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Texas Court of Appeals Holds That Follow-Form Excess Policy Affords Coverage for Defense Costs and Provides Guidance for How Excess Policies Can Override Primary Coverage Terms

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In *Ohio Cas. Ins. Co. v. Patterson-UTL Energy, Inc.*, 2022 Tex. App. LEXIS 8578 (Nov. 22, 2022), the Texas Court of Appeals addressed whether a fifth-level follow-form excess policy afforded coverage for defense costs, when the underlying primary policy provided coverage for defense costs as “ultimate net loss.” The Texas Court of Appeals held that the excess policy at issue did not clearly and unambiguously identify its divergence from the primary policy, such that it did not exclude coverage for defense costs.

The Ohio Casualty Insurance Company (“Ohio Casualty”) was an excess insurer for the Patterson Companies. Specifically, the Ohio Casualty excess policy provided coverage after the primary policy and other excess policies were exhausted. The Patterson Companies were sued in a personal injury lawsuit involving incidents at drilling rig sites, which resulted in large settlement and defense costs that exceeded the attachment point of the Ohio Casualty excess policy. The Patterson Companies made a claim on the excess policy to cover the settlement sum that entered the Ohio Casualty layer, as well as its defense expenses. Ohio Casualty funded its portion of the settlement within policy coverage but refused to indemnify or provide coverage for the Patterson Companies’ defense expenses. After Ohio Casualty refused to pay defense expenses on a claim, the Patterson Companies sued for breach of contract.

The Texas Court of Appeals began its analysis with the primary policy. The primary policy afforded coverage for “ultimate net loss,” defined to mean “the amount the ‘Insured’ is obligated to pay, by judgment or settlement, as damages resulting from an ‘Occurrence’ to which this policy applies, including [. . .] all ‘Defense Expenses’ in respect of such ‘Occurrence.’” Neither party disputed that the primary policy covered the insureds’ defense expenses, including attorney’s expenses.

The excess policy explicitly stated it will “follow” the primary policy, providing the same coverage unless excluded or specifically conditioned in the excess policy. The excess policy further provided that it pays the amount of “loss” covered by the policy, and defines “loss” as “those sums actually paid in the settlement or satisfaction of a claim which the [Insured] is legally obligated to pay as damages after making proper deductions for all recoveries and salvage.” Although a follow-form policy, the excess policy did not refer to or mention “ultimate net loss,” and did not contain independent definitions for “defense expenses” or “damages.”

Ohio Casualty first argued the excess policy unambiguously excluded coverage for defense expenses because it did not follow the definition of “ultimate net loss” and instead defined coverage based on a new definition of “loss” that did not include defense expenses. Ohio Casualty argued they did not have to expressly exclude defense expenses because the excess policy did not follow the primary policy as to coverage and terms. In other words, Ohio Casualty believed defining “loss” in the excess policy created an implicit divergence from the similar terms and related language of the primary policy.

For their part, the Patterson Companies argued that the definition of “ultimate net loss” in the primary policy was not supplanted by the definition of “loss” in the excess policy. The excess policy did not refer to or mention “ultimate net loss” and did not contain any independent definition of “defense expenses” or damages. As such, the excess policy existed in harmony with the terms and definitions of the primary policy. The Patterson Companies specifically noted the primary policy used both the defined term “ultimate net loss” and the term “loss,” albeit in its ordinary meaning, as further proof the terms did not overlap.

The Court ultimately rejected Ohio Casualty’s argument, siding with the Patterson Companies. According to the Court, because the excess policy did not include a definition of damages or specifically disavow the definitions in the primary policy. As such, the Court looked to the primary policy to determine if there was an applicable definition for “damages” that the excess policy would naturally “follow.” While the primary policy did not use “damages” as a defined term, it did explain that damages covered under the policy include “all ‘Defense Expenses’ in respect of such ‘Occurrence.’” The Court thus concluded that the excess policy too would cover defense costs.

Ohio Casualty also argued the term “damages” should be understood using its ordinary meaning, but the Texas Court of Appeals quickly disposed of that argument. While courts often give the words of insurance policies their ordinary and accepted meaning, that practice is not extended to the defined terms of an insurance policy. The Court concluded that there is little explanation as to why they should look to the ordinary meaning of the word “damages” when it is defined in the policy itself. The excess policy specifically states that it will “follow” the primary policy, providing the same coverage unless excluded or conditioned in the excess policy. The Court determined there was no clear and unambiguous language that excluded defense costs from coverage under the excess policy. Thus, the Court of Appeals ruled in favor of the Patterson Companies, concluding an excess policy “following form” must clearly and unambiguously identify its divergence from the primary policy to override the primary policy’s coverage.