

TEXAS INSURANCE LAW NEWSBRIEF

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SAN ANTONIO FEDERAL COURT DISMISSES EXTRA-CONTRACTUAL CLAIMS,
RECOGNIZES STOWERS AS SOLE REMEDY UNDER LIABILITY POLICY

Last Friday, a federal district court in San Antonio dismissed via Rule 12(b)(6) motion all extra-contractual claims asserted under a third-party liability insurance policy, enforcing established Texas law holding that a liability insurer's extra-contractual duties to its insured (and, by extension, a judgment creditor) are limited to the *Stowers* duty to reasonably respond to a settlement proposal within policy limits. In *Travelers Lloyds Ins. Co. v. Cruz Contracting*, No. 5:16-CV-759-DAE (W. D. Tex. March 17, 2017), a liability carrier filed a declaratory judgment action to determine coverage for a judgment against its insured. Both the insured and the judgment creditor responded by filing a litany of counterclaims for causes of action only legally recognized under first-party policies, including common-law bad faith, violations of Insurance Code Chapter 541 and 542, and associated DTPA violations. The carrier filed a 12(b)(6) motion seeking dismissal of all the extra-contractual claims.

On dual motions for dispositive relief, the district court rejected several unusual arguments, including the judgment holder's assertion that it was an intended third-party beneficiary of the policy and therefore had automatic legal access to all rights of the insured. The court noted that opinions of the Supreme Court of Texas highlight the concern that allowing third-parties to sue insurance carriers for causes of action that arise out of the first-party relationship between insured and insurer would create serious conflicts of interest, and concluded that merely holding a judgment did not negate existing supreme court precedent limiting the causes of action at issue to the first-party context. The court also concluded that controlling Texas law limits the insured's own extra-contractual remedy under a liability policy to *Stowers*, so even if the judgment holder had an assignment of rights, it would be still be limited to *Stowers*, and no party had asserted a facially plausible *Stowers* claim.

[**Editor's note:** Amber Dunten and Chris Martin of MDJW's Houston office had the privilege to represent Travelers in the district court. We want to congratulate Travelers on their win and express our firm's appreciation for the opportunity to protect its interests in this important litigation.]

FIFTH CIRCUIT HOLDS THAT BILLING GUIDELINES DID NOT PROVIDE
REASONABLE BASIS FOR INSURER TO DEDUCT CLAIMED LEGAL EXPENSES
INCURRED BY ITS INSURED

Last week, the Fifth Circuit Court of Appeals held an insurer arbitrarily relied on billing guidelines to deduct costs of defending its insured against professional liability claims and allowed the insured's breach of contract claims to proceed. *Aldous v. Darwin National Assurance Company*, 2017 WL 1032616 (Fifth Cir. 2017) traces its roots back to insured attorney Charla Aldous's successful handling of litigation between two trusts, eventually winning a judgment worth over \$100 million for her client Albert Hill. Alas, Mr. Hill decided that he preferred to keep the spoils to himself instead of paying Aldous a hefty contingency fee. A chain reaction of additional litigation then began when Aldous and two other attorneys who had assisted on Hill's case sued him to recover the fee. In response, Hill brought counterclaims for malpractice and breach of fiduciary duties against his erstwhile attorneys. Hill's claims triggered coverage under Aldous's professional liability insurance policy with Darwin National. Aldous and her long-suffering colleagues eventually prevailed against Hill, and a court awarded them \$21,942,961 in attorney's fees as well as \$2,586,560 worth of costs of defending against Hill's professional liability counterclaims. A dispute then arose between Aldous and her insurer over whether it had adequately paid the costs of her defense against Hill. Having not yet grown weary of litigation, Aldous sued her insurer for breach of contract. Based on declarations filed by her defense attorney in the previous suit, Darwin argued that she was prevented from recovering more than one-third of \$668,068.38 in defense costs. The District Court for the Northern District of Texas granted summary judgment in favor of the insurer, reasoning that Aldous was judicially estopped from recovering more than \$222,689.46 (one-third of \$668,068.38) and that Darwin had committed no breach of contract.

On appeal, the Fifth Circuit analyzed declarations filed by Aldous's defense attorney in the underlying suit and policy language to determine whether Darwin had properly paid attorney's fees. With respect to judicial estoppel, the Fifth Circuit noted the doctrine prevents parties from asserting a position contrary to one asserted in a prior suit in order to gain an unfair advantage. Here, in the prior suit, Aldous's attorney filed two declarations asserting the total amount of his fees was in fact over \$2 million. Noting that Aldous had never taken the position that she was entitled to only a one-third share of \$668,068.38 in that case, the Fifth Circuit held that she was not judicially estopped from recovering the full costs of her defense and reversed the district court's grant of summary judgment in favor of Darwin on that issue.

The Court then switched gears to analyze whether summary judgment in favor of Darwin on Aldous's breach of contract claim had been proper. On appeal, Aldous argued that Darwin had arbitrarily deducted fees and otherwise failed to fully pay her costs of defense. Darwin argued that the district court's decision should stand because its policy obligated it to pay only reasonable expenses and noted that "[t]he determination by the insurer as to the reasonableness of Claim Expenses shall be conclusive on all Insureds." Darwin argued that its reliance on its internal Billing Guidelines to categorically exclude certain legal expenses was functionally equivalent to a binding determination on the reasonableness of those expenses. On the contrary, Aldous argued that

Darwin never made a binding reasonableness determination and allowing Darwin to prevail without having done so would render the insurer's duty to defend illusory. The Fifth Circuit agreed with Aldous and held that Darwin had arbitrarily "slashed claimed costs" by relying on an extra-contractual document—its billing guidelines. As additional factual support for its ruling, the Fifth Circuit relied on correspondence between the insurance adjusters showing that Darwin's own adjuster thought the deductions from Aldous's legal bills were excessive. Thus, the justices reversed the district court's grant of summary judgment in favor of Darwin and allowed Aldous's breach of contract claims to proceed in the district court.