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FIFTH CIRCUIT HOLDS EXCESS INSURER HAS NO OBLIGATION TO MAKE PAYMENTS AFTER PRIMARY INSURER SETTLES INSURED'S CLAIMS FOR LESS THAN THE PRIMARY POLICY LIMIT

Recently, the Fifth Circuit held that an excess insurer had no obligation to make any payments after a primary insurer settled an insured's claims against it for less than its policy limits.

In, *Martin Res. Mgmt. Corp. v. AXIS Ins. Co.*, 14-40512, 2015 WL 6166661, at *1 (5th Cir. Oct. 21, 2015), Martin Resource Management Corporation ("MRMC") purchased excess insurance from AXIS Insurance Company ("AXIS"). The AXIS coverage began only after the underlying primary policy was "exhausted by actual payment under [the primary policy]." After suffering losses in a state lawsuit, MRMC sued to recover under its primary and excess insurance policies. MRMC eventually settled with its primary insurer for less than the liability limit in the primary policy. AXIS moved for summary judgment, arguing that settlement for less than the underlying policy limit does not trigger coverage under the terms of the AXIS policy. Summary judgment was granted in favor of AXIS, and MRMC appealed. The Court of Appeals was asked to answer the sole question whether the primary policy was exhausted, triggering the excess coverage afforded by AXIS.

After reviewing the language in the AXIS policy, the Fifth Circuit held the AXIS policy unambiguously precluded exhaustion by below-limit settlement. The Court noted the phrase "exhaustion by actual payment under [the primary policy]" made clear that the primary insurer must make payments to MRMC pursuant to its contract. The Court also rejected MRMC's argument that its below-limit settlement constitutes "actual payment," and that MRMC's "gap" payments, the difference between the settlement amount and MRMC's liability, could also constitute "actual payments under [the primary contract]" when the policy required exhaustion by actual payment.

The Court noted that the threshold question was whether the primary insurer failed to make payments under its policy. MRMC bargained for a below-limit settlement with its primary insurer and in exchange released it from further obligations under primary policy. Because MRMC agreed to absolve the primary carrier, it is foreclosed from arguing that the primary carrier failed in its obligations to make full payments under its policy.

FIFTH CIRCUIT FINDS THAT INSURER CANNOT AVOID PROMPT PAY PENALTIES BY POINTING TO INFORMATION THAT WAS NOT PROVIDED BY INSURED BUT DID NOT AFFECT CLAIM DECISIONS

In *Weiser-Brown Operating Co. v. St. Paul Surplus Lines Ins. Co.*, No. 13–20442, 2015 WL 5449134 (5th Cir., Sept. 16, 2015) the Fifth Circuit weighed in on Prompt-Payment liability under Chapter 542 of the Texas Insurance Code and on trial court ruling related to "bad faith" experts. This case involved an insurance dispute between Weiser–Brown Operating Company ("Weiser–Brown") and St. Paul Surplus Lines Insurance Company ("St.Paul"). On September 7, 2012 a jury found that St. Paul breached its insurance contract with Weiser–Brown by failing to pay Weiser–Brown's insurance claim for costs associated with the "loss of control" of an oil well. St. Paul was ordered to pay Weiser–Brown $2,290,457.03 in damages for its breach of contract. After trial, the district court awarded $1,232,328.14 in penalty interest to Weiser–Brown under the Texas Prompt Payment of Claims Statute, The court concluded that St. Paul violated the statute on November 21, 2009, when it failed to accept or reject Weiser–Brown's claim fifteen days after receiving certain requested information, and the court calculated interest accruing from the date of that violation. St. Paul appealed and argued that the district court erred in concluding that St. Paul violated the Prompt–Payment Statute and, alternatively, that the district court used the wrong accrual date in calculating interest under the statute. Weiser–Brown cross-appealed, claiming that the district court erred by granting judgment as a matter of law in favor of St. Paul on Weiser–Brown's bad-faith claim.

Weiser–Brown operates wells that explore for oil and had a control-of-well insurance policy with St. Paul. In August 2008 Weiser–Brown experienced a loss of control of a well in Lavaca County, Texas. In March 2009, Weiser–Brown notified St. Paul that it was interested in making a claim under the insurance policy for the event. St. Paul acknowledged the claim and appointed a loss adjuster to investigate. In a letter dated March 9, 2009, the adjuster requested seventeen categories of information from Weiser–Brown. Within one month, Weiser–Brown sent some, but not all, of the requested documentation. On June 9, 2009, the adjuster sent a letter to

Weiser–Brown indicating that it had received some of the requested documents, but still needed several others. On September 29, 2009, the adjuster informed Weiser–Brown via e-mail that an independent expert had reached a preliminary conclusion that "there was not a subsurface loss of control" of the well. The email noted that additional information had been requested. The adjuster asked Weiser–Brown to provide the additional information and to "advise" if it believed the expert's conclusion was incorrect. Weiser–Brown continued to send documents to the adjuster in October and November 2009.

On February 8, 2010, the adjuster informed Weiser–Brown that, after reviewing the additional information, the expert had not changed his conclusion that the well was never out of control. The e-mail concluded: "Again, please review this report and if you believe that the conclusions reached in the report are incorrect, please advise accordingly and provide any information or documentation in support." In March and April 2010, St. Paul sent two letters to Weiser–Brown explaining that it had not received a response and that it would close the claim in thirty days if no response was received. On April 26, 2010, Weiser–Brown responded that it was "studying the matter" and would "respond to that report shortly." On June 7, 2010, Weiser–Brown sent a one-page response to the expert's report, challenging his neutrality and conclusion. On June 23, 2010, St. Paul acknowledged receipt of Weiser–Brown's response and indicated that it would forward the response to the expert "for further review and comment." On July 16, 2010, Weiser–Brown filed the present lawsuit.

Weiser–Brown alleged that St. Paul breached the insurance agreement and brought claims for breach of contract and for bad faith, in violation of Texas Insurance Code § 541.2 As part of its breach-of-contract claim, Weiser–Brown asserted that St. Paul was liable under the Prompt–Payment Statute for 18% interest on any damages awarded. During trial, the parties agreed to submit the Prompt–Payment Statute issue to the court if the jury returned a verdict in favor of Weiser–Brown. At the close of Weiser–Brown's case, St. Paul moved for judgment as a matter of law on Weiser–Brown's § 541 bad-faith claim. The district court granted St. Paul's motion. The jury found that Weiser–Brown had not complied with the contract's conditions, however, the jury also found that St. Paul had waived compliance with those conditions. It further found that St. Paul breached the insurance agreement and awarded Weiser–Brown $2,290,457.03 in damages.

The parties then submitted the prompt-payment issue to the court. The district court concluded that St. Paul violated the Prompt–Payment Statute. The court found that "[b]y November 6, 2009, Weiser–Brown had complied with 'most,' but not all, of the requests for information in Watson's report." The court also held that, despite any omission, "St. Paul and its adjusters did not indicate in the February 8, 2010; March 30, 2010; or April 21, 2010 correspondence that any request for information remained unfulfilled or that determination of coverage was contingent upon receiving such information." Because St. Paul did not accept or reject Weiser–Brown's claim fifteen days later, on November 21, 2009, the district court held that St. Paul was liable to Weiser–Brown for "interest on the amount of the claim at a rate of 18 percent a year" from that date. The court subsequently entered a final judgment ordering St. Paul to pay $1,232,328.14 in interest under the Prompt–Payment Statute.

The court first analyzed the trial court's finding of liability under the Prompt-Payment Statue. The parties did not dispute that St. Paul did not accept or reject Weiser–Brown's claim until after the present lawsuit was filed. The question presented was whether St. Paul received "all items, statements, and forms required by the insurer to secure final proof of loss" such that § 542.056's fifteen-day deadline was triggered, and subsequently violated. See Tex. Ins.Code § 542.056(a). St. Paul argues that the district court "improperly changed the wording in 542.056" and urges the court to look at "the plain meaning of the statute's language." After discussing the lack of guidance and the different methods used by Texas court's on the issue, the court found: "common to all of these decisions is the understanding that the information and documentation "required by the insurer to secure final proof of loss" under § 542.056 will depend on the facts and circumstances involved in a given case." The documents required to prove a loss with respect to a defense claim might differ from the documents required to prove a loss with respect to a roof-damage claim that the insurer has already determined is only partially covered. Turning then to the facts of the present case the court found that as of November 6, 2009 Weiser-Brown had complied with most of the requests for information. The court further found that there had been no "back and forth between the adjuster and the oil company" to sort out a final loss amount because St. Paul concluded, and maintained, based on items of information requested and received, that the event was not covered. The court concluded with the statement that: "the insurer cannot avoid liability under § 542.056 by pointing after-the-fact to missing information, the absence of which did not affect the insurer's decision."

Weiser–Brown cross-appealed claiming that the district court erred in granting St. Paul's motion for judgment as a matter of law on the bad-faith claim under Texas Insurance Code § 541. The court found that, even though the jury ultimately disagreed with St. Paul and found that the well did experience a loss of control, the evidence at trial was insufficient to support a conclusion that coverage was obvious or that St. Paul had no reasonable basis to deny the claim. The court also found that there was no evidence of an "outcome-oriented investigation" because there was no evidence that St. Paul or its adjuster attempted to influence the independent expert's opinion.

Weiser–Brown also appealed the district court's exclusion of evidence of St. Paul's post-litigation conduct and the exclusion of testimony from expert Bill Arnold ("Arnold"). At trial, Weiser–Brown attempted to introduce numerous post-litigation filings to support its bad-faith claim. On appeal, Weiser–Brown limited its focus to St. Paul's unsuccessful summary judgment motion which Weiser–Brown claimed was based on grounds they knew were meritless. The court found that the evidence of post-litigation filings was proper under Fed.R.Evid 403 because it would likely confuse the jury, even if relevant. As to the exclusion of the expert

testimony from Arnold, the curt noted that it shared the trial court's concerns regarding the relevance and reliability of Arnold's testimony. Arnold intended to testify that St. Paul's failure to send a reservation of rights letter violated industry practice and should have informed the insured of a potential coverage issue before retaining an expert. The court found that such an "untestable, conclusory statement" would not assist the jury. The court also noted that Arnold had not worked for an insurer since 1978 and exhibited a lack of knowledge of the Texas Insurance Code during his deposition. Citing the "conclusory nature of his proposed testimony, coupled with his lack of knowledge regarding the Texas Insurance Code and lack of recent experience adjusting insurance claims" the court found no abuse of discretion in the district court's decision to exclude Arnold's testimony.

Concluding the trial court properly determined liability under the Prompt-Payment Statute and did not err in excluding evidence of post-litigation and unreliable expert testimony, the district court was affirmed in all respects.

HOUSTON COURT OF APPEALS AFFIRMS SUMMARY JUDGMENT IN FAVOR OF INSURER BASED ON SURFACE-WATER EXCLUSION

Last week, the Houston First Court of Appeals affirmed a trial court's grant of summary judgment on all claims in favor of Liberty Mutual. The dispute in *Tsai v. Liberty Mut. Ins. Co.*, No. 01-14-00677-CV, 2015 WL 6550769 (Tex. App.—Houston[1st Dist.] Oct. 29, 2015), arose out of a claim for water damage to the wood floors of the insureds home. In March of 2012, the Tsais noticed what they later described as "ridges" on the wood floors in the living room of their home. By August 2012, the damage had spread across the living room, and the wood flooring was separating. The Tsais made a claim with Liberty Mutual under their homeowners' policy regarding the damage to their wood floors. Liberty Mutual began an investigation to determine the source and the cause of the damage.

After eliminating a plumbing leak as the cause of the damage, Liberty Mutual retained an engineer to evaluate the damage and determine the cause and source of the water which had resulted in the flooring damage. The report from the engineering company observed that the wood flooring in the Tsais' living room "displayed an uneven appearance where the edges on the top of the board were higher than the top of the center of the boards, which is commonly referred to as a 'cupped' condition." The Tsais informed the engineer that in 2007 their neighbors to the north "installed a swimming pool, concrete patio areas, and gravel planters in areas of the north neighbors' yard, and a planter with shrubs were installed in the strip of land along the north edge/perimeter of the Tsai residence." The report also stated that the neighbors that moved in around February of 2010 to the north watered their planter significantly. The engineering company ultimately concluded that the cupped appearance in the wood floors was caused by water migration from the planter.

The engineering company prepared a report of its findings, signed by two professional engineers. Both Liberty Mutual and the Tsais agreed with the findings in the report. Based on the findings, Liberty mutual denied the claim. Liberty Mutual's denial letter stated, "Based on the results of the engineer's report, we are unable to assist you with your homeowner's claim. Unfortunately, the policy does not cover damages resulting from surface water entering the home at ground level." Liberty Mutual referred the Tsais to language in the insurance policy that excluded coverage for "water damage," including damage from "surface waters." The Tsais disagreed with Liberty Mutual's denial of coverage based on the water-damage exclusion. The Tsais sued Liberty Mutual and the neighbor, who had installed the planter. The Tsais asserted that Liberty Mutual had breached the insurance contract and had engaged in deceptive trade practices.

Liberty Mutual answered the suit and filed a motion for summary judgment. In the motion, Liberty Mutual argued that it had not breached the insurance contract as a matter of law because the claim was not covered by the policy because the claim fell within the policy's water damage exclusion. Liberty Mutual also claimed it was entitled to summary judgment regarding the extra-contractual claims. The Tsais responded to the motion for summary judgment and also filed their own motion for partial summary judgment. The Tsais asserted that their claim did not fall within the policy's water-damage exclusion. Alternatively, the Tsais asserted that their reasonable interpretation of the exclusionary language should be adopted because the exclusionary language is ambiguous.

The Court identified the language within the water-damage exclusion for damages caused by "surface water" as dispositive in this case. The Court disagreed with the insured's assertion that the damages were not caused by surface water or that the term was ambiguous. The Tsais argued three reasons why the water was not surface water: (1) the water was not "natural precipitation"; (2) the water was not diffused over the surface of the ground; and (3) alternatively, presuming it was surface water, it lost its character as surface when "it was absorbed by the mulch in the flower bed and drained into the Tsais' house." The Court addressed all three arguments in turn and found that the water in this case was surface-water and excluded under the Policy.

Because the damages were not covered under the Policy, and the terms were unambiguous, the Court affirmed the grant of summary judgment in favor of Liberty Mutual and denying the insured's motion. Because the surface-water issues were dispositive, the Court did not address the issue of exclusionary language for water below the ground.

WESTERN DISTRICT JUDGE FINDS ALLEGATIONS AGAINST ADJUSTER SUFFICIENT TO STATE A CLAIM AND GRANTS MOTION TO REMAND

A federal court in Waco recently held that an insured property owner had stated a claim against an insurance adjuster, requiring remand of the case to state court. The claim in *Sai Hotel Grp. Ltd. v. Steadfast Ins. Co.*, No. CIV.A. W-15-CV-263, 2015 WL 6511434 (W.D. Tex. Oct. 27, 2015), arose out of alleged damage to a commercial property from a wind and hailstorm on October 2, 2014. The insured, made a claim to Steadfast Insurance Company, which assigned local adjuster Thomas Gollatz to inspect the property and adjust the claim. Plaintiff alleged that Steadfast subsequently denied the claim relying "exclusively on Mr. Gollatz's substandard investigation."

After Plaintiff sued both Steadfast and the adjuster Gollatz, Steadfast removed the case to federal court, alleging that Leidy improperly joined the adjuster as a non-diverse defendant to defeat federal diversity jurisdiction. Judge Walter Smith noted that since there were no allegations of fraud, the inquiry is limited to whether the state court petition in effect at the time of removal provided a reasonable basis to believe that the plaintiff may recover against the non-diverse defendant under Texas law. Judge Smith noted specifically that the question is only whether or not there is a possibility that the Plaintiff might prevail.

Judge Smith began his analysis with the conclusion that the notice pleading standard under Rule 47 of the Texas Rules of Civil Procedure should be applied. He then referenced the addition of Rule 91a to the Texas Rules of Civil Procedure, which provides a standard for dismissal on the pleadings similar to that found in Rule 12(b)(6) of the Federal Rules of Civil Procedure. However, Judge Smith concluded that the "fair notice" standard of Rule 47 remains in effect and that courts which have analyzed improper joinder since the enactment of Texas Rule 91a have "for the most part" determined that the "fair notice" standard is still applicable.

Based on the conclusion that the broad fair-notice standard applies, and is not modified by Rule 91a, the Court found that Plaintiff's Original Petition "enumerated several instances" in which the adjuster's actions constitute violations of the Texas Insurance Code. The Court did not reference any specific allegations that met the fair-notice standard. Finding that Plaintiff had sufficiently pleaded causes of action against the adjuster under the fair-notice standard, Judge Smith remanded the case to state court.

[Editor's Note: Even though the Court did not specifically enumerate the factual allegations against the adjuster that met the fair-notice standard, it should be noted that the pleadings in this case contained more detail regarding actions taken by the individual adjuster than the generic first-party pleadings that are common in Texas storm litigation.]