visser shidlofsky llp

insurance law newsletter

March 7, 2008 Volume 2, Issue 4

LEE H. SHIDLOFSKY
VISSER SHIDLOFSKY LLP
7200 N. MOPAC EXPY.
SUITE 430
AUSTIN, TEXAS 78731
512.795.0600
512.795.0632
LEE@VSFIRM.COM

IN THIS ISSUE:

EVANSTON V. ATOFINA:

The Supreme Court of Texas rules on several key insurance issues, including the distinction between additional insured and contractual indemnity.

IF YOU WOULD LIKE TO BE PLACED ON OUR CONFIDENTIAL E-MAIL DISTRIBUTION LIST FOR FUTURE NEWSLETTERS, PLEASE E-MAIL LEE SHIDLOFSKY AT LEE@VSFIRM.COM.

THIS NEWSLETTER IS FOR INFORMATIONAL PURPOSES ONLY AND NOTHING CONTAINED WITHIN IT SHOULD BE CONSTRUED AS LEGAL ADVICE.

PAST ISSUES OF THE INSURANCE LAW NEWSLETTER AND OTHER PUBLICATIONS ARE ON OUR WEBSITE AT WWW.VSFIRM.COM

Evanston v. ATOFINA: TOO MUCH FOR ONE TITLE

On February 15, 2008, the Supreme Court of Texas handed down another significant insurance decision in *Evanston Insurance Co. v. ATOFINA Petrochemicals, Inc.*, 2008 WL 400394 (Tex. Feb. 15, 2008). Among other things, the Court's opinion addressed the relationship between an "additional insured" provision and a "contractual indemnity" provision in a subcontract. Moreover, the Court tackled an insurer's ability to contest the reasonableness of a settlement offer once it wrongfully denies coverage for a claim. And, in doing so, the Court significantly retreated from its prior landmark decision in *State Farm Fire & Casualty Co. v. Gandy*, 925 S.W.2d 696 (Tex. 1996). Finally, following on the heels of *Lamar Homes v. Mid-Continent Casualty Company*, the Court made clear that—in the context of liability policies—Article 21.55 of the Texas Insurance Code applies only to the duty to defend and *does not* apply to a breach of the duty to indemnify.

A. Background Facts

ATOFINA Petrochemicals, Inc. ("ATOFINA") entered into a contract with Triple S Industrial Corporation ("Triple S"), wherein the latter agreed to perform maintenance and construction work at ATOFINA's Port Arthur refinery. Under the terms of the contract, Triple S agreed to indemnify ATOFINA for all personal injuries and property losses sustained during the course of the contract, "except to the extend that any such loss is attributable to the concurrent or sole negligence, misconduct, or strict liability of [ATOFINA]." *Id.* at *1. In addition, Triple S agreed to carry primary and excess CGL insurance, naming ATOFINA as an additional insured on each policy. In complying with that requirement, Triple S procured a primary policy in the amount of $1 million from Admiral Insurance Company ("Admiral") and an excess policy in the amount of $9 million from Evanston Insurance Company ("Evanston").

While performing the contract, Matthew Todd Jones ("Jones"), a Triple S employee, died when he drowned in a storage tank of fuel oil after falling through a corroded roof at the ATOFINA refinery. Jones' survivors sued both Triple S and ATOFINA, alleging claims of wrongful death. Admiral tendered its $1 million limits, and ATOFINA then sought additional insured coverage from Evanston under the umbrella policy. When Evanston denied coverage for the claim, ATOFINA brought the insurer into the lawsuit as a third-party, seeking a declaration that it owed

(continued on next page)

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)

ATOFINA coverage. ATOFINA later severed its lawsuit against Evanston, and both parties moved for partial summary judgment. While those motions were pending, the underlying lawsuit settled for $6.75 million, and ATOFINA sought recovery of $5.75 million from Evanston, which represented the amount remaining after Admiral paid its limits.

At the trial court level, summary judgment was granted in favor of Evanston. The court of appeals reversed, finding that ATOFINA was an additional insured under the Evanston policy and remanding the case to the trial court for determination of statutory penalties and attorneys' fees. *See ATOFINA Petrochemicals, Inc. v. Evanston Ins. Co.*, 104 S.W.3d 247, 251–52 (Tex. App.—Beaumont 2003, pet. granted) (per curiam). On appeal to the Supreme Court of Texas, Evanston argued the following points: (1) ATOFINA is not covered for losses resulting from its sole negligence; (2) ATOFINA is barred under Texas law from obtaining a judgment for insurance proceeds based on losses arising from its own negligence; and (3) the settlement amount was unreasonable and thus unenforceable.

B. Additional Insured v. Contractual Indemnity

At the outset, the Court addressed the distinction between ATOFINA as a contractual indemnitee under the contract with Triple S and its status as an additional insured under the Evanston policy. The Court acknowledged that ATOFINA was not entitled to be indemnified under the parties' contract if the Jones' loss was attributable in any way to ATOFINA. Nevertheless, the Court said: "But ATOFINA does not seek indemnity from Triple S; it claims instead that it is entitled to indemnification from Evanston by virtue of its status as an additional insured on the umbrella policy." *Id.* at *2. Thus, the Court refused to look at the indemnity agreement in the subcontract and looked instead at the terms of the insurance policy itself.

Under the terms of the policy, which included several independent grants of additional insured status, an insured included:

> A person or organization for whom you have agreed to provide insurance as is afforded by this policy; but that person or organization is an insured only with respect to operations performed by you or on your behalf, or facilities owned or used by you.

Id. at *3. Evanston argued that ATOFINA did not qualify as an additional insured because the language does not cover additional insureds for their own negligence. Despite the lack of an apportionment of responsibility in the underlying lawsuit, Evanston urged that because Jones' death was caused solely by ATOFINA's negligence, the death did not "respect . . . operations performed by [Triple S]." *Id.*

The Court recognized a split of authority in the Texas courts of appeals regarding interpretation of additional insured provisions. In *Granite*

(continued on next page)

CASES TO WATCH:
(continued)

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)

Constr. Co. v. Bituminous Insurance Cos., 832 S.W.2d 427, 428 (Tex. App.—Amarillo 1992, no pet.), the court adopted a fault-based interpretation of "arising out of operations" and found that claim before it did not "aris[e] out of operations performed by" the insured because only the additional insured company was responsible for the injury. *ATOFINA*, 2008 WL 400394, at *3. Two other courts, on the other hand, adopted a more liberal causation theory of additional insured provisions, finding that such provisions create coverage only "with respect to liability arising out of" the named insured's operations. In *Admiral Insurance Co. v. Trident NGL, Inc.*, 988 S.W.2d 451 (Tex. App.—Houston [1st Dist.] 1999, pet. denied), the court found that because the accident caused injury to an insured's employee while he was on the premises for the purposes of working on a compressor that exploded, the alleged liability for his injuries "arose out of [the insured's] operations" and was covered under the additional insured provision. Similarly, in *McCarthy Brothers Co. v. Continental Lloyds Insurance Co.*, 7 S.W.3d 725, (Tex. App.—Austin 1999, no pet.), the court held that a worker's injury that occurred when retrieving tools at the job site "arose out of" the insured's operation, even though the negligence claim was against the additional insured premises owner.

Having reviewed that case law, the Court in *ATOFINA* sided with the Houston and Austin courts of appeals because the court in *Granite* relied upon extrinsic evidence when it looked to the terms of the service contract, which made the additional insured company responsible for the specific injury-causing act. *ATOFINA*, 2008 WL 400394, at *4. And, the Court said, even if it considered the contract before it in this case, it was distinguishable from that in *Granite*. In particular, the responsibility for maintaining the storage tank at the refinery was not assigned to any particular party in the service contract. The Court said: "Far from shifting any responsibility to ATOFINA, the specific terms of the service contract make Triple S responsible for all operations." *Id.* In addition, regardless of the terms of the underlying contract, the Court held that the "fault-based" interpretation of the additional insured provision is no longer prevailing law. *Id.* Rather, a more liberal interpretation applies:

> Generally, an event "respects" operations if there exists "a causal connection or relation" between the event and the operations; we do not require proximate cause or legal causation. In cases in which the premises condition caused a personal injury, the injury respects an operation if the operation brings the person to the premises for purposes of that operation. The particular attribution of fault between insured and additional insured does not change the outcome.

Id. (citations omitted). Under that interpretation, the Evanston insurance policy provided direct coverage to ATOFINA. In particular, since Jones was present at ATOFINA's facility for purposes of Triple S's operations when the accident occurred, the requisite causal nexus had been satisfied. *Id.*

(continued on next page)

Turning to the scope of coverage afforded under the policy, the Court recognized that several different grants of coverage existed in the "who is an insured" section. The Court found that each granted coverage independently of the others, and that limitations on coverage in one section could not be read into another section granting coverage. Finding that ATOFINA may be entitled to coverage under more than one clause, the Court held that "it is not unreasonable to conclude that the policy should be read to provide the broader measure of coverage available under the applicable clauses." *Id.* at *6. Accordingly, the Court determined that the scope of coverage did not exclude liabilities arising out of ATOFINA's sole negligence. *Id.* at *6.

In addition, the Court found Evanston's argument under *Fireman's Fund v. Commercial Standard Insurance Co.*, 490 S.W.2d 818 (Tex. 1972), to be misplaced. In that case, the Court explained, General Motors ("GM") was not entitled to indemnification because the contract at issue did not specifically extend the indemnity agreement to GM's own negligence. Notably, that case did not address the issue as to whether GM was entitled to coverage as an additional insured. Accordingly, the case clearly was distinguishable from the facts at hand. *Id.* at *7. Instead, the Court found that its decision in *Getty Oil Co. v. Insurance Co. of North America*, 845 S.W.2d 794 (Tex. 1992), was more on-point. In that case, the Court ruled that an insurance requirement in a contract was separate and distinct from an indemnity provision, such that the Anti-Indemnity Statute—which prohibited indemnification for one's own negligence—was inapplicable. Looking at the facts before it, the Court said: "[I]t is unmistakable that the agreement in this case to extend *direct* insured status to ATOFINA as an additional insured is separate and independent from ATOFINA's agreement to forego *contractual* indemnity for its own negligence." Thus, the *Fireman's Fund* decision did not bar ATOFINA from receiving insurance proceeds for losses arising out of its own negligence. *ATOFINA*, 2008 WL 400394, at *7.

C. A Breaching Insurer Cannot Question the Reasonableness of a Settlement

Having determined that ATOFINA was covered under Evanston's insurance policy, the Court next addressed Evanston's argument that ATOFINA failed to prove the reasonableness of the $6.75 million settlement. In particular, Evanston argued that it was not "bound" by the settlement. ATOFINA, in contrast, argued that Evanston's denial of coverage bars it from challenging the reasonableness of the settlement.

The Court turned to its prior decision in *Employers Casualty Co. v. Block*, 744 S.W.2d 940 (Tex. 1988), in which it held that an insurer that wrongfully denies coverage is barred from challenging the reasonableness of the settlement amount agreed to by an insured in an agreed judgment. The Court acknowledged that differences existed between the case before it and the facts in *Block*, but found that the rule applied nonetheless. In *Block*, the Court addressed two questions

(continued on next page)

regarding the effect of an agreed judgment between the plaintiffs and the insured: (1) did the agreed judgment bar the insurer from contesting the reasonableness of the settlement; and (2) did the same agreed judgment bar the insurer from contesting the agreed judgment's factual recitations regarding coverage?

Block's answer was clear:

> While *we agree with the court of appeals' conclusion that [the insurer] was barred from collaterally attacking the agreed judgment by litigating the reasonableness of the damages recited therein*, we do not agree with its conclusion that the recitation in the agreed judgment that the damage resulted from an occurrence on August 6, 1980 is binding and conclusive against [the insurer] in the present suit.

ATOFINA, 2008 WL 400394, at *8 (quoting *Block*, 744 S.W.2d at 943).

visser shidlofsky llp

The Court explained that in *Block* the insurer had violated the duty to defend, but in the case before it, Evanston had denied coverage altogether and no duty to defend was implicated. Additionally, the *Block* case was settled by agreed judgment, while ATOFINA employed a contractual settlement agreement and non-suit. Nevertheless, the Court held that those differences did not render *Block* inapplicable because the basis of the opinion did not rest upon the nature of the violated policy term or the formality of agreed judgments. Rather, those cases that bar an insurer's challenge "rest on principles of waiver and estoppel." Quite simply, "the principles of notice to the insurer and an intentional choice to forego *participation* in settlement discussions operate the same no matter how the insurer chooses to attack the settlement. . . . Had Evanston not unconditionally denied coverage, it too would have been able to influence the amount of the settlement." *Id.*

The Court then addressed the differences in posture of the *Block* case vis-à-vis the facts of the case before it. In *Block*, the underlying plaintiff sued the insurer as a judgment creditor, which drew criticism from the Court in *State Farm Fire & Casualty Co. v. Gandy*, 925 S.W.2d 696 (Tex. 1996). There the Court said:

> In no event, however, is a judgment for plaintiff against defendant, rendered without a fully adversarial trial, binding on defendant's insurer or admissible as evidence of damages in an action against defendant's insurer by plaintiff as defendant's assignee. We disapprove the contrary suggestion in dicta in *Employers Casualty Co. v. Block*, 744 S.W.2d 940, 943 (Tex. 1988), and *United States Aviation Underwriters, Inc. v. Olympia Wings, Inc.*, 896 F.2d 949, 954 (5th Cir. 1990).

ATOFINA, 2008 WL 400394, at *9 (quoting *Gandy*, 925 S.W.2d at 714). The Court then said that *Gandy* did not prevent the application of *Block* to the instant case for two reasons: (1) the case did not fit within

(continued on next page)

Gandy's "explicit and narrow" holding that only applied to a "specific set of assignments with special attributes"; and (2) the case did not implicate the concerns in *Gandy* with respect to muddying the waters as to evaluation of the merits of a plaintiff's claim with prolonged disputes and distorted trial litigation motives. *Id.* Expanding on that, the Court held that in the case before it, the "key factual predicate" of *Gandy* was missing because ATOFINA did not assign its claim against Evanston, but filed suit directly, which "removes this case from the formal bounds of *Gandy*." *Id.* In addition, preventing Evanston from challenging the reasonableness of the settlement would not extend the dispute, but would, by definition, shorten it. *Id.* Moreover, because ATOFINA was unsure if it would be covered, it never lost its motive to minimize the settlement amount, as it was unclear who ultimately would be responsible for footing the bill. Accordingly, to accomplish *Gandy's* goal regarding the fair determination of the value of a plaintiff's claim, the Court applied the *Block* rule, which encourages early intervention by insurers who are best suited for evaluating the value of a claim during settlement discussions. As such, the Court held that Evanston was barred from disputing the reasonableness of ATOFINA's settlement in light of Evanston's denial of coverage. Thus, Evanston was bound to pay the remaining $5.75 million of the settlement. The Court, however, was careful to note that while a collateral attack on the reasonableness of a settlement is impermissible, an insurer remains free to challenge coverage. *Id.* at *19 n.74.

visser shidlofsky llp

D. Article 21.55 Applies only to the Duty to Defend

In *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1 (Tex. 2007), the Supreme Court of Texas held that Article 21.55 (now re-codified at TEX. INS. CODE §§ 542.051–.061) applies to a CGL insurer's breach of the duty to defend. In *Lamar Homes*, the Court suggested that the duty to defend was a first-party duty owed by an insurer to the insured. *Id.* In *ATOFINA*, the Court rejected any application of Article 21.55 to a breach of the duty to indemnify. "A loss incurred in satisfaction of a settlement belongs to the third party and is not suffered directly by the insured." *ATOFINA*, 2008 WL 400394, at *10.

Commentary:

The ruling in *ATOFINA* is extremely significant. First, the Court made clear that a distinction exists between an indemnity provision and an additional insured requirement under a contract. Accordingly, at least in most circumstances, the limitations of one are not applicable to the other. Second, the Court read the multiple additional insured grants independent of one another and refused to apply limitations in one to another. This indicates the importance of reading the additional insured or "Who is an Insured" language very carefully. Third, and perhaps most importantly, the Court reigned in its earlier decision in *Gandy*. For over a decade, insureds and insurers alike have read the broad-sweeping language of *Gandy* to mean that its principles applied beyond the facts of the case at the Court's fingertips. In *ATOFINA*, the Court, in language that hardly can be considered dicta, specifically held that *Gandy* only

(continued on next page)

applied in a limited set of circumstances. For example, it appears that *Gandy* becomes an issue only in cases where a pre-trial assignment of an insured's claim against its insurer has been made. Accordingly, even though there was no "fully adversarial trial," Evanston could not contest the reasonableness of ATOFINA's $6.75 million settlement. Fourth, the Court clarified that Article 21.55 does not apply to the duty to indemnify. Suffice it to say, the *ATOFINA* opinion was chock full of holdings.

The Insurance Law Practice Group Handles:

- **Commercial General Liability**
- **Commercial Property**
- **Commercial Auto**
- **Crime**
- **D&O**
- **Employment Practices Liability**
- **Fiduciary Liability**
- **Inland Marine**
- **Professional Liability**
- **Specialized Manuscript Policies**

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.

Douglas P. Skelley is an associate at Visser Shidlofsky LLP. He represents and counsels corporate policyholders in numerous insurance law matters. He is a member of both the Insurance Law Section and the Construction Law Section of the State Bar of Texas.

The Insurance Law Practice Group represents corporate policyholders that are in disputes with their insurance companies, provides advice to plaintiffs in complex litigation on how to best maximize an insurance recovery, and provides risk-management consultation in connection with a wide-variety of contractual risk transfer issues. The Insurance Law Practice Group handles first-party and third-party insurance claims in state and federal courts at both the trial and appellate court levels. The Insurance Law Practice Group is committed to practical and pragmatic solutions to insurance issues.

Serving Clients Across Texas and Nationwide

V | S

visser shidlofsky llp