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INSURANCE LAW

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I. INTRODUCTION

This has been a significant year for Texas insurance law. Texas state and federal courts, as well as the Fifth Circuit, have decided a large number of significant cases. Due to space limitations, the following heart-wrenching and mind-expanding topics have been omitted: the nature of insurance,[1] health insurance,[2] life insurance,[3] ERISA,[4] most

1. *See* Bekins Moving & Storage Co. v. Williams, 947 S.W.2d 568 (Tex. App.—Texarkana 1997, no writ) (discussing whether a mover's provision to pay for the "declared value" of property in case of loss or damage was insurance or merely an incidental contract of guaranty or suretyship).

2. *See* Boon-Chapman, Inc. v. Tomball Hosp. Auth., 941 S.W.2d 383, 384 (Tex. App.—Beaumont 1997, no writ) (addressing two conflicting coordination of benefits clauses under group insurance plans); McMullen v. Employees Retirement Sys. of Tex., 935 S.W.2d 189, 191 (Tex. App.—Austin 1996, writ denied) (upholding a decision by the Board of Trustees of the Employees Retirement System of Texas that denied an insured state employee coverage for his son's eyeglasses and therapy under a group insurance policy).

3. *See* Sever v. Massachusetts Mut. Life Ins. Co., 944 S.W.2d 486 (Tex. App.—Amarillo 1997, writ denied) (considering beneficiary changes); Cates v. Cincinnati Life Ins. Co., 947 S.W.2d 608 (Tex. App.—Texarkana 1997, n.w.h.) (addressing lapsed policy for non-payment of premiums); Board of Trustees of the Employees Retirement Sys. of Texas v. Benge, 942 S.W.2d 742 (Tex. App.—Austin 1997, writ denied) (denying accidental death benefit arising from travel).

4. *See* 29 U.S.C. § 1001 (1997). *See* Texas Pharmacy Ass'n v. Prudential Ins. Co. of Am., 105 F.3d 1035, 1042 (5th Cir. 1997) (discussing statutory framework for administering

of auto insurance,[5] the interaction between releases and direct actions,[6] and insurance subrogation.[7]

II. INSURER BAD FAITH

We begin with the law of bad faith. Strictly speaking, insurance bad faith is derivative upon substantive insurance law and adjustment practice. But, the exposure of insurers has, for some time, been *the* "hot" topic in insurance law. Hence, we begin with bad faith.

All of the law of insurance bad faith is divisible into three parts. First is the "*Stowers* Doctrine," taking its name from the venerable case, *G.A. Stowers Furniture Co. v. American Indemnity Co.*[8] This doctrine regulates the conduct of liability insurers when a plaintiff offers to settle a covered claim within policy limits, but the insurer fails to settle. According to *Stowers*, if an insured suffers a judgment in excess of policy limits, and if the liability insurer was negligent in failing to settle that case within those limits, when the insurer received a liquidated and unconditional demand to settle within those limits, then the insurer is liable upon a negligence theory for amounts in excess of the policy limits.[9] Usually, it is assumed that the insurer is liable in tort for the entire excess judgment. We defer the discussion of the "*Stowers* Doctrine" until Part VI.

The second category of insurance bad faith is statutory bad faith. Generally, this includes actions brought under article 21.21 of the "Unfair

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coverage for prescription drugs); Barhan v. RyRon, Inc., 121 F.3d 198, 201 (5th Cir. 1997) (discussing the rules of civil procedure for reviewing ERISA claims); *see also* Clyde A. Wilson Int'l Investigations, Inc. v. Travelers Ins. Co., 959 F. Supp. 756 (S.D. Tex. 1997) (discussing rescission of plan); Leavitt v. BASF Corp., 946 F. Supp. 488, 491 (S.D. Tex. 1996) (discussing disability benefits, the terms of the plan, and the terms of the employee brochure); Christenson v. Mutual Life Ins. Co., 950 F. Supp. 179 (N.D. Tex. 1996) (addressing preemption).

5. *See* John Deere Ins. Co. v. Trukin' U.S.A., 122 F.3d 270, 275 (5th Cir. 1997) (addressing who is an insured under a truck policy); United Servs. Auto. Ass'n v. Perry, 102 F.3d 144, 152 (5th Cir. 1996) (discussing whether the United States government may receive reimbursement under 10 U.S.C. § 1095(a)(1) (1990) for medical services provided to a military hospital following an auto accident); State Farm Mut. Auto Ins. Co. v. Kelly, 945 S.W.2d 905 (Tex. App.—Austin 1997, writ denied) (The policyholder had coverage for a car which had been stolen, unbeknownst to him, and which was thereafter seized by the police; He, therefore, lost to the insured.).

6. *See* Angus Chem. Co. v. IMC Fertilizer, Inc., 939 S.W.2d 138 (Tex. 1997). The release of an insured does not constitute the release of the insurer of that insured. Nevertheless, under Texas law, since the insurer cannot be held liable without a determination of the insured's liability, complete and total release of the insured bars any suit in Texas against the insurer. *See id.* at 139. "In a jurisdiction where a determination of the insured's liability is not a prerequisite to an action against the insurer, and release of the insured is not an impediment to such action, Texas law does not preclude [the tort victim] from suing [the] insurers [of the alleged tortfeasor]." *Id.*

7. *See* Texas Farmers Ins. Co. v. Seals, 948 S.W.2d 532, 533-34 (Tex. App.—Fort Worth 1997, n.w.h.) (holding that if a lawyer for an insured obtains a recovery that benefits the insurer, it will owe attorneys' fees under the "common fund" doctrine, which allows the recovery of reasonable attorneys' fees to someone who, at his own expense, prosecutes a lawsuit and creates a benefit for others, as well as for himself).

8. 15 S.W.2d 544 (Tex. Comm'n App. 1929, holding approved).

9. *See id.* at 547.

Competition and Unfair Practices" sections of the Insurance Code,[10] actions against insurers brought under the Texas Deceptive Trade Practices—Consumer Protection Act (DTPA),[11] actions seeking penalties under article 21.55 of the "Prompt Payment of Claims" section of the Insurance Code,[12] and other statutes.

Third, the rubric *insurer bad faith* applies to the common law tort created by the Texas Supreme Court in 1987, whereby an insured may sue a first-party insurer for breaching its duty of good faith and fair dealing to the insured.[13] In 1996, the Texas Supreme Court held that common law insurer bad faith does not extend to liability insurance.[14] This third form of bad faith is often referred to simply as "bad faith," and we begin with it.

A. Common Law Insurer Bad Faith

The Texas Supreme Court decided four significant common law bad faith cases during the Survey period. One case limits the scope of common law insurer bad faith.[15] Another case changes the standard for common law insurer bad faith.[16] In this case, four members of the Court exhibited substantial reservations about the common law tort.[17] In a third case, the Court ostensibly applied the new standard in a controversial situation, and four justices dissented.[18] In the final case, the Court applied the new standard in a workers' compensation case, which it considered a simple case.[19]

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10. *See* Tex. Ins. Code Ann. art. 21.21 (Vernon Supp. 1998).
11. *See* Tex. Bus. & Com. Code Ann. §§ 17.41 (Vernon 1997 & Supp. 1998).
12. *See* Tex. Ins. Code Ann. art. 21.55 (Vernon Supp. 1998).
13. *See* Aranda v. Insurance Co. of N. Am., 748 S.W.2d 210 (Tex. 1998); Arnold v. National County Mut. Fire Ins. Co., 725 S.W.2d 165 (Tex. 1987).
14. *See* Maryland Ins. Co. v. Head Indus. Coatings & Servs., Inc., 938 S.W.2d 27, 28 (Tex. 1996). First-party insurance refers to contracts pursuant to which insurers are exclusively obligated to insureds. Third-party insurance involves contracts where the insurer may, at some point, become obligated to some third-party. Liability insurance is the paradigm of third-party insurance, while property and health insurance are paradigms of first-party insurance. The status of life insurance is a little confusing, but it is usually thought of as first-party insurance. Insurance that indemnifies an insured for payments he makes to someone he has injured should be treated as first-party insurance, but most courts classify it as third-party insurance. Workers' compensation has something of the same problem, although *Aranda* classifies it a first-party insurance with both the insured business and its worker qualifying as insureds. *See Aranda*, 748 S.W.2d at 212. There is a real problem under the rule in *Head*. Under many forms of liability insurance (such as commercial general, homeowners, and auto), the insurer has a duty to defend its insured when the insured is sued on a covered claim. Theoretically, that should be classified as first-party insurance, but *Head* appears to classify it as third-party insurance. *See Head*, 938 S.W.2d at 28-29. *See also* Trinity Universal Ins. Co. v. Bleeker, 944 S.W.2d 672 (Tex. App.—Corpus Christi 1997), *aff'd in part, rev'd in part*, 1998 WL 169689 (Tex. Apr. 14, 1998) (applying *Head* to a case in which the allegation was a botched defense).
15. *See* Stewart Title Guar. Co. v. Aiello, 941 S.W.2d 68 (Tex. 1997).
16. *See* Universe Life Ins. Co. v. Giles, 950 S.W.2d 48 (Tex. 1997).
17. *See id.* at 58 (Hecht, J., concurring).
18. *See* State Farm Lloyds Ins. Co. v. Nicolau, 951 S.W.2d 444 (Tex. 1997).
19. *See* United States Fire Ins. Co. v. Williams, 955 S.W.2d 267 (Tex. 1997).

B. Scope Limited

In *Stewart Title Guaranty Co. v. Aiello*,[20] the issue was whether the duty of good faith and fair dealing, which a first-party insurer owes its insured, continues after the entry of an agreed judgment against the insurer in favor of the insured. The Texas Supreme Court held that it did not, because the only legal relationship left between the parties after the entry of the judgment was the relationship of judgment creditor to judgment debtor.[21]

In *Aiello*, the property owners, the Aiellos, discovered utility easements on their property that were not excepted from the title insurance policy. The Aiellos made a claim, but Stewart Title refused to pay. The Aiellos filed suit, and the case eventually settled. Under the terms of the settlement, the Aiellos received $319,000, plus all court costs. The agreed judgment provided that the costs were to include $100 per day from a specified date until all closing papers were signed and plaintiffs received their funds. After the trial court signed the agreed judgment, the Aiellos attempted to contact Stewart Title several times, but neither its attorneys nor its officers responded. A month and a half after the entry of the agreed judgment, the Aiellos caused a constable to arrive at the offices of the title insurer with a writ of execution. Only then did Stewart Title commence closing. Even after it delivered the liquidated sums specified in the agreed judgment, Stewart Title failed to pay post-judgment interest and the $100 per day delay damages.

Thereafter, the Aiellos sued Stewart Title again claiming breach of the insurer's duty of good faith and fair dealing to its insured, breach of the DTPA, breach of article 21.21 of the Insurance Code, and breach of contract. Stewart Title counterclaimed for breach of contract, claiming that the Aiellos had failed to deliver a deed as promised. (It seems that the Aiellos had a duty to provide Stewart Title with a deed to the property and that the Aiellos had refused to do this for a time. It further appears that the Aiellos' duty to produce the deed was not defeated by the title company's failure to pay delay damages.)

By the time of trial, all claims against Stewart Title had been eliminated except those for breach of contract and breach of the duty of good faith and fair dealing. At trial, the Aiellos prevailed upon both of their claims, but Stewart Title prevailed on its breach of contract counterclaim. Based on the jury's findings, the trial court awarded the Aiellos in excess of $324,000, including delay damages, pre- and post-judgment interest, stipulated contract damages, mental anguish damages, $200,000 in exemplary damages, and $80,000 in attorneys' fees. Stewart Title was awarded $10,000 for its breach of contract claim, but the court declined to award Stewart Title any attorneys' fees. The court of appeals affirmed the award to the Aiellos, although it reduced the attorneys' fees, and it af-

20. 941 S.W.2d at 96.
21. *See id.*

firmed the judgment for Stewart Title, awarding it attorneys' fees of $87,500.

The Texas Supreme Court held that the fundamental issue was whether Stewart Title owed the Aiellos a duty of good faith and fair dealing after the agreed judgment was entered.[22] The purpose underlying the duty of good faith and fair dealing is to police the relationship between insurer and insured, especially during the claims process, because of the disparity of bargaining power inherent in the relationship, and because the insurer has exclusive control over the claims process.[23] For these reasons, an insurer and an insured are said to have a "special relationship"[24] which generates higher-than-arms'-length duties for the insurer—duties which, however, do not rise to the level of fiduciary duties.[25] The tort of insurer bad faith should not, the Court implies, be extended beyond what its underlying purposes make sensible. Once an insured becomes a judgment creditor of an insurer, the claims process is over. The insurer no longer has exclusive control over the situation, and the insured has a variety of legal remedies available to it by which it can collect on its judgment, "including execution, garnishment, turnover, or attachment."[26]

The Aiellos relied upon *Aetna Casualty & Surety v. Marshall*[27] in claiming that Stewart Title acted in bad faith. A workers' compensation policy was at issue in *Marshall.* The insurer had settled with the injured worker, and the agreement required Aetna to pay the worker's past medical bills as well as his future medical bills. Aetna did not pay. In *Aiello*, the Supreme Court distinguished *Marshall.* First, the decision in *Marshall* turned upon the Insurance Code and not upon the common law duty of good faith and fair dealing.[28] Second, in *Marshall*, the insurer had agreed to continue acting as an insurer, so it breached not only the settlement agreement, but also its duties as an insurer.[29]

Therefore, the Aiellos' common law bad faith claim failed, even though their action on the contract embodied in the agreed judgment survived.[30] Consequently, judgment would not support an award of punitive damages or an award of mental anguish.[31] In addition, although a finding of bad faith conduct may constitute a violation of article 21.21 of the Insurance Code, that claim failed, so the Aiellos could not obtain treble damages under that statute.[32]

There is one more aspect of the *Aiello* decision that is important here: the issue of attorneys' fees. The trial court awarded the Aiellos $80,000 in

22. *See id.* at 71-72.
23. *See id.* at 71.
24. *See* Arnold v. National County Mut. Fire Ins. Co., 725 S.W.2d 165, 167 (Tex. 1987).
25. *See Aiello*, 941 S.W.2d at 71.
26. *Id.*
27. 724 S.W.2d 770 (Tex. 1987).
28. *See Aiello*, 941 S.W.2d at 71.
29. *See id.* at 71-72.
30. *See id.* at 74.
31. *See id.* at 72.
32. *See id.*

attorneys' fees, but the court of appeals reduced that amount to $65,823.25. The court of appeals reasoned that the Aiellos' attorney spent time studying and considering matters that had occurred before the entry of the agreed judgment.[33] The Texas Supreme Court reversed on this point and restored the trial court's judgment.[34] Its reasoning was quite simple. Although the Aiellos' lawyer had attended to pre-judgment events, he had not been retained pre-judgment.[35] Moreover, the matters he studied were substantially related to the basis of the Aiellos' claim.[36] Indeed, he could not understand the Aiellos' claim without understanding what happened before the entry of the agreed judgment. Under well-established authority, therefore, the Court held that the Aiellos were entitled to their full attorneys' fees.[37]

But what about the attorneys' fees awarded to Stewart Title? The Court held that when Stewart Title paid $319,000, it had substantially complied with the contract contained in the agreed judgment and was entitled to the conveyance of the insured property by the Aiellos.[38] Hence, the Aiellos breached the contract contained in the agreed judgment, and Stewart Title recovered the attorneys' fees of $87,500 awarded by the jury.[39]

It is important to note that *Aiello* holds that the "special relationship" that generates the tort of bad faith can be terminated by the entry of a final judgment.[40] There is no indication in *Aiello*, however, that the mere filing of a lawsuit terminates the "special relationship." Indeed, there is every reason to believe that the "special relationship" survives the mere filing of a lawsuit. Although the invocation of the jurisdiction of Texas courts levels the playing field somewhat, it does not alter the fundamental power relations, nor does it terminate the insurer's exclusive control over the claims process.[41]

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33. *See id.* at 73.
34. *See id.*
35. *See id.*
36. *See id.*
37. *See id.*; *see also* Stewart Title Guar. Co. v. Sterling, 822 S.W.2d 1, 10 (Tex. 1991).
38. *See Aiello*, 941 S.W.2d at 74.
39. *See id.* The Court's opinion is not clear regarding the status of the $100 per day delay damages. One would have thought that if Stewart Title were refusing to pay these damages, and if they were accruing on a daily basis, then a required performance by the Aiellos would have been excused. Apparently not. Thus, *Aiello* stands for the proposition that if a promisee has done almost everything he is supposed to do, the promisor had better perform or else risk having to pay attorneys' fees. The law does not invite strident confrontationalism.
40. *See id.* at 72.
41. Does *Aiello* imply that if the insured has a final judgment against the insurer, there can be no such thing as bad faith during the appellate process? Not quite. In *Aiello*, there was not only a final judgment; there was an agreed final judgment, which could not be appealed.

C. Elements of Common Law Insurer Bad Faith

On July 9, 1997, the Texas Supreme Court decided three cases involving the common law duty of good faith and fair dealing that runs from first-party insurers to their insureds. These cases, at least potentially, have enormous implications for Texas insurance jurisprudence and practice. Although the Court has suggested that the three cases are nothing more than technical revisions of the elements of insurer bad faith and that nothing substantive has been altered, this disclaimer is open to some doubt.

1. Universe Life Insurance Co. v. Giles

The leading case on this issue during the Survey period is *Universe Life Insurance Co. v. Giles*,[42] which dramatically changed at least the wording of the legal standard governing the duty of good faith and fair dealing. Justice Spector wrote for the four-person plurality. Justice Enoch wrote a concurring opinion, and Justice Hecht, writing for another group of four, also concurred in the Court's judgment, although he held at least one view contradictory to that of the plurality.

Before *Giles*, an insurer breached its duty of good faith and fair dealing if it (1) denied a claim without having any reasonable basis and (2) either knew or should have known that it had no reasonable basis to do so.[43] After *Giles* was decided on July 9, 1997, an insurer breaches the duty of good faith and fair dealing owed to its insured when it fails to attempt to effectuate a settlement with its insured after its liability to its insured has become reasonably clear.[44] The most important thing to notice about the new standard is that it is identical to the language of section 4(10)(a)(ii) of article 21.21 and section 2(b)(4) of article 21.21—2 of the Insurance Code.[45] This language is also central to the Model Act from which both articles 21.21 and 21.21—2 are derived. Thus, the Texas Supreme Court has brought the common law tort of insurer bad faith into conformity with statutory requirements in Texas and elsewhere.

According to Justice Spector, writing for the majority, the reasons for assimilating the elements of common law insurer bad faith into the language of section 4(10)(a)(ii) of article 21.21 are several and significant.[46] First, by recasting the elements of the tort of bad faith in positive terms,

42. 950 S.W.2d 48 (Tex. 1997).

43. *See* Transportation Ins. Co. v. Moriel, 879 S.W.2d 10, 18 (Tex. 1994); *see also Aranda*, 748 S.W.2d at 213. Interestingly, the plurality opinion did not cite Arnold v. Nat'l County Mut. Fire Ins. Co., 725 S.W.2d 165 (Tex. 1987), which established the tort of bad faith in Texas.

44. *See Giles*, 950 S.W.2d at 55-56. The new standard carries forward important features of the old standard. Most significantly, insurers continue to have a duty to investigate claims. The Court takes this to be implied in the duty to adjust claims promptly, fairly, and equitably. How, implies the Court, could this be done if the insurer does not investigate the claim promptly, fairly, and equitably? *See id.* at 56 n.5.

45. *See* Tex. Ins. Code Ann. art. 21.21, § 4(10)(a)(ii) (Vernon Supp. 1998); Tex. Ins. Code Ann. art. 21.21—2, § 2(b)(4) (Vernon Supp. 1998).

46. *See Giles*, 950 S.W.2d at 55.

its conflict with the no evidence standard of review is eliminated.[47] No one, implies Justice Spector, has had any difficulty with no evidence review under article 21.21, so that standard apparently works. Second, by assimilating common law insurer bad faith into article 21.21, the Court creates a unity between the common law and the statutory law.[48] This will make fact finding by the jury more straightforward and will simplify the jury charge. Finally, both the bench and the bar are familiar with the liability-has-become-reasonably-clear standard because it has been around in one form or another since 1973.[49]

The plurality also decided that issues of insurer bad faith should remain issues for the jury.[50] As far as Justice Spector is concerned, that should not even be a significant issue. According to her, the Texas Supreme Court has "long recognized that the Texas Constitution confers an exceptionally broad jury trial right upon litigants. And we have warned that courts must not lightly deprive our people of this right by taking an issue away from the jury."[51]

If the action of the Court in *Giles* is simple, its reasoning is not. The plurality based the change on an argument that appellate courts have had difficulty applying the no evidence standard of review.[52] No evidence appellate review requires that the reviewing court take as true all evidence favoring the judgment and disregard all evidence not favoring the judgment.[53] If a judgment says that an insurance company has acted in bad faith, then the reviewing court must disregard all evidence suggesting that the insurance company did not act in bad faith.[54] But the essence of defeating a common law bad faith case is for the insurer to show that there was a bona fide dispute. In other words, the insurer must show that there was at least one respectably arguable—though erroneous—reason on the basis of which it could deny coverage.[55] Given the logical structure of no evidence review, however, it is unclear how an appellate court can look at evidence on the basis of which a claim might rationally but erroneously be denied. Thus, it becomes virtually impossible for an appellate court ever to perform a no evidence review of a judgment finding an insurer liable on a common law tort theory of insurer bad faith. But, the Court implies, there should always be the possibility of no evidence appellate review for every tort.

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47. *See id.*
48. *See id.* at 56.
49. *See id.*; *see also* Vail v. Texas Farm Bureau Mut. Ins. Co., 754 S.W.2d 129, 132-33 (Tex. 1988).
50. *See Giles*, 950 S.W.2d at 56.
51. *Id.*
52. *See id.* at 51; *see also* Columbia Universal Life Ins. Co. v. Miles, 923 S.W.2d 803, 808-10 (Tex. App.—El Paso 1996, writ denied). The Texas Supreme Court had recognized this problem before in National Union Fire Ins. Co. v. Dominguez, 873 S.W.2d 373, 376 (Tex. 1994) and Lyons v. Miller's Cas. Ins. Co., 866 S.W.2d 597, 600 (Tex. 1993).
53. *See Giles*, 950 S.W.2d at 51.
54. *See id.*
55. *See id.* Of course, there can be no bad faith denial of a claim if the insurer correctly denied coverage. There could still be bad faith delay, however.

The plurality considered adopting a standard that has been widely used elsewhere and upon which there is substantial commentary: the "fairly debatable" standard.[56] According to this standard, when an insurer's denial of a claim is fairly debatable, then the insurer cannot be guilty of bad faith.[57] The plurality believes that the advantage of this standard is that the supreme courts of sixteen other states have adopted it.[58] Although the Court does not mention them, there are two other advantages. First, it is the well-known standard of review in some parts of administrative law. Second, there is a fair chance that Texas adopted this standard when the Court said that an insurance company could not be guilty of bad faith if its controversy with the insured was a "bona fide dispute."[59]

The plurality rejected the fairly debatable standard, however, on the ground that it did not eliminate the no evidence review problem.[60] Unfortunately, the Court does not elaborate upon this observation, and we have difficulty understanding the argument. Justice Spector's discussion of the fairly debatable standard is extremely important, however, because she believes that it is virtually synonymous with the no-reasonable-basis standard that is being replaced.[61] The reason that this observation is important is quite simple. The Texas Supreme Court regards the no-reasonable-basis standard and the liability-has-become-reasonably-clear standard as essentially the same standard. If the no-reasonable-basis standard is really identical to the fairly debatable standard, then it follows that the liability-has-become-reasonably-clear standard is also (at least substantially) identical to it. Thus, although the Court has rejected the wording of the fairly debatable standard, it has adopted its substance. That fact is good news. It can now be used in making arguments to courts and juries.

The Court's discussion of the law of bad faith is hardly concerned with the facts of the *Giles* case at all.[62] Indeed, although the justices differ sharply about the foundation and contours of this part of the common law, they completely agree about the facts of this case. Under virtually any standard, the entire Court implies, the insurer was guilty of bad faith.[63] Roughly speaking, the plaintiff was insured under a health policy. The insurer declined to pay hospital and physician charges on the ground of a pre-existing condition. Unfortunately, the insurer had misread the medical records to some degree, and the medical records were both erroneous and confusing. The plaintiff and her doctors wrote the insurer to get this problem straightened out, but the insurance company still refused to pay. It was this continued refusal to pay that constituted the insurer's

56. *See id.* at 55.
57. *See id.*
58. *See id.*
59. *See, e.g., Moriel*, 879 S.W.2d at 10.
60. *See Giles*, 950 S.W.2d at 55.
61. *See id.*
62. *See id.* at 56-57.
63. *See id.* at 57-58, 79.

bad faith, so the Court upheld the bad faith portion of the judgment.[64] At the same time, the Court found that no evidence supported an award of punitive damages.[65] Consequently, the Court "affirm[ed] the judgment of the court of appeals for bad faith and actual damages, reverse[d] the judgment for exemplary damages, and reform[ed] the judgment to award Giles only actual damages, prejudgment and postjudgment interest, and costs."[66]

From a historico-political standpoint, the real problem in *Giles* was whether to abolish the common law tort of insurer bad faith completely.[67] A number of factors suggested that it might be a good time to get rid of the tort. Judicial and political philosophies of the individual justices have changed substantially since 1987 when the tort was created. So-called "tort reform" has been flying high in the Texas political scene for several years. Plaintiffs attorneys are not very powerful, politically speaking, these days, and insurance companies absolutely hate the tort because it opens the door to punitive damage assessments against them.

Obviously, in *Giles*, the Court rejected any bold eradication of the tort, and the reasoning of the plurality—at least—tends to suggest that the tort will remain part of the jurisprudential canon, at least for a little while. Indeed, Justice Spector indicated that the tort of common law insurer bad faith serves a valuable purpose. In particular, it levels the playing field between insurer and insured, and thereby reduces the inequality inherent in the claims process.[68] Justice Spector also defends the existence of the tort on three different grounds. First, most states allow some recovery of extra-contractual damages from miscreant insurers, while only a very few have refused the remedy.[69] Second, even critics of the tort of bad faith admit that some fair means must be implemented to level the playing field between insurers and insureds in the claims process.[70] Third, she points out that Texas law now carefully regulates awards of both punitive damages and mental anguish.[71]

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64. *See id.* at 57.
65. *See id.*
66. *Id.*
67. *See id.* at 52-54.
68. *See id.* at 52.
69. *See id.*
70. *See id.*
71. *See id.* at 54. Bad faith activities by an insurer justify punitive damages only when they are accompanied by "malicious, intentional, fraudulent, or grossly negligent conduct," and then only when the "insurer was actually aware that its action[s] would probably result in extraordinary harm not ordinarily associated with breach of contract or bad faith denial of a claim—such as death, grievous physical injury, or financial ruin." *Moriel*, 879 S.W.2d at 18, 24. Justice Spector remarked that the "relatively stringent standard of proof [established in *Moriel*] ensures that punitive damages will ordinarily be available only in exceptional cases," although she rejects the idea that the recovery of punitive damages is "'virtually impossible,'" as one commentator has suggested. *Giles*, 950 S.W.2d at 79 n.3. Moreover, it is a general feature of tort cases that mental anguish damages may not be recovered unless plaintiffs introduce "direct evidence of the nature, duration, and severity of their mental anguish, thus establishing a substantial disruption in the plaintiffs' daily routine." Parkway Co. v. Woodruff, 901 S.W.2d 434, 444 (Tex. 1995). According to Justice Spector, when the rule in *Parkway* is applied to bad faith cases, "mental anguish damages

Justice Enoch joined in the judgment of the Court but wrote separately in order to accomplish three purposes.[72] First, he suggested that *Lyons* and *Dominguez* had already set forth sound appellate procedures for no evidence review of trial court judgments based upon the common law tort of insurer bad faith.[73] One cannot simply look at the insurer's reasons for denying a claim individually and ask for each of them whether it constitutes an arguable reason. Instead, an insured "must take *all* of the information available to the insurer and present some evidence that no reasonable insurer would have denied or delayed payment of [the] claim based on that information."[74] Second, Justice Enoch pointed out that the new standard does not substantively revise the old one.[75] He suggests that the new standard really is nothing but a "semantic recasting,"[76] as opposed to a substantive revision. Third, Justice Enoch suggests that the other two opinions do not come to grips with the animating issue before the Court:

> What really is going on here is that most members of the Court are unsettled about the efficacy of the tort of bad faith in the first instance. Indeed, cogent arguments have been made that the tort should be eliminated. The bottom line, however, is that the Court has concluded that under certain facts and as between certain contracting parties, the bad faith tort (or some variation of that cause of action) should continue to exist.[77]

Justice Hecht also wrote a concurring opinion; however, in some ways, it reads more like a dissent than a concurrence. This is true for three reasons. First, he would have defined insurance bad faith as "unscrupulous, arbitrary conduct. . . ."[78] According to him, insurance bad faith occurs when an insurer oppresses an insured.[79] If the Legislature had not acted, Justice Hecht would have been inclined to recast "arbitrary conduct" in terms of the fairly debatable standard. But, the Legislature had acted. It made the liability-has-become-reasonably-clear standard not only part of article 21.21—2, but also part of article 21.21.[80] Consequently, the judiciary should bring the common law sister-tort into conformity with the Legislature's conception of how insurance claims should be regulated. At the same time, Justice Hecht would not impose liability

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will be limited to those cases in which the denial or delay in payment of a claim has seriously disrupted the insured's life." *Giles*, 950 S.W.2d at 54. In 1997, the Texas Supreme Court further curtailed the availability of mental anguish damages. In City of Tyler v. Likes, 41 Tex. Sup. Ct. J. 174, 1997 WL 760284, at *6 (Dec. 11, 1997), the Court indicated that mental anguish damages were not available where the only other source of damage was injury to property.

72. *See Giles*, 950 S.W.2d at 79.
73. *See id.*
74. *Id.* at 81.
75. *See id.* at 81-82.
76. *Id.* at 80.
77. *Id.* at 79-80 (citation omitted).
78. *Id.* at 59.
79. *See id.*
80. *See id.* at 69.

if the insurer's conduct was a mere mistake or even a negligent error.[81] He does not want the common law tort of insurer bad faith to become insurer claims malpractice.[82] Justice Hecht would reserve the tort of bad faith for intentional or reckless conduct.[83]

Numerous problems beset the tort of insurer bad faith. Insurers must weed out fraudulent claims if insurance prices are to be controlled. Yet, insurers face allegations of bad faith if they attempt to ferret out fraudulent claims and guess wrong. Further, because of their vagueness, the elements of common law bad faith are subject to substantial manipulation. Manipulation is also made possible, Justice Hecht implies, because insurance claims involve a process as opposed to merely isolated events.[84] Wherever there is a process, of course, participants therein may engage in opportunistic behavior by means of which they set each other up for liability. Again, because of the vagueness of the elements, the tort of insurance bad faith is essentially unpredictable. In addition, it is intractable from an administrative (i.e., settlement) point of view. It therefore drives up the price of insurance, enriching the few while visiting the resulting costs upon the many.

If the courts are to sanction this situation, Justice Hecht implies, the deterrent value of the tort needs to be quite clear. Alas, it is not, and the courts have done little to clarify it. For example, ten years after its creation, it is still not clear whether comparative bad faith or reverse bad faith exist. Nevertheless, Justice Hecht kept the standard of fair debatability alive because he believes that the liability-has-become-reasonably-clear standard is met if and only if the fairly debatable standard is also met.[85]

Second, Justice Hecht expressed substantial doubts about the tort of bad faith. Fundamentally, Justice Hecht objects to the tort because its conceptual structure is vague, changing, and immature, making it impossible to use in analyzing facts and predicting results.[86] Therefore, "to be viable [the elements of the tort] must be made more definite."[87]

Third, Justice Hecht would make the core issue of insurance bad faith an issue of law and thereby get rid of juries.[88] He would do this for the

81. *See id.* at 64.

82. *See id.* Justice Hecht spends some time distinguishing common law insurer bad faith from the tort of negligence, as well he might. The liability-has-become-reasonably-clear standard sounds very much like negligence. Interestingly, Justice Spector's plurality opinion neither affirms nor confutes Justice Hecht's discourse contrasting insurer negligence and insurer bad faith. Does silence imply agreement or its opposite? Justice Spector's omission will lead to substantial confusion among practicing lawyers. During the Survey period, at least two courts have observed that Texas jurisprudence does not recognize the tort of insurer claims negligence. *See* Higginbotham v. State Farm Mut. Auto. Ins. Co., 103 F.3d 456, 460 (5th Cir. 1997); Jimenez v. State Farm Lloyds, 968 F. Supp. 330, 334 (W.D. Tex. 1997).

83. *See Giles*, 950 S.W.2d at 60-73.

84. *See id.* at 60-61.

85. *See id.* at 69-70. Thus, eight members of the Court link the new standard intimately to fair debatability.

86. *See id.* at 59.

87. *Id.*

88. *See id.* at 70.

following five reasons:

(1) Whether something has become reasonably clear is, in many contexts, considered an issue of law—for example, whether a contract is ambiguous, whether the intent to create a trust is reasonably clear, whether administrative regulations pass constitutional due process muster, and so on.[89]

(2) Other states have made the fairly debatable standard a legal, rather than factual, matter.[90]

(3) The core issue as to whether the insurer's liability for a claim has become reasonably clear is essentially a legal issue, even if threshold factual issues need to be decided by the jury.[91]

(4) As a matter of public policy, courts are better suited than juries to work out the contours and limits of the tort of bad faith.[92]

(5) Applying the liability-has-become-reasonably-clear standard involves defining insurers' legal duties. Defining legal duties has traditionally been reserved for the courts. Juries are fact finders. In a variety of contexts, "policy-laden" matters are considered legal issues to be resolved by courts.[93]

As is often the case with position papers that represent the views of several people, Justice Hecht's argument is not entirely clear. The essence of his position, however, seems to be this: an insurer's liability has become reasonably clear when an insurer has or should have investigated a claim, and there is no *arguable* reason why the claim should be denied. A reason for denying a claim is *arguable* when it is the type of reason about which a reasonably well informed and judicious person might hold three beliefs: (1) that the reason is legally respectable; (2) that the appropriate court might well adopt it; and (3) that courts should adopt it.[94] In other words, it is the type of reason that might very well prevail in the court system. Notice that an arguable reason is not necessarily one to which ordinarily prudent insurers are attracted or one that ordinarily prudent insurers would like to see adopted. A judgment that a reason is an arguable reason—as opposed to a meritless reason—involves rationally predicting what courts might well do. It does not involve predicting that a court *will* adopt some rule or make some holding. It involves predicting that a court will regard it as a legally respectable position, even if ultimately erroneous. The discussion as to whether a reason for denying a claim is a bona fide reason, or whether an insurer's reason for denying the claim is fairly debatable, is really a discussion about how courts think about the law. Surely, that is a legal matter for a court and not a factual

89. *See id.*
90. *See id.*
91. *See id.*
92. *See id.* at 70-71.
93. *See id.* at 71.
94. *See id.*

matter for a jury.[95]

Justice Hecht does not believe that changing the elements of the tort solves the no evidence review problem. If an insurer commits the tort of bad faith, it has committed the tort because something is missing. This is true regardless of how the elements of the tort are formulated. "Bad faith is an unscrupulousness, an arbitrariness, a taking of unfair advantage; it is not a bona fide disagreement."[96] When an insurer commits bad faith, he must lack an even arguable reason for denying the claim.[97] So long as bad faith essentially involves the absence of something, no evidence review is problematic, precisely because the appellate court must ignore all evidence inconsistent with the verdict. The only way to circumvent this problem is to make the existence of bad faith a legal matter to be decided by the courts. "Only if the liability standard is a legal one can bad faith be kept separate from coverage disputes."[98]

2. *State Farm Lloyds v. Nicolau*

Every member of the Court regarded *Giles* as an easy case, factually speaking, because there was unanimous agreement that the insurance company had acted arbitrarily and oppressively.[99] The focus of controversy in *Giles* was the law. *State Farm Lloyds v. Nicolau*[100] is completely different. It is very much about the facts. Also, in *Giles*, there was a plurality opinion, along with two separate concurring opinions. In *Nicolau*, there was a five-person majority opinion, again written by Justice Spector;[101] there was a concurring opinion written by Justice Enoch, who also joined in the majority opinion;[102] and there was a dissenting opinion written by Justice Hecht, in which three other justices joined.[103]

Nicolau grew out of a coverage dispute under a homeowners policy. The Nicolaus' Corpus Christi home sustained substantial foundation damage. The homeowners policy excluded losses caused by "'inherent vice,' or by 'settling, cracking, bulging, shrinkage, or expansion of foundations.'"[104] However, there was an exception to these exclusions: they did not apply to losses caused by "'[a]ccidental discharge, leakage or over-

95. Thus, insurer bad faith can never be simply negligence. Whether an insurer has an arguably meritorious reason for denying a claim is not determined by whether a reasonably prudent insurer would articulate that reason, but whether a court would find the insurance company's reasoning arguable. *See id.* at 70. It seems to us that the best argument in support of this position is the fact that causation in appellate malpractice is not treated as an issue of fact. *See* Millhouse v. Wiesenthal, 775 S.W.2d 626, 628 (Tex. 1989). Curiously, the Court does not deploy this argument.

96. *Giles*, 950 S.W.2d at 79.

97. *See id.*

98. *Id.*

99. *See id.* at 57, 79, 82.

100. 951 S.W.2d 444 (Tex. 1997).

101. *See id.* at 446-53. Justice Cornyn, who joined in the majority opinion, has now left the Court.

102. *See id.* at 453.

103. *See id.* at 453-64.

104. *Id.* at 446.

flow of water' from within a plumbing system."[105] In other words, foundation damage caused by water leaks would be covered.

The Nicolaus noticed cracking in 1984. They had piers installed in the front of the house, but they noticed more cracking in 1986 and 1988. In 1989, their foundation contractor became alarmed by what appeared to be considerable movement. They could not tell, however, whether the front was sinking or the back was rising. The contractor, therefore, tested the plumbing system and discovered plumbing leaks toward the front of the house. Thereupon, the Nicolaus filed a claim with State Farm.

State Farm hired Haag Engineering, which provided State Farm with a report suggesting that these water leaks could not have caused the foundation damage. The Nicolaus thereafter obtained a second report from another engineering firm. The report hypothesized that there were abnormally large amounts of moisture toward the back of the house and that the moisture could have moved along the plumbing pipes from the point of the leakage to the back of the house. State Farm provided this report to Haag, but Haag rejected its conclusions and even remarked that moisture toward the back of the house was not abnormally large. State Farm denied coverage.

The Nicolaus filed suit. The jury found that State Farm breached the insurance contract and awarded damages for past mental anguish, punitive damages, and attorneys' fees. The trial judge set aside the jury verdict with respect to bad faith and entered a judgment for breach of contract. The court of appeals affirmed the judgment of the trial court on contract damages, but it reversed the trial court's refusal to enter judgment on the bad faith components of the verdict. Consequently, the court of appeals reversed and rendered on the issues of bad faith and entered a judgment favoring the Nicolaus.

State Farm, the petitioner before the Texas Supreme Court, no longer disputed contract damages. It took issue only with the bad faith components of the judgment. State Farm's argument was simplicity itself.

Premise One: Haag Engineering is an internationally reputable engineering company with substantial experience in the relevant subject matter.

Premise Two: Haag investigated the loss and provided reports concluding that plumbing leaks did not cause this foundation damage.

Premise Three: If an insurer relies upon a report prepared by a reputable engineering firm which investigates the loss, then it cannot be guilty of bad faith.

Conclusion: State Farm was not guilty of bad faith.

The Texas Supreme Court rejected this simple argument because it rejected *Premise Three*.[106] The Court held that reliance upon an expert's report is not sufficient to immunize an insurer from bad faith; the reliance

105. *Id.*
106. *See id.* at 448.

itself must be reasonable.[107]

Justice Spector found that there was some evidence supporting the proposition that State Farm's reliance upon Haag's report was not reasonable.[108] Justice Spector detailed this evidence at some length:

(1) Haag did a lot of work for insurance companies. Indeed, one of its engineers testified "that eighty to ninety percent of his work consisted of investigations for insurance companies."[109]

(2) The same engineer testified that he knew that if he reported that plumbing leaks caused foundation damage, the insurer would have to pay.[110]

(3) Haag Engineering held the "general view that plumbing leaks are unlikely to cause foundation damage," and the State Farm adjuster knew that this was Haag's general view when he hired Haag.[111]

(4) An attorney for the policyholder testified upon cross-examination by the insurer that she had personal knowledge as to State Farm practices and the practices of the adjuster and "that it was a 'fair inference' that [the State Farm adjuster], whom she knew, hired Haag because he was aware that Haag, as a general rule, would not agree that a leak caused foundation damage."[112]

(5) The Nicolaus' foundation repair contractor testified that he had reviewed eighty or ninety Haag studies of local foundation damage and that Haag had reported only twice that plumbing leaks contributed to foundation movement.[113]

(6) Neither State Farm nor Haag conducted an adequate investigation of the Nicolau site.[114]

(7) The Nicolaus obtained two expert reports. Haag apparently did no investigation after the second report, but merely criticized the second report of the insureds' experts based upon what it already believed.[115]

(8) Several expert witnesses, including one for State Farm, itself, disputed Haag's assertion that soil moisture contents under relevant portions of the Nicolau home were not abnormally high.[116]

Thus, there was some evidence, concluded the majority, to support the jury's finding of insurer bad faith.[117] At the same time, there was no evidence to support the jury's finding of malice, and hence, its assessment

107. *See id.* at 448-50.
108. *See id.* Note that the Texas Supreme Court did not say that the reliance was unreasonable. It only said that there was some evidence to support the proposition that it was unreasonable.
109. *Id.* at 448.
110. *See id.*
111. *Id.* at 448-49.
112. *Id.* at 449.
113. *See id.*
114. *See id.*
115. *See id.*
116. *See id.* at 450.
117. *See id.*

of punitive damages.[118] Nor was there any evidence to support the jury's finding that State Farm had acted unconscionably.[119] Nevertheless, the Court held that the Nicolaus might be entitled to additional damages under the DTPA because the jury found that State Farm had knowingly engaged in unfair or deceptive acts or practices.[120] Upon this ground, the Court remanded the case to the court of appeals.[121]

The plurality opinion noted that this case was submitted in accordance with the old bad faith standard, whereby the insurer's duty is breached if the insured denies a claim with no reasonable basis.[122] Indeed, the opinion focused on evidence supporting the proposition that State Farm's reliance upon Haag's report was not reasonable.[123] The Court also held that there was sufficient evidence in the record to sustain a bad faith finding under the new *Giles* approach.[124] However, the Court wholly failed to identify the evidence required under *Giles*. It is unclear what evidence showed that State Farm knew (or should have known) that it was reasonably clear that the claim was covered.

Justice Enoch's concurring opinion appears to pick up on this fact. This very short opinion notes that "[t]he court in *Giles* announces a 'modification' to the bad faith standard of liability. While I adhere to my view that such a modification was neither warranted nor particularly meaningful, my view did not prevail."[125] Even so, the Court's opinion in this case reflects the continuing vitality of *Lyons* and *Dominguez*.[126]

Justice Hecht wrote a lengthy, stinging dissent.[127] Justices Gonzales and Owen joined in his entire opinion. Chief Justice Phillips joined in all of the dissent except the first and most combative part.

The first part of Justice Hecht's dissenting opinion is a strongly worded critique of the common law tort of insurer bad faith. Justice Hecht brands it "nebulous," "unpredictable," and outside the rule of law.[128]

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118. *See id.* at 450-51.
119. *See id.* at 451.
120. *See id.* at 453.
121. *See id.*
122. *See id.* at 448.
123. *See id.* at 448-50.
124. *See id.* at 448.
125. *Id.* at 453.
126. *See* National Union Fire Ins. Co. v. Dominguez, 873 S.W.2d 373 (Tex. 1994); Lyons v. Millers Cas. Ins. Co., 866 S.W.2d 597 (Tex. 1993).
127. *See Nicolau*, 951 S.W.2d at 453-64.
128. *Id.* at 453. Justice Hecht quotes Judge Alex Kozinski of the Ninth Circuit. *See id.*; Oki Am., Inc. v. Microtech Int'l, Inc., 872 F.2d 312 (9th Cir. 1989). Judge Kozinski described an analogous tort as "more resembling a brick thrown from a third story window than a rule of law." *Id.* at 315. Justice Hecht remarks that the "only flaw in Judge Kozinski's metaphor is the implication that bad faith liability is limited to hapless passersby. A more accurate comparison would be to an assault weapon fired into a crowd at random." *Nicolau*, 951 S.W.2d at 453. Justice Hecht notes that that is "the defendant's perspective." *Id.* From the plaintiffs perspective, Justice Hecht observes that

> bad faith is more like Hollywood television's Wheel of Fortune, or closer to home, like the Texas lottery: it costs almost nothing to play, you can play whenever you want, and if you win you hit the jackpot—tens, maybe hundreds, of thousands of dollars for the awful mental anguish that invariably

The rule of law, after all, requires that a citizen be able to determine what is legally required of him, and a well-run legal system should permit litigants to be able to predict probable outcomes.[129] Only then will the settlement dimension of the litigation process be rational. But, says Justice Hecht, common law insurance bad faith is inconsistent with this aspect of the rule of law.[130]

Justice Hecht does not favor abolishing the tort of bad faith, although he probably would not have created it. Instead, he would utilize contract law; correctly applied, it would permit the recovery of consequential damages.[131] However, Justice Hecht observed that Texas courts are "so far down the tort road it would be hard to retrace our steps."[132] Nevertheless, since Texas has the tort of bad faith, it is the responsibility of the Texas Supreme Court to infuse that tort with "the principles, logic and limits necessary for any rule of law."[133] It is the responsibility of the Court to create real, genuine, and meaningful standards for judging actual cases. It may not simply leave this work to juries because "[j]uries are entitled to be told what the law is."[134] Juries cannot fulfill their fact finding function in the absence of legal standards which are not sufficiently precise to be used in the practical world. Mere rationalizations about general standards will not help.[135] The rule of law requires rules of law.

Justice Hecht did not believe that there was any evidence to support the proposition that State Farm had acted in bad faith.[136] "By any fair measure, the disagreement over what caused the shifting in the foundation of the Nicolaus' house was serious and substantive."[137] Justice Hecht cites the following considerations in support of his view:

(1) The Nicolaus themselves, for the five years between 1984 and 1989, did not perform the kind of testing which was held against Haag.[138]

(2) Though Haag held the general view that plumbing leaks seldom if ever caused foundation damage, there was a published study by engineers at the University of Texas at Arlington "which concluded that localized

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> seems to accompany denial of even the smallest insurance claim, and millions in punitive damages. And like the lottery, bad faith liability is paid ultimately by the public. Insurance companies have not been authorized to print their own currency; the money to pay successful plaintiffs and their attorneys comes from policyholders, and they obtain the money to pay premiums from wages or sales. In effect, bad faith is a levy on everyone to benefit a few—what some have called a tort tax.

Id. at 453-54.

129. *See id.* at 454.
130. *See id.*
131. *See id.* at 455.
132. *Id.*
133. *Id.*
134. *Id.*
135. Chief Justice Phillips did not join Justice Hecht in his vivid general critique of the foundations of the tort of insurer bad faith. *See id.* at 453.
136. *See id.* at 461-65.
137. *Id.* at 456.
138. *See id.* at 457.

leaks in an unpressurized sewer line under a slab foundation rarely caused significant shifting."[139]

(3) The Haag Engineers studied reports prepared by the Nicolaus' experts, and they relied upon them.[140]

(4) After the plumbing leaks were repaired, the Nicolaus' house continued to shift and crack.[141]

(5) The leaks were quite a long way away from the area of the house that shifted.[142]

(6) The Haag engineers constructed an experiment costing more than $4,000 to test their hypothesis, and the experiment tended to support their conclusion. The Nicolaus' engineers created their own experiment, which tended to suggest that more water might escape than in the Haag experiment. Even in that experiment, not enough water leaked to vindicate the Nicolaus' position.[143]

(7) The testimony of the Nicolaus' lawyer, elicited on cross-examination, should be assigned no weight whatever, precisely because the witness was the Nicolaus' lawyer.[144]

Justice Hecht would have reversed the bad faith findings.[145] Even he, however, would not subscribe to State Farm's simple argument. State Farm's *Premise Three* was too simple. Justice Hecht agreed that an insurer's reliance must be reasonable; he simply thought that State Farm's reliance was reasonable.[146]

3. *United States Fire Insurance Co. v. Williams*

United States Fire Insurance Co. v. Williams[147] rounds out the 1997 bad faith trilogy. *Giles* revised the law on simple facts and found bad faith.[148] *Nicolau* applied the revised law to complicated facts and found bad faith.[149] In *Williams*, a united Court, writing a *per curiam* opinion, applied the revised law to simple facts and found no bad faith.[150] Significant Supreme Court decisions on insurer bad faith have tended to come in pairs, with one of the cases involving workers' compensation insurance.[151] *Williams* continues part of this pattern.

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139. *Id.* at 458.
140. *See id.* at 460.
141. *See id.* at 457.
142. *See id.*
143. *See id.* at 460.
144. *See id.* at 463. Is Justice Hecht suggesting that the testimony of very interested—even partisan—witnesses should be assigned no weight? Texas law appears to be otherwise. If Justice Hecht's conclusions were adopted, Texas law of evidence and trial procedure would be revolutionized.
145. *See id.*
146. *See id.*
147. 955 S.W.2d 267 (Tex. 1997).
148. *See supra* notes 42-98 and accompanying text.
149. *See supra* notes 99-146 and accompanying text.
150. *See Williams*, 955 S.W.2d at 269.
151. *See, e.g.*, Arnold v. Nat'l County Mut. Fire Ins. Co., 725 S.W.2d 165 (Tex. 1987) (uninsured motorist coverage) and Aranda v. Insurance Co. of N. Am., 748 S.W.2d 210

Nathaniel Williams died in 1992 in the course and scope of his employment. U.S. Fire provided Mr. Williams' employer with workers' compensation insurance and also provided accidental death benefits to the beneficiaries of any worker killed while in the course and scope of his employment. The employer's report to the insurance company indicated that Mr. Williams' spouse was named "Lessie." Subsequently, another woman, Essie Williams, claimed the same benefits.

U.S. Fire took recorded statements from both Essie and Lessie. The facts were not really at issue. Essie and Nathaniel married in 1957 and separated in 1978 but never divorced, although though they intended to do so. At all times since 1978, Nathaniel lived with Lessie. U.S. Fire applied Workers' Compensation Commission Rule 132.3[152] and "determined that Essie was deemed to have abandoned Nathaniel."[153] In relevant part, Rule 132.3 provides that if a surviving spouse has abandoned the employee, without good cause, for more than a year immediately before the death of the employee, that surviving spouse shall be ineligible to receive death benefits.[154] The surviving spouse is deemed to have abandoned the employee "if the surviving spouse and the employee [have] not been living in the same household for more than one year preceding the employee's death."[155] There are several exceptions to this deemer-clause, although none of the specific clauses is relevant. There is a catch-all exception clause, however, which provides that the surviving spouse is not deemed to have abandoned the employee if they are living apart for some reason and "it is established that their separation is not due to the pending breakup of the marriage."[156] There was no dispute that Essie and Nathaniel had not lived together during the year preceding Nathaniel's death. None of the exceptions to the deemer-clause was relevant. Consequently, U.S. Fire denied Essie's claim and paid benefits to Lessie.

Nearly a year later, Essie filed a claim with the Workers' Compensation Commission. The Benefits Review Conference officer determined that Essie was not entitled to benefits. Subsequently, a contested hearing was held. The hearing officer concurred. Thereafter, Essie appealed to the Appeals Panel, which is the highest administrative level. The Panel reversed the decision of the contested case hearing officer in a split decision. The dissenting member of the Panel agreed with U.S. Fire, as had the benefits review officer and the contested case hearing officer.

Thereafter, Essie sued U.S. Fire for breach of the duty of good faith and fair dealing, violations of the DTPA, and violations of the Texas In-

(Tex. 1988); Lyons v. Millers Cas. Ins. Co. of Tex., 866 S.W.2d 597 (Tex. 1993) (non-workers' compensation case) and National Union Fire Ins. Co. v. Dominguez, 873 S.W.2d 373 (Tex. 1994).

152. 28 TEX. ADMIN. CODE § 132.3 (West 1997).

153. *Williams*, 955 S.W.2d at 268.

154. *See* 28 TEX. ADMIN. CODE § 132.3.

155. *Id.*

156. *Id.*

surance Code, as well as for intentional infliction of emotional distress. The trial court granted U.S. Fire a summary judgment as to all counts. The court of appeals affirmed summary judgment in part but reversed the judgment as to Essie's claim under the law of insurer bad faith. Thus, Essie had prevailed on her compensation claim at the administrative level. It was not, however, an issue in the trial court. The trial court poured her out on the common law and statutory bad faith claims. The court of appeals agreed as to the statutory bad faith claims (as well as the intentional infliction claim) but reinstated the common law bad faith claim and ordered the district court to put it to trial.

The matter then came before the Texas Supreme Court. Since the summary judgment was at issue, the Court was bound to resolve all doubt against U.S. Fire and to view the evidence most favorable to Essie. The issue before the Court was quite simple: had U.S. Fire established as a matter of law that it did not breach the duty of good faith and fair dealing that every first-party insurer owes its insured?[157]

Erroneous denials do not automatically amount to bad faith. Bona fide disputes about an insurer's liability under the insurance policy do not rise to the level of bad faith. Therefore, U.S. Fire was entitled to a summary judgment if the "summary judgment proof established that there was no more than a good faith dispute regarding the applicability of Rule 132.3."[158] At worst, what happened in this case was that the insurance company misinterpreted Rule 132.3. The Court held, however, that "[a]n insurer cannot be liable for bad faith simply because it misinterprets a rule."[159] If the insurer had an arguable interpretation of the rule, even if it was wrong, then it could not be guilty of bad faith. The Court found that "U.S. Fire's interpretation of the rule was at least arguable; three out of the five Commission reviewing officers shared that interpretation."[160] Therefore, U.S. Fire won, and the Court rendered a take-nothing judgment in its favor.[161]

As sound as the result in this case is, the logic of the case is troubling. Does it imply that if a respectable quasi-judicial authority supports the insurance company's position, then the insurance company cannot be liable for bad faith? What if the insurer has received authoritative legal advice from acknowledged coverage experts? *Williams* tends to suggest such facts may completely defeat a bad faith case. Of course, the decisions of quasi-judicial officers must not involve any irregularity, and the coverage opinion letter must not be subject to criticisms analogous to those leveled at Haag Engineering. Nevertheless, this is a relatively easy standard from a defendant's point of view.[162]

157. *See Williams*, 955 S.W.2d at 268.
158. *Id.*
159. *Id.* at 269.
160. *Id.*
161. *See id.*
162. Courts of appeals around the state and the Fifth Circuit have decided several cases involving the common law tort of insurer bad faith. See Higginbotham v. State Farm Mut.

D. Statutory Bad Faith

The Texas Supreme Court has not decided any cases involving either the Insurance Code or the Deceptive Trade Practices Act during the Survey period. Intermediate appellate courts, however, have rendered a number of such decisions.[163]

1. Article 21.21.

Yazdi v. Republic Insurance Co.[164] was a theft-of-contents case arising under a homeowners policy. The insured-plaintiff-appellant sought recovery for the theft of oriental rugs, a gold Rolex watch, a stereo, and a leather jacket. The insurer, which had issued a $50,000 homeowners policy, had its doubts and denied coverage. The insurer based its doubts upon the following facts: the insured had never purchased insurance before, although he claimed to have owned the items for a number of years; the insurance policy was about to expire; the insured had attempted to increase the value of the insurance; the insured had not attempted to purchase new insurance; the insured was unable to produce receipts for the purchase of the items claimed; and the insured's account of relevant facts was inconsistent on several points. Republic denied the insured's claim upon the ground of fraud. The insured sued for breach of contract, negligent claims handling, breach of the duty of good faith and fair dealing, violations of the Texas Insurance Code, and violations of the Texas Deceptive Trade Practices Act. Republic claimed that the insurance policy was void because of a provision prohibiting concealment of fraud and countersued for attorneys' fees under both the DTPA and the Insurance Code. The jury was unanimous in its verdict for the insurance company on the fraud defense, and it valued the insurer's attorneys' fees and costs at $35,000.

The significant issue for insurance law upon appeal was the award of attorneys' fees to the insurer. The appellate court affirmed the award on the ground that the trial court had not acted arbitrarily or unreasonably in deciding that the insured's claim was groundless and brought in bad faith.[165] The standard of review was abuse of discretion.[166] Hence, the trial court's determination that a party's claim was groundless and brought in bad faith would be reversed only if the trial court's decision

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Auto. Ins. Co., 103 F.3d 456 (5th Cir. 1997), where the property insurer was not guilty of bad faith when it had some reason to believe that the insured may have stolen his own car, even when it was ultimately found that the insured's company was wrong. *See id.* at 459-60. The overriding question in this case was, what constitutes bias (a bad thing) as opposed to preliminary hypothesis (an absolutely necessary thing)? *Higginbotham* also held that "Texas law does not recognize a cause of action for negligent claims handling." *Id.* at 460.

163. In one such decision, a court of appeals decided that recovery under the DTPA and recovery under the Insurance Code do not constitute a double recovery. *See* Bekins Moving & Storage Co. v. Williams, 947 S.W.2d 568, 584 (Tex. App.—Texarkana 1997, n.w.h.).

164. 935 S.W.2d 875 (Tex. App.—San Antonio 1996, writ denied).

165. *See id.* at 879-80.

166. *See id.* at 879.

was arbitrary and capricious. The specific test for whether a claim is groundless and in bad faith is "whether the totality of the tendered evidence demonstrates an arguable basis in fact and law for the consumer's claim."[167]

The court of appeals found that the record supported the trial judge.[168] This was true for several reasons. First, the insured's claim fit the pattern of questionable claims encountered by insurance company investigators in the past, e.g., it occurred shortly before the policy expired; the insured could not produce receipts; the policy had excessive coverage limits; and the insured tried to hustle the insurance company to move quickly. Second, there were many inconsistencies in the insured's story. Third, various facts about the insured indicated that he had a history of deceit; for example, he consistently used different spellings of his name, different birthdays, different addresses, and different social security numbers. Fourth, he had filed at least two previous personal injury claims. Fifth, he had deportation proceedings pending against him, and, sixth, he had been charged with petty theft several times.[169] In sum, the trial court had sized up the insured as a scam-artist, and the court of appeals thought the evidence supported that view. Consequently, the court of appeals affirmed the award of attorneys' fees.[170]

In *Keightley v. Republic Insurance Co.*,[171] National County Mutual Fire Insurance Company issued a liability insurance policy to Morish. Due to National County's financial difficulties, Republic Insurance Company, who would reinsure the National County policy, began to administer the reinsured policies. Morish was sued by the Keightleys, who recovered a judgment against Morish in excess of the limits of the National County policy. Thereafter, Morish sued Republic on causes of action allegedly arising from Republic's refusal to settle within policy limits. It was undisputed that Republic took over the duties and responsibilities with regard to settlement authority and claims adjusting on the lawsuit. Republic argued that Morish could not sue him based upon an article 21.21 violation because Morish was not a party to the reinsurance contract between Re-

167. Splettstosser v. Myer, 779 S.W.2d 806, 808 (Tex. 1989); *see* Donwerth v. Preston II Chrysler-Dodge, Inc., 775 S.W.2d 634, 637 (Tex. 1989).

168. *See Yazdi*, 935 S.W.2d at 880.

169. *See id.* at 879.

170. *See id.* at 880.

171. 946 S.W.2d 124 (Tex. App.—Austin 1997, no writ). In an unpublished opinion dated July 24, 1997, the court withdrew its judgment. *See* Keightley v. Republic Ins. Co., No.03-96-00073-CV (Tex. App.—Austin July 24, 1997) (not designated for publication), 1997 WL 420787. The parties filed a joint motion requesting that action. They had settled the case. The court still reversed the judgment of the trial court, and it still remanded the cause to the trial court. The purpose of the remand, however, was to enter judgment in accordance with the settlement agreement of the parties. *See id.* at *1. The original opinion is still precedentil authority. It was published; the decision withdrawing the original opinion was not published, and the action taken by the court of appeals remained unchanged. The decision of the trial court was reversed. (At this point, it is well to remember that orders, judgments, and decisions not designated for publication under Rule 90 of the Texas Rules of Appellate Procedure may not be cited as authority.) One suspects that Rule 90 will not be universally followed when it comes to *Keightley*.

public and National County. The court of appeals disagreed, noting that article 21.21, section 16(a) states the requisite elements for the statutory cause of action: (1) actual damages, (2) sustained by any person, and (3) caused by others engaging in an act or practice declared unfair or deceptive in section 4 of the article.[172] The court noted that privity of contract is not a stated element and held that the statutory elements are exclusive and should not be judicially altered by adding to them the element of contractual privity.[173]

In *Canutillo Independent School District v. National Union Fire Insurance Co.*,[174] a school district was sued based on the molestation of several elementary school students. The fact of the molestation was not in dispute. When the school district turned to its insurance company for coverage and defense under a School Leader's Errors and Omissions Act, the insurer disclaimed coverage based upon an exclusion in the policy for criminal conduct and assault. The court of appeals upheld the validity of this exclusion.[175] In addition to this substantive coverage claim, the school district alleged that the insurer violated section 21.21 of the Insurance Code by making misleading statements concerning the scope of coverage available under the policy. The letter from the insurance company to the insured stated that the policy covered, among other things, "alleged violations of federal or state constitutional civil rights."[176] One of the claims against the school district involved Title IX claims based upon the sexual molestation. The court held that this description in the policy could not constitute a misrepresentation as a matter of law.[177] Specifically, the statement did not indicate that all civil rights claims would be covered regardless of applicable exclusions.[178]

2. *DTPA*

The only significant DTPA-insurer bad faith case decided during the Survey period involved a liability policy.[179] The DTPA claim came up in the context of a *Stowers* problem.[180] We, therefore, defer the discussion

172. *See Keightley*, 946 S.W.2d at 127-28.

173. *See id.* at 128. Another case describing the scope of article 21.21 is Cypress Fairbanks Med. Ctr., Inc. v. Pan-American Life Ins. Co., 110 F.3d 280 (5th Cir. 1991). The issue in *Cypress* was whether ERISA pre-empted a hospital's article 21.21 claims against an insurance company. The Fifth Circuit held that the hospital's claims were not pre-empted. *See id.* at 282. Similarly, ERISA may not always pre-empt actions under § 21.21—6, which prohibits discrimination in the provision of insurance. *See* Christenson v. Mutual Life Ins. Co., 950 F. Supp. 179, 182-83 (N.D. Tex. 1996) (possibly unlawful discrimination).

174. 99 F.3d 695 (5th Cir. 1996); *see infra* Section V.G.

175. *See Canutillo*, 99 F.3d at 708-09.

176. *Id.* at 709.

177. *See id.*

178. *See id.*

179. *See* Trinity Universal Ins. Co. v. Bleeker, 944 S.W.2d 672 (Tex. App.—Corpus Christi 1997), *aff'd in part, ref'd in part*, 1998 WL 169689 (Tex. Apr. 14, 1998). For a case touching on the DTPA liability of insurers, see Bekins Moving & Storage Co. v. Williams, 947 S.W.2d 568 (Tex. App.—Texarkana 1997, n.w.h.) (holding that recovery for both breach of contract and a DTPA claim is a double recovery).

180. *See infra* notes 472-86 and accompanying text.

of this case until Section VI of this Article.

In *Keightley*,[181] a DTPA issue also arose. In addition to article 21.21 violations, Morish sued the reinsurer for alleged DTPA violations. On this cause of action, the court of appeals sided with Republic. Specifically, the court noted that a statutory cause of action under the DTPA "is available only to 'consumers,' a word defined as a person who acquires goods or services 'by purchase or lease.'"[182] The court held that Morish did not purchase or lease goods or services from Republic.[183] Further, there was no indication in the reinsurance contract between National County (Morish's insurer) and Republic (National County's reinsurer) that Morish was intended to be a beneficiary under the contract.[184] Accordingly, the court held that Morish did not have standing to assert a DTPA action.[185]

3. *Article 21.55*

Higginbotham v. State Farm Mutual Automobile Insurance Co.[186] is a significant case applying article 21.55 of the Insurance Code. *Higginbotham* was an auto theft case in which the insured recovered contract damages, but not extra-contractual damages. Article 21.55 provides for an eighteen percent penalty "[i]f an insurer delays payment of a claim following its receipt of all items, statements, and forms reasonably requested and required . . . for more than sixty days,"[187] unless certain other conditions, not relevant here, apply. The Fifth Circuit found that the insured had made a claim for proceeds on June 9, 1993. The claim was denied, and a payment was therefore not made within the prescribed period of time.[188] The issue before the court was whether non-payment after claim denial constituted a delay for the purposes of article 21.55. The court held that it did: "[a] wrongful rejection of a claim may be considered a delay in payment for the purposes of the 60-day rule and statutory damages."[189] The insurer asked the panel to reconsider its opinion or, in the alternative, to certify the question to the Texas Supreme Court, but the panel declined to do either.[190]

Teate v. Mutual Life Insurance Co. of New York[191] is another 21.55 case. The insurer denied life insurance benefits on the ground of material misrepresentation in the application process. The jury found in favor of the insured, and the district court assessed the eighteen percent penalty

181. *Keightley*, 946 S.W.2d at 128; *see supra* notes 171-73 and accompanying text.
182. *Keightley*, 946 S.W.2d at 128.
183. *See id.*
184. *See id.*
185. *See id.*
186. 103 F.3d 456 (5th Cir. 1997); *see supra* note 82.
187. TEX. INS. CODE ANN. art. 21.55 § 3(f) (Vernon Supp. 1998).
188. *See Higginbotham*, 103 F.3d at 461.
189. *Id.*
190. *See id.* at 462.
191. 965 F. Supp. 891 (E.D. Tex. 1997).

under article 21.55. The court expressly relied upon *Higginbotham*.[192] The issue before the court was whether the eighteen percent per annum penalty should be compounded annually from the date of the denial of the claim.[193] The insurance company suggested that it should not be compounded because the statute did not call for that. The district court sided with the insurer, noting that the statute says absolutely nothing about compounding the penalty.[194] "Consequently, the court must calculate the statutory damages by applying the 18 percent per annum rate as simple interest."[195] Article 5069-1.03 (applicable in this case but since repealed) provides for pre-judgment interest to accrue at the rate of six percent per annum with no compounding.[196] The district court held that the pre-judgment interest statute does not apply to the eighteen percent penalty provided under article 21.55.[197]

Teate also contains significant law on the calculation of attorneys' fees under article 21.55.[198] The parties had stipulated that a one-third contingency fee was reasonable. The problem was: How do you calculate the one-third? If the courts simply multiply the award by one-third and add one-third to the award, then, since the fee contract calls for the attorney to get one-third of the total, the plaintiff will not be made whole. More exacting mathematics is apparently required. The district court researched Texas law and reported that at least one court of appeals has held that "the trial court must calculate the total amount of the recovery so that after the attorney's percentage is allocated to attorney's fees, the remaining sum equals the amount of the claim plus eighteen percent per annum."[199] This issue—the question of how to calculate the amount of contingency fees—is one of the truly burning issues in the Texas law of civil procedure and insurance. Most personal injuries, settlements, and recoveries are funded by insurance, and when fee shifting statutes are involved, insurance companies have to pay more on judgments when the *Teate—Barclay* approach is utilized.

III. PROPERTY INSURANCE

Significant property insurance cases decided under Texas law during the Survey period have involved arson, plumbing related foundation damage, the appraisal procedure, interpleader procedure, and the debris removal clause.

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192. *See id.* at 893.

193. *See id.* at 893-94.

194. *See id.* at 894.

195. *Id.*

196. *See* TEX. REV. CIV. STAT. ANN. art. 5069-1.03 (now codified as TEX. FIN. CODE ANN. § 302.002 (Vernon Supp. 1998)).

197. *See Teate*, 965 F. Supp. at 893-94.

198. *See id.* at 894.

199. Mid-Century Ins. Co. v. Barclay, 880 S.W.2d 807, 812-13 (Tex. App.—Austin 1994, writ denied).

A. ARSON

Homeowners insurance policies, like other property insurance policies, do not contain an exclusion for arson. Instead, it is universally recognized that policyholders may not recover if they deliberately burn their own property. After all, it is an honored common law maxim that *no person shall profit from his own wrong doing.*[200] At the same time, many jurisdictions, including Texas, have developed an "innocent spouse rule," whereby if one spouse burns the property, the other spouse may recover.[201]

Chubb Lloyds Insurance Co. of Texas v. Kizer[202] concerned the innocent spouse rule. In 1986, the Texas Supreme Court decided that if a husband intentionally destroyed the separate property of his wife, the wife might recover.[203] The issue in *Kizer* was whether an innocent spouse might recover insurance proceeds when her spouse deliberately destroyed community property.

The Kizers, a married couple, owned a home and its contents. A fire destroyed the property, and the Kizers filed a claim. Chubb refused to pay upon the ground of arson, and the Kizers sued. A jury determined that Mr. Kizer deliberately set the fire, but Mrs. Kizer did not. The Fort Worth Court of Appeals held that the judgment entered upon the jury verdict was not against the great weight of the evidence for the following reasons: Mr. Kizer was the last to leave the house before it burned; Mrs. Kizer took her dog to work that morning, which she often did; only Mr. and Mrs. Kizer, plus their son, had keys to the house; the house was locked up when the fire department got there; the Kizers were experiencing financial difficulty; they had engaged in some financial maneuvers involving property transfers to protect their assets; and various members of the fire department testified to physical evidence which supported the idea that the fire had an incendiary origin.[204]

Whether Mrs. Kizer was entitled to recover under the policy was a more difficult issue. The trial court had awarded her $87,000 for one-half of the contents coverage[205] and $34,800 for attorneys' fees, plus pre-judg-

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200. There is no arson exclusion. There is no deliberate-destruction-of-property-by-the-insured exclusion. So how are these implied? Courts are usually unsympathetic to implied exclusions. One standard argument is that intentional destruction, such as arson, is not really a *risk*, and hence, is not covered. This is, of course, conceptual legerdemain. Any piece of property faces the risk of being destroyed by its owner. Or it may be better simply to say that intentional destruction is an implied exclusion made necessary by some types of policies.

201. *See* ROBERT H. JERRY, II, UNDERSTANDING INSURANCE LAW, § 63A, 385-86 (2d ed. 1997).

202. 943 S.W.2d 946 (Tex. App.—Fort Worth 1997, writ denied).

203. *See* Kulubis v. Texas Farm Bureau Underwriters Ins. Co., 706 S.W.2d 953, 955 (Tex. 1986).

204. *See Kizer*, 943 S.W.2d at 950.

205. The opinion is rather confusing regarding whether Mrs. Kizer had an interest in the house as well as the contents. The facts are roughly as follows. Mrs. Kizer had executed a conveyance of her interest in the house to her husband. Arguably, therefore, she had no interest in the house. In the court of appeals, Mrs. Kizer suggested that the convey-

ment interest. The court of appeals reversed the judgment and denied Mrs. Kizer any recovery.[206] The problem, of course, was that any payment to Mrs. Kizer for her share of the community property would itself be community property so that the payment would, in part, be the property of the person who intentionally destroyed the property. This has troubled courts deeply, and two Fifth Circuit decisions have not allowed this result.[207] In the only state court decision that has permitted such recovery of community property which had been destroyed, the community property was converted into separate property by a divorce.[208] So, absent the division of the community estate, Mrs. Kizer could not recover for her community property without benefiting her husband, an adjudged arsonist. The court of appeals acknowledged that the result appeared harsh, but pointed out that "preventing a wrongdoer from benefitting from his wrongdoing must be an overriding policy concern."[209]

B. Plumbing Related Foundation Damage

In *Sharp v. State Farm Fire & Casualty Insurance Co.*,[210] the Sharps filed a claim with State Farm for structural and cosmetic damage to their house. That damage resulted from a shifting foundation, which was in turn caused by a plumbing leak beneath the house. State Farm denied the claim.

The Sharps' homeowners policy was divided into two sections. Coverage A covered damage to the dwelling, while Coverage B covered damage to personal property. Coverage A provided "all risk" coverage. This means that any damage to a dwelling is covered, unless it is specifically excluded. The insuring agreement in Coverage A was subject to Exclusion *h*, and State Farm argued that Exclusion *h* precluded coverage for the Sharps' claim. That exclusion eliminated coverage for losses caused by "settling, cracking, bulging, shrinkage, or expansion of foundations, walls, floors, ceilings, roof structures, walks, drives, curbs, fences, retaining walls or swimming pools."[211] The exclusion, however, was subject to an exception. There was coverage for an "ensuing loss caused by . . . water damage . . . if the loss would otherwise be covered under [the] policy."[212] The Fifth Circuit held that Exclusion *h* eliminated coverage on its face.[213]

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ance was invalid, for various reasons, so she owned fractional interests in the house. Had her move been successful, the rule in *Kulubis* would have applied. The court of appeals refused this gambit, however, upon the ground that the point had not been preserved for review. *See id.* at 952-53.

206. *See id.* at 953.

207. *See* Webster v. State Farm Fire & Cas. Co., 953 F.2d 222 (5th Cir. 1992); Norman v. State Farm Fire & Cas. Co., 804 F.2d 1365 (5th Cir. 1986).

208. *See* Travelers Co. v. Wolfe, 838 S.W.2d 708 (Tex. App.—Amarillo 1992, no writ).

209. *Kizer*, 943 S.W.2d at 952.

210. 115 F.3d 1258 (5th Cir. 1997).

211. *Id.* at 1261.

212. *Id.*

213. *See id.*

There was another question, however. Coverage B covered personal property for losses caused by certain named perils. Accidental discharges and leaks of water from within the plumbing system were a named peril. Moreover, Coverage B specifically stated that Exclusion *h* would not apply to a loss within the accidental discharge and leakage peril. The Sharps took the position that the language of Coverage B overrode Exclusion *h* when the cause of the loss was an accidental plumbing leak. This position was the crux of the *Sharp* case.

The Fifth Circuit rejected the proposition that the text specifically included in Coverage B, "[a coverage] which applies only to personal property, may be imported into Coverage A, which applies to the dwelling or house, in order to create coverage for a loss that does not involve personal property damage."[214] Indeed, the judge regarded the Sharps' position as nonsense "and a rejection of the obvious structure of the policy. . . ."[215]

The Sharps further argued that there would have been coverage under the previous state-approved standard homeowners policy and that the committee charged with revising that form did not have the authority to restrict their coverage in any significant way. Moreover, the Sharps suggested that the Texas Department of Insurance had indicated that the accidental discharge language was ambiguous.[216] The Fifth Circuit rejected the extrinsic evidence upon the ground that the policy was not ambiguous.[217] It rejected the observations of the Department of Insurance because they were not precisely relevant to the language of Coverage B pertaining to Exclusion *h* and because the court did not think that the Department's remarks had binding legal significance.[218]

The Texas Department of Insurance was not at all pleased with the *Sharp* decision. On August 22, 1997, the Department issued Commissioner's Bulletin Number B-0032-97,[219] which addressed all property and casualty insurance companies. This four-page document, which bears the signature of Elton Bomer, the Commissioner of Insurance, is severely critical of *Sharp*, and it warns insurers not to rely upon the case:

> Because decisions of the federal circuit courts of appeals and federal district courts with respect to issues of state law are not binding on Texas state courts, the Department expects insurers to pay claims in accordance with the Department's position as stated in this bulletin, and the Department will monitor insurers for compliance . . . [and] insurer's refusal to pay claims . . . for damage to the insured dwelling, including damage to the foundation caused by settling, cracking, bulging, shrinkage, or expansion caused by the peril of acci-

214. *Id.* at 1262.
215. *Id.*
216. *See* 20 Tex. Reg. 10398 (1995) (proposed) (Oct. 6, 1995).
217. *See Sharp*, 115 F.3d at 1264.
218. *See id.* at 1262. Interestingly, shortly before *Sharp* was decided, a federal district court decided almost the same issue in almost the same way. *See* Jimenez v. State Farm Lloyds, 968 F. Supp. 330 (W.D. Tex. 1997).
219. Commissioner's Bulletin No. B-0032-97, Aug. 22, 1997.

> dental discharge, leakage or overflow of water from within a plumbing, heating, air conditioning system or household appliance may subject the insurer to disciplinary action for violations of the Texas Insurance Code, including unfair claim settlement practices pursuant to Article 21.21 § 4(10)(a) and Article 21.21—2.[220]

The reasoning in the Bulletin begins with the principal argument presented by the Sharps: the previous state-approved homeowners form provided coverage for foundation damage resulting from plumbing leaks, the body appointed to revise the policy had no authority to make substantive changes, and therefore, the current policy must be construed in conformity with its predecessor.[221] In addition, the Commissioner points out that the price of homeowners insurance includes allocations for dwelling damage caused by plumbing leaks.[222] The Commissioner is especially troubled by the situation around Corpus Christi, where, he says, nearly eighty percent of homeowners' losses result from the accidental discharge of water.[223]

Obviously, there will be further litigation on the subject. In his Bulletin, Commissioner Bomer also points out that the Legislature has a substantial interest in this matter.[224] No doubt, there will be further statutory revision, further administrative directives, and probably some revision of the homeowners policy.

C. Care, Custody, or Control

All property policies contain exclusions. They are especially important in so-called "all risk" policies, where the grant of coverage is very broad and subsequently shaped by the exclusions. One common exclusion is discussed in *AIU Insurance Co. v. Mallay Corp.*[225] This case concerned both liability insurance and property insurance. We consider the property aspects here and the liability aspects in Section V.

Mallay milled and ground parts used by Dow Chemical in one of its plants. In 1995, Dow sent Mallay a turbine, which Mallay was to burnish. After Mallay had completed the job at one end of the turbine, it used a crane to lift the turbine, to turn it 180 degrees, and then to replace it in the lathe. When the crane operator set the turbine in the lathe, however, it rolled, fell out, and dropped several inches. The turbine was so damaged that it could not be used without further repairs that Mallay could not perform.

Mallay sought coverage for the turbine under its property policy. That policy contained a Special Extended Coverage Endorsement that included the turbine. The grant of coverage in the Endorsement, however, was subject to a number of exclusions. One of them stated that the

220. *Id.* at 2-3.
221. *See id.* at 1-2.
222. *See id.* at 2.
223. *See id.*
224. *See id.*
225. 938 F. Supp. 407 (S.D. Tex. 1996), *aff'd*, 116 F.3d 1478 (1997).

"[p]olicy does not insure against loss [of] [a]ny property undergoing alterations, repairs, installation or servicing, including materials and supplies therefore, if directly attributable to the operations or work being performed thereon."[226]

The insurer argued that the unambiguous language of the exclusion was a straightforward elimination of coverage. In response, Mallay pointed out that the lathe was not on at the time of the accident and that the turbine was merely being loaded onto the lathe in preparation for being worked upon. Thus, the insured argued that the damages were not directly attributable to actual operations or work being performed by Mallay and, hence, fell within the coverage. The court was neither convinced nor amused. It "commend[ed] counsel [for Mallay] for the audacious creativity of this surreal argument," but the court would not "permit an abrogation of common sense."[227]

More interestingly, the Endorsement also contained a liberalization clause that extended coverage under some circumstances. The clause provided that if the relevant state agency prescribed the use of a new form within relevant time parameters, and if there was no increase in the premium for the use of that form, then the insured was to receive the benefit of that state-prescribed new form. The Texas State Board of Insurance approved the use of a new form within the relevant time parameter, and it provided coverage for the personal property of others that were within the care, custody, or control of the insured. Mallay sought to invoke coverage under this extension.

The extension, however, contained a restriction. The new form created coverage for the "'direct physical loss of or damage to Covered Property at the premises described [elsewhere in the insurance policy].'"[228] Further, the term "Covered Property" was restricted to property "'for which a Limit of Insurance is shown in the Declarations.'"[229] The declarations showed a limit of insurance for the insured's "stock," but the court found that the turbine was not "stock."[230] Consequently, the liberalization clause was no help.[231]

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226. *Id.* at 411 (alterations in original).

227. *Id.* at 412.

> The fact that the lathe was not turned on at the time is not dispositive. Arguing that the turbine was not being worked on because the lathe was not turned on and milling a turbine is analogous to arguing that a person is not 'painting' unless the brush is actually touching the wall. Every dip into the paint can would terminate the painting, only to have it resume again once the brush touched the wall.

Id.

228. *Id.* at 411.

229. *Id.*

230. *See id.* at 412.

231. Mallay also argued that the turbine constituted "stock" and, hence, was insured. The term "stock," however, is defined as "'merchandise held in storage or for sale, raw materials and in-process or finished goods, including supplies used in their packing or shipping.'" *Id.* at 413.

D. The Appraisal Provision

Virtually all homeowners policies contain an appraisal clause. Such clauses provide for something resembling binding arbitration when an insurance company and the insured cannot agree on the value of the loss. Either party may request an appraisal in writing.

In *Toonen v. United Services Automobile Association*,[232] the policyholder reported a claim for roof damage resulting from a hail storm. United Services Automobile Association (USAA) inspected the roof but found no storm damage. The insured requested a second inspection and hired a public adjuster. USAA performed the second inspection but again found no hail damage. The public adjuster demanded appraisal on behalf of the insured and appointed himself. USAA also appointed an appraiser. There the matter "sat" for approximately three months. Thereupon, the policyholder hired a lawyer who wrote the customary demand letter. Shortly thereafter, however, the two appraisers selected an umpire, and the appraisal board eventually found that the policyholder was entitled to $1266.35 to replace three missing shingles. Apparently, all members of the appraisal board agreed. USAA received the appraisal decision and dispatched a check. Neither the insured nor her lawyer responded. Instead, approximately six weeks later, suit was filed.

USAA moved for summary judgment on the breach of contract claim based on its appraisal and moved for summary judgment on the bad faith claim based upon the lack of any breach of contract. The trial court granted the motions. The court of appeals held that the public adjuster had implied actual authority, apparent authority, or both, to seek appraisal.[233] In addition, because neither the policyholder nor her lawyer explicitly responded to the insurance company's acknowledgment of the appraisal results when it sent her a check, the policyholder may have ratified the public adjuster's request.[234] Finally, the court of appeals affirmed the trial court's judgment that there was no bad faith because there was no breach of contract.[235]

E. Interpleader Problems

Marine Indemnity Insurance Co. of America v. Lockwood Warehouse & Storage[236] concerned recovery under a commercial property insurance policy for a warehouse. A fire destroyed the warehouse in 1993. It contained millions of dollars worth of property belonging to others which was also destroyed. The claims exceeded proceeds, so the insurer instituted an interpleader action. The insurer interpleaded nearly $1.3 million in coverage so that the various insureds could fight it out and the insurer

232. 935 S.W.2d 937 (Tex. App.—San Antonio 1996, no writ).
233. *See id.* at 941.
234. *See id.*
235. *See id.*
236. 115 F.3d 282 (5th Cir.), *cert. denied sub nom.* Grant Lockwood Partners Ltd. Partnership v. Maxwell House Coffee Co., 118 S. Ct. 414 (1997).

could get out of the way. The district court referred the matter to a special master, and she decided two general issues.

First, the policy, as written, did not apply to subleases on the premises. There were at least three levels of leases. The owner had executed a master lease to the premises manager. The premises manager in turn leased to others. At least two of those lessees had leased again. It was the leases on this third level (the sublessees) that concerned the court.

The insurance policy provided coverage for the personalty of persons other than the insured when (1) the property was "directly connected" with the insured's business, (2) when the property was in the "care, custody, or control" of the insured, or (3) when the insured was either "responsible" for the property or had "agreed in writing prior to the loss to insure [it]."[237] The special master found that none of these conditions was satisfied as to the sublessees. Moreover, the insurance policy in question contained an "other insurance" clause. It provided that the property insurance was excess with respect to every other kind of insurance. The special master found that the two sublessees had been fully compensated by other insurance funds, and hence, that the insurance policy in question (together with considerations of equity) precluded coverage. The district court adopted the decisions of the special master, and the Fifth circuit affirmed.[238]

The second issue concerned debris removal. The special master awarded the property owner money for sums it had incurred moving debris from the warehouse and cleaning up the property site after the fire. The property owner alleged that a master lessee and property manager had terminated its lease after the fire and had refused to clean up, even though it was obligated to do so under the lease. The Fifth Circuit reversed the special master and the district court on this point.[239] The court held that the policy made it clear that it was only the property manager/master lessee who could make a claim for debris removal and cleanup expenses.[240] Hence, the property owner could not demonstrate that it was an unnamed insured but intended beneficiary under the insurance policy.[241] The Fifth Circuit remanded the case to the district court to recalculate and redistribute the interpleader funds.[242]

IV. BUSINESS CRIME INSURANCE

Property insurance protects the insured against the loss or destruction of tangible property, whether real or personal. But what about intangible property, such as money, securities, accounts, and the like? One problem facing business is the theft of money, and sometimes this theft comes in

237. *Id.* at 285.
238. *See id.* at 291.
239. *See id.*
240. *See id.* at 290.
241. *See id.*
242. *See id.* at 291.

the form of employee embezzlement. There is insurance for some defalcations.[243]

One of the most interesting cases decided during the Survey period is *Lynch Properties, Inc. v. Potomac Insurance Co.*[244] Lynch Properties had an employee fidelity policy. Lynch Properties was in the commercial real estate business; however, it also performed a number of accounting services for the mother of the principal. She paid the company a fee for these accounting services, which was part of a larger $50,000 annual fee she paid to the corporation to manage investments that she had in one of its entities.

One of the bookkeepers embezzled approximately $19,000 from the personal account of the principal's mother. When the problem was discovered, the corporation transferred its own funds to replace those that had been embezzled. The corporation sought coverage from its insurer. The insurer denied coverage, and the insured sued. The district court sided with the insurance company.[245]

The policy covered losses resulting directly from employee dishonesty. The corporation's loss, however, did not directly result from employee dishonesty. The direct result of the employee's embezzlement was a loss in the personal account of the principal's mother. The corporation sustained a loss when it replenished funds that had been stolen. That should be counted, said the court, as an indirect loss.[246] Moreover, only certain forms of employee dishonesty are covered. Only those dishonest acts that are undertaken with the "manifest intent" to cause the insured to sustain a loss constitute insured events.[247] The insurer argued that the employee clearly intended to enrich herself but that there was no evidence that she had the manifest intent, i.e., the apparent or obvious intent, to injure the company.[248] Finally, the insurance policy restricted covered property to property that the insured owns, holds, or of which it may be legally liable. It is entirely unclear, reasoned the court, that the

243. Not all dishonesty is covered. *See* Dickson v. State Farm Lloyds, 944 S.W.2d 666, 668 (Tex. App.—Corpus Christi 1997, no writ) (holding that dishonest procurement of increased salaries is excluded from employee dishonesty insurance). *See also* Federal Deposit Ins. Corp. v. Fireman's Ins. Co., 109 F.3d 1084 (5th Cir. 1997). The court held that the Bankers Blanket Bond provided insurance for losses resulting from the insureds taking real estate mortgages (or similar instruments) which "prov[ed] to have been defective by reason of the signature thereon of any person having been obtained through trick, artifice, fraud or false pretenses." *Id.* at 1086. The court characterized the policy as requiring that mortgages or related instruments be defective and that the defect would be caused by a signature upon that mortgage or instrument being obtained by fraud. *See id.* at 1088. Certainly, the mortgages upon which the bank relied were defective in the sense of being relatively worthless. On the other hand, that defect was not caused by obtaining the bank's signature on any particular instrument. Moreover, the fact that the bank's signature was fraudulently procured did not cause defects in the mortgages.

244. 962 F. Supp. 956 (N.D. Tex. 1996).

245. *See id.* at 964.

246. *See id.* at 961.

247. *See id.* at 962.

248. *See* Federal Deposit Ins. Corp. v. United Pacific Ins. Co., 20 F.3d 1070, 1077 (10th Cir. 1994) (defining "manifest intent").

corporation would be legally liable for the employee's defalcation.[249] The corporation was not in the business of looking after the funds of others. Family ties, and not business relationships, were the essence of these dealings.

One wonders if this case was correctly decided. In fact, the person whose funds were stolen was a customer of the corporation. She paid a fee for a variety of services, including looking after her accounts. To be sure, that was not the main business of the corporation, but it did take a fee for its services. The corporation was legally responsible for her losses; in fact, the corporation was probably a trustee of her funds. Further, it is not clear that the phrase "manifest intent" is a subjective one. By any objective standard, someone in the position of the bookkeeper would realize that this conduct would cause injury to his employer. Hence, under frequently employed rules of insurance interpretation, the bookkeeper should be deemed to intend the natural and probable consequences of his criminal conduct. The most difficult issue is the requirement in the policy that the loss must "result directly from the employee's dishonesty." The court's position was that the corporation's loss was caused directly by its own decision to replace the lost funds and not by the embezzlement.[250] This is a very constricted view of what counts as a direct loss. Surely, the corporation's loss of funds is traceable in an obvious and direct way to the activities of the felonious bookkeeper. The intervening act of the corporation in making its customer whole did not divert, transform, or overly complicate the causal chain. Indeed, what the corporation did was entirely normal and reasonable under the circumstances.

V. LIABILITY INSURANCE

As previously stated, insurance is frequently divided into first-party insurance and third-party insurance. Contracts of insurance whereby an insurer agrees to pay damages on behalf of a tortfeasor are usually considered third-party, or liability, insurance. Often, contracts of liability insurance include a clause pursuant to which the liability insurer agrees to defend the insured if a suit is filed alleging that the insured is a tortfeasor of a covered sort. Often, insurers defending insureds have the discretion to settle such cases, but sometimes not. Sometimes defense expenses are part of policy limits; however, more usually they are not. Invariably, insureds are required to cooperate with the insurers in mounting a defense.

A. The Duty to Defend

The Supreme Court of Texas addressed the duty to defend four times during this Survey period. The cases uphold the continued validity of the "Complaint Allegation Rule," which is also known as the "Eight Corners

249. *See Lynch Properties*, 962 F. Supp. at 963.
250. *See id.* at 964.

Rule."[251] The rule is quite simple. If a petition alleges facts which would, if proved, require the insurer to make payments on behalf of the insured, then the insurer has a duty to defend. The truth of the allegations in the petition does not matter in the slightest. Under the Eight Corners Rule, courts are not to "read facts into the pleadings."[252] Furthermore, courts should not look "outside the pleadings, or imagine factual scenarios which might trigger coverage."[253]

In *National Union Fire Insurance Co. v. Merchants Fast Motorlines*,[254] the issue was whether a truck owner's allegedly negligent discharge of a firearm, which caused the death of a passenger in another vehicle, triggered a duty to defend under the truck owner's liability insurance. The insurer brought a declaratory judgment action seeking a judgment that it owed a defense neither under its commercial general liability policy nor under its trucker's policy. The trial court granted summary judgment to the insurer, but the court of appeals reversed. The insurer brought a single point of error to the Texas Supreme Court, complaining only that the court of appeals erred in holding that there was a duty to defend under the trucker's policy, which contained the following insuring agreement: "'We will pay all sums an insured legally must pay as damages because of bodily injury or property damage to which this insurance applies, caused by an accident and resulting from the ownership, maintenance or use of a covered auto.'"[255] The parties agreed that the truck was a "covered auto."

The Texas Supreme Court held that there was no duty to defend.[256] No factual allegation contained in the petition suggested that the plaintiff's injury and death resulted from the use of the truck. To be sure, negligent discharge of the firearm took place while the truck was being used. But, there was nothing to suggest that the discharge of the firearm *resulted* from the use of the truck. In order to trigger the insuring agreement, there must be a causal relationship between the injury and the use of the covered auto (i.e., the truck).[257]

In *Trinity Universal Insurance Co. v. Cowan*,[258] issues concerning the duty to defend arose under a homeowners policy. The insuring agreement stated that the insurer would provide a defense at its expense, by counsel chosen by the insurer, if a suit was brought against an insured for damages because of bodily injury or property damage caused by a cov-

251. "Eight corners" refers to a comparison of the four corners of the petition with the four corners of the policy. Of course, the locution "eight corners" is metaphoric. No insurance policies and few petitions are ever to be found on a total of two pages.

252. National Union Fire Ins. Co. v. Merchants Fast Motorlines, 939 S.W.2d 139, 142 (Tex. 1997).

253. *Id.* Thus, insurance law has restored "fact pleading." At least where a plaintiff wants to trigger insurance coverage, she is well-advised to eschew "notice pleadings."

254. 939 S.W.2d 139 (Tex. 1997).

255. *Id.* at 141.

256. *See id.* at 142.

257. *See id.*

258. 945 S.W.2d 819 (Tex. 1997).

ered occurrence. As is customary, the policy stated that the insurer had a duty to defend even if the suit was groundless, false, or fraudulent. The policy defined the phrase "bodily injury" to mean "bodily harm, sickness or disease,"[259] and the term "occurrence" was defined as an "accident."[260]

The gist of the tort case was simple and outrageous. A young man lived at home with his family. He worked at a grocery store as a photolab clerk. Someone delivered for development a roll of film containing revealing pictures of a young woman. The young man made extra prints of several of the pictures and took them home. He later flashed them around among his friends and word got back to the young woman of whom the pictures had been taken. She sued, alleging "severe mental pain, a loss of privacy, humiliation, embarrassment, fear, frustration, [and] mental anguish," both in the present and in the future.[261]

The Texas Supreme Court denied that the insurer had a duty to defend on two grounds. First, it held that pure mental anguish is not bodily injury.[262] This matter has been considered by a number of jurisdictions, and, according to the Texas Supreme Court, "[a] substantial majority of those courts considering the question . . . have held that purely mental injuries . . . do not constitute 'bodily injury.'"[263] Moreover, although the physical manifestations of mental anguish might trigger a duty to defend, pleading mental anguish does not automatically imply physical manifestations. As the Court succinctly stated the matter, "[p]hysical [m]anifestations [a]re [n]ot [i]mplicit in a [c]laim for [m]ental [a]nguish."[264]

Second, there was no occurrence pleaded, and hence, the insuring agreement was not triggered. The term "occurrence" is defined by means of the term "accident." Hence, the insuring agreement would be triggered only if plaintiff had pleaded an accident. The defendant's conduct was intentional at every turn, and all of the consequences of his conduct were foreseeable. Therefore, it was no accident.[265] The Court based this finding on a series of its own decisions, thereby making sure that everyone understands that its historic decisions on the duty to defend are alive and well.[266] The Court also took pains to point out that courts should take the term "accident" seriously for reasons of public policy.[267] "To hold otherwise would inappropriately enhance rather than minimize the

259. *Id.* at 822.
260. *Id.* at 826.
261. *Id.* at 822.
262. *See id.* at 824.
263. *Id.*
264. *Id.* at 825.
265. *See id.* at 827-28.
266. *See* State Farm Fire & Cas. Co. v. S.S. & G.W., 858 S.W.2d 374 (Tex. 1993); Republic Nat'l Life Ins. Co. v. Heyward, 536 S.W.2d 549 (Tex. 1976); Argonaut Southwest Ins. Co. v. Maupin, 500 S.W.2d 633 (Tex. 1973); Massachusetts Bonding & Ins. Co. v. Orkin Exterminating Co., 416 S.W.2d 396 (Tex. 1967).
267. *See Cowan*, 945 S.W.2d at 828.

moral hazard inherent in insurance."[268]

At the same time, the Court took pains to indicate that the mere intentional performance of an act does not necessarily mean that there has been no accident.[269] The occurrence of an accident is to be determined by the effects of the act, not the performance of the act.[270] The Court expressly rejected an argument from the insurer to the effect that "if an actor intended to engage in the contact that gave rise to the injury, there could be no 'accident.'"[271] First, such a construction would render one of the exclusions surplusage, and it is a fundamental norm of insurance contract construction that no passage in an insurance policy shall be rendered redundant.[272] Second, insurance is purchased to cover negligent acts. Many negligent acts are intentionally performed but performed in a context where the consequences are unanticipated. Think of a hunter firing a gun at an object he believes to be a deer but which is really a person. In that case, an act is performed intentionally, but the consequences are quite accidental.[273]

At the end of his unanimous and vigorous opinion, Justice Cornyn held that if a petition does not establish a duty to defend, an insurer has no duty to go beyond the petition and investigate.[274] Under the "Complaint Allegation Rule," insurers are "entitled to rely solely on the factual allegations contained in the petition in conjunction with the terms of the policy to determine whether [they have] a duty to defend."[275] Thus, the Court held that, under the facts of the *Cowan* case, there was no duty to investigate.[276]

The duty to defend came up again in *Farmers Texas County Mutual Insurance Co. v. Griffin*.[277] The Texas Supreme Court first decided this case on the same day it decided *Merchants Fast Motorlines*,[278] but it issued another opinion on November 13, 1997.[279] *Griffin* involved a drive-by shooting. Farmers insured James Royal, III. Royal had apparently

268. *Id.*

269. *See id.*

270. *See id.* at 827.

271. *Id.* at 828.

272. *See id.* The exclusion in question is the intentional injury exclusion, according to which the insurer is relieved of the responsibility of paying damages for any injury which is "expected or intended." Do the Court's arguments here really make sense?

273. *See id.* It is sometimes difficult to distinguish between fact pleadings and cause-of-action pleadings when making duty to defend decisions. *See* HVAW v. American Motorists Ins. Co., 968 F. Supp. 1178, 1182 (N.D. Tex. 1997) (When an allegation of negligence is contained within a larger allegation of a fraudulent conspiracy, the allegation of negligence will not trigger a duty to defend.).

274. *See Cowan*, 945 S.W.2d at 829.

275. *Id.*

276. *See id.* There is a puzzle in this holding. It is quite narrow. It is restricted to the facts of the case. Why? Given the breadth of the "Complaint Allegation Rule," why would the Court signal that under different facts, an insurer might have a duty to investigate?

277. 40 Tex. Sup. Ct. J. 362, 1997 WL 78574 (Feb. 21, 1997).

278. 939 S.W.2d 139 (Tex. 1997); *see supra* notes 254-57 and accompanying text.

279. Farmer's Texas County Mut. Ins. Co. v. Griffin, 955 S.W.2d 81 (Tex. 1997).

driven a car from which shots were fired, injuring Griffin. Farmers defended Royal subject to a reservation of rights and filed a declaratory judgment action seeking a determination as to both its duty to defend and its duty to indemnify.

In the first decision and in the second decision, the Texas Supreme Court held that the petition in the underlying case did not trigger either a duty to defend or a duty to indemnify.[280] This was true for two reasons. First, there were no factual pleadings that added up to an accident. Instead, the pleadings added up to intentional conduct, not negligent behavior.[281] Second, the insurance policy insured only against "auto accidents." Drive-by shootings are not auto accidents.[282] On these twin bases, the Court, in both decisions, held that there was no duty to defend and no duty to indemnify.[283]

Griffin filed a motion for rehearing. *Sua sponte* the Court asked the parties to brief whether the Court had jurisdiction to decide whether the insurance company had a duty to indemnify. Some years ago, the Texas Supreme Court, in *Firemen's Insurance Co. v. Burch*,[284] held that the Declaratory Judgment Act[285] did not give the Court jurisdiction to decide duty-to-indemnify questions before the resolution of the underlying tort case. The Court held that it had no jurisdiction to issue advisory opinions and that there was no justiciable controversy regarding the insurer's duty to indemnify before a judgment had been rendered against an insured.[286]

The *Burch* case is now nearly thirty years old. The courts of most states and the Fifth Circuit regard many duty-to-indemnify questions as justiciable before the underlying tort case is resolved, and the Texas Supreme Court itself has suggested that the parties should seek declaratory judgments as to the duty to indemnify before the underlying tort suit is resolved.[287]

But *Burch* was based on a provision in the Texas Constitution, and courts are loathe to overrule constitutional decisions. Fortunately, article V, section 8 of the Texas Constitution, the provision at issue, was amended in 1985 and significantly broadened the scope of district court

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280. *See id.* at 84.
281. *See id.* at 83.
282. *See id.*
283. *See id.* at 82-83.
284. 442 S.W.2d 331, 333 (Tex. 1968).
285. Act of April 26, 1943, 48th Leg., ch. 164 (current version at TEX. CIV. PRAC. & REM. CODE ANN. § 37.001 *et. seq.* (Vernon 1997 & Supp. 1998)).
286. *See Burch*, 442 S.W.2d at 333.
287. *See* State Farm Fire & Cas. Co. v. Gandy, 925 S.W.2d 696, 714 (Tex. 1996).

> *Gandy* requires an insurer to either accept coverage or make a good faith effort to resolve coverage before adjudication of the plaintiff's claim, and also suggests that the plaintiff may wish to participate in that litigation. If, as *Burch* held, coverage issues other than the duty to defend are always nonjusticiable, it would be impossible for an insurer to make a good faith effort to fully resolve coverage before a judgment has been rendered in the underlying claim.

Griffin, 955 S.W.2d at 84.

jurisdiction.[288] In particular, under the old constitutional provision, district courts had jurisdiction only over controversies valued at $500 or more.[289] Consequently, said the *Griffin* Court, because district courts could only speculate as to the value of the underlying tort case, they could not take jurisdiction over duty-to-indemnify questions before the resolution of the underlying case.[290] Now that the monetary limit has been eliminated, the district courts have original jurisdiction over "all actions, proceedings, and remedies."[291]

Consequently, duty-to-indemnify questions are now justiciable before the underlying tort case has been completed. At the same time, district courts retain the discretion to abstain from resolving indemnity issues until the underlying tort suit is resolved. This is obviously true when coverage hinges on tort issues. Thus, the Texas Supreme Court held that "the duty to indemnify is justiciable before the insured's liability is determined in the liability lawsuit when the insurer has no duty to defend *and the same reasons that negate the duty to defend likewise negate any possibility the insurer will ever have a duty to indemnify.*"[292] Federal district courts have always had the highly flexible, and nearly unreviewable, discretion to abstain. Now Texas courts have roughly the same power, but they have a rule to inform their decisions.[293]

Other courts have opined on the duty to defend during the Survey period.[294] Perhaps the most interesting discussion came up in *Western Alliance Insurance Co. v. Northern Insurance Co.*[295] This case involved a

288. *See id.* at 83.
289. *See id.*
290. *See id.* at 84.
291. *Id.* Strangely, the *Burch* decision had nothing to do with monetary limits. It had to do with whether the decision as to duty to indemnify constituted an advisory opinion.
292. *Id.* (emphasis added).
293. The duty to defend is always relative to a given pleading. Thus, if an insurer obtains an adjudication that it has no duty to defend and the plaintiff files a new petition in a tort case, necessarily, the former adjudication does not cover the amended pleading. If the changes in the pleading are minor, inconsequential, or factually immaterial, the insurer may be confident of its position. On the other hand, if the plaintiff has substantially changed his petition and has asserted new facts, the insured may acquire a duty to defend. Hence, it is difficult to see how a judgment declaring that an insurer has no duty to defend could ever completely foreclose the possibility that the insurer has no duty to indemnify, even if an insurer has a duty to indemnify only if it has a duty to defend—a proposition that is itself subject to some doubt.
294. *See, e.g.*, HVAW v. American Motorists Ins. Co., 968 F. Supp. 1178 (N.D. Tex. 1997) (holding that an allegation of professional malpractice by an attorney did not trigger a duty to defend under CGL policy); Aetna Cas. & Surety Co. v. Metropolitan Baptist Church, 967 F. Supp. 217 (S.D. Tex. 1996) (holding that misrepresentations can be occurrence under Texas law, triggering a duty to defend); Nguyen v. State Farm Lloyds, Inc., 947 S.W.2d 320, 323 (Tex. App.—Beaumont 1997, writ denied) (holding that a homeowners carrier need not defend as to allegation of slander, as that cause of action is not expressly covered); Dear v. Scottsdale Ins. Co., 947 S.W.2d 908, 914 (Tex. App.—Dallas 1997, writ denied) (holding that a carrier may settle without the permission of the insured, unless the policy expressly provides otherwise); State Farm Lloyds v. Kessler, 932 S.W.2d 732, 733, 739 (Tex. App.—Fort Worth 1996, writ denied) (finding no duty to defend where insured knowingly made false statements that caused purely economic damages to purchaser of insured's house).
295. 968 F. Supp. 1162 (N.D. Tex. 1997).

dispute between an excess liability carrier and a primary liability carrier. The primary carrier alleged that it had no duty to pay for an insured's defense because it had previously exhausted its coverage. It, therefore, resisted the excess insurer's attempt to obtain monies it paid on behalf of the insured through its subrogation rights.[296]

There were two underlying tort suits. Both of them arose out of an apartment building fire. In the first suit, the decedents' survivors sued the property manager, among others. They alleged that the property manager had negligently installed a water heater and had failed to install a smoke detector on the premises. The property manager was an additional insured under the Northern policy, as well as the Western Alliance policy. However, the Western Alliance policy was designated to be excess of the Northern policy. Nevertheless, Western Alliance defended the property manager, while unsuccessfully trying to persuade Northern to do so. The case against the property manager settled for $25,000 in excess of Western Alliance's limits. Western Alliance paid its limits, and Northern Insurance paid the rest. The two insurers agreed to mediate the coverage issues. The plaintiffs filed a second tort action, this one against the property owner, the FDIC. The FDIC was unquestionably an insured under Northern's policy, and Northern defended. After approximately a year and a half, Northern settled on behalf of the FDIC, exhausting its policy limits.

Thereafter, Western Alliance sued Northern, seeking to recover policy limits it paid on behalf of the property manager, plus its defense expenses. Northern refused to pay on the ground that its policy was exhausted by the FDIC suit. Northern's position was that an insurance company has no duty to defend once its policy limits are exhausted and, obviously, has no further duty to indemnify. The position of Western Alliance was that Northern had exhausted its policy after the case against the property manager was settled. Hence, Northern had limits available when the first suit settled, so it had a duty to pay, as well as a duty to defend. The court agreed with the arguments of Western Alliance and held that Western Alliance was entitled to reimbursement from Northern for defense expenses and indemnity sums.[297]

B. Insuring Agreement

The insuring agreement of the commercial general liability policy states that the insurer "will pay those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies."[298] This language is perfectly standard. Does this apply to all sorts of liability, or does it apply only to

296. *See* American Centennial Ins. Co. v. Canal Ins. Co., 843 S.W.2d 480, 481 (Tex. 1992) (holding that excess carriers may subrogate against primary carriers).

297. *See Western Alliance*, 968 F. Supp. at 1170.

298. *See, e.g.*, Data Specialties, Inc. v. Transcontinental Ins. Co., 125 F.3d 909, 911 (5th Cir. 1997).

liability that the insured faces as a result of being a tortfeasor? This question had never been answered under Texas law, but it came up in *Data Specialties, Inc. v. Transcontinental Insurance Co.*,[299] and the Fifth Circuit selected the narrower, tort-based interpretation of the clause.

In *Data Specialties*, the insured was an electrical contractor. He was hired to reconstruct the electrical system at a factory. As he was testing the electrical switchboard that had been installed, there was a short circuit, resulting in an explosion. Apparently, "a defective General Electric circuit breaker caused the explosion."[300] No one contended that Data Specialties was responsible for the accident. Nevertheless, pursuant to its contract, and pursuant to a sound customer relations philosophy, Data Specialties paid additional sums to complete the work. The question was whether Transcontinental was legally obligated to reimburse Data Specialties for those amounts.

The Fifth Circuit noted that there was no Texas authority on this issue. It reviewed authority from a number of other jurisdictions, as well as the writings of several commentators, and concluded that Texas courts would not require Transcontinental to pay unless its insured had tort-based liability.[301] The panel suggested that in making an insurance claim, Data Specialties was confusing liability with builder's risk insurance, which is a species of property coverage.[302]

C. Voluntary Conduct

Primary liability insurance policies, such as commercial general liability insurance, homeowners insurance, and automobile insurance, generally insure only against accidents. Umbrella policies and other excess insurance policies are somewhat broader, but all insurance is said to insure only against fortuities.[303] Sometimes, however, intentional conduct that accidentally causes an unexpected and injurious remote consequence generates coverage. But the intention of the tortfeasor may not be the

299. *See id.*

300. *Id.* at 910.

301. *See id.* at 912.

302. *See id.* at 913-14.

> Normally a party will have two primary insurance needs: insurance against loss of his property and insurance against his liability for the claims of others. When a contractor negligently causes an accident damaging his own property and that of others, he needs two separate policies to collect for his lost property and to be protected against claims of others whose property he damaged. The CGL policy covers the contractor for its tort liability. Builder's risk insurance, however, provides property insurance for a project under construction. This coverage reimburses the owner, or any party with an insurable interest such as a mortgage holder, for the accidental loss, damage, or destruction of the property, regardless of fault.

Id. at 914.

303. *See* Dow Chem. Co. v. Royal Indem. Co., 635 F.2d 379, 386 (5th Cir. 1981); Morrison Grain Co., Inc. v. Utica Mut. Ins. Co., 632 F.2d 424, 430 (5th Cir. 1980); Two Pesos, Inc. v. Gulf Ins. Co., 901 S.W.2d 495, 501 (Tex. App.—Houston [14th Dist.] 1995, no writ).

only question. Fortuitousness is the real issue. Shouldn't the insured's conduct also be less than fully voluntary if there is to be coverage?

This question was addressed in *Wessinger v. Fire Insurance Exchange*.[304] In this case, the tortfeasor got blind drunk and beat the tar out of the tort plaintiff. The plaintiff alleged that the tortfeasor negligently caused him injury, and the jury awarded the plaintiff $127,187 in damages. The insured-tortfeasor and the tort plaintiff joined together to sue the tortfeasor's insurer. The insurer claimed there was no accident.

The Dallas Court of Appeals relied upon *Argonaut S.W. Insurance Co. v. Maupin*[305] for the general rule regarding accidents: if the tortfeasor's acts are voluntary and intentional and if the injury is the natural result of the act, then the result was not caused by an accident, even if the result was subjectively unintended, unforeseen, and unexpected.[306] The *Wessinger* court construed *Maupin* to require a two-step analysis. First, the court must determine whether the tortfeasor's acts were voluntary and intentional. If the tortfeasor acted either involuntarily or unintentionally, then the inquiry stops, for there was an accident.[307] If the conduct was either intentional or voluntary, then a second step is necessary, and the court must analyze the consequences of the act. "When a result is not the natural and probable consequence of an act or course of conduct, it is produced by accidental means."[308] Natural results are those which ordinarily follow, which the reasonable person would anticipate, and which ought to be expected. The standard for judging whether consequences are natural and probable is an objective standard as "a person is held to intend the natural and probable results of his acts even if he did not subjectively intend or anticipate those consequences."[309]

With respect to the first step, the court held that there was no evidence suggesting that the tortfeasor slipped, fell, or contacted the victim by mistake.[310] Hence, his conduct was intentional and voluntary, and the fact that he was dead drunk was irrelevant.[311] Second, physical injury is a natural and probable consequence of a beating; the fact that the

304. 949 S.W.2d 834 (Tex. App.—Dallas 1997, n.w.h.).
305. 500 S.W.2d 633 (Tex. 1973).
306. *See id.* at 635.
307. *See Wessinger*, 949 S.W.2d at 837.
308. *Id.*
309. *Id.*
310. *See id.* at 838.
311. *See id.* at 839-40. Here, the court rejected the approach of the Massachusetts Supreme Court, which held that voluntary intoxication may defeat voluntariness for actions undertaken while intoxicated. *See* Hanover Ins. Co. v. Tachouni, 604 N.E.2d 689 (Mass. 1992). Instead, the court followed a decision of the Michigan Supreme Court, holding that voluntary intoxication could not defeat voluntariness or intentionality. *See* Group Ins. Co. v. Czopek, 489 N.W.2d 444, 449 (Mich. 1992). The court was unimpressed with the public need to finance compensation for victims. Instead, it found that there was a "general policy in Texas not to excuse conduct simply because the actor was voluntarily intoxicated." *Wessinger*, 949 S.W.2d at 840. This general policy is reflected in the Texas Penal Code, which states that "[v]oluntary intoxication does not constitute a defense to the commission of a crime." TEX. PEN. CODE ANN. § 8.04 (Vernon 1994). In addition, the court was concerned about relieving individuals of personal responsibility for their own conduct,

tortfeasor was drunk and did not subjectively anticipate this consequence is irrelevant.[312]

An analogous issue came up in *State Farm Fire and Casualty Co. v. Fullerton*.[313] Here, the issue was not drunkenness but insanity. Moreover, the substantive issues were once removed because the primary issue was preclusion. The tortfeasor killed his wife and stepdaughter. He pleaded guilty and was convicted of simple (as opposed to capital) murder. His defense lawyers believed that he had a good chance of acquittal if he pled not guilty by reason of insanity. However, they decided not to enter that plea because the tortfeasor was seventy years old. If he went to prison and became terminally ill, he would be sent home to die. If he were committed to a state mental hospital and became terminally ill, he would die there. So, the judgment of conviction recited that the tortfeasor was mentally competent.

The decedents' survivors sued the tortfeasor. State Farm provided the defense under a reservation of rights and filed a declaratory judgment action, seeking judgment of no coverage. In the declaratory judgment action, the tortfeasor apparently filed an affidavit pleading that he did not think insurance coverage existed and stating that "any action taken by me was intentional and intended to cause harm. . . ."[314] The other defendants in the declaratory judgment action—the plaintiffs in the underlying case—moved for the appointment of a guardian ad litem, claiming that the tortfeasor was not mentally competent. State Farm opposed the motion, but it was granted anyway.

The issue before the Fifth Circuit panel was whether the previous judgment of conviction precluded third parties from collecting on the insured's policy. State Farm had consistently argued in the trial court that it did. State Farm filed both a motion for summary judgment and a motion for judgment as a matter of law to close the evidence. The trial court denied those motions. At trial, decedents' survivors presented expert testimony that the tortfeasor was severely mentally ill and that he was suffering from delusions. The jury believed the testimony and found that the killings were unintentional. The district court entered judgment against the tortfeasor. The Fifth Circuit reversed, finding that the guilty plea precluded a finding of unintentional conduct under the insurance policy.[315] Judge Patrick Higginbotham wrote an opinion of case-book quality, depth, and precision.

Preclusion of fact issues is governed by state law.[316] Therefore, the responsibility of the panel is to make what Judge Higginbotham called

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and it was reluctant to create the possibility of "self-immunity" for responsibility through drunkenness. *See Wessinger*, 949 S.W.2d at 839.

312. *See id.* at 841.

313. 118 F.3d 374 (5th Cir. 1997).

314. *Id.* at 377. For an interesting case involving an insanity exclusion—a very rare bird indeed, at least in these parts—see Cary v. Allstate Ins. Co., 922 P.2d 1335 (Wash. 1996).

315. *See id.* at 378.

316. *See id.* at 377.

the right "*Erie*-guess."[317] In Texas, collateral estoppel requires that "(1) the facts sought to be litigated in the second action were fully and fairly litigated in the first action; (2) those facts were essential to the judgment in the first action; and (3) the parties were cast as adversaries in the first action."[318] The third requirement contains an important twist: "[t]o satisfy the requirements of due process, it is only necessary that the party *against whom* the doctrine is asserted was a party or in privity with a party in the first action."[319]

The second requirement did not detain the court. Obviously, the showing of voluntariness of intentional conduct is necessary for a conviction of murder. The other two requirements were a bit more complicated. Nevertheless, Judge Higginbotham found that Texas would likely treat the tortfeasor's plea as a "full and fair" litigation.[320] First, Texas courts have given default judgments in civil cases preclusive effect in spite of the superficial nature of the adjudication leading to those judgments.[321] Second, the Texas Supreme Court has suggested some willingness to give guilty pleas in murder cases heavy weight in subsequent civil proceedings,[322] even though this language is to be found in an aging case.[323] Third, Texas courts have characterized the law of issue preclusion in Texas as identical to federal law, and federal courts routinely give preclusive effect to guilty pleas.[324]

The third element of the Texas doctrine of collateral estoppel, as applied to this case, revolves around privity. Although Judge Higginbotham was concerned about "the dangers of formalism tied up in the word 'privity,'" he recognized that the label is alive and well in Texas legal discourse.[325] Hence, the court's inquiry was "whether Texas law allows [the insurer] to extend the preclusive effect of the murder conviction from [the tortfeasor] to the heirs of [his] victims."[326] Significantly, the decedents' heirs had no direct action against the insurance company. If they did, of course, collateral estoppel would not bar their claim.[327]

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317. *Id.* at 378.

318. Sysco Food Servs., Inc. v. Trapnell, 890 S.W.2d 796, 801 (Tex. 1994). The most recent pronouncement of the Texas Supreme Court on collateral estoppel is Johnson & Higgins of Texas, Inc. v. Kenneco Energy, Inc., 41 Tex. Sup. Ct. J. 268, 1998 WL 19542 (Dec. 16, 1998). It will be discussed in detail in the next Survey period. It is part of a seemingly never ending series of cases that began in the mid-1980s. *See* Armada Supply, Inc. v. Wright, 858 F.2d 842 (2d Cir. 1988); Armada Supply, Inc. v. Wright, 665 F. Supp. 1047 (S.D.N.Y. 1987); Kenneco Energy, Inc. v. Johnson & Higgins of Texas, Inc., 921 S.W.2d 254 (Tex. App.—Houston [1st Dist.] 1995), *rev'd*, 41 Tex. Sup. Ct. J. 268, 1998 WL 19542 (Jan. 16, 1998).

319. *Sysco Food*, 890 S.W.2d at 802 (emphasis added).

320. *Fullerton*, 118 F.3d at 381.

321. *See id.* at 381-82.

322. *See id.* at 382.

323. *See* Greer v. Franklin Life Ins. Co., 221 S.W.2d 857 (Tex. 1949).

324. *See Fullerton*, 118 F.3d at 383. Perhaps the most interesting part of the court's discussion of element one from *Sysco* is its scholarly discussion of cases from other jurisdictions addressing the point. *See id.* at 377-382.

325. *Id.* at 384.

326. *Id.*

327. *See id.* at 384-85.

Instead, the plaintiff was claiming the right to insurance proceeds through the rights of the insured, the criminally convicted tortfeasor. "In other words, [the insurer's] duty is to pay its insured; third parties can recover proceeds under the policy only insofar as their rights derived from [the insured's] right to recover proceeds."[328] Thus, the claims of the plaintiff are derivative upon his claims, and so they should be deemed to be in privity with him. According to Judge Higginbotham, this result places Texas squarely among the majority of the jurisdictions that have considered the problem.[329]

The court inferred the existence of privity from the fact that the tort plaintiffs had no direct action against the insurance company. It is certainly true that insurance companies may not be impleaded into tort actions.[330] Nevertheless, under most liability policies, tort victims may sue insurance companies to recover upon final judgments entered against an insured and obtained after an actual trial. Such provisions are routinely found in homeowners policies, commercial general liability policies, commercial umbrella policies, and commercial excess policies. Moreover, liability policies do not state that the insurer will pay indemnity sums to the insured. Rather, they state that the insurer will pay sums to others on behalf of the insured if the insured is adjudged to be a tortfeasor. Therefore, one wonders if Judge Higginbotham's argument that there was privity between the tort plaintiffs and the tortfeasor will hold up.

D. "TRIGGER"

Insurance policies are issued for definite time intervals. It is, therefore, important to know when the injurious act or injury took place. Generally speaking, in determining which policy covers what injuries, dates are important. Courts have developed different trigger rules for bodily injury and for property damage. In asbestos and other mass torts involving creeping injuries, it is often not possible to determine the precise time of injury. Some courts hold that asbestos injures the human body immediately upon breathing it in. This is called the exposure trigger. Some courts hold that the body is injured when injury becomes known or should become known. This is the manifestation trigger. And some courts hold that injury occurs not only upon exposure or upon manifestation, but at any time the noxious substance is contained within the body. This is called the "triple trigger." This rule is confined to bodily injury cases, however. In general, the manifestation rule applies to property

328. *Id.* at 385.

329. *See id.* Texas courts treat collateral estoppel as an equitable issue. Consequently, courts may decline to apply it if the results would be unfair. The panel found no unfairness. Moreover, the goals of issue preclusion were served by recognizing collateral estoppel in this case. In particular, it is important to prevent inconsistent judgments. Moreover, the panel recognized that "the Due Process Clause places limits on the use of offensive, non-mutual issues of preclusion." *Id.* at 386-87. The panel did not believe, however, that any due process rights of the tort plaintiffs were affected. *See id.* at 387.

330. *See* Jilani v. Jilani, 767 S.W.2d 671 (Tex. 1988) (Cook, J., concurring).

damage. This is true nationally, and it is true in Texas.[331]

In *American Home Assurance Co. v. Unitramp Ltd.*,[332] the court sought to apply the manifestation trigger rule in a property case. The responsibility of the district court, therefore, was to determine the date of the property damage.

Unitramp chartered a ship. While the ship was in Corpus Christi Bay, Unitramp ordered fuel from a fuel broker. It delivered the fuel on June 8, 1993. Unitramp kept the fuel in segregated bunkers. The ship left port on June 9. On June 14, after the ship was at sea, a surveyor reported that the water content of the fuel oil was too high. Although the ship had enough good fuel to complete its voyage to Africa, it diverted itself to Tampa to exchange the fuel.

Unitramp sued the fuel broker, which filed for bankruptcy. During the course of the bankruptcy proceedings, the stay was lifted and the parties agreed to a judgment of $210,000. Unitramp attempted to obtain payment from American Home, the broker's insurance carrier. American Home Assurance denied coverage on the ground that the insurance policy at issue became effective June 12, 1993, and the property damage occurred on June 9, 1993.

The Fifth Circuit, in an unpublished opinion, reviewed the decision of the district court in this case and remanded the case so that the district judge could apply the manifestation rule.[333] According to that rule, property damage manifests itself when property damage is actually sustained. Property damage is actually sustained when there is identifiable damage or identifiable injury. There is coverage for property damage when the identifiable damage or identifiable injury takes place during the policy period.[334] Performance of a negligent act or the negligent omission of an act is not itself property damage.[335] However, "[a] claimant's damage may be identifiable but not identified."[336] The court suggested that property damage manifests itself when "harm is reasonably detectable,"[337] rather than when the act takes place or when the property damage is actually found. This rule is especially important when the property damage is difficult to perceive.[338]

The district court found that Unitramp could easily have found the contamination in the fuel oil before it left port.[339] It simply chose a slower method for economic reasons. It could have had a local test made and

331. *See, e.g.*, Snug Harbor, Ltd. v. Zurich Ins., 968 F.2d 538, 544 (5th Cir. 1992); Cullen/Frost Bank v. Commonwealth Lloyds Ins. Co., 852 S.W.2d 252, 257 (Tex. App.—Dallas 1993, writ denied); Dorchester Dev. v. Safeco Ins. Co., 737 S.W.2d 380, 383 (Tex. App.—Dallas 1987, no writ).

332. 945 F. Supp. 1061 (S.D. Tex. 1996).

333. American Home Assurance Co. v. Unitramp, Ltd., 91 F.3d 141 (5th Cir. 1996).

334. *See Unitramp*, 945 F. Supp. at 1063.

335. *See id.*

336. *Id.*

337. *Id.*

338. *See id.*

339. *See id.* at 1064.

received results before leaving port. "Unitramp chose to save money on the local test and to risk the greater costs. Having cut its cost, the ship wants to impose liability for the loss, consequent on its 'savings' on the fuel seller. The vessel bears the full cost of its frugality."[340]

There is an unexplained difficulty in the *Unitramp* case. For insurance purposes, property damage arises when a tortfeasor damages existing property. There is no property damage if the tortfeasor merely sells a defective product.[341] On the basis of the reported opinions, the court had difficulty finding any property damage in this case. For there to have been property damage, the defective fuel oil would have had to injure the ship somehow. There is no indication that any such injury took place.[342]

E. WHO IS AN INSURED?

Frequently, insurance litigation is concerned with which persons or entities are insureds under the policy. Sometimes this is a simple question. A number of entities may be named on the declaration sheet or on an endorsement to the declaration sheet, and each of those entities is counted as a named insured, but there may be additional unnamed insureds. Most liability policies contain sections specifying the identity of additional unnamed insureds.[343]

The question of "who is an insured?" was addressed in *Western Indemnity Insurance Co. v. American Physicians Insurance Exchange*,[344] a case involving two medical malpractice liability carriers. In this case, a minor emergency center employed a physician. As part of his compensation, the center was to provide the physician with professional liability insurance. In addition, the physician was covered by an individual professional liability policy. Several months after he came to work for the center, the physician was sued for medical malpractice. Eventually, a jury verdict exonerated the physician.

The physician's personal professional liability insurance policy provided a defense. It requested contribution from the carrier for the center, which also scheduled the physician as an insured. The second carrier, after some waffling, decided that its policy was excess with respect to the individual policy and refused to contribute to the defense.

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340. *Id.* There are three kinds of property damage cases. First, there are cases where an act causes observed property damage immediately. Second, there are cases where the act causes property damage immediately, but it is not discovered. Third, there are cases where an act causes delayed damage. The district court implies that the manifestation rule is really best designed for cases of the third sort. *See id.* at 1065.

341. Indeed, most commercial general liability insurance contracts exclude coverage for such situations. *See generally* General Mfg. v. CNA Lloyds, 806 S.W.2d 297 (Tex. App.—Dallas 1991, writ denied).

342. *See Unitramp*, 945 F. Supp. at 1067.

343. *See* DONALD S. MALECKI & JACK P. GIBSON, THE ADDITIONAL INSURED BOOK (3d ed. 1998); GARY D. NELSON, *"Additional Insured" Endorsements*, 24 THE BRIEF 29 (Summer 1995).

344. 950 S.W.2d 185 (Tex. App.—Austin 1997, n.w.h.).

Both carriers relied upon the other's insurance clause. The policy issued by the carrier for the center contained a clause which stated that

> [t]his insurance is excess over any other valid and collectible insurance available to each [i]nsured . . ., whether such insurance is stated to be primary . . . or otherwise, except this insurance is not excess over any other valid and *collectible* insurance available to those Additional Insureds to which the Named Insured may be obligated by virtue of a written contract to provide insurance such as is provided by this policy. . . .[345]

The same policy defined the terms "Named Insured," "Additional Named Insured," and "Additional Insured." The designation "Named Insured" included anyone named in the policy as an insured and various officeholders of the insured. Thus, one could be a "Named Insured" without actually being named in the policy. "Additional Named Insureds" included physician-employees of the center while acting within the scope of their employment. The category of "Additional Insured" included hospitals, persons, or organizations to whom the Named Insured was obligated by written contract to provide insurance as would be provided under the policy.[346]

The key question was whether the physician was an "Additional Insured," an "Additional Named Insured," or both. According to the court of appeals, the physician could not be an "Additional Insured" because he was added to the policy by name, and one person (or entity) cannot be both a named insured and an additional insured.[347]

There is another reason why the physician-employee could not be both an "Additional Named Insured" and an "Additional Insured." Notice and reporting provisions in the policy referred only to "Named Insureds" and "Additional Named Insured." It is the notice and reporting by these entities that triggers the "Claims Made Policy." There were no notice or reporting provisions for "Additional Insureds." If one were both an "Additional Named Insured" and an "Additional Insured," it might be impossible to determine when a claim was made for the applicable coverage period.[348]

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345. *Id.* at 187 (emphasis added).

346. *See id.*

347. *See id.* at 188-90. The court acknowledged that the physician was not explicitly designated as a "Named Insured" in the policy. However, there was an endorsement to the policy listing "Scheduled Medical Professional." In the context of the entire policy, that list was clearly intended to be a list of additional named insureds. *See id.* at 188.

348. Sometimes the question of "who is an insured?" is truly esoteric, though interesting. *See, e.g.*, Certain Underwriters at Lloyds, London v. Oryx Energy Co., 957 F. Supp. 930 (S.D. Tex. 1997) (involving the interaction between the Federal Outer Continental Shelf Lands Act and the other insured provisions of the policy); Progressive County Mut. Ins. Co. v. Carway, 951 S.W.2d 108 (Tex. App.—Houston [14th Dist.] 1997, pet. denied) (involving the interaction between the Texas Motor Carrier Act, the Interstate Commerce Commission Regulations, the Texas Safety Responsibility Laws, and the other insured provisions of a policy).

F. VENDORS' ENDORSEMENTS

Manufacturers who purchase liability insurance may purchase vendors' endorsements. The endorsements extend coverage to wholesalers and retailers who merely sell the manufactured goods. They do not cover distributors who change the goods, change the packaging, or who are sued for independent torts.[349]

Thousands of women have sued Dow-Corning for manufacturing defective breast implants. Many of them have also sued the physicians who inserted them. These physicians have obtained defenses from medical malpractice carriers. Those carriers would like to see the manufacturers take over, or at least contribute to, the defense of the doctors. Interestingly, many of the physicians are uncomfortable about being denominated vendors of products.

This issue was addressed in *Texas Medical Liability Trust v. Zurich Insurance Co.*[350] Zurich insured Dow-Corning by means of six contracts from 1989 to 1994. Several of these contracts contained vendors' endorsements making vendors additional unnamed insureds. Two of the contracts restricted that status to the entities actually named in the attached schedules. Two of the contracts contained no such restrictions, and two of them contained a restriction but then left the schedule blank. Those four contracts were at issue in *Zurich*.

Each of the relevant vendors' endorsements included as an additional insured "'any person . . . (referred to below as vendor) . . . but only with respect to 'bodily injury' . . . arising out of 'Dow Corning's products' . . . *which are sold in the regular course of the vendor's business* . . .'"[351]

The district court granted summary judgment in favor of Zurich, and the Austin Court of Appeals affirmed.[352] It did so upon two grounds. First, it held that the physicians were not vendors.[353] An authoritative dictionary, *Webster's Third New International Dictionary*, defines the term "vendor" as "'one that offers goods for sale esp[ecially] *habitually or as a means of livelihood.*'"[354] The court held that plastic surgeons do not sell breast implants as a means of livelihood, nor do they do it habitually.[355] The court implied that when a plastic surgeon sells a breast implant, it is simply incidental to the medical services he is providing.[356]

Second, the court pointed out that the endorsement itself requires that the manufactured product be sold in the "regular course of the vendor's business." According to the court, doctors are in the business of render-

349. *See* Michael Sean Quinn, *Vendors' Endorsements*, 18 INS. LITG. RPTR. 375, 375-78 (July 1996).

350. 945 S.W.2d 839 (Tex. App.—Austin 1979, pet. filed).

351. *Id.* at 843 (emphasis added by the court).

352. *See id.* at 841-42.

353. *See id.* at 843.

354. *Id.* (alteration and emphasis added by the court) (citation omitted).

355. *See id.* at 844.

356. *See id.*

ing medical services, not selling manufactured products.[357] Hence, the plastic surgeon who sells a breast implant in the context of rendering medical services is not selling the implant in the regular course of her business.

The seam between sales and services for products liability law has a long history.[358] This line has been especially problematic in medicine.[359] Nevertheless, one wonders if this decision is soundly conceived. If a doctor actually includes the cost of the implant in the price she charges her patient, then, surely, she is selling the implant. If the doctor performs many breast implant surgeries, and if each of them involves the sale of the implant, then, just as surely, the doctor is selling implants in the regular course of her business, even if they are not a large profit center. Surely, one does not need to do something as habitually as one brushes one's teeth in order to be a vendor. If I am in the business of selling fine china and antiques, and I sell one or two antique wooden tricycles a year, I am a vendor of antique wooden tricycles. Yet, I do not sell them habitually (in the sense that I brush my teeth), and they do not make a substantial contribution to my livelihood.

G. Sexual Molestation

Liability insurers do not wish to be in the business of insuring against damages inflicted by sexually deviant conduct. Perhaps this is because the damages are simply too unpredictable and the defense costs too high. Historically, insurers have tried to avoid liability on the ground that there has not been an accident or that the injuries and damages that are either expected or intended from the standpoint of the insured are excluded. We shall examine some of these cases below. In recent years, many commercial general liability policies, medical malpractice policies, umbrella policies, and other excess policies have contained express exclusions for sexual molestation. Homeowners policies often do not. We will also look at some insurance contracts involving sex exclusions.

In *Preferred Risk Mutual Insurance Co. v. Watson*,[360] three children were allegedly molested by an employee of a church day-care center. The children and their parents filed two lawsuits. The church and its insurance company settled with the children; $100,000 was allocated among the children on a pro rata basis. The insurer put another $100,000 in escrow for the children, pending the outcome of a declaratory judgment action.

The church's insurance policy contained a sexual misconduct endorsement limiting coverage to $100,000 per "occurrence" and $300,000 per

357. *See id.*

358. *See* William C. Powers, Jr., *Distinguishing Between Products and Services in Strict Liability* 62 N.C. L. Rev. 415 (1984); Barbee v. Rogers, 425 S.W.2d 342 (Tex. 1968); *see also* Walten v. Jeffery, 907 S.W.2d 446 (Tex. 1995); William Powers, Jr., Texas Products Liability Law, § 10.0721 (2d ed. 1995).

359. *See generally* Powers, *supra* note 358.

360. 937 S.W.2d 148 (Tex. App.—Fort Worth 1997, writ denied).

policy. The insurer suggested that all of the childrens' claims constituted but a single "occurrence." It took this position based on the express language in the endorsement, to wit: "All acts of sexual misconduct by one person . . . will be considered one occurrence."[361] The court held that the language of the endorsement was unambiguous and that there was only one occurrence.[362] The court noted that other cases finding multiple occurrences were not relevant, since they did not include a technical definition of the term "occurrence."[363]

Canutillo Independent School District v. National Union Fire Insurance Co.[364] concerned a School Leaders Errors and Omissions Policy. An elementary health and physical education teacher abused at least five second-grade girls. The fact of the molestation was not in dispute. The school district notified the insurance company and requested a defense. Before they filed suit, the families offered to settle all claims against the school district for $30,000 per family—a total of $150,000. The district rejected the settlement, the families filed suit, and the insurer denied coverage, relying upon an exclusion in the policy for claims arising out of "criminal conduct, assault, battery, and bodily injury."[365] The families amended their complaint several times. In the second amended complaint, they sought money damages and declaratory relief under Title IX.[366]

On the eve of trial, the school district settled the underlying tort cases for $1,040,000. The school district partially satisfied the judgment by paying $40,000. The insurance company bought the rest of the judgment from the plaintiffs for $1 million; thereby, the insurer stepped into the shoes of the plaintiffs and became a judgment creditor of the school district. However, it was agreed that the insurance company would seek to recover the $1 million only if it obtained a declaratory judgment of no coverage. This was a very creative move. Senior officials of the insurance company would have been involved. Line adjusters do not generally have the kind of authority necessary to make a deal like this work.

The insurer filed the declaratory judgment action, and the school district counterclaimed with a declaratory judgment of its own, an action for contract damages, and an action under article 21.21 of the Insurance Code. The district court held that the insurer had a duty to defend because the tort plaintiff sought damages for intentional infliction of emotional distress and because it was unclear whether pure mental anguish constituted bodily injury under Texas law.[367] Moreover, the court held

361. *Id.* at 149.
362. *See id.* at 150.
363. *See id.*
364. 99 F.3d 695 (5th Cir. 1996).
365. *Id.* at 699.
366. 20 U.S.C. §§ 1681-1688 (1994); *see* Franklin v. Gwinnett County Pub. Schs., 503 U.S. 60, 76 (1992) (holding that the plaintiffs may recover money damages for sexual abuse by teachers through a private cause of action under Title IX).
367. *See Canutillo*, 99 F.3d at 702. This case was decided several months before the Texas Supreme Court decided *Cowan*, 945 S.W.2d at 823 (holding that "bodily injury" does

that the insurance company was obligated to indemnify the school district because the Title IX claims arose out of the conduct of the school district and not out of the conduct of the abusive teacher. The same was true of the intentional infliction claim.

Judge Emilio M. Garza, writing for the panel, reversed and rendered.[368] He held that the plain language of the policy excluded any claim involving allegations of criminal acts.[369] Actual sexual abuse clearly involved criminal acts—for example, assault and battery—so that any claim arising out of that conduct was excluded. This would include any claim that the school district failed to prevent the abuse, failed to protect the children from the abuse, or somehow detained the children and prevented their escape from the abuse. Each of these claims arose out of physical injuries inflicted upon the children. The district court thought otherwise, said the Fifth Circuit, because it focused on the causes of action rather than upon the facts.[370] For example, perhaps a cause of action for intentional infliction of emotional distress does not arise out of acts of sexual abuse. When one looks beyond the cause of action itself and examines the facts, it is clear that the facts of the intentional infliction of emotional distress alleged and the facts of the sexual abuse are intimately intertwined. When Texas courts determine whether an exclusion in an insurance policy applies, they

> examine the factual allegations showing the origin of the damages rather than legal theories asserted by the plaintiff. Where the legal claims asserted by the plaintiffs are not independent and mutually exclusive, but rather related to and dependent upon excluded conduct, the claims are not covered, even if asserted against the insured who did not himself engage in the prohibited conduct.[371]

Therefore, both the intentional infliction claim and the Title IX claim were related to, and dependent upon, the teacher's criminal sexual assaults, and they were excluded from coverage.[372]

Sexual abuse came up again in *Cornhill Insurance PLC v. Valsamis, Inc.*[373] The issue in *Cornhill* was whether claims of sexual harassment give rise to coverage. In the underlying tort case, the female plaintiff alleged that her supervisor made sexual remarks to her, touched her inap-

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not include purely emotional injuries or pure mental anguish); *see supra* notes 258-76 and accompanying text.

368. *See Canutillo*, 99 F.3d at 710.

369. *See id.* at 708-09.

370. *See id.* at 703.

371. *Id.* at 704 (citations omitted). Judge Garza thought the Texas law was clear: "where a claim against an insured would not exist 'but for' conduct explicitly excluded by the policy, the dependent claims are also not covered under the policy, regardless of whether the insured against whom the derivative claims are directed actually engaged in the excluded acts." *Id.* at 704-05.

372. *See id.* at 705. The school district argued that if it could not recover on this claim, there would be no coverage for anything, so the policy would be vacuous and its language meaningless. The Fifth Circuit rejected this view because it could think of many situations in which the insurer would have to pay. *See id.* at 706.

373. 106 F.3d 80 (5th Cir.), *cert. denied*, 118 S. Ct. 69 (1997).

propriately, exposed himself to her, made obscene gestures, and attempted to force himself upon her. When she reported this conduct, the supervisor tried to kiss her, asked her out repeatedly, and arranged to meet her alone. The employer-defendant sought coverage, but it was refused under three different policies: a comprehensive general liability policy, an excess comprehensive general liability policy, and an umbrella liability policy.

The insurance companies filed a declaratory judgment action. The tort plaintiff settled her suit against her employer and took an assignment against its insurance companies. The district court granted summary judgment for the insurers, and the Fifth Circuit panel affirmed.[374] One of the three policies at issue provided coverage for "personal injury," as well as for "bodily injury," and the term "personal injury" included publication in violation of an individual's right of privacy. Judge Higginbotham held that the facts pleaded in the plaintiff's underlying complaint did not amount to the tort of invasion of privacy because that requires an "'intrusion upon the plaintiff's seclusion or solitude, or into his private affairs.'"[375] It is not at all clear that offensive behavior by itself constitutes invasion of privacy, he said, for at least one Texas court has restricted the tort to physical invasion of property or some sort of spying.[376] Therefore, the plaintiff did not plead facts adding up to the tort of invasion of privacy, much less an invasion of privacy achieved through publication, as was required by the definition of "personal injury" in the policy.

The plaintiff sought coverage under the same policy for false imprisonment, which is also a species within the genus "personal injury." Here again, the panel found no pleading of false imprisonment.[377] There was no pleading of wilful detention. To be sure, plaintiff alleged that her supervisor attempted to force himself upon her in an unlocked supply room. Nevertheless, she did not allege that he kept her there by physical force or by threatening her with physical force. The allegation that she was detained did not amount to false imprisonment.[378]

The second policy contained an exclusion barring coverage for injuries to employees of the named insured. The exclusion was quite broad and covered both "bodily injury" and "personal injury." The exclusion, therefore, also knocked out coverage for plaintiff's negligent hiring and negligent supervision claims.

The same policy included an unusual endorsement, creating coverage for ship repairing operations. The tort victim claimed that her secretarial duties included accounting and scheduling for the ship repairing operations, and hence, that she was covered under that endorsement. Signifi-

374. *See id.* at 89.
375. *Id.* at 85 (quoting Industrial Found. v. Texas Indus. Accident Bd., 540 S.W.2d 668, 682 (Tex. 1976), *cert. denied*, 430 U.S. 931 (1977)).
376. *See id.* at 85 (citing Wilhite v. H. E. Butt Co., 812 S.W.2d 1, 6 (Tex. App.—Corpus Christi 1991, no writ)).
377. *See id.*
378. *See id.*

cantly, that endorsement was not subject to the employment exclusion. Nevertheless, the ship repairing endorsement provided coverage only for personal injuries that arose from ship repairing operations. Judge Higginbotham held that none of the plaintiff's allegations arose from covered activities.[379]

The third policy was an umbrella policy. Under that policy, coverage for personal injury required an "occurrence." The policy defined an "occurrence" as "an accident or a happening or event . . . which unexpectedly and unintentionally results in personal injury."[380] The court held that no intentional conduct could ever be an "occurrence," as that term is defined in insurance policies.[381] Furthermore, the plaintiff's negligence claims were so intertwined and dependent upon her intentional tort claims that they could not stand alone.[382] As a result, plaintiff's claims raised no possibility of coverage, so the insurers were entitled to summary judgment.[383]

Technically, *Cornhill* does not depend upon a sexual molestation exclusion. Nevertheless, it should be considered with the sexual molestation cases because it illustrates the hostility of the courts to coverage cases based upon sexual misconduct. In *Cornhill*, for example, the court assumed that case law regarding the definition of "occurrence" applied to the definition contained in the umbrella policy at issue. That assumption is almost certainly false. In most insurance policies, the term "occurrence" is defined by means of the word "accident." That was not the case in the umbrella policy at issue in *Cornhill*; "occurrence" was defined in terms of the words "accident," "happening," or "event."[384] While this definition is characteristic of many umbrella policies, it is *much broader* than the definition of "occurrence" to be found in primary liability policies. Indeed, it is virtually certain that the plaintiff's injuries were caused by happenings or events, although they were probably not caused by accidents.

A sexual abuse exclusion was explicitly at issue in *Acceptance Insurance Co. v. Bhugra Enterprises, Inc.*[385] This case arose out of an alleged rape at a motel owned by the insured. Unquestionably, rape is a form of sexual physical abuse and, therefore, excluded. In the underlying tort case, the plaintiff also sued the motel for DTPA violations. The court held that the DTPA claims were so intertwined with the excluded claims that they too were excluded from coverage.[386]

Bhugra contains an additional important point regarding federal declaratory judgment procedure. The insurance company filed a claim for

379. *See id.* at 86.
380. *Id.* at 87.
381. *See id.*
382. *See id.*
383. *See id.* at 88-89.
384. *See id.* at 87.
385. 946 F. Supp. 480 (N.D. Tex. 1996).
386. *See id.* at 482.

attorneys' fees, litigation-related expenses, and taxable court costs. The federal declaratory judgment statute does not provide for recovery of attorneys' fees, although it does not forbid such recovery either.[387] Hence, where jurisdiction is founded upon diversity of citizenship, state law controls. The Texas declaratory judgment statute provides that courts *may* award attorneys' fees and costs if they are "equitable and just," as well as "reasonable and necessary."[388]

Some of the defendants in *Bhugra* were insureds under the applicable policy but did not know it until the action arose. They, therefore, claimed that it would be inequitable and unjust to charge them with attorneys' fees. The court disagreed.[389] The defendants tendered the defense to the insurer per the policy and were not at all self-critical about their status as insureds or about the existence of coverage.[390] Since they put the insurance carrier to unnecessary expense, the assessment of the attorneys' fees was appropriate.

H. Pollution Exclusions

One of the most vigorously contested topics in liability insurance in recent years has been insurance for environmental exposures. Many parts of various liability policies come up: the "occurrence" language, the "expected or intended" exclusion, trigger, notice, and others. The focal point of much environmental insurance litigation, however, has been various pollution exclusions with which liability insurers have experimented.

Certain Underwriters at Lloyds' London v. C. A. Turner Construction Co., Inc.[391] concerned an absolute pollution exclusion.[392] In this case, a construction company appealed a declaration of no coverage for a personal injury suit arising from of the discharge of chemical fumes.

C. A. Turner Construction Company had a subsidiary. William Galbreath was a pipe-fitter employed by the subsidiary, and he was injured while welding pipe at a Texaco chemical plant. Galbreath was welding outside the building, but he was enclosed within a plastic tent to protect him from rain. The pipe contained rags, whose function was to prevent chemical leakage. When the rags were removed, either the rags or chemicals in the pipe came into contact with the very hot pipe that had just been welded. This contact created a cloud of phenol gas. Galbreath escaped the gas by diving out of the plastic tent. He suffered injuries as a result of inhaling the gas and of falling to the ground. Galbreath sued C. A. Turner, the parent of his employer, among others. Turner sought coverage from Lloyds' Underwriters, but it denied coverage on the ground of

387. *See* Tex. Civ. Prac. & Rem. Code Ann. § 37.009 (Vernon 1997).
388. *See id.*
389. *See Bhugra*, 946 F. Supp. at 483.
390. *See id.* at 481.
391. 112 F.3d 184 (5th Cir. 1997).
392. The exclusion is called "absolute" because it does not involve an express exception. A formerly used pollution exclusion excepted pollution events that were "sudden and accidental."

the pollution exclusion. Among other things, that exclusion rendered the insurance contract inapplicable to liability for any bodily injury "directly or indirectly caused by or arising out of" the pollution or contamination of air, "irrespective of the cause."[393] Galbreath, the injured worker, contended that there was no contamination of the air because injurious gas "fumes were confined to the temporary tent over the scaffolding."[394] In other words, plaintiff tried to distinguish between "traditional environmental pollution" and a "simple workplace accident" caused by fumes.[395] The Fifth Circuit panel acknowledged that there was a split of authority on this issue.[396] Some courts hold that not every injury caused by what could be classified as a pollutant constitutes pollution. These courts hold that, under some circumstances, the so-called absolute pollution exclusion is ambiguous.[397] Other courts, including a different panel of the Fifth Circuit, upheld the plain language of the exclusion, holding that it precludes coverage for "liability arising out of releases that do not cause widespread environmental harm."[398]

One wonders if the court got this one right. A necessary condition for the applicability of the exclusion is that there be "contamination of air, land, water and/or any other property and/or any person."[399] It is perfectly reasonable that the gas sprayed directly onto the worker's face. If so, then his injuries did not result from the contamination of air. Moreover, the phrase "contamination of air, land, water, or property" suggests that the injury must result from the contamination. It suggests that there must first be pollution in the form of contamination which then causes injury. If so, then *C. A. Turner Construction* may not have been correctly decided.

The Fifth Circuit took up coverage for pollution again in *SnyderGeneral Corp. v. Century Indemnity*.[400] SnyderGeneral owned a facility in Wilmington, North Carolina, where it manufactured air-conditioning and heating equipment from 1982 until 1988. Its operations involved the use of an industrial degreasing solvent, trichloroethane (TCA), and enormous amounts of ground water.

In 1983, there was an accident at the Wilmington plant. Approximately 500 gallons of TCA spilled from an above-ground storage tank. SnyderGeneral reported the spill to North Carolina authorities and cleaned it up to the satisfaction of the government. However, somewhat later, TCA, probably traceable to this spill, was found in the ground water at the Wilmington facility. SnyderGeneral cleaned up the site, and

393. *Id.* at 186.
394. *Id.*
395. *Id.* at 187.
396. *See id.*
397. *See id.*
398. *Id.* (citing American States Ins. Co. v. Nethery, 79 F.3d 473 (5th Cir. 1996)). Judge W. Eugene Davis, writing for the *Certain Underwriters* panel, lists the two lines of cases. *See id.* at 187 n.3-4.
399. *Id.* at 186.
400. 113 F.3d 536 (5th Cir. 1997).

the court reported that it spent approximately $2 million on the effort.[401]

SnyderGeneral had both primary liability coverage and umbrella coverage. The umbrella carrier, which had $25 million in limits, rejected the claim, and SnyderGeneral sued. The district court held that environmental clean-up costs are more like restitution than damages. It noted that the umbrella liability policy obligated the carrier to pay for damages imposed upon the insured. Consequently, the insurer was not liable to pay restitutionary sums.

The panel reversed. It held that "environmental cleanup costs, whether incurred by the federal government under CERCLA or by an individual who voluntarily undertakes the task of cleaning up hazardous waste, are damages and thus are covered by the language of [typical insuring agreements]."[402] The court believed this holding to be compelled by a previous case which found that "CERCLA-compelled clean-up costs were damages."[403] Judge Davis, writing for the *SnyderGeneral* panel, thought he was simply extending that rule to situations in which insureds clean up voluntarily before the government cleans up itself and sends the insureds a bill.[404]

The insurer also contended that the limited pollution exclusion clause barred coverage. The district court disagreed. The court held that (1) the term "sudden" in the exception to the pollution exclusion clause had a temporal component, i.e., that "sudden" means "quick,"[405] and (2) SnyderGeneral had created a fact question as to whether the 1983 accident was sudden.[406]

The insurer also claimed that there was an exclusion that precluded coverage for property that was in the care, custody, or control of the insured. The district court held that this exclusion "only precludes insurance coverage in cases in which the insured totally and physically manipulates property."[407] Upon that ground, the district court denied summary judgment. The court of appeals agreed because the insurer had not established that SnyderGeneral "totally and physically used or controlled the entire pool of groundwater at the Wilmington facility."[408]

In *Crown Central Petroleum Corp. v. Rust Scaffold Builders, Inc.*,[409] two employees of a contractor sued Crown Central for injuries resulting from exposure of the workers to airborne hydrofluoric acid at a battery unit in one of Crown's plants. The accident took place entirely indoors.

401. *See id.* at 538.
402. *Id.* at 539.
403. *Id.* at 538-39 (citing Bituminous Cas. Corp. v. Vacuum Tanks, Inc., 75 F.3d 1048 (5th Cir. 1996)).
404. *See id.*
405. *See id.* at 539. The court relied upon Mustang Tractor & Equip. Co. v. Liberty Mut. Ins. Co., 76 F.3d 89, 93 (5th Cir. 1996).
406. *See SnyderGeneral*, 113 F.3d at 539.
407. *Id.*
408. *Id.* (citing Hartford Cas. Co. v. Cruse, 938 F.2d 601 (5th Cir. 1991)).
409. 951 F. Supp. 636 (S.D. Tex. 1996). Judge Nancy Atlas arrived at the same conclusion that the Fifth Circuit later reached in *C. A. Turner Construction*, 112 F.3d at 184.

Indeed, it took place in an enclosed space within the interior of the building—a tank-like unit—where the workers were building scaffolding. Crown settled and sought recompense from an insurance carrier. That carrier insured the firm that was building the scaffolding. The firm had agreed to defend and indemnify Crown, and the firm's carrier insured that agreement. The carrier denied coverage based on the absolute pollution exclusion, and Crown sued to establish coverage.

The pollution exclusion stated that the insurance afforded by the policy did not apply to "[t]he contamination of any environment by pollutants that are introduced at any time, anywhere, in any way[, and] [a]ny bodily injury . . . arising out of such contamination."[410] The court held that this language unambiguously excluded coverage.[411]

Crown suggested that the language of the exclusion needed to be understood in terms of a brochure issued by the insurer describing its pollution coverage. The language of the brochure was: "Pollution Liability. The new policies do not cover this liability if the pollutants escape from your premises . . . ."[412] The exclusion in the previous policy did not apply to "sudden and accidental" emissions of pollutants; the new exclusion did not have this exception. District Judge Nancy Atlas rejected the proposition that the brochure had significance in construing the exclusion.[413] Moreover, she did not believe that the brochure supported Crown's position.[414] After all, the brochure eliminated the "sudden and accidental" exception to the exclusion.

Judge Atlas's decision may not be completely uncontroversial. The absolute pollution exclusion at issue was a non-standard one. It appeared to exclude bodily injury that arose out of the contamination of any environment by any pollutants. In other words, pollutants must have contaminated an environment, and that contamination must have caused bodily injury. The opinion does not state how the injured workers were exposed to hydrofluoric acid. If the exposure was *direct*, rather than through the intermediation of a polluted environment, then the terms of the exclusion would not be met. Moreover, the language of the brochure is extremely interesting. The brochure implies that the new, absolute pollution exclusion does not bar coverage if the pollutants have not escaped from the insured's premises. Unquestionably, Crown is considered an insured, and the pollutants did not escape from its premises.

Perhaps the most interesting environmental insurance case of the year is *Highlands Insurance Co. v. Kelley-Coppedge, Inc.*[415] Kelley-Coppedge laid a four-inch natural gas pipeline. During this operation, it struck a sixteen-inch crude oil pipeline, causing the release of approximately 1,600 barrels of crude oil. Much of the oil was recovered, but there was sub-

410. *Crown*, 951 F. Supp. at 638 n.3.
411. *See id.* at 624.
412. *Id.* at 640-41.
413. *See id.* at 641.
414. *See id.*
415. 950 S.W.2d 415 (Tex. App.—Fort Worth 1997, pet. granted).

stantial property damage to the land through which the pipeline easements passed. Kelley-Coppedge cleaned up after itself and attempted to mitigate the damage. It sought coverage under its commercial general liability policy from Highlands, and Highlands refused to pay. Kelley-Coppedge then filed suit seeking $296,225 in damages. It obtained summary judgment in this amount, plus interest and attorneys' fees. The issue in both the trial court and the court of appeals was the scope and applicability of the "Absolute Pollution Exclusion."

The Kelley-Coppedge policy provided that the property damage coverage would not apply to the discharge, disposal, or escape of pollutants "[a]t or from any premises, site or location which is or was at any time . . . occupied by . . . any insured. . . ."[416] The Fort Worth Court of Appeals thought that this was a simple case: it hinged entirely on whether Kelley-Coppedge occupied the premises, site, or location from which the pollution was discharged, disbursed, or released.[417] The court observed that one can "occupy" sites without owning them or without having any property interest in them at all, so long as one has "the right to occupy such portions of the property as are necessary to perform the obligations he or she has assumed."[418]

This case has caused something of a furor. Kelley-Coppedge filed a petition for review in the Texas Supreme Court. A number of entities have filed amicus briefs, including the Office of the Public Insurance Council, a number of contractor and subcontractor associations, and the Texas Association of Insurance Agents. One Amicus also filed a brief on behalf of the litigants.

Possibly, there are other exclusions that also apply to this case, but which have not been litigated. First, the policy excludes property damage arising from the discharge of pollutants "from any premises, site or location on which any insured . . . [is] performing operations . . . if the pollutants are brought on or to the premises, site or location in connection with such operations by such insured. . . ."[419] Literally speaking, Kelley-Coppedge brought the oil onto the site from which it was disbursed. It did this by inadvertently punching a hole in the pipeline. If it had not punched the hole, the pollutants would not have come to the site, and the contamination would not have occurred. Of course, the image most people have of *bringing substances on or to a site* does not normally include accidentally punching a hole and causing a leak. This is mere imagery, however; literally understood, the words "bring on or to a site" include exactly what happened in the *Kelley-Coppedge* case. Second, the policy excludes coverage for clean-up costs incurred at the instance of a third

416. *Id.* at 418.

417. *See id.* at 418-19.

418. *Id.* at 419. *See* Tri-County Serv. Co. v. Nationwide Mut. Ins. Co., 873 S.W.2d 719, 720 (Tex. App.—San Antonio 1993, writ denied).

419. *Kelley-Coppedge*, 950 S.W.2d at 418.

party. Unquestionably, the damages of Kelley-Coppedge were clean-up costs. It is a mystery why this issue was not litigated in the trial court.

I. EMPLOYEE EXCLUSIONS

Commercial General Liability (CGL) policies generally exclude coverage for "bodily injury" to employees of the insured when the injury arises within the course and scope of the employee's employment.[420] We have discussed this exclusion cursorily in Section V.G.[421]

During the Survey period, one case, *Nautilus Insurance Co. v. Zamora*,[422] considered the employee exclusion squarely. Zamora was a cashier in a restaurant. One day, three men entered the restaurant and began shooting. They killed two people. Zamora was wounded in the chest. She sued the restaurant in state court for negligence. The restaurant sought coverage under its commercial general liability policy. The carrier invoked the employee exclusion, filed a declaratory judgment action in federal court, and obtained summary judgment.

The employee exclusion ruled out coverage for "bodily injury" to any "employee of the insured *arising out of* and *in the course of employment* by the insured. . . ."[423] All parties agreed that Zamora's injuries occurred in the course of her employment. Therefore, the sole question before the circuit court was whether the injury arose out of her employment. The district court utilized the doctrine of "positional risk" employed in workers' compensation cases.[424] This test is a "but for" test whereby injury arises out of employment when the injury would not have been suffered but for the employment.[425]

The circuit court disagreed with the district court's "*Erie* guess."[426] The court held that, first, the positional-risk doctrine has been restricted to workers' compensation cases, and, second, Texas courts have utilized different tests for construing this kind of policy language.[427] Under Texas law, an injury arises out of employment if the injury occurs "while the employee is performing work-related duties."[428]

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420. Generally speaking, derivative claims of spouses, children, parents, and siblings of the employee are also excluded. Moreover, if the employer has an obligation to reimburse a third party for damages it has to pay (e.g., under an indemnity agreement), the exclusion applies.

421. *See supra* notes 373-84 and accompanying text (discussing *Cornhill*, where an employer-defendant sought coverage under a general liability policy for claims that the employee had been sexually harassed, and the employee exclusion barred coverage for injuries to the employee, as well as for claims based upon the employer's negligent hiring and negligent supervision).

422. 114 F.3d 536 (5th Cir. 1997).

423. *Id.* at 537 (emphasis added).

424. *See id.* at 538; *see also*, Walters v. American States Ins. Co., 654 S.W.2d 423 (Tex. 1983); Employers' Cas. Co. v. Bratcher, 823 S.W.2d 719 (Tex. App.—El Paso 1992, writ denied); North River Ins. Co. v. Purdy, 733 S.W.2d 630 (Tex. App.—San Antonio 1987, no writ).

425. *See Zamora*, 114 F.3d at 537-38.

426. *See id.* at 538.

427. *See id.* at 538-39.

428. *Id.* at 539.

The Fifth Circuit affirmed the holding of the district court.[429] The panel of the court of appeals disagreed with the district court only about which body of case law should be invoked to support the holding.

J. Care, Custody, or Control

AIU Insurance Co., v. Mallay Corp.[430] is discussed in Section III.C above.[431] The insurance policy at issue in *Mallay* involved both property aspects and liability aspects. Mallay, a repair contractor, dropped Dow Chemical's turbine and damaged it. The repair costs were $91,000, and Dow Chemical alleged that it suffered over $2.9 million in economic losses. Mallay sought liability coverage from AIU, its property and liability insurer.

AIU denied coverage and filed a declaratory judgment action. CGL insurance policies uniformly define "property damage" as "physical injury to tangible property, including all resulting loss of use of that property" or "loss of use of tangible property that is not physically injured."[432] Such policies also uniformly contain an exclusion for property damage to personalty of others which is in the care, custody, or control of the insured.[433] AIU argued that this exclusion applied and that it covered both damage to the turbine and Dow's economic losses.

Mallay argued that Dow lost the use of its chemical plant, even though the plant sustained no physical injury. By the definition of "property damage" in the policy, Dow's loss of its plant constituted property damage. Mallay contended that "property damage" was covered because it was never within the care, custody, or control of the insured.

The court sided with AIU.[434] Whatever loss of use Dow sustained resulted from physical injury to tangible property.[435] That property was personalty, it belonged to Dow, and it was in the care, custody, or control of Mallay.[436]

K. Claims Administration

Liability insurance policies contain a number of provisions governing the claims process. For example, insureds must give timely notice to their insurance companies, insureds must cooperate with their insurance companies, and so forth. Other legal principles governing the claims process

429. *See id.*
430. 938 F. Supp. 407 (S.D. Tex. 1996), *aff'd*, 116 F.3d 1478 (5th Cir. 1997).
431. *See supra* notes 225-31 and accompanying text.
432. *See, e.g., Mallay*, 938 F. Supp. at 410.
433. *See, e.g., id.* at 411.
434. *See id.*
435. *See id.*
436. *See id.* at 410-11. Mallay also sued its insurance agent. The court declined to exercise supplemental jurisdiction over those claims, and it dismissed them. The court was apparently exasperated with some aspects of this case. It ordered the parties "to file nothing further on these issues in this Court, including motions to reconsider and the like. Instead, the parties are instructed to seek any further relief to which they feel themselves entitled in the United States Court of Appeals for the Fifth Circuit." *Id.* at 413-14.

have been judicially created. Insurance companies must use so-called "reservation of rights" letters. They must have, roughly speaking, certain contents. In addition, there are principles governing the relationship between insurers and third-party claimants.

1. Notice

Hanson Production Co. v. Americas Insurance Co.[437] considered the insurer's late notice defense. The issue before the court was whether a surplus lines liability insurer must prove prejudice in order to avail itself of a late notice defense. Hanson Production operated an oil and gas field. In 1991, a non-operator sued Hanson in state court, alleging that Hanson had damaged the reservoir of oil and gas through overproduction. Twenty-seven months after service of the initial suit, Hanson notified its liability insurance company for the first time of the lawsuit and demanded a defense. The lawsuit went to trial approximately six months after Hanson gave notice, and a little over two months later Hanson settled the lawsuit for $795,000. The insurers declined to fund the settlement.

The insurance policy required the insured to provide the insurer with notice of suit "immediately" or "as soon as practicable" after the suit was served. Texas courts have construed this language to mean that the insured must provide the insurer with notice "within a reasonable time in light of the circumstances."[438] The language at issue is a condition precedent to the insurance company having any duties. Traditionally, Texas courts enforced this language as written and did not require that the insurance company demonstrate prejudice with the benefit of the condition. However, in 1972, the Texas Supreme Court invited the State Board of Insurance to issue an order creating a prejudice requirement.[439] The State Board did just that.[440] Board Orders, however, apply only to policies issued by licensed insurers. That is the extent of the Board's authority.[441] The question before the court was whether the prejudice requirement should apply to a surplus lines carrier, which is, by definition, an unlicensed insurer.[442]

Since Texas law was at issue, Judge Thomas Reavley, writing for the panel, followed *Erie* and tried to determine what Texas law might be. He stated that the panel was convinced that the Texas Supreme Court would require a showing of prejudice for surplus lines carriers, even though the State Board Order had never been extended to them, and even though the *Cutaia* case had not been overruled in twenty-five years.[443] Judge Reavley issued an important and controversial ruling:

437. 108 F.3d 627 (5th Cir. 1997).
438. McPherson v. St. Paul Fire & Marine Ins. Co., 350 F.2d 563, 566 (5th Cir. 1965).
439. *See* Members Mut. Ins. Co. v. Cutaia, 476 S.W.2d 278, 280-81 (Tex. 1972).
440. *See* Board Order No. 23080 (superseded in 1987 by Board Order No. 50602, which maintains the prejudice requirement).
441. *See* TEX. INS. CODE ANN. art. 5.13-2, § 8 (Vernon Supp. 1998).
442. *See* TEX. INS. CODE ANN. art. 1.14-2, § 2(b) (Vernon Supp. 1998).
443. *See Hanson*, 108 F.3d at 629.

> We believe the [Texas Supreme C]ourt would opt for a uniform rule of construction, reasoning that surplus lines insurers are surely aware that their policies, like all policies issued to Texas residents, are subject to Texas law and the rules of construction followed by the Texas courts. We note that nothing we can find in the Insurance Code suggests the Legislature intended to deprive the Texas Supreme Court of its traditional authority, under common law, to adopt rules of construction for insurance policies, as it does for all contracts.[444]

The court indicated that it was influenced by the Texas Supreme Court's decision in *Hernandez v. Gulf Group Lloyds*.[445] In that case, the Court held that when an insured violates a clause in the uninsured/underinsured motorist coverage section of an auto policy that restricts settling without the insurer's consent to the settlement, the insurer must show prejudice to it before the clause will be enforced.[446] Judge Reavley also remarked that he thought that the Texas Supreme Court would look to the law of other jurisdictions and indicated that there is a modern trend in favor of requiring proof of prejudice before applying the late notice condition.[447]

2. *Reservation of Rights Letters*

Under some circumstances, if a carrier becomes active in the claims process without informing the insured that it has doubts about coverage, the insurer can find itself estopped from denying coverage, especially if it wishes to rely upon an exclusion. Of course, estoppel here requires prejudice, just as it does everywhere else.[448]

Certain Underwriters at Lloyds, London v. Oryx Energy Co.[449] concerns "reservation of rights" letters. In *Certain Underwriters*, a man was badly injured on a drilling platform in the Gulf of Mexico. He was employed by Mallard Bay Drilling, but the platform was owned and operated by Oryx Energy. The worker sued Oryx, and Oryx sought indemnity from Mallard. The indemnity agreement was funded by insurance. Oryx was an additional insured under the policy, and Oryx made demands directly upon the insurer, including a demand to settle within policy limits. It is important to note that the insurer did not provide Oryx a defense. Mallard provided Oryx a defense; it hired independent trial counsel who apparently defended the case and negotiated the settlement. During those discussions, the worker offered to settle for $6 million in annuities.

There was a sharp conflict over the amount of coverage available to Oryx. Accordingly, Lloyds Underwriters agreed to provide $11,050,000 to fund the settlement upon the understanding that it could seek to hold

444. *Id.* at 630.
445. 875 S.W.2d 691 (Tex. 1994).
446. *See Hanson*, 108 F.3d at 630.
447. *See id.* at 631; *see also* 8 JOHN A. APPLEMAN & JEAN APPLEMAN, INSURANCE LAW AND PRACTICE § 4732 (1981).
448. *See* Michael Sean Quinn, *Reserving Rights Rightly: The Romance and the Temptations*, 7 COVERAGE 23, 25 (July-August 1997).
449. 957 F. Supp. 930 (S.D. Tex. 1997).

Oryx responsible and seek reimbursement for all sums paid in excess of Oryx's coverage, which the insurer believed to be $500,000.

Lloyds sued to recover the settlement dollars from Oryx. Oryx resisted on the grounds that Lloyds had either waived its coverage defenses or was estopped from asserting them. The district court rejected this move on two grounds.[450] First, Lloyds was not a volunteer. It did not intend to make a payment that it could not recover. At all times, it was perfectly clear that Lloyds Underwriters would seek the return of its money. Therefore, Lloyds did not waive its right to recover from Oryx.[451]

Second, the district court did not agree that Lloyds Underwriters was estopped from asserting coverage defenses.[452] The doctrine of estoppel only applies, the court held, when the insurer assumes the defense of its insured without obtaining an enforceable non-waiver agreement or communicating a reservation of rights letter.[453] The court held that the insurer never assumed or took control over the defense.[454] Since this necessary precondition on the applicability of the doctrine of estoppel was not satisfied in this case, the doctrine did not apply. The mere fact that the liability insurer did not communicate its reservation of rights for a year is of no consequence when one or more of the elements of estoppel is not satisfied.[455]

3. *Liability Insurer/Victim Relations*

Tort victims may not sue the insurance companies of tortfeasors until a final judgment is in place. Furthermore, the law of bad faith does not create any duties running from liability insurers to tort claimants.[456] Nevertheless, there are some legal nexuses between insurers and tort claimants. Notice that in *Griffin*, the insurer sought a declaratory judgment against both the insured and the tort plaintiff.[457] What is available to the insurer, however, may not always be available to the insured.

In *Gracida v. Tagle*,[458] a mandamus case, the appellate court considered whether the district court must permit an injured plaintiff to intervene in a declaratory judgment action between the insurer and the defendant-insured. The Roman Catholic Diocese of Corpus Christi sued two entities for defects in a building at a church. The insurer for one of the defendants, after receiving notice of the suit, filed a declaratory judgment action. Bishop Gracida, acting on behalf of the church, sought to intervene since "all of the Diocese's property is owned by Bishop Gracida

450. *See id.* at 934.
451. *See id.*
452. *See id.*
453. *See id.*
454. *See id.*
455. *See* Pennsylvania Nat'l Mut. Ins. Co. v. Kitty Hawk Airways, Inc., 964 F.2d 478, 481 (5th Cir. 1992) (articulating the elements of estoppel under Texas law).
456. *See generally* Maryland Ins. Co. v. Head Industrial Coatings & Servs., Inc., 938 S.W.2d 27 (Tex. 1996); Allstate Ins. Co. v. Watson, 876 S.W.2d 145 (Tex. 1994).
457. *See supra* notes 277-93 and accompanying text.
458. 946 S.W.2d 504 (Tex. App.—Corpus Christi 1997, n.w.h.).

as a corporate sole. . . ."[459] The district court refused the intervention, and the Bishop brought a mandamus action against the judge.

The court of appeals began with the premise that a person has a right to intervene if (1) he could have brought the action, or part of it, in his own name; or (2) if the action had been brought against him, he would have been able to defeat recovery, or at least part of it.[460] Furthermore, trial courts have broad discretion in determining whether an intervention should be stricken.[461] Striking a plea is an abuse of discretion if (1) one component of the above test is satisfied; (2) intervention will not unduly complicate an already existing case by multiplying the number of issues to be litigated; and (3) "the intervention is almost essential to effectively protect the intervenor's interests."[462]

The court of appeals held that the district court did not abuse its discretion.[463] In effect, it held that no elements of the proper test were met. The Bishop could not have brought this action in his own name. He had no contractual rights under the insurance policy until he obtained a judgment, and he was not a third-party beneficiary of the insurance policy. Since he had no contract rights, he could not enforce any contract rights, nor could he defeat the insurer's claim against the insured.[464]

It is important to notice that, at least under *Griffin*, the insurance company could have included the church as a defendant in its declaratory judgment action. That simple fact, however, does not give the tort claimant the right to intervene in that action. One wonders if this discrepancy in rights is a good thing.

Relations between insurers and tort claimants came up again in *DiGrazia v. Atlantic Mutual Insurance Co.*,[465] where the issue was whether a tort claimant could sue the liability insurer of another for independent misrepresentations. This was the second appeal of the case, and many of the facts are laid out in the first opinion.[466] The tort plaintiff owned a two-year-old thoroughbred filly. Plaintiff took the horse to a race-horse training farm. The owner of the farm took the horse to a veterinarian for treatment of a tendon problem. While the horse was at the veterinary hospital, there was an electrical storm, after which the veterinarian found the horse dead in her stall. The veterinarian reported that the horse probably died of electrocution during the storm or blood poisoning. The veterinarian thought that blood poisoning was the more probable cause of death. He notified his liability insurer, Atlantic Mutual, and forwarded his report to it. The owners of the horse did not

459. *Id.* at 506.
460. *See id.*; *see also* Guaranty Fed. Sav. Bank v. Horseshoe Operating Co., 793 S.W.2d 652, 657 (Tex. 1990); TEX. R. CIV. P. 60.
461. *See Gracida*, 946 S.W.2d at 506.
462. *Id.*; *see* Mendez v. Brewer, 626 S.W.2d 498 (Tex. 1982).
463. *See Gracida*, 946 S.W.2d at 507.
464. *See id.*
465. 944 S.W.2d 731 (Tex. App.—Texarkana 1997, no writ).
466. *See* DiGrazia v. Old, 900 S.W.2d 499 (Tex. App.—Texarkana 1995, no writ).

receive the report until November 30, 1991, over five months after the incident.

On November 8, 1993, the owners of the horse sued both the training farm and the veterinarian. Since the horse died on June 5, 1991, the trial court granted both defendants summary judgment based on the statute of limitations. The Texarkana Court of Appeals reversed as to the veterinarian upon the ground that he may have been guilty of fraudulent concealment.[467] The court of appeals remanded the case. Subsequently, the appellant sued the veterinarian's insurance company alleging that it had stated falsely that electrocution was the cause of the horse's death, thereby preventing them from asserting claims against the horse training farm. These claims were asserted on theories of fraud, DTPA violations, and violations of the Insurance Code. Atlantic Mutual defended on the grounds that it owed no duty to the plaintiffs, that the DTPA and the Insurance Code were inapplicable, that there was no independent cause of action for fraudulent concealment, and that they did not—as a matter of law—cause the plaintiffs any damages.

On appeal, the DTPA and Insurance Code issues were not assigned as error. The appellants challenged only the propositions that fraud was not actionable, that the veterinarian's insurer owed them no common law duties, and that the insurer's conduct could not have been the proximate cause of any harm.

The insurer argued that it did not have a duty to tell them about the veterinarian's report, so withholding it could not constitute fraud. The insurance company argued that fraud falls into two classes: affirmative misrepresentations and failures to disclose. Failures to disclose constitute actionable fraud only if the defendant had a duty to make disclosure, and this duty generally depends upon the antecedent existence of fiduciary or confidential relationships. The insurance company alleged that no such relationship existed between it and the owners of the horse. The court of appeals responded by pointing out that the owners of the horse were not relying upon the insurer's failure to disclose anything.[468] Rather, they accused the insurance company of affirmatively and falsely asserting that the sole cause of the horse's death was electrocution.

Accordingly, the Texarkana Court of Appeals held that the plaintiffs were not suing for fraudulent concealment, but for fraud.[469] The court noted that, under Texas law, a fiduciary relationship is not required for a finding of fraud by affirmative misrepresentation.[470]

VI. STOWERS DOCTRINE

Under Texas law, if a liability insurance company that is providing its insured a defense negligently fails to settle within policy limits after it

467. *See id.* at 503.
468. *See DiGrazia*, 944 S.W.2d at 735.
469. *See id.*
470. *See id.*; *see also* Trenholm v. Ratcliff, 646 S.W.2d 927, 930 (Tex. 1983).

receives an unequivocal demand to settle within those limits, then the insured may be liable for extra contractual damages. This is called the *Stowers* Doctrine.[471] The *Stowers* Doctrine is part of the law of insurer bad faith. The essence of insurer bad faith is the exposure of an insurer to extra contractual damages. Nevertheless, it is appropriate to defer the discussion of the *Stowers* Doctrine until after the discussion of liability insurance, since the *Stowers* Doctrine actually pertains to one dimension of liability insurance, namely, the situation in which a liability insurer is defending its insured. It is usually assumed that the insurance company will be liable for all damages in excess of the policy limits, although that question has never been squarely presented to the Texas Supreme Court.

In *Trinity Universal Insurance Co. v. Bleeker*,[472] the *Stowers* Doctrine was the central issue. Bleeker struck a pickup truck on I-35 while drunk. It contained fourteen members of two families. One of these people was killed, and the thirteen others were all injured, some of them seriously. Southern County Insurance Company provided Bleeker auto liability coverage for the legal minimum of $20,100 per person and $40,000 per accident. Trinity Universal reinsured Southern County and handled its claims. Bleeker had no other assets, the victims incurred substantial medical bills, and the hospitals filed liens in excess of $40,000 shortly after the accident.

One of the families hired an attorney to represent the estate of the decedent, the decedent's spouse, and her minor children. The attorney testified that he repeatedly communicated oral offers to settle the claims of his clients for as little as $20,000. He testified that all such offers were rejected. Eventually, he dispatched a letter containing an offer to settle in exchange for the insurance company's interpleading $40,000. The letter gave the insurance company thirty days to respond. When the attorney wrote the letter, he had not communicated with the hospitals regarding their liens. Trinity did not interplead the demanded sum within the allotted thirty days. However, it did tell the lawyer that it would like to settle the case for the policy limits if all parties would release Bleeker as part of the arrangement. For its part, Trinity did not communicate with Bleeker to discuss the attorney's letter or the alleged oral settlement offers.

After the allotted thirty days elapsed, the attorney agreed to represent all of the potential plaintiffs. The case proceeded to trial, and it resulted in a judgment exceeding $11 million. Subsequently, the plaintiffs sued the insurance company. The jury assessed damages of $12,836,976.75, and the court trebled that sum to $38,510,930.25. The attorneys' fees were

471. *See* G.A. Stowers Furniture Co. v. American Indem. Co., 15 S.W.2d 544 (Tex. Comm'n App. 1929, holding approved); *see also* American Physicians Ins. Exch. v. Garcia, 876 S.W.2d 842 (Tex. 1994).

472. 944 S.W.2d 672 (Tex. App.—Corpus Christi 1997, writ granted). *Bleeker* was reversed in part and affirmed in part on April 14, 1998. *See infra* note 486.

intended to represent fifty percent of the judgment, so the court eventually entered a judgment for $77,021,860.50.

With respect to the *Stowers*-demand, the court of appeals first held that oral offers to settle were sufficient to trigger *Stowers* duties.[473] Second, the court held that a *Stowers*-demand need not specifically state that the claimants will release the insured.[474] If the letter makes a policy-limits demand and mentions the *Stowers* doctrine, then the letter implies a willingness to release.[475] Third, the court of appeals rejected the insurer's argument that the hospital liens constituted conflicting and prior claims so that it could not make payments without creating exposure for itself above policy limits.[476] The court of appeals held that liens do not constitute ownership.[477] Therefore, until the insurer actually makes some payment, it retains full policy limits. Fourth, under the circumstances, thirty days may not have been enough time to make a rational decision.[478] But the tort claimants repeatedly made oral offers to settle before the written, thirty day offer was communicated. Hence, that period of time may have been enough. Fifth, although Bleeker expressed satisfaction with his insurance company's handling of the case, that did not constitute a bar to recovery under the *Stowers* Doctrine.[479]

The DTPA claim against Trinity was that Trinity failed to disclose to Bleeker the existence of an offer to settle. Such a failure can constitute a violation of the DTPA.[480] In *Bleeker*, the insurance company's failure to make such a disclosure was not proved to have caused any damages.[481] At a minimum, plaintiffs needed to prove that if the insured had been informed of the settlement offer, the offer would have been accepted.[482] There was no such proof. "There is no evidence that Bleeker would have wanted to accept the settlement offer if he had been informed of it,"[483] so there could be no proof of causation. Hence, the court reversed the DTPA components of the judgment. Since the award of attorneys' fees was contingent upon the DTPA finding, that component of the judgment was reversed as well.[484] Thus, the court reduced the size of the judgment

473. *See Bleeker*, 944 S.W.2d at 675.
474. *See id.* at 676.
475. *See id.*
476. *See id.*
477. *See id.*
478. *See id.* at 676-77.
479. *See id.* at 677. The dissenting judge disagreed with his colleagues on this point: "Bleeker's uncontroverted satisfaction with the representation he received from Trinity left no viable Stowers claim to be turned over to the plaintiffs." *Id.* at 682. The majority distinguished Charles v. Tamez, 878 S.W.2d 201 (Tex. App.—Corpus Christi 1994, writ denied), in which an insured objected to a court order to turn over his cause of action against his lawyers under the *Stowers* Doctrine. There, the insured stated that he would not have accepted the settlement offer anyway. *See Bleeker*, 944 S.W.2d at 677.
480. *See id.* at 679; *American Physicians*, 876 S.W.2d at 847 n.11; Ecotech Int'l, Inc. v. Griggs & Harrison, 928 S.W.2d 644, 649 (Tex. App.—San Antonio 1996, writ denied).
481. *See Bleeker*, 944 S.W.2d at 679.
482. *See id.*
483. *Id.* at 680.
484. *See id.*

by nearly $65 million.[485]

One wonders if this case is correctly decided. The Texas Supreme Court has said that when there are multiple claimants making demands upon insurance proceeds, the insurance company does not violate *Stowers* when it fails to accept an offer within policy limits, when that offer exceeds the amount left under the policy.[486] Of course, hospital liens are different than actual payments, but in the real world, hospitals pursue their liens and often enforce them. Under the circumstances, it is not clear that an insurer should be held liable for extra contractual damages when it fails to interplead a sum. Moreover, all *Stowers* offers must involve a willingness to release the insured. If there had been an offer to release in exchange for an interpleader, that would have done the claimants no good at all. If the insurance company interpleaded the sum, and, in exchange, claims had been released against the tortfeasor, they would have no continuing claim to the sum interpleaded. The *Stowers* Doctrine is designed to prevent insurance companies from being obstinate when their insureds are faced with clear liability where the insurance company will clearly have to pay. Situations like *Bleeker* are simply too complicated, and a reasonable insurance company might well not know what to do.

The *Stowers* Doctrine was addressed again in *Birmingham Fire Insurance Co. v. American National Fire Insurance Co.*[487] This case arose out of a brutal murder at a shopping center in Irving, Texas. The decedent's family filed a premises liability action against the owners and operators of the shopping center. Birmingham Fire was the primary carrier, and American National was the excess carrier. Birmingham Fire had $1 million in limits. It never offered more than $250,000, but the plaintiffs never considered any amount below $3.25 million. The underlying tort case was tried twice. The first trial ended in a defense verdict. The trial judge determined that the jury verdict was against the great weight of evidence and granted the plaintiffs a new trial. The insurance companies still offered no more than $250,000. In the second trial, the jury returned a verdict in excess of $10 million. This time, Birmingham tendered the ex-

485. *See id.* The plaintiffs brought a cross-point. They argued that it was error for the trial judge to fail to submit a jury issue on unconscionability under the DTPA. The court of appeals agreed. The order of the court of appeals is somewhat confusing. It affirmed the trial court judgment as to the *Stowers* claim, but it reversed the judgment with respect to the DTPA and insurance bad faith claims, and it remanded the case on the issue of unconscionability. *See id.* at 682. What happens now?

486. *See* Texas Farmers Ins. Co. v. Soriano, 881 S.W.2d 312 (Tex. 1994). On April 14, 1998, a unanimous Texas Supreme Court reversed the *Stowers* components of the court of appeals' judgment, affirmed the *Stowers* judgment of the trial court, and remanded the DTPA unconscionability claim for trial. Trinity Universal Ins. Co. v. Bleeker, 1998 WL 169689 (Tex. Apr. 14, 1998). In all other respects, the Texas Supreme Court affirmed the court of appeals' judgment and rendered judgment that Bleeker take nothing. The court assumed that Villegas's letter was actually a settlement offer, and it further assumed that "a Stowers demand may be made on behalf of only some of the total pool of potential plaintiffs, [nevertheless], Villegas did not meet the requirement [of the Stowers Doctrine] that he offer to release those claims fully." *Id.* at *2.

487. 947 S.W.2d 592 (Tex. App.—Texarkana 1997, writ denied).

cess carrier $1 million in supplementary payments in excess of $400,000. The excess carrier negotiated a $7.9 million settlement and sued the primary carrier, claiming that it had suffered $6.5 million in damages.

The centerpiece of the case was a *Stowers* action.[488] The Texarkana Court of Appeals held that there was no *Stowers* liability.[489] In order for an insurer to be liable upon a *Stowers* theory, the plaintiff in the underlying tort case must present a reasonable opportunity to settle the case. While it may not have to present a formal demand for a settlement within policy limits, there must be a clear indication that such a thing is possible. Only then does an insurer have *Stowers* duties. All things being equal, the insurer does not have to make settlement offers. It does not even have to solicit settlement offers from the third-party plaintiff.[490] "Liability is thus premised purely on negligent failure to accept a reasonable offer; it cannot arise from a 'failure to negotiate' because the insurer has no duty to undertake actions often required for negotiation, such as making a counteroffer."[491]

The excess carrier argued that insurance companies that affirmatively misbehave should have a duty to make settlement offers, even in the absence of a within-limits demand from the tort plaintiff. The Texas Supreme Court has held out the possibility that there may be an "affirmative misconduct" exception to the within-limits demand requirement of the *Stowers* Doctrine,[492] and a leading scholar of insurance law has endorsed this idea.[493] The Texarkana Court of Appeals, however, did not accept this argument. It refused to create an "affirmative misconduct" exception to the standard *Stowers* rule, and it said that even if there were such an exception, it would not apply it in this case.[494] The court was very uncomfortable with the idea of an "affirmative misconduct" exception, and it stated that "[s]uch an exception would reintroduce chaos and uncertainty into the neat conceptual framework erected by *American Physicians*."[495] Moreover, American National apparently tried to suggest that the primary carrier owed an especially high duty to it. The Texarkana Court of Appeals rejected this view, as well.[496] Indeed, the primary carrier owes no duty at all to the excess carrier. It owes duties only to its own insured, to which the excess carrier may become subrogated.[497] Thus, the "affirmative misconduct" exception, even if it existed, would not give an excess liability carrier any additional rights.

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488. *See* American Centennial Ins. Co. v. Canal Ins. Co., 843 S.W.2d 480, 483 (Tex. 1992) (excess carrier may bring *Stowers* actions against primary carriers).

489. *See Birmingham Fire*, 949 S.W.2d at 597.

490. *See id.*; Insurance Corp. of Am. v. Webster, 906 S.W.2d 77, 79 (Tex. App.—Houston [1st Dist.] 1995, writ denied).

491. *Birmingham Fire*, 947 S.W.2d at 597.

492. *See American Physicians*, 876 S.W.2d at 850 n.17.

493. *See* Kent D. Syverud, *The Duty to Settle*, 76 VA. L. REV. 1113, 1166-68 (1990).

494. *See Birmingham Fire*, 947 S.W.2d at 598.

495. *Id.*

496. *See id.* at 599.

497. *See id.*

American National suggested that, although there was not an explicit demand to settle within policy limits, there was the equivalent of such a demand. Both insureds, the excess carrier, and the tort plaintiffs all requested that Birmingham tender its policy limits. There was no factual dispute about this matter. Nevertheless, according to the court of appeals, this was not the equivalent of an offer to settle within policy limits.[498] Indeed, the tort plaintiffs wanted policy limits tendered from the underlying carrier so they could pursue the excess carrier for a settlement. "Because the [tort] plaintiffs did not promise to fully release [the insureds] in exchange for Birmingham's tender, the request did not trigger the *Stowers* duty."[499]

Stowers-type liability came up again in *Keightley v. Republic Insurance*

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498. *See id.*

499. *Id. Birmingham Fire* involved another issue pertaining to the "supplementary payments" section of the policy. Virtually all liability policies contain such sections. They obligate primary insurers to pay court costs, unlimited amounts of pre-judgment interest assessed on those portions of the policy which the insurer is obligated to pay, and all post-judgment interest on the entirety of a judgment that accrues before the insurer pays, offers to pay, or deposits money with the court on that part of the judgment which is insured. On April 14, 1992, Birmingham tendered in excess of what it thought its policy limits were as supplementary payments on one of the two primary policies. These supplementary payments covered the time interval between the entry of the judgment and the point in time in which Birmingham entered its limits, attorney ad litem fees to be taxed as costs, and other costs. Thereafter, on May 26, 1992, the excess carrier settled the underlying case for less than the judgment amount. Hence, there was no longer a judgment to trigger the insurer's duty to make supplementary payments. According to the court of appeals, therefore, the fundamental question was whether "a subsequent settlement obligate[s] an excess insurer (or, for that matter, an insured) to return supplementary payments which it was entitled to retain had it merely paid the judgment." *Id.* at 604-605. The court answered the question in the negative. The primary insurer's duty to make supplementary payments accrues when the judgment is entered, and thereafter continues through the passage of time. *See id.* at 605. Moreover, if a primary carrier tenders while the judgment is in place, it is complying with its duty as of that time, even if the judgment is subsequently extinguished by way of settlement. *See id.* The text of the insurance policy does not subject the insurer's duty to pay to a condition subsequent. Not only is that an unreasonable construction of the policy, but it would contravene the strong public policy in Texas favoring settlements. *See* Stewart Title Guar. Co. v. Sterling, 822 S.W.2d 1 (Tex. 1991). There was yet another "supplementary payments" issue. The excess carrier claimed that Birmingham owed four years of post-judgment interest on the entire underlying judgment because it did not tender its limits on the second policy for four years. That would have entitled the excess carrier to an additional recovery in excess of $6 million. In fact, the excess carrier was seeking interest on the entire judgment, even though it had settled four years earlier. The court of appeals was unsympathetic to this argument. Post-judgment interest accrues only on judgments that are in place. Once the judgment is extinguished by settlement, post-judgment interest no longer runs, and the supplementary payment section of the policy no longer applies. *See Birmingham Fire*, 947 S.W.2d at 606. Interestingly, the excess carrier would have been able to recover interest over the four-year period as prejudgment interest, since the court of appeals had held that Birmingham should have tendered its limits on the second primary policy four years earlier. *See id.* However, the sole argument on appeal related to payment of interest as post-judgment interest. Nevertheless, the court compelled Birmingham to make a supplementary payment from April 14, 1992, the date it tendered one of its policies, to May 26, 1992, the date of the settlement. The court reasoned that Birmingham erroneously failed to tender both of its policies. *See id.* In the absence of a full tender, it would be required to pay additional interest.

Co.[500] The insured purchased liability insurance from National County Mutual Fire Insurance Company. The company reinsured its policies with Republic. Because of National's financial difficulties, Republic began administering the policies that it reinsured in October of 1987. These activities continued until October 1988, when a court appointed a receiver to take over National's property and affairs.

Allegedly, Republic failed to conduct itself properly while administering the insured's claim. The insured's assignee sued Republic under article 21.21 of the Insurance Code,[501] the DTPA, and a *Stowers* claim. The trial court granted Republic summary judgment on all claims. The court of appeals agreed on the DTPA action because the insured was never a consumer in connection with the reinsurer.[502] On the other hand, the court held that there might be a claim under article 21.21, section 16(a) and that there might be a *Stowers*-like claim under the law of negligence.[503] The court noted that section 16(a) of article 21.21 does not require privity of contract, and the insured met all of the stated elements of that section (i.e., damages caused by deceptive acts).[504]

With respect to the *Stowers* claim, the court noted that ordinarily an insured would not have a *Stowers* type claim against a reinsurer.[505] However, since Republic voluntarily injected itself into settlement negotiations, the action could be viable since "the law places a duty of ordinary care upon any person who voluntarily enters upon an affirmative course of action affecting another's interest."[506] As an affirmative defense, Republic contended that after the court appointed a receiver for National, its hands were tied. The Austin Court of Appeals rejected this defense since the insured's assignee was complaining only about conduct that occurred after Republic took over the administration of National's policies and before the receiver was appointed.[507]

VII. UNINSURED/UNDERINSURED AUTO COVERAGE

Uninsured/underinsured motorist (UM/UIM) coverage is a peculiar form of first party coverage.[508] If A collides with B and is at fault, B generally recovers from A's liability carrier. Sometimes B has to sue A to do this. Occasionally, B recovers from his own auto carrier for property damage, and thereafter, B's auto carrier may subrogate against A. (Or, B's health carrier may pay for B's hospital bills and then proceed against

500. 946 S.W.2d 124 (Tex. App.—Austin 1997, n.w.h.); *see supra* notes 171-73 and accompanying text. The court of appeals withdrew its judgment as an unpublished opinion. *See supra* note 171.

501. *See* TEX. INS. CODE ANN. art. 21.21, § 16(a) (Vernon Supp. 1998).

502. *See Keightley*, 946 S.W.2d at 127-28.

503. *See id.*

504. *See id.*

505. *See id.* at 129.

506. *Id.* at 129; *see* Otis Eng'g Corp. v. Clark, 668 S.W.2d 307, 309 (Tex. 1983); Colonial Savings Ass'n v. Taylor, 544 S.W.2d 116, 120 (Tex. 1976).

507. *See Keightley*, 946 S.W.2d at 129-30.

508. Lack of space prevents discussion of other types of auto insurance cases.

A.) But what if A does not have any insurance or has insufficient insurance? B may buy coverage under his own auto policy which will insure him against losses from bodily injury and property damage for which he could have recovered from the tortfeasor's insurance company if there were such a company providing coverage in sufficient amounts. The important thing to remember about uninsured/underinsured motorist coverage is that the insured victim must be able to prove the tort case against the uninsured/underinsured motorist. Within this general domain, all sorts of technical problems arise.

A. WHO IS AN INSURED?

The Texas Supreme Court considered UM/UIM once during the Survey period in the case of *Grain Dealers Mutual Insurance Co. v. McKee*.[509] The issue was whether the minor daughter of the principal of a closely-held corporation was an insured.

Future Investments, Inc. was a corporation solely owned by Jerrell McKee, who was also its president. McKee's daughter was injured in a one-car accident. The car was not an insured vehicle, the daughter was not on corporate business, and she was not covered under the policy. The "who is an insured" section of the policy provided that "[y]ou and any *designated person* and any *family member* of either" is an insured.[510]

The Court held that the injured daughter was not an insured.[511] The word "you" referred to the corporate entity, Future Investments. It was the named insured. Corporations, by their very nature, do not have families. Consequently, the injured daughter was not a family member of the corporation.[512] The phrase "designated person" was explicitly defined in the policy as "an individual named in the schedule." The corporation did not name any designated persons in the schedule. Consequently, the injured daughter was not a designated person.[513]

McKee suggested that, for the purposes of insurance, he was the corporation. In effect, McKee suggested that the fundamental postulates of corporate law do not apply in insurance situations. The Court declined this gambit and applied the rule that corporations are distinct entities and not to be regarded as identical to the shareholders.[514] More significantly, McKee utilized staple arguments in insurance controversies, and the Texas Supreme Court rejected them. For example, it is axiomatic in insurance law (as it is in contract law) that terms should not be rendered

509. 943 S.W.2d 455 (Tex. 1997).
510. *Id.* at 457 (emphasis added). PIP coverage was also involved. This coverage involves small first party payments for injuries. It is designed to be administered mechanically. It is unnecessary to prove fault, for example. The PIP endorsement provided that the following are insureds: "[y]ou or any *family member* while *occupying* or when struck by any *auto*." *Id.* (emphasis added).
511. *See id.*
512. *See id.*
513. *See id.*
514. *See id.* at 458.

mere surplusage. McKee suggested that the phrase "family member" would be surplusage if his corporation, rather than he, were counted as the named insured. Justice Abbott, writing for all of the members of the Court except Justice Spector, who dissented, rejected this ploy.[515] He observed that insurance contracts are typically form contracts involving a number of options that an insured may select or reject. Under those circumstances, terms may be surplusage without violating fundamental rules of construction.[516] McKee also argued that unless he personally was the named insured, coverage under the UM/UIM endorsement would be illusory. The Court rejected this view on the ground that it was simply false. The fact that McKee's daughter did not have coverage for this accident did not imply that there was a lack of coverages for many other types of accidents.[517] Finally, McKee suggested that the statutes requiring UM/UIM coverage impliedly require, as a matter of public policy, that his daughter be an insured. The Court rejected this view on the ground that article 5.06-1(1) and article 5.06-3(b) both permit UM/UIM coverage to be restricted to persons covered under the policy.[518] This means that the public policy issues inherent in the statutes are carefully circumscribed. It is not part of the business of any court to expand on policy carefully delineated by the Legislature.[519]

In *McKee*, the Texas Supreme Court joined a substantial majority of jurisdictions that have held that no ambiguity is created by the combination of "family member" language with an entity as the named insured. In general, Justice Spector's dissenting opinion relies upon a group of minority decisions.[520]

B. PUNITIVE/EXEMPLARY DAMAGES

A continuing controversy in insurance law is whether punitive damages should be covered by ordinary liability insurance policies. Some states say *Yes*, while others say *No*.[521] A side show in this general controversy is whether UM/UIM provisions cover punitive damages. Texas courts are divided on this matter.[522]

In *Milligan v. State Farm Mutual Automobile Insurance Co.*,[523] one court of appeals indicated that punitive damages did not fall within UM/

515. *See id.*

516. *See id.* at 458-59.

517. *See id.* at 459.

518. *See id.*; TEX. INS. CODE ANN. arts. 5.06-1(1), 5.06-3(a) (Vernon 1981).

519. *See, e.g.*, Allen v. Mauro, 733 S.W.2d 228, 232 (Tex. Civ. App.—El Paso 1986, writ ref'd n.r.e.).

520. *See McKee*, 943 S.W.2d at 460-61.

521. *See* Michael Sean Quinn, *Punitive Damages and Liability Insurance: Whither Texas?* 18. INS. LITIG. RPTR. 121, 121 (March 1996).

522. *See id.* at 146-47.

523. 940 S.W.2d 228 (Tex. App.—Houston [14th Dist.] 1997, writ denied).

UIM coverage, thereby overruling one of its own cases.[524] *Milligan* was a drunk driving case. Both Milligan and her insurer agreed that the driver's conduct was grossly negligent. State Farm resisted paying punitive damages assessed because of the gross negligence. Article 5.06-1(5) of the Texas Insurance Code provides that UM coverage shall include "payment . . . of all sums . . . as damages . . . because of bodily injury."[525] The Motor Vehicle Safety Responsibility Act has long required that drivers have insurance and has long specified minimum coverages for damages arising "because of bodily injury."[526] In addition, the legislative intent behind article 5.06-1(1) of the Insurance Code and the Motor Vehicle Safety Responsibility Act was to "protect conscientious motorists from '*financial loss* caused by negligent financially irresponsible motorists.'"[527]

The precise language of the State Farm UM/UIM coverage was this: "We will pay damages which a covered person is legally entitled to recover from the owner or operator of an uninsured motor vehicle because of bodily injury sustained by a covered person, or property damage caused by an accident."[528] The issue was: what does "because of bodily injury" mean? Are punitive damages assessed *because of bodily injury*? In this case, the court of appeals said no. Instead, punitive damages are awarded because of the malicious conduct of the tortfeasor and for the purpose of punishment and deterrence.[529] Punitive damages are not for compensating losses, and so they are not *because of bodily injury*.

The court of appeals seemed troubled by the fact that punitive damages are recoverable under the liability portions of such policies as auto policies, homeowners policies, and the like,[530] but were able to side step the issue. The parties had not provided the court with the entire insurance policy, and so it was not part of the record. As more and more Texas courts refuse coverage for punitive damages under UM/UIM coverages, tension grows in Texas insurance jurisprudence about the insurability of punitive damages.

C. Unusual Uses

One of the most interesting and comprehensive opinions of the Survey period, *Mid Century Insurance Co. of Texas v. Lindsey*,[531] considered

524. *See Milligan*, 940 S.W.2d at 232 ("We no longer accept the position taken in *Tyler*."); Home Indem. Co. v. Tyler, 522 S.W.2d 594 (Tex. Civ. App.—Houston [14th Dist.] 1975, writ ref'd n.r.e.).

525. Tex. Ins. Code Ann. art. 5.06-1(5) (Vernon 1981).

526. Tex. Trans. Code § 601.072(a) (Vernon 1998).

527. *Milligan*, 940 S.W.2d at 231 (quoting Act of Oct. 1, 1967, ch. 202, § 3, 1967 Tex. Gen. Laws 448, 449) (emphasis added).

528. *Id.* at 229.

529. *See id.* at 231.

530. *See* American Home Assur. Co. v. Safeway Steel Prod. Co., 743 S.W.2d 693, 705 (Tex. App.—Austin 1987, writ denied) (holding that umbrella liability policies covered punitive damages and that no public policy was thereby violated).

531. 942 S.W.2d 140 (Tex. App.—Texarkana 1997, pet. granted).

whether the accidental discharge of a rifle would constitute an auto accident in the use of an automobile.

The insured was seated in his truck, which was parked next to an empty truck, near a lake in the countryside. A young boy returned to the empty truck. He was fishing with his father, who owned the truck; he had become chilly and had returned for coveralls. While moving about in the empty truck (the truck was locked, and the boy had to crawl into the truck through a sliding back window), the boy brushed against a loaded shotgun, which was positioned on a gun rack over the rear window of the truck. The gun discharged and wounded Lindsey in the next truck. Lindsey's damages exceeded the policy limits of the truck owner, so he proceeded against his own carrier for UIM coverage.

The trial court found coverage, and the court of appeals affirmed. It found that there was an accident within the meaning of the UM/UIM provisions of the policy, that the accident did arise out of the use of a underinsured motor vehicle, and that finding coverage would not contravene public policy.[532]

The UM/UIM language of the policy provided coverage for bodily injury caused by an accident. The question before the court concerned the meaning of the term "accident" in the context of UM/UIM coverage. Mid Century argued that it means "auto accident" or "motor vehicle accident," and then suggested that such accidents are essentially collisions. The court of appeals rejected this view.[533] The phrase "auto accident" and the phrase "motor vehicle accident" appear elsewhere in auto insurance policies, but they do not occur in the UM/UIM coverage sections. Hence, the coverage under the UM/UIM component of the policy may be somewhat broader than in the liability section.[534] Moreover, the term "accident" is surely not restricted to collisions. "An accident, when viewed from the standpoint of the victim, is an unexpected happening without intent or design."[535]

At the same time, the only accidents insured under the UM/UIM provisions of the policy were those where the liability of the owner or operator arose from the "ownership, maintenance or use" of the uninsured motor vehicle. The issue in *Lindsey* was *use*. Was the boy using the truck when he caused the firearm to discharge? The court of appeals reviewed a number of different tests for *use* and a number of different contexts in which the discharge of firearms has been said to constitute the use of a motor vehicle. These included loading and unloading, the use of the car as a gun rest, accidental discharge caused by the movement of the car, and accidental discharge of a firearm while being removed from a gun rack.[536] The *Lindsey* court thought the case before it most analogous to

532. *See id.* at 143-49.
533. *See id.* at 143.
534. *See id.*
535. *Id.*
536. *See id.* at 145-46.

the last component of the above taxonomy, and it observed that the majority of cases had found that the removal of a gun from a gun rack in a motor vehicle constituted a use of the motor vehicle.[537] Insurance issues such as this one are, of course, contract issues. Consequently, the controlling question was whether gun rack-related firearm discharges were within the contemplation of the parties to the insurance contract. The court of appeals observed that most of the cases that have considered the issue have held that they were: "It especially can be assumed to be within the contemplation of the parties that a pickup truck in Texas might be used to carry a gun."[538] The court also regarded it as important that the boy was trying to get into the truck when he caused the firearm to discharge.[539] Surely, entering a vehicle is a use of the vehicle.

The court distinguished its holding from other superficially similar cases.[540] *Lindsey* was not a deliberate drive-by shooting. It did not involve pointing a gun at anybody. It was not something that simply happened inside the truck with no relevance to the fact that it was a motor vehicle; thus, it was not like being bitten by a dog inside a car.[541]

Notably, the court also distinguished the recent holding of the Texas Supreme Court in *National Union Fire Insurance Co. v. Merchants Fast Motorlines*.[542] In *National Union*, the Texas Supreme Court held that there was no duty to defend a lawsuit when the allegations in the petition merely alleged that the driver of a vehicle negligently discharged a firearm resulting in injuries, since such allegations were insufficient to allege a "use" of the automobile.[543] In *Lindsey*, the court noted that the detailed facts indicated that the discharge occurred in the course of the boy's entry into the vehicle.[544]

Finally, the court of appeals gave short shrift to Mid Century's public policy argument. The insurer probably did not take its own argument seriously. It simply suggested that if there were coverage in the *Lindsey* case, then all sorts of absurdities would result. Apparently, Mid Century argued that if there were coverage in *Lindsey*, there would be coverage in the Oklahoma City bombing. The court responded that the public policy in favor of protecting the insured articulated in the UM/UIM sections of the Insurance Code is quite broad.[545] It is supposed to include many things. Moreover, "slippery slope" arguments should never be used to

537. *See id.* at 146.

538. *Id.* at 148. (One wonders if this statement is as true in cities as it is in rural areas.)

539. *See id.*

540. *See id.* at 148-49.

541. *See* State Farm Mut. Ins. Co. v. Peck, 900 S.W.2d 910 (Tex. App.—Amarillo 1995, no writ) (The court of appeals acknowledged that since *Griffin* bases itself on this case, it has taken on a new sheen.).

542. 939 S.W.2d 139 (Tex. 1997); *see supra* notes 254-57 and accompanying text.

543. *See National Union*, 939 S.W.2d at 141.

544. *See Lindsey*, 942 S.W.2d at 149.

545. *See id.*

deny coverage where coverage is actually warranted.[546]

VIII. INSURANCE ARBITRATION

Many insurance disputes are resolved by arbitration. Contracts of reinsurance almost always specify arbitration as the preferred mode of dispute resolution. When insurance companies squabble with each other, they frequently arbitrate the dispute in the end. Property insurance policies often involve "appraisal," which is a dispute resolution mechanism restricted to valuation and is very similar to arbitration. Title insurance policies often contain arbitration clauses.

One such clause was addressed in *Stewart Title Guaranty Co. v. Mack*.[547] Mack purchased real property for $160,000 and paid $1,670 to Stewart Title for a title insurance policy. Problems with the title arose. Mack sought coverage under the contract. Stewart Title denied coverage, and Mack sued. Stewart Title then sought to compel arbitration based upon provisions in the contract. The district court refused to compel arbitration under either the Texas General Arbitration Act[548] or the federal Arbitration Act.[549] The Texas act provides for interlocutory appeal, but the federal act does not. Hence, Stewart Title filed an appeal from the order denying arbitration of the Texas act and sought a writ of mandamus from the order denying arbitration under the federal act.[550] The court of appeals denied relief under both statutes.[551]

The Texas Arbitration Act mandates contractually specified arbitrations under a variety of circumstances.[552] However, the Act excludes any contract that involves an individual person or group of persons acquiring, among other things, real property, personal property, or services, where the total consideration paid is $50,000 or less.[553] This exclusion contains the following exception: if all relevant parties and their attorneys have signed a writing agreeing to submit to arbitration, that agreement is en-

546. *See id.* Although the court does not seem to realize this, its critique of "slippery slope" arguments implies that they never prove anything. This is a truth, but most lawyers, including most judges, do not seem to know it. For other UM/UIM cases, see Davis v. Allstate Ins. Co., 945 S.W.2d 844, 846 (Tex. App.—Houston [1st Dist.] 1997, writ dism'd by arg.) (Insureds may not recover under UM/UIM provisions if they release the tortfeasor and thereby prejudice the insurance company's subrogation rights. There must be actual prejudice. If the tortfeasor has no assets to satisfy any judgment that the insurance company might get, the settling tort victim/insured has not prejudiced the insurer.). UM/UIM provisions may exclude uninsured motor vehicles owned by governmental bodies. *See* Ohio Cas. Group of Ins. Cos. v. Chavez, 942 S.W.2d 654 (Tex. App.—Houston [14th Dist.] 1997, writ denied) (The exclusion contained an exception where the operator of the vehicle was uninsured. The court of appeals rejected the proposition that the term "*un*insured" in the exception to the exclusion should be construed to include "*under*-insured" vehicles as well.).

547. 945 S.W.2d 330 (Tex. App.—Houston [1st Dist.] 1997, writ dism'd w.o.j.).

548. TEX. CIV. PRAC. & REM. CODE ANN. § 171.001 (Vernon Supp. 1998).

549. 9 U.S.C. § 2 (1994).

550. *See* Jack B. Anglin Co. v. Tipps, 842 S.W.2d 266 (Tex. 1992).

551. *See Stewart Title*, 945 S.W.2d at 332-33.

552. *See* TEX. CIV. PRAC. & REM. CODE ANN. § 171.017.

553. *See id.* § 171.017(a)(1).

forceable.[554] Mack contended that he was exempt from compelled arbitration because the consideration he paid for his insurance policy was less than $50,000, and there was no written agreement signed by the parties and their attorneys mandating arbitration. Stewart Title contended that the court should look not at the cost of the insurance policy but to the coverage limit ($160,000) or to the purchase price of the real estate ($110,000). The court of appeals sided with Mack. It pointed out that the value or the price of the real estate was completely irrelevant.[555] The issue was what consideration was paid for the insurance policy.

The federal Arbitration Act applies only to contracts involving interstate commerce.[556] Stewart Title, as the party seeking to compel arbitration, had the burden of establishing its right to invoke the federal act.[557] Therefore, it had the burden of demonstrating involvement in interstate commerce.[558] It failed entirely in this regard. To be sure, title insurance business activities, in the aggregate, implicate interstate commerce.[559] But it does not follow that a single title insurance transaction involving an individual implicates interstate commerce.[560]

IX. INSURANCE AGENTS AND BROKERS

The law of insurance agents and brokers is an enormous, semi-systematized branch of the law, which is heavily impacted by the Texas Insurance Code. Because those engaged in the selling of insurance are frequently, by statute, the legal agent of the insurer, the conduct of agents and brokers can have an enormous impact upon the liabilities of insurers.

A. Risk Pool

This impact was addressed in *McKillip v. Employers Fire Insurance Co.*[561] McKillip applied for automobile insurance on April 3, 1992. She understood, from her agent, that the insurance would be provided through the assigned risk pool, which is administered by the Texas Automobile Insurance Plan (TAIP). The agent forwarded the application to TAIP, and on April 9, 1992, TAIP assigned McKillip to Employers. Employers issued insurance with an effective date of April 14, 1992. On April 11, 1992—three days before the issuance of the insurance—McKillip was seriously injured in an auto accident. Employers denied coverage on the ground that the policy had not been issued yet. McKillip con-

554. *See id.*
555. *See Stewart Title*, 945 S.W.2d at 332.
556. *See* Perry v. Thomas, 482 U.S. 483, 489 (1987); *Anglin*, 842 S.W.2d at 269-70.
557. *See Stewart Title*, 945 S.W.2d at 333.
558. *See* Cantella & Co. v. Goodwin, 924 S.W.2d 943, 944 (Tex. 1996).
559. *See* Golfarb v. Virginia State Bar, 421 U.S. 773, 784-85 (1975) (holding statewide price-fixing by lawyers conducting title searches to be impermissible).
560. *See Stewart Title*, 945 S.W.2d at 333. For another arbitration case involving an agency agreement, see American Employers Ins. Co. v. Aiken, 942 S.W.2d 156, 159 (Tex. App.—Fort Worth 1997, no writ) (Arbitration agreements are favored, construed broadly, and not unconscionable even if insisted upon by the insurer.).
561. 932 S.W.2d 268 (Tex. App.—Texarkana, 1996, no writ).

tended that the agent told her that she would be insured as of that very moment and, hence, that Employers was bound.

The court of appeals affirmed summary judgment in favor of Employers.[562] Although an "insurance agent can act as an agent for both the insured and the insurer," this dual role requires that the agent have the relationship of legal agency with the carrier.[563] TAIP's operating procedure prevented this from happening. Even assuming the truth of plaintiff's view of the matter, when the agent spoke, he could not have had the authority to speak for Employers. Indeed, as of the time of the representation, TAIP had not yet designated Employers as the insurer.

B. Broker's Duty to Speak Limited

In *Cogan v. Triad American Energy*,[564] one of the issues was whether an insurance intermediary had a duty to make disclosures to persons beyond the insurer and the insured. Triad American Energy Company organized a limited partnership for the purposes of developing "wind parks" to generate electricity from desert winds and selling them in southern California. Financial arrangements were typical of the speculative, tax-benefit driven, high leverage investment schemes that were common in the early 1980s. In 1985, Triad bought ESI, one of the companies that had manufactured turbines to be used in the wind parks. Triad arranged for ESI to purchase an insurance policy to secure its manufacturer's warranty. Part of the *Cogan* lawsuit involved a suit against the insurance brokers who arranged the policy between Lloyds and ESI. Apparently, that policy had been subjected to a number of endorsements so that the private placement memorandum did not accurately describe the policy, nor were the investors made aware of the changes in the insurance policy by any other means. Cogan and his cohorts tried to make the insurance broker liable for these problems, even though the broker "did not generate the representation about insurance in the placement memorandum."[565] At no time was the broker ever the legal agent of the investors. In fact, it was never the legal agent of Triad, but only of ESI (in the context of presenting claims) and of Lloyds (in the context of the issuance of the policy).

Insurance brokers do not have an affirmative duty to make disclosures to investors in insured entities.[566] An insurance broker may have a confidential relationship in the insurance context to the insurer and to the insured. However, it does not have such a relationship with anyone else, and once the policy is issued and the premiums are collected, the broker's duty is over. If there is no affirmative undertaking,

562. *See id.* at 270.
563. *See id.*
564. 944 F. Supp. 1325 (S.D. Tex. 1996).
565. *Id.* at 1331.
566. *See id.* at 1332.

> neither an underwriter nor a broker has a duty to disclose the terms of an insurance policy [which] it has issued [to any nonparty to the contract]. An insurance relation is not fiduciary to the potential creditors of the assured. . . . Investors, lenders, contractors, customers, and others that deal with a company have the means to protect themselves by requiring certificates of insurance, by examining the policies, or by accepting the risk that inheres in their transaction with the assured.[567]

Moreover, the terms of an insurance policy are confidential and proprietary as between the insurer and the insured.[568]

The court was openly contemptuous of the plaintiff's claims. It summarized the insurance broker component of the claims as follows: "The underwriter agreed to furnish a service, and that service may have turned out to be different from what the general partner had told its investors it would be."[569] This is not to be charged to the account of the broker. The court remarked that the plaintiff's "claims at common law and under state and federal securities and consumer laws are worse than their investment."[570]

X. INSURANCE INSOLVENCY

The insolvency of insurance companies is extensively regulated by state law. It is, therefore, largely exempt from the federal Bankruptcy Code.[571] Consequently, there is a wealth of state cases throughout the country concerning the details of processing insurance insolvency. Texas is no exception.[572]

A. ATTORNEYS' FEES

Texas Civil Practice and Remedies Code section 105.002 provides that when a state agency files a frivolous claim, an opposing litigant may recover attorneys' fees.[573] In *El Paso Electric Co. v. Texas Department of Insurance*,[574] the Texas Supreme Court held that when the State Insurance Liquidator files a frivolous claim, there may be a recovery for attorneys' fees.

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567. *Id.*
568. *See id.*
569. *Id.*
570. *Id.* at 1328. At one point, the investors complained that a bank recklessly lent them money. The court responded that reckless lending was not actionable by the borrower. "If the banker lent recklessly, the law furnishes no redress for imprudent receipt of funds. No harm was done to the borrowers. . . . Recovery for 'reckless lending' belongs to the bank, its shareholders, and its insurers, not to the borrowers who spent the lent money." *Id.* at 1329.
571. *See* 11 U.S.C. § 101 (1994).
572. Sometimes, the law of several states and principles of interstate comity and federalism can be at stake. *See* Clark v. Fitzgibbons, 105 F.3d 1049 (5th Cir. 1997) (federal court abstained from deciding a case involving orders of the "Arizona insurance receiver.").
573. TEX. CIV. PRAC. & REM. CODE ANN. § 105.002 (Vernon 1997).
574. 937 S.W.2d 432, 435-37 (Tex. 1996).

El Paso Electric purchased $70 million in annuities from First Service Life Insurance Company. First Service obtained government securities, which it pledged as collateral to secure the El Paso Electric annuities. First Service encountered severe financial problems. The Commissioner of Insurance appointed a conservator. The conservator disputed the validity of El Paso Electric's security interest in the government securities. El Paso Electric filed a declaratory judgment action to vindicate its interest. The conservator counterclaimed and alleged that El Paso Electric had conspired to collateralize the securities unlawfully. Thereafter, First Service was placed in receivership, and the State Insurance Liquidator was appointed receiver. He continued to prosecute the conservator's counterclaim and added additional alleged conspirators as parties. Eventually, El Paso Electric obtained partial summary judgment on the enforceability of its security interest and on the conspiracy claim. Subsequently, the receiver dismissed these counterclaims with prejudice as to all defendants. Each counter-defendant filed an action under section 105.002 for attorneys' fees. Since these parties claimed that the liquidator was acting on behalf of the State Board of Insurance, the Board intervened, "contending that the conservator and receiver did not act on behalf of any state agency."[575] The trial court accepted this argument and dismissed the attorneys' fees motions without reaching the issue of whether the claims were frivolous. The court of appeals affirmed, holding that the conservator and the receiver were acting in private representative capacities on behalf of First Service and its creditors and that they were not acting in any public capacity on behalf of the State Board of Insurance.[576]

The Texas Supreme Court began with the fundamental premise that "the Texas Insurance Code sets forth a comprehensive scheme for the liquidation, rehabilitation, and reorganization of insolvent insurers."[577] Nevertheless, according to the Department of Insurance, "the receiver essentially acts as a private trustee, representing the interests of the insurer and its creditors, not the interests of the State."[578] For this reason, the Department of Insurance argued that its actions could not be attributed to the State and that section 105.002 did not apply.

The Court rejected this view on several grounds. First, even if the receiver were a private trustee, and nothing more, he reports to the State because he is subject to the control of a relevant state agency.[579] Second, the receiver is not merely a private trustee, but "[t]o the contrary, the receiver principally performs a public, regulatory function."[580]

575. *Id.* at 434.
576. *See id.*
577. *Id.* at 434-35.
578. *Id.* at 435.
579. *See id.* at 436.
580. *Id.* ("While the receiver stands in the shoes of the insurer for purposes of asserting the insurer's rights on behalf of its creditors, the receiver also performs a public function in assuring an orderly and efficient liquidation.").

Third, the Department of Insurance argued that "the receiver is an agent of the receivership court, and thus cannot be deemed to be an agent of the State" for the purposes of section 105.002.[581] After all, that statute is restricted to executive agencies only. The Court rejected this view because, although the receivership court has some supervisory control, it is quite clear that the Legislature intended "to vest a significant amount of control in the executive branch, specifically for the purpose of creating a centralized, efficient liquidation system."[582]

Fourth, the Department of Insurance argued that the receiver is not a state agency because the statute does not authorize the Attorney General to represent the receiver, and if the receiver were a state agency, the statute would have authorized such representation. The Court rejected this argument because private representation of receivers is characteristic of the common law. "The Legislature's retention of one particular characteristic of common law receiverships (i.e., the selection and compensation of the receiver's counsel) does not alter the fundamentally public nature of this statutory scheme."[583]

B. State Guaranty Associations

State Guaranty Associations are entities created by the Legislature to mitigate the consequences of insurer insolvency, at least to some degree. There are several types of guaranty associations. During the Survey period, one reported case arose with respect to the Texas Life, Accident, Health and Hospital Service Insurance Guaranty Association.[584] Another case involved the Texas Property and Casualty Insurance Guaranty Association.

Texas Property & Casualty Insurance Guaranty Association v. Boy Scouts of America[585] arose out of the insolvency of Mission National Insurance Company, which had issued two liability policies to the Boy Scouts. Mission was placed in liquidation in 1987. This case concerned three negligence lawsuits against the Boy Scouts and certain councils in

581. *Id.* at 437.
582. *Id.* at 438.
583. *Id.* at 439. Chief Justice Phillips applied the analogous reasoning to the conservator and found that he too was included within section 105.002 as the result of the State's comprehensive control over insurance insolvency. *See id.* at 440. Justice Gonzalez filed a dissenting opinion with which Justice Spector joined. Judge Gonzales subscribed to the arguments set forth by the Department of Insurance: "The power to appoint or remove and set compensation is not coextensive with the power to control, especially when the receiver assumes a specific legal capacity distinct from the Board." *Id.* at 442. Moreover, according to Justice Gonzalez, the "Legislature must use clear and unambiguous language to waive sovereign immunity." *Id.* at 443.
584. *See* Unisys Corp. v. Texas Life, Accident, Health & Hospital Serv. Ins. Guar. Ass'n, 943 S.W.2d 133 (Tex. App.—Austin 1997, writ denied). The issue in this complex case was whether certain annuity contracts benefiting the Texas employees of Unisys and Marathon Oil were covered under the Texas Life, Accident, Health and Hospital Service Insurance Guaranty Association Act. *See* Tex. Ins. Code Ann. art. 21.28-D (Vernon Supp. 1998). This case arose out of the failure of Executive Life Insurance Company.
585. 947 S.W.2d 682 (Tex. App.—Austin 1997, n.w.h.).

Pennsylvania. The Boy Scouts filed claims with Texas Guaranty on their own behalf and with the Pennsylvania Guaranty Fund on behalf of the Pennsylvania councils. Both guaranty funds rejected the claims. The Boy Scouts paid the costs of defending and settling the lawsuits and then filed suit in Texas. Both guaranty funds moved for summary judgment. The trial court awarded the Pennsylvania council damages and attorneys' fees of nearly $350,000 to be paid by Pennsylvania Guaranty. It also awarded the Boy Scouts $126,500 for damages and attorneys' fees to be paid by Texas Guaranty.

In brief, the court of appeals held that Texas courts lacked personal jurisdiction over Pennsylvania Guaranty and, hence, that the litigation had violated its constitutional rights of due process.[586] The appellate court rejected the idea that "a guaranty association stands in the shoes of an insolvent insurer [for the purposes of personal jurisdiction]."[587] Furthermore, Pennsylvania's enabling statutes did not somehow consent to its guaranty fund being sued in a variety of jurisdictions because Pennsylvania Guaranty had not purposely established minimum contacts.[588] The court held that Pennsylvania Guarantee had little to do with Texas, and, in fact, the underlying lawsuits had little to do with Texas.[589]

The appeal of Texas Guaranty involved a scout who was rendered a quadriplegic while at scout camp in Pennsylvania. Eventually, the claim was settled for $4.75 million. The Boy Scouts paid $1.5 million, which included a self-insured retention of $500,000 and Mission's share of $1 million. It was Mission's share that the Boy Scouts sought to recover from Texas Guaranty. As stated above, the trial court granted the Boy Scouts summary judgment and awarded it $126,500.[590]

Texas Guaranty took the position that the Boy Scouts were not legally obligated to pay this sum and that they elected to pay it as a volunteer. Texas Guaranty contended that the Pennsylvania councils were legally obligated to pay claims and that the parent organization was not. The court of appeals rejected both of these arguments, holding that the Boy Scouts were legally obligated to pay.[591] That legal obligation arose out of settlement. The claims were covered, and since Mission had to pay, the guaranty fund had to pay.[592] Indeed, the Mission policy specifically provided that the Boy Scouts would become legally obligated to pay as the result of the compromise of a claim.

The court of appeals had no more patience with the volunteer argument. The court observed that it could not say that the Boy Scouts had

586. *See id.* at 693.
587. *Id.* at 687.
588. *See id.* at 689-90.
589. *See id.*
590. Although the underlying settlement against the Boy Scouts was for $4,750,000, the Texas Act limited the recovery against Texas Guaranty to $100,000. *See id* at 690 n.7; TEX. INS. CODE ANN. art. 21.28, § 5(8) (Vernon Supp. 1997). The balance of $26,500 constitutes attorneys' fees.
591. *See Boy Scouts*, 947 S.W.2d at 691-92.
592. *See id.*

no potential liability as a matter of law.[593] Hence, settlement might have been a prudent course. As a result, the Boy Scouts did not act as a volunteer.[594]

There was a more serious problem, however. Texas Guaranty challenged the reasonableness of the settlement. The Boy Scouts asserted that Texas Guaranty could not challenge the reasonableness of the settlement because they denied the claim.[595] The court rejected that argument, however, because the insurer had no duty to defend, so its rejection could not possibly have been prejudicial.[596] Therefore, the court held that Texas Guaranty could challenge the reasonableness of the settlement. This part of the case had to be tried.

C. Insolvency and Premiums

In *Webb v. Reynolds Transportation, Inc.*,[597] the insured bought auto liability coverage from Employers National Insurance Company. The state insurance regulation requires that all such policies shall be endorsed to provide for adjustment or modification of the rates in accordance with the relevant experience modifier.[598] Employers National failed to include the endorsement. Shortly after the policy took effect, the insurer sent Reynolds Transportation a substantially enhanced bill for premiums due. Reynolds refused to pay. Subsequently, the insurer became insolvent, although there was no suggestion that Reynolds' nonpayment caused the insolvency. The receiver pursued Reynolds for the payment.

As Chief Justice Hardberger observed, this case creates a square conflict between insurance regulatory law and contract law. State insurance regulatory law mandates the use of an experience modifier, while contract law would forbid a change in the premiums unless it is rooted in the express language of the contract. The San Antonio Court of Appeals sided with the insured; the contract trumps the regulation, even when the endorsement allowing premium modifications is mistakenly omitted by the insurer.[599] As the author of the adhesionary contract, the insured should have the right to rely on insurers, and so, the insurer should bear the loss.[600] Even though the receiver did nothing wrong, he could not have greater rights than the insurer had. Consequently, contract trumps regulation in premium assessment.[601]

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593. *See id.* at 692.

594. *See id.*

595. *See id.* (relying upon Employer's Cas. Co. v. Block, 744 S.W.2d 940 (Tex. 1988)).

596. *See id.* at 693.

597. 949 S.W.2d 364 (Tex. App.—San Antonio 1997, n.w.h.).

598. *See id.* at 365.

599. *See id.* at 367.

600. *See id.*

601. The court relied heavily on Nat'l Union Fire Ins. Co. v. Clemtex, Inc., 807 S.W.2d 824 (Tex. App.—Houston [14th Dist.] 1991, writ denied).

XI. CONCLUSION

In the last few years, substantive insurance law, common law insurer bad faith, statutory bad faith, and the *Stowers* Doctrine have become heavily litigated issues in Texas courts. Decades ago, few insurance issues were decided by the Texas Supreme Court. For now, times have changed, and insurance law is where the action is.