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JULY 2018 TEXAS INSURANCE LAW UPDATE

SUMMARY: Texas federal district courts were fairly busy considering insurance-related cases in July, although there were no major landscape-altering opinions during this month. The San Antonio Court of Appeals held that an insurer owed a defense to its insured under a strict eight-corners analysis of pleadings, even though it was clear from the evidence that an excluded driver was operating the vehicle at the time of the accident. The Fifth Circuit affirmed the dismissal of a policyholder's extra-contractual claims based on *Menchaca's* "Independent-Injury Rule" because the policyholder's extra-contractual claims were not truly independent of the policyholder's entitlement to policy benefits. In two opinions, separated by only two days, the Southern District of Texas gave mixed signals regarding whether and when courts will apply an extrinsic evidence exception. Finally, the Northern District confirmed that independent insurance adjusters may be liable for violating the Texas Insurance Code, and also applied broadly, an absolute pollution exclusion.

San Antonio Court of Appeals finds insurer owed a defense to named insured driver under strict eight-corners analysis, despite false representations by the named insured regarding an excluded driver.

In *Osbaldo Hurtado Avalos & Antonio Hurtado, as Assignees of Karla Flores Guevara v. Loya Insurance Company*, No. 04-17-00070-CV, 2018 WL 3551260 (Tex. App.—San Antonio July 25, 2018, no pet. h.), the San Antonio Court of Appeals considered a coverage dispute arising out of an underlying personal injury lawsuit. The underlying lawsuit arose out of a car accident between the Hurtados and Guevara's husband, Rodolfo Flores. On the day of the accident, Flores was moving Guevara's car outside of their home when he collided with the Hurtados' vehicle. Although Guevara was insured by Loya Insurance Company, the policy contained a named driver exclusion for Flores. The Hurtados pursued an insurance claim against Guevara, ultimately filing a negligence suit against her in the 49th District Court of Webb County.

The Hurtados pleading alleged that Guevera was the driver of the vehicle; however, according to Loya, it was learned that Flores, the excluded driver, was the driver at the time of the accident. Loya, therefore, sent a letter to Guevera denying coverage pursuant to the excluded

driver endorsement. Guevera's assigned defense counsel subsequently withdrew from his representation of Guevera. A judgment was ultimately entered against Guevara for $450,343.34. The Hurtados, as assignees of Guevera, filed a coverage lawsuit against Loya for breach of contract.

In the trial court coverage lawsuit, Loya filed a motion for summary judgment, arguing there was no coverage because of the excluded driver endorsement. In support of its motion, Loya attached the deposition of Guevera in which she testified Flores was the driver at the time of the accident. In a competing MSJ, the Hurtados argued Loya owed Guevera a duty to defend, as a matter of law. Summary judgment was granted in favor of Loya.

On appeal to the San Antonio Court of Appeals, the Hurtados argued that Loya had a duty to defend Guevera in the underlying lawsuit based on a strict eight corners analysis (inasmuch as the pleadings alleged Guevera was the driver at the time of the accident). Loya, on the other hand, argued that its duty to defend did not arise because Guevara breached the insurance policy prior to the filing of the underlying lawsuit.

The court of appeals held that, under a strict eight corners analysis Loya had a duty to defend Guevera, reasoning that the allegations in the relevant pleading only included allegations about Guevera as the driver. There were no allegations that Flores was the driver at the time of the accident. The court also pointed out that the extrinsic evidence regarding who was driving the vehicle at the time of the accident directly contradicted the pleadings. As such, the extrinsic evidence could not be considered.

With respect to Loya's argument that Guevera materially breach the policy by falsely reporting she was the driver, the San Antonio Court of Appeals disagreed. The court, pointed out that a defense of third-party claims provided by an insurer is a valuable benefit granted to the insured under the policy. Thus, if Loya knew the allegations in the pleading were untrue, it had a duty to establish such facts in defense of Guevera in the underlying lawsuit.

Becasue the court of appeals concluded Loya owed Guevera a duty to defend based on a strict eight corners analysis, the court reversed the trial court's summary judgment in favor of Loya and remanded the case back to the trial court for further proceedings consistent with its opinion.

Relying on *Menchaca's* "Independent-Injury Rule", Fifth Circuit affirms dismissal of policyholder's extra-contractual claims because policyholder's extra-contractual claims were not truly "independent" of the insured's entitlement to policy benefits.

In *Moore v. Allstate Texas Lloyd's*, No. 17-10904, 2018 WL 3492818, (5th Cir. July 19, 2018), the United States Court of Appeals for the Fifth Circuit considered an insurers motion to dismiss an insured's extra-contractual claims based on the Texas Supreme Court's *Menchaca* opinion. The dispute arose out of a storm-related event in which the insured's residential property sustained damages. The insured filed a claim with Allstate, who inspected the property three times. The first inspection occurred on January 3, 2016, when an Allstate employee determined that no storm damage occurred; the second inspection occurred two weeks later when that same employee examined the property and reached the same conclusion; and the third inspection occurred on January 30, 2016 when Allstate sent an independent engineer to inspect the property. On February 15, 2016, Allstate notified Moore of a "laundry list of perils, which Allstate would not cover under the claim." *Id.* at *1. Moore sued Allstate in Texas state court asserting breach of contract and extra-contractual claims including under the Texas Deceptive Trade Practices Act and the Texas Insurance Code.

The federal district court granted Allstate's motion to dismiss, finding that "Moore failed to plead facts sufficient to state a viable breach of contract claim." *Id.* Specifically, the court found that Moore failed to explain "'what happened or the nature of, or even the extent of, the damages his property allegedly incurred;' what Allstate 'did or failed to do that he alleges made the inspections inadequate;' or 'the date on which he made his claim or explain why he says [Allstate's] response was untimely.'" *Id.* In addition, the district court noted that, at "most, . . . Moore's 'complaint seems to be that he did not get paid as much as he thinks he should have been paid, but he has not alleged any facts to show that [Allstate] breached a contract between them.'" *Id.* On appeal, Moore argued that he pleaded sufficient facts to state a cause of action and, thus, the District Court erred in granting the motion to dismiss. The Fifth Circuit agreed with the District Court's dismissal.

The District Court dismissed Moore's extracontractual claims, holding that there "can be no recovery for extra-contractual damages for mishandling claims unless the complained of acts or omissions caused an injury independent of those that would have resulted from a wrongful denial of policy benefits." *Id.* at *2. According to Moore, in *Menchaca*, the Texas Supreme Court "established that if statutory violations cause an injury that is independent from breach of contract, then a plaintiff can recover even if the policy does not provide benefits." *Id.* Moore also argued "that the independent-injury rule 'does not reflect a pleading requirement, especially before any discovery has been conducted.'" *Id.* The Fifth Circuit stated that Moore was correct to point to *Menchaca*, but that "Moore misreads *Menchaca*." *Id.* Specifically, Moore pointed to *Menchaca*'s fourth rule, the "Independent-Injury Rule" which provides that "if an insurer's statutory violation causes an injury independent of the loss of policy benefits, the insured may recover damages for that injury even if the policy does not grant the insured a right to benefits." *USAA Texas Lloyds Co. v. Menchaca*, 545 S.W.3d 479, 489 (Tex. 2018).

The Fifth Circuit noted that the independent-injury rule applies "only if the damages are truly independent of the insured's right to receive policy benefits . . . . That is, the independent-injury rule 'does not apply if the insured's statutory or extra-contractual claims "are predicated on [the loss] being covered under the insurance policy" . . . or if the damages "flow" or "stem"

from the denial of the claim for policy benefits.'" *Moore*, 2018 WL 3492818 at *3. Rather, "when an insured seeks to recover damages that 'are predicated on,' 'flow from,' or 'stem from' policy benefits, the general rule applies and precludes recovery unless the policy entitles the insured to those benefits." *Id.* (cleaned up). Applied in the immediate case, Moore's common law and statutory claims "are predicated on the loss being covered under his residential policy. Thus, the general rule applies. Because Moore fails to state a breach of contract claim, and thus a right to receive policy benefits, Moore cannot recover for Allstate's alleged extra-contractual violations." *Id.*

Southern District of Texas refuses to consider insurer's extrinsic evidence in dispute over defense obligation.

In *Everest Nat'l Ins. Co. v. Gessner Eng'g, LLC*, No. CV H-17-2981, 2018 WL 3361458 (S.D. Tex. July 10, 2018) (Justice Nancy F. Atlas), Everest, the insurer, issued an Architects and Engineers Professional Liability Policy to Gessner for the period August 1, 2015 to August 1, 2017. The Policy broadly covered "wrongful acts arising out of the performance of professional services". *Id.* at *1. In addition, the policy required Everest to defend Gessner against "any covered claim, even if such claim is groundless, false or fraudulent". *Id.* Gessner was hired by a monastery to provide structural engineering services for a construction project. After the building was constructed, however, the monastery noticed water intrusion and filed a lawsuit against Gessner. Everest agreed to provide a defense, and also filed a declaratory judgment lawsuit, naming Gessner and the Monastery as Defendants.

The coverage dispute arose out of policy language providing that the insurance "applies to a wrongful act only if all of the following conditions are satisfied" and lists four separate conditions, including that "no insured had knowledge of such wrongful act and had no basis to reasonably anticipate a claim that would be made" prior to the inception of the Policy. *Id.* at *3. Another condition is that the "claim arising out of the wrongful act is first made against any Insured during the policy period." *Id.* The Monastery's state court petition was filed during the policy period. In the petition, the Monastery alleged that it learned of the deficient work "at some point in 2015". *Id.* The petition did not include any allegation that Gessner, prior to the inception of the Policy, had knowledge its work was deficient, or that Gessner had a reason to anticipate that the Monastery would assert a claim based on deficient work. In addition, although the petition alleged that the Monastery noticed intermittent water seepage in 2014, before the policy period, the Monastery specifically alleged that Gessner failed "to identify the role of its own error in causing the water infiltration problems". *Id.* Based on a strict eight-corners reading of the policy and petition, therefore, the court concluded that "the Monastery's professional negligence claim against Gessner is potentially within the Policy's scope of coverage and Everest has a duty to defend." *Id.* at *4.

Everest argued that the court should apply an extrinsic evidence exception to the eight-corners rule to consider evidence that the monastery had filed prior lawsuits against Gessner for deficient work. The Southern District noted that the Texas Supreme Court has never recognized an extrinsic evidence exception, despite multiple opportunities to do so. Reviewing those cases in which Texas federal courts have applied an extrinsic evidence exception, the Southern District noted that the Supreme Court has stated that if it were to recognize any extrinsic evidence exception, it would be limited to the situation where "it is initially impossible to discern whether coverage is potentially implicated *and* when the extrinsic evidence goes solely to a fundamental issue of coverage which does not overlap with the merits of or engage the truth or falsity of any facts alleged in the underlying case." *Id.* (quoting *GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church*, 197 S.W.3d 305, 309 (Tex. 2006)). Ultimately, the Southern district "decline[d] to apply an exception to the eight-corners rule in this case because . . . it is not *impossible* to discern whether coverage under the Policy is *potentially* implicated by the allegations in [the petition]." *Id*. Therefore, the court concluded that even had the Texas Supreme Court recognized an exception to the eight-corners rule, it would not apply in the immediate case.

Southern District of Texas concludes vague pleadings regarding timing of property damage does not trigger a defense, and that allegations in an underlying pleading can be considered in determining a defense with respect to a third-party pleading.

In *Evanston Ins. Co. v. Kinsale Ins. Co.*, No. 7:17-CV-327, slip op., (S.D. Tex. July 12, 2018) (Justice Micaela Alvarez), the Southern District of Texas reached the exact opposite result with respect to an extrinsic evidence exception to the eight-corners rule from its decision of two days prior. The insurance coverage dispute arose out of an underlying construction lawsuit involving two schools. The crux of the coverage dispute arose out of the general contractor's, VCC's, allegation that a subcontractor, NM, caused property damage. Both Evanston and Kinsale issued general liability insurance policies to NM, and each initially agreed to contribute to NM's defense. Kinsale subsequently withdrew from the defense, taking the position that the damages arose before NM's coverage with Kinsale began. VCC entered a contract with the project owner for one school on May 19, 2009, and on April 26, 2011 for the second school. According to the owner's petition against VCC, work on the first project occurred between May 19, 2009 and March 9, 2011, and the work on the second project occurred between April 26, 2011 and September 24, 2012. VCC's crossclaim against NM was silent as to the timing of the alleged property damage.

Kinsale issued CGL and excess liability policies to NM for the period August 6, 2013 to August 6, 20014. The Policies included a "Prior Injury or Damage Exclusion" endorsement which provided that:

> This insurance does not apply to "bodily injury" or "property damage" . . . which begins or takes place before the inception date of this policy or before the retroactive date of this policy if claims-made coverage applies, regardless of whether or not "bodily injury" or "property damage" . . . is known to any insured.

Id. at *3. In withdrawing from the defense of NM, Kinsale took the position that the property alleged in VCC's crossclaim against NM occurred prior to the inception of the Kinsale policy and was thus excluded by the "Prior Injury or Damage Exclusion". Evanston filed a declaratory judgment lawsuit against Kinsale, seeking a declaration that Kinsale had a duty to defend NM. Evanston also brought claims for breach of contract and contribution for the share of NM's defense costs Evanston incurred that should have been paid by Kinsale.

The Southern District first addressed whether it had jurisdiction over the case given that the dispute was among two insurers and NM was not a party to the DJ lawsuit. The Court concluded that Evanston did have standing to bring the declaratory judgment lawsuit.

> Although Plaintiff is neither a party to, nor an intended beneficiary of, the Policies between Defendant and NM, it has a very real interest in respect to the responsibilities of Defendant to provide defense to NM. If Defendant does not defend NM then Plaintiff will be required to cover its portion of the defense. The subject matter of the suit—the duty to defend NM—is definite and substantial. Each party has a stake in the outcome, and their interests are adverse. A declaratory judgment could redress and provide relief to the parties. Thus, this presents a justiciable actual controversy.

Evanston argued that the VCC crossclaim states a potentially covered claim for property damage and that, even if the claims for property damage were excluded, VCC's crossclaim also included claims for breach of contract, breach of warranty, negligence, contribution, and indemnity which would not be barred by the "Prior Injury or Damage" exclusion. Kinsale, on the other hand, argued that all damage alleged in the VCC Crossclaim occurred prior to the inception of the policies.

Evanston argued that, under Texas law, the district court was able to consider *only* the VCC crossclaim in determining the scope of Kinsale's duty to defend, and that "if the Court only considers the VCC Crossclaim, then Defendant has a duty to defend because 'the alleged property damage may have occurred during one or more of the policy periods in which its policies were in effect.'" *Id.* at 15. Kinsale responded that it should not be required to defend NM simply because the crossclaim was absent of dates, and that the underlying pleading should be considered because "(1) it is incorporated by reference; (2) it is necessary to understand the claims for which VCC seeks indemnity; and (3) the [] Counterclaim falls into the extrinsic evidence exception." *Id.* at *17.

Applying a strict eight-corners analysis, the Court noted that the "'four corners' of the VCC Crossclaim do not clearly provide dates when the alleged property damage occurred." *Id.* at 17. The only dates in the VCC Crossclaim are that VCC entered into two contracts with the owner in 2009 and 2011. "VCC brings claims against its subcontractors, including NM, 'in the

unlikely event it is found liable for defective work . . . .' But the VCC Crossclaim provides no date for when that work occurred." *Id.* at *18. Evanston argued that "since the VCC Crossclaim does not contain 'any factual allegation' as to the timing of the alleged property damage, the Court should find that the damage could have occurred at any time between the signing of the contracts and the filing of the VCC Crossclaim." *Id.* at *18. Evanston "is essentially arguing that because the VCC Crossclaim does not specifically rule out the possibility of a claim then that means there is a potential claim." *Id.* The Court rejected this argument, nothing that while a potentially covered claim "gives rise to a duty to defend, courts may not 'read facts into the pleadings,' and '[a] duty to defend should not be allowed to spring into existence based on artful or inartful pleading.'" The court went a step further, stating that if "the Court were to accept Plaintiff's argument, then artfully pled complaints that lack specific dates would be sufficient to bind insurance companies to defend claims that are clearly outside of the bounds of their policy." *Id.*

Next, the court addressed Kinsale's argument that the underlying pleading could be considered in determining an insurer's duty to defend with respect to a third-party claim. Noting that "the driving aim of the Court's analysis is to give meaning to the intent of the parties as stated in the relevant insurance policies", the Southern District concluded that it "may refer, if necessary, to the claims in the underlying suit in order to determine if the facts asserted trigger coverage." *Id.* Moreover, the court agreed with Kinsale's argument that the extrinsic evidence exception applied to the pleadings. Because the "alleged date of construction goes solely to a fundamental issue of coverage and does not implicate the merits or depend on the truth of the facts alleged", the court held it could consider the underlying allegations in determining Kinsale's duty to defend. Thus, because the underlying pleading included dates showing that the property damage occurred prior to the inception of the policy, the court determined that Kinsale's duty to defend was not triggered and as such, Evanston was not entitled to a declaration against Kinsale.

Northern District of Texas concludes Absolute Pollution Exclusion applies to preclude a defense and indemnity obligation by umbrella insurer.

The Northern District of Texas, in *Great Am. Ins. Co. v. ACE Am. Ins. Co.*, No. 4:18-CV-114-A, 2018 WL 3370620 (N.D. Tex. July 10, 2018), construed an absolute pollution exclusion which bars coverage for any liability "arising out of or in any way related to ... discharge, dispersal, seepage, migration, release or escape of 'pollutants,' however caused." *Id.* at *5. The alleged pollutant in issue included "rock fines" which the court defined as "small particles of rock generated as part of the stone crushing process at the quarry" which are "washed off with water and placed in ponds to settle, then 'removed, dried out and prepared for use as reclamation fill' at the quarry or sold as fill material or for other undefined purposes." *Id.* In the instant dispute, the rock fines caused physical damage to a stream and stream bed by

> (a) changing the flow and contours of the stream, including areas used for trout spawning; (b) filling in portions of the stream and flood plain thereby reducing the capacity of the stream and flood plain and increasing the risk of flooding in the area, which was already a flood-prone area; and (c) physically covering the micro and macro invertebrates that serve as a food source for fish and other species.

Thus, the court concluded that, "[w]ithout question, the absolute pollution exclusion applies and is fatal to [the insured's] claims for defense and indemnity from [the insurer]." *Id.*

Southern District of Texas grants summary judgment for insurer on statute of limitations defense.

In *Smith v. Travelers Cas. Ins. Co. of Am.*, No. CV H-16-1527, 2018 WL 3369683 (S.D. Tex. July 10, 2018), the Southern District of Texas considered a dispute in which an insured alleged that a lightning strike caused damage to the foundation and air conditioning unit of her commercial property. The insured reported the claim to Travelers on September 5, 2013, Travelers acknowledged the claim on September 7, 2013, retained engineers in September of 2013 to inspect the foundation and air conditioning unit, and after speaking with the insured several times in September and October, Travelers issued a letter denying coverage under the first party property insurance policy on November 13, 2013. *Id.* at *1-2.

On January 25, 2016, the insured filed a lawsuit against Travelers asserting claims for violations of the Texas Deceptive Trade Practice Act, for breach of contract, and for violations of the Texas Insurance Code. Travelers moved for summary judgment arguing that the statute of limitations barred all of the insured's claims. The district court noted that causes of action for breach of first party insurance contracts and violations of the DTPA and Insurance Code accrue on the date the insurer denies the insured's claim. But the court also noted that where there is no outright formal denial of the claim, the date of accrual is a fact question. In addressing when the Plaintiff's causes of action accrued, the district court noted that after making her initial claim for foundation and air conditioning unit damage, the Plaintiff never made an additional claim for damages, Travelers never made payments under the policy, never reopened the claim, and there was no evidence that Travelers ever changed its decision to deny coverage. Moreover, Travelers "expressly denied Plaintiff's claim in its Denial of Coverage Letter when it stated 'we will be unable to provide coverage for your claim as the damages sustained are excluded in the policy.'" *Id.* at *5. In December, 2013, the insured hired an engineer to inspect the damage, in August, 2014, the insured requested that Travelers reconsider its denial of coverage or Plaintiff would file suit. Travelers responded on October 13, 2014, Travelers responded that "while [the insured's] letter does not contain any additional or different information <u>which would cause Travelers to change its position in this matter</u>, if you will provide me some dates that the property is available for inspection, we will hire a third engineer to conduct an investigation . . . ." *Id.* (emphasis in original).

The Court held that these communications did not toll or reset the statute of limitations: "[a]ny requests by Plaintiff to reinvestigate its claim and any subsequent review by Defendant have no effect on the statute of limitations because Defendant did not alter its original decision to deny coverage." *Id.* The court also noted that, even "were the court to conclude that Defendant's third engineer's report constituted a formal denial, a second denial issued after Plaintiff's request for reconsideration does not restart the limitations period." *Id.* Thus, because Travelers "denied the Plaintiff's claim in its Denial of Coverage Letter and because Defendant never changed its position on the claim, the limitations period for all of Plaintiff's causes of action accrued on November 13, 2013." *Id.*

Northern District of Texas confirms that independent insurance adjusters may be liable for statutory violations of the Texas Insurance Code.

In *Recovery Resource Counsel v. ACE American Ins. Co., et al.*, No. 3:17-CV-2787-N, 2018 WL 3548912, (N.D. Tex. July 24, 2018), the Northern District of Texas reaffirmed that independent insurance adjusters can be held liable for statutory violations of the Texas Insurance Code including statutory bad faith provisions under Section 541. Specifically, the adjuster argued that statutory claims against him "fail as a matter of law because independent insurance adjusters cannot be liable under the Insurance Code provisions on which" the Plaintiff relied. *Id.* at *2. However, the Northern District has repeatedly held that "[a]djusters who are direct employees of the insurer as well as independent adjusters hired by the insurer can be liable under section 541" of the Texas Insurance Code. *Id.*

Western District of Texas finds Plaintiff entitled to attorney fees and statutory interest in first-party claim.

In *Agredano v. State Farm Lloyd's*, No. SA-15-CV-01067-RCL, 2018 WL 3579484 (W.D. Tex. Jul. 25, 2018), an insured prevailed in an underlying lawsuit against their insurer for breach of contract and insurance code statutory claims. Before the District court, the insured sought to recover attorney's fees and statutory interest under Chapter 38 of the Texas Civil Practice and Remedies Code, and Section 542.060 of the Texas Insurance Code. First addressing the Civil Practice and Remedies Code, the Court noted that Chapter 38 entitles a party to recover attorney's fees from an individual or a corporation under a conract claim. Because a Lloyd's plan is an unincorporated entity, the Court rejected the first argument.

Next, the district court considered whether the insured was entitled to recover attorney's fees under Section 542.060 of the Texas Insurance Code for the insurer's violations of the policy. The "Prompt-Pay" statute obligates an insurer who is liable under a policy and fails to promptly respond or pay a claim, to pay an additional 18% penalty per year, plus attorney's fees. The court

noted that the jury found that State Farm had breached the policy in refusing to pay a meritorious claim. Thus the Court held that the policyholder satisfied the requirements of Section 542.060. However, the policyholder failed to specifically request relief under the Prompt Pay statute.

The District Court held, however, despite the deficiency in the policyholder's pleadings, that Rule 54(c) of the Federal Rules of Civil Procedure, allowed the policyholder to recover attorney fees. The rule provides that every "final judgment should grant the relief to which each party is entitled, *even if the party has not demanded that relief in its pleadings.*" Fed. R. Civ. P. 54(c). Thus, although the policyholder did not specifically request attorney fees pursuant to Section 542.060 in its complaint, because the policyholder substantively complied with the Prompt-Pay statute, the Court concluded the policyholder was entitled to relief.

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