2014 YEAR IN REVIEW

SIGNIFICANT DECISIONS IN 2014:

INSURANCE LAW

By Jennifer Kelley

SUPREME COURT OF TEXAS

***Ewing Construction Company, Inc. v. Amerisure Ins. Co.*, 420 S.W.3d (Tex. 2014).**

In a decision addressing certified questions from the Fifth Circuit, the Supreme Court of Texas narrowly construed the contractual liability exclusion in a commercial general liability policy and concluded that:

> …a general contractor who agrees to perform its construction work in a good and workmanlike manner, without more, does not enlarge its duty to exercise ordinary care in fulfilling its contract, thus it does not "assume liability" for damages arising out of its defective work so as to trigger the Contractual Liability Exclusion.

In *Ewing*, Ewing Construction contracted with a school district to serve as a general contractor on some renovations and additions to a school. Shortly after the work was completed, the district complained that the tennis courts started cracking and flaking rendering them unusable. Suit was filed and Ewing tendered the defense to its insurance carrier Amerisure. Amerisure denied coverage based in part on the contractual liability exclusion which, in turn prompted Ewing to file a declaratory judgment action in federal court seeking coverage. The district court held that the contractual liability exclusion precluded coverage, the insured appealed and the Fifth Circuit certified questions involving the contractual liability exclusion to the Supreme Court of Texas.

The Supreme Court of Texas observed that the contractual liability exclusion precludes coverage when the insured contractually assumes liability, except when: (1) the insured's liability for damages would exist absent the contract, and (2) where the contract is an insured contract. In this case, the insurer argued that the contractual liability exclusion "means what it says" and the exclusion applies here because the insured contractually agreed to construct the tennis courts in a good and workmanlike manner, and therefore assumed liability for damages. The insured, on the other hand, argued that this case is distinguishable from the Court's decision in *Gilbert Texas Construction, L.P. v. Underwriters at Lloyd's London,* 327 S.W.3d 118 (Tex. 2010), and that the insured's agreement to perform in a good and workmanlike matter did not enlarge any duties it has at common law, and therefore, was not an "assumption of liability" within the meaning of the contractual liability exclusion.

In responding to the first certified question as to whether a general contractor that enters into a contract in which it agrees to perform its construction work in a good and workmanlike

manner, without more specific provisions enlarging this obligation, "assumes liability" for damages arising out of the contractor's defective work so as to trigger the Contractual Liability Exclusion, the Supreme Court of Texas answered "no". Consequently, the supreme court did not need to answer the second question of whether an exception to the exclusion applied.

***Gotham Ins. Co. v. Warren E&P, Inc.*, No. 12-0452, 2014 Tex. LEXIS 209 (Tex. Mar. 21, 2014).**

In *Gotham*, the Supreme Court of Texas rejected claims by an insurer based on equity because the insurer had contractual remedies under the policy. In that case, the insurance policy provided coverage for costs incurred to regain control of an oil well in the event of a blowout. The insured represented that it owned a 100% interest in the well. A blowout occurred and the insurer paid under the policy but later learned that the insured had only a partial interest in the well and others shared in the loss. The insurer sued the insured seeking return of its payments under both breach of contract and equity theories.

The Supreme Court of Texas, reemphasizing its holding in *Fortis Benefits v. Cantu*, 234 S.W.3d 647 (Tex. 2007), noted that "an insurer is limited to contractual claims when the policy addresses the matter at issue. Here the policy contains several clauses addressing misrepresentations, reporting, salvage and recoveries, subrogation and due diligence." The supreme court discussed issues related to the contractual remedies and, after finding some evidence in support of the insurer's contract claims, held that the insurer could not rely on its equitable claims for recovery. Accordingly, the judgment of the court of appeals was reversed and the case was remanded to that court to address the contract claims.

***Jaw the Pointe, LLC v. Lexington Ins. Co.*, No. 13-0711, 2014 Tex. LEXIS 851 (Tex. Oct. 3, 2014).**

The Supreme Court of Texas has agreed to hear oral arguments in a case involving the concurrent cause doctrine. The case concerns an apartment complex in Galveston that was severely damaged by Hurricane Ike. The insurer had issued a $25 million property policy on the apartment complex and other properties. The City of Galveston condemned the property, but the insurer refused to provide coverage for the demolition and rebuilding costs. The policy was subsequently exhausted by payments on other claims. The insured filed suit and recovered a jury verdict against the insurer for $1.2 million in compensatory damages and $2.5 million for knowing conduct. The Houston Court of Appeals, Fourteenth District, reversed the judgment on the concurrent causation doctrine because the City's condemnation order resulted from a covered peril (wind damage) and a non-covered peril (flood damage.). One of the issues before the Supreme Court of Texas is what burden should be placed on the insured to prove the amount of the covered loss when there are covered and non-covered perils that may have combined to cause a loss.

THE FIFTH CIRCUIT

***Star-Tex Resources, L.L.C. v. Granite State Insurance Co.*, 553 Fed. Appx. 366 (5th Cir. 2014).**

The Fifth Circuit applied its limited exception to the eight-corners rule to conclude that an insurer did not have a duty to defend or indemnify its insured.

In *Star-Tex Resources*, an intoxicated employee was driving a car on an auto auction lot when the vehicle the employee was driving struck a pedestrian employee, pinning the pedestrian between two vehicles and causing serious injury. Suit was filed against the employer and the responsible employee. The employer and responsible employee sought coverage under the employer's commercial general liability policy. The insurer denied coverage based on the policy's auto-exclusion. The insureds then filed a declaratory judgment action seeking a declaration that the insurer had a duty to defend them in the lawsuit. The trial court granted summary judgment in favor of the insurer.

On appeal, the Fifth Circuit discussed Texas' relatively strict version of the eight-corners analysis with regard to the duty to defend. The appellate court noted that the injured employee's petition only alleged in part that he was "seriously injured in an automobile collision caused by the negligence of…" the employee who was "under the influence of alcohol or drugs at the time of the collision." The Fifth Circuit observed that the petition did not say whether the employee was operating the vehicle, directing traffic, or working in some other capacity when the accident occurred. The Fifth Circuit, therefore, applied the limited exception to the eight-corners rule that it had previously adopted (that has not officially been adopted or rejected by the Texas Supreme Court), which permits the use of extrinsic evidence "only when relevant to the independent and discrete coverage issue, not touching on the merits of the underlying third-party claim", and concluded that the auto-exclusion did in fact apply. Accordingly, summary judgment in favor of the insurer was upheld.

***Molly Properties v. Cincinnati Insurance Co.*, 557 Fed. Appx. 258 (5th Cir. 2014).**

The Fifth Circuit Court of Appeals held that an insurer's failure to give notice of cancellation to the mortgagee does not affect cancellation unless the terms of the policy provide otherwise.

In *Molly Properties*, an insured filed suit against its insurer for breach of contract after the insurer denied the insured's fire claim for nonpayment of premiums. The insured did not dispute that the insurer notified the insured that its policy would be cancelled for non-payment of premiums. However, the insured argued that the policy was not cancelled at the time of the fire because the insurer failed to give notice of the cancellation to the mortgagee on the property. The Fifth Circuit, disagreed, holding that unless the terms of the policy provide otherwise, a policy cancellation is not affected by the failure of the insurer to give notice of cancellation to the mortgagee. The Fifth Circuit, therefore, concluded that because the policy at issue did not condition the cancellation of coverage on notification to the mortgagee, the issue of whether the insurer gave notice to the mortgagee was irrelevant as to the insured's loss of coverage.

The Fifth Circuit also held that the insured could not recover as a third-party beneficiary to an agreement between the insurer and the mortgagee. The appellate court stated that any promise by the insurer to provide a cancellation notice to the mortgagee was made for the benefit of the mortgagee, not the insured. Consequently, the Fifth Circuit affirmed the trial court's decision to grant summary judgment in favor of the insurer.

***Nat'l Liab. & Fire Ins. Co. v. R & R Marine, Inc.*, 756 F.3d 825 (5th Cir. 2014).**

The Fifth Circuit recently recognized an exception to Texas's general rule that a tort claimant has no direct cause of action against the tortfeasor's liability insurer until the insured-tortfeasor is adjudged liable to the claimant. In *Nat. Liability & Fire Ins. Co.*, the insurer initiated a lawsuit to disclaim liability on a policy covering its insured, a shipyard owner, which had allegedly damaged a third-party's vessel during repairs. The third-party counterclaimed against the insurer, arguing the policy obligated the insurer to cover all sums for which the insured became obligated to pay. The insurer acknowledged that if its insured was negligent, it would have to pay up to the policy limits once a final judgment was entered, but it further argued that the third-party did not have standing to sue it because no final judgment had been entered. The third-party responded that it was forced to file its compulsory counterclaim under the federal rules of civil procedure.

On appeal, the Fifth Circuit found that, under these circumstances, the third-party's counterclaim was compulsory and, therefore, the third-party had standing to bring its claim against the insurer. The Fifth Circuit then upheld the district court's finding of negligence and damages against the insured for which the insurer was liable under the policy. With regard to damages, however, the Fifth Circuit found the district court's application of the 18% statutory interest rate was improper because the Texas Insurance Code did not apply to marine insurance.

***Indemnity Ins. Co. of N. America v. W&T Offshore, Inc.*, 756 F.3d 347 (5th Cir. 2014).**

The Fifth Circuit examined the relationship between primary and umbrella insurance policies, and held that under the specific language of the policies in question, exhaustion of the primary insurance triggered the umbrella policy even though the claims which exhausted the primary coverage were not covered under the umbrella policy. In *Indemnity Ins. Co. of N. America*, the insured purchased a primary CGL policy, a primary "Energy Package" policy, and an umbrella policy. The Energy Package policy covered property damage and "operators' extra expenses," incurred by the insured itself, but the umbrella policy only covered claims made against the insured by third parties.

After Hurricane Ike, the insured submitted claims for property damage and extra expense for over 150 offshore drilling platforms, which exceeded $150 million. The insured was also legally required to remove the debris of the damaged platforms, for which it incurred another $50 million. After exhausting its total limits under the Energy Package policy with the $150 million in property damage and extra expense claims, the insurer tendered the debris removal claims to the umbrella carrier. The umbrella carrier refused the debris removal claims, asserting its coverage was not triggered because the claims which were paid by the underlying insurance were first-party claims, which are not covered by the umbrella policy.

The umbrella policy's insuring agreement covered claims in excess of the Retained Limit, which was defined to mean the limits of the underlying insurance or SIR. Nothing in the definition of the Retained Limit required that it be spent on claims which would be covered under the umbrella policy. On the other hand, the umbrella carrier argued that the policy

contained a drop-down clause which stated its obligations if the Retained Limit was exhausted "by payment of one or more claims that would be insured by our Policy," and this clause showed that only covered claims could exhaust the underlying limits.

After a careful parsing of the language, the Fifth Circuit held the policy was unambiguous and the insuring agreement required the umbrella carrier to pay otherwise covered claims anytime the Retained Limit was exhausted, regardless of the type of claim that resulted in the exhaustion. The Fifth Circuit concluded that the existence of the drop-down clause did not limit liability, but outlined additional duties in the event the retained limit was exhausted by claims which were covered under the umbrella policy.