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David A. Clark
Kristen W. McDanald
Joe Allen
Mark B. Shutt
Rick Boepple, Jr.
Nicholas Stepp
Timothy Cook
Clarissa Medrano

AKERMAN LLP
HOUSTON, TEXAS

This newsletter is intended to summarize significant cases impacting the insurance practice since the Spring 2018 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 Akerman LLP.

Courts, not arbitrators, decide the arbitrability of disputes between a signatory and a non-signatory to a contract with an arbitration clause. These decisions are reviewed de novo.

Jody James Farms, JV v. Altman Grp., Inc., 547 S.W.3d 624 (Tex. 2018).

The Supreme Court of Texas held that an insured's agreement to arbitrate disputes regarding determinations made by the insurer does not extend to disputes between the insured and the agent.

Jody James Farms purchased crop revenue coverage insurance policy from Rain & Hail LLC through the Altman Group, an independent insurance agency. The risk was reinsured by Federal Crop Insurance Corporation under the authority of the Federal Crop Insurance Act. Jody James lost part of a grain sorghum crop and made a claim. The insurer denied coverage because the claim was not reported timely and because the farm commingled crops from performing and nonperforming farm units. Jody James and the insurer arbitrated their dispute, and Jody James lost.

Thereafter, Jody James sued Altman Group, alleging breach of fiduciary duty and DTPA violations for Altman's alleged failure to timely report Jody James' claim to the insurer. Altman moved to compel arbitration, and Jody James opposed. The trial court entered an order compelling arbitration, at which Jody James lost. Jody James appealed the trial court's confirmation of the award, including the arbitrator's decision that the dispute between Jody James and Altman was arbitrable. The Amarillo Court of Appeals affirmed, relying on the deference owed an arbitrator's decisions. The policy's incorporation of the AAA Rules, reasoned the court of appeals, evinced a clear intent to arbitrate the question of arbitrability.

The Texas Supreme Court granted review and reversed. Incorporating the AAA Rules for disputes with a signatory does not, by itself, mean the signatory has agreed to arbitrate disputes with non-signatories. Absent clear and unmistakable evidence of the parties' intent to submit a matter to arbitration, a presumption favors adjudication of arbitrability by the courts. The question is not whether the signatory (in this case Jody James) agreed to arbitrate with someone, but whether a binding arbitration

agreement exists between Jody James and non-signatory Altman.

There are six scenarios where arbitration with non-signatories may be required: (1) incorporation by reference, (2) assumption, (3) agency, (4) alter ego, (5) equitable estoppel, and (6) third-party beneficiary. *In re Kellogg, Brown & Root, Inc.*, 166 S.W.3d 732, 739 (Tex. 2005). Altman argued that the insurance policy required arbitration of this dispute and, in the alternative, the agency, third-party beneficiary, and estoppel exceptions required arbitration.

The Supreme Court held that the arbitration agreement in the policy only required arbitration of disagreements between Jody James and the insurer over any determination made by the insurer. The policy's arbitration clause did not refer to other disputes or to all disputes related to the policy. This suit is not a disagreement between Jody James and the insurer; in fact, reasoned the court, Jody James embraces the insurer's denial of coverage and alleges that Altman caused the denial. As such, the court concluded that Jody James had not agreed to arbitrate this dispute.

An agency of a signatory may sometimes invoke an arbitration clause against another signatory. To establish an agency relationship, the non-signatory must show it was subject to the principal signatory's control and authorized to act as its agent. The court noted that the touchstone of an agency relationship is control. Because there was no indication that the insurer had control over Altman's actions in relaying a claim from Jody James to the insurer, Altman could not invoke its status as an agent in order to compel arbitration.

Arbitration agreements may also be enforced by third-party beneficiaries so long as the parties to the contract intended to secure a benefit to that third party and entered into the contract directly for the third party's benefit. The benefit must be more than incidental, and the contracting parties' intent to confer a direct benefit to a third party must be clearly and fully spelled out. Only the intention of the contracting parties is relevant, not whether the third party intended or expected to benefit from the contract. Statements of intent in a contract are not enough. The general statement of intent in the Federal Crop Insurance Act (FCIC must promote crop insurance through licensed private agents) is also inadequate to confer third-party beneficiary status on an independent insurance agent.

Altman also asserted two estoppel theories: direct-benefits estoppel and an "alternate estoppel" theory. Direct-benefits estoppel applies to parties who seek to derive a direct benefit from a contract with an arbitration agreement. It precludes a plaintiff from seeking to hold the non-signatory liable based on the terms of an agreement that contains an arbitration provision while simultaneously asserting the provision lacks force because the defendant is a non-signatory. You cannot have your contract and defeat it too. But, when the substance of the claim arises from general obligations imposed by state law, including statutes, torts, or other common law duties, or federal law, direct-benefits estoppel is not implicated, even if the claim refers to or relates to the contract or would not have arisen but for the contract's existence. Because Jody James' claims were predicated on common law tort and DTPA theories, and not on contractual obligations, the Court concluded that Altman could not claim direct-benefits estoppel.

Finally, Altman argued that an estoppel theory embraced by the Second Circuit permitted Altman to demand arbitration here.

In the Second Circuit, a non-signatory can compel arbitration when (1) the non-signatory has a "close relationship" with a signatory to a contract with an arbitration agreement, and (2) the claims are intimately founded in and intertwined with the underlying contract obligations. The Supreme Court rejected this argument too, stating that the relationship between a signatory–insurer and a non-signatory–independent agent must be more than as separate participants in a business transaction before the non-signatory can claim this alternative estoppel theory.

The Court held that courts, not arbitrators, must decide arbitrability of claims involving non-signatories to an arbitration agreement. Because Jody James had not agreed to arbitrate disputes with its insurance agent, Altman, Jody James could not be forced to arbitrate those claims. The court vacated the arbitration award and remanded Jody James' claims to the trial court for trial.

In light of *Menchaca,* the Supreme Court finds insurer did not waive challenges to extra-contractual findings

State Farm Lloyds v. Fuentes, 549 S.W.3d 585 (Tex. 2018).

Insureds Candelario and Maria Fuentes filed suit against their property insurer, State Farm Lloyds, for breach of contract, violations of the Texas Insurance Code, breach of the duty of good faith and fair dealing, and fraud. Specifically, the Fuentes' alleged they submitted a claim with State Farm for exterior and interior damage their home sustained in 2008 as a result of Hurricane Ike. State Farm paid the Fuenteses $4,988.63 for exterior damage, but an adjuster concluded the hurricane did not cause the interior damage. After filing suit, the Fuenteses' counsel sent State Farm a $392,000 demand letter.

State Farm pleaded an excessive-demand defense, but the trial court excluded all evidence of the demand letter and did not allow State Farm to submit a jury question on its defense. The jury found that both parties breached the insurance contract, but that the Fuenteses breached first. Subsequently, State Farm moved for a take-nothing judgment based on the jury's finding that the Fuenteses breached the insurance contract first. The trial court denied the motion,, disregarded the jury's findings about the Fuenteses' breach of the insurance contract, and rendered judgment for the Fuenteses, awarding them $18,818.39 for amounts owed under the insurance policy, $27,000 for mental anguish damages, $7,527 in statutory penalties, and more than $300,000 in attorney's fees.

State Farm appealed, arguing the trial court erred in disregarding the jury's findings and in excluding evidence of the Fuenteses' demand letter. The Court of Appeals affirmed the trial court's judgment on both issues, finding that State Farm waived its argument that the trial court erred in disregarding the jury's findings because its briefing addressed only the Fuenteses' breach of contract claim and did not challenge all of the extra-contractual grounds supporting the judgment.

On review before the Texas Supreme Court, State Farm argued it did not waive its argument that the trial court erred in disregarding the jury's findings because the extra-contractual findings were not freestanding grounds supporting the judgment, but rather dependent on contractual liability. Specifically, State Farm maintained it had consistently argued that the jury's findings about the Fuenteses' breach of the policy preclude State Farm's liability, contractual or otherwise, as a matter of law,

and that any lack of clarity in its briefing is due to confusion in the law that existed prior to the Texas Supreme Court's decision in *USAA Texas Lloyds Co. v. Menchaca*, which was issued during the pendency of State Farm's appeal to the Texas Supreme Court.

Agreeing with State Farm, the Texas Supreme Court ordered a new trial "because the parties lacked the benefit of the clarity [] provide[d]" in the *Menchaca* decision. However, the Texas Supreme Court affirmed the Houston Court of Appeals' judgment that the trial court did not err in excluding evidence of the Fuenteses' demand letter. Accordingly, the case was affirmed in part and vacated in part by the Texas Supreme Court, and remanded for a new trial.

Where an insured suffers both covered and non-covered losses, the insured bears the burden of offering evidence that allows the trier of fact to segregate the two

Certain Underwriters at Lloyd's of London v. Lowen Valley View, L.L.C., 892 F.3d 167 (5th Cir. 2018)

The Fifth Circuit affirmed summary judgment for an insurer when the insured failed to present evidence that would permit a jury to allocate the damage caused by a hailstorm during the policy period and damage caused by hailstorms outside of the policy period.

Certain Underwriters at Lloyd's of London ("Lloyd's") issued Lowen Valley View, LLC ("Lowen Valley") a commercial property insurance policy for the period of June 2, 2012 to June 2, 2013. In November of 2014, a Lowen Valley employee noticed that the shingles on the top of the roof "looked bad" and called a roofing contractor to investigate. The contractor found evidence of significant hail damage, which Lowen Valley reported to Lloyd's with an alleged date of loss of June 13, 2012. The June 2012 date was based upon a weather history report obtained by Lowen Valley's roofing contractor that listed nine hail events of varying severity occurring at the location between January 2006 and December 2014.

After receiving the claim, Lloyd's sent an adjuster to inspect the property who concluded that the roof would need to be replaced. Thereafter, Lloyd's commissioned Haag Engineering ("Haag") to prepare a report analyzing Lowen Valley's claim. In Haag's first report, it confirmed that the hotel had suffered hail damage and concluded that "the most recent hailstorm with hailstones large enough to cause the damage [Haag] observed was on June 13, 2012." In a separate report, Haag "conclude[d] that it is unlikely that hail only fell at this location one time." The report identified four dates for which both National Weather Service hail reports and third-party radar data suggested that hail greater than one inch in diameter fell in the vicinity of the hotel.

Lloyd's denied Lowen Valley's claim and filed a declaratory judgment action seeking a declaration that it owed no coverage for Lowen Valley's hail damage. The district court granted summary judgment on Lloyd's declaratory judgment for two independent reasons: (1) Lowen Valley failed to meet its burden to offer evidence that would allow a trier of fact to segregate covered losses from non-covered losses, and (2) Lowen Valley failed to provide prompt notice of its loss, and this delay prejudiced Lloyd's as a matter of law. The Fifth Circuit affirmed the trial court on the first ground and did not reach the second.

The Fifth Circuit began its analysis by noting two general rules: 1) an insured bears the burden of establishing that its claim is

covered by the policy; and 2) an insurer is only liable for losses covered by the policy. Accordingly, the Court concluded that "when covered and excluded perils combine to cause an injury, the insured must present some evidence affording the jury a reasonable basis on which to allocate the damage… If the insured falls short of meeting this burden, the insurer is entitled to summary judgment."

The summary judgment evidence showed that several hail storms struck the area and that only one of them was within the policy period. Consequently, Lowen Valley had the obligation to bring forth evidence of which storms caused the hail damage and evidence of how to allocate losses caused between occurrences inside and outside of the policy period. The evidence Lowen Valley presented was found to be insufficient because it failed to account for the prior hail storms and did not adequately explain why it should be assumed that the most recent hailstorm was also the most damaging hailstorm.

Therefore, the Court held that because Lowen Valley failed to bring forth any evidence of how to allocate damages among the storms, Lloyd's was entitled to summary judgment and owed no duty to provide coverage to Lowen Valley for the hail damage.

Independent Injury Requirement Revisited in Light of *Menchaca*/Discussion of *Garcia's* Anti-Stacking Rule in Context of Construction Defect Claim

Lyda Swinerton Builders, Inc. v. Oklahoma Surety Co., 903 F.3d 435 (5th Cir. 2018).

The Fifth Circuit withdrew its prior opinion in *Lyda Swinerton Builders, Inc. v. Oklahoma Surety Co.,* 877 F.3d 600 (5th Cir. 2017), in light of the Texas Supreme Court's opinion in *Menchaca,* and reversed the district court's judgment in favor of Oklahoma Surety on the Chapter 541 claim of an additional insured for breach of the duty to defend an underlying lawsuit.

Lyda Swinerton Builders ("LSB"), a general contractor, contracted with numerous subcontractors, including Oklahoma Surety's named insured, A.D. Willis Company ("Willis"), in connection with the construction of a ten-story office building. Willis was the roofing subcontractor. LSB's contract with Willis, which was entered into in April of 2005, required Willis to indemnify LSB, although portions of the indemnity agreement were lined through by Willis. The subcontract also required Willis to have general liability insurance coverage naming LSB as an additional insured. The Oklahoma Surety policy issued to Willis contained an endorsement naming LSB as an additional insured, but only with respect to liability "directly attributable" to Willis' work for LSB. The policy period was February 1, 2006 to February 1, 2007.

In January of 2005 the owner of the project assigned its interest in the contract with LSB to Adam Development Properties ("ADP"). On February 12, 2008, ADP filed an original petition against LSB. The construction defect allegations in the petition included allegations of deficiencies with the roof. In April 2011, ADP filed its first amended petition that included allegations that LSB breached its dutywith respect to supervising subcontractors.

LSB made multiple requests for a defense from Oklahoma Surety, each of which Oklahoma Surety denied. LSB requested a defense from the insurers of its other subcontractors as well and, like Oklahoma

Surety, many of these insurers denied LSB's requests.

In June 2012, one of the other insurers that had denied LSB's request for a defense filed a declaratory judgment action in federal court naming ADP, LSB and another party as defendants. LSB filed a third-party complaint in that action against Oklahoma Surety seeking damages and declaratory relief. LSB alleged causes of action for breach of contract, violations of Chapter 541 of the Texas Insurance Code and violations of the Prompt Payment of Claims Act (the "PPCA").

The district court granted partial summary judgment for LSB, holding that Oklahoma Surety breached its duty to defend LSB and violated the PPCA, entitling LSB to recover damages, including defense costs and statutory penalties. The district court denied Oklahoma Surety's motion for partial summary judgment based upon its contention that it did not owe a duty to defend LSB under *Garcia's* "anti-stacking rule." The district court conducted a bench trial on LSB's Chapter 541 claims, but concluded that LSB had not met its burden of proving that it had suffered an independent injury.

Oklahoma Surety appealed several of the district court's summary judgment rulings and two of its damage rulings. LSB cross-appealed the district court's ruling denying its Chapter 541 claim.

On appeal, the Fifth Circuit affirmed the district court's finding that LSB was an additional insured and that Oklahoma Surety owed LSB a defense. The Fifth Circuit also addressed Oklahoma Surety's argument that under *APIE v. Garcia,* 876 S.W.2d 842 (Tex. 1994), an insured is prohibited from stacking the coverage limits of multiple consecutive policies when a single claim involving an "indivisible injury" extends across several policy periods. Oklahoma Surety argued that another insurer, CNA, was responsible for the defense because the property damage alleged in ADP's lawsuit was an indivisible injury and that LSB had selected CNA to provide the defense. Oklahoma Surety contended that allowing LSB to recover defense costs from it would be an impermissible stacking of the Oklahoma Surety and CNA policies.

While the Fifth Circuit noted that it was not clear whether the Texas Supreme Court would extend *Garcia's* anti-stacking rule to the duty to defend, the court stated that it need not decide the issue because even if the anti-stacking rule applied, Oklahoma Surety's argument failed because it had not pointed to any evidence that LSB selected CNA for purposes of the defense before Oklahoma Surety denied LSB's request for a defense.

In *Menchaca,* the Texas Supreme Court announced five rules regarding "the relationship between contractual and extra-contractual claims in the insurance context." The two rules at issue in *LSB* were what the Fifth Circuit called the "entitled-to-benefits rule" and the "independent-injury rule."

Since LSB had established that it was entitled to a defense under Oklahoma Surety's policy, the Fifth Circuit held that it could recover those defense costs as actual damages under Chapter 541 if it can establish that Oklahoma Surety's alleged misrepresentations caused it to be deprived of that policy benefit. The Fifth Circuit further stated that such damages would be subject to trebling if LSB proved that Oklahoma Surety committed the statutory violation knowingly.

The Fifth Circuit also rejected Oklahoma Surety's contention that the "independent-injury rule" limited LSB's recovery, stating

that "the independent-injury rule does not restrict the damages an insured can recover under the entitled-to-benefits rule."

The Fifth Circuit also held that the district court erred in awarding statutory penalties under the PPCA through the date of payment rather than through the date of judgment. However, due to the reversal of the district court's judgment as to LSB's Chapter 541 claim, no judgment has been entered and LSB will be entitled to the statutory penalty through the date of the new judgment once it is entered by the district court.

Eight Corners Rule Applied to Demand Letters When No Complaint Was Filed

Spec's Family Partners, Ltd. v. Hanover Ins. Co., No. 17-20263, 2018 WL 3120794 (5th Cir. June 25, 2018)

Spec's Family Partners Ltd ("Spec's) is a retail chain that accepted payments from major credit cards. Spec's entered into a Merchant Agreement to process these payments with First Data Merchant Services, LLC. Between October 2012 and February 2014, Spec's credit card network was hacked by unknown criminals, resulting in First Data having to reimburse issuing banks the costs related to the fraudulent transactions. First Data wrote letters to Spec's demanding reimbursement of the amounts it had to pay to the issuing banks. In addition to demanding repayment under the terms of the Merchant Agreement, the demand letters claimed that there was "conclusive evidence of a breach of the cardholder environment at Spec's" and that Spec's was not compliant with the Payment Card Industry Data Security requirements.

Hanover issued a policy to Spec's that contained Directors, Officers and Corporate Liability Coverage that insured amounts the insured became obligated to pay because of "wrongful acts." The Hanover policy also obligated Hanover to defend claims unless coverage did not apply. The policy contained a contractual liability exclusion with the usual exception – that the exclusion did not apply to the insured's liability that it would have in the absence of the contract or agreement.

When Spec's put Hanover on notice of the demand letters, Hanover initially refused to defend or indemnify Spec's based upon the contractual liability exclusion. However, Hanover then withdrew its denial and agreed to provide a defense under a reservation of rights. The parties then entered into a separate Defense Funding Agreement.

Spec's sued First Data in federal court in Tennessee to recover amounts being withheld by First Data. Hanover complied with the Defense Funding Agreement for a few months, but then took the position that it was not obligated to pay for expenses incurred in the Tennessee lawsuit because they were not "defense costs" as they were incurred in connection with the prosecution of Spec's affirmative claims. Spec's then brought this action in federal court in Texas, asserting that Hanover breached the policy and the Defense Funding Agreement and violated Chapter 542 of the Texas Insurance Code. Spec's also sought a declaration that Hanover had an ongoing obligation to pay defense costs.

Hanover moved for judgment on the pleadings under Rule 12(c) asserting the contractual liability exclusion. The district court granted the motion, finding that while the demand letters were a claim, the claim arose out of the Merchant Agreement, triggering the contractual liability exclusion.

While there were no pleadings, both the district court and the Fifth Circuit conducted

a standard eight corners analysis using the four corners of the Hanover policy and the four corners of the demand letters. In reversing the district court, the Fifth Circuit found that the exception to the contractual liability exclusion applied because the demand letters referred to Spec's non-compliance with third-party security standards and demanded significant nonmonetary relief separate and apart from the Merchant Agreement. The court stated that the letters implicated both theories of negligence and contract law and implied that Spec's could be liable for the assessments wholly apart from any obligations under the Merchant's agreement. Thus, the case was remanded to the district court.

Applying *Menchaca*, when an insured does not have a right to policy benefits, the insured cannot recover extra-contractual damages unless the injury is truly independent of the policy

Moore v. Allstate Texas Lloyd's, No. 17-10904, 2018 WL 3492818 (5th Cir. July 19, 2018).

The Fifth Circuit reiterated that the independent-injury rule set out by the Texas Supreme Court in *USAA Tex. Lloyds Co. v. Menchaca*, 545 S.W.3d 479 (Tex. 2018) only applies if the damages are truly independent of the insured's right to receive policy benefits. Otherwise, the general rule will apply to preclude recovery.

Plaintiff, Glen Moore, alleged that on or about November 28, 2015, his property "suffered incredible damage due to storm related conditions." Accordingly, Moore filed a claim with Allstate Texas Lloyds ("Allstate") under his residential insurance policy. Allstate inspected the property three times, concluding each time that no storm damage had occurred. Allstate then sent Moore a letter asserting a laundry list of perils that Allstate would not cover under the claim. Moore sued Allstate asserting breach of contract and extra-contractual claims, namely breach of the common law duty of good faith and fair dealing, violations of the Texas insurance Code, and violations of the Texas Deceptive Trade Practices Act ("DTPA") and "tie-in-statutes."

Allstate moved to dismiss all claims, and the court granted the motion, holding that Moore failed to plead facts sufficient to state a viable breach of contract claim andthat "there can be no recovery for extra-contractual damages for mishandling claims unless the complained of acts or omissions caused an injury independent of those that would have resulted from a wrongful denial of policy benefits."

On appeal, Moore argued that the court erred in applying the independent-injury rule to dismiss his claims. According to Moore, the Texas Supreme Court in *Menchaca*, "established that if statutory violations cause an injury thatis independent from breach of contract, then a plaintiff can recover even if the policy does not provide benefits." Moore argued further that the independent-injury rule "does not reflect a pleading requirement, especially before any discovery has been conducted."

Although the Fifth Circuit noted that Moore was correct in pointing to *Menchaca* as the authority for the issue presented, the Fifth Circuit also stated that Moore misread *Menchaca* in arguing that the independent-injury rule "does not reflect a pleading requirement, especially before any discovery has been conducted." In so holding, the Fifth Circuit noted that the *Menchaca* court set out to clarify the "relationship between contract claims under an insurance policy and tort claims under the Insurance Code,"

announcing five different rules—the fourth of which Moore relied on in his appeal.

The fourth rule asserted in *Menchaca* declares that if an insurer's statutory violation causes an injury independent of the loss of policy benefits, the insured may recover damages for that injury even if the policy does not grant the insured a right to benefits. The Fifth Circuit, however, underscored that Moore omitted the Texas Supreme Court's explanation that this independent-injury rule only applies if the damages are truly independent of the insured's right to receive policy benefits. That is, the independent-injury rule "does not apply if the insured's statutory or extra-contractual claims 'are predicated on [the loss] being covered under the insurance policy… or if the damages 'flow' or 'stem' from the denial of the claim for policy benefits.'" The *Menchaca* court further explained that "[w]hen an insured seeks to recover damages that 'are predicated on' 'flow from,' or 'stem from' policy benefits, the general rule applies and precludes recovery unless the policy entitles the insured to those benefits.'"

As a result, the Fifth Circuit held that in accordance with *Menchaca* Moore was not entitled to reversal of the trial court's grant of Allstate's motion to dismiss because Moore's common law and statutory bad-faith claims were predicated on the loss being covered under his residential policy. Accordingly, the general rule applied and Moore could not recover for Allstate's alleged extra-contractual violations..

An Insured's compliance with the notice of suit provision of an insurance policy is a condition precedent to an insurer's liability

United Auto. Ins. Servs v. Rhymes, No. 05-16-01125-CV, 2018 WL 2077561 (Tex. App.—Dallas May 4, 2018, no pet.)

The Dallas Court of Appeals reiterated the long established rule that compliance with the notice of suit provision of an insurance policy is a condition precedent to an insurer's liability on the policy. Thus, the Court held that even where an insurer was sent a copy of the petition by the plaintiff suing the insured, the insurer cannot be liable for a default judgment rendered against its insured if the insured (rather than a third party) has not given notice to the insurer.

Alvin Rhymes ("Rhymes") sued Maria Hernandez ("Maria") for injuries he sustained in an automobile accident, allegedly caused by Maria's negligence.. Although Maria was served with process, she never answered the lawsuit and a default judgment was rendered against her. Prior to the default judgment being rendered, Rhymes was communicating with Maria's insurer United Automobile Insurance Services ("UAIS") and attempting to settle the case. UAIS made several attempts to contact Maria about the matter before the default judgment was signed, but UAIS was never contacted by Maria nor asked to defend the matter.

After the default judgment was entered, Rhymes sued UAIS alleging a cause of action for: i) breach of the insurance contract (based on Rhymes status as a third-party beneficiary under the contract); and ii) a "*Stowers/Negligence*" claim. The trial court dismissed the *Stowers* claim, but entered judgment on the breach of contract claim and awarded Rhymes the amount of policy limits. UAIS appealed the trial court's ruling on the breach of contract cause of action, and no appeal was taken on the *Stowers* claim.

The Dallas Court of Appeals overturned the trial court and held that notice to the insurer was a necessary prerequisite to any liability, and that an insurer has no duty to defend or indemnify if the insured has not given notice of the suit or requested a defense. Further, receipt of notice after a default judgment has become final and non-appealable establishes prejudice as a matter of law. Thus, because UAIS had not received any notice from its insured (Maria), it had no liability to Maria or to any third-party beneficiary stepping into her shoes after the default judgment had been rendered.

Rhymes initially attempted to argue that the notice of suit provision was satisfied by Rhymes sending a copy of the petition and confirmation of service on Maria to UAIS but the court held "that this fact is irrelevant." Instead, the Court held that "the insurer's duties are triggered when the *insured* gives notice and requests a defense. Notice given by a third party does not estop the insurer from asserting the insured's breach as a bar to liability." (emphasis added).

In response, Rhymes pointed to several cases which held that an insurer cannot avoid coverage on a notice clause unless the insurer demonstrates that it suffered prejudice. Rhymes argued that UAIS did not suffer prejudice from the lack of notice, because UAIS's claims file listed coverage as "clear" and liability as "accepted." The Court pointed out that all of the cases Rhymes relied on dealt with late notice and not a complete lack of notice. Until notice is actually received by the insurer (from the insured) , there is no duty to defend regardless of prejudice

Further, the Court held that regardless of how clear liability was, the lack of any notice before the default judgment established prejudice as a matter of law because it deprived UAIS of the opportunity to argue the merits and imposed a new burden of proof on new issues in order to set the default judgment aside.

Therefore, the Court held that Rhymes, as a third-party beneficiary, was not entitled to any benefits under the policy because Maria's failure to provide notice to UAIS resulted in a default judgment that was prejudicial as a matter of law.

An Insurer's Right to Settle is Not Limited to Claims it is Legally Obligated to Pay

Martin-de-Nicolas v. AAA Texas Cnty. Mut. Ins. Co., No. 03-17-00054-CV, 2018 WL 1868048 (Tex. App.—Austin Apr. 19, 2018, no pet. h.).

The Austin Court of Appeals held that even in the absence of a judicial determination establishing an insured's legal liability, the policy at issue allowed an insurer to settle the claims against its insured without the insured's consent.

The case arises out of a motor vehicle accident wherein Martin-de-Nicolas ("Martin"), hit a parked car owned by Rex Jones ("Rex"). Martin filed two lawsuits *pro se*: 1) a lawsuit against Rex for Rex's alleged negligence in parking on the wrong side of the street; and 2) a lawsuit against his insurer, AAA Texas County Mutual ("AAA") for settling Rex's claim against Martin against Martin's wishes.

In the first suit, a jury determined that Rex was not negligent, and instead that Martin "was negligent and was one-hundred percent at fault for causing the crash." In the second suit, the trial court held that under the terms of the insurance contract, AAA had the right to settle the claim without Martin's

permission. The second suit was appealed to the Austin Court of Appeals.

On appeal, Martin argued that language in the policy which provided that AAA would pay for damages for which an insured "is legally liable," in turn also prohibited AAA from settling claims for which the insured was not legally liable. Martin further insisted that "AAA should have determined for itself that he was not legally responsible because [Rex] was negligent per se for parking his car in the wrong direction and, therefore, should have refused to pay any damages claimed by Jones."

AAA argued that the "is legally liable language" required AAA to pay an insured's damages after a legal decision by a court or other adjudicative body determined that AAA's insured was responsible for causing the damages. However, AAA asserted that while the clause required it to pay for covered claims after a judicial determination has been made, that did not mean it could *only* make payments on those sorts of claims. Instead, AAA pointed to a separate provision of the policy which allowed AAA to settle claims or suits when AAA determines that settling is "appropriate." The right to settle then is independent of any judicial (or other) determination of liability.

The Court of Appeals agreed with AAA's interpretation and held that the policy unambiguously gave AAA the right to settle the suit within AAA's sole discretion and without first attempting to determine who is legally responsible.

Inclusion of Non-Waiver Clause in Policy is Not Dispositive of Whether Insurer Waived Rights Under Policy

In re American Nat'l Prop. and Cas. Co., ___ S.W.3d ___, No. 04-18-00138-CV, 2018 WL 3264932 (Tex. App. – San Antonio July 5, 2018, orig. proceeding).

While a non-waiver clause in an insurance policy is itself capable of being waived, where the insured did not show that the insurer "intentionally engaged in conduct inconsistent with claiming the right to enforce the nonwaiver agreement," the non-waiver clause barred any implied waiver of the insurer's right to seek appraisal. Even if the court had concluded that the insurer waived its right to seek appraisal, the trial court erred in denying a motion to compel appraisal because the insured failed to show that she was prejudiced.

Inae Oh ("Oh") was the insured on a commercial property policy issued by American National Property and Casualty Company ("American National"). Oh filed a claim for damages to the covered building as a result of a hail storm. American National investigated the claim and concluded that the building only sustained minor damage in an amount less than the deductible.

In August 2016, Oh sued American National and the adjuster alleging breach of contract, breach of the duty of good faith and fair dealing, violations of the Texas Insurance Code and DTPA and fraud. American National filed a general denial and demanded a jury trial. The parties unsuccessfully mediated the case.

On August 7, 2017, American National gave notice of its intent to invoke the appraisal clause in the policy and filed a motion to compel appraisal. Oh resisted the motion, claiming that American National had waived its right to appraisal because it did not plead appraisal as an affirmative defense, it denied the claim, and its participation in the litigation was inconsistent with its right to

invoke appraisal. The trial court denied the motion to compel appraisal.

In the mandamus proceeding, American National contended that the court need not consider Oh's arguments that it had waived its right to invoke appraisal because the policy contained a non-waiver clause that provided, in pertinent part, that the policy's terms can be amended or waived "only by endorsement issued by us and made part of this policy." The court of appeals stated that there can be no doubt that non-waiver clauses are binding and enforceable as a general matter, but that a non-waiver clause can be waived.

The court then considered whether American National "intentionally engaged in conduct inconsistent with claiming the right to enforce the nonwaiver agreement." The court concluded that Oh did not make such a showing and, therefore, the non-waiver clause bars any implied waiver of American National's right to seek appraisal. The court went on to conclude that even if it had concluded that American National waived the non-waiver clause, Oh had failed to show prejudice, noting that she herself initiated the litigation rather than first seeking appraisal. The Court of Appeals conditionally granted the petition for writ of mandamus and directed the trial court to order the parties to engage in the appraisal process.

Distinguishing Between Causation as a Liability Issue and Causation as a Damages Issue

Texas Windstorm Ins. Assoc. v. Dickinson Independent School District, 14-16-00474-CV, 2018 WL 2436924, – S.W.3d – (Tex. App. – Houston [14th Dist.] May 31, 2018, no pet. history).

The Fourteenth Court of Appeals considered whether the Dickinson Independent School District ("DISD") was entitled to judgment for breach of contract damages against Texas Windstorm Insurance Association ("TWIA") based solely on an appraisal award. The Court held that the trial court erred in granting motions for partial summary judgment because the "Appraisal Award" did not provide sufficient evidence to conclusively prove causation and damages. Specifically, whether and how much of the alleged loss was caused by a covered peril and otherwise subject to coverage under the policy terms and conditions.

TWIA issued a commercial windstorm and hail policy of insurance (the "Policy") to DISD, the named insured. The property damage allegedly arose from Hurricane Ike that struck Galveston County, Texas on September 13, 2008. There was no dispute that the occurrence was during the policy period.

DISD sued TWIA alleging breach of contract and related claims. TWIA invoked the insurance policy's appraisal provisions, and the resulting appraisal award totaled $10.8 million in damages. DISD subsequently amended its petition to abandon all claims except breach of contract. Based solely on the Appraisal Award, DISD filed traditional motions for partial summary judgment on the elements of causation and damages. TWIA opposed the motions because, among other things, DISD had not conclusively proven that the alleged damages reflected in the Appraisal Award were caused by covered perils. The trial court granted both motions in DISD's favor. The case proceeded to trial on the sole issue of whether TWIA breached the policy by failing to pay the appraisal award. The jury answered affirmatively. The trial court signed a final judgment against TWIA in the amount of $9,602,542.82.

To recover on a breach of contract claim, DISD was required to prove: (1) the existence of a valid contract (in this case, the Policy), (2) DISD performed or tendered performance, (3) TWIA breached the contract, and (4) DISD was damaged as a result of the breach. DISD's partial summary judgment was based on two elements of its contract claim: causation and damages. DISD was not entitled to recover under the Policy unless it proved the damages were covered under the Policy.

Under the doctrine of concurrent causes, when covered and non-covered perils combine to create a loss, the insured is entitled to recover that portion of the damage caused solely by the covered peril. The doctrine is not an affirmative defense or an avoidance issue, but instead it is a rule representing the basic principle that DISD was not entitled to recover under its insurance policy unless it proved the damage were covered by the Policy. It was DISD's burden to present some evidence upon which the jury could rely to attribute the alleged damages to the covered peril.

Because DISD could only recover for covered events, the burden of segregating the damage attributable solely to the covered event is a coverage issue for which it carried the burden of proof. Failure to segregate covered and non-covered perils is fatal to recovery. The Policy was a named-perils policy that insures for "direct physical loss to the covered property caused by windstorm or hail unless the loss is excluded in the Exclusions." Under a named-perils policy, "all perils not specifically included in the policy are excluded from coverage." Thus, to obtain judgment DISD first had to establish that the direct physical losses to its covered property were caused by windstorm or hail—in this instance, windstorm or hail during Hurricane Ike.

DISD attempted to meet its burden by relying solely on the Appraisal Award. DISD argued that the Appraisal Award resolved all issues of damages and causation. TWIA argued that the Appraisal Award only determined damages, not liability. TWIA further argued that when different causes are alleged for a single injury, causation is a liability question for the court.

The critical issue decided by the Fourteenth Court was whether the Appraisal Award in this case was alone sufficient to conclusively establish that DISD suffered $8,193,168.85 in covered losses. The Fourteenth Court relied heavily on *State Farm Lloyds v. Johnson*, 290 S.W.3d 886 (Tex. 2009). In *Johnson*, the Supreme Court of Texas discussed extensively the importance of ensuring that appraisal awards do not nullify insurance policy requirements. Although an appraisal provides an extra-judicial remedy for any disagreement regarding the amount of loss, appraisers are not to construe the policy or decide whether the insurer should pay. Although the line between liability and damage questions may not always be clear, the scope of appraisal is damages, not liability.

Appraisal clauses generally estop a party from contesting damages, but liability questions are reserved for courts when different causes are alleged for a single injury to property. Appraisers can decide the cost of repairs but if they can also decide causation there would be no liability questions left for the courts. By contrast, when different types of damage occur to different items of property, appraisers may have to decide the damage caused by each before the courts can decide liability. In this context, courts can decide whether a

particular type of damage is covered, but if courts can also decide the amount of damage caused by each, there would be no damage questions left for the appraisers.

Distinguishing between causation as a liability issue and causation as a damages issue may be complicated. An appraisal necessarily includes some causation element, because setting the amount of loss requires appraisers to decide between damages for which coverage is claimed from damages caused by everything else. In no event may appraisers rewrite the insurance policy. No matter what the appraisers say, the insurance company does not have to pay for repairs due to wear and tear or any other excluded peril because those perils are excluded. Although courts may afford appraisal awards due deference, appraisals do not supplant the judicial process.

The TWIA Policy at issue covered only direct physical loss to property "caused by" the named perils of wind and hail. It explicitly excluded loss or damage caused by or resulting from "rain, whether driven by wind or not unless wind or hail first makes an opening in the walls or roof of the described building." Even then, the Policy covered only loss to the interior of the building or insured property "caused immediately by rain" entering through a wind- or hail-created opening.

TWIA alleged that DISD's claimed damages were caused by non-covered events or perils. Five years had passed between Hurricane Ike and the appraisal inspections. During that period further weather conditions and ordinary wear and tear impacted the post-Ike condition of the DISD properties. The Fourteenth Court found that the summary judgment record contained evidence that raised genuine issues of material fact about the cause of the damage to DISD's buildings. They further found that the factfinder reasonably could infer that at least some of the damages referenced in the Appraisal Award were not caused by Hurricane Ike windstorm or wind-driven openings, but instead by subsequent events, including later weather conditions that occurred in the five years following the storm's landfall.

The only causation evidence before the trial court on summary judgment was the Appraisal Award. The Fourteenth Court held that DISD's reliance on the Appraisal Award was insufficient to conclusively prove causation and damages. Standing alone, the Appraisal Award simply did not provide sufficient evidence from which the trial court may determine as a matter of law which Appraisal Award damages, if any, were caused by a covered peril. The case was remanded to the trial court.

Enrollment in OCIP entitled Subcontractor to exclusive remedy defense under the TWCA for injuries to an employee of a Sub-Subcontractor

Austin Bridge & Road, LP v. Raquel Suarez, Lucila Suarez, Raquel Suarez, Ruben Dario Suarez, Individually and as Heirs to and Representatives of the Estate of Jose Dario Suarez, Deceased, No. 01-16-00682-CV, 2018 WL 2049356 (Tex. App.—Houston [1st Dist.] May 3, 2018, no pet.)

The First District Court of Appeals held that a subcontractor was entitled to the exclusive remedy defense under the Texas Workers' Compensation Act ("TWCA") for the fatal injuries sustained to the employee of a sub-subcontractor by virtue of an OCIP purchased by the owner of the worksite and the various agreements between each tier of subcontractors requiring each subcontractor to enroll in the OCIP.

On January 28, 2014, Jose Dario Suarez was killed while working for his employer, Derr & Isbell Construction, LLC ("Derr & Isbell") in connection with the construction of Baylor University's McLane Stadium (the "Project"). The incident occurred when the "man-lift" Suarez was tethered to on a barge on the Brazos River fell off the barge, causing Suarez to drown. Derr & Isbell had been hired onto the Project by Austin Bridge & Road, LP ("Austin Bridge"), which had been hired by the general contractor and its parent company, Austin Commercial, LP ("Austin Commercial"). Thereafter, Raquel Suarez, Lucila Suarez, Raquel Suarez, and Ruben Dario Suarez, individually and as heirs to and representatives of the Estate of Jose Dario Suarez, deceased (collectively, the "Suarezes") filed a wrongful death suit against Austin Bridge (and other companies not the subject of the appeal), and the trial court eventually entered judgment on a verdict of over $17 million.

Prior to the incident Baylor, as the owner of the worksite, purchased an Owner Controlled Insurance Program ("OCIP") for the Project. Under the contract (the "Prime Contract") between Baylor and the general contractor, Austin Commercial, Baylor agreed that it had purchased an OCIP for all "Enrolled Parties," including workers' compensation insurance. "Enrolled Parties" was defined as "the Owner, the OCIP Administrator, the Construction Manager at Risk [Austin Commercial] and Subcontractors and Sub-Subcontractors that are granted insured status on the OCIP Policies."

The Prime Contract required that Austin Commercial and its subcontractors and/or sub-subcontractors enroll in the OCIP, and, upon Baylor's discretion to modify or discontinue the OCIP, it further required Austin Commercial and/or its subcontractors or sub-subcontractors to purchase replacement insurance as specified by Baylor at Baylor's expense, up to the cost of the OCIP policies. The Prime Contract also incorporated the OCIP manual that required participating contractors to provide the necessary information for enrollment in the OCIP before the commencement of any work on the Project. According to the manual, after the contractor provided the necessary information, the insurance carrier would then issue a separate workers' compensation policy for each Enrolled Party.

Austin Commercial then entered into a subcontract with its subsidiary, Austin Bridge, consisting of a "Master Subcontract Agreement," a "Work Order," and various exhibits (the "Austin Bridge Subcontract"). The Master Subcontract Agreement expressly incorporated the Prime Contract while providing that in the event of a discrepancy the Master Subcontract would govern. The Work Order stated that it covered work on the Project, and it also provided that exhibits issued with the Work Order superseded exhibits issued with the Master Subcontract Agreement. Notably, Exhibit C to the Work Order required various types of insurance coverage and specifically stated that "Subcontractor [Austin Bridge] and its sub-subcontractors shall provide, at their own expense, Workers Compensation to cover full liability under the Workers Compensation Laws of the jurisdiction in which the Project is located at the statutory limits required by said laws."

Austin Bridge then subcontracted with Derr & Isbell to complete certain portions of the steelwork in constructing the bridge across the Brazos River (the "Derr & Isbell Subcontract"). The Derr & Isbell Subcontract also incorporated the terms of the Prime Contract and included various exhibits. Exhibit C.1 to the Derr & Isbell Subcontract required various types of insurance coverage

and stated that "Subcontractor [Derr & Isbell] and its sub-subcontractors shall provide, at their own expense, Workers Compensation to cover full liability under the Workers Compensation Laws of the jurisdiction in which the Project is located at the statutory limits required by said laws." In contrast, Exhibit D to the Derr & Isbell Subcontract required participation in the OCIP, stating that "OCIP enrollment is required. OCIP manual and enrollment forms are attached. Completed forms must be returned at least five days prior to starting work." Austin Commercial, Austin Bridge, and Isbell & Derr all enrolled in the OCIP, and each contractor was issued a separate workers' compensation policy.

After suit was filed, Austin Bridge filed a traditional motion for summary judgment, arguing that it was entitled to the exclusive remedy defense under the TWCA as the statutory employer of Suarez. The Suarezes filed a no-evidence motion for summary judgment on the same issue, arguing that Austin Bridge had no evidence to support its affirmative defense. The trial court denied Austin Bridge's motion and granted the Suarezes' motion. At trial, Austin Bridge asserted its exclusive remedy defense again in a motion for direct verdict and in a motion for judgment notwithstanding the verdict, which the trial court again denied. The jury found that Austin Bridge's negligence and gross negligence resulted in the death of Suarez and returned a verdict against Austin Bridge of over more than $17 million, which the trial court entered judgment upon.

On appeal, the First District Court of Appeals first reviewed the statutory framework under the TWCA, citing to Section 408.001 of the TWCA which states that "[r]ecovery of workers' compensation benefits is the exclusive remedy of an employee covered by workers' compensation insurance coverage…against the employer or an…employee of the employer for the death of or injury sustained by the employee." The Court further recognized that under Section 406.123 the TWCA "allows a contractor to enter into a written agreement to provide workers' compensation insurance coverage to the subcontractor and its employees, which permits the general contractor to become a statutory employer of the subcontractor and its employees for purposes of applying the exclusive remedy provision of the TWCA…."

The Court then reviewed the Texas Supreme Court's opinions in *HCBeck, Ltd. v. Rice*, 284 S.W.3d 349 (Tex. 2009), and in *TIC Energy & Chem., Inc. v. Martin*, 498 S.W.3d 68 (Tex. 2016). In *HCBeck*, the supreme court held that an OCIP administered and paid for by the project owner to provide workers' compensation coverage to all contractors and their employees entitled a general contractor to the exclusive remedy defense even though the general contractor did not directly purchase the OCIP and was only required to obtain workers' compensation insurance at the expense of the project owner if the project owner decided to discontinue the OCIP. As the court in *HCBeck* reasoned, the general contractor had "provided" workers compensation insurance as required by Section 406.123 by the projects owner's purchase of the OCIP that was backed by the general contractor's obligation assuring that workers' compensation insurance would remain in place in the event the project owner decided to discontinue the OCIP. Following *HCBeck*, the Supreme Court issued its opinion in *TIC Energy* in which it held that a subcontractor is entitled to the exclusive remedy defense as the fellow employee of a general contractor's employee by virtue of the general contractor's written agreement to provide workers' compensation insurance to the subcontractor. In doing so, the supreme

court rejected the plaintiff's argument that the subcontractor had not contributed "something of value" to the plaintiff, reasoning that the statutory immunity afforded by the exclusive remedy defense went both ways, that is, it mutually protected the general contractor's employees and the subcontractor's employees by the personal injury claims of those engaged in a common endeavor.

Finally, the First District Court of Appeals reviewed its own opinion in *Etie v. Walsh & Albert Co.*, 135 S.W.3d 764 (Tex. App.—Houston [1st Dist.] 2004, pet. denied) in which it held that "the statutory employer/employee relationship [created by section 406.123] extends throughout all tiers of subcontractors and that all covered employees are fellow servants who are equally entitled to workers' compensation benefits and equally immune from suit." The *Etie* court further concluded that "the purposes of the [TWCA] are best served by deeming immune from suit all subcontractors and lower tier subcontractors who are collectively covered by workers' compensation."

Turning to the instant case, the Court first concluded that the general contractor, Austin Commercial, had "provided" workers compensation insurance under the TWCA to all workers and contractors on the Project based on Baylor's agreement in the Prime Contract to provide the OCIP, the Prime Contract's incorporation of the OCIP manual, the requirement in the Prime Contract that Austin Commercial make enrollment in the OCIP a condition in its contracts with any subcontractors or sub-subcontractors, and the requirement under the Prime Contract that Austin Commercial or one of its subcontractors or sub-subcontractors obtain workers' compensation insurance at Baylor's expense in the event that Baylor discontinued the OCIP.

The Court next rejected the Suarezes' argument that the two subcontracts at issue did not constitute written agreements to provide workers' compensation insurance, pointing out that each successive subcontract incorporated the terms of the Prime Contract and required the subcontractors to participate in the OCIP. The Court further rejected the Suarezes' contention that neither of the subcontracts could have incorporated the terms of the Prime Contract because the Prime Contract was executed after the subcontracts, stating that the nature of the work described in each agreement clearly evidence an intention among the parties that Austin Commercial serve as the general contractor for the Project, that Austin Bridge perform part of the work as a subcontractor of Austin Commercial, and that Derr & Isbell perform work as a subcontractor of Austin Bridge. It added that at the time that the subcontracts at issue were executed the nature of the Project was sufficiently clear to the parties that they had knowledge of the terms of the Prime Contract and assented to those terms. Further, the subcontracts expressly incorporated the Prime Contract, the exhibits to the subcontracts incorporated the OCIP, and the Derr & Isbell Subcontract specifically provided that enrollment in the OCIP was required.

The Court then dismissed the Suarezes' argument that Austin Bridge only required enrollment in the OCIP but did not "provide" OCIP coverage to Derr & Isbell, relying on the fact that the Derr & Isbell Subcontract required that Derr & Isbell enroll in the OCIP and the fact that Baylor would pay for any replacement insurance if it discontinued the OCIP up to the extent of the cost of the OCIP policies. The Court noted the Supreme Court's statement in *HCBeck* that the term

"provide" includes a contract that serves as a "conduit" that "provides the workers compensation [coverage] by connecting the subcontractor to the monied party most able to pay." Thus, again, under *HCBeck's* holding, a contractor does not have to actually obtain or directly pay for workers' compensation insurance in order for it to be entitled to the exclusive remedy defense. Such a broad interpretation of the term "provide" best serves to protect the policy objectives of the legislature to ensure coverage of subcontractors and their employees.

The Court rejected the Suarezes' next contention that the Derr & Isbell Subcontract was required to set out the terms analyzed in *HCBeck*, finding it sufficient that the Prime Contract was expressly incorporated into the lower-tier contracts.

Finally, finding that the evidence conclusively demonstrated that the parties had actually performed under the terms of the contracts (i.e. the contractors had actually enrolled in the OCIP and a workers' compensation policy was actually issued to Derr & Isbell), the Court held that Austin Bridge was entitled to the exclusive remedy defense of the TWCA as either the co-employer or co-employee of Derr & Isbell.
Notably, the Court never directly addressed the apparent conflicting terms in the subcontracts that, on the one hand, required the subcontractors to provide their own workers' compensation coverage, while, on the other hand, also required the subcontractors to enroll in the OCIP. Based on the Court's conclusion that the Prime Contracts and subcontracts "provided" workers' compensation coverage, it is perhaps implicit in the opinion that the incorporation of the Prime Contract into the subcontracts and the express terms requiring OCIP enrollment evidenced the true intention of the parties that controlled over the terms requiring the subcontractors to provide their own coverage.

After holding that there was no evidence to support the jury's finding of gross negligence, the Court reversed the trial court's judgment in full and rendered judgment that the Suarezes take nothing.

"Legally Entitled to Recover" Does Not Include Claims Barred by Official Immunity

Loncar v. Progressive Cnty. Mut. Ins. Company, 553 S.W.3d 586 (Tex. App.—Dallas 2018, no pet.).

The Dallas Court of Appeals held that, under its plain and ordinary meaning, the phrase "legally entitled to recover" in an insurance policy precluded recovery of uninsured motorist benefits for an accident involving a city fire truck whose driver was protected by official immunity.

In May 2008, a vehicle driven by Plaintiff Brian Loncar collided with a City of Dallas fire truck in the middle of an intersection. The fire truck driven by Paul Ferguson was responding to a fire alarm call and had its emergency lights and siren activated. Loncar subsequently sued the City of Dallas for personal injuries. The City filed a plea to the jurisdiction on the grounds that Loncar's suit was precluded by official immunity. The trial court granted in part and denied in part the City's plea, which then took an interlocutory appeal from that order.

Meanwhile, Loncar amended his petition to join Progressive County Mutual Insurance Company ("Progressive") and Chubb Lloyds/Insurance Company of Texas ("Chubb") as defendants. He alleged that Progressive and Chubb issued to Loncar

respectively a primary insurance policy and excess insurance policy that provided uninsured/underinsured motorist coverage for his damages.

In the interlocutory appeal, the Dallas Court of Appeals issued an opinion holding that the city conclusively established that Ferguson was acting in good faith at the time of the accident and thus enjoyed official immunity. Accordingly, the Court of Appeals rendered judgment dismissing all remaining claims against the City of Dallas for lack of jurisdiction due to governmental immunity.

Subsequently, Chubb and Progressive moved for summary judgment on multiple grounds, which the trial court granted, and entered a take-nothing judgment. Loncar appealed.

Loncar's issue on appeal concerned the following clause in the uninsured/underinsured motorist coverage endorsement in Progressive's insurance policy:

> We will pay damages which an "insured" is *legally entitled to recover* from the owner or operator of an "uninsured motor vehicle" because of "bodily injury" sustained by an "insured[.]"

Specifically, Loncar argued that the trial court's grant of summary judgment to his insurers was error because they did not conclusively prove that he was not "legally entitled to recover" from Ferguson or the City of Dallas.

In support of this argument, Loncar contended that the clause "legally entitled to recover" means coverage exists if Ferguson's negligence caused the accident. However, the Dallas Court of Appeals rejected this argument and upheld the trial court's grant of summary judgment holding that, "[g]iving the phrase 'legally entitled to recover' its plain and ordinary meaning in context means that damages are covered if, on the facts, the insured has a legal right to a judgment from the owner or operator." In other words, the Court interpreted the Progressive insurance policy's uninsured/underinsured motorist coverage endorsement to mean that, if the insured has no legal right to recover anything from the vehicle's owner or operator, whether because of the motorist's lack of fault, immunity, or some other substantive defense, the insured is not "legally entitled to recover" any damages against the owner or operator, and the insured's damages are not covered.

Waiver and Estoppel Do Not Preclude an Insurer from Denying Coverage Under a Named Driver Exclusion

Dempsey v. ACCC Ins. Co., No. 05-16-01502-CV, 2018 WL 2077603 (Tex. App.—Dallas May 4, 2018, no pet.) (mem. op.).

The Dallas Court of Appeals held that the doctrines of waiver and estoppel do not operate to preclude an insurer from denying coverage under an automobile insurance policy based on a named driver exclusion.

Shashawna Clifton was driving a 2006 Chevrolet Trailblazer that rear-ended another vehicle driven by John Dempsey on July 24, 2012. ACCC Insurance Company ("ACCC") issued an auto insurance policy to Sherman Clifton that insured the 2006 Chevrolet Trailblazer. However, the policy contained a named driver exclusion that specifically excluded Shashawna from coverage.

Dempsey submitted a claim to ACCC for personal injuries and property damage allegedly caused by Shashawna's negligence, which ACCC denied. Notwithstanding its

denial of coverage though, an ACCC adjuster inspected Dempsey's damaged vehicle and ACCC issued a $650 check payable to Dempsey for the total loss of his vehicle. Additionally, ACCC wrote Dempsey's counsel and offered to settle his personal injury claim for $6,500. Dempsey rejected this offer and filed suit against Shashawna,, ACCC provided her with a defense.

At the same time as the underlying tort suit against Shashawna, ACCC filed a separate declaratory judgment action seeking a declaration that it had no liability under the policy due to the named excluded driver endorsement. After securing a judgment against Shashawna in the amount of $36,354.79 in the underlying tort suit, Dempsey filed a petition in intervention in the declaratory judgment action arguing that ACCC waived any claim that there was no coverage under the policy, and that it was estopped from denying coverage. ACCC subsequently moved for summary judgment, which the trial court granted. Dempsey appealed.

On appeal, Dempsey argued that the trial court erred in granting ACCC summary judgment because it had waived the excluded driver endorsement and was estopped from asserting the same. Specifically, Dempsey pointed to the fact that an ACCC adjuster inspected his damaged vehicle and that ACCC issued a check payable to Dempsey for the total loss of his vehicle and attempted to negotiate a settlement for his personal injury claims. The Dallas Court of Appeals rejected this argument on the grounds that the doctrines of waiver and estoppel cannot be used to re-write the contract of insurance and provide contractual coverage for risks not insured. Noting the Texas Supreme Court's prior opinions, the Dallas Court of Appeals explained:

> Waiver and estoppel may operate to avoid a forfeiture of a policy, but they have consistently been denied operative force to change, re-write and enlarge the risks covered by a policy. In other words, waiver and estoppel cannot create a new and different contract with respect to risks covered by the policy.

Based on this reasoning, the Dallas Court of Appeals concluded that the trial court did not err by granting ACCC summary judgment

Full and Timely Payment of Appraisal Award Precludes Prompt Payment Claim

Marchbanks v. Liberty Ins. Corp., 14-17-00004-CV, 2018 WL 4016931, at *1 (Tex. App.—Houston [14th Dist.] Aug. 23, 2018, no pet. h.).

The Fourteenth Court of Appeals affirmed the trial court's grant of summary judgment dismissing the insured's claims under the Prompt Payment of Claims Act (the "Act"), holding that the insurer's full and timely payment, based on an appraisal award, precluded the insured from recovering under the Act as a matter of law.

In granting summary judgment in favor of Liberty Insurance Corporation ("Liberty"), the court underscored that as it had held twice in the past, the general rule is that a full and timely payment of the amount owed under the policy based on an appraisal award precludes recovery on a claim under the prompt-payment statute as a matter of law. For the first time, however, the court articulated its reasoning for this rule of law. The court reasoned that because the second element of the prompt-payment statute is that that the insurer is liable for the claim, and an insurer's full and timely payment based on an appraisal award precludes a judgment against

the insurer as a matter of law, there is no judgment to which the eighteen-percent interest rate awarded under the prompt-payment statute might be applied. As a result, the insured is precluded as a matter of law from recovering under the Act.

In *Marchbanks*, appellant/plaintiff William Marchbanks reported a hail-damage claim to his homeowner's insurer, Liberty. Liberty acknowledged Marchbank's claim that same day and sent an adjuster to evaluate the claim the following day. The adjuster determined that Marchbank's roof damage was not storm-related and Liberty sent Marchbanks a denial letter expressing the same. Fifteen months later, Marchbacks notified Liberty that he found pieces of his roof coming off and believed that his house had sustained hail damage. Marchbanks requested a reinspection and a Liberty adjuster conducted the reinspection seven weeks later.

Following reinspection, the Liberty adjuster estimated that the amount of covered damage was $387.79, well below the deductible under the policy. Thus, Liberty sent Marchbanks a letter asserting that Liberty would not be paying any amount of the claim. Marchbanks filed suit against Liberty, alleging—among other things—claims under the Prompt Payment of Claims Act. Subsequently, Liberty invoked the appraisal process under the policy and the appraisers for Liberty and Marchbanks issued an award. Liberty sent Marchbanks a check for the amount it owed under the policy based on the appraisal award and then moved for summary judgment on Marchbanks's prompt-payment claims, arguing that Liberty's full and timely payment based on the appraisal award precluded Marchbanks from recovering under the Act as a matter of law.

Marchbanks, in turn, argued that Liberty was not entitled to summary judgment because Liberty violated two sections of the Prompt Payment of Claims Act *before* it invoked the appraisal process. Specifically, Marchbanks argued that Liberty violated section 542.055(a)(3) by failing to request items, statements, and forms that it reasonably believed were required following the first claim. Marchbanks also alleged Liberty violated section 542.056(a) by failing to accept or reject Marchbanks's claim within 15 business days of receiving all items, statements, and forms required. Marchbanks further disputed that Liberty's payment of the appraisal precluded Marchbanks from recovering under the Act. The trial court, however, granted Liberty's motion for summary judgment in its entirety and dismissed Marchbank's extra-contractual claims.

On appeal, the court reasoned that because Liberty timely tendered the full amount owed, any claims under the prompt-payment statute were precluded. The court held that pursuant to section 542.060(a)'s unambiguous language, in order to recover the eighteen-percent interest and reasonable attorney's fees under the prompt-payment statute, the claimant must show (1) that the claim was made under an insurance policy, (2) that the insurer is liable for the claim, and (3) that the insurer failed to follow one or more sections of the prompt-payment statue with regard to the claim. The court considered that under the second element—that the insurer is liable for a claim under the insurance policy—the element is not satisfied as a matter of law if the insured does not recover any judgment based on the insurer's liability under the policy. The court noted that following the insurer's full and timely payment based on an appraisal award, a plaintiff cannot recover a judgment against the insurer and, thus, a plaintiff cannot recover under the prompt-payment statute as a matter of law.

Although some have argued that an insurer's voluntary payment of the amount owed constitutes sufficient proof of the insurer's liability under the second element of the prompt-payment statute, the court rejected this argument and held that the insurer's payment only means that the insurance company has chosen not to seek to set aside the appraisal award, and has also elected not to assert any defenses to its liability. Moreover, the court underscored that once an insurer pays the full amount, the trial court will not determine whether the insurer is liable under the policy and, thus, the insured will not recover a judgment to which an eighteen-percent interest rate can be applied.

Accordingly, the court concluded that under the Legislature's unambiguous language in the prompt-payment statute, (1) the insurer's full and timely payment of the amount owed under the policy based on an appraisal award precludes the insured from recovering a judgment against the insurer based on its liability under the insurance policy as a matter of law, and (2) such a payment also precludes the insured from recovering on a claim under the prompt-payment statute as a matter of law. The court refused to act as a legislative body and second-guess the public-policy choices behind the statute or to weigh the effectiveness of its results.

Lastly, the court noted that roughly a week after Marchbanks filed his appellate brief, the Texas Supreme Court issued *USAA Tex. Lloyds Co. v. Menchaca*, 545 S.W.3d 479 (Tex. 2018). The court, recognized that *Menchaca* did not involve a prompt-payment claim or an appraisal award and, thus, the court did not interpret any language in the prompt-payment statute. In addition,even assuming that an insured could recover benefits under the insurance policy as actual damages under the Prompt Payment Act, *Menchaca* did not address whether an insured may recover eighteen-percent interest under the prompt-payment statute in the absence of any recovery of benefits under the insurance policy. As a result, the court held that the principles in *Menchaca* did not apply to Marchbank's appeal

Extrinsic Evidence of Prior Litigation Not Admissible on Duty to Defend

Everest Nat' Ins. Co. v. Gessner Engineering, LLC, ___ F.Supp.2d ____, Civ. Action No. H-17-2981, 2018 WL 3361458 (S.D. Tex. July 10, 2018).

In deciding whether Everest National Insurance Co. ("Everest") had a duty to defend Gessner Engineering LLC ("Gessner") under a claims made professional liability policy, the court declined to consider extrinsic evidence to determine when the claim was first made. Specifically, the court concluded that the exception to the eight corners rule did not apply to allow the consideration of earlier filed lawsuits because, looking at the four corners of the last filed lawsuit alone, it was not impossible to discern whether coverage under the policy was *potentially* implicated.

Everest issued a claims made Architects and Engineers Professional Liability policy to Gessner with a policy period of August 1, 2015 to August 1, 2016 and a renewal policy for the subsequent policy period. In February 2015, prior to the inception of either Everest policy, St. Paraskevi Greek Orthodox Monastery, Inc. (the "Monastery") filed suit against Gessner, and others alleging various defects in a dining hall building on which Gessner had performed engineering services. The Monastery later voluntarily nonsuited and dismissed Gessner from the lawsuit. In January 2016, the Monastery filed its First Amended Petition, again naming Gessner as

a defendant. In February 2016, the Monastery dismissed the lawsuit.

On April 1, 2016, the Monastery filed a new lawsuit against Gessner. On May 2, 2016, Gessner filed its answer and a plea in abatement in the new lawsuit. On July 17, 2017, the Monastery filed its Second Amended Petition in the new lawsuit. On September 14, 2016, Gessner notified Everest of the second lawsuit and requested a defense. Everest agreed to defend Gessner subject to a reservation of rights and filed a declaratory judgment action seeking a determination that it had no duty to defend. Gessner counterclaimed, and the case was presented on cross motions for summary judgment.

The district court noted that the second lawsuit was filed during the policy period of the Everest policy and that there is no allegation in the pleadings in that lawsuit that the Monastery had provided notice of its claim to Gessner prior to the policy inception date of August 1, 2015. There was no mention in the pleadings of the second lawsuit that the Monastery had filed prior lawsuits against Gessner. Thus, the court concluded that the allegations in the second lawsuit raised the potential that the Monastery first made its claim during the policy period of the claims made policy.

Everest argued that the court should apply an exception to the eight corners rule and consider evidence of the prior lawsuits against Gessner. The court recognized that the Texas Supreme Court in *GuideOne* noted that the Fifth Circuit had stated in *Northfield* that if the Texas Supreme Court were to ever recognize an exception to the eight corners rule, it would be a limited one and would only apply "when it is initially impossible to discern whether coverage is potentially implicated and when the extrinsic evidence goes only to a fundamental issue of coverage which does not overlap with the merits or engage the truth or falsity of any facts alleged in the underlying case."

The court declined to apply an exception to the eight corners rule, concluding that "it is not *impossible* to discern whether coverage under the Policy is *potentially* implicated by the allegations" in the second lawsuit. Thus, the court concluded that Everest owed Gessner a duty to defend.

"Result in" in a Builder's Risk Ensuing Loss Clause is ambiguous; Court adopts insured's construction

Nay Co. v. Navigators Specialty Ins. Co., No. 3:16-CV-02675-N, 2018 WL 4026346 (N.D. Tex. June 12, 2018)

In denying Hanover Insurance Company's Motion ("Hanover") for Summary Judgment, Judge Godbey held that the Ensuing Loss provision in Nay's Co.'s ("Nay") builder's risk policy was ambiguous, adopted Nay's construction of that clause, and then concluded that, even if the Defects Clause was triggered, the Ensuing Loss Clause operated to reinstate coverage.

Nay engaged Southern Commodities, LLC to install a new grain handling system. Nay also hired Feed Mill Erection Co., Inc. ("FMEC") as a subcontractor to install the elevator. Near the completion of FMEC's work, FMEC discovered that it needed to position a crane in a particular location to install a grain spout. The guy wires anchoring the elevator made it impossible to position the crane properly, so FMEC removed the north guy wires, and slackened the other guy wires. The elevator toppled over, damaging the elevator and surrounding property.

Nay had a builder's risk insurance policy with Hanover, which provides that Hanover covers "risks of direct physical loss or damage unless the loss is limited or caused by a peril that is excluded." The policy's Defects Exclusion provides:

> We do not pay for loss or damage caused by or resulting from an act, defect, error, or omission (negligent or not) relating to:
>
> > 1) design, specifications, construction, materials, or workmanship;
> > 2) planning, zoning, development, siting, surveying, grading, or compaction; or
> > 3) maintenance, installation, renovation, remodeling, or repair.
>
> But if an act, error, or omission as described above results in a covered peril, we do cover the loss or damage caused by that covered peril.

The policy defines covered peril as all "risks of direct physical loss or damage unless the loss is limited or caused by a peril that is excluded."

Nay filed a claim under its builder's risk policy for the collapse of the elevator and resulting damage to the elevator and surrounding property. Hanover denied coverage, and Nay filed suit against Hanover and two other insurance companies, alleging breach of contract.

Judge Godbey held that the Defects Exclusion bars coverage. Either the elevator toppled because of the removal of the guy wires or because of the combination of the guy-wire removal and the wind. If the former (as Hanover argued), the exclusion applies directly. If the latter, because the wind and the guy-wire removal are inseparable concurrent causes, Texas law provides that the exclusion is triggered.

Turning to the Ensuing Loss Clause, Hanover argued that this clause did not apply because Nay's removal of the guy wires did not result in the wind that Nay contends knocked down the elevator. Nay argued that the Ensuing Loss Clause reinstated coverage because the removal of the guy wires resulted in a covered peril—the collapse of the grain elevator due to wind.

Judge Godbey held that the Ensuing Loss Clause is ambiguous because "result in" is susceptible to more than one interpretation. Two considerations prompted Judge Godbey to adopt Nay's construction of the Ensuing Loss Clause. First, where a provision in an insurance policy is ambiguous, courts adopt the insured's reading so long as that reading is not unreasonable. Judge Godbey concluded that Nay's reading was not unreasonable, and adopted it.

Second, Judge Godbey noted that Hanover's proposed construction of the Ensuing Loss Clause would render coverage under the policy largely illusory. Insureds purchase builder's risk policies to protect against liability for construction-related activities. Hanover's Defects Exclusion excluded from coverage loss or damage caused by design, specifications, construction, materials, or workmanship; planning, zoning, development, siting, surveying, grading, or compaction; and maintenance, installation, renovation, remodeling, and repair. Particularly in combination with Hanover's narrow reading of the Ensuing Loss Clause, Judge Godbey concluded that the policy would essentially cover nothing at all. Courts

refuse to construe insurance policies in ways that render coverage illusory.

Judge Godbey denied Hanover's Motion for Summary Judgment, and concluded that, even if the Defects Exclusion was triggered, the policy's Ensuing Loss Clause reinstated coverage under the insured's reasonable construction of that clause.

Fortuity Doctrine Does Not Require Actual Knowledge

Moser v. Fidelity Nat'l Title Ins. Co., No. 4:17-CV-104, 2018 WL 1413346 (E.D. Tex. Mar. 21, 2018).

The United States District Court for the Eastern District of Texas affirmed on appeal a judgment entered in the United States Bankruptcy Court wherein it was found that an exclusion and the fortuity doctrine barred coverage under a title insurance policy issued by Fidelity National Title Insurance Company.

Kernell and Stanley Thaw were married in 2001 and, the following year, Stanley and Dr. Leslie Schachar began operating a business together. When the business failed, Schachar paid business debts that were guaranteed by both Stanley and Schachar and, on May 6, 2008, sued to recover Stanley's share of the debt. While this action was pending in state court, the Thaws made arrangements to purchase a home. On August 6, 2009, the state court granted a motion for partial summary judgment for Schachar in the amount of $349,535.82, plus $12,500 in attorneys' fees and post-judgment interest. On October 28, 2009, the Thaws executed a contract to purchase the home for a principal amount of $1,750,000. On November 1, 2009, the Thaws revised the contract for deed, increasing the principal amount to $2,150,000. On November 5, 2009, the state court issued a final judgment against Stanley, which Stanley appealed. On November 11, 2009, Schachar recorded an abstract of judgment in the real property records, before the Thaws moved into the home.

While Stanley's appeal was pending, the Thaws sought financing to pay off their home and, through their businesses, borrowed money to pay off the home at an accelerated rate. Around June 27, 2011, the Thaws paid off the contract for deed, obtained a special warranty deed for the home, and recorded it in the real property records. On June 28, 2011, Fidelity issued a title insurance policy to the Thaws. On July 26, 2011, a Texas court of appeals affirmed the Schachar judgment, and on November 4, 2011, the Texas Supreme Court denied Stanley's petition for review.

Thereafter, on December 2, 2011, Stanley filed a petition for relief under Chapter 7 of the Bankruptcy Code. Christopher Moser was appointed as Trustee of Stanley's bankruptcy estate, and Schachar filed a proof of claim, asserting he had a secured claim of $400,566.17. During the bankruptcy proceedings, it was held, and ultimately affirmed by the Fifth Circuit, that a judgment lien attached to the Thaws home on November 11, 2009, when Schachar filed his abstract of judgment and before the Thaws made the home their homestead. Thus, when the home was sold in September 2013, the Schachar Lien attached to the net proceeds of the sale—approximately $500,000.

Fidelity's title policy was a "contract of indemnity, meaning a promise to pay [the insured] or take other action if [the insured] ha[s] a loss resulting from a covered title risk. The policy further defined "Covered Title Risks" to include a lien on title because of a judgment. However, Fidelity's policy included an exclusion precluding from

coverage title risks "that are created, allowed, or agreed to by [the insured]."

On January 28, 2014, Moser, the bankruptcy trustee, made a demand on Fidelity for benefits under the title policy, which Fidelity denied. Moser subsequently sued Fidelity in an adversary proceeding, arguing that Fidelity breached the title policy by denying the claim. Thereafter, the Bankruptcy Court issued an order in the adversary proceeding holding that coverage under the title policy was barred by the exclusion stated above and the fortuity doctrine. Moser appealed this order to the United States District Court.

On appeal, Moser argued that the Bankruptcy Court erred in issuing its order because (1) the Thaws did not have the requisite intent and therefore could not have "created, allowed, or agreed to" the Schachar lien, and (2) the fortuity doctrine did not apply. The District Court rejected Moser's first argument finding his contention that the exclusion's language "created, allowed or agreed to" requires proof that the Thaws had full and specific knowledge of the Schachar Lien as unreasonable. In its holding, the District Court reasoned that:

> It would be unreasonable for insureds to engage in a scheme to avoid paying a debt if they had "full knowledge" that the scheme would fail. Under [Moser's] reading of [the exclusion], an insured who engages in substantial misconduct would be entitled to insurance benefits whenever an insurer cannot prove the insured acted with full and specific knowledge that the insured's conduct would result in liability, including circumstances of willful ignorance. This interpretation would essentially make a title insurer the guarantor of an insured's debt where, as here, an insured who intentionally refuses to fulfill the insured's financial obligations later denies knowing that a lien would arise as a consequence.

Similarly, the District Court also rejected Moser's second argument that the fortuity doctrine does not apply because the Thaws lacked actual knowledge of the Schachar lien and would not have understood the effect of an abstract of judgment even if they had known one had been filed. However, the District Court noted the following:

> Contrary to [Moser's] assertions, the fortuity doctrine does not require an insured to have specific, actual knowledge of the loss. Instead, the fortuity doctrine precludes coverage when the insured is or *should be aware* of an ongoing progressive or known loss at the time the policy is purchased.

Based on these reasons, the District Court rejected Moser's arguments on appeal and found that the bankruptcy court did not err in holding that Fidelity's title policy precluded coverage under its exclusion and the fortuity doctrine.

"Pollutant" Includes Both Hazardous and Nonhazardous Pollutants

Great Am. Ins. Co. v. ACE Am. Ins. Co., 4:18-CV-114-A, 2018 WL 3370620 (N.D. Tex. July 10, 2018).

The United States District Court for the Northern District of Texas, Fort Worth Division, held that, under Texas law, the pollution exclusion in a commercial umbrella insurance policy was clear, unambiguous, and absolute as to its application to a pollution claim arising out of a company's accidental discharge of waste material into a

stream, generated by the company's rock-crushing activities. In so holding, the court reasoned that "substances can constitute pollutants regardless of their ordinary usefulness," and that the term "pollutant" includes both hazardous and nonhazardous pollutants. As a result, the court held that the rock fines at issue were "waste material" as defined by the policy, and also that the rock fines became "irritants or contaminants" when they were discharged and dispersed where they did not belong. Accordingly, the court held that there was no duty to defend or indemnify a company against a suit by the state of New Jersey for violations arising out of damage to New Jersey resources because the absolute-pollution exclusion in the commercial umbrella policy excluded coverage for damage caused by the discharge of rock fines.

Following a demand for reimbursement of all costs to remove the rock fines from a New Jersey Spruce Run and for reimbursement of the costs of defense, Great American Insurance Company ("Great American") filed suit against Eastern Concrete Materials, Inc. ("Eastern") and Ace American Insurance Company ("ACE") seeking a declaratory judgment that (1) it had no duty to defend Eastern against a New Jersey pollution claim or to pay its defense costs; (2) it had no duty to indemnify Eastern against any liability arising from or relating to the New Jersey pollution claim; and (3) to the extent that Great American had any potential coverage obligations to Eastern in connection with the New Jersey pollution claim, its obligations were excess to coverage provided by the ACE policy. Great American also moved for summary judgment on these claims, arguing that the absolute-pollution exclusion provision of the policy barred coverage for the New Jersey pollution claim.

ACE had issued a commercial general liability ("CGL") policy to Eastern and/or its parent company U.S. Concrete, Inc. ("U.S. Concrete") and Great American issued a commercial umbrella insurance policy for the same period as the CGL policy, under which U.S. Concrete and some of its subsidiaries, including Eastern, were named insureds. The payment and defense obligations under Great American's commercial umbrella policy, however, were limited in pertinent part by an absolute pollution exclusion which provided:

> This insurance does not apply to:
>
> ***
>
> I. Any liability, including but not limited to settlements, judgments, costs, charges, expenses, costs of investigations, or fees of attorneys, experts, or consultants, arising out of or in any way related to:
>
> 1. The actual, alleged or threatened presence, discharge, dispersal, seepage, migration, release, or escape of "pollutants," however caused.
>
> 2. Any request, demand or order that any "Insured" or others test for, monitor, clean-up, remove, contain, treat, detoxify, neutralize, or in any way respond to or assess the effects of "pollutants."…
>
> ***

Pursuant to the policy, this exclusion applied to "any liability, costs, charges, or expenses, or any judgments or settlements arising directly or indirectly out of pollution whether or not the pollution was sudden, accidental, gradual, intended, expected, unexpected, preventable or preventable." "Pollutants"

were defined by the policy as "any solid, liquid, gaseous, or thermal irritant or contaminant, including, but not limited to, smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste material." "Waste material" included materials which were "intended to be or have been recycled, reconditioned or reclaimed."

In applying this exclusion to rock fines—small particles of rock generated as part of the stone crushing process at the quarry—the court noted that the fines were "washed off with water and placed in ponds to settle, then 'removed, dried out and prepared for use as reclamation fill'… or sold as fill material or for other undefined purposes." Further, the court found it important that the rock fines caused physical damage when pumped out of the settlement ponds into the New Jersey Spruce Run.

The court reasoned that "substances can constitute pollutants regardless of their ordinary usefulness," and emphasized that the Fifth Circuit has rejected the argument that a substance must generally act as an irritant or contaminant to constitute a pollutant under the pollution exclusion. Accordingly, the court found that the rock fines were clearly waste material generated in the rock crushing process, and that the fact that the fines were wanted or useful had no bearing on this classification. The court further considered that the rock fines in the present case were materials intended to be reclaimed within the policy's definition of "waste material." In addition, the court found that the fines were solids, and became irritants or contaminants when they were discharged and dispersed where they did not belong. As a result, the absolute pollution exclusion applied and was fatal to Eastern's claims for defense and indemnity from Great American under the umbrella policy.

Because the court held that Great American did not have a defense obligation, and because the pollution exclusion caused the insurance not to apply to the Spruce Run claim, the court also held that Great American did not have a duty to indemnify. As a result, the court granted Great American's motion for summary judgment and declared that the policy did not apply to, or provide coverage for, the benefit of Eastern as to any liability arising out of, or in any way related to, the pumping of rock fines into Spruce Run.

Breach of Contract Exclusion Does Not Encompass All Work Incidentally Related to the Contract

Mt. Hawley Ins. Co. v. Slay Eng'g, Texas Multi-Chem, & Huser Constr. Co., Inc., No. 5-18-CV-00252-OLG, __ F.Supp.3d __, 2018 WL 3946547 (W.D. Tex. Aug. 15, 2018)

The Western District of Texas held that an insurance company could not avoid its duty to defend on the basis of a standard-form breach of contract exclusion when the underlying lawsuit alleged that work was performed deficiently by both the insured (the general contractor) and its subcontractors. The court narrowly read the breach of contract exclusion by holding that it did not apply to a subcontractor's defective work merely because the subcontractor was incidentally connected to the contract between the general contractor and the plaintiff in the underlying suit. Instead, the court held that the exclusion would only apply to deficient work by the general contractor itself, or breaches of specific contractual duties the insured had undertaken.

The City of Jourdanton (the "City") entered into a construction contract with the insured

("Huser Construction") to construct a municipal sports complex. Huser Construction, in turn, hired various subcontractors to assist in completing the work. The City claimed that various aspects of the construction work were deficient and eventually sued Huser Construction alleging breach of contract and negligence claims. Specifically, the City alleged that "work performed by [Huser Construction], its subcontractors and suppliers, was [ ] defective and not in compliance with the requirements of the agreement with the City or with the duties of care arising thereunder."

After receiving notice of the lawsuit, Huser Construction's insurer, Mt. Hawley Insurance Co. ("Mt. Hawley"), filed a declaratory judgment action seeking a declaration that it owed no duty to defend Huser Construction by operation of the policy's breach of contract exclusion which excluded coverage for any claim or suit "arising directly or indirectly out of a breach of contract or breach of express or implied warranty." Mt. Hawley argued that "but for the contract [between Huser Construction and the City], there would be no cause of action to bring against Huser."

The court began its analysis by defining the scope of the breach of contract exclusion, holding that the contract exclusion should be read narrowly, and only pertains "to the insured's liability for repairing its own deficient work or to specific contractual obligations that the insured has assumed." In coming to this conclusion, the Court paid particular attention to the "Your Work" exclusion which excluded coverage for "property damage to your work arising out of it or any part of it…" but which specifically provided that "[t]his exclusion does not apply if the damaged work or the work out of which the damage arises was performed by a subcontractor." The court reasoned that:

> [I]t is not natural to interpret the Breach of Contract Exclusion such that it encompasses all work incidentally related to the Project regardless of the party that performed the work or the capacity in which it did so. Indeed, doing so in this case would both (i) *unnecessarily* render the subcontractor exception to the Your Work Exclusion without meaning, and (ii) mean that the Court has *impermissibly* resolved any potential ambiguity related to the scope of the exclusions in favor of the *insurer*, rather than the *insured*.
>
> Accordingly, the Court declines to adopt the sweeping interpretation asserted by Mt. Hawley, and instead finds that the Policies should be interpreted such that the subcontractor exception to the Your Work Exclusion still has meaning.

(emphasis in original).

The court also interpreted the "arising out of" language in the breach of contract exclusion to require a showing of "but for" causation and not merely an incidental connection to the contract. Therefore, in order for an insurer to overcome the duty to defend based on the breach of contract exclusion, the insurer would be required to prove "that the facts alleged in the Underlying Suit demonstrate that there are *no other* independent, covered (non-excluded) 'but for' cause of the alleged property damage

[independent of breach of contract].” (emphasis in original).

Based on the foregoing, the court concluded that because the allegations in the pleadings specifically alleged that “work performed by [Huser Construction], its subcontractors and suppliers, was [ ] defective…” that the pleadings alleged a possible separate and covered “but for” cause of the alleged property damage—defective work performed by a subcontractor—which would require Mt. Hawley to defend the suit.