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MAY 2021 TEXAS INSURANCE LAW UPDATE

TEXAS SUPREME COURT DETERMINES DECLARATORY JUDGMENT ACTION MAY BE USED TO DETERMINE A CARRIER'S UM/UIM OBLIGATION AND THAT COURTS HAVE DISCRETION TO AWARD INSUREDS THEIR ATTORNEY FEES.

In *Allstate Ins. Co. v. Irwin*, No. 19-0885, 2021 Tex. LEXIS 415 (Tex. May 21, 2021)[1] (publication statue pending), the insured, Daniel Irwin, was injured in a motor vehicle accident with an underinsured motorist. At the time of the accident, Allstate insured Irwin's truck and Irwin's policy included UIM coverage up to $50,000. Irwin settled with the other driver for her $30,000 policy limits, and thereafter sought his UIM policy limits of $50,000. Allstate offered to settle for $500. Believing Allstate's offer inadequate, Irwin sued Allstate in a direct action, seeking a determination of his damages from the accident, a declaratory judgment that he was entitled to recover under his UIM policy, and attorney's fees. Irwin's pleadings invoked the Uniform Declaratory Judgments Act (UDJA) for all relief. Allstate's answer denied Irwin's claim to UIM benefits under the policy and demanded a jury trial. Before trial commenced, the parties stipulated to Irwin's coverage under the UIM policy and to Allstate's entitlement to an offset from Irwin's $30,000 settlement with the other driver. The case was tried to a jury, with Allstate contesting Irwin's evidence of causation and damages. The jury found Irwin's damages from the accident to be $498,960.36. Irwin moved for entry of judgment but Allstate objected to Irwin's

[1] It appears that Allstate is currently in the process of seeking a rehearing before the Court.

proposed judgment insofar as it awarded attorney's fees or invoked the UDJA, but otherwise agreed that it owed its UIM policy limits and court costs, both of which it tendered to Irwin. The trial court's judgment acknowledged Allstate's payment of its policy limits and court costs and awarded Irwin his attorney's fees.

Allstate appealed the award of attorney's fees. The court of appeals affirmed the award, holding that the UDJA was properly invoked to determine Irwin's entitlement to UIM benefits under the policy and a proper basis for the award of attorney's fees. Allstate argued that Irwin's use of the UDJA to determine his contractual rights and to seek attorney's fees in a UIM case impermissibly circumvented this Court's decision in *Brainard*. The Texas Supreme Court affirmed the court of appeals' decision.

The Court reiterated its holding in the seminal UM/UIM case, *Brainard v. Trinity Universal Ins. Co*., 216 S.W.3d 809 (Tex. 2006). In *Brainard*, the insured settled his tort claim before obtaining a judgment against the third-party tortfeasor but because there had been no determination of liability and damages in the underlying tort case, the carrier declined to pay the UIM claim. The insured sued for breach of contract. In the ensuing lawsuit, a jury determined liability and damages in the underlying tort case. Based on the jury's findings as to the third-party tortfeasor's liability and the insured's damages, the trial court rendered judgment for the insured, awarding UIM benefits under the policy and attorney's fees under Chapter 38 of the Civil Practice and Remedies Code. In the appeal that followed, the Texas Supreme Court reversed the award of attorney's fees, observing that the insurance carrier had not breached the policy by refusing to pay UIM benefits, absent the prerequisites for payment, reasoning that the carrier was under no legal obligation to pay those benefits until the insured obtained a judgment establishing the liability and underinsured status of the other motorist. Until those determinations are made, it explained, "no contractual duty to pay" arises and "no just amount [is] owed" and, without a liquidated amount due under the contract, no basis existed for an award of attorney's fees under Chapter 38. In *Brainard*, however, the Court noted that the insured was not required to litigate those issues against the third-party tortfeasor, but may instead settle the tort claim and litigate UIM coverage with its insurer.[2]

The Court held that a declaratory judgment action is the appropriate remedy to resolve what is essentially a contractual dispute between the insured and the UM/UIM insurer. Under the Act, any "person interested" under a written contract "may have determined any question of construction or validity" arising under that contract and "obtain a declaration of rights, status, or other legal relations thereunder." The Court noted that declarations under the Act can be both negative (non-liability) and affirmative (liability) and that the declaration has the force and effect of a final judgment or decree. Either party to a written contract may seek declaratory relief if there is a question regarding rights, status, or other legal relations arising under it and therefore, a declaratory judgment is appropriate when a real controversy exists between the parties, and the entire controversy may be determined by judicial declaration.

[2] *Id.*, at *6 (citing Brainard at 818)

With regard to attorney fees, the Court stated that unlike Chapter 38, Chapter 37's UDJA does not require an award of attorney's fees to anyone; rather, it "entrusts attorney fee awards to the trial court's sound discretion." Because the UM/UIM contract provides for a "unique" first-party insurance claim, the insurance carrier's failure to pay is not an actionable breach of contract until the carrier is bound by an appropriate judgment. But even though no breach has occurred, a justiciable controversy may arise as to the parties rights and status under the contract. When such a controversy exists, and a declaration of the parties' rights will terminate the controversy between the parties or otherwise serve a useful purpose, the remedy is available to the court. Part of the remedy the UDJA affords is a discretionary award of reasonable attorney's fees when equitable and just. With regard to the case before it, the court held that because Chapter 37 provides for the award of attorney's fees, and the UDJA had not been invoked simply to replicate issues already before the court that might implicate Chapter 38, the award was not erroneous.

TEXAS SUPREME COURT PREVENTS UIM INSURER FROM ENFORCING A SETTLEMENT MADE ON JURY VERDICT WITH NO JUDGMENT, REQUIRING INSURER TO LITIGATE ITS INSURED'S LEGAL ENTITLEMENT TO RECOVER DAMAGES FROM THE UNDERINSURED MOTORIST.

In another underinsured motorist (UIM) decision, *In Re USAA General Indem. Co*., --- S.W.3d ---, No. 20-0075, 2021 Tex. LEXIS 373, 2021 WL 1822944 (Tex. May 7, 2021), the Supreme Court of Texas held that a UIM insurer may not enforce a jury verdict that is not reduced to judgment, but is instead settled after the verdict and disposed of without rendition of a final judgment. *In Re USAA* involved an auto accident in which the injured claimant sued both the defendant driver (Baldor) and his own UIM insurer (USAA), seeking damages in excess of the Baldor's liability insurance limits. USAA demanded its own separate trial on its liability under the UIM coverage, and the UIM claim was bifurcated from the tort claim and abated. After trial, the jury found Baldor 100% responsible for the accident and awarded damages in excess of the Baldor's liability insurance ($30,000). They then settled for the amount of the jury award and court costs ($161,114.79) (an amount less that the insured claimed were its damages) and dismissed the tort portion of the case without a final judgment. After the settlement and dismissal of the tort portion of the case, USAA consented in writing to the settlement. Then, with the abatement lifted on the UIM portion of the case, USAA moved for summary judgment arguing that trial on the UIM claim was no longer necessary because the jury verdict and subsequent settlement conclusively established both liability and damages. The claimant argued USAA had consented too late and was not now entitled to claim its contract damages were limited to the underlying jury verdict and settlement.

The court explained that under a standard Texas automobile insurance policy, an insured seeking underinsured motorist (UIM) benefits may pursue a variety of options: (1) sue the insurer directly to establish the motorist's fault and the insured's damages without suing the motorist; (2) sue the underinsured motorist with the insurer's written consent, making the negligence judgment binding against the insurer for purposes of the insurer's liability under the UIM policy; or (3) sue

the underinsured motorist without the insurer's written consent and then relitigate the issues of liability and damages in a suit for benefits under the UIM policy. The consent requirement protects the insurer from being bound to a default judgment or an inadequate defense by the underinsured motorist, leaving it to the insurer to determine whether to rely on the motorist's defense.[3] In this case, USAA declined to participate in the jury trial to establish the motorist's liability and demanded a separate trial on its liability under the UIM policy. Arguing the jury verdict and settlement payment collectively negated its liability to the insured for UIM benefits, the insurer sought a writ of mandamus compelling the trial court to render judgment in its favor on the jury's verdict. The Texas Supreme Court denied the writ.

In the majority opinion, the court declined to apply the doctrine of collateral estoppel to prevent the negligence and damages issues from being re-litigated because collateral estoppel applies only to final judgments and the post-verdict dismissal was not a final judgment. In addition, because a UIM insurer's contractual liability depends on the damages the insured is "legally entitled to recover" from the underinsured motorist, only a judgment, not merely a jury verdict, establishes the amount the plaintiff in any lawsuit is legally entitled to recover.

With regard to USAA's post-dismissal consent, the court explained that the consent requirement in the UIM policy protects the insurer from a default judgment or an inadequate defense by the underinsured motorist. A consenting insurer forfeits that protection altogether, as USAA purported to do here, and binds itself to the negligence suit's outcome, not merely the portions beneficial to it. If the suit's outcome is a judgment establishing the amount of damages the motorist caused the insured, the insurer is bound by that judgment's effect: the damages the insured is legally entitled to recover have been determined. If the outcome is a dismissal prior to any judgment establishing that amount, the insurer is likewise bound by the dismissal's effect: the damages the insured is legally entitled to recover have not been determined. According to the court, an insurer cannot give piecemeal consent – it either consents or refuses to consent to the outcome as a whole, and may not consent only to the parts it likes. Because USAA consented to the outcome, it also implicitly consented to the verdict's lack of enforceability without a final judgment. Therefore, the parties had to start over and conduct a separate trial to determine its insured's legal entitlement to recover damages from the underinsured motorist.

Two justices dissented to the majority opinion, focusing in part on the fact that for unknown reasons, the defendant's liability insurer funded the entire settlement of $160,000, rather than merely paying its $30,000 limit. The dissenting justices reasoned that because the claimant was fully compensated by Baldor's liability insurer, Baldor did not meet the definition of an "underinsured motorist" and there could be no possible UIM exposure. They also discussed the fact that USAA had participated in post-verdict hearings, sought judgment on the verdict at that time, and opposed dismissal of the case. Thus, the dissent expressed concern that the outcome created an opportunity for a claimant to obtain one jury verdict, collude with the defendant to dismiss the suit without judgment if he is not happy with the number (even over his UIM insurer's objection, which happened here) and then try liability and damages a second time

[3] 2021 Tex. LEXIS 373, at *1-2.

against the UIM insurer, hoping for a larger number the second time around. The dissent also cited existing supreme court precedent which holds that a dismissal with prejudice is tantamount to a final judgment on the merits. While the dissent agreed collateral estoppel only applies to final judgments when a third party attempts to relitigate them in a later suit, they pointed out that here, USAA was not a third party, and these events all took place within the confines of a single lawsuit. Therefore, traditional notions of collateral estoppel did not apply anyway. The dissent concluded the trial court had abused its discretion by refusing to enter a judgment on the verdict as USAA had requested, and argued mandamus should have been granted to prevent a second lengthy and expensive trial on fact issues that already been decided by one jury.

FEDERAL COURT HOLDS THAT PUTATIVE ADDITIONAL INSURED'S NOTICE TO A COMMERCIAL GENERAL LIABILITY INSURER AFTER JUDGMENT WAS ENTERED AGAINST IT IN A PERSONAL INJURY ACTION WAS LATE AND PREJUDICED THE INSURER AS A MATTER OF LAW.

In *Liberty Ins. Corp. v. Arch Ins. Co.*, 2021 U.S. Dist. LEXIS 92121, 2021 WL 1950037 (N.D. Tex. May 14, 2021), a court of the Northern District of Texas held that a putative additional insured's notice to a commercial general liability insurer after judgment was entered against it in a personal injury action was late and prejudiced the insurer as a matter of law. The court further held that extrinsic evidence supported application of the policy's auto exclusion to preclude coverage for a trucking accident and that coverage was justiciable although the underlying lawsuit remained on appeal.

On March 19, 2012, Mortenson and L.O. Transport, Inc. ("L.O."), entered into a subcontract agreement pursuant to which L.O. agreed to perform aggregate hauling for Mortenson, which was the contractor for construction of a project in Archer County, Texas. The subcontract required L.O. to name Mortenson as an additional insured on its CGL and auto policies and also contained a contractual indemnity provision.

TIG is the successor by merger to American Safety Indemnity Company ("ASIC"), which issued two policies (a CGL policy and an excess policy) to L.O. as its insured. In addition, defendant Arch Insurance Company ("Arch") issued a policy to L.O. which included commercial auto coverage.

On April 11, 2014, James M. Shelton ("Shelton") filed a first amended petition against Mortenson and others in Cause No. CV14-04-241 in the 271st Judicial District Court of Wise County, Texas (the "underlying lawsuit"). In it, Shelton alleged that on or about April 12, 2012, he was driving an 18 wheeler tractor trailer combination with a full load of gravel on Bell Road in Archer County when two other empty tractor-trailers headed in the opposite direction failed to yield the right of way to him, forcing Shelton to run off the road to avoid a head-on collision. Shelton's truck rolled into a ditch on the side of the road and he sustained severe injuries. Shelton asserted causes of action for negligence, negligent hiring, negligent entrustment, negligent

supervision, and gross negligence against Mortenson. He did not name L.O. as a defendant. In his third amended petition filed April 9, 2015, Shelton added an allegation that the manner in which Bell Road was widened, constructed, maintained, and/or modified by Mortenson for the Project was also a proximate cause of his truck rolling.

In May 2014, Mortenson placed its commercial general liability carrier, Liberty, on notice of the underlying lawsuit. Liberty undertook the defense of Mortenson in the underlying lawsuit. By letter dated June 3, 2016, Liberty made demand on L.O. to reimburse it for defense costs of the underlying lawsuit. L.O. apparently forwarded Mortenson's demand to Arch, which, by letter dated September 23, 2016, denied coverage under its policy.

On February 13, 2017, Mortenson filed suit against L.O. under Cause No. CV17-02-130 in the District Court of Wise County, Texas, for breach of contract arising out of the failure of L.O. to defend Mortenson in the underlying lawsuit. On November 1, 2018, L.O. filed a voluntary petition under Chapter 7 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Western District of Texas. Mortenson did not make an appearance in the bankruptcy case. The underlying lawsuit was tried in July 2019 and the jury returned a verdict against Mortenson. The final judgment was signed August 27, 2019. Mortenson appealed and the appeal was currently pending at the time of the Northern District's opinion in the case.

On August 13 or 15, 2019, L.O. tendered the defense of Cause No. CV17-02-130 (the contractual indemnification claim), to TIG's predecessor, ASIC. By letter dated November 19, 2019, ASIC denied the claim.

On February 5, 2020, Liberty filed its complaint in this action. Liberty sought defense and indemnity of Mortenson in the underlying lawsuit as an additional insured under the ASIC policies. It also sought to recover as contractual indemnitee under the subcontractor agreement between Mortenson and L.O., saying that it is subrogated to that right. This lawsuit was the first notice TIG received that Mortenson sought defense and indemnification in the underlying lawsuit as an additional insured under the ASIC policies.

TIG asserted three grounds in support of its motion for summary judgment: (1) TIG had no duty to defend or indemnify Mortenson as an additional insured under the ASIC policies due to Mortenson's and plaintiff's material breach of the policies' notice provisions; (2) coverage was excluded by the ASIC CGL policy's auto exclusion, and (3) Mortenson was not an insured under the ASIC excess policy. Citing to the ASIC policy's notice provisions, that court stated:

> When a commercial general liability insurance policy requires notice of a claim or suit "as soon as practicable," the failure to give such notice defeats coverage if the insurer was prejudiced by the delay. Texas courts have recognized that prejudice occurs as a matter of law when: (1) the insurer, without notice or actual knowledge of a suit, receives notice after entry of default against the insured; (2) the insurer receives notice of the suit and the trial date is fast approaching, thereby depriving it of an opportunity to investigate or mount an

> adequate defense; (3) the insurer receives notice of a lawsuit after the case has proceeded to trial and judgment has been entered against the insured; or (4) the insurer receives notice of a default judgment against its insured after the judgment becomes final and nonappealable. The insurer has no duty to notify the insured of coverage and no duty to defend until the insured notifies the insurer that it has been served with process and expects the insurer to defend. Once the case is over-that is, the jury has returned its verdict—notice is clearly too late. The cows have long since left the barn.[4]

In this case, the summary judgment evidence established that the underlying lawsuit was filed against Mortenson on April 11, 2014; Mortenson gave notice to plaintiff in May 2014 and plaintiff undertook Mortenson's defense; the jury returned its verdict on July 19, 2019; final judgment was signed August 27, 2019; TIG was not placed on notice of any claim for the defense and indemnification of Mortenson as an additional insured in the underlying lawsuit until February 7, 2020, when it received plaintiff's complaint in this action. The court concluded that notice was clearly untimely and prejudicial to TIG as a matter of law. Citing to *Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. Crocker*, 246 S.W.3d 603, 609 (Tex. 2008), the court held that L.O.'s tender of the underlying lawsuit to TIG for defense and indemnity on August 15, 2019 did not impose any duty on TIG to defend or indemnify Mortenson and that TIG was not obligated to act unless and until Mortenson made demand on it. And, apparently contrary to Mortenson's argument, there was no probative summary judgment evidence to support the allegation that TIG knew at any time before the filing of this lawsuit that Mortenson was demanding defense and indemnity of the underlying lawsuit as an insured under the ASIC policies.

FEDERAL COURT DETERMINES CINEMARK'S COVID-19-BASED INSURANCE CLAIM UNDER ITS "ALL RISKS" INSURANCE POLICY CAN MOVED FORWARD.

In *Cinemark Holdings v. Factory Mut. Ins. Co.*, Civil Action No. 4:21-cv-00011, 2021 U.S. Dist. LEXIS 90124 (E.D. Tex. May 5, 2021), Cinemark, the insured under an "all risks" policy which expressly included coverage for physical loss or damage by a communicable disease, won the chance to keep litigating its claims against its insurance company, Factory Mutual, seeking losses under a $500 million policy for business interruption due to COVID-19.

In early 2020, during the COVID-19 pandemic, over 1,700 Cinemark employees tested positive for, were exposed to, or displayed symptoms of COVID-19. Most of these employees were on Cinemark property just before testing positive. As a direct result of the damage caused by COVID-19 to its property, Cinemark was forced to close its theaters, incurring business income loss. Cinemark relied on its insurance coverage and submitted a claim to Factory Mutual in early, 2020. The Policy insures "against ALL RISKS OF PHYSICAL LOSS OR DAMAGE, except as

[4] *Id.* at * 9 -10 (citations omitted).

hereinafter excluded, while located as described in this Policy." The Policy also "insures TIME ELEMENT loss . . . directly resulting from physical loss or damage of the type insured." The Policy also had "Additional Coverages" which include coverage for "Communicable Disease Response" and "Interruption by Communicable Disease."

When Cinemark sued in November 2021, Factory Mutual had not issued a coverage position. In the lawsuit, Factory Mutual filed a Motion for Judgment on the Pleadings arguing that Cinemark had not alleged physical loss or damage, and that the Policy's Contamination Exclusion barred the claims. Factory Mutual argued the claims should be dismissed in a motion for judgment on the pleadings. It argued Cinemark did not allege a physical loss or damage, and that there was a contamination exclusion that should bar the claims. Cinemark disagreed, countering that the policy did cover physical loss or damage caused by communicable diseases.

The federal judge found that Cinemark had alleged plausible claims and therefore denied Factory Mutual's motion to dismiss on the pleadings. The court explained that the present case was different than another recent business interruption case that the judge did dismiss (*Selery Fulfillment v. Colony Insurance*). There, a company alleged that a government shutdown order caused a loss or damage to its property. The policyholder in *Selery* did not allege COVID-19 had entered its property. A covered physical loss required a physical alteration of the property, the judge ruled in the previous case. The judge found the Cinemark allegations were different: "Unlike *Selery*, Cinemark alleges that COVID-19 was actually present and actually damaged the property by changing the content of the air." *Id*. at *7. "Cinemark's policy is much broader than the one in *Selery* and expressly covers loss and damage caused by 'communicable disease.'" *Id.*

FIFTH CIRCUIT UPHOLDS JUDGMENT IN FAVOR OF EXCESS INSURER UNDER EXCESS LIABILITY POLICY WHERE THE CARRIER HAD THE RIGHT, BUT NOT THE DUTY, TO DEFEND.

In *Tex. Disposal Systems, Inc. v. FCCI Ins. Co.*, ---F.3d ---, No. 20-50274, 2021 WL 1805865 (5th Cir. May 5, 2021), the Fifth Circuit examined the defense obligations of excess carriers, affirming summary judgment for an excess insurer whose policy included a right, but not a duty, to defend the insured after exhaustion of the underlying policy limits.

This case involved an insured (TDS) who had a "tower" of four automobile liability insurance policies: FCCI provided primary coverage with a limit of $1 million per accident, then Rockhill Insurance Company followed by Liberty International Underwriters, Inc., with excess coverage of $1 million and $10 million, respectively. Finally, at the top of the tower, Arch provided excess coverage with a limit of $5 million. The first three policies imposed successive duties to defend. By contrast, the Arch policy gave Arch the "right[,] but not the duty," to defend covered claims upon the exhaustion of the FCCI, Rockhill, and Liberty policies. If Arch did assume TDS's defense, the policy provided that Arch "may . . . withdraw from the defense" upon the exhaustion of its coverage limit. Additionally, the policy gave Arch "the right, but not the duty, to be

associated with the insured or the underlying insurers or both in the investigation of any claim or defense of any [covered claim]."

FCCI, the primary carrier, defended TDS against a wrongful death case. Ultimately, the first three insurers reached partial settlements with various plaintiffs that exhausted their limits. Once the settlements were paid, they tendered the remaining unsettled claims to Arch, and FCCI terminated its defense. Arch declined to assume the defense, pointing out its policy did not require it to do so. TDS defended itself through the conclusion of trial and then sued both FCCI and Arch for the disputed defense costs and extra-contractual damages.

In the ensuing coverage lawsuit, TDS argued Arch either modified the policy by agreeing to defend it, or had already assumed the defense and was prevented from withdrawing it. The Fifth Circuit rejected the notion that a contract could be modified by the unilateral acts of one party without a clear meeting of the minds reaching a new agreement supported by consideration and found that there was no evidence that any such agreed modification had occurred in that case.

Under the excess policy, Arch could not assume the defense until "the total Limits of Liability of [the] underlying insurance . . . [were] exhausted solely by payment of loss." This condition was not satisfied until the Rockhill and Liberty policies were exhausted—five days after Arch notified TDS that it was declining to exercise its right to assume TDS's defense. TDS argued that Arch waived this condition on its right to defend. However, an insurer can only waive policy provisions intended for the insurer's benefit. The court found that the excess policy terms actually prevented Arch from assuming the insured's defense until the underlying policies had been exhausted by payment of judgment or settlements, which protects the underlying insurers from having their defense of the insured interfered with by a meddling excess carrier. Thus, Arch did not waive this condition on its right to defend and the district court correctly granted Arch summary judgment on the breach-of-contract claim.