



Great American Insurance Co. v. Hamel:

The Texas Supreme Court Clarifies the Circumstances under which a Judgment Entered against a Defendant-Insured May Be Enforced by a Plaintiff-Assignee in a Subsequent Coverage Action

By: Susan A. Kidwell

In *Great American Insurance Co. v. Hamel*, 2017 WL 2623067 (Tex. June 16, 2017), the Texas Supreme Court more precisely defined the circumstances under which an insurance company that wrongfully fails to defend an insured may be bound by a judgment against the insured in a subsequent suit brought by the underlying plaintiff as the insured's assignee. The Court re-affirmed that grounds for invalidating an assignment are narrow, but even when an assignment is valid, the Court made it clear that a judgment will not be enforced unless it resulted from a "fully adversarial trial." *Great American* is significant for: (1) defining the term "fully adversarial trial"; (2) explaining what sort of evidence is sufficient to establish the existence (or lack of) adversity; and (3) confirming that, when liability issues are not decided in a "fully adversarial trial," parties may properly litigate those issues in a subsequent coverage suit.

Background: The Hamels (underlying plaintiffs) hired a builder to finish building their home. A few years later, they noticed signs of water damage in their home and sued the Builder for problems allegedly related to improper use or installation of stucco on the exterior of their home. The Builder submitted the claim to its insurer, Great American Insurance Company, but Great American wrongfully denied the defense.

As the Court noted, "[w]ithout the benefit of insurance coverage, the Builder had limited assets to fund its defense." *Id.* at *3. The week before a bench trial, the parties entered into a Rule 11 agreement by which the Hamels agreed not to enforce a favorable judgment against any of the Builder's assets—except its insurance policy—in exchange for the Builder's agreement to appear at trial without seeking a continuance. After the trial court rendered judgment awarding the Hamels \$365,089 in damages (the "Damage Judgment"), the Builder assigned most of its rights against Great American to the Hamels.

The Hamels (as the Builder's assignee) then sued Great American for breach of contract and declaratory relief. After another bench trial, the trial court rendered judgment awarding the Hamels "covered damages in the underlying Damage Judgment of \$355,838, plus interest, court costs, and attorney's fees." *Id.* at *4. Great American appealed, arguing that it was not bound by the Damage Judgment under the Texas Supreme Court's holding in *State Farm Fire & Casualty Co. v. Gandy*, 925 S.W.2d 696, 714 (Tex. 1996), which prohibits the enforcement of judgments rendered without a "fully adversarial trial." But the El Paso Court of Appeals affirmed most of the trial court's judgment, "holding that Great American breached its duty to defend the Builder from the Hamels' suit, the Damage Judgment was the result of a fully adversarial trial, and the Builder's assignment of its claims against Great American to the Hamels was valid." *Great Am.*, 2017 WL 2623067 at *4.

Validity of the Assignment: The Texas Supreme Court reaffirmed the general rule that "an insurer that wrongfully refuses to defend its insured is barred from collaterally attacking a judgment or settlement between the insured and the plaintiff." *Id.* at *5. However, it also affirmed Gandy's holding that, when a plaintiff seeks to enforce a judgment against an insurer as *the insured's*



assignee, the assignment is invalid if (1) it was made prior to adjudication of the plaintiff's claim in a fully adversarial trial; (2) the defendant's insurer tendered a defense, and (3) the insurer either accepted coverage or made a good faith attempt to adjudicate coverage issues before adjudication of underlying claim. *Id.* Although the Court left open the question of "whether an assignment that lacked one or more of *Gandy's* characteristics could be invalid," it confirmed that, when *none* of those characteristics are present, there is "no reason to invalidate [the] assignment." *Id.* at *6. But that did not end the inquiry.

Enforceability of the Underlying Judgment against Great American: The Texas Supreme Court rejected the court of appeals' approach, which "necessarily requires courts to retroactively evaluate and thus second-guess trial strategies and tactics" in order to determine how "fully" (i.e., effectively) each party's trial performance was. *Id.* at *7. Instead, the Court clarified that "the controlling factor is whether, at the time of the underlying trial or settlement, the insured bore an actual risk of liability for the damages awarded or agreed upon, or had some other meaningful incentive to ensure that the judgment or settlement accurately reflects the plaintiff's damages and thus the defendant-insured's covered liability loss." *Id.* In other words, "proceedings lose their adversarial nature when, by agreement, one party has no stake in the outcome and thus no meaningful incentive to defend itself." *Id.* at *8.

Applying those principles to the present case, the Court concluded that "the pretrial agreement effectively removed any financial stake the Builder had in the outcome of the Damage Suit, thereby eliminating any incentive the Builder had to oppose the Hamels' claims. This turned the Damage Suit into a mere formality—a pass-through trial aimed not at obtaining a judgment reflective of the Hamels' loss, but instead at obtaining a potentially inflated judgment to enforce against Great American." *Id.* Under those circumstances, the Court held that the Damage Judgment was not binding under *Gandy*.

However, the Court declined to "suggest that a formal, written pretrial agreement that eliminates the insured's financial risk will always be either necessary or sufficient to disprove adversity." *Id.* at *9. Instead, it held that "the presence of such an agreement creates a strong presumption that the judgment did not result from an adversarial proceeding, while the absence of such an agreement creates a strong presumption that it did." *Id.* The Court then explained how each party might overcome their respective presumptions: (1) the insurer may "demonstrat[e] that, even though the plaintiff and insured defendant did not enter into any formal, written agreement, the evidence nonetheless establishes that the defendant had no meaningful stake in the outcome of the underlying litigation"; and (2) "the plaintiff (acting as the defendant's assignee) may overcome the presumption by submitting evidence demonstrating that the defendant retained a meaningful incentive to defend the underlying suit despite an agreement that eliminated the defendant's financial risk." *Id.*

At trial, the Builder expressly confirmed that "the parties' pretrial agreement eliminated any incentive the Builder had to defend against the Hamels' claims." *Id.* Based on that evidence, the Court held that "the Damage Trial was not fully adversarial and [therefore] the resulting judgment is not binding on Great American." *Id.*

Proper Remedy for Lack of Adversity: Although the Court refused to hold Great American to a judgment that did not result from a "fully adversarial proceeding," it also refused to "preclude the parties from properly litigating the underlying liability issues in a subsequent coverage suit." *Id.* at *10. After holding that the coverage suit "provided a vehicle to remedy the problems associated with the lack of adversity in the Damage Suit," the Court remanded the case in the interests of justice so the parties could properly litigate liability issues. *Id.* at *11.

Impact: *Great American* clarifies Texas law by confirming that (1) an assignment that does not meet any of *Gandy's* requirements is valid; (2) a judgment against an insured defendant is not enforceable by the plaintiff-assignee unless it is the result of a "fully adversarial trial"; and (3) when a judgment is not the result of a "fully adversarial trial," liability issues may be re-litigated in a subsequent



coverage action. Although the opinion repeatedly warns insurers about the “significant risks” of refusing to defend a claim (or at least litigate coverage) before a judgment is rendered, the outcome appears to mitigate those risks by significantly limiting a plaintiff’s ability to enforce an inflated judgment obtained in a non-adversarial proceeding. However, the Opinion also makes it clear that insurers cannot avoid liability altogether by refusing to defend a case and then arguing that an adverse—but covered—judgment is unenforceable because it was not the result of a “fully adversarial trial.” Under *Great American*, liability issues that are not properly litigated in the underlying litigation may have to be litigated in a subsequent coverage action.

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the author.

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