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Insurance Law

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INSURANCE LAW

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I. INTRODUCTION

During this Survey period,[1] Texas courts issued opinions analyzing the meaning of "property damage" under a commercial general liability policy (CGL policy), whether loss-of-use damages are recoverable under an underinsured motorist policy in the case of a total loss of property, the relevant standards for determining the duty to defend, and the justiciability of the duty to indemnify. The Texas Supreme Court continued to evaluate issues implicated by the statutory framework of the workers' compensation system. Moreover, courts examined issues associated with extra-contractual claims and the scope of the application of the *Stowers* doctrine.

II. CONTRACTUAL LIABILITY

A. COMMERCIAL GENERAL LIABILITY INSURANCE

In *U.S. Metals, Inc. v. Liberty Mutual Group, Inc.*, the Texas Supreme Court evaluated issues regarding whether property sustains property damage by the "mere installation" or incorporation of defective products and the scope of the "impaired property" exclusion under a CGL policy.[2] The insured, U.S. Metals, Inc. (U.S. Metals), sold and delivered to ExxonMobil 350 "stainless steel . . . flanges for use in . . . diesel units" at ExxonMobil's refineries.[3] The flanges were welded to piping before both "were covered with a special high temperature coating and insulation."[4] Several flanges leaked during post-installation testing, prompting ExxonMobil to conduct additional investigation of the products.[5] This "investigation revealed that the flanges did not meet industry standards, and ExxonMobil decided it was necessary to replace them to avoid the risk of

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1. This article encompasses opinions issued between November 1, 2015 and October 31, 2016.
2. U.S. Metals, Inc. v. Liberty Mut. Grp., Inc., 490 S.W.3d 20, 21–23 (Tex. 2015).
3. *Id.* at 21–22.
4. *Id.* at 22.
5. *Id.*

fire and explosion."[6] The replacement "process involved stripping the temperature coating and insulation" (destroying both in the process), "cutting the flange out of the pipe, removing the gaskets" (destroying them in the process), "grinding the pipe . . . smooth for re-welding, replacing the flange and gaskets," and then "replacing the temperature coating and insulation."[7]

ExxonMobil sued U.S. Metals seeking recovery of the costs associated with replacing the flanges and consequential damages for loss of use of the diesel units.[8] After settling the lawsuit, U.S. Metals sought "indemnification from its . . . insurer, Liberty Mutual Group, Inc." (Liberty).[9] Liberty denied coverage for the claim, prompting U.S. Metals to file a coverage lawsuit in federal court. Eventually, the case reached the U.S. Court of Appeals for the Fifth Circuit, which certified four questions to the Texas Supreme Court.[10] In its opinion, the supreme court summarized the issues presented:

> [T]he parties' dispute and the certified questions distill to two essential inquires. First: did the mere installation of the faulty flanges physically injure the diesel units when the only harm at that point was the risk of leaks? Or put more generally: is property physically injured simply by the incorporation of a faulty component with no tangible manifestation of injury? And second: is property restored to use by replacing a faulty component when the property must be altered, damaged, and repaired in the process?[11]

Regarding the first issue, the supreme court found that the term "physical injury" under the CGL policy "requires tangible, manifest harm and does not result merely upon the installation of a defective component in a product or system."[12] In reaching this decision, the supreme court initially commented that a *physical* injury was a separate and distinct concept from mere injury; thus, logic requires that physical injury be more than a mere diminution of value inherent in installing a faulty part.[13] Finding otherwise would render the word "physical" superfluous in contravention of the rules of contract interpretation.[14] Moreover, the supreme court pointed to its own doctrine regarding faulty workmanship claims, where in the case of defective installation, occurrences were deemed to happen at the time of damage rather than at the time of discovery.[15] The supreme court reasoned that adopting the incorporation theory would be inconsis-

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6. *Id.*
7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.* at 23.
11. *Id.* U.S. Metals did not seek coverage for any damage to the flanges themselves, conceding that Exclusion K (the "your product" exclusion) barred coverage for that aspect of the loss. *Id.* at 22.
12. *Id.* at 27.
13. *Id.* at 24–25.
14. *Id.*
15. *Id.* at 27.

tent with precedent, as it would allow for an occurrence *before* the time of actual damage.[16] While this had the unintended effect of precluding coverage for U.S. Metals due to ExxonMobil's proactive repairs, the supreme court reasoned that the wording of the CGL policy was "clear."[17] Thus, the supreme court held that the "diesel units were not physically injured merely by the installation of U.S. Metals' faulty flanges."[18]

Nevertheless, the supreme court recognized that the diesel "units *were* physically injured in the process of replacing the faulty flanges."[19] Thus, "the repair costs and damages for the downtime were 'property damages' covered by the policy unless Exclusion M applies."[20] That exclusion bars coverage under the CGL policy for "damages to property, or for the loss of its use, if the property was not physically injured or if it was restored to use by replacement of the flanges."[21] U.S. Metals argued that "the diesel units were not 'impaired property' and Exclusion M" did not preclude coverage for the loss of use of the diesel units "because the flanges were welded," meaning that the restoration of the diesel units required "much more than simply removing and replacing the flanges alone."[22] The supreme court disagreed:

> The policy definition of "impaired property" does not restrict *how* the defective product is to be replaced. U.S. Metals' argument requires limiting the definition to property "restored to use by the . . . replacement of [the flanges]" *without affecting or altering the property in the process*. That limitation cannot be fairly inferred from the text itself, nor would it make sense to do so. In U.S. Metals' view, the diesel units could not be restored to use by replacement of the flanges, not only because they had to be cut out and welded back in, but because of the wholly incidental replacement of insulation and gaskets. Coverage does not depend on such minor details of the replacement process but rather on its efficacy in restoring property to use. The diesel units were restored to use by replacing the flanges and were therefore impaired property to which Exclusion M applies. Thus, their loss of use is not covered by the policy.[23]

Though Exclusion M barred coverage for the loss of use claims, the supreme court recognized that the exclusion did not preclude coverage for the "insulation and gaskets destroyed" during the repair process.[24]

In rejecting the incorporation theory, the supreme court adopted an approach consistent with that of a majority of courts that have evaluated the issue.[25] Moreover, the supreme court remained consistent in its ap-

16. *Id.*
17. *Id.*
18. *Id.* at 28.
19. *Id.*
20. *Id.*
21. *Id.* at 22.
22. *Id.* at 28.
23. *Id.*
24. *Id.*
25. *Id.* at 26–27.

proach to what constitutes "property damage" under Texas law, noting that "faulty workmanship that merely diminishes the value of . . . [property] without causing physical injury or loss of use does not involve 'property damage.'"[26]

Nevertheless, in finding that the CGL policy provided coverage for the otherwise undamaged insulation and gaskets that were destroyed during the repair process,[27] disputes and litigation will likely continue over the scope of coverage for these so-called "rip and tear" or "get to" damages. The Fourteenth Houston Court of Appeals addressed coverage for rip and tear damages in *Lennar Corp. v. Great American Insurance. Co.*, finding that the costs were "damages because of . . . property damage."[28] In that case, the insured sought coverage for the removal and replacement of a defective Exterior Insulation and Finish System (EIFS). For some homes, the insured "presented evidence that it incurred other costs to repair the water damage in addition to the costs to actually repair the damaged areas . . . [when] windows were broken, driveways were cracked, and landscaping was damaged to repair the water damage."[29] In *U.S. Metals*, the Texas Supreme Court simply concluded that the insulation and gaskets intentionally destroyed to remedy the defective products were "not impaired property" and that "the cost of replacing them was therefore covered by the policy."[30] It is unclear whether *U.S. Metals* followed the *Lennar* precedent, that the destruction of the insulation and gaskets was covered because it constituted "damages because of . . . property damage,"[31] or whether the supreme court opened the door for a broader category of property damage under similar facts.

B. Auto Insurance

In *J & D Towing, LLC v. American Alternative Insurance Corp.*, the Texas Supreme Court held that loss of use damages are recoverable "in addition to the fair market value of the property" in the case of a total loss of personal property.[32] The insured, J & D Towing (J & D) is a towing company that owned a single tow truck. On December 29, 2011, a car collided with the passenger side of the truck, rendering the truck a total loss.[33] J & D settled with the other driver's insurer and used the proceeds from that settlement to purchase another tow truck.

Thereafter, J & D filed a claim arising out of the accident with its insurer, American Alternative Insurance Corporation (AAIC), asserting

26. *Id.* at 27 (quoting Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1, 8–10 (Tex. 2007)).
27. *Id.* at 28.
28. Lennar Corp. v. Great Am. Ins. Co., 200 S.W.3d 651, 678, 678 n.33 (Tex. App.—Houston [14th Dist.] 2006, pet. denied), *abrogated on other grounds by* Gilbert Tex. Const., L.P. v. Underwriters at Lloyd's London, 327 S.W.3d 118 (Tex. 2010).
29. *Id.*
30. *U.S. Metals*, 490 S.W.3d at 28.
31. *See Lennar Corp.*, 200 S.W.3d at 678.
32. J & D Towing, LLC v. Am. Alt. Ins. Corp., 478 S.W.3d 649, 677 (Tex. 2016).
33. *Id.* at 653.

that the proceeds from the other driver's insurer did not compensate J & D "for the loss of use of the truck."[34] AAIC denied coverage, arguing that under Texas law, loss-of-use damages are available for *partial* destruction of property but not in situations where there is *total* destruction.[35] J & D argued that making such a "distinction belies common sense and is out of step with the majority trend in other jurisdictions permitting loss-of-use damages in total-destruction cases."[36]

After an extensive discussion regarding the development of the law on this issue in both Texas and throughout the United States, the supreme court sided with J & D, holding that it was illogical for an "owner of totally destroyed personal property" to have no ability to recover loss-of-use damages.[37] In doing so, the supreme court explained that it was following the modern trend that such damages should be recoverable "in addition to the fair market value of the property immediately before the injury."[38] The loss-of-use damage constitutes a "wholly independent . . . measure of property damage" apart from the damage itself.[39] The supreme court did, however, caution that in allowing recovery of "loss-of-use damages in total destruction cases," it was not granting "a license for unrestrained raids on defendants' coffers."[40] Rather, these consequential damages "must be foreseeable and directly traceable to the tortious act" but must not be "too remote" or speculative.[41] Additionally, consequential damages "may not be awarded for an unreasonably long period of lost use," which indicates the claimant must mitigate its damages.[42]

C. Property Insurance

1. Fifth Circuit Evaluates Whether Coverage Exists for Claims That an Insured Was Legally Required to Upgrade His Roof Following Hail Loss

In *Toney v. State Farm Lloyds*, the U.S. Court of Appeals for the Fifth Circuit evaluated the proper method for calculating the amount of covered loss associated with the replacement of a roof.[43] Kenneth Toney insured his home with State Farm Lloyds. A hail storm damaged the roof of the home in March 2012.[44] Toney filed a claim, and eventually invoked the appraisal provision of his policy. The appraiser valued the claim at $67,431.47.[45] A portion of this appraisal included funds to replace the undamaged spaced decking of Toney's roof with solid sheathing. Toney

34. *Id.*
35. *Id.*
36. *Id.*
37. *Id.* at 657–676.
38. *Id.* at 676.
39. *Id.*
40. *Id.* at 677.
41. *Id.*
42. *Id.*
43. Toney v. State Farm Lloyds, 661 F. App'x 287, 288 (5th Cir. 2016) (per curiam).
44. *Id.*
45. *Id.*

argued that local ordinances required the upgrade, and as such, the policy should provide coverage for the additional expense.[46] Though State Farm Lloyds accepted part of the claim, it declined coverage for that part of the appraisal award related to roof decking, "citing the January 2013 letter from the [local] building inspector" stating that Toney was not required by law to replace the decking.[47] Toney sued, and State Farm Lloyds eventually won summary judgment in federal district court.[48] Toney appealed.[49]

The policy required State Farm Lloyds to pay for "'the legally required changes to the undamaged portion of the dwelling caused by the enforcement' of a building ordinance 'if the enforcement is directly caused by the same Loss Insured and the requirement is in effect at the time the Loss Insured occurs.'"[50] At the time the house was damaged, Texas had adopted the International Residential Code (IRC), which required only that *new* materials used and repairs performed "conform to the requirements for newly constructed" buildings.[51] The IRC specifically excluded those "[p]ortions of the structure" that were undamaged and unaffected "by the alteration."[52] Toney presented various letters in his defense, including an October 2012 letter from the local building inspector as proof that the replacement decking was required, but the Fifth Circuit observed that this letter merely cited those portions of the IRC that required new materials to meet standards imposed by code.[53] All other documents presented by Toney did not, according to the Fifth Circuit, establish that he was required by law to replace the sheathing on his roof.[54] Consequently, the Fifth Circuit ruled that State Farm Lloyds was "entitled to judgment as a matter of law."[55]

2. Fifth Circuit Finds That No Coverage Applies for a Hail Loss Due to an Insured's Failure to Provide Timely Notice of the Claim

In *Hamilton Properties v. American Insurance Co.*, the U.S. Court of Appeals for the Fifth Circuit examined whether an insured's delay in reporting a hail claim was grounds for an insurer to deny coverage.[56] Hamilton Properties insured its hotel through American Insurance Company (AIC) under a policy that provided coverage for "all risks of direct physical loss or damage, except as excluded or limited elsewhere."[57] The hotel

46. *Id.*
47. *Id.* at 289.
48. *Id.* at 289–90.
49. *Id.* at 290.
50. *Id.* at 291.
51. *See id.* at 292.
52. *Id.*
53. *Id.* at 292–93.
54. *Id.*
55. *Id.* at 293.
56. Hamilton Props. v. Am. Ins. Co., 643 F. App'x 437, 438 (5th Cir. 2016) (per curiam).
57. *Id.*

was allegedly damaged by a hailstorm in July 2009, but Hamilton Properties did not report the claim to AIC until February 2011.[58] AIC denied coverage, citing the delay in reporting as well as multiple intervening hail storms, which, according to AIC, could have "caused the damage."[59] Hamilton Properties sued AIC for breach of contract and extra-contractual claims, which the district court dismissed through summary judgment.[60]

On appeal, the Fifth Circuit court noted that "[t]he policy required that Hamilton provide to AIC 'prompt' notice" of a claim.[61] Texas courts interpret prompt to require "'that notice must be given *within a reasonable time* after the occurrence' of the damage."[62] Agreeing with the district court, the Fifth Circuit found that Hamilton Properties' unexplained delay in notifying AIC "was not prompt as a matter of law."[63] The Fifth Circuit recognized, however, that an "insured's breach of a prompt notice provision does not" in and of itself preclude coverage under a policy.[64] Rather, an insurer must demonstrate "that it was prejudiced" by a breach of a notice condition.[65] Such "[p]rejudice can arise when the failure to timely notify results in the insurer's 'inability to investigate the circumstances of an occurrence to prepare adequately to adjust or defend any claims.'"[66]

Hamilton Properties argued that the untimely notice did not impair AIC's ability to investigate the loss.[67] The Fifth Circuit disagreed, observing that it was "undisputed that . . . [the] delay" had cost AIC the ability to gather critical evidence, particularly the condition of the hail damage immediately "before and after" the storm.[68] Even if there was no prejudice from the late notice, the Fifth Circuit reasoned that Hamilton Properties produced no evidence "to establish a prima facie claim for breach of contract."[69] Texas law requires an insured to establish coverage.[70] The policy issued by AIC "covers damage by a hailstorm 'provided such loss or damage occurs during the term of [the] policy,'" which "was from February 16 to September 24, 2009."[71] Hamilton Properties identified no evidence of such damage during that time. Rather, the bulk of the

58. *Id.* at 438–39.
59. *Id.* at 439.
60. *Id.*
61. *Id.* at 440.
62. *Id.* (quoting Ridglea Estate Condo. Ass'n v. Lexington Ins. Co., 415 F.3d 474, 479 (5th Cir. 2005) (citing Stonewall Ins. Co. v. Modern Expl., Inc., 757 S.W.2d 432, 435 (Tex. App.—Dallas 1988, no writ))).
63. *Id.*
64. *Id.* (citing Blanton v. Vesta Lloyds Ins. Co., 185 S.W.3d 607, 611 (Tex. App.—Dallas 2006, no pet.)).
65. *Id.*
66. *Id.* at 440–41(quoting *Blanton*, 185 S.W.3d at 615).
67. *Id.* at 441.
68. *Id.*
69. *Id.*
70. *Id.* (citing Data Specialties, Inc. v. Transcon. Ins. Co., 125 F.3d 909, 911 (5th Cir. 1997)).
71. *Id.*

evidence identified only the present condition of the hotel, which would not "enable a [reasonable] jury to segregate damages" specific to the hailstorm and the policy period.[72] As such, Hamilton Properties' claim for breach of contract failed as a matter of law.[73]

D. Commercial Crime Insurance

In *Tesoro v. National Union Fire Insurance Co.*, the U.S. Court of Appeals for the Fifth Circuit evaluated whether an "unlawful taking" occurred to trigger "a commercial crime policy."[74] The insured, Tesoro Refining and Marketing Company, L.L.C. (Tesoro), was in the business of selling petroleum products, and in 2003 began selling fuel on an unsecured credit line of $25 million to Enmex Corporation (Enmex).[75] By December 2007, Enmex's account ballooned to $45 million.[76] An auditor contacted Tesoro's account supervisor regarding the outstanding balance, and the account supervisor represented that Enmex's credit account was "secured [with] a $12 million letter of credit."[77] A month later, a consultant for Tesoro inquired with the same account supervisor regarding the balance and he produced what purported to be "a $24 million letter of credit[.]"[78] This process repeated itself over the next few months and subsequent forensic analysis determined that the letters of credit had been generated in a password-protected portion of Tesoro's own server.[79] By December 2008, with Enmex's account balance at $90 million, Tesoro presented a $24 million "letter of credit to Bank of America," who promptly responded that the letter was a forgery.[80] Tesoro ceased sales to Enmex, sued, and then settled, ultimately presenting a claim with a proof of loss to its insurer, National Union Fire Insurance Company (National Union), for $15 million under its commercial crime policy.[81] The policy at issue contained "different 'insuring agreements' covering specific risks like employee theft, forgery and alteration, or computer fraud."[82] Tesoro argued the claim triggered the "Forgery and Alteration" insuring agreement, but National Union disagreed and denied coverage.[83] Tesoro then provided an amended proof of loss, claiming that the claim fell under the

72. *Id.* at 441–42.

73. *Id.* With respect to Hamilton Properties' "extra-contractual claims," the Fifth Circuit affirmed the district court's decision that those were not recoverable. *Id.* at 442. Noting that where there is no breach of contract, an insured can recover extra-contractual damages only when an insurer engages in "extreme" actions that cause damages "independent" of the insurance claim or "fail[s] to timely investigate [an insurance] claim." *Id.* The Fifth Circuit found that neither circumstance was present. *Id.*

74. Tesoro Ref. & Mktg. Co. v. Nat'l Union Fire Ins. Co., 833 F.3d 470, 472 (5th Cir. 2016).

75. *Id.*

76. *Id.*

77. *Id.*

78. *Id.*

79. *Id.* at 472–73.

80. *Id.* at 473.

81. *Id.*

82. *Id.*

83. *Id.*

"Employee Theft" coverage, but National Union still denied coverage.[84] The denials prompted Tesoro to sue, and the district court subsequently granted summary judgment in favor of National Union, reasoning that the "Employee Theft" insuring agreement did not "cover forgery losses independent of a theft and instead always required an 'unlawful taking' to trigger coverage."[85] Tesoro appealed.

The Fifth Circuit first analyzed the "Employee Theft" insuring agreement, which provides that National Union will "pay for loss of or damage to 'money,' 'securities,' and 'other property' resulting directly from 'theft' committed by an 'employee'" and that "[f]or purposes of this Insuring Agreement, 'theft' shall also include forgery."[86] The policy defined theft as "the unlawful taking of property to the deprivation of the Insured."[87] Tesoro contended that "the district court erred by requiring an 'unlawful taking,'" and that the proper reading of the policy was that theft was expanded by the latter sentence of the "Employee Theft" insuring agreement to include forgery.[88] The Fifth Circuit rejected this argument, noting that such a reading isolated the single sentence from the obvious context of the rest of the section, namely providing forgery as a possible means by which theft could occur.[89] Moreover, Tesoro's reading would have rendered meaningless a separate "Acts of Employees" exclusion regarding "employee forgery [of] commercial paper," since such acts would have become, by definition, theft and covered under the policy.[90]

The Fifth Circuit then made an *Erie* guess regarding whether there was a genuine dispute of material fact over whether the actions of Tesoro's account supervisor constituted an unlawful taking under the policy.[91] The Fifth Circuit noted that Tesoro's appellate brief was inconsistent in its characterization of what precisely constituted the loss, but assumed, *arguendo*, that the loss was the fuel sold to Enmex.[92] After a brief examination of the application of Texas theft statutes, the Fifth Circuit concluded that theft required that "those who consent to . . . transfer" of property "be aware of the deceptive representation in order to be induced by it" and that such deception must bear significantly on the decision to transfer property.[93] Assuming, *arguendo*, that the account supervisor forged the letters of credit, the Fifth Circuit found there was an "evidentiary deficit" in Tesoro's pleadings.[94] Tesoro "failed to offer . . . evidence" that substantially demonstrated that "it would have acted differently had it known the

84. *Id.*
85. *Id.*
86. *Id.* at 474.
87. *Id.*
88. *Id.*
89. *Id.* at 476.
90. *Id.* at 475–76.
91. *Id.* at 473–74.
92. *Id.* at 476–77.
93. *Id.* at 477–78.
94. *Id.* at 478–79.

Enmex account was actually not secured."[95] In point of fact, evidence in the record showed Tesoro "continued to sell . . . to Enmex" when it knew that Enmex was unsecured and over its credit line.[96] As such, no genuine dispute existed, the district court properly ruled in favor of National Union's motion for summary judgment, and the Fifth Circuit affirmed.[97]

E. Workers' Compensation Insurance

During the Survey period, the Texas Supreme Court again evaluated various issues implicated under the Texas Workers' Compensation System (WCS). These cases illustrate the strong public policy in favor of the application of the exclusive remedies and statutory requirements of the WCS. It appears that the Texas Supreme Court is not interested or otherwise unwilling to find exceptions or loopholes in the statutory scheme.

1. Texas Supreme Court Invalidates Settlement Agreement Between Injured Employee and Employer's Insurer

After an on-the-job injury, Bonnie Jones began receiving workers' compensation benefits from her employer's workers' compensation insurer.[98] She "made three claims for supplemental income benefits (SIBs)" in 2011, leading to a disagreement regarding "whether [she] was entitled to [benefits] for the fourteenth quarter."[99] Following a contested-case hearing, the hearing officer found that "Jones did not make an active effort to obtain employment for each week" of the fourteenth quarter and rejected her claim for benefits.[100] An appeals panel upheld the decision, and Jones sued.[101] "The Department of Insurance's Division of Workers' Compensation (Division) intervened after receiving a proposed judgment approving the settlement at issue" before the Texas Supreme Court.[102] In the proposed settlement, the insurer would make a partial payment for the SIBs despite Jones's failure to comply with the requirements.[103] Both the trial court and appellate court approved the settlement.[104]

The supreme court, however, did not agree with the decisions by the lower courts.[105] It began its analysis noting that the "workers' compensation regime" had been overhauled by the legislature with the specific purpose of reigning in inefficiencies that had "reached 'crisis proportions,'" through minimal "judicial review of agency determinations," specific benefits formulas, and strict requirements for receiving benefits at the center

95. *Id.* at 479.
96. *Id.*
97. *Id.* at 480.
98. Tex. Dep't of Ins. v. Jones, 498 S.W.3d 610, 612 (Tex. 2016).
99. *Id.*
100. *Id.*
101. *Id.*
102. *Id.*
103. *Id.*
104. *Id.*
105. *Id.* at 613–14.

of the regime.[106] While the Texas Labor Code did allow for settlements, the supreme court instructed that any such settlement must comply with the specific formulae provided in both the Texas Labor Code and regulations promulgated by the Division.[107] In the case at bar, the hearing officer "made a finding of fact" that precluded an award of benefits.[108] While the Labor Code authorizes settling certain disputes over SIB awards (e.g., where no disagreement exists regarding whether a worker satisfied eligibility requirements), this matter did not present such a situation. As a result, the supreme court declined to approve this settlement or any settlement that is void on its face.[109] According to the supreme court, to allow otherwise would run counter to the intent expressed by the legislature when it overhauled the workers' compensation system.[110]

2. Texas Supreme Court Finds That Independent Contractor Is Employee Under the Texas Labor Code

In *TIC Energy & Chemical, Inc. v. Martin*, a Union Carbide Corporation (Union Carbide) employee, Kevin Martin, lost his leg at a Union Carbide facility.[111] Martin "recovered workers' compensation benefits through an owner-controlled insurance program (OCIP) administered by Union Carbide's parent company, Dow Chemical Company."[112] Martin then sued TIC Energy and Chemical Inc. (TIC), a subcontractor that provided "maintenance services at the [Union Carbide] facility," claiming his injuries resulted from TIC's negligence.[113] Relying on the exclusive remedy provision of the Texas Workers' Compensation Act (WCA), TIC claimed that Section 406.123 of the Texas Labor Code provided a "statutory defense as Martin's deemed fellow employee."[114] In support of its position, "TIC produced evidence of a written agreement with Union Carbide that extended workers' compensation insurance coverage under the OCIP to TIC and its employees[.]"[115] Martin countered that TIC was an independent contractor under Section 406.122(b) of the Texas Labor Code, meaning that the exclusive remedy provision was inapplicable.[116] The trial court denied TIC's motion for summary judgment, but allowed an interlocutory appeal.[117]

The intermediate appellate court "concluded [that] Sections 406.122 and 406.123 'irreconcilably conflict' because 'Section 406.123(e) unam-

106. *Id.* at 611–12.
107. *Id.* at 614–17; *see id.* at 612 n.4 (citing generally TEX. LAB. CODE §§ 410.251–.258 (West 2015)).
108. *Id.* at 613.
109. *Id.* at 613–14.
110. *Id.* at 616.
111. TIC Energy & Chem., Inc. v. Martin, 498 S.W.3d 68, 70 (Tex. 2016).
112. *Id.*
113. *Id.*
114. *Id.*
115. *Id.*
116. *Id.* at 70–71.
117. *Id.* at 71.

biguously states that the general contractor is deemed the "employer" of the subcontractor for [workers' compensation] purposes, but Section 406.122(b) unambiguously states that the subcontractor is not deemed an "employee" of the general contractor for [workers' compensation] purposes.'"[118] The Texas Supreme Court rejected the appellate court's conclusion, noting that the two sections can be read in harmony.[119]

Specifically, Section 406.122 states the "general rule of employee status for workers' compensation purposes" while Section 406.123 created an exception "by which a general contractor [could] become a statutory employer" of a subcontractor by way of written agreement.[120] Martin's contention that 406.123 was the general rule and 406.122 the exception created a scenario where lower tier subcontractors could not be employees for purposes of the statute, thus rendering 406.122 surplus. Such construction would be contrary to both the rules of statutory construction and *HCBeck, Ltd. v. Rice*, where the supreme court had previously explained that a general contractor who has purchased workers' compensation insurance to cover its subcontractors pursuant to a written agreement is protected by the benefits given to employers under the WCA.[121] Separately, the supreme court rejected Martin's contention that the usage of the term "independent contractor" in subsections (a) and (b) of 406.122 was redundant.[122] Lastly, the supreme court rejected Martin's contention that reading 406.122 as the rule would "confer a benefit" on subcontractors "without substantive quid pro quo" as desired by the legislature.[123] Instead of simply conferring protection on subcontractors like TIC, the scheme allowed for all employees of a company like Union Carbide to enjoy protection from personal injury claims.[124] As a result, the supreme court found that TIC was entitled to rely on the exclusive remedy defense, and the case was remanded to the court of appeals for judgment in TIC's favor.[125]

III. EXTRA-CONTRACTUAL LIABILITY

A. *STOWERS* LIABILITY

A frequent dispute that arises between insureds and insurers is whether an insurer is obligated to tender its policy limits, pursuant to the *Stowers* doctrine, in response to a policy limits demand. The *Stowers* doctrine imposes a common law duty on insurers to exercise ordinary care in handling the settlement of claims in order to protect the insured from a

118. *Id.*
119. *Id.* at 76.
120. *Id.*
121. *Id.* at 74, 76; *see generally* HCBeck, Ltd. v. Rice, 284 S.W.3d 349 (Tex. 2009).
122. *Martin*, 498 S.W.3d at 77.
123. *Id.*
124. *Id.* at 77–78.
125. *Id.* at 78.

judgment in excess of the policy's limit.[126] To trigger the *Stowers* duty to settle, (1) the underlying claim must be covered by the policy; (2) the settlement demand must be "within the policy limits" and offer to fully release the insured; and (3) "the terms of the demand are such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to an excess judgment."[127] Circumstances involving multiple insureds, multiple claimants or multiple carriers on the same risk have led to various decisions from Texas courts.

1. Texas Supreme Court Finds Insurers Not Liable for $72 Million Verdict Because Claim Not Covered by the Policy

The threshold requirement to trigger *Stowers* liability is that the policy issued to the insured provides coverage for the loss.[128] A recent case from the Texas Supreme Court illustrates the dire consequences for an insured or assignee of an insured in the event that the *Stowers* judgment is based on a claim that is not covered by the policy. In *Seger v. Yorkshire Insurance Co.*, an accident killed a derrick hand who was working for a drilling company.[129] The parents of the decedent, the Segers, "obtained a judgment against the drilling company." The drilling "company assigned its rights against [its] insurers," who had denied coverage for the claim and rejected several settlement offers within the applicable limits, to the Segers.[130] Thereafter, the Segers "brought a *Stowers* action against [those] insurers" seeking to recover the judgment.[131]

Years of litigation resulted in a jury verdict in favor of the Segers and entry of judgment against the insurers for $37,213,592.01.[132] In the first appeal, the Amarillo Court of Appeals affirmed the trial court's decision that one of the settlement demands was within the policy limits, but it "reversed the trial court on six other holdings."[133] In particular, the court of appeals found that the drilling company's policy excluded coverage for injury to a leased-in worker.[134] And "because there was more than a scintilla of evidence that . . . the Segers failed to negate the applicability" of that "exclusion as a matter of law," the trial court had "erred in granting summary judgment on [that] issue."[135] On remand, the trial court entered a judgment in favor of the Segers for $71,696,547. The case was again appealed, and the trial court's judgment was set aside.[136] This time, the

126. Tex. Farmers Ins. Co. v. Soriano, 881 S.W.2d 312, 314 (Tex. 1994); G.A. Stowers Furniture Co. v. Am. Indem. Co., 15 S.W.2d 544, 547 (Tex. Comm'n App. 1929, holding approved).
127. Am. Physicians Exch. v. Garcia, 876 S.W.2d 842, 848–49 (Tex. 1994).
128. *Id.* at 848.
129. Seger v. Yorkshire Ins. Co., 503 S.W.3d 388, 392 (Tex. 2016).
130. *Id.* at 392–93.
131. *Id.* at 392.
132. *Id.* at 392–94.
133. *Id.* at 394.
134. *Id.*
135. *Id.*
136. *Id.* at 395.

court of appeals found "that the evidence was legally and factually insufficient to establish that" the drilling company had been damaged by its insurers.[137] Specifically, "the Segers relied exclusively on the inadmissible underlying judgment to prove damages, and that the trial court's judgment was the result of a proceeding that could not be characterized as a fully adversarial trial."[138] The court of appeals did not address the coverage issues, as "it held that the damages issue was dispositive."[139]

The supreme court upheld the appellate court's decision on different grounds, observing that before any question could be raised of a fully adversarial proceeding, the Segers first needed to establish all the necessary elements of a *Stowers* action, including whether the claim was actually covered by the drilling company's policy.[140] In particular, the supreme court found that the evidence conclusively established that the decedent "was a leased-in worker" for the drilling company, and as a result, the policy's exclusion for "leased-in employees/workers" applied.[141] Consequently, the "evidence [was] legally insufficient to support the jury's finding that the deceased worker was not a leased-in worker," the policy did not provide coverage for the damages recovered by the Segers, and the damages issue was moot under the *Stowers* action.[142]

2. Fifth Circuit Finds that Stowers Requires Insurer to Accept Reasonable Settlement Demand Even if It Does Not Unconditionally Release All Insureds

During the Survey period, the U.S. Court of Appeals for the Fifth Circuit also addressed issues created by a *Stowers* claim in *OneBeacon Insurance Co. v. T. Wade Welch & Associates*.[143] DISH Network Corporation (DISH) informed its attorneys who had handled an arbitration that DISH was potentially going to pursue a legal malpractice claim.[144] The law firm, in turn, notified its insurer, OneBeacon, of the potential claim, and OneBeacon responded by issuing a reservation of rights letter and requesting that the law firm notify it if DISH pursued formal claims. Subsequently, "DISH offered to settle and release the [law] firm in exchange for OneBeacon's policy limits."[145] However, DISH would not release the attorney whose conduct was the basis of the legal malpractice claim.[146] OneBeacon declined to accept the demand, noting that there were liability issues. OneBeacon subsequently rescinded the policy and filed suit for a declaration that an "exclusion barred coverage." The law firm counter-

137. *Id.*
138. *Id.* at 392, 395; *see* State Farm Fire & Cas. Co. v. Gandy, 925 S.W.2d 696, 714 (Tex. 1996).
139. *Seger*, 505 S.W.3d at 395.
140. *Id.* at 392.
141. *Id.* at 392–93.
142. *Id.* at 392.
143. 841 F.3d 669, 677–79 (5th Cir. 2016).
144. *Id.* at 673–74.
145. *Id.* at 674.
146. *Id.*

claimed and DISH intervened in the coverage lawsuit. DISH also initiated arbitration against the law firm, ultimately recovering an award of $12.5 million.

In the coverage suit, a jury found that OneBeacon was responsible for the arbitration award against the law firm, "plus $8 million in past and future lost profits, $5 million in exemplary damages, and $7.5 million in additional damages [based on] OneBeacon's 'knowing violation' of the Texas Insurance Code."[147] OneBeacon appealed, asserting that the district court erred by not applying an exclusion to bar coverage under the policy for the claim and that DISH's letter offering to settle was a valid *Stowers* demand.[148]

After determining that the exclusion did not apply, and that the policy provided coverage for the malpractice claim, the Fifth Circuit turned to the question of whether a letter from a third party plaintiff to the insured constituted a valid *Stowers* demand even though it offered to release the law firm and not the attorney in question.[149] While the Texas Supreme Court has not addressed such a situation, the Fifth Circuit had. Citing its opinion from *Travelers Indemnity Co. v. Citgo Petroleum Corp.*,[150] the Fifth Circuit followed that precedent and reiterated "that, when faced with a settlement demand over a policy with multiple insureds, an insurer fulfilling its *Stowers* duty is 'free to settle suits against one of its insureds without being hindered by potential liability to co-insured parties who have not yet been sued.'"[151] The Fifth Circuit explained that in *Citgo*, it had been influenced by the Texas Supreme Court's opinion from *Texas Farmer's Insurance Co. v. Soriano*.[152]

The Fifth Circuit specifically declined to follow the holding from a recent Texas appellate opinion where the state court found no *Stowers* liability with respect to an offer to release only an "insured employer [but] not [an insured] employee."[153] That case was distinguishable, according to the Fifth Circuit, because "the insured employer had explicitly [instructed] its attorney" against any settlement offers that did not release all claims against employer and employees.[154] As a result, the Fifth Circuit upheld the district court's decision regarding the *Stowers* issue.[155]

When the First Houston Court of Appeals issued its opinion in *Patterson*, some suggested that decision conflicted with the holdings in *Soriano* and *Citgo*, which instruct that *Stowers* permits an insurer to enter into a reasonable settlement, even if that settlement reduces or eliminates the

147. *Id.* at 675.
148. *Id.*
149. *Id.* at 677–78.
150. 166 F.3d 761, 764 (5th Cir. 1999).
151. *T. Wade Welch*, 841 F.3d at 678.
152. *Id.* (citing Tex. Farmers Ins. Co. v. Soriano, 881 S.W.2d 312, 314–16 (Tex. 1994)).
153. *Id.* at 678–79 (citing Patterson v. Home State Cty. Mut. Ins. Co., No. 01–12–00365–CV, 2014 Tex. App. LEXIS 4460 (Tex. App.—Houston [1st Dist.] Apr. 24, 2014, pet. denied) (mem. op.)).
154. *Id.* at 679.
155. *Id.*

insurance available for other claimants or other insureds.[156] These decisions, however, left open the question of whether *Stowers requires* an insurer in such a situation to accept the demand.[157] While *Patterson* answered that question in the negative, *T. Wade Welch* answered that question in the affirmative. As a result, it appears that a conflict now exists between Texas state courts and Texas federal courts, which the Texas Supreme Court may need to resolve.

B. Texas Insurance Code Chapter 542—Processing and Settlement of Claims

In *Quibodeaux v. Nautilus Insurance Co.*,[158] the U.S. Court of Appeals for the Fifth Circuit evaluated extra-contractual claims based on alleged violations of the Texas Insurance Code Chapter 542 (Chapter 542) following an insured's claim for damages to its properties caused by Hurricane Ike. The properties at issue included a day care center and a warehouse. After the hurricane, the insured submitted a claim for coverage to his insurer, Nautilus Insurance Company (Nautilus). Nautilus dispatched an independent adjuster, who provided estimates for less than the deductibles of $11,367.82 for damage to the day care center and $62,588.12 for damage to the warehouse.[159] Interestingly, Nautilus paid $12,149.69 for the damage to the day care and $72,720.97 for the damage to the warehouse, "explain[ing] at oral argument" that it had done so to resolve the claim in a more expedient manner.[160] The insured cashed both checks, meaning that Nautilus overpaid the claims by a total of $10,914.17.

The insured subsequently sued Nautilus in September 2010, asserting "breach of contract, statutory bad faith under Chapter 541 of the Texas Insurance Code, common law bad faith, violation of the Texas Deceptive Trade Practices–Consumer Protection Act, . . . and violation of Chapter 542."[161] Despite repeated requests that the insured submit a demand so that the matter could be resolved outside of litigation, no demand was ever provided. Nautilus removed to federal court and filed a motion to compel appraisal.[162]

While waiting on the district court's ruling on appraisal, the parties conducted discovery, which revealed for the first time that the insured was seeking damages for "unpaid contents damage."[163] The district court eventually granted the motion to compel appraisal and the appraiser assessed an amount of damage for the exterior of the buildings, which Nautilus paid. Six months later in November 2013, the insured made

156. J. Price Collins et al., *Insurance Law*, 2 SMU Ann. Tex. Surv. 199, 202–03 (2016).
157. *Id.*
158. 655 F. App'x 984, 985, 987–88 (5th Cir. 2016).
159. *Id.* at 985.
160. *Id.*
161. *Id.*
162. *Id.* at 985–86.
163. *Id.* at 986.

additional "claims for, among other things, damaged contents and lost business income, which needed to proceed to trial."[164] The district court denied the insured's motion to set a trial date and "ordered the parties to file dispositive motions" regarding the pending dispute. Nautilus subsequently won summary judgment and the insured appealed to the Fifth Circuit.

The Fifth Circuit first affirmed the district court's summary judgment for Nautilus on the insured's breach of contract claim and then turned to the common law bad faith and Chapter 541 claims.[165] Finding that Nautilus had not breached its contract—which is an essential "predicate" for maintaining a claim for bad faith—and that the insured showed "no exception to th[at] rule" applied, the Fifth Circuit affirmed the district court's summary judgment for Nautilus on these issues.[166]

Finally, the Fifth Circuit considered the insured's claims for damages under Chapter 542. The insured argued he was due payment because of Nautilus's delay both "between the initial payment[ ]" and the appraisal and "between the inspection and the initial payment."[167] The first claim was summarily dismissed as a matter of law, as "[a] plaintiff may not seek Chapter 542 damages for any delay in payment between an initial payment and the insurer's timely payment of an appraisal award."[168] With respect to the alleged delay in the initial payment in violation of Section 542.056, Nautilus conceded that it had failed to timely notify the insured of its "acceptance or rejection of the claim within [fifteen] . . . days" as required by that statute.[169] Nevertheless, the Fifth Circuit reached the following holding:

> The district court adopted the magistrate judge's report and recommendation, which held that the [Chapter 542] claims should be dismissed on the ground that they were barred by Nautilus's timely payment of the appraisal award. We review for plain error when a party is "served with notice of the consequences of failing to object" to a magistrate's report and recommendation but nonetheless does not object to the "magistrate judge's findings of fact, conclusions of law, or recommendation to the district court." Here, the magistrate judge's report and recommendation contained a clear warning about the consequences of failing to object. Nonetheless, [the insured's] objection as to the [Chapter 542] claims stated only that "the Magistrate erred in dismissing Plaintiffs' claim for penalty interest under § 542 of the Texas Insurance Code because, as demonstrated in Plaintiffs' summary judgment response, they are entitled to that interest for the time period preceding Defendant's untimely payments[.]" This objection addresses only untimely payment, which

164. *Id.*
165. *Id.* at 987.
166. *Id.*
167. *Id.*
168. *Id.* (citing *In re* Slavonic Mut. Fire Ins. Ass'n, 308 S.W.3d 556, 563 (Tex. App.—Houston [14th Dist.] 2010, no pet.)).
169. *Id.*

> could refer to only sections 542.057 (timely payment after acceptance) and 542.058 (timely payment), not section 542.056 (timely notice of acceptance of claim or of need for more time).[170]

Nautilus had overpaid on the claim initially in an attempt to resolve the claim in a "more expedient" manner. The Fifth Circuit found that because of that overpayment, Nautilus had fully compensated the insured for both the 18% penalty due for failure to notify the insured of acceptance of that claim and for any attorneys' fees associated with recovery of that interest.[171] Thus, the Fifth Circuit found that the insured had not shown that any delay had "affected his substantial rights[,]" and there was no reversible error.[172]

C. Duty of Good Faith and Fair Dealing

During the Survey period, the Dallas Court of Appeals addressed whether the duty of good faith and fair dealing exists in Texas with respect to claims by third parties. In *Martin v. State Farm Mutual Automobile Insurance Co.*,[173] the insured asserted claims that State Farm breached its contract by settling a liability claim against the insured because State Farm did not conduct a proper investigation of the accident. After rejecting the breach of contract claim,[174] the court of appeals noted that the remaining claims were "apparently based on the duty of good faith and fair dealing."[175] The court of appeals explained that the Texas Supreme Court has found that insurers owe no "common law duty of good faith and fair dealing" to their insureds with respect to the investigation and defense of claims by third parties.[176] The court of appeals further noted that the only potential extra-contractual exposure that State Farm could have in this context was for a breach of *Stowers*.[177] However, because State Farm both met its contractual obligations to its insured and settled the liability claim within limits, it had no exposure under that doctrine.[178]

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170. *Id.* (fourth alteration in original) (citation omitted).
171. *Id.* at 988–89.
172. *Id.* at 989.
173. No. 05-14–01473–CV 2016, Tex. App. LEXIS 2932, at *2 (Tex. App.—Dallas Mar. 22, 2016, pet. denied) (mem.op.).
174. *Id.* at *7–8; *see infra* Part IV.C.
175. *Martin*, 2016 Tex. App. LEXIS 2932, at *8.
176. *Id.* at *8–9 (citing Md. Ins. Co. v. Head Indus. Coatings & Servs., Inc., 938 S.W.2d 27, 28–29 (Tex. 1996) (per curiam)).
177. *Id.* at *9–10.
178. *Id.* The court also found that State Farm did not violate any common law duty of good faith and fair dealing with respect to Martin's claim for physical damage coverage to his own vehicle, as State Farm promptly paid for that damage. *Id.* at *10.

IV. CONTRACT INTERPRETATION

A. Duty to Defend and Duty to Indemnify

1. Whether Extrinsic Evidence Is Admissible in Determining the Duty to Defend

To determine whether an insurer has a duty to defend, Texas courts follow the "eight-corners rule," so-called because "only two documents are ordinarily relevant to the determination . . . : the policy and the pleadings of the third-party claimant."[179] Some jurisdictions allow (or even require) an insurer to examine facts extrinsic to the pleading in making a determination on the duty to defend.[180] Texas federal courts have consistently recognized an exception *may* exist under certain circumstances that would allow an insurer to use "extrinsic evidence" in determining the duty to defend.[181] Texas state courts have, in general, been less willing to recognize such an exception, likely because the Texas Supreme Court has never officially recognized that *any* exception even exists.[182] Unexpectedly, this issue has been the subject of extensive litigation as a result.

During this Survey period, courts again addressed the issue. In *Allstate County Mutual Insurance Co. v. Wootton*,[183] the plaintiff was injured in a car accident while riding as a passenger in a vehicle operated by his son and owned by the insured. The plaintiff sued the insured but did not include factual allegations in his pleading regarding his or his son's employment status with the insured or whether the plaintiff's "injuries arose out of or in the course of [his] employment" with the insured.[184] The insurer argued that it should be allowed to examine extrinsic evidence under either a "broad exception"[185] or "narrow exception"[186] to the eight-corners rule. The Fourteenth Houston Court of Appeals explained that while the Texas Supreme Court has never officially recognized an exception, if it were to do so "it would be the Narrow Exception."[187] Because it was possible to determine from the underlying pleading that coverage may be implicated for the damages sought, the court of appeals found that the insurer was bound by the eight-corners rule in evaluating its duty to

179. GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church, 197 S.W.3d 305, 308 (Tex. 2006) (citing King v. Dall. Fire Ins. Co., 85 S.W.3d 185, 187 (Tex. 2002)).

180. *Id.* at 308–09.

181. *Id.*

182. *See id.* at 308 ("[T]his Court has never expressly recognized an exception to the eight-corners rule . . . .").

183. 494 S.W.3d 825, 827 (Tex. App.—Houston [14th Dist.] 2016, pet. denied).

184. *Id.* at 832.

185. *Id.* at 833. Under the "broad exception," reference to extrinsic evidence is allowed "if (1) the pleading in the underlying case does not contain sufficient facts to determine whether coverage exists, and (2) the extrinsic evidence goes solely to a fundamental issue of coverage that does not overlap with the merits of . . . the underlying case." *See id.*

186. *Id.* Under the "narrow exception," reference to extrinsic evidence is allowed "if (1) it is impossible to discern whether coverage is potentially implicated by the pleading in the underlying case, and (2) the extrinsic evidence goes solely to a fundamental issue of coverage that does not overlap with the merits of . . . the underlying case. *See id.*

187. *Id.* at 833, 834–35.

defend.[188]

2. Ripeness of the Duty to Indemnify

Under Texas law, the "duty to defend and duty to indemnify are . . . separate [and] distinct . . . duties."[189] While the duty to defend is generally determined from an evaluation of "the factual allegations in the pleadings . . . [compared to] the terms of the policy," the duty to indemnify is based on the actual facts developed through the litigation.[190] In *Farmers Texas County Mutual Insurance Co. v. Griffin*, the Texas Supreme Court recognized "that the duty to indemnify is justiciable before the insured's liability is determined in the liability lawsuit when the insurer has no duty to defend *and the same reasons that negate the duty to defend likewise negate any possibility the insurer will ever have a duty to indemnify*."[191] However, the Texas Supreme Court has also opined that "an insurer [can] have a duty to indemnify," even if it has no duty to defend.[192] As a result, many courts have declined to address issues associated with indemnity prior to a judgment or settlement against the insured. The U.S. Court of Appeals for the Fifth Circuit recently addressed the relationship of these duties and the ripeness of the duty to indemnify.

In the case *Solstice Oil & Gas I, L.L.C. v. Seneca Insurance Co.*, Solstice Oil & Gas (Solstice) contracted with a third party, JAM Petroleum, LLC, (JAM) to "provide financing as [a] nonoperating interest holder" of an oil well.[193] JAM, in return, was in charge of drilling operations.[194] JAM hired OBES Incorporated (OBES) to perform directional drilling services with the hope of producing oil from a "predetermined underground target."[195] However, shortly after beginning the project, OBES's machinery caused "the well [to] deviate[ ] from its planned course by more than 400 feet."[196] OBES engaged PinPoint Drilling and Directional Services "to provide [additional] directional drilling [services,] tools[,] and survey data" to correct the issue, but to no avail.[197] A month after drilling commenced, OBES's services were terminated.[198] The following month, JAM attempted to reach the target by another route, but found it "to be a dry hole and the project was abandoned."[199]

Solstice sued OBES asserting that its "actions resulted in a misshaped well that caused 'physical injury to the well and to the integrity of the

188. *Id.* at 835–36; *see also* Shanze Enters., Inc. v. Am. Cas. Co., 150 F. Supp. 3d 771, 777–78 (N.D. Tex. 2015) (declining to examine facts extrinsic to the pleading).
189. Farmers Tex. Cnty. Mut. Ins. Co. v. Griffin, 955 S.W.2d 81, 82 (Tex. 1997).
190. D.R. Horton–Tex., Ltd. v. Markel Int'l Ins. Co., 300 S.W.3d 740, 744 (Tex. 2009).
191. *Griffin*, 955 S.W.2d at 84.
192. *D.R. Horton*, 300 S.W.3d at 741; *Griffin*, 955 S.W.2d at 82.
193. Solstice Oil & Gas Co. I v. Seneca Ins. Co., 655 F. App'x 221, 222 (5th Cir. 2016) (per curiam).
194. *Id.*
195. *Id.*
196. *Id.*
197. *Id.*
198. *Id.*
199. *Id.*

wellbore.'"[200] OBES's insurers agreed to provide a defense in the lawsuit. However, the insurers also moved for summary judgment, arguing that an exclusion barred coverage for the property damage caused by OBES.[201] The district court granted the insurers' motion that they had no duty to indemnify OBES, and OBES appealed.[202]

On appeal, the only issue before the Fifth Circuit was whether the insurers had a duty to indemnify OBES. The Fifth Circuit recognized that "Texas law only considers the duty-to-indemnify question justiciable after the underlying suit is concluded, unless '*the same reasons that negate the duty to defend likewise negate any possibility the insured will ever have a duty to indemnify*.'"[203] The court explained that the "fact that the pleadings support coverage under the policy [for purposes of duty to defend] suggests that there is at least *some* possibility [the insurers] will . . . have the duty to indemnify."[204] Due to the potential variance of issues and facts to be determined on remand, the court held under these facts that the "duty to indemnify [was] nonjusticiable" at the time the Fifth Circuit rendered its opinion.[205]

B. Notice

One area of insurance law that continues to see steady litigation involves the notice conditions of a policy. In *Gonzalez v. Philadelphia Indemnity Insurance Co.*,[206] Gaspar Gonzalez (Gonzalez) was involved in a motor vehicle accident on August 16, 2010, with an underinsured motorist. Gonzalez was operating his vehicle "in the course and scope of his employment with Alarm Security Group, LLC"; thus, he was insured under his employer's Philadelphia Indemnity Insurance Company (Philadelphia) policy.[207] The motorist in the other vehicle was operating a vehicle her mother owned, which was insured under a policy issued by Allstate Indemnity Company to the motorist's father.[208] On August 27, 2012, Gonzalez's counsel gave notice to Philadelphia of Gonzalez's intent to seek underinsured motorist benefits under the Philadelphia policy.[209] Philadelphia promptly requested additional information regarding the ac-

200. *Id.*
201. *Id.* at 222–23. The underlying lawsuit was pending in Louisiana. As a result, OBES's insurers were parties to the underlying litigation as a result of the Louisiana direct action statute. *Id.* at 222.
202. *Id.* at 223.
203. *Id.* at 224 (quoting Farmers Tex. City Mut. Ins. Co. v. Griffin, 955 S.W.2d 81, 84 (Tex. 1997)).
204. *Id.* at 225 (quoting *Griffin*, 955 S.W.2d at 84).
205. *Id.* at 226; *see also* Hartford Cas. Ins. Co. v. DP Eng'g, L.L.C., 827 F.3d 423, 431 (5th Cir. 2016). In *DP Engineering*, the Fifth Circuit held that although the insurers had no duty to defend based on a professional services exclusion, "[t]he allegations in the underlying lawsuits . . . [did] not conclusively foreclose that facts adduced at trial may show [the insured] also provided non-professional services, which would be covered under the policy." *DP Eng'g, L.L.C.*, 827 F.3d at 431.
206. 663 F. App'x 302, 303–04 (5th Cir. 2016).
207. *Id.* at 304.
208. *Id.*
209. *Id.*

cident.[210] On September 24, 2012, Gonzalez's counsel provided "some of the requested information, including medical bills . . . of at least $26,000."[211]

On November 2, 2012, Gonzalez signed a settlement agreement "with the other motorist, her parents, and Allstate for $25,000.00."[212] In conjunction with the settlement, Gonzalez released all parties from liability.[213] The Philadelphia policy covered accidents with underinsured vehicles "'only if' Philadelphia was 'given prompt written notice of [any] tentative settlement' with the underinsured motorist and Philadelphia '[a]dvance[d] payment to the "insured" in an amount equal to the tentative settlement agreement within 30 days of the receipt of notification.'"[214] Eighteen months later, on March 6, 2014, Gonzalez notified Philadelphia of the settlement and Gonzalez's continued intent to file an uninsured motorist claim to recoup medical costs that were in excess of the settlement amount.[215] In accordance with the policy, Philadelphia denied Gonzalez's claim.[216] Gonzalez sued Philadelphia for breach of contract, and Philadelphia removed to federal court.[217] Philadelphia filed a motion for summary judgment.[218]

The district court held that "Gonzalez's failure to timely notify Philadelphia of the settlement prejudiced Philadelphia as a matter of law and this prejudice entitled Philadelphia to summary judgment."[219] The "district court denied . . . reconsideration" based on Gonzalez's "fail[ure] to show cause for not . . . submitting" prior correspondence with Philadelphia at an earlier stage in litigation, and noted that the additional evidence would have not changed the district court's holding.[220]

On appeal, the issue before the U.S. Court of Appeals for the Fifth Circuit was whether Gonzalez's failure to provide notice to Philadelphia of the settlement prejudiced Philadelphia as a matter of law.[221] The Fifth Circuit relied on previous holdings in *Berkley Regional Insurance Co. v. Philadelphia Indemnity Insurance Co.* (*Berkley I*)[222] and *Berkley Regional Insurance Co. v. Philadelphia Indemnity Insurance Co.* (*Berkley II*).[223] The Fifth Circuit reiterated "that such notice provisions," like the policy provision in Gonzalez's policy, "afford the insurer 'valuable rights,'

210. *Id.*
211. *Id.*
212. *Id.*
213. *Id.*
214. *Id.*
215. *Id.*
216. *Id.*
217. *Id.*
218. *Id.*
219. *Id.*
220. *Id.* at 304–05.
221. *Id.* at 305.
222. *Id.* at 305–06 (discussing Berkley Reg'l Ins. Co. v. Phila. Indem. Ins. Co. (*Berkley I*), 690 F.3d 342, 344 (5th Cir. 2012))
223. *Id.* (discussing Berkley Reg'l Ins. Co. v. Phila. Indem. Ins. Co. (*Berkley II*), 600 F. App'x 230, 236–37 (5th Cir. 2015) (per curiam)).

such as 'the rights to join in the investigation, to settle a case or claim, and to interpose and control the defense.'"[224] The *Berkley* courts held that notice given after a dispute is settled prejudices the insurer by depriving it of a role in the settlement process and the ability to conduct its own investigation.[225] The Fifth Circuit noted that Gonzalez's failure to notify Philadelphia of a pending settlement prejudiced Philadelphia by denying it "valuable, bargained-for rights, including the rights to investigate the facts and parties to the settlement, participate in the settlement negotiations, and pursue subrogation."[226] The Fifth Circuit therefore affirmed.[227]

C. Insurer's Right to Settle

The Dallas Court of Appeals recently examined an auto insurer's right to exercise its option to settle a liability claim against its insured, even if the insured objects to the settlement on the basis that the insurer did not properly evaluate liability. In *Martin v. State Farm Mutual Automobile Insurance Co.*, Van K. Martin was insured by State Farm Mutual Insurance Company (State Farm).[228] Martin's son was in an auto accident with Jeffery Lonsdale, who was also insured by State Farm.[229] Martin made a claim for coverage under the collision coverage of his policy "for [the] damage to his vehicle."[230] Lonsdale also filed a claim for coverage under Martin's policy, but did so under the liability portion of that policy.[231] After "State Farm settled Lonsdale's claim," Martin filed suit, asserting that State Farm did not even interview his son and acted unreasonably in concluding his son was at fault for the accident.[232] As a consequence of this breach of contract, Martin asserted that he incurred damages associated with additional semi-annual premiums from this accident.[233] The trial court subsequently granted State Farm's motion for summary judgment on Martin's breach of contract claim and denied Martin declaratory judgment following a bench trial.[234] An appeal followed.

The court of appeals noted that the insuring agreement under the collision coverage portion of of Martin's policy gave the insurer the right to "settle . . . as [State Farm] consider[s] appropriate, any claim or suit asking for [covered] damages."[235] Finding that Martin presented "no evidence that State Farm did not consider the settlement [to be] appropriate," the court of appeals found that the breach of contract claim

224. *Id.* (quoting *Berkley I*, 690 F.3d at 348).
225. *Id.* at 306.
226. *Id.*
227. *Id.*
228. Martin v. State Farm Mut. Auto. Ins. Co., No. 05–14–01473–CV, 2016 Tex. App. LEXIS 2932, at *1 (Tex. App.—Dallas Mar. 22, 2016, pet. denied) (mem. op.).
229. *Id.* at *2.
230. *Id.*
231. *Id.*
232. *Id.*
233. *Id.*
234. *Id.* at *3.
235. *Id.* at *5–6.

failed as a matter of law.[236]

V. PROPER PARTIES TO COVERAGE LITIGATION

A long-standing principle in Texas insurance jurisprudence is that a third-party claimant "cannot sue the insured tortfeasor's insurer directly until the insured tortfeasor's liability has been . . . determined by agreement or judgment."[237] The Fourteenth Houston Court of Appeals recently evaluated and affirmed this law in the context of a medical payments claim in *Auzenne v. Great Lakes Reinsurance, PLC*.[238] Great Lakes Reinsurance, PLC (Great Lakes) insured Snowflake Donuts with a policy including a medical payments clause.[239] The claimant fell in the restroom on the premises of Snowflake Donuts, requiring him to go to the hospital where he ultimately incurred over $4,500 in medical expenses. The claimant submitted these to Great Lakes, but Great Lakes refused to pay, prompting the claimant to sue Great Lakes for breach of contract and violations of the Texas Insurance Code.[240]

At the time of the claimant's demand to Great Lakes, he had not sued or settled with Snowflake Donuts. As a result, Great Lakes moved to dismiss pursuant to Texas Rule of Civil Procedure 91a, citing that the claimant lacked standing to pursue the claims at issue in the lawsuit.[241] In response, the claimant asserted that "he ha[d] standing to sue" because he "was a third-party beneficiary" of the policy and thus was not required to "first [obtain] a determination of Snowflake Donuts' liability."[242] The trial court granted Great Lakes' motion to dismiss.

The court of appeals began its analysis by clarifying that while the no-direct-action rule was traditionally discussed in terms of standing, it was more properly thought of as a ripeness issue.[243] Citing *Patterson v. Planned Parenthood of Houston*, the court observed that "[a] case is not ripe when its resolution depends on contingent or hypothetical facts, or upon events that have not yet come to pass."[244] While "a claim need not be ripe at the time of filing, the party must demonstrate a reasonable likelihood" that it soon will be.[245] In the case of a third-party claimant, where there has been no finding regarding the insured's liability, there is

236. *Id.* at *7–8. The court also found that State Farm did not breach the contract by "[r]equiring Martin to pay [a] deductible" under Coverage D of "the policy." *Id.* at *7. The court noted that Martin's obligation to pay this deductible was expressly required by the policy terms, and that State Farm was therefore acting in accordance with its contractual rights in requiring payment of that deductible. *Id.*

237. *See In re* Essex Ins. Co., 450 S.W.3d 524, 525 (Tex. 2014) (per curiam); Angus Chem. Co. v. IMC Fertilizer, Inc., 939 S.W.2d 138, 138 (Tex. 1997) (per curiam).

238. 497 S.W.3d 35, 38 (Tex. App.—Houston [14th Dist.] 2016, no pet.).

239. *Id.* at 36–37.

240. *Id.* at 37.

241. *Id.*

242. *Id.*

243. *Id.* at 37–38.

244. *Id.* at 38 (quoting Patterson v. Planned Parenthood of Hous., 971 S.W.2d 439, 442 (Tex. 1998)).

245. *Id.*

no ripeness for a claim on the part of the third party.[246] Though the claimant asserted that the medical payments claims can be distinguished, the court rejected this argument on the basis that "Texas has consistently refused to make exceptions [to the no-direct-action rule] based on the types of claims brought or the status of the parties bringing them."[247] Likewise, the court rejected the argument that the trial court erred by not presuming the claimant's status as a third-party beneficiary, noting that no evidence had been adduced to indicate the claimant was named in the contract and no argument had otherwise been produced to overcome the traditional bar against naming a "stranger[ ] to the contract" as a beneficiary.[248] And, even assuming *arguendo* that the claimant was a third-party beneficiary, the claimant's rights under the contract were not ripe until a final judgment had been obtained against Snowflake Donuts.[249]

246. *Id.*

247. *Id.* at 38–39 (citing *In re* Essex Ins. Co., 450 S.W.3d 524, 527 (Tex. 2014) (per curiam); Ohio Cas. Ins. Co. v. Time Warner Entm't Co., 244 S.W.3d 885, 888–89 (Tex. App.—Dallas 2008, pet. denied); Rumley v. Allstate Indem. Co., 924 S.W.2d 448, 450 (Tex. App.—Beaumont 1996, no writ)).

248. *Id.* at 39.

249. *Id.* at 39–40.