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SUPREME COURT OF TEXAS
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No. 14-1007

IN THE SUPREME COURT OF TEXAS

**GREAT AMERICAN INSURANCE COMPANY AND
GREAT AMERICAN LLOYDS INSURANCE COMPANY,**
Petitioners,

v.

GLEN HAMEL AND MARSHA HAMEL,
Respondents.

**ON PETITION FOR REVIEW FROM CAUSE NO. 08-11-00302-CV
EIGHTH DISTRICT COURT OF APPEALS
EL PASO, TEXAS**

PETITIONERS' BRIEF ON THE MERITS

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TO THE HONORABLE SUPREME COURT OF TEXAS:

Petitioners Great American Insurance Company and Great American Lloyds Insurance Company ("Great American"), pursuant to Texas Rule of Appellate Procedure 55, respectfully submit this Brief on the Merits and show as follows:

STATEMENT OF THE CASE

This is an insurance case. Respondents Glen and Marsha Hamel ("Hamel") seek to collect a judgment they obtained against Great American's insured, Terry Mitchell Builder, Inc. ("TMB"), in an underlying lawsuit styled *Glen Hamel and Marsha Hamel v. Terry Mitchell Builder, Inc., et al.*, Cause No. 2002-20076-158 in the 158th Judicial District Court of Denton County (the "underlying lawsuit"). The underlying lawsuit involved defects in a house started by another contractor, but completed for Hamel by TMB. Hamel secured a judgment against TMB, and then filed suit against Great American to recover on the judgment.

The Honorable Judge David Evans presided in Hamel's case against Great American, which was filed in the 48th Judicial District Court of Tarrant County. The case proceeded to a bench trial on whether Great American is liable for the underlying judgment. On June 13, 2011, the trial court entered judgment against Great American. Great American timely filed its notice of appeal on September 9, 2011, with the Second District Court of Appeals in Fort Worth. By order dated September 26, 2011, this case was transferred to the Eighth District Court of

Appeals in El Paso. On September 19, 2014, the El Paso Court of Appeals rendered its opinion, which was authored by Justice Yvonne Rodriquez and joined by Chief Justice Ann Crawford McClure. Justice Guadalupe Rivera did not participate in the opinion, the citation for which is *Great Am. Ins. Co. v. Hamel*, 444 S.W.3d 780 (Tex. App.—El Paso 2014, pet filed). The Court of Appeals affirmed the trial court's decision that Great American is liable for the underlying judgment, but modified the trial court's ruling that Hamel is entitled to recover the mental anguish portion of the award. Great American filed a motion for rehearing, which was denied on October 29, 2014. On January 14, 2015, Great American filed its Petition for Review. On June 17, 2016, this Court ordered briefing on the merits. On July 6, 2016, the Court granted Great American an extension to and including August 17, 2016, to file this Brief on the Merits.

STATEMENT OF JURISDICTION

This Honorable Court has jurisdiction under Texas Government Code § 22.001(a)(2) because the Court of Appeals' decision conflicts with this Court's decision in *State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696 (Tex. 1996), and its progeny.

Further, this Honorable Court has jurisdiction under Texas Government Code § 22.001(a)(6) because the Court of Appeals committed a significant error of substantive law that is important to the jurisprudence of Texas.

ISSUES PRESENTED FOR REVIEW

The Court of Appeals found that the adversarial trial requirement of *State Farm Fire & Cas. Co. v. Gandy,* 925 S.W.2d 696 (Tex. 1996), did not apply because this case does not involve *Gandy*'s exact fact pattern. It also determined there was an adversarial trial in the underlying lawsuit, and that the underlying judgment did not result from collusion.

The following issues are presented for review:

1. Should *Gandy's* rule of refusing to enforce a judgment against a defendant's insurer in the absence of a fully adversarial trial apply in cases that do not match *Gandy's* precise fact pattern, but where the reasons for application of its rule are still present?

2. Is a proceeding where (1) the insured has no financial stake, (2) the parties entered into undisclosed agreements beforehand and during the proceeding and afterward took other affirmative steps to manufacture insurance coverage and to facilitate later coverage litigation, and (3) the insured's participation was minimal, collusive as a matter of law, and not an adversarial trial for purposes of the application of *Gandy*?

3. May a plaintiff recover from an insurer based on a judgment obtained by collusion or in violation of *Gandy's* adversarial trial requirement by submitting liability and damages evidence in a subsequent coverage trial, or is the original judgment tainted such that the plaintiff cannot recover?

STATEMENT OF FACTS

Hamel's house is constructed

Hamel hired GSM Corp. ("GSM") to build a house.[1] When the house was 60 to 70% complete, GSM abandoned the project.[2] Hamel contracted with TMB to finish the house, which was completed in October 1995.[3] The house was clad with an Exterior Insulation and Finishing System ("EIFS").[4]

TMB purchases the insurance policies

Great American insured TMB under general liability insurance policies beginning May 3, 1996, and continuing to May 3, 2001.[5] The Great American policies effective from May 3, 1999, through May 3, 2001, excluded coverage for damage when EIFS was used on the structure.[6]

Hamel notices problems

In August of 2000, Hamel noticed signs of water intrusion.[7] The first examination of the house took place in February 2002, when Don Yeandle, an expert retained by Hamel, conducted an investigation that revealed damage

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[1] Reporter's Record ("R.R."), Vol. 11, Ex. 10, pp. 35-36.
[2] R.R. Vol. 11, Ex. 10, pp. 32-33, 36.
[3] R.R. Vol. 11, Ex. 10, pp. 36, 39.
[4] R.R. Vol. 13, Ex. 39; R.R. Vol. 16, Ex. 105.
[5] R.R. Vol. 12, Ex. 16; Vol. 17, Ex. 111-114.
[6] R.R. Vol. 12, Ex. 16, endorsement CG8802 11/85.
[7] R.R. Vol. 11, Ex. 10, pp. 39-41; *Great Am. Ins. Co. v. Hamel*, 444 S.W.3d 780, 785 (Tex. App. El Paso – 2014, pet. filed).

throughout the building envelope.[8] Yeandle opined that problems with the house's EIFS caused or contributed to the problems.[9]

Hamel files suit against TMB

Hamel filed suit against TMB.[10] TMB tendered the defense to Great American, which declined to defend.[11] Great American declined to defend TMB because, among other reasons, when TMB tendered the suit to Great American the trigger rule followed in property damage cases by most Texas courts that had considered the issue was initial manifestation.[12] There was no question that water intrusion first manifested in August 2000,[13] during a policy that contained the EIFS exclusion.[14]

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[8] R.R. Vol. 13, Ex. 39; Vol. 16, Ex. 105.
[9] R.R. Vol. 13, Ex. 39; R.R. Vol. 16, Ex. 105.
[10] R.R., Vol. 14, Ex. 53.
[11] R.R., Vol. 12, Ex. 24.
[12] *See Dorchester Dev. Corp. v. Safeco Ins. Co*., 737 S.W.2d 380 (Tex. App.—Dallas 1987, no writ.); *OneBeacon Ins. Co. v. Don's Bldg. Supply, Inc*., 516 F. Supp. 2d 615 (N.D. Tex. 2006); *Am. Home Assur. Co. v. Unitramp Ltd*., 146 F.3d 311 (5th Cir. 1998); *Snug Harbor*, *Ltd. v. Zurich Ins*., 968 F.2d 538 (5th Cir. 1992); *State Farm Mut. Auto. Ins. Co. v. Kelly*, 945 S.W.2d 905 (Tex. App.—Austin 1997, writ denied); *Cullen/Frost Bank of Dallas, N.A. v. Commonwealth Lloyd's Ins. Co*., 852 S.W.2d 252 (Tex. App.—Dallas 1993), *writ denied,* 889 S.W.2d 266 (Tex. 1994) (per curiam). This Court in *Don's Bldg. Supply, Inc. v. OneBeacon Ins. Co*., 267 S.W.3d 20, 28-30 (Tex. 2008), which was decided three years after the conclusion of the underlying lawsuit, and during the first trial of this coverage case, announced that the trigger rule for Texas property damage cases is injury in fact. The coverage trial court declared a mistrial because of *Don's Building* and the parties, to a large extent, had to start the case again from scratch. R.R. Vol. 2, p. 6.
[13] R.R. Vol. 11, Ex. 10, pp. 39-41. *Hamel*, 444 S.W.3d at 785.
[14] R.R. Vol. 12, Ex. 16, endorsement CG8802 11/85.

TMB has no assets to pay any judgment Hamel might get – Hamel knows the only source of recovery is Great American

In the underlying lawsuit, Hamel sought significant damages, including recovery for repairs to the house, diminution in value of the property, reimbursement for temporary housing expenses, damage to the landscaping, and recovery for emotional distress.[15] TMB, a small home builder, had no assets to satisfy such a judgment. The only assets TMB owned were tools and a truck.[16] Thus, the only source of recovery was Great American. If the manifestation trigger rule were followed, there might have been no coverage because the Great American policy in effect at the time of initial manifestation contained an EIFS exclusion, which could have applied to Hamel's damages.[17]

Counsel for Hamel and TMB scheme to steer the suit into coverage under the Great American policy

With the possibility of no coverage hanging over their heads, Hamel and his counsel made an arrangement with TMB's lawyer so TMB would not put up a fight in the liability suit.[18] The attorneys for Hamel and TMB discussed the *Gandy* case, and tried to orchestrate a proceeding that would technically circumvent its application, while wholly disregarding its principles. [19]

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[15] R.R. Vol. 14, Ex. 53.
[16] R.R. Vol. 14, Ex. 67, pp. 19-20.
[17] R.R. Vol. 12, Ex. 16, endorsement CG 8802 11/85.
[18] R.R., Vol. 14, Ex. 67, pp. 11, 19-20, 30; Ex. 66, pp. 38-39, 46.
[19] R.R. Vol. 14, Ex. 66, pp. 18-19.

Hamel and TMB enter into a covenant not to execute against any of TMB's assets

On May 19, 2005, Hamel and TMB entered into an agreement whereby, in exchange for Terry Mitchell's agreement to testify at trial, Hamel agreed not to execute on Mitchell's assets to satisfy any judgment Hamel might obtain.[20] Hamel also agreed he would not attempt to pierce TMB's corporate veil or contest certain transfers of assets from TMB to other companies.[21] Hamel further agreed not to execute on TMB's tools or truck,[22] which were the only assets TMB owned.[23] This agreement insulated Mitchell and TMB from exposure for any of Hamel's damages because Hamel agreed, in essence, only to look to TMB's insurance policy to satisfy any judgment obtained.[24]

TMB drastically changes its position, drops its previously asserted defenses, and admits to liability

At the beginning of the lawsuit, TMB asserted numerous defenses against Hamel's claims, including the fact that it had no responsibility for the majority of the work on Hamel's home because it had been constructed by another builder.[25] Among the other defenses TMB asserted were a statute of limitations defense and a

[20] R.R., Vol. 11, Ex. 8.
[21] R.R., Vol. 11, Ex. 8.
[22] R.R., Vol. 11, Ex. 8.
[23] R.R., Vol. 14, Ex. 67, pp. 19-20.
[24] R.R., Vol. 11, Ex. 8.
[25] R.R. Vol. 12, Ex. 36.

failure to mitigate defense.[26] TMB maintained that it was not liable for any of Hamel's damages.[27] However, after Hamel signed the covenant not to execute, TMB drastically changed its position.[28]

On May 25, 2005, TMB signed a set of stipulations that conceded, among other things, that its conduct fell below the standard of care it owed Hamel.[29] The stipulations recited that TMB was responsible for the construction work already present before it became involved in the project.[30] This was contrary to TMB's written contract.[31] TMB admitted that it was liable for all of Hamel's damages, even those caused by third parties that TMB had no control over.[32] These stipulations were contrary to interrogatory answers that TMB had given.[33]

The stipulations contain unnecessary factual recitations solely for the purpose of steering the claims into coverage under the Great American policy

Hamel inserted "facts" and legal conclusions in the stipulations purporting to show that the EIFS on the house had nothing to do with his damages even though his main initial complaint was that the EIFS needed to be replaced because it had caused damage.[34] The stipulations executed by TMB contained statements

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[26] R.R. Vol. 12, Ex. 36.
[27] R.R. Vol. 12, Ex. 36.
[28] R.R. Vol. 12, Ex. 34.
[29] R.R. Vol. 12, Ex. 34, pp. 2-5.
[30] R.R. Vol. 12, Ex. 34, pp. 2-5.
[31] Compare R.R. Vol. 12, Ex. 34 (Stipulations) with R.R. Vol. 14, Ex. 45 (Contract).
[32] R.R. Vol. 12, Ex. 34, pp. 2-5.
[33] R.R. Vol. 12, Ex. 36.
[34] R.R. Vol. 14, Ex. 53; R.R. Vol. 13, Ex. 39; R.R. Vol. 16, Ex. 105.

regarding the EIFS on Hamel's house such as: "the construction problems identified herein are not related in any way to EIFS or any component part thereof…"[35]

The parties proceed to a sham trial where TMB has no stake in the outcome

The parties proceeded to a bench trial on May 26, 2005.[36] TMB had no financial stake in the outcome because Hamel had agreed not to execute on any of TMB's assets.[37] Mitchell directed TMB's attorney not to put up a fight because he had no stake in the matter.[38] Mitchell's personal assets were protected, and TMB had no significant assets on which Hamel could execute.[39] Any assets that TMB did own were also protected from execution by the agreement.[40]

TMB makes no effort to get credit for an earlier settlement

Earlier in the litigation, a co-defendant, STO, the manufacturer of the EIFS on the house, settled with Hamel for $25,000.[41] At the "trial" between TMB and Hamel, TMB made no attempt to get a settlement credit for the $25,000 paid by STO. Mitchell later testified that he was not concerned about getting a credit for the STO settlement after securing the covenant not to execute because he no longer

[35] R.R. Vol. 12, Ex. 34, p.4.
[36] R.R., Vol. 11, Ex. 10, p. 1.
[37] R.R., Vol. 11, Ex. 8; R.R., Vol. 14, Ex. 67, pp. 11, 19-20, 30.
[38] R.R., Vol. 14, Ex. 67, pp. 11, 19-20 30; Ex. 66, pp. 38-39, 46.
[39] R.R. Vol. 14, Ex. 67, pp. 13-14, 19-21, 26-27, 30.
[40] R.R., Vol. 14, Ex. 67, pp. 19-20
[41] R.R., Vol. 14, Ex. 68, p. 16.

had a stake in the case.[42]

Hamel introduces unnecessary coverage evidence at the liability trial and omits problematic evidence

At the "trial," Hamel questioned witnesses about EIFS, eliciting testimony that the EIFS had nothing to do with the problems at the house.[43] Neither this testimony, nor many of the proposed findings of fact and conclusions of law submitted by Hamel,[44] related to liability. The concept that EIFS had nothing to do with Hamel's problems is unsupported by the evidence that was developed up to the trial, and is contrary to what Hamel had earlier contended in the pleadings.[45] For example, some of the expert evidence Hamel developed (specifically the investigations and conclusions generated by Don Yeandle[46]) were not admitted at trial.[47] These reports were problematic in terms of the EIFS exclusion because, among other things, Yeandle's report[48] stated: "my attention was focused on flashing installation details at the EIFS cladding and areas where EIFS cladding intersected or terminated adjacent with roofing materials, fascia, or windows."[49] Yeandle's report was replete with references to the house's EIFS cladding, and

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[42] R.R. Vol. 14, Ex. 67, p. 21.
[43] R.R. Vol. 11, Ex. 10 at p. 29, 90-91.
[44] R.R. Vol. 14, Ex. 58.
[45] R.R. Vol. 14, Ex. 53-55.
[46] R.R. Vol. 13, Ex. 39, pp. MCG3252-63; R.R. Vol. 16, Ex. 105. Additionally, Hamel hired Richard Piper as an expert. Piper's report is included in the record at R.R. Vol. 13, Ex. 41, pp. MCG2995-97. However, it was not admitted into evidence in this case.
[47] R.R. Vol. 11, Ex. 10, p. 3.
[48] R.R. Vol. 13, Ex. 39; R.R. Vol. 16, Ex. 105.
[49] R.R. Vol. 13, Ex. 39, p. 1; R.R. Vol. 16, Ex. 105, p. 1.

how the cladding was intricately connected to all the damages to the house.[50]

TMB abandons its defenses under the parties' contract

Although Hamel's written contract with TMB contained a provision exonerating TMB from liability for GSM's work,[51] the contract was not admitted into evidence.[52] TMB made no effort to oppose Hamel's negligence claim by asserting the existence of the contractual provision or application of the economic loss rule.[53]

TMB's attorney makes no objections to any evidence, and he and Mitchell participate only minimally

At "trial," TMB's attorney, Robert Hudnall, gave no meaningful opening statement,[54] made no objections to Hamel's evidence, and asked a total of only nineteen questions on cross-examination.[55] Hudnall allowed Mitchell to admit to Hamel's allegations.[56] Hudnall asked only five questions of Mitchell[57] and did not try to rehabilitate any of Mitchell's numerous admissions, which were contrary to his previous interrogatory answers.[58] Hudnall asked Glen Hamel only seven

[50] R.R. Vol. 13, Ex. 39; R.R. Vol. 16, Ex. 105.
[51] R.R., Vol. 14, Ex. 45.
[52] R.R., Vol. 11, Ex. 10, p. 3.
[53] R.R., Vol. 11, Ex. 10.
[54] R.R., Vol. 11, Ex. 10, p. 6-7.
[55] R.R., Vol. 11, Ex. 10.
[56] R.R. Vol. 11, Ex. 10, pp. 8-34.
[57] R.R. Vol. 11, Ex. 10, pp. 32-33.
[58] R.R. Vol. 12, Ex. 36.

questions on cross examination,[59] and only seven questions of Hamel's expert, Don Yeandle.[60] The questions Hudnall asked Yeandle dealt mainly with Yeandle's offer to purchase Hamel's property, not with any of the substantive issues Yeandle testified to, or even Yeandle's qualifications to render the wildly speculative opinions he did. No effort was made to obtain any form of settlement credit for the $25,000 Hamel had received from co-defendant STO.[61] TMB's attorney did not make any argument against, or question Glen Hamel about, Hamel's request for a $50,000 award for mental anguish primarily suffered by his wife, who did not testify.[62] Hudnall called no witnesses on TMB's behalf, and made no closing argument.[63]

The parties conceal their scheme from the trial court

Neither the May 19 agreement nor the May 25 stipulations were put into evidence, nor was the trial court advised of their existence.[64]

TMB submits no findings of fact or conclusions or law

Only Hamel submitted proposed findings of fact and conclusions of law and a proposed judgment, which were signed without change on June 30, 2005.[65] The

[59] R.R. Vol. 11, Ex. 10, p. 75 and pp. 104-105.
[60] R.R., Vol. 11, Ex. 10, pp. 124-25.
[61] R.R. Vol. 14, Ex. 66, p. 15.
[62] R.R. Vol. 11, Ex. 10, pp. 69-71.
[63] R.R. Vol. 11, Ex. 10, page 126-27.
[64] R.R. Vol. 11, Ex. 10, p. 3; R.R., Vol. 14, Ex. 67, pp. 30-31; Vol. 15, Ex. 69, p. 14; Vol. 14, Ex. 66, pp. 36-39.
[65] R.R. Vol. 12, Ex. 15; R.R. Vol. 14. Ex. 50, 57, and 58.

findings of fact and conclusions of law were very similar to the stipulations Hamel and TMB previously agreed upon.[66]

Hamel gets the desired judgment, then TMB assigns its claims against Great American to Hamel

On June 30, 2005, the trial court entered a judgment awarding Hamel damages for repairs to the house, mental anguish, temporary housing costs, moving costs, and stigma.[67] On September 21, 2005, TMB assigned most of its rights against Great American to Hamel.[68] Hamel then filed this coverage suit against Great American.[69]

Hamel commences this coverage suit against Great American

Hamel filed suit against Great American to recover the judgment.[70] The case proceeded to a bench trial on whether Great American owed the judgment. On June 13, 2011, the trial court entered judgment against Great American, finding coverage for most of the underlying judgment and awarding Hamel attorney's fees, interest, and costs.[71] The trial court signed Findings of Fact and Conclusions of Law on July 20, 2011.[72] Among other things, the trial court concluded as a matter

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[66] R.R. Vol. 12, Ex.15; Vol. 12, Ex. 34.
[67] R.R. Vol. 12, Ex. 12.
[68] R.R. Vol. 12, Ex. 32. TMB retained its cause of action against Great American for any potential breach of the defense duty. Great American and TMB ultimately settled that claim. R.R. Vol. Ex. 67, pp. 31-32.
[69] C.R. Vol. 1, p. 2-7.
[70] C.R. Vol. 1, p. 2-7.
[71] C.R. Vol. 19, pp. 3448-3450.
[72] C.R. Vol. 19, pp. 3485-3495.

of law that the underlying proceeding was not collusive and was an adversarial trial.[73] Great American filed its motion for new trial on July 11, 2011, which was denied on August 23, 2011.[74] Great American timely filed its notice of appeal on September 9, 2011.[75] The Court of Appeals' opinion, for the most part, accurately states the facts, but omits many important details, which are explained above.

SUMMARY OF THE ARGUMENT

The Court of Appeals erred in not applying *Gandy's* adversarial trial requirement to this case, even though its facts differ from those presented in *Gandy*. The Court created *Gandy's* adversarial trial rule to protect the integrity of the judicial process, ensure the legitimacy of liability and damages determinations, and discourage collusion. These policies apply equally, if not more so, to certain cases that do not fall neatly within *Gandy's* exact fact pattern. This is one of those cases. Prior to the underlying proceeding, the parties destroyed any adversity between them by ensuring TMB had no stake in its outcome. The parties also entered into agreements they hid from the court, which not only destroyed adversity, but were designed to steer the case into coverage and to aid in the prosecution of subsequent coverage litigation. These violations of the fundamental principles announced by *Gandy* require a refusal to enforce the resulting judgment

[73] C.R. Vol. 19, pp. 3488-90.
[74] C.R. Vol. 19, pp. 3466-3473, 3501.
[75] C.R. Vol. 19, p. 3502.

against Great American because the judgment was not obtained through an adversarial trial. This is so even though Great American did not tender a defense to its insured, and there was no pre-trial assignment of TMB's rights. The principles of *Gandy*, and Texas law's well established protection of an insurer's right to contest indemnity, should result in applying *Gandy's* adversarial trial requirement and refusing to enforce the judgment in cases like this one.

The Court of Appeals erred in determining that the proceeding giving rise to the underlying judgment was an adversarial trial and not collusive. As a matter of law, where the insured has no financial stake in the outcome of a proceeding because the plaintiff has agreed not to execute on any of the insured's assets, there is no adversity and, therefore, no genuine contest of issues. When the trial court is neither advised of the parties' arrangement nor of stipulations signed by the insured that admit to liability, and there follows only a brief evidentiary hearing crafted to manufacture insurance coverage and in which the insured's participation is minimal, there is, as a matter of law, no adversarial trial and the result must be held collusive. Thus, the adversarial trial requirement was not met in this case.

Because *Gandy* supports application of the adversarial trial requirement to this case, and because there was no adversarial trial, the underlying judgment cannot be enforced against Great American. This means that any recovery by Hamel is precluded. Having created the tainted judgment in the first place, Hamel

cannot be heard to complain about that result. Neither the litigation of coverage issues in the trial court nor the admission of evidence relating to underlying liability and damage issues removes the taint associated with the findings and determinations that form the basis of the underlying judgment for which coverage was litigated. Where the judgment is tainted and collusive, liability and damages cannot be retried in the coverage case. The only result that furthers the policies of *Gandy* is that Hamel cannot recover.

ARGUMENT

1. THE COURT OF APPEALS ERRED IN REFUSING TO APPLY *GANDY'S* ADVERSARIAL TRIAL REQUIREMENT AND ENFORCING THE UNDERLYING JUDGMENT AGAINST GREAT AMERICAN EVEN THOUGH THIS CASE DOES NOT PRESENT *GANDY'S* EXACT FACT PATTERN.

In *Gandy*, this Court held that a judgment against State Farm's policyholder, Ted Pearce, in favor of Julie Gandy, a family member who sued Pearce for sexual assault, was not enforceable against State Farm because the proceeding between Pearce and Gandy was not an adversarial trial, but a proceeding designed to recover under State Farm's policy.[76] Rather than actually litigate liability and damages, the parties entered into an arrangement whereby Pearce assigned his rights under the policy to Gandy before trial, and consented to an agreed judgment

[76] *State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696, 714 (Tex. 1996).

against himself. Gandy, in turn, gave Pearce a covenant not to execute against his assets.[77]

Later, in *ATOFINA*, the Court considered the application of *Gandy* where the plaintiff and the insured entered into an agreed settlement of the plaintiff's claims.[78] The insured sought recovery of the settlement from its insurer. The Court determined that *Gandy* did not apply because there was no assignment of claims to the plaintiff and the insured had actually paid the settlement itself.[79] The insured paid not knowing whether there was ultimately coverage for the settlement. Because there was no collusion between the parties and no resulting distortion of liability or damages, *Gandy* was not implicated. The *ATOFINA* court stated in dicta that *Gandy* did not apply beyond its precise fact pattern.[80]

Sometimes, however, *Gandy's* precise facts are not present, but the reasons for refusing to enforce a judgment against an insurer because the judgment did not result from an adversarial trial are. Specifically, in cases where adversity is destroyed prior to the underlying proceeding because the insured has no stake in its outcome, where the parties conceal from the trial court the existence of agreements that alter the true nature and purpose of the proceeding, and where there is deliberate distortion of the proceeding geared toward the establishment of

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[77] *Id*. at 700-02.
[78] *Evanston Ins. Co. v. ATOFINA Petrochemicals, Inc*., 256 S.W.3d 660 (Tex. 2008).
[79] *ATOFINA*, 256 S.W.3d at 674.
[80] *ATOFINA*, 256 S.W.3d at 673.

insurance coverage and the facilitation of subsequent coverage litigation, a resulting judgment should not be enforceable against the insurer. Obviously, in such cases there is no adversarial trial. Because those factors are present here, the Court of Appeals erred in enforcing the underlying judgment against Great American. Whether and under what circumstances to apply *Gandy* is a question of law, which is reviewed *de novo*.[81]

A. The Reasons for Applying *Gandy* Exist in Cases Not Matching Its Fact Pattern

In *Gandy*, the Court specifically addressed the issue of whether an assignment of the insured's claims against the insurer to the plaintiff prior to trial was valid and enforceable.[82] It held that such assignments are invalid under a relatively specific set of circumstances, namely: (1) an assignment was made prior to determination of plaintiff's damages, (2) the insurer has tendered a defense, and (3) the insurer has either (a) accepted coverage, or (b) made a good faith effort to adjudicate coverage prior to trial.[83] But the Court also stated generally that "[i]n no event…is a judgment for plaintiff against defendant, rendered without a fully adversarial trial, binding on defendant's insurer or admissible as evidence of damages in an action against defendant's insurer by plaintiff as defendant's

[81] *In re Humphreys*, 880 S.W.2d 402 (Tex. 1994) (questions of law are always subject to *de novo* review).
[82] *Gandy*, 925 S.W.2d at 707-08.
[83] *Id*. at 714.

assignee."[84]

This case does not involve a *Stowers* claim, but is rather an attempt to recover on a judgment.[85] It also differs from *Gandy* in two respects: (1) Great American denied coverage and did not tender a defense,[86] and (2) TMB did not assign its rights against Great American to Hamel before the underlying proceeding, but did so soon afterward.[87] The absence of *Gandy's* exact fact pattern, however, does not mean that an underlying plaintiff and the defendant insured can do whatever they want to maximize liability, damages, and coverage. This Court's rationale for refusing to enforce a judgment against an insurer in the absence of a fully adversarial trial should also apply here. The parties' conduct violates the fundamental principles this Court announced in *Gandy*.

1. Lack of Incentive to Oppose Plaintiff

At the heart of *Gandy* is this Court's holding that a judgment rendered without a fully adversarial trial is not binding on defendant's insurer or admissible as evidence of damages in an action against defendant's insurer.[88] Its rationale for the adversarial trial requirement[89] emphasizes the potential for distorted results when an adversarial trial does not take place:

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[84] *Id.*
[85] R.R. Vol. 12, Ex. 12.
[86] R.R. Vol. 12, Ex. 17.
[87] R.R. Vol. 12, Ex. 32.
[88] *Gandy*, 925 S.W.2d at 713.
[89] *Id*. at 708.

> "[t]he principal problem with the arrangement, as the present case illustrates, is that once it is made, D no longer has any incentive to oppose P. If the agreement is struck prior to a trial of P's claims, D may agree to a judgment against himself, as in the present case, or may allow P to take a judgment after a brief evidentiary hearing in which D's participation, if any, is minimal…" [90]

As the Court noted, it is the insured's lack of incentive to oppose the plaintiff that creates the potential for distorted results.[91] This is why agreed judgments or judgments that result from brief evidentiary hearings without meaningful opposition are suspect in terms of the fairness and accuracy of the resulting liability and damages.[92] Once adversity is destroyed, there is no way to accurately determine what might have been.[93] The destruction of adversity, *i.e.,* the loss of a defendant's incentive to oppose the plaintiff's claims, is a key reason for the rule *Gandy* promulgated.

The Court confirmed this in *ATOFINA*. There, an additional insured sought to recover from an insurer the amount of its agreed settlement. In rejecting the application of *Gandy*, the Court noted there was no "risk of distorting litigation or settlement motives. ATOFINA settled without knowing whether or not it would be covered by the policy, leaving in place its motive to minimize the settlement amount in case it became solely responsible for payment."[94] Because the insured

[90] *Id.* at 713.
[91] *Id.*
[92] *See id.*
[93] *Id.*
[94] *ATOFINA,* 256 S.W.3d at 674.

paid the settlement amount itself, it obviously had a stake in the outcome and was motivated to settle on terms that were fair and reasonable.

On the other hand, in cases where the insured's financial stake in the outcome of the proceeding has been eliminated before determination of liability and damages, *Gandy's* concerns are implicated. *Yorkshire Ins. Co., Ltd. v. Seger* is instructive on this point. 407 S.W.3d 435, 436 (Tex. App.—Amarillo 2013), *aff'd on other grounds sub nom. Seger v. Yorkshire Ins. Co., Ltd.*, No. 13-0673, --- S.W.3d ----, 2016 WL 3382223 (Tex. June 17, 2016). In *Seger,* the insured, Diatom, was judgment proof and its individual principals had been non-suited prior to trial.[95] In ultimately applying *Gandy* and refusing to enforce the judgment that resulted from the proceeding against Diatom's insurer, the court of appeals stated that "[b]ecause neither Diatom nor its principals had any financial exposure in the underlying trial, unlike ATOFINA, Diatom had no incentive to contest its liability or to attempt to limit the assessment of damages after it was found liable."[96] As noted by the court of appeals in *Transp. Ins. Co. v. Heiman*, No. 05-95-00482-CV, 1999 WL 239917 at *9-10, 1999 Tex. App. LEXIS 3083, at * 27-28 (Tex. App. – Dallas Apr. 26, 1999, no pet.)(not designated for publication), it is the insured's insulation from any personal liability, such as from a covenant not to execute, that makes these sorts of arrangements so highly suspect.

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[95] *Seger*, 407 S.W.3d at 440-41.
[96] *Id*. at 441 (citing *ATOFINA*, 256 S.W.3d at 674).

Texas courts have applied *Gandy* and have refused to enforce judgments not resulting from adversarial trials against insurers where, by the time of the proceeding, the insured had no incentive to oppose the plaintiff's claims, resulting in the destruction of the adversarial relationship. *See, e.g., Stroop v. N. Cty. Mut. Ins. Co.,* 133 S.W.3d 844 (Tex. App. – Dallas 2004, pet denied) (precluding recovery of judgment based on *Gandy* and noting the difficulty presented by odd circumstances reflecting no adversarial relationship between parties to proceeding); *First Gen. Realty Corp. v. Md. Cas. Co.,* 981 S.W.2d 495 (Tex. App.—Austin 1998, pet denied) (agreed judgment and covenant not to execute violated *Gandy's* adversarial trial requirement); *Burney v. Odyssey Re (London) Ltd.*, No. 2:04-CV-032, 2005 WL 81722 (N.D. Tex., Jan. 14, 2005) (mem. op.), *aff'd*, 169 F. App'x 828 (5th Cir. 2006) (refusing to allow recovery of judgment based on *Gandy* where there was no fully adversarial proceeding). *See also Hendricks v. Novae Corp. Underwriting, Ltd.*, No. 13 C 5422, 2015 WL 1842227, at **4-6 (N.D. Ill. Apr. 21, 2015) (Texas law) (applying *Gandy* and refusing to enforce judgment against insurer in the absence of adversarial trial); c*f. Trinity Universal Ins. Co. v. Cowan,* 945 S.W.2d 819, 821 (Tex. 1997) (citing *Gandy* and suggesting that damages awarded in judgment entered following covenant not to execute and non-jury trial at which insured did not appear would not be binding on insurer or admissible); *Tex. Farmers Ins. Co. v. Kurosky,* No. 02-13-00169-CV,

2015 WL 4043278, at *6 (Tex. App.—Fort Worth July 2, 2015, no pet.) (mem. op.) (agreed judgment did not result from adversarial trial as contemplated by *Gandy*).

When the parties remain adverse and the insured has a financial stake in the outcome of the proceeding, then the insured is motivated to dispute findings of liability and to minimize the damages awarded. This helps to ensure that the results of the proceeding are legitimate rather than manufactured. But when adversity has been destroyed and the insured no longer cares about liability findings and damage awards, there is nothing to prevent the kinds of problems that caused the *Gandy* court concern.

2. *Undisclosed Agreements and other Measures that Distort Results and Facilitate Future Coverage Litigation*

Not only does distortion of results tend to take place when the insured has no incentive to oppose the plaintiff, but the potential for distortion is increased where the insured's incentive to oppose the plaintiff is accomplished by the use of agreements that are kept secret from the trial court and there are other steps taken designed to facilitate future litigation, particularly litigation over coverage for the resulting judgment.

This Court and others have expressed concern about agreements that distort litigation in a variety of contexts. For example, in *Elbaor v. Smith*, 845 S.W.2d 240 (Tex. 1992), the Court disapproved of "Mary Carter" agreements on public policy

grounds because, among other reasons, they distort the litigation process. *See also Zuniga v. Groce, Locke & Hebdon*, 878 S.W.2d 313, 318 (Tex. App.—San Antonio 1994 writ ref'd) (disapproving of assignability of legal malpractice claims on basis of potential to distort litigation); *H.S.M. Acquisitions v. West*, 917 S.W.2d 872, 881 (Tex. App.—Corpus Christi 1996, pet denied) (citing *Gandy* in non-insurance context and refusing to enforce agreed judgment as a distortion of the litigation process).

Indeed, in *Elbaor*, the Court not only disapproved of "Mary Carter" agreements because of their inherent tendency to distort the litigation process by altering the parties' normal adversarial relationship, but noted another cause of distortion was concealment from the finder of the fact of the arrangements giving rise to the parties' true motives. *Elbaor*, 845 S.W.2d at 249. *See also Scurlock Oil Co. v. Smithwick*, 724 S.W.2d 1, 8-11 (Tex. 1986) (Spears, J. concurring) (including among guidelines for use in connection with "Mary Carter" agreements full disclosure of the arrangement to the trial court and the jury). As the court noted in *Stein v. Am. Residential Mgmt.,* 781 S.W.2d 385, 389 (Tex. App.—Houston [14th Dist.] 1989), *writ denied*, 793 S.W.2d 1, (Tex. 1990) (per curiam), secret agreements like "Mary Carter" agreements have the potential to wreak havoc on the civil justice system.

When the finder of fact, whether it be a court or a jury, is unaware that a defendant has no financial stake in the outcome of a lawsuit and has stipulated to liability in advance, then the litigation process is distorted. Where the parties have entered into an arrangement that destroys adversity by eliminating the defendant's stake in the outcome, the finder of fact ought to be informed. If the defendant has signed stipulations that admit to liability, the fact finder should be told about it. Like "Mary Carter" agreements, undisclosed pre-trial covenants not to execute and stipulations of liability distort litigation, and the absence of full disclosure of the parties' arrangements affecting their motives should influence the decision whether to enforce a resulting judgment against a defendant's insurer.

Gandy's rationale also emphasized the parties' attempt to create a judgment that could be recovered from Pearce's insurer, State Farm.[97] Allowing enforcement of the judgment would have encouraged, rather than discouraged, continued litigation.[98] *Cf., Seger*, 407 S.W.3d at 441 (noting assignment of claim was specifically for the purpose of initiating another suit against CGL insurers). The existence of agreements or other secret efforts geared toward subsequent coverage litigation and that are unrelated to liability and damages are other hallmarks of the sort of resulting judgment that should not be enforced against a defendant's insurer. The lower courts have followed this Court's guidance in refusing to

[97] *Gandy*, 925 S.W.2d at 711-12.
[98] *Id*.

enforce judgments based in part on the design of the arrangement entered into by the plaintiff and the insured to steer the claim into insurance coverage and to facilitate subsequent coverage litigation.[99]

When an insured signs stipulations that contain gratuitous recitations of fact and legal conclusions designed to avoid an exclusion in an insurance policy, and when the plaintiff introduces evidence at a proceeding that has nothing to do with liability and damages but that is geared toward effecting insurance coverage, and subsequently submits findings of fact and conclusions of law to the trial court that likewise make sense only in the context of manufacturing insurance coverage and facilitating a subsequent lawsuit against the defendant's insurer to recover on the anticipated judgment, these considerations bring into play *Gandy's* concern about encouraging future litigation. Refusing to enforce a judgment resulting from such efforts is consistent with *Gandy's* rationale.

3. Gandy Should Not Be Limited to its Facts

Despite *ATOFINA's* dicta that *Gandy* does not apply outside its narrow fact pattern, the reasons for applying its rationale and refusing to enforce a judgment against a defendant's insurer without a fully adversarial trial exist in contexts that

[99] *See, e.g., Burney*, 2005 WL 81722 at * 4, (noting potential for promoting subsequent litigation in refusing to enforce judgment). *Cf., Zuniga*, 878 S.W.2d at 318 (noting potential of allowing assignability of legal malpractice claims to promote litigation rather than settlement); *H.S.M. Acquisitions*, 917 S.W.2d at 881 (refusing to enforce agreed judgment on grounds that doing so would promote litigation).

differ from *Gandy's* facts. *See, e.g., Seger*, 407 S.W.3d at 441 (applying *Gandy* to case where insurer did not defend). As an examination of *Gandy* and its progeny reveal, it is the destruction of adversity between the plaintiff and the defendant, with the defendant's resulting lack of incentive to oppose the plaintiff's claims, coupled with the potential for distorted results, the protection of the integrity of the judicial process, and the discouragement of collusion and subsequent litigation, that are the paramount concerns. Those factors are present in this case.

B. Refusing to Enforce the Underlying Judgment Will Further the Policies Behind *Gandy*

This case involves coverage for a judgment obtained under circumstances that implicate *Gandy's* concerns.[100] Namely, TMB had no financial stake in the outcome of the proceeding and had signed stipulations of fact that were essentially admissions of liability.[101] These stipulations were also geared toward insurance coverage. The trial court was never advised of these arrangements.[102] Additionally, Hamel introduced evidence at trial, and inserted various statements and legal conclusions in his proposed findings of fact and conclusions of law submitted to the trial court (which were the only findings of fact and conclusions of law

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[100] These circumstances are set out more fully in the next section of this Brief beginning at page 34.

[101] R.R. Vol. 12, Ex. 34.

[102] R.R. Vol. 11, Ex. 10, p. 3; R.R., Vol. 14, Ex. 67, pp. 30-31; Vol. 15, Ex. 69, p. 14; Vol. 14, Ex. 66, pp. 36-39.

submitted) designed to avoid the EIFS exclusion in the later Great American policies, and to steer the claim into coverage.[103]

Under these circumstances, application of *Gandy's* adversarial trial requirement and refusal to enforce the judgment against Great American will not only further the purposes for which *Gandy's* rule was announced, but will also ensure that an insurer's right to contest coverage remains meaningful in all appropriate cases. This is true even in circumstances where the insurer does not furnish a defense.

Great American emphasizes the narrowness of the application of *Gandy* it is urging. A judgment should not be enforced against the defendant's insurer only where adversity has been destroyed due to the insured no longer having any stake in its outcome, and there is secrecy coupled with measures taken to steer a claim into coverage and to facilitate subsequent coverage litigation.

1. *Great American's Refusal to Defend Should Not Preclude Application of Gandy*

Ordinarily, when an insurer wrongfully refuses to defend its insured, it is prohibited from relying on policy conditions, including the actual trial condition, to avoid liability.[104] The insurer in some instances may also be prohibited from

[103] R.R. Vol. 11, Ex. 10 at pp. 29, 90-91; R.R. Vol., 14, Ex. 58.
[104] *St. Paul Ins. Co. v. Rahn*, 641 S.W.2d 276, 278 (Tex. App.—Corpus Christ, 1982, no writ); *Gulf Ins. Co. v. Parker Prods., Inc.,* 498 S.W.2d 676, 679 (Tex. 1973); *Enserch v. Shand Morahan & Co., Inc.,* 952 F.2d 1485, 1496 n.17 (5th Cir. 1992).

contesting the reasonableness of a judgment and resulting factual determinations that are essential to the judgment.[105] *Gandy* and *ATOFINA* already affect these rules in some contexts.[106] Although even an insurer that has wrongfully refused to defend the insured is often entitled to contest coverage for any judgment it is asked to pay,[107] if essential findings on coverage issues result from the underlying proceeding, the insurer is at risk of being bound by those findings.[108]

The right to contest coverage should be meaningful. If the parties collude to produce findings solely for the purpose of triggering insurance coverage instead of litigating liability and damages straight up, then the insurer has no protection or assurance that liability and damages were fairly determined and coverage, as a practical matter, winds up being co-extensive with the duty to defend.[109] By definition, when parties to the litigation have taken steps designed to steer the claim into coverage and to set up a subsequent coverage lawsuit, the findings on which the judgment are based are suspect and should not be enforced against the insurer. Without an adversarial trial requirement, the insurer's right to contest

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[105] *Am. Physicians Ins. Exch. v. Cardenas*, 717 S.W.2d 707 (Tex. App.—San Antonio 1986, writ ref'd, n.r.e.); *Employers Cas. Co. v. Block*, 744 S.W.2d 940 (Tex. 1988). Such an insurer, however, is not bound by facts that affect coverage and that are non-essential to the judgment. *Block*, 744 S.W.2d. at 943.
[106] *ATOFINA,* 256 S.W.3d at 273 (quoting *Gandy*, disapproving of suggestion in dicta in *Block* to the effect that insurer is estopped from challenging the reliability of judgments used as evidence against it).
[107] *Block, 744 S.W.2d at 943; Enserch,* 952 F.2d at 1493.
[108] *See Cardenas*, 717 S.W.2d at 708.
[109] The duty to defend and the duty to indemnify are not co-extensive, but are separate and distinct duties. *Utica Nat'l Ins. Co. of Tex. v. Amer. Indem. Co.,* 141 S.W.3d 198, 203 (Tex. 2004).

coverage is rendered meaningless because there is nothing to stop the parties from engineering a proceeding to produce a covered judgment. Application of *Gandy's* rule to situations like the one presented in this case would help ensure that the insurer's right to contest coverage, even where it mistakenly does not defend, remains intact.

Of course, there are some instances where, when an insurer wrongfully refuses to defend, the insured does not have sufficient resources to mount a defense. Where there is no evidence of collusion, the judgment may be enforced against the insurer.[110] In cases where the insured does not have sufficient resources to mount a defense, the plaintiff can appear at trial and put on his case straight up, including evidence to support findings of liability and damages. Without indicia of collusion, the protections afforded the insurer under *Block* – that the insurer is not bound by non-essential fact findings and may re-litigate coverage issues – are adequate protection for the insurer.[111] Other arrangements, such as covenants not to execute and assignments, are not tainted following a legitimate determination of liability and damages.[112]

For example, in *Mid-Continent Cas. Co. v. JHP Dev., Inc.*, No. Civ.A.SA04CA-192-XR, 2005 WL 1123759, at *9 (W.D. Tex. Apr. 21, 2005),

[110] *See Block,* 744 S.W.2d at 943.
[111] *See, e.g., Mid-Continent Cas. Co. v. JHP Dev., Inc.*, 557 F.3d 207, 217-218 (5th Cir. 2009).
[112] *Gandy*, 925 S.W.2d at 714.

aff'd, 557 F.3d 207 (5th Cir. 2009), a default judgment was taken against the insured and the judgment creditor sought to enforce the default against the insurer. The court concluded that a default judgment can be a judgment entered after an actual trial only if "there is no hint of collusion between [the underlying parties]," and there was no "agreed judgment or any other kind of agreement" between the underlying parties."[113] In *JHP*, there was absolutely no showing of any agreement between the plaintiff and the insured. In the underlying proceeding, the insured did not appear at the default hearing and the state court judge set the damages. The *JHP* court made its decision based upon the absence of any evidence suggesting an agreement between the plaintiff and the insured. [114] The Fifth Circuit affirmed,[115] noting that *Block* applied in the absence of concerns implicating *Gandy*.

If the protections of *Gandy* do not apply in cases where there are indicia of collusion, then anytime an insurer mistakenly refuses to furnish a defense, it is entirely subject to whatever questionable result is manufactured by the plaintiff and the insured. This is not what the Court intended in *ATOFINA's* dicta when it limited *Gandy's* application to its specific factual circumstances. *Gandy's* concerns were not implicated in *ATOFINA*, but they are implicated in some cases where the

[113] *JHP*, 2005 WL 1123759 at *9.
[114] *Id*.
[115] *JHP*, 557 F.3d at 218.

insurer does not defend.[116] This is one such case.

2. *Sufficient Gandy Concerns Remain For Its Application to Hamel's Collusive Judgment*

Hamel did not just go down the courthouse and prove up his case. Under the circumstances presented, Great American's refusal to furnish a defense does not remove the taint associated with the liability and damages findings in the underlying judgment. Application of *Gandy's* adversarial trial requirement here will further its purposes of discouraging collusion and protecting the integrity of the judicial process. A judgment is presumed valid on its face; however, an insurer is not obligated to furnish indemnity for a judgment against its insured if the judgment was the result of fraud or collusion. *Gandy*, 925 S.W.2d at 714 ("If an insurer's liability is to be litigated in an action by a plaintiff as a defendant's assignee after such a judgment is rendered, it should be done on the strength of plaintiff's claims rather than the generosity of defendant's concessions.").[117]

[116] The absence of a pre-trial assignment here, unlike in a *Stowers* case, does not affect the reasons for *Gandy's* application. A *Stowers* claim belongs to the insured, and cannot be asserted by a third-party claimant without an assignment. *Foremost Cty. Mut. Ins. Co. v. Home Indem. Co.,* 897 F.2d 754, 758 (5th Cir. 1990). A third-party judgment creditor, however, may sue the insurer directly to recover on a judgment. *Roland v. Allstate Ins. Co.,* 370 F.2d 289, 291 (5th Cir. 1966); *Cumis Ins. Soc. v. Republic Nat'l Bank,* 480 S.W.2d 762, 767 (Tex. Civ. App. – Dallas 1972, writ ref'd, n.r.e.). Accordingly, the assignment was not necessary for Hamel to recover on the judgment. The parties' pre-trial agreements had already implicated *Gandy's* concerns without an assignment. Hamel did receive an assignment of most of TMB's claims against Great American, including extracontractual claims, but ultimately dropped them. R.R. Vol. 12, Ex. 32.

[117] S*ee also Seger*, 407 S.W.3d at 443; *Britt v. Cambridge Mut. Fire Ins. Co.*, 717 S.W.2d 476, 483 (Tex. App.—San Antonio 1986, writ ref'd n.r.e.) (holding judgment procured fraudulently against insurer could not form basis for collateral estoppel); *Burney,* 2005 WL 81722 at * 4 ("[insured and underlying plaintiff] confected the kind of sweetheart deal that *Gandy* prohibits");

Refusing to enforce judgments that result from the parties' taking collusive steps, unrelated to liability and damages, to eliminate adversity and steer a case into coverage for the purpose of pursuing subsequent coverage litigation not only discourages collusion and protects the integrity of the judicial process, but will make an insurer's right to contest coverage meaningful and help to prevent needless coverage litigation.

To summarize, even though the facts of this case do not match up exactly with those of *Gandy*, the rationale for *Gandy's* announced rule of not enforcing a judgment against the defendant's insurer in the absence of an adversarial trial fully applies. Accordingly, the Court of Appeals erred in not applying *Gandy*.

2. AS A MATTER OF LAW, THE JUDGMENT WAS COLLUSIVE AND NOT THE RESULT OF AN ADVERSARIAL TRIAL.

As set out in the previous section of this Brief, *Gandy's* adversarial requirement should have been applied, and the Court of Appeals erred in not applying it.[118] Additionally, however, the Court of Appeals determined that the

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Ross v. Marshall, 426 F.3d 745, 758 (5th Cir. 2005) (noting an insured who rejects defense offer must either reach reasonable settlement or provide reasonable defense for insurer to be bound by judgment); c*f., H.S.M. Acquisitions*, 917 S.W.2d at 879 (indemnitee must show settlement was reasonable and in good faith).

[118] The Court of Appeals did not apply *Gandy* to this case, although it did undertake an analysis of whether there was a fully adversarial trial. The Court of Appeals' rationale and analysis are unclear. In any event, the Court of Appeals approved the trial court's conclusions that there was, as a matter of law, an adversarial trial and no collusion. *Hamel*, 444 S.W.3d at 803-04 (approving trial court's conclusions of law) (*see also* trial court conclusion nos. 35, 36, 44, 45, 49). This determination is reviewed *de novo*. *In re Humphreys*, 880 S.W.2d at 404 (questions of law are always subject to *de novo* review).

underlying proceeding was an adversarial trial and not collusive.[119] This was error, because the record demonstrates that, as a matter of law, the proceeding between TMB and Hamel was in no way adversarial, but was a well-orchestrated attempt to create a judgment that would be covered under the Great American policy.

A. The Reason for the Collusion is Obvious

The motive for their arrangement is clear. TMB had no money to pay any judgment that Hamel might get.[120] Hamel knew the only source of recovery would be Great American. Hamel, however, worried that his judgment would not be covered under the Great American policy because most of the Texas cases that had addressed the question held that the coverage trigger was initial manifestation for latent property damage claims.[121] The policy in place when Hamel's damages manifested contained an exclusion for damages, such as Hamel's, when a structure contained EIFS.[122] The Hamel's house was clad with EIFS,[123] and any damages

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[119] C.R. Vol. 19, p. 3489, no. 44; *Hamel*, 444 S.W.3d at 803.
[120] R.R. Vol. 14, Ex. 67 at pp. 19-20.
[121] *See Dorchester*, 737 S.W.2d at 381; *Don's Bldg. Supply*, 516 F. Supp. 2d at 617.
[122] R.R. Vol. 12, Ex. 16, endorsement CG 8802 11/85. The exclusion was not limited to damages caused by EIFS. It excluded coverage for damages arising out of the insured's work with respect to any exterior aspect of a structure if EIFS was used anywhere on it. R.R. Vol. 12, Ex. 16, endorsement CG8802 11/85; *see also Pine Oak Builders, Inc. v. Great Am. Lloyds Ins. Co.,* 292 S.W.3d 48, 63 (Tex. App.—Houston [14th Dist.] 2006), *aff'd in part on other grounds, rev'd in part on other grounds*, 279 S.W.3d 650 (Tex. 2009); *Summit Custom Homes, Inc. v. Great Am. Lloyds Ins. Co.*, 202 S.W.3d 823, 831 (Tex. App.—Dallas 2006, pet. withdrawn), *abrogated on other grounds by Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1 (Tex. 2007) *and Don's Bldg. Supply, Inc. v. OneBeacon Ins. Co.*, 267 S.W.3d 20 (Tex. 2008).
[123] R.R. Vol. 11, Ex. 53; R.R. Vol. 13, Ex. 39; R.R. Vol. 16, Ex. 105.

that first manifested during the relevant Great American policy period would be excluded. The EIFS exclusion therefore had to be avoided.

Consistent with this effort, the underlying litigation and resulting judgment were crafted to get around a policy exclusion that likely would have prevented any recovery at all. Hamel and TMB took numerous steps, both in the stipulations and in the evidence presented at the "trial," to secure findings that EIFS had nothing to do with Hamel's damages, which was completely contrary to the initial reports that Hamel's experts generated.[124]

The Court should not reward Hamel's shenanigans, which are troubling to the conscience and do not square with the principles set out in *Gandy* and its progeny. TMB engaged in multiple actions furthering the conspiracy with Hamel to produce a judgment that would be covered by insurance.[125] There is no other explanation for what transpired. No reasonable litigant would have taken the steps that TMB did had it been concerned with the result. Each of these actions, including TMB's resulting minimal participation in the proceeding, is discussed below.

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[124] R.R. Vol. 13, Ex. 39; R.R. Vol. 16, Ex. 105.
[125] R.R. Vol. 11, Ex. 10, R.R. Vol. 12, Ex. 32, R.R. Vol. 12, Ex. 34; R.R. Vol. 11, Ex. 8.

B. The Collusive Steps Taken By Hamel and TMB Did Not Produce an Adversarial Trial

1. Covenant Not to Execute

Prior to the proceedings, TMB entered into a covenant not to execute with Hamel.[126] The effect of this agreement is that TMB would have no further exposure for any of Hamel's damages because Hamel agreed, in essence, only to look to TMB's insurance policy to satisfy any judgment it obtained. While Hamel may argue that the covenant not to execute did not protect all of TMB's assets, the practical result is that it did. Every asset TMB owned was specifically listed as being something Hamel would not look to in collecting his judgment.[127] The only actual asset TMB owed that was not included in the agreement was the Great American policy.

For Hamel to contend the agreement did anything other than remove TMB's and Mitchell's financial stake in the proceeding's outcome is disingenuous. In his deposition, Mitchell admitted that he directed TMB's attorney not to put up a fight, and that he had no stake in the outcome.[128] He also testified that he was not concerned about getting a credit for the STO settlement after executing the agreement because he no longer had a stake in the case.[129]

[126] R.R. Vol. 11, Ex. 8.
[127] R.R., Vol. 14, Ex. 67, pp. 11, 19-20, 30; Ex. 66, pp. 38-39, 46.
[128] R.R., Vol. 14, Ex. 67, pp. 11, 19-20, 30; Ex. 66, pp. 38-39, 46.
[129] R.R. Vol 14, Ex. 67, pp. 21, 30; Ex. 66, pp. 38, 46-48.

2. *Position Switching*

At the beginning of the lawsuit, TMB asserted many defenses against Hamel's claims, including that 1) TMB was not liable for the majority of the work on Hamel's home because it had been constructed by the prior builder, GSM; 2) third parties caused Hamel's damages; 3) Hamel failed to mitigate his damages; 4) the statute of limitations barred Hamel's claims; and 5) Hamel's claims were groundless and were brought in bad faith.[130]

However, TMB later changed its position, even though no new evidence regarding its culpability, or lack thereof, was developed. Instead of denying all liability, TMB, after receiving a covenant not to execute, admitted that it was responsible for all Hamel's damages, even those caused by third parties over which TMB had no control.[131]

3. *Stipulations of Liability*

TMB signed stipulations that amounted to an admission of liability.[132] Among other things, the stipulations recited that TMB was responsible for the construction that was there before it became involved in the project.[133] This was contrary to TMB's written contract.[134] TMB stipulated that it made several mistakes in the construction, including using improper nails, failing to notice water

[130] R.R. Vol. 12, Ex. 36.
[131] R.R. Vol. 12, Ex. 34, pp. 2-3.
[132] R.R. Vol. 12, Ex. 34.
[133] R.R. Vol. 12, Ex. 34, pp. 2-3.
[134] Compare R.R. Vol. 12, Ex. 34 (Stipulations) with R.R. Vol. 14, Ex. 45 (Contract).

intrusion, allowing the roof decking to be cut too short, and improper construction of the roof.[135] These stipulations were all contrary to interrogatory answers that TMB had given.[136]

TMB also stipulated that if the house allowed water to enter, that such would be negligence on its part.[137] It stipulated that if it failed to notice water intrusion into the house, that would be negligence.[138] TMB agreed that had it inspected the house more closely, it would have noticed and fixed the problem.[139] TMB agreed that this failure to inspect properly fell below the standard of care TMB owed to Hamel.[140]

Hamel's attorney, Hunter McLean, admitted in his deposition that he had the executed stipulations before trial and could have used them to impeach Terry Mitchell had he not testified the way McLean wanted.[141] The stipulations were a silent hammer over Mitchell's head that ensured he would testify exactly as Hamel wanted him to. The Court of Appeals naively concluded that because Mitchell testified to the same facts as were in the stipulations, there was no harm.[142] This completely overlooks the facts that produced the stipulations and ignores the

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[135] R.R. Vol. 12, Ex. 34, pp. 3-4.
[136] R.R. Vol. 12, Ex. 36.
[137] R.R. Vol. 12, Ex. 34, pp. 3-4.
[138] R.R. Vol. 12, Ex. 34, pp. 2-4.
[139] R.R. Vol. 12, Ex. 34, pp. 3-4.
[140] R.R. Vol. 12, Ex. 34, pp. 4-5.
[141] R.R. Vol 15, Ex. 69, pp. 14.
[142] *Hamel*, 444 S.W.3d at 803.

obvious: Mitchell had no choice but to testify to exactly what was in the stipulations. If he had not, his testimony would have been impeached. His testimony matching the stipulations does not mean that the testimony is truthful, as the Court of Appeals stated. It only means that Mitchell's testimony was secured in advance by the stipulations. The harm was already done before Mitchell ever took the witness stand. Pretending that the stipulations do not matter because Mitchell testified to the same facts in court ignores the collusion that produced the stipulations in the first place.

4. Concealment

Even more troubling is the fact that the parties concealed the existence of the stipulations and agreement not to execute from the trial court so that a sham of adversity would be presented.[143] Had the parties truly intended to save time by agreeing to the statements in the stipulations, why would they not introduce these into evidence, or at a minimum, make the court aware that they had executed such stipulations in the event the court wanted to move the proceeding along by deeming some of the duplicative live witness testimony unnecessary?

There is only one reason why the parties would choose to conceal their agreements from the trial court: so the court would render the judgment Hamel wanted without becoming suspicious of the motives for securing such a judgment.

[143] R.R. Vol. 11, Ex. 10, p. 3; R.R., Vol. 14, Ex. 67, pp. 30-31; Vol. 15, Ex. 69, p. 14; Vol. 14, Ex. 66, pp. 36-39.

The secrecy behind the agreements guaranteed that a sham of adversity would be presented. It further demonstrates complete disregard for what is typically the adversarial nature of the trial process.

5. Intentional Avoidance of Gandy.

Before they ever entered the courthouse, counsel for Hamel and TMB discussed *Gandy*,[144] and tried to orchestrate a proceeding that would technically circumvent its application. There would have been no need for this had they intended to conduct an adversarial trial. There would have been no need to discuss *Gandy* had they not known that their orchestrated proceeding might be discovered for what it really was, a planned effort to steer Hamel's judgment into coverage under the Great American policy and to secure an inflated judgment.

6. TMB put up no defense at the "trial" or afterwards

Other than showing up to the courthouse, TMB did nothing to defend its position.[145] The proceeding is summarized in the Statement of Facts portion of this Brief at pp. 5-15, and the entire transcript of the proceeding and the evidence admitted are in the record.[146] They do not take a long time to review.

In addition to TMB's conduct at the trial, its post-trial efforts also demonstrate its disinterest in the outcome of the proceeding. At the conclusion of

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[144] R.R. Vol. 14, Ex. 66, pp. 18-19.
[145] R.R. Vol. 11, Ex. 10.
[146] R.R. Vol. 11, Ex. 10.

the "trial," TBM failed to submit any proposed findings of fact or conclusions of law. The result of this was that the court entered judgment based solely on Hamel's proposed findings of fact and conclusions of law, which were very similar to the stipulations Hamel and TMB previously agreed upon.[147] Like the stipulations, the findings of fact and conclusions of law stated that TMB had a duty to inspect the construction and was responsible for informing Hamel of any problems with it, whether such problems were caused by TMB's work or GSM's work.[148] They stated that TMB did not complete the residence properly, and that TMB failed to discover any of the construction defects present.[149] They stated that the water intrusion into the house was due to TMB not completing the project in a good and workmanlike manner.[150] The findings of fact, like the stipulations, stated that TMB failed to notice the water intrusion, and was negligent in a number of ways, including failing to properly construct the roof, and using the wrong type of nails on the roof.[151]

Great American submits that, as a matter of law, the record of the proceeding and its surrounding circumstances show not an adversarial trial, but rather a collusive one. Hamel's defense of the proceeding is, essentially, that the manner in which the underlying proceeding was conducted is irrelevant because

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[147] R.R. Vol. 12, Ex. 34, compare with R.R. Vol. 12, Ex. 15.
[148] R.R. Vol. 12, Ex. 15.
[149] R.R. Vol. 12, Ex. 15.
[150] R.R. Vol. 12, Ex. 15.
[151] R.R. Vol. 12, Ex. 15.

Terry Mitchell testified truthfully.[152] Whether or not that is the case, TMB had legitimate defenses and the world will never know the true extent of TMB's responsibility for the problems at the house nor the amount of financial liability that should properly have been assessed against TMB because by May 26, 2005, the parties were no longer concerned about having those issues legitimately determined, but were instead concerned about insurance coverage. In no way could what transpired be called an adversarial trial.

7. Gratuitous Focus on Coverage

The stipulations executed by TMB and Hamel contained statements regarding the EIFS on Hamel's house. These had nothing to do with liability, but were an effort to get around a policy exclusion.[153] For example, contained within the stipulations are the following:

- "The types of construction problems identified herein are not related in any way to EIFS or any component part thereof or any failure to flash, seal, caulk, or failure to install it correctly. The problems would have occurred regardless of the type of exterior cladding used."

- "TBM did not design, manufacture, construct, fabricate, prepare, install, apply, maintain, or repair the EIFS that was installed on the Residence."[154]

During the proceeding, Hamel questioned witnesses about EIFS, eliciting

[152] *See* Glen and Marsha Hamel's Opening Brief, pp. 36-37.
[153] R.R. Vol. 12, Ex. 34.
[154] R.R. Vol. 12, Ex. 34, p. 4.

testimony that the EIFS had nothing to do with the problems at the house.[155]

The findings of fact and conclusions of law generated by the proceeding reiterated this same language, and also stated that the settlement with the manufacturer of the EIFS, STO, was unrelated to the damages sought in the suit against Hamel.[156] Like the stipulations, the findings of fact also concluded that EIFS had nothing to do with any of the house's problems.[157]

Neither the testimony, the stipulations regarding EIFS, nor the findings of fact and conclusions of law noted above[158] related to liability; they were introduced solely to get around the EIFS exclusion. The concept that EIFS had nothing to do with Hamel's problems is unsupported by the evidence that was developed up to the trial, and contrary to what Hamel had earlier contended in his pleadings.[159] For example, the expert evidence Hamel developed (specifically the investigations and conclusions generated by Don Yeandle,[160]) was not admitted at trial. These reports were problematic in terms of the EIFS exclusion because they stated that the EIFS cladding on the house caused or contributed to the problems Hamel complained of.[161]

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[155]R.R. Vol. 11, Ex. 10 at p. 29, 90-91.
[156] R.R. Vol 12, Ex. 11, finding no. 9.
[157] R.R. Vol. 12, Ex. 11.
[158] R.R. Vol. 12, Ex. 15. Vol. 12, Ex. 34.
[159] R.R. Vol. 14, Ex. 53-55.
[160] R.R. Vol. 13, Ex. 39; R.R. Vol. 16, Ex. 105.
[161] R.R. Vol. 13, Ex. 39; R.R. Vol. 16, Ex. 105.

Specifically, Yeandle noted in his report numerous instances of problems with the EIFS cladding, including mold growing on the EIFS due to water intrusion, fungal growth behind and between the EIFS foam insulation board, areas where the EIFS system was not properly sealed, EIFS cladding system not being properly wrapped, and the EIFS cladding allowing free space for water to travel in it. In fact, almost every damage item mentioned in Yeandle's report related to EIFS.[162]

8. TMB assigned its rights against Great American to Hamel

After procuring the desired judgment, TMB assigned its rights against Great American to Hamel.[163] In light of all the steps that Hamel and TMB took to get the judgment the way Hamel wanted it, the fact that this was done after the "trial" instead of before makes the entire scenario no less problematic.

9. Inflation of the Judgment Amount

The conspiracy produced a judgment that is inflated because it includes damages that TMB would not have been found liable for had an adversarial trial occurred. TMB admitted that it was responsible for the entire house,[164] when in fact, TMB constructed only 30-40 percent of it,[165] and the contract with Hamel

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[162] R.R. Vol. 13, Ex. 39; R.R. Vol. 16, Ex. 105.
[163] R.R., Vol. 12, Ex. 32.
[164] R.R. Vol. 12, Ex. 34, pp. 2-5.
[165] R.R. Vol. 11, Ex. 10, pp. 32-33, 36.

stated that TMB was not responsible for the prior builder's work.[166] Further, TMB made no attempt to get a settlement credit for the $25,000 paid by the EIFS manufacturer, even though it would have been entitled to a credit. The EIFS manufacturer, STO, paid Hamel $25,000 to settle his claims.[167] The record is clear that Hamel's damages are due to water intrusion into his house, and the water intrusion stems from the improper installation of EIFS on the home, as Hamel's expert, Don Yeandle, stated when he first inspected the home.[168] Not only did TMB fail to secure a settlement credit, but it carelessly allowed a finding of fact to be included stating that the problems with the EIFS were unrelated to TMB's work on the house, and that no settlement credit should be taken.[169]

Further, Yeandle's original bid to repair the property in 2002 was $71,639.38. But by the time of his trial testimony in May 2005, the amount had increased to the $169,089.70 that was awarded as repair costs in the final judgment.[170]

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[166] R.R. Vol. 14, Ex. 45.
[167] R.R., Vol. 14, Ex. 68, p. 16.
[168] *See* Yeandle's report regarding the damages, R.R. Vol. 13, Ex. 39; R.R. Vol. 16, Ex. 105.
[169] R.R. Vol. 12, Ex. 11, Finding of Fact no. 37.
[170] At a minimum, Hamel's failure to repair the problems in the interim shows a failure to mitigate damages, another defense initially raised, and later abandoned, by Hamel. R.R. Vol. 12, Ex. 36.

C. A Collusive Judgment Cannot Be the Result of an Adversarial Trial

Gandy held that a judgment for plaintiff against defendant, rendered without a fully adversarial trial, is not binding on defendant's insurer.[171] As a matter of law, the underlying judgment here is collusive, and therefore cannot be the result of an adversarial trial for purposes of *Gandy*. The Court of Appeals' approval of the collusive judgment is contrary to both *Gandy* and *State Farm Lloyds Ins. Co. v. Maldonado*, 963 S.W.2d 38 (Tex. 1998), which recognize the inherent injustice in holding an insurer responsible for a judgment based upon a trial that is not fully adversarial.[172] This is shown by the refusal of Texas courts, as well as courts in other jurisdictions, to enforce judgments obtained under circumstances similar to those presented by this case.

1. Texas courts refuse to enforce judgments resulting from collusive proceedings

Other Texas courts have refused to enforce a judgment under similar circumstances. For example, in *Vela v. Catlin Specialty Ins. Co.*, No. 13-13-00475-CV, 2015 WL 1743455, at *8 (Tex. App.—Corpus Christi Apr. 16, 2015, pet. denied) (mem. op.), the court was troubled that the insured's lawyer did not make an opening or closing statement, and did not offer any evidence into the record to challenge any of the plaintiff's claims. Further, the court was bothered by the fact

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[171] *Gandy*, 925 S.W.2d at 714.
[172] *Gandy*, 925 S.W.2d at 719.

that the insured was unconcerned, or even unaware, that a judgment had even been taken against him.[173] He had no actual stake in the matter due to the agreements that were made in advance of the "trial." Like here, the insured's attorney appeared at trial, but did very little to defend his client.[174] Given these factors, the *Vela* court found a "sham of adversity" and refused to enforce the judgment against the insurer.[175]

In *Seger,* the Seventh Court of Appeals applied *Gandy* and found that no adversarial trial had occurred when the insured's participation in the proceeding was minimal. The proceeding "more nearly resembled a post-answer default"[176] and could not fairly be characterized as adversarial or a fair determination of the claims against the insured.[177] The court found that *Gandy*'s concerns were implicated where, like here, the insured did not meaningfully contest the claims against it. As here, the insured appeared at trial but made no meaningful opening or closing statements, offered no evidence, and did not cross-examine any of the Segers' witnesses. *Id.* at *5.[178] While the circumstances leading up to a proceeding are certainly relevant to whether the proceeding is adversarial, in *Vela* and *Seger* the courts focused on the insured's level of participation at trial: "[t]o determine

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[173] *Vela*, 2015 WL 1743455, at *8.
[174] *Id.*
[175] *Id.* at *9.
[176] *Seger*, 407 S.W.3d at 443.
[177] *Id.*
[178] *See also First Gen. Realty,* 981 S.W.2d at 496-97; *Stroop,* 133 S.W.3d at 849-50 (both finding no adversarial trial).

whether an underlying judgment was the result of a fully adversarial trial, we must review the extent to which the parties to the underlying proceeding participated." *Vela*, 2015 WL 1743455, at *8.

When an examination of the underlying proceeding reveals that the insured did not meaningfully participate, there can be no adversarial trial. The earmarks of proceedings held not to be adversarial trials are things like failure to call witnesses or put on evidence, failure to effectively cross-examine the opponent's witnesses, failure to make opening and closing statements, and failure to object to the opponent's evidence, or proposed findings of fact and conclusions of law.[179] All of these factors were present in the underlying lawsuit.[180]

2. The way the Hamel judgment was procured would trouble courts in other jurisdictions as well

Even in jurisdictions that are generally accepting of consent judgments and assignments, courts will not enforce judgments procured by collusion or fraud.[181]

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[179] *See Seger*, 407 S.W.3d at 437; *Vela*, 2015 WL 1743455, at *3.

[180] R.R. Vol. 11, Ex. 10. *See also* Randall L. Smith et al., *Good Faith and Reasonable Consent Judgments:* Gandy *Does Not Answer All the Questions*, 49 S. Tex. L. Rev. 1, 63-64 (2007) ("To be sure, a stipulated or consent judgment which is coupled with a covenant not to execute against the insured brings with it a high potential for fraud or collusion. With no personal exposure the insured has no incentive to contest liability or damages. To the contrary, the insured's best interests are served by agreeing to damages in any amount as long as the agreement requires the insured will not be personally responsible for those damages. Given the accuracy of these observations, a stipulated judgment should only bind an insurer under circumstances which protect against the potential for fraud and collusion.").

[181] A Drake Law Review note, Justin A. Harris, *Judicial Approaches to Stipulated Judgments, Assignments of Rights, and Covenants Not to Execute in Insurance Litigation*, 47 Drake L. Rev. 853 (1999), analyzes three approaches taken by some states in situations where insureds effectively agree to judgments against themselves. The article concludes that the Texas *Gandy*

For example, in *Cont'l Cas. Co. v. Hempel*, 4 F. App'x 703 (10th Cir. 2001), the Tenth Circuit found a judgment unenforceable because it was collusive. As the court stated, a judgment "becomes collusive when the purpose is to injure the interests of an absent or nonparticipating party, such as an insurer or nonsettling defendant. Among the indicators of bad faith and collusion are unreasonableness, misrepresentation, concealment, secretiveness, lack of serious negotiations on damages, attempts to affect the insurance coverage, profit to the insured, and attempts to harm the interest of the insurer. They have in common unfairness to the insurer, which is probably the bottom line in cases in which collusion is found."[182]

Another example is *Spence-Parker v. Md. Ins. Grp.*, 937 F. Supp. 551 (E.D. Va. 1996), where the court, in finding the judgment the product of collusion, was deeply troubled by the defendant's lack of motivation to contest the amount of the judgment and the parties' secrecy with the trial court. Although (unlike here) the parties had informed the court that they had entered into an assignment and non-execution agreement, the district court determined that they had still misled the trial court into believing that the case had been adequately defended and that the judgment was the result of arm's length negotiation. The underlying lawsuit here is worse than in *Spence-Parker,* because in this case the parties never informed the

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approach is the most protective of an insurer's rights, refusing to enforce judgments unless they are the result of a fully adversarial trial. *Id*. at p. 875.

[182] *Hempel,* 4 F. App'x at 717. The district court's opinion is styled *Cont'l Cas. Co. v. Westerfield*, 961 F.Supp. 1502, 1505-09 (D.N.M. 1997) (outlining circumstances of collusive "trial," which were similar in many respects to this case).

trial judge of their agreements.[183] Like in *Spence-Parker*, TMB had no reason to care about the amount of the judgment because it would never be called upon to pay it.

Recently, the United States District Court for the Northern District of Illinois, in finding a judgment unenforceable against an insurer, recognized Texas law's suspicion of less than fully adversarial proceedings. In *Hendricks*, 2015 WL 1842227, the court refused to enforce a judgment against an insurer when the judgment was not the result of a fully adversarial trial. That the judgment was obtained through some consent of the parties was enough to convince the Illinois court that it would not be enforceable in Texas under *Gandy*.[184]

3. *The Hamel judgment, as a matter of law, is collusive and not the result of an adversarial trial.*

The Hamel judgment has all the marks of a proceeding that results from collusion. The Court of Appeals' conclusion that this proceeding was a genuine contest of issues cannot be squared with the trial transcript and the surrounding circumstances of the proceeding, and is wrong as a matter of law. There is no

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[183] R.R. Vol. 11, Ex. 10, p. 3; R.R., Vol. 14, Ex. 67, pp. 30-31; Vol. 15, Ex. 69, p. 14; Vol. 14, Ex. 66, pp. 36-39.

[184] *Hendricks,* 2015 WL 1842227, at **5-6. *See* Smith et al., *Good Faith and Reasonable Consent Judgments*, 49 S. Tex. L. Rev. at 17 ("In some jurisdictions, insurers are not bound by judgments rendered against insureds as parts of settlements if tort plaintiffs obtain judgments by fraud or collusion or insureds settle for unreasonable and imprudent amounts.") (citing cases from Arizona, California, Connecticut, Florida, Illinois, Indiana, Iowa, Kentucky, Minnesota, Missouri, Nebraska, New Mexico, New York, Oklahoma, South Dakota, Texas, Utah, U.S. Virgin Islands, Virginia, Washington, and Wyoming).

scenario under which the trial strategy employed by TMB takes place in a truly adversarial contest. Mitchell showed up at the courthouse and gave the testimony that Hamel wanted, in accordance with the stipulations. TMB's lawyer allowed this to happen because TMB had no stake in the outcome,[185] and because Mitchell could not pay him,[186] and had instructed him not to put up a fight.[187]

As a matter of law, the liability proceeding here was collusive and not an adversarial trial as required by *Gandy*. The Court of Appeals' determination that it was is an error this Court should correct.

3. HAMEL CANNOT RECOVER THE UNDERLYING JUDGMENT FROM GREAT AMERICAN.

The Court of Appeals held *Gandy* inapplicable because its exact fact pattern was not present. The opinion specifically describes the circumstances of *Gandy* and cites *ATOFINA* for the proposition that *Gandy* is thus limited.[188] It then lists the ways that the facts of this case differ from *Gandy*, and ultimately concludes that "*Gandy* is inapplicable…."[189] As shown above, Texas law supports application of *Gandy's* adversarial trial requirement to cases that do not involve *Gandy's* exact fact pattern, including some instances where the insurer wrongfully refuses to

[185] R.R., Vol. 14, Ex. 67, pp. 11, 19-20, 30; Ex. 66, pp. 38-39, 46.
[186] R.R. Vol. 14, Ex. 67, pp. 19-20.
[187] R.R., Vol. 14, Ex. 67, pp. 11, 19-20, 30; Ex. 66, pp. 38-39, 46.
[188] *Hamel*, 444 S.W.3d at 801-02.
[189] *Hamel*, 444 S.W.3d at 804.

defend.[190] As also shown above, there was, as matter of law, no adversarial trial here.[191] Accordingly, the circumstances of this case are such that the Court should not enforce the underlying judgment against Great American.

Application of *Gandy's* adversarial trial requirement must yield the result that Hamel cannot recover. Because it was obtained by collusive means, the judgment's liability and damages determinations are irredeemably tainted. Neither a trial of coverage issues in this case nor the admission of underlying liability and damages evidence in it cures the problem. Further, the overall purposes of *Gandy* are furthered by disallowing Hamel any recovery.

A. The Judgment is Tainted

The underlying trial transcript and the pre-trial agreements speak for themselves.[192] The judgment procured was based upon collusion between Hamel and TMB. Texas law recognizes that when such a judgment is obtained, the insurer upon which the plaintiff seeks to impose the judgment is not liable for it.[193] Further, because Hamel obtained the judgment through collusive means, it is equitable that Hamel should be barred from any recovery. To allow recovery would only be to reward collusive behavior. Hamel could have gone into court and

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[190] *Stroop,* 133 S.W.3d at 849-50 (precluding recovery of judgment based on *Gandy* and noting the difficulty presented by loss of adversarial relationship); *Seger,* 407 S.W.3d at 443 (applying *Gandy* in situation where insurer had no defense duty).
[191] R.R. Vol. 11, Ex. 10.
[192] R.R. Vol. 11, Ex. 10; R.R. Vol. 12, Ex. 34; R.R. Vol. 11, Ex. 8.
[193] *See Britt*, 717 S.W.2d at 482; *Laster v. Am. Nat'l Fire Ins. Co.*, 775 F. Supp. 985, 988 (N.D. Tex. 1991).

put on his liability and damage evidence in the underlying lawsuit straight up. He chose not to do so.[194]

B. The Trial of this Case Does Not Solve the Problem

Contrary to what Hamel urged in the Court of Appeals,[195] the fact that issues relating to coverage were tried in this action, where liability and damages evidence was also admitted, does not cure the problem. Apart from the *Gandy* issues, the proceedings in the trial court here were, in a nutshell, for the purposes of determining: (1) whether the earlier Great American policies, which did not contain the EIFS exclusion, were triggered because property damage occurred while those policies were in effect, and (2) whether Hamel segregated covered and non-covered damages and properly allocated damages among policy periods.[196] That does not, however, alter the tainted nature of the liability and damages determinations of the underlying judgment for which coverage was litigated.

Hamel contends that evidence admitted at the coverage trial relating to liability and damages is sufficient to justify enforcement of the underlying judgment, and essentially urges the Court to give him a second trial of his case to make up for the polluted result of the first collusive trial.[197] It is not only inequitable, but it is contrary to *Gandy* itself, to retry the liability action in the

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[194] That announcement of the injury in fact rule in *Don's Building* after the collusion rendered it wholly unnecessary changes nothing.
[195] *See* Glen and Marsha Hamel's Opening Brief, pp. 49-50.
[196] C.R. Vol. 16, pp. 2933-38.
[197] *See* Glen and Marsha Hamel's Opening Brief, pp. 49-50.

coverage case. In *Gandy*, this Court rejected that approach, which is followed in California.[198] As this Court stated, once adversity is destroyed, it is impossible to go back and determine what might have been.[199]

C. *Gandy's* Rationale Prohibits Any Recovery

Having colluded to produce a judgment that could be recovered from an insurer, Hamel should not be rewarded by any recovery. In that the purposes of *Gandy* are to protect the integrity of the judicial process and to discourage collusion, allowing recovery based on evidence submitted in the coverage trial, or in any way allowing Hamel to go back and re-establish TMB's liability, simply frustrates the reasons for *Gandy's* rule.[200] In fact, any recovery by Hamel frustrates *Gandy's* purposes. The end result must therefore be that Hamel is not permitted to recover at all.

CONCLUSION

The policies behind the adversarial trial requirement announced in *Gandy* are furthered by its application to cases that do not involve its exact fact pattern. In those cases where adversity is destroyed prior to trial and the insured has no stake

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[198] *Gandy*, 925 S.W.2d at 719, rejecting *Pruyn v. Agri. Ins. Co.*, 42 Cal. Rptr. 2d. 295 (Cal. Ct. App. 1995).

[199] *Gandy*, 925 S.W.2d at 719.

[200] The approach of not allowing any recovery is also consistent with Texas cases that have addressed the issue of collusive judgments separate and apart from *Gandy*. *See, e.g.*, *Britt*, 717 S.W.2d at 482 (insurer was not bound by a judgment when the insured failed to conduct a reasonable defense and colluded with the plaintiff to defraud the insurer); *Laster*, 775 F. Supp. at 988 (insurer had no liability because the nature of the defense conducted by the insured was inadequate).

in the outcome, and where the parties enter into undisclosed agreements and take other affirmative steps designed to steer a claim into coverage and aid in the prosecution of a subsequent coverage lawsuit, the judgment produced cannot be the result of an adversarial trial and should not be enforced against an insurer. This is true even where the insurer does not defend and where the insured's rights against the carrier are not assigned to the plaintiff before the proceeding.

As a matter of law, the proceeding that resulted in the underlying judgment here was collusive and not an adversarial trial. Hamel should not be permitted to recover from Great American based on the underlying judgment due to the way it was obtained. The coverage litigation that took place in the trial court does not erase the tainted liability and damages that form the basis of the underlying judgment.

Because the Court of Appeals erred in failing to apply *Gandy's* adversarial trial requirement to this case and enforcing the judgment against Great American, and because it also erred in determining that the underlying judgment here resulted from an adversarial trial and was not collusive, the judgment of the Court of Appeals should be reversed and rendered.

PRAYER

Great American prays that the Court grant its Petition for Review, reverse the Court of Appeals' judgment, and render judgment for Great American. It also prays for all other relief to which it is entitled.

Respectfully submitted,

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No. 14-1007

IN THE SUPREME COURT OF TEXAS

GREAT AMERICAN INSURANCE COMPANY AND
GREAT AMERICAN LLOYDS INSURANCE COMPANY,
Petitioners,

v.

GLEN HAMEL AND MARSHA HAMEL,
Respondents.

ON PETITION FOR REVIEW FROM CAUSE NO. 08-11-00302-CV
EIGHTH DISTRICT COURT OF APPEALS
EL PASO, TEXAS

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INTRODUCTION

Glen and Marsha Hamel's ("Hamel") response paints a misleading picture of this case. The thrust of Hamel's argument is that it is unworthy of the Court's attention. "Move along. Nothing to see here." But Hamel's version of the case is a distortion that, while containing some elements of the truth, emphasizes the unimportant and diverts attention away from the parties' collusive conduct. This collusion, which the parties hid from the underlying trial court, created the judgment. Hamel orchestrated the proceeding to avoid facts critical to insurance and to manufacture coverage where none existed, based on what both Hamel and TMB believed the law to be at the time. Hamel now argues the collusive conduct is "immaterial" to the outcome. However, the truth is that the collusion tainted the underlying lawsuit and resulting judgment. The stain cannot be washed away by later developments in the law.

In order to understand why Hamel did what he did, one must consider the circumstances at the time. Great American Insurance Company ("GAIC") refused to defend because it believed (as most courts had held) initial manifestation was the applicable trigger. Therefore, only its 2000-2001 policy applied to Hamel's claims. That policy contained an EIFS exclusion. When problems first manifested, Hamel's main complaint,[1] and the conclusion of his experts, was that the house's

[1] RR Vol. 14, Ex. 53, pages 3-4.

EIFS was faulty and caused wood rot and other damage.[2] Under a manifestation trigger, the EIFS exclusion precluded coverage. GAIC was not the only party mistaken about trigger. So was Hamel. It is Hamel's equally mistaken belief about trigger, coupled with his effort to avoid application of *State Farm Fire & Cas. Co. v. Gandy*, that is the key to understanding Hamel's conduct in obtaining the collusive underlying judgment.[3]

The judgment is the result of Hamel and TMB working to avoid the policy's EIFS exclusion while steering clear of *Gandy*. The parties' actions make sense only when viewed this way. The judgment was not the product of a genuine contest of issues, and Hamel's arguments otherwise are sorely wanting when examined in light of the circumstances existing at the time of the underlying "trial."

For the Court to condone Hamel's actions in procuring this judgment would be to jettison Gandy's concerns and encourage future conduct that will inevitably require the Court to visit Gandy again. Rather than kick the can down the road, the Court should approve what other Texas appellate courts have done under similar circumstances and address the uncertainty that has followed its ATOFINA dicta that Gandy is inapplicable outside its exact fact pattern.[4]

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[2] RR Vol. 13, Ex. 39.

[3] 925 S.W.2d 696 (Tex. 1996).

[4] *See Evanston Ins. Co. v. ATOFINA Petrochemicals, Inc.*, 256 S.W.3d 660, 673 (Tex. 2008) ("*Gandy's* holding was explicit and narrow, applying only to a specific set of assignments with special attributes. By its own terms, *Gandy's* invalidation applies only to cases that present its five unique elements.").

ARGUMENT

1. This Case Triggers *Gandy's* Concerns

In attempting to dissuade the Court from granting review, Hamel denies it presents any *Gandy* concerns. Hamel ignores the obvious questions his conduct raises. Important questions such as — why did he switch positions and claim EIFS had no bearing on his damages when he previously claimed it was the source of his problems? Why would he not just take a default judgment against TMB if TMB did not have resources to defend the case? Why would he give Mitchell, individually, a covenant not to execute when he claimed Mitchell had no liability? Why would he enter into stipulations where TMB admitted liability and then not even show them to the trial court? Why would he take an assignment of TMB's claims when, as he now argues, it was unnecessary because he could have pursued GAIC as TMB's judgment creditor? Why would he negotiate for Mitchell's appearance at trial when, if Hamel really needed Mitchell's testimony, he could have subpoenaed him? Why did the parties' attorneys feel the need to discuss *Gandy* at all? Why the effort, in the stipulations, the testimony, and the findings of fact and conclusions of law, to emphasize that EIFS had nothing to do with the problems when EIFS related only to coverage and not liability?

Each of these is a cause for concern under *Gandy,* and Hamel has no credible explanation for why he conducted the underlying proceeding as he did.

The only explanation that makes sense is that, after discussions with TMB's attorney, Hamel concluded he needed a "trial" — and one that avoided the EIFS exclusion — in order to recover against GAIC. Hamel wanted to enter into an arrangement with TMB, but was afraid it would not hold up under *Gandy*.

If Hamel took a default against TMB, GAIC would assert its EIFS exclusion and, with the opportunity to litigate coverage facts not already established in the liability case, would prevail on the exclusion. But if Hamel had a "trial," he could steer the facts into coverage by introducing evidence EIFS had nothing to do with his damages. With facts established in the liability trial showing EIFS did not cause his problems, Hamel could enforce the judgment against GAIC because GAIC had declined to defend.

Hamel's Brief is his effort to discredit GAIC and to explain away his conduct. But his explanations are sorely lacking, and each instance of questionable behavior triggers *Gandy's* concerns.

A. After the Pre-Trial Agreement, TMB had no Financial Stake in the Outcome of the Underlying Proceeding and Hamel Could Get a "Trial" — *Gandy* Concerns

Neither TMB nor its principal, Mitchell, had any financial stake in the underlying proceeding due to a pre-trial agreement not to execute. Hamel takes issue with GAIC's characterization of the agreement, but ultimately concedes the

point.[5] The record strongly supports GAIC's contentions about the agreement. Mitchell admitted in his deposition that TMB had no assets except for tools and a truck:

> Q: As of May 19, 2005, was Terry Mitchell Builder a shell company? And by that I mean a corporation with essentially no assets.
>
> A: Yeah, virtually a pickup truck and some tools and an office out of the house.
>
> Q: Okay. And in the agreement here, it says the Hamels further agree that Terry Mitchell may continue to use his personal tools of the trade and truck and will not seek to levy upon said assets even if in the name of Terry Mitchell Builder. So under this agreement, the Hamels really couldn't even – couldn't even go after the tools and truck, could they?
>
> A: Yes, sir.
>
> Q: Okay. And you knew all that by the time trial rolled around, correct?
>
> A: (Nods head up and down)
>
> Q: A verbal answer, please.

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[5] *See* Resp'ts' Br. 6 ("TMB had limited assets to pay for its defense or to satisfy any potential judgment,") 56 (TMB was a "judgment-proof insured with minimal assets").

A. Yes.[6]

TMB owned nothing but tools and a truck, and the agreement specifically exempted them from execution. Nowhere in his briefing does Hamel say what assets TMB did have at risk. There were none. The fact that TMB had nothing at stake is a primary reason why *Gandy's* concerns apply. With nothing to lose, TMB had no motivation to oppose Hamel or to contest the damages he was claiming.[7]

The agreement also allowed Hamel to avoid taking a default against TMB and to have a proceeding he could point to as a "trial." If TMB's financial status is meaningless, as Hamel argues, then why the agreement regarding execution in the first place? TMB could have just allowed a default. The answer is that Hamel needed to avoid *Gandy* by having a proceeding, one that TMB participated in, and one that "proved" EIFS had nothing to do with the loss. This explanation is the only one that makes sense of the parties' conduct.

The agreement also protected Mitchell from exposure. Hamel attempts to explain away the covenant not to execute on Mitchell's individual assets, saying he had no reason to bring Mitchell into the case. Continuing the "nothing to see here" approach, Hamel asks why a covenant not to execute against Mitchell individually

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[6] RR Vol. 14, Ex. 67, pages 19-20.

[7] Hamel also contends the agreement did not fully shield TMB from liability because it contained a representation that Mitchell had made no transfers in excess of $25,000 out of TMB. This in no way undercuts GAIC's argument that the agreement fully protected TMB. It only proves TMB did not have any money or assets to transfer to another entity.

should matter at all when he was not a party to the case and at no risk of a judgment. The answer to that question is another question: if Mitchell individually was not a defendant in the case, why did he need a covenant not to execute? He not only got one, but he also received an agreement that Hamel would never assert any alter ego claims.[8] The obvious purpose was to protect Mitchell from any collection proceedings, and to ensure the only asset Hamel could pursue was TMB's insurance policy. Like the rest of his arguments minimizing *Gandy* concerns, Hamel's attempt to explain Mitchell's individual shielding from liability is belied by critical analysis.

Finally, Hamel's insistence that the agreement was necessary to ensure Mitchell's appearance at trial is unbelievable. Hamel could simply have subpoenaed Mitchell had he needed Mitchell's personal testimony. There is no plausible scenario here where the purpose of the agreement limiting execution was to ensure an adversarial trial. Its purpose was to ensure there would not be one, so that Hamel's steering the case into coverage could proceed without distraction. Hamel clearly wanted there to be some sort of proceeding TMB participated in to help perpetrate a sham of adversity, thus appearing to satisfy *Gandy's* trial requirement while also creating a mechanism to avoid the EIFS exclusion.

[8] RR Vol. 11, Ex. 8.

In *Gandy*, the Court expressly stated that an insured's lack of financial incentive to oppose the plaintiff is a cause for concern.[9] While the Hamel/TMB agreement does not specifically say Hamel would not execute on any of TMB's assets, its effect was exactly that. The agreement protected all of TMB's assets from execution because the items mentioned in it were the only assets TMB owed. Hamel cannot plausibly deny these are *Gandy* concerns.

B. TMB Stipulated to Liability in Advance of "Trial," Gratuitously Aided Hamel's Quest for Coverage, and Changed Positions — Causes for Concern

Hamel's explanation of the pre-trial Stipulations entered into with TMB strains credulity. First, Hamel denies the Stipulations are an admission of liability. But the Stipulations, when taken together, are exactly that. When a defendant stipulates that it owed a duty of care and breached that duty, and that the plaintiff suffered damage because of the breach of that duty, then the defendant has stipulated to liability.

The following is just a sample of some of the "facts" contained in the stipulations:

> 3. As part of the agreement, TMB agreed to and had a duty to inspect all work, including that which was done by GSM and its subcontractors to make sure that it was done in a good and workman like manner and that there were no problems.[10]

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[9] *Gandy,* 925 S.W.2d at 713.
[10] RR Vol. 12, Ex. 34, page 3.

This stipulation is the opposite of what the contract obligates TMB to do. The contract states TMB bears no responsibility for construction done by the previous contractor, and before the date of the contract's execution, February 4, 1995.[11]

The stipulations go on to read:

> 10. TMB attempted to satisfy the duties it owed to the Hamels and if there were any problems with the construction, those problems were not detected by TMB and must not have been detected as a result of oversight.
>
> 12. If steel nails were used in the roofing system, TMB did not notice it. Using steel nails is a problem because they rust and allow water to enter. Galvanized nails or aluminum nails should have been used. TMB [sic] failure to notice the nails was an honest oversight.
>
> 13. If there is an area where there is a gap in the Fascia board, that is a problem because water can enter the Residence. TMB did not notice it and this failure was an honest oversight.[12]

TMB admits failing to engage in certain acts is negligence, and bolsters Hamel's position that any wrongful actions TMB took were merely careless oversight.

Hamel contends the Stipulations had to be true because every witness testified they were true. This overlooks TMB's lawyer calling no witnesses and

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[11] RR Vol. 14, Ex. 45, page 2, para. 1.
[12] RR Vol. 12, Ex. 34, page 3.

entering nothing into evidence.[13] All of Hamel's witnesses said the information in the Stipulations was true because they were the only witnesses testifying. TMB's attorney, Hudnall, never called a single witness to testify on TMB's behalf.[14] He never entered the contract between Hamel and TMB into evidence,[15] even though it exonerated TMB for much of the liability for Hamel's house.[16] He never conducted any meaningful cross-examination of the witnesses,[17] so there was no testimony elicited that would contradict the Stipulations. This does not make the Stipulations true. It only means TMB made no effort to contest them.

Next, the suggestion TMB executed the Stipulations "to obtain and perpetuate truthful testimony that would facilitate the trial of the Construction Liability"[18] borders on ridiculous. The parties entered into the Stipulations after the attorneys had discussed *Gandy*.[19] Their purpose cannot have been to streamline the trial process; otherwise, Hamel would have admitted them into evidence. The Stipulations are explainable only as insurance that Terry Mitchell would testify in accordance with them, and for the purpose of helping Hamel recover under TMB's policy.

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[13]Hamel's statement that the trial court decided the underlying case based on the evidence and not on the parties' agreements is disingenuous. Hamel tailored the evidence to a specific purpose made plain by agreements he concealed from the court.
[14] RR Vol. 11, Ex. 10, page 3.
[15] *Id.*; RR Vol. 11, Ex. 10, page 126.
[16] RR Vol. 14, Ex. 45.
[17] RR Vol. 11, Ex. 10, pages 32-33, 75, 103-05, and 124-25.
[18] Resp'ts' Br. 45.
[19] RR Vol. 14, Ex. 66, pp. 18-19.

Hamel's other proferred justification for the Stipulations, that they were obtained in lieu of discovery responses or deposition discovery, is unavailing. TMB executed the Stipulations[20] on the response date for the Requests.[21] TMB was under no obligation to enter into them. The Stipulations contained much the same information as the outstanding Requests for Admissions,[22] so TMB gained no benefit from executing them. Had TMB admitted all the Requests, it would have been less damaging to TMB's case than the Stipulations.

More important, however, the outstanding Requests for Admissions prove the parties created the Stipulations for another purpose entirely. The Stipulations contain additional admissions that were not present in the Requests for Admissions — stipulations relating only to coverage. In addition to admitting liability for failing to construct the residence properly, TMB in the Stipulations "admits" EIFS had nothing to do with the problems at Hamel's house:

> 20. The type of construction problems identified herein are not related in any way to EFIS or any component part thereof or any failure to flash, seal, caulk, or failure to install it correctly. These problems would have occurred regardless of the type of exterior cladding used.
>
> 21. TMB did not design, manufacture, construct, fabricate, prepare, install, apply, maintain, or repair the EFIS that was installed on the Residence.[23]

[20] RR Vol. 12, Ex. 34.
[21] RR Vol. 10, Ex. 5.
[22] RR Vol. 12, Ex. 33.
[23] RR Vol. 12, Ex. 34.

Stipulation 21 tracks the **exact** language of the EIFS policy exclusion, which states that coverage does not apply to "[t]he design, manufacture, construction, fabrication, preparation, installation, application, maintenance, or repair" of EIFS.[24] It is nothing but an attempt to avoid the EIFS exclusion.

Why would TMB stipulate that EIFS did not cause Hamel's damages when the source of the damages would not have changed TMB's exposure? According to Hamel's liability theory, TMB was responsible for everything in the house, regardless of whether TMB or GSM completed it. If the house was suffering from wood rot, and TMB admitted liability for that, TMB would be liable for the cost of repairing the wood damage. Why would TMB find it necessary to stipulate that EIFS had nothing to do with the problems, particularly if the EIFS exclusion is the "red herring" Hamel claims it is? It would not affect TMB's liability for Hamel's damages because TMB already admitted it was responsible for the construction in its entirety.[25] For example, Stipulation number 3 states: "TMB agreed to and had a duty to inspect **all** work, including that which was done by GSM and its subcontractors to make sure that it was done in a good and workman like manner and that there were no problems."[26]

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[24] RR Vol. 12, Ex. 16.
[25] RR Vol. 12, Ex. 34, page 3.
[26] RR Vol. 12, Ex. 34, page 2 (emphasis added).

The answer, once again, is coverage. When Hamel initially decided to pursue TMB, he claimed the home suffered damage because the EIFS was improperly installed, allowing water to penetrate the structure and cause damage to other components. Yeandle's conclusion in his report was: "**the EIFS cladding lacks proper sealing at virtually all windows, doors, mechanical penetration and dissimilar material joints. Back wrapping was inconsistent and detailing was poor for water management.**"[27] Hamel's Original Petition echoes these same conclusions.[28]

Hamel later changed his theory to avoid the policy's EIFS exclusion. Instead of EIFS being the source of the problems, Hamel insisted EIFS had nothing to do with his damages. He went to great lengths to do this, as is demonstrated by the unnecessary Stipulations regarding EIFS.[29] The only reason why admissions about EIFS would be included in the Stipulations is to steer Hamel's damages out of the EIFS exclusion and into coverage.

Stipulation Nos. 20-21 demonstrate that the Stipulations were an attempt to create insurance coverage separate and apart from any existing obligation TMB had to respond to Hamel's discovery. There is nothing in the Requests for Admissions that said anything about EIFS. However, the parties inserted

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[27] RR Vol. 13, Ex. 39, page 11.
[28] RR Vol. 14, Ex. 53, pages 3-4.
[29] RR Vol. 12, Ex. 34.

unnecessary recitations about EIFS having nothing to do with the house's problems into the Stipulations (as well as into the "trial" testimony and the Findings of Fact and Conclusions of Law).

These gratuitous "facts" put to rest any contention the Stipulations were a legitimate attempt to satisfy TMB's discovery obligations to Hamel. In fact, they demonstrate the entire underlying proceeding was a sham of adversity perpetrated to obtain a judgment that would avoid the EIFS exclusion in the GAIC policy that Hamel, like GAIC, believed applied to his claims. The gearing of a proceeding to facilitate subsequent coverage litigation is another *Gandy* concern.

The Stipulations also demonstrate both TMB's and Hamel's position shifting. TMB originally contended it had no liability for any of Hamel's damages.[30] However, in the Stipulations, TMB admits Hamel's entire case. Hamel also shifted his position. His experts and his petition originally contended EIFS was the primary cause of the house's problems.[31] He later switched positions, and went to great lengths to manufacture testimony that EIFS had nothing to do with his damages.

Gandy recognized this type of position shifting as a concern. The fact that the plaintiff and defendant in *Gandy* "took positions that appeared contrary to their natural interests for no other reason than to obtain a judgment against [the

[30] RR Vol. 12, Ex. 36.
[31] RR Vol. 13, Ex. 39, Vol. 14, Ex. 53, pages 3-4.

insurer]"[32] troubled the Court. The Court expressed concern that once the parties shifted their positions, it would be impossible to go back and find out the true scope of the insured's liability, if any: "[i]t is difficult enough to try to determine what P would have recovered had he gone to trial against D; the determination is even more difficult when D's opposing position must be reconstructed and its merits assessed without D's cooperation."[33]

As to Hamel's contention the Stipulations did not serve to prolong litigation, GAIC simply points out that here we all are, over a decade after the underlying "trial," still litigating. The Stipulations prolonged litigation because they helped to ensure a trial designed to pave the way to more litigation – this insurance litigation.

C. Hamel and TMB "Tried" The Case to Manufacture Coverage – Another Cause for Concern

The following questions and answers from the underlying trial testimony demonstrate the purpose of the proceeding was to avoid the EIFS exclusion in the GAIC policy in effect August 2000, when Hamel first noticed water intrusion problems. In questioning Terry Mitchell, Hamel's attorney asks:

Q: These problems that we have talked about, all of these problems

I have just identified with you, would you agree with me that

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[32] *Gandy*, 925 S.W.2d at 712.
[33] *Id*. at 713.

those don't have anything to do with what's commonly referred to as EIFS?

A: Yes.

Q: I'm sorry. Go ahead.

A: Yes.

Q: In other words, that doesn't have anything to do with the EIFS system or any part of the EIFS system, do they?

A: No.

Q: These problems would have occurred regardless of the type of exterior cladding used on that house?

A: Yes.

Q: And Terry Mitchell Builder, Inc., did not design, manufacture, construct, fabricate, prepare, install, apply, maintain, or repair the EIFS that was installed on the Hamels' house?[34]

A: No.[35]

He continued this line of questioning with Glen Hamel:

Q: You also mentioned just a minute ago that you had seen some checkerboarding on the house, and it's my understanding that

[34] Hamel is again tracking the EIFS exclusion here. RR Vol. 12, Ex. 16.
[35] RR Vol. 11, Ex. 10, page 29.

that checkerboarding phenomenon has nothing to do with water?

A: That's correct.

Q: Now, previously in this litigation, STO, the manufacturer of the exterior cladding on your house that was checkerboarding, they were a party, right?

A: That's correct.

Q: But the claims that you asserted against STO had to do with the checkerboarding?

A: That is correct.

Q: And that doesn't have anything to do with the points of entry where the water is coming in?

A: That is correct. Entirely different.[36]

Hamel's attorney repeated this same line of questioning with Yeandle:

Q: All these problems that we have just been through that have been sources of water entry in the residence, do they have anything to do with the EIFS system or any component of the EIFS system?

[36] RR Vol. 11, Ex. 10, pages 43-44.

A: No, the EIFS system is a barrier system, and we see no evidence that there is moisture that goes through the EIFS. It appears to all be coming from at the intersection of the roof and the eave – of the fascia boards, because there really is no eave over this house.

Q: My question is these problems are totally independent of the EIFS system, correct?

A: Yes, sir.[37]

This testimony from Yeandle is particularly curious because when Yeandle originally inspected the house, he opined that EIFS was a major source of Hamel's problems:

- "[M]y attention was focused on flashing installation details at the EIFS cladding and areas where EIFS cladding intersected or terminated adjacent with roofing materials, fascia or windows.

- The majority of accessible EIFS wall and trim surfaces were surveyed at grade using a Wet Wall Meter.

- The wet wall mater was used to scan the exterior EIFS stucco where several areas yielded reading greater than 20% relative moisture content.

- Green mold is visible growing on the EIFS stucco finish along the northwest lower corner of the garage.

- At the south elevation of the garage offset, there is a vertical and horizontal pattern visible through the EIFS finish coat. All

[37] RR Vol. 11, Ex. 10, pages 90-91.

indications are that the discoloration is a fungal growth behind and between the EIFS foam insulation board. The area of checker boarding is continuing to get larger and more pronounced.

- The west wall of the laundry room has a dryer vent that penetrates through the EIFS system with no sealant joint.

- There is not a sealant joint visible between the window frames, glass block and door frame intersections with EIFS cladding anywhere around the home.

- At the north side of the entry door and at the northwest corner of the entry, no starter strip was installed. In addition, the bottom edge of the EIFS cladding system was not properly back wrapped. Wood sheathing is exposed allowing water and moisture to migrate up behind the EIFS system. A high moisture level will cause wood rot of structure framing members and support mold growth. In many places, there is insufficient free space between finish grade and the base of the EIFS cladding; this will also contribute to unacceptable moisture level behind the EIFS cladding System.

- The vertical EIFS cladding rests on the roofing material with no free space for water to travel. There are no effective kicks out flashing to divert roof-shed water from impacting the EIFS cladding.

- At the entry offset and gutters, a diverter flashing is acting as a dam. This diverter causes water to backup under roof shingles and behind EIFS where it is entering the living space of the home…. In many locations water is deposited by way of the gutter onto the lower roof slope where it intersects with a vertical EIFS clad wall. Gutter down spout strappings have been attached to the EIFS cladding with nails, creating unsealed penetrations for moisture to enter the wall system.

- Expansion joints were omitted throughout the EIFS system. There are many visible stress cracks developing in the stucco finish.

- There is a large gap at the southeast inside corner of the patio. At the top of the wall, water can easily penetrate exterior cladding and become trapped in the wall framing. Deterioration of the sheathing and framing has begun in this area. The vertical EIFS is again placed directly on the roofing materials along the east slope at the south corner.

- The curved wall on the north side of the patio is poorly detailed for water management. The EIFS wall sits directly on top of the roofing shingles at the southeast slope above the family room. An opening in the EIFS cladding is visible at the ridge wall intersection, enabling water to run down behind the flashing.

- At the north elevation of the family room and kitchen, the moisture content near the guttering is elevated. There is mesh showing through the EIFS finish coat and black staining above the windows. There are three (3) horizontal cracks in the EIFS starting at the second floor offset.

- In conclusion, the EIFS cladding lacks proper sealing at virtually all windows, doors, mechanical penetration and dissimilar material joints. Back wrapping was inconsistent and detailing was poor for water management."[38]

Yeandle changed his opinion from EIFS being the cause of all the problems to EIFS having nothing to do with the problems. There is no explanation for such a shift in position except that Hamel was trying to avoid the EIFS exclusion.

[38] RR Vol. 13, Ex. 39.

Next, the following Finding of Fact and Conclusion of Law, which Hamel submitted to the underlying trial court and which was signed without change,[39] bolsters the conclusion the parties geared the "trial" toward manufacturing insurance coverage:

> 9. TMB did not design, manufacture, construct, fabricate, prepare, install, apply, maintain, or repair the EFIS that was installed on the Residence but rather hired subcontractors that performed that work. The types of construction problems addressed in these Findings of Fact are not related in any way to EFIS or any component part thereof or any failure to flash, seal, caulk, or failure to install it correctly. These problems would have occurred regardless of the type of exterior cladding used.[40]

Hamel pointing to TMB's lack of money to defend itself does not explain the parties' gratuitous efforts to steer the claim into coverage by avoiding the EIFS exclusion in the 2000-2001 policy, which Hamel, like GAIC, believed applied to the claim. Rather, the parties' actions are only explainable as part of an effort to stage a proceeding that would take the claim into coverage by avoiding the EIFS exclusion and simultaneously appearing to satisfy *Gandy's* requirement that there be a trial. Efforts to steer a claim into coverage, particularly when unrelated to legitimate liability and damages questions, are a cause for concern under *Gandy*.

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[39] Hamel claims that because TMB had the opportunity to submit its own Findings of Fact and Conclusions of Law, this somehow undermines GAIC's point. It does not. The point is that TMB did not submit any proposed findings or conclusions.

[40] RR Vol. 12, Ex. 15 ¶ 9. This finding tracks the exact language of the policy's EIFS exclusion. RR Vol. 12, Ex. 16.

D. Hamel and TMB Kept the Underlying Trial Court in the Dark — Yet Another Cause for Concern

Nowhere in Hamel's response is there an attempt to justify not telling the court about the parties' non-execution agreement and the Stipulations. If the purpose of the parties' pre-trial arrangements was to ensure an adversarial trial took place and TMB fulfilled its discovery obligations, why did they hide these arrangements? Hamel gives no explanation because the only explanation is obvious: Hamel wanted to perpetrate a sham of adversity. Hamel's failure to advise the underlying trial court of the whole truth should be troubling. One of *Gandy's* concerns is protecting the integrity of the judicial process. The existence of agreements that can distort the litigation process should be disclosed to ensure that integrity. Hamel's failure to advise the underlying court of what was going on is another cause for concern that he cannot explain away.

E. The Judgment was Distorted — One More Cause for Concern

The collusion between Hamel and TMB not only tried to avoid the EIFS exclusion while appearing to meet *Gandy's* adversarial trial requirement, but it also produced an inflated judgment. TMB made no effort to obtain a credit for the $25,000 settlement Hamel made with STO. The trial court awarded Hamel $50,000 for Marsha Hamel's mental anguish damages even though she did not testify at the proceeding. Additionally, Yeandle originally opined the repairs to the house would

cost approximately $71,639.38.[41] By the time of "trial," the cost for those repairs increased to $169,089.70.[42] The record contains no explanation why Hamel's damages increased so significantly from the time of Yeandle's original opinion to the time of "trial." While the judgment in favor of Hamel is not inflated to the obnoxious extent of the judgments in *Gandy* or *Seger*[43], it is inflated nonetheless. This is another cause for concern.

2. **Hamel Emphasizes the Unimportant**

Unlike GAIC's discussion of the EIFS exclusion in its policy, which Hamel calls a red herring, Hamel's arguments regarding the post-trial timing of TMB's assignment of rights to Hamel and the discussion of the actual trial condition in the GAIC policy really are red herrings. As noted in GAIC's Brief, Hamel, as a judgment creditor, could sue GAIC directly to recover on the judgment without an assignment from TMB. That the assignment was executed post-trial is of no consequence to whether *Gandy's* rationale should apply, particularly in light of the other collusive measures taken by the parties. The existence of the unnecessary assignment suggests an overall pattern of conduct designed to set up an insurer in connection with a non-adversarial proceeding geared toward facilitating

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[41] RR Vol. 13, Ex. 39, page 14.
[42] RR Vol. 12, Ex. 12, page 2.
[43] *Yorkshire Inc. Co., Ltd. v. Seger,* 407 S.W.3d 435, 439-43 (Tex. App.—Amarillo 2013), *aff'd on other grounds sub nom. Seger v. Yorkshire Ins. Co., Ltd.,* No. 13-0673, ___ S.W.3d____, 2016 WL 3382223 (Tex. June 17, 2016).

subsequent coverage litigation.[44] As for the actual trial policy condition, GAIC acknowledges an insurer that refuses to defend cannot insist on compliance with the condition. *Gandy* and its progeny are, however, a separate common law safeguard against the kind of collusion giving rise to Hamel's judgment against TMB.[45]

3. <u>Other Texas Courts Have Applied *Gandy* in Cases of Collusion</u>

Hamel's efforts to distinguish the cases GAIC cites are as unavailing as his argument that no *Gandy* concerns are present. In fact, the chart that appears at pp. 41-44 of his response shows that collusive judgments that do not result from adversarial trials are not enforceable against insurers under *Gandy's* rationale. The cases discussed in GAIC's Brief at pp. 22-24 and 47-49 expressly cite and rely upon *Gandy* as a basis for refusing to allow recovery on collusive judgments. While there is no reported Texas case that exactly fits the fact pattern presented here, some of the cases GAIC relies upon establish that collusive judgments are not enforceable under *Gandy's* rationale even in circumstances where the insurer does not defend. The circumstances giving rise to Hamel's judgment are perfectly analogous to those surrounding the judgments these other courts, applying Texas

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[44] Hamel asserted extracontractual claims against GAIC, but later dropped them. CR Vol. 16, page 2938.

[45] Hamel also concedes *Gandy's* adversarial trial requirement is separate from the issue of whether an insured's assignment of rights to the plaintiff is valid. *See* Resp'ts' Br. 19. Stated differently, Hamel concedes the rationale of *Gandy* requires, at a minimum, that courts must closely examine judgments that do not result from fully adversarial trials before they are binding on an insurer.

law, refused to enforce based on *Gandy*.[46]

Hamel contends this case is like *Great Am. Lloyds Ins. Co. v. Vines-Herrin Custom Homes, LLC,* No. 05-15-00230-CV, 2016 WL 4486656 (Tex. App.—Dallas, Aug. 25, 2016, no pet. h). That case, however, is distinguishable. In *Vines-Herrin*, Great American asserted a challenge to recovery of a judgment based on *Gandy*. The Dallas Court of Appeals rejected that challenge, and upheld the trial court's finding there was an adversarial trial. But the *Gandy* challenge in *Vines-Herrin* was based solely on the insured's agreement to arbitrate after a defense was denied. An insured's agreement to arbitrate is not comparable to what took place here: a pre-trial covenant not to execute on the insured's assets, stipulations of liability, a proceeding geared toward later coverage litigation, and agreements hidden from the trial court. There is no indication in *Vines-Herrin* the arbitration itself was a sham proceeding designed to manufacture coverage, or that the parties concealed anything from either the arbitrator or the trial court. These radically different facts distinguish *Vines-Herrin* from this case.

GAIC does not ask for a drastic expansion of *Gandy*. It only asks this Court to recognize there are cases, like this one, where its principles should apply outside of *Gandy's* exact fact pattern. Whether *Gandy* or the public policy principles that

[46] The primary distinction Hamel emphasizes in attacking GAIC's reliance on the cases it cites is that, in many of those cases, the insurer offered to defend. GAIC's point is that some cases present fact situations where *Gandy's* rationale should be applied when its exact fact pattern is absent.

underlie it apply to a specific set of circumstances is a question of law.[47]

4. GAIC's Denial Did Not Require Hamel's Collusion

Hamel argues that he and TMB did what an insured and a plaintiff have to do whenever the insured has limited assets and the insurer refuses to defend. Not so. A plaintiff with a legitimate claim can go to the courthouse, even if the insured does not appear, and put on his case, introducing evidence to support liability and damages. In the absence of collusion, Texas courts may uphold a judgment against an insured who cannot defend himself. *See Mid-Continent Cas. Co. v. JHP Dev., Inc.*, 557 F.3d 207, 217-18 (5th Cir. 2009).[48] Parties can enter into assignments and non-execution agreements after liability and damages are established. However, that is not this case because that is not what Hamel did. This case involves the removal of any financial incentive for TMB to oppose Hamel, admissions of liability, questionable efforts to manufacture insurance coverage and facilitate subsequent coverage litigation, and concealment from the trial court. Each of these raises the types of concerns expressed in *Gandy*.

There is nothing *per se* wrong with a plaintiff presenting a case to maximize insurance coverage. However, what happened here was much more than that. Hamel gratuitously introduced evidence relating to EIFS — evidence that had

[47] A trial court has no discretion in determining what the law is or in applying the law to the facts. *Walker v. Packer*, 827 S.W.2d 833, 840 (Tex. 1992).
[48] *Cf., Vines-Herrin*, 2016 WL 4486656.

nothing to do with liability or damages. In fact, the evidence was false — EIFS had much to do with the problems at the house, as demonstrated by the substance of Hamel's case before entering into the arrangement with TMB. Presenting a case to maximize insurance coverage is one thing. Colluding to manufacture coverage where it does not exist is quite another. Hamel's conduct in procuring the underlying judgment irredeemably taints it.[49]

5. The Underlying Proceeding Was Collusive and Not an Adversarial Trial

A primary *Gandy* concern is a judgment that results from a brief evidentiary hearing where the defendant's participation is minimal.[50] The following demonstrates the underlying proceeding was not a genuine contest of issues, but a sham of adversity designed to manufacture insurance coverage by avoiding the EIFS exclusion in the 2000-2001 GAIC policy.

- TMB's attorney did not enter the contract between TMB and Hamel into evidence even though it absolved TMB of responsibility for much of Hamel's damages.[51]

- As detailed above, Hamel went to great lengths to offer evidence that EIFS was not the cause of his damages through both witness testimony, and in the findings of fact and conclusions of law.[52] TMB never objected to such testimony.

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[49] Neither TMB nor its counsel are at fault for the proceeding: TMB and Terry Mitchell secured protection of their assets.
[50] *Gandy*, 925 S.W.2d at 713.
[51] RR Vol. 14, Ex. 45; RR Vol. 11, Ex. 10, page 3.
[52] RR Vol. 12, Ex. 15, para. 9; RR Vol. 11, Ex. 10, pages 29, pages 43-44, 90-91.

- TMB's attorney made no objections to any of the testimony given by Hamel's witnesses, even though much of it was wildly speculative and Hamel had laid no foundation for the witnesses' qualifications to testify.[53]

- TMB's attorney asked only seven questions of Glen Hamel on cross-examination, and made no effort to discredit any of Hamel's testimony.[54]

- TMB's attorney asked Yeandle only about his offer to purchase Hamel's house, and asked nothing about the speculative opinions Yeandle testified to, which were in direct contradiction to Yeandle's report.[55]

- TMB's attorney put on no evidence and called no witnesses.[56]

- TMB's attorney made no closing statement.[57]

- TMB's attorney made no effort to get a settlement credit for the $25,000 co-defendant STO paid.[58]

- TMB's attorney submitted no proposed Findings of Fact or Conclusions of Law.

TMB's lack of concern for the outcome of the case is also apparent because Mitchell encouraged TMB's attorney not to put up a fight. Although Hamel contends GAIC mischaracterizes the record on this point, Mitchell's testimony confirms GAIC's argument. Mitchell testified that he did not want to bear the

[53] RR Vol. 11, Ex. 10.
[54] RR Vol. 11, Ex. 10, page 75, 104-05.
[55] RR Vol. 11, Ex. 10, page 124-25.
[56] RR Vol. 11, Ex. 10, page 126.
[57] RR Vol. 11, Ex. 10, page 126.
[58] RR Vol. 11, Ex. 10.

expense of hiring experts in the case,[59] that he was "fed up" with the litigation,[60] and that he had no stake in the matter, so he just did not care what happened.[61]

Although a defendant concerned with its exposure would advocate strongly for any settlement credits due, TMB made no effort to get credit for STO's earlier $25,000 settlement."[62] The record demonstrates Hudnall never once during the proceeding even brought up the fact that co-defendant STO had paid for a portion of Hamel's damages, and never attempted to get a settlement credit.[63] Mitchell explains why in his deposition testimony:

> Q: Were you aware that your lawyer in the Hamel case did not make any effort to get a credit for that $25,000 that the Hamels got from STO in the Hamel case?
>
> A: I never, I've never heard anything about a credit or 25,000 from STO.
>
> Q: After you entered into the agreement that's Exhibit 8, you really didn't even care about that?
>
> A: (shakes head side to side)
>
> Q: A verbal response, please.

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[59] RR Vol. 14, Ex. 67, page 11 ("I would have to think that it was getting back to hiring expert witnesses and several different things in which I didn't want to get into the expense of doing.").
[60] RR Vol. 14, Ex. 67, page 18.
[61] RR Vol. 14, Ex. 67, page 21 (Q: "Okay. You wouldn't have cared because your assets were not at risk as of the time you entered into that agreement; is that correct? A: Yeah. I don't care.").
[62] Respondent's Brief, page 18.
[63] RR Vol. 11, Ex. 10.

A: No, sir.

Q: Okay, you wouldn't have cared because your assets were not at risk as of the time you entered into that agreement; is that correct?

A: Yeah, I don't care.[64]

Mitchell testified that he did not care about getting a settlement credit because he had no assets at stake. Hamel can point to nothing in the record demonstrating Hudnall ever tried to get a credit because such evidence does not exist.

Hamel went to great lengths in this case to demonstrate that TMB was not entitled to the credit. The findings of fact Hamel procured contain a gratuitous finding stating: "[t]he checkerboarding effect that the Hamels experienced on the Residence was due to other causes and therefore the prior settlement with the other Defendants is unrelated to the amount being awarded against TMB to compensate the Hamels for the water damage. Therefore, no settlement credit is due."[65] But the record shows the STO settlement was for the same damage.[66] TMB was therefore entitled to the credit.

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[64] RR Vol. 14, Ex. 67, page 21.
[65] RR Vol. 14, Ex. 58, page 7, para. 37.
[66] RR Vol. 14, Ex. 53, pages 6-7; Vol. 11, Ex. 3.

In sum, the trial court's conclusion that the underlying proceeding was an adversarial trial and not collusive cannot be squared with the evidence, and is wrong as a matter of law.[67]

6. **<u>The Coverage Trial does not Remove the Taint of the Underlying Judgment</u>**

Hamel's argument that the evidence admitted at the coverage trial absolves him of colluding to produce the underlying judgment is untenable. The entire rationale of *Gandy* is that once adversity is destroyed and the defendant no longer has any incentive to oppose the plaintiff, it is impossible to go back and determine what might have been.[68]

This Court's adoption of the injury in fact trigger in *Don's Building*[69] and its re-affirmance of an "all sums" approach in *Lennar Homes*[70] (which combined meant the underlying claim was covered under an earlier GAIC policy) do not change the fact Hamel's judgment was the product of collusion. Hamel, pursuant to an agreement hidden from the trial court, geared the proceeding toward avoiding an exclusion in an insurance policy. It would be inequitable to allow Hamel to benefit from his wrongful conduct by recovering on the underlying judgment. This Court should resist any temptation to look the other way just because, due to

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[67] *Cf. Seger,* 407 S.W.3d at 439-43 (discussing review of trial proceeding).
[68] *Gandy*, 925 S.W.2d at 713.
[69] *Don's Bldg. Supply, Inc. v. OneBeacon Ins. Co.*, 267 S.W.3d 20, 26-27 (Tex. 2008).
[70] *Lennar Corp. v. Markel Am. Ins. Co.*, 413 S.W.3d 750 (Tex. 2013).

subsequent unforeseen developments in the law, the underlying claims turned out to be covered and rendered Hamel's collusion unnecessary.

CONCLUSION

To allow recovery on the underlying judgment would be to encourage wrongful conduct and to diminish the integrity of the judicial process. If what happened in the underlying case is permissible under Texas law, then anytime an insurer wrongfully refuses to defend, it is subject to whatever deal its insured and the plaintiff manufacture. The right of an insurer under Texas law to contest coverage for a resulting judgment under those circumstances will be rendered meaningless. That was not what the Court meant to do when it stated in *ATOFINA* that *Gandy* was limited to its specific facts. The Court should not permit Hamel to recover on the tainted judgment, which he procured by perpetrating a sham of adversity on the underlying trial court.

WHEREFORE, PREMISES CONSIDERED, GAIC prays the Court grant its Petition for Review, review this case, reverse the judgment of the Court of Appeals, and render judgment that Hamel take nothing. GAIC also prays for such other and further relief as it may be justly entitled.

Respectfully submitted,

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Dated: November 1, 2016

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No. 14-1007

IN THE SUPREME COURT OF TEXAS

**GREAT AMERICAN
INSURANCE COMPANY AND
GREAT AMERICAN LLOYDS
INSURANCE COMPANY,**

Petitioners,

V.

**GLEN HAMEL AND
MARSHA HAMEL,**

Respondents.

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No. 14-1007

IN THE SUPREME COURT OF TEXAS

GREAT AMERICAN
INSURANCE COMPANY AND
GREAT AMERICAN LLOYDS
INSURANCE COMPANY,

Petitioners,

V.

GLEN HAMEL AND
MARSHA HAMEL,

Respondents.

RESPONDENTS' BRIEF ON THE MERITS

TO THE HONORABLE SUPREME COURT OF TEXAS:

Respondents, Glen Hamel and Marsha Hamel (the "Hamels"), pursuant to Texas Rule of Appellate Procedure 55, respectfully submit this Brief on the Merits and pray that this Court deny review or, in the alternative, accept review and affirm the judgment of the court of appeals, and, in support thereof, would show as follows:

STATEMENT OF THE CASE

The Hamels seek to collect a judgment that they obtained against Terry Mitchell Builder, Inc. ("TMB"), in an underlying lawsuit styled *Glen Hamel and*

Marsha Hamel v. Terry Mitchell Builder, Inc., et al., Cause No. 2002-20076-158 in the 158th Judicial District Court of Denton County (the "Construction Lawsuit"). TMB was insured by Petitioners Great American Insurance Company's and Great American Lloyds Insurance Company's (collectively "GAIC").

In the Construction Lawsuit, the Hamels alleged numerous defects in a house started by another contractor but completed for the Hamels by TMB. After a fully adversarial trial, in which TMB appeared and defended the case through its attorney Robert Hudnall ("Hudnall"), the Hamels secured a judgment against TMB. Thereafter, the Hamels also secured a partial assignment from TMB of its claims against GAIC. The Hamels, as judgment creditors and assignees, then filed suit against GAIC to recover on the judgment.

The Honorable Judge David Evans of the 48th Judicial District Court of Tarrant County presided in the Hamels' case against GAIC (the "Coverage Case"). TMB joined in the Coverage Case, and it ultimately settled with GAIC for GAIC's wrongful refusal to defend TMB in the Construction Lawsuit. Judge Evans conducted a bench trial on the coverage issues pertaining to indemnity and, on June 13, 2011, entered judgment against GAIC. GAIC timely filed its notice of appeal on September 9, 2011, with the Second District Court of Appeals in Fort Worth. By order dated September 26, 2011, this case was transferred to the Eighth District Court of Appeals in El Paso. On September 19, 2014, the court of appeals

rendered its opinion.[1] The court below affirmed the trial court's decision that GAIC is liable for the underlying judgment, but modified the trial court's ruling that the Hamels are entitled to recover the mental anguish portion of the award. GAIC filed a motion for rehearing, which was denied on October 29, 2014. On January 14, 2015, GAIC filed its Petition for Review. On June 17, 2016, this Court ordered briefing on the merits.

STATEMENT OF FACTS

A. The Hamels hired TMB to complete the construction of their home when the original contractor abandoned the job.

In 1994, the Hamels began construction of a new, single-family residence in Flower Mound, Texas (the "Home").[2] The Hamels originally contracted with GSM Corporation ("GSM") as the general contractor.[3] GSM abandoned the job, and the Hamels hired TMB as the general contractor to take over and complete construction.[4]

B. TMB failed to complete the home in a good and workmanlike manner, resulting in water infiltration that caused damage to the home.

TMB expressly agreed "that it would finish the building and complete improvements in a good and workmanlike manner, according to the plans and

[1] *See Great Am. Ins. Co. v. Hamel*, 444 S.W.3d 780 (Tex. App.—El Paso 2014, pet. filed).

[2] Reporter's Record ("R.R."), Vol. 10, Ex. 10, pp.35:18–23; 45:8–10; R.R., Vol. 14, Ex. 45.

[3] R.R., Vol. 10, Ex. 10, pp.35:25–36:11; R.R., Vol. 14, Ex. 68, pp.22:3–14.

[4] R.R., Vol. 11, Ex. 10, pp.36, 39; s*ee also Hamel*, 444 S.W.3dat 784–85.

specifications agreed upon by the parties . . . ."[5] TMB's duty to finish building the Home in a good and workmanlike manner required TMB to inspect and discover any defects created by GSM, so that the defects could be remedied prior to completion.[6]

TMB relied, in whole or in large part, upon subcontractors to provide its services at the Home.[7] TMB completed the Home in October of 1995. Subsequent to completion, the Home had numerous problems with the roofing structure, including holes, missing and improperly installed frieze boards, improperly cut roof decking, and problems with valleys and drainage.[8] All of these problems allowed water to infiltrate the Home, which caused wood rot to occur inside the Home's walls.[9] No one disputes the existence of these problems, that these problems allowed water to infiltrate the Home, that the water infiltration was the source of the wood rot, or that the Home was badly damaged by the wood rot.

Don Yeandle ("Yeandle") originally inspected the Home for the Hamels. He discovered high moisture levels behind the walls, found it had rotted from the

[5] R.R., Vol. 14, Ex. 45, ¶1; *see Hamel*, 444 S.W.3d at 785–86.

[6] R.R., Vol. 10, Ex. 10, pp.6:2–16; 10:16–23; 11:6–12:4.

[7] R.R., Vol. 14, Ex. 67, pp.36–41, 43:2–16; R.R., Vol. 10, Ex. 10, pp.9, 10, 13–15, 29:20-30.

[8] R.R., Vol. 10, Ex. 10, pp.82–89; R.R., Vol. 4, pp.194:2–197:7; R.R., Vol. 5, pp.25:24–27:6; 29:3–31:14; R.R., Vol. 10, Ex. 10, pp.82–93.

[9] R.R., Vol. 14, Ex. 68, pp.9:6–20.

inside out, and found wood rot in at least fifteen separate locations.[10] Indeed, he was able to reach inside the wall and pull out a rotting stud with his bare hand. Yeandle was eventually engaged to repair the Home.

C. The Construction Lawsuit.

1. The Hamels filed the Construction Lawsuit; TMB tendered the Construction Lawsuit to GAIC; and GAIC wrongfully denied coverage.

The Hamels sued TMB in the Construction Lawsuit. TMB was insured by GAIC under a commercial general liability policy (the "Policy").[11] GAIC was timely notified of the claims against TMB, the Construction Lawsuit, and of the trial of the Construction Lawsuit.[12] Rather than provide TMB a defense in the Construction Lawsuit and seek a declaratory judgment as to coverage, GAIC concluded—albeit incorrectly—that there was no coverage and left TMB to fend

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[10] R.R., Vol. 4, pp.52:9–56:2; 61:20–64:3; 65:10–25.

[11] *See* R.R., Vol. 16, Ex. 94 at Attachment A. GAIC issued five consecutive commercial general liability policies to TMB, bearing the following policy numbers: PAC9-86-48-81-00; PAC9-86-48-81-01; PAC9-86-48-81-02; PAC9-86-48-81-03; PAC9-86-48-81-04; and PAC9-86-48-81-05. *See* Clerk's Record ("C.R."), Vol. 19, p.3487. The policies were in effect from May 3, 1996 to May 3, 2001. *See id*. The judgment in the Coverage Lawsuit is against Great American Insurance Company and Great American Lloyds Insurance Company jointly and severally. Great American Insurance Company and Great American Lloyds Insurance Company filed a Rule 11 agreement in which they agreed to both be treated as the insurer and agreed to be jointly and severally liable in the event of an adverse judgment against them. Judge Evans held that Great American Insurance Company and Great American Lloyds Insurance Company are jointly and severally liable under the "First Policy"—policy number PAC9-86-48-81-00, effective from May 3, 1996 to May 3, 1997. *See* C.R., Vol. 19, pp.3487, 3492–93 (Findings of Fact ("FOF") & Conclusions of Law ("COL") Nos. 24, 60–65).

[12] R.R., Vol. 14, Ex. 66, pp.20–21; R.R., Vol. 14, Ex. 49.

for itself in the Construction Lawsuit.[13] Here, even though GAIC does not challenge that it wrongfully denied coverage, GAIC complains about the veracity of TMB's defense against the claims asserted in the Construction Lawsuit.

2. The Hamels secured TMB's attendance at the Construction Lawsuit trial.

Without the benefit of the insurance coverage it had purchased, TMB had limited assets to pay for its defense or to satisfy any potential judgment in favor of the Hamels.[14] In fact, shortly before trial, TMB terminated its counsel—Hudnall—and Hudnall had prepared a motion to withdraw.[15] TMB intended either for Mr. Mitchell to represent TMB himself[16] or that TMB simply would not appear at trial at all because TMB no longer could afford the experts or defense costs needed to proceed to trial.[17]

In order to secure Terry Mitchell's attendance at trial on behalf of TMB (because he was not a party to the lawsuit) and prevent the possibility of a continuance of the trial setting or the entry of a default judgment, the Hamels and

[13] R.R., Vol. 14., Ex. 49.

[14] R.R., Vol. 14, Ex. 66, p.35:14–19.

[15] Hudnall's motion to withdraw was never heard by the court nor was it granted, and he continued to represent TMB through trial and after trial.

[16] Of course, Mr. Mitchell could not represent TMB because Mr. Mitchell is not a licensed attorney.

[17] R.R., Vol. 14, Ex. 66, pp.23, 35.

TMB entered into a Rule 11 Agreement (the "Agreement"). GAIC repeatedly misstates the Agreement's terms. The full text of that the Agreement is as follows:

> The purpose of this letter is to confirm our position and agreement on a few of the questions you have raised on behalf of your client. The Plaintiff's claims are against Terry Mitchell Builder's, Inc. At trial the Hamels will seek a judgment against Terry Mitchell Builder's, Inc. If a judgment is taken against Terry Mitchell Builder's, Inc, the Hamels will not attempt to enforce or collect the judgment against the assets of Terry Mitchell, individually, or any of his other companies or business assets. The Plaintiff's will not attempt to pierce the corporate veil of Terry Mitchell Builder's, Inc. nor will Plaintiff's attempt to set aside, void or invalidate any transfer of assets from Terry Mitchell Builder's, Inc. to other corporations or business interests of Terry Mitchell. **This is based upon Terry Mitchell's representation that Terry Mitchell Builder's, Inc. has not transferred assets in excess of $25,000.00.** The Hamels further agree that Terry Mitchell may continue to use **his personal** tools of the trade and truck and will not seek to levy upon said assets even if in the name of Terry Mitchell Builders, Inc. **The Hamels do intend to pursue any other assets of Terry Mitchell Builder, Inc.** The Plaintiff's will agree that they will not assign any judgment against your client and they will agree not to publish or use said judgment to affect Terry Mitchell's credit.
>
> In consideration for these agreements by Plaintiff's, please have Terry Mitchell sign in the space below to evidence **his agreement to appear at trial scheduled for May 26, 2005 and will not seek a continuance**.[18]

The above, emphasized language is ignored or misstated by GAIC. The purpose of the Agreement was solely to insure that Mitchell appeared at trial and it was contingent upon a representation about transfers out of TMB. The purpose of the Rule 11 Agreement is the antithesis of the issue that so concerned this Court in

[18] R.R., Vol. 11, Ex. 8.

Gandy. GAIC, nonetheless, routinely argues that the Hamels' agreement not to pursue Mitchell's personal truck and tools removed any stake TMB had in the litigation, but those items were represented to be in Mitchell's name and, therefore, exempt from collection anyway.[19] At bottom, the purpose of the Rule 11 Agreement, and the Hamels' intent in entering into it, was to ensure an "adversarial trial, not a default judgment."[20]

3. The Hamels and TMB reached a Stipulation, in lieu of discovery responses or deposition of TMB.

The Hamels sent discovery requests to TMB that included requests for admission. Hudnall had objections to the Hamels' requests for admission and worked with the Hamels' counsel to resolve those issues.[21] In lieu of responding to the requests for admission or providing Mr. Mitchell for deposition, TMB signed a "Stipulation of Facts" (the "Stipulations").[22] TMB executed the Stipulations approximately one week before the trial, well after the conclusion of discovery and the designation and disclosure of expert witnesses.[23] The Stipulations did not include any admissions of liability. Rather, the Stipulations included admissions of

[19] *See* TEX. PROP. CODE § 42.002 (exempting from collection tools and equipment of trade and vehicles).

[20] R.R., Vol. 15, Ex. 69, p.7.

[21] R.R., Vol. 11, Ex. 6; R.R., Vol. 14, Ex. 66, p.22.

[22] R.R., Vol. 12, Ex. 34.

[23] *See id*.

facts and admissions of legal duties that were incapable of being contested in light of the evidence produced during the course of the litigation and the law.

Importantly, the Stipulations did not happen in a vacuum. Rather, the stipulations were a product of ongoing discovery. The Hamels had served TMB with requests for admission and had granted extensions to TMB to answer, so that TMB's responses were due less than a week before trial.[24] While TMB had objections to the discovery requests, TMB also had a duty to "admit" or "deny" each request.[25] Failure to answer an admission results in the admission being deemed admitted and failure to admit a request, when appropriate, is sanctionable.[26] Based on its own trial strategy, objections to the requests for admission, and limited resources, TMB made a decision to enter into the Stipulations rather than respond to the outstanding requests for admission.[27] Those Stipulations were never presented to the trial court.

[24] R.R., Vol. 12, Ex. 33; R.R., Vol. 14, Exs. 47–48.

[25] *See* TEX. R. CIV. P. 198.

[26] *See* TEX. R. CIV. P. 215.4(b).

[27] R.R., Vol. 14, Ex. 66 pp.19:16–20:16, 22:16–23:3, 23:9–24:17, 25:16–26:14, 38:3–39:15.

4. TMB participated in the Construction Lawsuit.

TMB participated in the Construction Lawsuit, including discovery,[28] and a one-day bench trial that occurred on May 26, 2005.[29] TMB was represented at trial by Hudnall[30] and Terry Mitchell appeared and testified on TMB's behalf.[31]

The Hamels presented substantial evidence—through the Hamel's and Yeandle's testimony—of the numerous construction defects and the damage it caused. Faced with undeniable construction defects, Hudnall argued and adduced evidence that the complained-of construction defects, save one, were GSM's work and that TMB was not responsible for GSM's work.[32] TMB's case-in-chief was put on through Hudnell's cross examination of witnesses.[33] TMB adduced evidence that the Home was 60%–70% complete when TMB got involved and that the roof was complete before TMB began its work.[34]

The Hamels argued, in response, that TMB had an independent duty to "finish building and complete the improvements, in a good and workmanlike

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[28] R.R., Vol. 14, Ex. 66 p.12.

[29] R.R., Vol. 10, Ex. 10.

[30] *Hamel*, 444 S.W.3d at 803.

[31] *See id.* at 785–86, 802 (stating that the trial court "found that TMB appeared at the construction trial and defended itself in good faith").

[32] R.R., Vol. 10, Ex. 10.

[33] R.R., Vol. 10, Ex. 10, pp.32:16–33:15; 75:2–13; 103:24–105:2; 124:3–125:5; s*ee Hamel*, 444 S.W.3d at 803.

[34] R.R., Vol. 10, Ex. 10, p.33:3–14.

manner, according to the plans and specifications agreed upon by the parties ...."[35] They argued that, regardless of whose work it was, TMB's duty to finish building the Home in a good and workmanlike manner required that TMB to inspect and discover any defects created by GSM, so that the defects could be remedied prior to completion.[36] The Hamels also adduced evidence of TMB's duty to inspect and identified specific construction defects performed by TMB's subcontractors that allowed water infiltration.[37] Yeandle, who also repaired the Home, testified to damages.[38] Neither side offered closing arguments, instead the court gave both parties the opportunity to present their own proposed findings of fact and conclusions of law to the court after the conclusion of the trial.[39]

5. After the court entered judgment in favor of the Hamels, TMB partially assigned its claims to the Hamels.

The 158th District Court of Denton County entered judgment in favor of the Hamels and awarded them $365,089.70, plus prejudgment interest of approximately $50,000.[40] Several months *after* entry of the judgment, TMB

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[35] R.R., Vol. 14, Ex. 45.

[36] R.R., Vol. 10, Ex. 10, pp.6:2–16; 10:16–23; 11:6–12:4.

[37] *See Hamel*, 444 S.W.3d at 787.

[38] R.R., Vol. 10, Ex. 10, pp.76:4–103:21.

[39] R.R., Vol. 10, Ex. 10, pp.126:11–127:10.

[40] R.R., Vol. 14, Ex. 50.

assigned some of its claims against GAIC to the Hamels.[41] GAIC again denied coverage, the Coverage Case followed with the Honorable David Evans presiding.

D. The "Second Fully Adversarial Trial"—the Hamels filed the Coverage Case after GAIC again wrongfully denied coverage.

The Coverage Case was the second, full trial regarding the defects and the damages flowing therefrom. GAIC conducted discovery and took the deposition of witnesses.

The entire record from the Construction Lawsuit was introduced into evidence, such that the obvious fact of an improperly constructed house and resultant damage was before Judge Evans.[42] However, in addition to the record and judgment from the Construction Lawsuit, Judge Evans also received testimony from TMB, Hudnall, Yeandle, the Hamels' counsel, and the Hamels, as well as from GAIC's witnesses.[43] GAIC also had an opportunity to cross-examine witnesses.[44]

Following a bench trial, Judge Evans entered judgment for the Hamels against GAIC, finding coverage for the judgment in the Construction Lawsuit and

[41] *See Hamel*, 444 S.W.3d at 787.

[42] C.R., Vol. 7 p.1245–Vol. 12 p.2367.

[43] *See Hamel*, 444 S.W.3d. at 787–97 (reviewing in great detail the Coverage Case before Judge Evans).

[44] *See id*. (describing the examination and cross examination of witnesses by GAIC).

awarding the Hamels their attorneys' fees, interest, and costs.[45] Judge Evans also signed Findings of Fact and Conclusions of Law in which he found that the Construction Lawsuit was not collusive and the judgment therein was the result of a fully adversarial trial.[46] On appeal, and with the benefit of the entire record, the court of appeals affirmed Judge Evans' decision that GAIC is liable for the judgment but modified it to exclude the damages that were awarded for mental anguish.[47]

SUMMARY OF THE ARGUMENT

Despite GAIC's best efforts to convince the Court otherwise, there is nothing remarkable about this coverage case. Before this Court, GAIC does not challenge coverage by way of exclusions but instead seeks to avoid liability for a covered claim through a skewed application of *Gandy*. The Hamels, however, did not enter into a pre-trial assignment or an agreed/consent judgment with TMB and then seek to enforce it against GAIC. The Hamels did not seek extra-contractual damages against GAIC. The Hamels did not enter into a *Mary Carter* agreement or any other agreement that amplified the damages or distorted the trial process.

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[45] C.R., Vol. 19, pp.3448–50.

[46] C.R., Vol. 19, pp.3485–95.

[47] Respondents do not challenge the court of appeals' ruling that damages for mental anguish are not recoverable.

Rather, this is a simple case where an insurer breached the Policy, left its insured to defend itself as best it could, and is now trying to avoid fulfilling its contractual obligations with conspiracy theories and arguments that are unsupported by the record and rejected by the courts below. GAIC's theme in this appeal, which is much narrower than what was presented to the trial court and the court below, is that it is relieved of its contractual obligations because of this Court's holding in *State Farm Fire & Casualty Co. v. Gandy.*[48] The concerns that supported this Court's holding in *Gandy*—a holding that this Court subsequently held was "explicit and narrow"[49]—simply do not warrant its extension to the facts and circumstances of this case.

ARGUMENTS AND AUTHORITY

GAIC breached the Policy by wrongfully denying coverage and leaving its insured, TMB, to defend itself in the Construction Lawsuit.[50] When an insurer fails to provide its insured a defense and the insured settles, the insurer can be bound by

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[48] 925 S.W.2d 696 (Tex. 1996).

[49] *Evanston Ins. Co. v. ATOFINA Petrochems., Inc.*, 256 S.W.3d 660, 673 (Tex. 2008).

[50] S*ee Hamel*, 444 S.W.3d at 801 ("Consequently, the trial court's findings and conclusions that Great American had a duty to provide a defense to TMB and wrongfully refused to do so are supported by evidence in the record."). GAIC's coverage denial was based, in large part, on its belief that a manifestation trigger applied in Texas and, therefore, the damages fell within a policy period that was subject to an EIFS exclusion. As this Court held, however, injury-in-fact is the proper trigger theory to be applied. *See Don's Building Supply, Inc. v. OneBeacon Ins. Co.*, 267 S.W.3d 20, 24–30 (Tex. 2008). In light of the holding in *Don's Building*, and the fact that the proper policy period did not have an EIFS exclusion, GAIC's entire discussion of the EIFS issue and its impact in the Construction Lawsuit is wholly irrelevant and is nothing more than a red herring.

and responsible for the settled-upon damages.[51] Only in *limited circumstances* can the insurer avoid such a settlement as "collusive" or lacking in adversity or as not being contested.[52] GAlC argues that this appeal falls within that limited exception created by *Gandy*, and asks this Court to drastically expand *Gandy* to include (1) circumstances in which the insurer wrongfully denied coverage, and (2) situations in which the insured entered into *any* pretrial agreement (not just pretrial assignments) and declaring that any such agreement is collusive as a matter of law.[53] Because the concerns at issue in *Gandy* are not present here, GAIC's request should be denied.

A. Breach of the duty to defend precludes GAIC from enforcing the "actual trial" condition.

Judge Evans held and the court of appeals affirmed that GAIC breached its contractual duties by failing to provide coverage to TBM in the Construction Lawsuit.[54] Typically, a commercial general liability policy contains a condition requiring an actual trial before a third-party can sue the insurer, and the Policy has such a condition:

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[51] *ATOFINA*, 256 S.W.3d at 671; *Employers Cas. Co. v. Block*, 744 S.W.2d 940, 942 (Tex. 1988).

[52] *See ATOFINA*, 256 S.W.3d at 671; *Block*, 744 S.W.2d at 942; *Gandy*, 925 S.W.2d at 696.

[53] *See, e.g.*, GAIC Br., at pp.34–35.

[54] *See Hamel*, 444 S.W.3d at 801.

> **SECTION IV–COMMERCIAL GENERAL LIABILITY CONDITIONS**
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> ***
>
> **3. Legal Action Against Us**
>
> ***
>
> A person or organization may sue us to recover on an agreed settlement or on a final judgment against an Insured obtained *after an actual trial*; but we will not be liable for damages that are not payable under the terms of this Coverage Part or that are in excess of the applicable Limit of Insurance. . . .[55]

But for GAIC's wrongful denial, it could have sought to enforce the "actual trial" condition in its Policy.[56] GAIC admits, as it must, that "when an insurer wrongfully refuses to defend its insured, it is prohibited from relying on policy conditions, including the actual trial condition, to avoid liability."[57] Thus, because it is uncontroverted that GAIC breached the "Policy," GAIC cannot enforce the "actual trial" condition.[58] Consequently, GAIC only can prevail if it can establish that the limited exception of *Gandy* applies—but it does not.

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[55] R.R., Vol. 12, Ex. 16, p.11 (emphasis added).

[56] *See Gulf Ins. Co. v. Parker Products, Inc.*, 498 S.W.2d 676, 679 (Tex. 1973); *Scottsdale Ins. Co. v. Sessions*, 331 F. Supp. 2d 479, 488 (N.D. Tex. 2003); *see also Hamel*, 444 S.W.3d at 790 ("Texas courts and federal courts applying Texas statutory and case law long and consistently have held that an insurance company cannot insist on compliance with an 'actual trial' requirement within its insurance contract where the insurer has breached its duty to defend.").

[57] GAIC Br., at p.29.

[58] Regardless, even if GAIC could invoke the "actual trial" condition, the evidence in the record supports the conclusion that the Construction Case was in fact an actual trial.

B. Correction of GAIC's Characterizations of the Record

Before turning to the merits of GAIC's arguments, it is necessary to correct several mischaracterizations, some of which are repeated throughout the briefing. Specifically, GAIC misstates the following:

Brief	Claim	Truth
Page 8	The Hamels agreed not to contest transfers of assets out of TMB	The non-execution agreement with Mitchell was *expressly* conditioned upon representations that no transfer of assets in excess of $25,000 had ever been made out of TMB.[59]
Pages 8 & 10	Mitchell and TMB were insulated from exposure for any of the Hamels' damages.	Mitchell was not a party and there was no basis upon which to make him a party.[60] His assets were protected because he was not a party to the lawsuit. Whatever assets that TMB had, except for a truck and tools of the trade, were subject to execution. *In fact, the agreement expressly states the Hamels' intent to go after all other assets.*[61]
Page 9	TMB stipulated to liability.	There was no stipulation to liability. TMB stipulated to facts that every witness has testified were true.

[59] R.R., Vol. 11, Ex. 8.

[60] R.R., Vol. 15, Ex. 69 16:10-12.

[61] R.R., Vol. 11, Ex. 8. Notably, the fact that TMB ultimately had no other assets is irrelevant and only goes to solidify that the Agreement was not collusive. TMB did not have anything but insurance and, therefore, the Hamels did not need to collude with TMB to secure coverage for the claim.

Page 9	TMB admitted it was liable for all of the Hamels' damages, even those caused by third parties over which TMB had no control.	Nowhere is such a stipulation made. Rather, the stipulated facts go to TMB's express obligation to "*finish building and complete [the Hamels' Home], in a good and workmanlike manner.*"[62] That included inspection of the existing work and at completion.[63]
Page 10	Mitchell directed TMB's attorney not to put up a fight because he had no stake in the matter.	Nowhere is there any testimony that Hudnall was told not to "put up a fight" because TMB or Mitchell had no stake in the outcome or for any reason whatsoever. Mitchell testified that he fired Hudnall, at one point, because of TMB's inability to pay defense costs / expenses. The remainder of Mitchell's cited testimony has nothing to do with instructions to Hudnall, but is a discussion of the Rule 11 Agreement and its existence.
Page 10-11	TMB made no effort to get credit for an earlier settlement.	Terry Mitchell testified that he had no knowledge of the settlement.[64] Thus, while he testified that he did not care about the settlement, that was three years after the fact.

With these corrections to GAIC's mischaracterizations of the record, Appellees turn to the merits of GAIC's challenge.[65]

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[62] R.R., Vol. 14, Ex. 45 at ¶1.

[63] R.R., Vol. 10, Ex. 10, pp.92–93).

[64] R.R., Vol. 14, Ex. 67, p.20:3–21:8.

[65] GAIC will claim that this is cherry picking the record to suit the needs of the Hamels; however, the reality is that the Hamels are directing the Court back to the same citations relied on by GAIC and merely pointing out that GAIC mischaracterizes that evidence.

C. *Gandy* does not apply to the facts of this case.

Gandy prohibits "sweetheart deals" where the purpose of a *pre-trial* settlement and assignment of an insured's claim is solely to recover monetary damages from an insurer.[66] A judgment resulting from such a situation is deemed collusive.[67] Neither the concerns underpinning *Gandy* nor the requisite elements for its application exist in this case. In that regard, *Gandy's* reasoning was simple: some deals make evaluating the merits of a plaintiff's claim difficult by prolonging disputes and distorting trial litigation motives.[68] However,

> not all cases implicate *Gandy's* concerns. [Courts] should not invalidate a settlement that is free from this difficulty [of fairly evaluating a plaintiffs claims] simply because it is structured like one that is not.[69]

The *rationale* behind *Gandy* does not exist in this case.

Notably, *Gandy's* invalidation of assignments under the particular fact pattern in that case[70] is separate from its requirement that "in no event is a judgment, rendered in favor of a plaintiff against an insured without a fully-adversarial trial, binding on the insured's insurer or admissible as evidence of

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[66] *Gandy*, 925 S.W.2d at 696; *Mid-Continent Cas. Co. v. JHP Dev., Inc.*, 557 F.3d 207, 218 (5th Cir. 2009); *Reyna v. Safeway Managing Gen. Agency*, 27 S.W.3d 7, 11 (Tex. App.—San Antonio 2000, pet. granted, judgm't vacated w.r.m.).

[67] *See JHP Dev.*, 557 F.3d at 218; *Reyna*, 27 S.W.3d at 11.

[68] *See ATOFINA*, 256 S.W.3d at 673–74 (stating the reasoning underpinning *Gandy*).

[69] *Id.*

[70] *Gandy*, 925 S.W.2d at 714.

damages in an action against the insurer by plaintiff as the insured's assignee."[71] Contrary to GAIC's assertion, however, the court of appeals correctly applied *Gandy* with respect to both the Assignment and the adversarial trial requirement.

1. *Gandy* does not invalidate TMB's assignment.

GAIC appears to no longer contest the validity of the Assignment under *Gandy*,[72] nor could it as *Gandy's* holding is inapposite to the facts of this case. It is important, however, to highlight the significant factual differences between this case and *Gandy* so as to demonstrate why this case is so far outside of the scope of *Gandy*.

In *Gandy,* this Court held that an insured's assignment of his claims against his insurer to a plaintiff is invalid if: "(1) it is made prior to an adjudication of plaintiff's claims against the insured in a fully-adversarial trial; (2) the insurer has tendered a defense; and (3) either (a) the insurer has accepted coverage or (b) the insurer has made a good faith effort to adjudicate coverage issues prior to the adjudication of the plaintiff's claim."[73] In *ATOFINA,* this Court held: "*Gandy's* holding was explicit and narrow, applying only to a specific set of assignments

[71] *Id*. at 714–15.

[72] GAIC Br., at pp.19–20.

[73] *Gandy*, 925 S.W.2d at 714.

with special attributes."[74] The differences between the facts of this case and the facts in *Gandy* could not be more stark.

Unlike *Gandy,* this case was not settled and there was no agreed or consent judgment. Every witness that was questioned stated there was no settlement of any nature.[75] Unlike *Gandy,* there was no pre-trial assignment of TMB's claims against GAIC. The assignment occurred months *after* the trial court had entered a judgment.[76] Unlike *Gandy*, there was neither a tender of a defense in this case nor was there an acceptance of coverage or a good-faith effort to adjudicate coverage issues. Based on the uncontroverted facts in the record, the court of appeals correctly concluded that TMB's post-judgment assignment was valid and that GAIC never tendered a defense, accepted coverage or made a good faith effort to adjudicate any coverage issues prior to the adjudication of the Hamels' claims against TMB.[77]

Additionally, as judgment creditors, the Hamels are third-party beneficiaries of the Policy and did not need an assignment to pursue their contractual damages against GAIC.[78] The assignment only would have been needed had the Hamels

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[74] *ATOFINA*, 256 S.W.3d at 673.

[75] R.R., Vol. 14, Ex. 66, pp.43–44; R.R., Vol. 14, Ex. 67, pp.32:20–33:21.

[76] R.R., Vol. 12, Ex. 14; R.R., Vol. 14, Ex. 66, pp.41–42.

[77] *See Hamel*, 444 S.W.3d at 802.

[78] *See, e.g.*, *Mid-Continent Cas. Co. v. Castagna*, 410 S.W.3d 445, 448 n.1 (Tex. App.—Dallas 2013, pet. denied) ("An injured third party can enforce an insurance policy against the insurer

pursued extra-contractual damages against GAIC, which they did not. Thus, any issue GAIC has with the Assignment is a red herring because the Assignment was entered into *after* the judgment in the Construction Lawsuit and did not give the Hamels a right that they did not already possess. Unable to fit within the factual requirements for applying the holding in *Gandy*, GAIC seeks to extend that holding to pretrial agreements such as the Stipulation and Agreement by contending that such agreements implicate the same "*Gandy* concerns" as expressed by this Court. GAIC is wrong.

2. There are no "*Gandy* concerns" in this case.

Because *Gandy* does not apply to the post-trial assignment, GAIC only can prevail if it establishes that the trial in the Construction Lawsuit was not a "fully adversarial trial."[79] *Gandy* does not specify what constitutes an "adversarial trial," but only states that an agreed judgment, without any supporting evidence and which is the result of collusion that distorts the measure of damages is not "adversarial." Here, there was no agreed judgment and the Construction Lawsuit court received evidence on all of the Hamels' claims. Despite labeling every aspect of the Construction Lawsuit a conspiracy or collusion, GAIC introduced no

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once it has been established by judgment or agreement that the insured has a legal obligation to pay the injured party damages." (citations omitted)).

[79] *Gandy*, 925 S.W.2d at 714 ("In no event . . . is a judgment for plaintiff against defendant, rendered without a fully adversarial trial, binding on defendant's insurer or admissible as evidence of damages in an action against defendant's insurer by plaintiff as defendant's *assignee*." (emphasis added)).

evidence of fraud or collusion because none exists.[80] GAIC merely raised *suspicions* of wrongdoing and collusion, not evidence. GAIC also offered no evidence that the testimony or evidence offered in the Construction Lawsuit was false, deceptive, or in any way distorted the parties' positions/motives in the Construction Lawsuit. In fact, the evidence conclusively establishes otherwise — every witness testified that the evidence adduced in the Construction Lawsuit was correct and truthful.[81]

This Court, in *ATOFINA*, stated that the reason for invalidating some assignments was simple: "Those assignments made evaluating the merits of a plaintiff's claim difficult by prolonging disputes and distorting trial litigation motives."[82] Again, *Gandy* recognized that it "should not invalidate a settlement that is free from this difficulty [of fairly evaluating a plaintiff's claims] simply because it is structured like one that is not."[83] As Judge Evans properly concluded, and the court of appeals affirmed, nothing about the judgment in the Construction Lawsuit raised the *Gandy* concerns.[84]

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[80] 1st Supp. C.R. at 426 (Stein Depo. p.26:13-22).

[81] R.R., Vol. 14, Ex. 67, pp.26–29, 30:1-3, 41:4-11; R.R., Vol. 14, Ex. 68, pp.12–14.

[82] *ATOFINA*, 256 S.W.3d at 673.

[83] *Gandy*, 925 S.W.2d at 714.

[84] *See* C.R., Vol. 19, pp.3485–95 (FOF & COL Nos. 44–52); *see also Hamel*, 444 S.W.3d at 801–04 ("We conclude the record shows a fully-adversarial trial of the claims in the construction case.").

i. Neither *Seger* nor *Vela* aid GAIC.

Failing to meet any of the *Gandy* elements, GAIC seeks to create its own standard for "adversity," arguing that *Seger*[85] and *Vela*[86] support the conclusion that the judgment in the Construction Lawsuit was a sham judgment resulting from collusion.[87] The facts of *Seger* and *Vela*, and the cases relied on therein, are significantly different from the facts here. In fact, even a cursory review of *Seger* and *Vela* demonstrate why *Gandy* has no application to this case.

In *Seger*, the court of appeals held that the underlying case was not the result of an adversarial trial based on the particular facts in that case;[88] however, this Court affirmed on other grounds.[89] The reasoning of the court of appeals was based on the following facts: The insured, Diatom, was not represented by counsel at trial, did not announce ready at the start of trial, presented no opening or closing argument, offered no evidence, did not cross-examine any witness, and did absolutely nothing at trial.[90] Diatom's general partner's participation was limited to

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[85] *Yorkshire Ins. Co., Ltd. v. Seger*, 407 S.W.3d 435 (Tex. App.—Amarillo 2013), *aff'd on other grounds sub nom.*, *Seger v. Yorkshire Ins. Co., Ltd.*, No. 13-0673, 2016 WL 3382223 (Tex. June 17, 2016).

[86] *Vela v. Catlin Specialty Ins. Co.*, No. 13-13-00475-CV, 2015 WL 1743455, at *1 (Tex. App.—Corpus Christi Apr. 16, 2015, pet. denied).

[87] *See* GAIC Br., at pp.47–49.

[88] *Seger*, 407 S.W.3d at 435.

[89] *See Seger v. Yorkshire Ins. Co., Ltd.*, No. 13-0673, 2016 WL 3382223, *1 (Tex. June 17, 2016).

[90] *See Seger*, 407 S.W.3d at 442.

that of a witness who was excused after providing testimony.[91] In short, the court of appeals in *Seger* concluded that the "underlying judgment was the result of a proceeding much more akin to a post-answer default than a fully adversarial trial."[92] Moreover, despite the evidence showing no more than $600,000 in damages, the court awarded $7,500,000 each to Roy Seger and Shirley Hoskins.[93] As the court of appeals noted, "[t]here was no evidence offered that would support awards of $7,500,000 to both Roy Seger and Shirley Hoskins."[94] Accordingly, there was no basis for supporting either the judgment or the assignment of the insured's *Stowers* claim.

The facts here are in stark contrast to those that the court of appeals in *Seger* found to support the lack of an adversarial trial. TMB was represented by counsel throughout the case, including discovery, trial, and post-trial proceedings.[95] TMB's counsel participated in the trial, cross-examined witnesses, and secured evidence from the witnesses favorable to TMB's position.[96] The trial court also engaged in

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[91] *See id*.

[92] *Id*.

[93] *See id*. at 437.

[94] *Id*. at 442. This is very similar to the facts in *Gandy*, in which the underlying judgment for $6,000,000 was completely unsupported by any evidence and, instead, was an agreed judgment based on the claimant's attorney's "personal evaluation" that the "figure of $12,500 per occurrence" and an "estimated 325 occurrences of sexual abuse" was "a fair evaluation of what the scope and extent of her injuries were." *Gandy*, 925 S.W.2d at 703.

[95] R.R., Vol. 14, Ex. 66, pp.7:4–9:23; R.R., Vol. 10, Ex. 10, pp.1–128.

[96] R.R., Vol. 10, Ex. 10, pp.6:20–7:17; 32:17–33:14; 75:1–13; 103:25–105:1; 124:4–125:5

the process, asking probing questions.[97] The court, as trier of fact, rendered judgment based on the evidence presented by the parties.[98] The judgment in the Construction Lawsuit was based on the evidence, as opposed to the *Seger* judgment that was approximately twenty-five times the actual damages presented and was based on "no evidence."[99] In short, the judgment in this case was the result of a trial that is remarkably different in procedure and substance than the trial in *Seger* that resulted in a massive and unsupported excess judgment that the claimants then sought to recover from the insurer.

Vela also is readily distinguishable. That suit involved a dispute between a contractor, Williams Development & Construction, Inc., (hereinafter "Williams") and a subcontractor, Adolfo Vela *d/b/a* Adelco Enterprises (hereinafter "Vela"), regarding the construction of a Kohl's Department Store in Brownsville, Texas.[100] Originally, "Vela filed suit against Williams and others for breach of contract related to unpaid money for his work on the Kohl's project."[101] Williams answered and counterclaimed against Vela for breach of contract and negligence.[102] Vela

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[97] R.R., Vol. 10, Ex. 10, pp.95:19–96:8.

[98] R.R., Vol. 10, Ex. 10, pp.127:9–10; R.R., Vol. 9, Ex. 3.

[99] *Seger*, 407 S.W.3d at 442.

[100] Vela, 2015 WL 1743455, at *2.

[101] *Id.*

[102] *Id.*

submitted the claim to his carrier, Catlin.[103] Catlin initially denied the claim, then "changed its mind and agreed to defend Vela under a reservation of rights pursuant to the policy's terms and conditions."[104] However, "Vela notified Catlin in writing that he declined Catlin's offer of a defense and moved forward with the litigation with his previous counsel."[105]

Prior to trial, Vela and Williams entered into a *Mary Carter*-type agreement controlling the mutual advancement of the remaining litigation proceedings and distribution of monies collected from any recovery against Catlin and its agent.[106] That agreement included the following terms:

> (1) Vela will non-suit, without prejudice, his claims against Williams;
> (2) Vela and Williams agree to waive their respective right to a jury trial for any litigation related to this case;
> (3) In any future lawsuit against Catlin and/or Campos to which Vela and/or Williams are parties, "all sums recovered by [Vela] and all sums recovered by [Williams] (hereinafter collectively the "Recovered Sum") shall be divided . . . as follows: (1) [. . .] $122,860 [. . .] to Vela; (2) $125,000 [. . .] to Williams; and (3) all of the remaining Recovered Sum . . . to Vela"; and
> (4) If Vela "in the aggregate recovers in excess of $200,000.00 from any source, including the

[103] *Id.*

[104] *Id.*

[105] *Id.*

[106] *Id*. at *3.

> Recovered Sum, . . . [Williams] shall be fully released."[107]

The litigation then morphed from a payment dispute to a construction defect case, with the parties agreeing to a division of proceeds from a contemplated coverage case that would be filed after the conclusion of the construction defect case.

The case proceeded to a bench trial solely on Williams' construction defect claims against Vela.[108] "Vela appeared at trial by and through his counsel, but he did not appear personally."[109] Williams presented three witnesses. At the conclusion of the trial, "Williams' counsel presented closing arguments, while Vela's counsel did not. Instead, Vela's counsel advised the trial court that the 'most effective way' for him to 'communicate [his] specific contentions would be in the form of objections to any of the proffered proposed findings of fact or conclusions of law.'"[110] The trial court entered a final judgment in Williams' favor.[111] Notably, when deposed in the subsequent coverage case, "Vela stated that he had no knowledge of the bench trial . . . and believed that he was still pursuing

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[107] *Id*.

[108] *Id*.

[109] *Id*. at *8.

[110] *Id*. at *3.

[111] *Id*.

Williams for money owed to him from the Kohl's project" and did not know that a judgment had been entered against him.[112]

The differences between *Vela* and this case could not be more evident. In *Vela*, the insurer had no duty to defend the claims against its insured. Nevertheless, the insurer offered a defense under a reservation of rights, but the insured declined. For that reason, the *Vela* court did not apply the *Block* rule.[113] Here, on the other hand, GAIC had a duty to defend, which it breached, offering neither a defense nor indemnification to TMB. The facts in *Vela* leave little doubt that the construction defect case was a sham designed by the parties to create an underlying judgment for purposes of seeking indemnification in a subsequent coverage lawsuit against an insurance carrier. Moreover, *Vela* involved a *pretrial* assignment and an agreement on division of proceeds for a future coverage case. In this case, the Hamels and TMB entered into a *post-trial* and *partial* assignment that actually was unnecessary because the Hamels were judgment creditors entitled to pursue a direct claim against GAIC for contractual benefits. The Hamels and TMB also did not agree to any division of insurance proceeds. In *Vela*, the defendant did not

[112] *Id*. at *8.

[113] The "*Block* rule" states that "if an insurer wrongfully denies coverage and its insured then enters into an agreed judgment, the insurer is barred from challenging the reasonableness of the settlement amount." *See id*. at 671 (citing *Employers Cas. Co. v. Block*, 744 S.W.2d 940 (Tex. 1988). In *ATOFINA*, this Court stated that it applies the "*Block* rule" to "encourage early intervention by the insurers who are best positioned to evaluate the worth of claims during settlement discussions." *ATOFINA*, 256 S.W.3d at 674.

appear at trial, did not know a trial had occurred, and did not know a judgment had been entered against him. In contrast, TMB appeared at trial personally and through counsel, knew exactly the status of the case, and defended itself at trial by securing favorable evidence and presenting arguments.[114] In short, *Vela* does nothing to support GAIC's arguments. Quite to the contrary, if anything, *Vela* supports the conclusion that the Construction Lawsuit was a fully adversarial trial.

ii. GAIC cites to numerous inapposite cases.

In addition to *Seger* and *Vela*, GAIC cites to a handful of other cases applying *Gandy*, contending that because those cases involved trials that were less than adversarial, the Construction Lawsuit must also be deemed non-adversarial. Those cases are inapposite.[115] In *Stroop v. Northern County Mutual Insurance Co.*,[116] for example, the issue before the court was whether a trial was fully adversarial under *Gandy*. The court noted the "novelty of the supposed jury 'trial'" the purpose of which "was to find facts concerning Sunset's fault and Dillen and Stroop's damages from the collision. But Sunset was not a named defendant, was not served with citation, and did not make an appearance in the Second Suit. Thus, the 'verdict' purported to determine hypothetically disputed fact questions between

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[114] *See Hamel*, 444 S.W.3d at 803 (detailing the favorable evidence TMB elicited at trial).

[115] *See* GAIC Br., at p.23.

[116] 133 S.W.3d 844 (Tex. App.—Dallas 2004, pet denied).

a party and a non-party."[117] Here, no dispute exists that TMB was an active party in the Construction Litigation.

In *First General Realty Corporation v. Maryland Casualty Co.*,[118] the court held that the underlying *agreed judgment* was not binding on the insurer. Unlike GAIC, however, the insurer in that case had not breached its duty to defend because it had offered to defend subject to a reservation of rights.[119] Moreover, this case does not involve an agreed judgment.

The case of *Burney v. Odyssey Re (London) Ltd.*[120] is also easily distinguishable from the case here. The underlying case in *Burney* involved defamation claims. The carrier ultimately agreed to provide its insured with an unqualified defense up to the policy limits, on the condition that it be allowed to exercise its contractual right to appoint counsel of its choosing. The insured refused to accept new counsel despite being warned three times that failure to allow substitution of new counsel would be considered a failure to cooperate under the policy and that coverage would be jeopardized, so the insurer rescinded the defense. Ultimately, the insured lost the jury trial and filed two motions for new trial, which were granted. Pending the second trial, the insured settled, entering an

[117] *Id*. at 849.

[118] 981 S.W.2d 495 (Tex. App.—Austin 1998, pet denied).

[119] *See id*. at 501.

[120] No. 2:04-CV-032, 2005 WL 81722 (N.D. Tex., Jan. 14, 2005).

agreement on the record that "purported to vacate the two orders granting a new trial, reinstate the original judgment as a final judgment, assigned to [plaintiff] all of [insured's] rights to sue his insurance carriers, and forever relieved [insured] of any and all liability for payment of any portion of the $450,000 judgment."[121] Although the carrier agreed to provide an unqualified defense, the insured nonetheless entered into what amounted to an agreed judgment.[122]

In *Hendricks v. Novae Corporation Underwriting, Ltd.*,[123] the insured and the claimant settled their dispute at mediation, entered into a consent judgment, and the insured agreed to assign all its rights to payment under the policy in exchange for a non-execution agreement.[124] The insured also agreed to cooperate with the claimant in its efforts to collect against the policy and agreed not to respond to requests for information regarding the settlement agreement.[125] Such clearly collusive behavior is not at issue in the instant case.

In *Trinity Universal Insurance Co. v. Cowan*,[126] this Court held that there was no coverage for an underlying judgment and only mentioned *Gandy* in passing. In *Cowan*, the carrier rescinded its defense of the insured, who then settled

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[121] *Id*. at *1–*2.

[122] *See id*. at *1, *4.

[123] No. 13 C 5422, 2015 WL 1842227, at *4–*6 (N.D. Ill. Apr. 21, 2015) (Texas law).

[124] *See id*. at *2.

[125] *See id*.

[126] 945 S.W.2d 819, 821 (Tex. 1997).

with the claimant by assigning his claims against his carrier in exchange for a non-execution agreement.[127] Only then did the claimant proceed to trial, at which the insured did not appear and defend the case and the court entered a judgment on the testimony of the claimant and her mother in the amount of $250,000 for mental anguish.[128] In contrast, the Assignment in this case was executed post-judgment rather than pre-trial. Moreover, TMB appeared and defended itself at trial.

Texas Farmers Insurance Co. v. Kurosky[129] also is inapposite, as that court noted that the record was "completely devoid of evidence that there was any sort of trial from which the final judgment resulted."[130] In *Kurosky*, Rust was injured while mowing her yard, and she sued Kurosky (her father and landlord) and his insurance company. The carrier sent Kurosky a reservation of rights letter apparently agreeing to defend the case. Rather than accept the defense, "Rust and Kurosky entered into an agreed final judgment against Kurosky for $300,000."[131] The court noted that there was no "evidence in the trial court regarding the amount of Rust's damages or the reasonableness of the agreed judgment" and "Rust failed to show that the insured complied with the conditions precedent and terms of the

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[127] *See id.*

[128] *See id.*

[129] No. 02-13-00169-CV, 2015 WL 4043278, at *5 (Tex. App.—Fort Worth July 2, 2015, no pet.) (mem. op.).

[130] *Id.*

[131] *Id.* at *1.

policy."[132] As such, although referencing G*andy*, *Kurosky* was resolved on the failure of the claimant to prove that the "actual trial" condition in the policy had been satisfied. Here, though, the "actual trial" condition is not at issue because GAIC breached its contract.

None of the referenced cases establishes that the Construction Lawsuit was not sufficiently adversarial. Here there was no settlement, no pre-trial assignment of claims, no non-execution agreement with a defendant,[133] no splitting of the recovery, and no agreed judgment or agreement to allow judgment against TMB. The Construction Lawsuit was determined by the trial court's consideration of evidence, and not based on an agreement of the parties. Every witness testified that the evidence professed in the Construction Lawsuit was truthful.[134] The parties did not discuss testimony, script anything or distort their respective positions.[135] Instead, the damages awarded were only those caused by TMB's negligence related to the roof issues.[136] After hearing all of the evidence, the trial court

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[132] *Id*. at *6.

[133] To reiterate, the Hamels agreed not to execute a judgment against Mitchell, personally, but he was not a party to the Construction Lawsuit and no basis existed to make him a party.

[134] R.R., Vol. 14, Ex. 67, pp.26–29, 30:1-3, 41:4-11; R.R., Vol. 14, Ex. 68, pp.12–14.

[135] R.R., Vol. 14, Ex. 66, 25:13–26:25, 36:4-13, 37:14-38:2, 43–44, 47:15–48:19; R.R., Vol. 14, Ex. 67, pp.16:14–18, 16:19–17:8, 22:7–22, 26:21–28:1, 41:4-11, 29:1–30:3, 30:4-12, 32:20–33:21, 42:23–43:1; R.R., Vol. 14, Ex. 68, pp.13–14); R.R., Vol. 15, Ex. 69, pp.13–17.

[136] R.R., Vol. 10, Ex. 10, pp.82–89; R.R., Vol. 4, pp.194:2–197:7; R.R., Vol. 5, pp.25:24–27:6, 29:3–31:14; R.R., Vol. 10, Ex. 10, pp.82–93.

properly made findings of fact and conclusions of law that there was no fraud or collusion, and the Construction Lawsuit was adversarial.

iii. This case is similar to another recent case in which GAIC wrongfully denied coverage and left its insured to fend for itself.

This case is not GAIC's only attempt to get out from paying a judgment against its insured after wrongfully denying a defense obligation. In *Great American Lloyds Insurance Co. v. Vines-Herrin Custom Homes, L.L.C. (Vines-Herrin II)*,[137] the court addressed whether the underlying arbitration was the result of an adversarial trial, concluding it was.[138] The factual background of *Vines-Herrin* is strikingly similar to facts here. Vines-Herrin Custom Homes, L.L.C. built a residence and sold it to Mr. Cerullo "who began noticing problems with the house almost immediately."[139] "The problems included water not draining from the courtyard, doors not closing properly, damages to sheetrock and baseboards, cracks in the ceiling, a window sinking into the frame, and finally, in 2002, the roof and the ceiling began to sag."[140] Cerullo sued Vines-Herrin for damages caused by construction defects.[141] Vines-Herrin demanded its insurers defend it under the

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[137] No. 05-15-00230-CV, 2016 WL 4486656, at *8 (Tex. App.—Dallas Aug. 25, 2016, no. pet. h.).

[138] *Id*. at *8.

[139] *Id*. at *1.

[140] *Id*.

[141] *Id*. at *2.

commercial general liability policies the company had purchased, and they wrongfully refused.[142] Although Vines-Herrin was entitled to a jury trial in the case filed by Cerullo, "in order to avoid a costly jury trial, Vines-Herrin and Cerullo agreed to arbitrate the dispute."[143] Vines-Herrin consulted its carriers prior to agreeing to the arbitration, and the insurers again denied coverage and offered no position on the arbitration.[144] "After the arbitrator entered its award [in the amount of $2,487,507.77], Cerullo and Vines-Herrin entered into a settlement agreement in which Cerullo agreed not to confirm the arbitration award in exchange for an assignment of Vines-Herrin's claims against the Insurers."[145]

During the ensuing coverage case, this Court decided *Don's Building*,[146] leading to a detour while the trial court and the court of appeals determined the application of the "actual injury rule" as the appropriate trigger theory in the case.[147] The court of appeals, in *Vines-Herrin I*,[148] determined that Vines-Herrin only was required to show that damages occurred during the policy period to

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[142] *See id.*

[143] *Id.*

[144] *Id.*

[145] *Id.*

[146] *Don's Building Supply Inc. v. OneBeacon Ins. Co.*, 267 S.W.3d 20 (Tex. 2008).

[147] *Vines-Herrin II*, 2016 WL 4486656, at *2.

[148] *Vines–Herrin Custom Homes, LLC v. Great Amer. Lloyds Ins. Co.*, 357 S.W.3d 166, 174 (Tex. App.—Dallas 2011, pet. denied) ("*Vines-Herrin I*").

trigger GAIC's duties.[149] On remand after *Vines-Herrin I*, GAIC argued that it was not obligated to indemnify its insured, despite wrongfully denying a defense, "because the arbitration award was not entered after an 'actual trial' or a fully 'adversarial trial.'"[150] The court of appeals rejected the argument, reasoning as follows:

> The trial court, however, found the arbitration proceeding was "fully adversarial." That finding is supported by the evidence, including both Cerullo's and the arbitrator's testimony. The Insurers ignore that testimony and instead generally suggest Vines-Herrin's agreement to arbitrate was inherently suspect. However, Texas law both favors and encourages arbitration. . . . Moreover, it is well-settled that an insurance company may not insist on an actual trial requirement when it has breached its duty to defend its insured. . . . Here, the Insurers had every opportunity to protect their interests by offering Vines-Herrin a defense, and indeed they had the duty to do so. Because they refused to provide a defense and denied all coverage, Vines-Herrin sought arbitration to reduce its litigation costs and, after it obtained an unfavorable result, it protected itself by assigning its claims to Cerullo in exchange for his agreement not to confirm the award.[151]

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[149] *Id*. at 173. This, too, is consistent with the conclusions of law by Judge Evans. *See* C.R., Vol. 19, pp.3485, 3492–93 (COL & FOF 61–64). In fact, subsequent opinions by the Dallas Court of Appeals and this Court establish the validity of Hamels' coverage positions. *See* Ltr Br. dated Sept. 2, 2014 (attached hereto as Exhibit A). This perhaps is the reason why GAIC no longer raises any of its coverage defenses in this appeal.

[150] *Vines-Herrin II*, 2016 WL 4486656, at *8.

[151] *Id*. (citations omitted).

In *Vines-Herrin*, the insured sought a defense and GAIC wrongfully denied coverage and did not provide a defense.[152] Vines-Herrin was left to defend itself and had to make decisions based on the economics of litigation and its ability to afford those costs, just as TMB was left to defend itself in this case with little or no resources. In Vines-Herrin, the defendant sought arbitration, here TMB entered into the Stipulation and Agreement.[153] Likewise, as in *Vines-Herrin II*, GAIC "ignores" the testimony supporting the finding that the Construction Lawsuit was a "fully adversarial trial" and instead suggests that the Stipulation and Agreement are "inherently suspect."[154] *Vines-Herrin* is directly on point, factually and legally. A breaching carrier, such as GAIC, cannot leave its insured in a lurch, and then complain about how the litigation was conducted—at least not under the circumstances present in both *Vines-Herrin* and the instant case.

iv. Other cases similarly have held that a defaulting insurer is bound by an underlying judgment.

In *JHP*,[155] the Fifth Circuit, applying Texas law, held that the insurer wrongfully denied its insured a defense in the underlying case and that a default judgment was the result of a fully adversarial trial. There, TRC Condominiums, Ltd. ("TRC") hired JHP Development, Inc. ("JHP") for the construction of

[152] *Id*. at *2.

[153] *See id*.

[154] *Id*.

[155] *Mid-Continent Cas. Co. v. JHP Dev., Inc.*, 557 F.3d 207 (5th Cir. 2009).

condominiums.[156] JHP failed to properly water-seal the project and large quantities of water penetrated the structure causing damage.[157] TRC terminated the contract with JHP and determined that repair and completion costs of $438,466 were attributable to the damage.[158] JHP notified Mid-Continent of the claim, and Mid-Continent denied coverage, claiming that there was neither an "occurrence" nor "property damage."[159] TRC sued JHP; JHP again notified Mid-Continent of the claim; and Mid-Continent again denied coverage and refused to provide a defense. A default judgment was entered against JHP in excess of $1.5 million. Mid-Continent filed the declaratory judgment action against both JHP and TRC, and TRC filed a counterclaim "alleging that it was entitled to indemnity for the default judgment against JHP and its attorney's fees in this suit as a judgment creditor and that it was entitled to relief for breach of contract as a third party beneficiary to the insurance contract."[160] The Fifth Circuit did not apply *Gandy* and instead applied the holdings in *ATOFINA* and *Block* in determining that Mid-Continent breached its duty to defend and was "bound by the amount of the judgment in the underlying suit."[161] The distinguishing fact for the court was that TRC's suit was "not an

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[156] *Id*. at 210.

[157] *Id*.

[158] *Id*.

[159] *Id*.

[160] *Id*. at 211.

[161] *Id*. at 218.

action against a defendant's insurer by a plaintiff as a defendant's assignee."[162] In other words, the fact that TRC filed its lawsuit as a judgment creditor was sufficient grounds, in light of Mid-Continent's wrongful denial of coverage, to enforce the default judgment against the insurer.

Similar facts support the same result in this case. Although TMB agreed to a partial post-judgment assignment, the Hamels are judgment creditors, like TRC, and GAIC breached its duty to defend. The fact that there was an unnecessary assignment after the fact does not change the calculus. If anything, the judgment in this case certainly was more adversarial than the default judgment in *JHP* because, unlike JHP, TMB actually attended trial and defended itself. As such, like in *JHP*, the Court should find that *Gandy* does not apply and GAIC is bound by the judgment in the Construction Lawsuit.

As demonstrated in the chart below, each of the cases finding that there was no adversarial trial was based on facts that do not exist in this case. Either the insurer agreed to defend, there was a pre-trial assignment, there was an excess judgment, or there was an agreed judgment. Each of those cases is distinguishable. The remaining cases are more in line with the facts of this case where a fully adversarial trial exists.

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[162] *Id*.

CASE	INSURER BREACHED	SETTLEMENT ASSIGNMENT AGREEMENTS	TRIAL	FULLY ADVERSARIAL TRIAL
State Farm Fire & Cas. Co. v. Gandy, 925 S.W.2d 696 (Tex. 1996)	Insurer offered defense subject to reservation of rights.	Final Agreed Judgment. Pre-trial assignment. $6,000,000	No.	No.
Seger v. Yorkshire Ins. Co., No. 13-0673, 2016 WL 3382223 (Tex. June 17, 2016)	Insurer denied coverage and did not defend.	Judgment. Post-trial assignment. $15 million.	Yes. But Diatom did not participate, other than as a witness. Trial "more akin to a post-answer default than a fully adversarial trial."	No.
Polinard v. United Servs. Auto. Assoc., No. 04-95-00425-CV, 1996 WL 460040 (Tex. App.—San Antonio Aug. 14, 1996, no pet.)	Insurer denied coverage and did not defend.	Settlement and assignment during trial. $35,000	Settled during trial.	No.
First Gen. Realty Corp. v. Maryland Cas. Co., 981 S.W.2d 495 (Tex. App.—Austin 1998, pet denied)	Insurer denied coverage and did not defend.	Judgment Pre-trial Covenant Not to Execute, Indemnification Agreement, and Assignment of Claims $9,000,000	Yes.	No.

CASE	INSURER BREACHED	SETTLEMENT ASSIGNMENT AGREEMENTS	TRIAL	FULLY ADVERSARIAL TRIAL
Transportation Ins. Co. v. Heiman, No. 05-95-00482-CV, 1999 WL 239917 (Tex. App.—Dallas Apr. 26, 1999, no pet.)	Insurer offered defense subject to reservation of rights	Agreed judgment. No assignment. $1 million	Settled.	No.
Heathcock v. Southern County Mutual, No. 14-97-00894-CV, 1999 WL 1041480 (Tex. App.—Houston [14th Dist.] Nov. 18, 1999, pet. denied)	Insurer denied coverage and did not defend.	Agreed judgment. Pre-trial assignment. $700,000	None.	No.
Burney v. Odyssey Re (London) Ltd., No. 2:04-CV-032, 2005 WL 81722 (N.D. Tex., Jan. 14, 2005).	Unqualified defense. Rejected by insured.	Settlement and Agreed Order. Pre-trial assignment.	First trial vacated and second trial not concluded.	No.
Vela v. Catlin Specialty Ins. Co., No. 13-13-00475-CV, 2015 WL 1743455 (Tex. App.—Corpus Christi Apr. 16, 2015, pet. denied)	Insurer offered to defend. Insured did not accept defense.	Judgment. Settlement. Assignment. Sharing arrangement.	Yes.	No.

CASE	INSURER BREACHED	SETTLEMENT ASSIGNMENT AGREEMENTS	TRIAL	FULLY ADVERSARIAL TRIAL
Stroop v. Northern County Mutual Insurance Co., 133 S.W.3d 844 (Tex. App.—Dallas 2004, pet denied)	Insurer denied coverage and did not defend.	Agreed judgment. Pre-trial assignment.. $750,000 (Dillen) $500,000 (Stroop)	No.	No.
Trinity Universal Insurance Co. v. Cowan, 945 S.W.2d 819, 821 (Tex. 1997)	Insurer initially defended subject to reservation of rights. Insurer later denied coverage and withdrew defense.	Judgment. Settlement, assignment, and non-execution agreement. $250,000	Yes.	Decided on coverage issue. Court only "noted" *Gandy* controlled whether the carrier was bound by the underlying judgment.
Texas Farmers Insurance Co. v. Kurosky, 945 S.W.2d 819, 821 (Tex. 1997)	Insurer defended subject to reservation of rights.	Agreed final judgment. Settlement. No assignment. $300,000	No.	No.
Employers Cas. Co. v. Block, 744 S.W.2d 940 (Tex. 1988)	Insurer denied coverage and did not defend.	Settlement. Agreed judgment. $45,000	No.	No ruling on adversarial trial. An insurer that wrongfully denies coverage is barred from collaterally attacking an agreed judgment by litigating the reasonableness of the damages.

CASE	INSURER BREACHED	SETTLEMENT ASSIGNMENT AGREEMENTS	TRIAL	FULLY ADVERSARIAL TRIAL
Scottsdale Ins. Co. v. Sessions, 331 F. Supp. 2d 479 (N.D. Tex. 2003)	Insurer denied coverage and did not defend.	Default judgment. No agreements $213,843.28	No.	Yes.
State Farm Lloyds Ins. Co. v. Maldonado, 963 S.W.2d 38 (Tex. 1998)	Insurer defended subject to reservation of rights.	Judgment. Settlement, non-execution agreement, reimbursement provision. No assignment. $2 million.	Yes.	Yes.
Evanston Ins. Co. v. ATOFINA Petrochems., Inc., 256 S.W.3d 660 (Tex. 2008)	Insurer denied coverage and did not defend.	Settlement. No assignment.	No.	Yes.
Mid-Continent Cas. Co. v. JHP Development, Inc., 557 F.3d 207 (5th Cir. 2009)	Insurer did not provide defense.	Default judgment. No assignment. $1 million	None.	Yes.
Great American Lloyds Insurance Co. v. Vines-Herrin Custom Homes, L.L.C. (Vines-Herrin II), No. 05-15-00230-CV, 2016 WL 4486656 (Tex. App.—Dallas Aug. 25, 2016, no. pet. h.)	Insurer denied coverage and did not provide defense.	Arbitration award. Post arbitration award settlement and assignment. $2.4 million	Yes.	Yes.

3. The Construction Lawsuit was a fully adversarial trial, even if GAIC does not like all of its insured's trial strategy.

i. The Stipulations, Agreement, and Assignment did not prolong the litigation.

In *Gandy*, the settlement had the effect of prolonging the litigation, not shortening it, because the settlement did not resolve the litigation.[163] In this case, although the Stipulations did not resolve the litigation, they also did not have the effect of prolonging the litigation in any respect. The Stipulations were entered into between the parties in lieu of responses to requests for admissions and the deposition of Mr. Mitchell.[164] The purpose of the Stipulations was to obtain and perpetuate truthful testimony that would facilitate the trial of the Construction Lawsuit.[165] The Stipulations had no bearing on whether the trial was adversarial.[166]

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[163] *Gandy*, 925 S.W.2d at 712.

[164] R.R., Vol. 12, Ex. 34.

[165] R.R., Vol. 14, Ex. 67, pp.26:25–29:25, 30:1-3, 41:4–11,42:23–43:1; R.R., Vol. 14, Ex. 68, pp. 12-14; *see also* R.R., Vol. 14, Ex. 66, pp.25:13–26:25, 36:4–13, 37:14–38:2, 43:1-45:2, 47:15-48:19; R.R., Vol. 14, Ex. 67, pp.16:14–18, 16:19–17:8, 22:7–22, 26:21–28:1, 41:4–11, 29:1–30:3, 30:4–12, 32:20–33:21; R.R., Vol. 14, Ex. 68, pp.l3–14; R.R., Vol. 15, Ex. 69 pp.7–17.

[166] TMB did not admit liability in the Stipulation, nonetheless, courts have held that actual trial occurred even when the defendant admits liability. *See, e.g.*, *Gulf Ins. Co. v. Vela*, 361 S.W.2d 904 (Tex. App.—Austin 1962, writ ref'd n.r.e.); *Pioneer Cas. Co. v. Jefferson*, 456 S.W.2d 410 (Tex. App.—Houston [14th Dist.] 1970, writ ref'd n.r.e.) In *Gulf Insurance,* the court held an actual trial occurred when the fact finder heard evidence from the plaintiff and his doctor in the underlying suit and the court rendered judgment for the plaintiff even though the defendant did not appear at trial. *See Gulf Ins.*, 361 S.W.2d. at 908. In *Jefferson,* there was an "actual trial" where the attorney for the insured appeared before the court and "***admitted liability***" and where, as in *Gulf Insurance,* the judgment recited that the pleadings and sworn testimony had been heard by the court. *See Jefferson*, 456 S.W.2d at 413. Here, the Hamels put on a more substantial case than the insureds in either *Gulf Insurance* or *Jefferson* and there was no admission of liability.

Similarly, the Agreement was entered into for the purpose of securing Mr. Mitchell's attendance at trial and preventing TMB from failing to appear and defaulting in the Construction Lawsuit, a very real possibility given TMB's inability to pay for its experts or counsel.[167] The Agreement did not perpetuate or prolong litigation; rather, it secured a prompt resolution because TMB agreed not to seek a continuance of the trial. Moreover, the Agreement did not encourage future litigation, as it secured a fully adversarial trial of the Construction Lawsuit and avoided the Hamels merely obtaining a default judgment to which GAIC undoubtedly would have objected.

In *Gandy*, this Court specifically encouraged insurance companies to make a good faith effort to adjudicate coverage prior to the adjudication of a claimant's lawsuit.[168] GAIC had the opportunity to seek a declaratory judgment that it did not owe TMB a defense, but it instead chose to rely on its misguided belief that the manifestation trigger applied—an issue squarely rejected by this Court[169]—to deny TMB a defense and leave TMB to fend for itself. GAIC's failure to secure a declaration supporting its coverage position is the cause of the litigation being prolonged, not the Stipulations, Agreement, or post-judgment Assignment. GAIC should not be rewarded for breaching its contract, failing to defend its insured, and

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[167] R.R., Vol. 15, Ex. 67, p.7:4-15.

[168] *See id.* at 714.

[169] *See Don's Building Supply Inc. v. OneBeacon Ins. Co.*, 267 S.W.3d 20 (Tex. 2008).

failing to secure a declaration as to its coverage obligations. To that same end, TMB certainly should not be punished for doing what it could to protect itself in light of financial constraints.

ii. Neither the Hamels nor TMB switched positions.

GAIC goes to great lengths to manufacture distortions of the parties' positions to satisfy one of the main concerns this Court had in *Gandy* regarding pre-trial assignments: a distortion of the parties' positions between the underlying litigation and subsequent coverage litigation. In *Gandy*, the Court analyzed four cases involving that concern. In *Zuniga v. Groce, Locke & Hebdon*, the issue was whether a client could assign its legal malpractice claim arising out of the litigation.[170] This Court explained that the court in *Zuniga* held that the client could not assign its claim because the assignee would argue in the first litigation that its case was meritorious and argue in the malpractice case that its underlying case would not have been successful "but for" the attorneys' negligence.[171] Similarly, in *Elbaor v. Smith*, the Court held that a "Mary Carter" agreement was void against public policy in part because a settling defendant would distort the trial against the non-settling defendant.[172] In *International Proteins Corporation v. Ralston–Purina Co.*, the Court held that a tortfeasor could not take an assignment of a plaintiff's

[170] 878 S.W.2d 313 (Tex.App.—San Antonio 1994, writ ref'd).

[171] *See Gandy*, 925 S.W.2d at 714 (discussing *Zuniga*).

[172] 845 S.W.2d 240 (Tex. 1992).

claim in settlement and prosecute that claim against a joint-tortfeasor.[173] Such assignments, this Court said in *Gandy*, "would not promote settlements and would confuse jurors."[174] Finally, the Court reviewed the decision in *Trevino v. Turcotte*, in which it invalidated the assignment of interests in an estate.[175] The assignment had the effect of allowing certain heirs to contest a will they otherwise were estopped from contesting.[176] In each of those cases reviewed by this Court in *Gandy*, the assignments had a distorting effect on the parties' true interests and how they litigated the case, causing the parties to argue inconsistent positions.

Notably, there has been no "position switching" that even remotely resembles what concerned this Court in *Gandy*. The Hamels consistently have maintained that they are owed actual damages *within* the limits of the Policy for TMB's failure to build and complete improvements to the Home in a good and workmanlike manner. The litigation distortions that come into play with extra-contractual remedies that were central to *Gandy's* reasoning, and which were then relied on by the court of appeals in *Seger*, are simply not at issue here.

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[173] 744 S.W.2d 932 (Tex. 1988).

[174] *Gandy*, 925 S.W.2d at 710.

[175] 564 S.W.2d 682 (Tex. 1978).

[176] *Gandy*, 925 S.W.2d at 711 (discussing *Trevino*).

GAIC argues that TMB switched positions during the course of the litigation, initially asserting many defenses that it later did not press.[177] GAIC states there was "no new evidence" and that the position changing must have been result of the Agreement.[178] GAIC, however, discounts the fact that the case was a week away from trial, both parties had engaged in discovery, and the Hamels had designated their experts by the time the Stipulation and Agreement were executed. Moreover, Hudnall testified that his defense of the case was not affected or changed by the Agreement.[179] As such, the Stipulation and Agreement are not evidence of collusion as GAIC claims.

GAIC cites to the deposition testimony of Mitchell and Hudnall for the proposition that "Mitchell admitted that he directed TMB's attorney not to put up a fight."[180] Such testimony does not exist in the record. Rather, Mitchell testified that he fired his counsel at one point because of defense costs and expenses, and Hudnall similarly testified that there were "financial constraints" that affected the way they could try the case.[181] No amount of creative interpretation of the actual testimony of Mitchell and Hudnall supports GAIC's contention. More importantly,

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[177] GAIC Br., at p.38.

[178] *See id.*

[179] R.R., Vol. 14, Ex. 66, pp.35 36.

[180] GAIC Br., at p.37 (citing R.R., Vol. 14, Ex. 67, pp. 11, 19-20, 30; Ex. 66, pp. 38-39, 46).

[181] R.R., Vol. 14, Ex. 66, p.38. Of course, having breached the duty to defend, GAIC is in no position to challenge the financial constraints.

both Judge Evans and the court of appeals rejected this argument as unsupported.[182] This Court should do the same.

GAIC's wrongful denial of defense and indemnity coupled with TMB's inability to afford a defense and the clear liability facts in the Construction Lawsuit do not convert the Stipulations, the Agreement, or the Assignment into collusive acts that distort the positions of the parties. What GAIC labels "position shifting" is nothing more than trial strategy in the course of a litigation where liability is obvious and the defendant has limited, if any, resources to defend itself.

GAIC's argument—which is essentially that Judge Evans acting as the fact finder incorrectly concluded that there was no collusion and the Construction Lawsuit was fully adversarial—is really a factual sufficiency challenge that already has been rejected upon thorough review by the court of appeals.[183] Moreover, the factual dispute of whether collusion existed has been determined twice against GAIC, in the Coverage Case and by the court of appeals.[184] GAIC essentially asks this Court to sit yet again as a fact finder, but that is not this Court's role.[185]

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[182] *Hamel*, 444 S.W.3d at 802–03.

[183] *See Hamel*, 444 S.W.3d at 799 ("Upon our review of the record, we hold the trial court's findings and conclusions in the coverage case are supported by sufficient evidence in the record.").

[184] *See In re A.B.*, 437 S.W.3d 498, 502 (Tex. 2014); *see also* TEX. GOV'T CODE § 22.225(a).

[185] *See Lennar Corp. v. Markel Am. Ins. Co.*, 413 S.W.3d 750, 756 (Tex. 2013), *reh'g denied* (Dec. 13, 2013) (refusing to overturn the factual findings regarding whether an insurer was prejudiced by an insured's unilateral settlement).

iii. The Construction Lawsuit was fully adversarial.

In stark contrast to the facts in *Seger*, *Vela*, and similar cases, the Construction Lawsuit was fully adversarial. GAIC contends that TMB did nothing but show up at the courthouse,[186] but TMB was represented by counsel, offered evidence, testified, cross-examined witnesses, argued, and presented the best defense it could in light of the undeniable facts.[187] TMB's counsel appeared at trial and defended TMB, eliciting "evidence favorable to its defense of TMB in the [Construction Lawsuit]."[188] The court below recognized that TMB's counsel's adduced evidence that:

> (1) the defects, other than the defective shower, were constructed by GSM rather than TMB; (2) the project was 60–70 percent complete when TMB became involved in the construction; (3) the roof was not constructed under TMB's watch; (4) the roof deck, roof valleys, and flat roof were already constructed when TMB took over the construction; (5) an inspector for the City of Flower Mound and another building inspector inspected the construction upon completion and determined that the newly-constructed home "passed" inspection; and (6) the Hamels' expert, Donald Yeandle, had been asked on the day of trial if he would make an offer on the house and had replied that he had in fact already done so. TMB also elicited Yeandle's testimony that the city inspector who approved the home after inspection had been negligent on two issues, one of

[186] GAIC's Br., at 41.

[187] *See Hamel*, 444 S.W.3d at 803. *See also* R.R., Vol. 14, Ex. 10.

[188] *Id*.

> which involved the failure to identify the holes at the top of the fascia board.[189]

Moreover, the court below quoted with approval the findings of fact that Judge Evans made specifically with regard to whether the Construction Case was adversarial:

> In Findings 30–32, 34–36, 42, 44–45, the trial court in the coverage case: (1) found that the testimony offered at the construction trial was truthful and not unduly influenced or affected by stipulations or any agreement or understanding between the parties; (2) found and concluded that all evidence and testimony admitted in the construction trial was truthful; (3) found that TMB appeared at the construction trial and defended itself in good faith; (4) found and concluded that the judgment in the construction case was not an agreed or consent judgment; (5) found and concluded that TMB's and the Hamels' strategies, action, and inaction, both pretrial, during discovery, and at trial, including preparation for and presentation of their respective cases at the construction trial were reasonable and conducted for a proper purpose, and concluded that such action, inaction, and strategies were not collusive or fraudulent; (6) found that the fact that the parties entered into stipulations in lieu of discovery responses is no evidence of lack of adversity, but rather is proper and in keeping with procedural ethical obligations to stipulate to matters not in dispute; (7) found and concluded that the construction trial was a genuine contest of issues resulting in an adversarial proceeding; and (8) found and concluded that the construction trial and the resulting judgment were not products of collusion, and that there was no fraud in

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[189] *Id*.

> either the construction trial or in obtaining of the construction judgment.[190]

The Construction Lawsuit was, as Judge Evans properly concluded and the court of appeals affirmed, fully adversarial and not a product of collusion.

Additionally, under Texas law, once GAIC breached its duty to defend, TMB was free to proceed as it saw fit—engaging its own counsel to either settle or litigate.[191] GAIC would have been liable for any damages assessed against TBM, up to the policy limits, subject only to the condition that any settlement be covered.[192] Before this Court, GAIC does not challenge coverage by way of exclusions but instead seeks to avoid liability for a covered claim through a skewed application of *Gandy*.

At bottom, the damages in this case are not the result of a settlement, an agreed judgment, or a consent judgment, but instead are the result of a fully adversarial trial in which the evidence supported the damages awarded. Accordingly, the liability and damages in this case are more certain and have been more closely scrutinized than had the case simply been settled. Simply put, if by entering into a settlement an insured can bind an insurer that wrongfully denies a

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[190] *Id.* at 802.

[191] *See, e.g.*, *Evanston Ins. Co. v. ATOFINA Petrochemicals, Inc.*, 256 S.W.3d 660, 671 (Tex. 2008).

[192] *See id.* at 674 ("[W]e hold that Evanston's denial of coverage barred it from challenging the reasonableness of ATOFINA's settlement.").

defense, how can an allegedly lackluster defense that actually involves testimony and presentation of evidence be any less binding on an insurer?

iv. The Stipulations and Agreements between the Hamels and TMB is not evidence of collusion.

The factual dispute of whether collusion existed has been determined in the Coverage Case and by the court of appeals.[193] Judge Evans, with the benefit of the Construction Lawsuit record and evidence, determined that "the testimony offered at the [Construction Lawsuit] was truthful and not unduly influenced or affected by stipulations or any agreement or understandings between the parties."[194] This factual determination was supported by evidence, as decided by the court of appeals.[195]

v. TMB's net worth does not determine adversarial nature of trial or GAIC's contractual duty.

GAIC sees collusion everywhere. That belief ultimately grows out of a single assertion—TMB essentially was judgment proof. TMB's net worth is the lynchpin of all of GAIC's arguments. GAIC argues that TMB's minimal assets meant that it did not have a sufficient stake in the Construction Lawsuit to put up a real fight. This supposed lack of motivation rendered the Construction Lawsuit less

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[193] *See In re A.B.*, 437 S.W.3dat 502 ("The authority to conduct a factual sufficiency review lies exclusively with the courts of appeals."); *see also* TEX. GOV'T CODE § 22.225(a) ("A judgment of a court of appeals is conclusive on the facts of the case in all civil cases.").

[194] *See Hamel*, 444 S.W.3d at 802.

[195] *See id.*

than adversarial. If GAIC is correct, then a defendant's balance sheet determines the sufficiency of any trial in which it might participate. From this, it would logically follow that only those with a positive balance sheet with significant assets could participate in an adversarial trial.

TMB's net worth assertion is wrong because an insured's net worth does not affect an insurer's duty to defend or indemnify. This is readily demonstrated by the following hypothetical. Assume *arguendo* that TMB was just a "shell," whose only assets were some used personal tools, a used truck, and the insurance policy. Further, assume that TMB was as obstructionist in the Construction Lawsuit, as GAIC suggests it should have been. Finally, assume that the Hamels obtained a judgment. GAIC would have a duty to indemnify and could not have required the Hamels to collect against TMB's assets or Mitchell's assets before contributing to the satisfaction of the judgment. In other words, GAIC's duty to indemnify would not be reduced by the value, if any, of TMB's assets. As a judgment creditor, the Hamels would have the right to seek satisfaction of the judgment from the GAIC policy.

Here, the Construction Lawsuit judgment was approximately $415,000.00.[196] The damages to the Home far exceeded the value of TBM's minimal assets—yet GAIC waxes eloquently how TBM's desire to protect those

[196] R.R., Vol.12, Ex. 11 and Ex. 12; C.R., Vol. 19 pp.3493–94.

minimal assets somehow taints the entire judgment. As an essentially judgment-proof defendant, TMB had exactly the same incentives before and after the Stipulations, before and after the Agreement, and before and after the post-judgment Assignment. The Hamels' decision not to levy against items of *de minimis* value neither distorted the Construction Lawsuit litigation nor prolonged it.

Finally, GAIC's net worth assertion is contrary to Texas law. A defendant's *inability* to satisfy a judgment does not affect the defendant's *liability*.[197] Whatever TMB's balance sheet, it does not determine whether the Construction Lawsuit was adversarial. While the absence of resources affected TMB's ability to fund its defense,[198] GAIC's refusal to honor its contractual obligation to defend certainly exacerbated that problem. GAIC's whole net worth argument is ironic considering that TMB's most valuable asset should have been its liability insurance, especially given that GAIC left its insured in a lurch and now complains the judgment-proof insured with minimal assets did not make the same trial decisions GAIC would have made had it defended the case.[199]

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[197] *Seger*, 279 S.W.3d at 770–71; *see also YMCA of Metro. Fort Worth v. Commercial Standard Ins. Co.*, 552 S.W.2d 497, 504 (Tex. Civ. App.—Fort Worth 1977, writ ref'd n.r.e.).

[198] R.R., Vol. 14, Ex. 66, pp. 23:14–24:17, 35:6-19, 38:13–39:23; R.R., Vol. 14, Ex. 67, pp. 10:4–11:25).

[199] Interestingly, while claiming that TMB did nothing to defend its case, GAIC simply directs this Court to a 127-page transcript of the trial proceedings, failing to pinpoint a single snippet of that transcript showing that TMB's defense was anything less than what it "should have been."

D. An insurer has options to protect itself from adverse judgments against its insureds.

When TMB tendered the Hamels claims for defense and indemnity, GAIC had options available to it other than merely denying its duties.

> An insurer faced with the dilemma of whether to defend a proffered claim has four options: (1) completely decline to assume the insured's defense; (2) seek a declaratory judgment as to its obligations and rights; (3) defend under a reservation of rights or a non-waiver agreement; or (4) assume the insured's unqualified defense.[200]

As in *Gandy*, most of the cases invalidating an assignment or finding that a trial is not adversarial involve an insurer who does not provide a defense or that does provide a defense that the insured rejects. Opting to decline to provide a defense is the only one of the four options that diminishes the protections available to the insurer—controlling the defense and settlement of the case. That is so because only an insurer who "'wrongfully refuses to defend' an insured is precluded from (1) insisting on compliance with certain policy conditions, and (2) collaterally attacking the reasonableness of an agreed judgment entered into between an insured and a third party."[201] An insurer cannot wrongfully deny its insured a

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See GAIC's Br., at 41 (citing R.R., Vol. 14, Ex. 10). GAIC's failure to supports its position is fatal to its claim.

[200] *Transp. Ins. Co. v. Heiman*, No. 05-95-00482-CV, 1999 WL 239917, at *3 (Tex. App.—Dallas Apr. 26, 1999, no pet.) (citing *Farmers Tex. County Mut. Ins. Co. v. Wilkinson*, 601 S.W.2d 520, 522 (Tex. Civ. App.—Austin 1980, writ ref'd n.r.e.)).

[201] *Id*. (citing *Employers Cas. Co. v. Block*, 744 S.W.2d 940, 943 (Tex. 1988)); *see also ATOFINA*, 256 S.W.3d at 674 (applying the "*Block* rule" to the circumstances of the case).

defense, then complain that the insured, left to its own devices, did not place the breaching insurer's interests above its own. As at least one noted commentator has stated:

> [C]ourts are also more inclined to find a fully adversarial trial where the insurer has breached its duty to defend as opposed to those situations where the insurer is defending or has tendered a defense that has been rejected by the insured. ***In those cases where the insurer has breached its duty to defend, the courts have apparently reasoned that the insured, having been left to its own devices, should be able to seek out what protection on its own it can find.***[202]

That is exactly what happened in the Construction Lawsuit. GAIC wrongfully denied, Mitchell and TMB entered into reasonable agreements based on the facts, some of which provided them protection from execution of a judgment, the case proceeded to trial, a judgment was entered, and post-trial TMB assigned some of its claims.

E. In the Alternative, the trial in the Coverage Case solves GAIC's concerns.

The Construction Lawsuit was fully adversarial and resulted in a valid, enforceable judgment against TMB that, in turn, is enforceable against GAIC. The only "taint" in the Construction Lawsuit was GAIC's wrongful denial of coverage. The analysis can stop at this point. But, if the Court disagrees, the fact remains that

[202] R. Brent Cooper, "*State Farm v. Gandy—Fully Adversarial Trial*," Texas State Bar Advocate—Insurance & Litigation, Winter 2006, Vol. 37 (emphasis added).

Judge Evans allowed for a full evidentiary trial in the Coverage Case. GAIC had the opportunity to make its coverage arguments, examine witnesses, put on witnesses of its own and evaluate the damages. Contrary to what happened in *Seger*, the Hamels did not simply rely on the judgment in the Construction Lawsuit as evidence. Accordingly, even if this Court is persuaded by GAIC's "conspiracy" arguments, any taint was cured by the subsequent Coverage Case.

A simple hypothetical supports this conclusion. Because GAIC breached its duty to defend, it could not insist on TMB's compliance with policy conditions. Moreover, at that point, TMB was free to settle the case if it chose to do so. Had TMB simply settled with the Hamels, it is undisputed that GAIC would not have been able to challenge the reasonableness of such a settlement.[203] Rather, GAIC only could have challenged whether the settlement was covered or not. GAIC got that very opportunity in the Coverage Case. Yet, if GAIC's position in this case is followed, TMB would be punished for actually having a trial instead of simply settling. Respectfully, that makes no sense at all.

Additionally, the evidence presented by the Segers and the Hamels in their respective coverage cases also significantly differ. The Segers relied entirely on the underlying judgment as proof of damages.[204] In contrast, the Hamels submitted the

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[203] *ATOFINA*, 256 S.W.3d at 670–74.

[204] *See id.* ("While we have determined that the underlying judgment was not evidence of Diatom's damages, the Segers could still present other evidence that Diatom suffered damage as

entire trial transcript, all evidence from the Construction Lawsuit and also put on live witnesses who testified regarding liability and damages. Thus, Judge Evans essentially held a second trial on the merits as part of the Coverage Case.[205] GAIC introduced competing evidence, cross-examined witnesses, and challenged both liability and damages.[206] Thus, GAIC had the opportunity to fully litigate any coverage concerns. Even a cursory review of the COA opinion demonstrates the depth to which testimony was provided in the Coverage Case.[207]

The trier of fact is the sole judge of the credibility of the witnesses and the weight to give their testimony.[208] The fact finder may choose to believe one witness and disbelieve another.[209] This is equally true when the fact finder is the trial judge.[210] Here, Judge Evans heard substantial testimony establishing TMB's negligence and the damages to the Hamels. Moreover, he heard evidence that negated the fraud/collusion and lack of adversity alleged by GAIC. If GAIC did not get an adversarial trial in the Construction Lawsuit, it certainly received one in

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a result of Insurers' failure to provide a defense and negligence in failing to settle the Segers' suit within policy limits. However, the Segers relied entirely on the underlying judgment as proof of damages.").

[205] The Coverage Case was fully adversarial and, in fact, the trial court sustained GAIC's objection to the admission of certain expert reports into evidence. *See Hamel*, 444 S.W.3d at 791.

[206] *See id.* at 787–97.

[207] *See id.*

[208] *City of Keller v. Wilson*, 168 S.W.3d 802, 819 (Tex. 2005).

[209] *Id.*

[210] *Sansom v. Sprinkle*, 799 S.W.2d 776, 778 (Tex. App.—Fort Worth 1990, no writ).

this case, with the same result. Even if Judge Evans, sitting as the fact finder, was presented with a conflict in the evidence between the direct, unequivocal testimony of witnesses and the conjecture and stacking of inferences urged by GAIC,[211] the trial judge could and did resolve the factual issues against GAIC.[212] The trial court, sitting as the fact finder, apparently believed and found credible testimony that there was no fraud, collusion, or actions taken to avoid an adversarial trial.[213] As such, GAIC's arguments fail, and no dispute can exist that, even if the Construction Lawsuit was not adversarial (and it was), the Coverage Case provided GAIC the opportunity to cure any such problem and GAIC simply failed to do so because the facts do not support GAIC's doomsday proclamations of fraud and collusion.

CONCLUSION

This case does not fall within the "explicit and narrow" holding of G*andy*. In this case, GAIC wrongfully denied coverage and breached its contract with TMB, and the Assignment was executed *after* judgment in the Construction Lawsuit.

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[211] Of course, GAIC's stacking of inferences is improper. *Schlumberger Well Surveying Corp. v. Nortex Oil & Gas Corp.*, 435 S.W.2d 854, 858 (Tex. 1968); *Briones v. Levine's Dep't Store, Inc.*, 446 S.W.2d 7, 10 (Tex. 1969); *Halliburton Co. v. Sanchez*, 996 S.W.2d 216, 219 (Tex. App.—San Antonio 1999, pet. denied).

[212] *McGalliard* v. *Kuhlmann*, 722 S.W.2d 694, 697 (Tex. 1986); *Rogers v. City of Fort Worth*, 89 S.W.3d 265, 277 (Tex. App.—Fort Worth 2002, no pet.).

[213] *City of Keller*, 168 S.W.3d at 819 (stating that "[m]ost credibility questions are implicit rather than explicit" and a reviewing court must assume the factfinder decided all of them in favor of the judgment if reasonable human beings could do so.).

Because GAIC wrongfully denied coverage and breached its contract with TMB, it cannot enforce the "actual trial" condition. Despite its breach and its inability to enforce the actual trial condition, a position GAIC does not challenge here, GAIC argues that *Gandy* requires TMB to essentially conduct a trial to GAIC's liking.

To the extent that an adversarial trial requirement even applies in circumstances where an insurer wrongfully denies coverage, as occurred here, trial in the Construction Lawsuit was fully adversarial. Stipulations, completely permissible under Texas law, were entered into. A limited non-execution Agreement in which the Hamels agreed not to levy against certain assets that were otherwise protected by law was entered into to secure an adversarial trial, not to avoid one. The case was tried to the court; both parties made opening statements; both parties questioned witnesses; both parties had an opportunity to submit post-trial briefing and proposed findings of fact and conclusions of law. Thus, the Construction Lawsuit was a fully adversarial trial. Moreover, even if the Court disagrees, no question exists that the Coverage Case was fully adversarial and afforded GAIC with the opportunity to fully present its case. In that regard, Judge Evans heard all of the evidence supporting the Construction Lawsuit judgment, in addition to receiving the judgment in evidence. His conclusion was that the

Construction Lawsuit was fully adversarial and that the judgment was supported by the facts. The court of appeals agreed after an exhaustive analysis.

GAIC seemingly forgets that *it* is the party that breached its obligations. Yet, it is GAIC that seeks the protections of this Court with a request that this Court expand *Gandy* beyond its explicit and narrow boundaries. Even if the Court were inclined to expand *Gandy* under certain circumstances, this is not the case to do it. This case does not involve extra-contractual damages that far exceed the actual damages. This case does not involve an agreed or consent judgment. This case does not involve a sham trial or a *Mary Carter* agreement. In reality, this case has none of the indicia that rightfully concerned the Court in *Gandy*. Reversing the court below in this matter would only serve to reward GAIC—the insurer that breached its contractual obligations under the Policy.

PRAYER

The Hamels respectfully pray that this Honorable Court deny GAIC's Petition for Review or, in the alternative, accept review and affirm the holdings of the Court of Appeals.

Respectfully submitted,

By: */s/ Lee H. Shidlofsky*

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I certify that this document contains 14,806 words. The body of the text is in 14 point font and the footnote text is in 12 point font.

By: *<u>/s/ Lee H. Shidlofsky</u>*
Lee H. Shidlofsky

Dated: October 14, 2016

EXHIBIT A

ACCEPTED
08-11-00302-CV
EIGHTH COURT OF APPEALS
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DENISE PACHECO
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08-11-00302-CV

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September 2, 2014

VIA E-FILE
Denise Pacheco, Clerk
Eighth Court of Appeals
500 E San Antonio Ave, Room 1203
El Paso, TX 79901-2408

Re: 08-11-00302-CV, *Great Am. Lloyds Ins. Co. v. Hamel* (transferred from the 2nd Court of Appeals)

Dear Ms. Pacheco:

The above-referenced matter was submitted on oral argument on April 16, 2013. Since that time, several relevant cases have been issued that support Appellees' legal position. Accordingly, Appellees respectfully request that this letter brief be submitted to the panel.

One of the key issues on appeal is Great American's contention that the Hamels had to prove the amount of damage that occurred in each policy year and, by *allegedly* failing to do so, the Hamels must lose.[1] That position has now been squarely rejected by both the Dallas Court of Appeals and the Supreme Court of Texas. In *Mid-Continent Casualty Company v. Castagna*, 410 S.W.3d 445 (Tex. App.—Dallas 2013, pet denied), Mid-Continent made the exact argument that its sister company makes in this case. The Dallas Court of Appeals, in a factually analogous case, rejected Mid-Continent's argument that the insured had to prove how much damage happened in each policy period or that the insured had the burden to segregate. More specifically, the Dallas Court of Appeals held that the insured could recover the *entirety* of its loss in any policy year in which *some* "property damage" occurred. *See id.* at 454–55. The Supreme Court's denial of the Petition for Review in *Castagna* is not surprising because, just a few days after *Castagna* was issued, the Supreme Court ruled the same way in *Lennar Corporation v. Markel American Insurance Company,* 413 S.W.3d 750 (Tex. 2013). Like in *Castagna*, the insurer argued that it's the insured's burden to prove how much damage occurred in each policy period and that, if the insured cannot do so, it must lose. The Supreme Court disagreed and held that an insurer is responsible for the entirety of the damages as long as at least some "property damage" occurred within the policy period. *See id.* at 758–59.[2]

[1] These arguments are embodied in Issues 3 & 4 of Brief of Appellants.

[2] The Hamels contend that they conclusively proved when the damage occurred and that, in failing to defend its insured, Great American cannot collaterally attack the judgment. Regardless, even if Great American's arguments on this point are accepted, the case law is now crystal clear that the Hamels can pick the Great American policy under which to recover. To that end, no doubt exists that *at least some* "property damage" occurred prior to Great American issuing a policy with an EIFS exclusion. Accordingly, consistent with the Hamels briefing as well as the

Another key issue is Great American's argument that no actual trial occurred and, therefore, the Hamels must lose as a matter of law.[3] In making this dubious argument, Great American places great reliance on the holding in *Yorkshire Insurance Company v. Seger*, 407 S.W.3d 435 (Tex. App.—Amarillo 2013, pet. reinstated).[4] As noted in a letter to this Court, dated August 14, 2013, the *Yorkshire* case is wholly distinguishable from the instant case. In particular, in contrast to *Yorkshire*, the instant case does not involve an assignment of extra-contractual or bad faith damages. More importantly, Great American wholly overlooks the fact that—unlike in *Yorkshire*—the instant case included a second trial in which the coverage court heard live testimony and Great American had an opportunity to cross-examine witnesses and challenge the evidence.[5] Accordingly, *Yorkshire* does nothing to support Great American's position in this case and it now appears that the Supreme Court may take a hard look at the very holding that Great American relies on.[6]

Very truly yours,

Lee H. Shidlofsky

c: Aaron L. Mitchell

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recent case law, Great American's "failure to allocate/segregate" arguments set forth in Issue 4 of Brief of Appellant must fail as a matter of law. Likewise, because some "property damage" occurred prior to the inclusion of an EIFS exclusion, Issue 3 raised by Great American also is moot.

[3] This issue is embodied within Issue 1 of Brief of Appellants.

[4] Although the Supreme Court had originally denied a Petition for Review in *Yorkshire*, the Supreme Court recently withdrew its denial and reinstated the Petition for Review.

[5] The *Lennar* case also is relevant to this point. In *Lennar*, the insured undertook a voluntary remediation program and there was no actual liability trial against the insured. Despite this fact, the Supreme Court held that the insurer was responsible for the entirety of the insured's voluntary remediation program. Moreover, like in the instant case, there was a coverage trial in which the insurer was able to challenge the evidence. *See Lennar,* 413 S.W.3d at 752–54.

[6] Given the differences between *Yorkshire* and the instant case, Appellees respectfully submit that this Court need not wait until the Supreme Court rules on the Petition for Review. Moreover, as previously briefed, this Court can simply follow the Supreme Court's ruling in *Evanston Insurance Company v. ATOFINA Petrochemicals, Inc.*, 256 S.W.3d 660 (Tex. 2008), wherein the Court held that "Gandy's holding was explicit and narrow, applying only to a specific set of assignments with special attributes." *Id. at* 673.