AN UPDATE ON RECENT INSURANCE COVERAGE DECISIONS AND THEIR IMPACT ON THE CONSTRUCTION INDUSTRY:

THE POLICYHOLDERS' PERSPECTIVE

LEE H. SHIDLOFSKY
DOUGLAS P. SKELLEY
BLAKE H. CRAWFORD
SHIDLOFSKY LAW FIRM PLLC
7200 N. Mopac Expy., Suite 430
Austin, Texas 78731
lee@shidlofskylaw.com
www.shidlofskylaw.com
(512) 685-1400

PRESENTED BY:

Lee H. Shidlofsky

33RD ANNUAL
CONSTRUCTION LAW CONFERENCE
March 5 & March 6, 2020
La Cantera Resort and Spa
San Antonio, Texas

TABLE OF CONTENTS

I. *Mid-Continent Casualty Company v. Petroleum Solutions, Inc.*, 917 F.3d 352 (5th Cir. 2019)

For the last several years, we explained that the dispute between Mid-Continent Casualty Company ("Mid-Continent") and Petroleum Solutions, Inc. ("PSI") was a "Case to Watch." This was due to the many significant coverage issues presented by the matter, which the district court surmised as being "suitable for a law school examination." *Mid-Continent Cas. Co. v. Petroleum Sols., Inc.*, No. CV 4:09-0422, 2016 WL 5539895, at *1 (S.D. Tex. Sept. 29, 2016), *amended,* CV 4:09-0422, 2016 WL 7491858 (S.D. Tex. Dec. 30, 2016), *aff'd in part, rev'd in part*, *Mid-Continent Cas. Co. v. Petroleum Sols., Inc.*, 917 F.3d 352 (5th Cir. 2019).

The district court issued a lengthy opinion evaluating (1) how the duty to cooperate applies in the context of general liability coverage in Texas and (2) whether there is general liability coverage for a claimant's attorneys' fees as "damages because of . . . 'property damage.'" Following oral argument before the Fifth Circuit on January 7, 2019, the Fifth Circuit issued its opinion on February 26, 2019, in which it affirmed in part and reversed in part the district court's findings, and remanded the case for entry of judgment. *Petroleum Sols.*, 917 F.3d at 354–55.

A. Background Facts

The facts in this case span nearly two decades and include a jury trial in the underlying liability lawsuit, an appeal to the Corpus Christi Court of Appeals, an appeal to the Supreme Court of Texas, a hearing in the trial court on remand, and a coverage dispute in the Southern District of Texas, lasting more than eight years. For purposes of this paper, however, we have taken the background facts as evaluated by the Fifth Circuit in its opinion.

According to the Fifth Circuit, the case arises from a leak in an underground fuel storage tank. In 1997, PSI constructed and installed an underground fuel tank system for Bill Head Enterprises ("Head") underneath its truck stop. In 2001, Head discovered fuel had leaked from the system. PSI notified Mid-Continent, with whom it had a commercial general liability policy (the "Policy"), of Head's potential claim against PSI. Mid-Continent retained counsel to investigate the claim. Mid-Continent and PSI believed that the cause of the leak was a faulty flex connector manufactured by Titeflex Corporation ("Titeflex"). *Id*. at 355.

Head sued PSI in February 2006, arguing that PSI was responsible for the faulty flex connector and the leak. Mid-Continent assumed PSI's defense but reserved its rights as to coverage obligations under the Policy. PSI brought a third-party claim against Titeflex, arguing that Titeflex was strictly liable under Texas Civil Practice and Remedies Code § 82.002 and seeking contribution and indemnity. Titeflex then filed a counterclaim against PSI under § 82.002. *Id.*

In June 2008, Mid-Continent told PSI that Titeflex had offered to dismiss its counterclaim if PSI would dismiss its third-party claim. PSI dismissed without prejudice its claim against Titeflex. The following day, Titeflex advised that it would dismiss its counterclaim only if PSI dismissed its claim with prejudice. Mid-Continent urged PSI to accept the settlement offer, but PSI was concerned that doing so would leave it without recourse against Titeflex if a judgment was entered against PSI and Mid-Continent denied coverage. So, PSI rejected the settlement offer. The case proceeded to trial and the jury returned a verdict in favor of Head and Titeflex. *Id*.

Mid-Continent then pursued a declaratory judgment action in the district court seeking a determination of the parties' rights under the Policy. It alerted PSI that it was denying coverage for the Titeflex judgment because PSI breached the Cooperation Clause by "fail[ing] to cooperate with Mid-Continent in the investigation and settlement of the Titeflex counterclaim." Mid-Continent also told PSI that, although the Professional Liability Endorsement ("PLE") in the Policy potentially provided coverage for the Titeflex judgment, an exclusion within the PLE precluded coverage. *Id*. That exclusion (Exclusion q) barred coverage for losses "caused intentionally by or at the direction of the insured."

The district court held that the PLE did not provide coverage for the Titeflex judgment, but that if it had, Exclusion q would not apply. It concluded that without the PLE, the Policy provided coverage for only part of the Titeflex judgment. It also concluded that the Cooperation Clause applied to PSI's claim against Titeflex, but genuine issues of material fact existed about whether PSI complied with the Cooperation Clause. The case proceeded to trial on this issue and whether Mid-Continent waived its right to assert the Cooperation Clause. The jury entered a verdict in PSI's favor. The district court then entered judgment partially in PSI's favor pursuant to its conclusion that only some of the Titeflex judgment was covered. PSI appealed and Mid-Continent cross-appealed. *Id.*

B. The Fifth Circuit Declines to Endorse the District Court's Holding as to the Cooperation Clause

In first evaluating the issues with the cooperation clause, the Fifth Circuit explained that the Policy required PSI to "cooperate with [Mid-Continent] in the investigation or settlement of the claim or defense against the 'suit.'" *Id*. at 356. Mid-Continent claimed that PSI breached this clause by refusing to dismiss its claim against Titeflex. The district court refused to find as a matter of law that the Cooperation Clause does not apply to the circumstance of an insurer requiring an insured to give up a right against a third party. At trial, the district court instructed the jury that "PSI complied with the Cooperation Clause if PSI's conduct was reasonable and justified under all the circumstances that existed." The jury found that PSI complied. *Id.*

The Fifth Circuit explained that Mid-Continent offered no law to "support its novel and dubious concept that the Cooperation Clause applies to an insured's affirmative claims against a third party." *Id.* To this extent, the Fifth Circuit explained that the "direction of the law in this area is against such a conclusion." *Id.* As a result, the Fifth Circuit declined to "endorse that holding by the district court." *Id*. Nevertheless, the Fifth Circuit found it unnecessary to examine the question further, as PSI prevailed on that issue at trial. *Id.* The Fifth Circuit also rejected Mid-Continent's argument that the jury instruction regarding the Cooperation Clause was an abuse of discretion. *Id.* Specifically, the district court had instructed the jury that PSI complied with the Cooperation Clause if its "conduct was reasonable and justified under all the circumstances that existed." *Id.* We note that the court also suggested in a footnote that Mid-Continent may have in fact waived its argument on the Cooperation Clause due to the fact that it sent a "generic reservation of rights letter" to the insured. *Id*. at 356 n.2.

C. The Fifth Circuit Holds that the Professional Liability Endorsement Covers the Titleflex Judgment

Moving to an analysis of whether the Policy covered the Titleflex judgment, the Fifth Circuit focused its analysis on the PLE. The PLE stated that subsection (d) should be added to the Insuring Agreement in the Policy. *Id*. at 357. Subsection (a) of the Insuring Agreement stated that Mid-Continent "will pay those sums that [PSI] becomes obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies." Subsection (d), added by the PLE, stated that "'Bodily Injury', 'Property Damage' or 'Money Damages' arising out of the rendering or failure to render professional services shall be deemed to be caused by an 'occurrence.'" The PLE also added a definition of "Money Damages" to the "Definition" section of the Policy. In particular, the PLE defined "Money Damages" as "a monetary judgment, award, or settlement." Finally, the PLE added various exclusions, including Exclusion q.

PSI argued that the PLE provided coverage for the Titeflex judgment because the judgment was a monetary judgment arising out of PSI's professional services: installation of the fuel tank system at Head's truck stop. *Id.* Mid-Continent, on the other hand, argued that the PLE did not expand coverage beyond the damages covered under the Insuring Agreement, but instead simply created another definition of "occurrence" by clarifying that damages "arising out of the rendering or failure to render professional services" are considered accidental. *Id.* Mid-Continent also argued that the Titeflex judgment did not arise out of PSI's installation of the fuel tank system, but rather from PSI's refusal to dismiss its claim against Titeflex. *Id.* The court rejected Mid-Continent's arguments.

With respect to Mid-Continent's first argument, the Fifth Circuit determined that the PLE and its inclusion of the definition of "Money Damages" provided for a broader range of damages than the common-law definition of "damages" when those damages arise out of professional services. Id. at 358. Thus, the Fifth Circuit agreed with the district court's analysis that Mid-Continent's interpretation of the PLE would render "superfluous the definition of 'occurrence' based on Money Damages and the addition of Money Damages to the 'Definitions' section of the Policy." *Id*. As this would be in violation of the basic rules of contract interpretation, the court declined to read the insuring agreement so narrowly. *Id.*

The Fifth Circuit also rejected Mid-Continent's second argument, finding that the entire Titeflex judgment was directly related to the leak in the fuel tank system that PSI installed. *Id*. at 359. Moreover, the Fifth Circuit found that Exclusion q did not apply. As noted, that exclusion bars coverage for "[l]oss caused intentionally by or at the direction of the insured." *Id.* Examining similar exclusions, the court explained that to carry its burden of proof, Mid-Continent was required to show that there was intentional damage, not just intentional conduct. *Id.* (citing *Tanner v. Nationwide Mut. Fire Ins. Co.*, 289 S.W.3d 828, 829 (Tex. 2009)). In reviewing the potential applicability of the exclusion, the court concluded as follows:

> PSI claims that, far from being substantially certain that a judgment would be entered against it if it refused the Titeflex settlement, PSI's appellate counsel repeatedly advised it that Titeflex likely would not succeed on its counterclaim. Mid-Continent points to the fact that PSI knew its claim against Titeflex was unlikely to succeed. But the issues with PSI's claim are

> due to Mid-Continent's actions, not PSI's; Mid-Continent's expert lost the alleged faulty flex connector that Titeflex manufactured and yet it was Mid-Continent that decided to assert a claim against Titeflex. Regardless, these problems largely concern the viability of PSI's claim against Titeflex, not Titeflex's counterclaim. Thus, the district court did not err in concluding that Exclusion q does not apply. Because Exclusion q does not bar coverage, Mid-Continent owes PSI coverage for the entire Titeflex judgment. We thus reverse the district court's conclusion that the PLE does not cover the entire Titeflex judgment and hold that it does.

Id. at 359–60.

D. Commentary

While the Fifth Circuit declined to endorse the district court's decision as to the Cooperation Condition, it appears to have sent a message that this type of "dubious concept" does not appear to be favored under Texas law. Moreover, potentially overlooked is the Fifth Circuit suggesting that Mid-Continent's "generic" reservation of rights letter may not have been sufficient to preserve arguments on the Cooperation Condition. It will be interesting to see if other courts pick up on the footnote and address with more substance the effect of a "generic" reservation of rights letter. Nevertheless, because PSI won on both issues at trial, the Fifth Circuit did not have to get into the weeds on these issues.

Last year, the issue of whether coverage exists for attorneys' fees awarded to a claimant was one that was being hotly contested following the district court's decision in *PSI* that attorneys' fees awarded pursuant to § 38.001 of the Civil Practice and Remedies Code are not "damages" and, therefore, are not covered. The Fifth Circuit, however, did not evaluate this issue in depth in its opinion. Rather, the court dropped a footnote towards the end of the opinion, explaining as follows:

> . . . Titeflex's claim against PSI in the underlying lawsuit was for indemnification under Texas Civil Practice and Remedies Code § 82.002(a). Titeflex also sought attorney's fees under § 82.002(g). When Titeflex won its suit against PSI, the judgment included damages under § 82.002(a) and attorney's fees under § 82.002(g), but it did not segregate the one from the other. The district court concluded that § 82.002(a) damages were covered under the Policy (not the PLE) but § 82.002(g) attorney's fees were not "damages," utilizing the district court's perception of that term as generally applied under Texas law, rather than a policy-specific definition. PSI appeals this ruling, but we do not reach its arguments since we conclude that the PLE covers the entire Titeflex judgment, as a "monetary judgment" under the broader definition provided by the Policy itself. We thus do not need to decide whether the term "damages," by itself, would encompass the entire Titeflex judgment.

Id. at 358 n.8. Thus, it appears that *PSI* may not have the impact that we originally anticipated as to that issue. Nevertheless, in early 2019, the Supreme Court of Texas determined in *Anadarko Petroleum Corporation v. Houston Casualty Company* that '"attorney's fees are generally not

damages, even if compensatory.'" 573 S.W.3d 187, 196 (Tex. 2019) (quoting *In re Nalle Plastics Family Ltd. P'ship*, 406 S.W.3d 168, 173 (Tex. 2013)). Given that opinion, it appears that it is left to the Texas legislature to address and fix this issue if it sees fit.

II. *Mt. Hawley Insurance Co. v. Huser Construction Company, Inc.*, No. H-18-0787, 2019 WL 1255756 (S.D. Tex. Mar. 19, 2019) and *Mt. Hawley Insurance Co. v. Slay Engineering*, 390 F. Supp. 3d 794 (W.D. Tex. 2019)

In *Mt. Hawley Insurance Co. v. Slay Engineering*, 335 F. Supp. 3d 874 (W.D. Tex. 2018) *(*"*Slay I*"), the United States District Court for the Western District of Texas found various exclusions did not apply to allegations against a general contractor for breach of contract and negligence. Most notably, the court in *Slay I* rejected the application of a "Breach of Contract" exclusion with respect to the insurer's duty to defend. A lot can happen in a year. Upon a motion for reconsideration, the court concluded that, while the breach of contract exclusion is ambiguous, based on the facts before the court, the exclusion *did* apply to bar coverage for all claims against the insured. *Mt. Hawley Ins. Co. v. Slay Eng'g*, 390 F. Supp. 3d 794, 802 (W.D. Tex. 2019) ("*Slay II*"). As part of its evaluation of the motion for reconsideration, the Western District specifically noted that, during the pendency of *Slay I*, the Southern District of Texas evaluated the exact same exclusion in the exact same policies in a dispute with the exact same parties and reached a contrary ruling in *Mt. Hawley Insurance Co. v. Huser Construction Company, Inc.*, No. H-18-0787, 2019 WL 1255756 (S.D. Tex. Mar. 19, 2019) ("*Huser*").

A. Background Facts of *Huser*

Huser involved damages arising out of the construction of an apartment complex in Pleasanton, Texas owned by Eagle Heights Pleasanton, LLC ("EHP"). *Huser*, 2019 WL 1255756, at *2. In connection with the project, Huser hired several subcontractors. One of those subcontractors was Schaffer, which was responsible for designing and installing the HVAC system. *Id*. at *3. After Huser completed work on the project in 2016 and EHP took possession, EHP discovered multiple deficiencies in the workmanship and materials used in the project. EHP claimed that work performed by Schaffer was deficient in multiple respects, including: (1) breaching a fire wall; (2) using the wrong type of ducts; (3) misplacing air vents; (4) leaving trash in the air ducts; (5) improperly installing electrical connections to the HVAC; and (6) using poorer quality units than those specified by the job architect. *Id.* EHP filed suit against Huser and Schaffer, asserting claims for breach of contract and negligence.

B. The Southern District Determines that the "Breach of Contract" Exclusion is Unambiguous and Bars Coverage for all Damages Alleged

In its opinion, the Southern District explained that the "Breach of Contract" exclusion was added to the Mt. Hawley policies by endorsement and bars coverage for "any claim or 'suit' for 'property damage' 'arising directly or indirectly out of' breaches of contract and/or warranty are not covered by the Mt. Hawley Policies." *Id*. at *6. According to the court, the parties' dispute focused on the following:

> (1) whether the property damage that is the subject of the Underlying Action "ar[ose] directly or indirectly" out of a breach of the contract between Huser

> and EHP and (2) whether the Mt. Hawley Policies' separate "Your Work" Exclusion, and its subcontractor exception, preserve coverage because the property damage in the Underlying Action was caused by a subcontractor.

Id. The court began its analysis by recognizing that, when an exclusion bars coverage for damage "arising out of" specified conduct, the claim need only bear an incidental relationship to the described conduct for the exclusion to apply. *Id.* (citing *Sport Supply Group, Inc. v. Columbia Cas. Co.*, 335 F.3d 453, 458 (5th Cir. 2003)). The court also recognized that the Supreme Court of Texas has interpreted the "arising out of" language "to mean that there is but for causation, though not necessarily direct or proximate causation." *Id.* (quoting *Utica Nat'l Ins. Co. of Texas v. Am. Indem. Co.*, 141 S.W.3d 198, 203 (Tex. 2004)). Moreover, the court explained that exclusions containing the "arising out of" language are "given a broad, general, and comprehensive interpretation." *Id*. The court also acknowledged that the "arising out of" language has a "much broader significance than 'caused by,'" with the former requiring only that the damage originate from, grow out of, or have connection with the conduct, as opposed to the latter, which generally requires proximate causation. *See id.* (citing *EMCASCO Ins. Co. v. Am. Int'l Specialty Lines Ins. Co*., 438 F.3d 519, 524–25 (5th Cir. 2006)).

The court determined that the "Breach of Contract" exclusion unambiguously applied to bar coverage for all the damages alleged against Huser, as those damages "'ar[ose] directly or indirectly' from Huser's alleged breach of its contract with EHP." *Id*. at *7–8 (alteration in original). Specifically, Huser's contract with EHP imposed upon Huser to supervise and staff the project with adequate subcontractors, and its failure to do so allegedly resulted in the damages sought by EHP.

Moreover, the court rejected Huser's arguments that the subcontractor exception in the "Damage to Your Work" exclusion negated the scope of the "Breach of Contract" exclusion. Relying upon the opinion from the Supreme Court of Texas in *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*, 242 S.W.3d 1 (Tex. 2007), Huser argued that the exception restored coverage for any damage caused by subcontractors, notwithstanding the "Breach of Contract" exclusion. *Huser*, 2019 WL 1255756, at *7. Disagreeing with this position, the court explained that, "Nothing in *Lamar Homes* prevents an insurer from adding an additional exclusion eliminating coverage for property damage arising out of a breach of contract. *Lamar Homes* held the opposite—the court discussed the many types of exclusions insurers can utilize, including those that exclude the insured's 'contractually-assumed liabilities.'" *Id*. (citing *Lamar Homes, Inc.*, 242 S.W.3d at 10). Thus, according to the court, because the subcontractor exception contained within the "Damage to Your Work" Exclusion expressly modifies only the "Damage to Your Work" Exclusion, not the other exclusions contained in the Mt. Hawley Policies, it was inapplicable as to the scope of the "Breach of Contract" exclusion. *Id.* The court also explained that, in the event of any conflict between the terms of an endorsement and other policy language, the language of the endorsement will control. *Id*. at *8.

C. Background of *Slay I* and *Slay II*

Slay I and *Slay II* involved a coverage dispute arising out of the construction of a municipal sports complex within the City of Jourdanton. Huser contracted with the City of Jourdanton to design and construct the project, which consisted of four little league baseball fields, a softball field,

parking lots and a new swimming pool. Huser subcontracted with Cody Pools, Inc. to design and build the swimming pool. Huser also subcontracted with Q-Haul, Inc. for earth work, grading and storm drainage work at the site. After substantial completion of the project, a Huser employee noticed cracks in the pool and parking lot paving. Cody Pool began repair work, but the problem was not cured. The City later notified Huser of several alleged deficiencies involving the swimming pool structure, asphalt paving, concrete flatwork and curbing, and overall drainage. When the City was not happy with the repair proposal, it sued Huser for breach of contract and negligence.

In *Slay I*, the court found that the "directly or indirectly" and "arising out of" language in the "Breach of Contract" exclusion required Mt. Hawley to demonstrate that Huser's breach of the contract was a "but for" cause of the alleged property damage. *Slay I*, 335 F. Supp. 3d 874, 885 (W.D. Tex. 2018), *holding modified on reconsideration by* 390 F. Supp. 3d 794 (W.D. Tex. 2019). Thus, in *Slay I*, the court explained that, for Mt. Hawley to prevail, the facts alleged in the underlying suit would have to demonstrate that there were *no other* independent, covered (non-excluded) "but for" causes of the alleged property damage. *Id*. Because the underlying suit alleged that "work performed by [Huser], its subcontractors and suppliers, was defective," the exclusion did not preclude the duty to defend because the possibility existed that entities other than Huser were responsible for the allegedly defective work and the resulting damage. *Id*. at 886. The court also rejected Mt. Hawley's "sweeping interpretation" in *Slay I* that the "Breach of Contract" exclusion made the subcontractor exception to the "Damage to Your Work" exclusion irrelevant. *Id*. at 887. As a result, the court concluded in *Slay I* that Mt. Hawley had a duty to defend Huser.

Mt. Hawley filed a Motion for Reconsideration. Recognizing *Huser*, which the court explained was "similar parallel litigation," the court agreed to reconsider its prior opinion as to the scope and application of the "Breach of Contract" exclusion. *Slay II*, 390 F. Supp. 3d at 796.

D. The Western District Determines that the "Breach of Contract" Exclusion is Ambiguous

The court explained that, in *Slay I*, it had adopted a more limited interpretation of the "Breach of Contract" exclusion to give meaning to both that exclusion and the application of the "Subcontractor Exception to the Your Work Exclusion." *Id*. at 799. The court recognized that an endorsement to an insurance policy controls in the event of an actual conflict with other terms in the policy but determined that, in this case, it was not clear whether there was any conflict between the "Breach of Contract" exclusion and the "Subcontractor Exception to the Your Work Exclusion." *Id*. The court concluded that "the scope of the Breach of Contract Exclusion is ambiguous," and, as such, must be construed "strictly against the insurer and liberally in favor of the insured." *Id*. (quoting *Barnett v. Aetna Life Ins. Co.*, 723 S.W.2d 663, 666 (Tex. 1987)). Further, the court found that an "even more stringent construction is required" in favor of the insured "where the ambiguity pertains to an 'exception or limitation on [the insured's] liability under the policy.'" *Id.* (quoting *Am. Int'l Specialty Lines Ins. Co. v. Rentech Steel LLC*, 620 F.3d 558, 562–63 (5th Cir. 2010)).

The court agreed that Huser's proffered interpretation of the "Breach of Contract" exclusion (*i.e.*, that it applies to property damage resulting from a breach of contract by the *insured* (as opposed to an insured's subcontractor or *any other party* to *any other agreement* at all related to

construction at the site) was "not itself unreasonable." *Id.* Accordingly, the court declined to reverse its ruling in *Slay I* regarding the scope of the exclusion.

E. Despite Finding the "Breach of Contract" Exclusion Ambiguous, the Western District Determines that it Bars Coverage

Although the court concluded "that it is reasonable to read the Breach of Contract Exclusion such that it only excludes property damage allegedly resulting from a breach of [the insured's] own contractual obligations," the court held that the exclusion nevertheless applied. *Id*. at 800. In *Slay I*, The court had previously distinguished between Huser's causation of property damage with its ultimate contractual liability for damages at the site, noting that "merely because Huser may ultimately be liable for certain of the City's economic losses under a breach of contract theory does not necessarily mean that all of the alleged property damage was causally attributable to Huser's alleged breach of its contract with the City." *Id.* Accordingly, the court found in *Slay I* that, if there was property damage caused solely by the subcontractors' defective work that was not the result of any breach by Huser of its own contractual obligations, those allegations potentially would support a covered claim. *Id.* (citing *Slay I*, 335 F. Supp. 3d at 888).

The court continued:

> Although the Court stands by its prior conclusion in the abstract, in this case, the allegations in the Underlying Suit demonstrate that all of the alleged property damage was causally attributable to [Huser's] alleged breach of [its] contractual obligations. Specifically, the Court's Prior Order did not properly account for the fact that Huser and Huser Construction agreed to numerous additional obligations under their contract with the City far exceeding a basic agreement not to themselves perform faulty workmanship at the site. For example, the allegations in the Underlying Suit allege that Huser Construction was tasked with: (i) managing onsite construction activities during the Project; (ii) providing onsite quality control and quality assurance during the project; and (iii) coordinating completion of all outstanding work on the project. [citation omitted]. The Underlying Suit further alleges that the allegedly defective work completed by Huser Construction's subcontractor, Cody Pools, was done "at Huser Construction's direction," and in light of Huser Construction's quality assurance and quality control obligations, Huser Construction breached its contract "by failing to ensure that Huser's subcontractor performed its Work in accordance with the Contract Documents." [citation omitted]. Finally, the Underlying Suit alleges that the agreement between Defendants and the City "requires [Huser] (including its individual members) to correct all defective work," and the Underlying Suit further alleges that Huser and Huser Construction have not corrected the non-conforming work despite notice and demand. [citation omitted].

Id. at 800–01.

According to the court, these allegations "clearly demonstrate" that this case presents a situation where the property damage may have been caused solely by a breach of contract by the subcontractors such that the subcontractors were a truly "independent" cause of the property damage. *Id*. at 801. Nevertheless, even if the subcontractors initially were responsible for the faulty workmanship, Huser allegedly breached the contract with the City by not properly supervising the work and/or by not repairing work per their contractual obligations. Thus, according to the court, Huser's breach of contract is the "but for" cause of all property damage at the site, regardless of whether the damage was caused by the work performed by Huser or whether it was caused by Huser's failure to supervise and/or repair faulty construction by the subcontractors. *Id.* Based on this, the court found that the "Breach of Contract" exclusion applied with respect to the City's breach of contract claim against Huser.

The court also recognized that the City asserted claims of negligence against Huser. The court specifically noted that the alleged "negligence" related to Huser's failure to perform the work in a good and workmanlike manner, failure to comply with the plans and specifications, and failure to act in a manner that conformed with the standard of care ordinarily employed by prudent design-builders. *Id*. at 802. Concluding that these "negligence" claims asserted by the City involved facts that bore an "incidental relationship" to the alleged breach of contract and/or warranty by Huser, the court concluded that those claims also were excluded by the "Breach of Contract" exclusion. Specifically, the court found that each of those allegations overlaps with, or is, at minimum, "incidentally related" to, the allegations regarding Huser's alleged breach of its contracts or warranties with the City. *Id*. As a result, the court concluded that Mt. Hawley owed no duty to defend Huser.

F. Commentary

The interesting aspect of *Slay I* was the court's finding that the "Breach of Contract" exclusion does not override the subcontractor exception in the "Damage to Your Work" exclusion. Often courts will find that endorsements trump the base policy language. Moreover, each exclusion is supposed to be read individually even if the result is that the application of one or more exclusions results in an overlap. To that end, in *Huser* and in *Slay II*, the courts found that the "Breach of Contract" exclusion applied regardless of the existence of the subcontractor exception to the "Damage to Your Work" exclusion. More interesting is the fact that the court in *Slay II* maintained its prior ruling that the "Breach of Contract" exclusion was ambiguous yet applied it broadly (and as to claims of negligence) upon reconsideration of the issue, while even noting that the issue was a "close call." In the event more insurers add manuscripted "Breach of Contract" exclusions, the scope of such exclusions likely will see continued litigation.

III. *Columbia Lloyds Insurance Company v. Liberty Insurance Underwriters, Inc.*, No. 3:17-CV-005, 2019 WL 2296920 (S.D. Tex. May 30, 2019)

In *Columbia Lloyds Insurance v. Liberty Insurance Underwriters, Inc.*, No. 3:17-CV-005, 2019 WL 2296920 (S.D. Tex. May 30, 2019), the United States District Court for the Southern District of Texas evaluated the scope of damages available to an insured based on the wrongful denial of defense coverage by an insurer.

A. Background Facts

The court began by explaining that it had previously held that Liberty Insurance Underwriters, Inc. breached its contract by wrongfully denying defense coverage for its insureds with respect to two underlying matters, one a state court lawsuit and the other an arbitration. *Columbia Lloyds Ins. Co. v. Liberty Ins. Underwriters, Inc*., No. 3:17-CV-005, 2018 WL 1569718, at *11 (S.D. Tex. Mar. 14, 2018). In its prior opinion, the court explained that it would evaluate "[t]he quantum of [the insureds'] recovery against Liberty for defense costs, fees and expenses" at a later date. *Id.* Subsequently, the court determined that an exclusion barred coverage for the insureds with respect to the "legal fees, costs, damages, and expenses related to the [a]rbitration," but that the insureds were entitled to summary judgment on their "prompt payment" claims, which amount would be resolved at a later time. *Columbia Lloyds Ins.*, 2019 WL 2296920, at *1. Thus, the court was left to evaluate the scope of the breach of contract damages stemming from the state court lawsuit and "prompt payment" damages stemming from the state court lawsuit and the arbitration. *Id.*

B. Evaluation of the Recoverable Amount of Attorneys' Fees in the State Court Lawsuit

At the time the court ruled that Liberty had breached the duty to defend as it related to the state court lawsuit, the insureds were funding their own defense. After the court's determination against Liberty, Liberty made partial payments totaling $108,041.82 towards the defense costs, which the insureds claimed was $42,906.94 short of the total amount the insureds had paid. *Id*. at *2. The insureds submitted invoices in support of its claim for that amount, including an affidavit from their attorney that all fees and costs incurred were defense-related and that the fees paid and incurred were both reasonable and necessary. *Id.* Liberty disputed $36,359.69 of that amount, arguing, in part, that the fees were not reasonable and not related to the defense of the state court lawsuit.

As to its first argument on reasonableness, the court rejected Liberty's position. The court explained that, under Texas law, "attorneys' fees and expenses incurred by an insured in an underlying lawsuit are damages produced by the insurer's breach of its duty to defend." *Id*. (quoting *Lyda Swinerton Bldrs., Inc. v. Okla. Sur. Co.*, 903 F.3d 435, 453 (5th Cir. 2018)). The court further recognized that "once an insurer has breached its duty to defend, the insured is free to proceed as he sees fit; he may engage his own counsel and either settle or litigate, at his option." *Id*. (quoting *Lyda Swinerton Bldrs*., 903 F.3d at 454). Thus, a breaching insurer "is in no position to object to defense-related expenditures that are supported by the record and that are not patently unreasonable." *Id*. (quoting *Lyda Swinerton Bldrs*., 903 F.3d at 454). Moreover, the court recognized that a breaching insurer "may not directly challenge the reasonableness and necessity of [an insured's] attorney's fees"; but may "contest the admissibility or sufficiency of [the insureds'] evidence or make relevant legal argument as [the insured] undertake[s the] burden of proving . . . damages." *Id*. (quoting *Shore Chan Bragalone Depumpo LLP v. Greenwich Ins. Co.*, 904 F. Supp. 2d 592, 604 (N.D. Tex. 2012)).

Finding that the evidence presented by the insureds presented information as to the work performed, what work was performed, and how much time the work required, the court found it sufficient evidence to support the insureds' claim. The court did, however, find that an invoice presented for $15,000 that simply reflected a billed amount of $15,000 due "FOR

PROFESSIONAL SERVICES" was insufficient to support summary judgment, as it did not document the specificity needed to make a fee determination. *Id.*

Moving next to its argument that an invoice for $7,738.25 related to the insureds' pursuit of affirmative claims as opposed to defense in the state court lawsuit, the court rejected Liberty's position. In particular, the court found that the insureds had submitted sworn declarations attesting that the work was related to the defense. Liberty, according to the court, offered "only speculation and conjecture that the [work] may really have related to [the] affirmative claim." *Id.* As such, the court found that the insureds' evidence was sufficient to support a finding that they were entitled to the $7,738.25 of that invoice.

C. Evaluation of Prompt Payment Act Claims

The court then moved to an evaluation of the claims by the insureds under the Prompt Payment of Claims Act, codified at Section 542 of the Texas Insurance Code. With respect to the state court lawsuit, Liberty argued that any "prompt payment" penalty interest should be calculated based on the amount of fees "still owed" at the time the court made its damages determination, as opposed to the amount of fees owed at the time that Liberty breached its duty to defend. *Id.* at *4. In particular, Liberty argued that the statutory penalty should be applied only to the difference between the amount of the insureds' underlying claim (*i.e.*, the total defense costs and fees paid by the insureds) and any partial payments Liberty previously tendered. The court rejected this interpretation, noting that, in *Republic Underwriters Ins. Co. v. Mex-Tex, Inc*., 150 S.W.3d 423 (Tex. 2004), the Supreme Court of Texas:

> did not apply penalty interest based on the amount of fees [the insurer] still owed at the time of its damages determination . . .; [r]ather, the . . . court applied interest to the fees [the insurer] still owed after the date the court determined that [the insurer] should have paid all [the insured's] defense fees and costs.

Id. (citing *Mex-Tex, Inc.*, 150 S.W.3d at 427).

With respect to the arbitration, the insureds sought to recover "prompt payment" interest on the $888,946.36 they incurred in defending themselves. *Id*. at *6. Liberty disputed this claim, noting that even though the court determined that Liberty breached its duty to defend in the arbitration, the court ultimately had determined that an exclusion barred coverage for the insureds with respect to that matter. *Id.* Liberty argued that the "prompt payment" interest applies only to a "claim," which should be limited to "the amount ultimately determined to be owed." *Id*. (citing *Mex-Tex, Inc.*, 150 S.W.3d at 426). Rejecting this "creative argument," the court explained that "penalty interest is applied to amounts that are still owed after the date the insurer should have tendered those amounts. There is no exception under the [Prompt Payment of Claims Act] based on a subsequent finding of a retroactive right to reimbursement of defense costs." *Id.* The court explained that its decision that Liberty had breached the duty to defend and violated the Prompt Payment of Claims Act with respect to the arbitration "did not disappear nor were they rendered moot by the Court's determination that the Fraud Exclusion applies in this case." *Id.*

D. Commentary

This case serves as a reminder to insurers that denying an obligation of a defense to an insured is at their own peril. Doing so wrongfully will result in penalties under the Prompt Payment of Claims Act even if a determination is made that no indemnity is owed. Moreover, this case reinforces the difficulties insurers will have challenging the reasonableness of fees incurred by an insured when the insurer breaches its duty to defend.

IV. *In re Farmers Texas County Mutual Insurance Co.*, No. 04-19-00180, 2019 WL 2605630 (Tex. App.—San Antonio June 26, 2019, orig. proceeding)

In *In re Farmers Texas County Mutual Insurance Co.*, No. 04-19-00180, 2019 WL 2605630 (Tex. App.—San Antonio June 26, 2019, orig. proceeding), the San Antonio Court of Appeals concluded that Texas law is unclear as to whether the *Stowers* doctrine requires there to be a judgment in excess of limits against the insured in order for the doctrine to be implicated.

A. Background Facts

Following a 2016 motor vehicle accident, Gary Gibson ("Gibson") sued Cassandra Longoria ("Longoria") for injuries he allegedly suffered in the accident. Gibson sought damages in the amount of $1 million, which exceeded Longoria's $500,000 policy limits. Gibson and Longoria attended mediation, where the mediator recommended the case settle for $350,000. Gibson sent a *Stowers* demand to Longoria's insurer, Farmers Texas County Mutual Insurance Co. ("Farmers"), advising that he would accept the proposed settlement of $350,000, but Farmers rejected the proposal and offered only $250,000. Gibson withdrew that demand, but he and Longoria continued settlement negotiations. *Id*. at *1.

Gibson subsequently made a demand for $350,000, and, in response, Farmers again offered only $250,000. Facing an upcoming trial, Longoria offered to pay the $100,000 difference to effectuate the settlement. Gibson accepted the offer, and Gibson and Longoria entered into a "Settlement Agreement and Release." Farmers paid $250,000 and Longoria paid $100,000. Longoria then sued Farmers alleging that it unreasonably refused to settle Gibson's claim. *Id.*

In the coverage lawsuit, Farmers filed a Rule 91a motion to dismiss. First, Farmers asserted that, because Gibson's suit against Longoria settled, there never would be a final judgment against her in excess of the policy limits. As a result, according to Farmers, Longoria did not have a cause of action against Farmers for negligent failure to settle because such a claim required that a negligent failure to settle result in an excess judgment against the insured. Farmers also argued that the court lacked subject-matter jurisdiction over the suit for the same reason. *Id.*

The trial court denied Farmers' first motion to dismiss. Longoria later amended her petition to add a breach of contract claim asserting, in part, that Farmers breached its contract by failing to accept an offer to settle the lawsuit. Thereafter, Farmers filed a second Rule 91a motion to dismiss, arguing that, under Texas law, it had no contractual obligation or duty to pay damages until it was determined Longoria was legally responsible for any damages, which would not occur because the lawsuit settled. *Id*. Farmers also asserted that it had no duty to defend or settle because the policy gave it the right to defend or settle claims against Longoria "as [it] consider[ed] appropriate." *Id.*

The trial court denied Farmers' second motion to dismiss, prompting Farmers to file a petition for writ of mandamus challenging both trial court orders.

B. The Appellate Court Holds that Farmers did not Breach its Contract

The appellate court first determined that Farmers did not breach its contract, and, thus, Longoria's breach of contract action had no basis in law or fact. *Id*. at *4. The court acknowledged that Longoria paid $100,000 of her own funds to effectuate the settlement because Farmers would only fund $250,000 of the total settlement. *Id.* at *3. Nevertheless, the court found that because "the policy did not contractually obligate [Farmers] to pay any specific amount towards a settlement," Farmers was free to defend and pay a settlement "as [it] consider[ed] appropriate." *Id.* (modifications in original).

C. The Appellate Court Finds that Texas Law is Unclear Whether *Stowers* Requires a Judgment in Excess of Policy Limits

Moving to the negligent-failure-to-settle claim, which the court identified as Longoria's *Stowers* claim, the court began by tracing the origins of the *Stowers* doctrine under Texas law. *Id*. According to the court, "[o]riginally, *Stowers* damages arose from a judgment in excess of policy limits." *Id.* (citing *Am. Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994)). The court recognized that the Supreme Court of Texas subsequently extended *Stowers* to include a settlement in excess of policy limits in the context of an excess carrier's cause of action against a primary carrier. *Id.* (citing *Am. Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480, 481 (Tex. 1992)). The court then concluded that "the issue of whether an insured has a *Stowers* cause of action against her insurance company when [a] case settles pre-trial and the insured has paid a portion of the settlement because the insurer refused to pay the entirety of the settlement demand has not been addressed by a Texas court." *Id.* As a result, a majority of the court concluded that the matter presented an issue of first impression.

Because of that, the court concluded that this issue of first impression potentially would qualify for mandamus relief if "the factual scenario has never been precisely addressed but the principle of law has been clearly established." *Id*. at *5 (quoting *In re State ex rel. Weeks*, 391 S.W.3d 117, 122 (Tex. Crim. App. 2013) (orig. proceeding)). Thus, according to the court, Farmers would be entitled to mandamus relief "if the principle of law [it] relies upon is 'positively commanded and so plainly prescribed under the law as to be free from doubt.'" *Id*. (quoting *In re Medina*, 475 S.W.3d 291, 298 (Tex. Crim. App. 2015) (orig. proceeding)). In light of those standards, the court of appeals concluded that mandamus relief on the negligent-failure-to-settle claim was not warranted because the principal of law on which Farmers relied upon—that a *Stowers* claim always requires an excess judgment—was not so clearly established "as to be free from doubt." *Id.*

The majority opinion drew a lengthy dissent from Chief Justice Sandee Bryan Marion, who opined that, while the exact fact pattern had not been previously addressed by Texas courts, the case did not present a legal issue of first impression. *Id.* at *6 (Marion, J., dissenting). Justice Marion explained that, under existing Texas law, *Stowers* requires that the insured be exposed to an excess judgment. *Id.* Justice Marion specifically noted that "the *Stowers* doctrine does not protect an insured against ***potential*** liability, nor does it protect an insured from incurring an excess judgment

in the first place. Rather, it affords an insured a remedy in the event of an excess judgment." *Id.* (emphasis in original).

D. Commentary

While salacious on its face, the opinion likely does little to change the *Stowers* landscape in Texas. Given the reasons outlined in the dissent, it is unlikely that this issue—outside the context of a mandamus review from a denial of a Rule 91a motion to dismiss—would garner much attention from any Texas courts. In fact, the "principle of law" the majority says is not established certainly seems to be established. As the dissent notes, the purpose of *Stowers* is to provide an insured a remedy if his or her insurer fails to accept a reasonable settlement that exposes the insured to excess liability. If no such excess liability exists, how is there a *Stowers* claim?

V. *Liberty Surplus Insurance Corp. v. Century Surety Company*, No. H-18-1444, 2019 WL 3067504 (S.D. Tex. July 12, 2019)

In *Liberty Surplus Insurance Corp. v. Century Surety Company*, No. H-18-1444, 2019 WL 3067504 (S.D. Tex. July 12, 2019), the Southern District of Texas evaluated the scope of coverage for an arbitration award against a general contractor. In doing so, the court addressed coverage for "rip-and-tear" property damage that has become a recent wrinkle in Texas construction defect litigation.

A. Background Facts

In January 2006, Descon Construction ("Descon") contracted with the City of Edinburg ("Edinburg") to build the Dustin Michael Sekula Memorial Library. Descon subcontracted with McAllen Steel Erectors ("McAllen Steel") to install the library's metal roof. Descon substantially completed the library in March 2007. The roof began to leak within two months of occupancy. Edinburg reported the leaks to Descon and, although multiple efforts were made to correct the leaking conditions, the leaks continued unabated for seven years. *Id.* at *1.

In August 2014, Edinburg sued Descon, asserting claims for breach of contract, breach of warranties, and negligence based, in part, on twenty alleged roof defects. The court ordered the lawsuit to arbitration, where the arbitration panel found that the library roof was "defective"; "the exterior stucco system was defectively installed"; and certain work, including fire-caulking, had not been performed. The panel concluded that Descon was liable for breach of contract and breach of warranty, entering an itemized damage award in favor of Edinburg against Descon for $1,506,099.94, which was detailed as follows:

a)	General Conditions:	$78,500.00
b)	Stucco Repair:	$46,049.00
c)	Fire-rated partitions (caulk)	$200.00
d)	Roof replacement, including structural repairs and ceiling tiles:	$364,556.00
e)	Contractor fee:	$39,144.00
f)	Contingency:	$52,845.00
g)	Attorney's fees:	$699,913.00

h) Consulting fees: $118,348.00
i) Prejudgment interest: $106,544.94

Id. The panel also found that McAllen Steel breached its subcontract with Descon by defectively installing the roof. As such, the panel determined that Descon was entitled to recover from McAllen Steel the total amount of $762,537.36 Of that amount, the panel itemized the damage award against McAllen Steel, apportioning a total of $364,556.00 to "Roof replacement including structural repairs and ceiling tiles." *Id.*

Descon sought coverage for the arbitration award from its insurer, Liberty Surplus Insurance Corporation ("Liberty"), who refused the claim. Liberty then sued Descon, Edinburg, and Century Surety Company ("Century")—who was McAllen Steel's general liability insurer—seeking declaratory relief that its policies did not cover the arbitration award. Edinburg and Century answered, counterclaimed, and crossclaimed. Liberty moved for summary judgment, arguing that its policies did not apply, or, alternatively, that Century had to cover the arbitration award because the panel found that McAllen Steel was liable, and Descon was an additional insured on the Century policy. Century and Edinburg also moved for summary judgment.

B. Whether Liberty's Policies Covered the Roof and Stucco Repair Damages

In its opinion, the court framed the issue as follows: "whether Liberty's policies cover only: (1) 'property damage' caused by the defective roof and stucco, as Liberty and Century argue; or whether the policies cover both (1) 'property damage' caused by the defective roof and stucco and (2) the cost of repairing the roof and stucco, as Edinburg argues. *Id*. at *5. Liberty and Century argued that, under Texas law, "[d]efective work in and of itself" does not constitute "property damage." *Id.* at *7. The insurers contended that, because Edinburg sought coverage for the cost of fixing defective work, Liberty's policies did not cover any arbitration-award damages. Edinburg responded that the cost of repairing faulty workmanship is covered if "the faulty workmanship results in 'physical injury' to tangible property." *Id.* According to Edinburg, the defective roof caused interior water damage and, as a result, Liberty was required to pay the damages awarded for roof- and stucco-repair costs. Edinburg also argued that, because the library sustained—and would continue to sustain—water damage until the roof was replaced, Liberty was obligated to pay for roof-replacement costs. *Id.*

To support its position, Edinburg relied upon *Lennar Corp. v. Markel American Insurance Co.*, 413 S.W.3d 750 (Tex. 2013) and *Crownover v. Mid-Continent Casualty Company*, 772 F.3d 197 (5th Cir. 2014). The *Lennar* case involved a lengthy dispute over whether Lennar's claims for losses from defective synthetic stucco were covered "property damage" under a commercial general liability policy. Lennar built over 400 homes with synthetic stucco that caused wood rot, mold, and termite infestation, among other water damage. After receiving complaints from homeowners, Lennar repaired synthetic stucco-related damage and replaced the defective synthetic stucco on all the homes, even those that had not sustained water damage. At issue in *Lennar* was whether the cost of finding synthetic stucco-related damage in order to repair that damage was covered "damages because of property damage." 413 S.W.3d at 757. Lennar had established at trial that it could not locate or fix water damage without replacing the defective synthetic stucco. Because Lennar asked the jury to consider only the cost of replacing the synthetic stucco from damaged homes and not the cost to replace the synthetic stucco as a preventative measure on

undamaged homes, the Supreme Court of Texas found that investigative costs were damages "because of" the covered "property damage." *Id.*

In *Crownover*, cracks began to show in the walls and foundation of the Crownovers' home shortly after the contractor completed construction. *Crownover*, 772 F.3d at 199. Moreover, problems with the air-conditioning system caused leaking in exterior lines and ducts inside the home, which made the system run continuously to compensate for the leaks, ultimately requiring replacement of the unit. In the arbitration that followed, the arbitrator awarded the Crownovers damages based on findings that "the foundation had failed" and that the air-conditioning unit "was not installed properly." *Id*. at 200. The Fifth Circuit rejected Mid-Continent's argument that the arbitration damages were not covered "damages because of property damage" under a commercial general liability policy, finding that the defectively installed air conditioning unit was "tangible property" and that "the loss of [its] use amounted to property damage." *Id.* at 207.

Having reviewed such cases, the court in *Liberty Surplus* found that the case law relied on by Edinburg was distinguishable. According to the court, the arbitration panel awarded damages to repair or replace ceiling tiles caused by the roof leaks. Thus, unlike the water damage at issue in *Lennar*, which could not be found or repaired without removing the exterior stucco of the homes, the library staff could see ceiling tiles with water stains. *Liberty Surplus Ins. Co.*, 2019 WL 3067504, at *8. Those stains showed which tiles were damaged and might collapse. Library employees would use a lift to replace the waterlogged tiles, proving that removing or replacing the defective roof was not necessary to find or fix damaged tiles. The court also found that, unlike the air-conditioning unit in *Crownover*, the arbitrators found that the library roof and stucco were themselves defective, not that they were damaged or unusable because of other defective work. *Id*.

Edinburg also contended that the repair costs were covered under *Crownover* because testimony during the arbitration proceeding showed that roof leaks required library staff to cordon off areas of the library. Finding that this argument conflated the duty to defend, which is based on the underlying complaint allegations, and the duty to indemnify, which is based on the facts established in the underlying litigation, the court rejected it. Specifically, the court explained that the arbitration award did not actually include loss-of-use damages, indicating that the panel rejected Edinburg's evidence as a basis to award damages. As Liberty only was required to cover "those sums . . . that [Descon was] legally obligated to pay as damages because of 'property damage,'" no support existed for a finding of coverage for loss of use. *Id.*

The court also rejected Edinburg's rip-and-tear "property damage" theory. According to Edinburg, the policies covered the roof-repair costs because replacing the roof would damage the library structure. *Id.* (citing *U.S. Metals, Inc. v. Liberty Mut. Grp., Inc.*, 490 S.W.3d 20, 28 (Tex. 2015)). In *U.S. Metals*, the Supreme Court of Texas determined, in part, that rip-and-tear damages were covered because there was evidence in the underlying dispute that replacing a defective part would damage other components of the non-road diesel unit in which the defective part was installed. *Id.* at 28. Edinburg contended that the $52,845 in "[c]ontingency" damages the arbitration panel awarded "addresse[d] the unforeseen damages and circumstances that arise from the roof removal." *Liberty Surplus Ins. Co.*, 2019 WL 3067504, at *8. According to the court, however, the arbitration award that was issued confirmed that the panel based its findings on the roof defects and did not specifically itemize damages for rip-and-tear costs. As a result, the court held that

Liberty's policy did not cover the costs associated with repairing or replacing the stucco or the roof, including loss-of-use or rip-and-tear damages. *Id.* at *9.

C. Whether Liberty's Policies Covered Ceiling Tile Damages

Additionally, Liberty argued that, because the award did not make a separate finding for repairing or replacing damaged ceiling tiles, the court should find that Liberty was not liable for any awarded damages, even those for ceiling tiles. The court determined that Liberty was correct that the arbitration award did not distinguish between ceiling-tile and roof-repair costs. Rather, the award states simply that Descon "must pay $364,556 for '[r]oof replacement including structural repairs and ceiling tiles.'" *Id.* As a result, the court ruled that the parties could engage in limited discovery to determine how much of the $364,556 was attributable to the replacement of ceiling tiles that were actually damaged. *Id.*

D. Commentary

The court drew a sharp distinction between damages for simple construction defects and damages because of "property damage." The court quoted from *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*, where the Supreme Court of Texas recognized that "faulty workmanship that merely diminishes the value of the home without causing physical injury or loss of use does not involve 'property damage.'" *Id*. at *6 (quoting *Lamar Homes*, 242 S.W.3d 1, 10 (Tex. 2007)). The court explained, however, that in *Lamar Homes*, the Supreme Court of Texas "did not clarify . . . whether a contractor's defective performance—and not just the damage caused by the defective performance—could be covered 'damages because of property damage' under the standard-form commercial general liability policy." *Id.* Here, the court concluded that the only damage that was because of "property damage" was for the ceiling tiles that actually suffered visible damage.

While it may seem rather straightforward to limit the scope of the covered damages as it relates to the ceiling tiles to those that show outward and obvious signs of damage, what if there are damaged tiles that do not show obvious signs of damage? The court in *Liberty Surplus* appeared to place a great deal of significance on the fact that library staff—who are presumably not construction experts—were responsible for simply identifying damaged tiles, and that those identified by the staff were the only tiles for which there was coverage under the Liberty policy. Perhaps that issue was fleshed out in greater detail during the "limited discovery" ordered by the court as to the amount of the damages that fell under the ceiling tile replacement portion of the arbitration award.

This case also serves as a reminder that, in the event that it is anticipated that there will be rip-and-tear type damages to remedy defective work, any judgment or settlement regarding that potential damage should be documented or otherwise accounted for if coverage for such damages is going to exist under a commercial general liability policy. Based on the court's analysis, it appears that the court would have potentially awarded some costs for the rip-and-tear damages had it been included within the itemized arbitration award.

On a final note, the court stated in a footnote that "Edinburg does not argue that Liberty is liable for arbitration-award damages related to "[f]ire- rated partitions (caulk)," $200.00; attorney's fees, $699,913; and "[c]onsulting fees and expenses," $118,348, conceding that those damages are not

at issue." *Id*. at *5 n.2. Though not entirely clear from the opinion, it appears that Edinburg may have conceded that these amounts were not covered by the policy.

VI. *Liberty Insurance Underwriters Inc. v. First Mercury Insurance Company*, No. 3:17-cv-3029-M, 2019 WL _____ (N.D. Tex. Aug. 2, 2019)

In *Liberty Insurance Underwriters Inc. v. First Mercury Insurance Company*, No. 3:17-cv-3029-M, 2019 WL ____ (N.D. Tex. Aug. 2, 2019), the United States District Court for the Northern District of Texas evaluated the issue of the "number of occurrences" that exist under a commercial general liability policy in connection with construction defect litigation.

A. Background

The underlying dispute arose out of the construction of a performing arts center for the Roma Independent School District ("RISD") by the Joe Williamson Construction Company ("JWCC"). RISD and JWCC agreed to a written construction contract in April 2005. In 2014, RISD sued JWCC in state court, alleging monetary damages resulting from defective construction of various parts of the performing arts center. RISD alleged property damage caused by a leaky roof, an improperly constructed concrete retaining wall, improperly constructed walls, a defectively constructed air conditioning system, and defective soil grading and drainage systems. The alleged damages included water damage from flooding, structural damage to the building from improper construction of the walls and roof, mold and water damage from humidity, and damage caused by bats and bat guano.

B. The Settlement Demand by RISD and Policies at Issue

In April 2017, just before trial, RISD made a time-sensitive settlement demand to JWCC for $3 million. JWCC demanded that Liberty Insurance Underwriters Inc. pay $2 million and that defendants First Mercury Insurance Company, Travelers Lloyds Insurance Company, and Travelers Indemnity Company (collectively, the "Defendants") collectively pay a total of $1 million to RISD. The Defendants paid the $1 million demanded, and Liberty also paid the $2 million, but under protest, reserving its rights to seek reimbursement from the Defendants.

The primary policy issued to JWCC by First Mercury was in effect from August 10, 2005 until August 10, 2010. The primary policy issued to JWCC by the Travelers companies was in effect from August 10, 2010 until August 10, 2013. These primary policies both had limits of $1 million per occurrence and $2 million in the aggregate. The policy issued by Liberty provided umbrella excess coverage for the period from August 10, 2006 to August 10, 2007, during which the primary policy was the First Mercury policy and had a limit of $2 million per occurrence and $2 million in the aggregate.

C. The Coverage Dispute

Liberty filed suit, contending that the alleged construction defects constituted at least two occurrences under the primary policies, requiring the Defendants to pay the full amount of the settlement between RISD and JWCC. The Defendants countered that all the issues with construction constituted one occurrence, and that they fulfilled their obligations under the policies by collectively paying $1 million of the settlement demand.

In its motion for summary judgment, Liberty contended that the work of each subcontractor was distinct from the work of the other subcontractors, was performed at different times and in different parts of the project, and pursuant to separate subcontracts, thus resulting in different occurrences of property damage under the primary liability policies. On the other hand, the Defendants claimed that JWCC's defective construction of the building was the singular occurrence that was the continuous cause of property damage. The Defendants urged the court to focus on the point in time when JWCC became exposed to liability, which was when the defective building was delivered.

In its opinion, the court explained that, when interpreting per-occurrence liability limits under similar policies, "[t]he few Texas cases that have addressed this issue apply a 'cause' analysis in determining whether a set of facts involves one or several occurrences." *Id.* at p. 3 (quoting *Ran-Nan Inc. v. Gen. Acc. Ins. Co. of Am.*, 252 F.3d 738, 740 (5th Cir. 2001)). Under such framework, the "number of occurrences" issue is determined by focusing on the events that caused the subject injuries and gave rise to the insured's liability. *Id.* (citing *H.E. Butt Grocery Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA.*, 150 F.3d 526, 530 (5th Cir. 1998)). "If all injuries stem from one continuous cause, then there is only one occurrence." *Id.* (citing *H.E. Butt Grocery Co.*, 150 F.3d at 534). "If the injuries stem from multiple causes, however, then there are multiple occurrences." *Id.* (citing *Ran-Nan*, 252 F.3d at 740).

Continuing, the court noted that, until 2007, Texas courts were split as to whether defective construction work performed in breach of a contract was an occurrence of "property damage" as defined in a standard commercial general liability insurance policy. In *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*, the Supreme Court of Texas resolved this issue, holding that property damage arising out of defective work is treated no differently from other property damage. Stated otherwise, any unexpected or unintended damage resulting from defective work constitutes an occurrence under a commercial general liability policy. *Liberty Insurance Underwriters*, No. 3:17-cv-03029-M, at pp. 4–5 (citing *Lamar Homes, Inc.*, 242 S.W.3d at 16).

According to the court, when there are multiple defects in a construction project, the law is not settled as to whether each defect is an individual occurrence under the primary insurance policies, or if the defective construction as a whole constitutes a single occurrence. However, the parties contended that two federal district court cases were instructive on this issue. The first, *Twin City Fire Insurance Co. v. Illinois National Insurance Co.*, involved defective construction of a roadway that prevented water from draining properly, leading to three separate car accidents, involving unrelated parties, over a period of a month. No. 1:11–cv–00144–S, 2012 U.S. Dist. LEXIS 197629 (W.D. Tex. March 12, 2012). Applying the cause analysis, the district court in *Twin City Fire* held that the defect in the construction was the "single event that both allegedly caused the injuries in the underlying suits, and gave rise to Twin City's liability; and therefore, the three accidents were a single 'occurrence' under the [commercial general liability] policy." *Id.*

The second, *Fina, Inc. v. Travelers Indemnity Co.*, involved a dispute over whether each of a number of workers' exposure to asbestos was a separate occurrence under a primary policy, or if the exposure of all the workers constituted one occurrence. 184 F. Supp. 2d 547, 552–53 (N.D. Tex. 2002). The court held that each worker's exposure was not a separate occurrence under the primary insurance policy but that exposure at separate facilities were separate occurrences from exposure at other facilities, because those exposures at different facilities caused the occurrences of injury. *Id.*

Relying on *Twin City Fire* and *Fina*, the court in *Liberty Insurance Underwriters* held as follows:

> [T]he cause analysis is the appropriate analytical framework to determine the number of occurrences under the primary policies. Although, here there are various types of construction defects, leading to different types of property damage, all of the property damage in this case was caused by a single event at a single facility — the defective construction by JWCC, or its subcontractors, of the performing arts center.

As a result, the court held that the defective construction and delivery of the performing arts center by JWCC was the specific event that harmed RISD and was the underlying cause generating liability for all the property damage that existed, constituting a single occurrence of property damage.

D. Commentary

An issue frequently in dispute, this opinion provides strong support for a primary carrier of a general contractor that it only has exposure up to its single occurrence limit in the context of construction defect litigation. The holding is consistent with the "cause" test that has been employed by Texas courts for years. In light of this opinion, we know of at least two federal judges that have applied the "cause" test to find a single occurrence where there are multiple construction defects—albeit one of those came in an oral order.

VII. *State Farm Lloyds v. Richards*, 784 F. App'x 247 (5th Cir. 2019), certified question accepted (Tex. Sept. 13, 2019)

Despite a multitude of opportunities, the Supreme Court of Texas has never opined one way or another as to whether an exception to the "eight corners" rule exists in determining an insurer's duty to defend. Even so, there has been some inconsistency within the Fifth Circuit, within federal district courts, and even among some state appellate courts. The Fifth Circuit recently certified a question to the Supreme Court of Texas to address the issue in *State Farm Lloyds v. Richards*, 784 F. App'x 247 (5th Cir. 2019), certified question accepted (Tex. Sept. 13, 2019). The certified question is limited to whether the "policy language" exception exists; however, the Supreme Court is not limited to the question certified and may provide general guidance on the scope of the "eight corners" rule and whether or to what extent extrinsic evidence is admissible in evaluating the duty to defend.

A. The "Eight Corners" Rule in Texas

Under Texas law, the general rule for determining whether an insurer has a duty to defend is the "eight corners" rule—so called because the only two documents ordinarily relevant to the determination of the duty to defend are the policy and the pleadings of the third-party claimant. *Pine Oak Bldrs., Inc. v. Great Am. Lloyds Ins. Co.*, 279 S.W.3d 650, 654 (Tex. 2009); *GuideOne Specialty Mut. Ins. Co. v. Missionary Church of Disciples of Jesus Christ*, 687 F.3d 676, 682 (5th Cir. 2012). Applying the rule, the "[f]acts outside the pleadings, even those easily ascertained, are ordinarily not material to the determination and allegations against the insured are liberally construed in favor of coverage." *GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church*, 197

S.W.3d 305, 308 (Tex. 2006) (quoting *Nat'l Union Fire Ins. Co. v. Merchs. Fast Motor Lines, Inc.*, 939 S.W.2d 139, 141 (Tex. 1997)). The scope of the duty to defend is broad: "Where the [petition] does not state facts sufficiently to clearly bring the case within or without the coverage, the general rule is that the insurer is obligated to defend if there is, potentially, a case under the [petition] within the coverage of the policy." *Missionary Church*, 687 F.3d at 683 (alteration in original) (quoting *Nat'l Union Fire Ins. Co.*, 939 S.W.2d at 141). The U.S. Court of Appeals for the Fifth Circuit has recognized that, "[b]ecause the only two documents relevant to the duty-to-defend inquiry are the insurance policy and the petition, an insurer's duty to defend can be determined at the moment the petition is filed." *ACE Am. Ins. Co. v. Freeport Welding & Fabricating, Inc.*, 699 F.3d 832, 840 (5th Cir. 2012). Thus, according to the court, "[r]esort to evidence outside the four corners of these two documents is generally prohibited." *Id.*

As recognized recently by Texas' Fourteenth Court of Appeals in Houston, "despite various requests over the years to recognize exceptions to the eight-corners rule, the Supreme Court has never done so." *Allstate County Mut. Ins. Co. v. Wooten*, 494 S.W.3d 825, 833 (Tex. App.—Houston [14th Dist.] 2016, pet. denied). The Supreme Court of Texas itself has eluded in several opinions to the fact that, while it "has never expressly recognized an exception to the eight-corners rule, other courts have." *See Pine Oak Bldrs., Inc.*, 279 S.W.3d at 654 (quoting *GuideOne Elite Ins. Co.*, 197 S.W.3d at 308). Making an *Erie* guess, the Fifth Circuit in *Northfield Insurance Co. v. Loving Home Care* suggested that, if the Supreme Court of Texas were to recognize an exception, it would apply only:

> when it is initially impossible to discern whether coverage is potentially implicated and when the extrinsic evidence goes solely to a fundamental issue of coverage which does not overlap with the merits of or engage the truth or falsity of any facts alleged in the underlying case.

363 F.3d 523, 531 (5th Cir. 2004). Two years later, the Supreme Court of Texas recognized the existence of this so-called "*Northfield* Exception" in *GuideOne*. 197 S.W.3d at 308–09. The Court, however, did not adopt the *Northfield* Exception, instead explaining that the duty-to-defend analysis could be determined from the pleading alone. The Court also stated that, although the insurer knew that the allegations within the pleading were incorrect, the insurer "agreed to defend the [insured] against allegations . . . potentially within coverage, even if the plaintiff's allegations were false or fraudulent. Therefore if [the insurer] knows these allegations to be untrue, its duty is to establish such facts in defense of its insured, rather than as an adversary in a declaratory judgment action." *Id.* at 310–11 (citing *Heyden Newport Chem. Corp. v. S. Gen. Ins. Co.*, 387 S.W.2d 22, 25 (Tex. 1965) (observing that the duty to defend coverage protects policyholders against the expense of suits seeking damages)).

The Court also explained that, if it were to recognize an exception to the eight-corners rule, it "would by necessity conflate the insurer's defense and indemnity duties without regard for the policy's express terms." *Id.* at 310. The Court recognized that, although the duty to defend and duty to indemnify are "are created by contract, they are rarely coextensive." *Id.* The Court noted that the particular language obligated the insurer to indemnify the insured in the event of a meritorious claim, but with respect to the duty to defend, the contract provided that the insurer should "defend any suit brought against [the insured] seeking damages, even if the allegations of the suit are groundless, false or fraudulent . . . ." *Id.* Thus, according to the Court, the policy

"defined the duty to defend more broadly than the duty to indemnify." *Id*. Since that opinion, the Supreme Court of Texas has stated multiple times that it has not recognized that any such exception to the "eight corners" rule exists.

The lack of definitive guidance from the Supreme Court of Texas has led to inconsistent application of the "eight corners" rule and questions as to the scope of exceptions—if any—to that rule under Texas law. While it seems that Texas federal courts—relying on the *Northfield* Exception—have been more willing to find that an exception exists, most Texas state courts have tempered the application of an exception, likely due to the blanket statement from the Supreme Court of Texas that it has never officially recognized that any such exception exists. Several state appellate courts have refused to even acknowledge that any exception to the "eight corners" rule exists under any circumstance, specifically referring to Supreme Court precedent. *See, e.g*., *Burlington N. & Santa Fe Ry. Co. v. Nat'l Union Fire Ins. Co*., 394 S.W.3d 228, 235 (Tex. App.—El Paso 2012, pet. denied) (declining to recognize any exception to the "eight corners" rule); *AccuFleet, Inc. v. Hartford Fire Ins. Co*., 322 S.W.3d 264, 273 (Tex. App.—Houston [1st Dist.] 2009, no pet.) (same); *Tex. Farm Burau Underwriters v. Graham*, 450 S.W.3d 919, 925 (Tex. App.—Texarkana 2014, pet. denied) (stating that reliance on deposition testimony not within the pleading would "violate[] the eight corners rule").

Additional complications have been created by rulings from the United States District Court for the Northern District of Texas that the "eight corners" rule is wholly inapplicable when the policy language at issue does not require the insurer to defend the insured even "'if the allegations of the suit are groundless, false or fraudulent.'" *See, e.g*., *State Farm Lloyds v. Richards*, No. 4:17-CV-753-A, 2018 WL 2225084, at *3 (N.D. Tex. May 15, 2018) (citing *B. Hall Contracting, Inc. v. Evanston Ins. Co*., 447 F. Supp. 2d 634, 645 (N.D. Tex. 2006), *rev'd on other grounds*, 273 F. App'x 310 (5th Cir. 2008)). In those cases, the court has found a "policy-language" exception to the "eight corners" rule based on the particular defense-obligation language in the insuring agreement of the policies at issue. In particular, the relevant portions of the insuring agreement provide that the insurer will:

> pay "those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies." . . . In addition, the policy imposes on [the insurer] the "duty to defend the insured against any 'suit' seeking those damages," . . . ; but, the policy goes on to say that "[h]owever, we will have no duty to defend the insured against any 'suit' seeking damages for 'bodily injury' or 'property damage' to which this insurance does not apply."

B. Hall Contracting, 447 F. Supp. 2d at 638. In finding a "policy-language" exception, the district court reasoned that the missing "groundless, false, or fraudulent" language in the particular policy form before the court was critical, as it meant that the insurer's duty to defend obligation was coextensive with—as opposed to broader—than its duty to indemnify, as the Supreme Court recognized in *GuideOne*. *Id*. at 645 (quoting from *GuideOne*, 197 S.W.3d at 310). According to that court, the insurer need only defend the insured if coverage actually applies, and the insurer could look to the actual facts in determining its defense obligation.

B. Certified Question of Whether the "Policy-Language" Exception to the "Eight Corners" Rule Exists

In *State Farm Lloyds v. Richards*, the United States District Court for the Northern District again held that the eight-corners rule did not apply based on the so-called "policy-language" exception. No. 4:17-CV-753-A, 2018 WL 2225084, *3 (N.D. Tex. May 15, 2018). The district court's decision was appealed to the Fifth Circuit. *State Farm Lloyds v. Richards*, 784 F. App'x 247 (5th Cir. 2019).

The underlying case involves the tragic death of a 10-year-old in an ATV accident at his grandparents' house. *Id.* at 248. The boy was under the temporary care of his grandparents at the time of the accident. Subsequently, the boy's mom sued the grandparents, who sought coverage for the lawsuit from their insurer, State Farm Lloyds ("State Farm"). State Farm initially agreed to provide a defense but then filed a declaratory judgment action, arguing that it had no duty to defend based on exclusions to the policy. *Id.*

The first exclusion was a "motor-vehicle exclusion" that precluded coverage for bodily injury "'arising out of the . . . use . . . of . . . a motor vehicle owned or operated by or loaned to any insured.'" *Id.* at 248–49. The term '"motor vehicle'" was defined to include an "'all-terrain vehicle' . . . owned by an insured and designed or used for recreational or utility purposes off public roads, while off an insured location." *Id.* at 249. Further, the policy defined the term '"insured location' to mean 'the residence premises.'" *Id.* To support its motion for summary judgment, State Farm included a crash report to show that the accident did not occur on the grandparents' premises. *Id.* State Farm also attached admissions by the grandparents that the accident did not occur at their premises. *Id.*

Additionally, State Farm relied on the '"insured exclusion," which:

> excludes coverage for bodily injury to any insured "within the meaning of part a. or b. of the definition of insured." The policy defines "insured" to mean "you and, if residents of your household: a. your relatives; and b. any other person under the age of 21 who is in the care of a person described above." State Farm thus attached the [grandparents'] admission that they were [the boy's] grandparents, as well as an order . . . appointing them as joint-managing conservators in order to show that [the boy] was a "resident of [the grandparents'] household."

Id. Over the insureds' objections, the court allowed State Farm to rely on the extrinsic evidence it submitted in conjunction with its summary judgment briefing. Finding that the extrinsic evidence established that the policy would not provide coverage—and, thus, there would be no duty to defend—the court ruled in favor of State Farm. The district court referenced and relied upon the "policy-language" exception to the "eight corners" rule in making its determination. *Id.* at 250.

On appeal to the Fifth Circuit, State Farm actually made no effort to defend the analysis of the district court. *Id.* at 250. The Fifth Circuit began its analysis by surveying the current jurisprudence regarding the application and scope of the duty-to-defend rule and circumstances where extrinsic evidence was allowed or disallowed in making the defense determination. Recognizing that "there

is no controlling Texas Supreme Court caselaw determining whether there is a policy-language exception to the eight-corners rule" and that the issue "involves important and determinative questions of Texas law," the Fifth Circuit certified to the Supreme Court of Texas the question of whether Texas courts should recognize the "policy-language exception to the eight-corners rule." *Id*. at 253.

C. Commentary

As noted, the certified question seems to be quite narrow, requesting an answer only as to whether the policy-language exception exists. In evaluating the issue, the Supreme Court of Texas hopefully will provide general guidance on if and when extrinsic evidence is admissible to determine the duty to defend. One key issue will involve whether the Court decides to draw a distinction between policy language that includes the "groundless, false or fraudulent" language in the insuring agreement and the policy language under which an insurer must defend only if the "suit" seeks damages for "bodily injury" or "property damage" to which the insurance applies. Of course, in order for one to determine if a claimant "seeks" damages for "bodily injury" or "property damage" to which the insurance applies, one need only look to the allegations in the "suit," as is that not the best evidence of what the claimant seeks regardless of whether it does so by asserting groundless, false or fraudulent claims?

Interestingly, the Supreme Court of Texas appears to have already provided an indication as to how it may answer the actual certified question. In *Pine Oak Builders*, the Supreme Court applied the "eight corners" rule and refused to allow the insurer to introduce extrinsic evidence that would have defeated the duty to defend. Though not specifically articulated in the actual opinion, the language in the policy at issue did not have the "groundless, false or fraudulent" language in the insuring agreement. Also notable, just weeks before the Fifth Circuit certified its question to the Supreme Court of Texas, the United States District Court for the Western District of Texas, in *Bitco General Insurance Corporation v. Monroe Guaranty Insurance Company*, No. SA-18-CV-00325-FB-ESC, 2019 WL 3459248 (W.D. Tex. July 31, 2019), declined to consider extrinsic evidence in evaluating whether a duty to defend existed under a commercial general liability policy. The policy at issue in *Bitco* did not have the "groundless, false, or fraudulent" language either. *Id*. at *4. The court determined that the "eight corners" rule governed and refused to apply the *Northfield* Exception because the extrinsic facts sought to be introduced overlapped with the merits of the underlying case. *Id*. at *6. *Bitco* currently is on appeal to the Fifth Circuit.

Richards and *Bitco* demonstrate the conflicting standards employed by the courts in evaluating whether a duty to defend exists under a liability policy. Those cases provide a prime example of the need for guidance from the Supreme Court of Texas as to this issue. What is certain is that any ruling by the Supreme Court of Texas is sure to garner extensive attention, analysis, and litigation moving forward.

VIII. *Aggreko, L.L.C. v. Chartis Specialty Insurance Co.*, 942 F.3d 682 (5th Cir. 2019)

In *Aggreko, L.L.C. v. Chartis Specialty Insurance Co.*, 942 F.3d 682 (5th Cir. 2019), the Fifth Circuit evaluated whether a covenant not to execute constituted a "settlement" sufficient to relieve the primary insurer of its duty to defend.

A. Background Facts

The underlying lawsuits arose out of fatal injuries suffered by James Andrew Brenek, II ("Brenek") on July 27, 2014, when he was electrocuted by an electrically-energized generator housing cabinet on a rig in Jefferson County, Texas. *Id*. at 684. At the time of his accident, Brenek was employed by and performing work for Guichard Operating Company, L.L.C. ("Guichard"), a drilling subcontractor. Guichard had leased the generator involved in the incident from Aggreko, L.L.C. ("Aggreko"). The rental agreement between Guichard and Aggreko required Guichard to maintain a commercial liability insurance policy during the lease period that would cover damages arising out of use of the leased equipment and include Aggreko as an additional insured. *Id.*

On the date of Brenek's death, Guichard had in place a primary commercial liability policy issued by The Gray Insurance Company ("Gray") and an excess commercial liability policy issued by Chartis Specialty Insurance Company, also known as "ASIC" ("ASIC"). Aggreko had in place a primary insurance policy issued by Indian Harbor Insurance Company ("Indian Harbor"). *Id.*

Following Brenek's death, his parents filed suit against Aggreko and Rutherford Oil Corporation ("Rutherford"), the owner of the rig on which Brenek's accident occurred. *Id.* at 684–85. Thereafter, Gray agreed, in response to demands by Aggreko and Rutherford, to indemnify and defend them as additional insureds under the Gray policy. ASIC, on the other hand, advised Aggreko, upon learning of the parents' lawsuit, that Aggreko did not qualify as an additional insured under the policy it issued to Guichard. *Id*. at 685. In response, Aggreko filed suit against ASIC, seeking declaratory relief with respect to ASIC's alleged obligations to Aggreko under its policy. *Id.*

B. Execution of the Covenant Not to Execute

Despite Aggreko's lawsuit against ASIC, Gray maintained its defense of Aggreko with respect to the lawsuit filed by the parents. The Gray policy had a liability limit of $1,000,000, subject to a $50,000 self-insured retention. On February 8, 2017, Gray and the parents reached two separate agreements regarding the claims against Rutherford and Aggreko. *Id*. With respect to Rutherford, Gray agreed to pay the parents $50,000 in exchange for a full and complete release of any and all claims that the parents had against Rutherford arising out of their son's accident and death. *Id.*

With respect to Aggreko, Gray agreed to pay the parents $950,000 on behalf of Aggreko in exchange for the parents' agreement to execute any subsequent judgment obtained by the parents as to Aggreko only against available insurance. *Id*. On the same date, Gray issued to the parents and their attorneys two checks—one in the amount of $50,000, and one in the amount of $950,000. On March 3, 2017, the parents executed a "Release and Settlement Agreement" and a "Covenant Not To Execute Agreement" ("Covenant Not to Execute"), setting forth the formal terms of the respective agreements they entered into with Gray. *Id.*

The Covenant Not To Execute stated that, by executing the agreement, the parents "jointly and severally, promise[ ], agree[ ] and covenant[ ] that they shall not seek to and will not execute on any Judgment obtained in their favor and against Aggreko in the Lawsuit save and except to the extent they can recover the Judgment from any insurance company which provides coverage to Aggreko." *Id.* The Covenant Not to Execute further provided that the parents would "enforce any

and all such Judgment against the available insurance only, and not against the assets of Aggreko or its respective present or former directors, officers, employees, [or] parent companies." *Id.* Additionally, the agreement indicated that the parents "acknowledge[ ] and agree[ ] that Aggreko retains whatever rights it may have under the law to reduce the amount of any damage award against it by way of settlement credit, proportionate responsibility, Tex. Civ. Prac. & Rem. Code Chapter 33, the One-Satisfaction Rule, or otherwise." *Id.*

C. Gray's Withdrawal of Defense and the Coverage Dispute

Asserting that it had paid the $1,000,000 policy limit of the Gray policy "in settlement regarding the Brenek occurrence," Gray took the position that it had no further obligations under its policy to Aggreko. *Id.* As a result of this "exhaustion" of limits, Gray explained by letter that it intended to withdraw its defense of Aggreko with respect to the parents' pending state court lawsuit. *Id.* Gray subsequently denied requests of Aggreko and Indian Harbor to maintain its defense of Aggreko. As a result, Indian Harbor instituted a declaratory action, seeking, among other things, recognition that Gray continued to owe a duty to defend Aggreko. Shortly thereafter, the district court issued an order consolidating Aggreko's lawsuit against ASIC with Indian Harbor's lawsuit against Gray. *Id.* at 686.

Indian Harbor filed a cross-motion for summary judgment in which it asked the district court to determine that the Covenant Not to Execute did not constitute a "settlement" of any of the parents' claims against Aggreko under Texas law and, therefore, that Gray had not exhausted its policy limit with respect to such claims. *Id.* In particular, Indian Harbor argued that the Covenant Not to Execute is not a "settlement" sufficient to have relieved Gray from its duty to defend Aggreko under the Gray Policy, since it did not release Aggreko from any tort liability or end any part of the parents' lawsuit against Aggreko. *Id*. at 689. Indian Harbor further contended that Gray's actions were part of a "strategy" to shift its duty to defend to Indian Harbor, an excess insurer. *Id.* Indian Harbor also argued that, because Gray had an ongoing duty to defend Aggreko in the parents' lawsuit, Gray was required to reimburse Indian Harbor for any costs spent in Aggreko's defense. *Id*. at 686. Indian Harbor based its position on the Fifth Circuit's opinion in *Continental Casualty Co. v. North American Capacity Insurance Co*., 683 F.3d 79 (5th Cir. 2012).

Gray, on the other hand, argued that Indian Harbor "elevates form over substance" and that the court should focus on whether the Covenant Not to Execute "provided similar protection as any document entitled 'release' or 'settlement'." *Aggreko*, 942 F.3d at 689. Gray further asserted that, in light of available excess insurance under Indian Harbor's policy, which would be inaccessible after full release of the parents' liability claims against Aggreko, the Covenant Not to Execute was as complete of a release as it could obtain. Additionally, Gray argued that the policy provision at issue was clear and unambiguous and did not explicitly require a release. *Id*. Gray relied on another decision from the Fifth Circuit to support its position—*Judwin Properties, Inc. v. United States Fire Insurance Co*., 973 F.2d 432 (5th Cir. 1992).

D. The Payments by Gray in Conjunction with the Execution of the Covenant Not to Execute Exhausted the Gray Policy Limits

The Fifth Circuit first determined that neither *Continental Casualty* nor *Judwin Properties* compelled resolution as to the dispute. *Aggreko*, 942 F.3d at 689. As a result, the Fifth Circuit

proceeded to conduct an *Erie* analysis of whether, under Texas law, the Covenant Not to Execute and payment of the remainder of the Gray policy proceeds constituted a "settlement" sufficient to have relieved Gray of its duty to defend Aggreko under the Gray policy. *Id*. at 691. The Fifth Circuit concluded that, upon review of pertinent Texas jurisprudence, if presented with the issue, the Supreme Court of Texas would conclude that a settlement occurred, as required by the Gray policy. *Id*.

The court first examined how Texas jurisprudence defined the term settlement: "the conclusion of a disputed or unliquidated claim, and attendant differences between the parties, through a contract in which they agree to mutual concessions in order to avoid resolving their controversy through a course of litigation." *Id*. (quoting *McCleary v. Armstrong World Indus., Inc*., 913 F.2d 257, 259 (5th Cir. 1990) (quoting *Priem v. Shires*, 697 S.W.2d 860, 863 n.3 (Tex. App.—Austin 1985, no writ))). The Fifth Circuit determined that there was "no dispute that the Covenant Not to Execute is a binding contract. Further, it is apparent that in that contract, mutual concessions were made: Gray paid $950,000 on behalf of Aggreko in exchange for the [parents'] agreement not to execute any tort judgment directly against Aggreko." *Id*. Though the Covenant Not to Execute did not end Aggreko's tort liability, that contract did conclude any claim that the parents had to Aggreko's personal assets and eliminated any personal exposure that Aggreko faced with respect to a potential tort judgment against it. *Id*. at 691–92. Additionally, the Fifth Circuit found that the Covenant Not to Execute effectively reduced the amount of damages that the parents could recover as a result of any finding of tort liability on the part of Aggreko by $950,000, as the parents acknowledged in the Covenant Not to Execute that Aggreko retained its rights under the law to reduce the amount of any damage award against it. *Id*. at 692.

The court concluded:

> Considering the foregoing, the fact that the [parents'] damages plainly exceed the Gray Policy limit, and the inability of Gray to obtain a full release of Aggreko without hampering the [parents'] excess coverage claims, we believe that the Texas Supreme Court would conclude that a settlement occurred as to the [parents'] claims against Aggreko.

Id.

In reaching this decision, the Fifth Circuit relied upon *Kings Park Apartments, Ltd. v. National Union Fire Insurance Co.*, 101 S.W.3d 525 (Tex. App.—Houston [1st Dist.] 2003, pet. denied), in determining that "Aggreko received the benefit of resolution of a portion of the monetary claim against it and a step toward a full release, since in the Covenant Not to Execute, the [parents] 'acknowledge[d] and agree[d] that Aggreko retain[ed] whatever rights it may have under the law to reduce the amount of any damage award against it' because of Gray's payment." *Aggreko*, 942 F.3d at 693. The court also recognized that, while Aggreko had not obtained any concessions from the parents on its own, Aggreko clearly received, as a result of the Covenant Not to Execute, the benefit of the parents' agreement not to execute any judgment directly against Aggreko. *Id.* Accordingly, the court concluded that "the lack of a release of Aggreko's liability is not dispositive of whether Gray's obligations to Aggreko under the Gray Policy were exhausted." *Id*.

The court further relied upon *Texas Farmers Insurance Co. v. Soriano*, 881 S.W.2d 312 (Tex. 1994), as demonstrating "the willingness of Texas courts to allow a liability insurer to reasonably exhaust its duties to its insured under the terms of its policy, including its duty to defend, even though it has not resolved all pending liability claims against the insured." *Aggreko*, 942 F.3d at 693. In particular, the court found that, despite Indian Harbor's suggestion that Gray's agreement with the parents was a maneuver to dump Aggreko's defense on it, there is no assertion or indication that payment of $950,000 to the parents by Gray on behalf of Aggreko to satisfy a portion of the damages sought for the death of their son was unreasonable. *Id*. at 694. Finally, the court explained that its conclusion that a "settlement" occurred under the terms of the Gray policy, was "in line with the Texas Supreme Court's goal of promoting public policies that encourage settlements." *Id*. (citing *Stewart Title Guar. Co. v. Sterling*, 822 S.W. 2d 1, 9 (Tex. 1991)).

E. Commentary

The Fifth Circuit's decision in this case is significant. Just two-and-a-half years ago, the Supreme Court of Texas found that an agreement, prior to trial, between a plaintiff and a defendant that the plaintiff would not execute a judgment against the defendant's assets rendered the subsequent litigation a non-adversarial trial such that the defendant's insurer, which had wrongfully denied coverage, was able to challenge the ultimate verdict in the underlying lawsuit by retrying liability in the coverage case. *See Great Am. Ins. Co. v. Hamel*, 525 S.W.3d 655 (Tex. 2017). To allow a primary insurer to obtain a similar agreement for its insured in the face of existing excess coverage seemingly achieves the same result rejected by the Court in *Hamel*. While the holding in *Aggreko* certainly will allow parties to explore new methods for reaching settlements in cases where an insured potentially has exposure in excess of its primary layer of coverage, doing so likely will spawn even more litigation as insureds and insurers alike try to navigate the narrow line between *Hamel* and *Aggreko*.

IX. *Great American Lloyds Insurance Co. v. Vines-Herrin Custom Homes, L.L.C.*, No. 05-18-00337-CV, 2020 WL 104622 (Tex. App.—Dallas Jan. 9, 2020, no pet. history).

In *Great American Lloyds Insurance Co. v. Vines-Herrin Custom Homes, L.L.C.*, No. 05-18-00337-CV, 2020 WL 104622 (Tex. App.—Dallas Jan. 9, 2020, no pet. history) ("*Vines-Herrin III*"), the Dallas Court of Appeals evaluated the appropriate standard for allocation of a judgment between multiple insurers.

A. Background

The dispute in *Vines-Herrin III* is the third appeal as to the coverage issues between the parties. As relevant to this dispute, the court provided a short background of the current issues. In particular, Vines-Herrin Custom Homes, L.L.C. and Herrin Custom Homes, Inc. (collectively, "Vines-Herrin"), a builder, purchased general liability coverage from Great American Lloyds Insurance Company and Mid-Continent Casualty Company (together, "the Insurers"). Emil G. Cerullo ("Cerullo") hired Vines-Herrin to construct his home and subsequently sued Vines-Herrin for alleged construction defects in the home. *See id.* at *1. The Insurers refused to defend Vines-Herrin with respect to Cerullo's lawsuit. Vines-Herrin then sued the Insurers, seeking a declaration that they owed duties to defend and indemnify under their policies with respect to the *Cerullo* lawsuit.

Cerullo's claim against Vines-Herrin was referred to arbitration, ultimately resulting in Cerullo recovering a total of $2,487,507.77. *Id.* The Insurers did not participate in the arbitration. Cerullo and Vines-Herrin agreed that Cerullo would not confirm the arbitrator's award in exchange for an assignment of Vines-Herrin's claims against the Insurers. After a bench trial on the coverage issues, the trial court first ruled in Vines-Herrin's favor. During pendency of post-judgment motions, however, the Supreme Court of Texas issued its ruling in *Don's Building Supply, Inc. v. OneBeacon Insurance Co.*, rejecting the "manifestation" trigger theory that the trial court had relied on in finding for Vines-Herrin against the Insurers. *Vines-Herrin Custom Homes, LLC v. Great Am. Lloyds Ins. Co*. 357 S.W.3d 166, 170 (Tex. App.—Dallas 2011, pet. denied) ("*Vines-Herrin I*") (citing *Don's Bldg.*, 267 S.W.3d 20, 24–25 (Texas 2008)). As a result of the adoption of the "actual-injury" rule in *Don's Building*, the trial court ultimately rendered a take-nothing judgment against Vines-Herrin. 2020 WL 104622, at *1. Vines-Herrin appealed that ruling.

In *Vines-Herrin I*, the court of appeals reversed the trial court's judgment, concluding that both Great American and Mid-Continent owed Vines-Herrin a duty to defend, and Great American's duty to indemnify was triggered. *Vines-Herrin I*, 357 S.W.3d at 173. The court remanded the case to the trial court for further proceedings. The trial court rendered judgment for Vines-Herrin in the amount of the arbitrator's award against both of the Insurers, jointly and severally, which the Insurers then appealed.

In what became *Vines-Herrin II*, the court of appeals concluded that both Insurers owed Vines-Herrin a duty to indemnify. *See Great Am. Lloyds Ins. Co. v. Vines-Herrin Custom Homes, L.L.C.*, No. 05-15-00230-CV, 2016 WL 4486656 (Tex. App.—Dallas Aug. 25, 2016, pet. denied) ("*Vines-Herrin II*"). The court also held in *Vines-Herrin II* that the trial court erred by ruling that each insurer was liable for the entire arbitration award. Accordingly, the court of appeals again remanded the case for further proceedings. *Id.* at *8.

The trial court rendered a second amended final judgment, allocating the $2,487,507.77 award on a pro-rata basis based on the number of days each insurer's policy was implicated for the damages incurred. The trial court's calculation resulted in a damage award against Great American for $872,057.32, and a damage award against Mid-Continent for $1,615,450.45. The trial court also awarded Vines-Herrin attorneys' fees and costs; however, the trial court denied Vines-Herrin's request for an award of attorneys' fees incurred in *Vines-Herrin II*.

B. The Court Holds that, under the Circumstances, Pro-Rata Allocation by Time on the Risk was Warranted

In *Vines-Herrin III*, the court of appeals first explained that, because the Insurers wrongfully denied defense coverage, they were precluded from collaterally attacking the judgment rendered against the insured. *Vines-Herrin III*, 2020 WL 104622, at *3 (citing *Great Am. Ins. Co. v. Hamel*, 525 S.W.3d 655, 662–63 (Tex. 2017); *Evanston Ins. Co. v. ATOFINA Petrochemicals, Inc.*, 256 S.W.3d 660, 670–74 (Tex. 2008)).

The court then rejected the argument by the Insurers that they may pay nothing at all if their insured failed to establish a specific amount of damages attributable to each policy period during the underlying arbitration. *Id*. The court explained that, in *Vines-Herrin II*, it expressly rejected the Insurers' argument that, "even if the evidence shows they should have indemnified Vines-Herrin

in some amount, Vines-Herrin's failure to present evidence showing what that amount was is fatal to its recovery." *Id*. (quoting *Vines-Herrin II*, 2016 WL 4486656, at *6). Rather, the court found in *Vines II* that the Insurers "were not required to indemnify Vines-Herrin for property damages caused by occurrences and damages, *both of which* occurred outside their respective policy periods." *Id*. (quoting *Vines-Herrin II*, 2016 WL 4486656, at *7) (emphasis added by the court). Consequently, Great American was not required to indemnify Vines-Herrin for damages that occurred during Mid-Continent's two policy periods, and Mid-Continent was not required to indemnify Vines-Herrin for damages that occurred during Great American's single policy period. *Id*. Conversely, the court found that "each Insurer is required to indemnify Vines Herrin 'for property damages caused by occurrences and damages, *both* of which' did occur during that Insurer's policy period." *Id.* (quoting *Vines-Herrin II*, 2016 WL 4486656, at *7) (emphasis in original).

When *Vines-Herrin II* was remanded to the trial court, Vines-Herrin offered proof that it suffered damages from occurrences in each of the three policy periods. This was done by submission of evidence regarding inspection reports, repair estimates, and photographs with respect to the problems at the home. *Id*. at *4. As a result of this testimony, the court in *Vines-Herrin III* concluded that, because Great American issued a policy for one of these policy periods and Mid-Continent issued policies for the remaining two, "[e]ach must indemnify Vines-Herrin accordingly." *Id.* at *3. The court also noted that the Insurers presented no evidence that damage occurred within the other insurer's policy period, presumably as a "strategy" not to present facts that would establish covered damage during one of the policies. *Id*. at *4 (citing *Vines-Herrin II*, 2016 WL 4486656, at *6). As a result of this strategy, the only evidence before the arbitrator and the trial court showed that property damage occurred during each respective policy period. *Id*. at *4.

To determine the proper allocation of indemnity between the Insurers, the trial court applied a "time on the risk" allocation. *Id.* Specifically, the court allocated the total arbitration award on a *pro rata* basis, based on the number of days each policy was implicated. The court in *Vines-Herrin III* found that, while no case cited by Vines-Herrin applied a time-on-the-risk allocation under the same circumstances as those presented, it did not necessarily mean that the "principle's underlying rationale may not apply." *Id.* In particular, the court looked to the Supreme Court of New Hampshire's opinion from *EnergyNorth Natural Gas, Inc. v. Certain Underwriters at Lloyd's*, 934 A.2d 517 (N.H. 2007), in which that court discussed "pro rata allocation" of loss among multiple insurers in a case involving long-term environmental pollution damages. *Id*.

In *EnergyNorth*, the Supreme Court of New Hampshire contrasted pro rata allocation with applying joint and several liability among insurers, describing pro rata allocation as follows:

> The other approach to allocating liability among multiple insurers is to apply proportional, or pro rata, liability. Under this approach, all the triggered insurers will be allocated a certain portion of the loss. The difference between joint and several allocation and pro rata allocation is that pro rata allocation allows the policy holder to recover only a portion of each triggered policy. The pro rata approach emphasizes that part of a long-tail injury will occur outside any particular policy period. Rather than requiring

> any one policy to cover the entire long-tail loss, pro rata allocation instead attempts to produce equity over time.

Vines-Herrin III, 2020 WL 104622, at *4 (quoting *EnergyNorth*, A.2d at 522–23). Likewise, the appellate court noted that the Supreme Court of South Carolina also had applied a time-on-the-risk framework to allocate damages among insurers in a case involving water penetration and progressive damage to a series of condominium projects. *Id*. (citing *Crossmann Communities of N. Carolina, Inc. v. Harleysville Mut. Ins. Co*., 717 S.E.2d 589 (S.C. 2011). In *Crossman*, the court explained:

> In cases where it is impossible to know the exact measure of damages attributable to the injury that triggered each policy, courts have looked to the total loss incurred as a result of all of the property damage and then devised a formula to divide that loss in a manner that reasonably approximates the loss attributable to each policy period. The basic formula consists of a numerator representing the number of years an insurer provided coverage and a denominator representing the total number of years during which the damage progressed. This fraction is multiplied by the total amount the policyholder has become liable to pay as damages for the entire progressive injury. In this way, each triggered insurer is responsible for a share of the total loss that is proportionate to its time on the risk.
>
> This formula is not a perfect estimate of the loss attributable to each insurer's time on the risk. Rather, it is a default rule that assumes the damage occurred in equal portions during each year that it progressed. If proof is available showing that the damage progressed in some different way, then the allocation of losses would need to conform to that proof. However, absent such proof, assuming an even progression is a logical default.

Id. at *4–*5 (quoting *Crossman*, 717 S.E.2d at 602 (footnotes omitted)).

Examining the case before it, the *Vines-Herrin III* court explained that the arbitrator rendered a final decision that Cerullo incurred $2,487,507.77 in actual damages as a result of Vines-Herrin's negligent construction of his home. At the arbitration and at the subsequent trial, Cerullo and Vines-Herrin established that these damages resulted from "separate occurrences, each of which caused damages in a single policy period." *Vines-Herrin II*, 2016 WL 4486656, at *7. In its findings of fact and conclusions of law accompanying the November 26, 2014 judgment, the trial court found that, in May 2000, Cerullo "noticed substantial flooding in his courtyard after a rainstorm"; "around Thanksgiving Day of 2000," Cerullo "noticed that the windows around the pool area were beginning to bow"; and, in "early 2002," Cerullo "noticed that his ceilings and roof were starting to sag, indicating deficiencies in the structural soundness of the Residence." Cerullo offered evidence at the arbitration relating to all of these problems and the cost to repair them.

The court explained that, because the Insurers wrongfully refused to defend Vines-Herrin or participate in the arbitration, they lost their opportunities to require that Cerullo and Vines-Herrin allocate an exact amount of damages to the relevant policy period or to request that the arbitrator do so." *Vines-Herrin III*, 2020 WL 104622, at *5. Specifically, the court found that neither Cerullo

nor Vines-Herrin was required to meet the extra burden of proving exactly how much of the damage occurred on any particular day. Neither was required to establish any sort of allocation among the absent insurers, and the arbitrator was not asked to make one. As a result, the court of appeals concluded that this case presented a problem similar to that of the time-on-the-risk cases: "how to apportion an established total amount of damages among the insurers whose policies were in effect during the time a portion of the loss was suffered by the insured." *Id.*

Under the circumstances, the court concluded there was legally and factually sufficient evidence to support the trial court's allocation of damages in its judgment, noting that the time-on-the-risk allocation meant that "each triggered insurer is responsible for a share of the total loss that is proportionate to its time on the risk." *Id*. (quoting *Crossmann*, 717 S.E.2d at 602). The court also upheld the award of attorneys' fees against the Insurers, noting that the award was warranted in light of the finding of coverage and that Vines-Herrin had presented sufficient evidence to support the award. *Id*. at *6.

C. Commentary

The proper method of allocation *among insurers* frequently arises, usually coming to a head days before a mediation. While many carriers work the issue out by agreement, some use the lack of Texas authority on allocation as a reason to withhold a significant contribution altogether. It will be interesting to see how courts evaluate the allocation issue in subsequent opinions based on the analysis and case law cited by the court in *Vines-Herrin III*. It is important to note, however, that this case involves an allocation issue by and between insurers. In Texas, absent policy language to the contrary, an insured is still entitled to pick the policy year that maximizes its insurance recovery. It is then up to the selected policy year to re-allocate among the triggered insurers.

X. Honorable Mention

A. *Maxim Crane Works, L.P. v. Zurich American Insurance Co.*, 392 F. Supp. 3d 731 (S.D. Tex. 2019)

The Texas Anti-Indemnity Act (the "TAIA"), which went into effect on January 1, 2012, limits the availability of contractual indemnity and additional insured coverage in certain circumstances. In particular, the TAIA states that in a construction contract, or in an agreement collateral to or affecting a construction contract, a provision requiring an indemnitor to indemnify, hold harmless or defend a party against a claim caused by negligence or fault, breach of statute, or breach of contract is void and unenforceable. TEX. INS. CODE § 151.102. Nevertheless, since going into effect in 2012, few courts have examined the breadth of or exceptions to the TAIA. In one prior opinion, the Western District of Texas found that if the prime construction contract was executed prior to the effective date of the TAIA, neither that prime contract nor any subcontracts subordinate to the prime contract are governed by the TAIA, even if the subordinate subcontracts were executed after January 1, 2012. *United States of America for the Use and Benefit of E J Smith Construction, Co., LLC v. Travelers Casualty & Surety Co.*, No. 5:15-CV-971 RP, 2016 WL 1030154, at *5 (W.D. Tex. Mar. 10, 2016). More recently, in *Maxim Crane Works, L.P. v. Zurich American Insurance Co.*, 392 F. Supp. 3d 731 (S.D. Tex. 2019), the United States District Court for the Sothern District of Texas examined the TAIA to determine the scope of additional insured coverage in a bodily injury case.

In *Maxim*, Skanska USA Building, Inc. ("Skanska") was the general contractor for the construction of an office building in Houston and hired Berkel & Company Contractors ("Berkel") as a subcontractor. Skanska had a contractor-controlled insurance program ("CCIP") that included worker's compensation coverage. Skanska required Berkel and other subcontractors to enroll and obtain coverage for the project. *Id*. at 732. Berkel enrolled in the CCIP and also had a separate general liability insurance policy with Zurich American Insurance Company (the "Berkel Policy"). Berkel leased a crane from Maxim Crane Works, LP ("Maxim") for the project. Maxim also had a separate general liability insurance policy with Zurich (the "Maxim Policy"). The Lease Agreement for the crane required Berkel to add Maxim as an additional insured under the Berkel Policy. *Id*. at 733.

In 2013, a Berkel employee overtaxed the crane, causing it to fall over. Part of the crane fell on Tyler Lee, the project superintendent and a Skanska employee, resulting in amputation. Lee received worker's compensation benefits through the CCIP. *Id*. Nevertheless, in 2014, Lee sued Berkel, Maxim, and other defendants in state court, alleging negligence and other state-law claims. When the state court litigation began, Maxim sought coverage from Zurich under the Berkel Policy as an additional insured, but Zurich denied coverage. Maxim also cross-claimed against Berkel for breach of contract, arguing that Berkel was required to defend and indemnify Maxim. *Id.*

In 2015, a jury awarded Lee more than $35 million in damages, allocating 90% of the fault to Berkel and 10% to Maxim. Maxim settled with Lee for $3,444,300.60, which Zurich paid from the Maxim Policy. Maxim then reimbursed Zurich for $3,000,000 of the settlement costs, as required under the applicable deductible endorsement. *Id.* at 734.

Then, under the Berkel Policy, Maxim sued Zurich to recover the $3 million that Maxim had reimbursed Zurich under Maxim's own policy, alleging that, because Maxim was an additional insured under the Berkel Policy, Maxim could recover from that policy the amounts it had been required to reimburse under its own policy. *Id*. Though the court found that Maxim had standing to recover the amounts it had already reimbursed Zurich from a third party based on the terms of the deductible endorsement, the court held that the TAIA voided Maxim's status as an additional insured under the Berkel Policy, because that coverage required the "Berkel Policy to cover Maxim 'against a claim caused by [Maxim's] negligence or fault.'" *Id*. at 738–39, 747 (citing TEX. INS. CODE §§ 151.102, 151.001(6)).

The court engaged in a lengthy discussion and analysis of various issues under Texas' workers' compensation law, ultimately holding that any determination that Lee was a "co-employer" under the Texas Workers' Compensation Act would not, in and of itself, establish that the "Employee Exception" to the TAIA preserved Maxim's additional insured status under the Berkel Policy. Likewise, the court found that the Workers Compensation Exception to the TAIA also did not apply. As a result, the court found that the TAIA voided Maxim's additional insued coverage under the Berkel Policy.

Though this case involved an evaluation of the effect of the TAIA in the workers' compensation context, it serves as one of the first true substantive evaluations of the limiting effect that the statute can have on additional insured coverage. The case was appealed to the Fifth Circuit, so it will be interesting to see how that court interprets the TAIA under these circumstances.

B. *Gateway Plaza Condo v. The Travelers Indemnity Company of America*, No. 3:19-CV-01645, 2019 WL 7187249 (N.D. Tex. Dec. 23, 2019)

In *Gateway Plaza Condo v. The Travelers Indemnity Company of America*, the Northern District of Texas evaluated whether an insured that failed to provide pre-suit notice as required by Section 542A of the Texas Insurance Code. Effective September 1, 2017, Section 542A applies to a first-party claim that "arises from damage to or loss of covered property caused, wholly or partly, by forces of nature, including an earthquake or earth tremor, a wildfire, a flood, a tornado, lightning, a hurricane, hail, wind, a snowstorm, or a rainstorm." TEX. INS. CODE § 542A.001(2)(C). Section 542A also requires a plaintiff to provide notice at least 61 days before an action is filed unless it is "impracticable" because: "(1) the [plaintiff] has a reasonable basis for believing there is insufficient time to give the presuit notice before the limitations period will expire; or (2) the action is asserted as a counterclaim." *Id.* § 542A.003(a), (d).

The property at issue suffered damage in a storm on or about June 2, 2017. The insurer denied coverage by letter dated October 6, 2017. *Gateway Plaza Condo*, 2019 WL 7187249, at *1. The insured retained a public adjuster by January 2018, a second adjuster by March 2019, and an attorney on April 26, 2019. The insured's attorney requested various documents from the insurer regarding the claim on May 3, 2019 and notified the insurer that suit would be filed on June 3, 2019. The insurer removed the suit to federal court and filed a motion to preclude attorney's fees.

In response, the insured admitted that it did not provide the requisite notice but argues that notice was not required because the insured "had a reasonable basis for believing that there was not enough time for a 60-day presuit notice." *Id*. at *2. Rejecting this argument, the court explained that the statute of limitations under Texas law for claims under the Texas Insurance Code and claims for bad faith is two years from the date that the coverage under the Policy was denied. *Id*. (citing *J.P. Columbus Warehousing Inc. v. United Fire & Cas. Co.*, Civ. A. No. 5:18-cv-00100, 2019 WL 453378, at *2 (S. D. Tex. Jan. 4, 2019)). Because the insured reported the claim on October 2, 2017, the court concluded it was "inconceivable that [the insurer] could have denied [the] claim before [the insured] first filed its claim in October 2017. As the statute of limitations would expire in October 2019, [the insured] did not have a reasonable basis for believing that there was insufficient time to give presuit notice when [the insured] filed the action on June 3, 2019." *Id*.

The court further reasoned that even if it disregarded the uncontroverted evidence establishing the date when the insured filed its claim, the earliest date the insured referenced for the inspection of its property or the denial of its claim was August 16, 2017. The insured filed suit, however, 74 days before this date. *Id*. Thus, the court concluded that the insured had in excess of 60 days to provide presuit notice before the limitations period expired. Additionally, the court explained that the insured presented no explanation for why it waited to hire an attorney and make the claim. According to the court, this was especially troubling given that the insured had retained public adjusters who provided the insurer with estimates as early as January 10, 2018, and who could have provided the insurer with the requisite notice. *Id.*

The case presents a solemn reminder to carefully watch both the statute of limitations deadlines and statutory deadlines when faced with a denial by an insurer, especially if the loss involves "forces of nature" and falls under Section 542A of the Texas Insurance Code. Failing to follow the

statutes could significantly reduce the potential recovery for an insured, even if there is a wrongful denial of coverage.

C. *Employers Mutual Casualty Company v. Amerisure Insurance Company*, No. 4:18-cv-00330, 2019 WL 3717634 (E.D. Tex. Aug. 7, 2019)

In *Employers Mutual Casualty Company v. Amerisure Insurance Company*, No. 4:18-cv-00330, 2019 WL 3717634 (E.D. Tex. Aug. 7, 2019), the court evaluated which insurer must assume the defense for an additional insured in an underlying personal injury lawsuit.

As part of the construction of a church, Mycon General Contractors, Inc. ("Mycon") hired Hatfield Acousticals & Drywall, Inc. ("Hatfield") as a subcontractor. Mycon and Hatfield entered into two agreements—a Subcontract Agreement and Work Order—in which Hatfield agreed to (1) defend and indemnify Mycon against certain claims and (2) procure liability insurance that named Mycon as an "additional insured." Employers Mutual Casualty Company issued a commercial general liability policy to Mycon. Amerisure Insurance Company issued a commercial general liability policy to Hatfield. Mycon was an additional insured under the Amerisure policy. *Id*. at *1.

Hatfield employed a drywall mechanic named Vicente Chavez during the construction project. Mr. Chavez allegedly sustained injuries during the construction project when a steel beam broke and struck Mr. Chavez in the head. Consequently, Mr. Chavez sued Mycon and another contractor at the project asserting claims of negligence and gross negligence. Employers and Amerisure then had a disagreement as to which carrier was required to assume Mycon's defense in the underlying lawsuit. *Id*.

Amerisure argued that its duty to defend Mycon as an additional insured was limited by the terms of the policy, the language of the Subcontract, and the language of the Work Order. *Id*. at *2. In particular, Amerisure argued that because both its policy and the Employers policy contained identical "other insurance" provisions, the court must disregard them and apportion the cost of Mycon's defene on a pro rata basis. *Id.* (citing *Hardware Dealers Mut. Fire Ins. Co. v. Farmers Ins. Exch.*, 444 S.W.2d 583, 586 (Tex. 1969); *Royal Ins. Co. of Am. v. Hartford Underwriters Ins. Co.*, 391 F.3d 639 (5th Cir. 2004)). Employers agreed with Amerisure that Mycon is owed a defense and that the "other insurance" clauses conflict. *Id.* at *3. Rather, citing to the Fifth Circuit's opinion from *American Indemnity Lloyds v. Travelers Property & Casualty Insurance Company*, 335 F.3d 429 (5th Cir. 2003), Employers argued that because the indemnity provision in the Subcontract Agreement was enforceable and implicated by the underlying lawsuit, the indemnity provision "shift[ed] exposure for the [underling lawsuit] to Hatfield." *Id*. at *3. Employers reasoned that Amerisure should thus bear the sole responsibility to defend Mycon. Amerisure countered by arguing that the indemnity provision was not triggered by the allegations.

The indemnity provision required

> Hatfield to indemnify Mycon against "any and all claims" (1) "arising out of or resulting from the performance" of Hatfield's work; (2) "provided that any such claim . . . is attributable to bodily injury . . . ;" and (3) the bodily injury is "caused in whole or in part by reasons of the acts or omissions or presence of the person or property of the Subcontractor or any of its agents

> [or] employees . . . .” Such claims “includ[e] without limitations, injuries, death, or damages which arise from or in connection with, or are caused by, any act, error, omission, or negligence of [Mycon] . . . .”

Id. at *4. The court examined each provision in turn to determine whether the indemnity agreement was implicated.

After evaluating the terms of the provision, the court agreed with Amerisure that the allegations in the underlying suit did not trigger the indemnity agreement. First, the court noted that in the underlying lawsuit, Mr. Chavez alleged that his claims arose out of or resulted from the performance, or failure in performance, of Mycon’s work, not Hatfield’s work. According to the court, the words of limitation in the indemnity provision demonstrated that the parties’ intent for Hatfield to indemnify Mycon *only* for claims arising from or as a result of Hatfield’s work. *Id*. at *5. Thus, the court concluded that the underlying lawsuit did not meet the first triggering factor of the indemnity provision.

The court further found that the third triggered factor was not met, which required that the injury must be “*caused in whole or in part* by reason of the acts or omissions or presence of the person or property of Subcontractor or ... [its] employees . . . .” *Id*. at *6 (emphasis in original). Employers contended that Mr. Chavez’s mere presence on the construction site caused his injury. The court found that Employers’ argument misconstrued the causal relationship pled in the underlying lawsuit. *Id.* Thus, while Mr. Chavez was physically present at the construction site when he was injured, the court declined to find that his presence *caused in whole or in part* his injury. *Id*. (citing *Gilbane Bldg. Co. v. Admiral Ins. Co.*, 664 F.3d 589, 598 (5th Cir. 2011) (noting that “caused by” requires proximate cause)).

The court did not perform an in-depth analysis of the additional insured coverage or even discuss the actual terms of the additional insured endorsement. Nevertheless, Employers admitted that if the indemnity provision was not implicated, that it would be obligated along with Amerisure to provide Mycon with a defense. As a result, the court concluded that Employers and Amerisure were required to provide Mycon with a defense, splitting the costs on a pro rata basis. *Id*. at *7.

D. *Barbara Technologies Corp. v. State Farm Lloyds*, No. 17-0640, 2019 WL 2710089 (Tex. June 25, 2019, mem. op.)

In *Barbara Technologies Corp. v. State Farm Lloyds*, the Supreme Court of Texas evaluated whether a payment of an appraisal award precludes liability under the Prompt Payment of Claims Act of the Texas Insurance Code.

Barbara Technologies Corporation (“Barbara Tech”) had a property insurance policy with State Farm Lloyds covering certain commercial property in San Antonio. A wind and hailstorm damaged the property on March 31, 2013, prompting Barbara Tech to file a claim with State Farm on October 17, 2013. *Id.* at *1. State Farm inspected the property about two weeks later and subsequently denied the claim on November 4, 2013, stating that the property sustained damages totaling less than Barbara Tech’s $5,000 deductible. Barbara Tech requested a second inspection on February 21, 2014, but State Farm’s subsequent inspection on March 4, 2014, resulting in the company finding no additional damage.

As a result, Barbara Tech filed suit on July 14, 2014, and State Farm invoked the appraisal provision under the policy on January 9, 2015. On August 18, 2015, approximately seven months after invocation of the appraisal provision, the appraisers agreed to an appraisal value of $195,345.63. State Farm received the appraisal award on August 19, 2015, and then paid $178,845.25—the appraisal value less depreciation and the deductible—on August 25, 2015. Barbara Tech received and accepted the payment and amended its petition to include only claims for violations of the Prompt Payment of Claims Act.

Barbara Tech argued that, although State Farm paid the appraisal value, State Farm nevertheless owed damages under the Prompt Payment of Claims Act because it delayed payment of the claim beyond the applicable statutory period. *Id.* at *6. State Farm argued that its timely payment of the appraisal amount, which was binding as to the amount of the loss, satisfied the requirements of the Act and foreclosed any statutory damages. Thus, the issue before the Supreme Court of Texas was "whether insurer can be liable for [Prompt Payment of Claims Act] damages when it initially denied the claim but later paid the insured in full according to the amount of loss determined through the policy's appraisal process." *Id.*

State Farm contended that the time period for accepting or rejecting the claim did not begin until its receipt of the appraisal award, and that it therefore paid timely—within four business days after it received the information required to secure final proof of loss. *Id.* The Court rejected State Farm's argument that the initiation of the appraisal process constituted an "additional information request" under the Texas Insurance Code. *Id.* The Court reasoned that, by denying the claim, State Farm essentially acknowledged that it had all the information it needed from Barbara Tech to determine whether there was a covered loss. *Id*. at *7. The Court further reasoned that "invocation of the policy's appraisal provision does not somehow start the investigatory period anew." *Id*. Thus, the Court found:

> Where the policy provides for an appraisal process if the parties "disagree on the value of the property or the amount of loss," as the policy here does, and the appraisal process was initiated only after State Farm rejected the claim, having determined that the value of the covered loss was below the deductible, use of the contractual appraisal process was not part of the insurer's investigation.

Id.

Next, the Court evaluated whether "full and timely payment in accordance with the appraisal forecloses any possibility of [Prompt Payment of Claims Act] damages." *Id.* The Court recognized that nowhere in the Act is a mention of appraisal, appraisal payments, or whether an appraisal has an effect on the statutory payment deadlines. *Id*. at *5. "We must interpret the absence of any such language in chapter 542 to mean that the Legislature intends neither to impose specific deadlines for the contractual appraisal process within the [Act] scheme nor to exempt the contractual appraisal process from the deadlines provided by the [Act]." *Id.* The Court also recognized that Texas state appellate courts previously had held that full and timely payment of an appraisal award

does preclude an insured from recovering damages under the Prompt Payment of Claims Act as a matter of law. *Id*. at *8 (collecting cases). Barbara Tech urged that State Farm could not avoid penalties because it had denied coverage for the loss; however, the Court found that State Farm never denied that Barbara Tech's loss was covered but simply disputed the extent of the loss and whether it met the deductible. *Id.* at *10. As a result, the Supreme Court of Texas held that neither State Farm's invocation of the policy's appraisal process for resolution of the dispute as to the amount of loss, nor State Farm's payment based on the appraisal amount, exempts State Farm from the Prompt Payment of Claims Act. Nevertheless, the Court further held that, without State Farm having accepted liability under the policy or having been adjudicated liable, Barbara Tech was not entitled to Prompt Payment of Claims Act damages as a matter of law. *Id*. at *17.

The Court's holding confirms that the purpose of the appraisal provision in an insurance policy is to adjudicate a dispute between the insured and insurer as to the scope of the loss, not whether a provision within the policy precludes coverage for the loss. The Supreme Court followed the language of the Prompt Payment Claims Act to ensure that it did not impose penalties on an insurer that does not outright reject a claim but invokes appraisal when challenged on its loss determination. In fact, the Court specifically hedged in its opinion that the result "might be different had the Legislature specified the effect, if any, of invoking an appraisal provision." *Id*. at *14. It would not be surprising to see this issue addressed the next time the Texas Legislature convenes.

In the meantime, several courts have followed the reasoning of the *Barbara* court: *See, e.g.*, *Lopez v. Allstate Texas Lloyds*, No. 7:18-CV-260, 2020 WL 292342 (S.D. Tex. Jan. 21, 2020) (denying competing motions for summary judgment as to Prompt Payment Claims Act, noting that the *Barbara Technologies* "clearly lays out that 'payment in accordance with an appraisal is neither an acknowledgment of liability nor a determination of liability under the policy for purposes of [Prompt Payment Claims Act] damages.'"); *Pearson v. Allstate Fire and Casualty Ins. Co*., No. 19-CV-693-BK, 2020 WL 264107 (N.D. Tex. Jan. 17, 2020) (declining to award an insured attorneys' fees after the insurer's timely payment of appraisal, noting that there was no "money judgment in [the insured's] favor"); *Shin v. Allstate Tex. Lloyds*, No. 4:18-CV-01784, 2019 WL 4170259 (S.D. Tex. Sept. 3, 2019) (holding that *Barbara Technologies* stands for the proposition that, in order for an insurer to avoid a Prompt Payment of Claims Act, the insurer must have made a reasonable preappraisal payment within the statutorily-provided period).

This decision is certain to spawn more litigation. Stay tuned!

XI. Cases to Watch

In *American Guarantee and Liability Insurance Company v. ACE American Insurance Company*, No. 4:18-CV-382, 2019 WL 4316531 (S.D. Tex. Sept. 12, 2019), *appeal filed* Nov. 15, 2019, the Southern District of Texas evaluated whether a primary insurer breached its *Stowers* duties in rejecting settlement demands prior to and during trial. While riding his bicycle, Mark Braswell ("Braswell") hit the back of a stopped landscaping truck owned by The Brickman Group Ltd., LLC ("Brickman"). Braswell sustained fatal head injuries as a result of the collision. Suit was filed against Brickman and the driver of the truck. *Id*. at *1.

ACE issued a primary liability policy to Brickman, which provided coverage in the amount of $2 million subject to a $500,000 self-insured retention. American Guarantee issued an excess liability policy to Brickman, which provided coverage in the amount of $10 million in excess of ACE's policy. while riding his bicycle and sustained fatal head injuries. At the outset of the case, the Brickman's defense counsel believed that they had a "very strong liability case." *Id*. at *2. There were known weaknesses in the case, though, namely that the driver was inconsistent on how long he was stopped on the road. Moreover, the Braswell family plaintiffs were very sympathetic. *Id.* Braswell and his wife were firefighters, and Braswell had been cited for bravery for rescuing a double amputee from a burning building. Additionally, after Braswell's death, his daughter began cutting herself, attempted a drug overdose, blamed herself for the accident, and spent a week in a mental hospital. She also frequently left notes for her father at the scene of the accident. Additionally, defense counsel reported to ACE that the trial judge and plaintiffs' counsel were weaknesses for the defense case, as the judge "tended to favor the plaintiff side" and plaintiffs' counsel was "one of the better trial attorneys in Harris County." *Id*. at *3.

In an August 2016 memo, defense counsel estimated the range of a potential verdict between $6 million and $8 million, noting that in the event that Braswell's negligence did not exceed 50% (which defense counsel believed to be a possibility), the most likely case would be a contributory negligence finding of 30-50%. Defense counsel concluded that the case had a settlement value in the range of $1.25 million to $2 million. *Id.* at *4. Based on this estimation, ACE calculated the settlement value as $600,000, which was calculated by multiplying the primary limit of $2 million by the 30% possibility of a plaintiffs' verdict as suggested by defense counsel. *Id*. at *3–4. Following several mock jury trials, jury research, and an initial mediation the estimate of the settlement value of the case by defense counsel and ACE remained the same. While initially agreeing with the assessment by defense counsel, a representative for American Guarantee subsequently obtained additional information regarding the trial judge and plaintiffs' counsel, causing her to change her assessment of the case. *Id*. at *5.

Thereafter, the parties went to a second mediation, which was unsuccessful. Just over a week later, plaintiffs' counsel sent a $2 million demand (the "First Demand"). The representative for American Guarantee emailed the ACE claims representative demanding that ACE accept the $2 million demand. In that email, American Guarantee raised issues regarding the reputation and success of the plaintiffs' attorney and tendency for the judge to favor the plaintiffs. *Id*. at *6. ACE rejected the First Demand, making a counteroffer of $500,000.

Trial began two weeks later. During the trial, the defense received multiple unfavorable evidentiary rulings. Many of these rulings by the judge were completely unexpected and effected the value of the case. *Id*. at *7. The judge excluded evidence that the truck was legally parked and allowed evidence regarding the effect of Braswell's death upon his daughter. Updates on the trial were provided to both ACE and American Guarantee. *Id*. At closing argument, plaintiffs sought $10 million in general damages.

During trial, the representative for American Guarantee emailed the representative for ACE to reiterate again that ACE's refusal to accept the First Demand was unreasonable "[g]iven the

adverse evidentiary and jury charge rulings by the Judge." *Id*. at *8. The plaintiffs then made a high/low offer of $1.9 million/$2 million with taxable court costs that fell within ACE's policy (the "Second Demand"). ACE reject the Second Demand, reasoning that defense counsel still evaluated "a defense verdict of 7 out of 10." *Id.* Hours later, plaintiffs made a final offer (the "Third Demand") in an email to defense counsel: "Plaintiffs renew their prior offer to settle for the policy limits of $2,000,000; such offer will expire when the jury announces that it has a verdict." *Id.* ACE also refused this demand. Defense counsel recognized that there were adverse rulings during trial, but at the close of trial, still continued to believe that the settlement value of the case was $1.25-$2 million.

The jury returned a verdict of almost $39,960,000.00, apportioning 68% responsibility to Brickman and 32% to Braswell. *Id*. at *9 The court entered judgment for $27,712,598.90 against Brickman. American Guarantee ultimately took control of the settlement negotiations post-verdict after ACE tendered $2 million. American Guarantee settled for $9,750,000, of which it paid $7,750,000.

In the coverage litigation, the only dispute was "whether the terms of the three offers were such that an ordinarily prudent insurer would have accepted them under the circumstances." *Id*. at *10. The court first concluded that ACE acted unreasonably in preparing its initial case evaluation. In particular, the court found that ACE's "valuation based solely on a primary insurer's limits is contrary to the purpose of *Stowers*, [which] obligates primary insurers to look at the potential of an excess verdict to the *insured*, not merely the potential loss of the primary insurer." *Id*. (citing *State Farm Lloyds Ins. Co. v. Maldonado*, 963 S.W.2d 38, 41 (1998)). Nevertheless, the court reasoned that the reasonableness of the actual valuation is not the ultimate inquiry. Rather, the Supreme Court of Texas has held that "[i]n the context of a *Stowers* lawsuit, evidence concerning claims investigation, trial defense, and conduct during settlement negotiations is necessarily subsidiary to the ultimate issue of whether the claimant's demand was reasonable under the circumstances, such that an ordinarily prudent insurer would accept it." *Id*. (quoting *Am. Physicians Ins. Exchange v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994)).

The court concluded that ACE did not breach its duty under *Stowers* when it rejected the First Demand. At that point, reasoned the court, ACE was aware of the weaknesses in the case, but a reasonable insurer could still have been confident in a defense verdict. Although there was a known risk that the judge would make adverse rulings at trial, defense counsel evaluated the risks at 50-50. Accordingly, the court found that a reasonable insurer could be cautiously optimistic that the jury would conclude that Braswell was more than 50% liable for the accident. To this extent, the court found that a reasonable insurer could continue to believe that the case had a settlement value of $1.25 million to $2 million and decline an offer at the top of that range. *Id*. at *11.

The court, however, found that ACE **did** breach its duty when it rejected the Second and Third Demands. According to the court, at the time when these demands were made, "ACE was aware of all of the adverse rulings and evidence presented during trial." *Id.* This included evidence and developments during the trial that that defense counsel did not anticipate, which, according to the court, "exacerbated the known weaknesses in the case [and] should have changed ACE's calculus."

Id. Further, the court determined that both the Second and Third Demands were within defense counsel's original settlement range and were for amounts that were viewed as reasonable by defense counsel, American Guarantee, and Brickman. Thus, "[a] reasonable insurer would have a reevaluated the settlement value of the case because, after these rulings, it would have been aware that there was little chance that the jury would determine that Mark Braswell was more than 50% liable." *Id.*

The case was appealed to the Fifth Circuit on November 15, 2019. Given the numerous disputes that arise between primary and excess carriers regarding settlement of large exposure cases, and all the factors considered by Judge Ellison, the Fifth Circuit's opinion could provide significant guidance on how to approach that issue from both sides of the bar.