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JANUARY 2019 TEXAS INSURANCE LAW UPDATE

STATE INSURANCE CASES

THE TEXAS SUPREME COURT RULED THAT A JOINT VENTURE PROVISION IN AN EXCESS INSURANCE POLICY DID NOT CAP COVERAGE FOR DEFENSE EXPENSES.

In *Anadarko Petroleum Corp. v. Houston Cas. Co.*, No. 16-1013, 2019 WL 321921 (Tex. Jan. 25, 2019), the Supreme Court of Texas held that a negotiated policy provision which capped an excess insurer's $150 million in limits at $37.5 million for its insured's third-party liability did not apply to the insured's defense costs that exceeded $100 million. In *Anadarko*, the Supreme Court of Texas reversed a lower appellate court ruling which allowed a group of underwriters to limit their indemnity obligations to pay for defense expenses incurred by Anadarko Petroleum Corporation and its affiliates stemming from the 2010 BP Deepwater Horizon oil spill. Anadarko was a minority interest owner of the well that was drilled by Deepwater Horizon.

The sole focus of the coverage dispute was coverage for the legal fees and related expenses Anadarko incurred defending against liability and enforcement claims. Anadarko argued that the "energy package" insurance policy covered all of its defense expenses, up to the policy's $150 million excess-coverage limit. The policies' underwriters argued that a joint venture provision in

the policy which limited their "liability" for any judgments or settlements to 25% of the policy limits also capped their liability for Anadarko's defense expenses by the same percentage.

The trial court agreed with Anadarko, but the court of appeals agreed with the underwriters. On appeal, the Supreme Court of Texas rejected the underwriters' argument, holding that the joint venture provision capped coverage only for Anadarko's liabilities to third parties and not its defense expenses, reasoning that by virtue of the policy's usage of the terms "liability" and "expense" in separate contexts, the joint venture provision - which did not mention the word "expense" – did not limit the underwriters' liability for Anadarko's defense costs and expenses. The supreme court looked beyond the dictionary meaning of the term "liability" and instead considered how the policy used the term at issue. It found that although the policy did not define the term "liability," it consistently distinguished between Anadarko's "liabilities" and "expenses." Based on the policy's usage of the term "liability" and its distinguishing references to "expenses," the court concluded that "liability" in the policy referred to an obligation imposed on Anadarko by law to pay for damages sustained by a third party who submits a written claim.

THE TEXAS SUPREME COURT RULED THAT TRIAL COURT SHOULD HAVE DISMISSED A DECLARATORY JUDGMENT ACTION WHICH SOUGHT A DECLARATION OF NONLIABILITY IN TORT.

In this mandamus proceeding, a CGL insurer, Houston Specialty Insurance Co. ("HSIC"), argued that the trial court erred by denying its motion to dismiss a declaratory judgment action because the declarations sought were of nonliability for legal malpractice. The Supreme Court of Texas agreed, reversing the trial court's denial of HSIC's motion to dismiss.

HSIC insured South Central Coal Company pursuant to a CGL Policy. The Coal Company was sued in LeFlore County, Oklahoma by the Carters, who alleged that the Coal Company had mined coal under their property without authorization and then sold it for profit. Acting on the legal advice of its coverage counsel, Thompson, Coe, Cousins & Irons, LLP, HSIC denied the Coal Company's request for a defense and denied coverage under the Policy.

The Coal Company then filed third-party claims against HSIC in the *Carter* lawsuit alleging breach of contract and breach of the duty of good faith and fair dealing. The trial court granted the Coal Company's motion for partial summary judgment on the issue of HSIC's duty to defend. The *Carter* lawsuit eventually ended with a settlement between the Carters and the Coal Company, which the parties referred to as the "*Carter* Settlement," and with a settlement between the Coal Company and HSIC, which the parties referred to as the "Insurance Settlement."

HSIC accused Thompson Coe of committing legal malpractice during its representation of HSIC in the *Carter* lawsuit and specifically by advising HSIC that it did not owe a duty to defend the Coal Company against the Carters' claims. HSIC demanded by letter that Thompson Coe pay

more than $2.8 million—roughly the amount of the Insurance Settlement—to avoid litigation. Thompson Coe responded by preemptively filing suit against HSIC in Harris County district court.

The sole cause of action pleaded by Thompson Coe was a request for declaratory relief under the Uniform Declaratory Judgments Act ("UDJA"). Thompson Coe sought ten declarations:

> a. There is no coverage under the Policy for the claims asserted in the *Carter* lawsuit;
>
> b. There is no duty to defend owed under the Policy for the claims asserted in the *Carter* lawsuit;
>
> c. The Oklahoma District Court's ruling that HSIC owed a duty under the Policy was incorrect as a matter of law;
>
> d. Thompson Coe is not liable for any erroneous judicial opinions;
>
> e. The *Carter* Settlement Agreement is collusive and/or unreasonable;
>
> f. HSIC is not bound by the *Carter* Settlement Agreement or the *Carter* Judgment;
>
> g. The Insurance Settlement Agreement is unreasonable;
>
> h. Thompson Coe is not bound by the *Carter* Settlement Agreement, the *Carter* Judgment or any other orders issued by the Oklahoma District Court;
>
> i. Thompson Coe is not bound by the Insurance Settlement Agreement;
>
> j. Thompson Coe was not negligent in issuing the Declination Letter.

HSIC sought to dismiss Thompson Coe's claims, arguing that they had "no basis in law" for several reasons, including the rule that a potential tort defendant may not use the UDJA to obtain a declaration of nonliability in tort. The Texas Supreme Court found that two of Thompson Coe's requested declarations, (d) and (j), expressly sought a declaration of nonliability, and each of the others was relevant only to a potential claim of legal malpractice by HSIC. The Court found that under *Abor v. Black*, 695 S.W.2d 564 (Tex. 1985), and relying on the rule that a potential tort defendant may not seek a declaration of nonliability in tort, the declarations were legally invalid, had "no basis in law," and should have been dismissed.

EL PASO COURT OF APPEALS FINDS INSURER'S PAYMENT OF APPRAISAL AWARD PROTECTED IT AGAINST EXTRA-CONTRACTUAL CLAIMS.

The El Paso Court of Appeals recently upheld prompt payment of an appraisal award as protection against all causes of action. *Hinojos v. State Farm Lloyds*, No. 08-16-00121-CV, 2019 WL 257883 (Tex. App.—El Paso Jan. 18, 2019, no pet. h.) (slip op.) involved a residential wind/hail claim. After State Farm paid its insured for the damage less the depreciation and the policy deductible, the insured sued State Farm asserting breach of contract, unfair settlement practices, violation of the prompt payment provisions of the Texas Insurance Code, breach of the duty of good faith and fair dealing, and fraud. In response, State Farm invoked appraisal and,

after the appraisal report, State Farm issued a check to the insured's counsel within 7 days. However, due to a clerical error, the check was sent to the wrong address. Less than one month after the appraisal report, after being made aware that insured/Plaintiff had not received the check, State Farm re-issued it. However, this time, Plaintiff's mortgagee had changed and the check had to be re-issued again. Plaintiff's counsel ultimately received the negotiable check roughly 3 months after it had first been sent out.

After State Farm won summary judgment in the trial court, the insured appealed. On appeal, Plaintiff argued summary judgment on his extra-contractual claims was improper because his entitlement to recovery on his extra-contractual claims does not turn on his breach of contract claims. Plaintiff attempted to argue around *Menchaca*[1] trying to distinguish it by arguing the Supreme Court only held extra-contractual claims were precluded where the insured was not entitled to coverage under the policy. He contends *Menchaca* did not preclude extra-contractual claims where, as here, the insurer was found *not* to have breached the contract, but the insured *was* entitled to coverage under the policy. The El Paso court did not find this distinction persuasive. "When an insurer has fully paid an appraisal award, no additional benefits are being wrongfully withheld under the policy, and in that situation, the only way an insured can recover any damages beyond policy benefits is where a statutory violation or act of bad faith caused an injury independent of the loss of benefits." Here, the Plaintiff had not alleged an independent injury, and therefore there was no issue of material fact on his statutory and bad faith claims.

FEDERAL INSURANCE CASES

THE FIFTH CIRCUIT COURT OF APPEALS UPHOLDS FINDING OF NO DUTY TO DEFEND AND INDEMNIFY WHERE POLICY EXCLUSIONS PRECLUDED COVERAGE FOR ALL ALLEGED DAMAGES.

In *United Fire and Casualty Company v. Kent Distributors, Inc*., No. 18-50134, 2019 WL 181182 (W.D. Tex. Jan. 11, 2019) (unpublished), United sought a declaratory judgment that it had no duty to defend or indemnify Kent Distributors, Inc. ("Kent"), the insured, in a lawsuit involving one of Kent's employees. The district court granted summary judgment to United, declaring that United had no duty to defend or indemnify Kent, which was upheld on appeal.

In the underlying suit, Shlana Mitchell ("Mitchell"), a store clerk, sued Kent, claiming that another Kent employee from a different store attacked and sexually assaulted her while she locked the store at closing time. Mitchell alleged that Kent negligently hired, retained, trained, and supervised its employees; failed to identify the threat posed by the employee; failed to warn her of the threat; failed to correct the dangerous condition; and that Mitchell sustained physical and mental injuries as a result.

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

United initially agreed to defend Kent but later denied coverage and withdrew from the defense, asserting that Mitchell's claims were excluded from coverage under both the CGL and Umbrella insurance policies.

Applying Texas law, the district court determined that United had no duty to defend or indemnify Kent in Mitchell's lawsuit under three policy exclusions: (1) the Employer's Liability Exclusion, which excludes coverage for an employee's "bodily injury" suffered during employment or while "[p]erforming duties related to the conduct of" the business; (2) the Texas Abuse or Molestation Exclusion, which excludes coverage for molestation or actual or threatened abuse of anyone in Kent's "care, custody, or control," or arising out of Kent's negligence in the employment, investigation, supervision, or retention of the alleged assailant; and (3) the Punitive or Exemplary Damages Exclusion, which states that the policy "does not apply to punitive or exemplary damages." Applying Texas's "eight corners rule," the district court held that there was no genuine dispute as to whether Mitchell's First Amended Petition contained factual allegations that triggered all three exclusions.

With regard to the Texas Abuse or Molestation Exclusion, Kent argued that Mitchell does not allege she was acting under Kent's control when she was attacked. The court noted that Mitchell's amended petition alleged that she "was employed by Defendant as a store clerk working at Kent Kwik #309" and that she was attacked "[w]hile alone locking the store at closing time[.]" Because the policies did not define the term "control," the district court interpreted control according to its commonly understood meaning as "the power or authority to manage, direct, govern, administer, or oversee." The Fifth Circuit agreed with the district court that Mitchell unambiguously alleged she was in Kent's care, custody, or control by stating she was employed by Kent and was locking the store at closing time when she was attacked.

Kent also argued that Mitchell did not allege abuse, molestation, or intent. The Fifth Circuit held the district court correctly found otherwise. Because the policy does not define "molest," the district court—again, supplying a commonly understood meaning—defined molest as "to annoy, disturb or persecute especially with hostile intent or injurious effect" or "to make annoying sexual advances ... to force physical and usually sexual contact." Mitchell's amended petition alleged that she "was attacked and sexually assaulted by a co-employee" and suffered bodily and mental injuries as a result. The Fifth Circuit agreed with the district court that there was no dispute that those allegations fell within the abuse or molestation exclusion.

Kent also argued that the district court erred when it struck an affidavit Kent filed that provided a separate account of Mitchell's incident which it argued called into question the applicability of the exclusions. Kent claimed that the court should have considered the affidavit as extrinsic evidence under an exception to the "eight corners rule." The court held that although some Texas courts have applied a narrow exception to the rule "where 'it is initially impossible to discern whether coverage is potentially implicated *and* when the extrinsic evidence goes solely to a fundamental issues of coverage which does not overlap with the merits of or engage the truth or falsity of any facts alleged in the underlying case[,]' " the exception did not apply here because Mitchell's First Amended Petition alleged facts entirely sufficient to determine whether

coverage was excluded.

TEXAS FEDERAL COURT FINDS DUTY TO DEFEND WHERE ENDORSEMENT DID NOT PRECLUDE COVERAGE FOR ALL CLAIMS ALLEGED IN COMPLAINT.

In *The Cincinnati Specialty Underwriters Insurance Company v. Preferred Wright-Way Remodeling and Construction, LLC*, No. 6:18-CV-00161-JDK, 2019 WL 172755 (E.D. Tex. Jan. 10, 2019), a commercial general liability insurer ("CSU") sought a declaratory judgment that it owed no duty to defend or indemnify its insured "Wright-Way." The CGL policy contained an Independent Contractors Limitations of Coverage Endorsement providing that the insurance will not apply to claims arising out of "operations performed for you by any independent contractors or subcontractors," unless certain conditions were met:

> As a condition to and for coverage to be provided by this policy, you must do all of the following:
>
> 1. Obtain a formal written contract with all independent contractors and subcontractors in force at the time of the injury or damage verifying valid Commercial General Liability Insurance written on an "occurrence" basis with Limits of Liability of at least:
>
> ***
>
> 2. Obtain a formal written contract stating the independent contractors and subcontractors have agreed to defend, indemnify and hold you harmless from any and all liability, loss, actions, costs, including attorney fees for any claim or lawsuit presented, arising from the negligent or intentional acts, errors or omissions of any independent contractor and subcontractor.
>
> 3. Verify in the contract that your independent contractors and subcontractors have named you as an additional insured on their Commercial General Liability Policy for damages because of "bodily injury", "property damage", and "personal and advertising injury" arising out of or caused by any operations and completed operations of any independent contractor or subcontractor. Coverage provided to you by any independent contractor or subcontractor must be primary and must be provided by endorsement CG 20 10 (7/04 edition) and CG 20 37 (7/04 edition), or their equivalent. Completed operations coverage must be maintained for a minimum of two years after the completion of the formal written contract.
>
> This insurance will not apply to any loss, claim or "suit" for any liability or any damages arising out of operations or completed operations performed for you by any independent contractors or subcontractors unless all of the above conditions have been met.

In the underlying lawsuit, Marla Craig brought negligence claims against Wright-Way and Michael Jennings Custom Woodworks ("Jennings") alleging that she was injured by a kitchen cabinet detaching from a wall at her home and striking her in the head. She claimed that Wright-Way, the general contractor, "maintained the overall construction responsibility for the home" and that it "hired [Jennings] to install the subject kitchen cabinets." CSU provided Wright-Way with a defense to the underlying suit subject to a reservation of rights and then simultaneously filed a coverage lawsuit.

CSU argued that Wright-Way failed to establish that it complied with the conditions precedent in the Endorsement. In response, Wright-Way did not dispute that it failed to comply with the requirements of the Endorsement but argued that summary judgment for CSU was improper because the underlying lawsuit included claims that "Wright-Way failed to warn and failed to instruct tenants about cabinet safety" and that these claims "are separate and distinct claims, and do not arise from any act or omission on the part of the Independent Contractor, Michael Jennings."

The federal court agreed with Wright-Way and denied CSU's motion for summary judgment. The court found that although the Endorsement precluded coverage for "any loss, claim or 'suit' ... arising out of the operations or completed operations performed for Wright-Way by any independent contractors or subcontractors," the Petition was not limited to claims against Wright-Way arising out of operations performed by an independent contractor or subcontractor but also included allegations that Wright-Way was *independently negligent* for failing "to warn and/or instruct tenants about cabinet safety." The Court found that the Petition included a claim against Wright-Way that would not be barred by the Endorsement and that the claim that Wright-Way failed to warn or instruct tenants about cabinet safety did not arise out of "operations ... performed for you by any independent contractors or subcontractors."

ANOTHER TEXAS FEDERAL COURT FINDS THAT INSURER'S PAYMENT OF APPRAISAL AWARD BARS EXTRA-CONTRACTUAL CLAIMS AGAINST IT.

In *Braden v. Allstate Veh. & Prop. Ins. Co.*, No. 4:18-CV-00592-O, 2019 WL 201942 (N.D. Tex. Jan. 15, 2019) (slip op.), after suit by its insured on a residential wind/hail claim, Allstate invoked appraisal. On or about September 25, 2018, Allstate received an appraisal award signed by the appraisers, setting the appraised replacement cost value ("RCV") at $9,005.92 and the actual cash value at $5,141.07. On September 28, 2018, Allstate tendered a letter to Plaintiff through her counsel, explaining that Allstate had sent Plaintiff a check with payment of the appraisal award for the RCV (less the deductible of $5,783.00 and prior payments of $2,323.45) in the amount of $899.47. Allstate then moved for summary judgment on all claims in the pending lawsuit. The court held that Allstate's prompt payment of the appraisal award protected it against all causes of action arising out of the loss, including breach of contract, Insurance Code violations, and bad faith.

"The effect of an appraisal provision is to estop one party from contesting the issue of damages in a suit on the insurance contract, leaving only the question of liability for the court." "Generally, tender of the full amount owed pursuant to the conditions of an appraisal clause is all that is required to estop the insured from raising a breach of contract claim." By payment of the full amount of an appraisal award, the insurer "complie[s] with every requirement of the contract, [and] it cannot be found to be in breach." Plaintiff argued that Allstate did not provide evidence that the checks were received or cashed by Plaintiff. The court held that Allstate did not need to show that Plaintiff received or cashed the payments ("acceptance of the payment is not a

necessary condition for estoppel."). "[S]o long as there is a binding and enforceable appraisal award and the insurer timely and full[y] pays the resulting award, estoppel should apply regardless of whether the insured actually accepts payment."

In granting summary judgment to Allstate on Plaintiff's claims for extra-contractual damages, the court relied on *Menchaca* to conclude that Plaintiff could not maintain any extra-contractual claims under the Texas Insurance Code because Plaintiff's alleged injuries 'are predicated on,' 'flow from,' or 'stem from' Plaintiff's claims for policy benefits.

TEXAS FEDERAL MAGISTRATE RECOMMENDS SUMMARY JUDGMENT IN FAVOR OF INSURER ON DUTY TO DEFEND WHERE ALLEGED CLAIMS ARE NOT COVERED UNDER THE POLICY.

In *Landrove v. Voyager Indemnity Insurance Company*, No. SA-18-CV-00615-FB, 2019 WL 317249 (W.D. Tex. Jan. 23, 2019), a federal magistrate recommended that the homeowner's insurer's motion for summary judgment be granted by the court, where the allegations in the Petition clearly showed the dog bite alleged in the underlying suit, occurred outside of the policy period. The court applied the "eight-corners" rule where an insurer's duty to defend is determined by the allegations in the pleadings and the language of the insurance policy. The magistrate also recommended to the court that summary judgment be granted in favor of the insurer for a second and independent reason: because the underlying lawsuit was for damages for personal injuries resulting to a dog bite by the insured's dog and the policy excluded coverage for animal bites.

JANUARY 2019 MCS-90 UPDATE (FEDERAL COURTS)

ALABAMA FEDERAL COURT HOLDS THAT THE FEDERAL "STATUTORY EMPLOYEE" DEFINITION DID NOT APPLY TO AN AUTO POLICY WHERE THE POLICY ITSELF SUPPLIED ITS OWN DEFINITION OF EMPLOYEE, EVEN THOUGH AN MCS-90 WAS ENDORSED ON THE POLICY.

Canal Insurance Company v. Michael Butler, No. 7:18-CV-00212-LSC, 2019 WL 277361(N.D. Ala. Jan. 22, 2019) was a declaratory judgment action that sought a determination of the parties' respective rights and obligations under an insurance policy issued by Canal to Defendant Alan Farmer Trucking, Inc. ("Alan Farmer"). Defendant Sheridan Logistics, Inc. ("Sheridan") was listed as an additional insured in the policy. On September 14, 2017, Defendant Michael Butler ("Butler") filed an underlying state court action against Alan Farmer and Sheridan. In the state court action, Butler alleged that he was injured while working as an independent contractor transporting military vehicles for Alan Farmer and Sheridan. Butler asserted that as he was unloading a tactical vehicle from a trailer when the vehicle flipped and injured him. Both Alan Farmer and Sheridan dispute that Butler had any duty to unload the vehicle.

Although the incident that formed the basis of the underlying state court action occurred on January 9, 2017, it was not reported to Canal until October 4, 2017, after Butler filed suit. Canal provided a conditional defense to Alan Farmer and Sheridan in the underlying action under a complete reservation of rights.

The Canal policy contained an "injury to employee" exclusion, which provided that the insurance coverage did not apply to bodily injury to an employee of the insured arising out of the employee's employment with the insured or performance of "duties related to the conduct of the 'insured's' business." The policy provision contained the following definition of the term employee: "'Employee" includes a 'leased worker'. 'Employee' does not include a 'temporary worker.'"

The parties disagreed as to whether these provisions (and provisions requiring the insured to provide Canal with prompt notice of the claim) relieved Canal of its duty to defend and to indemnify Alan Farmer and Sheridan in the underlying litigation. Canal moved for summary judgment, which the Alabama federal court denied.

Under the Injury to Employee Exclusion**,** the Canal policy excluded coverage for bodily injury to an employee of the insured arising out of: (1) his employment or (2) performance of duties "related to the conduct of the 'insured's' business." This exclusion applies "[w]hether the 'insured' may be liable as an employer or in any other capacity." The Canal policy also excludes

coverage for bodily injury suffered by a fellow employee of the insured during the course of his employment.

Canal argued that the definition of employee within these policy exclusions must be construed according to federal regulations because the Canal policy was subject to Federal Motor Carrier Safety Act regulations (49 C.F.R. § 387.7(a)), which state that no motor carrier can operate a vehicle until it has obtained the required level of insurance. The court found that this was evidenced by the policy's inclusion of the federally-mandated MCS-90 endorsement. The applicable federal regulations defining employee were in 49 C.F.R. §390.5. According to Canal, because the underlying state court complaint identified Butler as an independent contractor, Butler was a "statutory employee" under the federal regulations and the "injury to employee" exclusion applied to his claims.

The Alabama district court disagreed with Canal's contention that the "statutory employee" definition should be read into the policy because the Canal policy already included a definition of employee and "[t]his definition includes no reference to the federal regulations and provides no indication that the parties intended to use the 'statutory employee' definition." *Id.* at *4. The court found that a majority of courts to address this issue have concluded that the federal "statutory employee" definition does not apply where the policy itself supplies its own definition of employee. (citing as one example, *Canal Indem. Co. v. Rapid Logisitics, Inc.*, 514 Fed. App'x 474 (5th Cir. 2013) (distinguishing policy that included "leased worker" definition of employee from prior Fifth Circuit case where policy did not define the term employee)). The court then stated that these decisions "comport with the plain language of the MCS-90 endorsement, which states that 'all terms, conditions, and limitations in the policy to which the endorsement is attached shall remain in full force and effect as binding between the insured and the company.'" *Id.*, at *4.

After finding that the federal "statutory employee" definition did not apply to the Canal policy's exclusions, the court held that to determine whether the "injury to employee" exclusion applied, it was required to look to both the policy's definition of employee and the common understanding of the term. *Id.* at *5. The district court found that nothing in the underlying state court complaint suggests that Butler was acting as a leased worker and that Butler identified himself as an independent contractor. Applying the Canal policy as written, and giving the term "employee" its "common, everyday meaning," the district court concluded that the term "employee" as defined and used in the "injury to employee exclusion" did not include an independent contractor like Butler. As such, the employer liability exclusion did not preclude coverage.