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## Insurance Law

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# INSURANCE LAW

*J. Price Collins\**  
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## TABLE OF CONTENTS

|   |      |
|---|------|
| I. EXTRACONTRACTUAL LIABILITY .....   | 1785 |
| A. DUTY OF GOOD FAITH AND FAIR DEALING .....  | 1785 |
| 1. <i>Article 21.21 Provides a Private Cause of Action for an Insurer's Unfair Claims Settlement Practices</i> .... | 1785 |
| a. Recognition of Cause of Action Under Article 21.21 .....   | 1785 |
| b. Scope of Article 21.21 .....   | 1787 |
| c. The Statutory Liability Standards: "Reasonably Clear" Liability .....  | 1788 |
| d. "Proper Settlement Demand" Required .....  | 1789 |
| e. Liability Absent a Duty to Defend .....  | 1790 |
| 2. <i>Rocor Liability Standard Applies to Article 21.21 § 4(10)</i> .....   | 1791 |
| 3. <i>Tort Claims for Non-Renewal of Policy</i> .....   | 1792 |
| a. Fraud .....  | 1793 |
| b. Breach of Fiduciary Duty and Bad Faith .....   | 1794 |
| 4. <i>Duty of Good Faith and Fair Dealing Does Not Extend Beyond Judgment Against Insurer</i> .....                 | 1795 |
| B. PROMPT PAYMENT ACT (ARTICLE 21.55) .....   | 1797 |
| II. CONTRACTUAL LIABILITY .....   | 1798 |
| A. CGL AND UMBRELLA POLICIES .....  | 1798 |
| 1. "Occurrence" .....   | 1798 |
| a. Negligent Hiring .....   | 1798 |
| b. Providing Incorrect Information about a Former Employee .....  | 1801 |
| c. Construction Defects .....   | 1802 |
| 2. <i>Business Risk Exclusions</i> .....  | 1804 |
| 3. <i>Injury to Co-Employee</i> .....   | 1806 |
| a. Employee Exclusion .....   | 1806 |
| b. Definition of "Insureds" .....   | 1807 |
| 4. <i>Missing Policies</i> .....  | 1807 |
| 5. <i>Pollution Exclusion</i> .....   | 1808 |

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|    |   |      |
|----|---|------|
| a. | Exclusions Failed to Preclude Coverage for Arsenic Contamination Claims .....                     | 1808 |
| b. | Absolute Pollution Exclusion Applied to Insured's Spraying of the Insured's Odor Eliminator ..... | 1810 |
| B. | AUTOMOBILE POLICIES.....  | 1811 |
| 1. | Coverage for "Diminished Value" of Covered Auto .....   | 1811 |
| a. | Beaumont Court of Appeals Finds Coverage for Diminished Value .....                               | 1811 |
| b. | Houston Fourteenth Court of Appeals Rejects Diminished Value Coverage .....                       | 1813 |
| c. | Dallas Court of Appeals Finds Coverage for Diminished Value .....                                 | 1814 |
| 2. | Waiver of UIM and PIP Coverage.....   | 1815 |
| 3. | Owned Vehicle Exclusion—Meaning of "Occupying" .....  | 1817 |
| 4. | Owned Vehicle Exclusion—Meaning of "Struck By" .....  | 1818 |
| 5. | "Motor Vehicle Accident" .....  | 1818 |
| 6. | Worker's Compensation: Subrogation Rights Do Not Extend to UIM Claim.....                         | 1819 |
| C. | DIRECTOR & OFFICER LIABILITY: LATE NOTICE .....   | 1821 |

THE Survey period for 2002 yielded several significant cases, including a few landmark decisions. For example, the Texas Supreme Court ended the debate over whether claims can be asserted against a liability insurer under Texas Insurance Code, article 21.21 for the insurer's mishandling of third party claims—a debate fueled in part by the court's prior holdings in *American Physicians Insurance Exchange v. Garcia*<sup>1</sup> and *Maryland Insurance Co. v. Head Industrial Coatings & Services, Inc.*<sup>2</sup> The supreme court also surprised many in the insurance industry with its holding in *King v. Dallas Fire Insurance Co.*,<sup>3</sup> deciding that a negligent hiring claim against an employer can constitute an "occurrence" under a CGL policy, even if the plaintiff's injuries resulted from an employee's intentional misconduct. The court refused to follow Fifth Circuit precedent to the contrary.

While several decisions clarified certain issues, other opinions further muddied already murky water with respect to other issues. For example, during last year's Survey period, the Austin Court of Appeals held that damages from a builder's defective construction arose from intentional

1. *Am. Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842 (Tex. 1994).

2. *Md. Ins. Co. v. Head Indst. Coatings & Servs., Inc.*, 938 S.W.2d 27 (Tex. 1996) (per curiam).

3. *King v. Dallas Fire Ins. Co.*, 85 S.W.3d 185 (Tex. 2002).

acts and did not constitute an “occurrence.”<sup>4</sup> During this year’s Survey period, however, the Austin court retreated from its decision in *Devoe* and held that a home builder’s construction of faulty foundations constituted an “occurrence.”<sup>5</sup> Also, Texas appellate courts remain divided as to whether an insured is entitled to recover under a Texas standard automobile policy damages for inherent diminution in value to the insured vehicle, in addition to costs of repair.<sup>6</sup>

It would not be surprising if several of the cases discussed in this Survey were discussed in future decisions of the Texas Supreme Court. Several cases to watch include *Herrin v. Medical Protective Co.*<sup>7</sup> and the diminution in value cases.

## I. EXTRACONTRACTUAL LIABILITY

### A. DUTY OF GOOD FAITH AND FAIR DEALING

#### 1. *Article 21.21 Provides a Private Cause of Action for an Insurer’s Unfair Claims Settlement Practices*

##### a. Recognition of Cause of Action Under Article 21.21

In *Rocor International, Inc. v. National Union Fire Insurance Co.*,<sup>8</sup> the Texas Supreme Court held that article 21.21 of the Texas Insurance Code gives an insured a private cause of action against its liability insurer for unfair practices in settling third-party claims. *Rocor* involved an automobile accident caused by a Rocor employee who was operating a company truck under the influence of alcohol. The truck struck and killed two highway patrol officers; the families of the officers sued Rocor.<sup>9</sup>

After investigating the families’ allegations, Rocor and its attorney determined that the company would likely be found liable for the officers’ deaths. Rocor’s attorney, Terrence Martin, began settlement negotiations with the attorney representing the plaintiffs. The plaintiffs’ attorney, Charles Soechting, told Martin as early as June 1989, that he believed the case was worth the combined limits of Rocor’s primary and excess policies. Rocor’s coverage consisted of a \$1 million primary policy, with a \$1 million self-insured retention endorsement, and an \$8 million umbrella policy issued by National Union. The parties agreed to mediate the case in January 1990.<sup>10</sup>

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4. *Devoe v. Great Am. Ins.*, 50 S.W.3d 567 (Tex. App.—Austin 2001, no pet.).

5. *CU Lloyd’s of Tex. v. Main St. Homes, Inc.*, 79 S.W.3d 687 (Tex. App.—Austin 2002, no pet.).

6. See *Schaefer v. Am. Mfrs. Mut. Ins. Co.*, 65 S.W.3d 806 (Tex. App.—Beaumont 2002, pet. granted); *Smither v. Progressive County Mut. Ins. Co.*, 76 S.W.3d 719 (Tex. App.—Houston [14th Dist.] 2002, pet. filed); *Bailey v. Progressive County Mut. Ins. Co.*, 78 S.W.3d 708 (Tex. App.—Dallas 2002, pet. filed).

7. *Herrin v. Med. Protective Co.*, 89 S.W.3d 301 (Tex. App.—Texarkana 2002, pet. filed).

8. *Rocor Int’l, Inc. v. Nat’l Union Fire Ins. Co.*, 77 S.W.3d 253 (Tex. 2002).

9. *Id.* at 256.

10. *Id.*

Before the mediation, Rocor advised National Union that the exposure would likely reach the umbrella policy. National Union then exercised its contractual right to control the settlement negotiations.<sup>11</sup> Neither the primary policy nor National Union's umbrella policy included a duty to defend. Therefore, while National Union was entitled to control the settlement negotiations, Rocor remained responsible for the continuing costs of defense. After assuming control of the settlement negotiations, National Union cancelled the scheduled mediation and informed the plaintiffs that no settlement offer was open. National Union's attorney, Stanley Renneker, replaced Martin as Rocor's defense counsel.<sup>12</sup>

Once National Union assumed control of the settlement negotiations, offers passed between the parties over a period of fourteen months. Only one of the plaintiffs' settlement demands was ever presented in writing. That demand was for \$10 million. Renneker and National Union viewed the demand merely as an attempt to "Stower-ize" National Union rather than a realistic demand.<sup>13</sup>

Soechting had previously made an oral settlement demand of \$4.5 million. Renneker believed that the offer was for all claims against the insured and recommended that National Union accept it. Soechting testified, however, that this demand was intended to settle only the adult plaintiffs' claims and that he wanted an additional \$1.8 million for the children's claims. Thus, while Renneker believed the demand for all plaintiffs was \$4.5 million, Soechting intended the combined demand for all plaintiffs to be \$6.3 million.<sup>14</sup>

Approximately one year after National Union took over the settlement negotiations, it settled the children's claims for \$1.8 million. Several months later, National Union settled the adult plaintiffs' claims for \$4.6 million. After all claims were settled, Rocor sued National Union for attorney's fees and costs incurred during National Union's extended negotiations with the plaintiffs.<sup>15</sup>

Rocor alleged that National Union negligently handled the claims by failing to settle all claims a year earlier when Soechting would have accepted \$6.3 million. Rocor contended that this delay was unreasonable and unnecessarily exposed it to another year of expenses. Rocor specifically asserted that National Union violated article 21.21 of the Texas Insurance Code by failing to accept a reasonable settlement offer within its policy limits.<sup>16</sup> Rocor successfully tried its case against National Union to a jury, which found that the insurer was negligent and knowingly engaged in unfair or deceptive acts or practices in the business of insurance. National Union then moved for judgment notwithstanding the verdict, contending that Rocor could not maintain common law negligence or article

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11. *Id.*

12. *Id.*

13. *Id.* at 256-57.

14. *Id.*

15. *Id.* at 257.

16. *Id.* at 263.

21.21 causes of action against National Union based on its handling of a third-party claim. The trial court granted National Union's motion.<sup>17</sup>

Rocor subsequently appealed the trial court's judgment to the San Antonio Court of Appeals. A divided court of appeals reversed the trial court's judgment and rendered judgment for Rocor on its negligence claims.<sup>18</sup> Three justices concluded that Rocor could assert both claims of negligence and violations of article 21.21 against its insurer. Two justices believed that Rocor could recover only for common law negligence. Finally, two justices dissented, maintaining that Rocor should not recover against its insurer under either theory. Both Rocor and National Union filed petitions for review with the Texas Supreme Court.<sup>19</sup>

For the first time, the Texas Supreme Court addressed whether an insured is entitled to assert a claim against its liability insurer under article 21.21 for the insurer's handling of third-party claims. The supreme court rejected National Union's argument (and the suggestion from prior opinions issued by the supreme court) that such claims are restricted to first-party insurance claims. The supreme court recognized the cause of action and defined the standard of liability under the statute.<sup>20</sup>

#### b. Scope of Article 21.21

The supreme court found that article 21.21 permits "any person" to bring an action under the statute for damage caused by "another's" engaging in practice prohibited by the statute.<sup>21</sup> The supreme court noted that the legislature intended for article 21.21 to "comprehensively regulate and prohibit deceptive insurance practices."<sup>22</sup> Instead of proscribing what is a deceptive insurance practice, section 16(a) allows insureds to pursue claims for practices that the State Board of Insurance has declared unfair in its rules or regulations.<sup>23</sup> The supreme court found that State Board of Insurance Order No. 18,663<sup>24</sup> prohibits unfair or deceptive practices "as defined by the provisions of the Insurance Code."<sup>25</sup> The supreme court held that the broad prohibition on any deceptive practices under the Code encompassed activities prohibited under article 21.21-2, which identifies as unfair an insurer's "[n]ot attempting in good faith to effectuate prompt, fair, and equitable settlements of claims submitted in which liability has become reasonably clear."<sup>26</sup> While no private cause of action exists under article 21.21-2, the supreme court stated that the effect of the Board Order 18,993 was to make unfair claims settlement

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17. *Id.* at 257.

18. *Id.* at 257-58.

19. *Id.*

20. *Id.* at 258-60.

21. *Id.* at 258 (citing TEX. INS. CODE ANN. art. 21.21, § 16(a) (Vernon Supp. 2002)).

22. *Id.* (citing *Crown Life Ins. Co. v. Casteel*, 22 S.W.3d 378, 385 (Tex. 2000) (quoting *Liberty Mut. Ins. Co. v. Garrison Contractors, Inc.*, 966 S.W.3d 482, 486 (Tex. 1998))).

23. *Id.*

24. 28 TEX. ADMIN. CODE § 21.3 (West 2003) .

25. *Rocor Int'l, Inc.*, 77 S.W.3d at 258.

26. *Id.* (quoting TEX. INS. CODE ANN. art. 21.21-2, § 2(b)(4) (Vernon Supp. 2002)).

practices under article 21.21-2 actionable under article 21.21.<sup>27</sup> Citing its prior opinion in *Vail v. Texas Farm Bureau Mutual Insurance Co.*, the court held that the insured was entitled to assert a claim against the insurer under article 21.21.<sup>28</sup>

National Union argued that *Vail* did not support Rocor's article 21.21 claim because it was limited to first party insurance claims. National Union relied on the Texas Supreme Court's decision in *American Physicians Insurance Exchange v. Garcia*,<sup>29</sup> which involved a claim against a liability insurer for failing to settle a medical malpractice claim against its insured. The plaintiffs asserted a common law *Stowers* claim against the insurer, as well as statutory claims under article 21.21 and the DTPA. On appeal, the plaintiffs argued that *Vail* supported their statutory causes of action against the insurer. The supreme court disagreed, stating:

*Vail*, however, involved an insurer's bad faith refusal to pay a claim under a first-party property insurance policy. A *Stowers* action, by definition, involves an insurer's duty to settle a covered lawsuit—a situation that can only arise under a third-party liability insurance policy. Thus *Vail* is inapposite.<sup>30</sup>

Dismissing National Union's argument that *Vail* did not support Rocor's article 21.21 claim, the supreme court stated that nothing in its prior opinions "indicates that [the court] intended to limit an insured's statutory claims against its own insurer for unfair claim settlement practices to first-party insurance claims, and neither was necessary to our decision."<sup>31</sup> Concurring, Justice Hecht argued: "Plainly, *Garcia* limited *Vail*'s applicability to first-party claims. This limitation is consistent with *Vail*'s alternative holding that article 21.21 makes actionable a breach of the common law duty of good faith and fair dealing. That duty covers only first-party claims."<sup>32</sup> Justice Hecht contends that it "would be better to simply overrule *Garcia* as wrong than to pretend as if its words mean nothing."<sup>33</sup>

### c. The Statutory Liability Standard: "Reasonably Clear" Liability

Next, the supreme court addressed the statutory criteria for bringing a third-party claim under article 21.21. The supreme court noted that article 21.21 imposes liability on an insurer if the insurer does not "'attempt in [ ] good faith to effectuate prompt, fair, and equitable settlements of claims submitted . . . in which liability has become reasonably clear.'"<sup>34</sup>

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27. *Id.* at 258-59 (citing *Vail v. Tex. Farm Bureau Mut. Ins. Co.*, 754 S.W.2d 129 (Tex. 1988)).

28. *Id.* at 260 (citing *Vail*, 754 S.W.2d at 133-34).

29. *Id.* at 259 (citing *Garcia*, 876 S.W.2d at 845).

30. *Id.* at 266 (citation omitted).

31. *Id.* at 260.

32. *Id.* at 266.

33. *Id.*

34. *Id.* at 260 (alteration in original).

The supreme court then analyzed what constitutes “reasonably clear” liability under the statute.

The supreme court first noted that the Insurance Code does not identify situations when liability is “reasonably clear” such that an insurer may be subject to liability for failing to reasonably or promptly settle a claim.<sup>35</sup> National Union argued in favor of applying the common law *Stowers* test to the statute. The supreme court agreed and held that the *Stowers* test would provide an “appropriate framework.”<sup>36</sup> The supreme court noted that “[a]pplying the familiar common law standard promotes uniformity and prevents insurers from facing conflicting liability standards for failing to settle lawsuits filed by injured third-party claimants.”<sup>37</sup> Thus, the supreme court held that that the following elements must be satisfied in order to trigger an insurer’s statutory duty to reasonably attempt settlement of a third-party claim against the insured:

- 1) The policy must cover the claim;
- 2) The insured’s liability must be reasonably clear;
- 3) The claimant must make a proper settlement demand within policy limits; and
- 4) The demand’s terms must be such that an ordinarily prudent insurer would accept it.<sup>38</sup>

Since National Union did not dispute coverage, or argue that the insured’s liability was not reasonably clear, the court found that the first two elements of the 21.21 liability standard were satisfied.<sup>39</sup> National Union maintained that Rocor’s claim must fail nevertheless because there was no evidence that the plaintiffs made a proper settlement demand within policy limits such that an ordinarily prudent insurer would have accepted.<sup>40</sup>

#### d. “Proper Settlement Demand” Required

The supreme court noted that, in some jurisdictions, an insurer may incur tort liability for failing to settle even if the third-party claimant had not made a firm settlement offer.<sup>41</sup> However, the supreme court confirmed that Texas law “imposes no duty on an insurer to accept a settlement demand in excess of policy limits or to make or solicit settlement proposals.”<sup>42</sup> Accordingly, the supreme court held that “an insurer’s statutory duty to reasonably attempt settlement of a third-party claim against its insured is not triggered until the claimant has presented the insurer with a proper settlement demand within policy limits that an ordinarily

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35. *Id.*

36. *Id.* at 260-61.

37. *Id.* at 261.

38. *Id.* at 262.

39. *Id.*

40. *Id.*

41. *Id.* at 261.

42. *Id.* (citing *Am. Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 824, 849, 851 (Tex. 1994)).



prudent insurer would have accepted.”<sup>43</sup> The supreme court stated that a “proper settlement demand” at a minimum “must clearly state a sum certain and propose to fully release the insured.”<sup>44</sup>

The supreme court found that proper settlement demand was not presented to National Union and, therefore, National Union was not liable to Rocor under article 21.21. The supreme court based its decision on the fact that the record indicated confusion over the plaintiffs’ settlement demand. The only demand in writing was for \$10,000,000. Since the claim was ultimately settled for less than \$10,000,000, National Union could not be liable for rejecting this demand. Because the plaintiffs’ attorney did not clearly communicate his settlement demand to National Union, the supreme court found that a proper demand had not been made. The supreme court stated that to be a proper settlement demand, the settlement terms must be clear and undisputed.<sup>45</sup> Although a formal written settlement demand does not appear to be required, in light of the court’s decision, plaintiffs’ attorneys would be wise to present their demands in writing so that there is no confusion as to the terms of the proposed settlement.

e. Liability Absent a Duty to Defend

National Union argued that it could not be liable for Rocor’s defense costs because it did not owe Rocor a duty to defend under the umbrella policy. In support of this position, National Union suggested that the *Stowers* duty is “premised upon the insurer’s control of the insured’s defense.”<sup>46</sup> The supreme court disagreed, stating that its decision in *Stowers* also was premised upon the insurer’s control over settlements.<sup>47</sup> The supreme court pointed out that Rocor was not seeking recovery of its attorneys’ fees as a measure of contractual damages, but as tort damages.<sup>48</sup>

The *Rocor* decision is significant because, for the first time, the Texas Supreme Court extended its holding in *Vail* to third-party liability policies. Texas law now recognizes a statutory duty on the part of liability insurers to settle claims by third parties against their insureds once liability becomes reasonably clear. The standard for liability under article 21.21 is the same as the common law duty imposed by the *Stowers* doctrine. The insurer must accept a demand to settle a covered claim within the limits of the insurance policy if the insured’s liability is reasonably clear and the terms of the demand are such that an ordinarily prudent insurer would accept it. The duty does not include the duty to solicit settlement demands. Moreover, a proper demand must be clearly communicated such that the proposed settlement terms are clear and undisputed.

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43. *Id.* (citing *Garcia*, 876 S.W.2d at 849).

44. *Id.* (citing *Garcia*, 876 S.W.2d at 849).

45. *Id.* at 263.

46. *Id.*

47. *Id.*

48. *Id.* at 264.

## 2. Rocor Liability Standard Applies to Article 21.21, § 4(10)

*Chickasha Cotton Oil Co. v. Houston General Insurance Co.*<sup>49</sup> represents one of the first applications of the Texas Supreme Court's *Rocor* decision. In this case the insured, Chickasha Cotton Oil Co. (Chickasha), sought defense coverage from Houston General for various toxic tort lawsuits involving pollution of the air, ground, and water in Commerce, Texas. The pollution allegedly resulted from cotton waste incineration by a gin Chickasha owned from 1962 to 1969. Chickasha sought coverage under policies that had been issued to its predecessor by Houston General's predecessor. The policies consisted of comprehensive general liability coverage from 1946 to 1986, as well as umbrella policies issued between 1972 and 1986. Neither Chickasha nor Houston General could locate any of the policies issued before 1972. Moreover, only some of the post-1972 policies were identified and those policies contained pollution exclusions. Houston General denied coverage under all policies.<sup>50</sup>

Chickasha filed this declaratory judgment action seeking both defense and indemnity coverage. Chickasha also asserted contractual and extra-contractual claims, including a claim for alleged violations of Texas Insurance Code article 21.21.<sup>51</sup> Chickasha claimed that it had spent over \$7 million dollars defending and settling the claims.<sup>52</sup> The parties filed cross motions for summary judgment and the trial court granted summary judgment in favor of Houston General, dismissing with prejudice all of Chickasha's claims. Chickasha appealed.<sup>53</sup>

The Dallas Court of Appeals first addressed whether Chickasha had presented sufficient evidence of coverage to preclude summary judgment against it.<sup>54</sup> Finding that the trial court erred in granting summary judgment in favor of Houston General on the coverage issues, the court then considered whether summary judgment on the extra-contractual claims was erroneous. One issue was whether Chickasha had asserted a viable claim against Houston General under section 4(10) of article 21.21. At the time the appeal was filed, the Texas Supreme Court's decision in *Rocor*<sup>55</sup> had not yet been issued. Relying on pre-*Rocor* precedent, Houston General asserted that the 21.21 claims "are not available to Chickasha as to the third-party underlying claims here under controlling Texas case law."<sup>56</sup> Houston General cited *Maryland Insurance Co. v. Head Industrial Coatings & Services, Inc.* for the proposition that "the insured's rights against its insurer for the insurer's settlement practices were lim-

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49. *Chickasha Cotton Oil Co. v. Houston Gen. Ins. Co.*, No. 05-00-01789-CV (Tex. App.—Dallas Aug. 6, 2002, no pet.) (not designated for publication) 2002 WL 1792467.

50. *Id.* at \*1.

51. *Id.*

52. *Id.*

53. *Id.* at \*2.

54. *Id.* at \*4-5.

55. *Id.* at \*8.

56. *Id.* at \*7.

ited to the rights under the *Stowers* doctrine.”<sup>57</sup> The court of appeals noted that, at the time *Maryland Insurance Co.* was filed, “article 21.21 did not include section 4(10), which permits an insured to bring a cause of action against an insurer for unfair settlement practices.”<sup>58</sup>

Chickasha asserted a claim under section 4(10)(ii) of article 21.21, which defines as an unfair settlement practice “failing to attempt in good faith to effectuate a prompt, fair, and equitable settlement of a claim with respect to which the insurer’s liability has become reasonably clear.”<sup>59</sup> The court concluded that, although the Texas Supreme Court in *Rocor* interpreted article 21.21 as it existed before section 4(10) was added, its holding was applicable to claims based on section 4(10)(ii) because language interpreted in *Rocor* was “virtually identical to the language in section 4(10)(ii).”<sup>60</sup> Thus, the court held that, in order to assert a claim under section 4(10)(ii), the insured “must show that (1) the policy covers the claim, (2) the insured’s liability is reasonably clear, (3) the claimant has made a proper settlement demand within policy limits, and (4) the demand’s terms are such that an ordinarily prudent insurer would accept it.”<sup>61</sup>

Houston General argued that Chickasha’s claim under section 4(10)(ii) should fail as a matter of law because there was no evidence demonstrating that “coverage for the underlying claims was ‘reasonably clear.’”<sup>62</sup> The court rejected this argument stating that “[r]easonable clarity of coverage is not one of the elements under *Rocor* and section 4(10)(ii).”<sup>63</sup> The court held that the trial court erred in granting summary judgment in favor of Houston General.<sup>64</sup>

### 3. Tort Claims for Non-Renewal of Policy

In *Herrin v. The Medical Protective Co.*,<sup>65</sup> the insured, Bob J. Herrin, M.D., sued his malpractice carrier, The Medical Protective Company, and his insurance broker, as a result of the insurer’s failure to renew his medical malpractice insurance. Herrin claimed that the non-renewal of his malpractice coverage occurred after he consented to settle a surgical malpractice claim against him. He further claimed that he was induced into giving his consent to the settlement by representations that the settlement would not affect his coverage. Specifically, he alleged that he accepted the settlement only after Chuck Curtice, Medical’s general agent, assured him that the settlement was “nothing unusual” and that it “would have no

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57. *Id.* (citing *Md. Ins. Co.*, 938 S.W.2d at 28-29).

58. *Id.* (citing TEX. INS. CODE ANN. art. 21.21, §§ 4(10), 16(a) (Vernon Supp. 2002)).

59. *Id.* at \*8 (quoting TEX. INS. CODE ANN. art. 21.21, § 4(10)(ii) (Vernon Supp. 2002)).

60. *Id.*

61. *Id.* (quoting *Rocor Int’l Inc.*, 77 S.W.3d at 262).

62. *Id.*

63. *Id.*

64. *Id.*

65. *Herrin*, 89 S.W.3d at 304.

effect on his relationship with Medical.”<sup>66</sup> Herrin alleged that Curtice implied the settlement would not result in cancellation or non-renewal of his coverage.

In spite of Curtice’s alleged assurances, subsequent to the settlement, Medical refused to renew Herrin’s policy, citing “‘claim and suit frequency and severity.’”<sup>67</sup> This determination was made in spite of Herrin’s long-standing relationship with Medical and the fact that only a few claims had been made against him over a very long career. Evidence was also presented that field personnel, including Curtice, had recommended that Medical renew the policy. After the non-renewal of his coverage, Herrin was unable to find sufficient liability coverage and had to prematurely retire from the practice of medicine.<sup>68</sup> Herrin then filed suit against Medical alleging “common law fraud, breach fiduciary duty, violations of the Texas Deceptive Trade Practices Act (“DTPA”) and the Texas Insurance Code, and breach of contract.”<sup>69</sup>

The trial court granted Medical’s motion for summary judgment on all Herrin’s claims.<sup>70</sup> Herrin appealed the summary judgment arguing that genuine issues of material fact were raised concerning all of his allegations against Medical.<sup>71</sup>

The Texarkana Court of Appeals reversed the lower court’s summary judgment, holding that Herrin had raised sufficient fact issues to support all of his allegations, except for his breach of contract claim.<sup>72</sup> The court’s analysis regarding Herrin’s fraud, breach of fiduciary duty, and bad faith claims is particularly noteworthy.

#### a. Fraud

Medical argued that Herrin failed to present any evidence in support of the intent element of his fraud claim. Specifically, Medical maintained “that to have a legal basis for fraud, Curtice would have had to have *known* that Medical would drop Herrin’s coverage at the time he recommended Herrin settle” the malpractice claim.<sup>73</sup> Disagreeing, the court stated that “the intent element of common law fraud requires that he know or *should have known*.”<sup>74</sup> The court found that evidence establishing Curtice’s awareness of Medical’s policy to review “an insured’s claims history to consider nonrenewal when a claim in excess of \$100,000 is paid” created an issue of material fact as to whether Curtice knew or should have known Herrin’s policy would not be renewed.<sup>75</sup> The court

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66. *Id.*

67. *Id.*

68. *Id.*

69. *Id.* at 303-04.

70. *Id.* at 304.

71. *Id.* at 305, 307, 309-11.

72. *Id.* at 312.

73. *Id.* at 306.

74. *Id.* (emphasis added) (citing *Johnson & Higgins of Tex., Inc. v. Kenneco Energy, Inc.*, 962 S.W.2d 507, 524 (Tex. 1998)).

75. *Id.*

also found there was sufficient evidence to raise a fact issue regarding the other elements of the fraud claim.<sup>76</sup>

b. Breach of Fiduciary Duty and Bad Faith

The court also considered whether Herrin presented sufficient evidence on his claims of breach of fiduciary duty and breach of the duty of good faith and fair dealing. First, the court noted that Herrin based his fiduciary duty claim on the existence of an informal fiduciary relationship rather than a formal fiduciary relationship.<sup>77</sup> The court stated:

Informal fiduciary relationships may arise in circumstances “where a special confidence is reposed in another who in equity and good conscience is bound to act in good faith and with due regard to the interests of the one reposing confidence.” Whether an informal fiduciary relationship exists is typically determined by a trier of fact because those relationships hinge on the surrounding circumstances. Certain “special relationships” give rise to a tort duty of good faith and fair dealing. The common law duty of good faith and fair dealing does not exist in all contractual relationships. The duty only arises when a contract creates or governs a special relationship between the parties. A fiduciary duty encompasses at the very minimum a duty of good faith and fair dealing, but the converse is not true. The duty of good faith and fair dealing merely requires the parties to “deal fairly” with one another and does not require the high standard of trust present in a fiduciary relationship.<sup>78</sup>

The court found that Herrin’s summary judgment evidence was sufficient to raise a fact issue regarding the existence of an informal fiduciary relationship as well as a duty of good faith and fair dealing. Specifically, the court relied on deposition testimony from Curtice indicating that he knew and worked with Herrin for approximately fifteen years and on Herrin’s testimony that he trusted Curtice’s advice concerning the settlement because of the nature of their long-standing relationship.<sup>79</sup> The court found that a provision in the insurance policy requiring Herrin’s consent to settle a claim was “further summary judgment proof that Medical was under a duty of good faith and fair dealing.”<sup>80</sup>

It could be argued that this decision opens the door to a new theory of extra-contractual claims against liability carriers. In *Maryland Insurance Co.*, the Texas Supreme Court, reversing the court of appeals, refused to recognize a cause of action for bad faith against a liability insurer for failing to “investigate and defend claims by a third party against its insured.”<sup>81</sup> The lower court in *Maryland Insurance Co.* “reasoned that a duty of good faith and fair dealing arises because of the special relation-

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76. *Id.* at 307.

77. *Id.*

78. *Id.* at 307-08 (citations omitted).

79. *Id.* at 308-09.

80. *Id.* at 309.

81. *Md. Ins. Co.*, 938 S.W.2d at 27.

ship between insurer and insured, and because of the insurer's superior position in that relationship."<sup>82</sup> This reasoning is similar to the reasoning expressed by the *Herrin* court.

An attempt to distinguish *Herrin* from *Maryland Insurance Co.* can be made based on the perspective that the alleged breach of duty in *Herrin* occurred when the policy was not renewed and therefore did not involve the handling of third party claims as in *Maryland Insurance Co.* In *Maryland Insurance Co.*, the Texas Supreme Court held: "[A]n insured is fully protected against his insurer's refusal to defend or mishandling of a third-party claim by his contractual and *Stowers* rights. Imposing an additional duty on insurers in handling third-party claims is unnecessary and therefore inappropriate."<sup>83</sup> Viewed from another perspective, however, it could be argued that the breach of duty in *Herrin* did involve the handling of a third party claim. The basis for *Herrin*'s claims against Medical was not solely the nonrenewal of his malpractice coverage, but also the alleged statements made to induce him to provide his consent to the settlement of a third party claim. It is also interesting that the court stated, without qualification or limitation, that the existence of a consent-to-settle clause in the policy created a duty of good faith and fair dealing.<sup>84</sup>

It should be noted that a petition for review by the Texas Supreme Court was filed December 12, 2002. Unless reversed or clarified by the supreme court, it is foreseeable that insureds may attempt to rely on the *Herrin* opinion as a substitute for traditional common law bad faith claims, proscribed by *Maryland Insurance Co.*, by seeking to establish extra-contractual liability against liability insurers based on the alleged existence of an informal fiduciary duty. Such an alleged duty might be argued to exist based on the relationship the insured has with its insurance agent or on the reliance and confidence placed by the insured in a claims handler. Moreover, insureds under policies containing consent-to-settle clauses, common in professional liability policies, might attempt to rely on *Herrin* to support a common law bad faith claim. Such claims, however, to the extent they involve the duty to defend or the mishandling of third party claims, seem contrary to *Maryland Insurance Co.*

#### 4. *Duty of Good Faith and Fair Dealing Does Not Extend Beyond Judgment Against Insurer*

In *Mid-Century Insurance Co. of Texas v. Boyte*,<sup>85</sup> the Texas Supreme Court addressed the issue of whether an "insurer's common law and statutory duties of good faith and fair dealing extend beyond entry of judgment in favor of its insured." This case arose in 1992 when the insured, Randy Boyte, was involved in a car accident. Boyte made a claim against

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82. *Id.* at 28.

83. *Id.* at 28-29.

84. *Herrin*, 89 S.W.3d at 309.

85. *Mid-Century Ins. Co. of Tex. v. Boyte*, 80 S.W.3d 546, 547 (Tex. 2002) (per curiam).

his insurer, Mid-Century, for personal injury protection (“PIP”) and also asserted a liability claim against the other driver. Boyte filed suit against the other driver, and that driver’s carrier tendered its policy limits of \$100,000 to Boyte. Boyte then added Mid-Century to the underlying lawsuit asserting claims for UIM benefits.

In 1995, Mid-Century determined that Boyte’s UIM claim was worth \$120,000 and tendered \$20,000, which was the difference after subtracting the settlement with the other driver. Because Boyte needed additional medical treatment, his claims against Mid-Century for the remaining policy limits proceeded to trial.<sup>86</sup> The jury found that Boyte was entitled to the remaining \$80,000 available under the Mid-Century policy, and Mid-Century appealed the judgment. After the judgment, Boyte informed Mid-Century that he was in need of back surgery and that he could not afford it.<sup>87</sup> Despite the \$80,000 judgment for Boyte, Mid-Century only offered to pay \$23,400 for Boyte’s back surgery and therapy because the appeal was pending. Boyte declined this offer, and Mid-Century did not pay the \$80,000 until 1998, after the Fort Worth Court of Appeals affirmed the trial court’s judgment and the Texas Supreme Court denied review.

As a result of Mid-Century’s delay in settling his claim, Boyte sued Mid-Century for bad faith, breach of fiduciary duty, and violations of the Insurance Code and the DTPA. The case proceeded to trial, and the jury found that Mid-Century knowingly failed to attempt to effectuate a prompt, fair, and equitable settlement of Boyte’s claim when it knew or should have known that its liability was reasonably clear.<sup>88</sup> Mid-Century appealed arguing, among other things, that the duty of good faith and fair dealing does not extend beyond judgment. Specifically, Mid-Century alleged that “it and Boyte [were] no longer in an insurer-insured relationship but that they [were] in a judgment debtor-judgment creditor relationship since Boyte obtained a judgment against Mid-Century.”<sup>89</sup> In support of its argument, Mid-Century relied on *Stewart Title Guarantee Co. v. Aiello*,<sup>90</sup> in which “[t]he Texas Supreme Court held that an insurance company does not owe a duty of good faith and fair dealing on a claim when the claim has already been settled by both parties.”<sup>91</sup> The court of appeals affirmed the trial court’s judgment finding that the facts were distinguishable from *Aiello* because the agreed judgment in *Aiello* was subject to immediate execution, while the judgment in this case was superseded pending Mid-Century’s appeal.<sup>92</sup>

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86. *Id.*

87. *Id.*

88. *Mid-Century Ins. Co. of Tex. v. Boyte*, 49 S.W.3d 408, 411 (Tex. App.—Fort Worth 2001), *rev’d*, 80 S.W.3d 547 (Tex. 2002) (per curiam).

89. *Id.* at 413.

90. *Stewart Title Guar. Co. v. Aiello*, 941 S.W.2d 68, 70-72 (Tex. 1997).

91. *Mid-Century Ins. Co. of Tex.*, 49 S.W.3d at 413.

92. *Id.*

The Texas Supreme Court reversed the court of appeals' holding. In reaching its decision, the Texas Supreme Court held that the facts in this case were not distinguishable from *Aiello*. In particular, the Texas Supreme Court noted, "Like the agreed judgment in *Aiello*, Mid-Century's UIM judgment called only for payment of a sum of money to Boyte."<sup>93</sup> The supreme court held that the parties' relationship was transformed from one of insurer-insured to judgment creditor-judgment debtor upon the trial court's entry of judgment.<sup>94</sup> The supreme court explained that "an insurer's duty of good faith 'arises because of the disparity of bargaining power inherent in the insurer-insured relationship,'" which "'simply [does] not arise in the judgment creditor—judgment debtor context.'"<sup>95</sup> The supreme court held that Boyte, like the Aiellos, was not "vulnerable, [because he] had access to a number of enforcement remedies."<sup>96</sup> Thus, the supreme court held that Boyte had no bad faith cause of action based on Mid-Century's post-judgment conduct because the judgment extinguished Mid-Century's duty of good faith.<sup>97</sup>

#### B. PROMPT PAYMENT ACT (ARTICLE 21.55)

In *Wellisch v. United Services Automobile Ass'n.*,<sup>98</sup> the San Antonio Court of Appeals rejected the insureds' contention that their underinsured motorist (UIM) carrier violated Texas Insurance Code article 21.55 by waiting to pay their claim until a jury determined damages. The facts of the underlying case stem from a car rollover while the driver, Judith Salinas, was traveling at eighty miles per hour. Salinas was killed in the rollover and her passengers were severely injured. One of her passengers, fifteen-year-old Jessica Wellisch, was comatose after the accident and died five days later.<sup>99</sup>

Jessica Wellisch's parents sued Salinas's estate for wrongful death. Before the case was tried, the Wellisches settled with Salinas's automobile liability carrier for \$1,000,000. The settlement was approved by the Wellisches' UIM carrier, United Services Automobile Association ("USAA"). After the settlement, the Wellisches demanded that USAA tender the \$300,000 limit of their UIM policy. USAA refused, and the Wellisches sued the insurer.<sup>100</sup>

"The trial court ordered separate trials on the Wellisches' contractual and extracontractual claims."<sup>101</sup> Prior to the trial on the contractual liability, the Wellisches obtained partial summary judgment establishing

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93. *Mid-Century Ins. Co. of Tex.*, 80 S.W.3d at 548.

94. *Id.*

95. *Id.* (quoting *Aiello*, 941 S.W.2d at 71).

96. *Id.*

97. *Id.* at 549.

98. *Wellisch v. United Servs. Auto. Ass'n*, 75 S.W.3d 53, 58 (Tex. App.—San Antonio 2002, pet. denied).

99. *Id.* at 55.

100. *Id.*

101. *Id.*



Salinas's negligence in the accident.<sup>102</sup> After Salinas's negligence was established, a jury trial was held on damages. The jury found in favor of the Wellisches and awarded them \$6 million in damages. On the same day that the trial court entered the judgment, USAA tendered its full policy limits.<sup>103</sup>

The Wellisches then pursued their extra-contractual claims against USAA for initially denying their claim. The Wellisches moved for summary judgment on their extra-contractual allegations, arguing that USAA had violated the Texas Insurance Code's prompt payment provision under article 21.55.<sup>104</sup> USAA responded with its own motion for partial summary judgment, contending that the Wellisches were not legally entitled to their UIM policy benefits until the liability of the underinsured motorist was established and the amount of the Wellisches' damages was determined by the jury.<sup>105</sup> The trial court agreed and entered final judgment in favor of USAA. The Wellisches appealed.<sup>106</sup>

On appeal, the court held that an insurer is not obligated to pay UIM benefits until the insured is entitled to them.<sup>107</sup> The court also noted that, while the Texas Insurance Code requires the prompt payment of claims, "the statute is premised on the presumption that carriers have the right to dispute claims."<sup>108</sup> The court then addressed a line of cases relied on by the Wellisches to support their argument. The court found that in each of those cases the delay in payment was marked from the time a covered event arose.<sup>109</sup> The court found that in the Wellisches' case there was no covered event until the jury awarded damages to the Wellisches. Therefore, the insurer did not violate Texas Insurance Code article 21.55 by waiting to pay UIM benefits until the insureds' damages were determined by the jury.<sup>110</sup>

## II. CONTRACTUAL LIABILITY

### A. CGL AND UMBRELLA POLICIES

#### 1. "Occurrence"

##### a. Negligent Hiring

In the much-anticipated *King v. Dallas Fire Insurance Co.*,<sup>111</sup> the Texas Supreme Court held that a negligent hiring claim against an employer could constitute an "occurrence" under a commercial general liability (CGL) policy, despite the fact that the alleged injury resulted from an

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102. *Id.* at 55-56.

103. *Id.* at 56.

104. *Id.*

105. *Id.* at 56, 58.

106. *Id.* at 56.

107. *Id.* at 57.

108. *Id.* (citing *Dunn v. S. Farm Bureau Cas. Ins. Co.*, 991 S.W.2d 467, 474 (Tex. App.—Tyler 1999, pet. denied)) .

109. *Id.* at 58.

110. *Id.*

111. *King v. Dallas Fire Ins. Co.*, 85 S.W.3d 185, 186 (Tex. 2002).

employee's intentional conduct. In the underlying lawsuit, Carlisle King, the insured, was sued both individually and doing business as "Tiedown Construction Company" by Gregg Jankowiak. Jankowiak alleged that one of King's employees attacked him while the two were working at a common job site. Jankowiak claimed that King was negligent in hiring, training, and supervising the attacker, Carlos Lopez. Jankowiak specifically alleged that King negligently failed to check Lopez's criminal background to determine his propensity for violence or to provide him with training on how to properly respond to conflicts at work.<sup>112</sup>

After receiving each of Jankowiak's petitions, King forwarded them to his CGL carrier, Dallas Fire Insurance Company. Dallas Fire in turn refused to provide a defense, arguing that Jankowiak had not alleged an "occurrence," which was defined in the policy as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions."<sup>113</sup> King then filed a declaratory judgment action. The parties filed cross-motions for summary judgment and the trial court ruled in favor of Dallas Fire. King appealed, and the Houston Court of Appeals for the First District affirmed.<sup>114</sup> King then appealed to the Texas Supreme Court.

In analyzing whether the underlying lawsuit presented an occurrence under King's policy, the supreme court noted that there are three possible "standpoints" from which an injury-triggering event could be viewed: "(1) the insured's, (2) the victim's, or (3) the actor's."<sup>115</sup> The supreme court determined that the policy's language, prior precedent, and the history of the CGL policy all supported using the insured's standpoint to determine whether there has been an "occurrence" that triggers the duty to defend.<sup>116</sup>

In conducting its analysis, the supreme court first looked to the language of the policy, with particular interest in the "separation-of-insureds" provision. The supreme court determined that this provision effectively creates separate insurance policies for each insured.<sup>117</sup> The provision requires that the insureds be treated "[a]s if each Named Insured were the only Named Insured."<sup>118</sup> As a result, the supreme court concluded it was required to decide whether an "occurrence" had taken place as if King were the only insured under the policy.<sup>119</sup>

In reaching this conclusion, the supreme court expressly rejected arguments by *amicus curiae* in support of Dallas Fire contending that the separation-of-insureds clause evolved out of policy exclusions and should

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112. *Id.* at 187.

113. *Id.*

114. *Id.* (citing *King v. Dallas Fire Ins. Co.*, 27 S.W.3d 117, 119 (Tex. App.—Houston [1st Dist.] 2000), *rev'd*, 85 S.W.3d 185, 186 (Tex. 2002)).

115. *Id.* at 188.

116. *Id.*

117. *Id.*

118. *Id.* (alteration in original).

119. *Id.*

only apply to exclusionary clauses.<sup>120</sup> The supreme court agreed with Dallas Fire's supporters on the origins of the provision but found that the current separation-of-insureds clause is not limited to exclusions. Moreover, the supreme court held that, if the policy's drafters did not intend for the provision to apply to coverage under Section I of the CGL policy, "they could have said so."<sup>121</sup>

The supreme court also rejected Dallas Fire's argument that the holding in *Fidelity & Guaranty Insurance Underwriters, Inc. v. McManus* mandated that coverage under an occurrence-based policy is determined by the "injury-causing event," regardless of the separation-of-insureds provision.<sup>122</sup> In *McManus*, the supreme court held that an exclusion for "injuries caused by the 'ownership, maintenance, operation, use, loading or unloading of a recreational motor vehicle away from the residence'" precluded defense coverage for a negligent entrustment claim.<sup>123</sup> The supreme court stated that *McManus*, was inapposite because the exclusion involved in that case did not have an intent element.<sup>124</sup> The applicability of the exclusion in that case could be determined without regard to the insured's relationship to the event.

The court acknowledged that prior precedent from the Fifth Circuit supported Dallas Fire's position; however, the supreme court stated that the Fifth Circuit had not correctly interpreted Texas law.<sup>125</sup> The supreme court pointed to several of its prior opinions in support of this statement. The supreme court first noted that, in *Republic National Life Insurance Co. v. Heyward*, it held that the widow of a murder victim could recover under a life insurance policy because the "test of whether the killing is accidental within the terms of an insurance policy is not to be determined by the viewpoint of the one who does the killing, but rather from the viewpoint of the insured."<sup>126</sup> The supreme court went on to hold that even though these cases were not occurrence-based, they were relevant because the ultimate issue is whose standpoint determines if there has been an accident.<sup>127</sup>

The supreme court also noted that its decision in *Trinity Universal v. Cowan* was consistent with its application of the *Heyward* standard.<sup>128</sup> In *Cowan*, the supreme court held that no coverage existed under a homeowner's policy for an insured that made copies of a customer's revealing photographs and distributed them to his friends. The supreme court

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120. *Id.*

121. *Id.*

122. *Id.* at 189 (discussing *Fid. Guar. Ins. Underwriters, Inc. v. McManus*, 633 S.W.2d 787 (Tex. 1982)).

123. *Id.*

124. *Id.*

125. *Id.* at 191.

126. *Id.* at 189 (quoting *Republic Nat'l Life Ins. Co. v. Heyward*, 536 S.W.2d 549, 552 (Tex. 1976) (quoting *Hutcherson v. Sovereign Camp, W.O.W.*, 112 Tex. 551, 251 S.W. 491 (1923))).

127. *Id.*

128. *Id.* (discussing *Trinity Universal v. Cowan*, 945 S.W.2d 819 (Tex. 1997)).

found that this conduct was not accidental and, therefore, did not constitute an occurrence. The court emphasized that, unlike the employer in the present case, the “actor” committing the wrongdoing in *Cowan* was the insured.<sup>129</sup>

The supreme court expressly rejected contrary precedent from the Fifth Circuit, stating that the Fifth Circuit had “erroneously” presumed to interpret Texas law.<sup>130</sup> The supreme court found that the Fifth Circuit incorrectly “imputes the actor’s intent to the insured.”<sup>131</sup> Instead, the supreme court held that “whether one who contributes to an injury is negligent is an inquiry independent from whether another who directly causes the injury acted intentionally.”<sup>132</sup>

Finally, the supreme court suggested that the history of the CGL policy supports its position. The supreme court pointed out that beginning in 1966 the standard forms of the CGL policy limited occurrences to accidents “‘expected or intended from the standpoint of the insured.’”<sup>133</sup> In 1986 this definition was again revised. The 1986 revision removed the language “expected or intended from the standpoint of the insured” from the definition of “occurrence” and reinserted the phrase as a standard exclusion.<sup>134</sup> The supreme court held that, if it construed “occurrence” as narrowly as Dallas Fire requested, there would be no need for a number of typical exclusions, including those “covering assault and battery or sexual misconduct.”<sup>135</sup>

The supreme court ultimately held that, with respect to the employer, the allegations of negligent hiring, supervision and training in the underlying petition alleged an “occurrence,” regardless of the “actor’s” intentional conduct. The supreme court ruled that Dallas Fire had a duty to defend.

#### b. Providing Incorrect Information about a Former Employee

In *Acceptance Insurance Co. v. Lifecare Corp.*, the Corpus Christi Court of Appeals held that an insured’s alleged negligence in providing inaccurate information about a former employee to a subsequent employer constituted an “occurrence” under the insured’s commercial general liability (CGL) policy.<sup>136</sup> At one time, Gary Willis was employed by Lifecare, the insured. Sometime after leaving Lifecare, Willis went to work for Thomas Care Center (Thomas). Thomas contacted Lifecare to obtain information on Willis’s work history. Lifecare responded to the

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129. *Id.* at 190.

130. *Id.* at 191.

131. *Id.*

132. *Id.*

133. *Id.* at 192 (quoting ERIC MILLS HOLMES, HOLMES’ APPLEMAN ON INSURANCE § 117.1-.5 (2d ed. 2000)).

134. *Id.* (citing HOLMES, *supra* note 133, § 117.1).

135. *Id.* at 193.

136. *Acceptance Ins. Co. v. Lifecare Corp.*, 89 S.W.3d 773, 784 (Tex. App.—Corpus Christi 2002, no pet. h.).

request for information, but gave Thomas “wrong information” about Willis.<sup>137</sup> Subsequently, Willis sexually assaulted a woman while employed by Thomas. The injured woman, Davis, filed suit against both Thomas and Lifecare. Davis alleged that Lifecare was negligent in failing to exercise reasonable care in determining whether the information it sent to Thomas was correct.<sup>138</sup>

Lifecare sought coverage for Davis’s suit from its CGL insurers, Acceptance Insurance Company and Redland Insurance Company. The insurers denied coverage, contending there was no “occurrence” in light of Willis’s intentional acts.<sup>139</sup> Lifecare then filed a declaratory judgment action against the insurers seeking a determination of coverage. After the parties filed cross-motions for summary judgment, the court held that coverage applied. The insurers appealed.<sup>140</sup>

On appeal, the insurers argued that Davis’ allegations did not constitute an “occurrence” under “Coverage A” because the policy excluded coverage for bodily injuries “expected or intended from the standpoint of the insured.”<sup>141</sup> The insurers further argued Lifecare’s alleged negligence was related and interdependent on Davis’ intentional sexual assault based upon *Folsom Investments Inc. v. American Motorists Insurance Co.*<sup>142</sup>

The court found *Folsom* to be distinguishable because, in that case, the insured’s conduct was alleged to be interrelated to that of its allegedly abusive employee, based upon the insured’s knowledge of the ongoing abuse.<sup>143</sup> Next, the court noted that *Folsom* was based exclusively on Fifth Circuit precedent which had incorrectly interpreted Texas law.<sup>144</sup> The court recognized that this precedent was expressly rejected by the Texas Supreme Court in *King v. Dallas Fire Insurance Co.*<sup>145</sup> Thus, the court found *Folsom* inapplicable. The court held that the claim against Lifecare involved an “occurrence” under the policy because the insured did not intend to injure Davis, and the term “occurrence” is “largely determined by whether the activity was expected or intended from the standpoint of the insured.”<sup>146</sup>

### c. Construction Defects

*CU Lloyd’s of Texas v. Main Street Homes, Inc.*<sup>147</sup> involved claims against an Austin home builder, Main Street Homes, Inc., by home purchasers. The purchasers alleged that they observed defects resulting from

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137. *Id.* at 777.

138. *Id.*

139. *Id.*

140. *Id.* at 776.

141. *Id.* at 778.

142. *Id.* (citing *Folsom Invs., Inc. v. Am. Motorists Ins. Co.*, 26 S.W.3d 556 (Tex. App.—Dallas 2002, no pet.)).

143. *Id.* (citing *Folsom Invs., Inc.*, 26 S.W.3d at 561).

144. *Id.* at 778-79 (citing *Am. States Ins. Co. v. Bailey*, 133 F.3d 363 (5th Cir. 1998)).

145. *Id.* at 780 (citing *King*, 85 S.W.3d at 191).

146. *Id.* at 784.

147. *CU Lloyd’s of Tex.*, 79 S.W.3d at 687.

faulty foundations in homes they purchased from Main Street. They claimed that Main Street received warnings that the foundations of the homes, as designed, were inappropriate for the soil conditions and that Main Street disregarded these warnings and knowingly proceeded with construction.<sup>148</sup> Some of the home purchasers further alleged that Main Street relied on an inaccurate soil survey, which led to the deficient foundation designs, and that Main Street knew the foundations were destined to fail. Claims were asserted for “violations of the Texas Residential Construction Liability Act, Texas Deceptive Trade Practices Act, fraud, breach of implied warranty, negligence and fraudulent conveyance.”<sup>149</sup>

Main Street submitted the claims to its liability insurers. The insurers refused to provide a defense, contending that the claims did not involve an “occurrence” and the claims were excluded under the policies’ business risk exclusions. Coverage litigation ensued. The trial court granted summary judgment in favor of Main Street, holding that the insurers owed Main Street a duty to defend. The insurers appealed.<sup>150</sup>

The policies at issue provided coverage for “bodily injury” or “property damage” caused by an “occurrence.” Section I of both policies defined “occurrence” as “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.”<sup>151</sup> The policies did not define “accident.”<sup>152</sup>

The court stated that the term “accident” as used in a general liability policy “include[s] negligent acts of the insured causing damage which is undesigned and unexpected.”<sup>153</sup> “However, when the action taken is an intentional tort, there is no accident, regardless of whether the results are unintended or unexpected.”<sup>154</sup> The court stated the rule as follows: “If the tortfeasor’s acts are deemed intentionally harmful, there is no accident, therefore no occurrence, no duty to defend, and no policy coverage. However, if intentionally performed acts are not intended to cause harm but do so because of negligent performance, a duty to defend arises.”<sup>155</sup>

With respect to those petitions alleging negligence claims, the court held: “We need not determine whether the . . . petition alleges an intentional tort as the petition’s allegations against Main Street include allegations of negligence. Because at least one of the claims asserted in the . . . petition potentially falls within the scope of coverage, [the insurers’s] duty to defend is triggered.”<sup>156</sup> This holding suggests that the court viewed the mere presence of a negligence cause of action as sufficient to allege an “occurrence.” If, indeed, the court applied such a bright line

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148. *Id.* at 690.

149. *Id.*

150. *Id.* at 691-92.

151. *Id.* at 692-93.

152. *Id.* at 693.

153. *Id.* (citing *Mass. Bonding & Ins. Co. v. Orkin Exterminating Co.*, 416 S.W.2d 396, 400 (Tex. 1967)).

154. *Id.*

155. *Id.*

156. *Id.* at 694 (citations omitted).

rule, the court's analysis is contrary to the Texas Supreme Court's holding in *Farmers Texas County Mutual Insurance Co. v. Griffin*, which held that "[a] court must focus on the factual allegations rather than the legal theories asserted in reviewing the underlying petition."<sup>157</sup>

Regarding those petitions that did not include a cause of action for negligence, the court noted the absence of allegations that Main Street "intentionally designed the foundations to fail."<sup>158</sup> The court found allegations that "Main Street 'was aware, prior to the construction of the foundations . . . that the slabs as designed would be inadequate,'" and other similar allegations, insufficient to support the conclusion that the claimant's damages did not result from an "accident."<sup>159</sup> The court appeared to focus on the fact the causes of action were not limited to "intentional torts."

The court distinguished its prior holding in *Devoe v. Great American Insurance*, in which it held that a contractor's deficient and substandard construction of a home did not constitute an "accident" or an "occurrence" which could trigger coverage under a liability policy.<sup>160</sup> The court commented that the present case differed from *Devoe* because, unlike *Devoe*, the plaintiffs' claims were not restricted to shoddy workmanship.<sup>161</sup>

## 2. Business Risk Exclusions

After finding that the plaintiffs in *CU Lloyd's of Texas* had alleged an "occurrence," the court addressed the insurers' argument that the allegations were excluded under the business risk exclusions in the policies. The insurers argued that the policies did not provide coverage "for faulty workmanship or for a contractor's failure to perform his contract" and that "the business risk exclusions are designed to protect insurers from a contractor's attempt to recover funds to correct deficiencies caused by the contractor's questionable performance."<sup>162</sup>

The court first addressed exclusion A.2.j.(5), which excludes coverage for:

### j. Damage to Property

"Property damage" to:

(5) That particular part of real property on which you or any of your contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the "property damage" arises out of those operations . . . .<sup>163</sup>

157. *Farmers Tex. County Mut. Ins. Co. v. Griffen*, 955 S.W.2d 81, 82 (Tex. 1997) (citing *Nat'l Union Fire Ins. Co. v. Merchs. Fast Motor Lines, Inc.*, 939 S.W.2d 139, 141 (Tex. 1997)).

158. *CU Lloyd's of Tex.*, 79 S.W.3d at 694.

159. *Id.* (omission in original).

160. *Id.* at 695 (distinguishing *Devoe v. Great Am. Ins.*, 50 S.W.3d 567 (Tex. App.—Austin 2001, no pet.)).

161. *Id.*

162. *Id.*

163. *Id.* at 696.

The court held that this exclusion was inapplicable because the allegations in the petitions alleged that the plaintiffs purchased the homes after Main Street completed construction.<sup>164</sup> Consequently, since Main Street was not presently “performing operations,” the exclusion did not apply.

Next the court considered exclusion A.2.j.(6). This exclusion precludes coverage for:

j. Damage to Property

“Property damage” to:

(6) That particular part of any property that must be restored, repaired or replaced because “your work” was incorrectly performed on it.

Paragraph (6) of this exclusion does not apply to “property damage” included in the “products-completed operations hazard.”<sup>165</sup>

Because Main Street had completed and sold the homes before the alleged damage; the court held that the damage fell within the products-completed operations hazard.<sup>166</sup> Therefore, the exception to exclusion j.(6) was applicable.

The insurers also asserted exclusion A.2.k. as a basis for denial of coverage for Main Street. Exclusion k excludes coverage for “[p]roperty damage to ‘your product’ arising out of it or any part of it.”<sup>167</sup> The insurers claimed that Main Street’s homes were its “products.” “[Y]our product” was defined in the policies as “‘goods or products . . . manufactured, sold, distributed, or disposed of . . .’”<sup>168</sup> It also included “[w]arranties or representations made at any time with respect to the fitness, quality, durability, performance or use of ‘your product,’” as well as “providing or failing to provide warnings or instructions.”<sup>169</sup> Citing *Mid-United Contractors, Inc. v. Providence Lloyds Insurance Co.*, Main Street argued that the “definition of ‘your product’ [did] not apply to a building and its components.” The court agreed.<sup>170</sup>

Finally, the court addressed the insurer’s argument that exclusion A.2.l. was applicable. Exclusion l excludes coverage to “‘[p]roperty damage’ to ‘your work’ arising out of it or any part of it and included in the ‘products-completed operations hazard.’”<sup>171</sup> However, the court noted that this exclusion was subject to an exception “‘if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.’”<sup>172</sup> The petitions at issue alleged that the property damage was caused by Main Street’s subcontractors who designed and constructed the foundations; therefore, the court held that the exclusion was

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164. *Id.*

165. *Id.*

166. *Id.* at 697.

167. *Id.* (alteration in original).

168. *Id.*

169. *Id.*

170. *Id.* (citing *Mid-United Contractors, Inc. v. Providence Lloyds Ins. Co.*, 754 S.W.2d 824, 826 (Tex. App.—Fort Worth 1988, writ denied).

171. *Id.* at 697-98.

172. *Id.* at 698.



not applicable.<sup>173</sup>

### 3. *Injury to Co-Employee*

*Zaiontz v. Trinity Universal Insurance Co.*<sup>174</sup> involved a claim brought by an employee, Zaiontz, against his employer, Bio Zapp Laboratories, and Bio Zapp's president and majority shareholder, Michael Gershonsen, for injuries Zaiontz received during the course and scope of his employment. Zaiontz was injured "while spraying Bio Zapp's 'Smoke and Fire Odor Eliminator' in the interior of a smoke-damaged airplane."<sup>175</sup> Zaiontz sued Bio Zapp, a non-subscriber of workers' compensation insurance, and Gershonsen, alleging that his injuries resulted from Gershonsen's "negligence in preparing the 'Material Safety Data Sheet' that Zaiontz relied upon in using the Smoke and Fire Odor Eliminator."<sup>176</sup> Bio Zapp possessed a primary CGL policy and a commercial excess/umbrella policy. Coverage was denied under both policies.<sup>177</sup>

At trial, Zaiontz recovered a judgment in excess of one million dollars against Bio Zapp and Gershonsen.<sup>178</sup> Zaiontz sued Bio Zapp's liability insurers to collect on the judgment. In the coverage lawsuit, the insurers moved for summary judgment on the following grounds:

- (1) the subject insurance policies exclude coverage for any injury to an employee arising out of and in the course of employment by the insured;
- (2) the subject insurance policies exclude coverage arising out of pollution; and
- (3) [Gershonsen] [was] not an insured under the policies.<sup>179</sup>

The trial court granted the insurers' motion for summary judgment on only the first ground. Zaiontz and Gershonsen appealed, and the insurers cross-appealed on the denial of their two other bases for summary judgment.<sup>180</sup>

#### a. Employee Exclusion

On appeal, the insurers argued that the employee exclusions contained in the policies excluded injuries suffered by Zaiontz from coverage.<sup>181</sup> The exclusions at issue precluded coverage for "[bodily] injury" to: [a]n employee of the insured arising out of and in the course of employment by the insured."<sup>182</sup> In response, Zaiontz argued that based upon the separation-of-insureds clause, "the employee exclusion appli[ed] only if the

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173. *Id.*

174. *Zaiontz v. Trinity Universal Ins. Co.*, 87 S.W.3d 565 (Tex. App.—Austin 2002, pet. denied).

175. *Id.* at 566.

176. *Id.*

177. *Id.* at 566-67.

178. *Id.* at 566.

179. *Id.* at 567.

180. *Id.*

181. *Id.*

182. *Id.*

insured who is actually seeking coverage under the policy is the claimant's employer.'"183 The court agreed, holding that, because Gershonsen, the insured seeking coverage, was not Zaiontz's employee, the exclusion did not apply.184

#### b. Definition of "Insureds"

Next, the court analyzed whether Gershonsen was an insured under the primary CGL policy with respect to Zaiontz's allegations. The definition of "insureds" provided that Bio Zapp's "executive officers and directors are insureds, but only with respect to their duties as your officers or directors."185 The policy further provided that the definition of "insureds" included:

[Bio Zapp's] employees, other than [Bio Zapp's] executive officers, but only for acts within the scope of their employment by [Bio Zapp]. *However, no employee is an insured for:*

(1) "*Bodily injury*" or "*personal injury*" to [Bio Zapp] or to a co-employee while in the course of his or her employment . . . .186

Zaiontz argued that executive officers, like Gershonsen, are exempted from the exclusionary language italicized above. The court disagreed, stating that the exclusionary language applies to all employees and the term "'employee' refers to 'one who works for another,'" including executive officers.187 Accordingly, the court held that Gershonsen was not entitled to coverage under the primary CGL policy.188

#### 4. Missing Policies

In *Chickasha Cotton Oil Co. v. Houston General Insurance Co.*,<sup>189</sup> discussed above,<sup>190</sup> the court addressed whether the insured provided Houston General with enough evidence to establish coverage under a number of missing policies. The policies at issue were purchased by Chickasha's predecessor from Houston General's predecessor.<sup>191</sup> Neither party was able to locate any of the Houston General liability policies issued to Chickasha before 1972.<sup>192</sup> Moreover, only some of the umbrella and general liability policies issued by Houston General to Chickasha after 1972

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183. *Id.* (citing *Commercial Standard Ins. Co v. Am. Gen. Ins. Co.*, 455 S.W.2d 714 (Tex. 1970)).

184. *Id.* 567-68.

185. *Id.* at 569.

186. *Id.*

187. *Id.*

188. *Id.* at 570. The court held that Gershonsen was an insured under the umbrella policy but that coverage under that exclusion was precluded by the policy's pollution exclusion. See *infra* text accompanying notes 211-22.

189. *Chickasha Cotton Oil Co. v. Houston Gen. Ins. Co.*, No. 05-00-01789-CV (Tex. App.—Dallas, Aug. 6, 2002) (not designated for publication), 2002 WL 1792467.

190. See *supra* text accompanying notes 49-64.

191. *Chickasha Cotton Oil Co.*, 2002 WL 1792467, at \*1.

192. *Id.*

were found.<sup>193</sup>

The court of appeals noted that under Texas law a party seeking to recover under an insurance policy has the burden of proving the terms of the policy.<sup>194</sup> If a policy is unavailable, the insured may prove the terms through secondary evidence, including specimen policies from the insurer or mandatory policies from the Texas Department of Insurance.<sup>195</sup> The court noted that Chickasha had provided both specimen policies from Houston General and mandatory policies from the TDI as evidence of the pre-1972 policies.<sup>196</sup> Moreover, Chickasha submitted an affidavit from a former employee involved in purchasing insurance who stated that from as early as 1940 through 1972 Chickasha's policies were purchased from Houston General.<sup>197</sup> The court held that the samples and the affidavit constituted "some evidence" of the policies and their terms.<sup>198</sup>

Houston General also argued that Chickasha was not entitled to coverage because Chickasha failed to present evidence of the liability limits of the missing policies. The court held that evidence of limits was relevant to the issue of indemnity but not to the duty to defend. Specifically, the court stated that failure to present evidence of policy limits did not preclude the duty to defend because the duty to defend was not subject to the policy limits.<sup>199</sup> With respect to indemnity, the court agreed with Houston General that evidence of the policy limits was required.<sup>200</sup> Thus, the court held that the lower court erred in granting Houston General's no-evidence motion for summary judgment on the duty to defend but upheld summary judgment for the insurer on its duty to indemnify.<sup>201</sup>

## 5. Pollution Exclusion

### a. Exclusions Failed to Preclude Coverage for Arsenic Contamination Claims

In *Chickasha*,<sup>202</sup> discussed above,<sup>203</sup> the Dallas Court of Appeals held that the trial court erred in granting summary judgment against the insured for pollution-related claims based on an exclusion within a number of umbrella policies. The underlying plaintiffs' pollution claims concerned arsenic routinely released by the insured into the environment surrounding its gin through the burning of unusable portions of cotton plants treated with the substance. The underlying plaintiffs alleged that

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193. *Id.*

194. *Id.* at \*4 (citing Dairyland County Mut. Ins. Co. v. Martinez, 484 S.W.2d 785, 788 (Tex. Civ. App.—El Paso 1972, writ ref'd n.r.e.)).

195. *Id.* (citing Bituminous Cas. Corp. v. Vacuum Tanks, Inc., 975 F.2d 1130, 1132 (5th Cir. 1992); Bituminous Cas. Corp. v. Vacuum Tanks, Inc., 75 F.3d 1048, 1051 (5th Cir. 1996)).

196. *Id.*

197. *Id.* at \*3.

198. *Id.* at \*4.

199. *Id.*

200. *Id.*

201. *Id.* at \*5.

202. *Chickasha*, 2002 WL 1792467, at \*1.

203. See *supra* text accompanying notes 49-64 and notes 189-202.

the arsenic made them ill at the time it was dispersed and damaged property in the vicinity of the gin. The plaintiffs also claimed that they suffered emotional distress, mental anguish and various chronic physical ailments for years after the arsenic was released.<sup>204</sup>

The subject umbrella policies were issued by Houston General between 1972 and 1986. The insuring agreement in the policies covered "personal injury," "property damage," or "advertising liability" caused by an "occurrence."<sup>205</sup> The "policies defined 'personal injury' as meaning: (1) bodily injury, sickness, disease, disability or shock, including death arising therefrom, or, if arising out of the foregoing, mental anguish and mental injury."<sup>206</sup>

The pollution exclusion read as follows:

It is agreed that this policy does not apply to *bodily injury* or *property damage* arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acid, alkalis, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or any watercourse or body of water; but this exclusion does not apply if such discharge, dispersal, release or escape is sudden and accidental.<sup>207</sup>

The court noted that the pollution exclusion did not necessarily preclude coverage for all "personal injuries."<sup>208</sup> Rather, the exclusion only precluded coverage for "bodily injury," which was only one component of "personal injury." In addition to "bodily injury," the definition of "personal injury" included "sickness, disease, disability or shock, including death arising therefrom, or, if arising out of the foregoing, mental anguish and mental injury."<sup>209</sup> These additional components of "personal injury" were not excluded by the pollution exclusion. The court determined that the personal injuries alleged by the plaintiffs were not limited to "bodily injury" and, therefore, some of plaintiffs' claims were not excluded by the pollution exclusion.<sup>210</sup> Thus, the court found that summary judgment on this issue was improper and reversed in favor of the insured.

The result in this case arises from the use of inconsistent terms in the policies. The policies contained a relatively standard pollution exclusion, which precluded coverage for *bodily injury* caused by the sudden and accidental release of pollutants. Similar pollution exclusions were common in CGL policies at this time. However, Coverage A under such CGL policies generally provided coverage for "bodily injury" (rather than "personal injury") or "property damage" caused by an "occurrence." The definition of "bodily injury" was similar to that portion of the definition of "personal injury" quoted above from the subject umbrella poli-

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204. *Chickasha*, 2002 WL 1792467, at \*1.

205. *Id.* at \*5.

206. *Id.*

207. *Id.* at \*6.

208. *Id.*

209. *Id.*

210. *Id.*

cies. Accordingly, the language of the pollution exclusion was consistent with terminology used in standard CGL policies. However, by using the term “personal injury” rather than “bodily injury” in the insuring clause of the umbrella policies, an inconsistency between the insuring clause and the pollution exclusion arose, significantly narrowing the scope of the pollution exclusion.

b. Absolute Pollution Exclusion Applied to Insured’s Spraying of the Insured’s Odor Eliminator

In *Zaiontz v. Trinity Universal Insurance Co.*,<sup>211</sup> discussed in detail above,<sup>212</sup> Zaiontz, an employee of the insured, Bio Zapp, alleged that he sustained injuries while spraying Bio Zapp’s “Smoke and Fire Odor Eliminator.” TexPac argued that Zaiontz’s injuries were excluded by the absolute pollution exclusion. The exclusion precludes coverage for, “any liability arising out of the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of pollutants.”<sup>213</sup> Pollutants are defined as including, “any solid, liquid, gaseous, or thermal irritant or contaminant including smoke, vapor, soot, [or] fumes.”<sup>214</sup> Thus, TexPac argued that Bio Zapp’s “Smoke and Fire Odor Eliminator” was a pollutant that after being “dispersed” caused Zaiontz’s injuries.<sup>215</sup>

In its analysis, the court noted that the absolute pollution exclusion was unambiguous under Texas law.<sup>216</sup> Next, the court addressed Zaiontz’s argument that the “discharge, dispersal, seepage, migration, release or escape” required the pollutant to “leave the location of its placement.”<sup>217</sup> The court rejected this argument, finding that the “discharge,” “dispersal,” or “release” were equivalent to “spray.”<sup>218</sup> Because Zaiontz alleged that he was injured after the “Smoke and Fire Odor Eliminator” was sprayed into the interior of a plane, the court held that he was injured due to the product’s “discharge,” “dispersal,” or “release.”<sup>219</sup> The court dismissed Zaiontz’s reliance on *Union Pacific*, noting that case concerned an exclusion involving the “sudden and accidental” release of a pollutant.<sup>220</sup>

Finally, the court rejected Zaiontz’s argument that the pollution exclusion “does not apply until the substance has moved from an area which it does not pollute into an area which it does pollute.”<sup>221</sup> The court held that the plain language of exclusion’s definition of “pollutant” generally

211. *Zaiontz*, 87 S.W.3d at 565.

212. *See supra* text accompanying notes 174-88.

213. *Zaiontz*, 87 S.W.3d at 571.

214. *Id.*

215. *Id.*

216. *Id.* (citing *Nat’l Union Fire Ins. Co. v. CBI Indus., Inc.*, 907 S.W.2d 517, 521 (Tex. 1995)).

217. *Id.* at 571-72. Zaiontz cited *Union Pacific Resources Co. v. Aetna Casualty & Surety Co.*, 894 S.W.2d 401, 403 (Tex. App.—Fort Worth 1994, writ denied), in support of his argument. *Zaiontz*, 87 S.W.3d at 572.

218. *Zaiontz*, 87 S.W.3d at 573.

219. *Id.*

220. *Id.* at 572-73 (citing *Union Pac. Res. Co.*, 894 S.W.2d at 403).

221. *Id.* at 573.

encompassed the fumes from the "Smoke and Fire Odor Eliminator." The court also cited a Fifth Circuit case for the proposition that ordinary or useful products could constitute pollutants even if they typically do not inflict injury.<sup>222</sup>

## B. AUTOMOBILE POLICIES

### 1. Coverage for "Diminished Value" of Covered Auto

Several cases were decided during the Survey period that addressed the issue of whether a standard automobile policy provides coverage for the diminished value of a covered automobile after the automobile has been fully repaired. The split in Texas authority on this issue was not resolved in 2002. The Houston Fourteenth Court of Appeals remains firmly convinced that, as a matter of law, coverage for diminution in value does not exist. The Beaumont and Dallas Courts of Appeals, however, reach the opposite conclusion.

#### a. Beaumont Court of Appeals Finds Coverage for Diminished Value

In *Schaefer v. American Manufacturers Mutual Insurance Co.*,<sup>223</sup> the Beaumont Court of Appeals addressed the issue of whether coverage exists for diminished value of an insured's vehicle under a standard Texas automobile policy. Gary Schaefer brought the case against several insurers as a proposed class action on his own behalf and as a representative of all similarly situated Texans.<sup>224</sup> Schaefer moved for summary judgment seeking to establish that diminished value was covered as a matter of law. American Manufacturers Mutual Insurance Company (AMM) filed a cross-motion for summary judgment, arguing that Schaefer was not entitled to diminished value payments based upon a bulletin from the Texas Department of Insurance (TDI).<sup>225</sup> The trial court granted AMM's motion for partial summary judgment and denied Schaefer's motion. The court then dismissed the plaintiff's claims against all defendants with prejudice.<sup>226</sup>

On appeal, the court only considered the issue of whether AMM's automobile policy covered Schaefer's diminution in value claim.<sup>227</sup> The court stated that it had previously addressed the issue in *Smith v. American Fire and Casualty Co.*<sup>228</sup> In *Smith* the court found that there was evidence that repairs to the damaged vehicle at issue did not restore it to

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222. *Id.* (citing *Am. States Ins. Co. v. Nethery*, 79 F.3d 473, 475-78 (5th Cir. 1996)).

223. *Schaefer*, 65 S.W.3d at 806.

224. *Id.* at 807.

225. *Id.* AMM relied on the decision from *Carlton v. Trinity Universal Insurance Co.*, 32 S.W.3d 454 (Tex. App.—Houston [14th Dist.] 2000, pet. denied), in support of its motion. *Schaefer*, 65 S.W.3d at 807.

226. *Id.*

227. *Id.* at 808.

228. *Id.* (citing *Smith v. Am. Fire & Cas. Co.*, 242 S.W.2d 448, 453 (Tex. Civ. App.—Beaumont 1951, no writ)).

its pre-damage market value. The court also held that the words "repair and replace" found in the automobile liability policies include "a restoration of the automobile to substantially the same condition in which it was immediately prior to the collision."<sup>229</sup> The court pointed out that "[n]either *Smith* nor the cases cited therein have been overruled by the Texas Supreme Court."<sup>230</sup>

Next, the court decided to follow the Houston Fourteenth Court of Appeals' decision on this issue in *Carlton v. Trinity Universal Insurance Co.*, which was relied upon by the trial court in its granting summary judgment for AMM.<sup>231</sup> The court noted that the *Carlton* opinion cited *Roberdeau v. Indemnity Insurance Co.*, which ultimately held that a fact issue existed as to whether repairs to the vehicle at issue restored the vehicle to its former use.<sup>232</sup> The Beaumont Court of Appeals stated, "We strongly disagree that *Roberdeau* supports a holding that diminished value cannot be recovered, 'as a matter of law.'"<sup>233</sup>

Next, the court asserted that a number of cases since its decision in *Smith* supported its precedent, including the Texas Supreme Court's decision in *Superior Pontiac Co. v. Queen Insurance Co. of America*.<sup>234</sup> In that case the jury found that the value of the insured's car after repair was less than its value prior to the insured's automobile accident. The supreme court agreed that there was evidence to support the jury's findings, "from which it follows that the repair sum tendered by [insurer] would not compensate [plaintiff] for the loss she had suffered."<sup>235</sup>

The *Schaefer* court also cited *Fidelity & Casualty Co. of New York v. Underwood*,<sup>236</sup> which found that an insurer had materially breached its obligations under an insurance policy by offering only \$3,509.08 for repairs to a car that had decreased in value by \$6,500, even after repairs.<sup>237</sup> The *Fidelity* court noted that "once the vehicle is restored it will not be of substantially the same value as that of the vehicle prior to the loss."<sup>238</sup> Thus, the court held that the trial court erred in holding that *Schaefer* could not recover diminished value as a matter of law.<sup>239</sup> The court reversed and remanded.<sup>240</sup>

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229. *Id.* (quoting *Smith*, 242 S.W.2d at 453-54)).

230. *Id.*

231. *Id.* at 809 (citing *Carlton*, 32 S.W.3d at 454).

232. *Id.* at 810 (referring to *Roberdeau v. Indem. Ins. Co.*, 231 S.W.2d 948 (Tex. Civ. App.—San Antonio, writ ref'd n.r.e.)).

233. *Id.*

234. *Id.* (citing *Superior Pontiac Co. v. Queen Ins. Co. of Am.*, 434 S.W. 340, 341 (Tex. 1968)).

235. *Id.* (quoting *Superior Pontiac Co.*, 434 S.W.2d at 342).

236. *Id.* (citing *Fid. & Cas. Co. of N.Y. v. Underwood*, 791 S.W.2d 635 (Tex. App.—Dallas 1990, no writ)).

237. *Id.* (citing *Fid. & Cas. Co. of N.Y.*, 791 S.W.2d at 638, 643).

238. *Id.* (quoting *Fid. & Cas. Co. of N.Y.*, 791 S.W.2d at 643).

239. *Id.* at 810.

240. *Id.*

b. Houston Fourteenth Court of Appeals Rejects Diminished Value Coverage

In *Smither v. Progressive County Mutual Insurance Co.*,<sup>241</sup> the court framed the issue as follows: “Is an insurer obligated to pay a first party claim for the inherent diminished value of an insured vehicle following adequate and complete repair of the damaged vehicle?”<sup>242</sup> The court noted that jurisdictions across the country had addressed this issue with conflicting results.<sup>243</sup>

The insurer paid to repair damage to the insured’s vehicle resulting from an accident. After the repairs were made, the insured asserted a second claim for “inherent diminished value.” The insured sought coverage for the difference in the value of her car prior to the accident and its value after the repairs were complete. When the insurer denied her claim, the insured sued.<sup>244</sup>

The parties filed cross-motions for summary judgment.<sup>245</sup> The trial court granted summary judgment in favor of the insurer.<sup>246</sup> The insured appealed.

The Houston Fourteenth Court of Appeals noted that a split exists in Texas and national authority concerning whether an insurer must pay for the diminished value of an insured’s automobile after the automobile is fully repaired.<sup>247</sup> While acknowledging this split, the court pointed out that it had already ruled on the issue in *Carlton v. Trinity Universal Insurance Co.*,<sup>248</sup> which held that diminished value is not recoverable under a standard Texas personal automobile insurance policy as a matter of law. The court also cited *Carlton* for the proposition that “if the market value of the vehicle, after full, adequate, and complete repair or replacement, is diminished as a result of factors that are not subject to ‘repair’ or ‘replacement,’ the insurer has no obligation to pay the diminution in value.”<sup>249</sup>

The court noted that until *Schaefer v. American Manufacturers Mutual Insurance Co.*, it was the only court in Texas to have addressed this precise issue under the language of the standard Texas personal automobile insurance policy. The court recognized that, in *Schaefer*, the Beaumont Court of Appeals rejected the Houston court’s prior precedent and refused to hold that diminished value was not covered as a matter of law.<sup>250</sup> The Houston court criticized the *Schaefer* holding, stating that authority on which *Schaefer* relied was distinguishable because those cases were

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241. *Smither*, 76 S.W.3d at 719.

242. *Id.* at 720.

243. *Id.*

244. *Id.*

245. *Id.* at 720-21.

246. *Id.* at 721.

247. *Id.*

248. *Id.* (citing *Carlton*, 32 S.W.3d at 465).

249. *Id.* (quoting *Carlton*, 32 S.W.3d at 465).

250. *Id.* at 722 (citing *Schaefer*, 65 S.W.3d at 810).



decided on tort principles, rather than contract principles.<sup>251</sup> The court accused the *Schaefer* court of failing to address the meaning of the policy language as it now exists.<sup>252</sup> The court suggested that this was the difference between the *Schaefer* court's analysis and the Houston court's analysis in *Carlton*, in which the court said it applied "pure contract analysis in deciding whether diminished value was a covered loss."<sup>253</sup> In *Carlton*, the court found that the "repair and replace" limitation of liability under the standard policy form concerned the amount necessary to return the damaged vehicle to "substantially the same physical, operating, and mechanical condition as existed immediately before the loss."<sup>254</sup> Based upon this analysis, the court concluded that the standard Texas Automobile Policy did not cover inherent diminution in value as a matter of law.<sup>255</sup>

Finally, the court noted that, since the decision in *Carlton*, a number of other jurisdictions have addressed the same issue and have relied on *Carlton* as persuasive authority against inherent diminution in value coverage under standard automobile liability policies.<sup>256</sup> The court followed its own precedent and concluded that, as a matter of law, the insured was not entitled to recover inherent diminished value under the unambiguous terms of the standard Texas personal automobile insurance policy.<sup>257</sup>

### c. Dallas Court of Appeals Finds Coverage for Diminished Value

In *Bailey v. Progressive County Mutual Insurance Co.*,<sup>258</sup> the Dallas Court of Appeals addressed "inherent diminished value" coverage under a Texas automobile insurance policy. The insured's vehicle was damaged as a result of a serious accident. Their insurer paid to repair the damages; however, the repaired vehicle was worth \$9,000 less than it was before the accident.<sup>259</sup> After the insurer refused to pay for the vehicle's diminished value, the insured filed suit asserting that Progressive had failed to repair or replace their property with another of like kind and quality.<sup>260</sup> The insurer moved for summary judgment arguing that it had met its contractual requirements by repairing the vehicle and that diminished value was not recoverable under its policy. The trial court granted summary judgment for the insurer, and the insured appealed.<sup>261</sup>

The Dallas Court of Appeals relied on its holding in an earlier case involving a flood-damaged vehicle.<sup>262</sup> In that case the court said that it

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251. *Id.*

252. *Id.*

253. *Id.* at 723.

254. *Id.* at 723-24 (citing *Carlton*, 32 S.W.3d at 464-65).

255. *Id.* at 724 (citing *Carlton*, 32 S.W.3d at 564).

256. *Id.*

257. *Id.* at 725.

258. *Bailey*, 78 S.W.3d at 708.

259. *Id.* at 710.

260. *Id.*

261. *Id.*

262. *Id.* at 711 (citing *Fid. & Cas. Co. of N.Y.*, 791 S.W.2d at 635).

had held that the insurer was required to restore the damaged vehicle to “substantially the same value as that of the vehicle prior to the loss.”<sup>263</sup> The court’s ruling in *Fidelity* was based upon policy language stating that the insurer would have to pay what it cost to repair or replace the damaged automobile with one of “like kind and quality.”<sup>264</sup>

The court noted that the Beaumont Court of Appeals had recently relied on the *Fidelity* opinion in holding that inherent diminished value was covered under a Texas automobile liability policy.<sup>265</sup> The court also noted that the Houston Fourteenth Court of Appeals had reached contrary results in *Smither v. Progressive County Mutual Insurance Co.*<sup>266</sup> and in *Carlton v. Trinity Universal Insurance Co.*<sup>267</sup> Like the Beaumont court, the Dallas Court of Appeals rejected the precedent from Houston, noting that it conflicted with its own precedent and the weight of Texas authority on the issue.<sup>268</sup>

Finally, the court rejected the insurer’s reliance on a Texas Department of Insurance (TDI) bulletin which construed the language of the automobile policy as not providing coverage for diminished value.<sup>269</sup> The court found that TDI’s interpretation of insurance statutes had to be given great weight;<sup>270</sup> however, TDI’s interpretation of contractual language deserves no such consideration.<sup>271</sup> The court reversed and remanded.

## 2. Waiver of UIM and PIP Coverage

*Old American County Mutual Fire Insurance Co. v. Sanchez*<sup>272</sup> replaced and modified the court’s previous opinion in this case,<sup>273</sup> which was discussed in last year’s Survey.<sup>274</sup> The court addressed three issues: (1) whether a spouse who is the applicant for an automobile insurance policy, but not expressly named under the policy, can waive PIP and UM coverage for the insured;<sup>275</sup> (2) whether an insured is deemed to be occupying a vehicle when he is underneath the vehicle performing repairs;<sup>276</sup> and (3) whether the insured was “struck by” his unscheduled vehicle when a vehicle driven by an uninsured motorist collided with the in-

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263. *Id.* (quoting *Fid. & Cas. Co. of N.Y.*, 791 S.W.2d at 641).

264. *Id.*

265. *Id.* (citing *Schaefer*, 65 S.W.3d at 806).

266. *Id.* (citing *Smither*, 76 S.W.3d at 719).

267. *Id.* (citing *Carlton*, 32 S.W.3d at 454).

268. *Id.*

269. *Id.* at 712.

270. *Id.* (citing *State v. Pub. Util. Comm’n of Tex.*, 883 S.W.2d 190, 196 (Tex. 1994)).

271. *Id.* at 712-13 (citing *Balandran v. Safeco*, 972 S.W.2d 738, 741 (Tex. 1998)).

272. *Old Am. County Mut. Fire Ins. Co. v. Sanchez*, 81 S.W.3d 452 (Tex. App.—Austin 2002, no pet.).

273. *Id.* at 454 (discussing the withdrawal and replacement of its opinion in this matter on November 15, 2001).

274. See J. Price Collins & Lara K. Forde, *Insurance Law*, 55 SMU L. REV. 1155, 1194-96 (discussing *Old Am. County Mut. Fire Ins. Co. v. Sanchez*, No. 03-01-00150-CV (Tex. App.—Austin Nov. 15, 2001) (not designated for publication), 2001 WL 1422581, *withdrawn*, 81 S.W.3d 252 (Tex App.—Austin 2002, no pet.)).

275. *Sanchez*, 81 S.W.3d at 458-61.

276. *Id.* at 455-58.

sured's vehicle causing it to collapse on the insured.<sup>277</sup>

The insured, Mr. Sanchez, "was injured when an uninsured motorist hit a truck owned by [him] but not scheduled as a covered vehicle on his automobile insurance policy."<sup>278</sup> "At the time of the accident, Sanchez was underneath the truck working on the gas tank hose."<sup>279</sup> Sanchez sought "uninsured motorist coverage (UIM) and personal injury protection coverage (PIP)" from his insurer.<sup>280</sup> The insurer filed a declaratory judgment action seeking a declaration that it was not obligated to pay for Sanchez's injuries, and Sanchez counterclaimed.

The insurer sought summary judgment on several grounds including that Sanchez was "occupying" his truck at the time of the accident.<sup>281</sup> The trial court granted summary judgment on this ground.<sup>282</sup> The insurer also moved for summary judgment on the ground that Sanchez's wife rejected PIP and UIM benefits on the application for Sanchez's insurance, which constituted, the insurer argued, a rejection of PIP and UIM benefits by Sanchez.<sup>283</sup> Sanchez claimed that the rejection was not effective because "his wife was not the 'named insured.'"<sup>284</sup> The trial court denied the insurer's motion on this ground. The last summary judgment ground asserted by the insurer was that Sanchez was struck by his unscheduled vehicle, precluding coverage pursuant to the owned-vehicle exclusion.<sup>285</sup> The trial court did not rule on this ground.<sup>286</sup> Sanchez appealed; the insurer cross-appealed.<sup>287</sup>

On appeal, the court addressed the effect of Sanchez' wife's rejection of coverage for PIP and UIM coverage. Initially, the court agreed with the insurer that Sanchez was not entitled to PIP and UIM benefits because his wife effectively waived coverage. On reconsideration, the court determined that PIP and UIM coverage had not been waived. Sanchez argued his wife's rejection of coverage was invalid because the Texas Insurance Code only permits an insured "named under the policy" to reject PIP or UIM coverage.<sup>288</sup> Moreover, the rejection must be in writing.<sup>289</sup> Sanchez further argued that the court's previous ruling had incorrectly allowed the policy's definition of who is an insured to control over the Insurance Code's language.<sup>290</sup>

Old American responded that its policy defines "you" and "your" as

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277. *Id.* at 461-62.

278. *Id.* at 454.

279. *Id.*

280. *Id.* at 454-55.

281. *Id.* at 455.

282. *Id.*

283. *Id.*

284. *Id.*

285. *Id.*

286. *Id.*

287. *Id.*

288. *Id.* at 458 (citing TEX. INS. CODE ANN. art. 5.06(1) (Vernon 1981)).

289. *Id.* (citing TEX. INS. CODE ANN. art. 5.06-3 (Vernon 1981)).

290. *Id.*

the named insured and the named insured's spouse.<sup>291</sup> Old American also argued that the Texas Insurance Code did not limit the rejection of PIP and UIM coverage to the "named insured."<sup>292</sup> Thus, the insurer contended that the rejection was valid.

The court found Old American's argument to be inaccurate. The Texas Insurance Code provides that all automobile insurance policies should provide both uninsured motorist and personal injury protection coverage except where "*any insured named in the policy shall reject the coverage in writing. . . .*"<sup>293</sup> The statute's language does extend beyond the "named insured;" however, the universe of people who may reject coverage is limited to individuals specifically named in the policy.

Therefore, this time, the court sided with Sanchez. The court agreed that it had inappropriately applied policy language to the statute's mandate that only an insured named under the policy may reject PIP and UIM coverage. The court noted that the legislature drafted the provisions in question intending to provide broad PIP and UIM coverage.<sup>294</sup> The court also found that Texas case law has generally interpreted PIP and UIM clauses in favor of insureds.<sup>295</sup> The court held that the statute required that the person rejecting coverage be expressly named as an insured somewhere in the policy.<sup>296</sup> Thus, the court affirmed the trial court's refusal to grant the insurer's motion for summary judgment on this issue.<sup>297</sup>

### 3. *Owned Vehicle Exclusion—Meaning of "Occupying"*

In *Old American County Mutual Fire Insurance Co. v. Sanchez*,<sup>298</sup> the court disagreed with the trial court's finding that the "owned vehicle" exclusion precluded PIP and UIM coverage because he was "occupying" his vehicle. On appeal Sanchez argued that "occupying" a vehicle did not include lying under it while having contact only with its gas hose.<sup>299</sup> Old American responded that "contact" with the vehicle was enough to satisfy the definition of "occupying," which meant "in, upon, getting in, on, out or off" the vehicle.<sup>300</sup> Based on that definition, the court determined that Sanchez's claims would be barred unless he was found to be "upon" the vehicle.<sup>301</sup> Although the term "upon" was not defined in the policy, the court noted that under Texas law, the term suggests that one needs to be supported by an object to be deemed "upon" the object. The court declined to broaden the term "upon" to include "touching a vehicle from

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291. *Id.* at 459.

292. *Id.*

293. *Id.* at 458 nn.5-6 (citing TEX. INS. CODE ANN. arts. 5.06-1(1), 5.06-3 (Vernon 1981).

294. *Id.* at 459.

295. *Id.*

296. *Id.* at 460.

297. *Id.* at 462-63.

298. *Old Am. County Mut. Fire Ins. Co.*, 81 S.W.3d at 452.

299. *Id.* at 456.

300. *Id.*

301. *Id.*

below while resting on the ground beneath the vehicle.”<sup>302</sup> Therefore, because Sanchez was not “occupying” the vehicle, the court sustained Sanchez’s appeal on this issue.<sup>303</sup>

#### 4. *Owned Vehicle Exclusion—Meaning of “Struck By”*

The *Sanchez* court next addressed the insurer’s argument that the “struck by” provision of the “owned vehicle exclusion” precluded PIP and UIM coverage for Sanchez. The “owned vehicle exclusion” precluded coverage if the insured was “struck by” an unscheduled vehicle owned by the insured. The insurer asserted that Sanchez’s vehicle “struck” him when it collapsed on him and, therefore, PIP and UIM coverage was excluded under the owned vehicle exclusion.<sup>304</sup>

The court found that based on Texas precedent “a passive vehicle cannot be the striking force in a collision.”<sup>305</sup> The court also noted that Texas courts have held that the “object supplying the striking or ‘causative’ force does not have to directly contact the insured in order for” coverage to apply.<sup>306</sup> The court decided that Sanchez was injured by a vehicle set in motion by another vehicle, which was not his own and held that the “owned vehicle” exclusion did not bar coverage.

#### 5. *“Motor Vehicle Accident”*

In *Texas Farm Bureau Mutual Insurance Co. v. Sturrock*,<sup>307</sup> the court addressed what constitutes a “motor vehicle accident.” The case was initiated by an insured against his automobile insurer for its refusal to pay Personal Injury Protection (PIP) benefits. The insured claimed that he was entitled to the benefits for injuries he sustained when his foot became entangled as he was exiting his pickup truck. The insurer denied coverage on the basis that the insured had not been involved in a “motor vehicle accident.” The insurer based its denial on the facts that no other vehicle or person was involved in his injuries and that his car was turned off at the time he became entangled.<sup>308</sup>

To determine what constitutes a “motor vehicle accident,” the court looked at a number of Texas cases dealing with automobile liability claims involving only the insured’s vehicle.<sup>309</sup> The court concluded that coverage for single-vehicle “accidents” hinges upon whether the vehicle is “only incidentally involved and provides the ‘mere situs’ for an accident that could have occurred anywhere,” or where the injury-producing act

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302. *Id.* at 458.

303. *Id.*

304. *Id.* at 461.

305. *Id.* (citing *Gallup v. St. Paul Ins. Co.*, 515 S.W.2d 249, 249 (Tex. 1974); *Houston Fire & Cas. Ins. Co. v. Kahn*, 359 S.W.2d 892, 892 (Tex. 1962)).

306. *Id.* at 461-62 (citing *Latham v. Mountain States Mut. Cas. Ins. Co.*, 482 S.W.2d 655, 657 (Tex. App.—Houston [1st Dist.] 1972, writ ref’d n.r.e.)).

307. *Tex. Farm Bureau Mut. Ins. Co. v. Sturrock*, 65 S.W.3d 763 (Tex. App.—Beaumont 2001, pet. granted).

308. *Id.* at 765.

309. *Id.* at 765-67.

“involved the use of a vehicle as a vehicle.”<sup>310</sup> The court then noted that using a pickup truck necessitates “mounting and dismounting” the vehicle.<sup>311</sup> Moreover, the court held that a “motor vehicle accident” did not require a physical impact but merely an injury with a causative connection to the insured’s vehicle.<sup>312</sup> Thus, the court held that the insured’s entanglement in his vehicle was a “motor vehicle accident.”<sup>313</sup>

#### 6. *Workers’ Compensation: Subrogation Rights Do Not Extend to UIM Claim*

In *Liberty Mutual v. Kinser*,<sup>314</sup> “Michael Kinser was injured in an automobile accident while in the course and scope of his employment for Southwestern Bell Telephone Company” (“SWB”).<sup>315</sup> After the accident, SWB’s workers’ compensation carrier, Liberty Mutual, began paying Kinser’s medical bills.<sup>316</sup> Eventually, the other driver was determined to be responsible for the accident. That driver’s insurance carrier, Farmers, tendered its policy limits of \$25,000 in a check jointly payable to Kinser and Liberty Mutual.<sup>317</sup> Liberty Mutual applied the \$25,000 toward the satisfaction of its lien.

In addition, Kinser had his own uninsured motorist (UIM) coverage through State Farm Automobile Insurance Company. UIM policy limits were \$50,000. Because Liberty Mutual paid workers’ compensation benefits in excess of the \$25,000 Kinser recovered from Farmers, Liberty Mutual sought to recover from Kinser’s uninsured motorist carrier, pursuant to its subrogation rights. Kinser contested Liberty Mutual’s right to receive his UIM benefits.<sup>318</sup> Accordingly, State Farm interpleaded a portion of the UIM benefits to the court’s registry. Liberty Mutual and Kinser filed answers and cross-claims against each other. The trial court subsequently granted summary judgment in favor of Kinser.<sup>319</sup>

On appeal, the San Antonio Court of Appeals acknowledged that insurers have subrogation rights under the workers’ compensation statute.<sup>320</sup> The statute allows a carrier to “enforce the liability of [a] third party in the name of the injured employee.”<sup>321</sup> The court reviewed holdings by sister courts in *Employers Casualty Co. v. Dyess* and *Texas Work-*

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310. *Id.* at 767.

311. *Id.*

312. *Id.*

313. *Id.*

314. *Liberty Mut. v. Kinser*, 82 S.W.3d 71, 72 (Tex. App.—San Antonio 2002, pet. withdrawn).

315. *Id.*

316. *Id.*

317. *Id.*

318. *Id.*

319. *Id.* at 73.

320. *Id.*

321. *Id.* (quoting TEX. LAB. CODE ANN. § 417.001(b) (Vernon 1996 & Supp. 2002)).

ers' Compensation Insurance Facility v. Aetna Casualty & Surety Co.<sup>322</sup> In *Dyess*, "the Amarillo court concluded that the 'clear wording of the statute' did not support the UIM carrier's position that the workers' compensation carrier is only subrogated to the claimant's rights against third party tortfeasors."<sup>323</sup> "The Amarillo court held that the statutory right of subrogation applies to any parties liable for a claimant's injuries, regardless of whether that liability arose in tort or contract, and any contractual provision conflicting with that statutory right was invalid."<sup>324</sup> In *Texas Workers' Comp. Insurance Facility*, the Houston First District Court of Appeals followed *Dyess*, noting "that the subrogation statute did not expressly limit the workers compensation carrier's right to claims against third party tortfeasors."<sup>325</sup>

In analyzing the issue, the *Kinser* court found that statutory language surrounding what constitutes a "third party" was more clear in earlier statutory language. Prior to recodification, the statute referred to the liability of "that other person" instead of a "third party."<sup>326</sup> The court went on to note that the term "third party," when read in isolation, extended beyond tortfeasors. However, the court said that "[s]ection 417.001(a) modifies or limits the 'third party' to a 'third party who is or becomes liable to pay damages.'"<sup>327</sup> Thus, the court held: "[A] carrier is only entitled to subrogation against damages paid to an injured employee by a third party who is or becomes liable to pay damages."<sup>328</sup>

Next, the court addressed *Kinser's* position that the subrogation provision did not apply in his situation "because State Farm was liable for contractual benefits not damages."<sup>329</sup> *Kinser* "maintain[ed] that this contractual right to receive benefits is distinguishable from the right to recover damages."<sup>330</sup>

In addressing the distinction between "damages" and "benefits," the court cited Texas case law holding that "[a]n award of damages is defined as the sum of money the law awards as pecuniary compensation, recompense, or satisfaction for an injury done or a wrong sustained as a consequence of a breach of a contractual obligation or a tortious act."<sup>331</sup> The court then noted that the Texas Supreme Court had recognized a difference between damages awarded by a jury and benefits paid under

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322. *Id.* at 75 (discussing *Employers Cas. Co. v. Dyess*, 957 S.W.2d 884 (Tex. App.—Amarillo 1997, pet. denied); *Texas Workers' Comp. Ins. Facility v. Aetna Cas. & Sur. Co.*, 994 S.W.2d 923 (Tex. App.—Houston [1st Dist.] 1999, no pet.)).

323. *Id.* (citing *Dyess*, 957 S.W.2d at 889).

324. *Id.* (citing *Dyess*, 957 S.W.2d at 891).

325. *Id.* (citing *Tex. Workers' Comp. Ins. Facility*, 994 S.W.2d at 925).

326. *Id.* at 77-78.

327. *Id.* at 78.

328. *Id.*

329. *Id.*

330. *Id.*

331. *Id.* (quoting *City of Dallas v. Cox*, 793 S.W.2d 701, 733 (Tex. App.—Dallas 1990, no writ)).

an uninsured motorist policy.<sup>332</sup> The court also distinguished the holdings in *Dyess* and *Texas Workers' Compensation Insurance Facility* on the basis that the UIM policies at issue in those cases "were acquired and maintained by the claimant's employer, not by the claimant."<sup>333</sup> Thus, the court held "that the term 'damages' as used in section 417.001(a) does not include" uninsured motorist benefits.<sup>334</sup> The court affirmed the lower court's judgment on behalf of the insured.

### C. DIRECTOR & OFFICER LIABILITY: LATE NOTICE

In *Federal Insurance Co. v. CompUSA, Inc.*,<sup>335</sup> Judge Fitzwater addressed a declaratory "judgment action involving a claims-made" liability policy for directors and officers. The sole issue before the court was whether the insured's failure to comply with the policy requirement that it give its insurer notice of any claim "as soon as practicable" precluded its right to indemnity in the underlying case.<sup>336</sup> The court held that the insured failed to give the required notice and that the insurer did not have to show "actual prejudice" under a claims-made policy in order to deny the claim.<sup>337</sup>

Turning to the facts, the underlying lawsuit was filed in January 2000 by COC Services Ltd. (COC) against CompUSA. In the suit, COC alleged that CompUSA "had breached an agreement to form a joint venture" with COC "to expand CompUSA's personal computer business into Mexico."<sup>338</sup> COC filed an amended petition in February 2000, specifically naming James F. Halpin, CompUSA's President and CEO, as a defendant. COC's allegations against Halpin included "fraud, tortious interference, conspiracy, and unjust enrichment."<sup>339</sup> Both Halpin and CompUSA jointly answered in March 2000.<sup>340</sup>

In its answer, and throughout the litigation, CompUSA expressed that it viewed the lawsuit as frivolous. In spite of the insured's assessment of the lawsuit, the case went to trial and a jury returned a verdict in favor of COC.<sup>341</sup> The jury awarded the underlying plaintiff \$90 million against Halpin and the other defendants. The jury also awarded "COC \$175.5 million dollars against Halpin in exemplary damages."<sup>342</sup>

Six days after the verdict, and eleven months after COC first effected service of process, CompUSA notified Federal, its liability carrier, of the

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332. *Id.* (citing *Henson v. S. Farm Bureau Cas. Ins. Co.*, 17 S.W.3d 652, 654 (Tex. 2002)).

333. *Id.*

334. *Id.*

335. *Fed. Ins. Co. v. CompUSA, Inc.*, No. Civ. A. 301CV0593D, 2002 WL 1285263 (N.D. Tex. June 4, 2002).

336. *Id.* at \*1.

337. *Id.*

338. *Id.*

339. *Id.*

340. *Id.*

341. *Id.*

342. *Id.*



COC lawsuit and verdict.<sup>343</sup> The court of appeals noted that this evidence was undisputed and that the letter was the first formal notice by the insured to Federal concerning the lawsuit.

After receiving notice, Federal denied the claim and sought a declaratory judgment from the Northern District of Texas that it was not obligated to indemnify the insureds due to their failure to give notice of the claim “as soon as practicable.”<sup>344</sup> In addressing Federal’s declaratory judgment argument, the court focused on precedent concerning what constitutes notice “as soon as practicable,” the sufficiency of the notice of the actual claim, and whether an insurer must demonstrate actual prejudice stemming from the absence of the required notice.<sup>345</sup>

Concerning the “as soon as practicable” requirement, the court noted that the insurance policy read in relevant part:

The Insureds shall, as a condition precedent to exercising their rights under this coverage section, give to the Company written notice as soon as practicable of any Claim made against any of them for a Wrongful Act.<sup>346</sup>

Moreover, the policy’s notice clause required any notice to be sent to a specific address. The court next found that Texas courts have held that “as soon as practicable” is equivalent to “within a reasonable time.”<sup>347</sup> The court stated that “[w]hen the relevant facts are undisputed, the question whether notice was given ‘as soon as practicable’ or ‘within a reasonable time’ is a question of law.”<sup>348</sup>

Since it was undisputed that formal notification was not given to Federal until February 14, 2001, the court held that as a matter of law the notice was not given within a reasonable time. The court based this ruling on a prior district court opinion that discussed two Texas Supreme Court cases addressing what constitutes notice “as soon as practicable.”<sup>349</sup> In those cases the supreme court held that delays of 107 days and thirty-two days, respectively, were too long.<sup>350</sup>

Next, the court addressed whether Federal’s “actual” notice was sufficient. Concerning this point, the insured contended “that Federal received actual notice of the COC suit during March 2000, when a Federal underwriter” read a Form 10-Q on CompUSA’s web site concerning the COC suit.<sup>351</sup> The court rejected this argument, holding that the underwriter’s knowledge of the Form 10-Q did not “relieve the Insureds of

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343. *Id.*

344. *Id.* at \*2.

345. *Id.* at \*3.

346. *Id.* at \*2.

347. *Id.* at \*3 (citing *Chicago Ins. Co. v. W. World Ins. Co.*, No. Civ. A. 3-96-CV-3179R, 1998 WL 51363 at \*2 (N.D. Tex. Jan. 23, 1998)).

348. *Id.* (citing *Chicago Ins. Co.*, 1998 WL 51363, at \*2).

349. *Id.* (citing *Chicago Ins. Co.*, 1998 WL 51363, at \*3 (citing *Allen v. W. Alliance Ins. Co.*, 162 Tex. 572, 349 S.W.2d 590, 594 (1961); *Klein v. Century Lloyd’s*, 154 Tex. 160, 275 S.W.2d 95, 97 (1955))).

350. *Id.*

351. *Id.*

their obligation to comply with the notice” requirement, which was a condition precedent for coverage.<sup>352</sup>

Finally, the court held that Federal did not have to demonstrate that it suffered “actual prejudice” from the insured’s failure to give the required notice. The court found that, under Texas law, the effect of an insured’s non-compliance with its policy’s notice requirements depends whether the policy is “claims-made” or “occurrence-based.”<sup>353</sup> The insureds had argued that the policy was essentially an occurrence-based policy, because of an endorsement that created an extended recording period. The court, however, rejected this argument and held that, while the endorsement “allow[ed] certain claims made after the policy period has concluded to be treated as claims made within the policy period,” the provision was still “fully consistent with the Policy’s express language declaring it to have been written on a ‘claims made basis.’”<sup>354</sup>

The court agreed with the insured that Texas law requires an insurer to show actual prejudice before it can deny coverage based upon ineffective notice under an occurrence-based policy. The court stated that the reason for this requirement was that notice under an occurrence policy notice is “subsidiary” to the event that actually triggers coverage.<sup>355</sup> The court then stated that claims-made policies differ from occurrence policies in that the notice itself triggers coverage. Due to this distinction, the court held that it was proper to strictly interpret the notice requirements of a claims-made policy.<sup>356</sup> Thus, since Federal’s policy at issue contained no actual prejudice requirement for denying a claim due to ineffective notice, the insurer did not have to show actual prejudice. Based upon these findings, the court granted summary judgment in favor of Federal, finding that it had no duty to indemnify the insured.<sup>357</sup>

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352. *Id.* at \*3-4 (citing *FDIC v. Barham*, 995 F.2d 600, 604, n.9 (5th Cir. 1993)).

353. *Id.* at \*4.

354. *Id.* at \*5.

355. *Id.* (citing *Matador Petroleum Corp. v. St. Paul Surplus Lines Ins. Corp.*, 174 F.3d 653, 658-59 (5th Cir. 1999) (applying Texas law)).

356. *Id.* at \*4.

357. *Id.* at \*6.

