

12 INSURANCE POLICY CONSTRUCTION AND DEFENSES

- A. **Texas Rules of Policy Interpretation.** Insurance contracts are generally subject to the same rules of construction as ordinary contracts.²³⁹ When construing a written contract, a court is primarily concerned with ascertaining the true intent of the parties as expressed in the contract.²⁴⁰ Contracts are considered as a whole with each clause being used to help interpret the others.²⁴¹ With respect to an insurance policy, the plain, ordinary, and generally accepted meaning of words is preferred unless the policy itself shows the terms have been used in a technical or different sense.²⁴² When a policy permits only one interpretation, Texas courts are to construe it as a matter of law and enforce it as written.²⁴³ When terms or clauses within an insurance contract are capable of more than one reasonable interpretation, the contract may be ambiguous.²⁴⁴ But an ambiguity does not arise with respect to a policy merely because the parties advance conflicting interpretations.²⁴⁵ If an insurance contract is ambiguous, courts apply the “**contra-insurer**” rule by adopting the interpretation that favors coverage for the insured, and against the insurance company.²⁴⁶ Whether a contract is ambiguous is a question of law for a court to decide by looking at the contract as a whole in light of the circumstances present when the contract was entered.²⁴⁷ As with any contract, absent a finding of ambiguity, a court must interpret the meaning and intent of an insurance policy from the four corners of the policy without the aid of extrinsic evidence.²⁴⁸ An insurance company’s intent to exclude coverage within an insurance contract must be expressed in clear and unambiguous policy language.²⁴⁹
- 1) **Separation of Insureds Clause.** If the policy contains separation of insureds clause, it requires the insurer to determine the coverage of

²³⁹ *Kelley-Coppedge, Inc. v. Highlands Ins. Co.*, 980 S.W.2d 462, 464 (Tex.1998); *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 823 (Tex. 1997); *State Farm Life Ins. Co. v. Beaston*, 907 S.W.2d 430, 433 (Tex.1995).

²⁴⁰ *National Union Fire Ins. Co. v. CBI Indus., Inc.*, 907 S.W.2d 517, 520 (Tex.1995).

²⁴¹ *Meza Operating Co. v. California Union Ins. Co.*, 986 S.W.2d 749, 753 (Tex. App.–Dallas, 1999, writ denied); *Western Indem. Ins. Co. v. American Physicians Ins. Exch.*, 950 S.W.2d at 185, 188 (Tex.App.–Austin 1997, no writ).

²⁴² *Ramsay v. Maryland Am. Gen. Ins. Co.*, 533 S.W.2d 344, 346 (Tex. 1976).

²⁴³ *Upshaw v. Trinity Cos.*, 842 S.W.2d 631, 633 (Tex. 1992); *Hanson v. Republic Ins. Co.*, 5 S.W.3d 324, 327 (Tex. App.–Houston [1st Dist.] 1999, writ denied).

²⁴⁴ *Grain Dealers Mut. Ins. Co. v. McKee*, 943 S.W.2d 455, 458 (Tex. 1997). And the fact that one or more judges, including a retired United States Supreme Court justice, who looks at a particular clause in the policy and thinks it is capable of more than one reasonable interpretation apparently is not evidence of itself that the language is capable of more than one reasonable interpretation. See *Certain Underwriters at Lloyds, London v. Law*, 570 F.3d 574, 583-584 (5th Cir. 2009).

²⁴⁵ *Id.*

²⁴⁶ *Id.* at 458; *Hartrick v. Great American Lloyds Ins. Co.*, 62 S.W.3d 270, 274 (Tex. App.– Houston [1st Dist.] 2001, no pet.).

²⁴⁷ *Kelley-Coppedge*, 980 S.W.2d at 464.

²⁴⁸ *Westchester Fire Ins. Co. v. Stewart & Stevenson Services, Inc.*, 31 S.W.3d 654, 658 (Tex. App. -- Houston [1st Dist.] 2000, pet. denied).

²⁴⁹ *State Farm Fire & Cas. Co. v. Weed*, 873 S.W.2d 698, 699 (Tex. 1993).

each insured separately from that particular insured's perspective.²⁵⁰ Accordingly, care should be taken when deciding coverage issues as to third-party claims against multiple insureds under the same policy, as each insured's coverage issues may need to be considered separately.

B. Coverage Trigger - Texas Applies Actual Injury Rule

- 1) For CGL policies, property damage occurs when actual physical damage to the subject property occurred, not when the damage was or could have been discovered.²⁵¹ The key date is when injury happens, not when someone happens upon the injury; the focus should be on "when damage comes to pass, not when damage comes to light."²⁵²

C. Policy Defenses and Exclusions

- 1) **Misrepresentation in Policy Application.** The Texas Insurance Code provides that any insurance policy provision that makes the policy void or voidable if false statements are made in the policy application have no effect and are no defense in a lawsuit on the policy, unless at trial it is shown that the matter misrepresented was: 1) material to the risk, or 2) contributed to the contingency or event on which the policy became due and payable.²⁵³
 - a. It is a question of fact as to whether a misrepresentation made in the application for the policy or in the policy itself was material to the risk or contributed to the contingency or event on which the policy became due and payable.²⁵⁴
 - b. A defendant may only use the misrepresentation in application defense if the defendant shows at trial that before the 91st day after the date the defendant discovered the falsity of the representation, the defendant gave notice to the insured or beneficiaries that the defendant refused to be bound by the policy.²⁵⁵
- 2) **Lack of Notice.** Notice requirements are standard provisions in insurance contracts. A notice provision typically comes into play when the insured fails to timely notify the carrier of some event, and then seeks coverage for that event. The purpose of a notice requirement

²⁵⁰ *King v. Dallas Fire Ins. Co.*, 85 S.W.3d 185 (Tex. 2002).

²⁵¹ *Don's Building Supply, Inc. v. OneBeacon Insurance Co.*, 267 S.W.3d 20,25-26 (Tex. 2009); *Pine Oak Builders, Inc. v. Great American Lloyds Ins. Co.*, 279 S.W.3d 650, 653 (Tex. 2009).

²⁵² *Id.*

²⁵³ TEX. INS. CODE ANN. § 705.004 (formerly TEX. INS. CODE ANN. art. 21.16).

²⁵⁴ *Id.*

²⁵⁵ TEX. INS. CODE ANN. § 705.005 (formerly TEX. INS. CODE ANN. art. 21.17).

is to enable the insurer to investigate the circumstances of an accident while the matter is fresh in the minds of the witnesses so that it may adequately prepare to adjust or defend any claims that may be then or thereafter be asserted against persons covered by its policy.²⁵⁶ Historically, the failure to give timely notice is a breach of the insurance contract and can relieve an insurer of its obligations under the insurance contract.²⁵⁷ But with respect to certain policies, an added requirement was made by the Texas Department of Insurance which required a showing carrier prejudice before the carrier could rely on a lack of notice as a full defense to void coverage *with respect to bodily injury and property damage liability*. The prejudice requirement was added pursuant to an order issued by The Texas Department of Insurance, which required mandatory endorsements be placed in general liability and automobile insurance policies stating that "unless the company is prejudiced by the insured's failure to comply with the requirement, any provision of this policy requiring the insured to give notice of ... occurrence or loss ... shall not bar liability under this policy".²⁵⁸ In 2008, The Texas Supreme Court issued two opinions in this area that give further clarification as to the facts needed for insurers to use this as a complete defense to coverage.

- a. **Late Notice.** In *Paj, Inc. v. The Hanover Ins. Co.* the Court considered whether the insured's failure to timely notify its insurer of a claim defeated coverage under the policy where the insurer was not prejudiced.²⁵⁹ In this coverage case between PAJ and its insurance carrier, The Hanover, the parties stipulated that PAJ did not notify the insurer as soon as practicable as was required under the policy, and also that the insurer was not prejudiced by the untimely notice.²⁶⁰ Many cases discussing these issues have analyzed these issues in terms of whether the notice provision was a covenant or a condition precedent; such that if it was a condition precedent there would be no coverage if there wasn't first compliance with the condition. The Court held that it was unnecessary to determine whether a notice provision is a condition precedent or a covenant.²⁶¹ Rather, the Court noted the general national trend to require insurers to show prejudice before coverage can be avoided when the insured gives late notice.²⁶² The Texas Court followed this trend and held that the insurer has

²⁵⁶ *Employers Cas. Co. v. Glens Falls Ins. Co.*, 484 S.W.2d 570, 575 (Tex.1972); *Bay Elec. Supply, Inc. v. Travelers Lloyds Ins. Co.*, 61 F. Supp.2d 611, 619 (S.D.Tex.1999).

²⁵⁷ *Assicurazioni Generali Spa v. Pipe Line Valve Specialties Co.*, 935 F.Supp. 879, 887 (S.D.Tex.1996).

²⁵⁸ *Hanson Production Co. v. American Insurance Co.*, 108 F.3d 627, 629 (5th Cir.1997) (quoting Texas State Board of Insurance, Order No. 23080).

²⁵⁹ *Paj, Inc. v. The Hanover Ins. Co.*, 243 S.W.3d 630, 631 (Tex. 2008).

²⁶⁰ *Id.*

²⁶¹ *Id.* at 635.

²⁶² *Id.* at 634; *Ridgley Estate Condominium Assoc. v. Lexington Ins. Co.*, 415 F.3d 474, (5th Cir. 2005).

to show prejudice before it can avoid coverage when the insured gives late notice.²⁶³ Since the parties stipulated to no carrier prejudice, the insured's late notice in this case was not a defense to coverage.

- b. **UM/UIM policies.** In the *PAJ* opinion discussed above, the Court relied on a prior decision involving an insured's breach of the settlement-without-consent provision in an underinsured motorist claim.²⁶⁴ In that UIM case, the Court reaffirmed the rule that when one party commits a material breach, the other party's performance is excused. But the Court found in that case that the breach of this specific provision was immaterial and thus the insurer could not avoid liability under the policy without a showing of prejudice.²⁶⁵
- c. **No Notice.** In *National Union v. Crocker*, the Texas Supreme Court was asked to consider whether an insurer's actual notice that an insured has been served with process precludes the insurer from later claiming it was prejudiced from the insured's failure to notify the insurer of the process and request a defense.²⁶⁶ In this case, National Union had notice that an additional insured under its policy had been sued and served with process. The additional insured was apparently not aware of the coverage afforded him under the National Union policy and never requested a defense from National Union, nor did National Union inform the additional insured of the coverage.²⁶⁷ After a default judgment was taken against the additional insured, the plaintiff sued National Union for coverage as a third-party beneficiary of the policy.²⁶⁸ National Union argued that because the additional insured never provided the required notice, he never triggered the duty to defend, and therefore, there was no coverage.²⁶⁹ The Texas Supreme Court agreed. Notice and delivery of suit papers provisions serve two important purposes: (1) they facilitate a timely and effective defense of the claim against the insured and (2) they trigger the insurer's duty to defend by notifying the insurer that a defense is expected.²⁷⁰ An insurer's mere awareness of the claim or suit does not impose a duty on the insurer to defend

²⁶³ *Id.* at 635.

²⁶⁴ *Id.* (citing *Hernandez v. Gulf Group Lloyds*, 875 S.W.2d 691 (Tex. 1994)).

²⁶⁵ *Hernandez v. Gulf Group Lloyds*, 875 S.W.2d 691, 694 (Tex. 1994).

²⁶⁶ *Nat'l Union Fire Ins. Co. of Pittsburgh, P.A. v. Crocker*, 246 S.W.3d 603, 604 (Tex. 2008).

²⁶⁷ *Id.* at 604-605.

²⁶⁸ *Id.* at 605.

²⁶⁹ *Id.*

²⁷⁰ *Id.* at 608; *see also Maryland Cas. Co. v. Amer. Home Assur. Co.*, 277 S.W.3d 107, 114 (Tex. App. – Houston [1st Dist.]2009, **pet. filed**).

the insured.²⁷¹ The Court found that the default judgment prejudiced National Union, and that there was no coverage.²⁷²

- d. **Prejudice also required in Claims Made policies.** With claims made policies there is always a requirement in the contract that the claim be reported within some specified reporting period. Frequently, there is an additional requirement that the claim also be reported to the carrier “as soon as practicable.” With a claims made policy, Carriers are well within their right to deny coverage for claims that are not reported within the specified reporting period, because if there is no timely notice, there is no coverage.²⁷³ In cases where the claim was reported within the specified policy reporting period, but there is a dispute as to whether the claim was reported “as soon as practicable” in order for a carrier to deny coverage the carrier must show that the failure of the insured to give notice “as soon as practicable” caused prejudice to the insurer.²⁷⁴ The same rule applies when the policy only requires that the claim be reported “as soon as practicable.”²⁷⁵
- e. **Showing of Prejudice.** Prejudice can be shown as a matter of law or as a matter of fact.²⁷⁶ Whether an insurer has been prejudiced is usually a matter of fact for the jury to determine, but some cases are much more clear. For example, the Texas Supreme Court has held that “[t]he failure to notify an insurer of a default judgment against its insured until after the judgment has become final and nonappealable prejudices the insurer as a matter of law.”²⁷⁷

- 3) **Cooperation Clause.** Cooperation clauses are intended to guarantee to insurers the right to prepare adequately their defenses on questions of substantive liability.²⁷⁸ It is well established under Texas law that an insured's breach of a cooperation provision relieves an insurer of liability on the policy.²⁷⁹ The cooperation clause is a condition precedent that has been likened to the notice clause which requires a showing of prejudice before the insurer is relieved of liability.

²⁷¹ *Id.*

²⁷² *Id.* (The case was sent to the Texas Supreme Court on certified questions from the federal Fifth Circuit Court of Appeals. After the Texas Supreme Court's Opinion, judgment was rendered that Plaintiff nothing against National Union. *Crocker v. Nat'l Union Fire Ins. Co of Pittsburgh, P.A.*, 526 F.3d 240 (5th Cir. 2008)).

²⁷³ *Prodigy Communications Corp. v. Agric. Excess Surplus Ins. Co.*, 288 S.W.3d 374, 382 (Tex 2009).

²⁷⁴ *Id.*

²⁷⁵ *Financial Indus. Corp. v. XL specialty Ins. Co.*, 285 S.W.3d 877, 878-879 (Tex. 2009).

²⁷⁶ *Progressive County Mut. Ins. Co. v. Trevino*, 202 S.W.3d 811, 816 (Tex. App. – San Antonio 2006, pet. denied); *see also Maryland Cas. Co. v. Amer. Home Assur. Co.*, 277 S.W.3d at 114.

²⁷⁷ *Harwell v. State Farm Mut. Auto. Ins. Co.*, 896 S.W.2d 170, 174 (Tex. 1995).

²⁷⁸ *Lafarge Corp. v. Hartford Cas. Ins. Co.*, 61 F.3d 389, 397 (5th Cir. 1995).

²⁷⁹ *Filley v. Ohio Casualty Ins. Co.*, 805 S.W.2d 844, 847 (Tex. App.-Corpus Christi 1991, writ denied).

covenant.²⁸⁰ Accordingly, an insurer must prove prejudice before an insurer will be relieved of the policy obligations for an insured's failure to cooperate.²⁸¹

- a. Other conditions precedent exist in insurance policies, such as the requirement that a property inventory be provided, that a sworn proof of loss be submitted, that the insured submit to an examination under oath, that suit against the carrier be commenced after an actual trial against the insured, or that the insured actually replace damaged property before being entitled to recover replacement costs.²⁸²

- 4) **Prejudice required for Waiver and Estoppel to Apply.** Waiver and estoppel are defensive theories that have been used by insureds to avoid policy conditions that would cause a forfeiture of an insurance policy.²⁸³ The 1980 *Wilkinson* case prompted common acceptance of the use of these doctrines, developing what has been referred to as the *Wilkinson* exception.²⁸⁴ The *Wilkinson* exception held that these equitable principles were applicable to situations where an insurance carrier had assumed the insured's defense without obtaining a reservation of rights or non-waiver agreement and with full knowledge of the facts indicating non-coverage, such that all policy defenses, including those of non-coverage are held waived by the insurer or the insurer estopped from raising them.²⁸⁵ In a 2008, the Texas Supreme Court trimmed back the rule by holding that there is no "right" of non-coverage that is subject to being waived by the insurer, even by the assumption of the insured's defense with knowledge of the facts indicating non-coverage and without obtaining a valid reservation of rights or non-waiver agreement.²⁸⁶ That is, the Court disapproved the affect of the *Wilkinson* rule that effectively made non-coverage of a risk a type of "right" that an insurer could waive and thereby effect coverage for a risk it had not contractually assumed.²⁸⁷ The effect of the Court's decision was to add another requirement to the rule such that these doctrines are only applicable when the insured can show prejudice by the insurer's actions. Accordingly, the Court held that the doctrines of waiver and estoppel cannot be used re-write the contract of insurance and provide

²⁸⁰ *Progressive County Mut. Ins. Co. v. Trevino*, 202 S.W.3d at 816.

²⁸¹ *Id.* See also *State Farm Lloyds v. Brown*, 2009 WL 2902511, p* 3 (N.D. Tex. 2009).

²⁸² *Fitzhugh 25 Partners, L.P. v. Kiln Syndicate KLN 501*, 261S.W.3d 861, 864 (Tex. App. – Dallas 2008, pet. denied).

²⁸³ *Ullico Ins. Co. v. Allied Pilots Assoc.*, 262 S.W.3d 773, 781 (Tex. 2008).

²⁸⁴ *Id.* at 780.

²⁸⁵ *Farmers Tex. County Mut. Ins. Co. v. Wilkinson*, 601 S.W.2d 520 (Tex. Civ. App. – Austin 1980, writ ref'd n.r.e.) (The rule is based on the apparent conflict of interest that might arise when the insurer represents the insured in a lawsuit against the insured and simultaneously formulates its defense for non-coverage.).

²⁸⁶ *Ullico* at 782.

²⁸⁷ *Id.* at 781.

contractual coverage for risks not covered by the policy, but if the insurer's action prejudice the insured, then the insurer may still be estopped from denying benefits that would be payable under its policy as if the risk had been covered.²⁸⁸ For example, if an insurer defends an insured when no coverage for the risk exists, and the insurer's actions prejudice the insured, the lack of coverage does not preclude the insured from asserting an estoppel theory to recover for any damages it sustains because of the insurer's action.²⁸⁹

- 5) **Exclusions.** While an insured has the initial burden to establish that the claim comes within the scope of coverage provided by the policy, an insurer bears the burden to plead and prove that a claim comes within a policy exclusion or limitation of coverage.²⁹⁰ In a coverage dispute over the application of an exclusion, a court must adopt the construction of the exclusionary clause urged by the insured as long as that construction is not unreasonable, even if the construction urged by the insurer appears to be more reasonable or a more accurate reflection of the parties' intent.²⁹¹
- 6) **Doctrine of Concurrent Causes.** When covered and non-covered event combine to create a loss, the insured is entitled to recover only that portion of the damage caused solely by the covered peril.²⁹² This rule embodies the basic principle that an insured is not entitled to recover under their insurance policy unless they prove their damage is covered.²⁹³ An insured may only recover the amount of damage covered solely by the covered peril.²⁹⁴ The burden is on the insured to present some evidence upon which the fact finder can allocate the damages attributable to the covered peril.²⁹⁵
- 7) **Fortuity Doctrine.** The fortuity doctrine relieves insurers from covering certain behaviors that the insured undertook prior to purchasing the liability insurance policy.²⁹⁶ "Because the purpose of insurance is to protect insureds against unknown, or fortuitous, risks, fortuity is an inherent requirement of all risk insurance policies."²⁹⁷ Combining the principles of "known loss" and "loss in progress," the fortuity doctrine holds that insurance coverage is precluded where the

²⁸⁸ *Id.* at 787.

²⁸⁹ *Id.*

²⁹⁰ TEX. INS. CODE ANN. § 554.002 (formerly TEX. INS. CODE ANN. art. 21.58(b).; *Evergreen Nat'l Indem. Co. v. Tan It All, Inc.*, 111 S.W.3d 669, 675 (Tex. App.— Austin 2003, no pet.).

²⁹¹ *Nat'l Union Fire Ins. Co. v. Hudson Energy Co.*, 811 S.W.2d 552, 555 (Tex.1991); *Utica Nat'l Ins. Co. v. Am. Indem. Co.*, 141 S.W.3d 198, 202 (Tex.2004).

²⁹² *Wallis v. United Services. Auto. Ass'n.*, 2 S.W.3d 300, 302-303 (Tex. App. – San Antonio 1999, pet. denied).

²⁹³ *Id.* at 303.

²⁹⁴ *Id.*

²⁹⁵ *Id.*

²⁹⁶ *RLI Ins. Co. v. Maxxon Southwest Inc.*, 108 Fed. Appx. 194, 2004 WL 1941757, P*3 (5th Cir. 2004).

²⁹⁷ *Scottsdale Ins. Co. v. Travis*, 68 S.W.3d 72, 75 (Tex. App.— Dallas 2001, pet. denied).

insured is or should be aware of an ongoing progressive or known loss at the time the policy is purchased.²⁹⁸ Essentially, if an insured knows, or should have known, at the time it purchased the insurance policy, that its current behavior is wrongful and could result in liability, it effectively removes the risk element inherent in insurance, and therefore, a Texas court will not require the insurer to pay the claim.²⁹⁹

13 HANDLING THIRD-PARTY CLAIMS.

A. **The Insurer's Duties for Third-Party Claims - Defend & Indemnify.** Under most common liability policies, such as a standard CGL policy, an insurer has two separate, distinct and independent duties, the duty to defend, and the duty to indemnify.³⁰⁰ An insurer's duty to defend and its duty to indemnify are separate duties, and an insurer may have a duty to defend even when it has no duty to indemnify, and vice versa, an insurer may have a duty to indemnify even when it had no duty to defend.³⁰¹ Accordingly, allegations raised against the insured may fit within the policy coverage and trigger a duty to defend even if the facts actually established in the underlying suit negate the insurer's duty to indemnify.³⁰² However, if the factual allegations in an underlying complaint fall outside the policy coverage, neither duty is triggered.³⁰³

1) **Duty to Defend.** Whether an insurer has a duty to defend an insured in a lawsuit is determined by the “**eight corners rule**” which compares the factual allegations of the plaintiff's petition to the insurance policy, without regard to the truth or falsity of the allegations.³⁰⁴ Even if the allegations are groundless, false, or fraudulent the insurer is obligated to defend.³⁰⁵ When applying the eight corners rule, courts are to give the allegations in the petition a liberal interpretation, focus on the factual allegations that show the origin of the damages rather than on the legal theories alleged, and resolve all doubts concerning the duty to defend in favor of the insured.³⁰⁶ "It is not the cause of action alleged that determines coverage, but the facts giving rise to the

²⁹⁸ *Id.* (citing *Two Pesos, Inc. v. Gulf Ins. Co.*, 901 S.W.2d 495, 502 (Tex. App.– Houston [14th Dist.] 1995, no writ).

²⁹⁹ *RLI Ins. Co. v. Maxxon Southwest Inc.*, 108 Fed. Appx. 194, 2004 WL 1941757, P*3 (5th Cir. 2004).

³⁰⁰ *D.R. Horton-Texas, Ltd. v. Markel Int'l Ins. Co., Ltd.*, 300 S.W.3d 740, 743-744 (Tex. 2009). *See also Trinity Universal Ins. Co. v. Callan*, 945 SW.2d 819, 921-22 (Tex. 1997); *Farmers Tex. County Mut. Ins. Co. v. Griffin*, 955 S.W.2d 81, 82 (Tex. 1997).

³⁰¹ *Id.*

³⁰² *Id.*; *see also GuideOne Elite Ins. Co. v. Fielder Road Baptist Church*, 197 S.W.3d 305, 307 (Tex. 2006).

³⁰³ *Griffin*, 955 S.W.2d at 84.

³⁰⁴ *GuideOne* at 307; *Nat'l Union Fire Ins. Co. v. Merchs. Fast Motorlines, Inc.*, 939 SW.2d 139, 141 (Tex. 1997).

³⁰⁵ *Zurich Amer. Ins. Co. v. Nokia, Inc.*, 268 S.W.3d 487, 491 (Tex. 2008).

³⁰⁶ *Nat'l Union Fire Ins. Co. v. Merchants Fast Motor Lines, Inc.*, 939 S.W.2d 139, 141 (Tex. 1997).