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Appellate and Constitutional Law Update February 27, 2024

Texas Supreme Court Allows Claimant to Sue Insurers Directly After Settlement, But Holds Settlement Agreement Does Not Bind Insurers

***In re Illinois Nat'l Ins. Co.*, No. 22-0872** – Decided February 23, 2024

On February 23, the Texas Supreme Court unanimously held that an insured suffers a "loss"—and a claimant can sue the insurers directly—when the claimant and the insured settle, and the claimant agrees to look solely to the liability insurance policy for any recovery. But, because the insured doesn't face liability beyond the insurance proceeds, the insurer isn't bound by the settlement agreement during the subsequent coverage litigation.

"Because the settlement agreement establishes that [the insured] is legally obligated to pay and is 'in fact liable' to [the claimant] for any recoverable insurance benefits, [the claimant] has suffered a 'loss' under the policies and the no-direct-action rule does not prevent [the claimant] from suing the Insurers directly."

JUSTICE BOYD, WRITING FOR THE COURT

Background:

A group of investors (GAMCO) brought a securities class action against Cobalt International Energy—an oil-and-gas exploration company—after the SEC announced an investigation into Cobalt. Cobalt's insurers denied coverage and defense costs. After Cobalt filed for bankruptcy, it settled with GAMCO for $220 million—which the parties believed to be the maximum coverage available under Cobalt's liability insurance policies. GAMCO agreed to look solely to Cobalt's insurers to recover the $220 million; Cobalt agreed to allow GAMCO to control the coverage litigation but didn't assign its policies or coverage claims. Both parties denied any fault or liability. The bankruptcy court and U.S. district court presiding over the GAMCO-Cobalt suit approved the settlement.

GAMCO then intervened in Cobalt's ongoing contract suit against its insurers. The trial court denied the insurers' jurisdictional pleas and summary judgment motions, holding that (1) Cobalt's defense costs and the settlement amount are covered "losses" under the policies; (2) GAMCO can sue the insurers directly; and (3) the settlement agreement is admissible in the coverage litigation, not subject to collateral attack, and could be used to establish the amount of Cobalt's loss. The Fourteenth Court denied mandamus relief.

Issues:

(1) Does an insured suffer a "loss" under a liability policy when its settlement agreement with the claimant doesn't require the insured to pay money and limits the claimant's recovery to any liability coverage available under the policy?

(2) Can a claimant that agrees in a settlement agreement to look only to the insured's insurance policies for recovery sue the insurers directly for insurance benefits?

(3) Is the insured-claimant settlement agreement binding on the insurer or admissible as evidence to establish coverage or the amount of loss?

Court's Holdings:

(1) Yes. The insured suffered a covered "loss" because the settlement agreement legally obligated the insured to pay the claimant any insurance benefits it receives in its coverage dispute with the insurers. The insurance policies are assets that belong to the insured, and liability policies like those at issue here require the insurers to pay benefits on behalf of the insured regardless of whether the insured actually pays. In so holding, the Texas Supreme Court rejected the notion that the claimant's covenant not to execute on the judgment prevents the insured from having a legal obligation to pay under the settlement agreement.

(2) Yes. Because the settlement agreement established that the insured had a legal obligation to pay its insurance benefits to the claimant, the claimant can sue the insurers directly to recover under the policies. Although the "no direct action" rule generally bars claimants from suing a defendant's insurer directly, it doesn't apply once the insured's legal obligation to pay the claimant is established by judgment or settlement.

(3) No. Because the settlement agreement didn't result from a "fully adversarial proceeding," it isn't binding against the insurers or admissible to establish coverage or the amount of the insured's loss.

What It Means:

- The Court confirmed that, in the subsequent coverage litigation against the insurer, a settlement agreement between the insured and the claimant—which protects the insured "against any 'actual risk of liability' beyond its obligation to pay insurance benefits it may or may not receive"—would be neither binding nor admissible because it didn't "result from a fully adversarial proceeding."
- Although mandamus is generally "unavailable when a trial court denies summary judgment, no matter how meritorious the motion," the Court held that the insurers had no adequate remedy by appeal because the trial—at which the insurers wouldn't be able to challenge their liability for the full amount of the settlement agreement—would've been "a complete waste of the courts' and parties' resources."

Gibson Dunn Appellate Honors

The Court's opinion is available here.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding developments at the Texas Supreme Court. Please feel free to contact the following practice leaders:

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