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Client Alert

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Texas Supreme Court: Liability Insurers may have a Duty to Indemnify Even if the Duty to Defend Never Arises

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On February 25, 2011, the Texas Supreme Court held that a liability insurer may have a duty to indemnify its insured even if the duty to defend never arises. *See The Burlington Northern and Santa Fe Railway Company v. National Union Fire Ins. Co.*, 334 S.W.3d 217 (Tex. 2011). This decision reaffirms its prior, and somewhat controversial, decision in *D.R. Horton-Texas, Ltd. v. Markel International Ins. Co.*, wherein the Texas Supreme Court similarly held that liability insurer's "duty to indemnify is not dependent on the duty to defend and that [it] may have a duty to indemnify its insured even if the duty to defend never arises." 300 S.W.3d 740 (Tex. 2009).

Interplay Between the Duties to Defend and Indemnify

Under most liability insurance policies, an insurer assumes: (1) the duty to defend its insured against certain third-party claims, and (2) the duty to indemnify its insured, that is, to pay all covered claims, settlement or judgments against the insured. While both duties arise under the same policy, they are subject to different legal standards as to when and how they are triggered. In most jurisdictions, the duty to defend is triggered before litigation is completed, and is determined by comparing the allegations in the underlying petition or complaint to the policy (also known as the "eight corners rule"). If any of the allegations or claims against the insured would potentially lead to recovery under the policy, the insurer owes a duty to defend the insured, at least until the possibility of coverage is eliminated. On the other hand, the duty to indemnify is not triggered until litigation is completed and liability under the policy has been conclusively determined.

In other words, the insurer has a duty to defend its insured against a lawsuit based merely on the potential of liability under a policy, despite the fact that it could eventually be determined that the insurer has no duty to indemnify the insured. As a result, the duty to defend is generally considered to be broader than the duty to indemnify. Because the duty to defend is broader than the duty to indemnify, most insurers argue—and several jurisdictions agree—that "no duty to defend equals no duty to indemnify," regardless of extrinsic evidence. Recently, however, the Texas Supreme Court made it clear that Texas is not one of those jurisdictions.

The Burlington Northern and Santa Fe Railway Co. v. National Union Fire Ins. Co.

The Burlington Northern and Santa Fe Railway Company ("BNSF") contracted SSI Mobley ("Mobley") to control vegetation along certain areas of BNSF's railroad right-of-way. The contract term was "1994 through 1996," and it required Mobley to name BNSF as an additional insured on its liability policy during that time period. Following a fatal automobile accident with a train at one of the railroad crossings serviced by Mobley on August 25, 1995, the survivors of the decedents sued BNSF for failing to properly maintain the "excessive vegetations at the crossing at the time of the collision."

Pursuant to its service contract with Mobley, BNSF tendered defense of the case to Mobley's insurer, National Union, as additional insured under Mobley's policy. Even though the accident at issue clearly occurred during Mobley's service contract's term period, the underlying pleadings indicated that Mobley's actions had happened in the past. Based on these allegations, National Union denied that it had either the duty to defend or indemnify BNSF pursuant to the policy's "completed operations" exclusion. In turn, BNSF filed suit seeking a declaratory judgment that National Union had both duties. After some procedural maneuvering in the declaratory judgment action, the trial court granted summary judgment in National Union's favor, holding that it had no duty to defend or indemnify BNSF.

On appeal, the El Paso Court of Appeals affirmed the trial court's ruling. In reaching this conclusion, the appellate court applied the "eight corners rule" (i.e., compared the allegations in the underlying petition to the language in the policy) and determined that Nation Union had no duty to defend because the "completed operations" exclusion precluded coverage under the policy. Then, without considering any extrinsic evidence, the appellate court concluded that National Union must not have a duty to indemnify.

On review, the Texas Supreme Court held that the lower courts erred in not considering extrinsic evidence in evaluating National Union's duty to indemnify. While the Court acknowledged that "[i]n some circumstances the pleadings can negate both the duty to defend and the duty to indemnify[,]" the Court held that "the pleadings [in this case] do not show that contractual provisions and other extrinsic evidence cannot possibly bring Mobley's vegetation control

operations within coverage of National Union's policy for the 1995 accident when Mobley's contract unquestionably extended through 1996." As a result, the Texas Supreme Court reversed the appellate court's judgment and remanded the case back to that court to consider the summary judgment evidence in the record.

Conclusion

The *Burling Northern* ruling is a warning to all liability insurers that they still may owe a duty to indemnify even when the underlying pleadings negate the duty to defend. On the other hand, it is a reminder to all policyholders that claims for coverage might still exist even when the insurer appears to have no duty to defend. Either way, insurers and policyholders should never accept the allegations in the underlying pleadings as true when analyzing the duty to indemnify. If it appears the underlying facts may trigger coverage when the underlying allegations do not, such facts should not be ignored. Out of an abundance of caution, it may be necessary to retain experienced coverage counsel to evaluate these types of complicate coverage issues.

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