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INSURANCE LAW

by

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

I. EXCESS LIABILITY

THE year 1988 brought many changes in the area of excess liability for insurance carriers. During 1988 the Texas Supreme Court continued to expand and define the boundaries of the duties owed by insurance carriers to their insureds. This expansion has occurred with little predictability or logic. Principles stated by the Texas Supreme Court as late as 1987 were unexpectedly reversed by the court in 1988. Judging from the cases that are currently before the court, the newly elected court will quickly face the difficult task of explaining, developing, and possibly limiting these principles.

A. Refusal to Defend

Collateral Attack. In *Employers Casualty Co. v. Block*¹ the insurer issued a multi-peril insurance policy to Coating Specialists, Inc. (CSI). The policy provided coverage for property damage occurring between August 1, 1980, and August 1, 1981. CSI installed a Monoflex roof on a house purchased by George and Margie Block in February of 1978. The Blocks discovered the roof was leaking in August of 1979 and CSI subsequently repaired the roof and resprayed it with a plastic coating. The leaking recurred in August of 1980 when Hurricane Allen caused heavy rainfall in the San Antonio area. Later attempts to stop the leaking were unsuccessful.

The Blocks brought suit against CSI in June of 1982 under the Texas Deceptive Trade Practices-Consumer Protection Act and for breach of express and implied warranties. Employers Casualty received notification of the suit, but refused to defend on the ground that the damaging event had not occurred during the policy period. The Blocks and CSI entered into a settlement agreement providing for a \$47,500 judgment plus interest and attorneys' fees in favor of the Blocks. The agreed judgment recited that the

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1. 744 S.W.2d 940 (Tex. 1988).

damage to the Blocks' house resulted from an occurrence on August 6, 1980, within the policy period of the Employers Casualty policy.

CSI subsequently filed suit against Employers Casualty. The Blocks intervened as judgment creditors. The trial court ruled that CSI and the Blocks take nothing by way of their suit.² The court of appeals concluded that a determination that Employers Casualty wrongfully failed to defend its insured prevented it from collaterally attacking the final agreed judgment.³ The court reversed and held that the agreed judgment was binding on Employers Casualty.⁴

The Texas Supreme Court agreed that Employers Casualty was barred from collaterally attacking the agreed judgment by litigating the reasonableness of the damages.⁵ The court concluded, however, that the recitation in the agreed judgment that the damage resulted from an occurrence on August 6, 1980, conveniently within the policy period, was not binding and conclusive on Employers Casualty. The court held that the rule barring collateral attacks was not applicable since Employers Casualty was not attacking the validity of the judgment itself.⁶ Rather, the appropriate issue was whether the doctrine of collateral estoppel barred Employers Casualty from litigation of the issues regarding coverage.⁷

The Texas Supreme Court held that the doctrine of collateral estoppel did not bar Employers Casualty from relitigating the coverage issues on two separate grounds.⁸ First, the court stated that the finding of August 6, 1980, as the occurrence date was not an essential fact element in the underlying suit. The doctrine of collateral estoppel applies only to a specific issue determined in a prior lawsuit that was essential to the judgment in that suit.⁹ Second, the court emphasized that there was no privity between CSI and Employers Casualty because of the coverage dispute between the insurer and the insured.¹⁰

Effects of Wrongful Refusal to Defend/Covenants Not to Execute. In *Whatley v. City of Dallas*¹¹ Whatley filed suit against Del Gaudio, a Dallas

2. *Id.* at 942.

3. *Id.*

4. *Id.*

5. *Id.* at 943. The judgment against CSI was apparently within policy limits. A different rule may apply to damages in excess of the policy limits. See, e.g., *Whatley v. City of Dallas*, 758 S.W.2d 301 (Tex. App.—Dallas 1988, no writ), discussed *infra* at text accompanying notes 11-28. Further, prior Texas case law suggests that the reasonableness of the damages awarded in the underlying judgment may be attacked upon a showing of fraud or collusion. *Britt v. Cambridge Mutual Fire Ins. Co.*, 717 S.W.2d 476, 482-83 (Tex. App.—San Antonio 1986, writ ref'd n.r.e.) (holding that liability findings and damage awards could be challenged if fraud and collusion were established).

6. 744 S.W.2d at 943.

7. *Id.* The court held that collateral estoppel refers to issue preclusion, barring relitigation of any ultimate issue of fact actually litigated and essential to the judgment in the prior suit.

8. *Id.*

9. *Id.* (citing *Wilhite v. Adams*, 640 S.W.2d 875, 876 (Tex. 1982)).

10. *Id.* (citing RESTATEMENT (SECOND) OF JUDGMENTS § 58(a) (1982)).

11. 758 S.W.2d 301 (Tex. App.—Dallas 1988, no writ).

police officer, for use of excessive force in arresting him. After being served with suit papers, Del Gaudio presented a claim to the City of Dallas under its self-administered liability protection plan, offering Whatley's actions against Del Gaudio as a defense. The city refused to defend Del Gaudio on the ground that the plan did not cover Whatley's claim. Prior to trial, Whatley and Del Gaudio entered into a settlement whereby Del Gaudio would stipulate liability and would try the damage issue to the court. In return for the stipulation, Whatley provided Del Gaudio with a covenant not to execute. The trial court found that Whatley's damages were \$142,500 and entered a judgment against Del Gaudio for that amount.¹²

Subsequently, Whatley filed suit against the city for the payment of the judgment against Del Gaudio for the benefits afforded under the city's self-administered liability protection plan. Whatley was successful in his suit and recovered judgment against the city for \$100,000, the maximum benefits offered under the plan.

To satisfy the \$42,500 unpaid balance of the judgment, Del Gaudio assigned his claim against the city for wrongfully refusing to defend him to Whatley. The written assignment reaffirmed that Whatley would never attempt to enforce the judgment against Del Gaudio individually and would only seek satisfaction from the city and its self-administered liability protection plan. Whatley then filed suit against the city for breach of its duty to defend Del Gaudio.

On appeal, the Dallas Court of Appeals addressed three issues. The first was what liability, if any, attached as a result of the city's wrongful refusal to defend Del Gaudio in the underlying suit. In its analysis, the court treated the city as an insurer under an ordinary liability policy.¹³ The court held that the mere wrongful refusal of an insurance carrier to defend its insured will not subject the carrier to liability in excess of its policy limits.¹⁴ The court found that this rule was supported by the better reasoned case authority, citing *Employers National Insurance Corp. v. Zurich American Insurance Co.*¹⁵ and *Texas United Insurance Co. v. Burt Ford Enterprises, Inc.*¹⁶ The court further held that logic supported this conclusion. The court reasoned that if the city had defended Del Gaudio in the first lawsuit, it would not be liable to Whatley and Del Gaudio for an amount greater than the \$100,000 liability protection it had provided Del Gaudio, absent a showing that the city had negligently failed to settle with Whatley within the limits. Accordingly, the court concluded that the city was not liable for an amount in excess of the limits of liability.¹⁷ The court acknowledged the Fifth Circuit's holding in *Zurich* that liability in excess of the policy limits arises for the wrongful refusal to defend upon a proper claim and proof of negligence or

12. *Id.* at 303.

13. *Id.* at 304.

14. *Id.* at 308.

15. 792 F.2d 517 (5th Cir. 1986).

16. 703 S.W.2d 828, 835 (Tex. App.—Tyler 1986, no writ).

17. *Whatley*, 758 S.W.2d at 309.

bad faith in refusing to settle a claim,¹⁸ but the court expressed no opinion as to whether Texas courts would follow the exceptions recognized by the Fifth Circuit in *Zurich*.¹⁹

The second issue before the court was the effect of Whatley's covenant not to execute in Del Gaudio's favor in exchange for the assignment agreement. The court recognized the general rule that a claimant who covenants not to execute on any judgment he might obtain against an insured does not release the insurer who is wrongfully refusing to settle from liability up to the limits of its policy.²⁰ The court noted that the policy basis for this rule is that it enables the insured to extricate himself from the predicament that exists as a result of the wrongful acts of the insurer.²¹ The court further reasoned that because the judgment creditor has independent claims to enforce his judgment against both the insured and the insurer, an agreement not to enforce the judgment against the insured does not affect the judgment creditor's right to seek recovery on that judgment against the insurer.²² The court emphasized that this rule only applied to the extent of the policy limits; it did not permit such recovery in excess of the policy limits.²³ The court held that the judgment creditor of the insured has no right to sue the insurer directly for damages exceeding the policy limits; any such claim asserted by the judgment creditor must be as an assignee of the insured.²⁴ If the judgment cannot be enforced against the insured, then no injury exists. The court noted that to allow the creditor to release the insured from liability for such excess damages without effecting the release of the insurer would give the creditor and insured the power to extend the insurer's liability to any

18. *Id.* at 308 (discussing *Employers Nat'l Ins. Corp. v. Zurich Am. Ins. Co.*, 792 F.2d 517 (5th Cir. 1986) and *Blakley v. American Employers' Ins. Co.*, 424 F.2d 728 (5th Cir. 1970)).

19. *Id.* at 309.

20. *Id.* (citing *Young Men's Christian Ass'n v. Commercial Standard Ins. Co.*, 552 S.W.2d 497 (Tex. Civ. App.—Fort Worth 1977), *writ ref'd n.r.e.*, 563 S.W.2d 246 (Tex. 1978); *First Nat'l Indem. Co. v. Mercado*, 511 S.W.2d 354 (Tex. Civ. App.—Austin 1974, no writ); *Langeau v. Pittman*, 337 S.W.2d 343 (Tex. Civ. App.—Austin 1960, *writ ref'd n.r.e.*). In *William M. Mercer v. Woods*, 717 S.W.2d 391, 398 (Tex. App.—Texarkana 1986), *aff'd in part, rev'd in part*, No. 129521 (Tex. 1988) (WESTLAW, States Library, Tex. file) (rehearing pending), the court noted that "[N]ormally, a covenant not to execute is treated as a discharge" or release to avoid circuitry of action. *Id.* (citing *Panhandle Gravel Co. v. Wilson*, 248 S.W.2d 779 (Tex. Civ. App.—Amarillo 1952, *writ ref'd n.r.e.*) and *RESTATEMENT (SECOND) OF CONTRACTS* § 285(2), comment a (1981)). See also *Dicker v. Lomas & Nettleton Fin. Corp.*, 576 S.W.2d 672, 675 (Tex. Civ. App.—Texarkana 1978, *writ ref'd n.r.e.*) (agreement not to sue construed as release); *Praetorians v. Simons*, 187 S.W.2d 238, 241 (Tex. Civ. App.—Dallas 1945, no writ) (while an agreement not to sue is technically not a release it may be pled as a bar to related action); 15 *WILLISTON ON CONTRACTS* § 1823, p. 467, 468 (3d ed. 1972) (covenant not to sue effective as a release). "[A] covenant not to execute will not obviate the existence of damages when there is proof that an insured was forced to assign his rights against the insurer or other responsible parties to obtain that covenant." *Woods*, 717 S.W.2d at 398. Some jurisdictions have held covenants are ineffective to satisfy the policy requirement that the insured be "legally obligated to pay" the damages in question. See *Freeman v. Schmidt Real Estate & Ins., Inc.*, 755 F.2d 135, 138 (8th Cir. 1985) (discussing numerous authorities).

21. 758 S.W.2d at 310.

22. *Id.*

23. *Id.*

24. *Id.*

amount they might choose.²⁵ The court concluded that the covenant not to execute given by Whatley to Del Gaudio had the effect of releasing the City of Dallas from any excess liability.²⁶ The court reserved the issue of whether the rule stated would apply if the insurer had acted negligently or in bad faith.²⁷

Lastly, the court addressed the applicable statute of limitations. The court held that a claim for wrongful refusal to defend is a claim for breach of contract governed by the four-year statute of limitations.²⁸ The court, following its earlier holding in *Nash v. Carolina Casualty Insurance Co.*,²⁹ held that a cause of action for wrongful refusal to defend accrues when the refusal to defend occurs.

B. *Stowers Liability*

Intervention. In *Continental Casualty Co. v. Huizar*³⁰ the insurer sought to intervene in the appeal of a suit against its insured. The insured successfully moved for the dismissal of its appeal from a judgment in excess of policy limits after entering a covenant not to execute with the claimants. The court of appeals denied the insured's motion.³¹

The supreme court affirmed the judgment of the court of appeals, holding that the payment by the insurer of its policy limits, even though less than the amount of the judgment, constituted a waiver of its right to appeal.³² The court specifically reserved the question of whether the insurer had demonstrated a sufficient justiciable interest to entitle it to appellate review of the judgment.³³ Justice Gonzalez, in a dissenting opinion, correctly pointed out that the payment of the policy limits did not settle the entire controversy since there were still claims for damages in excess of the policy limits pending.³⁴ The dissent argued that the insurer should be able to pursue the appeal under the doctrine of virtual representation.³⁵ The dissent pointed out that if the insurer is allowed to pursue the appeal, then any findings made in the litigation would be binding upon Continental Casualty under the doc-

25. *Id.*

26. *Id.*

27. *Id.* Footnote 6 of the opinion states: "We express no opinion as to whether a judgment creditor may recover against an insurer damages awarded against its insured in excess of policy limits for which the insured is not personally liable if the insurer has acted negligently or in bad faith." *Id.* at 310 n.6.

28. *Id.* at 310-11.

29. 741 S.W.2d 598, 600-01 (Tex. App.—Dallas 1987, writ denied).

30. 740 S.W.2d 429 (Tex. 1987).

31. *Id.*

32. *Id.* at 430.

33. *Id.*

34. *Id.* at 433.

35. *Id.* When a named party "virtually represents" an unnamed person or entity's interests and those interests are adjudicated by a judgment, the person or entity whose interests were adjudicated is entitled to standing to appeal the judgment even though that person is not a named party to the suit. *Smith v. Gerlach*, 2 Tex. 424, 426-27 (1854); *Knium v. Slattery*, 239 S.W.2d 865, 866 (Tex. Civ. App.—San Antonio 1951, writ ref'd). This is really an exception to the general rule of appellate standing that "only parties of record may exercise the right of appeal." *Gunn v. Cavanaugh*, 391 S.W.2d 723, 724 (Tex. 1965).

trine of virtual representation.³⁶ If Continental Casualty were considered to be a stranger to the appeal with no standing, however, then relitigation of all factual issues would be required in any subsequent action against the insurer because it was not a party to the appeal.³⁷ Thus, judicial economy would dictate that the insurer should be permitted to intervene.³⁸

Abatement. In *Street v. Honorable Second Court of Appeals*³⁹ the trial court entered a judgment against the insured in the underlying tort claim. The insurer perfected an appeal on behalf of the insured to the Second Court of Appeals. While the appeal was pending, the insured brought an action against the insurer for negligently failing to settle the claim against him.⁴⁰ The insurer filed a plea in abatement claiming that the insured could not maintain a *Stowers* suit until he had exhausted all appellate remedies in the underlying tort action. The court of appeals granted the writ of mandamus and prohibition ordering the trial judge to abate the *Stowers* suit pending the appeal of the original tort action.⁴¹

The supreme court held that an action for negligent failure to settle does

36. *Continental Casualty Co. v. Huizar*, 740 S.W.2d 429, 432 (Tex. 1987). As a general rule, "an insurer who controls the defense of its insured . . . is bound by the material issues determined in the action against its insured." *Id.* at 434 (citing *Massachusetts Bonding & Ins. Co. v. Orkin Exterminating Co.*, 416 S.W.2d 396 (Tex. 1967)). This rule is part of the doctrine of collateral estoppel. *Employers Casualty Co. v. Block*, 744 S.W.2d 940, 943 (Tex. 1988), *discussed supra* at text accompanying notes 1-10. The doctrine of virtual representation would appear to be simply one aspect of the concept of privity. The dissent paints too broadly on this point because the insurer will only be bound if the material fact issue decided in the underlying suit parallels a material issue with respect to coverage or not under the policy. *Id.* Further, as the majority opinion correctly suggests, privity may not exist (1) where the insurer wants to appeal and the insured does not, and (2) where the insured either dismisses the appeal itself or terminates the involvement of the insurer in the defense of the case.

Justice Kilgarlin challenged the application of the virtual representation rule in *Huizar* because it was not clear there was an identity of interest in light of the fact the insurer "paid under protest" (anticipating future litigation) and because the cases dealing with the binding effect of the judgment on the insurer involved actions taken after the insured's liability had been "conclusively litigated" rather than having only a truncated appeal. *Huizar*, 740 S.W.2d at 432. Justice Kilgarlin also pointed out that the insurer might have a right of redress against the insured for breach of the conditions in the policy mandating that the insured cooperate with the insurer in defending the suit. *Id.* The cooperation clause defense could prove essential in situations where the judgment against the insured is eminently appealable and thus there is a reasonable chance that the excess judgment against the insured would be reversed.

37. This would appear to be entirely consistent with *Employers Ins. Co. v. Block*, 744 S.W.2d 940 (Tex. 1988), in that this situation presents a conflict such that privity could not be found to exist between the insurer and the insured.

38. 740 S.W.2d at 434. This is not the first time this issue has been presented. In *American Physicians Ins. Exch. v. Cardenas*, 717 S.W.2d 707 (Tex. App.—San Antonio 1986, writ *ref'd n.r.e.*), the insurance carrier sought to appeal by writ of error a judgment entered against its insured. The San Antonio court of appeals recognized the doctrine of virtual representation but held the insurer waived the right to appeal by writ of error when it failed to re-enter the defense of its insured when an amended pleading brought the acts within the insurer's policy period. The issue was appealed to the Texas Supreme Court, which declined to address the issue.

39. 756 S.W.2d 299 (Tex. 1988).

40. This action was brought under the doctrine created in *G.A. Stowers Furniture Co. v. American Indem. Co.*, 15 S.W.2d 544 (Tex. Comm'n App. 1929, holding approved).

41. 756 S.W.2d at 300.

not accrue until the judgment in the underlying case becomes final.⁴² The supreme court interpreted the term "final" to mean that point in time when the trial court no longer has power to alter the judgment, and execution on the judgment, if appealed, has not been superseded.⁴³ The court noted that during the pendency of the appeal, if a judgment is not superseded, the insured would be exposed to collection of the judgment.⁴⁴ The supreme court ignored the fact that the filing of the *Stowers* action does nothing by itself to alter the fact that execution on the judgment may go forward. As a result, the sole rationale for the decision crumbles under close examination. The majority applied a similar rationale in interpreting the no-action clause in the policy, which provided that no action would lie against the company until the insured's obligation to pay is made final, either by judgment against the insured after actual trial or by a written agreement between the insured, the claimant and the company. The court construed the clause to require only a trial, not an appeal.⁴⁵

After first discussing accrual and then interpreting the no-action clause, the court in *Street* embarked upon a clean-up campaign with respect to the implications of its "accrual" holding on the future interpretation of the statute of limitations.⁴⁶ The issue of whether the plaintiff's claim in *Street* was barred by limitations was simply not before the court. The court suggested that "accrual" in terms of whether suit may be brought is different from "accrual" for purposes of limitations.⁴⁷ The court stated that despite its holding that a *Stowers* suit may be brought even though the underlying judgment is on appeal, the *Stowers* cause of action does not accrue until all appeals have been exhausted.⁴⁸ The court then amazingly observed that "[n]o valid public policy is served by forcing an insured to bring an action which may ultimately prove unnecessary."⁴⁹ The court ignored this public policy in dealing with the term accrual in the context of abatement. It can be said with equal logical force that no public policy is served by forcing a defendant insurer into a *Stowers* action when it may ultimately prove unnecessary if the judgment in excess of the policy limits is reversed or modified on appeal.

The court's reasoning completely turns prior limitations case law on its head. Texas courts have long-recognized that "accrual" is the "date when the plaintiff first becomes entitled to sue the defendant based upon a legal wrong attributed to the latter."⁵⁰ The courts have also uniformly treated "accrual" in the context of abatement the same as in the context of limitations.⁵¹ Interpreting accrual differently in these contexts results in the crea-

42. *Id.* at 301.

43. *Id.*

44. *Id.*

45. *Id.* at 302.

46. *Id.*

47. *Id.* at 301.

48. *Id.* at 302.

49. *Id.*

50. *Zidell v. Bird*, 692 S.W.2d 550, 554 (Tex. App.—Austin 1985, no writ) (discussing numerous Texas cases dealing with the concept of accrual).

51. *E.g.*, *Philips v. Giles*, 620 S.W.2d 750, 751 (Tex. Civ. App.—Dallas 1981, no writ)

tion of a legal purgatory where the action has not accrued but suit may still be brought. As Justice Culver noted in a well-reasoned concurring and dissenting opinion, "[t]he court's opinion gives no reason for allowing this type of litigant two bites at the apple" in contrast to non-*Stowers* plaintiffs.⁵²

The court's opinion in *Street* has no application where damages other than the excess judgment may be involved or where there are wrongful acts alleged other than the failure to settle. For example, where the insurer is alleged to have wrongfully refused to defend, the insured is immediately injured because he must begin to pay for the defense of the case.⁵³ A cause of action accrues at the time of the tortious act or omission even though "the damages, or their extent, are not ascertainable until a later date."⁵⁴ Where there has been a wrongful refusal to defend, the fact the judgment has been appealed has no impact upon the fact the cost of the defense is being incurred by the insured. Thus, the action for the defense costs could never be rendered "unnecessary" by the reversal of the underlying judgment.

C. Good Faith and Fair Dealing

Third-Party Insurance. In *Hart v. Aetna Casualty & Surety Co.*⁵⁵ the claimant settled her tort claim against three parties insured by Aetna. The claimant released the defendants and Aetna. She subsequently brought suit against Aetna seeking to set aside the release, alleging Aetna breached its duty of good faith and fair dealing. The trial court granted an instructed verdict to Aetna on the issue of the duty of good faith and fair dealing. The Amarillo Court of Appeals held that while the duty of good faith and fair dealing runs from an insurer to its insured, no Texas case had applied this duty to an injured third-party claimant outside of the workers' compensation area.⁵⁶ Accordingly, the court held that Texas law did not recognize any

(applying "accrual" as interpreted in limitation cases as basis for determining the date of accrual for abatement purposes in an accountant malpractice suit).

52. *Street*, 756 S.W.2d at 303.

53. See *Nash v. Carolina Casualty Ins. Co.*, 741 S.W.2d 598, 600-01 (Tex. App.—Dallas 1987, writ denied) (involving accrual of wrongful refusal to defend causes of action based on contract, DTPA, and insurance code violations); see also *William M. Mercer, Inc. v. Woods*, 717 S.W.2d 391, 397-98 (Tex. App.—Texarkana 1986), *aff'd in part, rev'd in part*, No. 129521 (Tex. 1988) (WESTLAW, States library, Tex. file) (motion for rehearing pending) (involving suit against insurance agent for failure to procure insurance under negligence, DTPA, and insurance code theories).

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

55. 756 S.W.2d 27 (Tex. App.—Amarillo 1988, no writ).

56. *Id.* at 28. Arguments have been made that a different result should attach when the liability policy is a financial responsibility policy issued pursuant to TEX. REV. CIV. STAT. art. 6701h(10) (Vernon 1977). The argument is made that the statute confers upon injured plaintiffs the status of a third-party beneficiary under the contract of insurance. See *Dairyland County Mut. Ins. Co. v. Childress*, 650 S.W.2d 770 (Tex. 1983). The argument is then advanced that the contractual status of a third-party beneficiary under the contract would entitle the injured plaintiff to assert a cause of action for a breach of the duty of good faith and fair dealing. This argument, however, cannot be supported under prior Texas authority. First, the issue in the *Childress* case was whether a contractual relationship existed that would entitle the plaintiff to recover attorney's fees in a suit brought under the contract. The duty of good faith and fair dealing does not arise from the contract of insurance. In *Arnold v. National County Mut. Fire Ins. Co.*, 725 S.W.2d 165, 167 (Tex. 1987), the court declined to impose a *covenant*

duty of good faith and fair dealing extending between an insurer and a third-party claimant.⁵⁷

of good faith and fair dealing in connection with the issuance of an insurance policy, but instead imposed a tort duty. Further elaboration of this concept was given by the majority of the supreme court in *Chitsey v. National Lloyds Ins. Co.*, 738 S.W.2d 641, 643 n.1 (Tex. 1987), where the court stated: "We reject the court of appeals' characterization of this case as involving a 'covenant of good faith and fair dealing.' *Id.* Breaches of a covenant are contractual in nature. The breach in this case is not one of contract, but of a duty imposed by law."

Second, because the duty of good faith and fair dealing is not a contractual duty, the fact that a claimant may or may not be a third-party beneficiary under a policy of insurance is irrelevant to his standing to bring a cause of action under the duty of good faith and fair dealing. Rather, the inquiry must focus on whether a special relationship exists between the claimant and the insurer. In *English v. Fischer*, 660 S.W.2d 521, 524 (Tex. 1983) (emphasis added), Justice Spears stated: "I would note, however, that Texas courts have read a duty of good faith and fair dealing into many types of contractually-based transactions. The common thread among the cases in which courts have done so is a *special relationship* between the parties to the contract." Similarly, in *Arnold v. National County Mut. Fire Ins. Co.*, 725 S.W.2d 165, 167 (Tex. 1987), the court held: "While this court has declined to impose an implied *covenant* [emphasis in original] of good faith and fair dealing in every contract, we have recognized that a duty of good faith and fair dealing may arise as a result of a *special relationship* between the parties *governed or created by a contract*." (Emphasis added.)

A third-party claimant has no special relationship with the insurer. The insurer does not have the right to control the prosecution of the litigation by the injured party. Rather, the injured party is free to select counsel and to conduct the case in any manner that the plaintiff may see fit. There is no trust relationship between the parties because, until the accident occurred, there would have been no contact whatsoever between the insurer and the third-party claimant. As a result, the factual situation simply does not give rise to the necessary special relationship, and the fact that the policy of insurance was one issued under the financial responsibility statute should not change the result.

57. The only other Texas case to address this point is *Chaffin v. Transamerica Ins. Co.*, 731 S.W.2d 728, 732 (Tex. App.—Houston [14th Dist.] 1987, writ ref'd n.r.e.), which held that the duty of good faith and fair dealing does not run between a liability carrier and the third-party claimant. The majority rule in other jurisdictions is that the duty of good faith runs only to the insured, not to a third-party claimant. See *Dickey v. Alabama Farm Bureau Mut. Ins. Co.*, 447 So. 2d 693, 694 (Ala. 1984) (attempting to recover from automobile insurer for repairs to auto damaged in collision with the 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 tortfeasor); *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 the insureds); *Linscott v. State Farm Mut. Auto. Ins. Co.*, 368 A.2d 1161, 1163 (Me. 1977) (charging deceit and misrepresentation by tortfeasor's insurer); *Magalski v. Maryland Casualty Co.*, 21 Md. App. 136, 318 A.2d 843, 849 (1974) (claiming damages for tortfeasor's insurer's refusal to pay property damage); *Chavez v. Chenoweth*, 89 N.M. 423., 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, 502 N.E.2d 694, 698 (1986) (claiming against attorney's liability insurer); *Tank v. State Farm Fire & Casualty Co.*, 105 Wash. 2d 381, 715 P.2d 1133, 1139 (1986) (claiming against insurer of defendant in assault action). Texas law would also dictate this result because the duty of good faith arises out of the special relationship that exists between the insurer and the insured. *Arnold v. National County Mut. Fire Ins. Co.*, 725 S.W.2d 165, 167 (Tex. 1987). This special relationship does not exist between the insurer and the third-party claimant. *Duncan v. Lumbermen's Mut. Casualty Co.*, 91 N.H. 349, 23 A.2d 325, 326 (1941); see also Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1175-77 (1954) (discussing insurer's lack of duty to claimant). In a concurring opinion in *English v. Fischer*, 660 S.W.2d 521, 524 (Tex. 1983), Justice Spears noted that such a duty did not exist in all contractual relationships, only those that involve a special relationship. Justice Spears noted Texas law had recognized such a relationship existed in imposing a duty on insurers to make a good faith effort to settle a liability case. *Id.* (citing *G.A. Stowers Furniture Co. v. American Indem. Co.*, 15 S.W.2d 544, 547 (Tex. Comm'n App. 1929, holding approved). Indeed, under Texas law, the cause of action for excess damages for breach of this duty is personal to the insured

Workers' Compensation. In *Fuentes v. Texas Employers Insurance Association*⁵⁸ the workers' compensation carrier ceased paying a worker's medical and compensation benefits pending his appeal of an Industrial Accident Board ("IAB") award to the district court. After the worker prevailed in his suit to set aside the IAB award for an on-the-job injury, he filed suit against the carrier alleging, among other things, breach of the duty of good faith and fair dealing. The carrier filed a motion for summary judgment, which the trial court granted.⁵⁹ The San Antonio Court of Appeals recognized that a duty of good faith and fair dealing exists between a workers' compensation carrier and the worker. The court held that in order to prove a breach of this duty, the worker must establish (1) that the carrier lacked a reasonable basis for delaying or denying payment of the benefits of the policy, and (2) that the carrier knew or should have known that there was no reasonable basis for denying the claim or underlying payment of the claim.⁶⁰ The trial court held that the worker's own pleadings established that the insurance carrier had a reasonable basis for denying the claim. The worker's pleadings alleged that the denial of the claim was based upon a medical opinion. The court held that reliance upon a medical opinion was a reasonable basis for delaying or denying payment of the benefits under the policy, thereby negating the two elements of the cause of action.⁶¹

and may not be brought by the underlying tort claimant. See, e.g., *Hernandez v. Great Am. Ins. Co.*, 464 S.W.2d 91, 95 (Tex. 1971) (insured entitled to sue liability insurer for failure to settle); *Becker v. Allstate Ins. Co.*, 678 S.W.2d 561, 562 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd n.r.e.) (plaintiff had no standing to sue insurer for excess judgment against insured); *Samford v. Allstate Ins. Co.*, 529 S.W.2d 84, 87 (Tex. Civ. App.—Corpus Christi 1975, writ ref'd n.r.e.) (judgment creditor had no action against debtor's insurer for negligence in settling claim); *Cook v. Superior Ins. Co.*, 476 S.W.2d 363, 364 (Tex. Civ. App.—Beaumont 1972, writ ref'd n.r.e.) (judgment creditor could not sue judgment debtor's liability insurer).

To impose a duty of good faith between insurers and claimants would result in putting the insurer in a conflict of interest that would truly put the insurer on the horns of a dilemma. The law in Texas is quite clear that a duty of loyalty that rises to the level of a fiduciary duty is owed by the insurer under a liability policy. *Ranger County Mut. Ins. Co. v. Guin*, 723 S.W.2d 656 (Tex. 1987). Several duties arise out of this relationship. These duties include the duty to handle the claim in a prudent manner, to exercise ordinary care in settlement negotiations, and, where there are multiple claims, the duty to attempt to settle all claims within the policy limits. *Id.* There are numerous situations where it would be in the interest of the insured not to make a settlement offer or to offer an amount in settlement significantly below that which the injured claimant felt was appropriate. These situations could include instances where there are multiple claimants and only limited insurance proceeds, as well as situations where, because of the insured's reputation (for example, a professional), the insured does not want an offer of settlement to be made. In these situations, there would be a conflict between the interest of the insured and the third-party claimant and the extension of the duty of good faith and fair dealing to the third-party claimant would put the insurer in an unresolvable position.

58. 757 S.W.2d 31 (Tex. App.—San Antonio 1988, no writ).

59. *Id.* at 32.

60. *Id.* at 33 (following *Aranda v. Insurance Co. of North America*, 745 S.W.2d 210 (Tex. 1988); *Arnold v. National County Mut. Fire Ins. Co.*, 725 S.W.2d 165 (Tex. 1987); *Massey v. Armco Steel Co.*, 652 S.W.2d 932 (Tex. 1983)).

61. From the language of the opinion itself, it is impossible to determine whether the medical opinion was that of a physician who was hired by the injured worker or by the insurance carrier, or who was an independent medical examiner. The identity of the person or entity that hired the expert should not be determinative since the issue before the court is the reasonableness of the conduct of the insurer.

In *Izaguirre v. Texas Employers' Insurance Association*⁶² injured workers brought suit against their carrier, claiming injuries from intentional, bad faith denial and delay of workers' compensation payments. Two of the claimants, Solis and Guerro, had signed and filed in district court a release in connection with their worker's compensation claims. The release stated: "I understand and agree that the liability of said INSURANCE CARRIER is indefinite, uncertain and incapable of being satisfactorily established. . . ."⁶³ The court of appeals held that in order to state a cause of action for breach of the duty of good faith and fair dealing, the worker must allege that the insurer either denied a claim or delayed payment without any reasonable basis or failed to determine whether there was a reasonable basis for the denial or delay.⁶⁴ The court further held that an insurance company has a right to withhold payments in those cases where liability is uncertain.⁶⁵ The court concluded that the releases filed in the district court by Solis and Guerro, coupled with application of the doctrines of judicial estoppel and judicial admissions, precluded them from taking a position to the contrary.⁶⁶

The second issue addressed by the court of appeals was whether the doctrine of res judicata barred the bad faith claims.⁶⁷ The carrier asserted that

62. 749 S.W.2d 550 (Tex. App.—Corpus Christi 1988, writ denied).

63. *Id.* at 555.

64. *Id.*

65. *Id.*

66. *Id.* Generally, admissions contained in pleadings in a particular case amount to a judicial admission for the purposes of that case. 1A C. McCORMICK & R. RAY, TEXAS LAW OF EVIDENCE CIVIL AND CRIMINAL § 1144 (Texas Practice 3d ed. 1980). A judicial admission relieves a party offering the admission from proof of the admitted fact, and bars the admitting party from disputing the admitted fact; court pleadings in other actions containing statements inconsistent with the party's present position are generally regarded only as an ordinary admission. *Id.* § 1145. Ordinary admissions do not have the binding effect of judicial admissions. *Cameron County v. Velasquez*, 668 S.W.2d 776, 783 (Tex. App.—Corpus Christi 1984, writ ref'd n.r.e.). An ordinary admission in a pleading in another action, however, may rise to the level of a judicial admission if the following requirements are met:

- (1) The declaration relied upon was made during the course of judicial proceeding;
- (2) The statement is contrary to an essential fact embraced in the theory of recovery or defense asserted by the person giving the testimony;
- (3) The statement is deliberate, clear, and unequivocal, eliminating the hypothesis of mere mistake or inadvertence;
- (4) The giving of conclusive effect to the declaration will be consistent with the public policy upon which the rule is based;
- (5) The statement is not destructive of the opposing party's theory of recovery.

Id. In *Izaguirre*, the court of appeals found that the statement constituted a judicial admission. Because the pleading was filed in a former action, the court implicitly held that the five requirements necessary to raise an ordinary admission to the level of a judicial admission were met. 749 S.W.2d 550, 555 (Tex. App.—Corpus Christi 1988, writ denied).

67. *Izaguirre*, 749 S.W.2d at 555. One issue not addressed in the *Izaguirre* opinion, but which is certainly relevant, is the doctrine of collateral estoppel. This doctrine precludes relitigation of the material fact issues previously adjudged between the parties by a court of competent jurisdiction. *Kirby Lumber Corp. v. Southern Lumber Co.*, 145 Tex. 151, 196 S.W.2d 387, 388 (1946). The prior judgment is binding in a subsequent action between the same parties even though the subsequent action is based upon a different cause of action. *Benson v. Wanda Petroleum Co.*, 468 S.W.2d 361, 362 (Tex. 1971). A consent or agreed judgment has the same degree of finality and binding force as does one entered by the court at the conclusion of adversary proceedings. *Pollard v. Steffens*, 161 Tex. 594, 343 S.W.2d 234, 239 (1961).

"A party seeking to invoke the doctrine of collateral estoppel must establish (1) the facts

the bad faith claims could and should have been brought in the workers' compensation suit in the district court. The court of appeals disagreed, holding that the bad faith claims and workers' compensation claims are distinct and separate and that it is unnecessary to bring them together in the same lawsuit.⁶⁸

Lastly, the court addressed limitations. The court held that limitations do not begin to run on the cause of action for breach of duty of good faith and fair dealing until the underlying claim is resolved.⁶⁹ In the context of a workers' compensation case, the court held that the limitations did not begin to run until the district court's judgment had become final.⁷⁰

D. Deceptive Trade Practices and Article 21.21 of the Insurance Code

First-Party Insurance. Last year, in the case of *Chitsey v. National Lloyds Insurance Co.*,⁷¹ the Texas Supreme Court addressed the issue of liability of first-party insurers for bad faith claims handling practices under the Deceptive Trade Practices Act ("DTPA") and article 21.21 of the Insurance Code.⁷² At the same time the supreme court decided *Chitsey*, it had before it the case of *Vail v. Texas Farm Bureau Mutual Insurance Co.*⁷³ Despite that the factual and legal arguments were for the most part identical, the majority in *Vail* completely reversed itself from the position it had taken in *Chitsey*. According to the dissent, the "majority has had to resort to a tortured reading of the DTPA, the Insurance Code, and Vail's pleadings, and has ignored our recent opinion in *Chitsey v. National Lloyds Ins. Co.*"⁷⁴

The court held that the Vails proved a cause of action for bad faith claims handling practices under section 17.50(a)(4) of the DTPA on three alternative grounds.⁷⁵ First, the court found that the Vails had proved a cause of action under section 17.46(b) of the DTPA by obtaining a finding that the insurer had failed to exercise good faith.⁷⁶ Second, the court incorporated

sought to be litigated in the second action were fully and fairly litigated in the prior action; (2) those facts were essential to the judgment in the first action; and (3) the parties were cast as adversaries in the first action." *Bonniwell v. Beech Aircraft Corp.*, 663 S.W.2d 816, 818 (Tex. 1984). Applying the criteria of collateral estoppel, an agreed judgment making the recitations that were made in *Izaguirre* should also operate to collaterally estop the claimant on the issue of the uncertainty of the insurance carrier's liability.

68. 749 S.W.2d at 555. The court emphasized that the damages in a compensation claim and a bad faith suit are entirely dissimilar, noting that damages for the incapacitating injury, loss of earning capacity and mental suffering resulting from the injury are not recoverable in a bad faith suit. *Id.* at 553.

69. *Id.* at 556. This rule would not appear to have any application outside of the context of first-party policies, such as worker's compensation, health, life and property policies. Torts in the third-party coverage context, such as a wrongful refusal to defend can arise and be actionable prior to the underlying action becoming final. *See supra* note 29 and accompanying text.

70. *Id.* (citing *Arnold v. National County Mut. Fire Ins. Co.*, 725 S.W.2d 165, 167 (Tex. 1987)).

71. 738 S.W.2d 641 (Tex. 1987).

72. TEX. INS. CODE ANN. art. 21.21 (Vernon 1981 & Supp. 1989).

73. 754 S.W.2d 129 (Tex. 1988).

74. *Id.* at 138 (citation omitted).

75. *Id.* at 136.

76. *Id.* at 135. The court held that this finding fell within the broad ambit of § 17.46(b),

into DTPA section 17.50(a)(4) "article 21.21, section 16 of the Insurance Code, section 4(a) of Board Order 18663, and the definition of unfair claims settlement practice in article 21.21-2, section 2(d) of the Insurance Code."⁷⁷ The court in *Chitsey* utilized a similar approach.⁷⁸ In *Chitsey*, the plaintiff did not prevail because of his failure to demonstrate that the practices were committed with such frequency as to indicate a general business practice.⁷⁹ Rather than relying upon article 21.21-2 of the Insurance Code, the plaintiff relied upon Board Order No. 41454. The preamble to this order provided: "[u]nfair claim settlement practices means committing or performing with *such frequency* as to indicate a general business practice any of the following"⁸⁰ In *Vail* the plaintiff chose not to rely upon Board Order 41454, but rather upon the definitions contained in article 21.21-2, which has a similar preamble. Section 2 of article 21.21-2 provides: "[a]ny of the following acts by an insurer, if committed without cause and performed with *such frequency* as determined by the State Board of Insurance as provided for in this Act, shall constitute unfair claim settlement practices"⁸¹

The majority in *Vail* made a logically suspect attempt to distinguish section 2 of article 21.21-2 from Board Order 41454 by holding that frequency was not a prerequisite to the acts defined in article 21.21-2 as unfair trade practices, but rather it was only a prerequisite to the issuance of cease and desist orders by the Board.⁸² This reasoning is no more than judicial legerdemain employed to avoid *Chitsey* and to ease the burden on the insured in this type of case. The court's approach is certainly an artful form of legislative interpretation. The inconsistencies created by this reasoning will be but one of the many housekeeping matters that will have to be addressed by the newly constituted supreme court.

The majority in *Vail* also held⁸³ that the plaintiff had stated and proved a cause of action for unfair claims settlement practices by incorporating article 21.21, section 16 of the Insurance Code, section 4(b) of Board Order 18663, and the judicial determinations made by the court in *Arnold v. National County Mutual Fire Insurance Co.*⁸⁴ and *Aranda v. Insurance Co. of North America*⁸⁵ into section 17.50(a)(4) of the DTPA. The unsuccessful plaintiff in *Chitsey* made a similar attempt. Section 4(b) of Board Order 41060 prohibits unfair trade practices that have been *determined* pursuant to law to be an unfair or deceptive act or practice.⁸⁶ In *Chitsey* the plaintiff argued that a

which deals with "false, misleading, or deceptive acts or practices." *Id.* Section 17-46(b) includes a laundry list, which by its own terms and the *Vail* court's interpretation is not exhaustive. *Id.* The court gave no guidance as to how or why it reached the conclusion that a breach of the duty of good faith fell within the phrase "false, misleading, or deceptive acts."

77. *Id.* at 136.

78. 738 S.W.2d at 643.

79. *Id.*

80. *Id.* (emphasis added).

81. TEX. INS. CODE ANN. art. 21.21-2 (Vernon 1981) (emphasis added).

82. 754 S.W.2d at 134.

83. *Id.* at 135.

84. 725 S.W.2d 165, 167 (Tex. 1987).

85. 748 S.W.2d 210, 212-13 (Tex. 1988).

86. *Chitsey v. National Lloyds Ins. Co.*, 738 S.W.2d 641, 643 (Tex. 1987) quotes section

jury finding could constitute a determination by law. The supreme court in *Chitsey* disagreed, holding that "[a] jury's role is to decide matters of fact and not matters of law. . . . [T]he words 'determined by law' call for at least a state agency, if not legislative, determination and not just a jury finding."⁸⁷ In *Vail* the court held that the adoption of the duty of good faith and fair dealing in *Arnold v. National County Mutual Fire Insurance Co.*⁸⁸ constituted a determination by law.⁸⁹ Both dissenting opinions in *Vail* correctly point out that a pronouncement by the supreme court does not constitute a legislative or agency determination as required in *Chitsey*.⁹⁰

II. GENERAL LIABILITY

Asbestos. In *Dayton Independent School District v. National Gypsum Co.*⁹¹ the court ruled on a number of important issues involving coverage for claims for the cost of removal and replacement of asbestos. The court held that such claims pass the threshold test of involving property damage, which the policy defined as requiring physical injury to or loss of use of tangible property.⁹² The court emphasized that the suit against the insured alleged that the insured's products caused damage, including physical injury.⁹³ The court added that other courts have agreed that the incorporation of dangerous or defective products or components in a structure constitutes property damage.⁹⁴

Dayton is the first published opinion to deal with the issue regarding when coverage is triggered in asbestos property damage cases under Texas law.⁹⁵

4(b) of Board Order 41060, which provides that: "[i]rrespective of the fact that the improper trade practice is not defined in any other section of these Rules and Regulations, no person shall engage in this State in any trade practice which is determined pursuant by law to be an unfair method of competition or an unfair or deceptive act or practice in the business of insurance." (Emphasis by the court).

87. 738 S.W.2d at 643.

88. 725 S.W.2d 165, 167 (Tex. 1987).

89. *Vail*, 754 S.W.2d 129, 135 (Tex. 1988).

90. *Id.* at 138, 140.

91. 682 F. Supp. 1403 (E.D. Tex. 1988).

92. *Id.* at 1407.

93. *Id.* This would appear to be a reading of the pleadings that is so liberal and literal that it ignores the true nature of the claim, which was that the presence of the fibers caused the injuries. A mere presence is a far cry from a physical injury to tangible property. The court's position could have been bolstered by arguing that the claims involved a loss of use of tangible property, thus invoking the second prong of the policy definition of property damage. This approach, however, might still result in a finding of noncoverage because of exclusion (m) of the policy, which bars coverage for loss of use of property that is not physically injured resulting from the failure of the insured's work or products.

94. 682 F. Supp. at 1408. The court noted that in *United States Fidelity & Guar. Co. v. Wilkin Insulation Co.*, No. 84-CH-11676 (Ill. Ct. App., Aug. 14, 1987), the court reached a contrary result because there was no allegation of property damage in the underlying suit. 682 F. Supp. at 1408 n.12.

95. 682 F. Supp. at 1409. The court observed that one federal district court opinion, *National Standard Ins. Co. v. Continental Ins. Co.*, No. CA-3-81-1015-D (N.D. Tex., Oct. 4, 1983), dealt with the issue but was unpublished. It should be noted that the first case in the country dealing with this question was *Lac D'Amiante Du Quebec, Ltd. v. American Home Assurance Co.*, 613 F. Supp. 1549 (D.N.J. 1985), which the *Dayton* court only marginally acknowledged. 682 F. Supp. at 1409.

The court rejected the "manifestation" and "exposure" theories.⁹⁶ The court held that all policies covering the risk at any time from the date of installation until the date of removal or containment of the asbestos products would be triggered.⁹⁷ The court noted that in the case before it the claimant alleged that the insured's products released or threatened to release asbestos fibers from the date of installation.⁹⁸ The court concluded that each release was part of a continuing injury.⁹⁹

The court in *Dayton* further held that the insured had the right to choose which of its policies it will rely on for coverage.¹⁰⁰ Thus, subject only to the limits of liability, the insured could choose to place the entire loss on one carrier despite the fact that the policies of multiple insurers are triggered.¹⁰¹

96. 682 F. Supp. at 1409. Amazingly, the court relegated two important opinions of the Fifth Circuit Court of Appeals adopting the exposure theory to a footnote. *Id.* n.15. These decisions, *Porter v. American Optical Corp.*, 641 F.2d 1128 (5th Cir.), *cert. denied*, 454 U.S. 1109 (1981), and *Ducre v. Executive Officers of Halter Marine, Inc.*, 752 F.2d 976 (5th Cir. 1985), were made under Louisiana law, which did not differ from Texas law regarding the rules of insurance contract construction. Both decisions strongly suggest that the exposure rule is the correct rule under the rules of construction, and they give no hint that the court would vary its decision if the same rules of construction, albeit under the law of a different state, were applied.

97. 682 F. Supp. at 1410. The court labeled this pragmatic approach the soundest theory. *Id.* at 1409. It is only as sound as it is expedient.

98. *Id.* at 1409-10.

99. *Id.* at 1410. It is true that accumulation of the fibers led to discovery and therefore loss of use of the property, but it is not true that each release of fibers constituted a discrete injury. The court's continuing injury argument is a meager attempt to bring this case of property damage in line with the bodily injury cases, which base the continuous trigger theory on clear medical evidence that the disease process associated with asbestos results in multiple, cumulative, separate, and distinct physical injuries. No evidence was presented in *Dayton* that such a series of injuries was involved. Indeed, the court's decision is inconsistent with its own interpretation of property damage because there could be no diminution in value or loss of use because of contamination until it was discovered, a date obviously long after the date of installation.

Choosing the date of discovery would be more consistent with the weight of authority involving analogous property damage cases, which looks to the date the damage was reasonably apparent. See *Occurrence and Other Insurance Coverage Issues*, [1982] Defense Research Institute No. 2, at 2, 9 (Sept. 1982); Annotation, *Event as Occurring Within Period of Coverage of "Occurrence" and "Discovery" or "Claims Made" Liability Policies*, 37 A.L.R. 4th 382 (1984) (discussing if and when a loss is held to occur within the policy period coverage). See also *Kirkham, Michael & Assocs. v. Travelers Indem. Co.*, 361 F. Supp. 189, 193 (S.D. Tex. 1973) (city suffered actual damage at point defendant tendered Waste Treatment Facility to city, and not before during course of negligent conduct starting at time contract was awarded); *Bartholomew v. Insurance Co. of North America*, 502 F. Supp. 246, 252 (D.R.I. 1980), *aff'd sub nom. Bartholomew v. Appalachian Ins. Co.*, 655 F.2d 27 (1st Cir. 1981) (time of damage and/or accident is the time the claimant was actually damaged, which is not necessarily the same as the time the wrongful act was committed). The courts have applied a continuous trigger only in those cases in which the property damages have slowly accumulated over a continuous period of time. See, e.g., *California Union Ins. Co. v. Landmark Ins. Co.*, 145 Cal. App. 3d 462, 193 Cal. Rptr. 461, 462 (1983) (involving progressive leaks from a pipe running from a pool that resulted in continuous seepage of water that physically weakened the slopes of the land); *C.P.S. Chem. Co. v. Continental Ins. Co.*, 199 N.J. Super. 558, 489 A.2d 1265, 1267 (N.J. Super. Ct. Law Div. 1984) (involving deposits of toxic waste into a municipal dump over a lengthy period of time); *Gruol Constr. Co. v. Insurance Company of North America*, 11 Wash. App. 632, 524 P.2d 427 (1974) (involving improper piling of sod which resulted in dry rot that continued to accumulate and worsen over a length of period of time).

100. 682 F. Supp. at 1411.

101. *Id.* This aspect of *Dayton* is one of the most troubling. There is no sound reason for

The court added by way of quintessential obiter dictum that excess carriers would be required to pay when their underlying primary policy was exhausted and that they would not be allowed to wait until the exhaustion of other primary policies whose coverage was triggered.¹⁰² This remarkable holding, supported by no authority and devoid of any analysis of the excess policy terms, is contrary to Texas authority granting protection to the position of excess carriers in multiple insurer schemes.¹⁰³ Moreover, it wholly ignores the fact that virtually all excess or umbrella policies provide that they pay in excess of not only the designated underlying primary policy, but also all other available, collectible, or applicable coverage.¹⁰⁴

The court also stated that the work product and sistership exclusions would not bar coverage for asbestos property damage claims.¹⁰⁵ As to the former, the court held there was no claim for damage to the insured's own product.¹⁰⁶ As to the latter, the court stated that the exclusion only applied when the insured, as opposed to a third-party claimant, removed the sister products as a preventative measure.¹⁰⁷

Workmanship Exclusions. The court in *Mid-United Contractors, Inc. v. Providence Lloyds Insurance Co.*¹⁰⁸ fully examined the business risk exclusions in the standard form general liability policy and the broad form endorsement. First, the court held that the work product exclusion does not apply to claims against a general contractor for the defective construction of a building because a building is constructed, not manufactured, thus falling outside of the definition of "named insured's products" as provided in the policy.¹⁰⁹ The court apparently adopted the insured's argument that the general contractor provided a service, not a product.¹¹⁰ The *Mid-United*

giving such an arbitrary delegation of power to the insured. The court appears to have fashioned its own administrative framework without regard for the policy terms. The court's interpretation ignores the "other insurance" clauses in the policies, thus violating the rules that the policy must be construed so as to give meaning to all terms in the contract and that the court may not rewrite the contract. *Puckett v. U.S. Fire Ins. Co.*, 678 S.W.2d 936, 938 (Tex. 1984).

102. 682 F. Supp. at 1411 n.23.

103. For example, see *Carrabba v. Employers Casualty Co.*, 742 S.W.2d 709, 715 (Tex. App.—Houston [14th Dist.] 1987, no writ), and *Liberty Mut. Ins. Co. v. United States Fire Ins. Co.*, 590 S.W.2d 783, 785 (Tex. Civ. App.—Houston [14th Dist.] 1979, writ ref'd n.r.e.), which held that the excess carrier would not be required to pay until the limits of its underlying primary policy and that of a separate, unscheduled primary policy were exhausted. The court in *Carrabba* stated that an umbrella policy is unique in character and is always intended as "true excess over and above any type of primary coverage." 742 S.W.2d at 714-15.

104. See *infra* discussion at note 136 and accompanying text.

105. 682 F. Supp. at 1412. The work product exclusion excludes coverage for bodily injury or property damage arising from the insured's product or work performed by or on behalf of the insured. The sistership exclusion excludes coverage for replacement of a product if it is withdrawn from use because of a defect, either known or suspected. *Id.*

106. *Id.*

107. *Id.* The court added that the damage had already occurred and thus withdrawal of the products could not have been a preventative measure. *Id.* at 1412-13.

108. 754 S.W.2d 824 (Tex. App.—Fort Worth 1988, no writ).

109. *Id.* at 826. A named insured's products were defined in the policy as meaning: "goods or products manufactured, sold, handled or distributed by the named insured." *Id.*

110. *Id.* The court rejected without discussion or citation the numerous cases on both sides of this issue. *Id.* Instead, the court looked to Texas cases defining "manufacturing" and "products" in other contexts. *Id.*

interpretation appears to be inapplicable in those cases in which the contractor actually provides and incorporates the products that later fail.

Second, the *Mid-United* court held exclusion VI(A)(3) of the Broad Form Comprehensive General Liability ("CGL") Endorsement, which deals with completed operations losses, did not bar coverage for claims of damage to work performed by subcontractors.¹¹¹ The court reasoned that the purpose of the broad form endorsement was to broaden coverage and that the terms of the policy sought to achieve this purpose by omitting the phrase "on behalf of" from the modified broad form completed operations exclusion.¹¹² The court did not address a growing line of authority holding that when the general contractor transfers the completed project to the owner, all work performed by the subcontractors merges into the insured's, thus bypassing the need for the "by or on behalf of" language.¹¹³

Finally, the court made clear that the coverage was not unlimited because of the presence of exclusion VI(A)(2)(d)(iii), which bars coverage for damages to "that particular part of . . . property the restoration, repair or replacement of which has been made or is necessary by reason of faulty workmanship thereon."¹¹⁴ The court distinguished the recent decision of the Dallas Court of Appeals in *Dorchester Development Corp. v. Safeco Insurance Co.*¹¹⁵ on the basis that there was no allegation in the case before it that any property other than "that particular part" was damaged as a result of the insured's defective workmanship.¹¹⁶

In *Sarabia v. Aetna Casualty & Surety Co.*¹¹⁷ the court applied the standard CGL workmanship exclusion.¹¹⁸ The insured in that case completely overhauled the claimant's truck. The insured failed to insert certain parts in

111. *Id.* at 828. The claims in *Mid-United* did not involve allegations of a defect in a product or material actually provided by the named insured. *Id.* at 825. Instead, the allegations focused on negligent inspection, inadequate supervision, and defective design and installation. *Id.*

112. *Id.* at 827. The court noted that exclusion (o), which was replaced by exclusion VI(A)(3) in the broad form endorsement, stated coverage was not available for property damage to work completed by or on behalf of the named insured. *Id.* Under exclusion (o) the policy would exclude claims for damage to work performed by a subcontractor on behalf of the general contractor. *Id.*

113. *Id.*; see *Tucker Constr. Co. v. Michigan Mut. Ins. Co.*, 423 So. 2d 525, 528 (Fla. Dist. Ct. App. 1982) (holding constructed floor of restaurant not covered after contractor accepted subcontractor's work and transferred completed work to owner); *Knutson Constr. Co. v. St. Paul Fire & Marine Ins. Co.*, 396 NW.2d 229, 236 (Minn. 1986) (faulty workmanship was a business risk of the general contractor).

114. 754 S.W.2d at 828 (quoting the policy) (emphasis by the court). The court held that if brick panels were defectively installed by a subcontractor and caused water damage to the walls and supporting brick, then damage to the panels themselves would be excluded as "that particular part." *Id.* (emphasis by the court).

115. 737 S.W.2d 380 (Tex. App.—Dallas 1987, no writ).

116. *Id.* Both *Dorchester* and *Mid-United* construed exclusion VI(A)(2)(d)(iii) as applying to completed operations losses. The other subsections of VI(A)(2)(d) generally apply only to damage occurring while the work is actually being performed, not after it has been completed. See *Cooper & Huddleston, Insurance Law, Annual Survey of Texas Law*, 42 Sw. L.J. 389, 401, n.103 (1988). The *Dorchester* and *Mid-United* interpretation would appear to make VI(A)(3) redundant.

117. 749 S.W.2d 157 (Tex. App.—El Paso 1988, no writ).

118. The exclusion stated that coverage was not available for "property damage to work

the engine, resulting in damage to the engine. The court held that the claim was not covered because of the workmanship exclusion, emphasizing that the work performed was a major overhaul and no damage was alleged except as to property the insured repaired, replaced, or reworked.¹¹⁹

Intentional Acts. In *Baldwin v. Aetna Casualty & Surety Co.*¹²⁰ the court held that claims made by the state against an insured for carrying overweight loads on state highways in violation of Texas Revised Civil Statute Annotated article 6701d-11, resulting in damage to the highways, involved wholly intentional acts falling outside of the definition of "occurrence" in a CGL policy.¹²¹ The insurer in *Baldwin* denied coverage of the claim prior to the filing of any suit, forcing the insured to settle the claim on its own. In determining if the insurance coverage entitled the insured coverage for the settlement, the court of appeals reviewed the petition the state threatened to file but for the settlement.¹²²

The court rejected the nuisance claims in the complaint, which the court admitted could be based on negligent acts, because it found that the nuisance claims were based on the allegations of deliberate acts stated elsewhere in the complaint.¹²³ The court appears to have taken a broad, alternative allegation of nuisance and incorporated in it the allegations set forth elsewhere in the petition.¹²⁴ This reasoning would appear to be contrary to the rule that the underlying complaint must be liberally interpreted, and, in case of any doubt or ambiguity, the allegations must be read in the light most favorable to the insured.¹²⁵ Texas courts have repeatedly held that where there are some claims that might be within coverage and some that might be out of coverage, the insurer still must provide a defense.¹²⁶

The court in *Baldwin* also held that the insured's affidavit stating that he did not act knowingly was immaterial.¹²⁷ The court misapprehended the

performed by or on behalf of the *named insured* arising out of the work of any portion thereof." *Id.* (emphasis in original).

119. *Id.* at 157-58 (citing *Travelers Ins. Co. v. Volentine*, 578 S.W.2d 501 (Tex. Civ. App.—Texarkana 1979, no writ)).

120. 750 S.W.2d 919 (Tex. App.—Amarillo 1988, no writ).

121. *Id.* at 920-21. The policy defined occurrence as meaning: "an accident, including continuous or repeated exposure to conditions which results in bodily injury or property damage neither expected nor intended from the standpoint from the insured." *Id.* at 920.

122. The authors of this article had some participation in this suit. The court of appeals opinion fails to mention that the exemplary petition was one brought against another party and thus did not specifically address the particular offenses alleged to have been committed by *Baldwin*.

123. *Id.* at 921.

124. *Id.* This typhoid approach could doom many DTPA suits where negligence and knowing acts are alternatively pleaded against the insured. The reasoning would be that if the alleged acts were done "knowingly," then coverage is not available even if there are alternative causes of action plead that do not require proof of knowing or intentional acts. In other words, an allegation of an intentional or expected act infects all other allegations.

125. See *Heyden Newport Chem. Corp. v. Southern Gen. Ins. Co.*, 387 S.W.2d 22, 24-25 (Tex. 1965).

126. *Maryland Casualty Co. v. Moritz*, 138 S.W.2d 1095 (Tex. Civ. App.—Austin 1940, writ ref'd); see *Dohoney, The Liability Insurer's Duty to Defend*, 33 BAYLOR L. REV. 451, 452-63 (1981).

127. 750 S.W.2d at 921.

claim made by the insured as being only one for wrongful refusal to defend.¹²⁸ In fact, the insured sought to determine whether an obligation existed requiring the insurer to indemnify the insured for the settlement of the claim, which is not an issue determined solely by considering the underlying complaint against the insured.¹²⁹

Declaratory Relief. The court in *Providence Lloyds v. Blevins*¹³⁰ held that an insurer may not obtain a declaration of liability under an insurance policy through a declaratory judgment action until there is a resolution of the underlying personal injury suit.¹³¹ The court followed *Firemen's Insurance Co. v. Burch*¹³² in which the court held that declaratory relief was not available in such circumstances because the personal injury suit might result in a finding of no liability, thus rendering the declaration purely advisory in nature.¹³³

128. *Id.*

129. *Id.* The court in effect held that the only material evidence was a petition that the state had threatened to file against the insured if he had not settled. *Id.*

130. 741 S.W.2d 604 (Tex. App.—Austin 1987, no writ).

131. *Id.* at 606-07.

132. 442 S.W.2d 331 (Tex. 1968).

133. 741 S.W.2d at 606. The result of the *Burch* rule places both insureds and insurers in a terrible predicament where coverage issues are involved. Under this system, the insurer is, according to some authorities, required to respond to settlement offers and otherwise act as though coverage were in place. A. WINDT, INSURANCE CLAIMS & DISPUTES: REPRESENTATION OF INSURANCE COMPANIES AND INSUREDS, § 4.05 at 44-45 (2d ed. 1988). Obviously, if the insurer is incorrect in its assessment of the coverage issues, disastrous results could follow. See, e.g., *Johansen v. California State Auto Ass'n Inter-Ins. Bureau*, 15 Cal. 3d 9, 12-14, 538 P.2d 744, 746-50, 123 Cal. Rptr. 288, 290-91 (1975) (insurer liable for full amount of judgment, even amount in excess of policy limits, after failing to accept reasonable settlement offer because it felt matter not covered). But see *Beck v. Pennsylvania Nat'l Mut. Ins. Co.*, 429 F.2d 813, 819 (5th Cir. 1970) (insurer not liable for judgment in excess of policy limits when overall fact situation indicates insurer denied coverage on reasonable basis); *State Farm Mut. Auto. Ins. Co. v. Skaggs*, 251 F.2d 356, 359 (10th Cir. 1957) (insurer not liable for amount in excess of policy simply because refused settlement offer under reasonable mistaken belief of noncoverage); *Mowry v. Badger State Mut. Casualty Co.*, 129 Wis. 2d 496, 385 N.W.2d 171, 178-80 (1986) (insurer's duty to settle depends on whether claim is covered under policy and it will not be held strictly liable for the judgment in excess of coverage in the event its decision regarding coverage is erroneous). The insurer is provided no mechanism through which to make a good faith determination of the availability or not of coverage that will prevent such consequences. The uncertainty of the pending coverage issues results in serious difficulties for the claimant, who must guess correctly as to whether there is coverage or not, for the insurer, who must do the same thing, and for the insured, who must go through the course of litigation without knowing whether the claim will be covered or not. Absent a legislative solution to this problem, it would appear to be incumbent upon the courts or the legislature to develop some system that will enable coverage issues to be determined in a fashion that protects the claimant, the insured, and the insurer. Under the present system, a windfall is awarded to the one who makes the best guess. Moreover, the present system encourages a multiplicity of litigation and prolongs the resolution of disputes.

A direct action in which the insurer is a named party in the underlying tort suit, thus injecting insurance coverage in the suit, is not the solution. One possible solution would be to permit a declaratory judgment action on the basis that there is a justiciable controversy, not involving an advisory opinion, where coverage issues exist and there has been a demand for settlement within the policy limits. Other solutions, such as intervention by the carrier with an accompanying stay of the tort action pending resolution of the coverage issues, might prove helpful.

Insolvency. In *TXO Production Corp. v. Twin City Fire Insurance Co.*¹³⁴ the court held that the law does not require an excess carrier to “drop down” and assume the defense and indemnity obligations of the insured upon the primary carrier’s insolvency. The court followed the decision of the Fifth Circuit Court of Appeals in *Steve D. Thompson Trucking, Inc. v. Twin City Fire Insurance Co.*,¹³⁵ in which the court emphasized that it is the very nature of an excess policy for coverage to begin only after a predetermined amount of primary coverage is exhausted.¹³⁶ The court in *TXO* emphasized that the Fifth Circuit has been faced with the growing problem of primary insurer insolvency and has repeatedly refused to “transmogrify” the umbrella policy into a guaranty of the solvency of the primary insurer chosen by the insured.¹³⁷

134. 685 F. Supp. 156, 157 (E.D. Tex. 1988).

135. 832 F.2d 309, 310 (5th Cir. 1987).

136. 685 F. Supp. at 157.

137. *Id.* at 158. The policy in *TXO* included an other insurance provision to the effect that the policy was intended to be excess insurance “over any other valid and collectible insurance” available to the insureds. *Id.* at 157 (noting that the same policy in *TXO* was addressed in *Steve D. Thompson Trucking, Inc. v. Twin City Fire Ins. Co.*, 832 F.2d 309 (5th Cir. 1987)). The courts in other jurisdictions have reached a number of different results on the insolvency issue depending upon the language utilized in the contract. Those policies that state that coverage is for amounts in excess of the limits “covered by . . . underlying insurance” have found that there is no duty to drop down in the event of insolvency. *Mission Nat’l Ins. Co. v. Duke Transp., Inc.*, 792 F.2d 550, 552 (5th Cir. 1986) (the term “covered” in the excess policy means the insured has coverage in an underlying policy regardless of whether he can collect from the primary insurer); *Pergament Distrib., Inc. v. Old Republic Ins. Co.*, 128 A.D.2d 760, 513 N.Y.S.2d 467, 468 (1987) (the term “covered” in the excess policy is not ambiguous, with the only reasonable interpretation being an underlying policy insures against a certain risk regardless of whether the insured can collect in the underlying policy).

Courts interpreting policies that state that the coverage is provided in excess of amounts “recoverable or collectible” from underlying policies have found that the excess carrier has in fact assumed the risk of the primary carrier’s insolvency and must drop down in the event of the primary’s insolvency. *Reserve Ins. Co. v. Pisciotta*, 30 Cal. 3d 800, 814-15, 640 P.2d 764, 770-72, 180 Cal. Rptr. 628, 636-37 (1982) (parties allocated risk of primary insurer’s insolvency to excess insurer in ambiguous agreement that stated excess insurer is liable for amount of loss in excess of “the amount recoverable under the underlying insurance.”); *Donald B. MacNeal, Inc. v. Interstate Fire & Casualty Co.*, 132 Ill. App. 3d 564, 87 Ill. Dec. 794, 477 N.E.2d 1322, 1325 (1985) (excess insurer of bodily injury on recreational facility assumed risk of primary insurer’s insolvency when it included ambiguous language in its agreement covering losses in excess of the “amount recoverable” from underlying policies); *Gros v. Houston Fire & Casualty Ins. Co.*, 195 So. 2d 674 (La. Ct. App. 1967) (auto insurance clause providing that coverage “shall be excess insurance over any other valid and collectible insurance” refers to the conditions at the time of judgment instead of time of accident, and therefore, covers those losses that are uncollectible due to the primary insurer’s insolvency at the time of judgment); *Warner Indus., Inc. v. First State Ins. Co.*, 217 N.J. Super. 436, 526 A.2d 236, 240-41 (N.J. Super. Ct. App. Div. 1987) (policy language that excess insurer is liable for loss “in excess of the amount recoverable under the underlying insurance” is ambiguous; therefore, interpreting the phrase against the insurer, the excess insurer assumes the rest of the primary insurer’s insolvency). This approach has been rejected by at least one court. *Golden Isles Hosp., Inc., v. Continental Casualty Co.*, 327 So. 2d 789 (Fla. Dist. Ct. App. 1976).

Finally, courts interpreting policies stating that coverages in excess of the “applicable limits” of underlying insurance have reached different results. The vast majority of cases have found that the excess insurer is not required to drop down. *See, e.g., Zurich Ins. Co. v. Heil Co.*, 815 F.2d 1122, 1124-26 (7th Cir. 1987) (policy language providing excess insurer is liable only after claims exceed specified amount is unambiguous and does not obligate excess insurer to cover losses less than that amount upon the insolvency of the primary insurer); *Holland v. Stanley Scrubbing Well Serv.*, 666 F. Supp. 898 (W.D. La. 1987) (construing terms of insurance con-

Punitive Damages. The court in *American Home Assurance Co. v. Safeway Steel Products Co.*¹³⁸ held that an umbrella general liability policy provided coverage for punitive damage claims brought against the insured.¹³⁹ The court first trudged through an especially murky choice of law question, ultimately holding that Texas law applied because Texas was the site of the underlying tort and lawsuit despite that the insurance contracts were negotiated, executed, and premiums paid elsewhere and the insured was not a Texas resident.¹⁴⁰ On the coverage issue, the court rejected both constructional and public policy arguments against the availability of coverage.¹⁴¹

First, the court held that a claim of gross negligence against the insured did not amount to damages intended or expected from the standpoint of the insured.¹⁴² The court noted that the insuring agreements of the policies stated coverage was provided for "all sums" and "the total sum" the insured was legally obligated to pay as damages.¹⁴³ The court emphasized that this language was broad enough to reasonably encompass punitive damages and that, at the very least, such damages arise out of the alleged injuries.¹⁴⁴

Second, the court held that coverage for such damages is not against public policy.¹⁴⁵ The court reasoned that the purposes of punitive damages, to punish and to deter, would not be defeated by allowing coverage because, in Texas, juries are not allowed to consider the wealth or resources of the defendant in assessing punitive damages.¹⁴⁶ This part of the court's opinion is

tract according to their general and popular meaning, language unambiguously demonstrates excess insurer had no intent of ever becoming a primary insurer); *Guaranty Nat'l Ins. Co. v. Bayside Resort*, 635 F. Supp. 1456, 1458 (D.V.I. 1987) (excess insurer's liability is triggered only when conditions of policy are met, including the insured's damages exceeding \$500,000); *United States Fire Ins. Co. v. Capital Ford Truck Sales, Inc.*, 257 Ga. 77, 355 S.E.2d 428, 432 (1987) (excess insurer has no contractual obligation to defend or cover insured in personal injury action where terms of contract unambiguously state that the excess coverage is not applicable until damages exceed a specified dollar limit); *Value City, Inc. v. Integrity Ins. Co.*, 30 Ohio App. 3d 274, 508 N.E.2d 184, 286-88 (1986) (the assumption of primary risk of loss by the excess insurance carrier upon insolvency of the primary insurance carrier is an improper construction, using the plain meaning rule, of policy language providing the excess insurer has no liability on losses less than \$500,000). The Fifth Circuit has expressly followed this rule in *Steve D. Thompson* and the earlier case of *Continental Marble & Granite v. Canal Ins. Co.*, 785 F.2d 1258, 1259 (5th Cir. 1986). Those contrary cases holding that the excess carrier using the "applicable" language must drop down include the following: *Massachusetts Insurers Insolvency Fund v. Continental Casualty Co.*, 399 Mass. 598, 506 N.E.2d 118 (1987); *Gulezian v. Lincoln Ins. Co.*, 399 Mass. 606, 506 N.E.2d 123 (1987); *Macalco, Inc. v. Gulf Ins. Co.*, 550 S.W.2d 883 (Mo. Ct. App. 1977).

138. 743 S.W.2d 693, 701-02 (Tex. App.—Austin 1987, writ denied).

139. One of the appellants in this case, National Union, provided an umbrella policy that followed the form of the primary CGL policy. Thus, the court's holding is applicable to both primary and excess general liability policies. *Id.* at 695.

140. *Id.* at 697-99. The court interpreted art. 21.42 of the Texas Insurance Code as requiring the use of Texas law because the insurance policies became payable to Texas plaintiffs when the underlying judgments became final. *Id.* This provision has typically been found to apply where the insured is a Texas citizen or inhabitant, without regard being given to the location of the claimant.

141. *Id.* at 701-04.

142. *Id.* at 701.

143. *Id.*

144. *Id.* at 701-02.

145. *Id.* at 704.

146. *Id.*

subject to serious question after *Lunsford v. Morris*¹⁴⁷ in which the Texas Supreme Court permitted discovery and, under appropriate circumstances, admissibility of evidence of the defendant's wealth.¹⁴⁸

The court also asserted that the threat of increased premiums and the potential for damages in excess of coverage limits would in any event serve to deter potential wrongdoers.¹⁴⁹ The court admitted that prior Texas case law on the punitive damages coverage issue, interpreting automobile policies, had been substantially questioned.¹⁵⁰ The court, however, did not discuss the impact of the fact that the Texas Legislature has abolished coverage for punitive damages in certain types of policies. The court tacitly admitted that punitive damages are now quite easy to obtain in Texas and do not require high thresholds of proof of extreme conduct; the court recognized that such awards are so prevalent that they have become another business risk that may be passed on to the consumer.¹⁵¹

Notice. In *Stonewall Insurance Co. v. Modern Exploration, Inc.*¹⁵² the court reversed a summary judgment entered in favor of a judgment creditor against an excess umbrella liability insurer. The court held that the excess insurer had not waived the right to assert a late notice defense as a matter of law.¹⁵³ The court noted that a notice defense is not waived where liability is denied after the "reasonable" time period for giving notice.¹⁵⁴ The court added that the evidence was in dispute as to whether the insured had relied to its detriment on the insurer's actions, thus creating a fact issue as to the

147. 746 S.W.2d 471 (Tex. 1988).

148. *Id.* at 472-73. The court in *Lunsford* made clear that available resources and the ability to deter and punish were inextricably intertwined. *Id.* at 472. The court stated "[a] defendant's ability to pay bears directly on the question of adequate punishment and deterrence. That which could be an enormous penalty to one may be but a mere annoyance to another." *Id.*

149. *Safeway Steel*, 743 S.W.2d at 704. The court did not discuss the fact that insurance rates are heavily regulated and not necessarily subject to the type of on-the-spot increase that would amount to a deterrence.

150. *Id.* at 703. The court noted the leading decision in Texas on this point, *Dairyland County Mut. Ins. Co. v. Wallgren*, 477 S.W.2d 341, 342 (Tex. Civ. App.—Fort Worth 1972, writ ref'd n.r.e.), has been questioned. The court in that case reasoned that the fact that the state insurance board had approved the use of the all encompassing language "all sums" indicated that the public policy of Texas favored recovery of punitive damages. *Id.* This holding has been followed in numerous other cases involving different types of policies. *Ridgway v. Gulf Life Ins. Co.*, 578 F.2d 1026, 1029-30 (5th Cir.) (involving umbrella liability policy to trucking company), *reh'g denied en banc*, 583 F.2d 541 (5th Cir. 1978); *Big Town Nursing Homes, Inc. v. Reserve Ins. Co.*, 492 F.2d 523, 526 (5th Cir. 1974) (interpreting malpractice endorsement of general liability policy); *Home Indem. Co. v. Tyler*, 522 S.W.2d 594, 597 (Tex. Civ. App.—Houston [14th Dist.] 1975, writ ref'd n.r.e.) (construing uninsured motorist provision). The court in *Safeway* was correct in avoiding direct reliance upon the decision in *Dairyland*. That decision's determination of public policy from the state board of insurance's approval of standard form policy language is obviously very questionable. Moreover, this reasoning would not appear to be readily transferable to other forms of policies, such as general liability policies, which are not necessarily promulgated by the board.

151. 743 S.W.2d at 703-04.

152. 757 S.W.2d 432, 433 (Tex. App.—Dallas 1988, no writ).

153. *Id.* at 436.

154. *Id.*

applicability of the doctrine of estoppel.¹⁵⁵ Finally, the court held that the reasonableness of the notice was also a fact question despite the fact that the insured never gave written notice, that the primary did not give notice until six months after the occurrence, and that the insured allowed a default judgment to be taken against it by the judgment creditor without timely forwarding the suit papers to the insurer.¹⁵⁶

Constitutional Claims. In *Continental Casualty Co. v. McAllen Independent School District*¹⁵⁷ the Fifth Circuit held that a board of education liability policy, which excluded coverage for bodily injury, did not provide coverage for claims of bodily injury resulting from the abridgement of a constitutional right. The court stated that the "focus is on the origin of the damages, not the legal theory of the claim."¹⁵⁸

III. Automobile Insurance

Stacking of Underinsured Motorist Coverage. In *Stracener v. United Services Automobile Association*¹⁵⁹ a Texas appellate court for the first time addressed the issue of inter-policy stacking of underinsured motorist coverage.¹⁶⁰ Stracener was killed when a car driven by Lampe struck the automobile in which Stracener was a passenger. Stracener's decedents settled with Lampe's liability insurance carrier for \$27,500.¹⁶¹ Four separate underinsured motorist policies covered the car in which Stracener was a passenger.¹⁶²

The trial court granted United Services Automobile Association (USAA) summary judgment on the ground that the USAA policy was not applicable since Lampe's liability coverage exceeded the limits of the underinsured coverage provided by the USAA policy.¹⁶³ The court of appeals affirmed, holding that the insured could not stack all available underinsured motorist coverage in determining whether a tortfeasor fell within the definition of underinsured for one particular policy.¹⁶⁴ In reaching this holding, the court relied heavily on the wording of the insurance policy and the applicable stat-

155. *Id.*

156. *Id.* at 434-36.

157. 850 F.2d 1044, 1046 (5th Cir. 1988).

158. *Id.* at 1046-47.

159. 749 S.W.2d 158 (Tex. App.—Houston [1st Dist.] 1988, no writ).

160. Texas courts had previously addressed inter-policy stacking of uninsured motorist coverage. *See, e.g., American Motorists Ins. Co. v. Briggs*, 514 S.W.2d 233 (Tex. 1974); *American Liberty Ins. Co. v. Ranzau*, 481 S.W.2d 793 (Tex. 1972).

161. The opinion does not reveal the limits of liability of Lampe's coverage or whether the Straceners obtained consent to settle from the underinsured motorist carriers.

162. The limits of liability provided under the policies were as follows:

American National Property & Casualty Co.	\$100,000
State Farm Mutual Automobile Ins. Co.	\$ 10,000
Allstate Ins. Co.	\$ 25,000
United Services Automobile Association	\$ 15,000
TOTAL	\$150,000

749 S.W.2d at 159.

163. *Id.*

164. *Id.* at 160.

utes.¹⁶⁵ The court noted that both the policy and the statutory definition of underinsured motor vehicle¹⁶⁶ made reference to the insurance policy in the singular.¹⁶⁷

Article 5.06-1(2)(b) defines underinsured motor vehicle as being one of which the valid and collectible liability insurance coverage is in an amount "less than the limit of liability stated in the underinsured coverage of the insured's policy."¹⁶⁸ Likewise, the policy defines underinsured motor vehicle with reference to "the limit of liability for this coverage."¹⁶⁹ The court reasoned that the legislature would have referred to the policies rather than simply the policy if the legislature had intended the courts to stack all available policies in determining whether a tortfeasor was an underinsured motorist.¹⁷⁰

The court also distinguished cases allowing inter-policy stacking in the context of uninsured motorist coverage.¹⁷¹ The court stressed that those cases dealt with uninsured rather than underinsured coverage.¹⁷² The court reasoned that, by definition, a tortfeasor is not an underinsured motorist so long as he has available coverage in excess of the underinsured motorist coverage carried by the policy holder.¹⁷³

Less than four months after the First District Court of Appeals sitting in Houston held that inter-policy stacking was not permissible with respect to underinsured coverage, the San Antonio Court of Appeals reached the opposite conclusion. In *United Services Automobile Association v. Hestilow*¹⁷⁴ the court held that all underinsured motorist coverages available to an injured insured must be aggregated in order to determine whether a tortfeasor is an underinsured motorist. Ironically, the court in *Hestilow*, like the court in *Stracener*, focused on the intent of the legislature in drafting article 5.06-1 of the Texas Insurance Code.¹⁷⁵ The court determined that the purpose of the legislature in enacting underinsured motorist legislation was to provide an injured insured coverage in an amount no less than the coverage that he would have received had the tortfeasor been fully covered in relation to the claimant's underinsured motorist coverage.¹⁷⁶

Unlike the court in *Stracener*, the *Hestilow* court found the prior case law

165. *Id.* at 159-60.

166. TEX. INS. CODE ANN. art. 5.06-1(2)(b) (Vernon 1981).

167. 749 S.W.2d at 160.

168. TEX. INS. CODE ANN. art. 5.06-1(2)(b) (Vernon 1981).

169. 749 S.W.2d at 159.

170. *Id.* at 160.

171. *Id.*; see *supra*, note 159.

172. 749 S.W.2d at 160.

173. *Id.*

174. 754 S.W.2d 754 (Tex. App.—San Antonio 1988, no writ).

175. *Id.* at 757-60.

176. *Id.* at 758; see also *Infante v. Texas Farmers Ins. Co.*, 640 S.W.2d 321, 323 (Tex. App.—Beaumont 1982, writ ref'd n.r.e.) (stating the purpose of underinsured motorist provision and the construction of such provision in insurance agreements in light of settlement between injured and tortfeasor insurance company); *Muller v. Allstate Ins. Co.*, 627 S.W.2d 775, 777 (Tex. App.—Houston [1st Dist.] 1981, no writ) (construing purpose of underinsured motorist provision and application of such after injured received an amount from tortfeasor's insurer equal to the amount of the injured's underinsured motorist provision).

concerning stacking of uninsured motorist coverage to be applicable in the underinsured context.¹⁷⁷ The court reasoned that to deny stacking of underinsured policies would deny the insured benefits for which he paid premiums, and benefits for which the legislature demanded coverage.¹⁷⁸ Thus, the court concluded that separate policies must be stacked when determining whether a tortfeasor is underinsured.¹⁷⁹

The court in *Hestilow* expressly rejected the reasoning of the *Stracener* court.¹⁸⁰ The *Hestilow* court noted that the court in *Stracener* ignored the part of the Code Construction Act¹⁸¹ that provides that, in the absence of an express provision otherwise, the singular includes the plural.¹⁸² Since the court in *Hestilow* interpreted the legislative intent to mandate stacking, the court declined to follow the holding in *Stracener*.¹⁸³

Loading and Unloading. The court in *Hartford Fire Insurance Co. v. Rainbow Drilling Co.*¹⁸⁴ addressed the issue of whether an owner of an oilwell drilling rig who had hired the owner of a gin pole truck to help move the drilling rig was an additional insured under the policy covering the gin pole truck. Rainbow employed Union City to move an oilwell drilling rig from one site to another. Moore, an employee of Union City, was injured when a cable from the gin pole truck broke while the rig was being reassembled at the new site. Moore sued Rainbow, alleging that a Rainbow employee was directing a Union City employee to lift the rig superstructure with the gin pole truck at the time of the accident. Rainbow demanded that the insurers of the gin pole truck provide it with a defense in the suit brought by Moore, but the insurers denied coverage. Rainbow then brought a declaratory judgment action seeking to compel the insurers to provide it with a defense.

After a trial to the bench, the trial court entered judgment declaring that Rainbow was an additional insured under the policy covering the gin pole truck. Accordingly, the insurers owed Rainbow a defense in the Moore action.¹⁸⁵ The policy in question included persons using the truck with permission as additional insureds, except as to bodily injury arising out of the loading or unloading of the vehicle. The policy provided that with respect to loading or unloading, the other person is an insured only if he is a lessee or borrower of the vehicle.¹⁸⁶ The trial court found that Rainbow's directing of

177. 754 S.W.2d at 757-58.

178. *Id.* at 758.

179. *Id.* In stating its holding, the court emphasized the term "separate," thus implying that intra-policy stacking would not be proper. *Id.*

180. *Id.* at 761.

181. TEX. GOV'T CODE ANN. § 312.003(b) (Vernon Supp. 1989).

182. 754 S.W.2d at 761.

183. *Id.*

184. 748 S.W.2d 262 (Tex. App.—Houston [14th Dist.] 1988, no writ).

185. *Id.* at 263-64.

186. The policy provided:

Each of the following is an insured under this insurance to the extent set forth below:

(a) the named insured;

...

(c) any other person while using an owned automobile . . . with the permis-

Union City constituted a use of the vehicle and that such use did not constitute the loading or unloading of the truck.

The court of appeals, however, disagreed, holding that the insurers owed Rainbow no duty to defend it in the *Moore* suit.¹⁸⁷ After examining the allegations in Moore's petition, the court of appeals concluded that Moore's injuries arose out of the loading or unloading of the truck.¹⁸⁸ The court reasoned that loading and unloading continues until the operation for which the vehicle is being used is completed.¹⁸⁹ Applying that reasoning to the case before it, the court concluded that, since Rainbow and Union City were still assembling the rig at the time of the accident, the injuries arose out of the unloading of the gin pole truck.¹⁹⁰

The court also found that the petition could not be read to allege that Rainbow was a borrower of the truck.¹⁹¹ Since there was no evidence offered in the declaratory judgment action other than the petition, the court held that there was no evidence to support a conclusion that Rainbow was a borrower or a lessee of the vehicle.¹⁹² The court implicitly stated that evidence outside of the petition itself could be considered in determining who is an insured. This type of narrow exception to the complaint allegation rule is very sensible: on the one hand, it allows the party who is obviously an insured to get a defense despite defective allegations; on the other hand, it allows the insurer to avoid having to defend a party who was never intended to be an insured despite vague or erroneous allegations.¹⁹³

Assignments. In *State Farm Mutual Automobile Insurance Co. v. Ollis*¹⁹⁴ the El Paso Court of Appeals held that a liability insurer who settles a liability claim with an injured party after receiving notice that the injured party had

sion of the named insured, provided his actual operation or (if he is not operating) his other actual use thereof is within the scope of such permission, but with respect to bodily injury . . . arising out of the loading or unloading thereof, such other person shall be an insured only if he is:

(1) a lessee or borrower of the automobile

Id. at 263.

187. *Id.* at 266.

188. *Id.* at 265-66.

189. *Id.* at 266.

190. *Id.*

191. *Id.* at 267.

192. *Id.* The court's reference to evidence other than the petition raises an interesting issue. It is well settled in Texas law that an insurer's duty to defend is determined solely from the face of the pleadings and without reference to facts outside the pleadings. See *Argonaut Southwest Ins. Co. v. Maupin*, 500 S.W.2d 633, 635 (Tex. 1973); *Heyden Newport Chem. Corp. v. Southern Gen. Ins. Co.*, 387 S.W.2d 22, 24 (Tex. 1955).

193. Compare *McBroome-Bennett Plumbing, Inc. v. Villa France, Inc.*, 515 S.W.2d 32, 37 (Tex. Civ. App.—Dallas 1974, writ ref'd n.r.e.) (rule applying strict construction to ambiguities in insurance policy not applicable when dispute centers on whether claimant is an insured) with *Heyden Newport Chem. Corp. v. Southern Gen. Ins. Co.*, 387 S.W.2d 22, 25 (Tex. 1955) (complaint allegation rule is applicable even where a party is seeking to establish his status as an insured). An extensive discussion of this issue is presented in A. WINDT, *supra* note 133, § 4.05. Windt observes that the exception to the complaint allegation rule is "salutary." *Id.* at 145. He states that the insurer has not agreed "to defend a complete stranger to the contract." *Id.* at 144. He notes that the cases strictly applying the complaint allegation rule in such situations has been pro forma and devoid of legitimate analysis of the issue. *Id.* at 146.

194. 754 S.W.2d 781 (Tex. App.—El Paso 1988, no writ).

previously assigned any rights he had against the liability insurer to a third party is liable to the assignee as a matter of law.¹⁹⁵ Hernandez was injured in an automobile accident with Aldava, who carried automobile liability coverage with State Farm. In return for medical treatment made necessary by the accident, Hernandez assigned to his doctor all of his rights to receive benefits otherwise payable to Hernandez by State Farm. State Farm subsequently paid Hernandez \$9,000 in settlement of his claim, despite previously receiving from the doctor a copy of the assignment.

The doctor then brought a suit against State Farm in which the trial court granted the doctor's motion for summary judgment.¹⁹⁶ On appeal, State Farm argued that the summary judgment was improper because the doctor had not obtained a judgment from the insured, which State Farm argued was a prerequisite to the legal responsibility of the insurer.¹⁹⁷ The court of appeals, however, disagreed, holding that the insured became legally obligated to pay the Assignee upon execution of the settlement contract instead of damages.¹⁹⁸ The court based its holding on (1) the fact that the assignment was valid, and (2) the rule of law that once a debtor has knowledge of an assignment, he may not pay money to the assignor so as to deprive the assignee of his right.¹⁹⁹

The dissent argued that the insurer's responsibility is not triggered until there is some judgment entered against its insured.²⁰⁰ The release expressly denied any liability of the insured or the insurer. Thus, the dissent argued, the policy favoring settlement dictates against the majority's holding that a settlement agreement may make an insurer legally responsible to an injured party.²⁰¹ The dissent, however, confuses who is the injured party in the case before it. Since the assignment purported to assign all of Hernandez's rights, Hernandez no longer owned the cause of action and therefore had no valid claim to press against the insured.²⁰² Rather than paying \$9,000 to Hernandez, State Farm could have "bought its peace" for the entire claim for the \$4,461 that the doctor received by way of summary judgment.

IV. PROPERTY INSURANCE

Premium Payments. In *Union National Bank v. Moriarty*²⁰³ the court held that the doctrine of estoppel applied to prevent a forfeiture of a fire insurance policy.²⁰⁴ Beginning in 1980, part of Moriarty's mortgage payments to Union Bank went into an escrow account from which Union Bank would

195. *Id.* at 783.

196. *Id.* at 782.

197. The insuring agreement obligated State Farm to pay damages for bodily injury for which its insured became legally responsible because of an auto accident. *Id.*

198. *Id.* at 783.

199. *Id.* at 782-83.

200. *Id.* at 783.

201. *Id.* at 784.

202. See *Duke v. Brookshire Grocery Co.*, 568 S.W.2d 470, 472-73 (Tex. Civ. App.—Texarkana 1978, no writ).

203. 746 S.W.2d 249 (Tex. App.—Texarkana 1988, writ denied).

204. *Id.* at 252.

pay her insurance premiums to Aetna, the insurer of Moriarty's home. When Moriarty moved out of her home in 1980, she notified Union Bank, but not Aetna, of her new address. Aetna denied Moriarty's claim for benefits in 1983 when her house burned. The jury found that Union Bank was an agent for Aetna as defined in article 21.02 of the Texas Insurance Code,²⁰⁵ and that Union Bank's negligence in failing to notify Aetna of Moriarty's change of residence proximately caused her damages resulting from the fire.²⁰⁶

The Texarkana Court of Appeals held that Aetna was estopped to deny coverage on the house, even though the policy provided that coverage terminated when the insured ceased to be a resident of the house, since Aetna continued to accept premiums paid by Union Bank after Moriarty moved.²⁰⁷ The court concluded, in light of *Texas Farmers Insurance Co. v. McGuire*,²⁰⁸ that Moriarty was not seeking to change and enlarge the risk covered under the policy, but was "seeking to avoid a forfeiture of coverage on the basis that she was not residing in the house at the time of the fire."²⁰⁹ Therefore, estoppel could, and did, apply against Aetna because Union Bank's knowledge of Moriarty's change of address was imputed to Aetna under the agency theory.²¹⁰

Principal Dwelling. In *Spates v. Republic Insurance Co.*²¹¹ fire destroyed the insureds' home after they had moved to another residence. Republic refused the insureds' claim on the basis that they were not using the home as their dwelling place at the time of the fire. The trial court granted Republic summary judgment and the insureds alleged, inter alia, on appeal that there were factual issues as to the exact date they vacated their home. While the Texas Standard Homeowner's Policy at issue defined an insured dwelling as one

205. TEX. INS. CODE ANN. art. 21.02 (Vernon Supp. 1989). The instruction on agency given to the jury was essentially based upon the definition in art. 21.02. The instruction provided: "By agent, as used herein, is meant any person or company who receives, collects or transmits any premium of insurance or does or performs any other act or thing in the making or consummating of any contract of insurance for or with any such insurance company other than himself." *Moriarty*, 746 S.W.2d at 253. Aetna argued that Union Bank's interest as mortgagee in the premiums disqualified it from being an agent as provided in the jury instruction. *Id.* at 254. The court noted that the amount Moriarty owed on the mortgage was far less than her equity interest in the mortgage and, therefore, held that the full amount of the premium was *not* paid for Union Bank's benefit. *Id.* Union Bank was therefore an agent of Aetna since the evidence was uncontroverted that it accepted the premiums from Moriarty and then paid Aetna those premiums. *Id.*

206. 745 S.W.2d at 251.

207. *Id.* at 252-53.

208. 744 S.W.2d 601 (Tex. 1987).

209. 745 S.W.2d at 252-53.

210. *Id.* at 251, 253. The court quoted *American Fire & Casualty Co. v. Eastham*, 185 F.2d 729 (5th Cir. 1950), holding: "It is well-settled under Texas law that where the insurer acquires full knowledge of facts sufficient to work a forfeiture of its policy, and does not cancel the policy but retains the unearned premium, it waives the condition and is estopped to claim a forfeiture." *Moriarty*, 746 S.W.2d at 252 (citing *Eastham*, 185 F.2d at 730). The court also awarded Moriarty attorney fees since the award against Aetna under the estoppel doctrine is based upon the contract of insurance and attorney's fees are recoverable in such a situation. *Id.* at 255.

211. 756 S.W.2d 88 (Tex. App.—San Antonio 1988, no writ).

"occupied by the insured principally for dwelling purposes," it also provided that coverage expired sixty days after the dwelling becomes vacant.²¹² The San Antonio Court of Appeals held that the sixty-day grace period provision was controlling and not without legal effect.²¹³ Because Republic had failed to prove specifically when the house became vacant, the court reversed the summary judgment and remanded the case for trial.²¹⁴

Subrogation. In *Cox v. Realty Development Corp.*²¹⁵ the court considered whether a dismissal of a plaintiff's cause of action for discovery abuse also dismissed the subrogation claim of the plaintiff's insurer. In *Cox* the plaintiff brought suit against the defendants for damages he incurred from a fire at the defendants' apartment complex. The insurer intervened, asserting its subrogation rights to the plaintiff's cause of action to the extent it had made payments on the plaintiff's claim. The lower court found in favor of the plaintiff in the trial on liability.²¹⁶ When the plaintiff failed to appear at a deposition before the subsequent trial on damages, the court granted the defendants' motion for sanctions and dismissed the entire case.²¹⁷

The insurer, Aetna, argued on appeal that its claim was improperly dismissed since it had complied with the discovery request. The appellate court noted that the defendants brought their motion specifically as to the plaintiff's claim, and not against Aetna, and that the order of dismissal was predicated solely upon the discovery sanctions against plaintiff.²¹⁸ Accordingly, the court reversed the dismissal as to Aetna.²¹⁹ Also significant in the appellate court's decision was the fact that Aetna became pro tanto owner of the plaintiff's claim through payment and subrogation *before* the plaintiff's abuse of discovery.²²⁰

ERISA Preemption. Expounding the holding of the United States Supreme Court in *Pilot Life Insurance Co. v. Dedeaux*,²²¹ the Houston Court of Appeals ruled that ERISA²²² preempts the enforcement of not only state common law remedies²²³ but also state statutory remedies²²⁴ for the bad faith

212. *Id.* at 89.

213. *Id.* at 90.

214. *Id.* at 91.

215. 748 S.W.2d 492 (Tex. App.—Dallas 1988, no writ).

216. *Id.* at 493.

217. *Id.*

218. *Id.* at 494. The court rejected the defendants' argument that the boiler-plate language of the order "denying all relief not specifically granted by the court" effectively granted defendants a judgment non obstante veredicto against Aetna. *Id.*

219. *Id.*

220. *Id.* Moreover, the court recognized that the trial court's order of dismissal was in essence a sanction for the plaintiff's abuse of discovery and that Aetna had done nothing to merit this punishment. *Id.*

221. 107 S. Ct. 1549 (1987).

222. Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001-1641 (1982 & Supp. IV 1986).

223. *Gorman v. Life Ins. Co. of No. America*, 752 S.W.2d 710 (Tex. App.—Houston [1st Dist.] 1988, no writ).

224. *Cathey v. Metropolitan Life Ins. Co.*, 764 S.W.2d 286 (Tex. App.—Houston [1st Dist.] 1988, writ requested); *accord Juckett v. Beachum Improvement Prod., Inc.*, 684 F. Supp. 448 (N.D. Tex. 1988).

denial of benefits under a regulated employee benefit plan. In *Gorman v. Life Insurance Co. of North America* the insurer relied wholly upon the employer's conclusion that the trip during which an employee died was not business-related therefore denying death benefits under a regulated plan.²²⁵ Although the family sued the insurer for breaches of state common law and statutory duties, it secured jury findings only on common law theories of recovery.²²⁶ The court of appeals reasoned that, even though the state courts have concurrent subject-matter jurisdiction to enforce federal remedies with respect to regulated plans,²²⁷ they lack jurisdiction to entertain suits prosecuted under state common law because ERISA expressly preempts the enforcement of state law remedies relating to employee benefit plans within the scope of the act.²²⁸

The judgment in *Gorman*, however, did not require the court to address the question of whether state *statutory* remedies fall within the scope of an exception to the preemption doctrine. Congress explicitly excepted from the preemption clause state laws that "regulate insurance."²²⁹ Courts have held that insurance regulation for purposes of this exception is limited to those laws that are specifically directed toward that industry and not to the regulation of employee welfare benefit plans.²³⁰

225. 752 S.W.2d at 712.

226. *Id.* at 711.

227. *Id.* at 712.

228. *Id.* at 714. Holding that ERISA divests state *courts* of subject-matter jurisdiction confuses the preemption of state *legislative* action with a grant of exclusive judicial authority to a federal tribunal. This holding appears to be based on *Barry v. Dymo Graphic Systems, Inc.*, 394 Mass. 830, 478 N.E.2d 707, 711-12 (1985), in which the Massachusetts Supreme Court held that ERISA preemption could be raised for the first time on appeal because it presented a question of subject-matter jurisdiction. The court based its conclusion on an earlier holding in *Tosti v. Ayik*, 386 Mass. 721, 437 N.E.2d 1072 (1982), that the NLRA preempted state libel laws and divested the state courts of subject-matter jurisdiction.

The Massachusetts court's reliance on *Tosti* was misplaced because the NLRA expressly precludes not only the application of state law to labor disputes but also vests the NLRB with exclusive jurisdiction to adjudicate those disputes. *Garner v. Teamsters*, 346 U.S. 485, 490-91 (1953). Thus, in the context of the NLRA, the preemption in question is judicial as well as legislative and divests state courts of subject-matter jurisdiction to entertain suits relating to matters within the scope of that Act. *International Longshoremen's Ass'n v. Davis*, 106 S. Ct. 1904, 1916 (1986).

ERISA, on the other hand, contains no provision vesting a federal tribunal with exclusive jurisdiction to adjudicate suits relating to covered plans. Indeed, the Act expressly provides for concurrent jurisdiction by both state and federal courts, 29 U.S.C. § 1132(a)(1)(B), (e)(1) (1982), provided that the suit will be governed by federal substantive law that supersedes all state laws relating to any employee benefit plan. See 29 U.S.C. § 1144 (1982 & Supp. IV 1986). Thus, although the trial court in *Gorman* had jurisdiction of the suit, the plaintiffs sought to recover under an improper legal theory. Moreover, substantive legal defects in the theory of recovery alleged must be pointed out in writing before submitting the case to the jury. TEX. R. CIV. P. 90. Failure to do so results in a waiver of the right to later complain of those defects. *Stonecipher's Estate v. Butts' Estate*, 686 S.W.2d 101, 103 (Tex. 1985). Therefore, notwithstanding *Gorman*, the prudent practitioner would be well-advised to inform the trial court in writing that the opponent's state law theories of recovery are preempted by ERISA rather than raising that complaint for the first time on appeal.

229. 29 U.S.C. § 1144(b)(2)(B) (1982); *Gorman*, 752 S.W.2d at 711-12.

230. *Dedeaux*, 107 S. Ct. at 1554.

In *Cathey v. Metropolitan Life Insurance Co.*,²³¹ the plaintiffs alleged, in addition to common law theories of recovery, violations of DPTA and of articles 3.62 and 21.21 of the Insurance Code.²³² The court of appeals upheld the trial court's conclusion that federal law preempted the application of these statutes to suits relating to employee welfare benefit plans.²³³ The court reasoned that these statutes were not within the scope of the exception to the general rule of preemption because they did not regulate the substantive terms of insurance contracts and because these statutes had an impact on more than the insurance industry.²³⁴

V. HEALTH, LIFE, AND ACCIDENT INSURANCE

Change of Beneficiary. Two cases during the survey period dealt with change of beneficiaries of a life insurance policy. In *Seaman v. Seaman*²³⁵ the insured, Seaman, died in 1982; his life insurance death benefit was \$68,000. He and his first wife, Margie Seaman, had divorced in 1977. The divorce agreement dividing the marital property contained a provision awarding her all right, title, and interest in any insurance policies Seaman owned that were in effect as of the separation date. At the time of the divorce, the death benefit under the policy was \$44,000, as determined by Seaman's salary level at that time. Seaman married Carol W. Seaman, his second wife, in 1980 and named her as beneficiary of his life insurance policy, replacing Margie. After Seaman's death, both the first and second wives claimed the benefits. Accordingly, the insurer filed an interpleader. The jury determined that Seaman intended for his first wife, Margie, to receive all increases in the life insurance benefits that accrued after their divorce.

The *Seaman* court held that the property settlement agreement divested the insured of the right to change the beneficiary of the policy.²³⁶ Because Margie Seaman was already the beneficiary of the policy at that time, the court reasoned, she remained entitled to the benefits of the policy.²³⁷ Furthermore, the court held that the law of this case, established in an earlier appeal,²³⁸ was that the property settlement agreement contained ambiguous language regarding the parties intent for treatment of future increases.²³⁹ The court noted that the evidence in the case before it showed that such increases were made based upon the earning level that an employee attained and his tenure with the company. The court held that the property settlement agreement was not merely a court-ordered division but a contractual

231. *Cathey v. Metropolitan Life Ins. Co.*, 764 S.W.2d 286 (Tex. App.—Houston [1st Dist.], 1988, writ requested).

232. *Id.* at 288-89.

233. *Id.* at 291-92.

234. *Id.* at 290-91.

235. 756 S.W.2d 56 (Tex. App.—Texarkana 1988, no writ).

236. *Id.* at 58.

237. *Id.*

238. *Seaman v. Seaman*, 686 S.W.2d 206 (Tex. App.—Houston [1st Dist.] 1984, writ ref'd n.r.e.).

239. 756 S.W.2d at 59.

obligation enforceable under contract law.²⁴⁰ It therefore determined that the increases, although community property of the second marriage, were subject to the liability incurred by the insured before the second marriage in the property settlement agreement with his first wife.²⁴¹

In *Morehead v. Morehead*²⁴² the Texas Supreme Court, reversing a decision of the Texarkana court of appeals,²⁴³ held that the trial court correctly refused to consider a preliminary statement by the insurer in determining whether the widow of the insured, J. J. Morehead, or their son, James Ray Morehead, would receive the benefits of his life insurance policy.²⁴⁴ The insured had substituted James Ray as beneficiary after the couple divorced in 1974. The insured and his wife had remarried in 1978 and remained married at the time of his death.

The suit was filed as an interpleader action by Provident Life & Accident Insurance Company, who had taken over the coverage from Travelers Insurance Company in 1979. Although Provident had been dismissed by agreement after paying the court the policy benefits of \$84,000, James Ray Morehead relied on a preliminary statement made by Provident in answering requests for admissions while it was still a party. The court of appeals reversed and remanded the case concluding that the trial court should have admitted into evidence and considered Provident's preliminary statement.²⁴⁵ The appellate court held that this admission should have been considered on the issue of whether Provident waived the strict requirements of its policy provisions, and accepted the existing beneficiary designation, as well as its compliance with policy terms.²⁴⁶ The supreme court determined that the admission was inadmissible hearsay and that its allowance into evidence conflicted with Texas Rule of Evidence 802.²⁴⁷

Lapse of Policy. In *Jacobs v. Provident Life & Accident Insurance Co.*²⁴⁸ the insurer denied benefits under a life insurance policy on Paul C. Jacobs due to nonpayment of premiums for two months. The insurance premium was normally paid at the beginning of each month through a deduction from Jacobs' paycheck by the Missouri-Kansas-Texas Railroad Company (M-K-T). The policy included a thirty-one day grace period, allowing the insured to make a late premium payment and prevent lapse of the policy. On October 15, 1984, after the October premium payment had been made on Jacobs' policy, M-K-T discharged Jacobs. The policy lapsed on December 2, 1984. Jacobs had reached an agreement with M-K-T to reinstate him after a sixty day suspension without pay, but on December 3, 1984, before he returned to work or made any further premium payments, Jacobs was murdered. Mrs.

240. *Id.*

241. *Id.*

242. 741 S.W.2d 381 (Tex. 1987).

243. *Morehead v. Morehead*, 738 S.W.2d 42 (Tex. App.—Texarkana 1987, no writ).

244. 741 S.W.2d at 382.

245. 738 S.W.2d at 44-45.

246. *Id.* at 44.

247. 741 S.W.2d at 382.

248. 837 F.2d 213 (5th Cir. 1988).

Jacobs argued that the insurer had waived the automatic lapse provision of the policy. She based her argument on language in an insurance manual distributed by Provident to M-K-T employees, which stated that a double payment in one month could prevent a lapse in the previous month. She further argued that Jacobs relied on that passage and that a fraud or injustice on Jacobs would result from application of the automatic lapse provision.

The court held that Jacobs could not have reasonably relied on the language because it also contained a specific exception limiting it to an employee who had not left the service of the employer.²⁴⁹ The court reasoned that the language of the manual was broad enough to have alerted Jacobs to the danger that his policy might lapse, despite the fact that his discharge was converted into a suspension without pay, and that the evidence did not show any evidence of actual reliance.²⁵⁰ The court determined that a reasonable reading of the insurance manual and the record did not support estoppel against Provident, and therefore affirmed the district court's judgment.²⁵¹

Suicide. In *Massachusetts Indemnity & Life Insurance Co. v. Morrison*²⁵² Michael Morrison died when his car collided with a tree in 1984. The police found a handwritten note at the scene, which was ostensibly a suicide note. The police concluded the collision was a suicide, and Morrison's life insurance company denied benefits to his widow, the beneficiary, under a policy provision that the insurer was not obligated to pay benefits in the event of a suicide within two years of issuance of the policy. Mrs. Morrison brought suit, claiming that Morrison did not commit suicide, and the jury answered the single special issue in her favor.²⁵³ The insurance company appealed, alleging that the evidence established that the insured had committed suicide as a matter of law. Alternatively, it argued that the jury's finding was against the great weight of the evidence.

The purportedly conclusive evidence showed that Morrison was depressed prior to the collision and was suffering from marital, legal, and health problems. Nevertheless, the court held that some circumstantial evidence supported the jury's verdict. The court cited testimony from which the jury could have concluded that it was unlikely that anyone would purposely kill himself in the manner hypothesized by the insurer, that it would have been difficult for anyone to purposely hit the particular tree involved in Morrison's accident, and that there was some evidence to support an inference that Morrison's death was a homicide. In support of the last possible conclusion, the court cited testimony that the handwriting on the alleged suicide note might have been that of Morrison's father.²⁵⁴ The court also held that there was some evidence to support the theory that Morrison's death was an acci-

249. *Id.* at 214.

250. *Id.* at 214-15.

251. *Id.* at 215.

252. 745 S.W.2d 461 (Tex. App.—Beaumont 1988, writ denied).

253. *Id.* at 462.

254. *Id.* at 463.

dent, in that he was quite ill from severe pneumonia.²⁵⁵

Qualification of Beneficiary. In *Metropolitan Life Insurance Co. v. Carr*²⁵⁶ Carl D. Curlee, who was insured by Metropolitan Life Insurance Company, died intestate, unmarried, and without children. He had never designated a beneficiary under his life insurance policy with Metropolitan. Curlee was the illegitimate son of Mattie F. Bennett, to whom Metropolitan paid one-half of the policy proceeds. Raymond L. Carr claimed to be Curlee's biological father and claimed the other half of the life insurance benefits. At the time of his death, Curlee was an employee of the U.S. Postal Service, putting his life insurance benefits under the application of a federal law that sets forth the order of precedence of beneficiaries to a life insurance policy provided by the government to employees.²⁵⁷ This statute provides that such benefits are to be awarded to the parents of the employee if there is no designated beneficiary, widow, child, or descendants of deceased children of the employee.²⁵⁸ Metropolitan filed an interpleader action to determine whether Bennett or Carr was entitled to the remaining half of the policy proceeds.

The court first held that Texas law controlled the interpretation of the term "parent."²⁵⁹ The Texas Family Code definition of a male parent is "a man as to whom the child is legitimate, or an adoptive . . . father."²⁶⁰ Evidence in the record indicated that Carr was never married to Bennett, that they never attempted to marry, and that Carr's paternity had not been established under the provisions of the Texas Family Code, which would have made him legitimate. Furthermore, Carr did not adopt Curlee. Accordingly, the court concluded that Carr was not Curlee's parent on the date of his death.²⁶¹

The court also rejected Carr's attempt to prove his paternity under a provision provided by the Texas Probate Code to establish parental status.²⁶² The court stated that Carr must have accomplished his efforts to establish a right of inheritance pursuant to that Code provision or sue for voluntary legitimation pursuant to the Family Code²⁶³ prior to the decedent's death in order to be a parent within the meaning of the federal statute.²⁶⁴ Moreover, the court held under another provision of the federal statute that claims by persons designated as beneficiaries in section 8705(a) must be made no later than two years after the death of an employee.²⁶⁵ This provision provides that if a claim is not made by a section 8705(a) designee within two years of death, payment will be made to the claimant who is equitably entitled to

255. *Id.*

256. 690 F. Supp. 569 (N.D. Tex. 1988).

257. 5 U.S.C. § 8705(a) (1982 & Supp. IV 1988).

258. 690 F. Supp. at 570 n.1.

259. *Id.* at 571.

260. *Id.* (citing TEX. FAM. CODE ANN. § 11.01(3) (Vernon 1986)).

261. 690 F. Supp. at 571.

262. TEX. PROB. CODE ANN. § 42(b) (Vernon Supp. 1989).

263. TEX. FAM. CODE ANN. § 13.21(e) (Vernon 1986).

264. 690 F. Supp. at 572.

265. *Id.* (applying 5 U.S.C. § 8705(c) (Supp. 1988)).

such, in the judgment of the Office of Personnel Management.²⁶⁶ Since Carr had not been determined under Texas law to be the parent of Curlee within two years of his death, the court held that it was immaterial that he could now seek voluntary legitimation or a Probate Code determination of paternity.²⁶⁷

The court also rejected the argument that Bennett was barred from recovering by the equitable doctrine of unclean hands. Carr contended that Bennett and her family recognized him as Curlee's father, that Bennett listed Carr as Curlee's father in the funeral announcement, and that after the death, Bennett obtained Carr's waiver of his right to the insurance proceeds by representing falsely that the proceeds would barely pay for the funeral and that the funeral would not take place unless Carr signed the waiver.²⁶⁸ The court held that these assertions, even if true, would not support a jury verdict under the unclean hands doctrine.²⁶⁹

VI. MISCELLANEOUS

Blanket Bonds. The court adhered to a narrow definition of "counterfeit" in ruling for the insurers in *Reliance Insurance Co. v. Capital Bancshares, Inc.*²⁷⁰ In that case, both Reliance and International Insurance Co. issued to Capital a bankers blanket bond. Reliance also issued a savings and loan blanket bond to Sunbelt Bancorp. Both bonds provided the standard indemnity to the insured banks for certain enumerated losses contained in the bonds' insuring agreements. Both Capital and Sunbelt incurred substantial losses on loans each had made to the same debtor who pledged as collateral the same stock certificate representing 30,000 shares in American International Group (AIG) to each bank. The debtor, however, pledged stock that had never been issued to him by a certificate that contained the forged signatures of AIG's officers, transfer agent, and registrar. All parties filed motions for summary judgment and sought, inter alia, a declaratory judgment as to whether the losses were covered under Insuring Agreement (E) of the bonds.²⁷¹

266. 5 U.S.C. § 8705(c).

267. 690 F. Supp. at 572.

268. *Id.*

269. *Id.*

270. 685 F. Supp. 148 (N.D. Tex. 1988).

271. Insuring Agreement (E) provided indemnity for, in pertinent part:

(E) Loss resulting directly from the insured having in good faith, for its own account or for the account of others,

(1) acquired, sold or delivered, or given value extended credit or assumed liability, on the faith of, or otherwise acted upon, any original

(a) security, . . . which

(i) bears a signature of any maker, drawer, issuer, endorser, assignor, lessee, transfer agent, registrar, acceptor, surety, guarantor, or of any person signing in any other capacity which is a Forgery, or

(3) acquired, sold or delivered, or given value, extended credit or assumed liability, on the faith of, or otherwise acted upon, any item listed in (a) above which is a counterfeit.

The trial court granted summary judgment in favor of Reliance and International on the basis that the loans were not covered under Insuring Agreement (E) since the pledged stock certificates were not counterfeit as defined in the bonds and since the losses did not directly result from the forgeries on the certificates.²⁷² The bonds defined counterfeit as "an imitation which is intended to deceive and to be taken as an original."²⁷³ The court ruled the certificates in question were not counterfeit because "they [do] not imitate a genuine existing document."²⁷⁴

The court followed the reasoning and holding in *Bank of the Southwest v. National Surety Co.*²⁷⁵ in concluding that to be counterfeit under a bankers blanket bond or a savings and loan blanket bond, a document had to be an imitation of an "actual existing (or previously existing) original genuine document."²⁷⁶ Since there was no genuine stock certificate ever issued to the debtor or bearing the debtor's name, the pledged certificates were not counterfeit but mere fraudulent creations.²⁷⁷ The court rejected Capital's argument that a misrepresentation of the authenticity or genuineness of execution of an instrument creates a counterfeit.²⁷⁸ The court lastly held that Capital's and Sunbelt's losses did not directly result from the forgeries on the certificates as required under Insuring Agreement (E),²⁷⁹ but would have resulted had the signatures been authentic since the certificate itself was not genuine.²⁸⁰

Agents. In *Higginbotham & Associates, Inc. v. Greer*²⁸¹ an insurance agent procured a multi-peril insurance policy to cover the insured's bowling alley. After fire destroyed the bowling alley in 1981, the insurer issued a check to the insured for payment for the loss. That check, however, was returned unpaid to the insured because the insurer had become insolvent. The insured sued the agent for negligence in procuring the policy and for misrepresentations under the Texas Deceptive Trade Practices Act.

While the jury found for the insured on both causes of action, the trial court disregarded the findings of misrepresentation. On appeal, the agent argued that there was insufficient evidence to support the jury's findings of negligence. The appellate court agreed and held that there was no evidence of the agent's negligence and rendered judgment that the insured take nothing.²⁸² The court affirmed the general rule in Texas that an insurance agent

Id. at 149 n.1.

272. *Id.* at 150-51.

273. *Id.* at 150.

274. *Id.* (citing *Richardson Nat'l Bank v. Reliance Ins. Co.*, 491 F.2d 121, 123 (N.D. Tex. 1977), *aff'd*, 619 F.2d 557 (5th Cir. 1980); *Bank of the Southwest v. Nat'l Surety Co.*, 477 F.2d 73, 76 (5th Cir. 1973); *Exchange Nat'l Bank of Olean v. Insurance Co. of N. America*, 341 F.2d 673, 676 (2nd Cir.), *cert. denied*, 382 U.S. 816, 86 S. Ct. 37 (1965)).

275. 477 F.2d 73, 77 (5th Cir. 1973).

276. 685 F. Supp. at 150.

277. *Id.*

278. *Id.* at 151.

279. *See id.* at 149 n.1.

280. *Id.* at 152. *Reliance* was argued on appeal before the Fifth Circuit on October 6, 1988.

281. 738 S.W.2d 45 (Tex. App.—Texarkana 1987, writ denied).

282. *Id.*

is not a guarantor of the solvency of the company from which he obtains the insurance policy.²⁸³ If the agent knows the company to be insolvent at the time he procures the policy, however, he is liable for a loss suffered by reason of such insolvency.²⁸⁴

The court carefully noted that this case presented a different fact situation than did previous cases regarding an agent's liability for the insurer's insolvency since there was no evidence that the agent in this case had knowledge of the insurer's insolvency.²⁸⁵ The court held that an agent's negligence must be viewed with respect to his knowledge of the insurer's solvency *at the time the policy was issued* and not at the time of the loss and corresponding failure to pay the claim.²⁸⁶ Because there was no evidence that the agent knew, or could have known by using reasonable diligence, of the insurer's insolvency at the time he procured the insurance, the court held that the agent was not liable for the insured's loss claim due to the insolvency of the insurer.²⁸⁷

283. *Id.*

284. *Id.*

285. *Id.* at 47.

286. *Id.*

287. *Id.* The court did not consider other theories of negligence since the insurer's insolvency was the only cause of the insured's loss. The court noted that the insurance coverage was sufficient and that Greer made an independent choice in choosing the PIC policy. *Id.* at 47-48.

