PRIORITY OF COVERAGE OR:
WHO PICKS UP THE TAB AT THE END OF THE NIGHT

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Activities

Council Member, Council of the Insurance Law Section of the State Bar of Texas,
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Dallas Bar Association Tort and Insurance Practice Section,
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Recent Speeches and Papers Presented at Accredited Continuing Education Seminars and Published Articles

The Primary Excess Relationships, Or the Cause and Effect of Helicopter Carriers
State Bar of Texas, Twelfth Annual Advanced Insurance Law Course, San Antonio, Texas, 2015

Gilbert/Ewing – Contractual Liability Coverage
State Bar of Texas, Ninth Annual Advanced Insurance Law Course, Dallas, Texas, 2012

Auto Coverage under General Liability Policies,
Presented at the 16th Annual Insurance Law Institute, University of Texas School of Law, 2011

Other Insurance: One, Two, Three ... Not "It!"
Presented at the 15th Annual Insurance Law Institute, University of Texas School of Law, 2010

The Application of Pollution Exclusions in Texas
Presented at the 14th Annual Insurance Law Institute, University of Texas School of Law, 2009

Representative Reported Cases:

Colony Natl. Ins. Co. v. United Fire & Cas. Co., __ Fed.Appx. __ 2017 WL 436042 (5th Cir. 2017)

Quibodeaux v. Nautilus Ins. Co., 655 Fed.Appx. 984 (5th Cir. 2016)

Colony Ins. Co. v. Chesapeake Energy Corp., ___ F.Supp.3d ___ 2016 WL 5416517 (W.D.Okla. September 28, 2016)

Colony Ins. Co. v. Price, 622 Fed.Appx. 311 (5th Cir. 2015)(per curiam)

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Nautilus Ins. Co. v. Texas State Sec. and Patrol, 2010 WL 3239157 (W.D.Tex. June 18, 2010)

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James River Ins. Co. v. Affordable Hous. of Kingsville II, Ltd., 2012 WL 1551529 (S.D.Tex. Apr.27, 2012)

Continental Cas. Co. v. Consolidated Graphics, Inc., 646 F.3d 210 (5th Cir. 2011)

National Fire Ins. Of Hartford v. C. Hodges & Associates, PLLC, 825 F.Supp.2d 792 (W.D.Tex 2011)

Nautilus Ins. Co. v. Villalta, 558 Fed.Appx. 404 (5th Cir. 2014)(Mem.Op)

Nautilus Ins. Co. v. Steinberg, 316 S.W.3d 752 (Tex.App. – Dallas 2010, pet denied)

Transport International Pool, Inc. v. Continental Ins. Co., 166 S.W.3d 781 (Tex.App. – Fort Worth 2005, no pet.)

Nautilus Ins. Co. v. Country Oaks Apartments Ltd., 566 F.3d 452 (5th Cir. 2009)

Trinity Universal Ins. Co. v. Emplrs Mut. Cas. Co, 592 F.3d 687 (5th Cir. 2010)

Nat'l Fire Ins. Co. v. Entertainment Specialty Ins. Services, Inc., 485 F.Supp.2d 737 (N.D.Tex. 2007)

National Fire Ins. Co. v. NWM-Oklahoma, LLC, Inc., 546 F. Supp. 2d 1238 (W.D.Okla. 2008)

Transcontinental Ins. Co. v. Rainwater Const. Co., LLC, 509 F.3d 454, (8th Cir.(Ark.) 2007)

Nautilus Ins. Co. v. Nicky & Claire's Day Care, Inc., 630 F.Supp.2d 727 (W.D.Tex. 2009)

Nautilus Ins. Co. v. Reuter, 537 F.3d 733 (7th Cir. (Ind.) 2008)

Richmond Condominiums v. Skipworth Commercial Plumbing, Inc., 245 S.W.3d 646, (Tex.App.-Fort Worth 2008, pet. denied)

Am. S. Ins. Co. v. Buckley, 748 F.Supp.2d 610 (E.D.Tex.2010)

Personal

Mr. Melendi was born, and resides, in Dallas, Texas, and is a fourth generation Dallasite.
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PRIORITY OF COVERAGE OR: WHO PICKS UP THE TAB AT THE END OF THE NIGHT

Three insurance policies walk into a bar. The first policy announces that it will serve as primary unless other primary insurance is available, at which point it will serve as excess. The second policy also says that it is primary unless other available insurance is available, at which point it serves as excess. The third policy boasts that it is excess over all other policies whether primary, excess, or contingent. The three policies enjoy their beverages in peace, seemingly unaware of any potential conflict that may arise once the bartender makes the last call. A few drinks and Billy Joel songs later, the lights brighten and the bartender makes the last call. The policies then begin to argue over how the tab should be paid. Should the tab be split evenly between each? Should the first and second policy split the tab before the third is required to chip in?

The purpose of this paper is to discuss the recent developments of Texas law that courts will use determine how the tab is paid.

THE *HARDWARE* TEST: MUTUAL REPUGNANCY OR CO-EXISTENCE?

In our bar tab conundrum, each partaking policy had an "other insurance" clause impacting who would be responsible for the tab. Much like the real world, the policies were blissfully ignorant of any potential conflict between them. Only upon the occurrence of the last call being made did the dispute arise. Fortunately—or unfortunately depending on who you ask—Texas has a method for dealing with such disputes that is a little more nuanced than deciding by a high-stakes game of rock-paper-scissors.

In Texas, where policies contain competing "other insurance" clauses the court must first assess whether or not the provisions actually conflict.[1] Absent a conflict, the provisions are enforced as written. The test used to determine whether or not the provisions conflict is when, from the viewpoint of the insured, "she has coverage from either one or two policies but for the other, and each contains a provision which is reasonably subject to a construction that it conflicts with a provision in the other concurrent insurance."[2] The Fifth Circuit has declined to construe this holding narrowly.[3]

Generally, the clauses fall into three categories:

1. Escape — the carrier asserts its policy has no coverage if there is other insurance.
2. Pro rata — the carrier asserts that its liability is limited to its pro rata share of liability
3. Excess — the carrier asserts that it is excess of all other insurance

Specifically, while *Hardware* dealt with an escape clause and an excess clause, the Fifth Circuit uses the *Hardware* "but for" test as a guiding principle for determining whether a conflict exists between "other insurance" clauses generally.[4]

In adopting the "but for" approach, *Hardware* expressly declined to follow tests used in other jurisdictions because of their "mechanical application of some arbitrary test."[5] Specifically, the court declined the (1) prior-in-time approach in which the court looks at the effective date of the concurrent policies and where the earliest effective policy is liable; (2) the primary tortfeasor test, where the court examines the "directness" of the torfeasor's relationship with the insurer; and (3) the specificity test, where a general clause yields to a more specific clause.[6] The court held the "but for" test avoids the insured "los[ing] the benefit of the rule which requires a construction of the policy, either one of them, strictly against the insurer, both of them, and liberally for the insured."[7]

SCOTTSDALE INS. CO. V. STEADFAST INS. CO

Courts construing Texas law have applied the analysis in *Hardware* regularly over the years, and most recently the Southern District of Texas applied the *Hardware* principles in *Scottsdale Ins. Co. v. Steadfast Ins. Co.*, in which two insurers disputed which policy covered the apartment manager's liability for negligence.[8] The underlying lawsuit concerned the death of a child who was seriously injured after gaining access to an apartment complex swimming pool. The child's father sued the owner of the apartment complex (CVP Holdings, CVP Limited Partnership, and CVP

[1] *Hardware Dealers Mut. Fire. Ins. v. Farmers Ins. Exch.*, 444 S.W.2d 589 (Tex. 1969).

[2] *Id.*

[3] *Royal Ins. Co. of Am. V. Hartford Underwriters Ins. Co.*, 391 F.3d 639, 643 (5th Cir. 2004) (citing *St. Paul Mercury Ins. Co. v. Lexington Ins. Co.*, 78 F.3d 202, 210 (5th Cir. 1996)).

[4] *See Royal Ins. Co. of Am. v. Hartford Underwriters Ins. Co.*, 391 F.3d 639, 643 (5th Cir. 2004) (citing *St. Paul Mercury Ins. Co v. Lexington Ins. Co.*, 78 F.3d 202, 2010 (5th Cir. 1996)).

[5] *Hardware*, 444 S.W.2d at 588.

[6] *Id. at* 587.

[7] *Id.* at 589.

[8] *See* No. CV H-16-0273, 2017 WL 661520, at *1 (S.D. Tex. Feb. 17, 2017).

General Partners collectively "CVP") and the property management company (Kaplan Management Company[9]) based on (1) negligence, (2) negligence per se, (3) premises liability, (4) attractive nuisance, (5) and *res ipsa loquitur.* In the underlying litigation, Scottsdale indemnified and defended Kaplan. Steadfast refused to participate in either the settlement or the defense.

THE INSURANCE POLICIES

Like our bar dispute, *Scottsdale* involved three policies with "other insurance" clauses. Scottsdale issued to CVP a CGL policy (the Scottsdale Policy) and an excess policy (the Scottsdale Excess Policy). The Scottsdale Primary Policy provided liability limits of $1,000,000 per occurrence and $2,000,000 in the aggregate and included as an insured the CVP's real estate manager. It contained the following pro rata clause:

> If this insurance is primary, our obligations are not affected unless any other insurance is also primary. Then, we will share with all that other insurance by the method described in Paragraph c below [providing for pro rata apportionment].

The Scottsdale Excess Policy contained the following other insurance clause:

> If there is other collectible insurance available to the insured (whether such insurance is stated to be primary, contributing, excess or contingent) that covers a loss that is also covered by this Policy, the insurance provided by this Policy will apply in excess of, and shall not contribute with, such insurance. This Condition I. does not apply to any insurance policy purchased specifically (and which is so specified in such insurance policy) to apply in excess of this policy.

The Steadfast Primary Policy—issued to Kaplan Management—provided coverage for up to $1,000,000. The policy provided it was "primary except when there is other insurance applying on a primary basis," but also included an endorsement with the following "other insurance" clause:

> With respects [sic] to your liability arising out of your management of property for which you are acting as real estate management this insurance is excess over any valid and collectible insurance to you.

Last call was made and coverage litigation ensued. The dispute centered on the other insurance clauses contained in the Scottsdale Primary and Excess Policies and the other insurance clause contained in the Steadfast policy. Specifically, Scottsdale argued that under Texas law, both insurers issued Kaplan Management primary insurance policies with conflicting other insurance clauses. Due to this conflict, Scottsdale argued, the conflicting clauses drop out leaving both Scottsdale and Steadfast to contribute on a pro rata basis.[10] Scottsdale also argued its excess policy was subordinate to the Steadfast Policy, thus requiring the Steadfast policy to be exhausted before the Scottsdale Excess Policy was required to contribute.

Steadfast contended the "other insurance" provisions in each insurers' policies coexist harmoniously and therefore do not dropout. Specifically, the Steadfast Primary Policy provided that its policy is excess from any liability arising out of the management of a property for which Kapan was the real estate manager whereas the Scottsdale Primary Policy provided coverage as primary unless other insurance was also primary.[11] Steadfast contended that "[s]ince the Steadfast Policy is not primary under the circumstances in the underlying lawsuit, Scottsdale's obligations to cover Kaplan are not affected, and the provisions do not conflict." The Scottsdale Primary Policy issued to Kaplan provided that coverage was

[9] Kaplan Management was added as a defendant in the Plaintiff's First Amended Petition.

[10] In Scottsdale's Partial Motion for Summary Judgment, it argued "Steadfast's coverage was—at all times—concurrent for Kaplan with the coverage provided by the Scottsdale primary policy and that those two policies 'go first'—*i.e*, must be fully exhausted as to Kaplan's liability—*before* Scottsdale might theoretically be obligated to indemnify Kaplan under its excess policy. According to Scottsdale, *Hardware Dealers Mut. Fire. Ins. V. Farmers Ins. Exch.*, 444 S.W.2d 583 (Tex. 1969) required the conflicting "other insurance" clauses to be ignored. Under the guidelines set forth by *Hardware*, when an insured would have coverage "from either one of two policies but for the other, and each contains a provision which is reasonably subject to a construction that it conflicts with a provision in the other concurrent insurance" the two provisions are in conflict and must be ignored. *Hardware*, 44 S.W.2d at 589-90. This "but for" test is viewed from the standpoint of the insured. *Id.* Scottsdale argued that "but for" the other insurers' other insurance provision, Kaplan Management would have coverage for both policies.

[11] Steadfast also argued that the Property Management Agreement contained an indemnity provision rendering the "other insurance" clauses irrelevant. The indemnity provision provided that "'liabilities arising in the course of the business of the Property' will be the obligation of CVP".

unaffected unless "any other insurance is also primary" in which case the policies will provide coverage apportioned pro rata. Scottsdale contends this pro rata clause conflicted with Steadfast's Primary Policy's excess 'other insurance' provision and Steadfast's endorsement, which provided that the policy would serve as excess in the event liability stemmed from the insured's property management responsibilities. Specifically, Scottsdale argued the endorsement "logically requires the presence of other insurance to operate as an excess policy because, but for Scottsdale's Primary Policy, no insurer would defend and Steadfast would have been obligated to do so."[12] Steadfast argued its policy could only be required to contribute pro rata with Scottsdale's Excess Policy.

APPLYING HARDWARE

In following the framework put forth by *Hardware*, the *Scottsdale* court first analyzed whether there was a conflict between the two policies—would the insured have coverage under both policies but for the other policy's other insurance provision.[13] Stated another way, a conflict would be present if "[b]ut for Steadfast's policy, from Kaplan Management's perspective, it had a primary policy from Scottsdale, which required Scottsdale to defend Kaplan Management in the underlying suit."[14]. This analysis turned on the status of the insured and not the availability of other coverage.[15] As noted above, Steadfast argued that because Kaplan Management's liability stemmed from its role as a property manager, the endorsement made the policy excess to Scottsdale's Primary Policy and Scottsdale's Excess Policy.[16]

Because "a specific endorsement controls over general provisions in the main policy,"[17] the court held Kaplan's status as the property manager meant Steadfast's endorsement rendered the policy excess to Scottsdale's Primary policy. The court dismissed Scottsdale's application of the *Hardware* "but for" test. Scottsdale argued the Steadfast endorsement logically required the presence of other insurance in order to operate as an excess policy and but for Scottsdale's Primary Policy, no insurer would defend and Steadfast would have been obligated to.[18] In dismissing this argument, the court cited to the Steadfast policy, which provided that Steadfast obligated itself to defend in the event another insurer did not undertake to do so—"[w]hen this insurance is excess, we will have no duty to defend any claim or 'suit' that any other insurer has a duty to defend. If no other insurer defends, we will undertake to do so, but we will be entitled to the insured's rights against all those other insurers."[19] Scottsdale misapplied the *Hardware* test in that the Steadfast Policy did not create a conflict between two primary policies because "the absence of the Scottsdale Policy would not convert the Steadfast excess policy to a primary policy."[20] Because there was not a primary-to-primary policy conflict, *Hardware* did not apply and Scottsdale's pro rata clause and Steadfast's excess clause did not drop out.[21]

STEADFAST'S EXCESS CLAUSE VERSUS SCOTTSDALE'S 'TRUE EXCESS' POLICY

In our bar scenario, the third thirsty policy's other insurance clause provided it was excess over all other available insurance. Intuitively, this would lead the patron to believe it would pay only after the first and second patron paid. This intuition is not necessarily incorrect; however, the issue is a little more nuanced. Courts will consider a number of factors to determine whether a policy is true excess thus requiring subordinate policies to be exhausted before it's implicated.

In Texas, an excess clause in a primary policy will not have the effect of elevating a primary policy above a 'true excess' policy.[22] When determining whether a policy is a true excess policy, Texas courts will begin with the interpretation of the policy and analysis of the parties' intent.[23] Specifically, courts will consider whether the purported excess policy expressly

[12] *Scottsdale*, WL 661520 at *5.

[13] *Id.* at *4 ("The *Hardware Dealers* test, as applied by the Fifth Circuit, requires this court to analyze each policy "but for" the other, from the insured's perspective. If the insured would have a primary policy but for the presence of the other insurance, both insurers are primary and must contribute pro rata, despite the terms of their "other insurance" clauses. *See id*. But for Steadfast's policy, from Kaplan Management's perspective it had a primary policy from Scottsdale, which required Scottsdale to defend Kaplan Management in the underlying suit"). *See also supra* n. 14-18.

[14] *Scottsdale*, WL 665120 at *4

[15] *Id.*

[16] *Id.*

[17] *Mid-Continent Cas. Co. v. Bay Rock Operating Co.*, 614 F.3d 105, 114 (5th Cir. 2010).

[18] *Scottsdale*, WL 661520 at *5.

[19] *Scottsdale*, WL 661520 at *5.

[20] *Id.*

[21] *Id.*

[22] *Carrabba v. Employers Cas. Co.*, 742 S.W.2d 709, 715 (Tex.App.—Houston [14th Dist.] 1987, no writ); *Utica Nat. Ins. Co. of Texas v. Fid. & Cas. Co. of N.Y.*, 812 S.W.2d 656, 661 (Tex.App.—Dallas 1991, writ denied).

[23] *Carrabba*, 742 S.W.2d at 714.

designated a hierarchy in which coverage is only afforded after all subordinate policies have been exhausted.[24] True excess policies do not "attempt[] to limit a portion of its risk by describing it as 'excess,' nor is the policy a device to escape responsibility."[25] A primary policy with an excess clause does not possess the same characteristics as a true excess policy and does not provide the same extent of coverage.[26] Moreover, a primary policy with an excess clause is not mutually repugnant with a true excess policy so they do not cancel out.[27]

Relying on its endorsement, Steadfast argued it was not required to contribute to the settlement because its Policy was excess not only to Scottsale's Primary but also to Scottsdale's Excess Policy.[28] Alternatively, Steadfast argued its Policy and Scottsdale's Excess Policy had conflicting terms and thus the coverage should be apportioned pro rata.[29] Scottsdale countered that its Policy is a true excess policy and that the Steadfast Policy must be exhausted before reaching its Excess Policy.[30]

The Scottsdale Excess Policy contained the following Other Insurance clause:

> If there is any other collectible insurance available to the insured (whether such insurance is stated to be primary, contributing, excess or contingent) that covers a loss that is also covered by this Policy, the insurance provided by this Policy will apply in excess of, and shall not contribute with, such insurance. This Condition I. does not apply to any insurance policy purchased specifically (and which is also specified in such insurance policy) to apply in excess of this Policy.

The Steadfast Policy provided:

> If other valid and collectible insurance is available to the insured for a loss we cover under Coverage A or B of this Coverage part, our obligations are limited as follows:
>
> a. Primary Insurance
>
> This insurance is primary except when there is other insurance applying on a primary basis. Then b. below applies.
>
> b. Excess Insurance
>
> This insurance is excess over any of the other insurance, whether primary, excess, contingent or any other basis.
>
> When this insurance is excess, we will have no duty to defend any claim or "suit" that any other insurer has a duty to defend. If no other insurer defends, we will undertake to do so, but we will be entitled to the insured's rights against all those other insurers.

The court began its analysis by relying on the *Carrabba*[31] decision, which dealt with language very similar to the Scottsdale and Steadfast policies. In *Carrabba*, the Mission National Insurance Company policy—similar to the language in Scottsdale's Excess Policy—provided excess coverage if "other valid and collectible insurance with any other insurer is available to the insured covering a loss also covered by this policy, other than insurance that is specifically stated to be excess of this policy, the insurance afforded by this policy shall be in excess of and shall not contribute with such other insurance."[32] The Gulf Insurance Group policy –similar to Steadfast's policy—provided "[t]he insurance afforded by this endorsement shall be excess insurance over any other valid and collectible insurance available to the insured."[33] The court noted the Gulf Insurance Group policy did not expressly contemplate a hierarchy because it "did not specifically designate[]

[24] *Carrabba*, 742 S.W.2d at 714("There are acknowledged differences between an umbrella policy and a primary policy containing an excess clause. The coverage of the umbrella or 'catastrophe' policy, is unique. The umbrella policy is generally recognized as having been designed to pick up where primary coverages end, providing extended protection in a time when verdicts can be exceedingly high. Umbrella policies are therefore regarded as true excess over and above any type of primary coverage including excess provisions arising from primary policies.") citing 8A *J. Appleman, Insurance Law *715 and Practice* § 4909.85 (1981); *Utica*, 812 S.W.2d at 660("We hold that the excess policies in the Beasley line of insurance clearly intend a hierarchy of coverage that contemplates a specific order of contribution based on the exhaustion of applicable policy limits.").

[25] *Carrabba*, 742 S.W.2d at 715.

[26] *Id.*

[27] *Id.*

[28] *Scottsdale*, WL 661520 at *5. Steadfast asserted that its endorsement made its policy excess to any coverage available to Kaplan as a property manager.

[29] *Id.*

[30] *Id.*

[31] *See supra n. 32.*

[32] *Scottsdale*, WL 661520 at *6.

[33] *Id.*

the Mission policy [] as an underlying policy.'"[34] Further, the *Carrabba* court did not find a *Hardware* conflict between Mission Insurance Company's true excess and Gulf Insurance Group's primary.[35]

In relying on *Carrabba*, the *Scottsdale* court held Steadfast's policy was not excess over *Scottsdale's* umbrella policy and that the two policies were not mutually repugnant under the *Hardware* standard.[36] Consequently, the court held the Steadfast policy must be exhausted before reaching the Scottsdale True Excess Policy.[37]

The *Scottsdale* decision is not an anomaly because the court adhered to well established Texas law to parse through the priority of coverage issues. Namely, the court relied on *Hardware's* but for analysis to first ascertain whether a conflict existed. Secondly, the court relied on the *Carrabba* decision, which illustrated the inherent differences between a primary policy with an excess clause and a true excess policy. This framework continues to govern priority of coverage issues in Texas; however, as shown below, complications can occur in different coverage contexts.

NON-OWNED EXCESS CLAUSES IN AUTO POLICIES — DIFFERENT TAVERN PATRONS, SIMILAR CONFLICT

This schism surrounding our swilling sureties surfaces at saloons semiregularly. Whether it's "Closing Time" or "Don't Stop Believing," once the music stops and the barkeep passes the tab, policies become abruptly aware of their potentially conflicting provisions.

One such common context is in auto policies, where primary and excess relationships are often contingent on ownership of the vehicle. Take, for instance, *Snyder v. Allstate Ins. Co.*[38] The *Snyder* case is an auto accident case wherein two policies afforded coverage.[39] Each policy's other insurance clause stated "the policy provides only excess insurance with respect to non-owned automobiles, but provide for prorated coverage with respect to the owned automobile."[40] The court concluded that if the car involved in the accident, insured by Allstate, was an owned auto "then Allstate's coverage is primary and Fidelity 'non-owned' coverage is excess within the meaning of both policies."[41]

Now compare *Snyder* to *Safeco Lloyds Ins. Co. v. Allstate Ins. Co.*[42] In *Safeco* an insured driver was involved in an accident while driving a car the driver did not own. The court held that both of these policies provided coverage for the driver, and both policies' other insurance clauses purported to be excess, given who owned the car involved in the accident.[43] The policy that covered the car stated that it was excess in all situations where other insurance existed.[44] The driver's policy stated that it was excess in accidents involving cars that the insured (the driver) did not own.[45] Given the circumstances of the accident, the effect of both other insurance clauses was the same — each stated it was excess. Therefore, the court applies the *Hardware* rule and ignored both clauses.

A recent Fifth Circuit case demonstrates that the other insurance provisions should be ignored only when they truly conflict when applied to the facts of the case.[46] The *American States* case arose from an auto accident of a vehicle owned by one company driven by an employee of a second company.[47] Each company purchased an auto policy that provided coverage for the accident, but each policy contained an other insurance clause that provided primary insurance for autos owned by the named insured and rendered the coverage for autos not owned by the named insured.[48] The Fifth Circuit held that "[u]nlike the 'other insurance' clauses in *Hardware Dealers* . . . the existence of primary coverage under each of the 'other insurance' clauses in the [two] policies turns not on the availability of other insurance but rather on vehicle ownership."[49] Thus, the "conflict" portion of the *Hardware Dealers* test was not satisfied, and both provisions could be read in harmony — the insurer's whose named insured owned the car was responsible for primary coverage, and the non-owned-auto insurer provided excess coverage.[50]

These cases demonstrate that a court's analysis will turn on the other insurance provisions in each applicable policy as applied to the facts of the claim. If

[34] *Id.*

[35] *Id.*

[36] *Id.*

[37] *Id.*

[38] 485 S.W.2d 769, 770 (Tex. 1972).

[39] *Id.*

[40] *Id.* at 770.

[41] *Id.*

[42] 308 S.W.3d 49, 56 (Tex. App.—San Antonio 2009, no pet.).

[43] *Id.* at 56-57.

[44] *Id.* at 52.

[45] *Id.*

[46] *See Am. States Ins. Co. v. ACE Am. Ins. Co.*, 547 F. App'x 550, 554 (5th Cir. 2013).

[47] *Id.* at 552-53.

[48] *Id.* at 553.

[49] *Id.* at 553-54.

[50] *See id.*

the other insurance provisions, given the specific facts of the claim, are truly in conflict, *Hardware Dealers* mandates that they be ignored; however, if they do not truly conflict, courts apply the provisions as written.

Therefore, carriers, coverage counsel, and even concerned plaintiffs should obtain some specific pieces of information in order to assess priority of coverage. Two of the most important are the exact wording of the other insurance clauses involved, and whether the cars involved were being driven by their owners.

HARDWARE DEALERS - APPLIES TO DEFENSE COSTS, TOO?

While other insurance clauses are generally thought to apply only to an insurer's duty to indemnify,[51] the *Hardware Dealers* analysis can have a big impact on certain disputes involving defense costs. How? Let's say one of our imbibing insurance policies is an everyday auto policy that insures the owner of a 1987 Toyota Tercel up to $30,000. This policy contains a pro rata clause and drank one Lone Star all night. Now let's say the other policy pounded 17 bottles of Dom Pérignon. This one is a commercial policy that insures a corporation — the largest transporter of flaming dynamite in the U.S. — up to $5 million and contains an excess clause.

If both policies cover an accident and the mutual insured's defense costs were $1 million, how do the two policies allocate defense costs? The insurer that issued the commercial policy would likely argue that the carriers both have a complete duty to defend their mutual insured and therefore must split defense costs evenly — $500,000 apiece. The personal auto insurer may argue that a pro-rata split applies and it owes $10,000 compared to the commercial carrier's $990,000.

This issue came up outside of the auto context in *Royal Insurance.*[52] In that case a nursing home sued in a wrongful death and survival action by the family of a deceased resident, had a primary liability policy issued by Hartford which had an excess "other insurance" clause.[53] The nursing home had a second liability policy issued by Royal that contained a pro rata "other insurance" clause.[54] The Court found a conflict between the excess and pro rata clauses, and applied the *Hardware Dealers* rule to ignore the conflicting provisions and apportion liability pro rata, requiring both insurers to defend.[55] *Royal Insurance* cautioned against applying an overly narrow construction of the *Hardware Dealers* rule.[56]

Few courts have been willing to follow *Royal* and apply *Hardware Dealers*-type analysis to defense costs. However, in an auto coverage case out of the Southern District of Texas, Judge Rosenthal did just that. The facts of the case were similar the hypothetical above — a commercial and personal auto policy both covered an accident involving a common insured, and one issue before the court was how to divide defense costs. The parties settled after the hearing on the cross motions for summary judgment, but Judge Rosenthal issued a ruling during oral argument that appeared as a minute entry: "The court held that the 'other insurance' clauses in the two policies conflicted, and that the parties should share the costs of defense pro rata."[57] The result would have been that the personal auto insurer, whose policy had a much lower limit, was responsible for a fraction of the defense costs compared to the commercial insurer.

WHO BROUGHT THAT GUY? A/K/A ADDITIONAL INSUREDS

It is almost axiomatic that in order to understand the scope of coverage for any policy, in any dispute, there needs to be an understanding of the impact additional insureds may have the policy coverages available. Returning to our running theme, an additional insured endorsement would be the equivalent of one of the bar patrons bringing his high school friend — if the friend is "actor" who is "between roles" right now and who just moved into his parents' basement to "work some stuff out, man." Whether or not the friend's beverages are included in the tab can

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[51] *See Trinity Universal Ins. Co. v. Employers Mut. Ins. Co.*, 592 F.3d 687, 695 (5th Cir. 2010).

[52] *Royal Ins. Co. of America v. Hartford Und. Ins. Co.,* 391 F.3d 639, 643-644 (5th Cir. 2004).

[53] *Id*. at 640.

[54] *Id*. at 641.

[55] *Id*. at 644.

[56] *Id.* (citing *St. Paul Mercury Ins. Co. v. Lexington Ins. Co*., 78 F.3d 202, 210 (5th Cir. 1996) (court found that pro rata and escape clauses conflicted)). *See also*, *Travelers Lloyds Ins. Co. v. Pacific Employers Ins. Co.,* 602 F.3d 677, 687 (5th Cir. 2010) (following *Royal Insurance*, it applied *Hardware Dealers* rule to resolve conflict between two excess clauses); *Willbros RPI, Inc. v. Continental Cas. Co.,* 601 F.3d 306, 312-313 (5th Cir. 2010) (affirming that *Royal Insurance* is controlling and finding that an excess and pro rata clause conflicted notwithstanding the fact that a plain language reading of the policies would not have left the insured without coverage); *L-Con Inc. v. CRC Ins. Services,* 122 F.Supp.3d 627, 639 (S.D. Tex. 2015) (found *Hardware Dealers* conflict among several "other insurance" provisions, noting it applies even though "a plain language reading of the policies would not have left the insured without coverage").

[57] *See* ECF. No. 22, *Amerisure Mut. Ins. Co. v. Home State Cty. Mut. Ins. Co.,* No. 4:16-cv-00450 (S.D. Tex. Oct. 24, 2016).

depend on several factors. One such factor is whether or not a policy includes coverage for friends. Generally, this can be achieved in two ways. Either the policy will specifically name the friend as someone to be included on the tab, or the policy will contain language indicating a class or group of people is included.

The waters can quickly muddy as courts must ascertain whether the endorsement applies to a particular claim. For example, a fairly standard Commercial General Liability Policy's (CGL) Additional Insured Endorsement (CG 20 10 07 04) provides:

> With respect to the Third Party shown below, the insurance provided by this policy shall be primary and non-contributing insurance. Any and all other valid and collectable insurance to such Third Party in respect of work performed by you under written contractual agreements with said Third Party for a loss covered by this policy, shall in no instance be considered as primary, coinsurance, or contributing insurance. Rather, any such other insurance shall be considered excess over the above the insurance provided by this policy.
>
> Third Party to whom this endorsement applies is:
>
> ________________________.
>
> Absence of a specifically named Third Party above means that the provisions of this endorsement apply "as required by written contractual agreement with any Third Party for whom you are performing work."

* * *

Courts must ascertain who "you" and "your" applies to in order to properly define the scope of coverage. Generally, CGL policies define "you" and "your" to refer to the named insured shown in the declarations and not the named additional insured or omnibus named insured. As a consequence, a CGL policy generally does not provide for coverage for an entity performing work for a subcontractor notwithstanding the fact the subcontractor is an additional insured. Referring back to the "Who is an Insured" provision, the policy would provide coverage for the named insured and those **contracted** to act on the named insured's behalf— a subcontractor. The third party hired to work for the subcontractor may find this surprising. If they did a cursory review of the policy, they may mistakenly believe that they are entitled to coverage as an additional insured because of the "their acts omissions" were done on behalf of the named insured, albeit through the additional insured. But again, **"your"** is interpreted to mean the named insured, not the additional insured.

So, imagine a scenario where a putative AI enjoys additional insured coverage from two policies — the one your client issued to its named insured, as well as a second policy issued to another subcontractor by its separate insurer. The above endorsement appears in your client's policy. Its purpose seems to be to ensure that the coverage it provides is primary to the AI's own direct coverage. But is what the other subcontractor's insurer asserts, that by virtue of the endorsement, your client's additional-insured coverage is primary to all of the AI's *other* additional-insured coverage true? This is proven wrong when one remembers that the "you" referenced in the endorsement refers to the named insured on the policy, not the AI. The "Third Party" to whom the endorsement applies is the AI because AI is the party that your named insured contracted with. Your insured did not contract with either the other subcontractor or its insurer. The term "Third Party," therefore, has no application to this other subcontractor or its insurer.

Another complicating issue is the extent to which courts let the parties allocate priority of coverage themselves. Take, for instance, the *Deepwater Horizon*[58] and *ATOFINA*[59] cases. In *ATOFINA*, the Supreme Court of Texas held that the policies issued to the named insured property owner, Triple S, afforded additional insured coverage to ATOFINA.[60] The Court's reasoning was ostensibly based on the language of the policy alone; it held that each who-is-an-insured clause granted coverage independently, which allowed the excess policy to provide broader coverage than the underlying insurance.[61] However, the Court did look to the Triple S-ATOFINA contract to support its further holding that the contractual indemnity right that ATOFINA gave up was separate from its rights as an additional insured on the policy.[62]

Contrast that with *Deepwater*, where the Court held that the "language in the insurance policies providing additional-insured coverage 'where required' and as 'obliged' **requires us** to consult the Drilling Contract's additional-insured clause to

[58] *In re Deepwater Horizon*, 470 S.W.3d 452, 455 (Tex. 2015).

[59] *Evanston Ins. Co. v. ATOFINA Petrochems., Inc.*, 256 S.W.3d 660 (Tex. 2008)

[60] *Id.* at 665-68.

[61] *Id.* at 668.

[62] *Id.* at 670.

determine whether the stated conditions exist."[63] The difference, according to the court? The certificates of insurance issued by Triple S to ATOFINA:

> The existence of a certificate of insurance naming ATOFINA as an additional insured meant that, unlike *Urrutia* and the present case, there was no need to look to the underlying service contract to ascertain ATOFINA's status as "[a] person or organization for whom you have agreed to provide insurance as is afforded by this policy."[64]

The language that existed in the *Deepwater* case — "where required by contract" — is in virtually every ISO blanket AI form. Has the Court, therefore, has opened the door to consulting the underlying contract in nearly every additional insured claim. In practice, this author has certainly seen attorneys regularly cite *Deepwater* as a basis for asserting that the language of the contract must be considered before providing AI coverage.

Another factor may be the nature of the entities involved in the dispute. Texas Supreme Court in Deepwater chose not to address the Fifth Circuit's second certified question, regarding whether the presumption of coverage in favor of an insured applied in the case of highly sophisticated insurers.[65]

The *Deepwater* case involved an agreement between Transocean — one of the largest offshore drilling contractors in the world— and BP. Each of these companies may employ more attorneys than their insurers. Allowing sophisticated entities like BP and Transocean to execute agreements that provide a detailed allocation of priority of coverage may make sense.

But in other cases, this approach may not provide much clarity or make sense. Take, for instance, your average construction defect claim where the pertinent contract may be the one executed by a roofing subcontractor and the sub-subcontractor. The contract, if there is one, is likely not to lend any clarity to the situation. Therefore, the parties may be better off basing their coverage arguments solely on the language of the policy.

WHAT IF AN IOU FROM LAST WEEK IS INVOLVED – MULTIPLE YEARS OF COVERAGE

Let's return to the bar one more time to find the following scenario: Three policies are closing their tab after a spirited night. Before the night began, Policy A and Policy B agreed that Policy A will pick up the first $50 of the tab, after which Policy B will pick up the next $100. Policy C also put drinks on the tab and has $50 in his wallet. How do the policies split the $150 tab? Do the wallets of Policy A and C have to be empty—i.e., exhausted—before Policy B must pay? Or does Policy B have to pay his $100 after A pays his $50, meaning that C gets off without paying anything? Exhaustion by itself could be the subject of its own paper.[66] Therefore, this paper discusses the issue briefly, in order to address the issue of priority of coverage for long tail claims.

In long tail claims, where the damage occurs years after the occurrence and the policy's expiration, courts must first decide whether the insured is required to exhaust coverage vertically or horizontally. In *LSG Techs., Inc. v. U.S. Fire Ins. Co.*, the Eastern District of Texas made an *Erie* guess as to how the Texas Supreme Court would rule on whether an insured is required to exhaust its liability coverage vertically or horizontally.[67]

First, the court defined each type of exhaustion:

> Horizontal exhaustion means that each primary insurance policy triggered by a continuous loss must indemnify the policyholder to the full extent of its policy limits before any excess insurer can be required to pay.
>
> * * *
>
> Vertical exhaustion [or "spiking"] means that the first-in-time primary and excess policies will be exhausted before the next-in-time primary policy and excess policies will be tapped. In other words, vertical exhaustion provides that each excess policy in a triggered year is required to contribute to indemnification as soon as its particular underlying coverage is exhausted, even if other triggered primary policies (covering other periods) remain "untapped".[68]

[63] *Deepwater*, 470 S.W.3d at 465 (emphasis added).

[64] *Id.* at 463.

[65] *See In re Deepwater Horizon*, 728 F.3d 491, 499-500 (5th Cir. 2013).

[66] In fact, see this author's paper on the subject presented at the 2015 Advanced Insurance Law seminar.

[67] 2010 WL 5646054, at *16-17 (E.D. Tex. Sept. 2, 2010).

[68] *Id.* at *17.

After acknowledging that no Texas court had addressed the issue of which type of exhaustion is the rule in Texas, the court decided that based on a thorough examination of *Garcia*, the Texas Supreme Court would decide that vertical exhaustion most accurately reflects what appears to be the rule.[69]

In *LSG Technologies*, Trinity Lloyd's and Trinity Universal provided primary CGL coverage to two companies that were defendants in numerous asbestos and mixed dust cases alleging damages occurring over many years.[70] The insured had excess coverage through United States Fire Insurance and brought suit to secure the excess carrier's participation.[71] U.S. Fire argued that all of the primary policies must be exhausted before it was obligated to respond — essentially it propounded horizontal exhaustion.[72] On the other hand, the plaintiffs argued for vertical exhaustion.[73] The court stated that horizontal exhaustion could not be reconciled with the oft-quoted paragraph from *Garcia,* which states that the insured is in the best position to identify the policies that would maximize coverage.[74] The key to the decision rested on the anti-stacking rule of *Garcia*:

> [E]ven when a single occurrence triggers several policies, consecutive, non-overlapping policies cannot be combined — or "stacked" — to create a policy limit that equals the aggregate of the individual policies' limits. It would, therefore, be inconsistent with such a rule to require that the limits of consecutive, non-overlapping [policies] be exhausted before the excess insurer's obligations are triggered.[75]

The court then acknowledged that excess insurance was not at issue in *Garcia*, but seized on dicta from the case for guidance: "[M]ultiple policies may provide an aggregate limit under certain circumstances, *such as if the insured purchased concurrent excess liability insurance.*"[76] Thus, according to the Eastern District, the Texas Supreme Court would not employ horizontal exhaustion such that all primary policies that provide coverage must be exhausted before an excess carrier's obligations attach.[77]

Later, the court cited two public interest factors which it determined supported its decision to adopt vertical exhaustion: (1) it neither maximizes nor minimizes primary or excess coverage; and (2) it respects the distinction between primary and excess insurers while precluding excess insurers from avoiding coverage in long-term, continuous trigger cases.[78]

In *Trammel Crow Residential Co. v. St. Paul Fire & Marine Ins. Co.,* Judge Godbey, relying on *Garcia* and *LSG Techs.*, held that Texas law requires vertical exhaustion.[79] The court discussed the issue as follows:

> [The insured] advocates letting the insured pick any applicable policy year and park the loss there, potentially exhausting that year's primary coverage and "spiking" up into an excess layer. When the damage occurred over several policy years, this initially appears to saddle one unlucky year's carriers with a disproportionate share of the loss. On closer examination, however, that is not the case. An insurer who pays a disproportionate share of the loss simply assumes the burden of seeking recovery from other available policies. In the absence of vertical exhaustion, the burden to seek recovery from all potentially applicable polices would rest on the insured. From this perspective, the choice between vertical and horizontal exhaustion is one of which side should bear the burden of seeking contribution from other insurers-the insured or the carrier. It does not seem inequitable to place this administrative burden (and associated risks) on the carrier rather than the insured.

The relationship between primary carriers and excess carriers is anything but seamless. They often have divergent interests due to the differing duties and responsibilities. As a result, these competing interests often lead to disputes about the manner in which the case against the insured is being defended and the evaluation of the case from a liability standpoint. These issues are only further complicated by the presence of additional carriers through additional insured status or long tail claims. The relationships between the insured and insurer, and the insurer and other insurers, necessitate a legal architecture for delineating the

[69] *Id.*

[70] *Id.* at *2.

[71] *Id.*

[72] *Id.* at *17.

[73] *Id.*

[74] *Id.* at *19.

[75] *Id.*

[76] *Id.* at *19-20 (quoting *Garcia*, 876 S.W. 2d at 855 n.24.)

[77] *Id.*

[78] *Id.* at 21-22.

[79] No. 3:11-CV-2853, (N.D. Tex. Dallas Div. Jan. 21, 2014).

responsibilities of each—the priority of coverage. What type of exhaustion Texas requires and what constitutes exhaustion is inherently part of the priority of coverage discussion.

CONCLUSION — YOU DON'T HAVE TO GO HOME, BUT YOU CAN'T STAY HERE

As illustrated above, priority of coverage issues can come up in a variety of contexts and present varying complications. Being cognizant of the framework Texas courts use to navigate these issues is paramount for attorneys and insurers alike. Understanding the interplay between other insurance clauses; primary and excess lines of coverage; and exhaustion can mitigate uncertainty in underwriting and litigation. In short, enjoys a trip to the pub, but no one wants to get stuck with the entire tab.