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IN THIS ISSUE:

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National Union v. Crocker: The Ominous Decision for the Omnibus Insured

An interesting issue in Texas law involves an additional or omnibus insured who is unaware of its status as such, and whether an insurer must give such an insured a "heads-up" regarding the possibility of coverage. On February 15, 2008, addressing certified questions from the United States Fifth Circuit Court of Appeals, the Supreme Court of Texas answered the question with a resounding, "No." *See Nat'l Union Fire Ins. Co. v. Crocker*, 2008 WL 400398 (Tex. Feb. 15, 2008). Moreover, the Court held that proof of an insurer's actual knowledge of service of process in a suit against its additional insured, even when such knowledge is obtained in sufficient time to provide a defense for the insured, does not establish a lack of prejudice as a matter of law.

A. Background Facts

Beatrice Crocker ("Crocker") was a resident of Redwood Springs Nursing Home, which is owned by Emeritus Corporation ("Emeritus"). Richard Morris ("Morris") was an employee of the nursing home who allegedly swung open a door at the nursing home, which struck Crocker, causing her to be injured. Crocker filed a lawsuit against both Emeritus and Morris seeking compensation for those injuries. At the time of the accident, Emeritus was the named insured under a CGL policy issued by National Union Fire Insurance Company ("National Union"). Morris, who was acting within the course and scope of his employment when the accident occurred, qualified as an omnibus insured under the same policy. Unfortunately for Morris, however, he was unaware of the terms of the CGL policy and thus had no idea he qualified as an insured (i.e., an omnibus or additional insured) under the National Union policy.

Emeritus tendered the lawsuit to National Union, which agreed to defend the corporation. Morris never tendered the lawsuit to National Union, and so National Union did not defend Morris even though it knew he qualified as an insured under the policy and knew that he had been served with the lawsuit. In addition, National Union made no attempt to inform Morris that he was an insured under the policy. Morris never responded to the lawsuit against him and failed to appear at trial. National Union's attempts to communicate with Morris regarding Crocker's claims (both before and after Crocker filed her suit) were rebuked—certified mail was returned and repeated phone messages were not returned. Morris did

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CASES TO WATCH:

Ulico Cas. Co. v. Allied Pilots Ass'n, 187 S.W.3d 91 (Tex. App.—Ft. Worth 2005, pet. granted) (argued on April 11, 2007) (whether Texas recognizes coverage by waiver and/or estoppel when an insurer undertakes the defense without adequately reserving rights)

American Home Assur. Co., Inc. v. Unauthorized Practice of Law Comm., 121 S.W.3d 831 (Tex. App.—Eastland 2003, pet granted) (argued on September 28, 2005) (scope of the tripartite relationship between insurer, insured, and defense counsel retained by insurer)

OneBeacon Ins. Co. v. Don's Building Supply, Inc., 2007 WL 2258192 (5th Cir. Aug. 8, 2007) (certifying trigger issue to the Supreme Court of Texas)

Pine Oak Builders, Inc. v. Great Am. Lloyds Ins. Co., 2006 WL 1892669 (Tex. App.—Houston [14th Dist.] July 6, 2006, pet. granted) (scope of the eight-corners rule and proper trigger theory to apply to "property damage" cases)

talk to Crocker's attorney during a deposition, but he refused to speak privately with Emeritus' counsel.

At trial, Crocker presented her evidence and then moved to have the claims against Morris severed from the lawsuit. Only her claims against Emeritus were submitted to the jury, which rendered a "take nothing" judgment. The jury reasoned that Emeritus, acting by and through its agents within the course and scope of their employment, was not negligent. With regard to the severed claims, however, the court, a few days later, entered a $1,000,000 default judgment against Morris.

Crocker then filed suit against National Union in an effort to collect the $1,000,000 judgment as a third-party beneficiary to the policy. The case was removed to federal court where the parties cross-moved for summary judgment. National Union contended that the duty to defend was never triggered because Morris did not notify National Union that he had been sued and he did not request a defense. The insurer argued that because Morris failed to comply with the policy's notice provisions, he was not entitled to coverage or a defense, and that Crocker, standing in Morris' shoes, could not collect under the policy either. Crocker, on the other hand, argued that because National Union had actual notice of the lawsuit against Morris, it was not prejudiced by Morris' failure to comply with the policy's notice provisions. Moreover, Crocker believed that National Union's actual notice of the suit and failure to notify Morris of his insured status amounted to a breach of the duty to defend, making the insurer liable to Crocker for the entire judgment. In the federal district court, Crocker prevailed in light of Texas' law requiring National Union to show actual prejudice in order to establish a notice-based policy defense. In addition, that court ruled that National Union breached its duty to defend because it failed to provide Morris with notice that it would defend him.

B. The Certified Questions

On appeal by National Union, the Fifth Circuit certified three questions to the Supreme Court of Texas. Because it answered the first question in the negative, it did not address the second question, which was premised on an affirmative answer to question number one. Accordingly, only the following two questions were addressed:

1. Where an additional insured does not and cannot be presumed to know of coverage under an insurer's liability policy, does an insurer that has knowledge that a suit implicating policy coverage has been filed against its additional insured have a duty to inform the additional insured of the available coverage?

* * *

3. Does proof of an insurer's actual knowledge of service of process in a suit against its additional insured, when such knowledge is obtained in sufficient time to provide a defense for the insured, establish as a matter of law the absence of prejudice to the insurer from the additional insured's failure to comply with the notice-of-suit provisions of the policy?

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CASES TO WATCH:
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Johnson v. State Farm Lloyds, 204 S.W.2d 897 (Tex. App.—Dallas 2006, pet. granted) (scope of the standard appraisal clause)

Mid-Continent Cas. Co. v. JHP Development, Inc., 2005 WL 1123759 (W.D. Tex. Apr. 21, 2005) (appealed to the Fifth Circuit Court of Appeals) (application of exclusions j(5) and j(6))

D.R. Horton—Texas, Ltd. v. Markel International Ins. Co., Ltd., 2006 WL 3040756 (Tex. App.—Houston [14th Dist.] Oct. 26, 2006, pet. filed) (scope of the eight-corners rule and the relationship between the duty to defend and the duty to indemnify)

C. The Answers: No and No

1. No extra-contractual duty to defend an unknowing additional insured

In deciding that an insurer need not notify an additional insured (note: the term additional insured was used interchangeably with omnibus insured) of available coverage when the insurer has knowledge of a lawsuit against the additional insured implicating coverage, the Court found that its decision in *Weaver v. Hartford Accident & Indemnity Co.*, 570 S.W.2d 367 (Tex. 1978), governed the matter. *Crocker*, 2008 WL 400398, at *2. In *Weaver*, the Court held that an insurer was not liable to an additional insured's judgment creditor when the additional insured did not provide notice to the insurer of a lawsuit against it, even though the insurer knew about the suit and the additional insured had no knowledge of the policy. *Id.* (citing *Weaver*, 570 S.W.2d at 368, 370 (Greenhill, C.J., dissenting)). After discussing the facts of *Weaver*, the Court acknowledged that it had noted in that case that the insurance policy's notice provision served the purpose of "enabl[ing] the insurer to control the litigation and interpose a defense." *Id.* at *3 (quoting *Weaver*, 570 S.W.2d at 369). The *Weaver* court also had emphasized, however, that "a more basic purpose is to advise the insurer that an insured has been served with process and that the insurer is expected to timely file an answer." *Id.* (quoting *Weaver*, 570 S.W.2d at 369). Under the facts of that case, the insurer's knowledge that the suit had been filed against its insured did not satisfy the "more basic purpose" and did not require the insurer to "gratuitously subject[] itself to liability." *Id.* (quoting *Weaver*, 570 S.W.2d at 370). That the additional insured was ignorant of the policy in *Weaver* had no bearing on the Court's analysis. "Put simply, there is no duty to provide a defense absent a request for coverage." *Id.*

The Court then compared the case before it with the facts in *Weaver*. The cases are strikingly similar as (i) both involved additional insureds under liability policies; (ii) the injured party in both cases sued the named insured and the additional insured, but recovered nothing from the named insured; (iii) both additional insureds failed to forward suit papers to the insurer and thus were not provided a defense; (iv) both additional insureds lacked knowledge of the policies at issue, including the notice-of-suit provisions contained therein; and (v) both insurers argued that they were under no obligation to inform the additional insureds of the possibility of coverage. In *Weaver* the Court held that an insurer is not under a duty to inject itself into a lawsuit and provide a defense when its additional insured has neither requested a defense nor complied with the policy's notice provisions.

The Court then explained that its holding in *Weaver* had been "unanimously reaffirmed" in *Harwell v. State Farm Mutual Automobile Insurance Co.*, 896 S.W.2d 170, 172, 174 (Tex. 1995), where it held that an insurer did not have to subject itself to liability until it was properly notified of a lawsuit against its additional insured. Moreover, the

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Court acknowledged that its decisions in *Weaver* and *Harwell* turned on the idea that notice provisions serve two purposes: (i) they facilitate a timely and effective defense of the claim against the insured; and (ii) they trigger the insurer's duty to defend by notifying the insurer that a defense is expected. *Crocker*, 2008 WL 400398, at *4. In absence of such notice, a carrier simply is not required to unilaterally offer a defense until such has been requested. The Court did note, however, that an insurer perhaps *should* choose to inform its insured that a defense is available. Presumably, had National Union done so, both parties could have avoided the judgment against the additional insured and the years of subsequent litigation.

2. Prejudice—at least in this case—is irrelevant

In turning to the third certified question, the Court first acknowledged that "National Union was obviously prejudiced in the sense that it was exposed to a $1 million judgment." The question, according to the Court though, was whether National Union should be estopped to deny coverage because it was aware that Morris had been sued and had ample time to provide a defense. Based on its previous discussion, the Court found the answer to be "No." "'Because [National Union] was not under a duty to defend the suit against its insured when [it received notice of the claim], it is not estopped from asserting [the insured's] breach of the policy as a bar to its liability.'" *Id.* at *5 (citing *Harwell*, 896 S.W.2d at 175).

Turning back to the issue of prejudice, the Court distinguished its recent holding in *PAJ, Inc. v. Hanover Insurance Co.*, 2008 WL 109071 (Tex. Jan. 11, 2008) (for an in-depth discussion of this case, please see Volume 2, Issue 1 of the *Insurance Law Newsletter*, which can be found on our website at www.vsfirm.com/publications). *Crocker*, at *5. In particular, in *PAJ*, the insured was merely late in providing notice to its insurer, as it provided notice several months after first learning of the suit against it. In *Crocker*, in contrast, the notice simply was nonexistent. Stated otherwise, "[a]bsent a threshold duty to defend, there can be no liability to Morris, or to Crocker derivatively." *Crocker*, 2008 WL 400398, at *5.

Moreover, the Court explained that the requirement regarding notice of service of process is motivated by a distinct purpose as compared to the requirement regarding notice of a claim or occurrence. Reiterating its earlier reasoning for ruling in favor of the insurer, the Court said, "An insurer cannot necessarily assume that an additional insured who has been served but has not given notice to the insurer is looking to the insurer to provide a defense." *Id.* This is especially true in light of the fact that potential insureds, for a host of reasons, may not want to invoke coverage (e.g., when an insured wants to hire its own counsel and control its own defense). Accordingly, the Court held that National Union was under no obligation to offer a defense and found that changes in Texas law since *Weaver*, including its decision in *PAJ*, did not alter that

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conclusion. Thus, "[i]nsurers owe no duty to provide an unsought, uninvited, unrequested, unsolicited defense" and the Court refused to create an extra-contractual duty on behalf of insurers to do so. *Id.* at *6.

Commentary:

Simply put, the Crocker case stands for the proposition that an insurer has no contractual or extra-contractual duty to reach out to an omnibus or additional insured. Notably, the Court believes that the logistics in requiring an insurer to do so could be cumbersome because purportedly an insurer would then have "to keep track of potential litigants who may or may not be additional insureds, may or may not be entitled to coverage, and may or may not expect a defense to a claim." The Court also was quick to dismiss the "prejudice" requirement—at least in this case where the notice was non-existent instead of merely being late. The Court's decision in *Crocker* highlights the importance of evaluating potential coverage on behalf of your clients and tendering claims/lawsuits to all possible sources of coverage.

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GETTING TO KNOW LEE H. SHIDLOFSKY AND THE INSURANCE LAW PRACTICE GROUP . . .

Lee H. Shidlofsky is a founding partner of Visser Shidlofsky LLP. His practice is devoted to representing and counseling corporate policyholders in the area of insurance law, risk management, contractual risk transfer, and extra-contractual issues. He is Treasurer of the Insurance Law Section and holds a council position in the Construction Law Section of the State Bar of Texas. He is the author of numerous articles and seminar papers and is a frequent speaker at continuing legal education seminars in Texas and across the country. Mr. Shidlofsky has been named a "Super Lawyer" by Texas Monthly Magazine each year since 2004, including a ranking as a Top 50 attorney in the Central and West Texas Region for 2007, and is ranked as a top insurance coverage lawyer by Chambers USA and Who's Who Legal.

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