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JUNE 2018 TEXAS INSURANCE LAW UPDATE

SUMMARY: The Fifth Circuit Court of Appeals held that a criminal act exclusion in a commercial general liability policy applied to preclude coverage for a $20 million judgment; the Fifth Circuit granted summary judgment in favor of insurance carrier in case involving concurrent causation issues; the Dallas Court of Appeals concludes statute of limitations on insured's claims against the insurance carrier began when carrier closed its file; Corpus Christi Court of Appeals holds default judgment is not enforceable against insurance carrier due to no notice; Amarillo Court of Appeals reaffirms precedent that prompt payment of appraisal award precludes further recovery by the insured; Houston [Fourteenth] Court of Appeals finds fact issues existed on causation and damages; Western District of Texas broadly and narrowly interprets terms and phrases in an insurance policy so as to trigger an insurance carrier's duty to defend; and Southern District of Texas abates lawsuit for insured's failure to comply with new notice provisions.

The U.S. Court of Appeals for the Fifth Circuit has ruled that a $20 million judgment against a restaurant that committed the criminal act of giving alcohol to a minor was not covered by the restaurant's commercial general liability insurance policy.

In *Century Surety Company v. Seidel*, -- F.3d. --, No. 17-10026, 2018 WL 3115781 (5th Cir. June 25, 2018), Ajredin Deari, owner of Pastazios Pizza, Inc., allegedly lured an 18-year-old woman to his restaurant, plied her with alcohol despite her protests, and then drove her to a nearby hotel and sexually assaulted her. Deari later pleaded no-contest to the crime of aggravated assault. The woman sued Deari (alleging a variety of intentional torts) and the Pastazios restaurant (alleging negligence, gross negligence, Dram Shop liability, false imprisonment, and premises liability). She obtained a judgment for more than $20 million against Pastazios and Deari. With respect to Pastazios, the court found the restaurant liable for gross negligence, Dram Shop liability, and "negligent" false imprisonment, and imposed punitive damages.

The woman sought to enforce the judgment against the restaurant's general liability insurance carrier, Century Surety Company, asserting that Century had breached its duties under the policy to defend and to indemnify Pastazios with respect to her lawsuit. The U.S. District

Court for the Northern District of Texas granted summary judgment in favor of Century, and the woman appealed to the Fifth Circuit.

The Century policy excluded coverage for bodily injury: arising out of or resulting from a criminal act committed by any insured. The Fifth Circuit affirmed, holding that because all of the woman's injuries arose out of or resulted from the restaurant's criminal act of giving alcohol to a minor, the policy's criminal act exclusion applied and barred Pastazios' coverage claims.

In its decision, the circuit court noted that the policy did not define "crime" and, therefore, turned to Couch on Insurance to conclude that a misdemeanor is a crime. The court explained that, in Texas, it was a Class A misdemeanor to give alcohol to a minor in the absence of her parents. The Fifth Circuit noted that the woman's complaint against Pastazios stated that she was a minor and that Pastazios, the restaurant itself, had given her more than one alcoholic beverage. Thus, the Fifth Circuit found, the woman's bodily injury arose out of or resulted from a criminal act committed by Pastazios, the insured. In fact, the circuit court said, the woman's complaint was "unequivocal" that all of her injuries arose out of Pastazios' provision of alcohol. Accordingly, the Fifth Circuit concluded, coverage was precluded because all of the woman's injuries arose out of or resulted from Pastazios' criminal act of giving alcohol to a minor.

The U.S. Court of Appeals for the Fifth Circuit affirms summary judgment in wind/hail case, enforcing concurrent cause doctrine.

In *Certain Underwriters at Lloyd's of London v. Lowen Valley View, LLC*, 892 F.3d 167 (5th Cir. June 6, 2018), an employee of the insured (Hilton Garden Inn) noticed that the shingles on the roof "looked bad" and called a contractor to investigate. The contractor discovered evidence of significant hail damage, and the owner/operator of the hotel notified its insurance agent of the damage. The agent filed a notice of loss with the property insurer, Lloyd's, the same day, listing the date of loss as June 13, 2012—about a year and a half prior to the date of notice. The agent based the date of loss on a weather history report that listed nine separate hail events of varying severity between January 2006 and December 2014.

After receiving the claim, Lloyd's sent an adjuster to inspect the property. The adjuster determined that the roof would need to be replaced at an estimated cost of $429,000. Lloyd's then retained an engineering firm to analyze the claim. The engineering firm confirmed that the damage was caused by hail and concluded that the most recent hailstorm with hailstones large enough to cause the damage was on June 13, 2012. In a second report, the engineering firm described its first report as concluding that the damage "most likely" occurred on June 13, 2012. Lloyd's then denied the claim and—the same day—filed a lawsuit seeking a declaratory judgment that it owed no coverage to the insured. After the lawsuit was filed, Lloyd's engineering firm identified four different dates on which hail reports and weather radar data suggested there was hail at the location of the hotel. Only one of those four dates, June 13, 2012, fell within the relevant policy period, and the policyholder had no proof of when the damage

actually occurred. The only evidence that it happened on June 13, 2012, was the engineering firm's comment that the damage "most likely" occurred on that date, and the engineering firm stated that it never intended to suggest that June 13, 2012, was the known date of loss. The insurance carrier moved for summary judgment.

The trial court granted the carrier's motion for summary judgment based on the concurrent cause doctrine (i.e., when a covered and non-covered peril combine to cause damage, the insured bears the burden of demonstrating how much of the damage was caused solely by the covered peril). The Fifth Circuit agreed, stating, "Given the undisputed evidence of severe hail storms outside the coverage period, Lowen Valley's evidence does not afford the jury a reasonable basis on which to allocate the damage." *Id.* at 172. The court went on to affirm the dismissal of the insured's extra-contractual claims as well, relying on *Menchaca* for the proposition that "an insured cannot recover any damages based on an insurer's statutory violation if the insured had no right to receive benefits under the policy and sustained no injury independent of a right to benefits." *Id.* (citing *USAA Tex. Lloyds Co. v. Menchaca*, 14-0721, 545 S.W.3d 479, 489, 2018 WL 1866041, at *5 (Tex. Apr. 13, 2018)).

Dallas Court of Appeals finds statute of limitations on insurance claims begins when a claim is closed.

In *Jackson v. Gainsco Inc./Gainsco Auto Insurance*, et al, No. 05-16-01190-CV, 2018 WL 2979960 (Tex. App.—Dallas June 14, 2018, no pet. h.) (memo. op.), on January 27, 2013, Jackson was involved in a motor vehicle collision. She contended that this was a "hit and run" accident with an uninsured motorist. Jackson's vehicle was covered by an Auto Policy issued by Gainsco. Her policy included collision coverage, rental car reimbursement, and comprehensive uninsured/underinsured motorist coverage. Jackson reported the collision and vehicle damages to Gainsco. Gainsco completed its claim investigation and closed its investigation file on May 20, 2013. Jackson's vehicle was in the body shop for approximately six weeks and Jackson alleged that Gainsco did not pay the body shop the full amount of the repairs. On March 25, 2013, Jackson sued Gainsco in the 191st District Court of Dallas County, Texas. Jackson sought declaratory relief regarding her uninsured motorist coverage and also alleged that Gainsco breached its duty of good faith and fair dealing by refusing to timely pay her claim for vehicle repairs and rental car expenses. After Gainsco moved for summary judgment, Jackson voluntarily dismissed the first lawsuit. On May 22, 2015, Jackson again sued Gainsco, this time in the County Court at Law No. 4 of Dallas County, Texas. In this second lawsuit, Jackson claimed breach of the duty of good faith and fair dealing under the Insurance Code and Deceptive Trade Practices Act (DTPA). Gainsco filed a motion for summary judgment on the grounds that Jackson's claims were barred by the two-year statute of limitations. The trial court granted summary judgment and an appeal followed.

The Dallas Court of Appeals found that under Texas law, claims against insurers asserting a cause of action for breach of the duty of good faith and fair dealing accrue upon (1) the written denial of the claim or (2) some other indication of the insurer's position that it was not going to provide the requested coverage. In this case, the court found that Gainsco closing its file provided an "objectively verifiable event that unambiguously demonstrated intent not to pay the claim and triggered the limitations period." *Id.* at *4. Thus, the statute of limitations period began when the claim file was closed. Summary judgment was proper as the second lawsuit was filed more than two years after the causes of action accrued.

Corpus Christi Court of Appeals concludes default judgment is not enforceable against auto insurer due to no notice defense.

In *Rebecca Leigh Flores, et al. v. State Farm Mutual Insurance Company*, No. 13-17-00167-CV, 2018 WL 2731883 (Tex. App.—Corpus Christi June 7, 2018, no pet. h.) (memo. op.) Rebecca Leigh Flores and Fernando Medina were involved in a vehicle collision with Vanessa Hernandez, who was driving a vehicle insured under an automobile liability policy issued by State Farm Mutual Automobile Insurance Company. State Farm received notice that Ms. Flores and Mr. Medina had retained counsel in relation to the accident. State Farm then sent a letter to Ms. Hernandez advising her that Ms. Flores and Mr. Medina were represented by counsel and instructing her to notify State Farm if she "receive[d] any contact from this attorney or their representatives[.]" *Id.* at *1. Ms. Flores and Mr. Medina later sued Ms. Hernandez for negligence and obtained a default judgment. Ms. Hernandez did not forward the lawsuit to State Farm and did not otherwise notify State Farm that she had been sued. Thereafter, Ms. Flores and Mr. Medina sued State Farm, seeking to collect on the default judgment they had obtained against Ms. Hernandez. Ms. Flores and Mr. Medina moved for summary judgment, arguing that the judgment they had obtained against Ms. Hernandez made them third-party beneficiaries with respect to the insurance policy State Farm had issued to Ms. Hernandez. State Farm filed a response, arguing that it had no duty to defend under the policy because Ms. Hernandez had not complied with the policy's notice-of-suit provisions. State Farm moved for summary judgment. The trial court granted summary judgment in favor of State Farm, and Ms. Flores and Mr. Medina appealed.

The State Farm policy provided:

> **PART E — DUTIES AFTER AN ACCIDENT OR LOSS**
> A. We must be notified promptly of how, when and where the accident or loss happened. Notice should also include the names and addresses of any injured persons and of any witnesses. If we show that your failure to provide notice prejudices our defense, there is no liability coverage under the policy.
> B. A person seeking any coverage must:
> 1. Cooperate with us in the investigation, settlement or defense of any claim or suit.

> 2. Promptly send us copies of any notices or legal papers received in connection with the accident or loss.
>
> . . . .
>
> **LEGAL ACTION AGAINST US**
>
> A. No legal action may be brought against us until there has been full compliance with the terms of this policy. . . .

Id.

In its decision, the appellate court explained that, generally speaking, an injured person cannot sue the tortfeasor's liability insurer directly until the tortfeasor's liability has been determined by agreement or judgment. After judgment, the appellate court continued, the injured person can sue the insurer as a third-party beneficiary of the insurance policy. The appellate court added that, as a third-party beneficiary, the injured party "steps into the shoes" of the tortfeasor and is bound by the policy's conditions precedent – including its notice provision. Here, the appellate court pointed out, Ms. Hernandez had not complied with the notice requirements in the State Farm policy. Moreover, State Farm was unaware of the lawsuit filed by Ms. Flores and Mr. Medina against Ms. Hernandez until after judgment had been rendered. Therefore, the appellate court ruled, State Farm had no duty to defend or indemnify Ms. Hernandez in the underlying litigation and was not liable to Ms. Flores and Mr. Medina under the policy. In addition, the appellate court added, State Farm had established prejudice as a matter of law because it had not been notified of the default judgment against Ms. Hernandez until after the default judgment had become final and nonappealable. Accordingly, the appellate court concluded that the trial court had properly granted State Farm's motion for summary judgment.

Amarillo Court of Appeals affirms prompt payment of appraisal award precludes further recovery by insured.

In *Turner v. Peerless Indemnity Insurance Company*, No. 07-17-00279-CV, 2018 WL 2709489 (Tex. App.—Amarillo June 5, 2018) (memo. op.), an appraisal was conducted while the lawsuit was pending. Peerless promptly paid the resulting award and moved for summary judgment on all claims, which the district court granted. Turner appealed.

The court of appeals seemed genuinely confused as to what Turner's alleged contractual damages could be when he had been promptly paid all he was entitled to under the appraisal award and the policy's appraisal clause. The court rejected the idea that the difference between the carrier's initial claim payment and the amount of the appraisal award could constitute damages for a breach of contract, because the appraisal itself was a process provided for by the contract and the award was in compliance with the contract. Perhaps significantly, the court also held that the carrier's payment of the award 13 days after the award was issued, which included a delay of several days while the carrier sought confirmation of payment instructions, was timely

and reasonable as a matter of law. Thus, there was no breach of contract the court could identify, and the court upheld dismissal of the contract claim

With regard to Turner's extra-contractual claims, the court noted "the independent injury rule is alive and well, as reiterated by the Texas Supreme Court in its recent Menchaca opinion…" *Id.* at *4. Because Turner could not raise a fact issue implicating any injury that was genuinely independent of his failure to receive the policy benefits he wanted, the court found no independent injury and also upheld the dismissal of the extra-contractual claims.

Houston Court of Appeals, Fourteenth, finding in favor of insurance carrier, concluded fact issue existed on "causation and damages".

In *Texas Windstorm Insurance Association v. Dickinson Independent School District*, --S.W.3d--, No. 14-16-00474-CV, 2018 WL 2436924 (Tex. App.—Houston [14th Dist.] May 31, 2018, no pet. h.), TWIA invoked the appraisal provision to address the amount of property damage claimed by the Dickinson Independent School District ("District") following Hurricane Ike and a $10.8 million damages award was issued. The District then sought partial summary judgments on causation and damages. TWIA opposed the motions asserting that the School District had not conclusively proved that the damages, or any portion of them, were caused by a covered peril under the named peril policy. The trial court ruled in the District's favor and the only issue submitted to the jury was whether TWIA breached the policy by not paying the appraisal award. The jury answered "yes" and the trial court entered a final judgment against TWIA for $9,602,542.82. TWIA appealed.

On appeal, TWIA challenged the judgment based on four issues, the first of which was determined to be dispositive. In its first issue, TWIA argued that the District failed to conclusively prove damages caused by a covered peril under the policy. Or, that TWIA raised genuine issues of material fact of whether the damages were caused by a named peril under the policy. In its analysis, the court examined arguments asserted by both sides based on the Texas Supreme Court's decision in *State Farm Lloyds v. Johnson*, 290 S.W.3d 886 (Tex. 2009). The appellate court also examined the doctrine of concurrent causes, noting the insured's duty to segregate damages arising from covered and non-covered causes of loss. Here, the policy provided in part, coverage for "direct physical loss to the covered property *caused by windstorm*" unless excluded. *Id.* at *2. In a detailed analysis of the impact of the appraisal award, the court determined that "[s]tanding alone, the Appraisal Award simply does not provide sufficient evidence from which a court may determine as a matter of law which Appraisal Award damages, if any, were caused by a covered peril." *Id.* at *10. Accordingly, the judgment was reversed and the case remanded for further proceedings.

Western District of Texas broadly interprets the term "function" in a liquor liability endorsement and narrowly interprets the phrase "in the course of employment" in an employer's liability exclusion, triggering an insurer's duty to defend.

In *Sentry Select Insurance v. Ruiz*, No. EP-16-CV-00376-DCG, 2018 WL 3046942 (W.D. Tex. [El Paso Division] June 20, 2018, mem. op.), three employees of Rudolph Mazda consumed beer on Rudolph Mazda's premises after work. After socializing and consuming beer, one of those employees was driving his vehicle and struck a fourth employee, Villegas, in the front sales/service area as Villegas was walking across the parking lot leaving the premises. Subsequently, Villegas sued Rudolph Mazda under the doctrine of vicarious liability. Rudolph Mazda was insured by Sentry Select Insurance Company ("Sentry"), and Sentry filed a declaratory judgment action seeking declaration that it had no duty to defend.

The first dispute was whether the employees' after-work beer consumption fell within the scope of the term "function" as used in the policy's liquor liability endorsement. The endorsement provided that Sentry would indemnify the insured for "damages because of bodily injury arising out of the giving or serving of alcoholic beverages at functions incidental to the insured's garage business . . . . " *Id.* at *2. Rudolph Mazda argued that "functions" included any social gathering, inclusive of its employees' after-work beer consumption. Sentry, on the other hand, argued that "functions" included only company functions such as Christmas parties, company picnics, etc.., and not a gathering of a few employees after work to socialize. The court agreed with Rudolph Mazda and rejected Sentry's argument. That is, the court, noting that it was not aware of any Texas court decision interpreting or applying the term "functions" in the context of a liquor liability endorsement, found that gathering for the consumption of beer constituted a "function." Consequently, the court held that Sentry had a duty to defend. The court reasoned that nothing in the policy evinced a clear an unambiguous intent to exclude a particular type of social gathering, such as an after-work gathering of a few employees for beer consumption.

The second dispute was whether Villegas' injury occurred while she was in the course of her employment. The policy excluded from coverage damages because of bodily injury to an employee of the insured arising out of and "in the course of employment by the insured." *Id.* Sentry argued that the phrase "in the course of employment" should be construed by applying the "access doctrine," which is used in workers' compensation cases and is an exception to the general rule that compensation benefits do not extend to injuries incurred by employees going to and from work. However, the court declined to import the "access doctrine" in interpreting the phrase in question and, relying on the dictionary meaning and prior court decisions, concluded that the phrase "in the course of employment" meant "while the employee is performing work-related duties." *Id.* at *9. Consequently, the court held that Villegas was not in the course of her employment when she was injured and, thus, Sentry had a duty to defend.

Southern District of Texas abates lawsuit for plaintiff's failure to comply with new insurance code section 542A.003 notice letter requirements.

In *Jose Luis Perrett v. Allstate Insurance Company*, No. 4:18-CV-01386, 2018 WL 2864132 (S.D. Tex. June 11, 2018), the insured sued Allstate Insurance Company alleging violations of the Texas Deceptive Trade Practices Consumer Protection Act, the Texas Insurance Code, and breach of contract related to a claim arising from Hurricane Harvey. After Perrett filed in state court Allstate timely removed.

On October 10, 2017, Perrett's counsel sent Allstate a letter alleging that Allstate violated the Texas Insurance Code and the Texas Deceptive Trade Practices Act. Allstate moved to abate under § 542A.003 of the Texas Insurance Code, which requires plaintiffs seeking damages to give prior written notice of the complaint and the damages, including fees, "not later than the 61st day before the date a claimant files an action." Allstate argued that Perrett's notice did not include "a statement of the acts or omissions giving rise to the claims and the amount of reasonable and necessary attorney's fees incurred by the claimant" or a statement that a copy of the notice was provided to the claimant. Perrett argued that the notice satisfied the statutory requirements.

The Southern District (Chief Justice Lee Rosenthal) found that although the notice letter satisfied the requirements in § 542A.002(b), it did not satisfy § 542A.003(c)'s requirement that "[i]f an attorney or other representative gives the notice required under this section on behalf of a claimant, the attorney or representative shall: (1) provide a copy of the notice to the claimant; and (2) include in the notice a statement that a copy of the notice was provided to the claimant." Id. at *2. Perrett did not respond to Allstate's argument that the notice letter did not contain a statement that the letter was provided to Perrett. And because the letter did not satisfy this requirement, the case was abated until 60 days after Allstate receives proper written notice and Perrett was ordered to provide proper notice by June 18, 2018.

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