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R. Brent Cooper

Michael W. Huddleston

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INSURANCE LAW

by

R. Brent Cooper* and Michael W. Huddleston**

I. EXCESS LIABILITY

A. *Stowers Liability*

IN the past year Texas courts addressed important issues with respect to the scope and procedural application of *Stowers* liability. Many previously unanswered issues have been addressed and, if not resolved, have been analyzed. These cases reveal that Texas is very much becoming a prominent jurisdiction in explaining and promulgating bad faith insurance law.

1. Claim by "Other" Insurer

In *Foremost County Mutual Insurance Co. v. Home Indemnity Co.*¹ the Fifth Circuit faced a case of first impression under Texas law regarding excess liability. In *Foremost* the insured killed an individual while driving a motor home. Home Indemnity Company (Home) insured the defendant through a general liability policy with \$250,000 in coverage and a worker's compensation policy. Foremost County Mutual Insurance Company (Foremost) issued an automobile liability policy with limits of \$250,000. The Plaintiff tendered the claim to both companies for a defense. Home agreed to defend under its worker's compensation policy, but Foremost refused to defend. Prior to trial, Home's lawyers drafted a covenant to execute which the estates of the decedent executed. In the covenant, the insured assigned the plaintiffs any and all its rights of action against Foremost. At trial, Home failed to question any of the plaintiff witnesses and the trial court rendered a judgment against the defendant in the amount of \$3,797,000.²

Following the trial, Foremost settled its claims with the plaintiffs for \$3,200,000 and sought recovery of that amount from Home through subro-

* B.B.A., Texas A & M University; J.D., Southern Methodist University. Attorney at Law, Cowles & Thompson, Dallas, Texas.

** B.A., Texas A & M University; J.D., Southern Methodist University. Attorney at Law, Cowles & Thompson, Dallas, Texas.

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1. 897 F.2d 754 (5th Cir. 1990), *reh'g denied*, 902 F.2d 955.

2. *Id.* at 758.

gation and/or contribution.³ The trial court ordered that Home pay Foremost half of the \$3,200,000 settlement, holding Home liable for negligently failing to settle the case within its policy limits.⁴

The Fifth Circuit held that Foremost failed to prove all of the essential elements for a *Stowers* case.⁵ The court held that the mere refusal to accept a settlement offer alone does not give rise to a *Stowers* action, but the refusal to settle must also have been negligent and have caused harm to the insured.⁶ The court held that since Home obtained a covenant not to execute on behalf of its insured, Home's decision to refuse the settlement offer never resulted in injury to its insured and therefore no breach of any duty to the insured existed.⁷

Foremost argued that the court ignored prior Texas cases holding that a covenant not to execute drafted and executed by an insured with their insurer does not release the insurance carrier from liability.⁸ The Fifth Circuit rejected this argument for two separate reasons.⁹ First, the court held that the right to sue a carrier for a *Stowers* claim belongs exclusively to the insured and may only be prosecuted by a third party claimant pursuant to an assignment.¹⁰ In *Foremost* the insurer lacked an enforceable assignment from the insured and therefore had no standing to bring a lawsuit under Texas case law.¹¹ Secondly, the court held that the extension of the *Stowers* rule to the case before it would not serve the policy the courts attempted to advance in *YMCA v. Commercial Standard Insurance Co.*¹² when they created the rule that a covenant not to execute does not relieve the insurer of liability.¹³ The court explained that the purpose of the *YMCA* rule was to prevent an insurer from escaping liability by treating the policy as one of indemnity rather than liability.¹⁴

2. Guidelines for Determination of Negligence

In *Stroman v. Fidelity & Casualty of New York*¹⁵ the insurer defended the insured pursuant to a reservation of rights letter. The insurer refused to settle the claim within the policy limits and suggested that the insured settle the claim on their own behalf. When the case was called for trial, the in-

3. *Id.* at 756.

4. *Id.*

5. *Id.* at 757.

6. *Id.*

7. *Id.* at 757-58.

8. See *YMCA v. Commercial Standard Ins. Co.*, 552 S.W.2d 497, 504-05 (Tex. Civ. App.—Fort Worth 1977), writ ref'd n.r.e. per curiam, 563 S.W.2d 246 (Tex. 1978).

9. *Foremost*, 897 F.2d at 758.

10. *Id.*

11. *Id.*; see *Whatley v. City of Dallas*, 758 S.W.2d 301, 308-09 (Tex. App.—Dallas 1988, writ denied).

12. 552 S.W.2d 497 (Tex. Civ. App.—Fort Worth 1977), writ ref'd n.r.e. per curiam, 563 S.W.2d 246 (Tex. 1978).

13. *Foremost*, 897 F.2d at 758-59.

14. *Id.*

15. 792 S.W.2d 257 (Tex. App.—Austin 1990, writ denied).

sured and tort claimant entered into an agreed judgment for \$400,000, some \$300,000 in excess of the policy limits.

The tort claimant later filed suit pursuant to an assignment of the insured's right of action against the insurer. The trial court granted the insurer summary judgment on the *Stowers* claim. The court of appeals reversed, basing its reversal upon correspondence from the insurer advising that the case should be negotiated from the standpoint of the insured if possible.¹⁶ Importantly, the court held that the insurer's belief that coverage did not exist failed to insulate the insurer from liability under *Stowers*.¹⁷ The court of appeals set forth the following guidelines for determining if an insurer is negligent in failing to accept an offer to settle: if there exists 1) an opportunity to settle during the course of investigation or trial; 2) a failure to carry on negotiations to settle or make a counter offer after receipt of an offer to settle; 3) a failure to investigate all the facts necessary to protect properly the insured against liability; 4) if liability is clear, a greater duty to settle may exist; 5) whether the insurer acts negligently, fraudulently, or in bad faith; and 6) if there are conflicts in the evidence which increase the uncertainty of the insured's defense to the injured party's claim, the possibility of the insurer being held negligent increases.¹⁸

A second issue raised by the plaintiff in *Stroman* was whether the insurer could attack the reasonableness of the damages awarded in excess of the policy limits. The plaintiff asserted that under *Employers Casualty Co. v. Block*¹⁹ and *Ranger Insurance Co. v. Rogers*²⁰ the insurer cannot collaterally attack the agreed judgment by litigating the reasonableness of the damages. The court of appeals rejected this argument, holding that the damages, if any, which were caused by the failure of an insurer to settle within its policy limits constituted a question of fact for the jury rather than a question of law for the trial court.²¹

B. Deceptive Trade Practices Act and Article 21.21 of the Insurance Code

1. Jury Submission

In *Spencer v. Eagle Star Insurance Co.*²² the court faced the issue of what

16. *Id.* at 261.

17. *Id.*

18. *Id.* (following *Globe Indem. Co. v. Gen-Aero, Inc.*, 459 S.W.2d 205 (Tex. Civ. App.—San Antonio 1970), writ ref'd n.r.e. per curiam, 469 S.W.2d 164 (Tex. 1971)).

19. 744 S.W.2d 940 (Tex. 1988).

20. 530 S.W.2d 162 (Tex. Civ. App.—Austin 1975, writ ref'd n.r.e.).

21. *Stroman*, 792 S.W.2d at 261 (following *William M. Mercer, Inc. v. Woods*, 717 S.W.2d 391 (Tex. App.—Texarkana 1986), *aff'd in part*, 769 S.W.2d 515 (Tex. 1988)). The court in *William M. Mercer* was not the first court to address the issue of whether the existence of the judgment alone establishes damages as a matter of law. The Texas Supreme Court in *Montfort v. Jeter*, 567 S.W.2d 498 (Tex. 1978), stated that "the uncontradicted evidence at the trial is that the unpaid judgment was still 'hanging over [the head of the insured].'" *Id.* at 499. The court held that "[u]nder the judgment rule adopted in *Hernandez*, the existing judgment against Montfort is some evidence of actual damages." *Id.* at 500. The *Montfort* court, like the *Stroman* court, refused to hold that the proof of the underlying judgment established damages as a matter of law.

22. 780 S.W.2d 837 (Tex. App.—Austin 1989, no writ)

acts are actionable under article 21.21 of the Insurance Code and the Deceptive Trade Practices Act. In *Spencer* a fire destroyed the insured's business. The insureds made a claim on the policy for a loss of the building's contents as well as a loss of earnings. The insurer paid contents loss on a timely basis, but a tender of the business interruption loss was not made until after suit had been filed to recover payment.

At trial, the question posed to the jury was whether the handling of the business interruption claim by the insurer constituted an unfair practice in the business of insurance.²³ The jury answered affirmatively. The trial court, in response to a motion for judgment notwithstanding the verdict, concluded that the jury answer to the question posed would not support a judgment against the defendant.²⁴ The court therefore rendered a take nothing judgment against the plaintiffs.²⁵

On appeal, the insured argued that the jury's answer in fact would support a judgment in their favor pursuant to the Texas Supreme Court's decision in *Vail v. Texas Farm Bureau Mutual Insurance Co.*²⁶ The court of appeals rejected the contention of the insured, holding that such a finding did not meet the requirements of article 21.21 of the Texas Insurance Code.²⁷ The court noted that in *Vail* the supreme court enumerated three categories of conduct under article 21.21 which would result in liability to an insurer: 1) practices declared to be unfair in section 4 of article 21.21; 2) conduct defined in Insurance Board rules or regulations as "unfair or deceptive acts or practices in the business of insurance"; and 3) any practice defined by section 17.46 of the DTPA as an unlawful deceptive trade practice.²⁸

The court reviewed the acts and practices declared to be unfair in section 4 of article 21.21 and determined that these related to unfair competition between insurance companies.²⁹ As a result, the court held that none of these acts would afford a basis for recovery to the plaintiffs in the case.

Addressing the second category of conduct defined in the State Board of Insurance Rules and Regulations as unfair or deceptive acts and practices in the business of insurance, the court noted two potential sources of liability under these provisions. First, a practice that is defined by the Insurance Code or other rules and regulations promulgated by the State Board of Insurance may be deemed an unfair or deceptive trade practice.³⁰ The second alternative is an activity determined pursuant to case law to be an unfair or deceptive trade practice in the insurance business.³¹ After conducting a review of the Insurance Code and regulations adopted by the State Board of

23. The court defined "unfair practice" to mean "any act or series of acts which is arbitrary, without justification, or takes advantage of a person to the extent that an unjust or inequitable result is obtained." *Id.* at 838-39.

24. *Id.* at 830.

25. *Id.*

26. 754 S.W.2d 129 (Tex. 1988).

27. *Spencer*, 780 S.W.2d at 830.

28. *Id.*

29. *Id.*

30. *Id.* at 840.

31. *Id.*

Insurance, the court concluded that the definition of unfair practice submitted to the jury was not encompassed in any rule or regulation. Further, the court held that such practice did not constitute an activity determined by case law to be an unfair or deceptive act in the insurance business.³²

The third category of conduct which may result in liability to an insurer is any practice defined by section 17.46 of the DTPA as an unlawful deceptive trade practice. The *Spencer* court noted that *Vail* makes actionable not merely the "laundry list" items from section 17.46(b) but also unlisted practices pursuant to section 17.46(a).³³ The insured in *Spencer* argued that the finding made by the jury constituted an unlisted practice under section 17.46(a), entitling it to a judgment. The court of appeals rejected the plaintiffs' argument because the plaintiffs failed to secure a finding that the act or practice occurred and that it was deceptive, as required by *Vail*.³⁴

The Eastland court of appeals reached similar conclusions in *Wm. H. McGee & Co. v. Schick*.³⁵ In *McGee* the court determined that the insurer had engaged in "unfair and/or deceptive acts or practices in the handling of [the] Plaintiff's claim."³⁶ The Eastland court reviewed the *Vail* decision and determined that the current finding was not a holding that the insurer engaged in any of the practices declared to be unfair or deceptive by article 21.21, section 4.³⁷

The court likewise found that the jury's answer did not find that the insurer had engaged in conduct defined in the rules and regulations adopted by the State Board of Insurance under article 21.21 as a method of unfair competition or a deceptive act or practice in the business of insurance.³⁸ Finally, the court concluded that the wording of the jury question would not support a finding that the insurer had engaged in any practice defined as an unlawful, deceptive practice by the DTPA.³⁹ The court noted that unlawful deceptive trade practices were defined by the DTPA in section 17.46 to be "false, misleading, or deceptive acts or practices."⁴⁰ The court held that a finding of unfairness in the handling of the claim would not constitute a deceptive act or practice.⁴¹ The court in *McGee* took a position contrary to that of the *Spencer* court and held that "unlisted" acts or practices under section 17.46(a) are not made actionable under section 16 of Article 21.21.⁴²

2. Bad Faith

In *Allied General Agency, Inc. v. Moody*⁴³ the insured alleged, among

32. *Id.* at 842.

33. *Id.* (citing *Vail*, 754 S.W.2d at 135).

34. *Vail*, 754 S.W.2d at 135.

35. 792 S.W.2d 513 (Tex. App.—Eastland 1990, no writ).

36. *Id.* at 517.

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.* at 518.

41. *Id.* at 517.

42. *Id.* at 518.

43. 788 S.W.2d 601 (Tex. App.—Dallas 1990, writ denied).

other things, various violations of the DTPA, article 21.21 of the Insurance Code and the breach of the insurers' duty of good faith and fair dealing with regard to their insured.⁴⁴ The jury found that the insurer breached the duty of good faith and fair dealing. Based upon this finding, the trial court awarded the insured his actual damages plus additional damages pursuant to article 21.21.⁴⁵ On appeal the *Allied* court concluded that a common law cause of action may serve as the basis for a violation of section 16, article 21.21 of the Insurance Code so as to entitle the insured to actual damages plus punitive damages of two times the amount of actual damages.⁴⁶

C. Duty of Good Faith and Fair Dealing

1. Statute of Limitations

In *Murray v. San Jacinto Agency, Inc.*⁴⁷ the Texas Supreme Court took the opportunity to re-examine the accrual date for a breach of the duty of good faith and fair dealing cause of action for purposes of the commencement of the limitations period. In *Murray* the Ector County Independent School District established a self-funded group medical insurance program for its employees and their dependents. San Jacinto agency administered this program. In the summer of 1984, the plaintiff sought coverage for treatment of a condition. Because her husband had earlier requested that she be dropped from the policy, the San Jacinto Agency refused to verify coverage to the health provider for the plaintiff. Later, on March 15, 1985, the San Jacinto Agency reversed its position and reinstated coverage retroactive to the Spring of 1984.

The plaintiff filed suit against the San Jacinto Agency on March 27, 1986, alleging only negligent denial of coverage. Citation was not served upon the defendant until January 21, 1987. The plaintiff did not plead breach of the duty of good faith and fair dealing claim until September 2, 1987. The trial court granted summary judgment in favor of San Jacinto Agency based upon limitations. The court of appeals affirmed.⁴⁸

The issue before the supreme court was when the plaintiff's cause of action accrued. The agency argued that the accrual date should be September 5, 1984, the date the insurer denied coverage. Murray argued that the date of accrual should be March 15, 1985, the date the San Jacinto Agency admitted that the denial was unwarranted.

Prior to *Murray*, the court held in *Arnold v. National County Mutual Fire Insurance Co.*⁴⁹ that the statute of limitation does not accrue on a duty of good faith and fair dealing claim until the underlying contract claims are finally resolved.⁵⁰ The court in *Murray* determined that the accrual date set

44. *Id.* at 603.

45. *Id.*

46. *Id.* at 604.

47. 33 Tex. Sup. Ct. J. 404 (Apr. 18, 1990).

48. *Murray v. San Jacinto Agency, Inc.*, 759 S.W.2d 778 (Tex. App.—El Paso 1988), *rev'd*,

33 Tex. Sup. Ct. J. 404 (Apr. 18, 1990).

49. 725 S.W.2d 165, 168 (Tex. 1987).

50. *Id.*

forth in *Arnold* could not withstand traditional scrutiny and modified it to provide that the limitations period commences on a duty of good faith and fair dealing claim on the date the insured first suffers an injury, which in *Murray* was the date of denial.⁵¹

The court gave four reasons for its modification of the *Arnold* decision. First, the court noted that under existing Texas authority, the statute of limitations begins to run when facts exist which would authorize the claimant to seek a judicial remedy.⁵² The fact that additional damages may be sustained after the accrual date of the statute of limitations does not prevent the limitations period from commencing.⁵³ Once a denial of a claim has taken place, the insured may seek judicial relief.⁵⁴

Second, the purpose of a statute of limitations is to afford plaintiffs a reasonable time to present their claims and protect defendants and the court from having their case seriously impaired by loss of evidence, death or disappearance of witness, or disappearance of documents.⁵⁵ The court noted that under the *Arnold* accrual date, if the San Jacinto Agency had never admitted coverage, the contract claim never would have been "finally resolved," and theoretically, limitations would have never commenced.⁵⁶

Third, the court held that the use of the date of the denial of a claim is consistent with the well-established precedent in other jurisdictions.⁵⁷

Finally, the *Murray* court noted that *Arnold* incorrectly relied upon *Linkenhoger v. American Fidelity and Casualty Co.*,⁵⁸ which was a *Stowers* case. The court noted that the injury producing event in a *Stowers*'s third party action differs from that in a first party case.⁵⁹ In a *Stowers* case, the injury producing event is typically the underlying judgment in excess of the policy limits. In a first party case, however, the injury producing event occurs at the very least when the insurer unreasonably fails to pay an insured under the policy.⁶⁰

2. Timeframe for Determining Good Faith

In *Viles v. Security National Insurance Co.*⁶¹ the insureds filed a claim under their homeowner's policy to recover for damages caused to the wood portions of their foundation. The policy required the insured to file a proof

51. *Murray*, 33 Tex. Sup. Ct. J. at 405-06.

52. *Id.* (citing *Robinson v. Weaver*, 550 S.W.2d 18, 19 (Tex. 1977)).

53. *Id.* (citing *Atkins v. Crosland*, 417 S.W.2d 150, 153 (Tex. 1967)).

54. *Id.* The court faced only a wrongful denial claim in *Murray*. The court's opinion, by relying on the "some injury" rule, clearly dictates that in a case involving a wrongful delay in making payment limitations runs whenever payment should have been made or whenever some injury is suffered as a result of the delay. *Id.* at 406. The court recognized that if the insurer "strings an insured along without denying or paying a claim," limitations will be tolled under the doctrines of equitable estoppel or fraudulent concealment. *Id.* n.2.

55. *Id.* at 405.

56. *Id.*

57. *Id.* at 406.

58. 260 S.W.2d 884 (Tex. 1953).

59. *Murray*, 33 Tex. Sup. Ct. J. at 407.

60. *Id.*

61. 788 S.W.2d 566 (Tex. 1990).

of loss with the insurer within ninety days of the loss. The insurer denied the claim prior to the time the proof of loss was due. The insurer subsequently filed proof of loss late.

Insureds filed suit for breach of the duty of good faith and fair dealing. The jury answered the questions favorably to the insured and the trial court rendered judgment based upon the verdict.⁶² On appeal, the court of appeals reversed, holding that the insureds failed to obtain a jury finding providing that they had timely filed a proof of loss.⁶³

The supreme court reversed the judgment of the court of appeals, stating that the jury, in a claim for breach of the duty of good faith and fair dealing, must decide whether there was a reasonable basis for denial of the claim or delay in payment of the claim.⁶⁴ The court held that whether a reasonable basis for denial exists must be viewed as of the time the claim is denied.⁶⁵ As such, in *Viles*, the proof of loss was not due the insurer at the time the claim was denied by the insurer. Therefore, the insureds' failure to file the proof of loss could not have been a proper basis for a denial of the claim by the insurer.⁶⁶

3. *Res Judicata*

In *Marino v. State Farm Fire & Casualty Insurance Co.*⁶⁷ the Texas Supreme Court faced the issue of the application of *res judicata* in cases tried prior to the expansion of the doctrine of good faith and fair dealing to insurer-insured relationships. The insured in *Marino* had filed a suit against State Farm alleging that the insurer wrongfully denied the insured's claim for losses resulting from fire. In the earlier lawsuit, the insured made a claim not only in connection with the loss of the house but also for State Farm's alleged false, misleading and deceptive acts or practices in its dealings with the insured.⁶⁸ The insured asserted that State Farm acted unconscionably by taking advantage of his lack of knowledge, ability, experience, and capacity so as to result in a gross disparity between the value received and the consideration paid. State Farm denied the claim contending that the insured had set the fire intentionally to collect the insurance proceeds. The jury failed to find that the insured had set fire to his house and awarded the plaintiff the amount of the damage to the house and its contents.⁶⁹ The jury did not receive issues regarding State Farm's dealings with the insured and its handling of his claim. The court rendered judgment in favor of the insured for the amount of his loss plus attorney's fees but refused to make an award for the handling of the claim.⁷⁰

62. *Id.* at 567.

63. *Security Nat'l Ins. Co. v. Viles*, 773 S.W.2d 68 (Tex. App.—Fort Worth 1989), *rev'd*, 788 S.W.2d 566 (Tex. 1990).

64. *Viles*, 788 S.W.2d at 567.

65. *Id.*

66. *Id.* at 567-68.

67. 787 S.W.2d 948 (Tex. 1990).

68. *Id.* at 949.

69. *Id.*

70. *Id.* at 949.

The insured later filed a second suit against State Farm, alleging that State Farm breached its duty of good faith and fair dealing in handling his claim. The trial court granted State Farm summary judgment on the basis of res judicata.⁷¹ The Fort Worth court of appeals held that the doctrine of res judicata barred relitigation of all issues which could have been tried in the earlier trial.⁷² The court held that the cause of action for the insurer's breach of the duty of good faith and fair dealing it owes its insured grew out of the same operative facts as the claims asserted by the insured in the first suit concerning violations of the Texas Insurance Code and Deceptive Trade Practices Act and could have been litigated in the first suit.⁷³

The supreme court reversed the court of appeals. The court reasoned that the insured's bad faith claim was based on rights subsequently acquired by the insured; thus, it could not have been part of the former action and would not be barred by res judicata.⁷⁴ The supreme court noted that it had previously held that a judgment in one suit will not operate as res judicata to another suit on the same question between the same parties where in the interval the facts have changed or new facts have occurred which alter the legal rights or relationships of the parties.⁷⁵ The court noted that it had broadened this rule so as to apply it to situations where changes in statutory or decisional law had occurred in the interval.⁷⁶ The court noted that the duty of good faith owed insured parties by insurers was not adopted until a few weeks after the trial of the first action in *Marino*.⁷⁷ The court noted the judicial adoption of this duty of good faith not only conferred the rights upon the insured but also created a new common law cause of action⁷⁸ and that the prior trial therefore would not operate as res judicata.⁷⁹

71. *Id.*

72. *Marino v. State Farm Fire & Casualty Ins. Co.*, 774 S.W.2d 107 (Tex. App.—Fort Worth 1989), *rev'd*, 787 S.W.2d 948 (Tex. 1990).

73. *Id.* at 109.

74. *Marino*, 787 S.W.2d at 950.

75. *Id.* at 949-50 (citing *City of Lubbock v. Stubbs*, 160 Tex. 111, 114, 327 S.W.2d 411, 414 (1959); *Cowling v. Colligan*, 158 Tex. 458, 461, 312 S.W.2d 943, 947 (1958)).

76. *Id.* at 950 (citing *Powell v. Powell*, 703 S.W.2d 434, 436 (Tex. App.—Waco 1985, writ ref'd n.r.e.); *Colorado County Fed. Sav. & Loan Ass'n v. Lewis*, 498 S.W.2d 723, 731 (Tex. Civ. App.—Austin 1973, writ ref'd n.r.e.); *Murchard v. Berenson*, 307 F.2d 368, 369-70 (5th Cir. 1962), *cert. denied*, 371 U.S. 962, 83 S. Ct. 541, 9 L. ed. 2d 509 (1962)).

77. *See Arnold v. National County Mut. Fire Ins. Co.*, 725 S.W.2d 165 (Tex. 1987).

78. *Marino*, 787 S.W.2d at 950.

79. *Id.* at 950. The decision in *Marino* cannot be reconciled with other decisions of the supreme court regarding changes in the law. In *Duncan v. Cessna Aircraft Co.*, 665 S.W.2d 414 (Tex. 1984), the supreme court by judicial fiat imposed a new scheme of comparative causation. However, because the defendant had not raised the new scheme in its pleadings and offered no evidence to support a recovery under the scheme, the court denied the defendant the benefit of the change in the law. The court ruled that the defendant was required to anticipate the change in the law and raise the change in its pleadings and evidence. *Duncan*, 665 S.W.2d at 432-34; *see Sanchez v. Schinder*, 651 S.W.2d 249, 255 (Tex. 1983). In *Marino* when the case initially went to trial the application for writ of error in *Arnold* had been granted, the case had been argued, and the decision was pending. The opinion in *Arnold* was handed down approximately two weeks after the trial setting in *Marino*. Furthermore, in the initial trial setting of *Marino*, the plaintiff had article 21.21 and DTPA claims in his pleadings but chose not to submit them. *Marino*, 787 S.W.2d at 949. Nothing in the record in *Marino* would indicate

4. Duty to Third Parties

In *Caserotti v. State Farm Insurance Co.*⁸⁰ the Dallas court of appeals faced the issue of how far the duty of good faith and fair dealing should be extended. This case arose out of a vehicular collision in which State Farm insured both vehicles. The owner of one vehicle sued the other for damages resulting from the collision. Neither notified State Farm of the suit. The trial court entered a default judgment in the plaintiff's favor.⁸¹ Later, State Farm became aware of the lawsuit and hired an attorney to set aside the default. The attorney successfully had the default set aside and asserted a defense to the claim based upon the doctrine of release.⁸² Soon thereafter, the underlying tort claimant filed suit against State Farm alleging, among other things, that it breached its fiduciary duty toward her and the duty of good faith and fair dealing it owed her.⁸³ The trial court rendered summary judgment in favor of State Farm.⁸⁴

The court of appeals held that State Farm did not owe a duty of good faith and fair dealing to the underlying tort claimant with respect to the handling of the liability claim.⁸⁵ The court first noted that all cases imposing the duty of good faith and fair dealing involve first-party claims; that is, suits by insureds against their insurer under the insureds' policies for loss to the insureds' own person or property. The plaintiff in *Caserotti* claimed that State Farm owed her and the defendant the same duty of good faith and fair dealing since both were insured by State Farm.⁸⁶ The court rejected this argument, noting that the plaintiff did not allege that she was denied benefits under her own insurance policy but complained of the denial of benefits under the policy issued to the defendant, a third-party claim.⁸⁷ The court concluded that an insurer does not owe the duty of good faith and fair dealing to its insured when that insured asserts a third party claim against another insured of the same company.⁸⁸

that the plaintiff would have chosen to submit a claim for the breach of the duty of good faith and fair dealing had the trial court recognized such a duty existed.

80. 791 S.W.2d 561 (Tex. App.—Dallas 1990, writ denied).

81. *Id.* at 563.

82. *Id.* at 564.

83. *Id.*

84. *Id.* at 562.

85. *Id.* at 566.

86. *Id.*

87. *Id.*

88. *Id.* The *Caserotti* court follows two prior Texas courts holding that the duty of good faith and fair dealing does not run between a liability carrier and the third-party claimant. *Hart v. Aetna Casualty Ins. Co.*, 756 S.W.2d 27 (Tex. App.—Amarillo 1988, no writ); *Chaffin v. Transamerica Ins. Co.*, 731 S.W.2d 728, 732 (Tex. App.—Houston [14th Dist.] 1987, writ ref'd n.r.e.). The rule adopted by Texas is in line with the majority rule in other jurisdictions. See *Vickey v. Alabama Farm Bureau Mut. Ins. Co.*, 447 So. 2d 693, 694 (Ala. 1984) (attempting to recover from automobile insurer per perished auto damaged in collision with insured vehicle); *Murphy v. Allstate Ins. Co.*, 17 Cal. 3d 937, 940, 553 P.2d 584, 586, 132 Cal. Rptr. 424, 426 (1976) (seeking balance of wrongful death judgment from insurer of tort fusia); *Eichler v. Scott Pools, Inc.*, 513 N.E.2d 665, 667 (Ind. Ct. App. 1987) (seeking damages from automobile accident in which plaintiff's parents were insureds); *Linscott v. State Farm Mut. Auto. Ins. Co.*, 368 A.2d 1161, 1163 (Me. 1977) (charging deceit and misrepresentation by tortfeasor insured); *Magalski v. Maryland Casualty Co.*, 21 Md. App. 136, 141, 318 A.2d 843,

The plaintiff in *Caserotti* also alleged that State Farm breached a fiduciary duty owed to her. The court rejected this contention, holding that proof of a fiduciary relationship requires more than evidence of prior dealings between the parties and the subjective trust of one party.⁸⁹ The court noted that no Texas cases exist that recognize the existence of a fiduciary relationship between an insured and his insurer and, as a result, the court refused to allow such a remedy.⁹⁰

5. Attorney as Witness

In *Warrilow v. Norrell*⁹¹ the attorney for the plaintiff testified as an expert witness in the trial of the case and also served as an attorney. The insurer in that case filed a motion to disqualify the plaintiff's counsel on the grounds that he was a material fact witness as well as a designated expert. The trial court denied their motions.⁹² The court of appeals held that the trial court erred.⁹³

The court noted that Disciplinary Rule 5-102(a) requires the lawyer to withdraw if it is obvious he would be called as a witness on behalf of his client.⁹⁴ The court further noted four exceptions to the mandatory withdrawal rule: 1) if the testimony will relate solely to an uncontested matter; 2) if the testimony will relate solely to a matter of formality, and there is no reason to believe that substantial evidence will be offered in opposition to the testimony; 3) if the testimony will relate solely to the nature and value of legal services rendered in the case by the lawyer or his firm to the client; 4) as to any matter, if refusal would work a substantial hardship on the client because of the distinct value of the lawyer or his firm as counsel in a particular case.⁹⁵ In *Warrilow* the attorney testified regarding a non-waiver agreement as well as conversations regarding the denial of coverage. The court held that in light of the testimony as to conversations between the parties, the attorney should have been disqualified.⁹⁶

The court next addressed the issue of whether an attorney may testify as an expert witness in a bad faith case. The court noted several problems created when an attorney testifies as an expert witness in a case. First, the jury may be unable to distinguish among attorney's multiple roles, including

849 (1974) (claiming damages for tortfeasor insurer's refusal to pay property damage); *Chavez v. Chenoweth*, 89 N.M. 423, 429, 553 P.2d 703, 709 (Ct. App. 1976) (claiming against defendant's insurer for unreasonable delay); *D. H. Overmyer Telecasting Co. v. American Home Assurance Co.*, 29 Ohio App. 3d 31, 34, 502 N.E.2d 694, 698 (1986) (claiming against attorney's liability insurer); *Tank v. State Farm Fire & Cas. Co.*, 105 Wash. 2d 381, 386, 715 P.2d 1133, 1139 (1986) (claiming against insurer of defendant in assault action); see also *Cooper and Huddleston, Insurance Law, Annual Survey of Texas Law*, 43 Sw. L.J. 343, 350-51 (1989).

89. *Caserotti*, 791 S.W.2d at 564.

90. *Id.*

91. 791 S.W.2d 515 (Tex. App.—Corpus Christi 1989, writ denied).

92. *Id.* at 519.

93. *Id.*

94. *Id.*

95. Supreme Court of Texas, Rules Governing the State Bar of Texas, Article X, § 9 (Vernon 1988).

96. *Warrilow*, 791 S.W.2d at 520.

those of 1) an expert on the ultimate legal issues, 2) a critical fact witness on the issue of good faith and fair dealing, 3) an attorney responsible for upholding the standards of ethical conduct, and 4) a representative of a party to the suit.⁹⁷ Secondly, the court noted that such testimony puts the attorney-witness in the position of having to vouch for his own credibility when summing up to the jury.⁹⁸

Finally, the court recognized that a danger exists that the trier of fact, especially a jury, will tend to grant undue weight to the attorney's testimony and thereby disadvantage the opponent.⁹⁹ The court found that the admission of the attorney's testimony was calculated to cause and probably did cause a rendition of an improper judgment.¹⁰⁰

II. LIABILITY INSURANCE

A. *Legal Obligation to Pay/Estoppel*

In *State Farm Lloyds, Inc. v. Williams*¹⁰¹ the Dallas court of appeals, in an opinion by Chief Justice Enoch, addressed the meaning of the standard liability policy language requiring the insurer to pay "all sums which the Insured shall become legally obligated to pay as damages because of bodily injury."¹⁰² In *Williams* Claude Fulton shot his wife, his step-grandaughter, his step-daughter and then himself.¹⁰³ The step-daughter and her husband brought a wrongful death and personal injury suit against the estate of Claude Fulton and that of his wife. The alleged basis of liability against the wife's estate was section 5.61(d) of the Texas Family Code.¹⁰⁴ The court entered judgment against the wife's estate to the extent of her community property, including the homeowner's liability policy issued to her and her husband by State Farm.¹⁰⁵ After an assignment by the wife's estate, the claimants in the underlying suit brought a bad faith action against State Farm. The claimants convinced the district court to grant summary judgment, holding State Farm liable under the policy as a matter of law.¹⁰⁶

The court of appeals held that the resolution of the case required comparison of the judgment in the underlying tort suit to the policy terms.¹⁰⁷ The court found the judgment ambiguous, leading it to consider the record of the underlying trial and judgment to determine the nature of liability, if any,

97. *Id.* at 521.

98. *Id.* at 522.

99. *Warrilow*, 791 S.W.2d at 523. *But see* *Ayres v. Canales*, 790 S.W.2d 554, 557-58 (Tex. 1990) (requiring proof of actual prejudice resulting from continued representation).

100. *Warrilow*, 791 S.W.2d at 523.

101. 791 S.W.2d 542, 549 (Tex. App.—Dallas 1990, writ denied).

102. This portion of the policy was set forth under the heading "Coverage D—Personal Liability." *Id.* at 545.

103. *Id.*

104. Section 5.61(d) provides that "[c]ommunity property is subject to tortious liability of either spouse incurred during marriage." TEX. FAM. CODE ANN. § 5.61(d) (Vernon 1975).

105. *Williams*, 791 S.W.2d at 547.

106. *Id.*

107. *Id.*

imposed.¹⁰⁸ The court concluded that the claim was based on sections 5.61(d) and 4.031 of the Texas Family Code.¹⁰⁹ The court noted that section 5.61(d) subjects only the *community property* to the liability of the *other* spouse, and section 4.031(a) imposes personal liability on one spouse for the torts of the other only if there is proof of agency.¹¹⁰ The court found the judgment against the wife's estate did not impose a legal obligation to pay as damages as a result of personal liability; instead, the court found that a judgment under section 5.61(d) merely imposes an obligation on the community property for the personal liability of the *other* spouse.¹¹¹

The court distinguished *Walker v. Lumbermens Mutual Casualty Co.*,¹¹² relied upon by the claimants, by noting that the *Walker* court imposed *personal liability* against parents who sought coverage, not merely against their community property, for the willful torts of their children.¹¹³ The coverage determination made by the Dallas court is consistent with the few prior decisions in other jurisdictions.¹¹⁴

The court in *Williams* also addressed the issue of presumptive prejudice in

108. *Id.*

109. TEX. FAM. CODE ANN. § 4.031 (Vernon Supp. 1990); TEX. FAM. CODE ANN. § 5.61(d) (Vernon 1975).

110. *Id.*

111. *Williams*, 791 S.W.2d at 548. The court found that a seemingly contrary holding in *Lawrence v. Hardy*, 583 S.W.2d 795, 799 (Tex. Civ. App.—San Antonio 1978, writ ref'd n.r.e.), was erroneous in light of prior supreme court authority that a husband was not individually liable for the torts of the wife which were not aided and abetted by the husband. *Williams*, 791 S.W.2d at 548. The court also found that *Firemen's Ins. Co. v. Burch*, 426 S.W.2d 306 (Tex. Civ. App.—Austin), *aff'd in part and rev'd in part*, 442 S.W.2d 331 (Tex. 1968), which suggested that the liability of community property invoked liability insurance coverage, was dictum and erroneously based on the previously rejected rule that a husband is always personally liable for the wife's torts. *Williams*, 791 S.W.2d at 548.

112. 491 S.W.2d 696 (Tex. Civ. App.—Eastland 1973, no writ).

113. *Williams*, 791 S.W.2d at 549; *Walker*, 491 S.W.2d at 697-99 (citing TEX. REV. CIV. STAT. ANN. art. 5923-1 (Vernon 1962) (repealed 1973) (current version at TEX. FAM. CODE ANN. §§ 33.01-33.03 (Vernon 1986))). The *Williams* court noted that this statute presupposed parental control, which was not done by 5.61(d) with respect to the relationship of spouses. *Williams*, 791 S.W.2d at 549.

114. *See, e.g., Hartford Fire Ins. Co. v. Superior Court*, 142 Cal. App. 3d 406, 191 Cal. Rptr. 37 (1983) (holding that "relationship or marital status of the [insureds] gave rise to no independently insurable event which would place this case beyond the aircraft exclusions in the policies"); *Evans v. Pacific Indem. Co.*, 49 Cal. App. 3d 537, 540, 122 Cal. Rptr. 680, 683 (1975) (holding that "legal obligation to pay as damages" requirement not met by liability of one spouse's property for intentional torts of another; judgment was not actually rendered against the innocent spouse); *U.S.F. & G. Ins. Co. v. Brannan*, 22 Wa. App. 341, 347, 589 P.2d 817, 823 (1979) (holding that allowing coverage for innocent spouse would benefit the community and therefore benefit the guilty spouse and would therefore be contrary to public policy). The court in *Williams* rejected attempted distinctions of *Evans* on the basis that *Williams* involved a judgment entered against the innocent spouse, whereas *Evans* involved no such judgment. The court apparently reached this decision because of the fact that an innocent spouse need not even be joined in the suit against the guilty spouse in order for his or her community property to be subject to collection. TEX. FAM. CODE ANN. § 4.04 (Vernon 1975); 1 DORSANEO, TEXAS LITIGATION GUIDE § 12.03 [3], 12-10-12-11 (1989); *see Lawrence v. Hardy*, 583 S.W.2d 795 (Civ.—San Antonio 1978, writ ref'd n.r.e.) (holding that husband may be sued alone without joinder of tortfeasor wife). The court in *Williams* apparently concluded that the responsibility of the community property for the husband's tort existed under the statute; that statute, like the one in *Evans*, did not create separate and personal liability on the part of the innocent spouse. Thus, the judgment could do no more than the statute.

the context of the application of estoppel for failure of the insurer to reserve its rights prior to defending a claim against its insured. In *Williams* State Farm provided a reservation of rights letter to the estate of Claude Fulton, but it did not provide a separate one to the estate of the wife.¹¹⁵ The court held that while generally waiver and estoppel cannot be used to create insurance coverage where none otherwise exists, an exception exists if the "insurer assumes an insured's defense without declaring a reservation of rights or obtaining a non-waiver agreement, and with knowledge of facts indicating non-coverage . . ."¹¹⁶ The court rejected arguments that the decision of the Texas Supreme Court in *Texas Farmers Insurance Company v. McGuire*¹¹⁷ dispensed with the so-called exception.¹¹⁸

In *Williams* the court held that the exception requires a showing that the insured was harmed or prejudiced by the insurer's assumption of the defense without reservation.¹¹⁹ The *Williams* court rejected the estate's arguments that prejudice is conclusively presumed from the mere fact that the insured is deprived of the right to control his defense and the insurer is defending with a conflict of interest.¹²⁰ The court recognized that at least one Texas case had held that "the mere existence of a conflict of interests may be enough to demonstrate harm."¹²¹ The court refused an automatic presumption, holding instead that the insured must show he was harmed unless a conflict of interest or other harm is obvious.¹²²

115. *Williams*, 791 S.W.2d at 550. The court did not address arguments of State Farm that the provision of a reservation to one named insured is sufficient as to other insureds, thus avoiding application of waiver and/or estoppel. State Farm relied upon the decision of the Kentucky Court of Appeals in *Kentucky Farm Bureau Mut. Ins. Co. v. Harp*, 423 S.W.2d 233, 235 (Ky. 1967) (holding that non-waiver agreement obtained from named insured was effective as to "other insured").

116. *Williams*, 791 S.W.2d at 550 (citing *Farmers Texas County Mut. Ins. Co. v. Wilkinson*, 601 S.W.2d 520, 522 (Tex. Civ. App.—Austin 1980, writ ref'd n.r.e.); *Pacific Indemn. Co. v. Accl Delivery Serv., Inc.*, 485 F.2d 1169, 1173 (5th Cir. 1973) (applying Texas law) and numerous texts and annotations).

117. 744 S.W.2d 601, 603 (Tex. 1988).

118. The court in *McGuire*, citing *Washington Nat. Ins. Co. v. Craddock*, 130 Tex. 251, 109 S.W.2d 165 (1937), stated that "the doctrine of estoppel cannot be used to create insurance coverage when none exists by the terms of the policy." In a footnote to the opinion, the *McGuire* court refused to address the validity of a so-called exception to the general rule in the context where a defense is provided without a reservation of rights. *McGuire*, 744 S.W.2d at 603 n.1. The court stated that in the case before it this exception was not outcome determinative. The *Williams* court did not expressly address the numerous arguments in support of the holding that *McGuire* logically cannot stand with the continued validity of the exception. Indeed, the cases relied upon in *McGuire* indicate that the exception is solely limited to circumstances involving conditions of forfeiture, such as the breach of a no action clause or cooperation clause.

119. *Williams*, 791 S.W.2d at 552. The court emphasized that the courts have required proof of prejudice regardless of whether waiver or estoppel was asserted despite the fact that the doctrine of waiver generally does not require prejudice. *Id.* The court held the exception is a creature sharing elements of both waiver and estoppel. *Id.* at 552 n.2.

120. *Id.* at 553.

121. *Id.* (citing *Automobile Underwriters Ins. Co. v. Murrah*, 40 S.W.2d 233, 234-35 (Tex. Civ. App.—Dallas 1931, writ ref'd)).

122. *Williams*, 791 S.W.2d at 553; see also *Pacific Indemn. Co. v. Accl Delivery Serv., Inc.*, 485 F.2d 1169, 1175 (5th Cir. 1973), cert. denied, 415 U.S. 921, 39 L. Ed. 2d 476, 94 S. Ct. 1422 (1974); *Employers Casualty Co. v. Tilley*, 496 S.W.2d 552, 560 (Tex. 1973).

The *Williams* court held that a fact issue existed as to harm, precluding summary judgment, because of the ambiguous underlying allegations, the applicable law, and the resulting judgment.¹²³ The court noted that these facts also suggested the existence of a fact issue as to whether State Farm had knowledge of the facts indicating non-coverage.¹²⁴ The court concluded that the insurer could make a strong argument that the provision of a defense to the estate without reservation would not be prejudicial because the responsibility of the estate was automatic under 5.61(d), requiring no proof, no discovery and no real trial.¹²⁵ Providing a defense where there is a conflict of interest such as that in *Williams* would not appear to be even possibly prejudicial where the liability in the underlying suit is automatic and thus not subject to manipulation.¹²⁶ This is not a situation where the "insurer represents the insured . . . and simultaneously formulates its defense of non-coverage against the insured."¹²⁷ The court emphasized that its decision in no way sought to discourage insurers from defending their insureds, but if they do so when a question of coverage exists, a trial on the estoppel/waiver exception will await.¹²⁸

B. Insolvency/No Action

In *Harville v. Twin City Fire Insurance Co.*¹²⁹ the Fifth Circuit held that the placing of a primary carrier in receivership does not require the excess carrier to "drop down" and defend the insured. The excess policy in *Harville* required the insurer to provide a defense if no underlying insurer was "obligated to defend"¹³⁰ The court in *Harville* found its opinions in *Mission National Insurance Co. v. Duke Transportation Co.*¹³¹ and *Continental Marble & Granite v. Canal Insurance Co.*¹³² as giving "controlling guidance" despite the fact they dealt solely with the duty of an excess carrier to indemnify where the primary carrier was insolvent. The court noted that the purpose of excess insurance was to provide inexpensive insurance with high limits, and stated that this purpose would be defeated if the burden of insolvency could be shifted to the excess carrier.¹³³

The court held that since the excess carrier had no duty to defend, the no-

123. *Id.*

124. *Id.*

125. *Id.*

126. *Id.*

127. *Id.* at 551 (discussing *Pacific Indem. Co. v. Acel Delivery Serv., Inc.*, 485 F.2d 1169, 1173 (5th Cir. 1973) (Texas law), *cert. denied*, 415 U.S. 921, 39 L. Ed.2d 476, 94 S. Ct. 1422 (1974); *Employers Casualty Co. v. Tilley*, 496 S.W.2d 552, 560-61 (Tex. 1973); *Farmers Texas County Mut. Ins. Co. v. Wilkinson*, 601 S.W.2d 520, 522 (Tex. Civ. App.—Austin 1980, writ ref'd n.r.e.)).

128. *Williams*, 791 S.W.2d at 553.

129. 885 F.2d 276, 278 (5th Cir. 1989).

130. *Id.*

131. 792 F.2d 550 (5th Cir. 1986).

132. 785 F.2d 1258 (5th Cir. 1986).

133. *Harville*, 885 F.2d at 278-79.

action clause¹³⁴ still applied.¹³⁵ The court concluded that an agreed judgment with no actual trial, hearing, evidence or findings was insufficient to comply with the no-action condition in the policy.¹³⁶

C. *Hold Harmless Condition*

The Fifth Circuit interpreted an unusual hold harmless endorsement in an excess policy in *Amoco Canada Petroleum Co. v. Wild Well Control, Inc.*¹³⁷ This endorsement required, as a condition to coverage, that the insured obtain a hold harmless agreement. The insured, Wild Well, in fact was itself obliged to indemnify a third-party, Amoco.¹³⁸ The court rejected arguments that excess policies always intend to follow the form of the underlying primary policy, despite absence of specific language to this effect, and that the endorsement expressly narrowed coverage.¹³⁹ The court also rejected arguments suggesting that an exception to the workmen's compensation exclusion granted contractual coverage in contravention of the endorsement.¹⁴⁰ The court reasoned that the exception did not apply because it was limited to a contractual assumption of liability for another's liability incurred under a worker's compensation statute.¹⁴¹

The court concluded that the phrase "hold harmless" was not ambiguous.¹⁴² The court rejected arguments that the endorsement's reference to agreements "with" instead of "from" did not indicate that the agreements had to cover some as opposed to all possible claims.¹⁴³ Finally, the court held that a bold-type reference in the endorsement that it did not amend the terms of the policy "other than as above stated" was sufficient to expressly limit the coverage of the umbrella policy.¹⁴⁴

134. *Id.* at 279. The no-action clause bars an action against the insurer unless 1) the insured's liability has been determined after "actual trial" or 2) the claim has been determined by a written agreement consented to by the insurer. *Id.*

135. *Id.* The court noted that this condition precedent is only waived where the contract has been first breached by the insurer. *Id.* (discussing *First Nat'l Indem. Co. v. Mercado*, 511 S.W.2d 354 (Tex. Civ. App.—Austin 1974, no writ)).

136. *Harville*, 885 F.2d at 279.

137. 889 F.2d 585, 587 (5th Cir. 1989).

138. *Id.* at 586.

139. *Id.*

140. *Id.* The exclusion stated the policy would not apply "to any obligation for which the insured or any company as its insured may be held liable under any workmen's compensation, unemployment compensation or disability benefits law, or under any similar law provided, however, that this exclusion does not apply to liability of others assumed by the Name Insured under contract or agreement." *Id.*

141. *Id.* The court's decision is bolstered by additional Texas authority holding that an exception to an exclusion cannot amount to a grant of coverage in derogation of other policy terms and exclusions. *Travelers Ins. Co. v. Valentine*, 578 S.W.2d 501, 505 (Tex. Civ. App.—Texarkana 1979, no writ).

142. *Id.*

143. *Id.* at 588.

144. *Id.*

D. Duty to Defend

In *American Alliance Insurance Co. v. Frito-Lay, Inc.*¹⁴⁵ American Alliance brought a declaratory action in a New York court to obtain a ruling that it was not liable to indemnify Frito-Lay regarding an underlying suit based upon theories including patent infringement and unfair competition. After the initiation of the underlying suit, Frito-Lay demanded a defense from National Union Fire Insurance Company, its primary insurer, and American Alliance, its excess insurer. Frito-Lay brought suit against both carriers for their refusal to defend. After American Alliance commenced the declaratory action in New York, Frito-Lay amended its petition in its lawsuit in Texas asserting its right to indemnity. After this amendment, Frito-Lay obtained an order from the trial court enjoining American Alliance from pursuing the New York declaratory action.¹⁴⁶

The court held that the duty to defend and duty to indemnify are separate and distinct causes of action. The court reasoned that the duty to defend requires an examination of solely the complaint allegations and the provisions of the insurance policy without regard to any facts ascertained before suit, developed in the process of the litigation, or by the ultimate outcome of the suit.¹⁴⁷ The duty to indemnify is determined on the *actual facts* which underlie the pleadings and result in liability rather than the pleadings themselves.¹⁴⁸ The court concluded that the trial court abused its discretion in entering the injunction against American Alliance from pursuing its New York action regarding duty to indemnify.¹⁴⁹ The court reached this conclusion, in addition to the finding that the causes of action were found to be separate and distinct, since American Alliance's action was brought before the action was initiated by Frito-Lay in this suit.¹⁵⁰

In *Westchester Fire Insurance Co. v. American General Fire & Casualty Co.*¹⁵¹ the court affirmed a summary judgment against American General, holding that it did not have an obligation to defend or pay a claim brought against the insured, Masonry, for the death of one of its employees. The City of Austin was sued for damages in addition to those paid by Westchester under a worker's compensation policy. The City of Austin joined Masonry for statutory indemnity with respect to operations conducted near high voltage lines. Thereafter, Masonry notified American General of the city's suit for indemnity. American General declined to defend under both the policies it had issued to Masonry.¹⁵²

145. 788 S.W.2d 152 (Tex. App.—Dallas 1990, writ dismissed).

146. *Id.*

147. There are some limited circumstances where extrinsic evidence may be examined. See discussion in Cooper & Huddleston, *Insurance Law, Annual Survey of Texas Law*, 44 Sw. L. J. 329, 345 n.113 (1990).

148. *Frito-Lay*, 788 S.W.2d at 154.

149. *Id.*

150. *Id.* at 153-54.

151. 790 S.W.2d 816 (Tex. App.—Austin 1990, no writ).

152. One policy was a Texas commercial multi-peril policy and the other was a general liability-automobile policy. The first policy provided liability coverage as follows:

The Company will pay on behalf of the insured all sums which the insured shall

In a declaratory action brought by Masonry, the court held that the language of the employment exclusion "unambiguously excludes from coverage claims for indemnity arising out of bodily injury to Masonry employees."¹⁵³ The parties did not dispute that the city's claim arose out of a covered injury even though the claim took the form of suit for indemnity. As a result, the court concluded that the trial court correctly held that no duty to defend existed.¹⁵⁴

The court rejected the argument that the language of the exclusion was amenable to multiple reasonable interpretations. The court stated that the exclusion plainly demonstrated the parties' intention to exclude any obligation on American's part to pay *any liability* incurred by Masonry *by reason of bodily injury sustained by an employee*, regardless whether such liability resulted *directly* (as in the case of a claim against Masonry by an employee or his survivors) or *indirectly* (as in the case of a secondarily-liable party who becomes entitled to indemnity by discharging an obligation for which Masonry is primarily liable).¹⁵⁵ The court concluded that employee injuries were part of a class of risk American General declined to insure.¹⁵⁶

E. Estoppel

In *Arkwright-Boston Manufacturers Mutual Insurance Co. v. Aries Marine Corp.*¹⁵⁷ the court recognized, like *Williams*, that there is an "exception" to the rule that estoppel and/or waiver cannot be used to create coverage that would not otherwise exist where a defense is provided without a reservation of rights. The court also recognized that the insured must demonstrate prejudice.¹⁵⁸ In *Arkwright* the court held that where an excess carrier orchestrates settlement, without providing the legal defense, it still fits within the defense exception.¹⁵⁹ The court recognized an exception broader than the

become legally obligated to pay as damages because of bodily injury . . . to which this insurance applies, caused by an occurrence and arising out of . . . all operations necessary or incident to the business of the named insured . . .

The court noted exception subsection (J) which provided as follows:

To bodily injury to any employee of the insured arising out of and in the course of his employment by the insured or to any obligation of the insured to indemnify another because of damages arising out such injury.

The second policy provided liability coverage as follows:

The company will pay on behalf of the insured, all sums which the insured shall become legally obligated to pay as damages because of . . . bodily injury . . . to which this insurance applies, caused by an occurrence and arising out of the . . . use . . . of any automobile. . . .

The court noted subsection (C), which included the following exception:

To bodily injury to an employee of the insured arising out of and in the course of his employment by the insured or to any obligation of the insured to indemnify another because of damages arising out of such injury

Id. at 818.

153. *Id.*

154. *Id.*

155. *Id.*

156. *Id.*

157. 736 F. Supp. 1447, 1450 (S.D. Tex. 1990).

158. *Id.*

159. *Id.*

defense situation, stating that such a broad exception should apply in all cases where the insured party is prejudiced by reliance upon the insurer's actions taken without reservation.¹⁶⁰

The court noted that the estoppel/waiver analysis is three-pronged: 1) whether the insurer reserved its rights; 2) whether the insurer had "sufficient knowledge of the facts upon which to predicate estoppel"; and 3) whether the insured was prejudiced.¹⁶¹ The court observed that the insurer made no attempt to inform the insured of the coverage issues or the insurer's intent to settle the underlying claim and then seek reimbursement from the insured.¹⁶² The court held that mere oral notification was insufficient.¹⁶³

The court in *Arkwright* found the insured prejudiced as a result of it being barred by the insurer's settlement from having a jury determine its liability and damages.¹⁶⁴ The court also found that prejudice existed as a result of the insurer's failure to disclose the conflict of interest.¹⁶⁵ The court's opinion appears to rely on presumptive prejudice and thus it clearly conflicts with *Williams*. The opinion fails to even refer to *Williams*.

F. Limits/Professional Liability

The policy in *Tumlinson v. St. Paul Insurance Co.*¹⁶⁶ provided an each person limit as the maximum paid "for all claims resulting from the injury or death of any one person."¹⁶⁷ The court held that the undefined term "injury" did not include financial injury alleged to have been suffered by parents for bodily injury to their child.¹⁶⁸ The court held that "injury" must be viewed in context; to give it unlimited scope, the court reasoned, would be to negate the other policy terms referring to a limitation of all derivative claims.¹⁶⁹ A dissenting opinion urged that the policy was ambiguous because if the insurer had intended a single limit for bodily injury it could have said so but did not.¹⁷⁰

G. Employment/Workers' Compensation Exclusions

In *National Union Fire Insurance Co. v. Kasler Corp.*¹⁷¹ the Fifth Circuit

160. *Id.* at 1452.

161. *Id.* at 1451.

162. *Id.* The court recognized that it can be proper for an insurer to settle the underlying suit subject to reservation and then seek reimbursement from the insurer. *Id.* (citing *Employers Mut. Liability Ins. Co. v. Sears, Roebuck & Co.*, 621 F.2d 746, 747 (5th Cir. 1980); WINDT, *INSURANCE CLAIMS AND DISPUTES*, § 5.05 (2d ed. 1988)).

163. *Id.* This holding does not consider the facts and circumstances of each particular case. *Id.* at 1451 n.5. The doctrines of estoppel and waiver have never had a writing requirement. This "statute of frauds" for reservation of rights is unworkable and impractical.

164. *Id.* at 1452.

165. *Id.*

166. 786 S.W.2d 406, 407 (Tex. App.—Houston [1st Dist.] 1990, writ denied).

167. *Id.* (emphasis omitted).

168. *Id.* at 408.

169. *Id.* (discussing *McGovern v. Williams*, 741 S.W.2d 373 (Tex. 1987) (holding that loss of consortium claim derived from husband's personal injury claim subject to single limit)).

170. *Id.* at 409.

171. 906 F.2d 196 (5th Cir. 1990).

held that third-party claims for contribution against the insured derive from the primary claim of an employee of the insured and are excluded under exclusion (j), the employment exclusion.¹⁷² The court rejected the reasoning of the New Hampshire Supreme Court in *Royal Globe Insurance Co. v. Poirier*,¹⁷³ which held that exclusion (j) excludes only workmen's compensation claims. The court noted that exclusion (i) specifically addressed such claims, and thus exclusion (j) was clearly intended to be broader. The court also rejected arguments that employment exclusions should be read more narrowly as to third-party claims for contribution.¹⁷⁴ The court emphasized that the exclusion expressly referred to claims for *indemnity* arising out of a work-related injury, which was sufficiently broad to include claims for contribution.¹⁷⁵

H. Business Risk Exclusions

In *T. C. Bateson Construction Co. v. Lumbermens Mutual Casualty Co.*¹⁷⁶ the Houston court of appeals discussed what are commonly referred to as the business risk exclusions contained within comprehensive general liability policies.¹⁷⁷ The plaintiff in *Bateson* had in effect a comprehensive general

172. *Id.* at 197. Exclusion (j) states there is no coverage for bodily injury to an employee arising during the course of employment or "any obligation of the insured to indemnify another because of damages arising out of such injury." *Id.*

173. 120 N.H. 422, 426, 415 A.2d 882, 885-86 (1980).

174. *Id.* The insured urged this distinction to avoid *Aberdeen Ins. Co. v. Bovee*, 777 S.W.2d 442, 444 (Tex. App.—El Paso 1989, no writ), and *Travelers Indemn. Co. v. Cen-Texas Vending Co.*, 530 S.W.2d 354, 355 (Tex. Civ. App.—Eastland 1975, writ ref'd n.r.e.), both of which involved direct claims by employees against the insured/employer. There was no mention by the court that this distinction lacks merit in light of the fact that a "third-party" claim for indemnity is derivative of the primary claim.

175. *Id.* The court glided over the issue of whether a claim for contribution falls within the indemnity language in the exclusion. These are dissimilar legal concepts. Applying the rule that exclusionary language is to be even more strictly construed than other policy terms, a strong argument could be made, but apparently was not, that the exclusion applies only to indemnity, not contribution.

176. 784 S.W.2d 692 (Tex. App.—Houston [14th Dist.] 1989, writ denied).

177. In this case, the pertinent portions of the policy were as follows:

The company will pay on the behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of:

A. Bodily Injury or; B. Property Damage

To which this insurance applies, caused by an occurrence, and the company shall have the right and duty to defend any suit against the insured seeking damages on the account of such bodily injury or property damage,

The pertinent exclusions within the policy were as follows:

THIS INSURANCE DOES NOT APPLY:

(a) To liability assumed by the insured under any contract or agreement except incidental contract; but this exclusion does not apply to a warranty of fitness or quality of named insured products or a warranty that work performed by or on behalf of the named insured will be done in a workmen like manner

(l) To property damage to the named insured products arising out of such products or any part of such products;

(m) To property damage to work performed by or on behalf of the named insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith.

Id. at 694.

liability policy issued by Lumbermens for the years of 1969, 1970 and 1971. Bateson had entered into a contract with the University of Texas in September 1967 to construct the Lyndon Baines Johnson Library. The construction began in 1967 and was completed in November 1971. Prior to that time and thereafter, cracks appeared in the marble walls of the building. The University requested that Bateson repair these cracks. Bateson refused to make the repairs, and the University had to hire another contractor. The University subsequently filed suit against Bateson for indemnification of the costs of the repair job. Thereafter, Bateson made demand upon Lumbermens to defend this suit. Lumbermens denied Bateson's requested defense, asserting that the injury was not covered by its policy with Bateson.

The contract between Bateson and the University contained specific provisions regarding the specific type of marble which was to sheathe the library's exterior. The contract further prescribed a particular formula for the mortar to be used in anchoring the marble. Additionally, the contract specifically described how the marble was to be anchored. The only property damage alleged by the University was the cost to correct the marble with sheathing, install anchoring components and some related water damage. Investigation revealed that mortar which did not conform to the contract specifications caused at least in part, damage to the sheathing. This investigation revealed that the presence of gypsum in the mortar caused expansion, resulting in cracking of the marble. All of the materials, including the marble, anchoring components and mortar used to affix the marble sheathing to the structure, were provided by Bateson or its subcontractors, except, the masonry subcontractor, Don Rem, who was an independent contractor.

The underlying suit resulted in a settlement by Bateson for \$1,550,000 plus costs. Bateson then proceeded to file suit against Lumbermens for indemnification under its insurance policy with them. The trial court rejected the argument of Bateson that the exclusions were ambiguous as a matter of law and should be strictly construed against the insurer. The court of appeals affirmed the trial court's rendering of summary judgment, holding that the policy was not ambiguous and did not provide coverage for repair and replacement cost. The court noted that the purpose of comprehensive liability insurance is to protect the insured against claims for personal injury or property damage caused by the completed product. It is not meant to provide for the repair and replacement of the product.¹⁷⁸

The court rejected arguments by Bateson that "on behalf of the named insured" did not include independent contractors and thus would not exclude coverage.¹⁷⁹ Instead, the court held that independent contractors

178. *Bateson*, 784 S.W.2d at 695 (citing *La-marche v. Shelby Mut. Ins. Co.*, 390 S.W.2d 325, 326 (Fla. 1980)). The court further held:

In the context of this case the exclusions are designed to protect insurers from contractors' attempts to recover funds to correct deficiencies caused by contractors' questionable performance. Their use demonstrates the insureds' belief that the cost of not performing well is the cost of doing business and not considered part of the risk sharing scheme for which general liability policies are written.

179. *Id.*

must be considered within the language of the policy exclusion or the situation would result in coverage under the policy for the operations completed by independent contractors, but not the insured or its employees.¹⁸⁰ The court specifically noted that the independent contractor was not an independent contractor hired by the University of Texas but rather was hired by Bateson, the insured.¹⁸¹

The court further rejected Bateson's argument that the term work in exclusion (m) was ambiguous and should be interpreted to mean *labor* rather than *product*.¹⁸² The court held that if Bateson's interpretation was followed, there could be no property damage to the labor itself, but the only property damage would be to the product resulting therefrom.¹⁸³ The court noted that Bateson cited no authority for this argument. Moreover, the court rejected Bateson's argument that exclusion (m) was ambiguous regarding whether denial of coverage "to property damage to work" applied to portions of work of the insured other than that out of which property damage arose. The court held that upon specific review of Texas cases dealing with exclusion (m), the exclusion is not ambiguous and "it clearly denies coverage for damage to work of the insured that is not defective."¹⁸⁴

The court also rejected Bateson's argument that the policy is ambiguous regarding coverage for breaches of warranty and failure to perform work in a workmanlike manner, specifically with regard to the general insuring clause, the limits of liability provisions and exclusion (a). Bateson urged that the policy language would lead a reasonable insured to naturally assume that coverage would exist for all damages caused by the operations of independent contractors. The court held that the language of the insuring clause requires that the insurance apply to the coverage being sought and that the premium paid does not buy coverage for all property damage, only for the types of damage provided for in the policy.¹⁸⁵ The court stated that each exclusion is to be read independently of every other exclusion.¹⁸⁶ The court concluded that exclusion (a) was not ambiguous. Additionally, the court

180. *Id.* (citations omitted).

181. *Id.* at 696.

182. *Id.*

183. *Id.*

184. *Id.* The cases discussed by the court in concluding that exclusion (m) is not ambiguous included the following: *Mid-United Contractors, Inc. v. Providence Lloyds Ins. Co.*, 754 S.W.2d 824 (Tex. App.—Ft. Worth 1988, writ denied); *Dorchester Development Corp. v. Safeco Ins. Co.*, 737 S.W.2d 380 (Tex. App.—Dallas 1987, no writ); *McCord, Condrion & McDonald, Inc. v. Twin City Fire Ins. Co.*, 607 S.W.2d 956 (Tex. Civ. App.—Fort Worth 1980, writ ref'd n.r.e.); *Travelers Ins. Co. v. Volentine*, 578 S.W.2d 501 (Tex. Civ. App.—Texarkana 1979, no writ); *Eulich v. Home Indem. Co.*, 503 S.W.2d 846 (Tex. Civ. App.—Dallas 1973, writ ref'd n.r.e.); *Industrial Indem. Co. v. Hennessee Homes, Inc.*, 465 S.W.2d 955 (Tex. Civ. App.—Houston [1st Dist.] 1971, writ ref'd n.r.e.); *Employers Casualty Co. v. Brown-McKee, Inc.*, 430 S.W.2d 21 (Tex. Civ. App.—Tyler 1968, writ ref'd n.r.e.).

185. *Bateson*, 784 S.W.2d at 696 (citation omitted).

186. *Id.* (citation omitted). The court noted that the exception to exclusion (a) "merely removes breach of implied warranty of fitness, quality or workmanship from the specific exclusion relating to contractual liability. The exception remains subject to and limited by all other related exclusions contained in the policy." *Id.*

rejected Bateson's argument that the independent contractors' coverage provisions were ambiguous.¹⁸⁷

I. Effect of Tender of Defense

In *United States Aviation Underwriters, Inc. v. Olympia Wings, Inc.*¹⁸⁸ the insurer tendered a defense subject to a reservation of rights letter rejected by the insured. The insurer then filed a declaratory action to determine the coverage issue. The insured promptly entered a \$20 million consent judgment in favor of the underlying tort claimant who agreed with the insured only to execute judgment against the insurance policies.¹⁸⁹ The judgment recited that the settlement between the insured and the claimant was "in all things reasonable" and that "no fraud or collusion has occurred in the settlement of the case"¹⁹⁰

The Fifth Circuit held that the consent judgment against the insured was not enforceable against the insurer.¹⁹¹ The court summarized the effect of the rejection of a tender of defense subject to reservation as follows: 1) the tender with reservation does not breach the duty to defend; 2) the insurer has a duty to pay only to the extent that the damages involved covered conduct and/or injury; 3) the insurer can challenge the reasonableness of the damage award; and 4) the insured can defend itself unrestricted by policy conditions.¹⁹²

The court interpreted the Texas Supreme Court's decision in *Employers Casualty Co. v. Block*¹⁹³ to prohibit an insurer from contesting the reasonableness of a consent judgment entered on a settlement between its insured and an injured party when the insurer refused to defend. The court stated that *Block* did not extend this rule to an insurer who tenders a defense, reserving the right to later deny coverage.¹⁹⁴ The court reasoned that an insurer refusing to defend is in "privity with the insured on all essential issues in the underlying action" and thus cannot attack reasonableness, but an insurer which tenders a defense with reservation is not in privity and can accordingly attack reasonableness.¹⁹⁵ Thus, where defense is tendered with

187. *Id.*

188. 896 F.2d 949 (5th Cir. 1990).

189. *Id.* at 951.

190. *Id.* at 952.

191. *Id.* at 953.

192. *Id.* at 953-54. As to "reasonableness," the court noted that it must be determined that "the amount is excessive under the prudent uninsured standard," in order to allow a remittitur to reduce the damages to a proper amount. *Id.* at 954 (quoting *Rhodes v. Chicago Ins. Co.*, 719 F.2d 116 (5th Cir. 1983)). The court's assertion that the insured is freed from the policy conditions when it rejects a defense subject to reservation is erroneous. If the duty to defend is not breached, then there is no excuse for the insured sufficient to permit non-compliance with its own contractual obligation.

193. 744 S.W.2d 940 (Tex. 1988).

194. *Olympia*, 896 F.2d at 954 (discussing *Ranger Ins. Co. v. Rogers*, 530 S.W.2d 162 (Tex. Civ. App.—Austin 1975, writ ref'd n.r.e.) (insurer who tenders defense subject to reservation precluded from contesting reasonableness of consent judgment)).

195. *Id.* at 955. This rule is devoid of logic. An insurer denying coverage and an insurer reserving coverage defenses are both in conflict with the insured and could not possibly be in

reservation, the insurer has no need to collaterally attack the judgment because it could not bind it under *res judicata* or collateral estoppel.¹⁹⁶

Finally, the court held that the exclusion of evidence of the underlying settlement to show conspiracy to establish coverage was within the trial court's broad discretion.¹⁹⁷ The court reasoned that evidence that a settlement was entered six months after the alleged conspiracy was too shallow to meet the threshold of relevance necessary in such an action.¹⁹⁸

J. Cooperation

In *Insurance Co. of North America v. Southwestern Bell Telephone Co.*¹⁹⁹ the insured disappeared after the insurer entered a defense on his behalf. The insured's pleadings were eventually stricken for failure to answer discovery requests and a default judgment on behalf of the plaintiff was entered. The claimant then filed a garnishment action against the insurer. The insurer urged that it had no duty to pay because the cooperation clause of the policy had been violated by the insured's disappearance.²⁰⁰ The claimant argued that the failure to cooperate could not have harmed the insurer because its insured was strictly and automatically liable for damaging an underground telephone conduit. The court correctly rejected this argument, noting that strict liability applied only where the utility company had no notice of the danger to its lines.²⁰¹ Finally, the court held that it did not matter what standard — material or substantial or prejudice — applied in determining if the breach by the insured of the cooperation clause was actionable.²⁰² The court reasoned that either the striking of pleadings or the entry of a default judgment was sufficient to raise a fact issue precluding summary judgment on behalf of the insured.²⁰³

K. Professional Services/Policy Limits

In *Guaranty National Insurance Co. v. North River Insurance Co.*²⁰⁴ the court held that a malpractice and professional services exclusion barring coverage for bodily injury occurring "due to . . . the rendering of or failure to render . . . any service or treatment conducive to health or of a professional nature," did not bar coverage under a general liability policy for a hospital/insured's failure to monitor patients, repair windows, and maintain an adequate staff with respect to a psychiatric unit.²⁰⁵ The court interpreted

privity. It is only in the peculiar public policy vortex of insurance law that parties in conflict are treated as having such similar interests that they are said to be in privity.

196. *Id.* at 955 n.2.

197. *Id.* at 957.

198. *Id.*

199. 790 S.W.2d 812 (Tex. App.—Austin 1990, no writ).

200. *Id.* at 814.

201. *Id.* The court indicated that Bell had given inaccurate information as to the location of the lines and thus strict liability was inapplicable. *Id.*

202. *Id.*

203. *Id.* at 816.

204. 909 F.2d 133 (5th Cir. 1990).

205. *Id.* at 135.

the exclusion "to avoid coverage only for actions taken on behalf of a patient that were based on professional, medical judgment."²⁰⁶ The court noted that the failure to maintain a window so as to prevent the claimant's spouse from committing suicide did not involve the exercise of professional judgment where the decision to provide the protection had been made, but the plan to provide the protection was inadequately effectuated.²⁰⁷ The court specifically noted that the failure to adequately maintain the window involved a determination of whether the screws in the window sashes would be sufficient. The court characterized this as an administrative, rather than a medical, decision.²⁰⁸ The court looked to cases from other jurisdictions in which the use of equipment was involved in the accident. The court noted that in each case the courts found that the exclusion did not preclude coverage where the services in question did not require professional training as a prerequisite to performance.²⁰⁹

206. *Id.*

207. *Id.* at 136.

208. *Id.*

209. *Id.* (discussing *Duke University v. St. Paul Fire & Marine Ins. Co.*, 96 N.C. App. 635, 386 S.E.2d 762 (1990) (holding that injury to patient as she attempted to get out of specially designed dialysis chair where the casters of the chair had not been properly locked did not involve "professional services"), *review denied*, 326 N.C. 595, 393 S.E.2d 876 (1990); *D'antoni v. Sarah Mayo Hospital*, 144 So.2d 643 (La. App. 4th Cir. 1962) (holding that failure to raise side rail on hospital bed did not fall within the professional services exclusion)). The court recognized that some courts have in fact broadly construed the exclusion to destroy coverage. *Id.* (discussing *Antles v. Aetna Cas. & Surety Co.*, 221 Cal. App. 2d 438, 34 Cal. Rptr. 508 (1963) (holding that exclusion barred coverage for suit involving accident in which a negligently-mounted heat lamp fell on patient)). The court appears to have gone to great lengths to effectuate the distinct purposes of professional liability and general liability policies. The courts have recognized that these two types of policies were "intended to insure different risks, even if there is a small area in which the policies overlap." *Ratliff v. Employers Liab. Assurance Corp.*, 515 S.W.2d 225, 230 (Ky. 1974). There are at least two types of policies necessary for a professional: "professional liability insurance against liability stemming from rendering or failing to render any professional services, and a general liability policy against negligent acts stemming from premises and operations hazards." FC & S Bulletin (Casualty & Surety Section), *Public Liability Dma-1* (May 1981).

The court's discussion of the case authority in other jurisdictions is somewhat misleading. The vast majority of cases involving coverage questions where the underlying claim is one for negligent handling of equipment have held that such liability involves the rendition of "professional services." Annotation, *Coverage and Exclusions of Liability or Indemnity Policy on Physicians, Surgeons and Other Healers*, 33 A.L.R. 4th 4, § 10 (1984). One of the leading cases in this area is *American Policy Holder's Ins. Co. v. Michota*, 156 Ohio St. 578, 103 N.E.2d 817 (1952), in which the underlying claim involved the operation and maintenance of a hydraulic chair used by the physician in his work. The court held that "maintenance of the treatment chair in a proper and safe condition for the accommodation of patients was a service or duty directly connected with the practice by [the defendant] of his profession . . ." *Id.* at 819; see also *Harris v. Firemen's Fund*, 257 P.2d 221, 225 (Wash. 1953) (holding that injuries suffered by patient when on examination table fell within exclusion; emphasizing exclusion was broader than simply malpractice; adding that the equipment had been specially designed for rendition for professional services and was part of equipment of profession).

Nevertheless, the *Guaranty* court's opinion is indicative of a growing trend carefully analyzing the precise nature of the equipment and its use. Some courts have recognized that where the use of the equipment in question involves a purely mechanical act, the exclusion is not involved. See, e.g., *Grant v. Touro Infirmary*, 254 La. 204, 223 So. 2d 148, 151 (1969) (holding that sponge counting did not involve rendition or professional services because it was a mere mechanical manual act); *Gulf Ins. Co. v. Gold Cross Ambulance Serv. Co.*, 327 F. Supp. 149, 154-55 (W.D. Okla. 1971) (holding that ambulance services' refusal to transport patient in-

Importantly, the court in *Guaranty* suggested that while the maintenance of the window involved a business/administrative action, the failure to properly observe the patient did in fact involve professional services.²¹⁰ The court found that the failure to maintain and the failure to observe were in fact independent causes.²¹¹ The court noted that under Texas law, the insurer is liable where the loss is caused "by a covered peril and an excluded peril that are independent causes of the loss"²¹²

involved "manual labor" and thus did not amount to "professional services"); *D'antoni*, 144 So. 2d at 646. Other courts have held that all activity at a health care facility, such as a convalescent home, are not necessarily professional. *New Amsterdam Casualty Co. v. Knowles*, 95 So.2d 413, 414 (Fla. 1957) (holding that injury as result of falling from bed in nursing home did not involve "professional services"). Other courts have held that where the use of equipment or the premises involves a mere "manual act" and not the use of intellectual or specialized knowledge, then the exclusion is inapplicable. *Keepes v. Doctors Convalescent Center, Inc.*, 89 Ill. App. 2d 36, 231 N.E.2d 274, 276 (App. Ct. 1967) (holding that burn to child on indoor radiator when child was left alone by bathing attendant did not involve "professional services"; merely involved hazard of normal living). In contrast, courts have held that where the equipment is an integral part of the rendition of treatment, "professional services" are in fact involved. For example, in *Antles* the court held that the adjustment of a heating lamp in the rendition of chiropractic services was an integral part of the services provided. The court noted that the manner of adjustment of the lamp, the determination of the duration of exposure, and other factors requires special skill and training; thus, the use of the equipment was imbued with trained mental processes and the exclusion was found to be applicable. Interestingly, the Fifth Circuit did not mention its decision in *Demondre v. Liberty Mut. Ins. Co.*, 264 F.2d 70, 71 (5th Cir. 1959), in which the court found that plaintiff's negligence action against an insured for failing to place sideboards in hospital beds, resulting in a sedated claimant falling out of the bed, did not involve "professional services" as a matter of law. The court listed the following factors to be considered in determining whether a particular claim involves "professional services": 1) whether the act in question was by a professional; 2) examining the principal function of the apparatus in question; and 3) whether the omission to act involved action requested by the patient or whether such action was prescribed by a professional.

Only one Texas court has ever in fact interpreted the meaning of the term "professional services" in the context of an insurance policy. The Fifth Circuit also failed to mention this case. In that case, *Maryland Casualty Co. v. Crazy Water Co.*, 160 S.W.2d 102, 104 (Tex. Civ. App.—Eastland 1942, no writ), the claimant was a guest of a hotel that provided bathing services. Some of the persons taking baths at the hotel did so under a doctor's prescription. The work of the attendants, called "tubbers," required some training and skill, "including the ability to follow directions in a doctor's prescription in giving a bath." Their duties included the preparation of the bath, running of the water, testing the temperature and providing assistance to the bather in getting in and out of the tub. The court made clear that "professional services" refers to services pertaining "to some profession rendered by one in the pursuit of such profession." *Id.* at 103-04. The court added that this term does not include menial services or the services of a common laborer. The court emphasized that special consideration must be given to the specific nature of the *insureds'* task or business. The court held that the insured involved in the case before it was a hotel operator and that the bath house was merely incidental to this particular vocation; thus, the court added that operating a business is not the same thing as operating a profession. The court in *Maryland Casualty* reasoned that a "profession" involves "labor, skill, education, [and] special knowledge" *Id.* at 104-05. The court emphasized that the labor, "as well as the skill, however, involved is predominantly mental or intellectual, rather than physical or manual." *Id.* at 105. The court added that it is of the essence of the term "profession" that the profit should be dependent mainly upon the personal qualifications of the person by whom it is carried on. *Id.* Accordingly, the court held that the "tubber" involved in the case before it was *not* involved in the rendition of "professional services" within the meaning of the exclusionary language in the policy in question.

210. *North River*, 909 F.2d at 137.

211. *Id.* "[T]he jury found that each of the hospital's acts of negligence separately was in proximate cause" of the death. *Id.*

212. *Id.*

The second issue presented in *Guaranty* involved a different policy, the professional liability policy issued by U.S. Fire. The question addressed by the court was whether each claim is based upon the number of injuries or the number of acts of negligence.²¹³ The insured argued that each of the multiple plaintiffs' claims constituted a claim for purposes of the limit of liability section of the policy.²¹⁴ The court rejected the insured's arguments.²¹⁵ The court also rejected arguments that multiple grounds of liability create multiple claims, thus invoking the aggregate limit of the policy.²¹⁶ The court held that this novel theory was neither supported nor had it been adopted by the decisions of the Texas courts.²¹⁷

Judge Gee issued a dissenting opinion urging that the majority's holding with respect to professional services was incorrect. Judge Gee reasoned that "only a medical professional is equipped to assess the degree and character of restraint needful for the safety of a given psychotic patient and that, therefore, such a decision involves a professional judgment — the recognition and weighing of medical, not administrative, risk."²¹⁸ The dissent urged the decision of the Fifth Circuit in *Big Town Nursing Homes, Inc. v. Reserve Insurance Co.*²¹⁹ supported this conclusion.²²⁰

III. AUTOMOBILE INSURANCE

A. Uninsured/Underinsured Motorists

1. Stacking Coverages/Exclusionary Provisions

*Harwell v. State Farm Mutual Automobile Insurance Co.*²²¹ presented two issues: first, whether a plaintiff's underinsured motorists coverage is offset by a payment from an underinsured motorist; and, second, whether an exclusionary provision in one policy prevents stacking of the PIP coverage of the two policies when a plaintiff owns two vehicles that are insured under separate policies. Harwell sustained injuries when his motorcycle collided with an automobile. Harwell suffered \$40,000 in bodily injuries and \$5,000

213. *Id.*

214. *Id.* (citing *Chicago Ins. Co. v. Pacific Indemn. Co.*, 502 F. Supp. 724 (D. Md. 1980); *Pinheiro v. Medical Malpractice Joint Underwriting Assoc.*, 406 Mass. 288, 547 N.E.2d 49 (1989)).

215. The court interpreted Texas case law to "have held that claims by multiple plaintiffs are subject to the single claim limit when each of the plaintiffs' claims arise out of the same single injury or death." *Id.* at 138 (citing *McGovern v. Williams*, 741 S.W.2d 373 (Tex. 1987); *Madisonville I.S.D. v. Kyle*, 658 S.W.2d 149 (Tex. 1983); and *City of Austin v. Cooksey*, 570 S.W.2d 386 (Tex. 1978)).

216. *Id.* at 138 (distinguishing *St. Paul Fire & Marine Ins. Co. v. Hawaiian Ins. & Guar. Co.*, 2 Haw. App. 595, 637 P.2d 1146 (1981)).

217. *Id.*

218. *Id.*

219. 492 F.2d 523 (5th Cir. 1974).

220. The court held in that case that unlawful restraint of a patient involved professional services because the restraint involved the exercise of "a trained nursing judgment in obedience to an established medical policy" and not "a purely physical action in response to a business determination." *North River*, 909 F.2d at 139 (quoting *Big Town*, 492 F.2d at 525).

221. 782 S.W.2d 518 (Tex. App.—Houston [1st Dist.] 1989, no writ). The court withdrew its earlier opinion issued July 27, 1989 and substituted the current opinion.

in medical expenses. Harwell settled with the underinsured motorist's insurer for \$25,000, the full amount of that policy. State Farm, Harwell's insurer, paid him \$2,500 in personal injury protection under his motorcycle policy. Harwell thereafter sued State Farm to recover under his own motorcycle and automobile policies. The case was tried to the bench on stipulated facts.

The trial court found that Harwell's motorcycle policy covered the accident, but refused to stack the motorcycle policy with the other motorist's policy. The court found that since Harwell received payment under the motorist's policy, he was not entitled to any additional recovery under the second policy.²²² Accordingly, the court offset the \$20,000 underinsured motorists coverage in the motorcycle policy by the \$25,000 payment made by the other motorist. The trial court also found that Harwell's automobile policy failed to provide personal injury protection (PIP) because of Harwell's owned vehicle exclusion.²²³

Both of Harwell's policies had \$20,000 per individual underinsured motorists coverage with a maximum of \$40,000 per accident. Each policy provided \$2,500 in PIP. Following *Stracener v. United Services Automobile Association*,²²⁴ the appellate court held that Harwell could recover under the underinsured provision of his motorcycle policy.²²⁵ Since Harwell's damages were stipulated to be \$40,000 and the underinsured's policy paid Harwell \$25,000, \$15,000 damages remained. Under the underinsured provision Harwell was entitled to recover the remaining \$15,000 of his motorcycle policy, which provided \$20,000 in coverage.²²⁶

The court prohibited Harwell from recovering under the PIP provision of his automobile policy as well because Harwell's automobile policy contained an exclusionary clause stating that the policy would not provide PIP coverage for any person for bodily injury sustained while occupying a motor vehicle not covered in the policy declarations.²²⁷ Following the opinion in *Holyfield v. Members Mutual Insurance Co.*,²²⁸ the court found the exclusion to be valid and held that Harwell was not entitled to stack the PIP benefits of his two policies. The court specifically rejected Harwell's argument that *Stracener* instructed the court to stack the PIP benefits of Harwell's two policies. The court noted that the *Stracener* court held that a party's recovery under the uninsured provision of his policy cannot be offset

222. *Id.* at 519.

223. *Id.* The exclusionary clauses under the PIP clause stated:

We do not provide Personal Injury Protection Coverage for any person for bodily injury sustained:

4. While occupying . . . any motor vehicle (other than your covered auto) which is owned by you.

['Your covered auto' is defined as 'any vehicle shown in the declarations.']

224. 777 S.W.2d 378, 382-84 (Tex. 1989).

225. *Id.*

226. *Id.* at 520.

227. *Id.* at 519.

228. 566 S.W.2d 28 (Tex. Civ. App.—Dallas 1978), writ ref'd n.r.e. per curiam, 572 S.W.2d 672 (Tex. 1978).

by the recovery from the underinsured.²²⁹ In *Stracener*, no exclusionary clause precluded recovery. Here, the court found *Stracener* not to be controlling under the facts of this case since such a clause existed and found that the exclusionary provision in the automobile policy validly precluded recovery of \$2,500 PIP from the automobile policy.²³⁰

In *Moore v. State Farm Mutual Auto Insurance Co.*²³¹ the court addressed the question of whether coverage for uninsured or underinsured motorists benefits may be validly excluded for accidents resulting in injuries to an insured while occupying a vehicle other than one covered by the policy in question. Moore sustained his injuries when his vehicle was struck by a trailer that became unhitched from a passing automobile. Moore carried insurance under a policy on his own vehicle and also had coverage under an automobile policy issued to his father and sister with whom he resided.²³² Moore claimed entitlement under the underinsured and personal injury protection benefits of his family's policy in addition to the recovery gained through his own policy even though the family's policy expressly excluded coverage for injuries sustained while in a vehicle owned by any family member not identified in the policy declarations as a covered auto.²³³ Moore urged that, under the decision in *Stephens v. State Farm Mutual Automobile Insurance Co.*,²³⁴ the exclusions were invalid because they deprived him of the coverage required under article 5.06-1 of the Texas Insurance Code.²³⁵ The court of appeals rejected this contention, noting that the requirements of article 5.06-1 did not apply to his family's policy as that policy failed to afford him coverage while he was operating his own vehicle insured under another policy.²³⁶

2. Exclusion for Vehicle Furnished for Regular Use

*Briones v. State Farm Mutual Automobile Insurance Co.*²³⁷ involved a one vehicle accident wherein the passenger, Briones, sustained injuries while neither the truck nor the driver were insured.²³⁸ The injured party's uninsured motorist clause stated that an uninsured motor vehicle does not include any vehicle "owned by or furnished or available for the regular use of

229. *Harwell*, 782 S.W.2d at 520 (citing *Stracener v. United Serv. Auto. Assoc. v. Hestilow*, 777 S.W.2d 378, 382-84 (Tex. 1989).

230. *Id.*

231. 792 S.W.2d 818 (Tex. App.—Houston [1st Dist.] 1990, no writ).

232. *Id.* at 820-21.

233. *Id.* at 821.

234. 508 F.2d 1363, 1367 (5th Cir. 1975).

235. *Moore*, 792 S.W.2d at 821.

236. *Id.* On its face, the opinion appears to involve the broadest form of circular reasoning. Closer examination, however, reveals that the court probably intended to draw a distinction between limitations on coverage for persons insured and the scope of the persons insured under the policy. In other words, it is permissible for an automobile insurer to limit who is insured under the policy even though it is impermissible to limit uninsured-underinsured motorists coverage for those who fall within the class of persons insured.

237. 790 S.W.2d 70 (Tex. App.—San Antonio 1990, writ denied).

238. *Id.* at 71.

the insured or any family member."²³⁹ In the trial court, the parties stipulated that the only question to be litigated was whether the vehicle in which Briones rode was furnished or available for the regular use of Briones. The trial court entered summary judgment in favor of the insurer.

The evidence showed that Briones was an employee of Cervantes Trucking Company, the owner of the truck in question. His principal duty was to drive trucks assigned him. Briones customarily used any one of the five vehicles owned by Cervantes, as assigned to him by Cervantes. He had driven the truck in question regularly for a period of four years. In reviewing the facts of this case, as well as other Texas cases with similar facts,²⁴⁰ the court stated that Briones occupied a vehicle regularly furnished for his use. It concluded, however, that the case was governed by *Stracener*²⁴¹ and, citing *Stracener* at length, focused particularly on the language where the Texas Supreme Court outlined expectations of the insured when purchasing uninsured motorist coverage as well as the purpose of the uninsured motorist statute.²⁴² The court noted that it is doubtful that when Briones purchased the uninsured provision he believed he would not be protected if involved in an accident while a passenger in an uninsured motor vehicle owned by his employer, and driven by an uninsured co-employee.²⁴³

The San Antonio court of appeals also followed a Fifth Circuit opinion that outlined the standard of review used in determining the validity of an exclusionary provision in an uninsured motorists policy.²⁴⁴ That opinion stated that the key is whether the invocation of the exclusion would, under the circumstances of the particular case under consideration, operate to deprive an insured of the protection required by the Texas uninsured motorist statute.²⁴⁵ The court held that exclusionary clauses are invalid restrictions on coverage when they excuse the policy for which a premium has been paid from providing the minimum coverage required by the Texas uninsured motorist statute.²⁴⁶

The court further held that although earlier Texas courts of appeals have upheld the exclusion of coverage when persons are injured in vehicles regularly furnished an insured by third parties from the uninsured motorists cov-

239. *Id.*

240. *Id.* at 72 (citing *Hall v. Southern Farm Bureau Casualty Ins. Co.*, 670 S.W.2d 775 (Tex. App.—Fort Worth 1984, no writ); *International Serv. Ins. Co. v. Walther*, 463 S.W.2d 774 (Tex. Civ. App.—Austin 1971, no writ)).

241. *Id.* (citing *Stracener v. United Serv. Auto. Assoc.*, 777 S.W.2d 378 (Tex. 1989)).

242. *Briones*, 790 S.W.2d at 73. This merely compounds the erroneous terminology used in *Stracener*. The rules of construction in Texas focus on the intent of the parties as reflected in the plain meaning of the four corners of the contract, not on the reasonable expectations of the insured.

243. *Id.*

244. *Id.* at 73-74 (citing *Stephens v. State Farm Mut. Auto. Ins. Co.*, 508 F.2d 1363 (5th Cir. 1975)).

245. *Briones*, 790 S.W.2d at 74.

246. *Stephens*, 508 F.2d at 1367-68 (citing *Westchester Fire Ins. Co. v. Tucker*, 512 S.W.2d 679, 685 (Tex. 1974)); TEX. INS. CODE ANN. art. 5.06-1 (Vernon Supp. 1974).

erage, *Stracener* places serious doubts on the validity of such agreements.²⁴⁷ The court stated its unwillingness to condemn the exclusion of vehicles regularly furnished for the use of the insured in all cases but believed the better posture was to determine on a case-by-case basis whether the invocation of the exclusion would, under the circumstances of the particular case, operate to deprive an insured of the protection required by the Texas uninsured motorists statute.²⁴⁸ Accordingly, the court concluded that under the facts of *Stracener*, to deny the insured recovery under the uninsured motorists clause of his policy would frustrate the intent of the legislature to provide protection for conscientious motorists from financial loss caused by negligent financially irresponsible motorists as is mandated by the inclusion of uninsured and underinsured motorists coverage in the Texas Insurance Code.²⁴⁹

3. Default of Uninsured Motorist/Punitive Damages

In *Government Employees Insurance Co. v. Lichte*²⁵⁰ an uninsured driver, Hayes, struck Mrs. Lichte, the insured motorist. She, joined by her husband, sued their insurance carrier, Government Employees Insurance Company (GEICO). Lichte then joined the uninsured driver in the lawsuit. The uninsured driver failed to answer, and Lichte took a default judgment in the amount of \$100,000 for actual damages and \$400,000 for punitive damages. Lichte obtained a severance of that judgment and then moved for summary judgment against GEICO, which the court granted, for the sum of \$300,000. This amount represented the limit recoverable under the uninsured motorist provisions of the policy. The trial court also rendered judgment for GEICO on its counterclaim seeking declaratory relief, asserting that under the insurance policy provisions GEICO was not liable for punitive damages and/or Lichte's husband's claim for loss of consortium.

GEICO complained that the trial court should not have granted summary judgment since a default judgment was granted to Lichte against the uninsured motorist. The appellate court noted that GEICO could not have represented the uninsured motorist's interest at the default hearing because of a potential conflict of interest. The court noted that nothing in GEICO's policy or Texas law gave GEICO the right to either defend the uninsured motorist or object to the severance of Mrs. Lichte's claims against him. Conversely, Mrs. Lichte had every right to obtain a default judgment against the uninsured motorist and to insure that judgment became final as to him. Had GEICO taken any action preventing Mrs. Lichte from seeking and obtaining what she could from Hayes, GEICO would have arguably breached its duty to her.²⁵¹

Next, GEICO argued that the trial court erred in rendering summary

247. *Briones*, 790 S.W.2d at 74 (citing *Hall v. Southern Farm Bureau Casualty Ins. Co.*, 670 S.W.2d at 775; *International Serv. Ins. Co. v. Walther*, 463 S.W.2d at 774)).

248. *Id.*

249. *Id.*

250. 792 S.W.2d 546 (Tex. App.—El Paso 1990, no writ).

251. *Id.*

judgment for Lichte on her assertion that GEICO failed to plead the policy provision requiring its written consent to be bound by the prior default judgment arising out of Lichte's suit against the uninsured motorist. GEICO's policy provision pertaining to uninsured motorist coverage stated that any judgment for damages arising out of a suit brought without the insurer's written consent did not bind the insurer.²⁵² The court found that Texas Rule Civil Procedure 94 did not apply because the insurer's pleading burden failed to extend to matters affecting the insurer's general obligation to their insured, on which the claimant has the burden of proof.²⁵³ Rule 94 does not require an insurance company to affirmatively plead a provision in the policy that defines coverage.²⁵⁴

The provision in the Lichte's policy with GEICO that required Lichte to obtain GEICO's written consent in order for any judgment against an uninsured motorist to bind the insurer was a matter affecting GEICO's general obligation under the terms of the policy.²⁵⁵ The court held it did not concern a particular cause or risk which comes within a particular exception to the general liability under Texas Rule of Civil Procedure 94.²⁵⁶ Since Lichte failed to obtain GEICO's written consent as required, Lichte's judgment may have been a final binding judgment against the uninsured motorist, but it was not binding on GEICO.²⁵⁷ Accordingly, the appellate court held that the trial court erred in granting summary judgment against GEICO.

Finally, GEICO asserted that the trial court erred in rendering summary judgment awarding Lichte punitive damages because punitive damages are not recoverable under the uninsured motorist coverage provision in the insurance policy.²⁵⁸ The policy declaration sheet provided a \$300,000 limit for uninsured motorist coverage for bodily injury per person.

Citing *Stracener*, the El Paso court of appeals held that article 5.06-1(1) of

252. Although GEICO did not raise lack of written consent in its pleadings, the appellate court found that the provision requiring GEICO's written consent was not a condition precedent to bringing suit. *Id.* at 548.

253. *Id.*

254. TEX. R. CIV. P. 94.

255. *Id.*

256. *Id.*

257. The court cited with approval *Criterion Ins. Co. v. Brown*, 469 S.W.2d 484 (Tex. Civ. App.—Austin 1971, writ ref'd n.r.e.), wherein the policy provision providing for consent was analogous to the one in the *Lichte* case. That court stated that an insured seeking the benefits of his uninsured motorist insurance coverage had several choices:

- 1) Sue his insurance company directly without suing the uninsured motorist;
or
- 2) Obtain the written consent from his insurance carrier and then sue the uninsured motorist alone, the judgment obtained then would be binding on the insurance carrier; or
- 3) Without the consent of his insurance carrier go ahead and proceed against the uninsured motorist. However, any judgment obtained against the uninsured motorist will not be binding on the insurance carrier. Liability and damages will have to be relitigated.

258. *Lichte*, 792 S.W.2d at 548, 549. The uninsured/underinsured coverage provision of the policy stated that the company "will pay damages which a covered person is legally entitled to recover from the owner or operator of an uninsured motor vehicle because of bodily injury sustained by a covered person, or property damage, caused by the accident."

the Texas Insurance Code should be liberally construed to give full effect to the public policy concerns that led to its enactment, such as providing protection to insured motorists from uninsured motorists who are negligent and financially irresponsible.²⁵⁹ The court held that the uninsured/underinsured coverage provision allowing the insured to collect from the insurer those damages the insured would otherwise be entitled to recover from the uninsured motorist does not include coverage for an award of exemplary damages.²⁶⁰ The court reasoned that the purpose of allowing the recovery of punitive damages was to punish the wrongdoer who, in the instant case, was the uninsured motorist and not the insurer.²⁶¹

4. Personal Injury Protection

In *James v. Nationwide Property & Casualty Insurance Co.*²⁶² James was injured while a passenger in a motor vehicle driven by Tarter when an uninsured motorist struck Tarter's car. The parties stipulated that the uninsured motorist committed acts and omissions that negligently proximately caused the damages sustained by James. Nationwide Property covered Tarter and passenger James. James made a claim against the policy's personal injury protection (P.I.P.) provision for reimbursement of medical expenses totalling \$840. Nationwide reimbursed James for these claims. Thereafter, James made a claim for \$4,000 against the policy's uninsured motorists provision. Nationwide refused to pay the \$4,000, stating that it was entitled to an offset for the \$840 previously paid to James under the P.I.P. provision of the automobile policy. The trial court entered summary judgment awarding Nationwide an offset of the sum of \$840 leaving Nationwide obligated to pay James \$3,160.²⁶³

In affirming the trial court's summary judgment, the appellate court cited both article 5.06-3 of the Texas Insurance Code²⁶⁴ and the language of the policy. Article 5.06-3 makes personal injury protection coverage mandatory in Texas personal automobile policies. Article 5.06-3(h)²⁶⁵ allows the insurance carrier an offset on any other liability claims payable to a guest or passenger riding in the insured's vehicle.²⁶⁶ The court held that this Insurance

259. *Id.* (citing *Stracener v. United Serv. Auto. Assoc.*, 777 S.W.2d at 382; *Members Mut. Ins. Co. v. Hermann Hospital*, 664 S.W.2d 325, 327 (Tex. 1984)).

260. *Id.*

261. *Id.* The court's decision attempted to distinguish prior Texas cases allowing coverage for punitive damages. *See, e.g.*, *Ridgway v. Gulf Life Ins. Co.*, 578 F.2d 1026, 1029 (5th Cir.), *reh'g denied en banc*, 583 F.2d 541 (5th Cir. 1978); *Big Town Nursing Home, Inc. v. Reserve Ins. Co.*, 492 F.2d 523 (5th Cir. 1974); *American Home Assurance Co. v. Safway Steel Products Co.*, 743 S.W.2d 693, 701-702 (Tex. App.—Austin 1987, writ ref'd n.r.e.); *Dairyland County Mutual Ins. Co. v. Wallgren*, 477 S.W.2d 341, 343 (Tex. Civ. App.—Fort Worth 1972, writ ref'd n.r.e.). The court's distinction does nothing to rebut *Home Indemnity Co. v. Tyler*, 522 S.W.2d 594 (Tex. Civ. App.—Houston [14th Dist.] 1975, writ ref'd n.r.e.), which held coverage for punitive damages was available under uninsured motorist coverage.

262. 786 S.W.2d 91 (Tex. App.—Houston [14th Dist.] 1990, no writ).

263. *Id.*

264. TEX. INS. CODE ANN. art. 5.06-3 (Vernon 1981).

265. TEX. INS. CODE ANN. art. 5.06-3(h) (Vernon 1981).

266. *Id.*

Code provision allows the insurance carrier to offset any payments made for personal injury against liability insurance claims, including claims for uninsured motorist liability.²⁶⁷ The section of the insurance policy at issue in *James* stated that in order to avoid insurance benefit payments in excess of actual damages sustained, the insurer would pay all covered damages not paid or payable under personal injury protection coverage. Furthermore, the policy stated that any payment under the coverage provided by the policy to or for a covered person would reduce any amount that person was entitled to recover for the same incident under the liability coverage of the policy. Accordingly, the court held that the contract and statute entitled the insurer to take an offset for personal injury protection payments made to James and against amounts claimed by Nationwide for uninsured motorists coverage.²⁶⁸

5. *Government Vehicles As "Uninsured"*

In *United Services Automobile Association v. Blakemore*²⁶⁹ United Services Automobile Association (USAA) denied an uninsured motorist claim arising out of an accident with a government vehicle. Blakemore sued USAA seeking contractual and tort damages arising from USAA's denial of benefits under uninsured motorists insurance coverage of a policy issued Blakemore by USAA. The trial court granted Blakemore's motion for interlocutory summary judgment on the policy coverage issue, holding USAA liable to plaintiff for benefits covered by the uninsured motorists provision and awarding Blakemore \$100,000 plus pre-judgment interest and attorney's fees. Furthermore the trial court severed the coverage question so that the judgment could become final.²⁷⁰

Blakemore was operating his car incident to Army service when Brown hit his vehicle. Brown was driving a military vehicle while in the course and scope of his Army employment at the time of the incident. Undisputedly, Blakemore sustained damages of at least \$100,000.²⁷¹ Brown did not carry liability insurance applicable to the accident.

Relevant portions of the uninsured motorist provisions of the Brown's policy provided that an "uninsured motor vehicle" did not include any vehicle owned by a governmental body unless the operator of the vehicle lacked insurance and no statute imposed liability for damage upon the government.²⁷² The court noted that according to *Feres v. United States*,²⁷³ the government is not liable under the Federal Tort Claims Act for injuries to servicemen where the injuries arise out of or are in the course of activity incident to service.²⁷⁴ Thus, as to Blakemore, no statute imposed liability on

267. *James*, 786 S.W.2d at 94.

268. *Id.*

269. 782 S.W.2d 277 (Tex. App.—Waco 1989, writ denied).

270. *Id.* at 277.

271. *Id.* at 278.

272. *Id.*

273. 340 U.S. 135, 71 S. Ct. 153, 156, 95 L. Ed. 152 (1950).

274. *Id.*

the United States as a consequence of Brown's acts for the Blakemores' injuries received incident to service.²⁷⁵

While the appellate court refused to hold the policy ambiguous, the court noted that where the language is subject to a more reasonable interpretation, the construction which affords coverage will be adopted.²⁷⁶ USAA contended, however, that Blakemore was not legally entitled to recover from Brown as that term is set forth in the uninsured motorist provision of the policy. The court held that the qualification "legally entitled to recover" goes to the ability to establish the uninsured driver's fault and the extent of insured damages in order to recover and does not extend to the uninsured motorist's statute of limitation defense or a governmental immunity defense.²⁷⁷

Significantly, the court noted that the policy language would be rendered absolutely meaningless by the adoption of an interpretation meaning that "legally entitled to recover" conveyed the ability to sue the United States. If the court stated that that interpretation were to be, there could never be a situation wherein uninsured motorists could bring an uninsured claim against the carrier for an accident with a government vehicle.²⁷⁸ Accordingly, the court affirmed the summary judgment of the trial court.²⁷⁹

6. Estoppel To Deny Coverage

In *Hampton v. State Farm Mutual Automobile Insurance Co.*²⁸⁰ a truck driven by Gloria Mahloch struck 8-year-old April Hampton on a residential street. Hilda Hampton, April's mother, witnessed the incident. The Mahlochs had liability insurance covering damages of up to \$15,000 for each person and \$30,000 for each occurrence. The Mahlochs' insurance carrier tendered their policy limits to settle the Hamptons' claim. The Hamptons' attorney advised State Farm of the pendency of suit against the Mahlochs and offered the opportunity to settle the action for the policy limits. The Hamptons carried underinsured motorist coverage with State Farm which had limits of \$50,000 for each person and \$100,000 for each incident.

State Farm's attorney responded to the Plaintiff that if the Hamptons recovered \$30,000 from the Mahlochs, then the balance remaining under the underinsured motorist coverage would only be \$70,000. The letter consented to the settlement with the Mahlochs and stated that the underinsured motorist coverage would become inapplicable at such time as a settlement with the Mahlochs was completed.

After settling with the Mahlochs, the Hamptons made a demand on State Farm for payment of the balance of the underinsured motorist coverage. State Farm, being represented by lawyers different from those previously

275. *Blakemore*, 782 S.W.2d at 278.

276. *Id.*

277. *Id.* at 279.

278. *Id.*

279. *Id.*

280. 778 S.W.2d 476 (Tex. App.—Corpus Christi 1989, no writ).

handling the Hamptons' claim, filed a motion for summary judgment asserting that the judgment settling the Mahloch suit precluded the assertion of any claims against it. The Defendants also asserted that since Greg Hampton had not witnessed the incident causing the injuries to April, he lacked any cause of action. The trial court denied the summary judgment motion on the basis of *res judicata* but granted it as to the ground that April's father had no cause of action for injuries.

The case proceeded to trial and the Hamptons sought damages from State Farm for the injuries to Hilda Hampton in excess of insurance coverage afforded by the Mahlochs and within the limits of the State Farm's underinsured motorist coverage, as well as treble damages, breach of implied covenant of good faith and fair dealing and the violations of the Texas Deceptive Trade Practices Act and the Texas Insurance Code. A jury found both Gloria Ann Mahloch and April Hampton negligent and that their negligence proximately caused the occurrence. The jury further apportioned the negligence sixty percent against Gloria Mahloch and forty per cent against April Hampton. The jury awarded damages in the form of mental anguish suffered by Mrs. Hampton of \$25,000. In addition, it found that State Farm had breached its duty of good faith and fair dealing with regards to policyholder Hilda Hampton.²⁸¹ The trial court, discarding the jury's verdict, entered judgment notwithstanding the verdict for State Farm.

The appellate court found that evidence existed sufficient to support the jury's finding that Gloria was more negligent than April and a judgment disregarding the negligence finding against Gloria was improper. Therefore, the court concluded that the motion for judgment now was erroneously granted and reversed.²⁸²

Finally, State Farm contended that *res judicata* precluded Hilda's recovery because she had already been satisfied by the Mahloch judgment. The Corpus Christi court of appeals found that State Farm's actions led the Hamptons to believe that they would not forfeit their claim to recover the coverage due from State Farm by accepting the policy limits from the Mahlochs. Accordingly, the appellate court held State Farm estopped from using a settlement obtained in this matter to preclude claim liability.²⁸³ The appellate court therefore reversed the trial court and rendered judgment that Hilda Hampton recover \$50,000.00 from State Farm.²⁸⁴

7. *Renewal after rejection of uninsured motorist coverage*

*Berry v. Texas Farm Bureau Mutual Insurance Co.*²⁸⁵ involved an appeal from summary judgments in favor of two insurance companies and a suit for uninsured motorist benefits under four separate policies. Texas Farm Bureau Mutual Insurance Company issued three of the policies and National

281. *Id.* at 478.

282. *Id.*

283. *Hampton*, 778 S.W.2d at 479.

284. *Id.* at 480.

285. 782 S.W.2d 246 (Tex. App.—Waco 1989, writ denied).

County Mutual Insurance Company issued the fourth. Billy and Betty Berry, the insureds under each policy, sued Texas Farm Bureau and National County for uninsured motorist benefits after being injured by an uninsured motorist while occupying a vehicle jointly owned by the Berrys which was insured only under National County's policy.

Texas Farm Bureau received a summary judgment on the ground that its policies excluded any recovery for bodily injury sustained by an insured while occupying an owned but unscheduled vehicle. The court based National County's summary judgment on the ground that the automobile being driven by the Berrys lacked uninsured motorists coverage because Betty Berry, the named insured, had rejected such coverage on the original policy and was suing on a renewal policy.

Texas Farm Bureau's three policies contained an exclusion that barred recovery of uninsured motorist benefits by an insured who sustained bodily injury while occupying an owned but uninsured vehicle. The Berrys contended that the exclusion could not be enforced because it restricted the uninsured motorist coverage mandated by article 5.06-1. The court noted that since the decision in *Holyfield* Texas appellate courts have consistently upheld the exclusion in suits involving uninsured motorist coverage.²⁸⁶ Thus, the appellate court upheld the summary judgment granted to Texas Farm Bureau based on the exclusion.²⁸⁷

Under the National County policy, the declaration page stated that the Berrys' automobile was not insured for uninsured or underinsured motorist coverage. Article 5.06-1(1) provides in part that uninsured and underinsured motorist coverages does not apply if the named insured rejects the coverage in writing.²⁸⁸ Further, the uninsured motorist coverage does not have to be included in renewal policies.²⁸⁹

The question presented to the court asked whether the policy in effect on the date of the accident was a renewal policy as that term is used in article 5.06-1(1). Specifically the parties asked the court whether the legislature's intent was to require a written rejection of uninsured motorist coverage on every new, separate and distinct contract between the parties, although each successive policy is connected in an unbroken chain of coverage back to the original or initial policy on which uninsured motorist coverage was rejected. The Berrys claimed that each policy issued after the initial policy was an original, not a renewal policy, because each had a new policy number and was complete in and of itself. Furthermore, the declaration page of the policy stated that it was the "original policy declarations." Although the Berrys originally rejected in writing underinsured motorist coverage in

286. *Barry*, 782 S.W.2d at 247 (citing *Beaupre v. Standard Fire Ins. Co.*, 736 S.W.2d 237, 239 (Tex. App.—Corpus Christi 1987, writ denied); *Broach v. Members Ins. Co.*, 647 S.W.2d 374 (Tex. App.—Corpus Christi 1983, no writ); *Equitable Gen. Ins. Co. v. Williams*, 620 S.W.2d 608, 611 (Tex. Civ. App.—Dallas 1981, writ ref'd n.r.e.)).

287. *Id.*

288. TEX. INS. CODE ANN. art. 5.06-1(1) (Vernon 1981) (emphasis added).

289. *Id.*

connection with the original policy issued by National County, a new written rejection was not included in subsequent policies.

The court considered the general rule set forth in *Great American Indemnity Co. v. State*,²⁹⁰ which provides that a renewal of a policy constitutes a separate and distinct contract for the period of time covered by the renewal, except where the provisions of the extension certificate show that the purpose and intention of the parties was not to make a new contract but was to continue the original contract in force with such limitation found in clear and unambiguous terms within the four corners of the certificate.²⁹¹ The court also looked to the accepted definitions of "renew," and determined that the legislature intended the term "renewal policy" to include new contracts that "begin again," "recommence," "resume," "re-establish," "re-create," and "replace" a preceding policy without a lapse of coverage.²⁹² Accordingly, National County was not obligated to provide uninsured motorist coverage in the policy sued on because Betty Berry had rejected such coverage in writing in connection with the issuance of the initial policy period.²⁹³ Thus, the summary judgments were affirmed.²⁹⁴

*Sims v. Standard Fire Insurance Co.*²⁹⁵ presented similar issues. The policy in question contained an endorsement in which the insured, Sims, expressly agreed that the statutorily required uninsured/underinsured motorists and personal injury protection coverages would not apply when the insured's vehicle was operated by her sister.²⁹⁶ When the insured sued the insurer to recover for injuries she sustained as a passenger while her sister was driving the insurer urged that the endorsement precluded its liability as a matter of law.²⁹⁷ The insured agreed that although the insured may validly reject both coverages in a written instrument, under the Texas Supreme Court's decision in *Unigard Security Insurance Co. v. Schaefer*,²⁹⁸ any attempt, short of complete rejection, to limit coverage under the policy's personal injury protection benefits was statutorily impermissible.²⁹⁹ The court in *Sims* rejected this contention by noting that although the decision in *Unigard* stated that coverage limitations other than written rejections were invalid, the court in *Unigard* only considered the *manner* of the rejection and not the *scope* of the rejection.³⁰⁰ Accordingly, the court in *Sims* held that the endorsement in which the insured expressly rejected personal injury protection coverage when her sister operated the covered vehicle was valid and consistent with article 5.06-3 even though it was not a total rejection.³⁰¹

290. 229 S.W.2d 850, 853 (Tex. Civ. App.—Austin 1950, writ ref'd).

291. *Id.*

292. 782 S.W.2d at 249.

293. *Id.*

294. *Id.*

295. 781 S.W.2d 328, 329-31 (Tex. App.—Houston [1st Dist.] 1989, writ denied).

296. *Id.* at 329-30.

297. *Id.* at 331-32.

298. 572 S.W.2d 307, 307 (Tex. 1978).

299. *Sims*, 781 S.W.2d at 329-30.

300. *Id.* at 331.

301. *Id.*

Concerning the uninsured/underinsured motorists benefits, the insured urged that the rejection endorsement was also invalid because it had not been attached to the policy, either at the time it was originally issued or when it was renewed.³⁰² Although some evidence on this point presented the possibility that the endorsement may not have been attached, the court concluded that because the evidence was undisputed that the insured had requested, agreed to, and signed the endorsement, the mere failure, if any, to attach the endorsement to the policy did not affect its validity.³⁰³

B. Other Automobile Cases

1. Waiver of Forfeiture

Although a policy may be forfeited for the failure to pay premiums, an insurer may waive the right to forfeit the policy if it engages in unequivocal conduct inconsistent with that right.³⁰⁴ In *Schachar v. Northern Assurance Co.*³⁰⁵ the court expanded the circumstances constituting a waiver by holding that the mere retention of the policyholders' check and failure to notify the policyholders that it had cancelled the policy was conduct sufficiently inconsistent to relinquish the right to treat the policy as having been forfeited.³⁰⁶ Shortly after mailing the original bill, the insurer notified the policyholders that their policy would be cancelled if payment was not received within one week of the stated due date.³⁰⁷ On the due date, the policyholders mailed their payment by check to the insurer.³⁰⁸ When the insurer presented the check for payment, the bank refused to honor it.³⁰⁹ The insurer, however, neither notified the policyholders nor returned the check until after the cancellation date had passed and the policyholders' car had been stolen.³¹⁰ The court reasoned that the insurer, under these circumstances, waived its right to forfeiture of the policy on the ground that retaining the dishonored check, and, hence, the cause of action for collection together with the failure to notify the policyholders that their policy had been cancelled was inconsistent with treating the policy as having been canceled prior to the theft.³¹¹

2. Persons Insured

In *Neilson v. Allstate Insurance Co.*³¹² the court addressed the question of

302. *Id.*

303. *Id.* at 333 (citing *Fidelity Union Life Ins. Co. v. Methven*, 162 Tex. 323, 325, 346 S.W.2d 797, 800 (1961); *Travelers Indem. Co. v. Columbus State Bank*, 442 S.W.2d 479, 482 (Tex. Civ. App.—Houston [1st Dist.] 1969, no writ)).

304. *Bankers Life & Loan Ass'n. of Dallas v. Ashford*, 139 S.W.2d 858, 860 (Tex. Civ. App.—Galveston 1940, no writ).

305. 786 S.W.2d 766 (Tex. App.—Dallas 1990, writ denied).

306. *Id.* at 768, 769.

307. *Id.* at 768.

308. *Id.*

309. 786 S.W.2d at 766.

310. *Id.* at 767.

311. *Id.* at 768.

312. 784 S.W.2d 735 (Tex. App.—Houston [14th Dist.] 1990, no writ).

whether a deceased named insured's legal representative was insured under an automobile policy renewed in the deceased insured's name after the named insured's death. The policy in question provided that if the named insured died during the policy period, the insured's legal representative was insured under the policy to the extent of the representative's obligation to use or maintain the deceased's automobile.³¹³ The policy, however, expressly provided that coverage would end at the end of the policy period.³¹⁴ Finding this provision clear and unambiguous, the appellate court held that the policy afforded no coverage to the legal representative of the deceased who renewed the policy in the name of the deceased insured without advising the insurer of the insured's death.³¹⁵ The court explained that adopting a contrary rule would materially alter the insurer's risk as well as violate the express terms of the policy.³¹⁶ The court also rejected the legal representative's contention that the insurer was estopped to deny coverage by having accepted premium payments.³¹⁷ It explained that while doctrines of waiver and estoppel may be invoked to prevent a forfeiture of policy benefits, they may not be used to materially alter the nature of the risks covered by an insurance policy.³¹⁸

3. "Other Insurance" Clauses

In *U.S. Fire Insurance Co. v. Aetna-Casualty & Surety Co.*³¹⁹ the primary and excess insurers of a vehicle involved in a fatal collision, settled the wrongful death claim for an amount in excess of the limits of the primary policy insuring the vehicle.³²⁰ The excess carrier then sued the driver's primary insurer to recover the amount paid in settlement on the theory that the excess carrier's duty to contribute to the settlement did not arise until after the driver's primary insurer had paid its policy limits.³²¹ The excess policy provided that if insurance coverage was available under another policy other than that "specifically purchased as being in excess of this policy," the excess policy's coverage would be excess over such other insurance.³²² Further, a manuscript endorsement on the excess policy provided that the excess "policy [would] apply regardless of the existence of other insurance that would apply on the same basis."³²³ The excess carrier argued that "insurance . . . on the same basis" referred only to other true excess policies and, therefore, its policy applied only in excess of all other primary policies. The driver's

313. *Id.* at 737.

314. *Id.*

315. *Id.* at 736.

316. 784 S.W.2d at 737.

317. *Id.*

318. *Id.*; see also *Minnesota Mut. Life Ins. Co. v. Morse*, 487 S.W.2d 317, 320 (Tex. 1972) (insurer not estopped by incontestability clause); *Parchman v. United Library Life Ins. Co.*, 640 S.W.2d 694, 697 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd n.r.e.) (beneficiary not entitled to raise issue of waiver).

319. 781 S.W.2d 394 (Tex. App.—Houston [1st Dist.] 1989, no writ).

320. *Id.* at 395-96.

321. *Id.* at 396.

322. *Id.*

323. *Id.*

primary carrier responded, however, that "insurance . . . on the same basis" referred to any other insurance in excess of the primary coverage for the vehicle, regardless of whether that policy was issued as primary or excess insurance. On the basis of this interpretation, the primary carrier concluded that the coverage afforded by the excess policy for the vehicle was prior to its coverage because its other insurance clause declared that the driver's primary policy was in excess of any other applicable insurance. The court of appeals agreed with the primary insurer holding that the primary policy was in excess of the excess policy because the latter policy was "not the kind of 'umbrella' policy that comes into play only when all other . . . insurance has been exhausted" but rather was one which "applie[d] when *its* underlying insurance [was] exhausted."³²⁴ The court reached this conclusion by treating the endorsement concerning "other insurance . . . on the same basis" as superceding rather than supplementing the "other insurance" clause in the body of the excess policy.³²⁵

The decision of the court is directly contrary to the decisions of the Houston's Fourteenth District court of appeals in *Carrabba v. Employers Casualty Co.*,³²⁶ and *Liberty Mutual Insurance Co. v. United States Fire Insurance Co.*,³²⁷ in which the court specifically held that an excess policy is always intended to be over and above true primary policies, regardless of the presence of excess "other insurance" clauses in such primary policies.³²⁸

In *United States Fire* the court concluded that a manuscript endorsement stating that the United States Fire policy would apply "regardless of the existence of other insurance that would apply on the same basis" differed from the language utilized in *Liberty Mutual* and *Carrabba*. The court failed, however, to understand that both of those decisions make very clear that insurance, which applies on the "same basis", means what it says: if the policy is a true excess policy, then the other insurance referred to must itself be true excess coverage. Both *Liberty Mutual* and *Carrabba* make clear that a primary policy with an excess "other insurance" clause does not amount to a true excess policy.

Another distinction attempted by the *United States Fire* court is based upon the titling of the United States Fire policy as an "excess insurance policy" and not an "umbrella" policy as in *Carrabba*. In truth, this distinction is entirely meritless. The court cites to no authority justifying this distinction in treatment. Indeed, the very policy provisions quoted by the court from the U.S. Fire policy make clear that it is virtually identical in all respects to the policies involved in *Carrabba* and *Liberty Mutual*, and, therefore, entitled to similar protection. The court's reading of the term "same basis" completely ignores the context, the interpretation of an excess policy, and is inconsistent with the policies set forth in *Liberty Mutual* and *Car-*

324. 751 S.W.2d at 399. Interestingly, the court confuses "excess" insurance, with true "umbrella" insurance.

325. *Id.*

326. 742 S.W.2d 709, 715 (Tex. App.—Houston [14th Dist.] 1987, no writ).

327. 590 S.W.2d 783, 785 (Tex. App.—Houston [14th Dist.] 1979, writ ref'd n.r.e.).

328. 742 S.W.2d at 715; 590 S.W.2d at 785.

rabba which seek to protect excess carriers so that the availability of excess coverage at low cost can be encouraged.

4. *Scheduled Automobiles/Subrogation/Volunteer*

In *Foremost County Mutual Insurance Co. v. Home Indemnity Co.*³²⁹ the court held that a general liability policy providing coverage for damages because of bodily injury "to which this insurance applies, caused by an occurrence and arising out of the ownership, maintenance or use . . . of any automobile" is in no way restricted to only those automobiles listed on schedules attached to the policy.³³⁰ The court reasoned that the phrase "to which this insurance applies" referred to "bodily injury," not to "any automobile." Thus, the schedule in the policy could not be incorporated into the insuring agreement through that particular phrase. The court explained that if the insured had intended to limit coverage to automobiles listed on the schedule, it could have defined this specifically instead of simply stating "any automobile."³³¹ The court also rejected arguments that the premium schedule suggested that an automobile must be listed on the schedule in order to be classified as an owned automobile. Again, the court urged that if the result had been intended, policy language to this effect could have been used and indeed was used in one of the other insurer's policies involved in the case.³³²

IV. PROPERTY INSURANCE

A. *Rust or Corrosion Exclusion*

*National Fire Insurance Co. v. Valero Energy Corp.*³³³ involved a dispute over a claim made by Valero Energy Corporation for losses due to faulty design of a citrate scrubber. Due to defects and resulting damage, Valero had to shut down its refinery several times between June 1983 and May 1984 in order to make repairs and alterations and to replace faulty components. National Union denied the ten-million-dollar claim based on exclusions in its policy for loss caused by rust or corrosion and for costs of making good faulty workmanship, materials, construction or design.³³⁴ The court found that the exclusion for rust damage did not apply because the evidence showed that sudden and unexpected corrosion occurred as a result of faulty design, rather than by the gradual natural deterioration causing ordinary

329. 897 F.2d 754 (5th Cir. 1990).

330. *Id.* at 756.

331. *Id.*

332. *Id.*

333. 777 S.W.2d 501 (Tex. App.—Corpus Christi 1989, writ denied).

334. The text of the exclusions was as follows:

- (h) Loss or damage caused by rust, corrosion, frost or freezing unless resulting from a peril insured against; . . .
- (j) Cost of making good faulty workmanship, materials, construction or design, but this exclusion shall not be deemed to exclude physical loss or damage arising as a consequence of faulty workmanship, material, construction or design; . . .

777 S.W.2d at 505.

rust. It concluded, therefore, that since faulty design was a peril insured against by the policy, the corrosion damage fell within coverage due to an exception to the exclusion for damage resulting from "a peril insured against."³³⁵ The court also concluded that the exclusion for the costs of "making good" faulty design did not apply due to an exception in the policy to the exclusion for physical damage arising as a consequence of faulty design. It noted that the loss could be characterized in two ways: as loss caused by Valero's need to replace an inadequate transition piece and demisters, and as physical damage to the transition piece and demisters that was a consequence of the faulty design and inadequacy of the components, necessitating the replacement.³³⁶ Without finding specifically that the exclusion was ambiguous, the court stated that it must adopt the construction of an exclusion clause that favors the insured as long as that construction is not unreasonable.³³⁷ The court concluded that the loss must therefore be characterized as one sustained as a consequence of faulty design, bringing it within the exception to the exclusion and thus within the coverage of the policy.³³⁸

The court also found that the trial court did not err in submitting a special issue of coverage under the policy to the jury in broad form.³³⁹ The court stated that it was proper for the trial court to submit instructions to the jury explaining the conditions under which the exclusions and exceptions to the exclusions would affect coverage under the policy. National Union had submitted an instruction with one of its own special issues, but the court of appeals found that the tendered instruction incorrectly instructed the jury to deny coverage if it found that damage to the transition piece resulted from corrosion and did not explain the exception contained in the exclusion for corrosion damage caused by "a peril insured against."³⁴⁰ The court also held that the trial court did not err in submitting the issue of compensatory damages in one broad form issue, adding that the trial court should have given instructions explaining the correct formula for calculating damages under the policy. Such damage instructions, however, were not requested by National Union in the proper form. Although National Union had submitted instructions accompanying its own requested special issues, which were not submitted to the jury, the appellate court held that the trial court should not be required to pick through a party's own tendered instructions to construct an instruction to conform to an issue actually submitted.³⁴¹ Rather, National Union should have objected to the charge and tendered instruc-

335. *Id.* at 506.

336. *Id.*

337. *Id.* (citing *Blaylock v. American Guar. Bank Liab. Ins. Co.*, 632 S.W.2d 719, 721 (Tex. 1982); *Glover v. National Ins. Underwriters*, 545 S.W.2d 755, 761 (Tex. 1977)).

338. 777 S.W.2d at 506.

339. The first special issue asked the jury: "Did a loss occur which was covered and payable under the policy?" The jury answered this issue affirmatively. The second special issue asked the jury: "What was the amount of such loss, if any, payable under the policy?" The jury answered \$10,000,000. *Id.*

340. *Id.*

341. *Id.*

tions on the proper measure of damages in substantially correct form as to the issues submitted by the court.³⁴²

B. Appraisal

In *Hartford Lloyd's Insurance Co. v. Teachworth*³⁴³ the Fifth Circuit determined that a provision in an insurance policy providing for appraisal was not an arbitration agreement governed by the Federal Arbitration Act (FAA). The insured, Teachworth, made claims for hurricane and freeze damage under his Texas multi-peril insurance policy issued by Hartford Lloyd's. When Teachworth and Hartford could not agree on the extent of the damage, Teachworth invoked the appraisal provision in his policy.³⁴⁴ Teachworth's appraiser estimated the total loss at approximately \$4,154,681, while Hartford's appraiser arrived at a figure of approximately \$1,419,951. Pursuant to the policy, the appraisers submitted their differences to an umpire appointed by a Galveston County judge. The umpire agreed in large part with Teachworth's appraiser. The two of them rendered a written appraisal award in the amount of \$3,770,043. Hartford then filed a declaratory judgment action alleging the invalidity of the award because Teachworth's appraiser had not acted impartially and because Teachworth had acted fraudulently during the appraisal process. The trial court determined that the appraisal award was an arbitration award governed by the FAA, and accordingly reviewed the award under sections 10 and 11 of that statute, which circumscribe a court's authority to vacate or modify an arbitration award. The court determined that these sections did not give Hartford the right to a jury trial on the validity of the award, so the validity of the award was tried to the bench, which affirmed on appeal.³⁴⁵ Hartford then argued that the FAA did not apply to appraisal awards. The Fifth Circuit reasoned that insurance appraisals and arbitrations have significant differences because appraisals are informal and typically involve the appraisers conducting their own independent investigation and basing their decisions on their own knowledge to determine only the amount of loss, while arbitrations are quasi-judicial proceedings that involve formal hearings, notice to parties,

342. *Id.*

343. 898 F.2d 1058 (5th Cir. 1990).

344. The appraisal provision read as follows:

Appraisal . . . In case the insured and this Company shall fail to agree as to the actual cash value or the amount of loss, then, on the written demand of either, each shall select a competent and disinterested appraiser and notify the other of the appraiser selected within twenty days of such demand. The appraisers shall further select a competent and disinterested umpire; and failing for fifteen days to agree upon such umpire, then, on request of the insured, or this Company, such umpire shall be selected by a judge of a district court of a judicial district where the loss occurred. The appraisers shall then appraise the loss, stating separately actual cash value and loss to each item; and, failing to agree, shall submit their differences, only, to the umpire. An award in writing, so itemized, of any two when filed with this Company shall determine the amount of actual cash value and loss. Each appraiser shall be paid by the party selecting him and the expenses of appraisal and umpire shall be paid by the parties equally.

Id. at 1059.

345. *Id.*

and testimony of witnesses, and may resolve the entire controversy between parties or merely legal or factual disputes. The court ruled that the insurance appraisal provision in the policy was not an arbitration agreement and therefore that the district court misapplied the FAA, harming Hartford by denying it a jury trial on the validity of the award, applying the wrong standards in assessing that validity, and making factual findings under FAA standards that defeated Hartford's policy coverage defenses.³⁴⁶ The decision was therefore remanded to federal district court for a review of the appraisal under Texas law.³⁴⁷

C. Limitations

In *Bazile v. Aetna Casualty Surety Co.*³⁴⁸ L.N. Bazile sued four insurance companies for denying her claim for a fire loss that occurred on April 17, 1981. Bazile hired a public adjusting firm and an attorney to assist her in filing her claim. The adjuster filed the proofs of loss with the various insurers on August 8, 1981. Three days later, an agent acting on behalf of all four companies rejected the proofs of loss as not timely filed as required by the policies. More than three years later Bazile filed suit. The trial court granted summary judgment on limitations grounds, finding the suit barred under the provisions of the policies that required suit to be brought within a specific time.³⁴⁹ The appellate court held that contractual provisions which limit the time in which to file suit are valid and enforceable. It rejected Bazile's apparent contention that the limitation period did not begin to run because the proofs of loss were not received and accepted by the insurers, holding that the cause of action accrued sixty days after the proofs of loss were rejected, and the limitation period began to run at that time, thus barring Bazile's 1984 lawsuit.

D. Rights Against Guarantors

In *Lexington Insurance Co. v. Gray*³⁵⁰ guarantors of a promissory note sued Lexington Insurance Company to determine their liability to Lexing-

346. *Id.* at 1061-62.

347. *Id.* at 1063.

348. 784 S.W.2d 73 (Tex. App.—Houston [14th Dist.] 1989, writ dismissed). The Texas Supreme Court originally granted writ on this case, but later withdrew consideration and ordered the writ dismissed.

349. Of the three insurance contracts of insurers that were parties to this appeal, all provided in part as follows:

The amount of loss for which this Company may be liable shall be payable sixty days after proof of loss, as herein provided, is received by this Company and ascertainment of the loss is made either by agreement between the insured and this Company expressed in writing or by the filing with this Company of an award as herein provided.

No suit or action on this policy for the recovery of any claim shall be sustainable in any court of law or equity unless all the requirements of this policy shall have been complied with, and unless commenced within two years and one day next after cause of action accrues.

Id. at 74.

350. 775 S.W.2d 679 (Tex. App.—Austin 1989, writ denied).

ton, which insured the property subject to the note. The property had been destroyed by fire, and litigation had established that the property owner had committed arson and therefore was not entitled to recover under Lexington's policy. The lender, InterFirst Bank of Austin, filed this suit against Lexington and Gray, one of the guarantors, claiming that the bank was entitled to the insurance proceeds and that Gray was liable to the bank under his guaranty agreement. Eight days after suit was filed, Lexington paid the bank the whole principal due on the note, with interest. The bank then dismissed its claim and executed an assignment and assignment of deed of trust, giving Lexington all its rights in the mortgage and other securities as provided in the standard mortgage clause under the policy. Lexington and Gray, with the other guarantors who intervened, filed claims against each other. The trial court granted summary judgment for the guarantors.

The appellate court found that where the parties had in effect agreed in advance that the matter would be governed by contract principles instead of equitable principles, there was no reason for the equitable principles usually found in subrogation cases to come into play.³⁵¹ The court held that in a case such as the one before it, in which the mortgagee had, pursuant to a standard mortgage clause, fully assigned the mortgage debt and collateral to an insurer that had paid the entire indebtedness, the relative equities of the party had little, if any, effect on the insurer's right to recover from a third party who owed the mortgagee indemnity but who was innocent of any negligence or other wrongdoing with regard to the original damage or loss to the collateral. Therefore, the court held that the guarantors had not proven as a matter of law that they lacked liability to Lexington under subrogation or assignment.³⁵²

The court also rejected the guarantors' language in the bank's motion to dismiss, stating that payment by Lexington had "fully discharged the liability of any party, including . . . Gray." The appellate court held that because Lexington's payment and the bank's assignment to Lexington occurred

351. The standard mortgage clause found in the policy provided that any reimbursement by Lexington for loss or damage would be payable to the "mortgagee (or trustee) as [its] interest may appear, and this insurance, as to the interest of the mortgagee (or trustee) only therein, shall not be invalidated by any act or neglect of the mortgagor or owner of the within described property." This clause also provided that

[W]henver this Company shall pay the mortgagee (or trustee) any sum for loss or damage under the policy and shall claim that as to the mortgagor or owner no liability therefore existed, this Company shall to the extent of such payment, be thereupon legally subrogated to all the rights of the party to whom such payment shall be made, under all securities held as collateral to the mortgage debt, or may at its option, pay to the mortgagee (or trustee) the whole principal due or to grow due on the mortgage with interest accrued thereon to the date of such payment, and shall thereupon receive a full assignment and transfer of the mortgage and on all such other securities.

Id. at 681. The court stated that this clause provided two options in the event of damage to the property securing the indebtedness to the mortgagee, under circumstances in which the insurer has no liability to the mortgagor: 1) the insurer could pay the mortgagee the amount of the loss or damage and thereupon be "legally subrogated" to all that party's rights; or 2) the insurer could pay the entire principal due or to become due on the note, with interest, and receive a full assignment and transfer of the mortgage. This case involved the second option.

352. *Id.* at 687.

nearly two weeks before the filing of the motion to dismiss, and the guarantors presented insufficient summary judgment evidence to show that the bank had any remaining authority to release the guarantors from liability on the note and that as a result there was at the very least a material fact issue as to the bank's power to declare the note discharged and release the guarantors.³⁵³ The court also found the record inadequate to conclude that a collateral estoppel defense was established as a matter of law because it lacked the pleadings from the Missouri federal court suit filed against Lexington by the insured and therefore could not determine what theory of damages were pursued by Lexington in that court.³⁵⁴

V. LIFE INSURANCE

A. Accidental Death

The Fifth Circuit, in *Chen v. Metropolitan Insurance & Annuity Co.*,³⁵⁵ addressed the issue of whether an individual, who died of alcohol poisoning, died as a result of an accident. On September 18, 1986 Ching Sing Lee died as a result of drinking too much brandy. Lee and a companion had been drinking American alcohol in a Chinese fashion, drinking ice tea glasses of brandy in two or three swallows. The life insurance policy contained an accidental death rider that provided payment in the amount of \$100,000 if "the insured died, directly and independently of all other causes, as the result of an accident."³⁵⁶

Relying upon *Republic National Life Insurance Co. v. Heyward*,³⁵⁷ the Fifth Circuit noted that the question of whether something is an accident depends upon the reasonable anticipation of the insured viewed from the insured's standpoint. In analyzing the standard, the court noted that it is common knowledge that one who goes rock climbing, or bear hunting, or hang gliding, may die. The question is, however, whether the person engaged in the activity should have reasonably believed the activity would cause his death.³⁵⁸ Turning to the facts of the case, the Fifth Circuit held that it was improper for the trial court to rule as a matter of law that Lee should have reasonably foreseen that death was the natural and probable consequence of his ingesting the amount of brandy that he did.³⁵⁹

In what appears to be dictum, the Fifth Circuit went on to construe an exclusion of the policy for death that is caused or contributed to directly or indirectly by the use of any drug without the advice of a licensed medical practitioner.³⁶⁰ While recognizing that dictionaries and scientific journals typically categorize alcohol as a drug, the court noted that the beneficiaries'

353. *Id.* at 688.

354. *Id.*

355. 907 F.2d 566 (5th Cir. 1990).

356. *Id.* at 567.

357. 536 S.W.2d 549 (Tex. 1976).

358. 907 F.2d at 568.

359. *Id.* at 567-68.

360. From the wording of the opinion it is difficult to determine whether this is dictum or not. Apparently, the trial court based its summary judgment for the insurer in part upon this

definition suggested a distinction between "alcohol" and "drug." Applying proper rules of construction, the court determined that it must accept a reasonable construction that favors the insured if one exists. Consequently, the court construed the term "drug" in the policy so as not to include alcohol within the meaning of that term.

B. Application Misrepresentations - Delivery of Application to Insured

In *Wise v. Mutual Life Insurance Co.*³⁶¹ the Fifth Circuit considered whether an insurer may avoid liability on a life insurance policy because of misrepresentations made on the application for the policy. Judge Reavley, writing for the court, noted that typically an insurer may not rely upon such misrepresentations unless a copy of the application has been delivered to the policy holder. After examining Texas case law and the insurance statutes, the court determined that Texas recognizes an exception to the rule that an application must accompany the policy for life insurance. Consequently, the court determined that the failure to attach or deliver a copy of the application with the life insurance policy to the policy holder prior to his death would not prevent the insurer from relying upon the misrepresentations so as to avoid liability on the life insurance policy.³⁶²

In *American Home Assurance Co. v. Brandt*³⁶³ Dow Chemical Company employed Robert Brandt as a pilot and held a life insurance policy for his benefit through American Home Assurance Company. After Brandt died in an airplane crash, the beneficiary sought to recover upon the policy, but American Home relied upon an exclusion in the policy that provided that employees would not be covered for air travel if acting as a pilot or a crew member.³⁶⁴ The central issue in the trial court concerned whether Brandt acted as a pilot of the plane at the time of the crash. The issue submitted to the jury placed the burden of proof to show that the exclusion was operative upon American Home. American Home contended that the burden was upon the insured to show that the occurrence did not fall within the exclusion.

The court of appeals, after examining the issue submitted, held that "once an insurer pleads an exception to the insurance policy coverage, the burden then shifts to the insured to show that the occurrence did not fall within the exception or exclusion of the policy."³⁶⁵ Such a holding is consistent with prior case law in Texas and with Texas Civil Procedure Rule 94.³⁶⁶ While such a rule is consistent with Texas procedure and contract law, the rule is contrary to that in most jurisdictions. In other jurisdictions the insurance

exclusion. However, in a footnote the court noted that Metropolitan had not pursued this exclusion as a basis for denying the accidental death benefits. 907 F.2d at 567 n.1.

361. 894 F.2d 140 (5th Cir. 1990).

362. *Id.* at 141-42.

363. 778 S.W.2d 141 (Tex.App.—Texarkana 1989, writ denied).

364. *Id.* at 142.

365. *Id.* at 143.

366. See *Shaver v. National Title & Abstract Co.*, 361 S.W.2d 867, 869 (Tex. 1962); TEX. R. CIV. P. 94.

company typically bears the burden of proving that a policy exclusion is applicable.³⁶⁷

C. Gross Negligence and Willfulness

The Houston fourteenth district court of appeals considered the question of whether gross negligence constitutes willfulness under the forfeiture provision of life insurance proceeds in the insurance code in *Rumbaut v. Labagnara*.³⁶⁸ The insured's sons by a previous marriage sought to deny the insured's husband the benefit of life insurance proceeds because the sons alleged that the husband had "willfully" caused their mother's death. In its charge to the jury, the court defined willfully in a disjunctive manner as meaning a desire to bring about the physical results of the act or believing such results were substantially certain to follow, or to mean more than intentional conduct which results from momentary thoughtlessness, inadvertence or error of judgment.³⁶⁹ In considering the definition, the court of appeals determined that the definition violated the Texas Supreme Court's definition in *Greer v. Franklin Life Insurance Co.*³⁷⁰ In *Greer* the Court determined that "willfully" requires more than the beneficiary's intent that the death of the insured result from his or her act. It additionally requires the factor of illegality.³⁷¹

After determining that the definition given by the trial court was incorrect, the court of appeals examined whether the evidence was legally sufficient to support a finding of willfulness so as to determine whether it must remand or whether it could render a verdict. The evidence disclosed that the husband and wife set sail in the Gulf of Mexico during the height of hurricane season while neither had experience aboard a sailboat, that the wife had limited swimming skills and that the ship was in poor condition. The evidence also demonstrated that the appellant was in debt without a means to pay off the debt because he had quit work. Based upon this evidence, the court of appeals determined that there was some evidence of willfulness so as to require a remand of the cause to the trial court.³⁷² The dissent, written by Chief Justice Curtiss Brown, argued that the evidence was no evidence, either direct or circumstantial. He concluded that "evidence that this was a two person 'ship of fools' will not meet the test."³⁷³

D. Temporary Life Insurance

In *Tam Nu La v. Aetna Life Insurance Co.*³⁷⁴ the Houston fourteenth district court of appeals considered the question of whether or not an insured was covered by temporary life insurance during the time in which his appli-

367. A. WINDT, *INSURANCE CLAIMS & DISPUTES* § 9.01, at 442-43 & n.2 (2d ed. 1988).

368. 791 S.W.2d 195 (Tex. App.—Houston [14th Dist.] 1990, no writ).

369. *Id.* at 196.

370. 148 Tex. 166, 221 S.W.2d 857 (1949).

371. 221 S.W.2d at 859.

372. 791 S.W.2d at 199.

373. *Id.* at 200 (Brown, C.J., dissenting).

374. 781 S.W.2d 630 (Tex. App.—Houston [14th Dist.] 1989, writ dismissed).

cation for life insurance was being processed. Nguu Huynh applied for life insurance on October 14, 1986. At that time, because he could not afford to pay the premium, he postdated his check for the premium amount to October 30, 1986. Mr. Huynh died October 29, 1986. The widow of the deceased then brought suit claiming benefits under a temporary insurance provision in the application. The trial court granted summary judgment in favor of Aetna based on nonpayment of the premium and on the ground of material misrepresentation in the application.

The court of appeals determined that there was a material fact issue regarding the intent of the decedent as to whether his check was for payment for temporary insurance. With regard to the misrepresentation in the application, the court noted that the misrepresentation appeared in a document entitled "Agent's Report." The court of appeals determined that the misrepresentation as to the amount of life insurance already in force was not established to be a part of the life insurance application. Consequently, the court of appeals determined that summary judgment was improper.³⁷⁵

E. Application Misrepresentations as a Defense to DTPA and Insurance Code Violations

In *Koral Industries, Inc. v. Security-Connecticut Life Insurance Co.*³⁷⁶ Koral sought to obtain a new key-man life insurance policy on the life of Lewis Lindsey from Security-Connecticut because the rates offered by Security-Connecticut were lower than those of Koral's current carrier. In filling out the application, Lindsey did not disclose that he had been hospitalized on three separate occasions and that he had received counseling and treatment regarding depression and the excessive use of alcohol. Security-Connecticut issued a \$1 million insurance policy naming Koral as the beneficiary and as a result of the newly issued policy, Koral allowed its prior policy to expire. In 1986 Lindsey died, and Koral submitted a claim for payment of the policy proceeds. Security-Connecticut discovered Lindsey's omissions and misrepresentations in the application for insurance and thereafter denied payment.

Koral brought suit against Security-Connecticut for breach of a duty of good faith and fair dealing, violation of the Deceptive Trade Practices Act (DTPA), and violations of the Insurance Code. After trial to a jury, the trial court rendered judgment in favor of Koral on all causes of action except for the breach of the duty of good faith and fair dealing and for statutory violations. Both parties appealed. On appeal, Security-Connecticut argued that it had no liability based upon the jury's answers regarding the fraudulent misrepresentations. Security-Connecticut argued that the jury's affirmative answer that Security-Connecticut knew facts which would have put it on inquiry regarding the omissions from the application should be disregarded. After a review of the applicable Texas authority, the court of appeals held

375. *Id.* at 634.

376. 788 S.W.2d 136 (Tex. App.—Dallas 1990), writ denied per curiam, 802 S.W.2d 650 (Tex. 1990).

that the great weight of Texas authority provides that an insurer must have actual knowledge of the misrepresentation before the insured may avoid a defense based on those false representations. In other words, a finding that the insurer "should have known" of the fraud or misrepresentation will be insufficient to prevent an insurer from avoiding liability on a policy in which the insured has made material misrepresentations.³⁷⁷

Koral argued that the misrepresentation defense should only be a valid defense against the breach of contract cause of action and that the other causes of action, DTPA and breach of the duty of good faith and fair dealing, are extracontractual and unaffected by the jury's finding of fraud by Lindsey. The court of appeals disagreed, holding that "a recovery by Koral based on its other causes of action would be inherently inconsistent with the denial of recovery on its breach of contract cause of action."³⁷⁸ Consequently, the court indicated that the defense of misrepresentation is sufficient to avoid liability under the Insurance Code or for breach of the duty of good faith and fair dealing as well as to avoid a breach of contract action.

VI. HEALTH, LIFE AND ACCIDENT INSURANCE

A. ERISA Preemption

Several cases during the survey period address ERISA preemption of state law claims. In *Frankoff v. Mutual Life Insurance Co.*³⁷⁹ the trial court granted summary judgment in favor of Mutual Life in a declaratory judgment action based upon the ERISA preemption.³⁸⁰ The appellate court, however, addressed whether ERISA applied by considering whether the insured was an employee and thus a "participant" under the ERISA statutes.³⁸¹ Mr. Frankoff was a sole practicing attorney who had procured health insurance under a professional group insurance trust.³⁸² Mr. Frankoff counterclaimed against Mutual Life after it filed a declaratory judgment action for cancellation of the policy.³⁸³ Mutual Life denied a claim because of the alleged omissions of Mrs. Frankoff's medical condition.³⁸⁴ Mutual Life obtained summary judgment dismissing the plaintiff's state law cause of action because of the ERISA preemption.³⁸⁵

The appellate court reversed the summary judgment, holding that the evidence establishing the status of Mr. Frankoff lacked sufficiency to consider him an ERISA participant as a matter of law.³⁸⁶ In rendering its holding, the court relied in part on *Peckham v. Board of Trustees*,³⁸⁷ which held that

377. *Id.* at 146.

378. *Id.* at 147.

379. 792 S.W.2d 764 (Tex. App.—Houston [14th Dist.] 1990, writ denied).

380. *Id.* at 764.

381. 29 U.S.C. § 1001 (1988).

382. 792 S.W.2d at 765.

383. *Id.*

384. *Id.*

385. 29 U.S.C. § 1144(a).

386. 792 S.W.2d at 766.

387. 653 F.2d 424 (10th Cir. 1981).

a sole proprietor could not enroll himself along with his employees, thereby creating a dual status.³⁸⁸ The court further held that it was the insurer's burden to adduce summary judgment evidence establishing Mr. Frankoff as an employee/participant as defined under ERISA.³⁸⁹

In another case a federal district court held that the ERISA preemption applied to claims under articles 3.62 and 21.21 of the Texas Insurance Code.³⁹⁰ In *Multicare Health Care Services, Inc. v. General American Life Insurance Co.*³⁹¹ the Court held, without much discussion, that the relief afforded under article 3.62 is preempted by ERISA.³⁹²

In addressing article 21.21 of the Texas Insurance Code, the court concluded that this article is a law regulating insurance within the meaning of the ERISA savings clause.³⁹³ The "savings clause" provides that "nothing in the subchapter shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities."³⁹⁴ The court nevertheless held that the intent of the civil enforcement provisions of ERISA³⁹⁵ is that they provide the exclusive vehicle for participants and beneficiaries to bring suit for improper processing of claims under an ERISA plan.³⁹⁶ Accordingly, the court held that "actions under State statutes which regulate unfair or deceptive insurance practices are preempted by ERISA when the actions are brought by plan participants or beneficiaries."³⁹⁷

In a related matter, the court also held that Multicare, as an assignee of the benefits of the insured, had standing to pursue this cause of action against General American under ERISA.³⁹⁸

In *Pan American Life Insurance Co. v. Erbauer Construction Corp.*³⁹⁹ the court held that ERISA preemption amounts to an affirmative defense that can be waived by a defendant who does not plead the defense and does not offer evidence or obtain findings in the trial court regarding the preemption.⁴⁰⁰ In rendering its holding, the court followed its prior holding in *Cas-*

388. 792 S.W.2d at 766.

389. The court also hinted that it would be wise to include the pertinent provisions of the subject policy in the summary judgment evidence. *Id.*

390. TEX. INS. CODE ANN. art. 3.62, 21.21 (Vernon Supp. 1990).

391. 720 F. Supp. 581 (N.D. Tex. 1989).

392. *Id.* at 582. Article 3.62 provides that an insurer that fails to pay a loss within 30 days after the demand is liable for the amount of the loss, 12% damages on the amount of the loss, and reasonable attorney's fees for the prosecution and collection of said loss. TEX. INS. CODE ANN. art. 3.62 (Vernon Supp. 1990). This court had previously held that article 3.62 is preempted in *Juckett v. Beecham Home Improvement Prod., Inc.*, 684 F. Supp. 448, 451-52 (N.D. Tex. 1988).

393. 720 F. Supp. at 582.

394. 29 U.S.C. § 1144(b)(2)(A).

395. 29 U.S.C. § 1132.

396. 720 F. Supp. at 582.

397. *Id.* (citing *Kanne v. Connecticut Gen. Life Ins. Co.*, 867 F.2d 489, 493-94 (9th Cir. 1988)). The court in *Kanne* held that ERISA preempted § 790.03(H) of the California Insurance Code, which provides a cause of action for unfair insurance practices similar to article 21.21 of the Texas Insurance Code.

398. 720 F. Supp. at 581-82.

399. 791 S.W.2d 146 (Tex. App.—Houston [1st Dist.] 1990, no writ).

400. *Id.* at 149.

*tillio v. Neely's TBA Dealer Supply, Inc.*⁴⁰¹ and the Dallas court of appeals opinion of *Great North American Stationers v. Ball*.⁴⁰²

Erbauer and these two decisions follow a line of cases that hold that the application of the ERISA preemption is a choice-of-law question which can be waived if not timely asserted.⁴⁰³ A cogent dissenting opinion in *Erbauer* addresses the ERISA preemption issue with informative detail.⁴⁰⁴ The dissent explains that the federal courts have exclusive jurisdiction in certain circumstances under ERISA, while in other situations, the federal and state courts have concurrent jurisdictions.⁴⁰⁵ Generally, federal and state courts have concurrent jurisdiction in claims brought by a participant or a beneficiary⁴⁰⁶ to recover benefits under the plan, to enforce rights under the terms of the plan, or to clarify rights to future benefits under the plan.⁴⁰⁷ The dissent holds that most claims under ERISA fall within the exclusive jurisdiction of the federal courts, particularly those brought by a fiduciary.⁴⁰⁸ Because *Erbauer's* claim against Pan American resulted from Pan American's alleged improper handling of *Erbauer's* benefit claims, it was analogous to a breach of fiduciary duty that could be brought by a fiduciary as defined in ERISA.⁴⁰⁹ Accordingly, the dissenting opinion stated that the case should be reversed because the state court lacked subject matter jurisdiction over *Erbauer's* claims.⁴¹⁰

In *Brown v. Granatelli*⁴¹¹ the Tuneup Masters Employee Benefit Plan (Plan) provided group health care benefits for employees of Tuneup Masters and their families, including the Browns.⁴¹² Mr. Granatelli, the owner of Tuneup Masters, purchased excess or "stop loss" insurance from North America Life and Casualty Co. (NALAC).⁴¹³ Under this "stop loss" insurance, NALAC was to reimburse the Plan for claims the Plan pays which

401. 776 S.W.2d 290 (Tex. App.—Houston [1st Dist.] 1989, writ denied).

402. 770 S.W.2d 631 (Tex. App.—Dallas 1989, no writ).

403. See *Dueringer v. General Am. Life Ins. Co.*, 842 F.2d 127, 129-30 (5th Cir. 1988); *Castillio*, 776 S.W.2d at 294; *Ball*, 770 S.W.2d at 633.

404. *Erbauer*, 791 S.W.2d at 159-60 (Dunn, J., dissenting).

405. *Id.* at 159.

406. See 29 U.S.C. § 1002(7)-(8) (1988). ERISA defines "participant" as:

any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer or members of such organization, or whose beneficiaries may be eligible to receive any such benefit.

29 U.S.C. § 1002(7) (1988). ERISA further defines "beneficiary" as a "person designated by a participant, or by the terms of an employee benefit plan, who is or may become entitled to a benefit thereunder." 29 U.S.C. § 1002(8).

407. 791 S.W.2d at 159 (Dunn, J., dissenting); 29 U.S.C. § 1132(a)(1)(B) (1988).

408. *Id.*; 29 U.S.C. § 1132(e)(1) (1988).

409. *Id.*; 29 U.S.C. §§ 1109, 1132(a)(2) (1988).

410. *Id.* This dissenting opinion also has an excellent discussion as to the type of state laws that are preempted by ERISA as well as who has standing to sue under ERISA. *Erbauer*, 791 S.W.2d at 155-159 (Dunn, J., dissenting).

411. 897 F.2d 1351 (5th Cir. 1990) (applying Texas law).

412. *Id.* at 1352.

413. *Id.* at 1353.

exceeds \$30,000 for any covered individual during the policy year.⁴¹⁴ The Plan was amended to exclude coverage for all newborn babies until the thirty-first day after birth. Also excluded was coverage for any baby that was disabled, hospitalized, or sick on that thirty-first day.⁴¹⁵

The Browns incurred significant medical expenses because of physical problems and birth defects of two premature babies. After the Browns filed suit in state court against the Plan and Granatelli, the defendants removed the case to federal court and joined NALAC as third-party defendant. The Browns thereafter sought summary judgment on the basis that article 3.70-2(E) of the Texas Insurance Code⁴¹⁶ required the Plan and NALAC's policy to provide coverage for newborns.⁴¹⁷ The court granted summary judgment for the defendants, holding that ERISA preempted article 3.70-2(E) and the Plan was not structurally defective.⁴¹⁸

The parties stipulated to various facts, apparently one of which was that the Plan was an Employee Benefit Plan within the meaning of ERISA.⁴¹⁹ The Fifth Circuit court of appeals affirmed the district court and held that article 3.70-2(E) does not apply to the "stop-gap" insurance purchased by the Plan.⁴²⁰ The court reasoned that stop loss insurance was not "accident and sickness" insurance as addressed in article 3.70-2(E).⁴²¹ Furthermore, the court held that because of ERISA's "deemer clause," the state is preempted from requiring the plan to include losses because of newborns with congenital defects.⁴²² The court then reasoned that the Plan's payments to beneficiaries "cannot be considered insurance payments."⁴²³

The Court in *Brown* further held that the "stop loss" policy that the Plan purchased does not qualify as either an individual or a group policy because the Plan was the beneficiary, not individuals.⁴²⁴ Accordingly, article 3.70-2(E) is not applicable because its mandates apply only when a policy's

414. *Id.* NALAC had no authority to approve or disapprove claims submitted, to manage the Plan, or to approve changes in the Plan itself. *Id.*

415. *Id.* at 1353.

416. TEX. INS. CODE ANN. art. 3.70-2(E) (Vernon 1981).

417. 897 F.2d at 1353.

418. *Id.*

419. *Id.* at 1352. Article 3.70-2(E) provides, in pertinent part, that:

No individual policy or group policy of accident and sickness insurance . . . delivered or issued for delivery to any person in this state which provides for accident and sickness coverage of additional newborn children or maternity benefits, may be issued in this state if it contains any provisions excluding or limiting initial coverage of a newborn infant for a period of time, or limitations or exclusions for congenital defects of a newborn child.

TEX. INS. CODE ANN. art. 3.70-2(E) (Vernon 1981).

420. 897 F.2d at 1353.

421. *Id.* at 1354; *Cuttle v. Federal Employees Metal Trades Council*, 623 F. Supp. 1154, 1157 (D. Me. 1985); *cf. United Food & Commercial Workers & Employers Arizona Health & Welfare Trust v. Pacyga*, 801 F.2d 1157, 1161-62 (9th Cir. 1986).

422. 897 F.2d at 1353-54. The "deemer clause" provides, in pertinent part, that no Employee Benefit Plan shall be deemed to be an insurance company . . . or to be engaged in the business of insurance . . . for purposes of any law of any state purporting to regulate insurance companies. 29 U.S.C. § 1144(b)(2)(B) (1988).

423. 897 F.2d at 1355.

424. *Id.*

primary coverage is for health and accident coverage. The "stop loss" policy was purchased primarily to cover the Plan's catastrophic losses. The court carefully warned that employers could not avoid the mandates of article 3.70-2(E) by merely naming an employee benefit plan as the insured on a policy that, in essence, actually insures the Plan's participants.⁴²⁵

B. Application of Article 21.21 to Employer's Benefit Program

In *Texas Health Enterprises, Inc. v. Gentry*⁴²⁶ the court held that an employee could not maintain a cause of action under article 21.21 of the Texas Insurance Code⁴²⁷ against her employer, who was not a subscriber to the Texas Worker's Compensation Act.⁴²⁸ In *Gentry*, the employer provided the Plaintiff an employee handbook that listed "Worker's Compensation" as an employee benefit.⁴²⁹ After the employer denied Mrs. Gentry's claims for compensation for an on-the-job injury, she brought suit for violations of article 21.21, breach of contract and negligence.⁴³⁰ The court held that the employers' benefit program was incidental to its business of nursing home care.⁴³¹ Accordingly, it held that article 21.21 would not apply because it was enacted to regulate trade practices in the "business of insurance."⁴³²

C. Policy Exclusion

In *Pierce v. Benefit Trust Life Insurance Co.*⁴³³ the accident insurance policy excluded, *inter alia*, an accident or loss caused, or contributed to, by a hernia of any kind.⁴³⁴ The insured suffered a hernia from lifting a fifty pound bag from the trunk of a car.⁴³⁵ The insured alleged that Benefit Trust was not entitled to summary judgment because the exclusion was ambiguous. The insured alleged that the loss was not caused by a hernia, but rather by the lifting incident.⁴³⁶

The court disagreed, holding that the exclusion was not ambiguous and that the hernia did not result from an "accident."⁴³⁷ The court reasoned that the insured had intentionally lifted the bag from the car; therefore, the hernia was not a result of an accident, although it was unexpected and

425. *Id.* Justice Brown issued a cogent dissenting opinion wherein he argues, *inter alia*, that the "stop loss" insurance policy is a policy subject to article 3.70-2(E) because it effectively reimburses employees for certain eligible expenses, and because the parents of the children are necessary third-party beneficiaries of the "stop loss" protection of the Plan. *Id.* at 1357 (Brown, J., dissenting).

426. 787 S.W.2d 604 (Tex. App.—El Paso 1990, no writ).

427. TEX. INS. CODE ANN. art. 21.21 (Vernon 1981 & Vernon Supp. 1990).

428. *Id.* at 606-07.

429. *Id.*

430. *Id.*

431. *Id.* at 607.

432. *Id.*

433. 784 S.W.2d 516 (Tex. App.—Amarillo 1990, writ denied).

434. *Id.* at 517.

435. *Id.*

436. *Id.* at 518.

437. *Id.*

unintended.⁴³⁸

D. Misrepresentation

In *Soto v. Southern Life & Health Insurance Co.*⁴³⁹ the court held that in Texas there is no affirmative defense of negligent misrepresentation concerning the avoidance of life insurance policies.⁴⁴⁰ Mrs. Soto brought suit against Southern Life for proceeds under a life insurance policy insuring her deceased husband.⁴⁴¹ Southern Life pleaded and proved the affirmative defenses of misrepresentations and fraud.⁴⁴² The trial court submitted a jury question asking whether Mr. Soto was *negligent* in misrepresenting his health in response to questions on the application.⁴⁴³ The Corpus Christi court of appeals held that this submission constituted error because, under Texas law, the insurer must plead and prove that the insurer *willfully* and *intentionally* made a material misrepresentation.⁴⁴⁴ Accordingly, a negligence issue on misrepresentation was improper. The court held, nevertheless, that this error was harmless because the jury also affirmatively found in a separate question in the charge that Mr. Soto knew that representations were false and that they were intended to deceive Southern Life into issuing him a life insurance policy.⁴⁴⁵ Accordingly, the court of appeals affirmed the trial court's judgment.⁴⁴⁶

438. *Id.* (citing *Argonaut Southwest Ins. Co. v. Maupin*, 500 S.W.2d 633, 635 (Tex. 1973)).

439. 776 S.W.2d 752 (Tex. App.—Corpus Christi 1989, no writ).

440. *Id.* at 756.

441. *Id.* at 753-54.

442. *Id.* at 755.

443. *Id.* at 756.

444. *Id.* (citing *Allen v. American Nat. Ins. Co.*, 380 S.W.2d 604, 607-08 (Tex. 1964); *Republic-Vanguard Life Ins. Co. v. Walter*, 728 S.W.2d 415, 418 (Tex. App. Houston, [1st Dist.] 1987 no writ); *Allied Bankers Life Ins. Co. v. De La Cerda*, 584 S.W.2d 529, 533-34 (Tex. Civ. App.—Amarillo 1979, writ ref'd n.r.e.); *Beynum v. Signal Life Ins. Co.*, 522 S.W.2d 696, 698 (Tex. Civ. App.—Dallas, 1975, writ ref'd n.r.e.); *Haney v. Minnesota Mut. Life Ins. Co.*, 505 S.W.2d 325, 328 (Tex. Civ. App.—Houston [14th Dist.] 1974, writ ref'd n.r.e.). The essential elements of a misrepresentation affirmative defense to avoid the insurance policy are the following: "1) the making of a representation by the insured; 2) the falsity of the representation; 3) reliance thereon by the insurer; 4) intent to deceive on the part of the insured; and 5) the materiality of the representation." 776 S.W.2d at 756 (citing *Mayes v. Massachusetts Mut. Life Ins. Co.*, 608 S.W.2d 612, 616 (Tex. 1980); *Southern Life and Health Ins. Co. v. Medrano*, 698 S.W.2d 457, 461 (Tex. App.—Corpus Christi 1985, writ ref'd n.r.e.)).

445. 776 S.W.2d at 756.

446. *Id.*