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TEXAS SUPREME COURT RULES THAT EXCESS POLICY'S QUALIFIED FORM FOLLOWING PROVISION DID NOT INCLUDE COVERAGE FOR DEFENSE COSTS

The Ohio Casualty Insurance Company v. Patterson-UTI Energy, Inc., __S.W.3d ___; 2024 WL 5172096 (Tex. 2024)

In *Ohio Casualty v. Patterson,* the Texas Supreme Court analyzed the contractual relationship between an insured (Patterson) and an excess carrier (Ohio Casualty). The subject of their dispute was coverage for defense expenses with regard to a drilling-rig incident that exhausted the primary policy and several layers of excess insurance below Ohio Casualty's layer. In fact, Ohio Casualty covered its share of the settlements, however, it refused to fund Patterson's uncovered defense expenses.

The settlements emanating from the Patterson drilling rig incident exhausted the primary policy, several excess policies and they were partially funded by Ohio Casualty itself. Even so, Patterson incurred several millions of dollars of defense expenses that Ohio Casualty refused to cover leading to this coverage litigation. The trial court ruled in favor of Patterson that the defense expenses were covered under the Ohio Casualty policy. Next, the Houston 14th District Court of Appeals affirmed the trial court judgment in favor of Patterson.

The Texas Supreme Court, then granted Ohio Casualty's Petition for Review and it began its analysis by quoting from an 1886 Texas Supreme Court opinion published in the very first edition of the Southwest Reporter holding:

> As early as 1886, this Court recognized the "cardinal principle of … insurance law" that [t]he policy is the contract; and if outside papers are to be imported into it, this must be done in so clear a manner as to leave no doubt of the intention of the parties.

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2024 WL 5172096 at *2 quoting *ExxonMobil Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh,* 672 S.W. 3d 414, 418 (Tex. 2023) (in turn quoting from *Goddard v. E. Tex. Fire Ins. Co.,* 1 S.W. 906 907 (Tex. 1886)). The Court noted that it had "applied this principle in the context of follow-form excess-insurance policies. *Id.* citing *RSUI Indem. Co. v. Lynd Co.*, 466 S.W.3d 113, 118 (Tex. 2015).

In construing form-following excess policies, the Texas Supreme Court found that "follow-form" excess policies only "to *some degree* incorporate the provisions of the underlying policy," which "is determined by the excess policy's text." *Id.* (emphasis in the original). Accordingly, the Court reviewed the insuring agreement of the Ohio Casualty excess policy, which stated:

> We will pay on behalf of [Patterson] the amount of "loss" covered by this insurance in excess of the "Underlying Limits of Insurance[.] … Except for the terms, conditions, definitions and exclusions of this policy, the coverage provided by this policy will follow the [underlying policy].

Id.

Next, the Court focused on whether the disputed defense expenses constituted a "loss" because "'loss' is all the [Ohio Casualty] policy agrees to cover." *Id.* Here, the Ohio Casualty policy defined "loss" as:

> Those sums actually paid in the settlement or satisfaction of a claim which [Patterson is] legally obligated to pay as *damages* after making proper deductions for all recoveries and salvage.

Id. at 2-3. *(*emphasis added). In this regard, the Texas Supreme Court opined that "loss" under the Ohio Casualty policy required Patterson to be "legally bound to pay the amount [of the loss] 'in the settlement or satisfaction of a claim … as damages.'" *Id.* at 3.

On this point, the Texas Supreme Court "agree[d] with Ohio Casualty that the [Ohio Casualty] excess policy does not cover attorneys fees as 'loss,'" because they "do not constitute 'damages.'" *Id.* at 6. Since a party's own attorneys fees "are not, and have never been, damages," in order for Patterson's defense expenses to qualify a "loss," the term "damages" would have to be given a specialized meaning. *Id.*

On the one hand, the primary policy specifically provided that defense expenses were covered. On the other hand, the Ohio Casualty policy did not so provide and it did not define "damages." *Id.* With regard to the breadth of "damages," the Texas Supreme Court reasoned that the context surrounding the word "damages" in the Ohio Casualty policy did not suggest anything other than its usual definition. Accordingly, the Court rejected the notion that damages in the Ohio Casualty policy included an expanded definition to include defense expenses. In this regard, the Court deduced that "a party paying its *own* defense expenses would not do so 'in the settlement or satisfaction of a claim'". *Id.* at 5.

After ruling in favor of Ohio Casualty that its excess policy did not cover the subject defense expenses incurred by Patterson, the Texas Supreme Court utilized the remainder of the opinion rejecting Patterson's arguments as to why the Ohio Casualty policy incorporated the primary policy's coverage of defense expenses. Among the points made by Court were: "Patterson attributes far too much to the excess policy's 'follow-form' status; and Patterson relies heavily but mistakenly on our decision in *RSUI*." *Id.* at 4.

Next, the Texas Supreme Court addressed Patterson's argument that because the Ohio Casualty excess policy's asbestos and pollution exclusions specifically excluded coverage for defense expenses, the Ohio Casualty excess policy must otherwise cover them. In other words, why else would these exclusions need to include defense expenses if defense expenses were not otherwise covered.

On this point, the Texas Supreme Court addressed whether these provisions exclusion of defense expenses were irrelevant redundancies or potentially material surplusage, finding that the Ohio Casualty

> excess policy's specific references to attorneys fees in the asbestos and pollution exclusions were understandable redundancies designed to eliminate any conceivable doubt—not surplusage that would alter our interpretation that would alter our interpretation of the rest of the policy. The language of the two exclusions suggests a belt-and-suspender approach.

Id. at 5.

In so doing, the Texas Supreme Court made two notable points. First, "[l]ike all canons of construction, the surplusage canon 'must be applied with judgment and discretion, and with careful regard to context." *Id.*. Second, "when faced with legal language that appears repetitive or otherwise unnecessary, [] drafters often include redundant language to illustrate or emphasize their intent." *Id*.

In ruling that the Ohio Casualty policy did not cover defense expenses, the Texas Supreme Court criticized the court of appeals for "first examining the terms of the [primary] policy and then looking to the excess policy to determine coverage." *Id.* at 1. As a result, the Court concluded that: "[t]his mistaken approach led to an erroneous result: while the underlying policy covered the insured's defense expenses, the excess policy does not." *Id.*

One takeaway from the Texas Supreme Court opinion in *Ohio Casualty v. Patterson* is that qualified form following excess insurers will not be held to a standard of perfection with respect to drafting policy terms to exclude coverage for types of losses covered by the primary and/or underlying policies. Another takeaway is that inconsistencies within a policy can be justified as irrelevant redundancies as opposed to surplusage that supports broadening the coverage.

It is interesting to note that *Ohio Casualty v. Patterson* is a unanimous opinion. Accordingly, no segment of the Court offered a contrary construction of the Ohio Casualty policy, such as the construction relied on by the trial court and the court of appeals. Another interesting

aspect is that it is the final Texas appellate insurance opinion participated in by the retiring Chief Justice Nathan Hecht. Chief Justice Hecht has long made his mark on Texas insurance law going back at least to his concurring opinion in the landmark excess versus primary equitable subrogation *Stowers* opinion: *American Centennial Ins. Co. v. Canal Ins. Co.*, 843, S.W. 2d 840, at 485-86 (Tex. 1992), which laid the foundation for later cases such as *American Phys. Ins. Exch. v. Garcia,* 876 S.W.2d 842 (Tex. 1994).

At the end of the day, *Ohio Casualty v. Patterson* is another example of the Texas Supreme Court focusing on the policy language to restrict coverage; as opposed to relying on construction rules and the like to broaden coverage. As a result, by many accounts, Texas has emerged as the most unique jurisdiction for insurance law in the country,