Reviewing the Hamel Case: The Importance of "Fully Adversarial" Proceedings

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The Texas Supreme Court recently issued its decision in *Great American Insurance Co. v. Hamel*, a closely watched case regarding the ability of insurers to contest liability for a judgment rendered against an insured who enters into a pre-trial agreement with a plaintiff that renders subsequent litigation not "fully adversarial."

Two incompatible lines of cases collided in *Hamel*. On one hand, the Supreme Court held, in *State Farm Fire & Casualty Co. v. Gandy*, 925 S.W.2d 696 (Tex. 1996), that a commercial general liability insurer cannot be bound by the judgment of a court against an insured that resulted from a pre-trial settlement agreement between a plaintiff and an insured. Such an agreement, whereby the plaintiff may obtain an admission of liability from the defendant in exchange for the plaintiff's promise to hold the defendant harmless and to try to collect on the judgment only against the defendant's insurer, presents an obvious risk of unfairness to the insurer. On the other hand, the Court has also ruled (in *Emp'rs Cas. Co. v. Block*, 744 S.W.2d 940 (Tex. 1988)), that an insurer that wrongfully refuses to defend its insured is barred from collaterally attacking a judgment or settlement between its insured and the plaintiff.

The facts in *Hamel* presented a perplexing combination of policy considerations. In *Gandy* the insurer had agreed to provide a defense to its insured, but the insured settled with the plaintiff before trial anyway and assigned his rights under his homeowner's policy to the plaintiff. In *Hamel*, by contrast, Great American *denied* a defense to its insured, Terry Mitchell Builders, Inc., or "TMB," when TMB was sued by homeowners who said that TMB had botched construction work it did on their house, resulting in water intrusion damages. Great American later conceded that its denial of a defense was a mistake, and that it should have agreed to provide a defense to TMB under the policy.

Before trial, the *Hamel* plaintiffs and TMB agreed that the plaintiffs would not attempt to pierce the corporate veil to collect any judgment against TMB's owner, but would proceed only against TMB's insurer, if TMB would not ask for a continuance and appear at trial. TMB also stipulated to certain facts that were important to establishing its liability for damages suffered by the plaintiffs. After the trial, which resulted in rendition of a $365,089 judgment against TMB, TMB assigned most of its rights against Great American to the plaintiffs.

So which policy considerations take precedence in a situation like this? Does the Court punish the insurer for denying a defense to the insured—wrongfully, as Great American admitted here—by refusing to allow it to challenge the trial court's judgment? Or is the danger of unfairness presented by the alleged collusion by plaintiff and TMB strong enough to override the onus on Great American for wrongfully denying the insured a defense at trial?

The Supreme Court held that the deleterious effects of collusion outweigh the policy concerns related to the insurer's denial of a defense to its insured. Thus, even in cases where an insurer has wrongfully denied a defense, "the controlling factor [in determining whether the insurer may collaterally attack a judgment or settlement] 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." The Court concluded that the plaintiffs and TMB eliminated the risk of financial liability to TMB's owner on the judgment that was eventually rendered by the trial court. It went on to hold that subsequent coverage litigation did not fully address the factual bases of the judgment obtained by the plaintiffs in the original trial. Thus, in the "interest of justice," the Court said, the judgment was reversed and remanded—in effect giving Great American a second try at challenging the original trial court's findings.

What does the *Hamel* case mean for Texas insurers? Our first-blush take is that *Hamel* will probably not dramatically affect the behavior of most carriers. In our experience, a decision to deny a defense to an insured is only taken after considerable deliberation. And for good reason: leaving an insured without resources or legal help to deal with a lawsuit is a good way to end up with a bad result at trial—a bad result that could come back to haunt the insurer in subsequent coverage litigation. While *Hamel* may offer some consolation to carriers who get it wrong in assessing their duty to provide a defense, it is not likely to induce many insurers to roll the dice with respect even to difficult claims. On the other hand, Texas insurers now have clear authority to contest even a judgment rendered at an ostensibly adversarial trial where evidence indicates that the insured, as a result of an agreement with the plaintiff, bore no real risk of financial liability for that judgment.