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# AUGUST 2018 TEXAS INSURANCE LAW UPDATE

**SUMMARY: This month, the Fifth Circuit Court of Appeals held that settlement proceeds resulting from indemnity agreements between a general contractor and its subcontractors are "Other Insurance" which may offset amounts due under the policy, placing the burden of proving whether any portion of the settlements were covered by the Policy on the insured. In addition, the Amarillo Court of Appeals affirmed a trial court's decision that an insurer was not in bad faith and did not breach the contract where it paid an appraisal award immediately, finding the insured failed to demonstrate that any policy benefits were withheld or that it had any damages from any injury independent of its policy claim under *Menchaca*.[1] The Texarkana Court of Appeals also relied on *Menchaca* in determining an insurer had no duty to defend its insured, with respect to the insured's claim to recover defense costs it incurred in the underlying suit. With regard to appraisal, a Texas federal court found that a Homeowners Insurer's 6-month delay from time of impasse to invoking appraisal, was not unreasonable under the facts. Finally, a Texas federal court gives guidance on dismissing an adjuster under Insurance Code Chapter 542A and removal of suit to federal court.**

## FIFTH CIRCUIT HOLDS THAT SETTLEMENT PROCEEDS RESULTING FROM INDEMNITY AGREEMENTS BETWEEN A GENERAL CONTRACTOR AND ITS SUBCONTRACTORS ARE "OTHER INSURANCE" AND MAY OFFSET AMOUNTS COVERED BY THE POLICY, PLACING BURDEN OF PROVING WHETHER PORTION OF SETTLEMENTS WERE COVERED UNDER POLICY ON THE INSURED.

In ***Satterfield and Pontikes Const. Inc.*, No. 17-20513, 2018 WL 3671370 (5th Cir., August 02, 2018, mem. op.)**, Satterfield and Pontikes Construction, Inc. ("S&P") was hired as a general construction contractor for a courthouse construction project by Zapata County, Texas. S&P hired numerous subcontractors. According to the court, "the project did not go well" and Zapata County terminated S&P

[1] *USAA Tex. Lloyds Co. v. Menchaca*, 545 S.W.3d 479 (Tex. 2018).

and retained new contractors to complete the construction. Zapata County sued S&P and the parties arbitrated their dispute. An arbitration panel found that S&P failed to build the courthouse in a good and workmanlike manner and that the courthouse suffered physical harm and damage. The panel awarded Zapata County over $8 million in damages, attorney fees, and arbitration costs.

S&P included its subcontractors in the arbitration, seeking money pursuant to the indemnification clauses in the subcontracts. With notice to its insurer, U.S. Fire, of its efforts to settle, S&P subsequently entered into settlement agreements with its subcontractors for approximately $4.4 million. The settlement agreements did not allocate the proceeds to the damages/liabilities they covered.

Because the settlements did not cover the arbitration award, S&P turned to its insurance providers, including its excess provider, U.S. Fire, to pay the balance of the arbitration award. U.S. Fire argued that it could not determine whether the funds S&P recovered from subcontractors of the courthouse project went to damages covered under U.S. Fire's policy because S&P failed to allocate those proceeds when settling with the subcontractors. U.S. Fire argued that if the subcontractor settlements were used to pay for damages covered under U.S. Fire's policy, then S&P would be getting a double recovery and would be unjustly enriched.

U.S. Fire, however, contended there was no shortfall for it to pay and denied S&P's claim. According to U.S. Fire, there was no shortfall because certain damages awarded by the arbitration panel (for mold remediation, attorney's fees, prejudgment interest, and arbitration fees) were not covered under its policy, and once those damages and another insurer's first layer of insurance were removed from the $8 million award, the subcontractor settlement proceeds (i.e. "Other Insurance" according to U.S. Fire) was greater than the amount of potentially covered damages under its policy.

S&P then sued U.S. Fire. The district court granted summary judgment in favor of U.S. Fire.

On appeal, S&P argued that the subcontractor settlements were not "Other Insurance" and, therefore, U.S. Fire was not entitled to use the settlement proceeds to offset amounts covered by its policy. Other Insurance" was defined in the policy as "<u>any type of Self-Insurance or other mechanism by which an Insured arranges for funding of legal liability for which this policy also provides coverage.</u>"

S&P characterized the subcontractor settlements as the products of "contractual risk transfer mechanisms" arguing that the subcontractor indemnity contracts were intended to "shore up leaks or gaps in insurance coverage." The Fifth Circuit disagreed. The Court held that the plain language of the policy allowed it to affirm the district court. "An indemnity agreement falls under the plain language of the 'Other Insurance' provision of U.S. Fire's policy—which is very broad—because it is a 'mechanism by which an Insured arranges for funding of legal liabilities for which [U.S. Fire's] policy also provides coverage' and therefore, the settlement proceeds resulting from an indemnity agreement also count as "Other Insurance."

In a second issue on appeal, S&P argued that the district court erred when it placed the burden on S&P to show that the subcontractor settlements were allocated to either covered or noncovered damages under U.S. Fire's policy and that it had the right to allocate the subcontractor settlement proceeds to the damages not covered by U.S. Fire's policy. The Fifth Circuit disagreed, reasoning that S&P was in a better position to allocate the settlement proceeds. "U.S. Fire did not have the power to structure the settlements to attribute the proceeds to one kind of damages or another." Therefore, S&P had the burden of proof to show it properly allocated its settlement proceeds between covered and noncovered damages,

and if S&P could not meet its burden, it is assumed that all of the settlement proceeds went first to satisfy the covered damages under U.S. Fire's policy.

## AMARILLO COURT OF APPEALS HOLDS THAT INSURER WAS IMMUNE TO INSURED'S CONTRACT AND BAD FAITH CLAIMS AFTER INSURER PAID APPRAISAL AWARD

In ***Biasatti v. GuideOne National Ins. Co.,*** **No. 07-17-00044-CV, 2018 WL 3946352 (Tex. App.—Amarillo, Aug. 16, 2018)**, the Amarillo Court of Appeals affirmed the trial court's decision in favor of the insurer on an insured's contractual and extra-contractual claims against the insurer after the insurer paid an appraisal award.

In August 2013, after wind and hail damaged property owned by TopDog Properties, TopDog filed a claim with its insurer, GuideOne National Insurance Company. After its investigation, GuideOne determined that the estimated cost to repair the damage was $1,896.88 and because this amount was less than the policy deductible of $5,000, TopDog was not entitled to payment.

TopDog requested an additional inspection. GuideOne retained an engineer, who confirmed the adjuster's findings of "minor wind damage and no hail damage to the roofs." Believing that the damage had been underestimated, TopDog told its insurance agent in March 2014 that it wished to proceed with an appraisal of the claim. GuideOne responded that only GuideOne could invoke the appraisal process under the policy and, based on its conclusion that it had sufficiently investigated the claim, GuideOne declined to do so.

TopDog sued GuideOne in August 2014. The following April, GuideOne sought to initiate the appraisal process, which TopDog resisted. The trial court denied GuideOne's motion to compel appraisal, but in September 2015 an appellate court directed the trial court to grant GuideOne's motion to compel appraisal. The trial court ordered appraisal, the parties designated appraisers, and the trial court appointed an umpire. On September 16, 2016, the umpire filed the appraisal award, in which the parties' appraisers and the umpire unanimously set the amount of loss at $168,808. Several weeks later, GuideOne issued a check to TopDog for $146,927.20, which was the amount of the award less the $5,000 deductible and 10% depreciation.

TopDog sued alleging breach of contract and bad faith. The parties filed competing motions for summary judgment against each other. TopDog argued that GuideOne had breached its contract and had failed to timely pay TopDog's claim as required by the Prompt Payment of Claims Act ("PPCA"). GuideOne argued that, because it paid the appraisal award, TopDog could no longer maintain any of its claims against GuideOne. The trial court granted GuideOne's motion.

On appeal TopDog argued that GuideOne had breached the insurance contract when it refused to pay any amount for the loss in September 2013, since the appraisal later determined that the amount of TopDog's loss was $168,808 arguing that when an appraisal determines that the insurer significantly underpaid the amount of the loss when it made its claims decision, the insurer has breached the contract as a matter of law.

The Amarillo Court of Appeals affirmed the trial court in favor of GuideOne. In its decision, the appellate court found that (1) the parties contractually agreed that, in the event of a disagreement as to the amount of the loss, GuideOne could invoke the appraisal process to set that amount; (2) the process was invoked; and (3) GuideOne then tendered payment to TopDog in the amount of the appraisal award, less the deductible and depreciation. Therefore, although there was a substantial difference between the appraisal award and the amount of damage GuideOne initially found, GuideOne paid that difference following appraisal and therefore, there was no evidence on the element of damages and the breach of contract claim failed. The appellate court added that the GuideOne policy specifies that the purpose of the appraisal process is to "set the amount of the loss" but that it did "not purport to determine whether a breach" had occurred.

In its second issue, TopDog argued that an insured who establishes the loss was underpaid by the insurer may recover delay penalties under the PPCA if the insurer's payment of the appraisal award occurred after the statute's deadlines for prompt payment. In its third issue, TopDog argued that payment of an appraisal award does not preclude any claims against an insurer under common law bad faith causes of action. The appellate court affirmed the trial court's judgment in favor of GuideOne. Relying on the Texas Supreme Court's recent *Menchaca* case that an insured can recover actual damages caused by the insurer's statutory violation or bad-faith conduct only if the damages are separate from and differ from benefits under the policy, it denied that the requisite "independent injury" can be predicated on policy benefits which have already been paid. The court pointed out that the GuideOne policy provided coverage and GuideOne had made payment once the parties had completed the appraisal process. Therefore, TopDog received the benefits it was entitled to under the policy and failed to demonstrate that any policy benefits were withheld or that it had any damages from any injury independent of its policy claim.

## FEDERAL COURT RULES THAT 6-MONTH DELAY WAS NOT UNREASONABLE AND GRANTED HOMEOWNERS INSURER'S MOTION TO COMPEL APPRAISAL

In ***Rogers v. Nationwide General Ins. Co.*, No. 4:18-CV-00213 (E.D. Tex. Aug. 13, 2018)**, a homeowner's insurer (Nationwide) demanded appraisal six months after reaching an impasse with its insured (Rogers) over the amount payable for damage to Rogers' home – and four months after Rogers had filed a bad faith lawsuit against Nationwide. A federal district court in Texas determined Nationwide had not waived its right to demand appraisal under its insurance policy.

After Rogers' home was damaged in a hail storm on March 26, 2017, he made a claim for the damage to his homeowners' insurance carrier, Nationwide. Nationwide assigned the claim to its adjuster, Dotson, who inspected the property and found a total of $9,175.35 in hail damage but found no damage to the home's tile roof. Rogers asked Nationwide to re-inspect his home, and an inspector, Hall, found hail damage to three tiles on Rogers' roof. In light of Mr. Hall's report, Dotson completed a new estimate of damage. The next day, Nationwide issued a letter to Rogers covering a portion of the claim but denying full replacement of the roof. Later, Rogers' public adjuster prepared an estimate for repairs totaling $163,497.12 and a photo report showing evidence of hail damage to the roof. Dotson again revised his estimate, but Nationwide maintained its denial of a full roof replacement.

Rogers sued Nationwide for breach of the duty of good faith and fair dealing and violations of the Texas Deceptive Trade Practice Act and Texas Insurance Code. Shortly after the parties filed their pleadings, Nationwide invoked appraisal under the policy, selected an appraiser, and requested that Rogers designate an appraiser within 20 days. Rogers would not agree to proceed with appraisal. Nationwide then filed a motion to compel appraisal under its policy and to abate the case pending the outcome of the appraisal.

Rogers argued that Nationwide had waived its right to demand appraisal because it had unreasonably delayed invoking appraisal for six months after the parties had reached an impasse and four months into active litigation, and that he had suffered prejudice as a result of that delay. Nationwide asserted that it had requested appraisal at a reasonable time and that Rogers had not been prejudiced because the policy gave both sides the same opportunity to demand an appraisal. Nationwide also asserted that the policy contained a non-waiver clause that prevented an implied waiver of its right to invoke appraisal.

The district court granted Nationwide's motion, explaining that the parties had reached an impasse no later than December 21, 2017, when Nationwide declined a settlement offer from Rogers. The district court also pointed out that after Nationwide rejected Rogers' offer, no settlement discussions took place, even after Rogers filed his lawsuit in February 2018, and that Nationwide had first requested an appraisal on June 27, 2018, about six months after the parties had reached an impasse.

The court found that because the policy did not include a time frame in which a party had to request an appraisal, Nationwide needed to request appraisal "within a reasonable time from the moment of impasse." The court stated Rogers had pointed to no authority to suggest that a six-month delay was per se unreasonable, absent other conduct that would result in waiver. Furthermore, there was no "intentional conduct inconsistent with [Nationwide's] right to invoke the contractual right of appraisal" nor was there intentional conduct inconsistent with claiming the right to enforce the policy's nonwaiver agreement.

The district court further found that even if Nationwide had waived the non-waiver clause and had waived its right to seek an appraisal based on delay, Rogers had not demonstrated that he had been prejudiced. Although Rogers argued that hiring an expert financially burdened him, the district court reasoned that it was "difficult to see how prejudice could ever be shown" when the policy gave both sides the same opportunity to demand appraisal. The court then exercised its discretion to abate the case until the appraisal process was completed.

## TEXARKANA COURT LOOKS AT FACTS, NOT LEGAL THEORIES, TO DETERMINE DUTY TO DEFEND AND APPLIES MENCHACA TO DISMISS EXTRA-CONTRACTUAL CLAIMS

In ***Bush Constr., Inc. v. Texas Mut. Ins. Co.*, No. 06-18-00021-CV, 2018 WL 3862859 (Tex. App.—Texarkana Aug. 15, 2018) (slip op.)**, an insured's employee (Hall) was injured on a railroad job while using a piece of equipment designed and maintained by his employer, the insured (Bush). Hall sued Bush and Union Pacific (railroad) for damages he incurred (Hall suit). Texas Mutual, Bush's insurer,

initially tendered a defense to Bush for the Hall suit under reservation of rights but later withdrew the defense. Bush assumed its own defense of the Hall suit, which was eventually settled. Bush then filed this lawsuit against its insurance agent, Texas Mutual, and two other defendants, seeking to recoup the sums it incurred in defending the Hall suit and other damages. Bush asserted claims against Texas Mutual for breach of contract, violations of the Texas Prompt Payment Act, unfair and deceptive acts or practices in the business of insurance, breach of the implied duty of good faith and fair dealing, and tortious interference.

The trial court granted Texas Mutual's motion for summary judgment as to all claims asserted against it and the Texarkana court of Appeals affirmed. The court employed Texas's "eight corners" analysis to determine if Texas Mutual had a duty to defend Bush. In the Hall suit, Bush had asserted a cause of action against his employer under the Federal Employers' Liability Act (FELA), however that claim was expressly excluded from coverage. Bush argued that because Hall had also asserted a cause of action for products liability, which was not excluded, Texas Mutual was required to defend the whole suit. The court employed the rule that in determining whether an insurer has a duty to defend, courts do not consider the legal theories of recovery asserted, rather, they look to the factual allegations showing the *origin* of the damages claimed to determine whether the claim is covered by the policy. Based on the allegations, it was clear the claimant was injured while he was performing work subject to the FELA, which barred coverage for all his damages, regardless of the theory of recovery. While Hall also alleged that Bush negligently designed the brushcutter, "this does not allege a separate origin of his injury, but rather a separate legal theory of recovery." The court held that under either legal theory of recovery, negligence or products liability, the origin of Hall's injuries occurred in work subject to the FELA, which was excluded under the plain terms of the Policy. Consequently, Texas Mutual did not have a duty to defend the Hall suit.

After concluding the carrier had no duty to defend and therefore had not breached its contract, the court then affirmed the judgment in favor of Texas Mutual with respect to the insured's extra-contractual claims. The court applied the Texas Supreme Court's recent holding in *USAA Texas Lloyds v. Menchaca* to conclude that the lack of coverage for the claim barred all extra-contractual causes of action. The insured argued its claims for unfair claim settlement practices under Texas Ins. Code Chapter 541 were not coverage-dependent, but the court once again relied on *Menchaca* to reject this proposition.

## TEXAS FEDERAL COURT GIVES GUIDANCE ON DISMISSING ADJUSTER AND REMOVAL OF SUIT TO FEDERAL COURT UNDER CHAPTER 542A

In ***Electro Grafix, Corp. v. Acadia Ins. Co.*, SA-18-CA-589-XR, 2018 WL 3865416 (W.D. Tex. Aug. 14, 2018) (slip op.)**, the federal court for the Western District considered whether it had diversity jurisdiction over a removed case and provided procedural guidance to insurers who seek to remove a case to federal court under Texas Insurance Code 542A. In *Electro Grafix*, the insured/plaintiff (a Texas corporation) sought coverage under its policy with Acadia (a New Hampshire corporation) for potential hail damage. In a nutshell, the petition alleged there was hail damage but that Acadia wrongfully determined there was no hail damage. The insured filed suit against Acadia and against Odermatt in his individual capacity, the adjuster in Texas, who plaintiff alleged attempted to obtain an inappropriate settlement with plaintiff. Plaintiff asserted claims against Acadia for fraud, breach of contract,

noncompliance with the Texas Insurance Code, breach of the duty of good faith and fair dealing, and violations of the Texas Deceptive Trade Practices Act ("DTPA"). Plaintiff brings a claim against Odermatt for noncompliance with the Texas Insurance Code.

Pending before the court was plaintiff's motion to remand to state court and Odermatt's motion to dismiss. The court found that Odermatt was improperly joined and denied plaintiff's motion to remand.

The court stated the general rules regarding diversity jurisdiction: (1) for diversity jurisdiction to be proper, the court must be certain that all plaintiffs have a different citizenship from all defendants; (2) the removing party bears the burden of showing that federal jurisdiction exists and that removal was proper; and (3) the removing party can establish federal jurisdiction based on 28 U.S.C. § 1332 by demonstrating that a non-diverse defendant has been "improperly joined." To establish improper joinder, a removing party must show an "inability of the plaintiff to establish a cause of action against the non-diverse party in state court."

Under the Texas Insurance Code, "[i]f a claimant files an action to which this chapter applies against an agent and the insurer thereafter makes an election under Subsection (a) with respect to the agent, the court shall dismiss the action against the agent with prejudice." *Tex. Ins. Code* § 542A.006(c); § 542A.006(a) ("[A]n insurer that is a party to the action may elect to accept whatever liability an agent might have to the claimant for the agent's acts or omissions related to the claim by providing written notice to the claimant.")

In its notice of removal, Acadia stated that, before Odermatt was served with Plaintiff's lawsuit, Acadia provided written notice that it accepted "whatever liability Odermatt might have to [Plaintiff] for Odermatt's acts or omissions related to this claim." Therefore, Acadia argued, Plaintiff has no valid claim against Odermatt under the Texas Insurance Code.

Plaintiff argued that the Court should not consider Acadia's written notice indicating that it elected to accept whatever liability Odermatt might have because such written notice is "information beyond the four corners of the State Court pleadings" and should not be considered in a Rule 12(b)(6)-type motion. The district court disagreed stating it could consider such information when determining if a party is improperly joined/jurisdiction.

The court held that the defendants showed that Acadia provided plaintiff with written notice of its election to accept whatever liability Odermatt might have in this case and under the Texas Insurance Code, when an insurer elects to accept liability for an agent and notifies the claimant, the court "shall dismiss" the claimant's action against the agent. TEX. INS. CODE § 542A.006(c). Thus, defendants showed that any potential claim against Odermatt would be dismissed under the Texas Insurance Code. Accordingly, the court found Odermatt was improperly joined and denied plaintiff's motion to remand.

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