Martin, Disiere, Jefferson & Wisdom

The Weekly Update of Texas Insurance News

TEXAS INSURANCE LAW NEWSBRIEF

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FIFTH CIRCUIT HOLDS SETTLEMENT PROCEEDS FROM SUBCONTRACTORS TO GENERAL CONTRACTOR CONSTITUTE "OTHER INSURANCE"

Last week, the Fifth Circuit Court of Appeals held that settlement proceeds resulting from indemnity agreements between a general construction contractor and its subcontractors constituted "Other Insurance." In *Satterfield and Pontikes Const. Inc.*, No. 17-20513, 2018 WL 3671370 (5th Cir., August 02, 2018, mem. op.), Satterfield and Pontikes Construction, Inc. ("S&P") was hired as a general construction contractor for a courthouse building project by Zapata County, Texas. S&P, in turn, hired numerous subcontractors. The project went poorly. Consequently, an arbitration panel found that S&P failed to build the courthouse in a good and workmanlike manner, and awarded Zapata County millions of dollars for mold remediation, dome construction, roof replacement, fireproofing, other repairs, attorney's fees, prejudgment interest, and arbitration fees.

S&P subsequently entered into settlement agreements with its subcontractors, but the settlement proceeds did not cover the total arbitration award and the settlement agreements did not allocate the proceeds to the damages they covered. Due to the shortfall, S&P turned to its insurance provider, United States Fire Insurance Company ("U.S. Fire"), to pay the balance of the arbitration award. U.S. Fire, however, contended there was no shortfall for it to pay and denied S&P's claim. According to U.S. Fire, there was no shortfall because damages for mold remediation, attorney's fees, prejudgment interest, and arbitration fees were not covered under its policy, and considering the amount of those damages removed, the subcontractor settlement proceeds (i.e. "Other Insurance" according to U.S. Fire) was greater than the amount of potentially covered damages under its policy. In response, S&P sued U.S. Fire.

"Other Insurance" was defined in the policy as "any type of Self-Insurance or <u>other mechanism by which an Insured arranges for funding of legal liability for which this policy also provides coverage.</u>"

On appeal, S&P contended that the subcontractor settlements were not "Other Insurance" and, thus, U.S. Fire was not entitled to use the settlement proceeds to offset amounts covered by its policy. More specifically, S&P contended that the subcontractor indemnity contracts were, by their nature, intended to "shore up leaks or gaps in insurance coverage" (i.e. to cover legal liabilities for which U.S. Fire's policy did not provide coverage). The court disagreed. The Court held that "settlement proceeds resulting from an indemnity agreement count as 'Other Insurance.'" The Court further held that the indemnity agreements "fell under the plain language of the 'Other Insurance' provision." The court reasoned that the provision was broad and the indemnity agreements were a "mechanism by which an Insured arranges for funding of legal liabilities . . . ."

In a second issue on appeal, S&P contended that it had the right to allocate the subcontractor settlement proceeds to the damages not covered by U.S. Fire's policy. S&P additionally contended that U.S. Fire had the burden to show which amounts of the subcontractor settlements were allocated for covered damages versus uncovered damages under U.S. Fire's policy. The court again disagreed. The court held that S&P had the burden of proof to show it properly allocated its settlement proceeds between covered and noncovered damages, and if S&P could not meet its burden, it is assumed that all of the settlement proceeds went first to satisfy the covered damages under U.S. Fire's policy. The court reasoned that S&P was in a better position to allocate the settlement proceeds and "U.S. Fire did not have the power to structure the settlements to attribute the proceeds to one kind of damages or another."

U.S. DISTRICT COURT AGAIN REJECTS ARGUMENT THAT INDEPENDENT ADJUSTERS CANNOT BE HELD LIABLE UNDER SECTION 541 OF THE TEXAS INSURANCE CODE

On July 24, 2018, the Unites States District Court for the Northern District of Texas again rejected an independent adjuster's argument that he cannot be held liable under section 541 of the Texas Insurance Code by virtue of his status as an independent adjuster. In *Recovery Resource Counsel v. ACE American Ins. Co.*, No. 3:17-CV-2787-N, 2018 WL 3548912, (N.D. Tex. [Dallas Division] July 24, 2018, mem. op.), the insured reported hail damage to its insurer, ACE American Insurance Company ("ACE"). ACE hired Kirn, an independent insurance adjuster, to investigate the claim. In turn, Kirn hired an inspection company to determine if the property sustained hail damage. The inspection company reported that the property did not sustain hail damage, and ACE denied the claim. The insured subsequently filed suit alleging that ACE and Kirn violated Texas Insurance Code Sections 541.060 and 541.061. In response, Kirn filed a motion to dismiss, contending that independent insurance adjusters cannot be held liable under the Insurance Code. The court swiftly rejected this argument, relying on Northern and Southern District Court precedent that "adjusters who are direct employees of the insurer as well as independent adjusters hired by the insurer can be liable under section 541."