ENGAGING IN COVERAGE LITIGATION

While corporate policyholders obviously prefer to reach an amicable resolution with insurers, it is sometimes necessary to consider whether litigation is necessary to resolve disputed coverage. And part of that consideration is whether it is in the corporation's interest to file its own action, before the insurer.

A. Declaratory action / breach of contract

Depending on the nature of the dispute and on the type of policy involved, litigation options essentially include filing an action for declaratory relief, or for breach of contract.

1. Declaratory action

The Texas Declaratory Judgment Act comprises Chapter 37 of the Civil Practice & Remedies Code, Title 2, Subtitle C, §§37.001-37.011. Its remedial purpose is to settle and afford relief from uncertainty and insecurity with respect to rights, status, and other legal relations, and it is to be liberally construed and administered. §37.002. The DJA specifically applies to construction of contracts, either before or after there has been a breach. §37.004.

Since the basis of a declaratory judgment typically is interpretation of policy wording, those questions are issues of law to be decided by the court and not submitted to a jury. But where the declaratory proceeding involves the determination of an issue of fact, the issue may be tried and determined in the same manner as issues of fact are tried and determined in other civil actions in the court in which the proceeding is pending. §37.007.

However, a court is not empowered to issue purely advisory opinions, but must decide actual cases and controversies. For a controversy to be justiciable, there must be a real controversy between the parties that will actually be resolved by the judicial relief sought. See State Bar of Tex. v. Gomez, 891 S.W.2d 243, 245 (Tex. 1994). A declaratory judgment is appropriate where a justiciable controversy exists as to the rights and status of the parties and the declaration will resolve the controversy. Brooks v. Northglen Ass'n, 141 S.W.3d 158, 163–64 (Tex. 2004).

In the context of third-party liability policies, the duty to defend typically is justiciable prior to resolution of the underlying lawsuit, because it is determined solely on the allegations of the underlying pleading in comparison with the policy wording. Firemen's Insurance Co. v. Burch, 442 S.W.2d 331 (Tex.1968). By contrast, the duty to indemnify relies upon all evidence established at trial supporting a final judgment, whcih may differ from the allegations of the bare pleading, and so declaratory relief is not appropriate prior to conclusion of the underlying lawsuit by judgment or settlement. D.R. Horton–Texas, Ltd. v. Markel Int'l Ins. Co., 300 S.W.3d 740 (Tex.2009). The sole exception to this rule is that a duty to indemnify may be justiciable before the insured's liability is determined in the liability lawsuit when the insurer has no duty to defend and the same reasons that negate the duty to defend will likewise negate any possibility the insurer will ever have a duty to indemnify. Farmers Tex. County Mut. Ins. Co. v. Griffin, 955 S.W.2d 81, 84 (Tex.1997)(holding that no facts could be developed in the underlying tort suit that can transform a drive-by shooting into a covered auto accident).

In the first-party insurance context, declaratory relief may be available to interpret disputed policy provisions, where resolution will resolve a coverage controversy between the policyholder and insurer.

Federal courts exercise further discretion in determining whether to decide a declaratory judgment action involving insurance coverage issues. Factors that warrant the federal court to decline jurisdiction includes:

* whether there is a pending state action in which all of the matters in controversy may be fully litigated;

* whether the plaintiff filed suit in anticipation of a lawsuit filed by the defendant;

* whether the plaintiff engaged in forum shopping in bringing the suit;

* whether possible inequities in allowing the declaratory plaintiff to gain precedence in time or to change forums exist;

* whether the federal court is a convenient forum for the parties and witnesses;

* whether retaining the lawsuit would serve the purposes of judicial economy; and

* whether the federal court is being called on to construe a state judicial decree involving the same parties and entered by the court before whom the parallel state suit between the same parties is pending.

See Sherwin–Williams Co. v. Holmes County, 343 F.3d 383 (5th Cir.2003).

Under the Texas DJA the court may award costs and reasonable and necessary attorney's fees as are equitable and just. §37.009. The award of attorney's fees in declaratory judgment actions is within the trial court's discretion and is not dependent on a finding that a party "substantially prevailed." Barshop v. Medina, 925 S.W.2d 618, 637–38 (Tex. 1996).

Federal courts do not recognize this provision of the DJA as "substantive law" and therefore do not award attorneys' fees to either party, even when sitting as an Erie court and handling a case removed from an initial state court filing. See Camacho v. Tex. Workforce Comm'n, 445 F.3d 407, 409–12 (5th Cir. 2006).

2. Breach of contract

Declaratory relief is more often sought by insurers than policyholders, because as a practical matter money damages typically are at issue if the policyholder believes the insurer has failed to comport with its policy obligations. So, for the policyholder, an action for breach of contract and damages may make better sense.

However, the insurer must actually deny a defense, or fail to pay policy benefits, before a breach can occur; merely reserving rights seldom constitutes a breach of contract in an of itself. See State Farm Lloyds Insurance Co. v. Maldonado, 963 S.W.2d 38 (Tex.1998); see also Motiva Enters., LLC v. St. Paul Fire and Marine Ins. Co., 445 F.3d 381, 386–87 (5th Cir. 2006)(reservation by insurer did not breach policy, so insurer entitled to assert contractual right to consent to settlement).

Should the policyholder prevail in a breach of contract action, its attorneys' fees are recoverable under Tex.Civ.Prac.&Rem.Code, §38.001. However, fees and costs only may be awarded when actual

damages are found, and not when there is liability but no damages. See Intercontinental Grp. P'ship v. KB Home Lone Star L.P., 295 S.W.3d 650 (Tex. 2009).

B. Should policyholder file first when question of coverage raised?

A conscientious policyholder faced with an impending and inevitable coverage dispute may well consider whether it is of benefit to file first to win the "race to the courthouse" for some particular advantage. This decision involves a keen balancing of whether the benefits of forum choice outweigh the cost and the loss of a less formal avenue for resolving the dispute. The factors to be considered depend on the particulars of the case.

Among those factors may be consideration of applicable law, where a particular forum may be more likely than another to utilize beneficial substantive law. Or a jury trial may be seen as beneficial in a particular matter, whereas early resolution through summary disposition of legal issues might be of more benefit in another; in the former instance a Texas state court forum is typically seen as advantageous, whereas in the latter instance federal courts may be a likely forum for dispositive rulings on complex legal issues.

A policyholder who files an action in state court that can provide "more complete" relief and resolution is likely to prevail in holding that forum against an insurer-filed suit in federal court where the district court exercises some discretion in whether to proceed or abate an action in favor of another proceeding. See Wilton v. Seven Falls Co., 515 U.S. 277, 115 S.Ct. 2137, 132 L.Ed.2d 214 (1995); Exxon Corp. v. St. Paul Fire and Marine Insurance Co., 129 F.3d 781 (5th Cir. 1997). A policyholder also may look to add as defendants parties who are Texas residents - - often adjusters or other intermediaries involved in the coverage who arguably have independent liability - - in order to prevent the insurer from successfully removing a state court case to federal court on the basis of diversity. See e.g. Centaurus Inglewood, LP v. Lexington Ins. Co., 771 F.Supp.2d 667, 671–72 (S.D.Tex.2011);

The forum maneuvering of parties involved in hurricane and hail coverage cases in southeast Texas and the Rio Grande Valley in recent years, has resulted in a sharp focus in the current Texas legislative system. A bill is working its way through the process that would require 60-day advance notice by a policyholder to the insurer prior to filing suit, with detailed particulars of the loss claim, coverage demand and expenses incurred to date for attorneys' fees and costs. No suit could be filed by either party within 61 days of such notice; any suit filed without the requisite notice would be subject to abatement; and a policyholder could lose the right to recover attorneys' fee for failure to meet these requirements.

At the date of this paper a committee substitute bill has passed and it has been placed on the intent calendar, but is not known whether the bill or some form of it will be passed in the 85th Legislative Session. http://www.capitol.state.tx.us/BillLookup/History.aspx?LegSess=85R&Bill=SB10

It is clear, however, that the legislature is interested in the problem and is seriously considering statutory response in order to minimize the "forum shopping" options currently open to policyholders.

C. Pay attention to Policy particulars

In determining where and how to bring suit against the insurer, it is important to pay close attention to the Policy wording. Most if not all of the sorts of policies issued to sophisticated corporations will include particulars of their consent to be sued, and details for service of suit.

Sometimes a policy provision may even require the insurer to consent to suit filed in state court, waiving their right to remove an action to federal court. In Ensco Int'l Inc. v. Certain Underwriters at Lloyd's, 579 F.3d 442, 448–49 (5th Cir. 2009), the Fifth Circuit concluded that a forum selection clause establishing "exclusive" venue "in the Courts of Dallas County, Texas" constituted a prima facie waiver of the right to remove. The court reasoned that permitting removal despite such a waiver provision would read the word "exclusive" out of the parties' agreement. See also Grand View PV Solar Two, LLC v. Helix Elec., Inc., 847 F.3d 255 (5th Cir. 2017)(confirming same).

On the opposite side of the spectrum, some forms of policies issued to sophisticated corporations - - especially higher layers of liability excess or umbrella coverage - - may require arbitration to resolve any disputes. Under Texas law, a written agreement to arbitrate is valid and enforceable if an arbitration agreement exists and the claims asserted are within the scope of the agreement. Tex.Civ.Prac.&Rem. Code §§ 171.001, 171.021. Texas courts are should not deny a motion to compel arbitration unless the arbitration clause in the parties' agreement is not susceptible of an interpretation that is sufficiently broad so that it includes the matters at issue in a dispute. See Prudential Sec. Inc. v. Marshall, 909 S.W.2d 896, 899 (Tex. 1995) (orig. proceeding).

For example, the so-called "Bermuda Form" requires arbitration "seated" in London applying English procedural rules, but New York substantive law. See generally Richard Jacobs et al, LIABILITY INSURANCE IN INTERNATIONAL ARBITRATION: THE BERMUDA FORM (2nd ed. 2011)[ISBN-13: 978-1841138756; ISBN-10: 1841138754]. And even an additional insured who is a non-signatory in the policy issued to the direct insured, may nonetheless be bound by that policy's arbitration provisions. Lexington Insurance Company v. Exxon Mobil Corporation, No. 09-16-00357-CV, 2017 WL 1532271 (Tex. App.—Beaumont, Apr. 27, 2017)

In the next article in our series we will address Choice of Counsel.