THE ZELLE LONESTAR LOWDOWN

Dedicated to Texas First-Party Property Claims

The Zelle Lonestar Lowdown | Tuesday, November 14, 2023 | ISSUE 7

Welcome to The Zelle Lonestar Lowdown, our monthly newsletter bringing you news from the trenches on everything related to Texas first-party property insurance claims and litigation. If you are interested in more information on any of the topics below, please reach out to the author directly. As you all know, Zelle attorneys are always interested in talking about the issues arising in our industry.

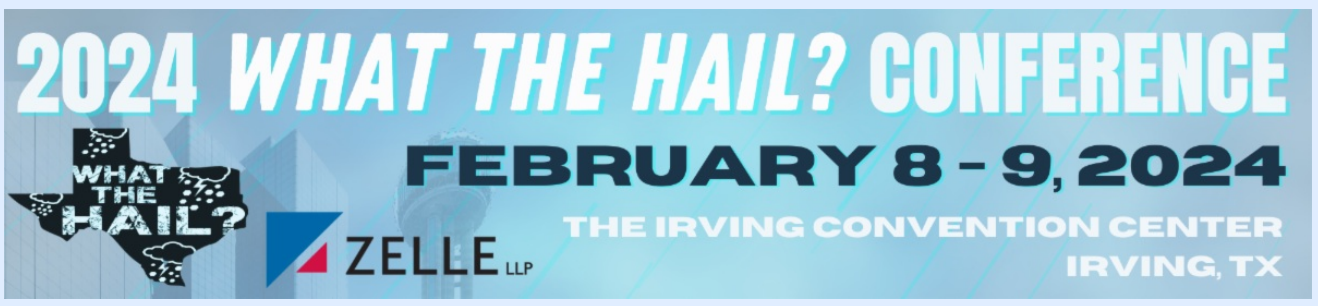
INSIDE THIS ISSUE

Upcoming Events

You don't want to miss this!

December 5, 2023: Jennifer Gibbs will be presenting "Attorney Wellness in a Post-Pandemic Legal World" for the Tort and Insurance Practice Section of the Dallas Bar Association on Tuesday, December 5th, 2023 from 12:00 pm - 1:00 pm CST in Dallas, TX. This in-person presentation will offer 1.0 of Ethics CLE Credit. More information here.

December 5, 2023: Steve Badger will be presenting "Big Issue" Problems in the First-Party Claims World – And How We Fix Them" with Brian Goodman (Goodman & Donohue LLC) as part of the NAPIA First Party Claims Conference in Boston, MA on Tuesday, December 5, 2023 from 8:30 am - 10:30 am EST. More information here.



2024 *WHAT THE HAIL?* Conference February 8-9, 2024!!

REGISTRATION IS FILLING UP - SECURE YOUR SPOT NOW!!!

The **2024 *WHAT THE HAIL?* Conference** will be held on February 8-9, 2024 at the Irving Convention Center at Las Colinas in Irving, Texas. Here are the details:

Key Information

- **Cost:** $100 (inclusive of all classes/meals/events)
- **Dates:** Thursday, February 8 and Friday, February 9, 2024 - Two-day seminar format (all day Thursday/half-day Friday)
- **Location:** Irving Convention Center at Las Colinas
- **Continuing Education:** Approved for 12 hours of Texas CE credit (10 General and 2 Ethics)
- **Rooms:** The Westin Irving Convention Center. Book your rooms **here!**
- **Events:**
  - Welcome Reception Wednesday, February 7, 2024 for all attendees 6:00 pm - 9:00pm.
  - The legendary 80's Party will return on Thursday evening (February 8, 2024) at the Toyota Music Factory, with a full concert by *The Molly Ringwalds* band... and a few other special surprises.

A few sponsorship opportunities remain available! (contact abannon@zellelaw.com)

Register

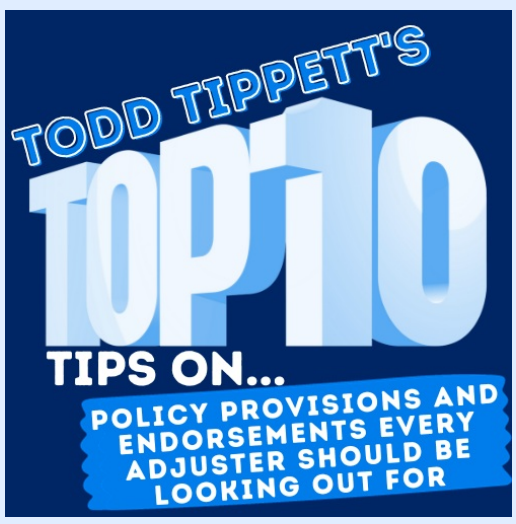
Non-renewal, Cancellation, Reformation, and Rescission of Insurance Policies

by **Brian Odom**, **Michael Upshaw**, and **Bella Arciba**

The Texas Legislature recently adopted HB1900, which amends the notice requirements for nonrenewal in Texas Insurance Code Sections 551.105. While these new deadlines are noteworthy, non-renewal is only one of several mechanisms available to insurance carriers that wish to cease insuring a particular risk on the terms initially agreed.

It is important that insurers understand the distinctions between non-renewal, cancellation, reformation, and rescission of insurance policies, as well as the standards and deadlines applicable to residential versus commercial properties in the context of each of these mechanisms. This is particularly true where there is an open claim, or where there is good cause to non-renew, cancel, reform, or rescind a policy due to misrepresentations by an insured or a material change to an insured risk during the course of a policy term. The Texas Legislature's recent change of the rules relating to non-renewal should serve as a reminder to insurance practitioners that a general familiarity with all of the available tools for ending or modifying a contractual relationship with an insured is key. Knowing when and how to properly employ these tools can aid in avoiding the proverbial "bad breakup" when the time comes to part ways with an insured.

Read the full article here



1. **Revised Cosmetic Damage Endorsement** – there are various new versions of this endorsement, with some providing coverage only when the storm at issue causes immediate penetration of water or moisture through the "roof covering". Be on the lookout for this revised language, as companies are moving away from the standard ISO endorsement.

2. **Absolute Notice of Claim Deadline** – this endorsement contractually bars a claim submitted more than one year after the date of loss (some as short as six months). Courts have found the one year deadline to be enforceable without a prejudice requirement.

3. **Actual Cash Value Definition** – policies typically did not define actual cash value; some policies now provide a definition that contractually outlines the factors (material, labor, tax, overhead and

News From the Trenches

by **Steve Badger**

Some old and some new hot topics getting a lot of attention in the first-party claims world this month….

1. Hail Dents To TPO Membranes – We are seeing a lot of claims involving minor dents to ISO board below TPO membranes, even when the membrane itself is agreed to be not damaged. These claims all allege a reduction in R-value or loss of wind uplift resistance. Technical papers, however, refute both of these contentions. So are these claims covered? I don't believe so. There is no physical loss or damage. The roof continues to shed water as it did prior to the dents occurring. We will have to see what the courts think of these claims in the months ahead. In the meantime, one thing is for certain, insurers are revising their "cosmetic damage endorsements" to encompass this issue. We have already drafted several.

2. UPPA And The Stonewater Case – The Stonewater case continues to receive a lot of attention as people are realizing the extreme ramifications of the wrong outcome in this matter. The case involves an attack by a contractor on the Texas Public Insurance Adjuster Licensing Act, by seeking a finding that the Act constitutes an unconstitutional restraint on free speech. Yes, you read that right. They are arguing that anyone should be allowed to provide the services of a public adjuster under their right to free speech. The case is presently pending before the Texas Supreme Court. A decision is expected in the months ahead. You can read a copy of an amicus brief we filed on behalf of the insurance industry trade groups **here.** This is a scary case. If the Court gets this wrong, anyone – literally anyone, including the contractor doing the repair work – will be able to act on behalf of a Texas home and building owner in negotiating insurance claims. Wow! If this happens, katy bar the door, as an assortment of crooks and frauds from around the country will all rush to Texas to become unlicensed and unregulated claims advocates.

profit, etc.) that should be considered when calculating depreciation on an ACV measure. This eliminates the "should labor be depreciated?" argument.

4. **Revised Appraisal Clause** – insurers are revising appraisal clauses adding significant additional parameters governing the appraisal process, including who can serve as an appraiser, how to obtain a proper umpire, deadlines to complete the process, and the scope of the appraisal. These revised provisions attempt to address many of the abuses in the process.

5. **Limitation to Actual Cash Value Endorsement** – this increasing common endorsement limits recovery to Actual Cash Value for any roofing surface over 15 years old. One version states the insured bears the burden of proving the age of the roofing surface. Another version states that an engineer retained by the carrier shall determine the age of the roof.

6. **Managed Repair/Preferred Contractor Program** – this endorsement contractually allows the carrier to select the contractor to be retained for making proper repairs or replacement of damaged property. The purpose of this endorsement is to control excessive unit costs and over-scoped measures.

7. **Pre-existing Damage Endorsement** – this endorsement explicitly states what is already unambiguously implicit in the policy – that it excludes coverage for any and all damage that occurred prior to policy inception. This exclusion applies regardless of whether such damages were apparent at the time of the inception of the policy. The burden for proving when the damage occurs lies with the insured.

8. **HVAC Hail Guard Endorsement** – this endorsement excludes hail and/or wind damage to HVAC systems unless the HVAC systems at issue have properly installed hail guards or other hail protection at the time of the physical loss or damage.

9. **Suits Against Us Endorsement** – this endorsement requires the insured to bring suit or action against the carrier within 2 years and one day after the breach/cause of action accrues. Under Texas law, any contractual suit limitation that runs from the date of loss and is less than 2 years and one day is likely unenforceable.

10. **Matching Endorsement** – this endorsement sets either a limitation or express sublimit for matching undamaged siding, soffit, fascia, roofing, windows, walls, ceiling, flooring, cabinetry, carpeting and other components of the building when only some of those components have been damaged by a covered loss.

If you would like to further discuss any of these policy provisions and endorsements, please contact me at ttippett@zellelaw.com or **214-749-4261.**

3. Invoking The Right To Repair – Almost every policy contains a provision allowing the insurance company to actually repair the damaged property at issue in the claim. But insurance companies have been loathe to invoke the provision, obviously to avoid the argument that the insurance company took on responsibility for the repair work. This past mentality is now changing. Faced with grossly inflated contractor estimates and an onslaught of appraisal demands by contractors seeking to increase their revenue on every claim, insurance companies are deciding that the advantages of invoking the right to repair far outweigh the minimal risk that a qualified contractor engaged to complete the work will do something wrong. Some insurers have even asked us to draft form claim documents and help them establish an entire program directed at invoking the right to repair and fixing damaged roofs. This is coming as a predictable reaction to contractor abuses in the claims process. I like it, as the insured gets their roof replaced quickly by a qualified contractor (yes, our clients will use qualified contractors).

4. MMA Criminal Investigation – It was just a matter of time. Recent media reports confirm that the Louisiana State Police have begun a criminal investigation into McClenny Moseley & Associates. Word on the street is that the FBI is nosing around as well. This shouldn't come as a surprise to anyone given the allegations of insurance fraud, barratry, forgery and bank fraud that have surfaced over the past year. **Here** is an article talking about the investigation.

5. Excessive Umpire Billings In Appraisal – Reputable and honest appraisers working on both sides, policyholder and insurance company, have recently reached out to me complaining about excessive umpire billings. These billings typically come in the form of grossly excessive retainer agreements or ridiculous fee schedules based on the size of the dispute between the parties. Another problem includes umpires writing down a ridiculous number of hours for tasks that should be completed in far less time. But everyone is scared of upsetting the umpire and getting a bad award, so no one objects. This has to stop. I encourage the umpire certification groups (PLAN, IAUA, WIND, and others) to look into this issue and require that their certified umpires simply bill at a reasonable hourly rate and to fairly record their time on an hourly basis. What's so wrong with that? That's how most other professionals bill. Perhaps legislation is needed to address this abuse (and others) in the appraisal process.

6. Payoffs, Kickbacks, And Fraud Schemes – Every month , information on new payoff, kickback, and referral schemes cross my desk. In the weeks ahead I'll be posting on LinkedIn about two doozies -- one in Arkansas involving a cash payment to a witness to avoid a trial subpoena and one in Texas where it appears that a Florida-based and Texas licensed public adjuster "loaned" his public adjuster number to a restoration contractor so that the contractor could effectively act as a public adjuster in its Texas projects. Yep. These are real examples of matters I am presently looking at. I encourage you to connect with me on LinkedIn and follow my posts about issues in the first-party claims world. In fact, my post on Sunday about Xactimate pricing and subcontractor invoices has generated a ton of attention, with almost 40,000 views and over 100 comments. Here is a link to my **LinkedIn** page.

7. The 2024 *What The Hail?* Conference – Be sure not to miss the blurb in this month's Lowdown about the 2024 *What the Hail?* Conference. As many of you know, Zelle started this event back in 2012 to bring a few clients together so that we could talk about the crazy increase we were seeing in hail damage claims. Since that time, it has grown into one of the largest insurance industry conferences in the country. We expect 600 people to attend in February. In a day and a half, we cover everything going on in our Texas weather-related claims, covering all the underwriting, claim, technical, and legal (and appraisal) issues arising in these matters. And not only is it a great educational event, it's also a really fun party. Our Thursday night 80's Party has become legendary as perhaps the best industry event of the year. Be sure to register soon before the event fills to capacity.

The Northern District Court Holds that Attorneys'

Fees Must Correspond to Damages Awarded

by **Lindsey Bruning**

Montgomery v. State Farm Lloyds, No. 3:21-CV-3039, 2023 WL 6465134 (N.D. Tex. Oct. 2, 2023).

Montgomery v. State Farm Lloyds involved an award of attorneys' fees after Plaintiff's successful trial against Defendant in a first-party property coverage case involving storm damage to Plaintiff's property. The case was tried in front of a jury, who reached a verdict in favor of Montgomery, finding that State Farm Lloyds breached the property insurance policy and engaged in unfair or deceptive acts or practices. The final judgment awarded damages totaling $11,426.09 and provided that Montgomery shall recover reasonable attorneys' fees.

After the final judgment was issued, Montgomery requested reasonable and necessary attorneys' fees in the amount of $171,700.00. In deciding the issue, the Court first considered Montgomery's entitlement to attorneys' fees and found that Montgomery is eligible to recover attorneys' fees under Chapter 38 of the Texas Civil Practices and Remedies Code as well as Chapters 541 and 542 of the Texas Insurance Code. *Montgomery*, 2023 WL 6465134, *2.

The inquiry then turned to calculating the amount that a prevailing party should be awarded for attorneys' fees. The Northern District Court outlined the three-step method of calculating reasonable and necessary attorneys' fees under Texas – and federal – law:

1. The court "must determine the reasonable number of hours expended on the litigation and the reasonable hourly rates for the participating lawyers." *Id.* (citing *Louisiana Power & Light Co. v. Kellstrom*, 50 F.3d 319, 324 (5th Cir. 1995)).
2. "[T]he court multiplies the reasonable hours by the reasonable rates." *Id.*
3. "[T]he court may decrease or enhance the amount based on the factors laid out in [*Johnson v. Georgia Hwy. Exp., Inc.,* 488 F.2d 714, 717-19 (5th Cir. 1974)] and [*Arthur Andersen & Co. v. Perry Equip. Corp.,* 945 S.W.2d 812, 818 (Tex. 1997)]." *Id.*

The Court noted that the first two steps supported the requested attorneys' fees totaling $171,700.00. *Id.* Further, most of the *Johnson* and *Andersen* factors also supported such attorneys' fees. *Id.* at *3. However, the Court ultimately found the requested fee award of $171,700.00 was unreasonable based on the disproportion between the fees requested and the damages awarded. *Id.*

Noting that this factor alone will not render an attorneys' fees award excessive, the Court found that "the 'degree of success obtained' by a prevailing plaintiff is the 'most critical factor' in determining an award of attorneys' fees." *Id.* Further, "[a]warded fees must bear a 'reasonable relationship to the amount in controversy or to the complexity' of the circumstances of the case." *Id.* (citing *Jerry Parks Equip. Co. v. Southeast Equip. Co.*, 817 F.2d 340, 344 (5th Cir.1987).

In this case, the requested attorneys' fees were "nearly fifteen times the amount Montgomery was awarded at trial." *Id.* at *1. The Court further noted that the case was an insurance contract dispute with no novel or particularly complex issues of law. *Id.* As such, the Court found the proposed $171,700.00 figure unreasonable and reduced it to an amount equaling only three times the damages awarded ($34,500.00), an amount that bore "a more rational relationship to the amount awarded." *Id.*

On November 1, 2023, Plaintiff Christie Montgomery filed a Notice of Appeal of the Court's Order on Attorneys' fees. We will be watching this appeal as the holding may have lasting implications on "small" or more "run-of-the-mill" coverage cases going forward. This case illustrates why it is important to consider challenging submitted attorneys' fees when warranted.

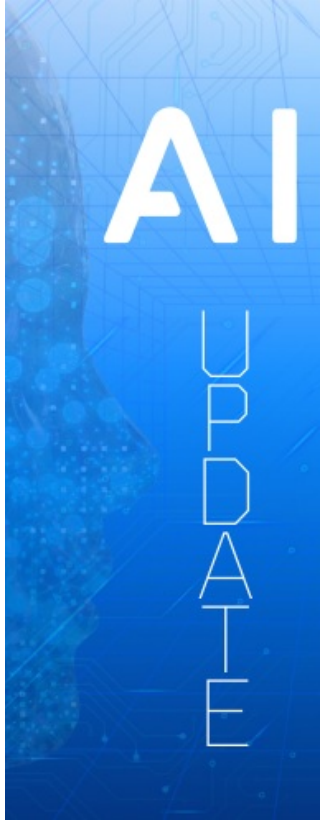
AI Update

Regulating Artificial Intelligence in the Insurance Marketplace

by **Jennifer Gibbs**

In 2023, at least 24 states and the District of Columbia have introduced bills related to AI, at least 14 states have adopted resolutions or enacted legislation aimed at regulating AI, and many states have established groups to study artificial intelligence.

On September 21, 2023, the Colorado Division of Insurance adopted a new regulation governing the use of algorithms and predictive models that use "external consumer data and information sources" (ECDIS). The purpose of the regulation, which becomes effective on November 14, 2023, is to prevent Colorado-licensed life insurers that rely on models and ECDIS from engaging in race-based discrimination.**[1]** Although Colorado appears to be the first to issue AI regulations in the insurance industry, other states like New Jersey, Virginia and Washington have proposed similar laws,



stressing the need for governance and transparency regarding AI systems in insurance.

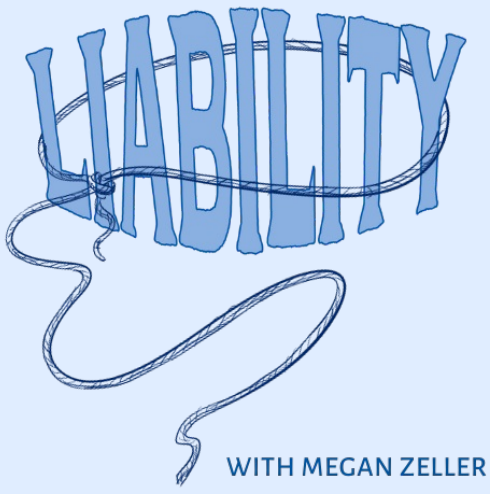
These new laws illustrate, however, that there is no current consensus regarding a single definition of artificial intelligence. For example, Connecticut defines artificial intelligence as an "artificial system that 'performs tasks under varying and unpredictable circumstances without significant human oversight or can learn from experience and improve such performance when exposed to data sets." *See* Connecticut SB 1103. Rhode Island H 6423 states that artificial intelligence includes "computerized methods and tools, including, but not limited to, machine learning and natural language processing, that act in a way that resembles human cognitive abilities when it comes to solving problems or performing certain tasks." Texas defines artificial intelligence in HB2060 as systems capable of "perceiving an environment through data acquisition and processing and interpreting the derived information to take an action or actions or to imitate intelligent behavior given a specific goal and learning and adapting behavior by analyzing how the environment is affected by prior actions."

At the most basic level, artificial intelligence refers to machine-based systems that produce an outcome based on information inputted to it.**[2]** Some are concerned that legislators should land on a common definition of AI and should be aware of the potential harm regarding how these systems have been trained to use data. Other experts think legislators don't need a definition to govern artificial intelligence but favor a core set of rules applied to any program that uses automated systems, no matter the purpose.

And although there does not appear to be a consensus as to the definition of artificial intelligence, almost all agree that governance and requirements of AI are likely to be implemented across all lines of insurance, and prudent insurance carriers should be building teams of experts familiar with AI and its complex algorithms to respond to increased regulatory oversight of this emerging technology.

[1] https://www.jdsupra.com/legalnews/new-final-ai-regulation-from-colorado-8253973/
[2] https://coloradonewsline.com/2023/10/06/artificial-intelligence-legislators-are-looking-for-definition/

Lassoing Liability
with Megan Zeller



Hold Your Horses: Insurers May Still Have a Duty to Indemnify Even if They Don't Have a Duty to Defend

Texas has long-held that a duty to indemnify is a separate analysis from the duty to defend, where the duty to defend has generally been considered the "broader" duty. *See, e.g., Zurich Am. Ins. Co. v. Nokia, Inc.*, 268 S.W.3d 487, 490 (Tex. 2008). Nonetheless, from a practical standpoint, the question insurers have encountered is once it has been determined that there is no duty to defend, do they *really* have to still worry about a duty to indemnify? The Fifth Circuit has recently answered this question with a resounding "yes."

In ***Liberty Mutual Fire Insurance Company v. Copart of Connecticut***, 75 F.4th 522 (5th Cir. 2023), the Fifth Circuit overruled in part a lower Texas court's decision when it concluded "the assumption that the duty to indemnify cannot exist where there is no duty to defend is 'faulty.'" In *Copart*, the insurer disputed whether, in light of certain pollution exclusions in the primary and excess policies, it had a duty to defend or indemnify Copart. Like most CGL policies, Coverage A in the primary policies provided that the insurer:

> will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend the insured against any "suit" seeking those damages. However, we will have no duty to defend the insured against any "suit" seeking damages for "bodily injury" or "property damage" to which this insurance does not apply.

The primary policies also contained a pollution exclusion, which excluded from coverage any "'[b]odily injury' or 'property damage' which would not have occurred in whole or part but for the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of 'pollutants' at any time."

The insurer filed a declaratory judgment in the Northern District of Texas, where, after filing a subsequent Motion for Summary Judgement, the court ruled because the insurer "has no duty to defend the Underlying Suit, it follows that it has no duty to indemnify." The Fifth Circuit, however, found that the Northern District's ruling was premature and incorrect, and even provided examples of how the insurer could potentially still be on the hook for indemnifying Copart if the damages determined at trial were somehow not related to the pollution exclusion.

While *Copart's* duty to indemnify analysis is similar to the Texas Supreme Court's prior ruling in *D.R. Horton-Texas, Ltd. v. Markel Int'l Ins. Co.* , 300 S.W.3d 740, 744-45 (Tex. 2009), it nonetheless is an important reminder to insurers that jumping the gun with a duty to indemnify analysis can be costly. When reviewing for coverage for high-risk claims, there may be some merit in issuing the ROR and providing a defense even when the duty to defend seems unlikely, so that the insurer can control future costs. Although this approach certainly isn't recommended for every case, it is important for insurers and coverage counsel to consider how *Copart* impacts claims going forward.

542A Petition Notice is No Notice: Attorneys' Fees Precluded

by **Kiri Deonarine**

Plaintiffs attempting to circumvent the presuit notice requirement under Chapter 542A of the Texas Insurance Code should beware as a case in the Northern District of Texas recently illustrated how a court can preclude them from recovering their attorneys' fees. Additionally, an insurer can plead and prove that it is entitled to presuit notice in its answer – no motion is required.

In ***NewcrestImage Holdings, LLC, et al. v. Travelers Lloyds Insurance Co.***, a court in the Northern District of Texas, Amarillo Division considered three issues: (1) whether a section in a petition providing notice of intent to pursue claims under Chapters 541 and 542A of the Texas Insurance Code satisfies the presuit notice requirement under Chapter 542A; (2) whether pleading and proving that an insurer did not receive presuit notice in an answer is sufficient to deny attorneys' fees; and (3) whether the Court's conclusions are consistent with the legislative intent of Chapter 542A. No. 2:23-CV-039-BR, 2023 WL 6849999, at *1 (N.D. Tex. Oct. 17, 2023).

Chapter 542A of the Texas Insurance Code applies to actions involving first-party insurance claims arising from alleged damage to covered property caused by "forces of nature," such as "a flood, a tornado, lightning, a hurricane, hail, wind, a snowstorm, or a rainstorm." Tex. Ins. Code § 542A.001(2). Chapter 542A applies to all actions against insurers or their agents, including but not limited to: "(1) an action alleging breach of contract; [or] (2) an action alleging negligence, misrepresentation, fraud, or breach of a common law duty." *Id.* § 542A.002(a).

Section 542A.003 of the Texas Insurance Code requires a claimant seeking damages against an insurer to give written notice "not later than the 61st day before the date a claimant files an action." . . . ." *Id.* § 542A.003(a). The notice required by section 542A.003 must include, among other information, a statement of facts or omissions giving rise to the claim, the amount alleged to be owed as damages, and the amount of reasonable and necessary attorney's fees incurred as of the date of the notice. *See id.* § 542A.003(b). The purpose of this notice obligation is to encourage settlement.

NewcrestImage involves an insurance coverage dispute related to property damage resulting from Winter Storm Uri. Accordingly, 542A applies. NewcrestImage attempted to provide presuit notice of its intent to pursue claims under Chapters 541 and 542A of the Texas Insurance Code to the insurer in its Original Petition in state court on February 7, 2023. The insurer filed its Original Answer in state court – pleading and proving that it did not receive the required 542A presuit notice on March 6, 2023. After the insurer removed the case to federal court on March 13, 2023, the insured filed its Amended Complaint on May 3, 2023, which included the Chapter 541 and 542A claims. On May 17, 2023, the insurer filed its Amended Answer – pleading and providing that it did not receive the proper presuit notice. And on June 7, 2023, the insurer filed its Motion to Preclude Attorneys' Fees.

Ultimately, with regard to the first issue, the Court found that alleged 542A presuit notice contained in a petition cannot be presuit notice. Presuit notice must be provided to the insurer before a petition is filed.

Spotlight:

Zelle recognized as a

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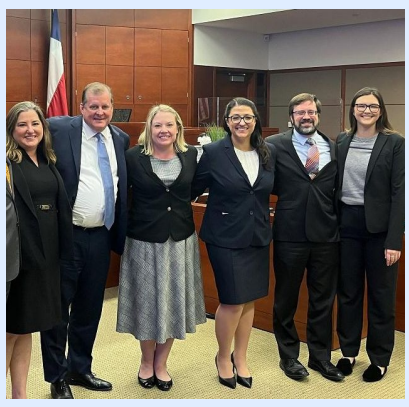
ZELLE LLP

Best Lawyers has recognized Zelle LLP with rankings in the 2024 National and Metropolitan Tier categories! Read more here.



Zelle attorneys doing what they do best! Dallas office's Shannon O'Malley, Brett Wallingford, Kristin Cummings, Kiri Deonarine, Michael O'Brien, and Claire Fialcowitz after a successful trial.

Reach out to Zelle LLP if your organization would benefit from a presentation, class, discussion, or seminar from one of our attorneys.

Contact Us!

Turning to the second issue, a defendant that does not receive pre-suit notice meeting the requirements of section 542A.003 may plead and prove that it did not receive said notice. *See* Tex. Ins. Code § 542A.007(d). If a defendant files such a pleading and subsequently proves it did not receive the pre-suit notice required by section 542A.003 at least sixty-one days before plaintiff's commencement of suit, "the court may not award to the claimant any attorney's fees incurred after the date the defendant files the pleading with the court." Such a pleading must be filed no later than the thirtieth day after the date on which the defendant filed its original answer in the action.

As in *NewcrestImage*, insurers often plead and prove they did not receive the presuit notice in their answer and also file a motion to preclude attorneys' fees. The issue in this case is whether the Motion to Preclude Attorneys' Fees should have been filed thirty days after the insurer's original answer. The Court found that the pleadings in Travelers' Original Answer were sufficient to deny attorneys' fees. The Court pointed out that the word "motion" is not mentioned in Chapter 542A. Accordingly, an insurer is not required to file a pleading separate from its answer within 30 days.

Finally, the Court found that its opinion is consistent with the legislative intent of Chapter 542A based on the plain language of the statutes.

NewcrestImage illustrates how serious courts can be about presuit notice in 542A claims. Insurers' awareness of the issues and their defenses can significantly limit their potential liability. Including the necessary 542A defenses in an insurer's answer if it has not received presuit notice, is a relatively easy way to comply with the statutes and preserve the insurer's rights.

Southern District Finds No Waiver of Insurer's Appraisal Demand, but on Unsuspecting Grounds

by **Paige Tackett**

In a recent case from the Southern District of Texas, the court reaffirmed that a policyholder cannot recover extracontractual damages under the Texas Prompt Payment of Claims Act before establishing liability under a policy that exceeds the applicable deductible. Further, a policyholder must show the futility of claim settlement negotiations to establish an impasse that triggers the timeframe for invoking appraisal. The issuance of coverage position letters, demand letters, or pre-suit notice letters might not be enough.

In *Tanglegrove TH Condo Ass'n v. Journey Ins. Co.* , the court considered two motions brought by the parties. No. 4:23-CV-01135, 2023 WL 7222128 (S.D. Tex. Nov. 2, 2023) First, the policyholder filed a summary judgment motion, in which it requested the court to hold as a matter of law that the insurer violated Chapter 542 of the Texas Insurance Code, known as the Texas Prompt Payment of Claims Act ("TPPCA"), for its failure to timely investigate and pay covered wind and hail damage to insured property. Second, the insurer filed a motion to compel appraisal and abate the litigation pending the completion of appraisal, as set forth in the policy terms.

Policyholder's Motion for Summary Judgment

To prevail on a claim for TPPCA damages, a policyholder much show (a) the insurer's liability under the policy, and (b) the insurer's failure to comply with the statute in processing or paying the claim. Here, in response to the policyholder's motion, the insurer argued that summary judgment was improper because the policyholder failed to make the threshold showing of liability—that it had sustained covered damage sufficient to require payment under the policy.
Based on the absence of evidence demonstrating liability under the policy, much less liability exceeding the applicable deductible, the judge found that the policyholder was not entitled to summary judgment on its Chapter 542A claim. In reaching this conclusion, the court relied on the Texas Supreme Court's holding that "'[T]he TPPCA's . . . requirements culminate in a determination either that the claim is covered and the amount of loss exceeds the deductible" **Barbara Techs. Corp. v. State Farm Lloyds, 589 S.W.3d 806, 817 (Tex. 2019)**.

Insurer's Motion to Compel Appraisal and Abate

Separately, the court considered the insurer's motion to compel appraisal and abate the litigation until the completion of appraisal, as written in the policy terms. The policy at issue contained an appraisal clause, providing, in relevant part, that if the parties "fail[ed] to agree on the amount of the loss, . . . any party may demand an appraisal of the loss in writing for disputes greater than $500." Further, the policy contained a "no action" clause, in which the parties agreed that "no one may bring a legal action against

[the insurer] under this [Policy] unless ... [t]he parties have participated in Appraisal," as outlined in the appraisal provision.

The insurer invoked appraisal seven months after suit was filed—and over a year after the claim adjustment began. For this reason, the policyholder opposed the motion, arguing that the insurer waived the right to appraisal. Under Texas law, to establish an insurer's waiver of its right to appraisal, a policyholder must demonstrate that: (1) the parties have reached an impasse; (2) after reaching an impasse, the insurer did not invoke appraisal within a reasonable time; and (3) the policyholder will suffer prejudice because of the delay.

The policyholder made three arguments to show an impasse between the parties, each rejected by the court. First, the policyholder pointed to a coverage position letter in which the insurer denied the existence of any claimed hail damage to the property. The court opined that this type of letter, "by itself, does not establish that the parties had reached a point where both sides understood that further negotiations would be futile." Further, the evidence demonstrated that the parties continued to engage in good faith claim negotiations after the letter was sent.

Second, the policyholder argued that an impasse had been reached after issuing a demand letter to the insurer. In response, the insurer advised that its investigation was still ongoing, as it was in the process of engaging a consultant to re-inspect the property and evaluate the claimed damage. In evaluating this argument, the court cited to an appellate court holding that a "demand letter is not proof of an impasse because sending such a letter is intended to encourage settlement, which implies further negotiation." See In re **Acceptance Indem. Ins. Co., 562 S.W.3d 655, 661 (Tex. App.—San Antonio 2018, no pet.)** The representations in the insurer's response also evidenced to the court that the claim was still under investigation at this time.

Third, the policyholder argued that the impasse occurred when upon issuance of its Texas Insurance Code Chapter 542A pre-suit notice letter. Chapter 542A permits a party who receives a notice letter to request the opportunity to (a) inspect the subject property within 30 days of receipt and (b) to provide a written response within 60 days of receipt. Here, the evidence showed that the insurer did neither of the two, which the court found "particularly telling"—"certainly [giving] the impression that future settlement negotiations would be futile." Based on the insurer's lack of response, the court determined that date suit was filed, which was seven months before the insurer invoked appraisal, should have marked the point of impasse.

But the court's analysis did not stop there. The court addressed one additional fact that "significantly alter[ed] the legal landscape:" the parties voluntarily agreed to participate in mediation six months after suit was filed. The court interpreted this mediation as "a joint decision by the parties to sit down in an attempt to iron out their differences and resolve this litigation once and for all." To this end, the court concluded that the point of impasse occurred the date mediation failed.

After determining the point of impasse, the court evaluated whether the insurer invoked appraisal within a reasonable timeframe. Here, the insurer invoked appraisal 20 days after mediation, which the court held "no doubt" represented a reasonable timeframe in which to assert appraisal rights under the policy. We note the court most likely would have expressed doubt as to whether seven months, the period between filing suit and invoking appraisal, was a reasonable timeframe.

Finally, as to the third prong, the court found that the policyholder failed to demonstrate prejudice. While policyholder argued it suffered prejudice because it had incurred significant expert costs, these costs were incurred *before* the date of impasse proffered by the policyholder. Further, the policyholder conceded the expert costs were incurred in complying with the Chapter 542A pre-suit notice requirements, not because of any alleged delay in the insurer's invocation of appraisal. Thus, the policyholder would have incurred these costs even in the absence of an appraisal demand.

Based on these findings, the court granted the insurer's motion to compel appraisal and abated the litigation in accordance with the policy's "no action" provision.

The court's analysis is a good reminder for insurers to be cognizant of how they interact with policyholders during claim negotiations. If a court can point to specific conduct or communications that demonstrate the futility of further claim negotiations, then the clock for invoking appraisal begins to tick. To avoid a compelling waiver argument, be sure to explain to a policyholder—in writing—the outstanding information or action needed to complete a claim investigation. Respond promptly to settlement demands and pre-suit notice letters when an investigation or negotiations are still ongoing. And when further claim negotiations do become futile, act quickly to invoke appraisal rights under a policy.

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