Updates
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Texas Supreme Court Strengthens Additional Insured Coverage Rights

In a recent decision, the Supreme Court of Texas issued helpful guidance to businesses, nonprofits, and individuals seeking coverage as an "additional insured" under policies issued by a business partner. On April 14, 2023, in *ExxonMobil Corporation v. National Union Fire Insurance Co. et al.*, Case No. 21-0936, the court determined that National Union owed Exxon coverage as an "additional insured" for workplace injury claims under an umbrella policy that National Union issued to an Exxon subcontractor. The court rejected efforts by National Union to defeat coverage by relying on documents outside of the umbrella policy (i.e., extrinsic evidence). In so doing, the court provided a critical roadmap to Texas policyholders, putative additional insureds, and insurers alike on how to view outside nonpolicy evidence when considering a disputed insurance claim. Most significantly, the court would not consider extrinsic documents that were not clearly incorporated into the policy. This ruling provides a strong reminder for business leaders and deal makers to be thoughtful in structuring commercial contracts to maximize potential risk transfer in the event of a claim or loss.

The Case

ExxonMobil (the owner) sued its subcontractor's umbrella insurance carrier to recoup payments made to the subcontractors' employees for workplace injuries allegedly caused by the owner's negligence. Part of the injury settlement amount came from the subcontractor's primary insurance policies, including one held with the same carrier, National Union, which was now refusing to provide Exxon with additional insured coverage under its umbrella policy. National Union argued that there was no coverage under the umbrella policy because the owner and the subcontractor had a service agreement in place that required the subcontractor to furnish primary insurance that designated the owner as an additional insured but did not extend to umbrella insurance. Exxon

disagreed, arguing that the terms of the service agreement were not incorporated into the umbrella policy and that the umbrella policy followed the terms of the primary policy—a policy under which Exxon was indisputably an additional insured

Relevant Contract and Policy Language

The umbrella policy defined "insured" to include:

"…any person or organization, other than the Named Insured, included as an additional insured under Scheduled Underlying Insurance, but not for broader coverage than would be afforded by such Scheduled Underlying Insurance."

The umbrella policy's definition of "Scheduled Underlying Insurance" included the primary policy, which, in turn, covered "any person or organization" to which the policyholder (the owner's subcontractor) is obligated by "any contract or agreement" to provide insurance "of the type provided by this policy."

Under the service agreement, the subcontractor agreed to carry and maintain insurance that included "its normal and customary Commercial General Liability insurance coverage and policy limits or at least $2,000,000, whichever is greater" and that designated the owner and its affiliates as "additional insureds."

The Ruling

The court held that the owner was an additional insured under the umbrella policy and that recovery under the umbrella policy was not limited by the payout limits of the primary policy, or by the terms of the service agreement.

In doing so, the court used a three-step analysis to determine whether the terms of the primary policy and the service agreement (extrinsic documents) were incorporated into the umbrella policy. The analysis is as follows:

1. Begin with the text of the policy at issue (the umbrella policy).
2. Refer to other contracts or extrinsic documents *only* if the policy clearly requires doing so.
3. Refer only to the terms of such extrinsic documents that were incorporated and no further.

The court held that the owner was an additional insured under the umbrella policy because the text of the umbrella policy—specifically its reference to the "Scheduled Underlying Insurance" in its definition of "insured"—required referring to the primary policy to determine the scope of the definition. And because the primary policy coverage extended to "any person or organization" to which the policyholder is obligated to provide insurance, the owner fits the definition by virtue of the policyholder's obligations under the services agreement. In other words, the court looked at the text of the policy (step 1) and determined that it had to refer to extrinsic documents because the definitions of the policy required it to do so (step 2). The court then incorporated the relevant terms of the primary policy and of the service agreement (step 3) and concluded that the owner was an additional insured under the umbrella policy.

However, the court refused to incorporate other terms of those same extrinsic documents into the umbrella policy because—unlike the additional insured term—those other terms were not clearly incorporated into the umbrella policy. The terms, if incorporated, could have limited the recovery available to the owner under the umbrella policy. The insurer argued for limiting recovery in two ways. First, it argued that any recovery under the umbrella policy was limited by the incorporation of the payout limits of the primary policy. Second, it argued that any recovery was limited by the terms of the service agreement.

As to the first argument, the court again focused on the umbrella's policy definition of "insured" (step 1). Specifically, the court focused on whether the definition's disclaimer of "broader coverage" in its reference to the primary policy required the incorporation of the primary policy's payout limits. The court explained that while it had to refer to the primary policy to determine what type of coverage was included under the umbrella policy (step 2), the umbrella policy did not incorporate the primary policy's payout limits (step 3). Thus, despite referring to the primary policy to determine the scope of coverage, the umbrella policy's payout was not limited by the primary policy terms.

The court relied on "conventional usage" of "coverage" and "umbrella insurance" to reach its conclusion. "Coverage," the court reasoned, contemplates the risks covered and not the amounts recoverable. And "umbrella insurance," the court explained, is triggered only by reaching the limits of other policies. In other words, limiting an umbrella policy payout to the limits of a primary policy would effectively render the umbrella policy meaningless. Because the parties did not include language that clearly required it, the court declined to reach such an absurd conclusion.

As to the second point, the insurer argued that the terms of the service agreement limited the owner's recovery under the umbrella policy. The insurer relied on the primary policy's definition of "additional insured," which includes organizations to which the policyholder is contractually obligated to furnish insurance "*of the type* provided by this policy." Because the service agreement only required *primary* insurance, the insurer argued, the owner is entitled to nothing more. In other words, the insurer argued that umbrella insurance is of a different type than primary insurance. And because the owner is only an additional insured by virtue of that service agreement, the language in the service agreement limited the amount of recovery available.

The court did not analyze whether the primary policy and the umbrella policy covered the same *type* of insurance. It was irrelevant, the court explained, because the terms of the service agreement were not incorporated into the umbrella policy. Thus, the court could not refer to the terms of the service agreement, an extrinsic document, to find that it limited recovery under the umbrella policy (and even if it could, the court explained, the agreement referred only to minimums and not maximums). To be clear, the language of the umbrella policy required referring to the service agreement and the primary policy to determine *who* was insured. But it did not require incorporating any other terms of that agreement. Incorporation by reference, the court explained, must be *clearly manifested.*

Takeaways

This ruling affirms the importance of carefully reviewing the language of insurance policies—both one's own and those of business partners—to confirm that the policy correctly covers the parties, risks, and amounts. Terms and definitions that cross-reference other terms or documents are especially important, as only a *clear manifestation* of incorporation will suffice. Lacking such clear manifestation, the court will not (and cannot)

refer to any terms, agreements, or contracts beyond the text of the insurance policy.

Relying on the principles restated by the Supreme Court of Texas, we recommend the following:

- Review policies closely to see that the language used clearly manifests which extrinsic terms, contracts, or agreements, if any, are to be incorporated by reference.
- Do not assume that the entirety of an extrinsic agreement will be incorporated by reference just because some of its terms are referred to in the policy.
- Always closely review the additional insured provisions in commercial contracts to ensure they provide strong risk transfer to the insurer.
- Review policies closely to see what rights business partners may have under them.
- Ask for and review any policies that business partners may obtain in order to understand the scope of coverage and ensure that it matches what the business partners agreed to provide.

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