FALL 2017 NEWSLETTER

INSURANCE LAW UPDATE

By Jennifer Kelley

OVERVIEW OF TEXTING-WHILE-DRIVING LAW IN TEXAS:

As of September 1st, texting and using other types of electronic messaging while driving is illegal in Texas. House Bill No. 2 ("HB 2") prohibits drivers from using "a portable wireless communication device to read, write, or send an electronic message while operating a motor vehicle unless the vehicle is stopped." Under the new law, "electronic message" means "data that is read from or entered into a wireless communication device for the purpose of communicating with another person." However, it is an affirmative defense to prosecution if a driver uses a portable wireless communication device in conjunction with a hands-free device or to do, among other things, the following: (1) navigate using a GPS or other navigation system; (2) report illegal activity, summon emergency help, or enter information into an app that provides information relating to traffic and road conditions to app users; (3) read an electronic message that the person reasonably believed concerned an emergency; or (4) to activate a function that plays music. Of course, drivers may still get pulled over if a police officer suspects them of texting or using the device for other prohibited purposes.

HB 62 includes provisions intended to preempt local texting-and-driving ordinances; however, it does not necessarily supersede stricter bans (i.e., hands-free laws) that currently exist in many Texas cities. Violations of the law enacted by HB 62 are punishable by a fine of $25-99 for first-time offenders; $100-200 for repeat offenders. HB 62 also provides that, if an accident caused by prohibited conduct results in the death or serious bodily injury of another person, the driver can be charged with a Class A misdemeanor punishable by a fine not to exceed $4,000 and confinement in jail for a term not to exceed one year (in addition to any other charges or penalties).

OVERVIEW OF SOME SIGNIFICANT CHANGES TO INSURANCE LAW IN TEXAS:

A. Statutory Damages for Property Damage Claims

A new chapter has been added to the Insurance Code, giving consumers the right to recover statutory damages for non-payment of property damage claims. This applies to an action on a claim against an insurance company or insurance agent alleging a breach of contract, negligence, misrepresentation, fraud, or breach of a common law duty. The claimant is required to give at least 60 days written notice to the insurance company or agent to file an action under this new chapter. The person receiving the notice has 30 days from the date of the receipt to send a written request to the claimant to arrange to inspect the property that is the subject of the claim.

An insurance company that is a party to litigation may elect or accept whatever liability the insurer's agent might have to the claimant by providing written notice. If the insurance company accepts liability, the evidence of the agent's acts or omissions may still be offered at trial, and a judgment against the company must include any liability that would have been assessed against the agent. The insurer is not allowed to make this election if it is in receivership at the time the claimant commences an action against the insurer.

If a defendant proves that it was entitled to but did not receive the pre-suit notice as required at least 61 days prior to the date the action was filed, the defendant may file a pleading notifying the court of the failure to give the notice, and the court may not award the claimant attorneys' fees that are incurred after the date the defendant files. The defendant's pleading must be filed not later than the 30th day after the date the defendant files an original answer.

B. Required Notice of Material Change in Coverage

In regard to personal automobile insurance, homeowner's insurance, or farm or ranch owner's insurance, if the insurance company makes a material change to the existing policy coverage, the policy is considered canceled. Material change means either a reduction in coverage, changes to coverage conditions, or changes to the duties of the insured. However, an insurance company may avoid the cancellation by providing the policyholder with written notice of each material change in each form of the policy offered on renewal to the insured from the form of the policy held immediately before the renewal. This must appear in a conspicuous place in the renewal notice, clearly indicate each material change to the policy being made on renewal, be written in plain language, and be provided to the insured no later than the 30th day prior to the date of renewal. The insurance company is also required to provide written notice to each agent of the insurance company's election to make a material change to a policy form on renewal at least 30 days prior to the change being made.

C. Cancellation and Non-Renewal of Liability Insurance Policy

The Legislature changed the procedure for an insurance company to cancel or not renew a liability insurance policy for general, professional (other than medical professional), commercial automobile, commercial multi-peril, and any other type or line of liability insurance designated by the department. The insurance company may reduce or restrict coverage by endorsement or other means if it provides the insured with written notice of any material change in each form of the policy offered on renewal to the insured form the form of the policy held immediately before renewal. The notice must appear in a conspicuous place in the notice of renewal, clearly indicate each material change to the policy being made, be written in plain language, and be provided to the insured no later than the 30th day before the renewal date. This notice is also required to be sent to each agent of the insurer and to indicate clearly each material change being made to the policy form.

D. Notice to Lienholder of Cancellation Comprehensive or Collision Automobile Insurance Coverage

The commissioner is required to adopt rules requiring an insurance company that is canceling a personal automobile insurance policy that provides comprehensive or collision physical damage coverage for an automobile subject to a purchase money lien to notify the lienholder, if known, that the coverage will be canceled.

E. Background Checks for Employees of Public School Contractors

HB 3270 , amending Section 22.0834 of the Education Code, provides background checks required for public school contractor's employees. This bill requires school district and charter school contractors and subcontractors to prevent their employees from providing services at any public school if the employee has been convicted of a felony offense involving individuals under 18 years of age within the last 30 years.

The bill provides that contractors or subcontractors can be required to submit criminal background information to the contracting school system, including fingerprinting and photographs of all employees who may have an opportunity for direct contact with sturdents. Under this bill, the contractors and subcontractors will have to attest that they have received and analyzed all criminal background histories related to employees who potentially have direct contact with students. This statute, however, will not apply to the construction of new school facilities or for construction work to be completed at least seven days before the facility will be used for instructional services or when the contractor's employees and students are kept separate.

F. Pre-Suit Bill Notice for Hail Claims

HB 1774 addressed hail damage insurance claims. The bill requires an insured to provide written notice to the insurer at least 61 days before filing the claim against an insurer or agent relating to damage to real property caused by an earthquake, earth tremor, wildfire, flood, tornado, lightning, hurricane, hail, wind, snowstorm, or rainstorm. The pre-suit notice must provide a statement of the acts giving rise to the claim, the specific amount alleged to be owed, and amount of reasonable and necessary attorneys' fees already incurred by the claimant. The bill also requires a court to abate the action if the defendant filed a motion for abatement and the court found the defendant didn't receive pre-suit notice or was denied a request to inspect, photograph, or evaluate the property. Abatement will continue for the later of 60 days after complying notice was given or 15 days after the requested inspection occurred.

Under the law, attorneys' fees will be calculated as the lesser of the following: the amount of reasonable and necessary attorneys' fees supported by sufficient evidence at trial and determined to have been incurred by the claimant in bringing the action; the amount of attorneys' fees that may be awarded to the claimant under any other applicable law; of the amount to be awarded in the judgment, divided by the amount alleged to be owed, then multiplied by the total reasonable and necessary attorneys' fees supported by sufficient evidence and determined to have been incurred in bringing the action. The bill requires the court to award the full amount of reasonable and necessary attorneys' fees if the amount to be awarded in the judgment divided by

the amount alleged to be owed was at least 0.8, not limited by statute, and recoverable. The court is prohibited from awarding attorneys' fees if this fraction was less than 0.2, of if the claimant failed to provide pre-suit notice.

G. Policy Approval

Policy forms for commercial property insurance are now required to be filed with and approved by the Department of Insurance before they can be issued and delivered in Texas. This change pertains to policy forms including commercial fire, allied lines, commercial inland marine insurance, commercial crime coverage, boiler and machinery insurance other than explosion, glass insurance provided as part of other coverage, and insurance covering other perils or providing other coverages, as authorized by the commissioner.

THE SUPREME COURT OF TEXAS CLARIFIES THE CIRCUMSTANCES UNDER WHICH A JUDGMENT ENTERED AGAINST A DEFENDANT-INSURED MAY BE ENFORCED BY A PLAINTIFF-ASSIGNEE IN A SUBSEQUENT COVERAGE ACTION.

In *Great American Insurance Company v. Hamel*, -- S.W.3D --, No. 14-1007, 2017 WL 2623067 (Tex. February 28, 2017), the Texas Supreme Court more precisely defined the circumstances under which an insurance company that wrongfully fails to defend an insured may be bound by a judgment against the insured in a subsequent suit brought by the underlying plaintiff as the insured's assignee. The supreme court re-affirmed that grounds for invalidating an assignment are narrow, but even when an assignment is valid, the court made it clear that a judgment will not be enforced unless it resulted from a "fully adversarial trial." *Great American* is significant for: (1) defining the term "fully adversarial trial"; (2) explaining what sort of evidence is sufficient to establish the existence (or lack of) adversity; and (3) confirming that, when liability issues are not decided in a "fully adversarial trial," parties may properly litigate those issues in a subsequent coverage suit.

Background: The Hamels (underlying plaintiffs) hired a builder to finish building their home. A few years later, they noticed signs of water damage in their home and sued the Builder for problems allegedly related to improper use or installation of stucco on the exterior of their home. The Builder submitted the claim to its insurer, Great American Insurance Company, but Great American wrongfully denied the defense.

As the Court noted, "[w]ithout the benefit of insurance coverage, the Builder had limited assets to fund its defense." *Id*. at *3. The week before a bench trial, the parties entered into a Rule 11 agreement by which the Hamels agreed not to enforce a favorable judgment against any of the Builder's assets—except its insurance policy—in exchange for the Builder's agreement to appear at trial without seeking a continuance. After the trial court rendered judgment awarding the Hamels $365,089 in damages (the "Damage Judgment"), the Builder assigned most of its rights against Great American to the Hamels.

The Hamels (as the Builder's assignee) then sued Great American for breach of contract and declaratory relief. After another bench trial, the trial court rendered judgment awarding the

Hamels "covered damages in the underlying Damage Judgment of $355,838, plus interest, court costs, and attorney's fees." *Id*. at *4. Great American appealed, arguing that it was not bound by the Damage Judgment under the Texas Supreme Court's holding in *State Farm Fire & Casualty Co. v. Gandy*, 925 S.W.2d 696, 714 (Tex. 1996), which prohibits the enforcement of judgments rendered without a "fully adversarial trial." But the El Paso Court of Appeals affirmed most of the trial court's judgment, "holding that Great American breached its duty to defend the Builder from the Hamels' suit, the Damage Judgment was the result of a fully adversarial trial, and the Builder's assignment of its claims against Great American to the Hamels was valid." *Great Am.*, 2017 WL 2623067 at *4.

Validity of the Assignment: The Texas Supreme Court reaffirmed the general rule that "an insurer that wrongfully refuses to defend its insured is barred from collaterally attacking a judgment or settlement between the insured and the plaintiff." *Id*. at *5. However, it also affirmed *Gandy's* holding that, when a plaintiff seeks to enforce a judgment against an insurer as *the insured's assignee*, the assignment is invalid if (1) it was made prior to adjudication of the plaintiff's claim in a fully adversarial trial; (2) the defendant's insurer tendered a defense, and (3) the insurer either accepted coverage or made a good faith attempt to adjudicate coverage issues before adjudication of underlying claim. *Id*. Although the court left open the question of "whether an assignment that lacked one or more of *Gandy's* characteristics could be invalid," it confirmed that, when *none* of those characteristics are present, there is "no reason to invalidate [the] assignment." *Id*. at *6. But that did not end the inquiry.

Enforceability of the Underlying Judgment against Great American: The Texas Supreme Court rejected the court of appeals' approach, which "necessarily requires courts to retroactively evaluate and thus second-guess trial strategies and tactics" in order to determine how "fully" (*i.e.*, effectively) each party's trial performance was. *Id*. at *7. Instead, the Court clarified that "the controlling factor is whether, at the time of the underlying trial or settlement, the insured bore an actual risk of liability for the damages awarded or agreed upon, or had some other meaningful incentive to ensure that the judgment or settlement accurately reflects the plaintiff's damages and thus the defendant-insured's covered liability loss." *Id*. In other words, "proceedings lose their adversarial nature when, by agreement, one party has no stake in the outcome and thus no meaningful incentive to defend itself." *Id*. at *8.

Applying those principles to the present case, the Court concluded that "the pretrial agreement effectively removed any financial stake the Builder had in the outcome of the Damage Suit, thereby eliminating any incentive the Builder had to oppose the Hamels' claims. This turned the Damage Suit into a mere formality—a pass-through trial aimed not at obtaining a judgment reflective of the Hamels' loss, but instead at obtaining a potentially inflated judgment to enforce against Great American." *Id*. Under those circumstances, the Court held that the Damage Judgment was not binding under *Gandy*.

However, the Court declined to "suggest that a formal, written pretrial agreement that eliminates the insured's financial risk will always be either necessary or sufficient to disprove adversity." *Id*. at *9. Instead, it held that "the presence of such an agreement creates a strong presumption that the judgment did not result from an adversarial proceeding, while the absence of such an agreement creates a strong presumption that it did." *Id*. The Court then explained

how each party might overcome their respective presumptions: (1) the insurer may "demonstrat[e] that, even though the plaintiff and insured defendant did not enter into any formal, written agreement, the evidence nonetheless establishes that the defendant had no meaningful stake in the outcome of the underlying litigation"; and (2) "the plaintiff (acting as the defendant's assignee) may overcome the presumption by submitting evidence demonstrating that the defendant retained a meaningful incentive to defend the underlying suit despite an agreement that eliminated the defendant's financial risk." *Id.*

At trial, the Builder expressly confirmed that "the parties' pretrial agreement eliminated any incentive the Builder had to defend against the Hamels' claims." *Id.* Based on that evidence, the Court held that "the Damage Trial was not fully adversarial and [therefore] the resulting judgment is not binding on Great American." *Id.*

Proper Remedy for Lack of Adversity: Although the court refused to hold Great American to a judgment that did not result from a "fully adversarial proceeding," it also refused to "preclude the parties from properly litigating the underlying liability issues in a subsequent coverage suit." *Id.* at *10. After holding that the coverage suit "provided a vehicle to remedy the problems associated with the lack of adversity in the Damage Suit," the court remanded the case in the interests of justice so the parties could properly litigate liability issues. *Id.* at *11.

Impact: *Great American* clarifies Texas law by confirming that (1) an assignment that does not meet any of *Gandy's* requirements is valid; (2) a judgment against an insured defendant is not enforceable by the plaintiff-assignee unless it is the result of a "fully adversarial trial"; and (3) when a judgment is not the result of a "fully adversarial trial," liability issues may be re-litigated in a subsequent coverage action. Although the opinion repeatedly warns insurers about the "significant risks" of refusing to defend a claim (or at least litigate coverage) before a judgment is rendered, the outcome appears to mitigate those risks by significantly limiting a plaintiff's ability to enforce an inflated judgment obtained in a non-adversarial proceeding. However, the Opinion also makes it clear that insurers cannot avoid liability altogether by refusing to defend a case and then arguing that an adverse—but covered—judgment is unenforceable because it was not the result of a "fully adversarial trial." Under *Great American*, liability issues that are not properly litigated in the underlying litigation may have to be litigated in a subsequent coverage action.