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The Northern District of Texas finds that the submission of defense costs invoices is not necessary to trigger liability under the Prompt Payment of Claims Act

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Trammell Crow v. Virginia Surety: A Favorable Spin on the Prompt Payment of Claims Act

On December 1, 2008, Chief Judge Sidney A. Fitzwater of the Northern District of Texas issued an opinion touching on the extent of an insurer's duty to defend, as well as its liability for damages under the Prompt Payment of Claims Act. *See Trammell Crow Residential Co. v. Virginia Surety Co., Inc.*, 2008 WL 5062132 (N.D. Tex. Dec. 1, 2008). The court held that Virginia Surety owed a defense to its insured against allegations of discrimination against persons with disabilities. In addition, the court applied *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*, 242 S.W.3d 1 (Tex. 2007), in determining that Virginia Surety was obligated to pay 18% interest to Trammell Crow for violating the Prompt Payment of Claims Act. After ruling on those issues, the court also denied the insurer's motion for summary judgment on Trammell Crow's unfair settlement practices claims, as well as its motions for severance, abatement and leave to file a response to Trammell Crow's surreply. The court's rulings on the duty to defend and the Prompt Payment of Claims Act, however, serve as the focus of this issue of the *Insurance Law Newsletter*.

A. Background Facts

On July 9, 2007, The Equal Rights Center (the "ERC") filed a lawsuit against Trammel Crow Residential Company ("Trammell Crow") in the U.S. District Court for the District of Columbia (the "*ERC Litigation*"), alleging that Trammell Crow was liable for discriminating against persons with disabilities in violation of the Fair Housing Act (the "FHA") and the Americans with Disabilities Act of 1990 (the "ADA"). In particular, ERC alleged that Trammell Crow discriminated against persons with disabilities by "designing, constructing, controlling, managing, and/or owning covered multifamily dwellings . . . in such a manner as to deny persons with disabilities access to, and the use of, these facilities." *Id.* at *1. Further, ERC contended that the discriminatory conduct injured the ERC and its members—most of whom are persons with disabilities. ERC sought "such damages as would fully compensate the ERC for the injuries incurred as a result of Trammell Crow's discriminatory housing practices and conduct." *Id.*

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CASES TO WATCH:

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)

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)

Virginia Surety Company, Inc. issued an insurance policy to Trammell Crow that contained a "Personal and Advertising Injury Liability Coverage Endorsement," which provided that Virginia Surety owed Trammell Crow a defense against any suit seeking damages for a covered "personal injury." A covered personal injury is one that arises out of an offense committed in the coverage territory during the policy period. And, the term "personal injury" specifically is defined as including injury arising out of discrimination because of physical disability. *Id.* Nevertheless, when Trammell Crow notified Virginia Surety of the *ERC Litigation* on November 13, 2007, Virginia Surety denied that it owed a defense against the claims. *Id.* at *2. As a result, Trammell Crow filed its suit alleging that Virginia Surety had breached its contract, had a continuing defense duty and that it violated Chapter 542 of the Texas Insurance Code for failing to promptly provide a defense.

B. The Court Finds that Virginia Surety Owed a Defense to Trammell Crow.

Virginia Surety claimed that no defense existed because "(1) the ERC Litigation does not allege facts that constitute a "personal injury" under the Policy; (2) the alleged discrimination was not committed during the Policy period; (3) the 'willful violation of ordinance' exclusion precludes coverage; and (4) the fortuity doctrine bars coverage." *Id.* at *3. Addressing the allegations in the petition, the court rejected Virginia Surety's position, finding that the ERC clearly alleged an offense under the definition of "personal injury" and that it suffered the injury—not just that its members did. *Id.* It also rejected Virginia Surety's contention that the ERC could not allege a personal injury because *it* was not personally discriminated against because the policy did not require a plaintiff to personally suffer the discrimination. *Id.* at *4. Rather, the policy requires Virginia Surety to defend its insured whenever a plaintiff seeks damages for personal injury that arises out of such discrimination. Under the facts before it, the court held that the ERC sought damages because of a covered personal injury. *Id.*

The court then turned to Virginia Surety's claim that the personal injury alleged did not occur during the policy period. *Id.* at *5. In doing so, Virginia Surety relied on the Supreme Court of Texas' recent decision in which the Court held that an insurer's duty to defend only is triggered by an "injury in fact" that occurs during the policy period. *Id.* (citing *Don's Building Supply, Inc. v. OneBeacon Insurance Co.*, 267 S.W.2d 20 (Tex. 2008) (for an in-depth discussion of this case, please see Volume 2, Issue 7 of the *Insurance Law Newsletter*, which can be found on our website at www.vsfirm.com/publications)). The Northern District of Texas found *Don's Building Supply* to be inapposite, however, as the policy at issue before the court in *Trammell Crow* required only that a "personal injury" "arise[] out of an offense committed during the policy period." *Id.* Thus, it is the *offense* rather than the *injury* resulting from that offense that triggers an insurer's defense duty under Coverage B. Accordingly, *Don's Building Supply* was inapplicable to this case. And,

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looking at the allegations in the *ERC Litigation* the court found that the ERC alleged that Trammell Crow—at a minimum—owned properties covered by the policy during the policy period and that the personal injury arose out of that ownership. As such, the court ruled that the ERC "seeks by its lawsuit damages for an alleged offense that falls within the Policy's 'personal injury' coverage." *Id.* at *6.

The court also rejected Virginia Surety's reliance on an exclusion for the willful violation of an ordinance and the fortuity doctrine. With regard to the exclusion, the court reiterated that an insurer carries the burden to prove the application of an exclusion or limitation and that Virginia Surety had failed to meet that burden, as it did not quote the provision it sought to invoke and did not establish that the ERC sought only damages arising from "willful" violations of the FHA and the ADA. *Id.* at *6. With respect to the fortuity doctrine, the court again noted that the insurer held the burden and again failed to meet it. In particular, while Virginia Surety acknowledged that application of the fortuity doctrine is subject to Texas' "eight corners" rule, the insurer failed to cite any allegations in the *ERC Litigation* that would indicate that Trammell Crow knew or should have known of an ongoing loss when it purchased its policy. The court found Virginia Surety's argument "logically fallacious" because it assumed that because the ERC alleged that Trammell Crow had been violating the FHA and the ADA since 1991 that Trammell Crow *knew* that it had been violating those Acts. *Id.* at *7. The court disagreed because that is not what the allegations stated and because none of the alleged statutory violations require intentional acts or a knowing violation. *Id.* Because Virginia Surety pointed to no factual allegations to support its argument and the court found none, the court dismissed Virginia Surety's reliance on the fortuity doctrine.

In light of the foregoing, the court found that Trammell Crow was entitled to a defense from its insured and granted summary judgment in its favor on that issue. Moreover, the court held that such duty to defend the insured was ongoing and also granted summary judgment in Trammell Crow's favor on that claim. *Id.* at *7–*8.

C. Virginia Surety Breached Its Contract

The parties did not dispute that they have a valid and enforceable contract and that Trammell Crow performed its duties under the contract. The primary argument was that Virginia Surety had not breached the contract because it owed no defense to Trammell Crow. Because the court found otherwise, however, Trammell Crow had established the first three elements necessary for a finding of a breach of contract. The fourth element, that Trammell Crow suffered damages as a result of the breach, then was addressed by the court. *Id.* at *8.

The court noted that Trammell Crow did not seek summary judgment on the amount of its damages, but it was required to show that it suffered some damages to satisfy that element of its cause of action. In that

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regard, Virginia Surety did not argue that Trammell Crow had not suffered damages, only that the affidavit filed to support its claim of damages was not the "best evidence" of its defense costs and that it was incompetent evidence for establishing that Virginia Surety had paid nothing toward the defense. *Id.* at *8–*9. The court rejected both arguments though, finding that the "best evidence" rule had no application to the case and that the affidavit was competent because it was made by Trammell Crow's Risk Management Director, who was familiar with the claim and would have known whether Virginia Surety contributed to the defense. *Id.* As such, the court found that all four elements were met and that Virginia Surety breached its contract. *Id.* at *9.

D. Virginia Surety Violated the Prompt Payment of Claims Act

Under the Prompt Payment of Claims Act (codified at Sections 542.051–.061 of the Texas Insurance Code), insurers are prohibited from delaying payment of first-party claims. The federal court noted that the Supreme Court of Texas "recently held that an insured's right to a defense benefit is a first-party claim, and that the Prompt Payment of Claims Act 'may be applied when an insurer wrongfully refuses to promptly pay a defense benefit owed to the insured.'" *Id.* (quoting *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 20 (Tex. 2007) (for an in-depth discussion of this case, please see Volume 1, Issue 5 of the *Insurance Law Newsletter*, which can be found on our website at www.vsfirm.com/publications)). When an insurer violates the Prompt Payment of Claims Act, it is liable to pay the insured, "in addition to the amount of the claim, interest on the amount of the claim at the rate of 18 percent a year as damages, together with reasonable attorney's fees." *Id.* (quoting TEX. INS. CODE ANN. § 542.060 (Vernon 2007)).

Trammell Crow urged that Virginia Surety violated the Prompt Payment of Claims Act because it denied a defense to Trammell Crow on December 26, 2007 and had not contributed any amount to the defense. In the meantime, Trammell Crow claimed that it had paid significant defense costs in the *ERC Litigation*. *Id.* at *10. Because Virginia Surety had delayed in providing that defense benefit for more than 60 days, Trammell Crow contended that the Act had been violated as a matter of law.

In retort, Virginia Surety argued that it was not liable for damages because Trammell Crow never submitted its legal bills or invoices for expenses it incurred in defending itself in the underlying litigation. More specifically, Virginia Surety claimed that no damages exist under the Act "unless the insured retains counsel in the underlying lawsuit, begins receiving statements for legal services, *and such statements are submitted to the insurer*." *Id.* (citing *Lamar Homes*, 242 S.W.3d at 19; TEX. INS. CODE § 542.056(a)). Further, Virginia Surety said that those invoices are the last piece of information necessary to value the insured's loss. While the Northern

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District of Texas "agree[d] that proof of the insured's defense costs are necessary to calculate the damages for which the insured is liable, it disagree[d] with the premise that an insurer cannot be liable under the [] Act *unless* the insured has submitted statements of its defense costs to the insurer." *Id.*

Turning to *Lamar Homes*, the court said that the Supreme Court of Texas concluded that the loss resulting from the wrongful denial of a defense obligation "is quantified after the insured retains legal counsel and begins receiving statements for legal services." *Id.* (quoting *Lamar Homes*, 242 S.W.3d at 19). The Supreme Court said:

> These statements or invoices are the last piece of information needed to put a value on the insured's loss. And when the insurer, who owes a defense to its insured, fails to pay within the statutory deadline, the insured matures its right to reasonable attorney's fees and the eighteen percent interest rate specified by the statute.

Id. (quoting *Lamar Homes*, 242 S.W.3d at 19 (internal citations omitted)). The Northern District of Texas said that Virginia Surety "seriously misquote[d]" the second sentence of that quote by stating in its brief that:

> *Only* [And] when *an* [the] insurer, who owes a defense to its insured, fails to pay *the submitted defense costs* within the statutory deadline *of the Texas Insurance Code*, the insurer matures its right to reasonable attorney's fees and the eighteen percent interest rate specified by the statute.

Id. at *11 (quoting Virginia Surety's brief and emphasizing language added by the insurer (in italics) and taken away (in brackets)). By altering the quote without acknowledging the alteration, the court found that Virginia Surety's argument was very misleading.

In any event, the court disagreed with Virginia Surety's position, finding that it ran counter to *Lamar Homes'* reasoning that the insured suffers actual loss when the defense obligation is rejected. The court interpreted *Lamar Homes* to hold that liability arises upon the wrongful rejection of a defense, but attorneys' fees cannot be awarded and prejudgment cannot accrue until the defense costs actually are incurred. "In other words, there can be a determination of liability without a calculation of damages." *Id.*

Commentary:

Most Texas insurance law commentators interpreted *Lamar Homes* to require the actual submission of defense costs invoices to an insurer that has denied a defense in order to trigger liability under the Prompt Payment of Claims Act. In fact, based on this interpretation, we

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advise our clients to submit redacted invoices to the insurer as received. The *Trammell Crow* case suggests, however, that actual submission is not necessary. While we agree with Judge Fitzwater's logic, and have always taken the position that the submission of invoices *should not be necessary* when an insurer denies a defense, we are not prepared to abandon the advice that the safest approach is to submit redacted invoices as received. We will continue to monitor the progress of the *Trammell Crow* case and this issue and will provide updates in future issues of the *Insurance Law Newsletter*.

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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 Secretary 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. Lee 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 2008, and is ranked as a top insurance coverage lawyer by Chambers USA and Who's Who Legal. Lee recently was elected a Fellow of the Texas Bar Foundation.

Douglas P. Skelley and Melissa L. Kelly are associates at Visser Shidlofsky LLP. They each represent and counsel corporate policyholders in numerous insurance law matters. Doug and Melissa are members of both the Insurance Law Section and the Construction Law Section of the State Bar of Texas.

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