FALL 2013 NEWSLETTER

INSURANCE LAW UPDATE

By Jennifer Kelley

THE FIFTH CIRCUIT

***In re Deepwater Horizon v. Transocean Offshore Deepwater Drilling, Inc.*, 728 F.3d 491 (5th Cir. La. 2013).**

In *Deepwater Horizon*, the Fifth Circuit, applying Texas law, originally held that when a service provider agrees to secure additional insured coverage for a service purchaser and to indemnify the service purchaser for certain claims, the terms of the insurance policy determine the insurer's obligations which may not be limited to those stated in the indemnity provision. However, on rehearing, the Fifth Circuit withdrew its earlier opinion and certified two questions to the Supreme Court of Texas, acknowledging that there were important and determinative questions of Texas law for which there is no controlling Texas Supreme Court precedent.

The Fifth Circuit observed: "The Texas Supreme Court has never recognized a sophisticated insured exception to the general rule of interpreting insurance coverage clauses, nor has it ever indicated *contra proferentem* would not apply in construing these clauses." However, "it is possible that such an exception may be deemed appropriate in a case like this, where all the parties involved are highly capable contractors." For example,

> [o]n the one hand, the facts here indicate Insurers were not involved in drafting the Drilling Contract, and thus construing ambiguities in that contract against them might be inappropriate. But on the other, the Insurers were involved in drafting the umbrella policy language at issue, and the failure of that policy language to limit coverage in underlying "Insured Contracts" to the liabilities assumed by the named insured in those contracts is part of what ails the Insurers now.

Accordingly, the Fifth Circuit certified the following two questions to the Supreme Court of Texas as issues of first impression:

> 1. Whether *Evanston Ins. Co. v. ATOFINA Petrochems., Inc.*, 256 S.W.3d 660 (Tex. 2008), compels a finding that BP is covered for the damages at issue, because the language of the umbrella policies alone determines the extent of BP's coverage as an additional insured if, and so long as, the additional insured and indemnity provisions of the Drilling Contract are "separate and independent"?
>
> 2. Whether the doctrine of *contra proferentem* applies to the interpretation of the insurance coverage provision of the Drilling Contract under the *ATOFINA* case, 256 S.W.3d at 668, given the facts of this case?

FEDERAL DISTRICT COURTS

***Jack Terry and Eden Terry v. Safeco Ins. Co. of America*, No. H-10-0340, 2013 U.S. Dist. LEXIS 132859 (S.D. Tex. Sept. 17, 2013).**

In *Terry*, the Southern District of Texas, Houston Division, held that the five-day-payment provision under Chapter 542 of the Texas Insurance Code (Prompt Payment) does not require payment of every settlement offer within 5 days. The district court also held that Chapter 542 does not require "rolling" payouts every five days even if the insured rejects a settlement offer and demands more, and the insurer increases its offer. In this uninsured-motorist insurance case, the insureds and the insurer entered into negotiations to settle the insured's' medical costs. The insurer rejected the insureds' initial demand because it determined that the insureds were partially at fault for the auto accident. After several negotiation moves by both parties to settle all of the claims, the insureds sued their insurer alleging that their insurer failed to "timely acknowledge, investigate, accept, and pay the claim." The district court disagreed with the insureds, explaining that the insurer's settlement offers were not a partial acceptance of the claim under the prompt-payment statute. The insurer rejected its insureds' demand before offering settlement, and the insurer's settlement offers stated the reasons why Safeco was not approving payment of the full amount. The district court, therefore, concluded that the insurer's approval of part of the claim for settlement purposes was not a notice of acceptance for the purpose of the prompt-payment statute.

SUPREME COURT OF TEXAS

***Lennar Corp. v. Markel American Ins. Co.*, No. 11-0394, 2013 Tex. LEXIS 597 (Tex. Aug. 23, 2013).**

In *Lennar*, the Supreme Court of Texas held that an insurer is responsible for the costs of a settlement that it does not consent to if the insurer is not prejudiced. The supreme court also held that, under the terms and conditions of the subject policy, the insurer was responsible for the insured's remediation costs.

Trial Court and Court of Appeals Proceedings

From 1992 to 1998, Lennar Corporation ("Lennar") and its predecessor built homes using an imitation stucco siding called an Exterior Insulation and Finish System ("EIFS"). It was later discovered that the EIFS trapped moisture, which resulted in damage to the EIFS and to the building materials beneath it.

After a national television program televised a story on the moisture problems caused by EIFS, Lennar began receiving phone calls from concerned homeowners. In response, Lennar developed a "voluntary business plan" to inspect and repair the EIFS on many of the homes. When the repairs failed to solve the moisture problems, Lennar decided to remove the EIFS on all of the homes and replace it with conventional stucco, regardless of whether any particular home had suffered water damage.

Lennar filed suit against its liability insurers, including Markel American Insurance Company ("Markel"), which issued excess coverage. The trial court granted summary judgment in favor of Markel, holding that coverage did not exist for Lennar's losses. The Houston [14th Dist.] Court of Appeals, however, reversed the judgment in part holding that the costs to repair water damage and the costs to remove EIFS to repair underlying water damage were covered, but also holding that the costs to remove and replace EIFS as a preventative measure on homes that had not yet suffered water damage were not covered. The appellate court remanded the case to the trial court, and specifically instructed Lennar to apportion its loss among those costs that were covered and those that were not.

On remand to the trial court, Lennar argued that it could not determine if water damage had occurred without first removing the EIFS. It asked the jury to award damages for the costs to remove the EIFS on all homes, without regard to whether any home had actually sustained damage. Lennar did not offer any evidence of the costs it incurred to remove EIFS solely from the damaged portions of homes. After a jury trial, the trial court awarded Lennar nearly $3 million in actual damages. Markel appealed, arguing that it did not owe coverage for any of the damages because Lennar failed to apportion the covered portion of the judgment from the uncovered portion.

The Houston [14th Dist.] Court of Appeals agreed with Markel's argument, reasoning that because Lennar bore the burden to establish the amount of covered damages under the Markel policy, it had the burden of presenting evidence from which the jury could allocate between covered and uncovered damages at trial. Thus, because Lennar failed to do so, it failed to meet its burden to prove what damages were covered. Consequently, the appellate court held that coverage was barred for the entire claim.

The appellate court also held that Lennar had failed to establish that any of the costs it incurred fell within the definition of "ultimate net loss" under the Markel policy. The policy defined "ultimate net loss" as "the total amount of damages for which the insured is legally liable in payment of . . . 'property damage.'" The policy provided that "ultimate net loss" could be established "by adjudication, arbitration, or a compromise settlement to which we [Markel] have previously agreed in writing." Because there had not been any adjudication or arbitration of any claims, and because Lennar had settled the claims without Markel's written consent, the appellate court held that the payment of the losses did not satisfy the definition of "ultimate net loss." Accordingly, the appellate court held that the losses were not covered on this basis too.

Notably, the appellate court had earlier held in the prior appeal that Markel would need to establish prejudice in order to prevail on a coverage defense based on a breach of the voluntary payment clause in the conditions section of the policy. The court of appeals, however, held that prejudice was not required to be shown when an insurer challenges whether the claim falls within the grant of coverage to begin with—that is, whether the losses fell within the definition of "ultimate net loss." The appellate court concluded that injecting a prejudice requirement into the analysis of "ultimate net loss" would require the court to rewrite the policy, which Texas law prohibits.

The Houston [14th Dist.] Court of Appeals reversed the trial court's judgment and the Texas Supreme Court granted petition for review.

Supreme Court of Texas Proceedings

At issue before the Supreme Court of Texas was whether Markel was responsible for: (1) costs when Lennar settled without Markel's consent and (2) costs to determine whether or not the property was damaged and costs to remediate damage that began before and continued after the policy period.

With regard to an insurer's responsibility for settlement costs, the supreme court noted that an insurer must suffer a material prejudice in order to excuse coverage. Markel argued that Lennar's remediation settlements were prejudicial, largely because Lennar offered remediation to homeowners that never would have sought redress. Further, Markel maintained that Lennar's unilateral settlement was a material breach of the insurance policy because it significantly impaired Markel's position to adjust claims, provide a defense, or be involved in negotiating a settlement. The supreme court disagreed, observing that the jury did not find Markel's arguments persuasive, and concluding that the jury was entitled to credit evidence that, had Lennar not proceeded with its remediation process, the damages would have worsened with the deterioration of EIFS and the remediation costs increased.

The supreme court next addressed whether the policy's consent-to-settlement requirement excused coverage as a matter of law. The supreme court held that Lennar's failure to comply with the policy's consent-to-settle provision did not excuse Markel's liability under the policy unless it was prejudiced by the remediation settlements. Because the issue of whether Markel suffered prejudice from Lennar's remediation efforts was resolved by the jury in Lennar's favor, no prejudice was established and Markel was not excused from providing coverage.

As to the issue of an insurer's responsibility to pay for costs to determine if property is damaged, the supreme court noted that the policy obligated Markel to pay "the total amount" of Lennar's loss "because of" property damage that "occurred during the policy period". The supreme court reiterated that the "because of" language "is susceptible to a broad definition". Thus, "[u]nder no reasonable construction of the phrase can the cost of finding EIFS property damage in order to repair it not be considered to be 'because of' the damage." In reaching its conclusion, the supreme court emphasized that it "was not confronted with a situation in which the existence of damage was doubtful."

Finally, on the issue of an insurer's responsibility to pay for remediation costs for damage that began before and continued after the policy period, the supreme court reaffirmed its decision in *American Physicians Insurance Exchange v. Garcia*, 876 S.W.2d 842 (Tex. 1994), in which it held:

> If a single occurrence triggers more than one policy, covering different policy periods, then different limits may have applied at different times. In such a case, the insured's indemnity limit should be whatever limit applied at the single point in time during the coverage periods of the triggered policies when the insured's

> limit was highest. The insured is generally in the best position to identify the policy or policies that would maximize coverage. Once the applicable limits is identified, all insurers whose policies are triggered must allocate funding of the indemnity limit among themselves according to their subrogation rights.

The supreme court, therefore, concluded that Markel was responsible for Lennar's entire remediation costs and not just its pro rata share.

TEXAS COURTS OF APPEALS

***Donna Hopper v. Argonaut Ins. Co.*, No. 03-12-00734-CV, 2013 Tex. App. LEXIS 13030 (Tex. App.—Austin, Oct. 18, 2013, no pet. h).**

In *Hopper*, the Austin Court of Appeals addressed the impact of *Texas Mutual Ins. Co. v. Ruttiger*, 381 S.W.3d 430 (Tex. 2012), in which the Supreme Court of Texas abolished the common law duty of good faith and fair dealing in workers' compensation cases, and its effect on suits arising out of bad faith allegations based on Texas' workers' compensation claims. The plaintiffs in *Hopper* were the wife and child of the recipient of worker's comp benefits who died of a painkiller overdose approximately three years after the injury. The insurer first disputed whether the claimants were in fact beneficiaries, and then whether the decedent's death was related to the covered injury. Two years after the decedent's death, the claims were resolved following a benefit review conference, and the insurer agreed that the decedent's wife and two of her children were beneficiaries, and that the compensable injury was a producing cause of the decedent's death.

The beneficiaries ultimately sued the insurer and the insurer's adjuster for mishandling the claim and delaying payment of death benefits. Among other claims, the beneficiaries asserted that the insurer and the adjuster made negligent, malicious, and knowingly false statements that the beneficiaries were not entitled to coverage. The insurer and adjuster filed motions for summary judgment based in significant part on the *Ruttiger* opinion. The trial court granted summary judgment and the Austin Court of Appeals affirmed, holding that the beneficiaries' misrepresentation-based statutory claims did not fall within the *Ruttiger* opinion's narrow exception for false statements relating to the policy. In reaching its decision, the court of appeals noted that the beneficiaries' allegations only concerned statements relating to whether the claim was covered. Similarly, the court of appeals held that common law claims of fraud, negligent misrepresentation, and unconscionability failed because there was no evidence of improper conduct other than those allegations related to the claim-settlement process, and all such claims were foreclosed by *Ruttiger*.

***Shafaii Children's Trust v. West American Ins. Co.*, No. 14-12-00447-CV, 2013 Tex. App. LEXIS 12461 (Tex. App.—Houston [14th Dist.], Oct. 8, 2013, no pet.).**

In *Shafaii*, the Houston [14th Dist.] Court of Appeals affirmed the general rule that an insured must establish breach of contract as a threshold for a bad faith claim. In that case, the insured sued its insurers for business personal property (BPP) damage alleged to have been caused by Hurricane Ike. The insured submitted an inventory claiming $288,000 in BPP damage at a newly acquired location. The policy provided coverage for BPP at newly acquired locations,

but coverage was limited to 10% of the declared BPP limit. The declared BPP limit was $66,000, so the insurer paid 10% of that limit, or $6,600.

The parties' dispute centered on an endorsement that increased the maximum BPP limit from $100,000 to $250,000. The endorsement stated, "If a limit is shown elsewhere in the policy for any of these coverages, then that limit applies in addition to the limits shown below." The insured claimed the phrase "in addition to" meant it was entitled to receive 10% of the declared value AND the entire $250,000, while the insurer argued that the endorsement did not alter the 10% limit, but merely changed the maximum cap from $100,000 to $250,000.

The court of appeals agreed with the insurer, observing that the insured's reading would have provided the insured with BPP coverage for newly acquired property that was four times its existing declared BPP value. The court further noted that ambiguity must be evident from the face of the policy itself, and the mere fact of disagreement between the parties was not enough to create an ambiguity that must be construed in favor of coverage. Therefore, the court rejected the insured's affidavit claiming it had been told the $250,000 was on top of the existing 10%.

Notably, after finding the insurer's interpretation of the policy was the only reasonable one, and that its payment of $6,600 therefore had ***not*** been a breach of contract, the court summarily disposed of the insured's bad faith claim in a footnote, relying on *Republic Ins. Co. v. Stoker*, 903 S.W.2d 338 (Tex. 1995) and *Toonen v. USAA*, 935 S.W.2d 937 (Tex. App.—San Antonio 1996, no writ), in which the San Antonio Court of Appeals concluded that an insured does not have a bad faith claim in the absence of breach of contract by the insurer. The appellate court then went on to address the insured's fraud claim separately, examining the evidence and affirming dismissal on no-evidence grounds.

***Christopher Hennen and Misty Hennen v. Allstate Ins. Co.*, No. 13-12-00645-CV, 2013 Tex. App. LEXIS 11367 (Tex. App.—Corpus Christi, September 5, 2013, no pet.).**

In *Hennen*, the Corpus Christi Court of Appeals affirmed a trial court's granting of a no-evidence motion for summary judgment in favor of an insurer and rejected claims of lack of cooperation and bad faith asserted by the insured. In this property damage case, the insureds settled with Direct TV for $40,000 following a fire at their residence. Afterwards, they filed suit against their insurer, alleging that they settled for 1/5 the "true" value of their claim because their insurer refused to allow them access to the insurer's expert. The trial court granted the insurer's no-evidence motion for summary judgment.

On appeal, the appellate court assumed that Texas law recognizes a cause of action for the alleged "lack of cooperation" in order to address the issues on appeal. The appellate court, however, found no evidence to support the insureds' "conclusory and speculative" damages assessment. Further, the appellate court found no evidence of damages proximately caused by the insurer's alleged bad faith. Accordingly, summary judgment in favor of the insurer was affirmed.

***Marquis Acquisitions, Inc. v. Steadfast Ins. Co.*, No. 05-11-01663-CV, 2013 Tex. App. LEXIS 10185(Tex. App.—Dallas, Aug. 14, 2013, no pet.).**

In *Marquis Acquisitions*, the Dallas Court of Appeals held that an unspecified conflict of interest between multiple insured defendants was not enough to require a liability insurer to retain separate counsel or relinquish control over an unqualified defense to the preferred attorney of the insured. In that case, the insured tendered the defense of an underlying lawsuit involving a fire at an apartment complex to its insurer. The insurer provided an unqualified defense to the insured and a number of other insureds, and assigned counsel to the insured.

An attorney with an ongoing business relationship with the insured defendants sent multiple letters to the insurer claiming a conflict of interest between the set of defendants with ownership interests in the apartment complex and the set with management interests. The insurer asked for additional information, but none was forthcoming. A few weeks after the insurer provided its defense, retained counsel submitted a detailed report explaining that, while there was no present conflict, a potential conflict existed. The insurer then assigned a second attorney to the defense so that the parties with the potential conflict had independent representation.

The Dallas Court of Appeals first addressed the insured's contract claim, which the court summarized as a complaint that the insurer did not timely secure the second attorney after first being notified of the potential conflict. The appellate court observed that there is no Texas law requiring an insurance company to *independently* evaluate potential conflicts among multiple insureds. Moreover, the appellate court concluded that once the insurer had the well-developed opinion of assigned counsel that a potential conflict existed, the insurer immediately retained a second attorney to handle the defense of the parties implicated by the possible conflict of interest. The court of appeals finally determined that even if the insured's contract liability theory had any merit, the insured could not base its damages solely on attorneys' fees incurred in an effort to force the insurer to provide separate counsel; because the insured had no independent contract damages, attorneys' fees alone were not recoverable.

The Dallas Court of Appeals concluded that the insured's common law bad faith claims failed because a *bona fide* dispute existed between the insured and the insurer as to the possibility that there was a conflict of interest between the defendants in the underlying lawsuit. In fact, the summary judgment evidence showed that the insurer never denied the insured's request for separate counsel, but instead determined that the request was premature, and that early evaluations did not indicate that a conflict existed. There also were no damages suffered by the insured because of any delay. The appellate court resolved the insured's statutory bad faith claims by holding that the insured's appellate arguments for statutory liability were waived, and that even if they had not been waived, the insured could not show damages. Having concluded that there was no merit to the insured's claims, the Dallas Court of Appeals affirmed summary judgment in the insurer's favor.