IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION

DIESEL BARBERSHOP, LLC; WILDERNESS OAKS CUTTERS, LLC; DIESEL BARBERSHOP BANDERA OAKS, LLC; DIESEL BARBERSHOP DOMINION, LLC; DIESEL BARBERSHOP ALAMO RANCH, LLC; and HENLEY'S GENTLEMEN'S GROOMING, LLC,	§	**CIVIL ACTION NO.: 5:20-cv-00461**
Plaintiffs,	§	
v.	§	
STATE FARM LLOYDS,	§	
Defendant.	§	

DEFENDANT'S MOTION TO DISMISS PLAINTIFFS' SECOND AMENDED PETITION FOR FAILURE TO STATE A CLAIM

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1. Defendant State Farm Lloyds ("State Farm") files this motion to dismiss Plaintiffs' Second Amended Petition ("SAP"), pursuant to Fed. R. Civ. P. 12(b)(6).

I. INTRODUCTION

2. Plaintiffs have sued State Farm for coverage of business interruption losses that Plaintiffs admit occurred as a result of "the Covid-19 outbreak and the subsequent Bexar County and State of Texas Orders," which required non-exempted businesses to cease activities (with certain listed exceptions). (SAP ¶ 7; [8-2] at 9.) Plaintiffs assert claims for breach of contract, claiming coverage under the Loss of Income and Civil Authority provisions of their policy endorsements. They also assert claims for unfair settlement practices under the Texas Insurance Code, violation of the "prompt payment" requirements of the Texas Insurance Code, and breach of the duty of good faith and fair dealing.

3. In order to trigger coverage, Plaintiffs' businessowners insurance Policy requires "accidental direct physical loss to" property. (Policy at 3.)[1] The presence or suspected presence of a virus, however, does not constitute the requisite "accidental direct physical loss to" property to trigger coverage. Under Texas law, examples of accidental direct physical loss include damage caused by fires, ice, hail, and winds, *i.e.*, perils that cause actual, tangible physical damage to property.

4. Moreover, the Policy contains a Virus Exclusion barring coverage for "any loss which would not have occurred in the absence of ... Virus." (Policy at 5-6.) Plaintiffs' factual allegations establish that this exclusion bars their claims. Plaintiffs also ask this Court to nullify the plain language of their insurance policies on "public policy" grounds. That request contravenes

[1] True and correct copies of Plaintiffs' policies are attached as Exhibits A-1 to A-6 to the Declaration of Susan E. Egeland submitted herewith. Because the relevant provisions of the policies are identical, the policies will be cited as the "Policy" herein.

100 years of Texas insurance precedent and definitive rulings of the Texas Supreme Court regarding the interpretation of insurance policies. *E.g., Fiess v. State Farm Lloyds*, 202 S.W.3d 744, 753 (Tex. 2006).

5. "[I]t is the court's duty to give the words used their plain meaning." *Puckett v. U.S. Fire Ins. Co.*, 678 S.W.2d 936, 938 (Tex. 1984). "If policy language is worded so that it can be given a definite or certain legal meaning, it is not ambiguous and we construe it as a matter of law." *American Mfrs. Mut. Ins. Co. v. Schaefer*, 124 S.W.3d 154, 157 (Tex. 2003). Here, the Policy's plain language excludes coverage for losses that occur as a result of a virus.

6. Nor does a "crisis" such as the COVID-19 pandemic justify the nullification of policy terms that preclude coverage. The Texas Supreme Court recognized precisely this when it held that "Texas courts must stick to what [insurance] policies say." *Fiess*, 202 S.W.3d at 753. They "must enforce the contract as made by the parties, and cannot make a new contract for them," even "when a crisis arises." *Id.* Under "Texas jurisprudence," courts enforce the policies "as written" and are "loathe to engraft by judicial fiat additional terms requiring [an insurer] to assume liability for a risk the Policy specifically excluded." *Farmers Ins. Exch. v. Greene*, 376 S.W.3d 278, 286 (Tex. App.—Dallas 2012) (citing *Fiess*, 202 S.W.3d at 745), *aff'd*, 446 S.W.3d 761 (Tex. 2014).

7. Insurance companies exclude certain causes of loss where the risk is difficult or impossible to estimate and may be catastrophic—as it is for viruses, as was demonstrated by the Severe Acute Respiratory Syndrome (SARS) outbreak in 2002-03 and is now shown again by the COVID-19 pandemic.[2] *Cf. Gowland v. Aetna*, 143 F.3d 951, 953 (5th Cir. 1998) (noting that "[i]t is uneconomical for private insurance companies to provide flood insurance"). To impose liability

[2] Insurance policies exclude coverage for such potentially catastrophic hazards as "volcanic eruption," "nuclear hazard," "war," and "flood." (*See* Policy at 5.)

retroactively for an excluded peril, as Plaintiffs ask the Court to do, does not serve public policy, but would arbitrarily impose an inequitable burden on State Farm and other insurers to cover a risk that their policies explicitly and unambiguously informed policyholders was not covered and for which the insurers did not charge a premium. Such a result would contravene settled Texas law in insurance cases and would violate State Farm's due process rights and other constitutional guarantees.

8. For these reasons and those set forth below, Plaintiffs' Second Amended Petition should be dismissed for failure to state a claim.

II. LEGAL STANDARD

9. "To survive a Rule 12(b)(6) motion to dismiss, the plaintiff must plead 'enough facts to state a claim to relief that is plausible on its face.'" *Mission Toxicology, L.L.C. v. UnitedHealthcare Ins. Co.*, 2018 WL 2222854, at *3 (W.D. Tex. Apr. 20, 2018) (Ezra, J.) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). "The '[f]actual allegations must be enough to raise a right to relief above the speculative level, on the assumption that all the allegations in the complaint are true (even if doubtful in fact).'" *Id.* (quoting *Twombly*, 550 U.S. at 555). "'A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.'" *Id.* (quoting *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009)).

10. The Court may take judicial notice of the underlying insurance policies, which are referenced in the complaint and are central to Plaintiffs' claims. *Mission Toxicology*, 2018 WL 2222854, at *3; *see Walker v. Beaumont Indep. Sch. Dist.*, 938 F.3d 724, 735 (5th Cir. 2019).

III. PLAINTIFFS FAIL TO STATE A CLAIM

A. Plaintiffs' Breach Of Contract Claim Should Be Dismissed

11. The interpretation of an insurance contract is a legal issue for the Court. *National*

Union Fire Ins. Co. v. Kasler Corp., 906 F.2d 196, 198 (5th Cir. 1990); *see also Fiess*, 202 S.W.3d at 746. The Court looks first to the policy language. Under Texas law, "it is the court's duty to give the words used their plain meaning." *Puckett*, 678 S.W.2d at 938. "If policy language is worded so that it can be given a definite or certain legal meaning, it is not ambiguous and we construe it as a matter of law." *Amer. Mfrs. Mut. Ins. Co.*, 124 S.W.3d at 157. An insurance policy is construed as a whole, including endorsements, which are part of the policy and cannot be "read in a vacuum." *Penthouse Owners Ass'n, Inc. v. Certain Underwriters at Lloyds, London*, 612 F.3d 383, 389 (5th Cir. 2010).

12. To recover under an insurance policy, an insured has the initial burden of establishing coverage under the terms of the policy. *Gilbert Tex. Constr. L.P. v. Underwriters at Lloyd's London*, 327 S.W.3d 118, 124 (Tex. 2010). If the insured proves coverage, then to avoid liability the insurer must establish that the loss is within an exclusion. *Id*. If the insurer makes that showing, the burden shifts back to the insured to show that an exception to the exclusion (if any) brings the claim back within coverage. *Id*.

13. Under the plain language of Plaintiffs' Policy, Plaintiffs' claimed losses (i) do not meet the terms of coverage and (ii) are subject to exclusions, including the Policy's Virus Exclusion. Plaintiffs' breach of contract claims should thus be dismissed as a matter of law.

i. <u>Coverage For Plaintiffs' Alleged Losses Is Barred By The Virus Exclusion</u>

14. Plaintiffs' claims are barred by the Policy's Virus Exclusion, which states:

> **SECTION I – EXCLUSIONS**
> 1. We do not insure under any coverage for any loss which would not have occurred in the absence of one or more of the following excluded events. We do not insure for such loss regardless of: (a) the cause of the excluded event; or (b) other causes of the loss; or (c) whether other causes acted concurrently or in any sequence with the excluded event to produce the loss; or (d) whether the event occurs suddenly or gradually, involves isolated or widespread damage, arises from natural or external forces, or occurs as a result of any combination of these:
> …

> **j. Fungi, Virus or Bacteria**
> ...
> (2) Virus, bacteria or other microorganism that induces or is capable of inducing physical distress, illness or disease; …. (Policy at 5-6 (¶ 1, j (2)).)

The heading for the exclusion conspicuously includes "Virus" in bold type. The Policy's table of contents also separately lists the "Fungi, Virus Or Bacteria" Exclusion. (Policy at 1.)

15. Plaintiffs' Endorsement for "Loss of Income and Extra Expense," under which Plaintiffs sue, expressly incorporates Section I of the Policy, which contains the Virus Exclusion. (Endorsement at 1.)[3] Further, each coverage provided by the Endorsement expressly requires a "Covered Cause Of Loss," which is defined in the Policy in Section I as losses that are, *inter alia*, not "[e]xcluded in Section I—Exclusions." (Policy at 4.) The Virus Exclusion thus applies to all of Plaintiffs' claims, which are brought for coverages provided by the Endorsement.

16. The Virus Exclusion is unambiguous. The Texas Supreme Court has given effect to a similarly-worded exclusion in a State Farm policy that barred coverage for mold. *Fiess*, 202 S.W.3d at 753. In *Fiess*, the court held that the exclusion, which stated "[w]e do not cover loss caused by ... rust, rot, mold or other fungi," barred coverage for mold contamination caused by water damage that was otherwise covered by the policy. *Id*. The court explained that it must consider an insurance policy in its entirety, and "cannot overlook the obvious—that the policy provision here begins by stating unambiguously, '[w]e do not cover loss caused by mold.'" *Id*. at 748. The Texas Supreme Court emphatically declined to abandon these settled principles of policy interpretation because of a "crisis":

> For more than a century this Court has held that in construing insurance policies where the language is plain and unambiguous, courts must enforce the contract as made by the parties, and cannot make a new contract for them, nor change that which they have made under the guise of construction .... Texas courts must stick

[3] True and correct copies of the Endorsements are found on the following bates-numbered pages in the Policy Exhibits attached to the Egeland Declaration: Ex. A-1 (000047-50); Ex. A-2 (000118-121); Ex. A-3 (000232-236); Ex. A-4 (000305-308); Ex. A-5 (000417-420); Ex. A-6 (000510-513).

to what those policies say, and cannot adopt a different rule when a "crisis" arises. *Id*. at 753 (quotation marks and citations omitted).

17. Other courts throughout the country have similarly enforced the plain meaning of exclusions like the one at issue here. For example, in *Mount Vernon Fire Insurance Co. v. Adamson*, an insurer sought a declaratory judgment that it was not required to indemnify a landlord under a commercial insurance policy for a tenant's suit for damages allegedly caused by mold in the apartment. 2010 WL 3937336, at *1 (E.D. Va. Sept. 15, 2010), *report and recommendation adopted*, 2010 WL 3937335 (E.D. Va. Oct. 6, 2010). The policy contained an exclusion barring coverage for "mold, fungus, bacteria or virus." *Id*. Finding the plain language of the exclusion to be unambiguous, the court held that the insurer had "no coverage obligation." *Id*. at *6. Likewise, in *Alexis v. Southwood L.P.*, the court affirmed summary judgment for the insurer, holding that a "communicable disease exclusion" barred coverage for diseases transmitted from exposure to raw sewage. 792 So. 2d 100, 102 (La. App. 4 Cir. July 18, 2001). And in evaluating insurance claims for flood damage from Hurricane Katrina, the Fifth Circuit held that coverage was barred by the policies' unambiguous water damage exclusions. *In re Katrina Canal Breaches Litig.*, 495 F.3d 191, 214 (5th Cir. 2007).

18. Plaintiffs allege they are entitled under the Policy to coverage for losses that occurred "as a result of" "the Covid-19 outbreak and the subsequent Bexar County and State of Texas Orders" that closed their businesses (SAP ¶¶ 7, 11-13, 15), to "protect the health, safety and welfare" of residents from the Covid-19 disease "caused by a coronavirus." (*Id.* ¶¶ 8-10 & [8-2] at 8 and [8-3] at 3.) Plaintiffs further allege that "[t]he presence of the virus all over Bexar County alone triggers coverage because it renders the Properties unsafe" or "unusable for their intended purpose." (SAP ¶ 12.) Plaintiffs' allegations establish that a virus is in the chain of causation for

their alleged losses, which are thus barred by the Policy's Virus Exclusion.

19. Though Plaintiffs allege that the Virus Exclusion "states that it applies only where a virus, that is a microorganism, is the fully realized and actual cause of the loss" (SAP ¶ 16), the Policy says no such thing. Rather, the Virus Exclusion applies to any loss where a virus is anywhere in the chain of causation. The lead-in language to the Virus Exclusion (and other exclusions) excludes from coverage "any loss which would not have occurred in the absence of one or more of the [listed] excluded events" and provides that State Farm does not "insure for such loss regardless of (a) the cause of the excluded event; or (b) other causes of the loss; or (c) whether other causes acted concurrently or in any sequence with the excluded event to produce the loss; or (d) whether the event occurs suddenly or gradually, involves isolated or widespread damage, arises from natural or external forces or occurs as a result of any combination of these." (Policy at 5-6 (¶ 1, j (2)).) This language bars coverage for losses if "virus" is "in any sequence" in the chain of causation, even if there are also other causes. *Tuepker v. State Farm Fire & Cas. Co.*, 507 F.3d 346, 354 (5th Cir. 2007); *Tsai v. Liberty Mut. Ins. Co.*, 2015 WL 6550769, at *6 (Tex. App.—Houston [1st Dist.] 2015) (under "lead-in" language similar to State Farm's, loss caused by an excluded event is not covered even if loss was "caused by a combination of covered and excluded perils"). Here, Plaintiffs' alleged losses "would not have occurred in the absence of" a "virus" and are thus excluded from coverage under the Virus Exclusion.

20. In an attempt to avoid the unambiguous language of the contract, Plaintiffs allege in a conclusory fashion that any "construction of the language of the policies" that does not provide "coverage for business interruption and other losses" is "void as against public policy." (SAP ¶¶ 45-46.) Plaintiffs offer no support for this allegation. Nor can they. As an insurer operating in Texas, all of State Farm's Policy language, including the Virus Exclusion, was reviewed and

approved by the Texas Department of Insurance. *See Greene v. Farmers Ins. Exch.*, 446 S.W.3d 761, 774-75 (Tex. 2014). In 2006, following the SARS epidemic, hundreds of insurers, including State Farm, were granted approval by the Texas Department of Insurance to use the Virus Exclusion at issue here. *See* Tex. Dep't of Ins., "Advisory Organization and State Agency Approved/Accepted Filings," *available at* https://www.tdi.texas.gov/commercial/documents/pcadvform.pdf (State Farm's virus exclusion, submitted in ISO Circular CL 2006-OVBEF, was approved on October 5, 2006) (Ex. A-8 to Egeland Declaration at pp. 13 & 19).[4] To this end, the Texas Supreme Court instructs that "adherence to the contract language and reluctance to rewrite contracts with the benefit of hindsight are hallmarks of our contract jurisprudence, but these principles are inviolable in the context of insurance contracts, where the policy language and forms are adopted or approved by an executive body created for that purpose." *Greene*, 446 S.W.3d at 774-75; *see also Yancey v. Floyd West & Co.*, 755 S.W.2d 914, 924 (Tex. App.—Ft. Worth 1988) (rejecting policyholder's argument that insurance provision contravened public policy).

21. Texas, like other states, looks to its statutes and court decisions as the basis for public policy. *See, e.g.*, *Stubbs v. Ortega*, 977 S.W.2d 718, 722 (Tex. App.—Ft. Worth 1998). There is no public policy underlying Texas statutes or expressed in court decisions that would support requiring insurers to pay for business interruptions due to coronavirus or government-mandated closures due to the coronavirus despite clear policy language excluding that risk. Where "unambiguous provisions of the policies clearly restrict[] coverage, and premiums were presumably" priced accordingly, "there [is] no basis on which to invalidate the limitations on coverage." *Yancey*, 755 S.W.2d at 924. There are no Texas statutes or court decisions supporting

[4] "Judicial notice may be taken of matters of public record." *Walker*, 938 F.3d at 735; *see also Firefighters' Ret. Sys. v. EisnerAmper L.L.P.*, 898 F.3d 553, 558 n.2 (5th Cir. 2018); *Funk v. Stryker Corp.*, 631 F.3d 777, 783 (5th Cir. 2011). Likewise, "[w]hen a defendant attaches documents to its motion that are referred to in the complaint and are central to the plaintiff's claims, the court may also properly consider those documents." *Walker*, 938 F.3d at 735.

the contention that an insurance contract violates public policy by excluding (with the approval of Texas insurance regulators) a risk (such as virus) where the magnitude of the risk is unpredictable, and where, if the excluded event occurs, it may impose an undue burden on insurance reserves and on the insurance industry generally.

22. Plaintiffs' passing attempt to bar reliance "on the Exclusions as a result of regulatory and/or administrative estoppel" (SAP ¶ 20) is also meritless. "Regulatory estoppel" is not recognized in Texas and "has been rejected by virtually every other state and federal court to address the issue." *SnyderGeneral Corp. v. Great Am. Ins. Co.*, 928 F. Supp. 674, 682 (N.D. Tex. 1996), *aff'd*, 133 F.3d 373 (5th Cir. 1998); *see also Shaw v. Liberty Mut. Fire Ins. Co.*, 2016 WL 561409, at *5 (M.D. Fla. Feb. 12, 2016) (collecting cases).

23. Plaintiffs seek to have the Court retroactively invalidate the Virus Exclusion in State Farm's policies. (SAP ¶¶ 19-21.) Not only would doing so violate settled principles of Texas law, *see Fiess*, 202 S.W.3d at 753; *Farmers Ins. Exch.*, 376 S.W.3d at 286, but the resulting imposition of retroactive liability under State Farm's insurance contracts would also violate the fundamental protections of the United States and Texas Constitutions against denial of due process and taking of property without just compensation.[5] State Farm's contract rights, as well as the funds that Plaintiffs claim should be paid by State Farm for losses barred by the Virus Exclusion, are protected property interests for purposes of due process. *See Stidham v. Tex. Comm'n on Private Sec.*, 418 F.3d 486, 492 n.29 (5th Cir. 2005). As such, these interests are protected from arbitrary and irrational state interference by the due process clauses of the United States and Texas Constitutions. *See Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 15 (1976); *E. Enters. v. Apfel*, 524 U.S. 496, 535 (1998). The retroactive assessment of liability for such uncovered "losses"

[5] *See* U.S. Const., Amdts. 5, 14; Tex. Const. art. I, §§ 17, 19.

would constitute arbitrary interference with those property interests that is unfair and in violation of due process. *See Pension Benefit Guar. Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 733 (1984); *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 574-75 & n.22 (1996).

24. To create new insurance coverage and new liabilities that State Farm never contracted to provide and for which the policyholders were not charged premiums would unfairly and arbitrarily force State Farm and other insurers to bear the enormous costs of a public catastrophe. Policyholders such as Plaintiffs had no reasonable expectation of compensation for losses excluded by the Virus Exclusion in their policies, and State Farm had a settled expectation that it was not undertaking to insure such losses. Rewriting insurance policies to cover excluded COVID-19 claims would drain insurers' reserves set aside to cover other policyholders' covered losses. The drastic change in settled Texas law and the retroactive creation of liability under State Farm's insurance contracts sought by Plaintiffs would violate the basic guarantees of fairness protected by the Due Process Clause. *See id.*[6]

25. Such retroactive rewriting of State Farm's policies and imposition on State Farm of the "disproportionate and severely retroactive burden" of liability would also contravene the "fundamental principles of fairness underlying the Takings Clause[s]" of the United States and Texas Constitutions. *See E. Enters. v. Apfel*, 524 U.S. at 536-37 (invalidating legislation that would have imposed far-reaching retroactive liability for health benefits on employers).[7]

26. For these reasons, the Court should hold that the Policy's Virus Exclusion is enforceable and excludes Plaintiffs' claimed losses from coverage.

[6] The fact that Plaintiffs seek a retroactive imposition of liability through the courts rather than through the legislature does not render their claims constitutionally permissible. *See Gore*, 517 U.S. at 572 n.17 ("State power may be exercised as much by a jury's application of a state rule of law in a civil lawsuit as by a statute").

[7] The Takings Clause "stands as a shield against the arbitrary use of government power," whether exercised through the courts or by the legislature. *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 164 (1980).

ii. Even Without The Virus Exclusion, Plaintiffs Do Not Allege Covered Losses

27. Even without the Virus Exclusion that bars their claims, Plaintiffs do not state a claim for coverage for the separate reason that their allegations are insufficient to establish the required "accidental direct physical loss to" property. (Policy at 3; Endorsement at 1.a., 2.a., 3b.)

28. Plaintiffs' conclusory allegation that "the pandemic and health care crises have resulted in the Plaintiffs' suffering a physical loss of the insured properties or alternatively damage to the insured Properties" (SAP ¶ 11) does not identify an "accidental direct physical loss to" property or explain what it is. This allegation fails "'to state a claim to relief that is plausible on its face'" or to allow a "'reasonable inference that the defendant is liable for the misconduct alleged.'" *Mission Toxicology*, 2018 WL 2222854, at *3 (citations omitted).

29. Even if Plaintiffs had alleged that the coronavirus was present at their properties (which they have not), that would not constitute "accidental direct physical loss." The requirement that the loss be "physical" is "'widely held to exclude alleged losses that are intangible or incorporeal and, thereby, to preclude any claim against the property insurer when the insured merely suffers a detrimental economic impact unaccompanied by a distinct, demonstrable, physical alteration of the property.'" *Hartford Ins. Co. v. Miss. Valley Gas Co.*, 181 F. App'x 465, 470 (5th Cir. 2006) (citation omitted); *see also Port Auth. of N.Y. & N.J. v. Affiliated FM Ins. Co.*, 311 F.3d 226, 235 (3d Cir. 2002); *Univ. Image Prods., Inc. v. Chubb Corp.*, 703 F. Supp. 2d 705, 711 (E.D. Mich. 2010), *aff'd sub nom. Univ. Image Prods., Inc. v. Fed. Ins. Co.*, 475 F. App'x 569 (6th Cir. 2012). In Texas, examples of direct physical loss include structural damage from hurricane winds, *JAW The Pointe, L.L.C. v. Lexington Ins. Co.*, 460 S.W.3d 597 (Tex. 2015); hailstorms, *State Farm Lloyds v. Kaip*, 2001 WL 670497, at *2–3 (Tex. App.—Dallas June 15, 2001); and ice storms, *Allianz Cornhill Int'l v. Great Lakes Chem. Corp.*, 2006 WL 778618, at *6 (S.D. Tex. Mar. 24, 2006). These cases, all of which involve tangible damage, do not support the

notion that a virus, which does not impair the structural integrity of property, constitutes direct physical loss.

30. Plaintiffs incorrectly allege that "longstanding Texas precedent holds 'physical loss' can occur without actual physical damage to a property." (SAP ¶ 13.) To the contrary, like the Fifth Circuit in *Hartford Ins. Co.*, 181 F. App'x at 470, the district court for the Northern District of Texas held that the term "physical loss" "cannot fairly be construed to mean physical loss in the absence of physical damage." *Ross v. Hartford Lloyd Ins. Co.*, 2019 WL 2929761, at *7 (N.D. Tex. July 4, 2019). "[D]irect physical loss" requires a "'distinct, demonstrable, physical alteration of the property'" and "'exclude[s] alleged losses that are intangible or incorporeal," thereby precluding claims "when the insured merely suffers a detrimental economic impact." *Id.* at *7 (citation omitted); *see also J.O. Emmerich & Assocs., Inc. v. State Auto. Ins. Cos.*, 2007 WL 9775576, at *3 (S.D. Miss. Nov. 19, 2007) (same).

31. In a case analogous to this one, the court applied this rule in rejecting a claim for business interruption losses due to the presence of mold and bacteria in a ventilation system, holding that the insured had not shown "that it suffered any structural or any other tangible damage to the insured property." *Univ. Image Prods.*, 703 F. Supp. 2d at 710. So, too, here.

32. Nor does it suffice that Plaintiffs experienced a "loss of the covered property" "because they were unable to operate" due to the governmental closure "Orders." (SAP ¶¶ 12, 15; *see id.* ¶ 11.) As in *Source Food Technology v. U.S. Fidelity & Guaranty Co.*, 465 F.3d 834 (8th Cir. 2006), where there was a loss of use of property due to a governmental embargo order, "the policy's use of the word 'to' in the policy language 'direct physical loss *to* property' is significant." *Id.* at 838 (emphasis in original). Plaintiffs' "argument might be stronger if the policy's language included the word 'of' rather than 'to,' as in 'direct physical loss of property' or even 'direct loss

of property.' But these phrases are not found in the policy." *Id.* "[T]he policy's use of the words 'to property' further undermines [Plaintiffs'] argument" that coverage is triggered under the Policy. *Id.* Plaintiffs' breach of contract claim should be dismissed.

iii. The Policy's Civil Authority Provision Is Inapplicable

33. Plaintiffs allege they are entitled to coverage under the Civil Authority provision in an Endorsement to the Policy. (SAP ¶¶ 13-15.) At its beginning and end, the Endorsement states: "The coverage provided by this endorsement is subject to the provisions of **SECTION I — PROPERTY**, except as provided below" and "All other policy provisions apply." (Endorsement at 1, 4.) Under the plain terms of the Policy and its Endorsement, Plaintiffs have not pled facts that meet the requisite elements to trigger the Civil Authority provision. Those elements include:

- "When a Covered Cause Of Loss" (Endorsement, ¶ 4 (p. 2)), *i.e.*, "accidental direct physical loss to" property "unless the loss is … [e]xcluded" (Policy, Section I – Covered Causes Of Loss (p. 4));
- "causes damage to property other than property at the described premises" (Endorsement ¶ 4 (p. 2)); and
- a "civil authority … prohibits access to the described premises, provided that both of the following apply:" (*id.*);
  - "[a]ccess to the area immediately surrounding the damaged property is prohibited by civil authority as a result of the damage, and the described premises are within that area but are not more than one mile from the damaged property; and" (*id.*);
  - "[t]he action of civil authority is taken in response to dangerous physical conditions resulting from the damage or continuation of the Covered Cause Of Loss that caused the damage, or … to enable a civil authority to have unimpeded access to the damaged property." (*Id.*).

The failure of even one of these contractual elements warrants a finding of no coverage. Plaintiffs' pleading fails on each of them.

34. Plaintiffs do not allege a legally cognizable "Covered Cause Of Loss." Rather, they affirmatively allege an excluded cause of loss: the COVID-19 coronavirus. Plaintiffs allege that

they sustained losses due to "the Covid-19 outbreak and subsequent Bexar County and State of Texas Orders" (SAP ¶ 7). These Orders were issued "due to imminent threat arising from COVID-19." [8-2] at 2; *see also* [8-3] at 3 (same). As discussed above, the Policy states: "We do not insure under any coverage for any loss which would not have occurred in the absence of ... Virus." (Policy at 5-6 (¶ 1, j (2).) The Virus Exclusion thus bars coverage.

35. Nor do Plaintiffs plead a cognizable claim for damage to nearby property—a prerequisite to obtain coverage under the Civil Authority provision. *See Dickie Brennan & Co. v. Lexington Ins. Co.*, 636 F.3d 683, 685 (5th Cir. 2011); *Kean, Miller, Hawthorne, D'Armond McCowan & Jarmar, LLP v. Nat'l Fire Ins. Co.*, 2007 WL 2489711, at *3 (M.D. La. Aug. 29, 2007). Instead, the governmental Orders concern a "public health emergency" caused by the COVID-19 coronavirus. (*E.g.*, [8-2] at 1).

36. "[C]ivil authority coverage is intended to apply to situations where access to an insured's property is prevented or prohibited by an order of civil authority issued as a direct result of physical damage to other premises in the proximity of the insured's property." *Dickie Brennan*, 636 F.3d at 686-87 (citations omitted); *see United Air Lines, Inc. v. Ins. Co. of State of Pa.*, 439 F.3d 128, 131 (2d Cir. 2006); *S. Tex. Med. Clinics, P.A. v. CAN Fin. Corp.*, 2008 WL 450012, at *9 (S.D. Tex. Feb. 15, 2008). For example, coverage might apply where a civil authority orders an insured building closed for safety reasons while an adjacent building that was damaged by fire is being repaired. *See Syufy Enters. v. Home Ins. Co.*, 1995 WL 129229, at *2 n.1 (N.D. Cal. Mar. 21, 1995); *United Airlines, Inc. v. Ins. Co. of State of Pa.*, 385 F. Supp. 2d 343, 352 (S.D.N.Y. 2005), *aff'd*, 439 F.3d 128 (2d Cir. 2006). A "causal link" must exist between prior actual damage to nearby premises "and the action by a civil authority." *S. Tex. Med. Clinics*, 2008 WL 450012, at *10; *see Kelaher, Connell & Conner, P.C. v. Auto-Owners Ins. Co.*, 2020 WL 886120, at *6

(D.S.C. Feb. 24, 2020); *Not Home Alone, Inc. v. Phila. Indem. Ins. Co.*, 2011 WL 13214381 at *6 (E.D. Tex. Mar. 30), *report & recommendation adopted*, 2011 WL 13217067 (E.D. Tex. Apr. 8, 2011). No such situation is alleged here.

37. Plaintiffs fail to plead the requisite causal link between actual damage to nearby premises and the prohibition on access. The Bexar County Order does not preclude access to the insured premises because of any alleged damage to other property within a mile of the described premises. Rather, it permits access to, among other things, "maintain security, upkeep, and maintenance of the premises, equipment or inventory." ([8-2] at 9 (¶ I. 2).) A causal relationship is also absent when civil action is taken due to fear of future harm, rather than prior actual physical damage. Thus, when construing similar policy language, courts have rejected civil authority coverage where businesses had losses due to preventive governmental measures, such as pre-hurricane evacuations or the threat of terrorist attacks, before any physical damage occurred. *See Dickie Brennan*, 636 F.3d at 686–87; *S. Tex. Med. Clinics*, 2008 WL 450012, at *10; *Not Home Alone, Inc.*, 2011 WL 13214381, at *6-7; *United Air Lines*, 439 F.3d at 134-35; *Jones, Walker, Waechter, Poitevent, Carrere & Denegre, LLP v. Chubb Corp.*, 2010 WL 4026375, at *3 (E.D. La. Oct. 12, 2010). Here, because the Bexar County Order was issued "due to imminent threat arising from COVID-19" ([8-2] at 2), and not because of prior "actual physical damage," Plaintiffs' "business interruption losses are not covered by [their] policy." *S. Tex. Med. Clinics*, 2008 WL 450012, at *10 (quotation marks omitted).

38. Moreover, the provision has additional requirements, including that "[a]ccess to the area immediately surrounding the damaged property is prohibited by civil authority … as a result of the damage," where the described premises are within that area (but no more than a mile away). (Endorsement ¶ 4.a(1).) Plaintiffs do not so allege. In fact, "[a]ccess to the area immediately

surrounding the damaged property" is not "prohibited." Beyond the lack of physical barricades, the Bexar County and Texas Orders allow access to hospitals, clinics, laboratories, vehicle manufacturers, automotive suppliers, gas stations, grocery stores, and liquor stores. ([8-2] at 9-12 (¶ I.2(i)); [8-3] at 5.) Individuals may still "engage in activities or perform tasks essential to their health and safety," "obtain necessary services or supplies for themselves and their family or household members" ([8-2] at 9), "provid[e] or obtain[] other essential services," and "engag[e] in physical activity like jogging or bicycling" in these areas ([8-3] at 5). In short, Plaintiffs have failed to allege the factual predicates for coverage under the Civil Authority provision. Their claim for breach of that provision fails as a matter of law.

iv. <u>The Policy's "Loss of Income" Coverage Is Inapplicable</u>

39. Plaintiffs allege they are entitled to coverage under the Loss of Income Coverage provided by the Endorsement. (SAP ¶ 12.) Beyond being barred by the Virus Exclusion, Plaintiffs are not entitled to Loss of Income coverage because they do not meet the conditions for coverage. Such coverage is provided for a suspension of operations caused by "accidental direct physical loss to property." (Endorsement at 1.) But as shown above, Plaintiffs' allegations are insufficient to constitute "accidental direct physical loss to property." *See supra* ¶¶ 27-32.

40. Under Plaintiffs' allegations, the other requirements for "Loss of Income" coverage are also not satisfied. Not only do the policies provide that State Farm "do[es] not insure ***under any coverage*** for any loss which would not have occurred in the absence of … Virus" (Policy at 5-6 (emphasis added)), but the Loss of Income provision also expressly requires that the loss "must be caused by a Covered Cause Of Loss." Under the plain terms of the Policy, a virus is not a "Covered Cause Of Loss." (Policy at 4, 6.)

41. Further, to the extent that Plaintiffs' suspension of business was caused by the Bexar County Order, it is not a covered loss. That Order is not, and did not cause, the required

"accidental direct physical loss to property." Moreover, under the Policy's "Acts or Decisions" Exclusion, "[c]onduct, acts or decisions … by a governmental body" do not constitute a covered loss, and if such acts and decisions "cause," "contribute to," or "aggravate" an excluded loss (such as virus), the loss remains excluded. (Policy at 8); *see also infra* ¶¶ 45-46.

42. Loss of Income coverage applies to loss of income sustained due to the necessary suspension of operations "during the 'period of restoration,'" the period when the property is "repaired, rebuilt or replaced with reasonable speed and similar quality" or until "business is resumed at a new permanent location." (Endorsement at 2.) Here, there is no period of restoration. There are no allegations that the coronavirus necessitated repairs, replacement, or rebuilding, or that new permanent locations are being sought. Loss of income coverage is not available for a suspension of operations where, as here, a shutdown is due to government order.

v. Additional Policy Exclusions Bar Plaintiffs' Claims

43. Despite Plaintiffs' allegations otherwise (SAP ¶ 18), coverage is also barred by the "Ordinance or Law," the "Acts or Decisions," and the "Consequential Loss" Exclusions.

44. The "Ordinance or Law" Exclusion bars coverage for any loss due to "[t]he enforcement of any ordinance or law" "[r]egulating the ... use ... of any property," and "applies … even if the property has not been damaged." (Policy, Exclusions ¶ 1.a (p. 5).) Under such an exclusion, when governmental officials impose certain restrictions on the "use" of property, the insured must "absorb the expense" of complying with those restrictions. *MarkWest Hydrocarbon, Inc. v. Liberty Mut. Ins. Co.*, 558 F.3d 1184, 1192 (10th Cir. 2009).

45. The "Acts or Decisions" Exclusion bars coverage for any loss caused by "[c]onduct, acts or decisions … of any person, group, organization, or governmental body whether intentional, wrongful, negligent or without fault." (Policy, Exclusions ¶ 3.b (p. 8).) Thus, where a claimed loss is caused by the acts or decisions of a governmental authority, the loss is excluded from

coverage. For example, in *Cytopath Biopsy Lab., Inc. v. U.S. Fidelity & Guaranty Co.*, 774 N.Y.S.2d 710 (App. Div. 2004), the "Acts or Decisions" exclusion in the plaintiff's policy barred coverage for alleged business interruption losses because "the real losses claimed herein resulted from refusal by the [governmental] authorities to permit resumption of operations until proper permits were obtained and a more acceptable ventilation system was installed." *Id.* at 711; *see also Worldwide Sorbent Prod., Inc. v. Invensys Sys., Inc.*, 2014 WL 12597394, at *11 (E.D. Tex. July 31, 2014) (applying Acts or Decisions exclusion); *Scottsdale Ins. Co. v. Sally Grp., LLC*, 2012 WL 1144577, at *13 (S.D. Tex. Apr. 4, 2012) (same).

46. Here, because an act by a governmental official allegedly caused Plaintiffs' losses by putting restrictions on the use of Plaintiffs' properties (SAP ¶¶ 9-11), the Ordinance or Law Exclusion and Acts or Decisions Exclusion are each implicated. Either one bars coverage.

47. Additionally, the "Consequential Loss" Exclusion bars coverage for "loss whether consisting of, or directly and immediately caused by … [d]elay, loss of use or loss of market." (Policy, Exclusions ¶ 2.b (p. 6).) The Loss of Income and Extra Expense endorsement also excludes "any other consequential loss." (Endorsement, Exclusions, ¶ 2 (p. 3).) Courts have upheld similar consequential loss exclusions where an insured alleged that "its damages were caused by its inability to access" its property and "did not contend that its [property] had been physically damaged in any way." *Petroterminal de Panama, S.A. v. Houston Cas. Co.*, 114 F. Supp. 3d 152, 160 (S.D.N.Y. 2015), *aff'd*, 659 F. App'x 46 (2d Cir. 2016). Plaintiffs allege that they sustained "losses related to business interruption" (*i.e.*, lost profits) due to their inability to use their property due to the "Bexar County and State of Texas Orders." (SAP ¶ 7.) Such claims are consequential losses barred by the Policy's exclusion for loss caused by loss of use. *See Petroterminal de Panama, S.A. v. Houston Cas. Co.*, 659 F. App'x 46, 51 (2d Cir. 2016).

B. The Texas Insurance Code Claims Fail As A Matter Of Law

48. Claims alleging violations of the Texas Insurance Code are "subject to the heightened federal pleading requirements of Rule 9(b) because they are claims predicated on misrepresentations and fraud." *Brasher v. State Farm Lloyds*, 2017 WL 9342367, at *7 (W.D. Tex. Feb. 2, 2017) (Ezra, J.). Plaintiffs' threadbare allegations do not meet this burden because they fail to allege "the *particulars* of time, place, and contents of the false representations, as well as the identity of the person making the misrepresentation and what he obtained thereby." *Id.* at *8. Accordingly, Plaintiffs' allegations "fail[] to meet the plausibility federal pleading standard applied using a Rule 12(b)(6) analysis, much less the Rule 9(b) heightened fraud pleading standard," *id.* at *7, and should be dismissed.

i. Plaintiffs Fail To Plead Misrepresentation

49. Plaintiffs' "Misrepresentation of Insurance Policies" claim (SAP ¶ 27) should be dismissed because, where, as here, "the alleged misrepresentations concern a party's failure to fulfill its contractual duties, the alleged failure to perform these duties does not constitute a misrepresentation under the Texas Insurance Code …, but is more properly raised as a breach of contract claim." *Travelers Lloyds Ins. Co. v. Cruz Contracting of Tex., LLC*, 2017 WL 5202890, at *6 (W.D. Tex. Mar. 17, 2017) (Ezra, J.). Further, claims for "unfair settlement practices" under the Texas Insurance Code are only triggered when "the liability of the insurer is reasonably clear." *Primerica Life Ins. Co. v. Gross*, 2018 WL 2181101, at *11 (W.D. Tex. Mar. 27, 2018) (Ezra, J). As discussed above, under the plain language of the Policy, Plaintiffs' claims are not covered, and any representation to that effect was accurate and not a misrepresentation. *See Thomas v. State Farm Lloyds*, 218 F. Supp. 3d 506, 519 (N.D. Tex. 2016) (rejecting plaintiffs' claim that "defendants misrepresented the Policy to them by explaining that it did not cover their claim" where in fact there was no coverage). Plaintiffs' misrepresentation claim under the Texas

Insurance Code should thus be dismissed.

ii. Plaintiffs Do Not Properly Plead A Violation Of The Prompt-Payment Act

50. Plaintiffs' claim under various sections of Chapter 542 of the Texas Insurance Code, also known as the Texas Prompt Payment of Claims Act ("TPPCA"), should likewise be dismissed. (SAP ¶¶ 28-33.) To state a claim under the TPPCA, "a plaintiff must show that ... the insurer is liable for the claim." *Primerica Life Ins. Co.*, 2018 WL 2181101, at *8. As discussed above, Plaintiffs cannot rightfully assert coverage under the plain terms of the Policy. Plaintiffs' TPPCA claim should be dismissed.

C. Plaintiffs' Breach of Duty of Good Faith/Fair Dealing Claim Should Be Dismissed

51. Plaintiffs' claim for breach of the duty of good faith and fair dealing is without merit. (SAP ¶¶ 34-36.) "The standard for [this] common law" claim "is the same as that for statutory … [Texas Insurance Code] claims." *Jaramillo v. Liberty Mut. Ins. Co.*, 2019 WL 8223608, at *8 n.9 (N.D. Tex. Apr. 29, 2019) (citing *Progressive Cty. Mut. Ins. Co. v. Boyd*, 177 S.W.3d 919, 922 (Tex. 2005)). No facts are pled that would allow an inference of anything more than a good-faith dispute over the scope of coverage. Plaintiffs' claims are not covered under the plain terms of the Policy. They have not properly pled claims under the Texas Insurance Code. Plaintiffs' corresponding common law claim fails as well. *Id.*

IV. CONCLUSION

52. For the foregoing reasons, State Farm respectfully requests the Court to grant its motion to dismiss Plaintiffs' Second Amended Petition for failure to state a claim.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on May 8, 2020, I caused a true and correct copy of the foregoing to be filed on the Court's CM/ECF system, which served notice on all counsel of record.

/s/ Susan E. Egeland
SUSAN E. EGELAND