TADC INSURANCE LAW UPDATE

Fall 2012

David A. Clark
Robert L. Horn
Brian T. Bagley
Scott R. Davis
Benjamin T. Zinnecker
Kent L. Harkness

Beirne, Maynard & Parsons, L.L.P.
Houston, Texas

This newsletter is intended to summarize significant cases impacting the insurance practice since the Spring 2012 newsletter. It is not a comprehensive digest of every case involving insurance issues during this period or of every holding in the cases discussed. This newsletter was not compiled for the purpose of offering legal advice. Any opinions expressed herein are those of the authors and do not necessarily reflect the views of Beirne, Maynard & Parsons, L.L.P.

RIGHT TO INDEPENDENT COUNSEL

Downhole Navigator, L.L.C. v. Nautilus Ins. Co., 686 F.3d 325 (5th Cir. 2012).

Offer to defend subject to a reservation of rights did not create a conflict of interest sufficient to justify insured's insistence upon independent counsel because "facts to be adjudicated" in underlying case were not the same as the "facts upon which coverage depends."

Sedona sued Downhole alleging that Downhole negligently executed a deviation plan, which caused damage to a well. Nautilus issued a CGL policy to Downhole that contained exclusions for expected or intended injury, certain physical injury to tangible property and errors in connection with "any test performed or … [in] [a]n evaluation, a consultation or advice given by, or on behalf of the insured." Nautilus tendered a qualified defense to Downhole for the Sedona lawsuit, reserving its rights on these grounds.

Downhole rejected Nautilus' qualified defense, insisting upon independent counsel. Downhole filed a declaratory judgment action seeking a judgment that Nautilus had a duty to defend and indemnify Downhole for the Sedona suit and that Nautilus was obligated to cover the cost of Downhole's independent counsel.

Upon cross-motions for summary judgment, the trial court denied Downhole's motion in its entirety, ruling that Nautilus was not obligated to reimburse Downhole for the cost of hiring independent counsel and that it was premature to rule on the duty to indemnify. The Fifth Circuit affirmed. Applying the principle from *Davalos*, the Court found that the facts to be adjudicated in the Sedona litigation were not the same facts upon which coverage depends. The Court noted that the Sedona litigation involved the issue of whether Downhole negligently performed its deviation work. Although the policy excluded coverage for "testing or consulting" services, the jury in the underlying lawsuit would not be asked to decide whether Downhole's work constituted "testing or consulting."

Downhole argued that facts might be "developed" in the underlying litigation that could impact coverage, relying on *Unauthorized Practice of Law Committee v. American Home Assurance Co.*, 261 SW3d 24, 39 (Tex. 2008). In rejecting this argument, the Fifth Circuit wrote:

> "Neither in *Unauthorized Practice* nor elsewhere has the Texas Supreme Court ever held that a conflict arises any time the attorney offered by the insurer could be tempted -- in violation of his duty of loyalty to the insured -- to develop facts in the underlying lawsuit that could be used to exclude coverage."

Thus, the Fifth Circuit concluded that because the "facts to be adjudicated" in the Sedona litigation were not the same "facts upon which coverage depends," the "potential conflict" raised by Downhole did not disqualify Nautilus' chosen counsel and Downhole was not entitled to reimbursement for the cost of hiring independent counsel.

INSURED'S CLAIM FOR DEFENSE COSTS DOES NOT GIVE RISE TO BAD FAITH CLAIM

OneBeacon Ins. Co. v. T. Wade Welch & Assocs., H-11-3061, 2012 WL 2403500 (S.D. Tex. Jun. 25, 2012).

Lamar Homes' holding that an insured's claim for defense costs is a "first-party claim" as that term is used in section 542.060 of the Texas Insurance Code does not create a common law duty of good faith and fair dealing in the context of an alleged breach of the duty to defend.

In *Welch,* the district court considered OneBeacon's motion to dismiss various contractual and extra-contractual claims asserted by its insured in this insurance coverage dispute. Only one of those claims is addressed in this summary – the insured's claim that OneBeacon's attempts to rescind its liability policies and refusal to defend certain third-party claims against the insured -- gave rise to a cause of action for breach of the common law duty of good faith and fair dealing in light of *Lamar Homes.* The district court's order addresses various other issues, including the insured's breach of contract claims, *Stowers* claim, and whether fraud was pled with the requisite particularity. The reader is commended to Judge Miller's well-reasoned opinion if these topics are also of interest.

In asserting that OneBeacon's actions with respect to its refusal to defend the underlying claims constituted a breach of the duty of good faith and fair dealing, the insured relied on the Texas Supreme Court's decision in *Lamar Homes* in which the Court held that an insured's claim for defense costs was a "first party claim" within the meaning of the Texas Insurance Code. The insured reasoned that if such a claim is a first party claim, the insurer owed the insured a duty of good faith and fair dealing.

The district court found that *Lamar Homes'* interpretation of the term "first party claim" was limited to claims brought under the Texas Insurance Code and does not apply to claims for breach of the common law duty of good faith and fair dealing. The court noted that the imposition of such a duty was unnecessary because the insured was adequately protected against an insurer's refusal to defend or mishandling of a third-party claim by its contractual and *Stowers* rights, as the Texas Supreme Court held in *Maryland v. Head.*

LATE NOTICE/PREJUDICE
EXCESS CARRIER

Berkley Regional Ins. Co. v. Philadelphia Indem. Ins. Co., 690 F.3d 342 (5th Cir. 2012).

Lack of notice of underlying lawsuit to excess carrier until after verdict required reversal of summary judgment against excess carrier.

Towers of Town Lake Condominiums was insured by a primary policy with limits of $1 million issued by Nautilus and an excess/umbrella policy issued by Philadelphia. Rouhani, a dentist who slipped and fell on the Towers premises, sued Towers claiming substantial damages. Nautilus defended Towers, but notice of the suit was not provided to Philadelphia.

The case was mediated, but negotiations broke down with Rouhani's demand at $215,000 and Nautilus' offer at $150,000. The case was tried and the jury awarded Rouhani over $1.6 million. After the verdict, Towers demanded that Philadelphia pay the amount in excess of the primary limit and Philadelphia refused based on late notice, as well as other policy defenses.

Nautilus obtained a supersedeas bond from Berkley, its sister company, and appealed the judgment on behalf of Towers, but the appeal was ultimately unsuccessful. Nautilus paid its primary limits and Berkley paid an additional $709,738.89 under its supersedeas bond. After a series of assignments, Berkley brought suit against Philadelphia to recover the amounts it paid.

On cross-motions for summary judgment, the trial court granted summary judgment against Philadelphia in favor of Berkley. On appeal, the sole issue was whether the failure to give Philadelphia notice before the verdict forfeited coverage under the Philadelphia policy.

After a detailed analysis of Texas law concerning notice/prejudice in the context of primary carriers, the Fifth Circuit ruled that there was no basis for a different rule for excess carriers. The court noted that Philadelphia was not just notified late, it was not notified until after "all material aspects of the trial process had concluded and an adverse jury verdict was entered." Thus, Philadelphia lost the ability to conduct an investigation or evaluate the case. "More importantly … Philadelphia lost a seat at the mediation table." As the Fifth Circuit aptly put it, "The cows had long since left the barn when Philadelphia was invited to close the barn door."

Thus, the Fifth Circuit reversed the trial court's grant of summary judgment in favor of Berkley. While Philadelphia urged that it was entitled to summary judgment, the Fifth Circuit found that fact issues existed and remanded the case to the district court. It appears from a footnote that the fact issues related to whether Philadelphia had received constructive notice of the underlying suit through an insurance

agent, but the Fifth Circuit also noted that the only summary judgment motion filed by Philadelphia contained in the record did not move on the "late notice" ground.

JUSTICIABLE CONTROLVERSY REMAINS AFTER DENIAL OF COVERAGE

Transp. Ins. Co. v. WH Cleaners, Inc., 372 S.W.3d 233 (Tex. App. – Dallas 2012, no pet. h.).

Court of Appeals reversed trial court's grant of insured's plea to the jurisdiction, finding that a justiciable controversy exists in a declaratory judgment action filed by insurers after denying coverage for an underlying third-party claim.

WH Cleaners was one of a number of defendants in a lawsuit filed in Indiana alleging that the defendants caused contamination to leased premises and should be forced to pay for the environmental cleanup. WH put the insurers on notice, claiming it was an additional insured under the insurance policies. The insurers formally denied coverage and then filed a declaratory judgment action seeking a determination that they owed no duty to defend or indemnify the underlying lawsuit based on the pollution exclusions. The carriers also sought a declaration that WH was not an additional insured under the policies.

The purported insureds filed a plea to the jurisdiction challenging the trial court's subject matter jurisdiction. The insureds raised several arguments claiming that there was no justiciable controversy, including that the carriers were in effect seeking a declaration that their denial of coverage was not a breach of the insurance contracts and that "such a determination is not a proper subject of a declaratory judgment."

The Dallas Court of Appeals rejected the notion that there is no justiciable controversy between an insurer and its insured simply because the insurer denied coverage prior to seeking a determination of its rights and obligations under the insurance contract pursuant to the Texas Uniform Declaratory Judgments Act.

EXTRINSIC EVIDENCE

Colony Nat'l Ins. Co. v. Unique Indus. Product Co., No. 11-20355, 2012 WL 3641523 (5th Cir. Aug. 24, 2012).

The Fifth Circuit holds that extrinsic evidence showing insured knew of, but failed to disclose, loss that pre-dated coverage was not admissible to determine insurer's duty to defend when such evidence overlapped facts of underlying claims.

Colony insured Unique under two consecutive CGL policies running from October 16, 2005 through October 16, 2007. The polices provided coverage for "bodily injury" or "property damage" occurring within the policy period, but contained a known-loss exclusion that excluded from coverage a loss that Unique knew occurred prior to the policy period.

Unique was in the business of supplying plumbing parts, including brass fittings and swivel nuts, to Uponor, Inc. In approximately June 2004, Uponor placed Unique on notice that Unique's parts were failing, resulting in property damage to Uponor's end-users. Unique began supplying different swivel nuts to Uponor, but the problems persisted, now accompanied by complaints of brass fitting failures. On August 24, 2006, representatives from Uponor and Unique met to discuss the fitting and swivel nut failures. Uponor alleged that Unique agreed to take responsibility for existing and future claims related the allegedly defective parts. Unique allegedly refused to take responsibility for future failures involving their parts. Uponor sued Unique in Texas and Minnesota.

Unique tendered the cases to its insurer, Colony, for a defense. Colony denied coverage, relying in part on the known-loss exclusion. A declaratory judgment action was filed. After considering an affidavit from an underwriter from Colony and the insurance application discussed therein, the district court granted summary judgment in favor of Colony on the grounds that Unique knew of the losses alleged in the Texas and Minnesota lawsuits prior to purchasing the CGL policy (triggering the known loss exclusion).

The Fifth Circuit reversed, holding that the district court's consideration of extrinsic evidence was not permissible, as the extrinsic evidence pertained to both coverage determinations and the merits of the underlying case. The Fifth Circuit explained that generally courts are restricted to review of the "eight corners" of the third-party pleading and policy to determine a duty to defend, but that an exception allowing consideration of extrinsic evidence may exist when it is initially impossible to discern whether coverage is potentially implicated *and* when the extrinsic evidence goes *solely* to a fundamental issue of coverage. Because the extrinsic evidence did not go solely to the coverage issue, but instead involved facts of the underlying dispute, consideration of such evidence was improper.

GuideOne Specialty Mut. Ins. Co. v. Missionary Church of Disciples of Jesus Christ, 687 F.3d 676 (5th Cir. 2012).

District court erred in disposing of the underlying tort claims in the process of adjudicating a declaratory judgment action and in weighing the evidence in support of those claims to decide the duty to defend and indemnify.

The underlying tort lawsuit arose out of an automobile accident involving Gilmore, the plaintiff, and Meyer, who was driving a van owned by Salgado, an employee of the Church. Gilmore sued the Church, Salgado, and Meyer in state court, alleging that Meyer was negligent and that the Church and Salgado had negligently entrusted the van to Meyer. This underlying lawsuit remained pending during the declaratory judgment action.

GuideOne issued a CGL policy to the Church that covered both owned and "non-owned autos." GuideOne filed a declaratory judgment action in federal court against Gilmore, Meyer, Salgado and the Church seeking declarations that it had no duty to defend or indemnify Meyer, Salgado or the Church. Meyer failed to answer and the district court entered a default judgment against him.

GuideOne filed a motion for summary judgment against Gilmore, Salgado and the Church, which the district court granted. In doing so, the district court ruled that Guideone had no duty to defend or indemnify Salgado or the Church in the underlying lawsuit; that neither the Church nor Salgado had any duty to Gilmore relating to the accident; and enjoining Gilmore from prosecuting any further actions in connection with the accident. The district court concluded that under the GuideOne policy, the duty to defend and the duty to indemnify were coextensive. The district court then examined the evidence – extrinsic evidence – presented by the parties and having resolved the issues in the underlying state court case against Gilmore, determined that GuideOne had no duty to indemnify or defend the underlying action.

Gilmore appealed. On appeal, the Church and Salgado defended the district court's rulings, including the rulings that GuideOne had no duty to defend or indemnify them.

In reversing the district court's rulings, the Fifth Circuit found that the court had not followed the "well-established approach" of examining the duty to defend based upon the eight corners rule. The Fifth Circuit rejected GuideOne's argument that its duty to defend should be determined by weighing the evidence in support of Gilmore's claims, noting that the evidence considered by the district court to determine coverage overlaps with the merits of Gilmore's action and thus, does not fall withing the "very narrow" exception to the rule. Based upon its own application of the eight corners rule, the Fifth Circuit concluded that GuideOne had a duty to defend Salgado and the Church and that any decision on the duty to indemnify was premature.

Finally, the Fifth Circuit found that the district court's exercise of jurisdiction over Gilmore's state law claims was improper and that the Anti-Injunction Act does not allow the district court to enjoin Gilmore from bringing her claims in another forum.

Nautilus Ins. Co. v. Southern Vanguard Ins. Co., No. 3:10-CV-1975-L, 2012 WL 3730945 (N.D. Tex. Aug. 29, 2012).

A certificate of insurance is extrinsic evidence that courts may not consider it in determining whether a duty to defend exists.

Nautilus brought a declaratory judgment action against E & J Masonry (insured), Thompson (an additional insured) and Thompson's insurers – Southern Vanguard and South Insurance (collectively "Southern") – after a fork lift rolled over and killed an employee of E &J. E & J was a subcontractor of Thompson's on a construction site. The representatives of the deceased employee sued E & J and Thompson.

Southern initially accepted coverage but subsequently tendered the defense and indemnity to Nautilus. Nautilus denied coverage and moved for summary judgment against Southern, Thompson and E & J based on an endorsement that excluded coverage for "bodily injury" to the insureds' employees that occurred during the course of employment. Southern did not respond. Thompson and E & J argued that, while the endorsement cited by Nautilus was unambiguous, the court should refrain from enforcing the endorsement because an Accord Certificate of Insurance failed to put them on notice of the coverage provided under the policy.

In granting Nautilus's motion for summary judgment and rejecting the arguments of Thompson and E & J, the court refused to consider the certificate of insurance, holding it was impermissible extrinsic evidence. The court further held that if an exception to the eight-corners rule were recognized, it would

not apply in this case because the court was able to discern coverage by looking within the eight corners of the underlying petition and the Nautilus Policy. Because there was no duty to defend, the court likewise found no duty to indemnify.

The court then turned to the fraud claims asserted by Thompson and E & J based on the Accord Certificate of Insurance. Noting the lack of any authority cited by Thompson and E & J to support their contention that a certificate of insurance could support a claim for fraud, the court granted summary judgment in favor of Nautilus. Finally, the court rejected arguments that Nautilus had waived its right to exclude coverage under the endorsement through the certificate of insurance.

STATUTORY INTEREST UNDER CHAPTER 542

U.S. Fire Ins. Co. v. Lynd, No. 04–11–00347–CV, 2012 WL 3326344 (Tex. App. – San Antonio Aug. 15, 2012, no pet. h.).

San Antonio Court of Appeals modifies order, affirming trial court's judgment awarding statutory interest on the amounts previously paid by insurer.

This case modifies an appellate court opinion that was the subject of the Spring 2012 newsletter. As noted in the Spring 2012 newsletter, the San Antonio Court of Appeals determined in its opinion of April 25, 2012 that the insured's statements in the Proofs of Loss signed by the insured created a fact issue as to whether property damage was caused by a single or two occurrences. In reversing summary judgment against U.S. Fire, the Court of Appeals refrained from deciding U.S. Fire's appellate issue concerning the trial court's award of statutory interest under Chapter 542 of the Texas Insurance Code.

On rehearing, the Court of Appeals withdrew its earlier opinion and issued a new opinion. The new opinion did not substantively change the court's reversal of the summary judgment against U.S. Fire based upon the existence of a fact issue concerning whether the damage was caused by one or two occurrences. However, in its new opinion, the court did address U.S. Fire's appeal of the award of the statutory penalty on the $5 million single occurrence limit that U.S. Fire conceded was owed and that had been paid to the insured.

In sum, the Court of Appeals concluded that under the facts of the case, there was more than a scintilla of evidence to support the trial court's determination of the date by which U.S. Fire had all of the information needed to accept or reject the claim, and that U.S. Fire violated Chapter 542 by not making payment of its single occurrence limit on a timely basis. Therefore, the Court of Appeals affirmed the portion of the trial court's judgment awarding statutory interest on the amounts previously paid by U.S. Fire.

WHO IS AN "INSURED"

State Farm Fire & Cas. Co. v. Lange, No. 11-20396, 2012 WL 2547105 (5th Cir. July 3, 2012) (slip op.) (per curiam) (not designated for publication under 5TH CIR. R. 47.5), *affirming* No. H-09-2011, 2011 WL 149482 (S.D. Tex. Jan. 18, 2011) (mem. op.).

This case affirms a district court opinion that was the subject of the Spring 2011 newsletter, holding that the named insured's son was not an insured because his "primary residence" was his apartment, not his parents' home.

ALCOHOL EXCLUSION

Likens v. Hartford Life & Acc. Ins. Co., 688 F.3d 197 (5th Cir. 2012).

The alcohol exclusion does not require commission of an illegal act while intoxicated in order to apply.

An insured under a life insurance policy came home drunk and fell. After the fall, the insured died. At the time of his death, the insured had a blood alcohol content of 0.262. A medical examiner determined that the immediate cause of death was "complications following blunt trauma with fracture of cervical spine"; she listed "chronic ethanolism" under the title "other significant conditions contributing to death but not resulting in underlying cause."

The life insurance policy at issue excluded coverage for "any loss resulting from ... [i]njury sustained as a result of being legally intoxicated from the use of alcohol" (the "alcohol exclusion").

The insurer denied the claim under the alcohol exclusion. The beneficiary exhausted her administrative appeals and filed a lawsuit. The insurer filed a motion for summary judgment on the alcohol exclusion, which the district court granted. The Fifth Circuit affirmed.

The court held that the plain meaning of "legally intoxicated" is that one is intoxicated according to the definition specified in the law of that jurisdiction.

Under Texas law, a person is legally intoxicated if that person has an alcohol concentration of 0.08 or more—regardless of whether or not the activity at issue was illegal. Therefore, the insured met the definition of legal intoxication under Texas law.

The court further held that, based on the medical examiner's findings, alcohol was the main cause of the insured's death because the intoxication "contributed significantly to the resulting death," even though it "was not itself the underlying cause of the death." The court noted that, even if the insured was prone to falling down, his extremely high level of intoxication made falling more likely.

CONTRACTUAL LIABILITY EXCLUSION

Ewing Const. Co., Inc. v. Amerisure Ins. Co., 690 F.3d 628 (5th Cir. 2012).

This opinion withdraws and supersedes the original opinion dated June 15, 2012 (684 F.3d 512), and certifies two questions to the Texas Supreme Court related to the scope of a CGL policy's contractual liability exclusion.

The insured architect entered into a construction contract with a school district to construct tennis courts. Unlike the contract in *Gilbert Texas Construction, L.P. v. Underwriters at Lloyd's London*, 327 S.W.3d 119 (Tex. 2010), this contract contained no express assumption of liability for damage to third party property. The insured subcontracted some or all of the work. After construction of the tennis courts was complete, the school district complained of defects and filed a lawsuit against the architect and structural engineer. The insured architect tendered the defense to its insurer under a CGL policy. The policy contained a contractual liability exclusion that provided that:

> **2. Exclusions**
>
> This insurance does not apply to:
>
> ...
>
> **b. Contractual Liability**
>
> "Bodily injury" or "property damage" for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages:
>
> **(1)** That the insured would have in the absence of the contract or agreement ....

The insurer denied coverage under the contractual liability exclusion.

The insured filed a coverage action, and the parties filed cross-motions for summary judgment. The district court denied the insured's motion, granted the insurer's motion, and held that the insurer owed no duty to defend or indemnify because of the contractual liability exclusion.

The insured appealed, and in its original opinion, the Fifth Circuit affirmed the district court. However, in this opinion, the two questions certified to the Texas Supreme Court are:

> 1. Does a general contractor that enters into a contract in which it agrees to perform its construction work in a good and workmanlike manner, without more specific provisions enlarging this obligation, "assume liability" for damages arising out of the contractor's defective work so as to trigger the Contractual Liability Exclusion.
>
> 2. If the answer to question one is "Yes" and the contractual liability exclusion is triggered, do the allegations in the underlying lawsuit alleging that the contractor violated its common law duty to perform the contract in a careful, workmanlike, and non-negligent manner fall within the exception to the contractual liability exclusion for "liability that would exist in the absence of contract."

USE OF AN AUTO / *MID-CONTINENT* LIMITATIONS

Nat'l Cas. Co. v. Western World Ins. Co., MO-11-CV-091 (W.D. Tex. June 5, 2012).

(1) The process of ferrying a person from a dialysis center to an ambulance does not involve the use of an auto. (2) *Mid-Continent* does not apply when insurers dispute coverage.

This case (the "Duty to Indemnify Case") is related to *National Casualty Co. v. Western World Insurance Co.*, 669 F.3d 608 (5th Cir. 2012) (the "Duty to Defend Case"), which was discussed in the Spring 2012 newsletter. In the Duty to Defend Case, the Fifth Circuit affirmed the district court's holding that both Western World and National Casualty had a duty to defend, but that the duty to indemnify issue was not yet ripe.

After the underlying lawsuit settled, National Casualty (who issued a business auto policy) brought the Duty to Indemnify Case against Western World (who issued a CGL policy). National Casualty and Western World each sought declarations that there was no duty to indemnify under their respective policies. National Casualty also sought recovery against Western World under a subrogation provision in the auto policy.

On cross-motions for summary judgment, the court held that National Casualty did not have a duty to indemnify, but Western World did. The evidence developed in the underlying lawsuit indicated that the EMTs were not actually placing the insured into the ambulance at the time of the patient's injuries. Rather, the patient was being ferried from the dialysis center to an ambulance. As such, the incident did not involve the use of an auto. This meant that there was no coverage under the auto policy. It also meant that the auto exclusion did not apply to preclude coverage under the CGL policy, and Western World therefore owed a duty to indemnify.

The court also held that National Casualty was entitled to reimbursement from Western World. The court noted that the Fifth Circuit has limited *Mid-Continent* to situations where insurers (1) were co-primary insurers; (2) did not dispute that both covered the loss; and (3) were subject to pro rata clauses. *Amerisure Ins. Co. v. Navigators Ins. Co.*, 611 F.3d 299, 306 (5th Cir. 2010). Because both National Casualty and Western World denied their obligation to provide coverage, *Mid-Continent* did not apply, entitling National Casualty to reimbursement from Western World.

SUBROGATION, ASSIGNMENT AND MORE *MID-CONTINENT* LIMITATIONS

Continental Cas. Co. v. North American Capacity Ins. Co., 683 F.3d 79 (5th Cir. 2012).

The Fifth Circuit distinguished *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co*., holding that an excess insurer was entitled to recover defense costs from three primary insurers under subrogation clause, despite insured's purported assignment of all its claims against the primary insurers.

The underlying lawsuit involved a fire at Valero's oil refinery in Benicia, California. Valero alleged that Encompass, who was hired by Valero to design, engineer, and construct a co-generation facility at the refinery, caused the fire though its and its subcontractor's negligence. Valero sued Encompass seeking over $40 million in damages. Encompass was insured under three primary insurance policies: (1) a Continental Casualty Company CGL policy, (2) a Columbia Casualty Company professional liability policy, and (3) a North American Capacity Insurance CGL policy carried by one of its subcontractors, which named Encompass as an additional insured. In addition, Encompass carried a commercial umbrella policy through National Union Fire Insurance Company, which contained a subrogation clause.

In November 2002, while the underlying suit was pending, Encompass filed for Chapter 11 bankruptcy. In 2003, the bankruptcy court approved an agreement between Valero and Encompass under which the bankruptcy stay would be lifted to allow Valero to pursue its claims against Encompass in exchange for Valero's agreement to seek only damages the insurance policies would cover. Encompass also assigned to Valero all of its rights and claims that it had against its insurers, which became effective only upon breach by the insurers. No liability was conceded to Valero, nor was the contractual obligation of Encompass's insurers impaired.

As the underlying action between Valero and Encompass progressed, Continental provided the initial defense of Encompass, as the other two primary insurers (Columbia and North American) denied any defense obligation. A coverage lawsuit was then initiated. Subsequently, Continental and Columbia entered a settlement agreement with Valero. The purported settlement, however, did not resolve any controversy or liability between the insured, Encompass, and Valero. Shortly thereafter, on December 30, 2005, Continental tendered Encompass's defense to National Union (excess insurer), who took over the defense in January 2006 subject to a reservation of rights.

Ultimately, the underlying action between Valero and Encompass was settled, and the indemnity responsibility of each insurer was resolved. Each insurer, however, reserved its claims against the others regarding the proper allocation of the approximately $5.7 million in defense costs incurred over the 5-year period the underlying case was pending (of which Continental paid $2.7 million, and National Union paid $3 million). The insurers filed opposing summary judgment motions.

National Union, as an excess carrier, invoked the subrogation clause in its policy and sought recovery of defense costs from the primary insurers. The primary insurers argued that the insured's 2003 assignment of its claims against its insurers prevented

National Union's recovery under its subrogation claim. In short, they argued that National Union was stepping into "empty shoes". Continental also claimed that its prior settlement with Valero satisfied its duty to defend Encompass, while Columbia and North American disclaimed any duty to defend or indemnify.

The district court, relying in part on *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co*., held that when Encompass assigned its claims against its insurers to Valero in the 2003 bankruptcy agreement, neither Encompass nor its subrogee (National Union) retained the ability to bring suit against the other insurers. Simply put, because an insurer's recovery through subrogation depends on "standing in the shoes" of the insured, Encompass's "empty shoes" prevented recovery under National Union's subrogation claim.

The Fifth Circuit reversed, holding that National Union was able to recover defense costs under its theory of contractual subrogation. First, the court held that 2003 assignment did not empty Encompass' shoes, but rather, only gave Valero an avenue of collection if it were successful on its claims against Encompass. The court reasoned that to hold otherwise would violate the principle that an insured's interests are to be placed above those of its insurers, as it would punish National Union from stepping up and covering the defense. Second, the court held that the 2003 assignment was contingent upon a favorable judgment for Valero, and no such judgment had yet been obtained in 2003. Accordingly, the primary insurers' respective duties to defend remained effective through final disposition of the Valero claims in 2007. Finally, the court noted the resulting absurdity if the 2003 assignment were interpreted to allow an assignment of Encompass' right to demand a defense to its adversary.

Turning to whether the primary insurers had a duty to defend, as the subrogation holding presupposed such coverage existed, the Fifth Circuit upheld the trial court's ruling that each primary insurer owed such a duty. The court dismissed the argument that the purported settlement among Continental, Colombia and Valero absolved any duty to defend, holding such agreement was not a settlement of any claims or liability involving the insured, but instead an advance to be paid towards a future global settlement. The court then rejected Columbia's argument that it owed no defense because Encompass failed to meet its $250,000 self-insured retention limit, holding the policy did not require such payment by the insured itself, and that the millions paid by the other insurers satisfied this limit. Finally, applying California law, the court held North American failed to eliminate the possibility of coverage under its policy. Based on these findings, and the conflicting language of the three primary polices as to coverage when other polices of insurance existed, the court affirmed the trial court's holding that the defense costs be prorated among the three primary insurers.

Great American Lloyds Ins. Co. v. Audubon Ins. Co., No. 05-11-00021-CV, 2012 WL 3156571 (Tex. App.—Dallas Aug. 6, 2012, no pet. h.).

Mid-Continent v. Liberty Mutual does not apply to consecutive primary policies because they cover different injuries, making the other insurance clauses inapplicable.

Holigan Family Investment, Inc., a homebuilder, purchased insurance policies from Great American, Audubon and other insurance carriers that provided coverage from July 1, 1997, through April 1, 2002. The Great American policy provided coverage from July 1, 1995 through July 1, 1997.

In 2001, homeowners sued Holigan in Harris County District Court alleging that the homebuilder negligently constructed their home. Several of the insurers agreed to defend the homebuilder. Great American initially agreed to pay one-third of the defense costs. About a year later, however, Great American withdrew its agreement,. concluding that, based on discovery in the lawsuit, the earliest date any damage occurred was around March 30, 1998, which was outside its policy period. Audubon and the other insurers continued to defend the homebuilder. The homeowners eventually nonsuited the Harris County lawsuit and re-filed in Dallas County. Audubon and the other insurers continued to represent the homebuilder and ultimately settled the case.

Audubon then sued Great American for contribution and reimbursement of defense and settlement costs. The parties filed cross-motions for summary judgment. Audubon moved for partial summary judgment contending that Great American breached its contract with the homebuilder by withdrawing its defense and refusing to indemnify the homebuilder. Great American moved for summary judgment arguing that its duty to defend was not triggered because the petition did not allege facts sufficient to show that bodily injury or property damage occurred during Great American's policy period; its duty to defend was not triggered because an exclusion applied to preclude coverage; and Audubon's claims

are barred by the Texas Supreme Court's decision in *Mid–Continent Insurance Co. v. Liberty Mutual Insurance Co.*, 236 S.W.3d 765 (Tex. 2007).

The trial court granted Audubon's motion and denied Great American's motion. Great American appealed.

On appeal, Great American argued that a duty to defend is not triggered under the eight corners rule where the underlying pleadings contain absolutely no allegations regarding the timing or dates of anything, including construction, repairs, or when the alleged damage or injuries occurred. Audubon responded that Great American owed a duty to defend because the allegations in the petition did not show that the claim clearly was not covered.

Applying the eight corners rule, the Dallas Court of Appeals found the homeowners filed the underlying lawsuit in 2001 and alleged bodily injuries and property damages in the "past." Relying on *Gehan Homes, Ltd. v. Employers Mut. Cas. Co.*, 146 S.W.3d 833, 838 (Tex. App.—Dallas 2004, pet. denied), the court of appeals determined that "when facts alleged in a petition are not sufficient to show clearly that there is no coverage, then the insurer has a duty to defend a case that potentially alleges a claim covered by the policy." Construing the allegations liberally in favor of the insured, the appellate court concluded that Great American owed a duty to defend.

Great American also argued that it did not have a duty to defend because the homeowners' allegations against the homebuilder for faulty workmanship fell within the exclusion for "damage to your work." The "damage to your work" exclusion however had a subcontractor exception. Finding the homeowners petition alleged "that the homebuilder and its 'contractors,' 'agents,' and 'representatives' were negligent…", the court of appeals determined that the allegations were sufficient to claim that subcontractors may have performed the work and, as a result, the exclusion for "damage to your work" did not apply to preclude Great American's duty to defend.

Great American further argued on appeal that it and Audubon are co-primary insurers and the Texas Supreme Court's decision in *Mid–Continent* bars claims for reimbursement and contribution of defense costs. Although the "other insurance" provisions of Great American's and Audubon's policies were identical to those in *Mid–Continent*, the court of appeals distinguished the case from *Mid-Continent* because the Great American and Audubon policies covered different policy periods–meaning the policies did not cover the same injury or damage. As a result, the court concluded that Great American and Audubon were, not co-primary insurers, and *Mid-Continent* did not bar Audubon's claim for contribution and reimbursement.

SUBROGATION AND UNFAIR CLAIM SETTLEMENT PRACTICES

Great American Assurance Co. v. Wills, No. SA-10-CV-353-XR, 2012 WL 3962037 (W.D. Tex. Sept. 10, 2012).

Texas Insurance Code section 542.003(b)(4) does not create a private cause of action, but even if it did, the lack of contractual privity between co-insurers coupled with unavailability of insurer to assert insured's claims through subrogation precludes action between co-insurers.

Great American sued Zurich for reimbursement following a disagreement over the handling of a claim against their mutual insured. After Zurich balked at a settlement opportunity that Great American was willing to pay its pro-rata share of, but could not satisfy within its own policy limit, the case proceeded to trial, resulting in a judgment exceeding the limits of both policies.

Great American alleged it was entitled to reimbursement from Zurich for amounts it had to pay in excess of its pro-rata share of the previous settlement demand. Great American relied on Texas Insurance Code Section 542.003(b)(4), arguing that Zurich "failed to attempt in good faith 'to effect a prompt, fair and equitable settlement of a claim submitted in which liability has become reasonably clear.'"

The court held Section 542.003(b)(4) did not create a private cause of action, but even if it did, it would not afford Great American a private cause of action against its co-insurer. The court explained that Great American had no direct relationship with Zurich to allow for such an action, and thus that Great American was precluded from asserting the rights of its insured as against Zurich under any theory of subrogation because there was no dispute as to coverage, both insurance contracts contained a pro-rata clause, and Great American was primarily liable for the debt for which is sought reimbursement.

EQUITABLE SUBROGATION

Allstate Ins. Co. v. Spellings, No. 01-00-0165-CV, 2012 WL 2452051 (Tex. App.—Houston [1st Dist.] June 28, 2012, no pet. h.).

Equitable subrogation does not allow insurer to "step into the shoes" of a third-party claimant.

The daughter of the named insured on an auto policy was driving a car and collided with another car, dying as a result of her injuries. The insurer settled with the passengers of the other car. Then the named insured filed a wrongful-death suit against several parties, including the parents of the daughter's best friend, alleging that they provided the alcohol that led to the collision. The insurer filed a plea in intervention, arguing that, under an equitable subrogation theory, it had standing to make claims against the defendants by virtue of the fact that it made settlement payments for the insured.

The court held that the doctrine of equitable subrogation did not apply to this fact pattern. It noted that, in the insurance context, the doctrine of equitable subrogation only permits the insurer to stand in the shoes of its insured; it does not permit the insurer to stand in the shoes of a third-party claimant.

PROPERTY DAMAGE COVERAGE DOES NOT EXTEND TO HUMAN BODY PARTS

Evanston Ins. Co. v. Legacy of Life, Inc., 370 S.W.3d 377 (Tex. 2012).

In answering two certified questions from the Fifth Circuit, the Texas Supreme Court held that: (1) property damage coverage did *not* extend to deceased family member's body parts, and (2) personal injury coverage did *not* extend to claims for mental anguish following alleged unauthorized use of such body parts in the absence of alleged physical damage or disease to the *plaintiff's* body.

Debra Alvarez consented for Legacy of Life, Inc. (Legacy) – an organ donation charity – to harvest some of her terminally ill mother's tissues after she died. Alvarez alleged she only consented because Legacy represented the tissues would be distributed on a nonprofit basis. When Alvarez discovered that Legacy would allegedly profit from harvesting her deceased mother's tissues, she sued Legacy. Alvarez brought various claims against Legacy, seeking compensatory damages, mental anguish damages, restitution, exemplary damages, and attorney's fees. Importantly, Alvarez did not allege that she or her mother suffered a physical injury. Instead, Alvarez alleged that her mother's estate, as the legal and rightful owner of the remains, was wrongfully deprived of them, causing restitution damages to the estate and mental anguish damages to Alvarez.

Legacy requested a defense from Evanston, and Evanston denied coverage. Evanston then filed a suit in federal district court seeking a declaration that it owed no duty to defend Legacy. Both Legacy and Evanston moved for summary judgment. The district court denied Evanston's motion, and granted Legacy's motion, declaring that Evanston had a duty to defend on the basis that a Texas court could potentially find human tissues to be property. On appeal to the Fifth Circuit two certified questions were submitted to the Texas Supreme Court:

> 1. Does the insurance policy provision for coverage of "personal injury," defined therein as "bodily injury, sickness, or disease including death resulting therefrom sustained by any person," include coverage for mental anguish, unrelated to physical damage to or disease of the plaintiff's body?
>
> 2. Does the insurance policy provision for coverage of "property damage," defined therein as "physical injury to or destruction of tangible property, including consequential loss of use thereof, or loss of use of tangible property which has not been physically injured or destroyed," include coverage for the underlying plaintiff's loss of use of her deceased mother's tissues, organs, bones, and body parts?

Answering both in the negative, the Court first examined whether the facts stated within the four corners of the Alvarez complaint could possibly come within the scope of coverage set out in the four corners of the policy. Addressing the "personal injury" coverage first, the Court noted that while mental anguish damages are generally recoverable without any physical manifestation, the policy language modified this rule by requiring physical harm. Specifically, because the policy defined "personal injury" as including "*bodily* injury, sickness or disease . . ." (emphasis added), the Court held an allegation of physical harm was required to

trigger a defense obligation. The Court reasoned that the term "bodily" modified not only "injury", but also "sickness and disease" as set forth in the definition. The Court relied in large part on its decision in *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 823 (Tex. 1997), and rejected Legacy's attempt to distinguish *Cowan* on the ground that a different defined term was involved, as the same definition was at issue in both cases. Because Alvarez did not allege a physical injury, her claims against Legacy did not trigger Evanston's duty to defend.

Turning to Legacy's property coverage argument, the Court framed the issues as whether Alvarez *or* her mother's estate's claims for loss of use of the tissues are claims for loss of use of "tangible property" – the only type of property covered by the subject policy. As to Alvarez's potential property rights, the Court then recognized: (1) next of kin have no right to possess a body other than for burial or final disposition, (2) next of kin have no right to use tissues unless they have been designated by the individual as a transplant recipient, (3) next of kin have no right to transfer tissues other than as set forth in the Anatomical Gift Act, and (4) next of kin have no right to exclude others from possession, other than to seek damages in certain circumstances for acts done beyond their consent. With this backdrop, the Court held "we cannot say that tissues have attained the status of property of the next of kin." Noting even fewer rights are enjoyed by a decedent's estate, the Court likewise held that tissues were not property of the estate.

OCCURRENCES AND INTENTIONAL ACTS

Branham v. State Farm Lloyds, No. 04–12–00190–CV, 2012 WL 3985925 (Tex. App.—San Antonio, Sept. 12, 2012, no pet. h.) (mem. op.).

Lamar Homes did not modify prior cases holding that intentional misrepresentations in connection with the sale of a home are not an occurrence.

Branham sold her home to Patrick and Melissa McCullough. Afterwards, the McCulloughs sued Branham asserting several causes of action including breach of contract, negligence, negligent misrepresentation, and intentional torts based upon a litany of alleged misrepresentations, nondisclosures, and deceptive acts designed to conceal prior damage to the home. Branham submitted a claim to State Farm Lloyds for defense and indemnity. State Farm denied Branham's claim.

Branham sued State Farm for failing to provide her a defense and indemnity in the underlying lawsuit. Branham and State Farm filed competing motions for summary judgment. State Farm's motion asserted it had no duty to defend or indemnify Branham because: the McCulloughs' petition did not allege damages arising from a covered occurrence; the McCulloughs' petition did not seek property damages as defined by Branham's policy; and the policy excluded coverage for intentional conduct.

The trial court granted State Farm's motion and entered a take nothing judgment on Branham's claims. Branham appealed.

On appeal, Branham acknowledged that the Texas courts of appeals in *State Farm Lloyds v. Kessler*, *Freedman v. Cigna Ins. Co.*, and *Huffhines v. State Farm Lloyds* previously held that voluntary and intentional acts are not occurrences, and thus an insurance carrier has no duty to defend a homeowner who makes misrepresentations in selling a home. Branham, however, argued that the facts in those cases were distinguishable, or, alternatively, the holdings in those decisions were doubtful given the Texas Supreme Court's subsequent holding in *Lamar Homes, Inc. v. Mid–Continent Cas. Co.*, 242 S.W.3d 1 (Tex. 2007).

Attempting to distinguish *Kessler*, *Freedman*, and *Huffhines*, Branham argued she could have "negligently" forgotten about the prior damage and insurance claim. Applying the eight corners rule, the San Antonio Court of Appeals found the McCulloughs did not allege Branham forgot about the prior damage, but instead, the McCulloughs alleged Branham intentionally made false representations and concealed prior damage. The court of appeals also determined that the McCulloughs' mere allegation of negligence, as an alternative cause of action, along with the intentional torts is insufficient to convert the claims based on intentional torts into covered accidents within the meaning of the insurance policy. With this understanding, the court of appeals rejected Branham's argument and concluded State Farm did not owe a duty to defend under this theory.

Additionally, Branham argued the decisions in *Kessler*, *Freedman*, and *Huffhines* had questionable precedential value after the Texas Supreme Court defined "accident" in *Lamar Homes*. The court of appeals rejected this argument finding the Texas Supreme Court's definition of "accident" in *Lamar Homes* to be consistent with the holdings in *Kessler*, *Freedman*, and *Huffhines*. The court of appeals

determined the alleged damages resulting from Branham's alleged misrepresentations were not an unexpected "accident" but were, instead, the natural and expected result of Branham's design or plan to conceal the true facts. Thus, based on the allegations in the McCulloughs' petition and the language in the policy defining an "occurrence" as an "accident" and excluding intentional conduct, the court concluded State Farm did not have a duty to defend.

ASSAULT AND BATTERY AND INTENTIONAL ACTS EXCLUSIONS/*GRIFFIN* EXCEPTION

Atain Specialty Ins. Co. v. Chang, No. H-12-160, 2012 WL 2194116 (S.D. Tex. June 12, 2012).

Because no reasonable fact finder could conclude that numerous gunshot wounds were *not* the result of an assault, the "assault and battery" exclusion precluded the duty to defend and the *Griffin* exception applied such that the duty to indemnify was justiciable prior to resolution of the underlying case.

A security guard hired by Chang fired twenty-eight rounds at Perez while Perez was on Chang's premises outside a nightclub, and Perez subsequently filed suit against Chang and others. Chang made a claim under his policy with Atain after which Atain filed a declaratory judgment action against Chang and Perez, and sought summary judgment that it had no duty to defend or indemnify Chang.

The central issue in the declaratory judgment action was whether Perez's negligence claim against Chang arose out of assault and battery. The policy contained an "assault and battery" exclusion applicable to "Assault and Battery committed by an insured, any employee of any insured, or any other person." (emphasis added).

Chang and Perez argued the "assault and battery" exclusion was inapplicable because the underlying suit involved a negligence claim by Perez. Chang further argued the security guard was acting in self-defense which triggered a "reasonable force" exception to the policy's "intentional acts" and "assault and battery" exclusions; since the security guard was acting in self-defense he could not have committed an assault or battery.

The court rejected Chang's contention that the reasonable force exception applied to the "assault and battery" exclusion and found that it need not resort to the use of extrinsic evidence to determine that the "assault and battery" exclusion applied. The face of the pleading clearly alleged that the security guard intentionally, knowingly, or recklessly discharged his weapon numerous times, triggering the exclusion.

Although the duty to indemnify is usually not justiciable until resolution of the underlying suit, the court found that the *Griffin* exception to this general rule applied. In *Griffin*, in the context of a drive-by shooting, the Texas Supreme Court held that "the duty to indemnify is justiciable before the insured's liability is determined in the liability lawsuit when the insurer has no duty to defend and the same reasons that negate the duty to defend likewise negate any possibility the insurer will ever have a duty to indemnify." *Griffin*, 955 S.W.2d. at 84.

Because there was no set of facts in the underlying lawsuit from which the fact finder could conclude that the numerous gunshot wounds suffered by Perez were the result of anything other than an assault, the "assault and battery" exclusion precluded any duty to defend or indemnify.

BREACH OF CONTRACT EXCLUSION/*GRIFFIN* EXCEPTION

Scottsdale Ins. Co. v. Mt. Hawley Ins. Co., Civ. Action No. M-10-58, 2011 WL 9169946 (S.D. Tex. June 15, 2011), *affirmed* No. 11-40792, 2012 WL 4052642 (5th Cir. Sept. 14, 2012).

A breach of contract exclusion in a CGL policy that negates coverage for any claim or suit "arising directly or indirectly out of" breach of contract or warranty applies equally to negate coverage for tort claims when those claims are at least incidentally related to breach of a contract or a warranty.

Plaintiffs Scottsdale Insurance Company and Old Republic Lloyds of Texas filed suit against defendant Mt. Hawley Insurance Company seeking declaratory judgment that Mt. Hawley owed the parties' mutual insured, D & F Industries, a duty to defend and indemnify for claims made against D & F. Both sides moved for summary judgment.

The court first assessed the duty to defend by applying the "eight corners" rule and looking to the pleadings in the underlying suit, which alleged claims by a contractor and school district for negligence, indemnity, and breach of contract and subcontract against D & F, a subcontractor in a construction project to build a high school.

All three insurers—Scottsdale, Old Republic, and Mt. Hawley—issued CGL policies covering D & F. The primary distinguishing characteristic was that Mt.

Hawley's policy contained an endorsement with a breach of contract exclusion. The exclusion negated coverage for any claim or suit for injury or damage "arising directly or indirectly out of" breach of an express or implied contract or warranty.

Mt. Hawley argued the breach of contract exclusion applied equally to the contract and tort claims against D & F in the underlying suit based on the reasoning that courts, including the Texas Supreme Court, interpret "arising out of" language to require only an incidental relationship between the claim in question and the conduct that invokes the exclusion. In other words, if the claim has at least an incidental relationship to the excluded conduct, there is no duty to defend the claim, irrespective of whether that claim sounds in contract, tort, or otherwise. Thus, Mt. Hawley argued the breach of contract exclusion was intended to exclude coverage for any type of construction defect claim that might otherwise fall within a CGL policy, even if that claim sounded in tort.

Conversely, Scottsdale and Old Republic contended the breach of contract exclusion did not apply to negligence claims because such an interpretation would be unreasonable and render meaningless other policy provisions and make coverage illusory. Instead, the exclusion should be interpreted to exclude coverage only for claims seeking contract damages, or to eliminate coverage for claims that would otherwise fall within a subcontractor exception to a "your work" exclusion, *i.e.*, to preclude coverage for claims arising from a subcontractor's defective workmanship that resulted in damage to its own work.

In assessing the parties' respective interpretations of the breach of contract exclusion, the court focused primarily on the language of the exclusion itself. The court was particularly swayed by Mt. Hawley's argument and the fact that the exclusion utilized broad language clearly stating that it applied to any claim or suit directly or indirectly "arising out of" breach of contract or warranty. Thus, the exclusion reached any claim or suit even incidentally related to a breach of a contract or a warranty.

In so holding the Court recognized that such a broad exclusion did not render other language meaningless or the policy illusory because the exclusion could not completely exclude any claim against an insured whose work was contractual in nature. The Court noted that the exclusion would not apply simply based on an incidental relationship between a claim and the existence of a contract. Rather, there had to be an incidental relationship between a claim and the breach of a contract or failure to carry out contracted-for services in a good and workmanlike manner (*i.e.*, a breach of warranty).

Given the broad scope of the breach of contract exclusion and the fact that the all of the allegations in the underlying suit exhibited at least an incidental relationship to breach of the contracts or the implied warranties involved, the court held that the exclusion negated Mt. Hawley's duty to defend.

The Court also applied the *Griffin* exception and held that the exclusion negated Mt. Hawley's duty to indemnify because any fact that could establish D & F's liability in the underlying suit would "arise out of" breaches of contract and/or warranty.

CLAIMS MADE COVERAGE

Oceanus Ins. Co. v. White, 372 S.W.3d 700 (Tex. App.—El Paso 2012, no pet.).

Notice of claim under a claims-made-and-reported policy by one insured is not notice of claim against another insured.

The Whites asserted a medical malpractice claim against a doctor. The Whites first made an oral demand and later a written demand. These demands were forwarded to JUA, which insured the doctor and the clinic that employed him at the time. Subsequently, in 2008, the Whites notified the clinic that they had a potential claim against the clinic itself. The clinic reported this claim to Oceanus, its carrier at the time.

In the coverage action, the court determined that the Oceanus policy precluded coverage for claims reported to a prior carrier. Because the claim against the doctor had been reported to JUA, a prior carrier, the Whites' claim against the doctor was not covered by the Oceanus policy.

The court further concluded that the 2008 claim by the Whites against the clinic was not a claim first made against the doctor during the Oceanus policy period. Therefore, there was no claim against the doctor under the Oceanus policy that could be reported under that policy.

LATE NOTICE AND PREJUDICE

Centaurus GF Champions, LLC v. Nutmeg Ins. Co., Civil Action No. 10-4646 (S.D. Tex. May 10, 2012).

Under an occurrence policy, the insurer must establish prejudice in order to prevail on the affirmative defense of late notice. An insurer does not receive notice under a prompt notice provision simply because the insurer is aware of potential damage and sets up a reserve in anticipation of a claim.

Centaurus owned an apartment complex when Hurricane Ike made landfall in September 2008. Centaurus submitted a Property Loss notice to Nutmeg on July 23, 2010, for damages sustained during Ike. The Notice included the comment that the insured had not previously been aware that the total damage would exceed the deductible, and it estimated damages in excess of $2,000,000.

Centaurus filed suit alleging breach of contract, unfair settlement practices, violation of the Texas Insurance Code, breach of the duty of good faith and fair dealing, violation of DTPA, and negligence. Nutmeg moved for summary judgment based on the late notice defense. In support of its argument of late notice, Nutmeg asserted that, July 23, 2010, the date Centaurus submitted its written notice of claim, was the appropriate date to consider for the issue of late notice. Centaurus argued that this was not the correct date to consider because (i) its insurance agent gave notice to Nutmeg shortly after the storm, and (ii) Nutmeg already had notice of the damage following Ike, as indicated by its own communications and conduct in 2008 and 2009.

The court considered an affidavit from Centaurus' insurance agent, stating that he notified Nutmeg of the damage approximately one week after the storm, but noted that there was no evidence of the actual notice. The court also considered Nutmeg's internal memoranda and other evidence, which indicated that Nutmeg was aware of potential damage to the property, had driven by the property and noted there was no visible damage, and that the entity retained by Nutmeg to conduct an initial inspection had set up a reserve for the property.

The conditions section of the policy required that the insured should "as soon as practicable report in writing to the Company or its agent every loss, damage or occurrence which may give rise to a claim under this policy and shall also file with the Company or its agent . . . a detailed sworn proof of loss." The policy required that the sworn Notice of Loss contain a description of the property, and a description of how, when, and where the loss or damage occurred.

Based on the evidence submitted and the policy's terms the court determined that July 23, 2010 was the correct date to consider for the issue of late notice because that was the date a formal Notice of Loss was submitted to Nutmeg. The court reasoned that Nutmeg's proactive monitoring of the property and bracing for a potential claim did not equate to the notice contemplated by the contract.

The court found Centaurus' explanation that it was not aware the loss would exceed its deductible until July 2010 and the evidence submitted was sufficient to raise a fact issue as to when the damage became apparent and whether Centaurus' notice was reasonable.

Because the policy at issue was an occurrence policy, Nutmeg was required to prove prejudice in order to prevail on the late notice defense.

The court found Nutmeg's argument that it was prejudiced because it lost the opportunity to observe the damage when it occurred in September 2008 or speak with tenants or others familiar with the damage was sufficient to raise a fact issue as to whether it was prejudiced. However, because Centaurus raised a fact issue as to whether its Notice of Loss was untimely in the first place, the court held that Nutmeg was not entitled to summary judgment on its affirmative defense of late notice.

POLICY APPLICATION MISREPRESENTATION

Texas Farm Bureau Mut. Ins. Co. v. Rogers, 351 S.W.3d 103 (Tex. App.—San Antonio 2011, pet. denied).

Insured's material misrepresentation voided policy which precluded claim that insurer ratified policy by making payment.

The insured obtained a homeowner's policy from Farm Bureau pursuant to requirements of her mortgage. The policy provided maximum coverage of up to $160,000 for the house and $96,000 for personal property. On January 14, 2009 the home was completely destroyed by fire. After the insured filed a claim under the policy Farm Bureau instituted a criminal background check.

The insured admitted to a claims investigator that she had a criminal record, despite her express denials of any criminal background in the policy applications. Farm Bureau notified the insured and the mortgagee that it was rescinding the policy as of the original

application date due to the insured's misrepresentation as to her criminal background. Nevertheless, Farm Bureau paid the mortgagee $127,549.69—the full balance of the mortgage lien pursuant to the Mortgage Clause in the policy.

The insured sued Farm Bureau for breach of contract as well as various extra-contractual claims. Prior to trial, the insured died and the trial court permitted the insured's heirs to proceed with all of the claims over Farm Bureau's objection that the heirs lacked standing to pursue the insured's DTPA claims.

A jury found that (i) the insured made a material misrepresentation in the policy application, (ii) Farm Bureau ratified the insurance contract, and (iii) Farm Bureau caused confusion or misunderstanding but did not do so knowingly. The jury awarded damages in favor of the insured up to the remaining amount of the policy limit for the house and a total of $15,000 for personal property.

Both parties appealed. The court noted it is a well-known principle that DTPA claims do not survive the original consumer's death and held that as a result, the jury's finding that Farm Bureau caused confusion or misunderstanding could not support an award of damages.

The court held that because the jury found that the insured made a material misrepresentation in the policy application, the policy was void and could not be ratified. Since neither the jury findings as to the DTPA claim nor the ratification issue could support an award of damages, the court reversed the trial court's judgment and rendered a take nothing judgment.

VACANCY EXCLUSION

Farmers Ins. Exch. v. Greene, No. 05-11-00487-CV, 2012 WL 3132440 (Tex. App.—Dallas Aug. 2, 2012, no pet. h.).

Vacancy provision functioned as an exclusion, as it excepted a specific condition (vacancy) from coverage, rather than required action by the insured upon the vacancy of a dwelling.

Farmers issued a homeowners' insurance policy to Greene. The policy contained a vacancy provision suspending coverage for any damage to Greene's home sustained 60 days after the dwelling became vacant. Greene notified Farmers that she was moving to a retirement community and selling her house. Four months after Greene moved from her home, a fire spread from a neighboring property to Greene's property causing a fire loss. Greene made a claim under the policy for the fire damage to her house. Relying on the vacancy provision, Farmers denied the claim.

Greene brought suit against Farmers and moved for partial summary judgment on her breach of contract claim. Greene relied, in part, on Section 862.054 of the Texas Insurance Code, which provides that an insured's breach of a provision or condition relating to fire insurance does not constitute a defense unless the violation contributed to the loss. Greene asserted Farmers owed her benefits under the policy because she did not commit a substantial breach of the policy, that section 862.054 prohibits denial of her claim absent a showing of prejudice, and Farmers suffered no prejudice as a result of the vacancy. Farmers argued that coverage was suspended under the policy's vacancy clause, that it "did not breach the policy by denying the claim for coverage that was suspended," and that section 862.054 simply did not apply. Farmers never contended that Greene breached or violated the policy by leaving the house vacant.

The trial court granted Greene's motion for partial summary judgment on her breach of contract claim. The trial court found that Greene 'violated' the vacancy clause, but such violation did not render the policy void and did not constitute a defense to Greene's suit absent a showing that such violation contributed to the loss.

On appeal, Farmers argued the trial court misinterpreted the vacancy provision to require Greene to perform an act and that section 862.054 was inapplicable to Greene's claim. The Dallas Court of Appeals agreed, finding the vacancy provision was clear and unambiguous in that it suspended coverage 60 days after the residence became vacant. The appellate court noted that the vacancy provision functioned as an exclusion – it excepted a specific condition (vacancy) from coverage – rather than a provision requiring Greene's performance. Because the vacancy clause did not require Greene to perform an act, the appellate court found no violation or breach. The appellate court concluded that "describing the vacancy exclusion in terms of a breach or violation is a nonsequitur."

Contrary to Greene's argument that section 862.054 should preclude Farmer's defense based upon the vacancy provision, the court of appeals noted that the vacancy of the home increased the risk of insuring it, and, under such circumstances, the court was "loathe to engraft by judicial fiat additional terms requiring

Farmers to assume liability for a risk the [p]olicy specifically excluded." The appellate court determined that section 862.054 requires a "breach or violation" of a "warranty, condition, or provision" contained in a policy. Because there was no breach, the statute did not apply to Greene's claims.

SEVERANCE AND ABATEMENT

In re State Farm Mut. Auto. Ins. Co., No. 08-12-00176-CV, 2012 WL 4099081 (Tex. App.—El Paso Sept. 19, 2012, no pet. h.).

Severance of extra-contractual claims from contractual claims mandatory when defendant has made a settlement offer on the contract claim. Court of Appeals, however, declined to "create an ironclad rule depriving the trial court of discretion to deny abatement."

Rosa Duran was injured when she was struck by an underinsured motorist. Duran settled her claim with the underinsured motorist for $25,000, the full amount of liability insurance the motorist had in force at the time of the accident. Duran then made a claim on two separate State Farm Mutual policies, one issued to her husband and the other issued to her daughter.

State Farm offered Duran $7,500 to settle both claims. Displeased with the settlement offer, the Durans sued State Farm for breach of contract and asserted various extra-contractual claims. State Farm moved for severance and abatement of the extra-contractual claims from the breach of contract claim. The trial court denied State Farm's motions. State Farm sought mandamus relief from the trial court's order.

The El Paso Court of Appeals determined that severance of extra-contractual claims is mandatory when an insurer has made an offer to settle the underlying breach of contract claim. The appellate court determined "no rule of law mandates that a trial court abate extra-contractual claims when it orders severance." Instead, a trial court should analyze whether abatement would (1) promote justice, (2) avoid prejudice, and (3) promote judicial economy before making its decision, and the proponent of abatement must show that it will be prejudiced if abatement is not ordered. The court of appeals found that the trial court abused its discretion by not severing the extra-contractual claims and granted State Farm's request for mandamus relief on this point. The appellate court however also found that State Farm failed to carry its burden on the elements required for abatement.

State Farm moved for rehearing on the abatement portion. On rehearing, while the appellate court declined to deprive the trial court of any discretion to deny abatement when a settlement had been made, the court of appeals agreed with State Farm under the facts of this case. The appellate court held that abatement of extra-contractual claims in uninsured/underinsured cases is required in most instances because of the unique nature of such a case. The court of appeals also held that an insurer's contractual duty to pay damages to an insured arises only if the insured is legally entitled to recover from the uninsured/underinsured motorist by establishing the liability and underinsured status of the motorist and the amount of damages. The court of appeals determined that State Farm had established that it should not be required to expend the effort and expense of litigating the extra-contractual claims prior to the insured proving they are legally entitled to recover from the uninsured/underinsured motorist and that State Farm's remedies on appeal were inadequate. Therefore, the court of appeals conditionally granted State Farm's petition for writ of mandamus and directed the trial court to sever and abate the extra-contractual claims.

In re St. Paul Surplus Lines Ins. Co. and Travelers Companies Inc., No. 14-12-00443-CV, 2012 WL 2015796 (Tex. App.—Houston [14th Dist.] June 1, 2012, orig. proceeding, man. denied).

Severance and abatement of extra-contractual claims, including cross-claims, from contractual claims is mandatory when co-defendant has made a settlement offer on the contract claim.

St. Paul denied a claim submitted by Vertex Holdings, L.P., for property damage and business income losses caused by Hurricane Ike. After rejecting two settlement offers by St. Paul, Vertex filed suit against St. Paul, its parent corporation, and the agency that sold the policy, Harco. Vertex alleged breach of contract against St. Paul, and Vertex also alleged various other extra-contractual claims against St. Paul and Harco. After Vertex filed suit, St. Paul made additional offers to settle Vertex's claims, which Vertex rejected.

Harco subsequently filed a cross-claim against St. Paul. St. Paul moved to sever and abate the extra-contractual claims by Vertex and Harco. The trial court denied St. Paul's motions, and St. Paul sought mandamus relief from the trial court's orders.

The Fourteenth Court of Appeals determined that severance and abatement of extra-contractual claims, including those asserted in cross-claims, is mandatory when an insurer has made an offer to settle the underlying breach of contract claim. The Court of Appeals found that the trial court abused its discretion by not severing and abating all the extra-contractual claims and conditionally granted St. Paul's request for mandamus relief.

PROPERTY DAMAGE COVERAGE: CONSTRUCTION DEFECT

D.R. Horton, Inc. v. American Guarantee & Liability Ins. Co., 2012 WL 1893977 (N.D. Tex. May 22, 2012).

In light of *Lennar* and *Don's Building Supply,* in order to establish liability of an excess carrier for amounts paid in settlement of construction defect claims, the insured was required: (1) to allocate between the uncovered costs to repair the construction defects and the cost to repair any resulting covered property damage; (2) to establish that covered property damage occurred during the policy period; and (3) to prove that the underlying insurance limits and self-insured retentions were exhausted through payment of covered property damage that occurred during the policy period.

In this coverage action, D.R. Horton sought recovery under a liability policy issued by American Guarantee for claims alleging construction defects in a number of residential complexes constructed and sold by D.R. Horton. The policy issued by American Guarantee was a second level excess policy for the policy period from July 1, 1999 to July 1, 2000, sitting above underlying liability policies issued by Admiral and National Union for the same policy period.

American Guarantee moved for summary judgment, contending that D.R. Horton could not establish that it became legally obligated to pay because of property damage that occurred during the policy period or that the underlying limits were exhausted in payment of such damages. In granting American Guarantee's motion for partial summary judgment, the district court cited *Lennar* for the proposition that the cost of repairing construction defects does not constitute property damage. Rather, the insured must apportion the insured costs or repairing property damage to other property from the cost to repair or remedy the construction defects themselves.

Further, the court noted that under *Don's Building Supply,* the insured had the burden of establishing that the covered property damage actually occurred during the policy period. While recognizing the Texas Supreme Court's comment in *Don's Building Supply* that "pinpointing the moment of injury retrospectively is sometimes difficult", the district court found that the affidavit submitted by D.R. Horton failed to meet that burden.

The court also held that in order to satisfy its burden of proof against an excess insurer, D.R. Horton had to establish that the limits of the two underlying insurance policies were exhausted, and that D.R. Horton's self-insured retentions were satisfied, through the payments of claims covered by those policies; that is, that the payments under the underlying policies were for covered property damage that occurred during the policy period. Again, the court found that D.R. Horton failed to carry its burden.

Accordingly, the court granted American Guarantee's motion for partial summary judgment and dismissed D.R. Horton's breach of contract claims with prejudice.

EARTH MOVEMENT AND WATER EXCLUSIONS PRECLUDE COVERAGE

Texas Renegade Constr. Co., v. Hartford Lloyd's Ins. Co., No. H-11-1730 (S.D. Tex. June 18, 2012).

Exclusions for loss "caused directly or indirectly" by earth movement or underground water precluded coverage for damage to building caused by leaking water pipe.

Renegade owned a commercial building insured by a Business Insurance Policy issued by Hartford. In 2009, Renegade discovered a leak in an underground water pipe connecting the building to the city's water main. The leak was repaired. Approximately two years later Renegade began noticing foundation and structural damage to the building. It was undisputed that the earlier underground water leak caused the foundation and structural damage.

Hartford denied Renegade's property claim based, in part, on exclusions in the policy for "loss or damage caused directly or indirectly" by:

a. Earth Movement

* * *

(4) Earth sinking (other than sinkhole collapse), rising or shifting including soil conditions which cause settling, cracking or other disarrangement of foundations or other parts of realty. Soil conditions include … the action of water under the ground surface;

* * *

f. Water

* * *

(4) Water under the ground surface pressing on, or flowing or seeping through:

(a) Foundations, walls, floors or paved surfaces; …

The district court rejected the insured's contention that these exclusions only excluded damage produced by natural events and did not exclude damage produced by man-made or artificial events, such as leaking water pipes, finding instead that the two exclusions unambiguously excluded coverage for Renegade's claim.

The court also rejected Renegade's extra-contractual claims because the claim was not covered. The district court dismissed Renegade's negligence claim on the ground that Texas does not recognize a cause of action for negligent claims handling.