Fanning Harper Martinson Brandt & Kutchin

COVERAGE DEPARTMENT:
Jennifer Kelley
Direct Dial: 972-860-0304
jkelley@fhmbk.com
Kathryn Vaughan
Direct Dial: 972-860-0309
kvaughan@fhmbk.com
Mariam Shakir
Direct Dial: 972-860-0363
mshakir@fhmbk.com
Stephanie Pitel
Direct Dial: 972-860-0352
spitel@fhmbk.com

www.fhmbk.com

2020 TEXAS INSURANCE LAW HIGHLIGHTS

Despite the virtual shut-down of many Texas courts due to the Covid-19 Pandemic, certain noteworthy insurance coverage cases were decided by Texas courts during the 2020 year.

GROUNDLESS CLAIM CLAUSES HAVE NO BEARING ON APPLICABILITY OF EIGHT-CORNERS RULE, ACCORDING TO TEXAS SUPREME COURT

In *Richards v. State Farm Lloyds*, 597 S.W.3d 492 (Tex. 2020), the Supreme Court of Texas addressed the question of whether the application of the eight-corners rule depends upon the presence of a "groundless-claims clause" in an insurance policy (such clause being an express agreement to defend claims that are "groundless, false or fraudulent").

Jayden Meals, a ten-year old child died in an all-terrain vehicle ("ATV") accident when he was under the supervision of his paternal grandparents. The deceased's mother, Amanda Meals ("Meals"), sued the paternal grandparents, Janet and Melvin Richards (collectively, the "Richards"), alleging negligent failure to supervise and instruct Jayden ("Meals' lawsuit"). Specifically Meals alleged that Jayden was under the Richards' supervision at the time of the accident, which occurred on or near the Richards' residence. The Richards tendered the lawsuit to its homeowner's insurance policy carrier, State Farm Lloyds ("State Farm"). Although State Farm agreed to defend the Richards under reservation of rights, State Farm commenced a coverage action against the Richards in the Northern District of Texas, seeking a declaration that State Farm had no duty to defend or indemnify the Richards in the Meals' lawsuit.

In the coverage action, State Farm moved for summary judgment arguing that Meals' claims were not covered under the policy because the policy's "motor-vehicle exclusion" applied. Pursuant to the motor-vehicle exclusion, there was no coverage for bodily injury that arose from "use" of a motor vehicle owned or operated by or rented or loaned to any insured. State Farm argued that an ATV used, while off an insured location, is a "motor vehicle" under the exclusion. State Farm further argued that this exception applied because the injury arose from use of Richards' ATV on a public recreational trail, not on Richards' property. In order to prove location of the accident, State Farm submitted extrinsic evidence (the police's vehicle crash report specifying location of the accident). In addition, to support its argument that the policy's "insured exclusion" applied and that Jayden was an "insured" because the Richards were his joint managing conservators, State Farm submitted a court order from a suit affecting the parent-child relationship (SAPCR). The Richards, however, argued that the eight-corners rule prohibited the court from considering any evidence, including the crash report and the SAPCR order.

The district court allowed State Farm's submission of extrinsic evidence and held that the eight-corners rule did not prohibit consideration of such evidence because the eight-corners rule only applied to insurance policies that specifically required the insurer to defend 'all actions against its insured no matter if the allegations of the suit are groundless, false or fraudulent." Because State Farm's policy did ***not*** include this "groundless-claims clause," the court reasoned, the eight-corners rule did not apply ***at all*** and granted summary judgment to State Farm.

Richards appealed to the Fifth Circuit and the Fifth Circuit certified the following question to the Texas Supreme Court: "Is the policy–language exception to the eight-corners rules articulated previously in *B. Hall Contracting Inc. v. Evanston Ins. Co*. 447 F. Supp. 2d. 634 (N.D Tex. 2006) a permissible exception under Texas law?"

State Farm argued that the eight-corners rule was created to enforce groundless-claims clauses and the rule should only apply to policies containing groundless-claims clauses or similar language. The Richards, however, argued that the eight-corners rule was not dependent on groundless-claims clauses in policies. The Texas Supreme Court agreed with the Richards. The court pointed out that it has repeatedly affirmed the eight-corners rule without requiring policies to include a groundless claims clause. The purpose of the eight-corners rule, the court held, is to effectuate the contractual agreement (i.e. insurance policy) and to enforce its consistency and predictability so that the parties to the contract (namely the insurer and the insured) know the way courts will interpret the policies. The court noted that insurers, such as State Farm, know how to contract around contractual duties to defend and merely excluding a groundless claims clause from a policy is not sufficient to avoid the long-standing eight-corners rule. "State Farm did not contract away the eight-corners rule altogether merely by omitting from its policy an express agreement to defend claims that are 'groundless, false or fraudulent.'"

The Texas Supreme Court noted that in certain cases where a petition states a claim that could trigger the duty to defend, but the petition is silent on facts necessary to determine coverage, "some courts often allow extrinsic evidence on coverage issues that do not overlap with the merits in order to determine whether the claim is for losses covered by the policy." But whether the Texas Supreme Court would permit such a practice will have to decided another day: "The Fifth Circuit did not ask for our opinion on that practice, so we express none."

TEXAS SUPREME COURT HOLDS PAYMENT OF AN APPRAISAL AWARD DOES NOT BAR CLAIMS UNDER THE TEXAS PROMPT PAYMENT OF CLAIMS ACT

In *Biasatti v. GuideOne Nat'l Ins. Co.*, 601 S.W.3d 792 (Tex. 2020), the Supreme Court of Texas addressed the following issues: (1) whether an insurer's payment of an appraisal award pursuant to a unilateral appraisal clause bars the insured's claims under the Texas Prompt Payment of Claims Act ("TPPCA"), and (2) whether such payment bars an insured's breach of contract and statutory and common-law bad-faith claims.

In *Biasatti*, Steven Biasatti and Paul Gross d/b/a TopDog Properties ("Top Dog") sustained wind and hail damage to their jointly owned properties that were insured by GuideOne National Insurance Company ("GuideOne"). Following inspection, GuideOne concluded that the damages amounted to less than TopDog's $5,000.00 deductible and, as such, declined payment. Second inspection upon TopDog's request confirmed GuideOne's initial conclusion. GuideOne declined to entertain TopDog's request for a third inspection, after which TopDog requested to invoke the policy's appraisal process. GuideOne, however, refused, and took the position that only GuideOne had the right to invoke the policy's unilateral appraisal clause. As a result, TopDog sued GuideOne, alleging claims of breach of contract, common-law and statutory bad faith, and violations of TPCCA. More than eight months later, GuideOne demanded an appraisal which TopDog declined, leading GuideOne to obtain an order compelling the appraisal. Following the appraisal process, the total loss was set at $168,808.00. In October 2013, GuideOne made payment of the appraisal award, minus the deductible and depreciation. Both GuideOne and TopDog moved for summary judgment, however, the trial court denied TopDog's motion and granted GuideOne's motion, finding that all of TopDog's claims were barred based on GuideOne's payment of the appraisal award. The appellate court affirmed and TopDog then appealed to the Supreme Court of Texas. The Supreme Court of Texas ruled in favor of Top Dog, holding that the payment of appraisal award did <u>*not*</u> bar TopDog's claims under the TPPCA; however, with regard to whether TopDog's breach of contract and statutory and common law bad faith claims were barred, the court remanded the question to trial court without giving an opinion.

In reaching its decision, the Texas Supreme Court relied on its own recent decisions. Specifically, the court noted that in *Barbara Techs. Corp. v. State Farm Lloyds*, 589 S.W.3d 806, (Tex. 2019), the Supreme Court found that payment of appraisal award does not foreclose TPPCA damages, even though the payment is neither an acknowledgment nor a determination of liability. Notably, the court did not decide in *Barbara Technologies* whether acknowledgement or determination of liability was necessary to obtain damages under TPPCA. The court also acknowledged its prior holding in *Ortiz v. State Farm Lloyds*, 589 S.W.3d. 127, (Tex. 2019), where it found that payment of an appraisal award bars claims of breach of contract and common law and statutory bad faith claims, *unless the insured sustained an independent injury*. TopDog argued that GuideOne is liable under TPPCA based on *Barbara Technologies*, and that a finding of liability is not required in order to grant TPPCA damages. This argument presented the question Texas Supreme Court previously declined to answer in *Barbara Technologies*: is a determination of liability needed to obtain damages under TPPCA?

The Supreme Court of Texas held that the appellate court erred by ruling that TopDog could not maintain its TPPCA claim because it did not allege an independent injury and the available policy benefits were all paid. The court found that this ruling was inconsistent with *Barabara Technologies*,

which allowed TPPCA damages despite payment of an appraisal award. With regard to TopDog's breach of contract and bad faith claims, the court noted that the even though the appellate court's ruling that the claims were barred was consistent with *Ortiz*, *Ortiz* did involve a unilateral appraisal clause. Therefore, recognizing that the court has not considered whether payment of an appraisal award under a unilateral clause has the same effect on TopDog's breach of contract and bad faith claims, the Supreme Court remanded this question to trial court.

*This case was one of many that the Texas Supreme Court considered this year dealing with these two questions. Due to the Supreme Court's recent opinions in *Barabara Technologies* and *Ortiz*, the lower courts issued many conflicting decisions, but the Texas Supreme Court remanded each case with further instructions and clarification to resolve the dissonance. See also *Alvarez v. State Farm Lloyds*, 601 S.W.3d 781 (Tex. 2020); *Marchbanks v. Liberty Ins. Corp*., 602 S.W.3d 917 (Tex. 2020); *Lazos v. State Farm Lloyds*, 601 S.W.3d 783 (Tex. 2020); *Perry v. United Servs. Auto. Ass'n*, 602 S.W.3d 915 (Tex. 2020).

TEXAS SUPREME COURT ADOPTS EXCEPTION TO EIGHT-CORNERS RULE FOR EXTRINSIC EVIDENCE REGARDING COLLUSIVE FRAUD AND FINDS NO DUTY TO DEFEND WHEN INSURED ENGAGED IN COLLUSIVE FRAUD

In *Loya Ins. Co. v. Avalos*, No. 18-0837, 63 Tex. Sup. Ct. J. 969, 2020 Tex. LEXIS 373 (May 1, 2020), the Texas Supreme Court analyzed whether or not the eight corners rule applied to evidence establishing collusive fraud. Typically under the eight-corners rule, the only admissible evidence when determining whether an insurer has a duty to defend its insured is (1) the pleadings against the insured and (2) the terms of the insurance policy.

In this case, Karla Flores Guevara ("Guevara") obtained an automobile insurance policy from Loya Insurance Company ("Insurer") which explicitly excluded her husband, Rodolfo Flores ("Flores"), from coverage. At a later date, Flores was driving Guevara's car and was in a car crash with two individuals (the "Hurtados"). Guevara, Flores, and the Hurtados collectively decided to tell law enforcement and the Insurer that Guevara was driving the car at the time of the collision. The Hurtados sued Guevara who was appointed counsel through her Insurer. Guevara admitted to her counsel that Flores was driving during the accident and her counsel relayed the information to her Insurer.

Her Insurer immediately denied Guevara defense and coverage. The trial court awarded the Hurtados $450,343.34 against Guevara. Guevara assigned her rights against her Insurer to the Hurtados who then brought this suit against the Insurer for negligent denial of defense and coverage, breach of the insurance contract, breach of the duty of good faith and fair dealing, and violation of the Texas Deceptive Trade Practices Act. The Insurer counterclaimed for breach of contract, fraud, and sought a declaratory judgment that it had no duty to defend or indemnify Guevara because Flores was not a covered driver. The evidence the Insurer needed to present to prove the collusive fraud fell outside the evidence usually allowed by the eight-corners rule.

The Texas Supreme Court held that extrinsic evidence is admissible to prove "collusive fraud" occurred. The Supreme Court of Texas also held that if the insurance provider has been "confronted with undisputed evidence [that] 'collusive fraud'" that occurred during the insured's attempt to gain coverage, then the insurance company does not owe the insured a duty to defend and need not obtain a declaratory

judgment prior to denying a defense. The important factor in "collusive fraud" is the collective arrangement between the parties to intentionally mislead the insurer.

This decision gives insurance companies a new, strategic tool to bypass providing a defense where "collusive fraud" is obvious. However, this tool carries a substantial risk should the insurance company choose to deny or withdraw defense on the basis of suspected "collusive fraud" prior to seeking declaratory judgment because if a court later decides that there was no fraud, the insurance company will have breached its duty to defend.

FEDERAL APPEALS COURT APPLIES EIGHT-CORNERS RULE AND STRICTLY CONSTRUES BUSINESS RISK EXCLUSIONS TO CONCLUDE PETITION TRIGGERED INSURER'S DUTY TO DEFEND

In *Gonzalez v. Mid-Continent Cas. Co*., 969 F.3d 554 (5th Cir. 2020), the Fifth Circuit Court of Appeals addressed whether the Insurer's duty to defend triggered.

In 2013, Gilbert Gonzales ("Gonzales") was hired by Mr. Hamilton to install siding on Hamilton's house. In 2016, Hamilton's house was damaged in a fire. Hamilton sued Gonzales alleging that when Gonzalez installed the siding, he punctured the electrical wiring when he hammered the siding in with nails. This allegedly created a dangerous condition that ultimately produced the house fire three years later in 2016. In 2013, Gonzales had a commercial general liability policy issued by Mid-Continent Casualty Company when he performed the construction work. The policy canceled in June of 2014. Mid-Continent denied coverage to Gonzales on the basis that Hamilton's complaint only alleged that the property damage occurred in 2016 and there were no allegations that property damage occurred before 2016 during the policy period.

The Fifth Circuit acknowledged that its analysis was constrained by the eight-corners rule. The Court reiterated that Mid-Continent's duty to defend did not arise if the alleged property damage occurred after the insurance policy was canceled, but is triggered if any of the property damage was alleged to have occurred while the policy was in effect.

The Petition contained the following paragraph describing the factual allegations forming the basis of the plaintiffs' claims and also alleged that Gonzalez's work occurred in 2013:

> The injuries and damages suffered by Plaintiffs and made the basis of this action arose out of an occurrence on or about December 1, 2016, at the property in question that relates back to construction and/or installation of siding occurring before the date of loss. The property in question had a fire caused by the construction and/or installation of siding by Defendants when Defendants improperly hammered nails through electrical wiring. Defendants were in charge of and oversaw the construction and/or installation of siding at the property in question, and their acts and/or omissions allowed a fire to occur.

Under Texas law, the relevant inquiry regarding whether property damage occurred "during the policy period" was when the property damage was alleged to have occurred, not when the date the property damage is discovered. According to the court, "[t]he Petition alleges numerous negligent acts that occurred in that year. These include allegations of "substandard work," "failure to proper[l]y inspect .

. . work on the property in question," "[f]ailure to perform safe construction and/or installation on the property in question," and "[o]ther acts of negligence." *** Furthermore, the Petition's description of the damages includes "actual damages to property contained within the property in question," such as the electrical wires. The Petition thus alleges that the electrical wires were damaged in 2013." The court noted that the Petition also alleged that the 2016 fire "relates back to [the] construction and/or installation of siding" in 2013.

Mid-Continent argued that the policy's j(5) and j(6) exclusions applied to preclude coverage. Those exclusions preclude coverage for property damage to: (1) "that particular part" of property on which Gonzales executed his work; and (2) that particular part of any property that must be restored, repaired, or replaced because Gonzales' work was incorrectly performed on it. Construing those exclusions strictly against Mid-Continent, the Fifth Circuit held that neither of the exclusions negated Mid-Continent's duty to defend.

> "The j(5) and j(6) exclusions apply only to 'that particular part' on which the insured 'performed' work. The plain and ordinary meaning of 'particular' is '[r]elating to a part or portion of anything; separate; sole; single; individual; specific; as, the particular stars of a constellation.' *** 'Part,' in turn, means 'something less than a whole.' … 'perform' means '[t]o carry out or into full execution; esp. some action ordered or prompted by another or previously promised; to put into complete effect; to fulfill; as, to perform another's will or one's vow; to perform certain conditions.' … Hamilton ordered Gonzalez to perform work on the siding. Gonzalez promised to do it. That was the individual, separate, sole, specific part of the home upon which Gonzalez agreed to perform work. Hamilton did not order Gonzalez—and Gonzalez did not promise—to work on the house's electrical wires. The house's internal wiring system is entirely separate from its external siding. And no reasonable person would think that a promise to install siding on the outside of a home carries with it a promise to (and liability for) work on the electrical system inside the home. The siding and wires are, in short, separate 'particular part[s].'

ENGAGING IN A CHOICE OF LAW ANALYSIS, THE FIFTH CIRCUIT DETERMINES THAT TEXAS LAW APPLIED TO AN UMBRELLA POLICY FINDING THAT THE "DOMINANT CONSIDERATION" IS THE PLACE OF CONTRACTING

In *E. Concrete Materials, Inc. v. Ace Am. Ins. Co*., 948 F.3d 289 (5th Cir. (Tex.) January 17, 2020), the Fifth Circuit Court of Appeals addressed (1) how to determine what state's law applies to the insurance agreement through a choice of law analysis and (2) whether the insurance company had a duty to defend or indemnify the insured in a lawsuit involving the unplanned discharge of "rock fines"(pellets produced during the course of quarry operations).

Eastern Concrete Materials ("E. Concrete") purchased a commercial umbrella insurance policy from Great American Insurance Company ("GAIC"). The policy contained a pollution exclusion which precluded coverage in the event that any pollutants were released or escaped the control of E. Concrete. In the underlying lawsuit, one of E. Concrete's subsidiaries unintentionally released "rock fines" into a local fishing creek in New Jersey. Local environmental agencies subsequently required E. Concrete to fund the removal of the "rock fines," clean and restore the creek, and pay the associated fines. E. Concrete sought

reimbursement under its umbrella policy. GAIC in turn filed suit seeking a declaratory judgment that it did not owe E. Concrete a duty to defend or indemnify the underlying suit based on the pollution exclusion in the policy.

The Fifth Circuit first addressed the district court's decision that it had personal jurisdiction over E. Concrete, finding that the district court properly exercised jurisdiction. The court then resolved what law governed the insurance policy (Texas vs. New Jersey), in order to determine the applicability of the pollution exclusion. The court noted the rule that when a contract contains no choice-of-law provision and no statute indicates which law to apply, Texas courts apply the "law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties" – also known as the "most significant relationship" rule.

The facts showed that E. Concrete was a New Jersey corporation that operates rock quarries in New Jersey. It is a wholly-owned subsidiary of U.S. Concrete, a Delaware corporation with its principal place of business in Euless, Texas. At least two of Eastern Concrete's officers—its president and secretary—live in Texas, where they also serve as officers for U.S. Concrete. U.S. Concrete purchased the umbrella insurance policy for itself and more than sixty subsidiaries, including E. Concrete, from GAIC, an Ohio Corporation. The GAIC Policy, which provides nationwide coverage to the named insureds, was negotiated, brokered, and issued in Texas.

The district court held that "Texas has the most significant relationship to the substantive issue to be resolved, that is, whether the absolute pollution exclusion precludes insurance coverage." In support, the court observed that: the GAIC Policy "was negotiated, brokered, and issued in Texas"; "Texas courts would not give weight to the location of the insured risk" because the policy is national in scope; U.S. Concrete's "justified expectations," as purchaser, "would be met by application of Texas law"; and New Jersey's interest is small because "the cleanup has already taken place."

The Fifth Circuit agreed with the district court, holding that the primary factor in resolving the choice of law analysis is "the place of contracting, not the place of the underlying incident." The court noted that GAIC pointed out "giving [controlling] weight to the location of the insured risk would potentially subject an insurer, through one contract, to the laws of numerous states on issues that are more appropriately determined by the state's law that promulgated the policy form at issue." In addition, it stated, where the harms have been remedied, "a state 'has little interest in whether any settlements or judgments are paid by [the insured], or instead, by its insurers, or in regulating the scope of a pollution exclusion clause contained in an insurance policy issued in [a different state].'" Because Texas was the state where the insurance policy was contracted, Texas law applied to the policy. Applying Texas law, the court affirmed the district court's determination that GAIC had no duty to defend and indemnify E. Concrete due to the policy's pollution exclusion.

THE FIFTH CIRCUIT FINDS A BUILDER'S RISK POLICY'S "ENSUING LOSS" PROVISION PRELUDES COVERAGE FOR THE CLAIM

In *Balfour Beatty Constr. v. Liberty Mut. Fire Ins. Co*., 968 F.3d 504 (5th Cir. 2020), the Fifth Circuit Court of Appeals addressed whether an "ensuing loss" provision within a commercial inland marine policy that included builders' risk coverage precluded coverage. Balfour Beatty Construction

("Balfour") was hired by Trammel Crow (developer) as the general contractor for the construction of a large commercial office building in Houston. Balfour subcontracted with Milestone for the erection of structural steel, stairs, and ornamental steel on the Project. Balfour obtained the builders' risk policy from Liberty Mutual Fire Insurance Company. The insurance policy included both Balfour and Milestone as additional insureds on the policy. Several months after construction began, a previously welded material fell down the side of the building damaging the windows on the lower floors. Trammell Crow, Balfour, and Milestone tendered the claim to Liberty under the Policy. Liberty denied coverage.

The Policy contained a general insuring clause, under which Liberty insured risks of loss or damage, to the extent those losses are not caused by an excluded peril. Under the exclusionary clause, Liberty will not cover losses "caused by" or "resulting from . . . act[s], defect[s], error[s], or omission[s] . . . relating to . . . construction" (the "Exclusion"). However, under the exception to the Exclusion, Liberty will cover any loss caused by "an act, defect, error, or omission" that "results in a covered peril" (the "Exception"). A covered peril is a "risk[] of direct physical loss or damage unless the loss is . . . caused by a peril that is excluded." Liberty conceded that the window damage was a "direct physical loss or damage" that falls under the general insuring clause. And the parties agreed that, absent the Exception, the Exclusion would bar coverage to Balfour and Milestone because the window damage resulted from Milestone's construction or installation activity. Therefore, the question was whether the Exception applied to reinstate coverage for the claim, that is, did the " act, defect, error, or omission" "result[ed] in a covered peril."

Balfour argued that the "ensuing loss" exception to the exclusion provided it with coverage. The court held that a plain reading of the Exception showed that it does not reinstate coverage for the claim. "A ensuing loss provision like the one presented here is only triggered when one (excluded) peril results in a distinct (covered) peril, meaning there must be two separate events for the Exception to trigger." The court found that the welding operation involved falling slag, which damaged the exterior glass of the building and thus, the welding operation is inseparable from the falling slag; they were not two separate events. The falling slag is not an independent event that "resulted in a covered peril." Instead, the falling slag during the welding operation constituted damage, caused by an act of construction or installation, to the exterior glass. The court also held that even if the falling slag was separable from the welding operation, it was not a "covered peril." Thus, the claim was not covered because it fell within the Exclusion.

THE FIFTH CIRCUIT DETERMINES A PRIMARY INSURER'S REJECTION OF A $2M STOWERS DEMAND WAS UNREASONABLE, ALLOWING EXCESS CARRIER TO RECOVER AMOUNTS IT CONTRIBUTED TO POST-VERDICT SETTLEMENT.

Mark Braswell died after his road bike collided with a stopped truck. His survivors (the Braswells) sued the truck's owner, the Brickman Group Ltd., LLC. Brickman was primarily insured by ACE and secondarily insured by AGLIC. ACE rejected three Braswell settlement offers before and during trial, and the jury awarded the Braswells nearly $28 million. The Braswells and Brickman eventually settled for nearly $10 million, of which AGLIC, the excess carrier, paid nearly $8 million. AGLIC sued ACE for equitable subrogation, arguing that because ACE violated its *Stowers*[1] duty to

[1] *G.A. Stowers Furniture Co. v. Am. Indem. Co.*, 15 S.W.2d 544 (Tex. Comm'n App. 1929)) ("*Stowers*").

accept one of the three settlement offers for the primary policy limits, ACE had to cover AGLIC's settlement contribution. The district court agreed on both counts, holding that all three demands invoked the *Stowers* duty. The Fifth Circuit Court of Appeals agreed that ACE's *Stowers* duty was triggered but only by the Braswells' third offer, and that ACE violated its duty to settle the lawsuit for the primary policy's limits ($2 million).

Under Texas law, the *Stowers* duty requires an insurer "to exercise ordinary care in the settlement of claims to protect its insureds against judgments in excess of policy limits." But not all settlement demands give rise to a *Stowers* duty. "The *Stowers* duty is not activated by a settlement demand unless: (1) the claim against the insured is within the scope of coverage, (2) there is a demand within policy limits, and (3) the terms of the demand are such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to an excess judgment." Further, *Stowers* applies only when "the settlement's terms [are] clear and undisputed." The offer "must also be unconditional" and cannot "carry[] risks of further liability."

The only settlement offers at issue in the case were the second and third offers. With regard to the second offer, the court held that the record before it showed that the second offer to settle for "$1.9MM to $2.0MM *with costs*" was ambiguous because the parties had different interpretations of what the term "with costs" meant (there was "great confusion" according to the court).

The third offer, however, removed the "with costs" portion of the offer and stated it was an unconditional offer by all plaintiffs to settle all claims against all defendants for the total sum of $2 million, the underlying policy's limits. ACE made three arguments why the third offer did not generate a *Stowers* duty, but the court addressed only one. ACE's argument was: because Michelle Braswell (the wife of Mark Braswell), individually, asserted claims alongside her minor children, whom she represented as next friend, this generated adverse interests and mandated at least court and perhaps guardian ad litem approval of any settlement. Therefore, the requirements of third-party approval for a settlement made the plaintiffs' demand inherently "conditional." The Court of Appeals stated that because no Texas court had ruled on this issue in the *Stowers* context, it must make an "*Erie*" guess.

The court stated the general rules in Texas that (1) "[a] minor does not have the legal capacity to employ an attorney or anyone else to watch over her interests . . . . [Instead] Rule 44 of the rules of civil procedure authorizes appearance by a next friend," (2) "If an adverse interest arises between the real plaintiff and next friend, the next friend is no longer competent to represent the minor," (3) "If the court determines that a conflict exists, the court must appoint a guardian ad litem," (4) If no guardian ad litem is appointed when required, "a judgment entered in favor of a minor . . . is not binding on him, and he may thereafter sue to have it set aside," and (5) even if a guardian is properly appointed and agrees to the settlement, "a judgment ratifying the compromise cannot be rendered without a hearing and evidence that the settlement serves the minor's best interest."

Based on these rules, the Court of Appeals stated if the third settlement offer had been accepted and *if* the trial court perceived an adverse interest between Michelle and her children, the trial court would have had to appoint a guardian ad litem who, along with the court, had to approve the settlement in order to bind the minors. With that said, however, "Texas courts have not explicitly determined whether the uncertainty about judicial and third-party approval necessarily creates an unacceptable 'risk[] of further liability' that precludes a *Stowers* duty."

The court found that there was no evidence that the settlement offer was more favorable to

Michelle than her children or that Michelle was operating with interests adverse to those of her children or that had the third settlement offer been accepted, Michelle would have placed maximizing compensation for her own injuries above her children's claims. The court concluded: "…we do not read Texas law to *require* guardian ad litem appointment—and thus third-party approval—in this or every case where a parent serves as next friend for her children. And because such appointments are not required, we cannot conceive that every settlement generated in a case involving claims of a parent on behalf of herself and children violates *Stowers* because of a bare potential conflict of interest." Because the record was "void of any specter of adverse interests between Michelle and her children had the third lump sum settlement offer been accepted," her children would have been bound by it. Accordingly, the third offer generated a *Stowers* duty because it "proposed to release the insured fully" and it was *not conditional*.

With regard to the third *Stowers* element, that an ordinarily prudent insurer would have accepted the offer, the court concluded on the record before it, and the adverse rulings that occurred during the trial prior to the third settlement offer, the evidence was clearly sufficient to show that a reasonably prudent insurer would have settled for the $2 million ACE policy limits.

SOUTHERN DISTRICT OF TEXAS FINDS PROFESSIONAL SERVICES EXCLUSION APPLIED TO PRECLUDE COVERAGE IN WRONGFUL DEATH SUIT

In *Project Surveillance, Inc. v. Travelers Indem. Co.,* CA No.: 4:19-CV-03324, 2020 U.S. Dist. LEXIS 9383 (S.D. Tex. January 21, 2020), the district court for the Southern District of Texas addressed whether a professional services exclusion in a CGL policy applied to preclude the insurer's duty to defend in a wrongful death lawsuit.

In *Project Surveillance*, Project Surveillance, Inc. ("Project Surveillance") was sued by a number of plaintiffs bringing claims of negligence against Project Surveillance for the death of Mario Tejada Melchor, an individual who died while working on a construction project ("Underlying Lawsuit"). The plaintiffs in the Underlying Lawsuit alleged that Project Surveillance was hired to provide safety supervision or other services for the project and was negligent because Project Surveillance: 1) failed to inspect or adequately inspect the project, 2) failed to warn or adequately and timely warn, 3) failed to assure that the project was being conducted in a safe manner, 4) failed to verify that sloping, shoring or a trench box was being provided, 5) failed to report or require sloping, shoring or trench box for trenching or excavation, and 6) failed to stop work when adequate sloping, shoring or trench box was not being used. Although Project Surveillance's professional liability insurance carrier assumed its defense in the Underlying Lawsuit, Project Surveillance's commercial general liability ("CGL") carrier, Travelers Indemnity Company ("Travelers") declined to defend, claiming that the CGL policy's professional services exclusion applied.

Traveler's CGL policy included an exclusion entitled "EXCLUSION- ENGINEERS, ARCHITECT OR SURVEYORS PROFESSIONAL LIABILITY," which precluded coverage for damages arising out of the rendering or failure to render any professional service. The term "professional service" was defined as any service requiring specialized skill or training, and included a list of tasks. Following Traveler's declination, Project Surveillance filed an action in the Southern District of Texas, seeking a declaratory judgment that Travelers owed a duty to defend and indemnify Project Surveillance in the Underlying Lawsuit. Traveler's moved to dismiss, arguing that every allegation against Project

Surveillance constituted an excluded professional service under Traveler's CGL policy. The district court agreed with Travelers and granted its motion to dismiss.

In reaching its decision, the court noted that the Underlying Lawsuit alleged that Project Surveillance was retained to provide "safety supervision or other services for the project." Safety supervision constituted a "professional service" because it required specialized skill or training. Moreover, the court noted that the CGL policy's list of examples of professional services included many "supervision-related activities" such as failure to "prepare … [give] any warning," "supervisions," "inspection," "control," "surveying activity or service," "job site safety," ""construction administration," and "monitoring .. necessary to perform any of [those] service." Also, Project Surveillance did not dispute that safety supervision was a professional service. However, Project Surveillance argued that because the plaintiffs in the Underlying Lawsuit alleged that Project Surveillance was retained to provide "other services" in addition to supervision, the professional services exclusion did not preclude Travelers' duty to defend. The court disagreed, finding that there were six specific allegations of negligence against Project Surveillance in the Underlying Lawsuit, all of which, even if construed liberally, arose out of failure to provide safety supervision, which was a covered professional service.

CGL POLICY'S EXCLUSIONS FOR "EARTH MOVEMENT" AND "DEFECTIVE WORK" PRECLUDE INSURER'S DUTY TO DEFEND AND INDEMNIFY HOMEBUILDER

In *Mid-Continent Cas. Co. v. McCollum Custom Homes,* No. 4:18-CV-4132, 2020 U.S. Dist. LEXIS 118505 (S.D. Tex. 2020), the Southern District of Texas addressed whether an insurance policy's exclusions for "Earth Movement" and "Defective Work" triggered then insurance company's duty to defend.

The Mark family bought a "spec" home in Houston, Texas from the seller and general contractor, McCollum Custom Homes ("McCollum"). Shortly after the home was completed, the Mark family moved in. They discovered a multitude of issues with the home's foundation, including cracks in the drywall, mortar, and bricks, leaking windows, and foundation shifts. McCollum had a commercial general liability (CGL) insurance policy (the "Insurance Agreement") with Mid-Continent Casualty Company. The Mark family brought suit against McCollum for damages arising from the defects in construction. The Insurer began providing defense to McCollum under a reservation of rights while simultaneously seeking declaratory judgment that the Insurance Agreement did not impose a duty to defend McCollum in the underlying suit because the damages fell under the "Earth Movement" and "Defective Work" exclusions.

The Southern District of Texas determined that there were three categories of damage where the Insurer's duty to defend could arise. The first category included the flooring damages alleged to have been caused by McCollum mishandling materials. McCollum argued that the damages to the floors were not encompassed in the "Earth Movement" exclusion however; the Southern District of Texas agreed with the Insurer that the flooring damages fell within the "Defective Work" exclusion. The court reasoned that the alleged flooring damages could have only resulted from McCollum's work being "defective, deficient, non-conforming," or from "fail[ing] to meet industry practice standards" which clearly fell within the "Defective Work" exclusion. Therefore, the first category did not trigger Mid-Continent's duty to defend.

The second category included the pool damages. McCollum claimed the underlying cause of the defect may be attributable to a third-party's negligence. However, the court noted that it was constrained by the eight-corners rule to only consider the Petition and the policy. Thus, it did not consider the third-party's actions. The court ruled that the policy did not cover the third-party's negligence, and even if it did, the damage fell within the "Earth Movement" exclusion. Thus, the second category of property damage also did not trigger Mid-Continent's duty to defend.

The third category included a laundry list of remaining defects/damages. The court determined the policy explicitly excluded all of the items on this list from coverage under the "Earth Movement" exclusion. The court based this decision on McCollum's statements in the First Amended Original Petition:

> "The foundation movement is a major problem but is not the only one. The foundation movement contributed to and/or caused other significant problems."

which illustrated that the foundation shifting due to the Earth's movement at the very least contributed to the list of damages. This contribution of the Earth's movement, no matter how small, triggered the "Earth Movement" exclusion and precluded Mid-Continent's duty to defend.

INSURED'S SUIT FOR EXTRA-CONTRACTUAL DAMAGES WITHOUT A BREACH OF CONTRACT CLAIM ENDS IN DISMISSAL

In *Garza v. Allstate Fire & Cas. Ins. Co.*, No. 7:19-CV-129, 2020 U.S. Dist. LEXIS 101689 (S.D. Tex. 2020), the Southern District of Texas addressed whether an insured can bring an extra-contractual claim against their insurer without a breach of contract claim.

In the underlying case, Aaron Garza ("Garza") was involved in an automobile collision with a third-party ("Third-Party") who was at fault. Garza sustained $26,180.00 in medical expenses. The Third-Party offered Garza $30,000.00 (the Third-Party's insurance policy limit) to settle Garza's claims against him. Allstate Fire & Casualty Insurance Company ("Insurer") gave Garza permission to accept this settlement offer. After accepting, Garza claimed that the Third-Party's Insurance limit was not sufficient to cover his medical expenses. Garza submitted a claim to his Insurer under for uninsured motorist coverage. The Insurer informed Garza that his claim did not meet the threshold for an Underinsured Motorist claim.

Garza subsequently filed suit against his Insurer for violations of the Texas Insurance Code not for denying his claim, but rather for denying his claim without providing any explanation for it's denial. Garza claimed the Insurer committed three violations of Chapter 541 of the Texas Insurance Code. The alleged violations were "(1) failing to make a good faith attempt to effectuate a prompt, fair, and equitable settlement;" "(2) failing to provide adequate explanation;" and (3) refusing to conduct a reasonable investigation before denying a claim. The Insurer moved to dismiss the case for failure to state a claim upon which relief can be granted.

While Garza's suit against the Insurer is not rooted in the uninsured or underinsured motorist policies, the Southern District of Texas went through a lengthy analysis of what its decision would have been if that had been the case. Uninsured or underinsured motorist coverage is governed by tort law and the Texas Supreme Court held in *Brainard vs. Trinity Universal*, 216 S.W.3d 809 (Tex. 2006) that the

insured has the burden of proving it is "legally entitled" to recover damages from a third-party tortfeasor. Under *Brainard*, to prove "legal entitlement" to recover damages from a third-party tortfeasor, the insured must first obtain a judgment that establishes the third-party is both liable and underinsured. However, the Texas Supreme Court in *USAA Tex. Lloyds Co. v. Menchaca*, 545 S.W.3d 479 (Tex. 2018) outlined specific circumstances when the aforementioned judgment is not a prerequisite to bringing an extra-contractual claim. The court determined that Garza's claim was not encompassed within the circumstances outlined in *Menchac*a.

The court distinguished *Brainard* from the case at hand by highlighting that *Brainard* relief is sought from underinsured motorist coverage whereas Garza's desired relief stemmed from violations of the Texas Insurance Code. Since there was no claim for a breach of contract and Garza did not have a judgment against the Third-Party establishing the insured's legal entitlement to damages, Garza's only path to an extra-contractual remedy against the Insurer is if he was in compliance with the "independent-injury" rule. Garza had the burden to show that the Insurer's act was so extreme that it caused an injury not arising out of the policy, to satisfy the "independent-injury" rule. Garza attempted to make this argument, however the court relied on the five-part test established in *Menchaca*, that states "[a]n insured cannot recover any damages under the Insurance Code based on an insurer's statutory violation unless the insured establishes a right to receive benefits under the policy or an injury independent of a right to benefits." Because Garza did not sufficiently allege an independent injury as contemplated by the *Menchaca* decision, the court granted the Insurer's motion to dismiss the lawsuit for failing to state a claim upon which relief could be granted.

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