

THOUGHT LEADERSHIP

News

SUPREME COURT REVISITS GANDY, “FULLY ADVERSARIAL TRIAL” REQUIREMENTS

Newsbrief

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In an important recent decision, the Supreme Court of Texas re-examined the scope of *State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696 (Tex. 1996), and its “fully adversarial trial” requirement in determining the binding effect of a judgment against a liability insurer in an action by the insured’s assignee. In *Great American Lloyds Ins. Co. v. Hamel*, — S.W.3d —, No. 14-1007 (June 16, 2017) (slip op.), the carrier refused to defend a builder against a homeowner’s construction defect suit involving EIFS damage. The carrier later conceded that its refusal to defend the builder had been made in error.

Having no funds to defend the suit and no significant assets, the builder did little to defend itself and entered into a pretrial agreement under which the builder’s owner would appear at trial, and the homeowner would not attempt to enforce any judgment against his personal assets or tools of his trade (he later admitted the company had no other assets). The builder made damaging pretrial stipulations admitting liability. After a bench trial, the trial court rendered a large judgment against the builder based on the homeowner’s findings of fact. The builder then assigned its claims against the carrier to the homeowner, who sued the carrier to recover the judgment. In the resulting insurance litigation, both the trial court and the court of appeals concluded the underlying judgment was binding on the carrier, despite the carrier’s arguments that it violated *Gandy*.

The Texas Supreme Court first noted that this case did not fall within the classic *Gandy* parameters because unlike *Gandy*, the assignment of the builders’ claims was made after the trial, the carrier had breached its duty to defend, and the carrier had neither accepted coverage nor made a good faith attempt to adjudicate coverage before the trial of the underlying suit. Therefore, there was no doubt that the assignment of claims from the builder to the homeowner was valid. Rather, the crux of the suit was *Gandy*’s pronouncement that **“in no event... is a judgment for plaintiff against defendant, rendered without a fully adversarial trial, binding on defendant’s insurer or admissible as evidence of damages in an action against defendant’s insurer by plaintiff as defendant’s assignee.”** *Gandy* at 714. The court observed that by imposing the fully adversarial trial requirement, it “shifted focus toward whether the underlying judgment accurately reflects the plaintiff’s damages and thus the insured’s covered loss.”

In attempting to answer the question of whether a given trial was “fully adversarial,” the court noted the inherent difficulty of critiquing trial strategy after the fact, and declared a focus on the trial details to be “misplaced.” The court clarified that **“the controlling factor is whether, at the time of the underlying trial or settlement, the insured**

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bore an actual risk of liability for the damages awarded or agreed upon, or had some other meaningful incentive to ensure that the judgment or settlement accurately reflects the plaintiff’s damages and thus the defendant-insured’s covered liability loss.” The court went on to rephrase it for the hard of hearing: “**Stated another way, proceedings lose their adversarial nature when, by agreement, one party has no stake in the outcome and thus no meaningful incentive to defend itself.**” Here, the parties’ pretrial agreement eliminated any meaningful incentive the builder had to contest the judgment, and the declared the resulting judgment not binding on the carrier.

The court then went on to hold that “**while we will not hold an insurer to a judgment that was not the result of an adversarial proceeding, we will not preclude the parties from properly litigating the underlying liability issues in a subsequent coverage suit.**” Naturally, the parties to this case had considered the underlying liability to be largely a closed issue and had not fully litigated it in the coverage suit. Therefore, the court remanded for a new trial to fully explore the liability issues – in essence, a re-trial of the underlying suit, with the carrier filling the role of the fully adverse defendant.

Editor’s Note: A major lesson of this case is that a claimant cannot stick the insurer with a large judgment by making a “sweetheart” deal with the defendant-insured, even if all the *Gandy* red flags are carefully avoided. The claimant will have to truly prove its damages in a fully adversarial trial in which the defendant has a genuine stake, but that trial may be either against the insured, or, ultimately, the carrier itself. Re-litigating liability issues years after the fact comes with its own set of disadvantages, including fading memories, lost evidence, and dead or disappeared parties and witnesses, and they can cut both ways. Therefore, it is in the interest of all parties to try liability once and get a reliable answer the first time.