The Weekly Update of Texas Insurance News
TEXAS INSURANCE LAW NEWSBRIEF
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February 18, 2008

This past Friday February 15, 2008, the Texas Supreme Court issued three very significant decisions impacting Texas Insurance Law. While we have summarized these decisions below, should you have any pending matters involving the issues discussed, feel free to contact any of our attorneys for additional information.

TEXAS SUPREME COURT HOLDS PUBLIC POLICY DOES NOT PROHIBIT INSURANCE COVERAGE FOR PUNITIVE DAMAGES

This past Friday, the Texas Supreme Court answered the following certified question presented by the Fifth Circuit: "Does Texas public policy prohibit a liability insurance provider from indemnifying an award for punitive damages imposed on its insured because of gross negligence?" In *Fairfield Insurance Co. v. Stephens Martin Paving, L.P.*, 2008 WL 400397 (Tex. February 15, 2008), the Court in a limited holding, found "Texas public policy does not prohibit coverage under the type of workers' compensation and employer's liability insurance policy at issue in this case." In doing so, the Court provided an extensive and thought-provoking discussion of the law from other jurisdictions, Texas statutory and legislative considerations, Texas case law addressing the issue in other contexts and public policy issues including the "freedom of contract" and the underlying purpose of imposing punitive damages.

In this case, the employee died as a result of on the job injuries and the resulting lawsuit alleged the insured employer "failed to follow and enforce OSHA safety rules and regulations." The policy at issue provided workers' compensation and employers' liability insurance that covered "all sums the insured [Stephens Martin Paving] legally must pay as damages because of bodily injury to [its] employees, provided the bodily injury is covered by this Employers Liability Insurance" But, it excluded coverage for damages arising from injuries caused by intentional acts and "punitive or exemplary damages because of bodily injury to an employee employed in violation of law." However, an endorsement provided "[t]his exclusion does not apply unless the violation of law caused or contributed to the bodily injury." Because the certified question only focused on the public policy consideration, the court did not address the potential coverage issues and presumed the policy covered the punitive damages sought.

In reaching its decision that coverage for punitive damages was not against Texas public policy, the court focused on the statutory workers' compensation scheme and accompanying insurance regulations. The court found because the Texas Workers Compensation Act allowed recovery of exemplary damages caused by the employer's gross negligence and because the Texas Department of Insurance execution of that scheme and approval of policy forms reveals an "intent to provide coverage for gross-negligence" while excluding intentional acts, the high court of Texas found the "Legislature's expressed intent is that Texas public policy does *not* prohibit insurance coverage for claims of gross negligence in this context."

TEXAS SUPREME COURT HOLDS INSURER HAS NO DUTY TO NOTIFY ADDITIONAL INSURED OF AVAILABLE LIABILITY COVERAGE AND ACTUAL KNOWLEDGE OF SUIT AGAINST THE INSURED DOES NOT PRECLUDE A PREJUDICE FINDING

Last Friday, the Texas Supreme Court answered "no" to the following certified questions from the Fifth Circuit:

> 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?
>
> 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?

In *National Union fire Insurance Co. v. Crocker*, 2008 WL 400398 (Tex. February 15, 2008), a nursing home resident sued the insured nursing home and its employee for injuries suffered when hit by a door swung open by the employee. The employee was terminated after the incident but before suit was filed. The insurer defended the nursing home but did not defend the employee even though the claims against him were covered and the insurer knew he had been served. The insurer attempted to contact the employee by phone and mail without success. During the suit, the employee spoke privately with plaintiff's counsel at a deposition but refused to speak with the nursing home's defense counsel. At trial, the jury returned a take nothing defense verdict against the nursing home but the court entered a $1,000,000 default judgment against the employee. The injured resident then sought to collect against the liability insurer because of its alleged coverage on the employee.

The federal district court hearing the coverage case found the insurer breached its duty to defend the employee by failing to notify him of the available coverage. That court also found prejudice had to be shown to establish a coverage defense based on late notice and the insurer's "actual awareness" of the suit against the employee precluded it's ability to establish the required prejudice. On appeal, the Fifth Circuit certified the above questions to the Texas Supreme Court. In addressing the notice requirement in last Friday's decision, the Texas Court observed that a "more basic purpose" of requiring an insured to forward suit papers to the insurer is to advise them that the insured has been served and the insurer is expected to file an answer on their behalf. An insurer's knowledge that suit has been filed "does not satisfy this 'more basic purpose' or require the insurer to "gratuitously subject itself to liability." The high court noted: "Simply put, there is not duty to provide a defense absent a request for coverage."

Addressing the prejudice question, the court distinguished its recent decision in *PAJ, Inc. v. Hanover Insurance Co.* 2008 WL 109071 (Tex. 2008) (*See Texas Insurance Law Newsbrief* January 14, 2008), by observing in *PAJ* the notice was actually late in contrast to the present case where there was no notice from the additional insured at all. Because an insured may opt against seeking a defense from an insurer for a number of reasons, the Texas Supreme Court concluded that "insurers owe no duty to provide an unsought, uninvited, unrequested, unsolicited defense." As such, the insurer had no duty to inform the employee of available coverage or to voluntarily undertake his defense. And, the high court concluded actual knowledge of the suit against him did not establish prejudice as a matter of law.

TEXAS SUPREME COURT WITHDRAWS 2006 OPINION AND LIBERALLY CONSTRUES ADDITIONAL INSURED PROVISION

Last Friday, the Texas Supreme Court withdrew its 2006 opinion in *Evanston Ins. Co. v. Atofina Petrochemicals, Inc.*, 2006 WL 1195330 (Tex. May 5, 2006) (where the high court found the additional insured provisions of the policy were not broad enough to indemnify the third-party's own acts of negligence, but it failed to decide whether the scope of this coverage is limited in any way by the separate indemnity agreement between the third-party and the policy's named insured). Last Friday, the Texas Supreme Court reversed itself and closely examined the interplay between a contractual indemnity agreement and the scope of coverage afforded to additional insureds. In *Evanston Ins. Co. v. Atofina Petrochemicals, Inc.*, 2008 WL 400394 (Tex. February 15, 2008), the court specifically addressed three specific issues: 1) "whether a commercial umbrella insurance policy that was purchased to secure the insured's indemnity obligation in a service contract with a third party also provides direct liability coverage for the third party;" 2) "whether the insurer is bound to pay the amount of an underlying settlement between the additional insured;" and 3) "whether article 21.55 (now Chapter 542) of the Texas Insurance Code, the "Prompt Payment of Claims" statute, authorized the imposition of penalties and attorney's fees for the insurer's failure to pay the claim timely."

Addressing the first issue involving the breadth of additional insured coverage, the court focused on the policy language defining who is an insured, the provision discussing the named insured's duty to indemnify the additional insured, and a separate provision defining an insured to include "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." The court reasoned that each "who-is-an-insured" clause served to grant coverage independently and, therefore, it held the policy provided the broader scope of coverage and did not exclude liabilities arising out of the additional insured's sole negligence.

Addressing the second issue of "whether the insurer was bound to pay the amount of an underlying settlement between the additional insured," the court revisited related decisions and held the insurer's "denial of coverage barred it from challenging the reasonableness" of the settlement and the insurer was thus bound to pay the $5.75 million settlement. Addressing the third issue of whether article 21.55 of the Texas Insurance Code applied in this context, however, the court observed the claim in this case was a third-party claim involving the insured's liability to another and not a first-party claim falling within the statute. Accordingly, the court held that the additional insured was not entitled to attorney fees or damages under article 21.55.

Editor's note: The high court's treatment of the 21.55 penalty provision is interesting in light of the court's ruling last month in *Lamar Homes* where it addressed the same statute in a liability claim involving the duty to defend. Last Friday's decision in *Atofina Petrochemicals* properly ruled the penalty provision does not apply to indemnity benefits under a liability policy. It still leaves claims for previously tendered defense benefits subject to the 18% statutory penalty pursuant to last month's decision in *Lamar Homes*, despite the obvious inconsistency between the two decisions. A majority of the Texas Supreme Court apparently doesn't have any problems with applying the 18% statutory penalty to *defense benefits* under a liability policy when coverage is later determined to exist, but it does have problems applying the same penalty provision to the same claim under the same policy as it relates to *indemnity benefits*. Friday's decision in *Atofina Petrochemicals* is simply a good illustration of why the 21.55 holding in *Lamar Homes* last month was terribly wrong.