



The Weekly Update of Texas Insurance News

TEXAS INSURANCE LAW NEWSBRIEF



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A Service of Martin, Disiere, Jefferson & Wisdom L.L.P.

Principal Office 808 Travis, 20th Floor Houston, Texas 77002 713.632.1700 FAX 713.222.0101
900 S Capital of Texas Hwy, Suite 425 Austin, Texas 78746 512.610.4400 FAX 512.610.4401
16000 N Dallas Parkway, Suite 800 Dallas, Texas 75248 214.420.5500 FAX 214.420.5501

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FIFTH CIRCUIT COURT OF APPEALS UPHOLDS INSURER'S DENIAL OF COVERAGE FOR THE COST OF INDEPENDENT COUNSEL

On June 29, 2012, the Fifth Circuit Court upheld an insurer's denial of coverage for the cost of independent counsel after its insured, a Texas oil drilling services firm, rejected the insurer's offer of representation in a lawsuit. *Downhole Navigator, L.L.C. v. Nautilus Ins. Co.*, --- S.W.3d ---, 2012 WL 2477846, No. 11-20469 (5th. Cir. June 29, 2012).

The insured, Downhole Navigator L.L.C., was sued by an oil well operator after work Downhole performed for the operator caused damage to an oil well. Downhole notified its commercial general liability insurer, Nautilus Insurance Co., of the suit. In response, Nautilus offered a qualified defense under a reservation of rights to decline indemnifying Downhole if the suit against the drilling firm fell under one of several policy exclusions. Downhole responded that Nautilus' reservation of rights "created a material conflict with respect to the selection of counsel," adding that the situation forced Downhole to select its own counsel. Downhole demanded that Nautilus cover all damages related to the claim including its attorneys' fees. Nautilus refused to reimburse Downhole for the cost of its independent counsel, advising that Downhole was not entitled to separate counsel under the circumstances.

Downhole then filed an action seeking a declaratory judgment that Nautilus had a contractual duty to defend and indemnify its insured in the third party lawsuit. The United States District Court for the Southern District of Texas agreed that the insurer was not required to reimburse Downhole for the cost of hiring an independent counsel. The Fifth Circuit Court of Appeals affirmed, holding (1) because the facts to be adjudicated in the third party lawsuit were not the same facts upon which coverage depended, the potential conflict in this case did not disqualify the attorney offered by Insurer to represent Insured; and (2) therefore, Insured was not entitled to reimbursement from Insurer for the cost of hiring independent counsel.

U.S. Circuit Judges Edward C. Prado, Thomas M. Reavley and Priscilla R. Owen served on the panel. Judge Prado wrote the opinion of the Court.

[**Editor's Note:** MDJW congratulates Nautilus on this successful coverage appeal. Levon Hovnatanian, Jamie Cooper, and Ruth Brenton of MDJW represented Nautilus in the trial court and on appeal in this matter.]

SUPREME COURT OF TEXAS HOLDS HOMEOWNER MUST PRESENT EVIDENCE TO SHOW THAT REPAIR COSTS ARE REASONABLE AND NECESSARY

In a per curium opinion issued on June 29, 2012, the Texas Supreme Court held that an estimate for damages created through a widely used software program did not in itself prove that the repair and remediation costs were “reasonable or necessary.” *McGinty v. Hennen*, --- S.W.3d ---, 2012 WL 2476877, No. 11–0288 (Tex. June 29, 2012)

In this construction dispute, a homeowner sued a homebuilder for negligence, breach of express and implied warranties, breach of contract, and DTPA violations, among other claims. Shortly after moving into the home, the homeowner noticed water leaks and mold. The homeowner retained a contractor who estimated remedial costs for the damages to be in excess of \$651,000.00 using Xactimate software. At trial, the jury determined (1) that the difference in the value of the home as it was received by the homeowner and the value it would have had if it had been built according to the contract was \$262,885.83, and (2) the reasonable and necessary cost of repair to be \$651,230.72. The builder moved for judgment notwithstanding the verdict in which it argued that no evidence supported that damage award. The trial court denied the motion. The Court of appeals affirmed.

The Texas Supreme Court granted certiorari as to the following issues: (1) did the homeowner produce evidence of the difference in market value, as of the date of closing, between the house received and a house built according to the contract, and (2) did the homeowner present evidence that the estimated repair cost was reasonable and necessary. The builder argued that just because the remediation costs were determined using a widely used software program (i.e., Xactimate) did not prove that the cost was reasonable or necessary. The Court agreed. The Court also determined that estimated out-of-pocket expenses alone did not establish that the cost of repair was reasonable, and that additional evidence was necessary. In this case, the homeowner did not present any other evidence, such as his own testimony or testimony by his experts, regarding the reasonableness of the repair costs. The Court stated that even though the homeowner’s expert testified that he used the Xactimate software and that such testimony explained how the remediation figure was derived, the testimony did not support the jury’s finding that the estimated cost of repair was reasonable.

The Court determined that the evidence was legally insufficient to support the jury’s finding that \$651,230.72 was a reasonable and necessary cost to repair the house. The Court further determined that the homeowner did not produce evidence of the difference in market value, as of the date of closing, between the house received and a house built according to the contract. Therefore, the Court reversed the court of appeals’ judgment and render judgment that the homeowner take nothing on his breach-of-contract claim.

**FIRST COURT OF APPEALS OF TEXAS HOLDS INSURER HAS NO CLAIM
FOR EQUITABLE SUBROGATION TO EXTENT PAYMENTS EXCEED
AMOUNTS OWED IN PROPORTION TO FAULT OF INSURED.**

The Houston Court of Appeals recently held that an insurer could not bringing an equitable-subrogation claim against a third party to the extent that the insurer sought recovery of payments in excess of amounts owed in proportion to the fault of its insured. *Allstate Ins. Co. v. Spellings*, --- S.W.3d ---, 2012 WL 2452051, No. 01–11–01065–CV (Tex. App.—Houston [1st Dist.] June 28, 2012).

Scott Jeffrey, the father of seventeen-year-old motorist who was killed in two-car automobile accident, filed wrongful death action against the Spellings, parents of his daughter’s best friend, alleging the Spellings allowed his daughter to be provided with alcoholic beverages. Jeffrey’s automobile insurer,

Allstate Insurance Company, filed plea in intervention, asserting a claim for equitable subrogation to recover amounts it paid to settle claims of Helen and Jim Haywood, the other motorists who died as a result of injuries they sustained in the automobile accident with Jeffrey's intoxicated, daughter. Allstate contended that it was entitled to "step into the shoes" of the Haywoods to pursue reimbursement from the Spellings for the monies paid out for medical, bodily injury, property damage and collision claims. Allstate also argued that it was entitled to take on the claims and defenses of the Haywoods because it paid for the Haywoods' damages and that it should be allowed to proceed on its claims against the Spellings because they were primarily responsible for the accident.

The Spellings filed motion for summary judgment arguing that Allstate was precluded from seeking reimbursement for payments it had made to the Haywoods under any legal theory or type of subrogation because Allstate "stands in the shoes of its insured(s) for subrogation purposes" and a "settling tortfeasor" like Allstate "has no right to contribution." The 281st District Court of Harris County granted Spellings' motion and severed Allstate's equitable-subrogation claim. Allstate appealed.

On appeal, the Houston Court of Appeals stated that equitable subrogation allows the insurer to stand in the shoes of the *insured*, and thus obtains only those rights held by the insured against a third party, subject to any defenses held by the third party against the insured. In this case, however, Allstate sought to stand in the shoes of the Haywoods, not its insureds, in attempt to recover from the Spellings amounts that it paid as the liability insurer of the Jeffreys.

The Court of Appeals determined that, to the extent Allstate's issued payments in excess of the amounts owed in proportion to fault of insured (i.e., Jeffrey's daughter), such payments were voluntary. The Court affirmed the trial court's decisions concluding that Allstate was not entitled to recoup the payments it made to the Haywoods by intervening in Scott's wrongful-death suit and bringing an equitable-subrogation claim against the Spellings.

SUPREME COURT OF TEXAS HOLDS INSURER HAS NO DUTY TO DEFEND ORGAN DONATION CHARITY AGAINST CLAIMS FOR MENTAL ANGUISH AND LOSS OF TISSUES

In *Evanston Ins. Co. v. Legacy of Life, Inc.*, a case of first impression, the Texas Supreme Court considered two certified questions from the Fifth Circuit Court of Appeals: (1) whether an insurance policy provision for coverage of "personal injury" includes coverage for mental anguish and (2) whether a provision for coverage of "property damage," includes coverage for loss of use of tissues, organs, bones, and body parts." *Evanston Ins. Co. v. Legacy of Life, Inc.*, --- S.W.3d ---, 2012 WL 2476935, No. 11-0519 (Tex. June 29, 2012).

In the underlying suit, the plaintiff, Debra Alvarez, alleged that while her mother was terminally ill, she consented to an organ donation charity's harvesting of some of her mother's organs and tissues after her mother's death because the charity was a non-profit corporation. The charity, Legacy of Life, Inc., instead transferred the tissues to a for-profit company, which sold the tissues to hospitals at a profit. Alvarez alleged that Legacy caused her mental anguish and deprived her and estate of use of property through wrongfully profiting from sale of her deceased mother's tissues. Legacy subsequently sought coverage under its general liability insurance issued by its insurer, Evanston Insurance Company. Evanston denied coverage on the basis that the conduct alleged was outside the scope of the insurance policy's coverage.

Evanston brought action against Legacy seeking declaration that insurer had no duty to defend it in underlying lawsuit. The United States District Court for the Western District of Texas denied Evanston's motion for summary judgment and granted summary judgment to Legacy as to insurer's duty to defend. Evanston appealed.

The Fifth Circuit certified the following questions for consideration by Supreme Court of Texas: (1) "Does the insurance policy provision for coverage of 'personal injury,' defined therein as 'bodily injury, sickness, or disease including death resulting therefrom sustained by any person,' include coverage for mental anguish, unrelated to physical damage to or disease of the plaintiff's body?" (2) "Does the insurance policy provision for coverage of 'property damage,' defined therein as 'physical injury to or destruction of tangible property, including consequential loss of use thereof, or loss of use of tangible property which has not been physically injured or destroyed,' include coverage for the underlying plaintiff's loss of use of her deceased mother's tissues, organs, bones, and body parts?"

The Texas Supreme Court answered both questions in the negative. On the first issue, the Court held that because the term "bodily" modified "injury, sickness, and disease" in the policy's definition, a physical manifestation was required for sickness or disease to be covered. Since no physical injuries were alleged, the claim alleged against Legacy did not trigger Evanston's duty to defend under the personal injury component of its policy. As to the second question, the court turned to its holding in *Burnett v. Surratt*, in which it held that tissues are quasi property of the next of kin but they are not the property of the next of kin. *Burnett*, 67 S.W.2d 1041, 1042 (Tex. Civ. App.—Dallas 1934, writ ref'd). Therefore, Court held that the loss of use of tangible property did not include the loss of use of the mother's tissues by Alvarez or her mother's estate.

Justice Eva Guzman delivered the opinion of the Court.

TEXAS SUPREME COURT HOLDS ATTORNEY-CLIENT PRIVILEGE DOES NOT APPLY TO COMMUNICATIONS BETWEEN INSURER'S LAWYER AND EMPLOYER IN COMP BAD FAITH CASE

In a recently issued-opinion, the Texas Supreme Court held that the attorney-client privilege did not apply in a bad faith action brought by an injured employee against a workers' compensation insurer to communications between the insurer's lawyer and the employer during the underlying administrative proceedings. *In re XL Specialty Ins. Co.*, --- S.W.3d ---, 2012 WL 2476851, No. 10-0960 (Tex. June 29, 2012).

In considering the "allied litigant privilege" applicable in multi-party litigation, the Court determined that Texas Rule of Evidence 503(b)(1)(C) applies to joint defense situations in Texas where multiple defendants, represented by separate counsel, work together in a common defense, and that the protection afforded under the Rule only protects communications be made in the context of a pending action.

In response to the insurer's argument that the communications at issue were protected by the insurer-insured relationship, the Court stated that it did not recognize a general insurer-insured privilege but agreed that in certain circumstances, communications between an insurer and its insured may be shielded from discovery by the attorney—client privilege. In this case, the communications at issue were made between the insured's lawyer and a third party who was not represented by insurer's lawyer (or any other lawyer) and was not a party to the litigation or any other related pending action. Therefore, the Court held

that the insurer failed to show that the communications were within the parameters of Rule 503 and were thus not protected from discovery under the allied litigant doctrine or any other part of Rule 503.

Chief Justice Wallace B. Jefferson delivered the opinion of the Court, in which Justices Nathan Hecht, Dale Wainwright, David Medina, Paul W. Green, Phil Johnson, Justice Eva Guzman, and Debra Lehrmann joined. Justice Don R. Willett issued a dissenting opinion in which he took issue with the fact that the question answered by the majority, albeit weighty, arose possibly from a claim that no longer exists.

TEXAS SUPREME COURT HOLDS TEXAS WORKERS' COMPENSATION ACT DOES NOT DEPRIVE TRIAL COURT OF SUBJECT MATTER JURISDICTION TO REVIEW IMPAIRMENT RATING

In *American Zurich Ins. Co. v. Samudio*, --- S.W.3d ---, 2012 WL 2476798, No. 10-0554 (Tex. June 29, 2012), American Zurich appealed a decision issued by the Division finding that an insured worker, Daniel Samudio, had an impairment rating of twenty percent. Under the Texas Workers' Compensation Act, an injured worker's impairment income benefits are determined in part by the impairment rating assigned by the Texas Department of Insurance's Division of Workers' Compensation. TEX. LAB.CODE § 408.121(a)(1). While section 410.310(c) of the Act limits the evidence that a trial court may consider in reviewing an impairment rating assigned by the Division and precludes the court from assigning a rating that was not presented to the agency, it does not prevent the court from setting aside an invalid rating and remanding to the Division for further proceedings.

American Zurich appealed the impairment decision to district court contending that the impairment rating the Division assigned was invalid, and that Samudio had either no impairment rating, or that the correct rating was ten. Samudio filed a plea to the jurisdiction contending that the trial court lacked subject matter jurisdiction because the trial court was not empowered to provide the relief American Zurich sought. Samudio argued that American Zurich's petition presented no justiciable controversy because the trial court was only empowered to award an impairment rating that was presented to the agency, and the only rating before the agency was the twenty percent rating. The trial court granted Samudio's plea and dismissed the case. The court of appeals affirmed.

On appeal before the Texas Supreme Court, Justice Debra Lehrmann issued an opinion for the court holding that the Texas Workers' Compensation Act did not deprive the trial court of subject matter jurisdiction to resolve an impairment rating appeal. The Court therefore reversed the court of appeals' judgment and remanded to the trial court for a determination as to whether an impairment rating had been properly made in conformance with the Guides to the Evaluation of Permanent Impairment and presented to the Division. The Court instructed that, if the trial court found no impairment rating had been properly issued, the matter should then be remanded to the Division for a new impairment determination.

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