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TEXAS INSURANCE LAW NEWSBRIEF

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FEDERAL COURT APPLIES DEEPWATER HORIZON TO GRANT SUMMARY JUDGMENT FOR CARRIER IN AN ADDITIONAL INSURED COVERAGE DISPUTE

Last Wednesday, a south Texas federal court granted summary judgment in favor of a commercial liability insurer in an additional insured coverage dispute. In *Miramar Petroleum, Inc. v. First Liberty Ins. Corp.*, No. V-15-0028, 2015 WL 7301096 (S.D. Tex. Nov. 18, 2015), Miramar hired Nicklos Drilling Company to work on an oil well. The contract required Nicklos to indemnify Miramar for certain types of claims and also to provide insurance to Miramar covering that same set of claims. Nicklos assumed liability for damage to the surface equipment, while Miramar assumed liability for the in-hole equipment. Nicklos bought liability insurance from First Liberty, which included a blanket additional insured endorsement. The endorsement expressly stated it applied only to the extent required by written contract with the additional insured.

The well blew out, and Miramar sued Nicklos and others for damages associated with the blowout. Nicklos filed a counterclaim against Miramar for non-payment for its drilling services as well as the damage to its in-hole equipment. Miramar tendered Nicklos' counterclaims to First Liberty and demanded a defense as an additional insured under the First Liberty policy. First Liberty contended it was not obligated to defend Miramar against a counterclaim by its own named insured.

To answer the question of whether Miramar was entitled to additional insured status under the First Liberty policy for the counterclaims, the district court applied the Texas Supreme Court's opinion from earlier this year in *In re Deepwater Horizon*. *Deepwater Horizon* affirmed that if the insurance policy refers to the contract between the named insured and additional insured to determine the extent of additional insured coverage, then the policy and the contract are "inexorably linked" and the contract controls the scope of coverage provided by the policy.

The court therefore examined the drilling contract and the scope of the indemnity obligations assumed by Nicklos. It found Nicklos only assumed responsibility for three clearly delineated types of claims, and none of them were claims for damage to in-hole equipment or claims for payment for services. Therefore, First Liberty had no obligation to defend Miramar against any of the claims asserted by Nicklos.

This case provides a good example of how courts are applying *Deepwater Horizon* to resolve additional insured coverage disputes. Blanket additional insured endorsements which expressly limit the additional insured coverage to the minimum required by contract are now very common in the industry, and this case is an object lesson in how to parse them. This situation could also have been resolved with less uncertainty by including a Cross Suits endorsement on the policy, which excludes claims brought by any insured against any other insured.

FIFTH CIRCUIT APPLIES FEDERAL COMMON LAW TO PREVENT DOUBLE RECOVERY UNDER WIND AND FLOOD POLICIES

The Fifth Circuit recently applied federal common law to prevent a double recovery under a FEMA-backed flood policy. In *Lowery v. Fidelity Nat'l Property & Cas. Ins. Co.*, --- F.3d ---, 2015 WL 6848323 (5th Cir. Nov. 6, 2015), the insureds, the Pyes, suffered a severe loss to their Galveston duplex home in Hurricane Ike. They filed a claim for damages with their windstorm insurer and their flood insurer, Fidelity. The Pyes ultimately received $66,765.84 from their windstorm insurer for the wind damage, and Fidelity paid them $76,968.23 for flood damage to the structure and $30,367.49 for flood damage to the contents. At that point, the Pyes had received a total payment of approximately $174,000, of which approximately $143,000 was for damage to the structure. The Pyes then sold the property, unrepaired, for $58,000.

The Pyes still wanted more money, and retained an attorney who obtained an adjuster's estimate for the flood damage to the structure in the amount of $175,180. The attorney then submitted a sworn proof of loss claiming the $250,000 flood policy limit. Upon receiving this new claim, Fidelity retained a new adjuster to measure the damage, who returned an estimate of the actual cash value of flood damage at $147,340.01.

The trial court applied the Texas “one satisfaction” rule and held that between the $143,000 they had already been paid for structure damage, and the $58,000 in sale proceeds of the unrepaired property, the Pyes had been paid more than the pre-Ike market value of the property, which was $195,000, and thus were not entitled to any additional payments.

The primary legal question on appeal was whether Texas common-law principles like the “one satisfaction” rule applied to this interpretation of the Standard Flood Insurance Policy (SFIP). The court held, and the parties agreed, that the SFIP is governed by federal common law, applying standard insurance principles, not state law. Ultimately, though, the Fifth Circuit held that regardless of whether it is called the “one satisfaction” or the “double recovery” rule, standard insurance principles prohibit the insured from obtaining a double recovery from two carries for a single loss. This is true even if the two policies cover mutually exclusive risks, such as these wind and flood policies. While the result may be an immediate windfall to one of the insurers, principles of subrogation between carriers mean the windfall will not necessarily serve to enrich the insurer.

APPELLATE COURT FINDS COVERAGE FOR DEFENSE EXPENSES / FACT ISSUES ON INTERRELATED CLAIMS & COVERAGE FOR SETTLEMENT INVOLVING DISGORGEMENT CLAIMS

The Houston Court of Appeals, 14th District, recently addressed an insured's request for defense costs under a directors and officers insurance policy and coverage issues involving interrelated claims and disgorgement claims against the chief financial officer. The court reversed summary judgment in favor of the insurer finding coverage for the defense costs and facts issues related to the interrelated claims and disgorgement issues precluded summary judgment. In *Burks v. XL Specialty Insurance Company*, 2015 WL 6949610 (Tex.App. - Houston [14th Dist.] November 10, 2015), Burks, a chief financial officer, was sued by the plan agent for his bankrupt company seeking in part disgorgement of property received in lieu of future obligations owed to him by the company. XL denied Burks's request under the directors and officers policy for coverage and defense costs. Burks settled the claim against him by the bankruptcy plan's agent and then sued XL for breach of contract and other causes of action. The trial court granted summary judgment in XL's favor and Burks appealed.

The court first addressed XL's argument that the claims against Burks were not "interrelated claims" as defined under the policy and that the "no extrinsic evidence rule" under an eight corners analysis precluded the court from examining the shareholder claims. The court disagreed that the rule applied to a case like this where there was no duty to defend, but a duty to advance defense expenses. After review, the court found a similarity between the shareholder derivative claims and found fact issues made summary judgment on this ground improper. The court also noted that the intentional act and disgorgement exclusion relied on by XL, specifically excepted "Defense Expenses" as defined, from the exclusion. Accordingly, they held even if the disgorgement claims are excluded, summary judgment on defense expenses was improper.

Lastly, the court examined Burks's claim for indemnity for the settlement and assertion that fact issues of whether the settlement represented a disgorgement preclude summary judgment on that basis. The court noted that the settlement agreement was not part of the record, that the plan agent sought more than mere disgorgement(e.g. "money judgment" and "attorney's fees"), and the stipulation of dismissal contained no admission of wrongdoing. The court observed that the policy defines "Loss" to include settlements and no Texas court has held that disgorgement is uninsurable as a matter of law. Accordingly, the court held that issues of material fact precluded summary judgment in favor of XL and they reversed the trail court's judgment in XL's favor and remanded the breach of contract claims to the trial court for further proceedings.

COURT HOLDS NO DUTY TO DEFEND EMPLOYER BASED ON DEFINITION OF “EMPLOYEE” FOUND IN FEDERAL MOTOR CARRIER SAFETY ACT OF 1984.

In *Scottsdale Indem. Co. v. Rural Trash Service, Inc.*, 2015 WL 6736529 (S.D. Tex. November 3, 2015), the district court examined Scottsdale’s motion for summary judgement on a duty to defend and duty to indemnify its insured, Rural Trash Service, Inc. in a tort suit brought by Joseph Rios for injuries he sustained as a garbage truck driver for Rural. While emptying a dumpster a fire erupted. Rios left his truck to seek help, although other employees told him to get back in the truck. Rios was severely burned when the fire triggered an explosion. Rural was covered by a commercial auto insurance policy with Scottsdale. Scottsdale accepted Rural’s defense under a reservation of rights, and then filed this declaratory judgment action.

The primary issue in Scottsdale’s motion for summary judgment concerned the policy’s bodily injury exclusion for an “employee” arising out of and in the course and scope of his employment. The Court recognized that an insurer bears a heavy burden of establishing the application of an exclusion. The Court further noted that the underlying suit’s petition did not indicate if Rios was an “employee” or “independent contractor.” And, the Court reviewed the policy and found there was no definition of “employee.” However, Form F of the Policy incorporates the Texas state motor carrier regulations into the Policy. Those regulations, in turn, incorporate the definition of “employee” in the Federal Motor Carrier Safety Act of 1984 (FMCSR.) Since FMCSR defines “employee” to include both employees and independent contractors, the Court concluded Rios’ claims were excluded from the Policy. Accordingly, summary judgment was granted in favor of Scottsdale.

INSURER SUCCESSFULLY INVOKES APPRAISAL CLAUSE LATE IN THE LAWSUIT

The Amarillo Court of Appeals construed an insurer's demand to invoke the appraisal clause in its commercial property insurance policy with its insured after the parties had conducted discovery, designated experts and unsuccessfully mediated the matter. *In Re Century Surety Co.*, 2015 WL 6689532 (Tex.App.-Amarillo November 2, 2015.) the insured rejected Century Surety's May 1, 2015 demand for appraisal. Century then tendered a written offer to settle the insured's claims on June 18 which was also rejected. Century then moved to compel appraisal and to sever and abate the extra-contractual claims. The insured argued that Century waived its right to appraisal. The trial court denied Surety's motions on August 10 and September 15, 2015. Trial was set for December 14, 2015, with a discovery cutoff of November 13.

The Court of Appeals recognized that waiver of a right to appraisal requires an intentional relinquishment of a known right or intentional conduct inconsistent with claiming the right. To establish "waiver," the party challenging appraisal must show the parties reached an "impasse" and that the failure to demand appraisal within a reasonable time prejudiced the opposing party. Since the insured failed to make a showing of "prejudice," the Court of Appeals found the trial court abused its discretion by failing to compel appraisal without deciding if the parties had reached an impasse. Additionally, because the insured alleged claims of breach of contract and extra-contractual claims, the trial court was held to have abused its discretion in not severing and abating the extra-contractual claims because Century had offered to settle the claims.

TWO DALLAS FEDERAL DISTRICT COURTS FIND FRAUDULENT JOINDER – DENY MOTIONS TO REMAND COVERAGE CASES TO STATE COURT.

In *Thomas v. State Farm Lloyds*, 2015 WL 6751130 (N.D. Tex. November 4, 2015) (Judge Boyle), Thomas sued State Farm Lloyds and the insurance adjuster in state court for allegedly mishandling their insurance claim under a Texas Dwelling Insurance Policy. The claim arose out of an incident with the Thomas' plumbing system that damaged their property, including the foundation and interior and exterior structures. The Plaintiffs alleged claims against the insurance adjuster of violations of chapter 541 of the Texas Insurance Code, fraud and conspiracy to commit fraud. State Farm removed the case to federal district court on the basis of diversity of citizenship, asserting that the adjuster was fraudulently joined. Plaintiffs moved to remand. The Court denied Plaintiffs' motion to remand for the following reasons:

The Court noted that in March 2013, the Texas Supreme Court adopted Tex.R.Civ.P 91a. This rule allows for Rule 12(b)(6) type analyses for the dismissal of state court cases with no basis in law or fact. The Court recognized it as changing the pleading standard from "fair notice" to "enough facts to state a claim for relief that is plausible on its face." The Court then construed the Plaintiffs' allegations against the adjuster under this new standard to determine if the adjuster had been fraudulently joined to defeat diversity jurisdiction.

The Court held there was no reasonable factual basis for holding that a claim had been alleged against the adjuster under Texas Insurance Code Section 541.060(a)(1). This section prohibits "misrepresenting to a claimant a material fact or policy provision relating to coverage at issue." The Court held the following allegations do not constitute a misrepresentation of the policy itself, so they are not actionable under this Section: failing to conduct a reasonable investigation, understating the amount of damage to Plaintiff's property, using her own statements as a basis for denying or underpaying the claim, failing to provide an adequate explanation for the claim denial, and misrepresenting that the damage was not covered.

The Court held that Texas Insurance Code Section 541.060(a)(2)(A) did not apply to the claims against the adjuster because this section forbids, "failing to attempt in good faith to effectuate a prompt, fair, and equitable settlement of … a claim with respect to which the insurer's liability has become reasonably clear." The Court recognized this Section only applies to conduct preceding the settlement of a claim. However, in this case, the only allegations against the adjuster were for "not adequately explaining the reasons for denying or underpaying Plaintiffs' claim" which is conduct after the claim decision.

The Court held the adjuster could not be liable under Texas Insurance Code Section 541.060(a)(3) and 541.060(a)(4) because an insurance adjuster does not have the responsibility nor authority to comply with them. Section 541.060(a)(3) punishes the failure to promptly provide a reasonable basis in the policy for denial of a claim. Section 541.060(a)(4) prohibits failing to affirm or deny coverage of a claim within reasonable time, or submit a reservation of rights to the policyholder.

The Court held the adjuster could not be liable under Texas Insurance Code Section 541.060(a)(7) which prohibits refusing to "pay a claim" without conducting a reasonable investigation. Plaintiffs alleged the adjuster performed an outcome-oriented investigation which resulted in a biased, unfair and inequitable evaluation of the loss. Also, the adjuster allegedly "did not properly inspect the [p]roperty and failed to account for and/or undervalued many of Plaintiffs' exterior and interior damages, although reported to [State Farm.]" The Court reasoned that these allegations against the adjuster were actually for a failure to investigate, rather than for a failure to pay.

Finally, the Court rejected the allegations against the adjuster of fraud and conspiracy to commit fraud because Federal Rule of Civil Procedure 9(b) requires fraud to be "state[d] with particularity" and "the circumstances constituting fraud." The Court noted the Plaintiffs' allegations were conclusory, and they did not allege they relied on any misrepresentations of the adjuster.

Conversely, in *Fernandez v. Allstate Fire and Cas. Ins. Co.*, 2015 WL 6736675 (N.D. Tex. November 4, 2015)(Judge Fitzwater), the Court examined a motion to remand a residential wind/hail case against Allstate wherein the remand focus was on claims against an insurance sales agent who was a Texas citizen. The Court recognized that improper joinder is shown by either actual fraud in pleading jurisdictional facts or plaintiff is unable to establish a cause of action against the non-diverse party. The Court used a 12(b)(6) type analysis to reject the motion to remand.

The Court reasoned that even though both an out of state adjuster and an in state sales agent were joined in the allegations against the carrier, Allstate, the only allegations that can reasonably be inferred to apply to the sales agent were those of misrepresentations regarding the coverage the Policy provided. However, the Plaintiff lumped together all the Defendants in "undifferentiated averments." This "does not satisfy the requirement to state specific actionable conduct against the non-diverse defendant." The Court further noted the Plaintiff could not rely on the conclusory allegations that merely track the statutory language.

The Court also specifically addressed the Texas Insurance Code Section 541.060(a)(1) claims against the sales agent. Plaintiff contended the sales agent represented "that the Policy included hail and windstorm coverage for damage to Plaintiff's house." The Court noted that the representation was undoubtedly true since the Policy did cover physical loss caused by windstorm or hail. Thus, those specific factual allegations could not support a violation of that Section.

Thus, as a result of the Plaintiff's failure to make "sufficient allegations for the court to reasonably predict that she might be able to recover against [the sales agent] on any of her claims…" the Court ruled the agent was improperly joined. The motion to remand was denied.

[**Editor's Note**: these two cases show that removal and remand issues in the federal courts of Texas differ drastically in their treatment from case to case and even from judge to judge. The perceptions of the nature of the allegations in a plaintiff's pleadings frequently differ drastically from judge to judge even in the same Division.]

NEWSBRIEF TO RESUME DECEMBER 7th

The Texas Insurance Newsbrief will resume our publication the week of December 7th. We wish all of our readers in the U.S. a wonderful Thanksgiving holiday. MDJW will be closed on Friday, November 27th, and our Newsbrief staff will resume writing after the holiday weekend.