specify a lawful limitations period by including a "savings clause" without a specified limitations period, the four-year statute of limitations governing written contracts applied).

5 *See* 800 S.W.2d 826, 828 (Tex. 1990).

6 *See Arnold v. Nat'l Cnty. Mut. Fire Ins. Co.*, 725 S.W.2d 165, 168 (Tex. 1987), *holding modified by Murray v. San Jacinto Agency, Inc.*, 800 S.W.2d 826 (Tex. 1990).

7 *Murray*, 800 S.W.2d at 828*; see also Smith v. Travelers Cas. Ins. Co. of Am.*, 932 F.3d 302, 311 (5th Cir. 2019).

8 *Tobin Endowment v. Great Am. Assurance Co.*, No. 5:20-CV-1146, 2022 WL 817895, at *5 (W.D. Tex. Mar. 17, 2022) (collecting cases) (emphasis added).

9 *See Pace v. Travelers Lloyds of Texas Ins. Co.*, 162 S.W.3d 632, 634-35 (Tex. App.—Houston [14th Dist.] 2005, no pet.).

10 Tex. Bus. & Com. Ann. Code § 17.565.

11 *Wagner & Brown, Ltd. v. Horwood*, 58 S.W.3d 732, 734 (Tex. 2001).

12 Tex. Bus. & Com. Code Ann. § 17.565.

13 *See Silo Rest. Inc. v. Allied Prop. & Cas. Ins. Co.*, 420 F. Supp. 3d 562, 586-87 (W.D. Tex. 2019).

14 *See e.g., id.* at 574 (holding "[d]espite the variety of claims asserted, the applicable statute of limitations is either two years for the extra-contractual claims or two years and a day for Plaintiffs' contractual claims.").

15 Tex. Ins. Code Ann. § 542A.003(d).

16 Black's Law Dictionary (11th ed. 2019).

17 *Hvlavinka Equip. Co. v. Nationwide Agribusiness Ins. Co*, 546 F. Supp. 3d 534, 537 (S.D. Tex. 2021).

18 *Perrett v. Allstate Ins. Co.*, 354 F. Supp. 3d 755, 757 (S.D. Tex. 2018).

19 *State Farm Lloyds v. Johnson*, 290 S.W.3d 886, 894-95 (Tex. 2009).

20 *Tadeo v. Great Northern Ins. Co.*, No. 3:20-CV-00147-G, 2020 U.S. Dist. LEXIS 132214, 2020 WL 4284710, at *23 (N.D. Tex. July 27, 2020).

21 *Pemberton v. Unitrin Preferred Ins. Co.*, No. 1:21-CV-00452, 2022 U.S. Dist. LEXIS 127190; 2022 WL 2763160, at *3-6 (W.D. Tex. Jan. 6, 2022).

22 *Id.* at *7.

23 *Id.*

24 354 F. Supp. 3d at 758.

25 *Id.*; *see Carrizales v. State Farm Lloyds*, No. 3:18-CV-0086, 2018 U.S. Dist. LEXIS 58875, 2018 WL 1697584, at *2, 4 (N.D. Tex. Apr. 6, 2018).

26 *Mount Canaan Missionary Baptist Church v. Westchester Surplus Lines Ins. Co.*, No. 4:19-CV-00660, 2019 U.S. Dist. LEXIS 241178; 2019 WL 13114309 at *13-15 (S.D. Tex. August 13, 2019).

27 *Id.*

28 *Id.* at *14.

29 *Id.* at *13.

30 *Id.*

31 Tex. Ins. Code Ann. § 542A.003(c).

By Christina A. Culver & Megan L. Tilton

THE ATTORNEY-CLIENT PRIVILEGE: A REVIEW OF THE PRIVILEGE AND POTENTIAL WAIVER

I. INTRODUCTION

The attorney-client privilege is designed to protect from disclosure certain confidential communications between an attorney and his or her client relating to legal advice.[1] The privilege is a concept of the law of evidence that is derived from statutory and common law in all fifty states. It is the oldest recognized privilege in U.S. jurisprudence and traces its origins back as early as the reign of Queen Elizabeth I in the sixteenth century.[2]

The privilege allows attorneys to represent their clients adequately and zealously, with full knowledge of the subject matter of their representation. However, not all communications between an attorney and their client are protected by the privilege. Generally, for a communication to be privileged under Texas law, the communication must be (1) seeking legal advice; (2) from a legal professional in his or her capacity as such; (3) related to that legal purpose; (4) made in confidence; and (5) by the client.[3] The form of the communication is often immaterial—i.e., privileged communications can be made via an oral conversation, a written document, an e-mail exchange, or in another form. Section II will discuss the fundamental elements of the attorney-client privilege. Section III will discuss recent cases concerning the potential waiver of the attorney-client privilege as well as a discussion of Texas law.

II. A REVIEW OF THE ELEMENTS OF THE ATTORNEY-CLIENT PRIVILEGE

A. An Attorney-Client Relationship Must Exist

There must be an attorney-client relationship for the privilege to exist, and the client must be seeking legal advice. The privilege applies to both prospective clients and actual clients.[4] Those clients may be individuals, corporations, partnerships, or associations, who consult a lawyer in that lawyer's professional capacity.[5] In the context of a corporation, the privilege can also apply to communications between the corporation and its staff counsel or outside counsel.[6] For corporate clients, courts are particularly cautious in applying the privilege to ensure corporations cannot shield information by simply routing it through counsel.[7] Regardless of their particular position, however, "when an employee acting within the scope of their employment meets with the employer's counsel and seeks legal advice on behalf of the employer, those communications are protected by the attorney-client privilege."[8]

B. The Communication Must Be For and Relate To a Legal Purpose

For a communication to be protected it must be confidential and "made in furtherance of the rendition of professional legal services to the client."[9] When a lawyer performs non-legal services, such as supplying business advice, acting as an accountant, insurance adjuster, public relations professional, or otherwise, the privilege does not attach.[10] For example, in an insurance context, if an attorney is performing the function of a claims adjuster, *i.e.*, investigating a claim and determining whether a loss is covered, courts will generally find that the attorney-client privilege does not apply because it is a non-legal, business function of an insurance company.[11] However, sometimes what constitutes claims handling and the rendition of legal advice can be unclear. Accordingly, a court will have to engage in an *in camera* review of each potentially protected communication in order to determine whether the attorney was performing legal services.

In some cases, a Texas court has found that an attorney wears two hats—*e.g.*, that of a claims handler and as legal counsel.[12] The court in *OneBeacon Ins. Co. v. T. Wade Welch & Associates* analyzed whether OneBeacon Insurance Company ("OneBeacon") had improperly redacted its claims file and withheld certain documents on the basis of the attorney-client privilege and the work product

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doctrine.[13] The court acknowledged that pursuant to Texas law, "[t]o the extent an attorney acted as a claims adjuster, claims process supervisor, or claim investigation monitor, and not as a legal advisor, the attorney-client privilege would not apply."[14] However, where an attorney serves as both legal counselor and claims handler, the portion of the communications that are for legal services shall still be protected so long as the communications meet the other requirements for maintaining the privilege.[15] Therefore, the key inquiry regarding when communications are privileged turns on whether there is a shift from investigating a claim to providing legal advice.

C. The Communication Must be Made by the Client

In some instances, an attorney's communications to a client may also be protected by the privilege so long as the other elements establishing privilege are met.[16] Communications by an attorney to a client may also be privileged if "they would tend to disclose the client's confidential communications."[17]

D. The Communication Must be Made in Confidence

The attorney-client communication must also be intended to be confidential.[18] For example, a client or prospective client speaking to his or her lawyer about a pending lawsuit in a private office with no one else present would suggest that the conversation was confidential. In contrast, if a client speaks to his or her attorney in a public setting, in close vicinity to others, and at a loud volume, then there could be a question as to whether those communications were intended to be held in confidence.[19]

Additionally, in *League of United Latin American Citizens v. Abbott*, the party seeking disclosure argued that communications between the chair of the Texas Legislature's redistricting committee and his attorney were not privileged because the chair publicly discussed information related to the subject matter of the communications in a committee hearing.[20] The court closely scrutinized the discussion and found that the attorney-client privilege had not been waived because the chair only discussed his "understanding and personal beliefs, not privileged communications."[21] The court concluded that the communications were made in confidence and not disclosed to any third party.[22] The court found that the manner in which the chair answered the questions he was asked during the committee hearing safeguarded the substance of his communications with his attorney in a manner sufficient to maintain the attorney-client privilege.[23]

If a client repeats an otherwise confidential conversation to a third-party, or if a third-party is present when the attorney and client communicate, then the conversation may not be privileged. This general premise does not apply, however, to agents of the employee or agents of the client so long as the agents "(1) had the authority to obtain professional legal services on behalf of the client; (2) had authority to act on legal advice rendered to the client; or (3) made or received the confidential communication while acting within the scope of his employment for the purpose of effectuating legal representation to the client."[24] In the insurance context, policyholders often include their insurance broker in communications with coverage counsel because insurance brokers often place the policy and are familiar with the policyholder's operations and claim history. Courts take a fact specific approach in determining whether an insurance broker constitutes an agent of the insured and whether the communication remains privileged.[25] Additionally, where an insurer has an obligation to defend its insured, communications between the insurer and insured are usually privileged.[26]

E. What is Not Protected by the Attorney-Client Privilege

Now that we have examined what is protected under attorney-client privilege, this article will examine what is not protected. Under Texas law, the attorney-client privilege "attaches to the complete communication between attorney and client, including both legal advice and factual information."[27] The court in *In re ExxonMobil Corp.* stated:

> It is inconceivable that an attorney could give sound legal advice on a client's case if he or she did not include an application of the law or opinion to the specific facts of that case. If we were to hold that all or part of a document containing privileged information should be disclosed because it also included facts pertinent to the lawsuit, the purpose of the attorney-client and work-product privileges would be annihilated. The ultimate effect of such a holding would be that clients would be reluctant to give their attorneys any factual information for fear that it would be subject to discovery. And no attorney could even begin to prepare a case for trial, or be able to give sound advice for lack of those facts. Such a chilling intervention into the attorney-client relationship under the guise of "looking for facts," pierces the core of a critical privilege to carve out limited and usually superfluous morsel of discovery otherwise obtainable. The cost is too great.[28]

The court held that documents containing both legal and factual information were privileged and could be withheld

from production in their entirety. However, the court also noted that the factual information may be obtained through other means such as depositions or other forms questioning where the attorney or other party may be required to provide a neutral recitation of the facts.

F. How to Assert Attorney-Client Privilege

As a preliminary matter, the party asserting the privilege bears the burden of establishing that an attorney-client relationship existed and the privileged nature of the communication.[29] The privilege can be asserted in any proceeding in which testimony is compelled, such as civil, criminal, or administrative trials, or regulatory and disciplinary proceedings.[30] If the privilege applies, compelled disclosure is prohibited regardless of need, subject to a few exceptions.[31] The privilege can and must be asserted throughout the discovery process, including but not limited to, during document production, interrogatory responses, and depositions.[32] Texas Rule of Civil Procedure 193.3 provides in relevant part that:

> **193.3 Asserting a Privilege**
>
> A party may preserve a privilege from written discovery in accordance with this subdivision.
>
> (a) **Withholding privileged material or information.** A party who claims that material or information responsive to written discovery is privileged may withhold the privileged material or information from the response. The party must state -- in the response (or an amended or supplemental response) or in a separate document -- that:
>
> (1) information of material responsive to the request or required disclosure has been withheld,
>
> (2) the request or required disclosure to which the information or material relates, and
>
> (3) the privilege or privileges asserted.

The U.S. District Court for the Northern District of Texas has concluded that "a privilege log must identify each document and provide basic information, including the author, recipient, date and general nature of the document."[33] Texas Rule of Civil Procedure 193.3(b) also provides that a party seeking discovery may serve a written request that the withholding party identify the information withheld after receiving a response indicating that information has been withheld from production.

G. How Long Does the Privilege Last?

The attorney-client privilege remains in effect after the attorney-client relationship ends and even after the client dies.[34] An attorney may never divulge the contents of those communications or a client's secrets without the client's permission unless an exception applies.[35]

H. Waiver of Attorney-Client Privilege

As a general principle, "[t]he attorney-client privilege is waived when the holder of the privilege voluntarily discloses the privileged material to a third party."[36] If you fail to assert a claim of privilege, it is likely waived.[37] Privileged documents may also be inadvertently produced to an opposing party during the discovery process. Texas Rule of Evidence 511(b)(2) states, "in a Texas state proceeding, an inadvertent disclosure does not operate as a waiver if the holder followed the procedures of Rule of Civil Procedure 193.3(d)."[38] Texas Rule of Civil Procedure 193.3(d) dictates the steps the parties must take when a communication is produced that is subject to a claim of privilege. Rule 193.3(d) states:

> A party who produces material or information without intending to waive a claim of privilege does not waive that claim under these rules or the Rules of Evidence if—within ten days or a shorter time ordered by the court, after the producing party actually discovers that such production was made—the producing party amends the response, identifying the material or information produced and stating the privilege asserted. If the producing party thus amends the response to assert a privilege, any party who has obtained the specific material or information must promptly return the specified material or information and any copies pending any ruling by the court denying the privilege.[39]

However, Texas courts have found that the privilege is waived if a party does not take reasonable precautions to prevent disclosure because "[i]nadvertent production is distinguishable from involuntary production."[40] Accordingly, if a document is disclosed "due to inattention, unwittingly—but nonetheless voluntarily," the communications will not be protected by the attorney-client privilege.[41]

Another form of waiver is the "at issue" waiver. "At issue" waiver occurs when a party used the privilege offensively and puts the subject matter of their privileged communications at issue in litigation. This requires the invasion of the privilege

to determine the validity of a claim or defense of the party asserting the privilege, and application of the privilege would deprive an adversary of vital information.[42] Privileged communications are not at issue merely because a party alleges in a responsive pleading that they were not negligent or did not engage in the conduct of the claim asserted against them.[43] For example, in *Republic Insurance Co. v. Davis*, the court found that an insurer did not put their privileged communications at issue by filing a declaratory judgment action because the insurer was not seeking affirmative relief, which did not constitute an offensive use of the privilege.[44]

I. Exceptions and Defenses

There are several exceptions to the attorney-client privilege—some are more relevant to this article than others. First, the crime-fraud exception to attorney-client privilege is implicated when attorney/client communications are made in furtherance of a crime or fraud.[45] The protections afforded by the attorney-client privilege do not apply "if the lawyer's services were sought or obtained to enable or aid anyone to commit or plan to commit what the client knew or reasonably should have known to be a crime or fraud."[46]

Particularly relevant to insurance coverage cases is the joint defense privilege, which is sometimes referred to as the common legal interest exception. The common interest doctrine allows independently represented parties with a common legal interest to share information with each other without waiving the attorney-client privilege if a joint defense effort, or strategy, has been decided upon.[47] If the parties cannot demonstrate that they shared a common legal interest with one another, however, then the privilege cannot be asserted.[48] The common interest doctrine is not definitive in its protection for insureds or an insurer against disclosure of privileged information when an insurer is involved in the insured's defense. For example, in *In re XL Specialty Insurance Co.*, the court found where an insurer's outside counsel communicated with an insured regarding the status of proceedings, the insurer and the insured had a common legal interest. However, because the communication was not made to the insured's counsel, the communications were not privileged.[49] Conversely, in *In re Skiles*, the court found the joint defense privilege applied where the defendant in the underlying lawsuit previously participated in extensive settlement negotiations with plaintiff's counsel's firm.[50] A policyholder may also be permitted to use the common interest doctrine as a shield to preclude a liability claimant from accessing privileged communications between the policyholder, its insurer, and its defense counsel.[51]

III. A DISCUSSION OF THE POTENTIAL WAIVER OF THE ATTORNEY-CLIENT PRIVILEGE

The Mississippi Supreme Court made headlines in 2020 with *Travelers Property Casualty Co. of Am. v. 100 Renaissance, LLC* when it found that an insurer impliedly waived the attorney-client privilege and allowed the discovery of an insurer's in-house counsel's communications. In considering the case, the Supreme Court of Mississippi considered whether the attorney-client privilege was waived when a disclaimer letter was drafted by the insurer's in-house counsel and sent under the adjuster's signature.[52] The Court said yes. In that case an unidentified driver struck a flagpole owned by 100 Renaissance and caused $2,134 in damages.[53] 100 Renaissance filed a claim under its automobile-liability insurance policy with Travelers, seeking uninsured motorist coverage.[54] Travelers denied coverage because the flagpole was not a covered auto.[55] Counsel for 100 Renaissance disputed the denial because Mississippi's UIM statute provided coverage for the flagpole. Mississippi Code Section 83-11-101(2) (Supp. 2019) stated:

> No automobile liability insurance policy or contract shall be issued or delivered after January 1, 1980, unless it contains an endorsement or provisions undertaking to pay the insured all sums which he shall be legally entitled to recover as damages for property damage from the owner or operator of an uninsured motor vehicle . . . .[56]

Travelers' adjuster sought help from in-house counsel.[57] The adjuster then denied the claim again.[58] The insured sued Travelers for bad faith and deposed the adjuster.[59] In the transcript, the adjuster disclaimed any knowledge of the statute:

> Q: Just looking at the statute, the plain language of the statute right here, okay, [Section] 83-11-101(2), you looked at before. Is there coverage under that statute, under the plain reading of that statute?
>
> Q: In your opinion.
>
> A: I don't know. I'm not an attorney. I don't know anything about statutes. That's what we have General Counsel for. I deal with policy language, what's in the policy.[60]

Travelers paid for the damage, but the insured maintained its bad faith claims and sought production of email between the adjuster and in-house counsel as well as the in-house counsel's deposition.[61] Following an *in camera* review, the trial court ordered production of the emails as well as production of in-house counsel for a deposition.[62] Travelers filed an interlocutory appeal, which was granted.[63]

Ultimately, the Supreme Court of Mississippi held that the adjuster's testimony put the attorney-client privilege at issue and therefore waived the privilege.[64] Her testimony was bereft of any knowledge or information as to why the claim was denied.[65] The decision was based primarily on the fact that the second denial letter was written after in-house counsel's involvement and was signed by the adjuster.[66] The Court noted that "[g]enerally, it may be expected that the person who signs a letter has personal knowledge of the matters set forth in the letter."[67] Furthermore, the Court found that the adjuster lacked the necessary personal knowledge, explaining:

> Travelers sent the denial letter to Renaissance in an effort to explain its arguable and legitimate basis to deny the claim. The letter was signed by [the adjuster]; but based on her deposition testimony, it clearly was prepared by someone other than [the adjuster], most likely [in-house counsel]. If so, [in-house counsel] did not act as legal counsel and give advice to [the adjuster] to include in the denial letter. Instead, the denial letter contained [in-house's counsel's] reasons to deny the claim. [The adjuster's] signature was simply an effort to hide the fact that [in-house] counsel, not [the adjuster] had the personal knowledge of Travelers' reasons to deny the claim and to use the attorney-client privilege as a sword to prevent Renaissance from discovering the reasons from the person who had personal knowledge of the basis to deny the claim.[68]

The Court found that the claims handler relied substantially, if not wholly, on in-house counsel to prepare the denial letter, so the reasoning of in-house counsel should be discoverable.[69]

Similarly, Texas courts have set forth stringent requirements, as they have repeatedly held that if an attorney is "merely performing the ordinary business functions of an insurance company," their communications with an insurer are not privileged.[70] Accordingly, if an insurance company cannot point to a "definite shift from acting in its ordinary course of business to acting in anticipation of litigation," then its documents and other information are discoverable.[71]

In *Lanelogic, Inc. v. Great American Spirit Insurance Co.*, the court required an insurer to produce documents prepared by or sent to its attorney because the insurer could not point to a particular point in time at which it began acting in anticipation of litigation.[72] There, the court observed that "courts have routinely recognized that the investigation and evaluation of claims is part of the regular, ordinary, and principal business of insurance companies."[73] As a result, those materials are not privileged.[74] Similarly, in *OneBeacon*, the court provided further guidance regarding when communications are privileged. Specifically, the court stated:

> What would otherwise be routine, non-privileged communications between corporate officers or employees transacting the general business of the company do not attain privileged status solely because in-house or outside counsel is 'copied in' on correspondence or memoranda. The distinction is based on the purpose of the communication.[75]

The pertinent question, therefore, is when the insurer shifts from investigating to acting in anticipation of litigation, and the answer depends on a number of factors, such as the date coverage is denied or when the matter is referred to outside counsel.[76] Unlike in *Lanelogic*, the court in *OneBeacon* found that communications between the insurer and its counsel were protected because OneBeacon stated it was anticipating litigation, and it took action consistent with that statement by referring the matter to outside counsel and sending a denial letter to its insured.[77]

Texas courts continue to reiterate the standards it set forth in *Lanelogic* and *OneBeacon* in cases like *Skogen v. RFJ Auto Group, Inc. Emp. Benefit Plan*, where the court held that communications between the insurer and its attorney were not protected because they did not point to a definite enough shift from acting in the insurer's ordinary course of business.[78] Instead, the communications merely "discuss[ed] the investigation, evaluation, denial, and status" of the insured's claims.[79]

IV. CONCLUSION

The attorney-client privilege may be waived when outside counsel is engaged in investigating and evaluating or processing a claim. Policyholders over the past few years have attempted to obtain claims file documents and institutional documents from an insurer during coverage litigation with an emphasis on communications with outside counsel. Insurers rigorously fight these attempts, sometimes without success. Ultimately, Texas law demonstrates the importance of being precise about the role of attorneys in the claims handling process, whether the claims are in the first- or third-party context. Failure to clearly demarcate this role can lead to the discoverability of otherwise privileged information. Texas law is clear that if an insurer cannot point to a definite shift from acting in its ordinary course of business to acting in anticipation of litigation, communications between the insurer and its attorney may not be covered by the attorney-client privilege. As such, it is crucial for attorneys to keep in mind these key factors to assess whether they might erode

the attorney-client privilege in cases involving coverage disputes.

1 The work product doctrine is distinct from and broader than the attorney-client privilege. Attorneys must be diligent in evaluating whether the doctrine applies separately from the attorney-client privilege. Tex. R. Evid. 192.5(a)(1).

2 *See Upjohn Co. v. U.S.*, 449 U.S. 383, 389 (1981); *Butler v. American Heritage Life Ins. Co.*, No. 4:13-CV-199, 2016 WL 367314, at *1 (E.D. Tex. Jan. 29, 2016) (citing *U.S. v. Edwards*, 303 F.3d 606, 618 (5th Cir. 2002)); *see also* Jason Batts, *Rethinking Attorney-Client Privilege*, 33 Geo. J. Legal Ethics 1, 5 (2020).

3 *See* Tex. R. Evid. 503(b); *see also Huie v. DeShazo*, 922 S.W.2d 920, 925 (Tex. 1996).

4 *See In re Auclair*, 961 F.2d 65, 69–70 (5th Cir. 1992) (privilege can also apply to a prospective client, even if the attorney is not ultimately retained); *Perkins v. Gregg County, Tex.*, 891 F. Supp. 361, 364 (E.D. Tex. 1995) (the privilege applies even if the lawyer ultimately declines to represent the prospective client); *Mixon v. State*, 224 S.W.3d 206, 209–10 & n. 1 (Tex. Crim. App. 2007) (there is no requirement that an attorney-client relationship be formed before the privilege is applied).

5 *See State v. DeAngelis*, 116 S.W.3d 396, 404 (Tex. App.—El Paso 2003, no pet.) (citing Tex. R. Evid. 503(a)(1)).

6 *In re Fairway Methanol LLC*, 515 S.W.3d 480, 487-88 (Tex. App.—Houston [14th Dist.] 2017, no pet.).

7 *In re LTV Secs. Litig.*, 89 F.R.D. 595, 602 (N.D. Tex. 1981).

8 *Texas Tech Univ. Health. Scis. Ctr. – El Paso v. Niehay*, 641 S.W.3d 761, 789 (Tex. App.—El Paso 2022, pet. filed) (citing *Nat'l Tank Co. v. Brotherton*, 851 S.W.2d 193, 197–98 (Tex. 1993)).

9 *Head v. State*, 299 S.W.3d 414, 444–45 (Tex. App.—Houston [14th Dist.] 2009, pet. ref'd).

10 *See Advanced Tech. Incubator, Inc. v. Sharp Corp.*, 263 F.R.D. 395, 398 (W.D. Tex. 2009); *U.S. v. Davis*, 636 F.2d 1028, 1044 (5th Cir. 1981) (holding attorneys do not always act in a legal capacity and instead sometimes serve as a business advisor, agent, or other capacity, in which cases the attorney-client privilege does not apply).

11 *See OneBeacon Ins. Co. v. T. Wade Welch & Assocs.*, No. H-11-3061, 2013 WL 6002166, at *4 (N.D. Tex. Nov. 12, 2013).

12 *Id.*

13 *Id.* at *5.

14 *Id.* at *4. (quoting *Harper v. Auto–Owners Ins. Co.*, 138 F.R.D. 655, 671 (S.D. Ind.1991)).

15 *Id.* at *3.

16 *Advanced Tech. Incubator*, 263 F.R.D. at 397–98.

17 *Soverain Software LLC v. Gap, Inc.*, 340 F. Supp. 2d 760, 762 (E.D. Tex. 2004).

18 *Nguyen v. Excel Corp.*, 197 F.3d 200, 207 n.18 (5th Cir. 1999); *State v. Martinez*, 116 S.W.3d 385, 393 (Tex. App.—El Paso 2003, no pet.).

19 *See U.S. v. Robinson*, 121 F.3d 971, 976 (5th Cir. 1997) (citing *U.S. v. Melvin*, 650 F.2d 641, 646–47 (5th Cir. 1981)).

20 *League of United Latin Am. Citizens v. Abbott*, 342 F.R.D. 227, 231 (W.D. Tex. 2022).

21 *Id.* at 236.

22 *Id.*

23 *Id.*

24 *Total Rx Care, LLC v. Great Northern Ins. Co.*, 318 F.R.D. 587, 596 (N.D. Tex. 2017) (internal quotation marks and citation omitted).

25 *See e.g., In re TETRA Techs., Inc. Sec. Litig.*, No. 4:08-CV-0965, 2010 WL 1335431, at *5 (S.D. Tex. Apr. 5, 2010) (finding that communications with attorney that included a broker maintained privilege so long as the communications were "to facilitate the rendition of legal services"); *Homeland Ins. Co. of N.Y. v. Clinical Pathology Labs., Inc.*, No. 1-20-CV-783-RP, 2022 WL 17255798, at *3 (W.D. Tex. Nov. 28, 2022) (holding that "Rule 503(B) protects not only confidential communications between the lawyer and the client, but also the discourse among their representatives" so long as the other requirements are met) (quoting *In re XL Specialty Ins. Co.*, 373 S.W.3d 46, 49–50 (Tex. 2012)).

26 *In re Fontenot*, 13 S.W.3d 111, 113-–14 (Tex. App.—Fort Worth 2000, no pet.).

27 *In re ExxonMobil Corp.*, 97 S.W.3d 353, 357 (Tex. App.—Houston [14th Dist.] 2003, no pet.).

28 *Id.* at 357-58 (quoting *Pittsburgh Corning Corp. v. Caldwell*, 861 S.W.2d 423, 425 (Tex. App.—Houston [14th Dist.] 1993, orig. proceeding)).

29 *See Jordan v. Ct. of App. for Fourth Sup. Jud. Dist.*, 701 S.W.2d 644, 648-49 (Tex. 1985).

30 Tex. R. Evid. 503.

31 *Id.*

32 *In re Park Cities Bank*, 409 S.W.3d 859, 868 (Tex. App.—Tyler 2013, no pet.) (holding that a party may assert the privilege throughout the discovery process by withholding documents and providing evidence of the applicability of the privilege).

33 *Jolivet v. Compass Groups USA, Inc.*, 340 F.R.D. 7, 21 (N.D. Tex. 2021) (citation omitted).

34 *See Morrison v. State*, 575 S.W.3d 1, 26 (Tex. App.—Texarkana 2019, no pet.).

35 *See id*; *see also* Tex. R. Prof. Conduct 1.05(b)-(d).

36 *Niehay*, 641 S.W.3d at 789 (citing Tex. R. Evid. 511(a)(1)).

37 *See id.* at 790 (citing *Granada Corp. v. Hon. First Ct. of App.*, 844 S.W.2d 223, 226 (Tex. 1992) (failure to take reasonable precaution in document production that results in an inadvertent disclosure constitutes a waiver of the attorney–client privilege); *Delaporte v. Preston Square, Inc.*, 680 S.W.2d 561, 564 (Tex.

App.—Dallas 1984, writ ref'd n.r.e.) (a party's "failure to assert the attorney-client privilege at the time of his deposition resulted in a waiver of the matter being protected by the attorney-client privilege"); *Eloise Bauer & Assocs., Inc. v. Elec. Realty Assocs., Inc.*, 621 S.W.2d 200, 204 (Tex. App.—Texarkana 1981, writ ref'd n.r.e.) (failure to object to question regarding a written communication between the attorney and client waives the privilege)).

38 Tex. R. Evid. 511(b)(2).

39 Tex. R. Evid. 193.3(d).

40 *Granada Corp.*, 844 S.W.2d at 226.

41 *Id.*

42 *See Ginsberg v. Fifth Court of Appeals*, 686 S.W.2d 105, 107 (Tex. 1985).

43 *See Parten v. Brigham*, 785 S.W.2d 165, 168 (Tex. App.—Fort Worth 1989, no writ).

44 *Republic Ins. Co. v. Davis*, 856 S.W.2d 158, 164 (Tex. 1993).

45 *See Volcanic Gardens Mgmt. Co., Inc. v. Paxson*, 847 S.W.2d 343, 346-47 (Tex. App.—El Paso 1993, no writ) (applying the exception where an attorney declined to further represent a client because he believed the claim was fraudulent); *In re USA Waste Mgmt. Res., L.L.C.*, 387 S.W.3d 92, 98 (Tex. App.—Houston [14th Dist.] 2012, no pet.) (declining a waiver of the attorney-client privilege where the party asserting the exception could not connect the communications to the alleged crime).

46 Tex. R. Evid. 503(d)(1).

47 *See In re XL Specialty Ins. Co.*, 373 S.W.3d at 50–51; *In re JDN Real Estate-McKinney L.P.*, 211 S.W.3d 907, 922 (Tex. App.—Dallas 2006, pet. denied); *see also* Tex. R. Evid. 503(d)(5).

48 *See In re XL Specialty Ins. Co.*, 373 S.W. 3d at 53–55.

49 *Id.*

50 *In re Skiles*, 102 S.W.3d 323, 325–27 (Tex. App.—Beaumont 2003, no pet.) (per curiam).

51 *See In re XL Specialty Ins. Co.*, 373 S.W. 3d at 53.

52 *Travelers Prop. Cas. Co. of Am. v. 100 Renaissance, LLC*, 308 So.3d 847, 857 (Miss. 2020), reh'g denied (Jan. 14, 2021).

53 *Id.* at 848.

54 *Id.*

55 *Id.*

56 *Id.* at 849.

57 *Id.*

58 *Id.* at 849-–50.

59 *Id.* at 850–53.

60 *Id.* at 853.

61 *Id.*

62 *Id.*

63 *Id.*

64 *Id.* at 855.

65 *Id.*

66 *Id.*

67 *Id.*

68 *Id.*

69 *Id.* at 857.

70 *OneBeacon Ins. Co.*, 2013 WL 6002166, at *4.

71 *Lanelogic, Inc. v. Great Am. Spirit Ins. Co.*, No. 3-08-CV-1164-BD, 2010 WL 1839294, at *5 (N.D. Tex. 2010).

72 *Id.*

73 *Id.*, at *5 (quoting *Piatkowski v. Abdon Callais Offshore, L.L.C.*, No. Civ. A. 99–3759, 2000 WL 1145825, at *2 (E.D. La. Aug.11, 2000)).

74 *See generally id.*

75 *OneBeacon Ins. Co.*, 2013 WL 6002166, at *3 (internal citations and quotation marks omitted).

76 *Id.* at *5.

77 *Compare OneBeacon Ins. Co.*, 2013 WL 6002166, at *6 *with Lanelogic*, 2010 WL 1839294, at *7.

78 *Skogen v. RFJ Auto Group, Inc. Emp. Benefit Plan*, No. 4:19-CV-585-SDJ-KPJ, 2020 WL 5039101, at *3 (E.D. Tex. 2020).

79 *Id.*

By John D. Wood, Esq., Green, Klein, Wood and Jones

WILL "GREEN UPGRADE" COVERAGE BRING POLICYHOLDERS TO GREENER PASTURES?

Introduction

This article critically compares "green" insurance with traditional "actual cash value," "replacement cost value," and "ordinance and law" coverages; expresses concerns over illusory coverage; warns against a particular moral hazard called "immune breach" of the policy; and encourages property owners to purchase so-called "green" upgrades.

Introducing "Green" Insurance

So-called green buildings are becoming increasingly popular. A green building is "a development that stresses the holistic practice of creating structures so as to produce, operate, and maintain a building that brings together respect for the environment, conservation of materials, efficient utilization of resources, and provides positive influences on its occupants while aspiring to sustainability."[1] A number of pressures are driving corporations to adopt so-called "Economic, Social, and Governance" practice improvements in governance, including financial viability, changes to regulatory policy, consumer and investor pressure, and the enlightened self-interest demonstrated by corporate social responsibility.[2] These insured assets present unique risks and insurance coverage opportunities.

Attorneys representing policyholders should anticipate whether their clients' insurance needs are being met by the products they purchase. The value of these policies depends on the coverage afforded, the conditions precedent to payment, the exclusions that pare back on these coverages, and whether the insurance company complies with its contractual duties by paying out on losses in good faith and without requiring insureds to undertake costly efforts to receive the benefits for which they bargained. To properly appreciate the benefits from obtaining "green upgrade" insurance, we must first consider the limitations of alternative forms of property insurance.

"A typical property insurance policy covers the costs to reconstruct or replace property damaged as the result of a casualty based on a valuation of the building or loss."[3] "At its core, the insurance system attempts to transfer a loss through a contractual relationship whereby an insured conveys a benefit to an insurer in exchange for the obligation to perform at a later point in time. The benefits received by an insurer generally make it liable for providing resources to compensate an insured for its loss in an amount sufficient to return the property to a condition reasonably comparable to its condition prior to the casualty."[4]

Because a "green" building is substantially different than a building comprised of traditional construction materials and methods, it presents a different risk. Accordingly, "The Insurance Services Office (ISO) and insurance carriers offer specific green building endorsements in an effort to augment the underlying property policy" to adequately insure this asset class.[5]

Green building endorsements appear to offer far superior benefits to policyholders than Actual Cash Value ("ACV"), Replacement Cost Value ("RCV"), and Ordinance and Law ("O&L") insurance. To better understand green building endorsements, this article first reviews the basic principles of valuing insured losses that pre-date these endorsements and which have set the stage of caselaw that will be used to interpret same.

Actual Cash Value Coverage Can Be a Wind Egg

The weakest form of coverage for an insured physical property is where the value of the asset is calculated using the ACV valuation method. "In an ACV valuation, the coverage

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is determined by subtracting the depreciated use from the current cost of replacement."[6] Depreciation in general means the wear and tear physical structures are subject to, from the time they were built to the time in which the covered peril occurred. Depreciation is incremental obsolescence.

An ACV-only policy does not make the insured whole again after a property casualty event because the ACV approach, "often fails to provide the covered party with sufficient funds to rebuild after a loss." An ACV settlement frequently, "does not even return the property to working order."[7] The sad reality for policyholders with ACV-only coverage on an older building is they probably do not realize they are only entitled to the depreciated value of the damaged property.

Because it deducts depreciation, ACV is therefore a minimum viable product at best, especially where the insured owns property that is not conforming to the current building code. The discount received for choosing ACV instead of, for example, RCV which we discuss next, is likely not worth the savings for most owners. To be clear, ACV insurance is not appropriate when insuring a Class A commercial, LEED-certified, or anything potentially considered to be a "green," building. Because of these deficiencies in risk sharing, banks and other mortgagees should require better than ACV coverage to insure the collateral on real estate loans.

The Typical Two-Step Payment Process for RCV Claims Creates a Moral Hazard that Puts Policyholders at Risk of an "Immune Breach"

In contrast to ACV coverage, "a replacement cost approach covers the property without the reduction for depreciation. This effectively allows a property owner to receive a 'new' property for an 'old' one at the insurer's expense."[8] As the name implies, the replacement cost valuation is based on what it would cost in today's market to replace the damaged property, regardless of the condition of the property at the time of the loss. This is premised on the notion that the insurance company insures the property as they find it. This is fair because an insurance company can avail itself of underwriting practices on the assets they insure.

A standard RCV provision reads as follows:

> A1 — Replacement Cost Loss Settlement — Similar Construction is replaced with the following: a. We will pay the cost to repair or replace with similar construction and for the same use on the premises shown in the Declarations, the damaged part of the property covered under SECTION I — COVERAGES, COVERAGE A — DWELLING, except for wood fences, subject to the following: (1) until actual repair or replacement is completed, we will pay only the actual cash value at the time of the loss of the damaged part of the property, up to the applicable limit of liability shown in the Declarations, not to exceed the cost to repair or replace the damaged part of the property; (2) when the repair or replacement is actually completed, we will pay the covered additional amount you actually and necessarily spend to repair or replace the damaged part of the property, or an amount up to the applicable limit of liability shown in the Declarations, whichever is less; (3) to receive any additional payments on a replacement cost basis, you must complete the actual repair or replacement of the damaged part of the property within two years after the date of loss, and notify us within 30 days after the work has been completed; and (4) we will not pay for increased costs resulting from enforcement of any ordinance or law regulating the construction, repair or demolition of a building or other structure, except as provided under Option OL — Building Ordinance or Law Coverage.

In *Latigo Plaza, Inc. v. Travelers Lloyds Ins. Co.*, plaintiffs owned commercial properties insured against loss by wind and hail.[9] After plaintiffs submitted their claims, the insurance company's adjuster advised them, "under the Policy until the damaged property is actually repaired or replaced, Travelers would make payment based solely on the Actual Cash Value of the repairs, which it defined as the cost of repairing or replacing the damaged property less reasonable depreciation for age, wear and tear, deterioration and obsolescence. Plaintiffs were further advised that once the repairs were made, they could then recover the depreciation costs that had been withheld."[10]

This two-step process is typical of property & casualty claims settlement practices in Texas. The initial payment of the actual cash value amount is ordinarily used as something of a down payment to kick-start the commencement of repairs to the lost or damaged property. Once the repairs are completed, the insured is supposed to receive the withheld depreciated amount in which case they will finally be paid the full benefit of the insurance policy.

In general, a replacement cost coverage clause requiring repairs or replacements to be made before the insured can recover costs for same is enforceable.[11] Where such language is found, the insured might be required to replace the destroyed property out of pocket (through working capital, tapping a line of credit, or otherwise) before it is entitled to recovery of replacement cost proceeds. What happens under the common scenario when the insurance company refuses to properly pay the actual cash value, and the insured does not have enough money to commence repairs? Most policyholders do not have the available working capital or credit to fund complete replacement of all damaged

property without adequate assistance from their insurance company. Let's call this hypothetical scenario the "immune breach" where the carrier fails to pay enough for the insured to complete repairs, the insured lacks the financial means to complete them, and is unable to do so before instituting a lawsuit to recover damages.

Policyholder attorneys should be careful to advise their clients with RCV coverage about potential pitfalls in tapping the full benefits of these policies. Insurance carriers might attempt to leverage certain fact patterns against the policyholder to undermine the value of RCV coverage by effectively imposing a pre-suit requirement on policyholders of a financial outlay up to the entire value of the damaged property before triggering the carrier's duty to pay those replacement costs. As such, vast swathes of the marketplace may be unwittingly financially exposed as under-insured despite reasonable expectations of having an insurance product that purports to pay to replace their damaged property.

This outcome was avoided in *State Farm Lloyds v. Hanson*[12], but only by a default in the defense's motion practice. In *Hanson* the Houston Court of Appeal noted:

> State Farm argues even if Hanson provided evidence that her roof sustained a covered loss, she failed to prove that she satisfied the policy's condition precedent to trigger any obligation for State Farm to make replacement cost payments. State Farm points to language within the loss settlement endorsement of Hanson's policy stating that State Farm would only pay the actual cash value at the time of the loss of the damaged part of the property, up to policy limits and not to exceed the cost to repair or replace the damaged part, 'until actual repair or replacement is completed.' […] In her petition, Hanson averred that '[a]ll conditions precedent to Plaintiff's right to recover have been fully performed, or have been waived by Defendants.' By operation of Rule 54, Hanson was required to prove only the conditions precedent that State Farm specifically denied. In its answer, with regard to conditions precedent… State Farm, however, did not specifically deny that Hanson was not entitled to repair or replacement costs because she had not completed actual repair or replacement. Therefore, assuming without deciding actual repair or replacement was a condition precedent to Hanson's recovery of repair or replacement benefits pursuant to her policy, because State Farm did not specifically deny this condition precedent, Hanson was not required to prove at trial that she had completed any actual repair or replacement.[13]

The *Hanson* outcome is fair, but only accidentally so—the insured enjoyed the benefit of RCV coverage despite experiencing an "immune breach" scenario, only because State Farm failed to specifically deny the condition precedent had occurred.

In other cases, policyholders have been less fortunate. That repairs must actually be made before recovering the depreciation holdback is articulated in *Fitzhugh 25 Partners*,[14] which *Hanson* distinguishes because, "there the insurer did not wholesale deny coverage, but rather disputed its liability for any additional replacement costs after acknowledging coverage for the insured's claim and tendering actual cash value of the damaged property."[15]

Courts should consider the insurance company's claims handling practices in any given dispute to determine whether it would have been fair or reasonable to require the insured to comply with any condition in the policy when the insurance company is themselves in breach. It is unfair to allow insurance companies to selectively enforce the terms and conditions in their policies.

Unless this line of reasoning is disavowed carriers could attempt to effectively eviscerate the additional benefit provided by RCV coverage when compared to ACV coverage. Under a certain set of facts, the defense argument seems to imply that all you have to do to convert an RCV policy into an ACV policy is to breach the contract and unless the insured completely funds the repairs before initiating the suit, the carrier would only be ordered to pay the ACV amount, if anything. If that argument gained traction and were accepted by the courts (and it should not), it would preclude all but the wealthiest policyholders from ever receiving the benefit of the bargain.

The Doctrine of Prevention Should Apply Wherever the Insured is Unable to Perform Repairs Because of the Carrier's Breach of the Policy

Texas law provides a well-recognized "doctrine of prevention" that has been—and should continue to be—applied in the circumstances underlying the "immune breach" scenario. Under the doctrine of prevention, "when a promisor wrongfully prevents a condition from occurring that condition is excused." *Devonshire*, 2014 U.S. Dist. LEXIS 135939, at *20.[16] In *Service Steel Warehouse Co. v. Ace Am. Ins. Co.*, No. H-09-691, 2011 WL 43425, at *1 (S.D. Tex. Jan. 6, 2011), the court held that when an insurer fails to properly tender ACV, the insured may be excused from the replacement requirement and still recover full RCV benefits. *Id.* & n.2; COUCH ON INSURANCE § 176:59 (3d ed. Westlaw 2011) ("Even where actual replacement is mandated, compliance may be excused by the insurer's actions. The insurer's failure to advance the necessary funds to rebuild may have this effect."). "The doctrine of prevention does

not require proof that the condition would have occurred 'but for' the wrongful conduct of the promisor but requires only that the promisor's conduct contributed materially to the nonoccurrence of the condition." *D & S Realty, Inc. v. Markel Ins. Co*., 816 N.W.2d 1, 16 (Neb. 2012).

Devonshire discusses that "in cases where the doctrine has been applied to allow an insured to recover replacement costs, the insurer either completely denied the claim **or** refused to make any payments until it was too late for the insured, who was frequently an unsophisticated party, to make repairs." *Devonshire*, 2014 WL 4796967, at *7 (emphasis added). To be fair, the doctrine of prevention should also be applied to benefit sophisticated policyholders as well.[17]

The United States District Court has noted, "by contrast ... courts have refused to extend the doctrine where the insurer already paid the insured actual cash value" *Devonshire*, 2014 WL 4796967, at *7. However, this refusal to apply the doctrine of prevention could be misguided if it is based on the assumption that any ACV payment is good enough—as this is not always true.

In *D & S Realty, Inc. v. Markel Ins. Co., supra,* the Nebraska Supreme court discussed the differences between ACV and RCV policies and noted that a requirement that the insured repair or replace the damaged property as a condition to recovering replacement cost damages is generally enforceable.[18] The Court further noted that, "we must determine whether and under what circumstances a wrongful denial of coverage excuses the insured's duty to comply with the repair/replace condition."[19] The Supreme Court refused to limit the doctrine of prevention to bad faith denials by an insurer and stated: "[W]hether the denial was in good or bad faith, it would be 'wasteful[] and useless' to require the insured to comply with the repair/replace condition when, by doing so, the insured would not obtain recognition of coverage. The law does not require the doing of a useless act. According to Williston on Contracts, 'the performance of a condition precedent is waived where the other party has unequivocally declared by word or act that performance of the condition will not secure performance of the counter-promise.' Courts have explained that not allowing claims of prevention based on the erroneous denial of coverage would trap the insured 'in a no win situation.' The insured, in order to recover under the replacement cost coverage he or she purchased, would have to incur the cost of repairs and replacements when there is no guarantee that a future breach of contract action by the insured will be successful.[20]

Failing to apply the doctrine of prevention can lead to egregiously unfair outcomes. In *Versai*, the policyholder suffered tens of millions in uncompensated loss despite having adequate coverage because the court did not apply the doctrine of prevention and thus allowed an "immune breach" to occur. The Fifth Circuit Court of Appeals per curiam discusses the Hurricane Katrina dispute as follows:

> The Lloyds insurance policy insured the Versailles Arms Apartments property against "Risks of Direct Physical Loss or Damage," and the policy's basis of valuation hinges on Versai's replacement efforts. The "Replacement Cost Endorsement" provision of the insurance policy states, in Subparagraph "d," that "[u]ntil replacement has been effected the amount of liability under this Policy in respect of loss shall be limited to actual cash value at the time of loss." Subparagraph "c" requires Versai to execute this replacement with "due diligence and dispatch." The district court interpreted these provisions to mean that "[t]he insured cannot recover replacement costs until such time as repairs are actually made."
>
> Versai asks the court to find that the insurers' duties to pay replacement costs is triggered when Versai demonstrates "readiness" to enact replacements on the property. The language of the contract does not support his interpretation… . Versai is not entitled to payment because it has not made the requisite replacements to be entitled to reimbursement.[21]

Versai is problematic for several reasons. First it failed to apply the doctrine of prevention. Second, the definition of "effected" in the policy, as in the sentence, "until the replacement has been effected," could have reasonably been construed differently. Specifically, "effected" even in the past tense, could have meant the same as "actually and necessarily incurred"—and could be interpreted in such a manner as to have this condition satisfied by the policyholder entering a reconstruction contract to make repairs of the loss underlying the dispute. If so, the replacement has been "effected" when the insured has entered into a binding contract to bring about the replacement through operation of that contract. Alternatively, assuming the phrase "replacement has been effected" means the repairs must have been made by the policyholder to trigger liability for the RCV amount, then this undercuts the carrier's argument over the Municipal Ordinance Extension (discussed below), which requires only the costs be "incurred" rather than "replacement has been effected." Alternatively, assuming the Replacement Cost Endorsement was correctly construed, the precondition that the repairs actually be made, should be waived in any case where the carrier's breach prevents the insured from completing the repairs.

Thus, whenever the total amount of coverage implicated by a loss is not actually transferred through these risk sharing

instruments to the policyholders, less materials are ordered, less workers are engaged, less damaged property is renovated than what should have been the case. Communities impacted by property casualty and loss are subject to the economic drag of delays or diminutions in claim payments, and in some cases never recover.

This is illustrated by the facts of *Versai*. The coverage provided to the policyholder in that dispute purported to provide Replacement Cost Coverage as well as a Municipal Ordinance Extension to pay for the cost of building code compliance. However, because the insured did not pay what was estimated to be around twelve million dollars in unpaid replacement costs and around ten million dollars out of pocket in code compliance costs before initiating the suit, the insurance carriers were granted summary judgment on the breach of contract and virtually all other claims. The facts of *Versai* are set forth in more detail in endnote 22.[22]

Ordinance and Law Coverage Can be Severely Limited By Conditions Precedent

As the difference between ACV and RCV coverage demonstrates, the way a property is valued determines in part how much of the risk of casualty and loss the insured can contractually shift to the insurance carrier. Other factors driving the amount of risk sharing effectuated by an insurance policy are the exclusions and limitations imposed on the insured. For example, standard exclusionary language found in a cause-of-loss form will exclude loss amounts from so-called "ordinance and law"; that is, many policies limit or entirely avoid coverage for loss caused not by a sudden and accidental direct physical loss but rather by the "enforcement of any ordinance or law regulating construction, repair or demolition of a building or other structure, unless endorsed to this policy."[23]

In Texas, the "building, zoning or land use ordinance or law" at issue in these cases is found in the International Residential Code, as adopted by the State of Texas.[24] The facts in *St. Luke's Episcopal Health Sys. Corp. v. Factory Mut. Ins. Co.*, illustrate some of the practical limitations policyholders face when seeking to obtain the benefits of Ordinance and Law Coverage:[25]

St. Luke's Episcopal Hospital bought coverage from Factory Mutual Insurance Company for

> property damage and business interruption. In June 2001, tropical storm Allison struck Houston, flooding the hospital's basement. It lost power from damage to its electrical switchgear, consisting primarily of normal and emergency power distribution centers.
>
> Funded by Factory, the hospital used its own electrical contractor to repair or replace the distributors. Within ten days, the initial repairs were completed, and the hospital re-opened. The hospital's claim for reconstruction included the cost to replace the refurbished distributors with new distributors. It claims the refurbished distributors do not meet code requirements because they are unlisted by a nationally recognized agency, like Underwriter Laboratories…
>
> [In response to requests for information], [t]he hospital responded with a January 15, 2002, letter, written by John M. Evans, Jr. of the Texas Department of Health, at the request of the Federal Emergency Management Agency. It addressed the expiration of temporary relocation waivers granted to hospitals after the flood allowing them to move patients to a location not covered by its license. It also expressed the department's position that when functional components are repaired or replaced, the system must still meet code standards.
>
> Out of a $95,630,993 proof of loss claim by the hospital, the parties agreed on $60,599,879 as undisputed. Factory rejected the remainder, refusing to replace the repaired equipment with new equipment. Relying on Evans' testimony, Factory argues that the January letter was not technically a deficiency notice and, therefore, did not constitute administrative action directed to the hospital. St. Luke's then sued. […]

The Court analyzed the policy in determining whether Factory had a duty to replace the equipment and specifically discussed whether the city actually enforced code requirements, noting:

> "Enforcement" is the "carrying out of a mandate or a command." BLACK'S LAW DICTIONARY 528 (6th ed. 1990). The phrase "enforcement of a law" focuses not on what the code technically says but on what building officials actually require. The city carries out the "mandate or command" of a code provision by executing building standards and withholding permits for construction in violation of those standards. Here, no positive action was undertaken by city officials, nor was the hospital sanctioned as a result of the alleged noncompliance…

According to the hospital, the letter mandates compliance with new construction requirements of Chapter 133 of the Texas Administrative Code. This includes requiring that systems be listed with a nationally recognized listing agency. The hospital is wrong.

When the health department intends to notify a hospital of a rule violation, it issues a deficiency notice. The 2002 letter it is not a deficiency notice. John Evans, who penned the letter, attests that its intent was not to require replacement of the hospital's basement-level equipment with new UL-listed equipment. Instead, the letter addressed temporary relocation waivers and required repaired or replaced equipment to function properly. Indeed, the letter itself explains that "when renovations take place and repairs are made to functional components, the entire system shall *perform* up to the standards contained in the rules." (emphasis added). The letter does not mandate the replacement of an entire system as a result of repairs or replacements to that system. If that were the case, each time a hospital replaced a fan motor on an older air conditioning system, the entire system would have to be evaluated for current compliance and potentially replaced. According to Evans, this is not the intent of the department rules, nor how they were then interpreted. Instead, the 2002 letter was simply a letter issued to FEMA at FEMA's request to clarify relocation waiver issues allowing the agency to release funds.…

St. Luke's has been open and operating its repaired equipment, with health department approval, for more than five years. The department of health inspected the repaired equipment before allowing the hospital to reopen, and has frequently inspected the hospital since. There has been no enforcement of a law or ordinance as required under the policy. The hospital cannot show that it was not restored to its pre-flood conditions. Factory has, therefore, complied with all applicable provisions of its policy.

There are a few problems with the outcome in *St. Luke's Episcopal*. The operative fact to trigger the demolition and increased cost of construction provision is some positive action undertaken by city officials such as a red tag notice or an actual sanction for noncompliance. If this is the correct legal standard, then insureds' rights are eviscerated by the dereliction of duty by government officials. This is contrary to public policy for (1) enforcement of building codes, (2) construing the insurance policy in favor of coverage, and (3) not creating a moral hazard whereby insureds have an incentive to flagrantly violate the building code to incur an enforcement action for noncompliance.

A second public policy issue with requiring an actual deficiency notice to trigger code compliance coverage is the notion that we should not be focused on what the code literally specifies for technical requirements. Under this reasoning the insurance company never has to pay for code compliance as long as the building department is lax—even if the insured has to incur the costs of compliance to avoid committing a misdemeanor.

In other cases, local building authorities have been more zealous than those in *St. Luke's Episcopal* in taking enforcement action. See, *e.g.*, *Port Cargo Service, LLC v. Certain Underwriters at Lloyd's,* where property damage from an EF-3 tornado was so severe that it prompted the City of New Orleans to write to the policyholder, declaring that the property was, "damaged at approximately ninety-five percent (95%) . . . only a complete rebuild will achieve current code compliance," and "any newly rebuilt structure would need to be 'elevated to current City and Federal flood elevation requirements in order to be compliant.'"[26]

An extraordinary incident of municipal official action that did entitle the policyholder to Ordinance & Law coverage for repair of undamaged property as a result of bringing it into compliance with building code is described in *Houston Specialty Ins. Co. v. Meadows West Condo Assoc*:[27]

> The Property consists of 124 condominium units situated in 18 buildings. The fire damaged two units, 166 and 167, both located in one building. The remaining 17 buildings were undamaged. There is no dispute that HSIC paid the claim submitted by Meadows West related to damages to Units 166 and 167-$48,876.80 as replacement cost to repair the building damage and for lost business income. What is in dispute is Meadows West's claim for the costs associated with reconfiguring the duct work in units that were not damaged by the December 26, 2012 fire. Meadows West contends there is coverage for those costs under the Policy's Ordinance or Law provision. HSIC filed this declaratory judgment action seeking a declaration that there is no such coverage under the Policy.

The court discussed the Fire Department's investigation, including a certified letter requiring the building to retain a mechanical engineer to redesign the unsafe conditions and

that if the building did not reply in a timely manner, they would file a legal action. In response:

> Meadows West contracted with a Louisiana registered architect to design a rigid metal duct work layout and then contracted with a Louisiana licensed commercial contractor to perform the removal and installation in order to replace the flex duct work, per Manuel's "suggestion."
>
> The proposed repair was reviewed and permitted by Manuel and the Lafayette Consolidated Government. The work was completed by the end of July 2013 throughout all 18 buildings of the property for a cost of $316,489.10. An insurance claim for these costs was submitted to HSIC. By letter dated April 16, 2013, HSIC denied coverage for the costs to reconfigure the duct work not damaged in the fire. The letter stated that "the Policy covers direct physical damage or loss to the Property." It also stated that the Ordinance or Law provision of the Policy did not apply because "(1) there was no applicable ordinance or law at the time of loss regulating the repair or reconstruction of the duct work; and (2) to the extent Meadows asserts there is such an ordinance or law, Meadows failed to comply with the ordinance or law before the fire loss at issue."
>
> Citing the Policy Exclusions, HSIC stated, "[e]ven if the reconfiguration of the duct work were to fall within the Ordinance or Law coverage, the coverage must be read in conjunction with the Policy's exclusions" (1) Faulty or Defective or Inadequate Construction/ Workmanship/Maintenance and (2) Governmental Action. …
>
> HSIC further argues that Section 116 relates to the process and authority for a building official to address unsafe structures and does not govern how such buildings should be repaired or constructed. HSIC cites Manuel's January 18, 2013, letter in support of its position that Manuel was not enforcing or seeking to enforce an actual ordinance or law requiring demolition and regulating repair. HSIC notes that in the letter Manuel "requested" that a Louisiana licensed contractor make the necessary repairs and stated that he could not design such a repair but made "suggestions" in that regard. HSIC further notes that neither Manuel nor Chaisson cited any ordinance or law Meadows West had to follow.[28]

The court disagreed and found coverage. However, in the *Meadows West* case, the policyholder benefited by an extraordinarily assertive local building official that literally coerced the insured into complying with the International Building Code at peril of shutting off the power to the noncompliant property. This should not be the legal standard for whether code compliance costs are due, or we will end up with systematically under-enforced building codes which exist to protect consumers.

In *Toney v. State Farm Lloyds*, a letter from the city requiring the insured to comply with the code was not considered to be enforcement because the city retracted it:[29]

> Plaintiff filed a homeowner's insurance claim with State Farm for damages resulting from a hail and windstorm which occurred on March 28, 2012. Thereafter, Plaintiff invoked the appraisal provision of the policy, and the appraisers agreed on an appraisal award of $67,431.47 on November 13, 2012. A portion of the appraisal award, totaling $9,076.63, was allocated for new roof bracing, which consisted of a solid plywood understructure ("solid decking"), as a replacement for the then existing bracing, consisting of a spaced plywood understructure ("spaced decking"). It is undisputed that the disputed, roof-replacement portion of the appraisal award is required, if at all, due to code requirements governing roof repairs, and not because the decking itself was damaged.
>
> Decking requirements for roof repairs are governed by the International Residential Code ("IRC"), as adopted by the State of Texas. On October 24, 2012, the City of Mission issued the first of two letters ("October-24 Letter"), with the salutation "To Whom It May Concern," stating: "It has been confirmed by the [International Code Council] that the City of Mission, Texas require [sic] [solid decking] for all wood frame construction as per IRC." On November 21, 2012, State Farm sent a letter to the Toneys advising them it was paying the appraisal award but was withholding $9,076.63 pending investigation of roof-replacement policy requirements. On January 22, 2013, City issued a second letter ("January-22 Letter") stating that, after its investigation of code requirements, "if the roof has pre-existing spaced sheathing, the code does not require solid sheathing to be placed for a re-roofing project." Thereafter, on February 14, 2013, State Farm sent a second letter advising the Toneys that no coverage existed for the $9,076.63 cost associated with the more expensive decking…
>
> In the motion and response, the parties do not disagree that enforcement is required in order to actuate Defendant's liability; instead, the parties dispute when and whether enforcement occurred. In its motion, Defendant asserts contractual compliance because there is no evidence of enforcement. Specifically, Defendant points to the lack of evidence of the City withholding a building permit pertaining to the Toneys' roof or sanctioning the Toneys for failing to replace any part of the roof with solid wood decking. For his part, Plaintiff argues that the enforcement

> condition is satisfied by the October-24 Letter, in which the City set forth the ICC's interpretation of the IRC as requiring repairs to roofs which previously featured spaced decking to feature solid decking; as a result, Plaintiff argues that the City was enforcing the solid-decking requirement at the time the home was damaged….
>
> The crux of these competing contentions is whether the City's issuance of the letter constitutes enforcement under the contract. The Court finds that the letter does not constitute enforcement, and that the City had not effected enforcement of the requirement[….]

In sum, the enforcement action of the local building officials and other municipal authorities may be dispositive in a dispute over whether payment is due for costs to comply with the building code. This is an unreasonable standard. We should encourage all repairs to comply with the highest applicable standard regardless of the enforcement appetite of local authorities. Public policy favors requiring carriers to pay for costs of code compliance without regard to whether these are enforced at the time. The reasoning is similar to requiring drivers to comply with the speed limit, even if the speed limit is not currently being enforced by law enforcement on the side of the road with radar guns aimed at oncoming traffic.

The building code, and the speed limit, exist to keep humans from recklessly killing themselves and others. "We are a nation of laws, not of men" finds new meaning here. We should build our structures in compliance with the stated rules for buildings to be safe, with no regard given to whether local authorities comply with their own duties to issue deficiency notices. The policyholder's rights should not be so arbitrarily impacted.

To be "Paid" or to be "Incurred" Makes All the Difference in the World for the Typical Insured

Policyholders should be mindful of the conditions precedent to recovery in Ordinance & Law coverages. Again, the *Versai* decision is instructive. To wit, the plain language of a key term in the policy was apparently given the wrong definition, and this erroneous definition was used against the policyholder to deprive it of the benefits of the Municipal Ordinance Extension for which it bargained.

> Versai's insurance policy includes a "Municipal Ordinance Extension" covering regulatory compliance costs incurred because of property damage from an event such as Hurricane Katrina. When certain preconditions are met, the policy *then* "insures costs actually and necessarily *incurred* in (a) the demolition and clearing of the site of the undamaged portion of the insured building, and (b) reconstructing the building to conform with the law or ordinance." (emphasis added). Versai concedes that "the repairs [to the Versailles Arms apartments] have not been completed," and it fails to identify any costs which have already been incurred. Although Versai may be able to show anticipated costs of complying with current building codes, Versai's insurance policy is explicit: Versai is not entitled to costs of compliance until after it has incurred the expenses of code compliance….
>
> Versai's claim for replacement costs likewise was properly dismissed because Versai has not completed repairs on its property as required by the insurance policy.[30]

To be clear, the apparent mistake lies with the meaning attributed to the word, "incur." Incur does not mean "already paid my bill." A patron at a restaurant "incurs" the cost of her meal merely by ordering it, not by having already paid for it. We do not ordinarily use the phrase "incur" to talk about past payments but rather future liabilities, and terms used in contracts should be given their plain and ordinary meaning. Beyond common usage, the dictionaries support this interpretation as well. To "incur" a cost means to become subject to that cost, to become liable for a cost—it does not mean "to have already paid" that cost.[31] Entering into a contract to perform the work is an "incurred cost" because it is the undertaking of a contractual liability; the restoration contractor could sue the policyholder for specific performance; the insured is now subject to the cost of code compliance because the insured entered into a contract the performance of which would invariably (actually and necessarily) require the insured to pay for these costs. If the insurance company wanted to require the insured to pay for these costs in advance of remitting payment, then the policy term could have read, "paid or incurred," as most policies do. But it did not. Whether the policy language is "paid" or "incurred" or both, the insured should receive the full benefit of the policy by entering into a restoration contract to complete the repairs, not by having already spent the money on repairs.

Courts should require no more than the policyholder entering into a contract to complete repairs, to constitute compliance with a policy provision requiring insureds to "incur" a cost before the carrier's liability is triggered. Forcing the insured to actually spend the money when the policy only requires the loss amount to be incurred does violence to the plain language of these contracts and imposes onerous financial burdens on policyholders just to recover what they are entitled.

In reflecting on these code compliance cases, it may be that the courts are getting these disputes right, but the insurance carriers are wrong in writing these policies to completely shift this cost of code compliance to consumers of insurance products. The risk transfer of the cost of code compliance to the policyholders has been overwhelmingly effective. It may be Texas Department of Insurance should take a hard look at the number of caveats to effective coverage that have been introduced into P&C policies in this state.

The Illusory Coverage Doctrine Should be Used to Reform ACV and RCV Coverages in Certain Cases

The illusory coverage doctrine is implicated by ACV policies where depreciation is applied so aggressively and the settlement value is so paltry the policyholder is unable to do anything close to what they bargained for when they procured insurance in the first place. The illusory coverage doctrine might also be implicated by the "immune breach" scenario in the context of disputed RCV claims. Further, we might ask, how should a court construe an insurance policy that purports to insure against hail loss, and yet provides such an aggressive "cosmetic damage waiver" that all but eliminates coverage for hail damage to a metal roof? What about an insurance policy that purports to provide replacement cost coverage against all perils for the insured asset, and yet includes an actual-cash-value endorsement for roofing surfaces that eviscerates the value of the policy after a hailstorm? Or what about an insurance policy that purports to pay for costs to comply with the building code, but not if the property did not comply before the loss, and if the property was fully in compliant before the loss, the carrier will only pay for code compliance if the building owner first receives a violation notice from the building code official (a seemingly impossible confluence of events)?

These scenarios are in certain respects analogous to illusory coverage doctrine cases; for example, a "liability insurance policy sold to DISH Network that contains an exclusion for liability 'arising out of the ownership, operation or use of any satellite,'" and, "a liability insurance policy sold to a tavern that purports to cover general commercial liability, yet contains an exclusion for liability 'arising out of or in connection with the manufacturing, selling, distributing, serving or furnishing of any alcoholic beverages.'"[32]

Increasingly, Texas policyholders are frustrated to find out that the insurance they thought they bought is not the insurance they got. In an illusory coverage doctrine case, the policyholder would argue that the exclusions and limitations contained in the policy "wiped out so much of the coverage that otherwise would have existed under the policies' insuring clauses that the coverage would be practically worthless;" in other words, the insured suffered from the illusion that the policy covers a risk that it does not effectively cover.[33] It was applied in *U.S. Gypsum Co. v. Admiral Ins. Co.*, to a manuscript "repair and replacement exclusion" that "would [have] basically eliminate[d] any property damage claim from coverage under the 'comprehensive' liability policy…."[34]

The Illusory Coverage Doctrine ("ICD") "is somewhat obscure, and no precise formulation of the doctrine has yet achieved predominance among American jurisdictions."[35] One helpful way to think about the ICD is with the "shadow metaphor" elucidated by Ian Weiss:[36]

> How can we tell if an insurance policy features illusory coverage? My discussion of this issue will rely on a metaphor of shadows cast by exclusions upon the coverage that would otherwise exist. The shadow metaphor allows us to clearly visualize two distinct factors that could determine whether the ICD is triggered. The first, which I will call "scope," corresponds to the size of the shadow: over how much insurance coverage must the exclusion's shadow extend before the ICD is triggered? The second, which I will call "degree," corresponds to the darkness of the shadow: does the coverage that falls beneath the exclusion's shadow disappear completely, or is there still some possibility that the policyholder will be able to use that coverage?
>
> With respect to scope, I will conclude that no scope should be construed as being so narrow as to preclude the ICD from being triggered. In other words, as long as the shadow cast by an exclusion is dark enough, the ICD should be triggered no matter how narrow the shadow is. Once the court finds any coverage shrouded in a shadow dark enough to trigger the ICD, the court should not proceed to consider how much other coverage is left beyond the shadow's reach. With respect to degree, I will conclude that an exclusion should not need to completely eliminate the possibility that a policyholder could benefit from the overshadowed coverage in order to trigger the ICD. Instead, the ICD should be triggered if the coverage that remains available "is extremely minimal and affords no realistic protection" even if "there might be some small circumstance where coverage could arguably exist." In other words, the shadow must be very dark, but not necessarily pitch black.
>
> Once the ICD is triggered—that is, once the court has found a policy to contain illusory coverage—the next question is what the court should do about it. I will conclude that the right remedy for illusory coverage is to reform the offending exclusions—and only the offending exclusions—to conform to the policyholder's reasonable expectations regarding their coverage. Thus, if an insurer denies coverage on the sole basis of an exclusion or set of exclusions that render the coverage illusory, the court should require the insurer to provide coverage if and only if the policyholder had a reasonable expectation that the policy made such coverage available.

The Supreme Court of Texas appears to have accepted the reasonable expectations doctrine in *Utica Nat. Ins. Co. v. American Indem.*: "In determining the scope of coverage, we examine the policy as a whole to ascertain the true intent of the parties.[37] *Mid-Century Ins. Co. v. Lindsey*, 997 S.W.2d 153, 158 (Tex.1999) ("Fundamentally, of course, the issue is what coverage is intended to be provided by insurers and acquired and shared by premium payers."); *Nat'l Union Fire Ins. Co. v. CBI Indus., Inc.*, 907 S.W.2d 517, 520 (Tex.1995) ("Insurance policies are controlled by rules of interpretation and construction which are applicable to contracts generally. The primary concern of a court in construing a written contract is to ascertain the true intent of the parties as expressed in the instrument.") Reasonable expectations are often affected by the conditions surrounding the formation of the policy language and by the type of clause at issue." However, Justice Hecht's dissent in *Utica* strongly detracts from this approach: "I must confess that I have no idea what the Court intends by this statement, which is made without reference to authority. Standing alone, it is a truism: reasonable expectations are, indeed, often affected by such things. But the statement might be taken to imply that someone's reasonable expectations—probably an insured's, and probably not an insurer's—have something to do with determining the coverage afforded despite the policy language. That implication risks tension with the Court's prior pronouncement that "'an insured may not complain that his or her reasonable expectations were frustrated by policy limitations which are clear and unambiguous.'"[38] It is beyond the scope of this article to settle this question.

Given the Limitations of ACV, RCV, and O&L Coverage, "Green" Upgrade Coverage May Be the Answer for Modern Building Owners

The Texas cities of Dallas, El Paso, and Houston—among dozens of other major US cities—have implemented some kind of "green" building code that, in general, requires certain new construction or major renovations to comply with LEED certification. For example, on June 23, 2004, the Houston City Council adopted the Green Building Resolution that set a target of Silver level LEED certification for new construction, for replacement facilities, for major renovations of city of Houston owned buildings, and for facilities with more than 10,000 square feet of occupied space.[39]

According to the Houston City Council, "utilizing sustainable design practices will significantly reduce operations and maintenance costs and decrease the negative impact of buildings on the environment and occupant health in the City of Houston…. [and the] planning, design, construction, and operation of the City of Houston's buildings, facilities, and leaseholds should have a significant positive effect on Houston's air quality, water quality, and quality of life, while contributing to the environmental and economic sustainability of our City."[40]

Insurance policies issued in these markets need to offer "green" coverage or we are going to see significant inefficiencies in restoring these areas if a major loss were to occur there. Any new construction or replacement facilities, such as in the event of a total loss, would need to comply with the ordinance, but if the property owners do not have Green Upgrade coverage, this compliance may be an expensive proposition. These property owners should procure "green upgrade" coverage to avoid being under-insured.

While existing structures usually do not have to meet new building code regulations introduced after construction because of grandfathering provisions, if the owner of an existing "grandfathered" building suffers an insured casualty event, "the law usually requires the repair or replacement of the structure to adhere to the latest regulations. When this occurs, an insurer of [a] building… built prior to a significant change in regulations, may take a greater loss than anticipated when fulfilling its obligations… The insured, too, might encounter an unexpected construction bill if the costs associated with constructing a conforming building exceed those of constructing a building identical to the original one."[41]

As we saw in our discussion of O&L coverage, above, insureds who think they have coverage for the increased costs of construction due to application of the latest standards set forth in the building code may be in for a rude awakening. As such, when insuring a modern building or in anticipation of long-term ownership of a commercial structure, policyholders should procure coverage that goes beyond your typical O&L: Green Upgrade.

The standard form of this so-called "Green Upgrade" coverage is found in the Insurance Services Office "Increased Cost of Loss and Related Expenses for Green Upgrades" endorsement to the Building and Commercial Property Coverage Form published in 2009 (hereinafter Green Building Endorsement). The Green Building Endorsement amends RCV coverage in the underlying policy, "in an effort to address the unique characteristics of a green building."[42] For example, in the event of a covered peril, this endorsement requires the insurance carrier:

> to repair or replace the structure with materials and products recognized by a third-party verification organization or governmental entity that sets a standard related to green products and practices. The

> endorsement amends the discretionary replacement cost coverage to include the 'reasonable additional costs to repair or replace lost or damaged parts… with materials and products that are recognized by a Green Standards-setter as Green.' For a partial loss, the endorsement provides coverage for the replacement of those building components or systems with an equivalent "Green" one.
>
> Moreover, this endorsement extends coverage to include the additional expenses that may arise out of the direct loss related to the unique characteristics connected to green buildings. To this end, the insurer agrees to provide payments for waste reduction and recycling, for building aeration and tests associated with air quality, for design and professional services, and third-party certification fees and related equipment testing.
>
> Under the waste reduction and recycling coverage, the endorsement provides payments from the insurer when an insured reuses or salvages building materials and contents as well as when removing and hauling recyclable construction waste for proper disposal…
>
> Likewise, the endorsement requires that an insurer pay for the costs associated with the building's indoor air quality when construction is completed. This coverage includes aerating the affected parts of the building as well as any necessary tests to evaluate the air quality in conformance with a third-party certification organization's requirements. […]
>
> In reviewing the common coverages offered by the different insurance companies, each endorsement provides compensation for the recertification of a building in the event of a casualty. This generally includes the costs associated with: debris removal that comports with sustainable practices, the fees for hiring the appropriate design professionals to gain certification, the need for testing and balancing of the systems within the structure, and the commissioning of the building. Each endorsement also eliminates many of the exclusions contained in the underlying property policy for a vegetative roof and makes individually unique coverages for this feature available.

There are several varieties of Green Upgrade coverage available in the marketplace today. The intriguing aspect of this form of insurance is that, unlike ACV, RCV, and O&L, the Green property endorsement provides true betterment coverage—going above and beyond simply making an insured whole after a loss to allow for reconstruction with improved damage mitigating features that go beyond the minimum requirements of most building codes. The coverage also does not require a draconian enforcement action by the civil authority to enjoy the benefits of insurance coverage for the costs of complying—or going beyond—the building code.

The effect of "Green" insurance is to reduce the environmental footprint of commercial and industrial buildings, and to harden the resilience of insured assets so they are less vulnerable to casualty and loss in the first place. Unless the insurance company liable for the loss that triggers "Green Upgrade" coverage renews their coverage of that asset for several consecutive years, paying out on such a claim may create what economists call a "positive externality" insofar as the resulting structure is less risky to insure, but some other insurance company gets to enjoy the resilience of the LEED certified property. To ameliorate this positive externality, states should offer insurance carriers incentives to offer this kind of insurance.

Included here is a specimen form of coverage provided by The Hartford, meant to pay Costs to Upgrade to "Green" Alternatives:

> **A.** The following **Additional Coverage** is added to the PROPERTY CHOICE COVERAGE FORM: Costs to Upgrade to "Green" Alternatives
>
> **1. If** [**direct physical loss** or direct physical **damage**] by a **[Covered Cause of Loss]** occurs to **[Covered Property]** we will also pay for the [**reasonable**] additional costs that you incur to: **a. Repair or replace** the lost or damaged Covered Property using **products or materials** that are "Green" alternatives to the lost or damaged Covered Property, in accordance with: **(1)** The minimum standards of a **"Green Authority" [if]** the "Scheduled Premises" where the loss or damage occurred was not "Green" certified by a "Green Authority" prior to the loss or damage; **[or] (2)** The standards of a "Green Authority" consistent with the pre-loss "Green" certification level, if the "Scheduled Premises" where the loss or damage occurred was "Green" certified prior to the loss or damage, **[provided that]** the "Green" alternatives are otherwise of comparable quality and function to the lost or damaged Covered Property.
>
> **b.** Employ "Green" **methods or processes of construction, disposal or recycling** including ventilation or flush out of air systems, in the course of the repair and replacement of the lost or damaged Covered Property, in accordance with: **(1)** The minimum standards of a "Green Authority" if the "Scheduled Premises" where the loss or damage occurred was not "Green" certified by a "Green Authority" prior to the loss or damage; **[or] (2)** The standards of a "Green Authority" consistent with the pre-loss "Green" certification level, **[if]** the "Scheduled Premises" where the loss or damage occurred was "Green" certified prior to the loss or damage.

c. Hire a design professional(s) accredited by a "Green Authority" to participate in the reconstruction, replacement or repair of the Covered Property;

d. Hire an engineer(s) accredited by a "Green Authority" to supervise the repair or replacement of the Covered Property to verify that replacement systems and mechanicals have been installed and configured to perform to building design or manufacturer's specifications;

e. Apply to a "Green Authority" for certification of your "Scheduled Premises" in connection with the repair or replacement of the lost or damaged Covered Property.

2. Costs to Upgrade to "Green" Alternatives applies **[only if]** replacement cost valuation applies to the lost or damaged Covered Property **[and then only if]** the lost or damaged property is actually repaired or replaced **[as soon as reasonably possible]** after the loss or damage (not to exceed two years from the date of loss or damage).

3. This Additional Coverage **[does not apply]** to any expenses incurred to exceed your pre-loss level of certification, **[if]** you had attained certification by a "Green Authority" for the Covered Property prior to the Covered Cause of Loss.

4. This Additional Coverage does not require you to pursue, nor guarantee success of, certification by a "Green Authority."

5. a. The most we will pay in any one occurrence for Costs to Upgrade to "Green" Alternatives under this endorsement is $100,000 for all "Scheduled Premises" **unless a different limit of insurance is shown** in the above Schedule.

b. If a different limit of insurance is show in the above Schedule then that different limit of insurance is the most we will pay in any one occurrence for all "Scheduled Premises" for Costs to Upgrade to "Green" Alternatives.

c. The limit for Costs to Upgrade to "Green" Alternatives applies in any one occurrence, regardless of the number of "Scheduled Premises" or buildings damaged in that occurrence.

d. If a Green Choice - Limit of Insurance is shown as applying to a "Scheduled Premises" in the Property Choice Schedule of Premises and Coverages, then that limit of insurance is the most we will pay in any one occurrence at that "Scheduled Premises" for Costs to Upgrade to "Green" Alternatives.

e. This is an **additional amount** of insurance.

B. THE FOLLOWING ADDITIONAL COVERAGE IS ADDED: Green Alternatives — Increased Period of Restoration

1. If direct physical loss or direct physical damage by a Covered Cause of Loss occurs to covered building property at a "Scheduled Premises," **Business Income coverage is revised** to include the actual loss of income you sustain during the reasonable and necessary increase in the period of restoration that is actually incurred to:

a. Repair or replace the lost or damaged Covered Property as stated in A.1.a.

b. Employ "Green" methods or processes of construction, disposal or recycling in the course of the repair and replacement of the lost or damaged Covered Property as stated in A.1.b.

2. The Increased Period of Restoration provided by this endorsement is subject to a **maximum period of up to 30 consecutive days** from the date the period of restoration would have otherwise ended had "Green" alternatives not been used.

3. This Additional Coverage Green Alternatives — Increased Period of Restoration is **included in, and does not increase** the applicable Limit of Insurance in the above referenced Coverage Forms.

4. The term Period of Restoration as found in the above referenced Coverage Forms and as used in this endorsement **does not include** any increased Period of Restoration due to: **a. Review and/or approval** by a "Green Authority" regarding your application for certification of your "scheduled Premises," should you elect to pursue certification; **or b. Conducting test and balance analysis** of the heating, ventilation or air conditioning systems to confirm that they have been installed properly and meet manufacturer's and design professional's standards.

C. ADDITIONAL EXCLUSIONS

1. Coverage provided by this endorsement does not apply to any "Scheduled Premises" where: **a.** Replacement Cost valuation does not apply; **b.** Ordinance or Law Additional Coverage does not apply; or **c.** Building(s) are vacant.

2. This endorsement does not apply to "stock."

3. Coverage provided by this endorsement does not include any increase in costs, loss or damage attributable to any "Green" standards for which you were under order or mandate from an existing authority, but you did not comply with, before the loss or damage.

D. ADDITIONAL DEFINITIONS

As used in this endorsement:

1. "Green" means products, materials, methods and processes that **conserve** natural resources, **reduce** energy or water consumption, **avoid** toxic or other polluting emissions or otherwise **minimize** their impact on the environment.

2. "Green Authority" means the United States Green Building Council (LEED® Green Building Rating System); the Green Building Initiative™ (Green Globes™ Assessment And Rating System); or the Environmental Protection Agency and the Department of Energy (EnergyStar® requirements).

As you can see, the coverages provided in a "Green" endorsement are far broader than anything typically found in ACV, RCV, or O&L coverage. That is because the standard for determining what kind of repairs or replacement expenditures are appropriate is dictated by a 3rd party Green Authority rather than a more comercially driven insurance company. With Green Upgrade coverage, property that sustains an insured casualty event will have funding available to build it back better than it was before the loss, because the standard is set by principles of sustainable and resilient architecture rather than the result of an adversarial claims adjustment process where depreciation, code compliance exclusions, and moral hazards undermine the restoration process.

Conclusion

Insurance policies should encourage and incentivize transitioning the man-made or "built" environment away from inefficient and vulnerable construction methods and toward more sustainable, resilient construction methods. The increasing frequency and severity of severe weather events are underscoring the importance of adapting our infrastructure to withstand volatile weather patterns as the new normal. This includes property casualty and loss resulting from fire, floods, hail, tornados, wind, and hurricanes. The Texas Department of Insurance should do a more aggressive job of limiting the terms of insurance policies issued in the State of Texas to ensure they are not or undermining reasonable expectations of consumers of insurance products. Meanwhile, policyholder lawyers should encourage their clients to consider taking out Green insurance to avoid some of the concerns raised herein about ACV, RCV, and O&L coverage.

1 21 Vill. Envt'l L.J. 1, 33 (2010).

2 *See, e.g.*, Amy Hefley, Deborah Low, and D. Ryan Nayar, *Current Trends and Business Implications of ESG*, 19th Annual Advanced Business Law, Chapter 7 (November 4–5, 2021).

3 Darren A. Prum, *The Next Green Issue: Considering Property Insurance for the Green Building*, 7 Vill. Envt'l L.J. 1, 33 (Winter 2013) (citing 1 James S. Trieschmann, et al., Am. Inst. for Chartered Prop. Cas. Underwriters, Comm. Prop. Ins. & Risk Mgmt. 132 (4th ed. 1994)).

4 *d.* (citing Robert E. Keeton & Alan I. Widiss, *Insurance Law, A Guide to Fundamental Principles, Legal Doctrines, and Commercial Practices*, § 3.1(a) (1988)).

5 *Id.* (citing Ins. Serv. Off., Increased Cost of Loss and Related Expenses for Green Updates (2009) [hereinafter Green Building Updates]). The *Next Green Issue* article by Prum also references a number of other examples of "Green" coverage including that offered by Fireman's Fund Ins., Property-Card Green Coverage Endorsement (2010); Lexington Ins., Upgrade to Green – Commercial Endorsement (2008); and Liberty Mut. Grp. Of Co., Green Select (2008).

6 *The Next Green Issue: Considering Property Insurance for the Green Building, supra* note 3 at 132 and 146.

7 *Id.* at 146.

8 *Id.*

9 2014 U.S. Dist. LEXIS 191137 (W.D. Tex. July 1, 2014).

10 *Id.* at *2.

11 *Fitzhugh 25 Partners, L.P. v. Kiln Syndicate KLN 501*, 261 S.W.3d 861, 864 (Tex. App.—Dallas 2008, pet. denied); *see also Brelian, Inc. v. Liberty Mut. Fire Ins. Co.*, No. H-09-1383, 2010 WL 11575473, at *15 (S.D. Tex., Oct. 28, 2010).

12 *State Farm Lloyds v. Hanson*, 500 S.W.3d 84 (Tex. App.—Houston [14th Dist. 2016], pet. denied)

June 30, 2016, Opinion Filed. NO. 14-15-00093-CV. 500 S.W.3d 84 *; 2016 Tex. App. LEXIS 6937.

13 *Id.* at 95-6.

14 261 S.W.3d at 864.

15 *Hanson*, 500 S.W.3d at 96 n. 14.

16 *Devonshire Real Estate Mgmt., LP v. American Ins. Co.*, 2014 WL 4696967 (N.D. Tex. 2014).

17 *See, e.g., Dickler v. CIGNA Prop. & Cas. Co.*, 957 F.2d 1088, 1096 (3rd Cir. 1992) (while first suggesting plaintiff real estate group should have rebuilt, court then holds, "Cigna's refusal to adjust the loss denied [plaintiff] funds which could have been used to commence rebuilding. We…instruct the District Court to modify its judgment so as to allow [plaintiff] one year to rebuild from the time that it receives compensation for the building's actual and to order that, should the [plaintiff] rebuild within that year, [plaintiff] shall receive a supplemental payment as required

by the insurance policy such that the total recovery would equal the building's replacement cost.") (footnotes omitted).

18 816 N.W.2d at 12.

19 *Id.* at 13.

20 *Id.* at 14 (internal citations omitted).

21 *Versai Mgmt. Corp. v. Clarendon Am. Ins. Co.*, 597 F.3d 729, 737-38 (5th Cir. 2010).

22 "Versai manages the Versailles Arms Apartments in New Orleans...Fortynine [sic] of the [fifty residential HUD-subsidized] buildings suffered extensive damage during Hurricane Katrina during August of 2005 and were rendered uninhabitable until the property was repaired. The fiftieth building was destroyed in a natural gas explosion during the storm. Following the disaster, Versai notified its insurers of the hurricane damage to the property and submitted claims with the assistance of its retained private adjusters and contractors. In February of 2006, Versai retained SCC Ventures, L.L.C., to conduct repairs on the property. That month, SCC Ventures estimated that the repairs would cost $17,878,326... Versai promptly notified all its insurers about the losses and damage sustained to the Versailles Arms Apartments after Hurricane Katrina...[The carriers made an undisputed partial payment, then, o]n August 23, 2006, Versai presented EFIC and Claredon with a sworn statement in proof of loss, which was not prepared by the insurance companies, for the amount of $6,082,882.69 each. The companies did not submit additional payment. In September of 2007, the original $17,878,326 estimate of the cost to repair the premises increased by approximately ten million dollars to include the costs of compliance with updated building codes, which would require additional repairs. No payments for code compliance were rendered...By the end of 2008, the only completed repairs to the Versailles Arms Apartments consisted of demolishing portions of the property, gutting certain areas, re-framing parts of the structure, and repairing some of the roofing. Versai entered into a contract to sell the apartments to Peltier Gardens, L.L.C., but the deal ultimately fell through. Versai has since retained ownership of the apartments. On August 25, 2006, Versai filed suit against Clarendon and EFIC, alleging that Clarendon and EFIC had not paid the full amount due under the excess non-flood policies for property damage, business interruption loss, replacement costs, and code compliance upgrades. Versai claimed that these failures amounted to breaches of contract, breaches of the duties of good faith and fair dealing, and violations of Louisiana Revised Statues sections 22:1892 and 22:1973... In July of 2008, EFIC and Clarendon moved for summary judgment on all claims... The district court granted summary judgment for EFIC and Clarendon on all claims[.]...Versai contests the district court's grant of summary judgment on its claim for payment for the costs of bringing the Versailles Arms Apartments into compliance with current building codes. The district court granted summary judgment for EFIC and Clarendon because Versai had not produced any evidence showing it had incurred such costs—a prerequisite to payment under the terms of the insurance contract." *Versai,* 597 F.3d at 733-34,37 (internal citations omitted).

23 1 James S. Trieschmann, et al., Am. Inst. for Chartered Prop. Cas. Underwriters, Commercial Prop. Ins. and Risk Mgmt. 132, 190 (4th ed. 1994).

24 *See* Tex. Loc. Gov't Code Ann. § 214.212.

25 No. H-03-5534, 2007 WL 1217763, at *1-3 (S.D. Tex. April 24, 2007).

26 No. 17-6192, 2018 WL 4042874, at *1 (E.D. La. August 34, 2018).

27 No. 13-02150, 2014 WL 6982520 (W.D. La. Dec. 9, 2014).

28 *Id.* at *2 (internal citations omitted).

29 108 F. Supp. 3d 475, 477-78 (S.D. Tex. 2014).

30 *Versai*, 597 F.3d at 737 (internal citations and references omitted).

31 *Incur*, Merriam Webster Dictionary (12th ed. 2023) (defined as "to become liable or subject to: bring down upon oneself").

32 Ian Weiss, *The Illusory Coverage Doctrine: A Critical Review*, 166 U. Pa. L. Rev. 1545 (2018) [hereinafter Weiss] (citing *Dish Network Corp. v. Arch Specialty Ins. Co.*, 989 F. Supp. 2d 1137, 1153-54 (D. Colo. 2013), *aff'd sub nom., Dish Network Corp. v. Arrowood Indem. Co.*, 772 F.3d 856 (10th Cir. 2014); *Monticello Ins. Co. v. Mike's Speedway Lounge, Inc.*, 949 F. Supp. 694, 695 (S.D. Ind. 1996)); *see also* Marion B. Adler et al., *The Illusory Coverage Doctrine: Going Beyond the "Plain Language" of the Policy*, American College of Coverage Counsel 2021 Annual Meeting (Sept. 22-4, 2021).

33 Weiss, at 1546.

34 268 Ill. App. 3d, 598, 633-34 (Ill. Ct. App. 1994).

35 Weiss.

36 Weiss, at 1546-48.

37 141 S.W.3d 198, 202 (Tex. 2004).

38 *Id.* at 208 (citations omitted) (Hecht, J., dissenting).

39 *See* City of Houston, Tex., Resolution No. 2004-15, "A Resolution Authorizing the City to Establish the U.S. Green Building Council's LEED Certification as a Standard for New or Replacement Facilities and Major Renovation of City of Houston Owned Buildings and Facilities with More than 10,000 Square Feet of Occupied Space," available at chrome-extension://efaidnbmnnnibpcajpcglclefindmkaj/http://www.greenhoustontx.gov/reports/leedinhouston.

40 *Id.*

41 Darren A. Prum, *The Next Green Issue: Considering Property Insurance for the Green Building*, 7 Va. L. & Bus. Rev. 421, 429 (Winter 2013) (citing 1 James S. Trieschmann, et al., Am. Inst. for Chartered Prop. Cas. Underwriters, Commercial Prop. Ins. & Risk Mgmt. 132, 190 (4th ed. 1994)).

42 *Id.* at 438-39, 452-53.

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