Duty of Liability Insurer to Additional Insureds

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

SECONDARY SOURCES

DUTY OF LIABILITY INSURER TO ADDITIONAL INSUREDS

A standard commercial general and auto liability policy impose no duty upon an insurer to inform an additional insured of potential coverage. Until now, Texas law has not imposed any duty upon insurers to provide a defense until an insured and/or an additional insured seeks one. If an insurer has knowledge of a suit filed against its additional insured, does an insurer have a duty to disclose that there is coverage available to him even though he has not tendered a defense? The United States Court of Appeals for the Fifth Circuit has certified to the Supreme Court questions regarding an insurer's duty to disclose coverage to an additional insured who has not sought a defense from the insurer.

The Fifth Circuit in *Crocker v. National Union* certified the following questions to the Supreme Court:

> 1. Where an additional insured does not and cannot be presumed to know of coverage under an insurer's liability policy, does an insurer that has knowledge that a suit implicating policy coverage has been filed against its additional insured have a duty to inform the additional insured of the available coverage?
>
> 2. If the above question is answered in the affirmative, what is the extent or proper measure of the insurer's duty to inform the additional insured, and what is the extent or measure of any duty on the part of the additional insured to cooperate with the insurer up to the point he is informed of the policy provisions?
>
> 3. Does proof of an insurer's actual knowledge of service of process in a suit against its additional insured, when such knowledge is obtained in sufficient time to provide a defense for the insured, establish as a matter of law the absence of prejudice to the insurer from the additional insured's failure to comply with the notice of suit provisions of the policy? *Nat'l Union Fire Ins. Co. v. Beatrice Crocker*, 466 F.3d 347 (5th Cir. 2006)(Tex.).

A. Facts of *Crocker v. Emeritus Corporation and Richard Morris, 2002 WL 33008626 (Tex.)*

In the underlying case, Beatrice Crocker sued Morris and Morris's former employer, Emeritus Corporation for injuries she suffered in May of 2000 when Crocker was struck by a swinging door, allegedly pushed negligently by Morris while acting in the course and scope of his employment at a nursing home where Crocker resided. National Union, who was the general liability carrier for Emeritus, provided a defense for Emeritus but did not provide a defense for Morris, who would be an additional insured under National Union's policy since he was an employee of Emeritus acting in the course and scope of his employment at the time of the accident. Because Morris failed to forward the suit papers to National Union or otherwise inform National Union of the suit against him and did not request a defense, National Union did not provide him with a defense. Morris never answered Crocker's suit and a default judgment was rendered against him.

The case was called to trial in October of 2003, but Morris did not enter an appearance. At the conclusion of all the evidence the trial court in Crocker's motion, severed the claims against Morris into a separate suit before submitting the charge to the jury. The jury rendered a take nothing verdict against Crocker, specifically finding that Emeritus, acting through its agents, including Morris, was not negligent. A month later the trial court granted a default judgment for Crocker on the severed claims and entered judgment against Morris in the amount of $1,000,000. Crocker then sued National Union as a third party beneficiary of Emeritus's liability policy that covered Morris as an additional insured. In Crocker's suit against National Union, both parties moved for summary judgment. National Union argued that Crocker, who stands in Morris' shoes, cannot recover under Texas law as National Union's duty to defend Morris was never triggered because Morris did not forward the suit papers to National Union or notify National Union that he had been sued and request a defense. Alternatively, National Union argued that they were prejudiced as a matter of law by Morris's breach of the policy's cooperation clause, namely by his failure to tender his defense to National Union.

National Union relied on its policy provision that:

> ***Before coverage will apply, you must notify us in writing of any claim or suit against you as soon as possible. You must:***
>
> a. immediately record the specifics of the claim and the date you received it;
>
> b. send us copies of all demands, suit papers or other legal documents you receive, as soon as possible**."**

Crocker argued that National Union was not prejudiced by Morris's failure to forward the suit papers because National Union was aware of the lawsuit against both its named insured, Emeritus and

its additional insured, Morris, and National Union was on notice that Morris had been served. Because National Union breached its duty to defend Morris as a matter of law, Crocker alleged that she was entitled to the full amount of the default judgment.

The district court agreed with Crocker, finding that National Union failed to meet its burden under Texas law to show prejudice and therefore it had a duty to defend Morris. Also, National Union breached this duty by failing to notify Morris that it would defend the claims against him. Crocker's MSJ was granted and Crocker was awarded $1,000,000. National Union appealed.

B. Insurer's Scope of Extra Contractual Duty may depend of what kind of Additional Insured is involved.

There are two categories of additional insureds: (1) those persons or organizations who are automatically included as insureds within the Persons Insured or other provisions of the policy because they belong to a group with close ties to the named insured and (2) those persons or organizations who are provided insured status in response to a provision contained in a business contract; these persons or organizations are added as an additional insured under an endorsement. The Crocker court referred to Richard Morris as an additional insured under the policy issued by National Union to Emeritus. Morris is not specifically named in the National Union policy or any endorsements thereto; therefore, he is not what courts sometimes refer to as an "additional named insured." *Western Indem. Ins. Co. v. Am. Physicians Ins. Exch.,* 950 S.W.2d 185, 189 (Tex. App.—Austin 1997, no pet.)(defining "additional named insured" as a person or entity specifically named in the policy as an insured subsequent to the issuance of the original policy). Nor is Morris an additional insured under an endorsement applying to contracts that may require additional-insured status. Morris is covered under National Union policy through the policy's definition of an insured, which includes "any present or former employee solely acting in his or her capacity as such." While many courts refer to any party covered under a policy but not specifically named as an "additional insured" see *Western Indem. Ins. Co*., Courts on occasion referred to such a person as Morris as an "omnibus insured." *Weaver v. Hartford Accident & Indemnity Co*., 570 S.W.2d 367 (Tex. 1978).

In *Weaver v. Hartford Accident & Indemnity. Co*., 570 S.W.2d 367 (Tex. 1978), the insurer, Hartford, issued a comprehensive auto liability policy to J.C. Thomas Enterprise. *Id*. at 368. The policy defined an "insured" as the named insured (Thomas Enterprises) and any person using its vehicle with permission. Where someone meets the generalized policy definition of an insured, the term "omnibus insured" rather than an additional insured has been used. *Weaver v. Hartford Accident & Indemnity Co*., 570 S.W.2d 367 (Tex. 1978). The moniker "omnibus" was assigned to the provisions used to designate covered persons or organizations under early automobile policies because the policy automatically encompassed virtually anyone who could be liable for an insured vehicle. The precise definition of "insured" was "any person using the automobile, provided the actual use thereof is with the permission of the named insured."(The term "omnibus" is a word that connotes a "vehicle designed to carry a comparatively large number of passengers.") Donald Malecki, Pete Ligeros, Jack P. Gibson, *The Additional Insured Book* 5th Ed. 2004, p.277). Although the current designation of who is an Insured is not as broad as the earlier definition, the term "omnibus clause" is still commonly used, particularly with respect to issues involving additional insured status under auto insurance policies.

In *Weaver*, the court addressed whether compliance with the notice of suit provision applied to the omnibus insured. Weaver was injured in an accident with Busch while Busch was driving a truck owned by his employer, J.C. Thomas Enterprise. Weaver filed suit against Busch; Busch did not file an answer. Weaver amended his suit, adding Thomas as a defendant, alleging that Weaver was in the course and scope of his employment for Thomas when the accident happened. Weaver non-suited Thomas and obtained a default judgment against Busch. He then sued Hartford, Thomas' liability carrier, for the default judgment because Busch was an additional insured under the Hartford policy. The trial court decided that Busch was an insured under the Hartford policy and judgment was rendered against Hartford for $100,000, which was their policy limits. The case was appealed and the judgment was reversed. The Supreme Court affirmed the appellate courts decision noting that Busch failed to forward the suit papers and because Busch was not operating the vehicle with the permission of Thomas, Hartford had no reason to believe that Busch expected Hartford to defend him. *Id*. 369. The court stated that the basic purpose of the requirement that the insured forward suit papers to the insurer " **is to advise the insurer that an insured has been served with process and that the insurer is expected to timely file an answer**." *Id*.

The majority opinion in *Weaver* did not address the additional insured's ignorance of his rights and duties under the Hartford policy, but both dissenting opinions address the omnibus insured. Chief Justice Greenhill dissent was based largely on his observation that "the omnibus insured is really a stranger to the actual

provisions of the written insurance policy." There was no showing that Busch had ever seen the insurance policy or that he should do anything to comply with it. *Id*. at 370. Justice McGee's dissenting opinion referenced the argument made in Weaver as to whether Hartford had a duty to inform Busch that he might be covered by the policy, where Hartford was aware Busch had a minimal education and might not comprehend insurance coverage between his employer and the insurer. *Id*. (McGee dissenting). The majority nonetheless held that Hartford had no duty to undertake Busch's defense. *Id*. at 370.

However in *Allstate Insurance Co. v. Darter*, 361 S.W.2d 254 at 255 (Tex. App.—Fort Worth 1962, no writ), the court held that an additional insured who was unaware of the coverage complied with the policy provision requiring giving notice of the accident to the insurer as soon as practicable. In *Darter*, the additional insured waited 109 days after the auto accident occurred to report the accident to Allstate. Allstate contended that it should not be held liable for any part of the judgment because notice of the accident was not given to it by the additional insured soon as practicable. The court held that Allstate was liable for damages caused by the additional insured. The court stated in Appleman, *Insurance Law and Practice*, Vol. 8, p. 54, § 4738: "An additional insured, operating an automobile with the permission of the owner, has been held to be a proper person to give notice to the insurer. Such additional insured could not be expected nor required to give notice before he knew of the existence of the policy or of the fact that he was covered thereby; * * *" and at p. 87, § 4745: "An insured's lack of knowledge of the existence of insurance excused a delay in giving notice, as a matter of law, where he was not guilty of a lack of due diligence. And an additional insured was under no duty to give notice until he had knowledge that he was covered by the policy." *Darter* at 256.

The distinction between the holdings in *Darter* and *Weaver* is that *Darter* addressed the notice of accident (required to give notice as soon as practicable) whereas Weaver addressed the notice of service of citation (condition precedent to the insurer's liability). *Lummus v. Western Fire Ins. Co.*, 443 S.W.2d 767 (Tex. App.—El Paso 1969, no writ), addressed both the notice of the accident and notice of the suit. In *Lummus*, the named insured was an auto dealership. A dealership customer was allowed to try out a new car and had a collision. Notice of the accident and notice of the suit were given by the dealership but not by the driver, who was an additional insured on the dealership's policy. The insurer for the dealership successfully defended the suit for the dealer but did not defend the driver, against whom a default judgment was taken. The Court of Appeals affirmed a judgment for the insurance company on the basis that even if no notice of accident were required beyond that given by the named insured, because the additional insured never sent any suit papers or citations to the insurance company and asked them to defend him, no action could lie against the company as this is a condition precedent which was not carried out. *Id*. at 771.

C. Prejudice Requirement post-Weaver.

If the court applied the implicit holding in *Weaver* to the facts in the *Crocker* case, then Morris' ignorance of his obligations under the National Union policy would be no excuse for his failure to forward suit papers and request a defense, and National Union's actual and timely notice of the accident and suit would not have satisfied the purpose of the notice provision because National Union did not know it was expected to defend Morris. *Weaver* at 369. However, the *Weaver* case was decided prior to the change in Texas law in 1973, when the State Board of Insurance mandated that an insurer be prejudiced by an insured's failure to provide notice before the insurer can avoid liability due to such failure. State Bd. Of Ins., Revision of Texas Standard Provision for General Liability Policies-Amendatory Endorsement-Notice, Order 23080 (March 13, 1973) quoted in *Chiles v. Chubb Lloyds Ins. Co*., 858 S.W.2d 633, 635 (Tex. App.—Houston[1st Dist.] 1993 writ denied). Even though a condition precedent of cooperation is not satisfied, an insurer will not escape liability unless it was prejudiced by the lack of cooperation.

1. Breach of Notice of Suit Provision.

In *Liberty Mutual Insurance Company v. Cruz*, 883 S.W.2d 164 (Tex. 1993), the insurer became aware through a newspaper article that its named insured had been involved in an accident. The insurer did not, however, receive notice of the resulting lawsuit against its insured until forty-one days after entry of an adverse default judgment. *Id*. at 165. The court observed that "although notice, the condition precedent to the policy, was not given according to the policy, the insurer does not escape liability, unless it was `prejudiced' because of the lack of notice." *Id*. It went on to hold that the insurer had been prejudiced as a matter of law: **"An insurer that is not notified of suit against its insured until a default judgment has become final, absent actual knowledge of the suit, is prejudiced as a matter of law."** *Id*. at 166. Apparently, the finding of prejudice as a matter of law was based on the insurer's inability to prevent the default judgment due to the lack of notice. See *Id*. ("Had the insurer known of the suit, it might have chosen to answer for the insured and litigate the merits of the underlying suit."). In *Cruz*, the court did not discuss the purpose of the notice provision as it had in *Weaver*.

In *Harwell v. State Farm Mut. Automobile Ins. Co*., 896 S.W.2d 170 (Tex.1995), the court again addressed the prejudice resulting from a failure to comply with the notice of suit provisions of a policy. The case involved a two car collision in which one of the drivers (Hubbard) died and the other (Leatherman) was seriously injured. Hubbard had been an additional insured under her mother's automobile liability insurance policy issued by State Farm Mutual Automobile Insurance Company (State Farm). Almost two years after the accident, Leatherman sued Hubbard's estate. On the same day, Leatherman's attorney, Groce, filed an application with the probate court seeking the appointment of Groce's legal secretary, Harwell, as administrator of Hubbard's estate. After Harwell was appointed temporary administrator of Hubbard's--estate, Leatherman served Harwell with citation in the lawsuit. Harwell, however, at the time of service, had not yet qualified as administrator. Groce informed State Farm of the suit against Hubbard's estate by a letter with, inter alia, a copy of the petition enclosed, and advised State Farm to answer the suit to prevent a default judgment, Groce later called State Farm's attorney, Anderson, to tell him that Leatherman would amend the petition when Harwell became the estate's permanent administrator and re-serve Harwell. After Harwell qualified as administrator of Hubbard's estate, Leatherman filed his first amended petition. Harwell waived service and filed a general denial, but she never forwarded any papers pertaining to the Leatherman suit against Hubbard's estate to State Farm. When the case went to trial, Harwell appeared pro se and offered no defense Judgment was rendered against Hubbard's estate. However, Groce waited to notify State Farm, and it did not otherwise become aware, of the judgment, until after the time to appeal or file a motion for a new trial had expired. State Farm then sued Harwell and Leatherman seeking a declaratory judgment that it was not liable for the judgment against Hubbard's estate.

In the unanimous *Harwell* opinion, the court reiterated its *Weaver* observation that "one of the purposes of a notice of suit provision in an insurance policy is to notify the insurer that the insured has been served with process and that the insurer is expected to defend the suit." 896 S.W.2d at 173 (citing *Weaver*, 570 S.W.2d at 369). Although State Farm's agent had notice from Groce of Leatherman's claim against the estate, the court observed that notice of a claim is not notice of a *suit. Id*. at 174. In addition, the court stated that State Farm's notice of Leatherman's intent to serve Harwell when she qualified as administrator was not the same as actual knowledge of service of process: “It was Harwell's duty to notify State Farm of the suit against its insured when she received service of process; it was not State Farm's duty to determine when or if Harwell was served." *Id*. at 174. The court stated, "Until State Farm received notice of the suit, it had no duty to undertake Hubbard's defense." *Id*. The court further observed that "State Farm would have gratuitously subjected itself to liability if it appeared on the insured's behalf before it received notice that Harwell was joined in the lawsuit and properly served, or that she had accepted service and appeared in the suit" *Id*.

The court then stated, "The insured's failure to notify the insurer of a suit against her does not relieve the insurer from liability for the underlying judgment unless the lack of notice prejudices the insurer." *Cruz* at 165. The court found that Harwell's failure to notify State Farm of the suit prevented State Farm from undertaking a defense and minimizing its insured's liability, and it *"prejudiced the insurer as a matter of law." Id*. The court also observed in a footnote, however, that "this is not a case in which the insurer received actual knowledge of a suit against the insured from a third party," *Id*. at 174, arguably implying that the insurer's actual knowledge of the served suit might result in a different outcome.

2. Knowledge of Suit by Insurer

Texas courts of appeals have reached different conclusions when dealing with cases in which the named insured failed to comply with the policy’s notice-of-suit provision but the insurer nonetheless had actual knowledge of the suit. In *Allstate Insurance Co. v. Pare*, 688 S.W.2d 680 (Tex. App.–Beaumont 1985, writ re f d n r e.), the named insured was covered under an automobile liability policy. As in *Cruz*, the policy's notice-of-suit provision expressly required a showing of prejudice before the insurer could deny coverage. *Id.* at 681. After suit was filed, the insured failed to provide a copy of the pleadings to the insurer. However, the evidence showed that, before suit was filed, the insured was in constant contact with the insurer, during which the insured repeatedly asked the insurer to protect the insured's interest *Id*. at 682. The evidence further showed that the insurer repeatedly gave assurances to the insured that the insurer was handling the matter. The insurer undeniably received a copy of the pleadings, identifying the named insured as a defendant, from the plaintiffs counsel. *Id*. at 683. Because there was considerable evidence from which a jury could conclude that the insured wanted the insurer to defend him in the lawsuit, the court of appeals affirmed the jury's finding that the insurer had not been prejudiced by the insured's failure to forward the suit papers. *Id.* at 682.

In *Ohio Casualty Group v. Risinger*, 960 S.W.2d 708 (Tex. App.— Tyler 1997, writ denied), the named insured never forwarded the suit papers to the insurer

but the evidence showed that the insurer "had actual knowledge of the filing of the lawsuit against its insured because [the plaintiff] sent it a complimentary copy of the petition. *Id*. at 712. The court relied on *Cruz* to support its statement that proof of the insurer's actual knowledge of suit "would show that the insurer was not prejudiced by its insured's failure [to comply with the policy's notice-of-suit condition precedent]." *Id*. at 711. It also noted that such proof would defeat the insurer's "affirmative defense of non-liability under the policy." *Id*. Although this *Risinger* language suggests that the insurer's actual knowledge means that it is not prejudiced as a matter of law, the Risinger court actually only concluded that the evidence was sufficient to affirm the trial court's fact finding of no prejudice and consequent judgment against the insurer.

3. Additional Insured's Failure to Comply with Notice Provision.

The above cases all dealt with the failure of a named insured to comply with the policy's notice provisions, but *Aetna Casualty & Surety Co. v. Martin*, 689 S.W.2d 263 ((Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.), a post-*Weave*r case, dealt with an additional insured's failure to comply with the policy's notice provision. Martin Surgical Supply Company as well as Myers-Carter Lab, were two of four defendants charged with manufacturing and/or selling an allegedly defective drug, Gomenol. Martin purchased the drug from Myers-Carter Lab. Unknown to Martin, Myers-Carter was insured by Aetna Casualty & Surety Company, under a policy of insurance containing a broad form vendor's endorsement which covered as an additional insured any company that distributed or sold Myers-Carter products. Aetna provided a defense to Myers-Carter only, and Martin hired its own legal counsel. Although Aetna knew that Martin was a customer of Myers-Carter, Aetna never informed Martin that they were an additional insured under Aetna's policy. Martin's attorney did not make a written demand on Aetna for reimbursement of Martin's legal expenses under the Aetna policy's vendor's endorsement until after the conclusion of the underlying trial. Aetna denied Martin's claim on the grounds that Martin did not timely request coverage and voluntarily incurred its legal expense. Martin asserted that it had no duty to comply with the notice provisions of the Aetna policy until it had actual knowledge of the available coverage, citing *Allstate Insurance Co. v. Darter*, S.W.2d 254, 255 (Tex.App.—Fort Worth 1962, no writ), which quoted Appleman, *Insurance Law and Practice*, Vol. 8, §4745 in stating:

> An insured's lack of knowledge ... excused a delay in giving notice, as a matter of law, *where he was not guilty of a lack of due diligence*. (Emphasis added).

The court held that an insurer's failure to disclose that an additional insured had coverage under a policy was in violation of the DTPA as failure to disclose coverage was a false, misleading, or deceptive act or practice. *Martin* at 269.Although *Martin* prevailed on their DTPA claim for failure to disclose to *Martin* that they had coverage under Aetna's policy, the court of appeals affirmed the portion of the judgment where the jury found that lack of due diligence on *Martin's* part, coupled with Martin's failure to comply with policy's notice provision, relieved Aetna from liability for the breach of contract claim. *Martin* at 271.

D. Potential Problems if Supreme Court answers Certified Questions Affirmatively

The following are a few of the problems that may arise if the Supreme Court determines that an insurer is required to provide coverage before an insured affirmatively seeks coverage.

1. An additional insured may be afforded coverage rights by virtue of an indemnity contract of which the insurer has no knowledge of. This is often the case in situations involving general and sub-contractors. How will the insurer determine who these unnamed insureds are?

2. Insurers are not a party in a suit, and are forced them to rely on defense counsel, whose sole responsibility is to the insured. What if the circumstances make it undesirable for the named insured to share limits with an additional insured? Could the named insured instruct his defense counsel not to advise the insurer of facts that might provide "notice" for an additional insured? Does the insurer have a duty to scour pleadings to determine if there may be other insureds, and then notify them?

3. How far would this duty extend? If a claims handler is reading the newspaper and learns of a lawsuit against a company for whom it has handled claims in the past, is the claims handler under a duty to affirmatively research whether that lawsuit would be covered by any policy issued by the insurance company?

4. Will premiums increase since the court would now be placing the responsibility on the insurer and not the insured to identify situations in which the policy may be implicated? The notice of claim and notice of suit provisions currently places this responsibility on the insured, but if the Court creates this extra-contractual obligation of the insurer, will the premiums reflect this extra obligation?

5. Are we going to change established law holding that an insurer has no obligation to pay pre-tender defense costs, as there is no duty to defend prior to notice?

6. What if the insurer takes some affirmative action to defend an insured, even where no defense has been requested, and that insured did not wish to respond to a lawsuit, and did not want an insurer to unwittingly subject them to the jurisdiction of a court? The insured may think the claim is insignificant or otherwise prefer to deal with it outside the insurance context. Or the insured may feel he will be better represented by his own attorneys

7. How can attorney-client relationship be formed with retained defense counsel, if there is no obligation of communication or cooperation on the part of the insured? An insurer cannot without any input from the insured, create an attorney-client relationship and appear on behalf of the insured.

Conclusion

The styling of the certified questions to the Supreme Court reveals that the focus is on the insurer's obligations and not the insureds. The standard Commercial General Liability at issue in Crocker imposes no obligation upon an insurer to inform an additional insured of potential coverage in the absence of any action by the insured to seek out coverage. This new duty would require an insurer to inform unnamed additional insureds of potential coverage before the insurer can enforce any condition precedent to coverage.

The Texas Supreme Court now has the opportunity to bring some clarity and reason to these issues. While the Court should be fair in outlining the parameters of compliance, so that an insurer cannot capriciously deny coverage, it can also be hoped that the Court will recognize the policy provisions as conditions precedent, and put the burden of compliance back where it belongs.