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Insurance Law

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*H. Michelle Caldwell**

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The last year may have been the most pivotal year for insurance law decisions since the late 1980s. This Article discusses the significant insurance cases in Texas during this Survey period.

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I. BAD FAITH

A plaguing and much-debated issue in previous years was whether an insured could recover extracontractual damages in the absence of coverage. The case which finally answered most of the questions, *Republic Insurance Co. v. Stoker*,¹ arose out of a multiple car accident in which the Stokers' automobile rear ended another vehicle. An unidentified pickup truck dropped a load of furniture on the highway, causing a chain reaction collision, but the truck was not struck by any of the vehicles involved in the collision. Because the Stokers had no collision insurance, they submitted a claim under their uninsured/underinsured motorist coverage with Republic. The independent adjusting firm hired by Republic recommended that the claim be denied because it appeared that the driver, Mrs. Stoker, was more than 50% at fault in causing the accident.² Republic denied the claim on that basis. The Republic policy provided uninsured motorist coverage for damages caused by an unidentified hit and run vehicle only if the vehicle had actual contact with the insureds' car. Republic, however, did not initially rely on the lack of physical contact with the pickup as its basis for denying coverage.

After Republic denied their claim, the Stokers sued for breach of contract, breach of the duty of good faith and fair dealing, and violations of the Deceptive Trade Practices Act (DTPA) and Texas Insurance Code article 21.21. Their claims were primarily based on Republic's "invalid" reason for its denial, *i.e.*, Mrs. Stoker's alleged fault. Republic moved for summary judgment on both the Stokers' contractual and extracontractual claims because the policy provided no coverage in the absence of physical contact. The trial court granted summary judgment on the contract issue, finding no coverage existed for the Stokers' claim. The court, however, submitted the rest of the case to the jury, which found that Republic breached its duty of good faith and fair dealing and violated the DTPA and article 21.21.³ The court of appeals affirmed the trial court's judgment.⁴

The Stokers did not contest the finding of no coverage under the policy and did not contend that they were damaged by any delay in Republic's processing of their claim. The sole issue before the Texas Supreme Court was whether Republic could incur extracontractual liability for denying the Stokers' claim on an erroneous basis even though a proper basis for the denial of coverage existed.

The court noted that the first element of the tort of common law bad faith requires an objective determination of whether a reasonable insurer

1. 903 S.W.2d 338 (Tex. 1995).

2. At trial, Mrs. Stoker conceded that fault is an issue in recovering uninsured motorist benefits. *Id.* at 339.

3. The statutory violations were based solely on the Stokers' common law bad faith claim. *Stoker*, 903 S.W.2d at 339.

4. *Id.* at 339-340.

under similar circumstances would have delayed payment of or denied the claim in question.⁵ In affirming the trial court's judgment, the El Paso Court of Appeals relied on *Viles v. Security National Insurance Co.*,⁶ in which the Supreme Court held that whether there is a reasonable basis for the insurer's denial of the claim is determined by the facts known by the insurer at the time the claim was denied.⁷ The Supreme Court stated, however, that *Viles* did not support the Stokers' claim because unlike *Viles*, the Stokers' claim never triggered coverage under the Republic policy due to the absence of physical contact between the vehicles.⁸ The court held that the dispositive factor is whether, based upon the facts existing at the time of the denial, a reasonable insurer would have denied the claim.⁹

Additionally, while acknowledging that a claim under the policy is independent from a bad faith claim, the court noted that there was no precedent for holding a carrier liable for denying a claim not covered by the policy.¹⁰ Emphasizing that the first element of a bad faith claim is the *absence* of a reasonable basis for denying or delaying payment of benefits, the court concluded that Republic did not fail to determine whether there was a reasonable basis for denying the Stokers' claim.¹¹

The court concluded by noting, "As a general rule there can be no claim for bad faith when an insurer has promptly denied a claim that is in fact not covered."¹² However, ominously perhaps for carriers, the court

5. *Id.* at 340 (citing *Aranda v. Insurance Co. of N. America*, 748 S.W.2d 210, 213 (Tex. 1988)).

6. 788 S.W.2d 566 (Tex. 1990).

7. *Id.* at 567.

8. *Stoker*, 903 S.W.2d at 340.

9. *Id.* (citing *Aranda*, 748 S.W.2d at 213).

10. *Id.*

11. *Id.* The court also rejected the Stokers' argument that they were entitled to rely on Republic's reason for denying their claim in deciding whether to file suit, noting that the Stokers were apparently no more persuaded by the coverage language of the policy than by Republic's statement to them that Mrs. Stoker was to blame for the accident. *Id.* at 341. Because they contested both reasons for the denial, the Stokers could not preclude Republic from relying on a reason for denying their claim that existed at the time of the denial, even if it was not the reason Republic gave.

12. *Id.* at 341. In support, the court cited: *O'Malley v. United States Fidelity & Guar. Co.*, 776 F.2d 494, 500 (5th Cir. 1985) (noting that no Mississippi case has ever allowed bad faith recovery for the insured without first establishing liability under the policy); *Gilbert v. Congress Life Ins. Co.*, 646 So. 2d 592, 593 (Ala. 1994) (plaintiff bears the burden of proving a breach of contract by the defendant); *Reuter v. State Farm Mut. Auto. Ins. Co., Inc.*, 469 N.W.2d 250, 253 (Iowa 1991) ("a bad faith failure to pay the insured when the event occurs . . . may subject the insurer to tort liability"); *Wittmer v. Jones*, 864 S.W.2d 885, 890 (Ky. 1993) (noting that in order to establish a tort action for bad faith the insured must first prove that the insurer was obligated to pay under the policy); *Pemberton v. Farmers Ins. Exchange*, 858 P.2d 380, 382 (Nev. 1993) ("An insurer fails to act in good faith when it refuses 'without proper cause' to compensate the insured for a loss covered by the policy."); *Bartlett v. John Hancock Mut. Life Ins. Co.*, 538 A.2d 997, 1000 (R.I. 1988) ("there can be no cause of action for an insurer's bad faith refusal to pay a claim until the insured first establishes that the insurer breached its duty under the contract of insurance"); see also OSTRAGER & NEWMAN, *INSURANCE COVERAGE DISPUTES* § 12.01 at 503 (7th ed. 1994) ("The determination of whether an insurer acted in bad faith requires as a predicate a determination that coverage exists for a loss in question."); 15A RHODES, *COUCH ON*

left open the possibility that an insurer may, under some circumstances, incur liability for a breach of the duty of good faith and fair dealing in denying a claim that is not covered by the policy, noting:

We do not exclude, however, the possibility that in denying the claim, the insurer may commit some act, so extreme, that would cause injury independent of the policy claim. Nor should we be understood as retreating from the established principles regarding the duty of an insurer to timely investigate its insureds' claims. These circumstances are not present in this case.¹³

Significantly, the *Stoker* court also did not address the issue of a carrier's liability under either the DTPA or Insurance Code in the absence of a covered claim, leaving substantial questions as to the viability of those causes of action.

In an equally significant decision, the Supreme Court did address one aspect of the Insurance Code. In *State Farm Life Insurance Co. v. Beaston*,¹⁴ the Beastons bought State Farm life insurance policies in 1982. Mr. Beaston's policy lapsed on December 28, 1983, after he failed to pay the premium. The thirty-one day grace period expired on January 28, 1984. Three days after the expiration of the grace period, Mr. Beaston died in an automobile accident. State Farm refused to pay benefits under the policy since coverage lapsed before Mr. Beaston's death. Mrs. Beaston brought suit against State Farm asserting, among other things, violations of article 21.21, and contending that she was entitled to receive the policy benefits because under the terms of the policy, the policy's lapse should have been "cured."

At trial, the court granted an instructed verdict for Mrs. Beaston on the coverage issue and the jury found that State Farm engaged in unfair deceptive acts which were the producing cause of Mrs. Beaston's damages. The jury failed to find, however, that State Farm (1) had engaged in any false, misleading or deceptive act or practice; (2) had engaged in any unconscionable course of action; (3) was negligent; or (4) was grossly negligent. Because the response in the jury charge to the question of whether State Farm had "knowingly" engaged in any unconscionable conduct was conditioned on an affirmative response to the question of whether it had engaged in any unconscionable course of action that was a producing cause of damage to Mrs. Beaston, the jury never reached the "knowing" question. Even though it awarded no policy benefits as damages, the jury awarded Mrs. Beaston attorneys' fees and \$200,000 for her past mental anguish. The trial court entered judgment for the face amount of the policy but refused to award damages for mental anguish, treble damages or attorneys' fees. The court of appeals affirmed the judgment, increased the award of attorneys' fees, and reinstated the jury's

INSURANCE LAW 2d § 58:1 at 249 (Rev. ed 1983) ("As a general rule there may be no extracontractual recovery where the insured is not entitled to benefits under the contract of insurance which establishes the duties sought to be sued upon.").

13. *Stoker*, 903 S.W.2d at 341 (citing *Aranda*, 748 S.W.2d at 214).

14. 907 S.W.2d 430 (Tex. 1995).

award of mental anguish damages, concluding that the trebling of those damages was mandatory under the former version of article 21.21, which governed the case.¹⁵

At the outset of its analysis, the Texas Supreme Court concluded that the lower courts' interpretation of the policy lapse was incorrect and reversed the award of life insurance policy benefits to Mrs. Beaston.¹⁶ The court addressed the award of mental anguish damages, noting that, like the DTPA, article 21.21 provides that a party may recover its actual damages against a defendant who has violated the statute's provisions.¹⁷ Noting that recovery for emotional distress damages are generally not permitted without "some additional threshold showing,"¹⁸ the court acknowledged its prior holdings restricting awards for mental anguish damages¹⁹ and held that there was "no reason that a culpable mental state should not also be required to recover mental anguish damages under article 21.21."²⁰ Because the DTPA and article 21.21 are interrelated, the court has required a threshold finding of a culpable mental state as one of the prerequisites for the recovery of mental anguish damages in DTPA cases not involving personal injury.²¹ The court concluded that it was logical to require a similar culpable mental state under article 21.21. Since "knowingly" was the only culpable mental state found in the statute,²² the court concluded that mental anguish damages are not recover-

15. *Id.* at 432. The court noted that § 16 of former article 21.21 provided that "any plaintiff who prevails may obtain . . . three times the amount of actual damages. . . ." Act of May 21, 1973, 63rd Leg., R.S., ch. 143, § 2(c), 1973 Tex. Gen. Laws 322, 338, *amended by* Act of April 4, 1985, 68th Leg., R.S., ch. 22, § 3, 1985 Tex. Gen. Laws 395, 395. The current version of article 21.21 provides that a prevailing plaintiff can recover treble damages only if "the trier of fact finds that the defendant knowingly committed the acts" of which the plaintiff complains. TEX. INS. CODE ANN. § 21.21, § 16(b)(1) (Vernon Supp. 1996).

16. *Beaston*, 907 S.W.2d at 432-434.

17. *Id.* at 435. The court noted that neither the DTPA nor article 21.21 defines "actual damages." *Id.* Texas cases, however, have concluded that "actual damages" available under article 21.21 or the DTPA are those damages recoverable at common law. *Id.* (citing *Brown v. American Transfer & Storage Co.*, 601 S.W.2d 931, 939 (Tex. 1980), *cert. denied* 449 U.S. 1015 (1980); *Frank B. Hall & Co. v. Beach, Inc.*, 733 S.W.2d 251, 265 (Tex. App.—Corpus Christi 1987, writ ref'd n.r.e.); *St. Paul Ins. Co. v. McPeak*, 641 S.W.2d 284, 287 (Tex. App.—Houston [14th Dist.] 1982, writ ref'd n.r.e.)).

18. *Beaston*, 907 S.W.2d at 436 (citing *The Parkway Co. v. Woodruff*, 901 S.W.2d 434, 442 (Tex. 1995) as an example that the emotional distress or similar injury be accompanied by a physical injury "resulting from a physical impact or was produced by a particularly upsetting or disturbing event.").

19. *Id.* at 435. In *Brown v. American Transfer & Storage Co.*, 601 S.W.2d 931 (Tex. 1980), the court held that mental anguish damages were not recoverable in a DTPA case in the absence of willful conduct or a resulting physical injury. *Id.* at 939. Similarly, the court held in *Duncan v. Luke Johnson Ford, Inc.*, 603 S.W.2d 777 (Tex. 1980), that some proof of a willful tort, gross negligence or willful disregard must be present to support an award of mental anguish damages. *Id.* at 779.

20. *Beaston*, 907 S.W. 2d at 435.

21. *Id.* at 436 (citing *Luna v. North Star Dodge Sales, Inc.*, 667 S.W.2d 115, 117-18 (Tex. 1984); *Duncan*, 603 S.W.2d at 779; *Brown*, 601 S.W.2d at 939).

22. *Id.* at 435. "Knowingly" is defined as "actual awareness of the falsity, unfairness, or deception of the act or practice made the basis for a claim under section 16 of this article. 'Actual awareness' may be inferred where objective manifestations indicated that a person acted with actual awareness." TEX. INS. CODE ANN. § 21.21(2)(c) (Vernon Supp. 1996).

able under article 21.21 without an express finding of knowing conduct, in addition to the other prerequisites for recovery of mental anguish damages under the common law. Because the jury failed to find that State Farm's conduct was knowing, the Supreme Court reversed the judgment of the court of appeals and rendered a take-nothing judgment against Mrs. Beaston on her article 21.21 claim.

In *Transport Insurance Co. v. Faircloth*,²³ the Texas Supreme Court revisited the duties owed by a carrier to a third party claimant. The Kervins were killed when an Allied Van Lines tractor-trailer struck their pickup truck. Allied's insurer, Transport, believing that the 15-year-old Faircloth was the daughter of the Kervins, sought to settle her claim against Allied. Following the accident, a family friend of the Kervins was appointed Faircloth's guardian. A month after the collision, Faircloth's claim against Allied was settled for \$250,000.

After reaching majority, Faircloth sued Transport, its independent adjuster, and the guardian, alleging that they had conspired to defraud her of the true value of her claim. Faircloth was eventually revealed as neither the natural nor the adopted child of the Kervins. Transport countered that Faircloth defrauded it by leading its representatives to believe that she had a right to collect for the Kervins' deaths. The jury considered the case under a number of theories, including breach of the duty of good faith as well as DTPA and Insurance Code violations. After receiving a verdict in her favor, Faircloth elected to recover under the statutory remedies. On appeal, the court of appeals held that the jury findings against Transport was a determination "pursuant to law" that the defendants committed a deceptive act or practice actionable under the Insurance Code and the DTPA and that there was evidence that the defendants had breached a duty to deal in good faith with Faircloth.²⁴

The Texas Supreme Court, however, found that the statutory theories upon which Faircloth had recovered were unavailable to her because she was not a "consumer."²⁵ Following its holding in *Allstate Insurance Co. v. Watson*,²⁶ the court held that article 21.21 of the Insurance Code expressly makes actionable those acts or practices defined in section 17.46 of the DTPA as unlawful deceptive practices.²⁷ Faircloth contended that she had pleaded and proved a violation of section 17.46(b)(23)²⁸ and that such a violation is actionable under the Insurance Code. But the Texas Supreme Court held that "an action pursuant to section 17.46(b)(23). . . was not available to Faircloth because an insurer negotiating [a settle-

23. 898 S.W.2d 269 (Tex. 1995).

24. *Id.* at 273.

25. *Id.* at 269.

26. 876 S.W.2d 145 (Tex. 1994).

27. *Id.* at 149.

28. Section 17.46(b)(23) makes unlawful "the failure to disclose information concerning goods or services which was known at the time of the transaction if such failure to disclose such information was intended to induce the consumer into a transaction into which the consumer would not have entered had the information been disclosed." TEX. BUS. & COM. CODE ANN. §17.46(b)(23) (Vernon 1987 & Supp. 1996).

ment] with a third party is neither inducing a 'consumer' into a transaction nor withholding information concerning 'goods and services.'"²⁹ The court noted that third parties negotiating a settlement with an insurer seek the proceeds of the policy rather than to purchase or lease any of the carrier's services.³⁰ A party whose only relation to an insurance policy is to seek policy proceeds, the court held, is not a "consumer."³¹ Because Faircloth was not a "consumer" and the information Transport allegedly withheld from her did not concern "goods or services," the court held that there was no actionable Insurance Code violation.³²

The court also agreed with Transport's argument that Faircloth's lack of "consumer" status defeated any standing she had to recover for an "unconscionable course of conduct."³³ The court also reversed Faircloth's additional damages awarded on account of Transport's alleged "knowing" violations of the DTPA and Insurance Code since Faircloth could not prove an actual violation of those statutes.

Faircloth also claimed that Transport owed her a duty of good faith and fair dealing arising out of the "special relationship" between Faircloth and Transport which developed as a result of Faircloth's dealings with the independent adjuster.³⁴ The court held in *Allstate Insurance Co. v. Watson*³⁵ that an insurer owes no duty of good faith to third-party claimants under the Insurance Code without reaching the question of a possible common law duty.³⁶ The court analyzed Faircloth's claim in terms of the relationship among the third-party claimant, the insured, and the insurer, noting that Faircloth's interests were adverse to Allied, and that Transport's duty of good faith and fair dealing ran only to Allied, its insured. Transport's duties to Allied consisted of defending and, if warranted by the facts, settling the claim consistent with Allied's best interests. The court held that in the interest of public policy it could not require insurance companies to perform duties for third party claimants that are "co-extensive and conflicting" with the duties owed to their insureds since such duties would "necessarily compromise the duties the insurer owes to its insured."³⁷ The court held that, in Faircloth's case, no compelling facts suggested a special relationship existed to warrant imposing on Transport

29. *Faircloth*, 898 S.W.2d at 273. The court noted that the DTPA defines a consumer as "an individual . . . who seeks or acquires by purchase or lease, any goods or services." *Id.* (citing TEX. BUS. & COM. CODE ANN. § 17.45(4) (Vernon 1987)). Further, section 17.45(1) defines "goods" as "tangible chattels or real property purchased or leased for use," and "services" as "work, labor, or service purchased or leased for use." *Id.*

30. *Id.* at 274.

31. *Id.* (citing *English v. Fischer*, 660 S.W.2d 521, 524 (Tex. 1983)).

32. *Id.*

33. *Id.* Violations under section 17.50 as opposed to section 17.46, are not grounds for liability under the Insurance Code. TEX. BUS. & COM. CODE ANN. §17.50(a)(3) (Vernon 1987 & Supp. 1996).

34. *Faircloth*, 898 S.W.2d at 269; see *Arnold v. National County Mut. Fire Ins. Co.*, 725 S.W.2d 165 (Tex. 1987); *Aranda v. Insurance Co. of N. Am.*, 748 S.W.2d 210 (Tex. 1988).

35. 876 S.W.2d at 150.

36. *Id.*

37. *Faircloth*, 898 S.W.2d at 279.

either a duty of good faith and fair dealing or a fiduciary duty owed to Faircloth.³⁸

One court, however, further distinguished the common law cause of action of bad faith from statutory remedies available to insureds. In *Lusk v. Puryear*,³⁹ Lusk sought benefits under the personal injury protection coverage of her Mid-Century automobile insurance policy for injuries she sustained in an accident. Mid-Century filed an interpleader action and tendered the balance of unpaid benefits to the trial court to avoid adverse and conflicting claims after receiving notice of Lusk's intent to revoke her assignments of benefits to her healthcare providers. The Lusks filed a cross-claim against Mid-Century for breach of contract and statutory damages under article 21.55 of the Insurance Code for its failure to pay benefits within 30 days. Mid-Century then filed a motion to sever the cross-action from the interpleader action and to abate proceedings on the Insurance Code claim until the underlying suit was resolved on the ground that the cross-action constituted a separate and distinct "bad faith" claim under article 21.21 of the Insurance Code. After the trial court granted Mid-Century's motion, the Lusks filed a petition for writ of mandamus. The court of appeals rejected Mid-Century's assertion that the breach of contract allegation was an allegation of "bad faith" under article 21.21 and that the article 21.55 violation allegation was a separate cause of action from the contract claim, mandating severance and abatement under Rule 41. In granting the writ of mandamus, the court noted that "the entire liability of Mid-Century, both on the insurance policy and under article 21.55, was put in issue as one cause of action."⁴⁰

Finally, in *Aetna Casualty & Surety Co. v. Garza*,⁴¹ the court considered allegations of bad faith in the context of Aetna's failure to pay a suspected arson loss. After a fire destroyed her home, Garza filed a claim with Aetna. Over the course of the next two years, accusations flew as to whether the insured or the insurer was more recalcitrant during the investigation of the claim. Ultimately, however, a jury awarded Garza more than \$1.7 million in damages based on Aetna's breach of the duty of good faith and fair dealing and violations of the Insurance Code and DTPA. In affirming the bad faith finding against Aetna, the court noted that while Aetna was correct in asserting it had a right to conduct a "thorough investigation,"⁴² the court rejected Aetna's contention that the carrier was investigating or gathering facts to prove anything during that time frame about the circumstances of the fire, since Aetna's own investigators had ruled out Garza as the source of the arson early in the case.⁴³ The court held that Aetna's conduct of "targeting the insureds and ignoring other

38. *Id.*

39. 896 S.W.2d 377 (Tex. App.—Amarillo 1995, no writ).

40. *Lusk*, 896 S.W.2d at 380.

41. 906 S.W.2d 543 (Tex. App.—San Antonio 1995, writ dismissed by agreement).

42. *Id.* at 550.

43. *Id.*

possible suspects" was proper evidence of bad faith.⁴⁴ The court further determined that Aetna's failure to provide Garza with a copy of her insurance policy, despite numerous requests, supported the jury's finding of DTPA violations. The *Garza* court also found that the Aetna adjuster responsible for the handling of the claim was not subject to liability for a breach of the duty of good faith and fair dealing, noting that previous Texas decisions declined to extend that duty to the carrier's agents or contractors.⁴⁵ Significantly, the court reversed Garza's award of punitive damages against Aetna. Relying on *Transportation Insurance Co. v. Moriel*,⁴⁶ the court found that there was no evidence that Aetna acted with "malice" in delaying payment of Garza's claim.⁴⁷

II. STOWERS DUTY

In *Willcox v. American Home Assurance Co.*,⁴⁸ Frederick Willcox, Jr. was confronted by a civil process server who allegedly rammed his vehicle into Willcox's, exited the vehicle brandishing a gun, and approached Willcox to serve a subpoena. After a brief altercation, Willcox suffered a heart attack and subsequently died. Willcox's family initially filed suit in state court against the process server and his employer, but later amended the petition to name the attorney who retained the process server and his law firm as defendants. After the law firm's professional liability carrier, American Home, declined to provide a defense to the attorney and his law firm based on the policy's "bodily injury" exclusion, State Farm, the law firm's general liability carrier, assumed the defense of the law firm. The Willcoxes, the law firm, and State Farm ultimately reached a settlement in which the Willcoxes released the law firm from liability with the express understanding that the settlement money would be payable solely from the proceeds of the American Home policy or from the proceeds of any lawsuit brought by plaintiffs or their assigns.

The Willcoxes, proceeding on their own behalf and as assignees of the law firm, filed suit against American Home. American Home moved for summary judgment on the causes of action for breach of contract, violations of the DTPA, common-law negligence, negligence per se based on

44. *Id.* at 551. The court cited *State Farm Fire & Cas. Co. v. Simmons*, 857 S.W.2d 126, 133 (Tex. App.—Beaumont 1993, writ denied) (failure to investigate possible suspects identified by insured is bad faith); *Automobile Ins. Co. v. Davila*, 805 S.W.2d 897, 906 (Tex. App.—Corpus Christi 1991, writ denied), *overruled on other grounds*; *Hines v. Hash*, 843 S.W.2d 464, 469-70 (Tex. 1992).

45. *Id.* (citing *Natividad v. Alexsis, Inc.*, 875 S.W.2d 695, 696-98 (Tex. 1994); *Ayoub v. Baggett*, 820 F. Supp. 298, 299-300 (S.D. Tex. 1993); *Arzehgar v. Dixon*, 150 F.R.D. 92, 94-95 (S.D. Tex. 1993); *Hartford Cas. Ins. Co. v. Walker County Agency, Inc.*, 808 S.W.2d 681, 686 (Tex. App.—Corpus Christi 1991, no writ)).

46. 879 S.W.2d 10 (Tex. 1994).

47. The court declined to determine whether the definition of "malice" submitted by the court to the jury would support the punitive damages award since it allowed the jury to find either actual or implied malice. *Garza*, 906 S.W.2d at 554. The court did note, however, that the definition offered by Aetna was closer to the court's previous definitions of "actual malice necessary to support an award of punitive damages." *Id.*

48. 900 F. Supp. 850 (S.D. Tex. 1995).

DTPA violations, negligent misrepresentations and breach of the *Stowers* duty.⁴⁹ Under the *Stowers* doctrine, an insurer must exercise that degree of care and diligence which an ordinarily prudent person would exercise in the management of his own business in responding to settlement demands within policy limits.⁵⁰

The Willcoxes argued that they were entitled to recover the entire settlement amount from American Home based upon its wrongful refusal to furnish the law firm with a defense in the underlying lawsuit. In accordance with a long line of Texas state and federal cases, the court held that an insured's damages for wrongful refusal to defend are generally limited to policy limits, expenses in defending the underlying suit, and expenses associated in prosecuting the suit to enforce the judgment or settlement against the insurer.⁵¹ The court noted, however, that an insurer's wrongful refusal to defend does not operate as an estoppel or waiver of the carrier's right to assert the policy defense of non-coverage.⁵² Therefore, damages in either a judgment or settlement must be apportioned between covered and non-covered claims under the policy.⁵³ Accordingly, subject to proof that the settlement agreement be reasonable and not the product of fraud or collusion, the court held that the Willcoxes could pursue their contractual claims against American Home up to the policy limits.⁵⁴

The court also noted that Texas state court did not impose *Stowers* liability where the carrier failed to assume the defense of the insured, since a critical element of the *Stowers* doctrine is that the carrier act as a ordinarily prudent person in the management of the insured's defense.⁵⁵ Noting that the Fifth Circuit previously "guessed" that the *Stowers* duty persisted after the denial of coverage, the court held that the Fifth Circuit's prediction was no longer viable in view of current Texas decisions.⁵⁶ Specifically, the court noted that the *Stowers* duty is triggered by receipt of an *unconditional* offer of settlement.⁵⁷ After reviewing the two separate demand letters in the underlying lawsuit, one conditioned on the absence of other available insurance and the other conditioned on the actual amount of available coverage, the court concluded that the *Stowers* duty was never triggered.⁵⁸ Interestingly, the court added that even if the *Stowers* duty had arisen, the inclusion of a covenant not to enforce provision in the settlement agreement negated the Willcoxes' right to recover an amount in excess of policy limits.⁵⁹

49. The *Stowers* doctrine resulted from *G.A. Stowers Furniture Co. v. American Indem. Co.*, 15 S.W.2d 544, 547 (Tex. Comm'n App. 1929, holding approved).

50. *Id.*

51. See generally discussion at 900 F.Supp. 855-856.

52. *Willcox*, 900 F. Supp. at 856.

53. *Id.*

54. *Id.* at 857.

55. *Id.* at 858.

56. *Id.*

57. *Willcox*, 900 F. Supp. at 858.

58. *Id.* at 859.

59. *Id.* (citing *Blakely v. American Employers Ins. Co.*, 424 F. 2d 278, 734 (5th Cir. 1970)).

The court also held that the Willcoxes were precluded from proceeding on their claims for negligent misrepresentation and DTPA violations since they offered inadequate evidence to support such claims against American Home based on its failure to defend the law firm in the underlying suit.⁶⁰ Additionally, the court noted that *American Physicians Insurance Exchange v. Garcia*⁶¹ appears to limit an insured's recovery on negligence-type claims to the policy limits, and that burdening the carrier with an excess judgment under *Stowers* is inappropriate absent proof that the insurer was presented with a reasonable opportunity to prevent the excess judgment by settling within the applicable policy limits.⁶² Furthermore, the court noted that the Willcoxes attempted to disguise their breach of the duty to defend claim as a negligence claim.⁶³ The *Willcox* court opined, in light of recent decisions indicating a reluctance to transform contract claims into tort claims, that the Texas Supreme Court would probably reject a "negligence" claim based solely on an insurer's breach of the duty to defend.⁶⁴

In *Insurance Corp. of America v. Webster*,⁶⁵ Zabodyn sued Webster for medical malpractice. Webster's malpractice insurance consisted of a \$100,000 primary policy with ICA and a \$750,000 excess policy with U.S. Fire. ICA's policy required Webster's consent to any settlement. Following trial and entry of a judgment in excess of \$1.2 million, Webster assigned to Zabodyn his causes of action against ICA and U.S. Fire, and he and Zabodyn filed suit against both carriers. Ultimately, U.S. Fire paid \$300,000 on the condition that it would be reimbursed if Webster and Zabodyn recovered from ICA. At trial, the plaintiff's experts testified that ICA was negligent in failing both to make offers to settle the case and to accept two offers to settle the underlying malpractice case for \$100,000—the amount of ICA's policy. The jury found that ICA was negligent and grossly negligent, and that it knowingly committed an unfair practice in the business of insurance. As a result, the jury awarded Webster \$300,000 in mental anguish damages and \$7.2 million in punitive damages. ICA appealed on the basis that insufficient evidence supported the jury's findings.

In its opinion, the court of appeals noted that an insurer may incur liability for its negligence in connection with investigation, preparation, defense and settlement of third-party claims.⁶⁶ The *Stowers* duty, however, does not require a carrier to make or solicit offers to settle third-party claims.⁶⁷ Before a carrier incurs *Stowers* liability, the settlement demand must fully release the insured in exchange for either a stated sum

60. *Id.* at 862.

61. 876 S.W.2d 842, 848 (Tex. 1994).

62. *Willcox*, 900 F. Supp. at 862.

63. *Id.* at 863.

64. *Id.*

65. 906 S.W.2d 77 (Tex. App.—Houston [1st Dist.] 1995, writ denied).

66. *Id.* at 79.

67. *Garcia*, 876 S.W.2d at 848.

of money or the limits of the policy.⁶⁸ Additionally, these three elements must be present: (1) the claim against the insured is covered under the policy; (2) the demand is within policy limits; and (3) the terms of the demand are acceptable to an ordinarily prudent insurer, considering the likelihood and degree of the insured's potential exposure to an excess judgment.⁶⁹

Examining the two settlement offers in light of the *Stowers* doctrine, the court of appeals noted that Zabodyn's first offer recited that Webster's attorney represented \$100,000 as the extent of Webster's insurance and, based upon that representation, offered to settle the case for that amount. The offer, however, also stated that the offer was null and void if there was other insurance. Similarly, Zabodyn's second offer, referring to Webster's discovery responses indicating that Webster had only \$100,000 in available coverage, offered to settle the case for \$99,999 in reliance upon those representations. The court of appeals concluded that both offers were unambiguous, but were conditioned upon the absence of other insurance.⁷⁰ The court concluded that because other insurance existed at the time the offers were made, it was impossible for ICA to accept them.⁷¹ Since ICA never had a reasonable opportunity to accept the only settlement offers made by Zabodyn's attorneys, the court held that ICA could not be negligent or grossly negligent under *Stowers*.⁷²

III. GENERAL LIABILITY

A. OCCURRENCE, BODILY INJURY AND PROPERTY DAMAGE

In *Allstate Insurance Co. v. Mauldin*,⁷³ the Ralstons sued Mauldin for sexual molestation of their child, alleging both intentional acts and Mauldin's negligent failure to obtain treatment for pedophilia. Allstate, Mauldin's homeowners carrier, brought a declaratory judgment action seeking a determination that it was not obligated to defend or indemnify Mauldin for the Ralstons' claims.⁷⁴ Proceeding on a concurrent causation theory, the Ralstons conceded that Mauldin's intentional acts were excluded from coverage, but argued that Mauldin's negligent failure to seek treatment for pedophilia was an independent cause in fact of their child's damages.⁷⁵ Citing Texas cases holding that intent to injure is inferred as a

68. *Webster*, 906 S.W.2d at 80 (citing *Garcia*, 876 S.W.2d at 848-49).

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

70. *Id.*

71. *Id.* at 81.

72. *Id.*

73. 869 F. Supp. 478 (W.D. Tex. 1994).

74. The homeowners policy covered damages sustained as the result of an "accident" or "occurrence" and excluded intentional acts. *Id.* at 479.

75. Under Texas law, concurrent causation occurs where two separate and independent acts, one covered by the policy and the other excluded, concurrently cause injury. *Warilow v. Norrell*, 791 S.W.2d 515, 526 (Tex. App.—Corpus Christi 1989, writ denied). Typically, in a concurrent causation situation, coverage exists under the insurance policy. *Id.*

matter of law in instances of an adult's sexual molestation of a child,⁷⁶ the court concluded that Mauldin's negligent failure to seek treatment for pedophilia was not an independent cause of the child's damages.⁷⁷ Accordingly, the court held that Allstate was under no duty to defend or indemnify Mauldin in connection with the Ralstons' lawsuit.⁷⁸

In a similar case, *Allen v. Automobile Insurance Co. of Hartford, Connecticut*,⁷⁹ Metcalfe pleaded guilty to the offense of indecency with Allen, a child. Following Metcalfe's conviction, Allen sued Metcalfe for injuries he suffered from Metcalfe's repeated sexual molestations of him between 1987 and 1989. Metcalfe's homeowners' carrier joined Hartford in an action against Metcalfe and Allen seeking a declaration that their policies did not provide coverage for Allen's lawsuit. All of the policies excluded coverage for personal injuries intentionally caused by the insured, and there was no dispute that all of Allen's claims arose out of Metcalfe's sexual molestation of him. After summary judgment was granted in favor of the carriers, Allen appealed, arguing that the insurers failed to present evidence that Metcalfe intended to injure him. Additionally, Allen claimed that his suit was for injuries caused by Metcalfe's negligence, gross negligence, and negligent infliction of emotional distress. Amazingly, Allen even argued to the court that an "occurrence" had resulted from Metcalfe's intentional conduct since the sexual molestation of a child by an adult "is not so inherently injurious that injury is certain to follow."⁸⁰ The court of appeals disagreed, holding that sexual molestation is an intentional injury as a matter of law.⁸¹ Agreeing with other cases holding that the "act" is the "harm" and one cannot exist without the other, the court held that "intent to molest is, by itself, the same as the intent to harm."⁸² Adopting the Western District's rationale in *Commercial Union Insurance Co. v. Roberts*,⁸³ the court elaborated that injuries resulting from sexual molestations were not risks "contemplated by the parties" to homeowners' policies because such policies are relatively inexpensive means of providing general coverage to protect individuals to from unforeseen occurrences.⁸⁴ Therefore, the expansion of coverage to include child molestation would cause homeowners' policies to become too costly for a majority of the public.⁸⁵

In *Maryland Casualty Co. v. Texas Commerce Bancshares, Inc.*,⁸⁶ Mrs.

76. See *Commercial Union Ins. Co. v. Roberts*, 7 F.3d 86 (5th Cir. 1993); *Government Employees Ins. Co. v. McGinty*, 832 F. Supp. 1092 (W.D. Tex. 1993); *Maayeh v. Trinity Lloyds Ins. Co.*, 850 S.W.2d 193 (Tex. App.—Dallas 1992, no writ).

77. *Mauldin*, 869 F. Supp. at 480.

78. *Id.*

79. 892 S.W.2d 198 (Tex. App.—Houston [14th Dist.] 1994, no writ).

80. *Id.* at 201.

81. *Id.* at 199.

82. *Id.* at 200 (citing *J.C. Penney Cas. Ins. Co. v. M.K.*, 804 P.2d 689 (Cal. 1991); *Allstate Ins. Co. v. Kim W.*, 160 Cal. App. 3d 326, 332-33 (Cal. Ct. App. 1984)).

83. 815 F. Supp. 1006, 1007 (W.D. Tex. 1992).

84. *Allen*, 892 S.W.2d at 201 (citing *Roberts*, 815 F. Supp. at 1007).

85. *Id.*

86. 878 F. Supp. 939 (N.D. Tex. 1995).

Goldenberg established a trust fund at Texas Commerce Bank (TCB) for the benefit of her three children. The children subsequently sued TCB, alleging that TCB failed to comply with the trust documents, aided and abetted their father in defrauding them with respect to trust assets, failed to provide them with copies of the trust agreement, and failed to distribute trust assets to each beneficiary upon reaching twenty-one years of age. Alleging causes of action for negligence, negligent misrepresentation, gross negligence, conversion, constructive fraud, breach of fiduciary duty, fraud, fraudulent concealment, and conspiracy, the children sought actual damages for loss of funds from the trust fund, losses in connection with the trust rental property, and damages for pain and suffering and mental anguish. Maryland, TCB's general liability carrier, filed a declaratory judgment lawsuit requesting a declaration that it had no duty to defend or indemnify TCB because of the absence of "bodily injury" or "property damage" in the underlying suit.

Relying on *Travelers Indemnity Co. v. Holloway*,⁸⁷ the court tersely noted that the term "bodily injury" unambiguously excluded the emotional nonphysical injuries alleged in the Goldenberg suit.⁸⁸ Even though TCB argued that the allegations also involved the "loss of use of tangible property" under the definition of "property damage," the court held that the children's allegations concerning the real property were not encompassed within the definition of "property damage" because the children sought recovery for economic losses, *i.e.*, lease income from the property, unpaid taxes on the property, the difference between the fair market value of the property and its actual sales price, and the cost to repair damage and destruction to the property.⁸⁹ With respect to the claims of conversion of the trust account, the court also determined that this claim was for pure economic loss and not for "property damage."⁹⁰ Accordingly, the court held that Maryland Casualty had no duty to defend or indemnify TCB.⁹¹

The Austin court of appeals, while acknowledging *Holloway*, forged its own independent analysis of the definitions of "occurrence" and "bodily injury." In *Trinity Universal Insurance Co. v. Cowan*,⁹² Gage, in the course and scope of his employment as a photo lab clerk, made extra prints of provocative photographs of Cowan and gave them to his friends. After Cowan discovered, through a friend, that Gage had wrongfully distributed the photographs, she filed suit against Gage and his employer, alleging negligence and gross negligence. Although Trinity initially defended Gage under reservation of rights, Trinity ultimately concluded that the damages were not covered by the policy and withdrew the defense. Gage assigned his claims against Trinity to Cowan in exchange for

87. 17 F.3d 113, 115 (5th Cir. 1994).

88. *Maryland Cas. Co.*, 878 F. Supp. 942.

89. *Id.*

90. *Id.* at 943.

91. *Id.*

92. 906 S.W.2d 124 (Tex. App.—Austin 1995, writ requested).

a covenant not to execute against his personal assets. Cowan subsequently took a \$250,000 judgment against Gage in the underlying lawsuit after Gage failed to appear at trial and filed suit against Trinity alleging that Trinity committed various common law and statutory bad faith insurance practices in denying coverage for the claim. The trial court granted partial summary judgment in favor of Cowan on the issue of coverage, leaving for resolution at trial the damages issues, including Trinity's extra-contractual liability. On the eve of trial, Cowan and Trinity settled, agreeing to the \$250,000 underlying judgment plus attorneys fees and post judgment interest, but reserving Trinity's right to appeal the issues of coverage and the amount of the underlying judgment. In exchange, Cowan waived her extracontractual claims.

On appeal, Trinity argued that Cowan's claim did not involve "bodily injury" caused by an "occurrence." With respect to the "occurrence" issue,⁹³ the court held that an "occurrence" takes place where the resulting injury or damage was unexpected or unintended, regardless of whether the policyholder's acts were intentional.⁹⁴ As further support for its conclusion, the court undertook a bit a judicial discovery and cited the comments of the Chairman of the Readable Homeowners Advisory Committee, which had made recommendations for changes to the standard Texas homeowners policy which was revised effective October 1, 1990:

What we have accomplished is a revision of every one of the homeowner forms and endorsements, and this will be presented today. And this was accomplished in line with you charge of making sure that there is no restriction in coverage available to any insured under an existing homeowners policy in Texas.⁹⁵

The court reasoned that these broad statements mandated that "[b]ecause the 1990 revision was not intended to restrict coverage, policies issued after the revision must also cover unintentional injuries result-

93. The concept of "occurrence" has bewildered the Austin Court of Appeals in other decisions. See Circle "C" Ranch Co. v. St. Paul Fire & Marine Ins. Co., No. 3-91-388-CV, 1993 WL 142131 (Tex. App.—Austin May 5, 1993, *opinion withdrawn by agreement*) in which the court distorted the phrase "expected or intended" from the policy's definition of "occurrence" with the phrase "sudden and accidental" from the policy's limited pollution exclusion.

94. *Cowan*, 906 S.W.2d at 129 (citing Republic Nat'l Life Ins. Co. v. Heyward, 536 S.W.2d 549, 557 (Tex. 1976); Pacific Mut. Life Ins. Co. v. Schlakzug, 143 Tex. 264, 183 S.W.2d 709, 711 (1944); Travelers Ins. Co. v. Volentine, 578 S.W.2d 501, 503 (Tex. Civ. App.—Texarkana 1979, no writ); State Farm Fire & Cas. Co. v. S.S., 858 S.W.2d 374, 377 (Tex. 1993)).

95. *Id.* at 129 (citing *Hearing on Property Insurance Rules Concerning Texas Homeowners Policy and Related Matters Before Texas State Board of Insurance* [hereinafter *Hearing on Property Insurance*], Board Docket No. 1715, at 5 (Feb. 14, 1990) (transcript available from Texas Department of Insurance, Austin, Texas)). Interestingly, only at one point during the proceedings on the Readable Homeowners policy did any committee member discuss the liability coverage. The majority of references made during the meeting to expansion of coverage concerned only the property coverage of the proposed readable homeowners policy. See, e.g., *Hearing on Property Insurance*, at 10 ("The second part of the policy is the liability section, which covers your liability to third parties and follows the same general format and has also been very greatly simplified.") (emphasis added).

ing from intentional acts.”⁹⁶ Because Trinity conceded that Gage neither intended, nor knew with substantial certainty, that Cowan would be injured as a result of his actions, the court held that Gage’s conduct fit within the policy definition of “occurrence.”

Trinity also argued that Cowan’s allegations of pure mental anguish did not qualify as “bodily injury” since Cowan’s allegations did not include any physical manifestations of such mental anguish. Distinguishing *Travelers Indemnity Co. v. Holloway*⁹⁷ on its facts, the *Cowan* court concluded that an allegation of mental anguish *implicitly* raises a claim for resulting physical manifestations.⁹⁸ Accordingly, the *Cowan* court concluded that summary judgment was proper because Cowan pleaded and proved “bodily injury.”⁹⁹

Additionally, Trinity challenged the reasonableness of the \$250,000 default judgment in the underlying lawsuit, contending that since Gage breached his obligation to defend the Cowan lawsuit with due diligence and reasonable prudence, the resulting excessive damage award could not be charged against Trinity. Citing *Employers Casualty Co. v. Block*,¹⁰⁰ the court held that while Trinity was not precluded from litigating the coverage issues, the unreasonableness of an underlying judgment is not a permissible ground for collateral attack by an insurer.¹⁰¹

B. EMPLOYEE BODILY INJURY EXCLUSION

In *National Union Fire Insurance Co. v. National Convenience Stores, Inc.*,¹⁰² Carbajal sued her former employer, NCS, alleging that her direct supervisor, Fischer, took advantage of his supervisory role by physically and sexually harassing her. Additionally, Carbajal alleged that NCS negligently promoted Fischer to a supervisory position without adequate investigation, and failed to provide Fischer with adequate training, guidance or support. The court of appeals concluded that Carbajal alleged a bodily injury which was excluded because it arose out of and in the course of Carbajal’s employment by NCS.¹⁰³ The court noted that, in order to have a covered cause of action, Carbajal must allege negligence by NCS causally connected to the damages she suffered. The court noted, however, that the negligence alleged by Carbajal was causally connected to her damages only through her supervisor’s conduct.¹⁰⁴ Specifically, the court held that all of the acts alleged that arguably resulted in bodily in-

96. *Cowan*, 906 S.W.2d at 130.

97. 17 F.3d at 115.

98. *Cowan*, 906 S.W. 2d at 131.

99. *Id.*

100. 744 S.W.2d 940 (Tex. 1988).

101. *Cowan*, 906 S.W.2d at 132 (citing *Block*, 744 S.W.2d at 943; a collateral attack may be made by a carrier under limited circumstances involving the jurisdiction or capacity of the court rendering judgment); *see also* Commonwealth County Mut. Ins. Co. v. Moctezuma, 900 S.W.2d 798, 801 (Tex. App.—San Antonio 1995, writ dismissed).

102. 891 S.W.2d 20 (Tex. App.—San Antonio 1994, writ no writ).

103. *Id.* at 21.

104. *Id.*

jury occurred on NCS's premises during office hours or during an office party.¹⁰⁵ Based on her own pleadings, the court held that any bodily injury Carbajal suffered arose out of and in the course of her employment by NCS, causing the application of the employee bodily injury exclusion.¹⁰⁶

C. PHYSICAL AND MENTAL ABUSE ENDORSEMENT

In *Western Heritage Insurance Co. v. Magic Years Learning Centers and Child Care, Inc.*,¹⁰⁷ the Wilsons operated Magic Years Learning Center, a day care center. During the course of her employment with the center, Mr. Wilson sexually harassed Alexander. Alexander brought suit and the Wilsons and Magic Years demanded a defense from their general liability carrier, Western Heritage.¹⁰⁸ In a declaratory judgment action filed by Western Heritage, the district court determined that the carrier owed a defense to all three named insureds.

On appeal, the Fifth Circuit considered the application of an abuse endorsement, an assault and battery exclusion and an employee bodily injury exclusion. While the policy contained a standard "occurrence" definition, an endorsement to the policy amended the definition of bodily injury to include sex-related injuries.¹⁰⁹ The endorsement also provided that the "insurance applies separately to each Insured."¹¹⁰ The Fifth Circuit noted that the abuse endorsement obviously trumped the "occurrence" definition with respect to the Alexander claim.¹¹¹ Moreover, the court noted that even if the endorsement did not override the definition of "occurrence," the allegations of the Alexander petition could not be read to imply that either Mrs. Wilson or Magic Years expected or intended Alexander's injuries.¹¹²

The Fifth Circuit also found in favor of the insureds with respect to a conflicting exclusionary endorsement for assault and battery. Noting that the Alexanders' allegations for assault and battery, unlawful imprisonment and intentional infliction of emotional distress were merely alterna-

105. *Id.*

106. *Id.*

107. 45 F.3d 85 (5th Cir. 1995).

108. The policy listed "Charles & Doris Wilson dba Magic Years Learning Center and Child Care, Inc." as the named insured. *Id.*

109. The endorsement read:

In consideration of the premium charged, it is hereby understood and agreed that Bodily Injury or Property Damage includes any act, which may be considered sexual in nature and could be classified as an Abuse, Harassment, Molestation, Corporal Punishment or an Invasion of an individual's right of Privacy or control over their physical and/or mental properties by or at the direction of an Insured, an Insured's employee or any other person involved in any capacity of the Insured's operation

Id.

110. *Id.*

111. *Id.*

112. *Western Heritage*, 45 F. Supp. at 88. The court noted specifically that the severability of interests clause must be applied separately to each insured. *See id.* at 89, n.3.

tive characterizations of the underlying cause of action for sexual harassment, the court held that, as between the abuse endorsement and the assault and battery exclusion endorsement, the abuse endorsement was controlling.¹¹³ The court also applied the policy's severability of interests clause to the employee bodily injury exclusion, determining that Magic Years was the employer of Alexander, but the Wilsons were not.¹¹⁴ The court also distinguished the language of the employee bodily injury from the "occurrence" definition and the assault and battery exclusion, noting that the employee bodily injury exclusion could be read in conjunction with the abuse endorsement without rendering the endorsement meaningless.¹¹⁵

D. ASSAULT AND BATTERY EXCLUSION

In *Burlington Insurance Co. v. Mexican American Unity Council, Inc.*,¹¹⁶ Zertuche, a resident of a youth home operated by the insured, sued MAUC for injuries she received when she was assaulted while off the premises. Burlington, MAUC's owners', landlords' and tenants' liability carrier, denied coverage for the claim based on an exclusionary endorsement for assault and battery.¹¹⁷ The court specifically rejected MAUC's attempt to circumvent the exclusion by asserting that concurrent causation permitted coverage for Zertuche's assault. The court found that the negligence of MAUC in allowing Zertuche to leave the premises and the assault by an unknown assailant were "related and interdependent," causing the application of the exclusion to the entire claim.¹¹⁸

E. THE POLLUTION EXCLUSION

Heralding a series of high-impact insurance decisions, in a relatively terse decision by Justice Bob Gammage, a unanimous supreme court upheld the validity of several versions of the absolute pollution exclusion in a case that has received national attention over the last two years. In *National Union Fire Insurance Co. of Pittsburgh v. CBI Industries, Inc.*,¹¹⁹ the court addressed absolute pollution exclusions in the policies of several layers of insurance for an insured which suffered losses stemming

113. *Id.* at 89.

114. *Id.*

115. *Id.* at 90.

116. 905 S.W.2d 359 (Tex. App.—San Antonio 1995, no writ).

117. The text of the endorsement read:

It is agreed and understood that this insurance does not apply to bodily injury or property damage arising out of assault and battery or out of any act or omission in connection with the prevention of such acts, whether caused by or at the instigation or direction of the insured, his employees, patrons or any other person.

Id. at 360.

118. *Id.* (quoting *Commercial Union Ins. Co. v. Roberts*, 7 F.3d 86, 89-90 (5th Cir. 1993)).

119. 907 S.W.2d 517 (Tex. 1995).

from an accidental explosion.¹²⁰ In October 1987, a subsidiary of CBI was working on the cleaning, repair and replacement of certain equipment at Marathon Petroleum Company's Texas City refinery. While CBI was supervising the removal of a convection section of a heater unit, the crane's load dropped onto a pipe connected to a storage tank which contained hydrofluoric acid, a toxic waste under EPA standards. CBI claimed that Marathon, in contravention of standard industry practices, failed to empty the storage tank and that CBI did not know about the presence of the chemical in the tank before the accident. Many residents of Texas City later sued CBI and others, claiming they suffered injuries when a large cloud of hydrofluoric acid loomed over the city after the accident. CBI tendered the defense of the suits to its carriers, which all denied coverage on the grounds that the absolute pollution exclusions in their policies excluded coverage for the claims. In its declaratory judgment action, CBI argued that the exclusions contained both patent and latent ambiguities. The trial court ruled in favor of the carriers before CBI had an opportunity through discovery to obtain documents which it believed would support its theory that the exclusions were ambiguous and were not meant to exclude coverage in every instance.

After citing the Texas rules of construction for insurance policies, the supreme court distinguished patent ambiguities from latent ambiguities.¹²¹ The court criticized the Houston Court of Appeals for failing to make a determination of patent or latent ambiguity, and for holding instead that the trial court had abused its discretion by rendering summary judgment before the parties could obtain discovery in the case. The court of appeals had noted in its decision¹²² that CBI was not given adequate time to conduct discovery on the circumstances surrounding and underlying the contract, and therefore, CBI could not raise a fact issue on latent

120. The National Union policy contained this version of the absolute pollution exclusion:

This policy does not apply to . . . any Personal Injury or Property Damage arising out of the actual or threatened discharge, dispersal, release or escape of pollutants, anywhere in the world; . . . "Pollutants" means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste material. Waste materials include materials which are intended to be or have been recycled, reconditioned or reclaimed.

Id. at 519.

The Anglo American and Rome policies contained this version of the exclusion:

Notwithstanding anything to the contrary contained in this policy, this policy is amended in that it shall not apply to any claim or claims: For personal injuries or property damages directly or indirectly caused by seepage or pollution or contamination of air, land, water or any other property, however caused and whenever occurring.

Id.

121. *Id.* at 520. The court noted that a patent ambiguity is evident on the face of the contract when the language is susceptible to more than one reasonable interpretation. However, a latent ambiguity arises when the circumstances surrounding and underlying a seemingly unambiguous contract causes an ambiguity to arise. *Id.*

122. *CBI Industries, Inc. v. National Union Fire Ins. Co.*, 860 S.W.2d 662 (Tex. App.—Houston [14th Dist.] 1993 writ granted).

ambiguity.¹²³ The court of appeals also summarized the industry-wide evidence, noting that such evidence should have indicated to the trial court that CBI could have raised a fact issue on latent ambiguity if it had been given more time for discovery.¹²⁴

The supreme court stated that an ambiguity must arise when the contract is read in context of the surrounding circumstances, not after parol evidence is admitted to create an ambiguity.¹²⁵ The facts surrounding the accident (the release of the hydrofluoric acid and the subsequent alleged personal injuries), the court noted, were apparently "fully developed."¹²⁶ The evidence gleaned by CBI from the insurance industry did not relate to the application of the insurance policy to the accident, but rather applied to the intent of the insurance industry and its regulators as to the effect of the absolute pollution exclusion.¹²⁷ The court rejected CBI's contention that the exclusions were latently ambiguous, instead declaring the language in the exclusions "clear and susceptible of only one possible interpretation" and holding that the absolute pollution exclusions were clear and unambiguous.¹²⁸

The *CBI* decision certainly puts a damper on the arguments of insureds who relied on the Houston Court of Appeals' opinion to weaken the absolute pollution exclusion. However, carriers should keep in mind that the versions of the absolute pollution exclusion¹²⁹ considered by the court are not the standard exclusion f. found in the current 1988 ISO form CGL policies.¹³⁰ While the *CBI* case bodes well for insurance carriers, *CBI* may be limited to its facts (and wording) in future decisions.

123. *Nat'l Union*, 907 S.W.2d at 520 (citing *CBI*, 860 S.W.2d at 666).

124. *Id.*

125. *Id.* at 521.

126. *Id.*

127. *Id.*

128. *Nat'l Union*, 907 S.W.2d at 522.

129. *See supra* text accompanying note 120.

130. The standard "pollution exclusion," exclusion f., found in the 1988 ISO CGL coverage form reads:

This insurance does not apply to:

- f.
- (1) "Bodily injury" or "property damage" arising out of the actual, alleged or threatened discharge, dispersal, seepage migration, release or escape of pollutants:
 - (a) At or from any premises, site or location which is or was at any time owned or occupied by, or rented or loaned to, any insured;
 - (b) At or from any premises, site or location which is or was at any time used by or for any insured or others for the handling, storage, disposal, processing or treatment of waste;
 - (c) Which are or were at any time transported, handled, stored, treated, disposed of, or processed as waste by or for any insured or any person or organization for whom you may be legally responsible; or
 - (d) At or from any premises, site or location on which any insured or any contractors or subcontractors working directly or indirectly on any insured's behalf are performing operations:
 - (i) if the pollutants are brought on or to the premises, site or location in connection with such operations by such insured, contractor or subcontractor; or

The Fifth Circuit, too, was eager to jump on the pollution exclusion band wagon. In *Constitution State Insurance Co. v. Iso-Tex Inc.*,¹³¹ Iso-Tex's business consisted of handling, transporting, storing and disposing of radioactive medical waste. Iso-Tex was sued by individuals who claimed that they suffered personal injuries as the result of its alleged deposit of enormous quantities of hazardous radioactive materials near their homes. The policies issued to Iso-Tex contained an absolute pollution exclusion.¹³² The Fifth Circuit, adopting the holding in *CBI Industries*, found the exclusion unambiguous and rejected Iso-Tex's attempt to characterize the medical waste as something other than a "pollutant."¹³³

In *Northbrook Indemnity Insurance Co. v. Water District Management Co., Inc.*,¹³⁴ residents alleged bodily injuries due to exposure to well water contaminated with toxic and hazardous substances, including benzene, for which the insured Water District was to test. Relying on *CBI Industries*, the court held that the absolute pollution exclusion clause unambiguously excluded coverage for the bodily injury claims.¹³⁵ Significantly, the court, in rejecting Water District's claims that the residents sought to recover for wrongful entry, adopted the "same nucleus of facts" test in disallowing coverage under Coverage B for "personal injury" for underlying suits which alleged injury due to exposure to contaminated

- (ii) if the operations are to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of pollutants.

Subparagraphs (a) and (d)(1) do not apply to "bodily injury" or "property damage" arising out of heat, smoke or fumes from a hostile fire.

As used in this exclusion, a hostile fire means one which becomes uncontrollable or breaks out from where it was intended to be.

(2) Any loss, cost or expense arising out of any:

- (a) Request, demand or order that any insured or others test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of pollutants; or
- (b) Claim or suit by or on behalf of a governmental authority for damages because of testing for, monitoring, cleaning up, removing, containing, treating, detoxifying or neutralizing, or in any way responding to, or assessing the effects of pollutants.

Pollutants means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed.

131. 61 F.3d 405 (5th Cir. 1995).

132. The pollution exclusion found in the policy read:

This insurance does not apply to:

(1) "Bodily injury" or "property damage" arising out of the permanent or transient contamination of the environment by pollutants.

(2) Any loss, cost, or expense arising out of any governmental direction or request that you test for monitor, clean up, remove, contain, treat, detoxify or neutralize pollutants.

Pollutants means any solid, liquid, gaseous, or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemical and waste. Waste includes materials to be recycled or reclaimed.

Id. at 407.

133. *Id.* at 408-09.

134. 892 F. Supp. 170 (S.D. Tex. 1995).

135. *Id.* at 173.

well water.¹³⁶

Most courts in Texas appear to uphold the absolute pollution exclusion.¹³⁷ Not every court, however, flatly applies the exclusion. In *Pro-Tech Coatings, Inc. v. Union Standard Insurance Co.*,¹³⁸ Pro-Tech manufactured and sold coating products. Plaintiffs in two separate lawsuits alleged that while they were employed by entities in Lufkin, Texas they were exposed to products containing, among other things, asbestos and silica dust.¹³⁹ The plaintiffs, alleging that they had industrial dust diseases, sued Pro-Tech on a variety of legal theories. When Pro-Tech requested a defense from Union Standard and Union Standard Lloyds in the two lawsuits, both carriers filed a declaratory judgment action seeking a determination that they had no duty to defend Pro-Tech because of the application of the pollution exclusions in their respective policies.¹⁴⁰ Pro-Tech counterclaimed for a declaration that the carriers were under a duty to defend. The trial court granted summary judgment for the carriers and Pro-Tech appealed.

The court of appeals reviewed the petitions in the underlying lawsuits and concluded that neither one alleged that Pro-Tech owned, rented or occupied any location in Lufkin, that the plaintiffs' injuries occurred at a location used by or for Pro-Tech or others for the handling, storage, disposal or treatment of waste, or that the pollutants were at any time transported, handled, stored, treated, disposed of or processed as waste by or for Pro-Tech or anyone for whom Pro-Tech was liable.¹⁴¹ The carriers, however, asserted that Pro-Tech and its contractors or subcontractors

136. *Id.* at 175. *Water District* also adopts the reasoning of *A.J. Gregory v. Tennessee Gas Pipeline Co.* where the court held that permitting coverage for pollution under a policy's "personal injury" coverage "would render the pollution exclusion meaningless." 948 F.2d 203, 209 (5th Cir. 1991) (applying Louisiana law).

137. *See Dorsett Bros. Concrete Supply, Inc. v. Northbrook Prop. & Cas. Ins. Co.*, No. CIV.A.H-92-2546, (S.D. Tex. Sept. 10, 1995). The case involved an employee of Ice Express who claimed that he contracted aplastic anemia as a result of walking through and standing in water that, unknown to him, was contaminated by hydrochloric acid and muriatic acid. The court held that the words or terms of the pollution exclusion were clear and unambiguous and that if the plaintiff's injuries resulted from the contaminated products, *i.e.*, hydrochloric and muriatic acid, there was no coverage under the terms of the policy, and therefore, no duty to defend. *See also Navajo Refining Co. v. Cigna Ins. Co.*, No.3:95-CV-0441-P (N.D. Tex. June 8, 1995). *Navajo* involved a ruptured pipeline which caused gasoline to seep into the surrounding neighborhood, including homes. The *Navajo Refining* court found that an absolute pollution exclusion was unambiguous in its application to the claim and dismissed Navajo's claim for indemnification under Rule 12(b)(6).

138. 897 S.W.2d 885 (Tex. App.—Dallas, 1995, no writ).

139. Apparently, Pro-Tech's products were distributed to facilities in Lufkin where the plaintiffs were allegedly exposed to them. *Id.* at 886.

140. These exclusions, which are similar to exclusion f. contained in most standard ISO-form commercial general liability policies, exclude coverage for bodily injury arising out of the actual, alleged, or threatened discharge, disbursement or release or escape of pollutants: (a) at premises owned, rented or occupied by the insured; (b) at any site used by or for the insured or others for the handling, storage, disposal, processing or treatment of waste; (c) which were at any time transported, handled, or stored by the insured or anyone for whom the insured is legally responsible; or (d) at or from any site or location on which the insured or any contractors or subcontractors were working on the insured's behalf or performing operations. *Id.* at 890.

141. *Id.* at 890.

performed "operations" at the Lufkin sites and that Pro-Tech's "operations" were the sale and delivery of its products to those businesses and that the companies delivering the products were Pro-Tech's contractors or subcontractors.¹⁴² The court rejected this argument, concluding that the petitions merely suggested that Pro-Tech's products "ended up" at the Lufkin companies.¹⁴³ The court, noting that the term "operations" was not defined in the policies, concluded that it was ambiguous and adopted the insured's construction.¹⁴⁴ Accordingly, the court held the carriers were under a duty to defend Pro-Tech in the underlying lawsuits.¹⁴⁵

F. INSURED'S WORK EXCLUSION

In *Taylor v. Travelers Insurance Co.*,¹⁴⁶ Taylor was hired by the Case Corporation to remove ferrous oxide from car exteriors that were damaged while parked at a Case plant. Chemicals used by Taylor to remove the ferrous oxide, however, caused damage to the finish of many of the vehicles.¹⁴⁷ When Taylor was unable to repair the damage to Case's satisfaction, Case sued Taylor seeking reimbursement for the cost of correcting his defective work and a declaration that it did not owe Taylor on the parties' contract. Taylor requested a defense from Travelers in the Case lawsuit under his garage liability insurance policy. After Travelers refused to defend Taylor, he settled with Case and sued Travelers for Case's recovery, which he contended resulted from Travelers' refusal to defend and its denial of coverage. The district court granted Travelers' motion for summary judgment based on the "insured's work" exclusion in Taylor's policy.¹⁴⁸

On appeal, the Fifth Circuit addressed the issue of whether Case's claim against Taylor was excluded under the Travelers policy. The court applied the Texas "eight corners" rule, under which an insurer examines only the pleadings against the insured and compares the factual allegations of the pleadings with the relevant policy provisions in deciding whether to defend.¹⁴⁹ The determinative inquiry was what constituted Taylor's work product. The Fifth Circuit examined Case's allegations

142. *Id.*

143. *Pro-Tech*, 897 S.W.2d at 890.

144. *Cf. TriCounty Service Co., Inc. v. Nationwide Mut. Ins. Co.*, 873 S.W.2d 719 (Tex. App.—San Antonio 1993, writ denied) (holding that insured was "performing operations" through its subcontractor at time rain washed priming oil from parking lot into creek).

145. *Pro-Tech*, 897 S.W.2d at 890.

146. 40 F.3d 79 (5th Cir. 1994).

147. *Id.* at 80.

148. The "insured's work" exclusion eliminated coverage for "[p]roperty damage to work you performed if the property damage results from any part of the work itself or from the parts, materials or equipment used in connection with the work." *Id.* at 82.

149. *Id.* at 81 (citing *Gulf States Ins. Co. v. Alamo Carriage Serv.*, 22 F.3d 88, 90 (5th Cir. 1994); *Feed Store, Inc. v. Reliance Ins. Co.*, 774 S.W.2d 73, 74-75 (Tex. App.—Houston [14th Dist.] 1989, writ denied); *American Alliance Ins. Co. v. Frito-Lay, Inc.*, 788 S.W.2d 152, 153-54 (Tex. App.—Dallas 1990, writ dismissed); *Fidelity & Guaranty Ins. Underwriters, Inc. v. McManus*, 633 S.W.2d 787, 788 (Tex. 1982)).

against Taylor, holding that Taylor was hired to repair the exterior finishes of the vehicles and that Taylor's work product was the "restored" exterior finishes, *i.e.*, the removal of the ferrous oxide deposits.¹⁵⁰ Case's petition sought monetary damages related to the repair or replacement of Taylor's defective work on the vehicle finishes, including reimbursement for the expenses of refinishing the surfaces Taylor damaged and the cost of replacing the damaged parts that could not be repaired. Because only damages for the repair or replacement of the vehicle finishes were involved, the court concluded that the underlying allegations fell within the scope of the coverage exclusion and that Travelers had no duty to defend.¹⁵¹

G. ADVERTISING INJURY

Coverage B for "personal injury" and "advertising injury" gained new recognition in Texas coverage litigation in a hard-wrought en banc decision by the Houston Court of Appeals. In *Two Pesos, Inc. v. Gulf Insurance Co.*,¹⁵² Two Pesos operated a chain of fast food Mexican restaurants. In 1987, Taco Cabana, another Mexican food chain, sued Two Pesos for intentional and deliberate infringement of trade dress and misappropriation of trade secrets, recovering a judgment of over \$2 million. The federal court that rendered the judgment also issued a permanent injunction ordering Two Pesos to change the appearance of its restaurants. Two Pesos appealed to both the Fifth Circuit and the United States Supreme Court, but lost.¹⁵³ While the appeals were pending, Taco Cabana filed a motion in the trial court asking for an award of "supplemental damages" suffered after the entry of the original judgment on the basis that Two Pesos had not changed its conduct or trade dress during the pendency of the appeals.¹⁵⁴ "Supplemental damages" were proper, claimed Taco Cabana, because trade dress infringement is a continuing tort.¹⁵⁵

After the judgment in the underlying federal case was entered and during the appeals, Two Pesos obtained a general liability insurance policy from Gulf, disclosing the litigation on its application for the policy. After Taco Cabana made its claim for "supplemental damages," Two Pesos sought coverage under the Gulf policy's advertising injury liability coverage. Gulf denied coverage and filed a declaratory judgment action seeking a declaration that it was under no duty to defend or indemnify Two Pesos in the Taco Cabana lawsuit. Two Pesos counterclaimed against Gulf for bad faith. Gulf moved for summary judgment on the coverage issues, arguing (1) the "supplemental damages" claim did not arise from an offense that occurred during the Gulf policy; (2) the "supplemental

150. *Id.* at 83.

151. *Taylor*, 40 F.3d at 83.

152. 901 S.W.2d 495 (Tex. App.—Houston [14th Dist.] 1995, no writ).

153. *Taco Cabana Int'l, Inc. v. Two Pesos, Inc.*, 932 F.2d 1113 (5th Cir. 1991), *aff'd*, 505 U.S. 763 (1992).

154. *Two Pesos*, 901 S.W.2d at 498.

155. *Id.*

damages" claim did not arise from a fortuitous loss, but was instead a "known loss" or a "loss in progress;" and (3) coverage for the "supplemental damages" claim for continued trade dress infringement would violate public policy.¹⁵⁶ The trial court rejected Taco Cabana's contention that the "supplemental damages" claim was covered and that Gulf had acted in bad faith.

On appeal the Houston Court of Appeals, after deciding that the issue of Gulf's duty to indemnify Two Pesos was moot due to subsequent developments in the underlying litigation, analyzed Gulf's duty to defend Two Pesos in light of Taco Cabana's "supplemental damages" claim. Taco Cabana essentially alleged that (1) trade dress infringement is a continuing tort; (2) Two Pesos had not changed its conduct or trade dress during the appeals; (3) Taco Cabana was damaged as a result of Two Pesos' continuing violations; and (4) the supplemental damage award should be based on a damage model used by the jury in arriving at the original judgment. Although acknowledging that trade dress infringement is a continuing tort, the court concluded that Taco Cabana did not sue Two Pesos on a new cause of action, but rather sought damages based on infringement already found by the jury in the underlying lawsuit.¹⁵⁷ The court agreed with Gulf's argument that the infringement of which Taco Cabana complained was committed before the Gulf policy was issued when Two Pesos decided to model its restaurants on Taco Cabana's.¹⁵⁸ The court reasoned that Taco Cabana did not allege any new acts of infringement occurring during the policy period, but instead sought damages for continued infringement as found by the jury.¹⁵⁹ Based on Taco Cabana's allegations, the court concluded that the offense occurred before the policy period began and that only the damages from that offense continued into the Gulf policy period.¹⁶⁰

Further, the court rejected Two Pesos' argument that the "advertising injury" liability coverage of the Gulf policy had no fortuity requirement since it did not use the terms "occurrence" or "accident."¹⁶¹ Instead, the court concluded that the fortuity doctrine centers not only on the concepts of accidental or intentional conduct, but also incorporates the principles of "known loss" and "loss in progress."¹⁶² These aspects of the fortuity doctrine, stated the court, "focus on the proposition that insurance coverage is precluded where the insured is, or should be, aware of an ongoing progressive loss or known loss at the time the policy is purchased."¹⁶³ Because the "loss in progress" principle is a fundamental part of insurance law, the court concluded that the risk of injury from

156. *Id.* at 498-99.

157. *Id.* at 501.

158. *Id.*

159. *Two Pesos*, 901 S.W.2d at 501.

160. *Id.*

161. *Id.*

162. *Id.*

163. *Id.* (citing *Inland Waters Pollution Control, Inc. v. National Union Fire Ins. Co.*, 997 F.2d 172, 175-77 (6th Cir. 1993)).

Two Pesos' continued infringement was readily apparent, or should have been apparent, at the time the Gulf policy inception.¹⁶⁴ The court held that permitting coverage under the circumstances would violate public policy by giving the insured protection for a known loss and allowing the insured to benefit from its own wrongdoing.¹⁶⁵ Accordingly, in addition to rejecting the bad faith claim against Gulf, the court held that coverage for Two Pesos' continued trade dress infringement was precluded because the claim constituted a "known loss" or a "loss in progress."¹⁶⁶

H. EMPLOYMENT PRACTICES EXCLUSION

In *Potomac Insurance Co. of Illinois v. Peppers*,¹⁶⁷ Bezuch and Peppers were involved together in both business and personal relationships. After their personal relationship soured, Bezuch sued Peppers for conversion of personal property, tortious interference with business relations, fraud, defamation, intentional infliction of emotional distress and breach of fiduciary duty. The commercial general liability policy issued by Potomac contained an employment-related practices exclusion.¹⁶⁸ The *Peppers* court reasoned that by virtue of the facts that both Peppers and Bezuch were either officers/directors or employees of their limited partnership, the employment-related practices exclusion applied to exclude the allegations of defamation by Peppers against Bezuch. The court held:

Bezuch's allegations supporting his defamation claim against Peppers are quite clear to the extent that such defamation occurred within the context of Peppers' and Bezuch's involvement with RPI. Regardless of Peppers' and Bezuch's exact positions with RPI, the allegations . . . are based on alleged defamation that arose out of Peppers and Bezuch's respective positions with RPI. Thus, such allegations of defamation are related to the employment practices of RPI. As Bezuch's defamation claim is subject to the Policy's employment practices exclusion, no duty to defend arises from this claim.¹⁶⁹

The reasoning of the *Peppers* court seems shallow, considering that at least some of the alleged defamations, while related to the "business" of RPI, did not arise out of the "employment practices" of RPI.¹⁷⁰ The court also applied the "knowledge of falsity" exclusion to the defamation

164. *Two Pesos*, at 502.

165. *Id.*

166. *Id.*

167. 890 F. Supp. 634 (S.D. Tex. 1995).

168. The text of the employment-related practices exclusion read as follows: "This insurance does not apply to "personal injury" to a person arising out of any employment-related practices, policies, acts or omissions, such as coercion, demotion, evaluation, reassignment, discipline, defamation, harassment, humiliation or discrimination directed at that person." *Id.* at 641.

169. *Id.* at 645.

170. For example, Bezuch alleged that Peppers defamed him "to numerous persons with whom Bezuch had ongoing business relationships, and through lies and fraudulent actions killed many of Bezuch's valuable business relation." *Id.* at 644. Bezuch also alleged that Peppers "communicated with numerous persons with whom Bezuch had ongoing business relationships, and communicated orally and in writing that Bezuch had done reprehensible acts which he in fact did not do." *Id.*

allegations which specifically alleged that Peppers had made certain statements with knowledge that they were false.¹⁷¹

I. LATE NOTICE

In *Harwell v. State Farm Mutual Automobile Insurance Co.*,¹⁷² Leatherman and Hubbard were involved in an auto accident in December 1986 in which Hubbard was killed. In December of 1988, the Leatherman family filed suit against "Tammy D. Hubbard, Deceased." The probate court appointed Harwell, legal secretary for the Leathermans' attorney, as the temporary administrator of Hubbard's estate. When Harwell was served with citation on behalf of Hubbard's estate, however, she had not qualified to be the administrator of the estate. Harwell failed to send a copy of the Leathermans' petition to State Farm, Hubbard's auto carrier. In July 1989, the Leathermans' attorney sent a copy of the petition, the police report and a letter from the district court coordinator directly to State Farm. Several months later, the attorney also spoke with a State Farm representative who advised the attorney that State Farm was not going to represent Harwell or furnish her with a defense. Even after the petition was amended, Harwell did not send State Farm copies of the amended petition or the notice for trial setting. At trial, Harwell appeared *pro se* but did not offer any evidence in defense of the estate. Thirty-one days after the judgment in the underlying case was signed, the Leathermans' attorney sent a copy of the judgment to State Farm seeking payment. After filing a declaratory judgment action, State Farm ultimately won summary judgment, which was affirmed by the court of appeals,¹⁷³ on the basis that Harwell had failed to comply with the notice provisions of the policy.

In its opinion affirming the lower courts, the Texas Supreme Court noted that the notice of suit provision¹⁷⁴ is a condition precedent to the insurer's liability on the policy, and that, until State Farm received notice of the suit (and service of process), it had no duty to defend either Harwell or Hubbard's estate.¹⁷⁵ Specifically, the Court acknowledged that

171. *Id.* at 644.

172. 896 S.W.2d 170 (Tex. 1995).

173. *Harwell v. State Farm Mut. Auto. Ins. Co.*, 876 S.W.2d 494 (Tex. App.—Fort Worth), *aff'd* 896 S.W.2d 170 (Tex. 1995).

174. The notice of suit provision in Hubbard's State Farm personal auto policy provided:

We must be notified promptly of how, when and where the accident or loss happened. Notice should also include the names and addresses of any injured persons and of any witnesses. If we show that your failure to provide notice prejudices our defense, there is no liability coverage under the policy. A person seeking coverage must:

1. Cooperate with us in the investigation, settlement or defense of any claim or suit.
2. Promptly send us copies of any notices or legal papers received in connection with the accident or loss.

Harwell, 896 S.W.2d at 173.

175. *Id.* at 173-74.

Harwell was never made a party to the suit and had not qualified as the estate's administrator at the time she was served with the initial pleadings.¹⁷⁶ Any notice before Harwell qualified as administrator was merely notice of a *claim*, according to the court, and did "not equate to actual knowledge of suit against an insured."¹⁷⁷ The insured, Harwell in this case, had an affirmative duty to notify State Farm of the suit under the holding of the court.¹⁷⁸ The court further held that State Farm demonstrated prejudice as a matter of law due to Harwell's failure to provide notice of the suit.¹⁷⁹ The court declined to distinguish between cases of default judgment and cases in which the insured appears but offers no evidence or defenses.

In *Nagel v. Kentucky Central Insurance Co.*,¹⁸⁰ Turner sued the insureds, her former husband and his relatives, for unlawfully maintaining possession of and secreting her children. The insureds paid for their own defense for nine months before forwarding the suit to their homeowners and general liability carriers. The carriers assumed the defense of the suit and eventually settled with Turner. The carriers, however, refused to reimburse the insureds for the defense costs they had incurred prior to giving notice of the suit. Although the insureds claimed they were entitled to recover such costs under a quantum meruit theory, the court of appeals flatly rejected this argument because of the "voluntary payments" clause in each of the policies.¹⁸¹ Because the policies specifically prohibited the insureds from incurring such expenses, the court held that the doctrine of quantum meruit was inapplicable to the insureds' claim.¹⁸²

J. OTHER INSURANCE CLAUSE

In *CNA Lloyds of Texas v. St. Paul Insurance Co.*,¹⁸³ Harris sued her dentist for malpractice based on alleged acts that began on August 12, 1985, and continued through June 24, 1987. St. Paul issued a liability policy to the dentist covering events occurring from October 28, 1984, to October 28, 1985, with a limit of liability of \$100,000 per claim. CNA issued a liability policy to the dentist covering occurrences from October 28, 1985, to October 28, 1987, with a limit of liability limit of \$1 million per claim. Before trial, the carriers settled with Harris for \$262,500, with CNA contributing \$162,500 and St. Paul contributing its \$100,000 policy

176. *Id.* at 174.

177. *Id.* (citing *Liberty Mut. Ins. Co. v. Cruz*, 883 S.W.2d 164, 165, n. 2 (Tex. 1995); *Members Ins. Co. Branscum*, 803 S.W.2d 462, 466-67 (Tex. App.—Dallas 1991, no writ)).

178. *Id.*

179. *Harwell*, 896 S.W.2d at 174.

180. 894 S.W.2d 19 (Tex. App.—Austin 1994, writ denied).

181. All of the policies contained provisions similar to this: "The insured shall not, except at his own cost, voluntarily make any payment, assume any obligation or incur any expense other than for such immediate medical and surgical relief to others as shall be imperative at the time of the accident." *Id.* at 21.

182. *Id.* at 21-22.

183. 902 S.W.2d 657 (Tex. App.—Austin 1995, writ dismissed by agreement).

limit.¹⁸⁴ St. Paul reserved its right to seek reimbursement from CNA for the settlement amount St. Paul believed it overpaid based on the "other insurance" clause in its policy. That clause provided that if a claim covered under the St. Paul policy was also covered under another insurance policy, St. Paul would contribute only its pro rata share of the total amount of insurance covering the claim, up to its coverage limits. St. Paul prevailed against CNA in the trial court on a motion for summary judgment and CNA appealed.

On appeal, CNA argued that the "other insurance" clause did not apply when other insurance provided consecutive rather than concurrent coverage. The court held that the language of the insurance policies was unambiguous and that the St. Paul "other insurance" clause applied when a claim covered by the St. Paul policy was also covered under other insurance.¹⁸⁵ Since the carriers had stipulated that the insurance coverage of the claim was concurrent, the court held that the plain language of the policy's "other insurance" clause rendered it applicable for apportionment purposes.¹⁸⁶

The court also rejected CNA's argument that St. Paul's "other insurance" clause required "stacking," that is, the adding up of limits provided under the applicable insurance policies to determine the total limit of coverage.¹⁸⁷ CNA argued that "stacking" contravened *American Physicians Insurance Exchange v. Garcia*.¹⁸⁸ Although the court agreed that an insured is not allowed to "stack" the limits of the applicable policies to determine the amount of coverage available, the court held that the insurance policies did not provide for a reduction of an insurer's liability limits if an injury only partially occurred during the policy period.¹⁸⁹ Instead, both policies obligated the insurers to pay the sums that the insured becomes legally obligated to pay, not merely a pro rata portion of that amount. Consequently, once triggered, both the St. Paul and CNA policies provided full coverage up to policy limits for Harris' entire claim. St. Paul's "other insurance" clause provided that when other insurance covers a claim also covered by St. Paul, St. Paul would pay its pro rata portion of the total amount of insurance covering the claim. The total amount of insurance covering Harris' claim included the full liability limits of both policies. Therefore, under the court's holding, while an insured's indemnity amount may not be calculated through "stacking," the allocation of each insurer's liability for the settlement of Harris' claim was determined by adding the liability limits of each insurer.¹⁹⁰

184. It was undisputed that continuous acts of malpractice resulted in one injury which triggered coverage under both insurance policies. *Id.* at 658.

185. *Id.* at 660.

186. *Id.*

187. *Id.*

188. 876 S.W.2d 842 (Tex. 1994).

189. *CNA Lloyds*, 902 S.W.2d at 660.

190. *Id.* at 661.

IV. HEALTH AND LIFE INSURANCE

In *Marineau v. General American Life Insurance Company*,¹⁹¹ Mr. Marineau purchased a \$300,000 life insurance policy from General American with money he had embezzled from General American while acting as its agent. After he died and Mrs. Marineau made a claim for benefits under the policy, General American filed a declaratory judgment action. Under Texas law, a person seeking to recover embezzled funds has the initial burden to trace the embezzled funds to specific property.¹⁹² However, once the embezzled funds are traced into specific property, that property becomes the subject of a constructive trust unless the property is proved to have been purchased with the wrongdoer's own funds and not embezzled funds.¹⁹³ Because Mrs. Marineau did not contest the court's finding that her husband embezzled money from General American and placed that money into an account from which policy premiums were paid, she was unable to meet her burden of proof that Mr. Marineau's own funds were used to purchase the policy. Marineau also argued that Texas Insurance Code article 21.22,¹⁹⁴ which provides that life insurance benefits are generally not available to creditors to pay the debt or liability of the insured or of any beneficiary, precluded General American from benefitting from the constructive trust. In the absence of controlling Texas law, the court observed that the majority rule shelters the policy and its proceeds for the benefit of the victim,¹⁹⁵ even where a statute protects the proceeds of insurance policies from actions by creditors.¹⁹⁶ Declining to permit article 21.22 to be used as a shield for fraud, the court held that when an insurance policy's premiums are paid with funds fraudulently obtained, the beneficiary of the policy holds the future proceeds from that policy in trust for the owner of the stolen funds.¹⁹⁷

In *Parsaie v. United Olympic Life Insurance Co.*,¹⁹⁸ United Olympic, through a soliciting agent, sold a health insurance policy to Parsaie. On

191. 898 S.W.2d 397 (Tex. App.—Fort Worth 1995, writ requested).

192. *Id.* at 400 (citing *Meyers v. Baylor University*, 6 S.W.2d 393, 394 (Tex. Civ. App.—Dallas 1928, writ ref'd)).

193. *Id.* (citing *Maryland Cas. Co. v. Schroeder*, 446 S.W.2d 117, 120-21 (Tex. Civ. App.—El Paso 1969, writ ref'd n.r.e.); *Moseley v. Fikes*, 126 S.W.2d 589, 597 (Tex. Civ. App.—Fort Worth 1939), *aff'd*, 136 Tex. 386, 151 S.W.2d 202 (1941); *Meyers*, 6 S.W.2d at 394-95).

194. TEX. INS. CODE ANN. art. 21.22 (Vernon 1990).

195. *Marineau*, 898 S.W.2d at 401, n.1 (citing *Brodie v. Barnes*, 132 P.2d 595 (Cal. Ct. App. 1942); *Board of Pub. Instruction v. Mathis*, 181 So. 147 (Fla. 1938); *Jansen v. Tyler*, 151 Or. 268, 47 P.2d 969 (1935); *Exchange State Bank v. Poindexter*, 19 P.2d 705 (Kan. 1933); *Truelsch v. Northwestern Mut. Life Ins. Co.*, 202 N.W. 352 (Wis. 1925); *Massachusetts Bonding & Ins. Co. Josselyn*, 194 N.W. 548 (Mich. 1923); *Thum v. Wolstenholme*, 61 P. 537 (Utah 1900); *Holmes v. Gilman*, 34 N.E. 205 (N.Y. 1893); *Lohman v. General Amer. Life Ins. Co.*, 478 F.2d 719 (8th Cir.), *cert. denied*, 414 U.S. 857 (1973)).

196. *Id.* at 401 (citing *First Nat'l Bank v. Pope*, 117 So. 2d 174 (Ala. 1959); *Mullikin v. Pedersen*, 71 N.W.2d 485 (Neb. 1955); R.L. Mowson, Annotation, *Right with Respect to Proceeds of Life Insurance of One Whose Funds Have Been Wrongfully Used to Pay Premiums*, 24 A.L.R.2d 672 (1952) (Later Case Service 1982 & Supp. 1994)).

197. *Id.* at 402.

198. 29 F.3d 219 (5th Cir. 1994).

the application, Parsaie indicated that she had not been diagnosed or treated for disease of or injury to her reproductive system within the last five years and that she was not taking medicine for a medical condition. Two months later, Parsaie was hospitalized and incurred substantial medical bills. After an investigation, United Olympic denied the claim on the basis that Parsaie had misrepresented her condition on the application. United Olympic also rescinded the policy and refunded her premium. Parsaie sued for improper rescission, breach of the duty of good faith and fair dealing, negligence and violations of the DTPA and Insurance Code. The district court granted United Olympic's motion for summary judgment partly based on the alleged misrepresentation.

The Fifth Circuit reversed, finding that a fact issue existed with respect to Parsaie's intent to deceive the insurer. Parsaie contended that she understood little English, had not read the application, and signed the application at the insistence of the soliciting agent. With respect to her claim of breach of the duty of good faith and fair dealing, the Fifth Circuit also rejected the district court's finding that a comparison of Parsaie's application with her medical records was an investigation sufficient to give United Olympic a reasonable basis for denying her claim and for believing that she had committed fraud.¹⁹⁹ Finally, because of the Texas Supreme Court's decision finding no distinction between recording agents and soliciting agents,²⁰⁰ the Fifth Circuit reversed the lower court's holding that Parsaie could not recover on her negligence and DTPA claims on the basis that the acts of the soliciting agent could not be imputed to United Olympic.

V. PROPERTY

In *Hennessey v. Vanguard Insurance Co.*,²⁰¹ the Hennesseys were insured by Vanguard when a storm damaged the roof of their house. Vanguard determined that the damage to the roof could be repaired for \$2520. The Hennesseys believed that a proper repair required replacement of the entire roof at a cost of \$18,700. Due to this dispute over the cost of repair, Vanguard invoked the policy's appraisal provision.²⁰² Vanguard's appraiser determined that \$2555 would cover piecemeal repairs to the roof, while the Hennesseys' appraiser placed full replacement cost of the roof at \$18,000. Surprisingly, the umpire set the cost of repair at \$800, and Vanguard's appraiser revised his appraisal to join the umpire's \$800 estimate. Because Vanguard had already paid the Hennesseys \$2,520, it closed its file. The Hennesseys sued Vanguard asserting various

199. *Id.* at 221.

200. *Celtic Life Ins. Co. v. Coats*, 885 S.W.2d 96 (Tex. 1994).

201. 895 S.W.2d 794 (Tex. App.—Amarillo 1995, writ denied).

202. Under the terms of the appraisal provision, each party selects a competent and disinterested appraiser. The appraisers then select an umpire and jointly determine the amount of the loss. In the event that the appraisers cannot agree, they are to submit their differences to the umpire. An agreement as to the amount of damage between any two of these three would be determinative and binding on the insured and the insurer. *Id.* at 796.

extracontractual theories of recovery and contending, among other things, that the appraisal was not binding. The trial court granted summary judgment in favor of Vanguard.

The court of appeals addressed the issue of the validity of appraisal awards and the available grounds for disregarding such awards. Texas permits parties to disregard an otherwise binding arbitration in three situations: (1) when the award was made without authority; (2) when the award was the result of fraud, accident or mistake; or (3) when the award was not made in substantial compliance with the terms of the contract.²⁰³ However, every reasonable presumption is made in favor of upholding an appraisal award. The Hennesseys contended that the disparity between the arbitration award and their appraiser's determination raised a fact issue about the impartiality of the appraisal. The court held that "disparity, even gross disparity, between an appraisal award and the cost of repair, cannot support a finding of bias or partiality without additional evidence" of unfairness or defect in the appraisal process.²⁰⁴

In *State Farm Fire & Casualty Co. v. Griffin*,²⁰⁵ the Griffins purchased two insurance policies in 1989 from State Farm: a homeowners policy and a flood risk policy. In May 1989, the Griffins' home flooded and they collected almost \$32,000 for the damage. In February 1990, the Griffins' home caught fire. State Farm's adjuster estimated the loss at approximately \$60,000. In settling the fire claim, the adjuster deducted the actual cash value of the items which had been totaled in the flood loss but not yet completely repaired from the actual cash value of the fire loss. Noting that the insureds were not entitled to be paid twice, State Farm sent the insureds a draft for almost \$38,000, representing the fire damage to the house which was not totaled in the flood loss. After the Griffins rejected that offer, State Farm tendered another \$5000, which was also rejected. The Griffins subsequently filed suit over the \$17,000 difference, alleging breach of contract and breach of the duty of good faith and fair dealing.

The trial court granted summary judgment for the Griffins on the basis that the "pro rata" provision of the "other insurance" clause in the homeowners policy²⁰⁶ did not apply where the policies covered different risks,

203. *Id.* at 798.

204. *Id.* at 799 (citing *Fisch v. Transcontinental Ins. Co.*, 356 S.W.2d 186, 191 (Tex. Civ. App.—Houston 1962, writ ref'd n.r.e.); *Camden Fire Ins. Ass'n. v. McCain*, 85 S.W.2d 270 (Tex. Civ. App.—San Antonio 1935, writ denied)).

205. 888 S.W.2d 150 (Tex. App.—Houston [1st Dist.] 1994, no writ).

206. The homeowners policy provided:

The company shall not be liable for a greater proportion of any loss from any peril or perils than (a) the amount of insurance under this policy bears to the whole amount of fire insurance covering the policy, whether collectible or not, and whether or not such other fire insurance covers against the additional peril or perils insured hereunder, nor (b) for a greater proportion than the amount hereby insured bears to all insurance, whether collectible or not, covering in any manner such loss; nor (c) where this policy is subject to a deductible clause, its pro rata share in excess of the deductible amount.

888 S.W.2d at 155.

e.g., fire and flood. Although the court of appeals agreed that the “pro rata” provision did not apply in the Griffins’ case, the court reversed the lower court’s decision on fundamental insurance principles. The court noted that an insurance policy is a contract of indemnity under which an insurer is only obligated to pay the insured the amount of its actual loss.²⁰⁷ A “pro rata” clause is not an exception to the principle of indemnity, but instead eliminates the potential for a double recovery. Where the “pro rata” clause does not apply, the insurance contract remains a contract of indemnity.²⁰⁸ The court further stated that because the \$17,000 was not actually expended on repairs by the Griffins, State Farm’s payment of that amount would have given the Griffins a double recovery.²⁰⁹ In addition to rejecting the Griffins’ breach of contract claim, the court found that since the Griffins’ bad faith claim was based on the same act as their contract claim, State Farm was entitled to summary judgment on that claim as well.²¹⁰

In *Telepak v. United Services Automobile Ass’n.*,²¹¹ the Telepaks brought a claim under their all-risk homeowners policy for foundation damage to their house caused by settling. The Telepaks’ homeowners insurer, USAA, denied the claim based on an exclusion for damage resulting from settling or cracking of the foundation. The Telepaks believed that their loss fell under an exception to the exclusion which provided that the exclusion did not apply to settling caused by accidental leakage from an air conditioning system. At trial, the jury decided the damage was not caused by an accidental leakage of water from within an air conditioning system. On appeal, the Telepaks contended that the jury charge incorrectly placed the burden to negate application of the exclusion upon them.

Under article 21.58(b) of the Texas Insurance Code,²¹² insurers must plead and prove the application of a policy exclusion as an affirmative defense. An insured, on the other hand, must plead and prove that his claim is within the insuring language of the policy. The statute, however, is silent as to the burden of proof on exceptions to exclusions. After determining that article 21.58(b) was unambiguous, the court of appeals focused on the statute’s language providing “[a]ny language of exclusion in the policy and any exception to coverage claimed by the insurer constitutes an avoidance or an affirmative defense.”²¹³ The court concluded that an exception to an exclusion is not “language of exclusion” or an “exception to coverage” as set out in article 21.58(b).²¹⁴ An exception to an exclusion, the court held, “creates coverage rather than excluding it or

207. *Id.* at 156.

208. *Id.*

209. *Id.* at 157.

210. *Griffin*, 888 S.W.2d at 157-58.

211. 887 S.W.2d 506 (Tex. App.—San Antonio 1994, writ denied).

212. TEX. INS. CODE ANN. art. 21.58(b) (Vernon Supp. 1996).

213. *Telepak*, 887 S.W.2d at 507 (citing TEX. INS. CODE ANN. art. 21.58(b)).

214. *Id.*

limiting it."²¹⁵ Because the insured must prove that his claim is within coverage, the burden of proof was properly placed on the Telepaks.

VI. AUTOMOBILE

A. COVERED PERSONS

In *Grain Dealers Mutual Insurance Co. v. McKee*,²¹⁶ McKee was president and sole shareholder of a company insured by a commercial auto policy issued through Grain Dealers. The policy included personal injury protection and uninsured/underinsured motorist coverage. McKee's daughter was seriously injured in a one car accident while her stepsister was driving. The personal auto carriers for both the stepsister and McKee paid their policy limits. Although the parties stipulated that neither the car nor the stepsister was covered by the Grain Dealers policy, and that the accident occurred on a purely personal outing unrelated with any business pursuit of McKee's company, McKee filed a claim on the Grain Dealers policy arguing that his daughter was an insured. The trial court granted summary judgment for McKee. On appeal, the sole issue was "whether a family member of a president and sole shareholder of a family-owned corporation is covered under family-oriented language in an insurance policy in which only the corporation is the named insured."²¹⁷ The court of appeals distinguished *Webster v. United States Fire Insurance Co.*,²¹⁸ where the court concluded that it was unreasonable to interpret the family-oriented language in a policy issued to a corporation to extend to the corporation's employees.²¹⁹ In the McKees' case, the injured person was a member of the immediate family, the sole-shareholder of a family-owned corporation. While the policy term "named insured" referred unequivocally to the corporation and "you" and "your" were unambiguously defined throughout the policy as the "named insured," the uninsured/underinsured motorist and PIP endorsements indicated that the "insured" was "you and any family member."²²⁰ Noting that a corporation cannot have family members, the court cited the "family member" definition as "a person related to you . . . who is a resident in your household."²²¹ The court reasoned that the family-oriented language in an endorsement to a policy which appeared not to insure family members created an ambiguity.²²² Applying principles of insurance policy construction, the court held that it was reasonable to conclude that an endorsement specifically adding coverage for family members would be reasonably understood as providing underinsured motorist coverage for

215. *Id.* (citing *National Fire Ins. Co. v. Valero Energy Corp.*, 777 S.W.2d 501, 506 (Tex. App.—Corpus Christi 1989, writ denied).

216. 911 S.W.2d 775 (Tex. App.—San Antonio 1995, writ requested).

217. *Id.* at 779.

218. 882 S.W.2d 569, 573 (Tex. App.—Houston [1st Dist.] 1994, writ denied).

219. *Grain Dealers*, 911 S.W.2d at 779.

220. *Id.* at 781.

221. *Id.*

222. *Id.* at 780.

members of the McKee family independent of whether they were occupying a covered vehicle at the time of the injury.²²³ The court affirmed the summary judgment, holding that McKee's daughter was covered as a "family member" under the endorsements of the policy.

In *Nationwide Property & Casualty Insurance Co. v. McFarland*,²²⁴ as McFarland worked underneath his car, Mashewske tried to start the car. When Mashewske shifted the car into neutral, it rolled backward, fell off the jacks and landed on McFarland, who sustained injuries as a result. McFarland sued Mashewske for negligently "manipulating the controls" of his car. Mashewske demanded a defense from McFarland's carrier, Nationwide, on the basis that he was "using" the covered auto at the time of the accident. Nationwide provided Mashewske with a defense under reservation and filed a declaratory judgment action. Nationwide contended Mashewske was not a "covered person" under the policy because he was not "using" the car at the time of the accident. The trial court found in favor of Mashewske and Nationwide appealed.

On appeal, Nationwide asserted that Mashewske's actions constituted "maintenance" of the auto rather than "use," and that the policy only covered those persons "using" the covered auto as omnibus insureds.²²⁵ McFarland contended that Nationwide's interpretation of the term "use" constituted an impermissible attempt to insert an implied exclusion into the policy, conflicted with the Texas Motor Vehicle Safety-Responsibility Act,²²⁶ and could not overcome Mashewske's reasonable interpretation of the term "use." The court found that the terms "maintenance" and "use" are distinct terms in an automobile policy.²²⁷ The court noted that the purpose behind the injury-causing act was what determined whether a particular act constituted "use" as opposed to "maintenance."²²⁸ Mashewske's actions in manipulating the car's controls while McFarland lay underneath the car, the court held, could only have been intended to assist McFarland in the maintenance of the car.²²⁹ The court also rejected McFarland's contention that Nationwide's interpretation conflicted with the Texas Safety Responsibility Act and held that the Act only requires coverage for those persons specifically named in the insurance policy and those using a motor vehicle with the named insured's permission.²³⁰ The Act specifically exempts persons, like Mashewske, in possession of a non-

223. *Id.* at 781.

224. 887 S.W.2d 487 (Tex. App.—Dallas 1994, writ denied).

225. *Id.* at 492.

226. TEX. REV. CIV. STAT. ANN. art. 6701h, *repealed* by Acts of 1995, 74th Leg., ch. 165, § 24(a), eff. Sept. 1, 1995.

227. *McFarland*, 887 S.W. 2d at 493 (citing *State Farm Mut. Auto. Ins. Co. v. Pan American Ins. Co.*, 437 S.W.2d 542, 545 (Tex. 1969) (noting that term "maintenance" is expressly *included* in broadly stated insuring clause of policy (covering damages "arising out of the ownership, maintenance, or use of the vehicle") and expressly *excluded* from more narrowly drawn omnibus clause of policy (insuring only those "using" covered auto) (emphasis in original))).

228. *Id.* at 493.

229. *Id.* at 494.

230. *Id.* at 495.

owned vehicle for the sole purpose of maintenance or repair.²³¹ Finally, the court noted that the rule mandating construction in favor of an insured applies only in cases where the policy language is ambiguous and not where the meaning of the policy terms is clear.²³²

In *Amica Mutual Insurance Co. v. Moak*,²³³ Moak was killed in an auto accident. In probate court, Moak's estate, wife, son, two children from a previous marriage and parents divided \$1 million in insurance proceeds deposited by the negligent driver's insurance company. At issue was an additional \$500,000 in underinsured motorist benefits deposited with the court by Amica, Moak's insurer. Moak's wife and son contended that they were the only ones entitled to the benefits because the others were not "covered persons." Interpreting the policy to cover all of Moak's immediate family, the magistrate held that principles of collateral estoppel applied and the parties were entitled to recover damages in the same proportion as in the probate court. On appeal, the Fifth Circuit affirmed the magistrate's interpretation of the policy but reversed the ruling on collateral estoppel.

The argument was over the definition of "covered person" in the underinsured motorist coverage.²³⁴ Moak's wife argued that she and her son were the only persons who satisfied the definition of "covered person" because they lived with Moak, while Moak's other children and parents did not. The court, however, rejected that argument, holding that all of Moak's children and his parents were all "covered persons" since they were entitled to recover damages under the Texas wrongful death statute²³⁵ for bodily injury sustained by Moak, who was a person described in category (1) of the "covered person" definition.²³⁶ The court also held that Moak's wife was not collaterally estopped from litigating the amount of damages she and each of the children were entitled to recover under the policy because that issue was not actually litigated or necessary to the agreed judgment in the prior proceeding relating to the division of the insurance proceeds from the negligent driver's carrier.²³⁷

B. COVERED AUTO

In *State Farm Mutual Automobile Insurance Co. v. Cobos*,²³⁸ Cobos was given a company truck for use on the job and for transportation to and from work; he rarely used the truck for other purposes. Cobos was the named insured on his State Farm personal family auto policy. Cobos

231. *Id.* (citing TEX. REV. CIV. STAT. ANN. art. 6701h, § 1D-2 (Vernon Supp. 1994)).

232. *McFarland*, 887 S.W.2d at 496.

233. 55 F.3d 1093 (5th Cir. 1995).

234. The policy defined "covered person" as: "1. You or any family member; 2. Any other person occupying your covered auto; 3. Any person for damages that person is entitled to recover because of bodily injury to which this coverage applies sustained by a person described in 1. or 2. above." *Id.* at 1095.

235. TEX. CIV. PRAC. & REM. CODE § 71.004 (Vernon 1986).

236. *Moak*, 55 F.3d at 1096.

237. *Id.* at 1097.

238. 901 S.W.2d 585 (Tex. App.—El Paso 1995, writ denied).

drove the truck to a relative's home to help repair the roof. When Cobos' son needed to return home to retrieve a tool, he could not take the family car he had driven to the work site because it was blocked in by several other vehicles and he had turned over his keys to his aunt, who was unavailable. With his father's permission, the son took Cobos' company truck and was involved in an accident. State Farm denied coverage on the grounds that the vehicle fell within the exclusion for unlisted vehicles furnished or available for the regular use of the insured and because the vehicle was not a temporary substitute for a covered vehicle. The trial court rejected these arguments and held that the vehicle was not furnished for Cobos' regular use and that the vehicle was a temporary substitute at the time of the accident. In affirming, the court of appeals noted that whether or not a vehicle is furnished for regular use "is subject to change depending on the uses to which the vehicle is put."²³⁹ While no coverage would have been afforded if the collision occurred while Cobos was driving in the scope of his employment, the court noted the evidence demonstrated that the vehicle was only available to Cobos for business purposes, meaning that the vehicle was not furnished for Cobos' regular use for non-work purposes.²⁴⁰ Using a lesser-reasoned argument, the court also held that the company truck was a temporary substitute vehicle²⁴¹ for the family car, noting that a covered vehicle can be considered unavailable due to "loss" if the keys to the covered vehicle are unavailable.²⁴²

C. CONSENT TO SUE

In *State Farm Mutual Automobile Insurance Co. v. Azima*,²⁴³ Azima claimed injuries as a result of an automobile accident with an uninsured motorist. Although Azima made claims under portions of her policy, she did not initially make a demand under the uninsured motorist provision since neither she nor State Farm knew the other driver was uninsured. After reimbursing Azima for some of her claims, State Farm sent her a subrogation letter stating that she would have to contact the other driver or his insurer for reimbursement for any out-of-pocket expenses not covered by the State Farm policy. Azima learned the other driver was uninsured after she filed suit against him. Azima obtained a \$1 million default judgment against the other driver and demanded that State Farm pay the limits of her uninsured motorist coverage. State Farm refused, however, claiming Azima never obtained its written consent to sue the other

239. *Id.* at 589.

240. *Id.*

241. The State Farm policy issued to Cobos defined "Your covered auto" in part as: "4. Any auto or trailer you do not own while used as a temporary substitute for any other vehicle described in this definition which is out of normal use because of its: a. breakdown; b. repair; c. servicing; d. loss; or e. destruction." *Id.* at 588.

242. *Id.* at 589.

243. 896 S.W.2d 177 (Tex. 1995).

driver.²⁴⁴ The Texas Supreme Court held that the subrogation letter was not evidence that State Farm consented to Azima's suit, since it merely stated that Azima needed to make a "claim" with the other driver for expenses not covered by the State Farm policy, but did not sanction a "suit" by Azima for damages covered by her own policy.²⁴⁵ The court explained that policies require the insured to obtain written consent to sue from the insurer "to protect the carrier from liability arising from default judgments against an uninsured motorist or from insubstantial defense of the uninsured motorist."²⁴⁶ The court also found an alleged conversation with a State Farm adjuster giving her permission to sue to be inadmissible parol evidence since the subrogation letter was not ambiguous.²⁴⁷

D. AUTO ACCIDENT

In *State Farm Mutual Insurance Co. v. Peck*,²⁴⁸ Peck and Salazar were taking Peck's dog to the veterinarian in Peck's car when the dog mauled Salazar. Salazar sued Peck, alleging that she was negligent in failing to confine and restrain the dog in a secure place while Salazar was under her care and supervision. The State Farm auto policy issued to Peck provided coverage for injuries "because of an auto accident." State Farm filed a declaratory judgment action after Peck demanded a defense, and joined American States, Peck's homeowners carrier. The trial court ruled that the auto carrier, but not the homeowners carrier, had a duty to defend Peck. On appeal, the court noted that although it is not defined in the policy, the term "auto accident" is plain and unambiguous as a matter of law.²⁴⁹ Noting that other jurisdictions require that a causal nexus between the auto and the accident,²⁵⁰ the court held that the fact that Salazar was sitting in the car when the dog bit him did not supply the causation needed to trigger coverage.²⁵¹

E. FELLOW EMPLOYEE EXCLUSION

In *Truck Insurance Exchange v. Musick*,²⁵² Musick purchased a Truck business auto policy for his pickup truck. While in the course and scope of his employment, Musick accidentally ran over and killed Quilo, a fellow worker. Quilo's family sued Musick and his employer for Quilo's death. Truck denied Musick's demand for a defense, citing the "fellow

244. The State Farm uninsured motorist coverage, like the standard Texas personal auto policy, provided that a "judgment for damages arising out of a suit brought without our [State Farm's] written consent is not binding on us." *Id.* at 178.

245. *Id.*

246. *Id.* at 178 (citing *Allstate Ins. Co. v. Hunt*, 469 S.W.2d 151, 153 (Tex. 1971)).

247. *Id.*

248. 900 S.W.2d 910 (Tex. App.—Amarillo 1995, no writ).

249. *Id.* at 913.

250. *Id.* (citing *Farmers Ins. Co. v. Grelis*, 718 P.2d 812, 813 (Wash. Ct. App. 1986); *Jordan v. United Equitable Life Ins. Co.*, 486 S.W.2d 664, 667 (Mo. Ct. App. 1972)).

251. *Id.*

252. 902 S.W.2d 68 (Tex. App.—Fort Worth 1995, writ denied).

employee" exclusion,²⁵³ and filed a declaratory judgment action. The parties stipulated that Musick and Quilo were co-employees performing their duties in the course and scope of their employment at the time of the accident. The trial court concluded that the "fellow employee" exclusion was partially unenforceable, that Truck owed a defense, and that Truck must make payment under its policy to Musick for the underlying lawsuit.²⁵⁴

On appeal, the Fort Worth Court of Appeals noted that the exclusion unambiguously expressed the insurer's intent to preclude coverage for bodily injury to fellow employees of the insured arising out of and in the course of the fellow employee's employment.²⁵⁵ The court rejected Musick's argument that the fellow employee exclusion was in conflict with the Texas Motor Vehicle Safety Responsibility Act.²⁵⁶ Unlike the "family member" exclusion partially struck down by the Texas Supreme Court in *National County Mutual Fire Insurance Co. v. Johnson*,²⁵⁷ the "fellow employee" exclusion is authorized under the Act which prohibits auto policies from insuring risks also covered by a workers' compensation statute.²⁵⁸ The court held that the "fellow employee" exclusion is actually an "expression" of public policy.²⁵⁹ Accordingly, the court found the "fellow employee" exclusion valid and enforceable, and that Truck had no duty to defend or indemnify Musick in the underlying lawsuit.²⁶⁰

F. INTENTIONAL INJURY EXCLUSION

The court applied the intentional injury exclusion in *Misle v. State Farm Mutual Automobile Insurance Co.*²⁶¹ While riding in Ogiste's car, Howard used a BB gun to shoot unsuspecting individuals for "fun." Misle was shot and required surgery. Misle sued Howard and two passengers in the car. State Farm filed a declaratory judgment action for a determination that it did not owe a defense to any of the defendants because of the intentional injury exclusion in Ogiste's policy. In affirming the trial court's finding of no coverage, the court cited Howard's specific intent of "getting a reaction" from the victims and his disregard of the other passengers' warnings to stop.²⁶² The court noted that Howard apparently intended to "cause an offensive bodily contact or the apprehension of

253. The exclusion provided: "This insurance does not apply to any of the following:

5. FELLOW EMPLOYEE

Bodily injury to any fellow employee of the insured arising out of and in the course of the fellow employee's employment."

Id. at 70.

254. *Id.* at 69.

255. *Id.* at 70.

256. *Id.* at 71.

257. 879 S.W.2d 1 (Tex. 1993).

258. *Musick*, 902 S.W.2d at 71; *see* TEX. REV. CIV. STAT. ANN. art. 6701h, § 21(e)(1) (Vernon 1971). Art. 6701h has since been repealed.

259. *Musick*, 902 S.W. 2d at 71.

260. *Id.*

261. 908 S.W.2d 289 (Tex. App.—Austin 1995, no writ).

262. *Id.* at 291.

such contact."²⁶³ The court concluded that the fact that Howard did not intend Misle's specific injuries was immaterial.²⁶⁴ Finally, the court noted that Howard's actions and Misle's injuries also did not constitute an "accident" within the context of the insuring agreement.²⁶⁵

G. EXCLUDED DRIVER ENDORSEMENT

In *Wright v. Rodney D. Young Insurance Agency*,²⁶⁶ Wright's son, unlicensed and expressly excluded from Wright's policy, was involved in an automobile accident with Chance. Chance sued the Wrights for the son's negligence and gross negligence, and for the Wrights' negligent entrustment. The Wrights contended that the excluded driver endorsement attached to the policy was ambiguous and that summary judgment was improper since there was a fact issue regarding their knowledge of the effect of the exclusion. The court, however, rejected this contention, finding that the exclusion was unambiguous and that the Wrights could not create a fact issue regarding their intent to cover their underage and unlicensed son.²⁶⁷ The court also declined the Wrights' argument that the excluded driver endorsement was contrary to public policy and the Texas Motor Vehicle Safety-Responsibility Act, noting that "nothing in the Act or its underlying public policy mandates financial protection for insured drivers from claims arising from the negligent entrustment of their automobiles to excluded drivers."²⁶⁸ The excluded driver endorsement actually furthers public policy, according to the court, because it is intended to keep unsafe drivers from driving and permit the families of such drivers access to affordable insurance.²⁶⁹

VII. WORKERS COMPENSATION

In *Twin City Fire Insurance Co. v. Davis*,²⁷⁰ Davis suffered a back injury at work and filed a workers' compensation claim with Twin City. Davis' doctor prescribed a hot tub or jacuzzi as therapy for her injury. Davis and Twin City settled the compensation claim for \$37,500 and five years' future medical expenses. Shortly after the agreement was finalized, Davis made a claim for a \$3500 hot tub. After investigating the medical necessity of the prescription for the hot tub, Twin City denied the claim even though an outside consulting agency, pursuant to Twin City's referral, adopted the doctor's recommendation but suggested a \$150 side-mounted portable whirlpool unless Davis' size precluded the use of a regular bathtub.

263. *Id.*

264. *Id.* (citing Restatement (Second) of Torts § 16(1) (1965)).

265. *Id.* (citing *Argonaut Southwest Ins. Co. v. Maupin*, 500 S.W.2d 633 (Tex. 1973) and distinguishing *State Farm Fire & Cas. Co. v. S.S.*, 858 S.W.2d 374, 377-78, n.2 (Tex. 1993)).

266. 905 S.W.2d 293 (Tex. App.—Fort Worth 1995, no writ).

267. *Id.* at 295.

268. *Id.*

269. *Id.*

270. 904 S.W.2d 663 (Tex. 1995).

Davis sued Twin City for the denial of her claim, alleging fraud, breach of contract, intentional and negligent infliction of emotional distress, Insurance Code violations, DTPA violations, failure to pay workers' compensation benefits, and breach of the duty of good faith and fair dealing. At trial, the jury found that Twin City had engaged in unfair or deceptive trade practices, failed to deal fairly and in good faith with Davis, and failed to pay reasonable and necessary medical expenses under the settlement agreement. The jury awarded Davis \$3500 in actual damages without specifying which theory supported the award. The jury did not find that Davis suffered physical pain or mental anguish due to Twin City's bad faith, but nonetheless awarded Davis punitive damages of \$100,000 against Twin City. The trial court entered judgment for \$3500 in actual damages, a 12% statutory penalty and attorneys' fees, but denied Davis recovery of the punitive damages. On appeal, the court of appeals reinstated the punitive damages and otherwise affirmed the judgment.

The Texas Supreme Court held that an award of punitive damages cannot be based on breach of contract alone, but must be accompanied by an independent tort. The court in *Aranda v. Insurance Co. of North America*²⁷¹ held the exclusivity provision of the workers' compensation act did not bar a claim against a carrier for breach of the duty of good faith and fair dealing.²⁷² The claimant must show, however, that the claim for the breach is separate from the compensation claim and produced an independent injury. Because the jury only awarded Davis the cost of the hot tub, an expense covered by the settlement agreement and the Workers' Compensation Act, and found Davis suffered no other injury from Twin City's denial of the claim, the court held that Davis was not entitled to a punitive damages award.²⁷³

In *Maintenance, Inc. v. ITT Hartford Group, Inc.*,²⁷⁴ Maintenance purchased private workers' compensation insurance until 1990, when it was forced to apply for insurance through the Texas Workers' Compensation Assigned Risk Pool. Maintenance ultimately sued Hartford, the Pool's servicing company for Maintenance, for breach of the duty of good faith and fair dealing and for violations of the DTPA, contending that Hartford was "overly lenient" in settling and paying workers' compensation claims. This conduct, Maintenance alleged, caused Maintenance's experience rating and insurance premiums to rise to the point where Maintenance was forced to cancel its coverage with the Pool. The trial court granted summary judgment for Hartford, concluding that the Pool was the actual insurer and that Hartford was merely the servicing company. The court held that no cause of action existed in Texas against a workers' compensation carrier or its agent for paying claims too quickly or excessively. The court of appeals affirmed the summary judgment

271. 748 S.W.2d 210 (Tex. 1988).

272. 904 S.W.2d at 666-67 (citing TEX. REV. CIV. STAT. ANN. art. 8306, § 3 (repealed by Act of 1989, 71st Leg., 2d C.S., ch.1 § 16.07(7), 1989 Tex. Gen. Laws 114)).

273. *Id.* at 667.

274. 895 S.W.2d 816 (Tex. App.—Texarkana 1994, writ denied).

based on Hartford's alleged liability as Maintenance's insurer, but reversed and remanded as to Maintenance's other claims against Hartford for alleged wrongs committed in other capacities.²⁷⁵

Relying on Texas Insurance Code article 5.76,²⁷⁶ the statute in effect at the time of the claim, the court of appeals agreed that Hartford was not Maintenance's insurer.²⁷⁷ Its reasoning was based on the literal language of the applicable statutes regarding the provision of insurance to applicants and on the flexibility allowed by the statutes for servicing companies.²⁷⁸ When an insurance application is approved, the Pool designates a servicing company, a Pool member, to issue a policy. Under the terms of article 5.76, the Pool is the insurer, not the servicing company.²⁷⁹ Based on this reasoning, the court concluded that Hartford did not owe Maintenance a duty of good faith and fair dealing because it was not the insurer. The court concluded that Maintenance's remedy was to appeal to the State Board of Insurance to obtain relief for alleged improper acts.²⁸⁰ Relying on principles of agency, however, the court held that Hartford could be liable in its individual capacity based on Maintenance's DTPA claims.²⁸¹ Concluding that Hartford's limitation of liability as a Pool member could not shield Hartford from liability for its ordinary torts or wrongs against Maintenance (apart from any breach of a duty of faith and fair dealing), the court reversed the summary judgment and remanded those claims to the trial court.²⁸²

VIII. AGENCY

One of the most significant cases decided in 1995 by an intermediate appellate court was a common law bad faith and insurance code case involving the denial of defense and coverage under a liability insurance policy. In *Maryland Insurance Co. v. Head Industrial Coatings and Services, Inc.*,²⁸³ Head contracted to do work for Texas Utilities (TU), agreeing to indemnify TU for any injury claims arising out of the work and to purchase contractual liability insurance for its indemnification obligation. Through its agent, Gans & Smith, Head purchased a general liability policy from Maryland. Head specifically instructed the agent to include con-

275. *Id.* at 820.

276. TEX. INS. CODE ANN. art. 5.76, amended by TEX. INS. CODE ANN. art. 5.76-2 (Vernon Supp. 1996) (Act of December 12, 1989, 71st Leg., 2nd C.S., ch. 1, § 16.01, 1989 Tex. Gen. Laws 114).

277. *Maintenance, Inc.*, 895 S.W.2d at 816-17.

278. *Id.* at 817-18.

279. TEX. INS. CODE ANN. art. 5.76 (a)(8), (c) and (d). As further support for its decision that Hartford was not Maintenance's insurer, the court of appeals referred to the newly revised article 5.76-2, which defines the responsibilities of the Pool and the servicing company. Among other things, the revised article provides that the servicing company need not be a member of the Pool and does not even have to be an insurance company. TEX. INS. CODE ANN. art. 5.76-2, § 4.08(a) and (d) (Vernon Supp. 1996).

280. *Maintenance, Inc.*, 895 S.W.2d at 819 (citing TEX. INS. CODE ANN. art. 5.76 (j)).

281. *Id.*

282. *Id.* at 820.

283. 906 S.W.2d 218 (Tex. App.—Texarkana 1995, no writ).

tractual liability coverage, but the agent apparently committed a clerical error and the policy issued did not include the proper endorsement to create such coverage.

A Head employee was injured and subsequently brought suit against TU and Head. After TU demanded indemnification from Head, Maryland determined that TU's claim for indemnity was not covered under the policy. Upon receiving a reservation of rights letter from Maryland, Head contacted its agent, who assured Head that the TU claim was covered. However, the agent later discovered his error in failing to secure the appropriate coverage, and unsuccessfully attempted to contact Maryland. Later, Maryland denied coverage to Head for TU's indemnification claim.

In the underlying trial, the employee recovered a judgment against TU, and TU recovered a judgment on its indemnity cross-claim against Head. A suit for wrongful denial of its claim by Head against Maryland and its agent was in progress at the time the underlying judgments were rendered. Subsequently, Head settled with the employee and TU, assigning to Head their causes of action against Maryland and agreeing not to execute on the underlying judgments. Gans & Smith also guaranteed settlement funds to Head in exchange for Head's hold harmless agreement. Head dropped the agent from the case, but Maryland brought the agent back into the suit as a third-party defendant. At trial, in light of the agent's testimony about his clerical error, Maryland admitted that Head's claim was covered, and offered to pay the policy benefits. The jury determined that Maryland violated the Insurance Code by engaging in unfair or deceptive acts, but had not acted knowingly. The jury also found that Gans & Smith neither breached any fiduciary duty owed to Maryland nor breached its agency contract with Maryland.

On appeal, the court held that a breach of the duty of good faith and fair dealing under a liability insurance policy can constitute an unfair or deceptive act or practice subjecting the carrier to a liability under article 21.21 of the Insurance Code.²⁸⁴ The court held that there was sufficient evidence that Maryland breached its duty of good faith and fair dealing based upon the acts of its agent. Noting that a carrier is liable to the insured for acts of agents which breach a duty of good faith and fair dealing,²⁸⁵ the court held that the agent's failure to acknowledge his clerical error was "tantamount to misrepresentation because he was aware that coverage was being denied due to his failure to correct his error."²⁸⁶ The agent's acts were attributable to Maryland and as such, were sufficient evidence that Maryland breached its duty of good faith and fair dealing to Head. The court also found that a knowing misrepresentation by an agent meets the requirements for knowing misrepresentation in the

284. TEX. INS. CODE ANN. art. 21.21 (Vernon 1981 & Supp. 1996).

285. *Maryland Ins. Co.*, 906 S.W.2d at 227 (citing *Natividad v. Alexsis, Inc.*, 875 S.W.2d 695 (Tex. 1994)).

286. *Id.*

DTPA and Insurance Code.²⁸⁷ Because Gans & Smith was Maryland's local recording agent,²⁸⁸ Maryland was charged with a knowing violation of the Insurance Code based upon the agent's failure to disclose the policy error. Under the court's analysis, the knowledge of the agent is the knowledge of the company itself, and the agent's knowledge is imputed to the principal.

With respect to Maryland's cross-claims against Gans & Smith, the court determined that Maryland waived its argument that Gans & Smith breached its agency agreement, but found that the jury's determination that Gans & Smith had not breached its fiduciary obligations to Maryland was against the great weight and preponderance of the evidence.²⁸⁹ Although the court gave the agent some credit for his half-hearted attempts to contact Maryland, the agent's persistent conduct in failing to tell the carrier of his mistake overwhelmed any efforts he made to inform Maryland of the grievous coverage error.²⁹⁰

With the presence of a conflicted carrier-agent relationship and multi-million dollar liability riding the line, the *Head* case appears to be bound for the Supreme Court.

IX. MISCELLANEOUS

A. STATUTORY

Perhaps the most significant change to the Texas Insurance Code was the amendment of article 21.21 § 4, to include specific unfair settlement

287. *Id.* (citing *Underwriters Life Ins. Co. v. Cobb*, 746 S.W.2d 810 (Tex. App.—Corpus Christi 1988, no writ); *Celtic Life Ins. Co. v. Coats*, 885 S.W.2d 96 (Tex. 1994)).

288. A local recording agent is vested with authority coextensive with the insurer for writing insurance policies. 906 S.W.2d at 229 (citing *Blakely v. American Employers' Ins. Co.*, 424 F.2d 728 (5th Cir. 1970); *American Nat'l Life Ins. Co. v. Montgomery*, 640 S.W.2d 346 (Tex. App.—Beaumont 1982, writ ref'd n.r.e.)). "A local recording agent has the authority to speak and act for the company and to transact all insurance business which that company is authorized to transact under its permit from the state." *Id.* (citing *Home Ins. Co. v. Roberts*, 129 Tex. 178, 100 S.W.2d 91 (1937)).

289. *Id.* at 234.

290. *Id.*

practices.²⁹¹ After *Allstate Ins. Co. v. Watson*,²⁹² the extent to which unfair claims settlement practices defined in article 21.21-2 furnished private causes of action was unclear. The Texas Supreme Court, in *Vail v. Texas Farm Bureau Mutual Insurance Co.*,²⁹³ stated that insureds have a private

291. As amended, the Act reads:

Section 4. The following are hereby defined as unfair methods of competition and unfair and deceptive acts or practices in the business of insurance:

- (10) Unfair Settlement Practices. (a) Engaging in any of the following unfair settlement practices with respect to a claim by an insured or beneficiary:
- (i) misrepresenting to a claimant a material fact or policy provision relating to coverage at issue;
 - (ii) 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;
 - (iii) failing to attempt, in good faith, to effectuate a prompt, fair, and equitable settlement under one portion of a policy of a claim with respect to which the insurer's liability has become reasonably clear in order to influence the claimant to settle an additional claim under another portion of the coverage, provided that this prohibition does not apply if payment under one portion of the coverage constitutes evidence of liability under another portion of the policy;
 - (iv) failing to provide promptly to a policyholder a reasonable explanation of the basis in the policy, in relation to the facts or applicable law, for the insurer's denial of a claim or for the offer of a compromise settlement of a claim;
 - (v) failing within a reasonable time to:
 - (A) affirm or deny coverage of a claim to a policyholder; or
 - (B) submit a reservation of rights to a policyholder;
 - (vi) refusing, failing, or unreasonably delaying an offer of settlement under applicable first-party coverage on the basis that other coverage may be available or that third parties are responsible for the damages suffered, except as may be specifically provided in the policy;
 - (vii) undertaking to enforce a full and final release of a claim from a policyholder when only a partial payment has been made, provided that this prohibition does not apply to a compromise settlement of a doubtful or disputed claim;
 - (viii) refusing to pay a claim without conducting a reasonable investigation with respect to the claim;
 - (ix) with respect to a Texas personal auto policy, delaying or refusing settlement of a claim solely because there is other insurance of a different type available to satisfy all or any part of the loss forming the basis of that claim; or
 - (x) requiring a claimant, as a condition of settling a claim, to produce the claimant's federal income tax returns for examination or investigation by the person unless:
 - (A) the claimant is ordered to produce those tax returns by a court;
 - (B) the claim involves a fire loss; or
 - (C) the claim involves lost profits or income.
- (b) Paragraph (a) of this clause does not provide a cause of action to a third party asserting one or more claims against an insured covered under a liability insurance policy.

TEX. INS. CODE ANN. art. 21.21 § 4 (10) (Vernon Supp. 1996). The new code provisions apply to actions accruing on or after September 1, 1995, and to all actions filed on or after September 1, 1996, regardless of the date of accrual.

292. 876 S.W.2d 145 (Tex. 1994).

293. 754 S.W.2d 129 (Tex. 1988).

cause of action for violations of unfair claims settlement practices prohibited by article 21.21-2 even though that statute does not itself provide for a private cause of action.²⁹⁴ The private cause of action for violations of unfair claims settlement practices, under the *Vail* opinion, was provided by article 21.21 § 16 and certain provisions of the Texas Administrative Code. In *Watson*, however, the court stated that a third-party claimant had no private cause of action for unfair claims settlement practices under article 21.21-2 because the statute did not provide for a private cause of action.²⁹⁵ In the tort reform package passed by the Texas legislature during 1995, the questions raised by *Watson* and *Vail* are clearly answered. Additionally, article 21.21 § 4 also includes provisions regarding misrepresentations previously found in the Texas Administrative Code.²⁹⁶ Clearly, a private cause of action exists under article 21.21 § 16 against a person or entity who has engaged in acts that were once violative of article 21.21-2 and certain provisions of the Texas Administrative Code.

Section 16(a) of article 21.21 also now uses causation language instead of the previous "as a result of" language in providing relief to a person who has suffered actual damages by another's unfair method of competition or unfair or deceptive act or practice in the business of insurance.²⁹⁷ Section 16 also requires a party seeking relief to give 60 days written notice prior to filing suit, instead of 30 days required under the old law.²⁹⁸ Additionally, the prior provision regarding offers to settle claims²⁹⁹ under section 16 is deleted in its entirety and replaced by two new sections which detail the entire settlement offer process³⁰⁰ and provide guidelines for mediation of such cases.³⁰¹ A party receiving notice of a claim may tender an offer within 60 days after receipt of the claim.³⁰² Depending on whether mediation is held, the party against whom the claim is pending

294. *Id.* at 134.

295. *Watson*, 876 S.W.2d at 150.

296. As amended, the Act reads:

Section 4. The following are hereby defined as unfair methods of competition and unfair and deceptive acts or practices in the business of insurance:

- (11) Misrepresentation of Insurance Policy. Misrepresenting an insurance policy by:
 - (a) making an untrue statement of material fact;
 - (b) failing to state a material fact that is necessary to make other statements made not misleading, considering the circumstances under which the statements were made;
 - (c) making a statement in such manner as to mislead a reasonably prudent person to a false conclusion of a material fact;
 - (d) making a material misstatement of law; or
 - (e) failing to disclose any matter required by law to be disclosed, including a failure to make disclosure in accordance with another provision of this code.

TEX. INS. CODE ANN. art. 21.21 § 4 (11) (Vernon Supp. 1996).

297. *Id.*

298. *Id.*

299. *Id.*

300. TEX. INS. CODE ANN. art. 21.21, § 16A (Vernon Supp. 1996).

301. *Id.* § 16B.

302. *Id.* § 16A(a).

may continue to make offers of settlement.³⁰³ All offers of settlement must contain an amount of settlement of the claim for damages and an amount of reasonable and necessary attorneys' fees to compensate the claimant as of the date of the offer.³⁰⁴ If the amount of the settlement is the same as or substantially the same as or more than the amount of damages found by the trier of fact, the claimant may not recover damages in excess of the lesser of (1) the amount of damages tendered in the settlement offer; or (2) the amount of damages found by the trier of fact.³⁰⁵ Any party may compel mediation in a case in which damages of at least \$15,000 are sought, unless the party seeking to compel mediation agrees to pay for the mediation costs.³⁰⁶

The Insurance Code prohibits persons in the insurance industry from engaging in any practice of unfair discrimination, including (1) refusing to insure; (2) refusing to continue to insure; (3) limiting the amount, extent, or kind of coverage available; and (4) charging an insured a different rate for the same coverage because of race, color, religion, national origin, age, gender, marital status, geographic location, or full or partial disability.³⁰⁷ Additionally, health carriers may not use underwriting guidelines based on an individual's fluency or literacy in English.³⁰⁸ Health insurers are also required to enroll children under coverage plans even if the child (1) has a pre-existing condition; (2) was born out of wedlock; (3) is not claimed as a dependent on the parent's federal income tax returns; (4) does not reside with the parent or within the insurer's service area; or (5) is, or has been, either an applicant for or recipient of medical assistance.³⁰⁹

With respect to uninsured and underinsured motorist coverage, suits against carriers may only be brought in the county in which the policyholder or beneficiary filing the suit resided at the time of the accident or in the county where the accident occurred.³¹⁰

B. DECLARATORY JUDGMENT ACTIONS

In *Wilton v. Seven Falls Co.*,³¹¹ a unanimous panel of the United States Supreme Court held that a federal district court possesses broad discretion to grant or decline to grant a declaratory judgment, and that the review of a district court's decision to stay or dismiss a declaratory judgment action in deference to a state court action will be reviewed by federal appellate courts under an abuse of discretion standard. *Wilton*

303. *Id.* §§ 16A(b) and (c).

304. TEX. INS. CODE ANN. art. 21.21, § 16A(d) (Vernon Supp. 1996).

305. *Id.*

306. *Id.*

307. *Id.*

308. *Id.*

309. TEX. INS. CODE ANN. art. 3.96-2 (Vernon Supp. 1996). The amendment applies to all policies delivered, issued for delivery or renewed after January 1, 1996.

310. TEX. INS. CODE ANN. art. 506.1, § 8 (Vernon Supp. 1996).

311. 115 S. Ct. 2137 (1995).

involved the issue of whether a federal district court in Houston selected by a group of London Underwriters or a state court in Austin preferred by the policyholder should proceed to decide coverage issues over whether a large judgment in an oil and gas ownership case was covered under certain London Market policies. The London Underwriters filed the federal court coverage declaratory judgment action first. Subsequently, the policyholder filed suit against the London Underwriters in Texas state court. The state case, however, could not be removed to federal court because other parties in the underlying litigation joined suit and asserted claims against their Texas insurers, thereby destroying diversity jurisdiction. The policyholder then filed a motion to dismiss or stay the London Underwriters' federal coverage declaratory judgment action, which was granted by the federal judge. After that decision was affirmed by the Fifth Circuit,³¹² the United States Supreme Court granted a *writ of certiorari* to determine whether the federal district court had the power to enter the stay order and, to determine the standard of review that federal courts of appeals should use in determining whether a district court stay order is proper.

In affirming the lower courts' decisions, the United States Supreme Court relied on the 53 year-old opinion of *Brillhart v. Excess Insurance Co.*³¹³ Under *Brillhart*, a federal district court presented with a motion to stay or dismiss a coverage declaratory judgment action in deference to a state court lawsuit over the same subject matter must decide "whether the questions in controversy between the parties to the federal suit, and which are not foreclosed under the applicable substantive law, can better be settled in the proceeding pending in the state court."³¹⁴ The court also analyzed the Federal Declaratory Judgment Act,³¹⁵ characterizing it as "an enabling Act, which confers a discretion on the courts rather than an absolute right upon the litigant."³¹⁶

Although the court clearly recognized a federal district court's discretion to entertain a coverage declaratory judgment action, it was far from clear in detailing what a federal district court should consider in deciding whether to exercise that discretion. Basically, it stated that the *Brillhart* opinion provided some "useful guidance in that regard."³¹⁷ Under *Brillhart*, a district court should examine the "the scope of the pending state court proceeding and the nature of the defenses open there."³¹⁸ Also, the federal district court should consider "whether the claims of all parties and interests can satisfactorily be adjudicated in that proceeding, whether necessary parties have been joined, whether such parties are amenable to

312. *Wilton v. Seven Falls Co.*, 29 F.3d 623 (5th Cir. 1994), decision ordered published at 41 F.3d 934.

313. 316 U.S. 491 (1942).

314. *Id.* at 495.

315. 28 U.S.C. §§ 2201, 2202 (1994).

316. *Wilton*, 115 S. Ct. 2137, 2143 (1995) (citing *Public Serv. Comm'n v. Wycoff Co.*, 344 U.S. 237, 241 (1952)).

317. *Id.* at 2140.

318. *Id.* at 2141 (quoting *Brillhart*, 316 U.S. at 495).

process in that proceeding, etc.”³¹⁹ The *Wilton* and *Brillhart* opinions further note that other cases “might shed light on additional factors governing a district court’s decision to stay or dismiss a declaratory judgment action at the outset.”³²⁰

The *Wilton* opinion appears to maintain the status quo, at least as far as coverage litigation in the Texas federal courts is concerned. Accordingly, *Wilton* probably does not eliminate and may not even reduce the practice by insurers of filing federal court coverage declaratory judgment actions. It should be noted that many declaratory judgment actions do not involve the presence of additional parties that might disrupt diversity of citizenship between the insurer and the policyholder. In those cases, removal will always be available to the insurer, notwithstanding a policyholder’s preference to litigate in state court. Furthermore, *Wilton* does not appear to affect a situation where an insurer files a state court coverage declaratory judgment action which is followed by a competing state court lawsuit filed by the policyholder in another venue. In those instances, the first filed lawsuit should acquire dominant jurisdiction.³²¹

319. *Id.*

320. *Wilton*, 115 S. Ct. at 2141.

321. See *Dallas Fire Ins. Co. v. Davis*, 893 S.W.2d 288 (Tex. App.—Fort Worth 1995, orig. proceeding).

