



NEW TEXAS COVERAGE CASE ALERT – November 17, 2010

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Ambiguous Reservation of Rights Letters and Mishandling of Non-Insured's Defense Cause Trucking Insurer to Have Potential Responsibility for Clearly Uncovered Judgment Entered Against a Non-Insured Male "Cross-Dresser"

In 2008 the Texas Supreme Court held in the *Ullico* case that the doctrines of waiver and estoppel cannot operate to re-write the coverage afforded by a liability policy even if the insurer defends an insured without reserving rights to deny coverage. But the court left open the possibility that if the insurer failed to reserve rights and that caused actual prejudice or harm to the insured, there could be circumstances where the insurer could be held liable under estoppel principles. A November 10, 2010 opinion from a Dallas federal judge, *Canal Ind. Co. v. Palmview Fast Freight Transp., Inc.*, 2010 WL 4520908 (N.D. Tex. 2010) now gives us at least one example of how sloppy claims handling and hired defense counsel's lack of clarity in who they represent and mishandling of the trial can lead to a really bad outcome for both counsel and the insurer that hired them.

Canal insured a trucking firm but not an individual, Vela. Both were sued by a driver who was injured during unloading operations. Canal tendered a defense to both via a single defense firm even though it was undisputed that the policy did not cover Vela. Defense counsel filed an answer for the company but not Vela, but during the course of the case then filed motions and discovery sometimes on behalf of "defendants." Defense counsel, according to Vela, also assured him at various times that they represented both him and the company, so he did not hire separate counsel. Canal's several reservation of rights letters sent to Vela at different times but addressed to the trucking company raised the employee injury and worker's compensation exclusions, but not the issue that Vela individually was not an insured on the policy. With trial only a week away, another attorney from the defense firm appeared at a pretrial conference and represented that she did not know whether her firm represented both or only the company. The next day, Plaintiff nonsuited the company, leaving Vela as the only defendant. That same day, Canal issued a third reservation of rights addressed to Vela at his residence address but still ambiguous as to whether it was addressing coverage for him individually or only the company. It also did not alert him that he was not an insured on the policy. Defense counsel finally filed an answer for Vela on the morning of trial.

On defense counsel's advice, Vela did not appear at trial, as defense counsel believed that there was possibly a service defect and because she did not believe that the jury would like that Vela was a cross-dresser. Although Vela had earlier told defense counsel that Plaintiff had tested positive for cocaine on the day of the accident, defense counsel failed to retain a toxicology expert or prove up the drug test results in admissible form and the judge excluded the evidence. The jury returned a verdict against Vela for over \$300,000.

In Canal's declaratory action, after finding no *waiver* of coverage defenses, the court held under *Ullico* that there were fact questions on *estoppel*, *i.e.*, whether Canal and defense counsel



misrepresented material facts with knowledge of those facts and intent that they be relied upon by Vela and whether Vela, in fact, detrimentally relied on them. This was because of:

- Defense counsel's assurances to Vela that they represented him leading Vela to not hire his own counsel;
- Canal's confusing and ambiguous reservation of rights letters that, while sent to Vela, did not clearly purport to address his, as opposed to the company's, coverage problems;
- Canal's failure to have defense counsel withdraw after the nonsuit of the named insured company and, defense counsel's filing of an answer on behalf of Vela on the morning of trial instead;
- Defense counsel's lack of adequate trial preparation arguably leading to the adverse verdict.

PRACTICAL POINTERS: This case illustrates (1) the importance at the outset that the insurer and its defense counsel understand precisely who defense counsel is being hired to represent and how a fuzzy understanding of that can lead to big problems down the road; (2) the importance of early/timely separate reservation of rights letters to each defendant making it clear whose coverage problems are being addressed, especially when there is a close connection between the defendants and some coverage issues apply to one but not the other. As this case demonstrates, while coverage defenses applicable to only one, seemingly peripheral, defendant may seem inconsequential early in a case, they may become critical later, particularly if the plaintiff dismisses claims against the main defendant leaving only the defendant originally viewed as peripheral.

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