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INSURANCE LAW

by

Jeff Dykes* and Otway B. Denny, Jr.**

I. LIABILITY INSURANCE

NEGLIGENT Entrustment. *Fidelity & Guaranty Insurance Underwriters Inc. v. McManus*¹ was a declaratory judgment action brought by Fidelity & Guaranty Insurance Underwriters against its insured concerning the company's duty to defend under a Texas homeowner's policy.² The evidence showed that the insured, Harold McManus, purchased a trail bike for his son, James. James allowed his friend, Craig Wolley, to ride the trail bike. Wolley then collided with another bike ridden by Daniel Garcia. Garcia sued both Wolley and James McManus, claiming that McManus had negligently entrusted the trail bike to Wolley.

The trial court held that Fidelity had no duty under the homeowner's policy to defend a suit alleging negligent entrustment because the policy excluded actions arising from the ownership, operation, and use of recreational motor vehicles.³ Although the jury found that the trail bike was a recreational motor vehicle, the court of civil appeals held that the exclusion clause did not apply because negligent entrustment is a separate and distinct cause of action involving the permission to use and not the actual use of the vehicle."⁴

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1. 633 S.W.2d 787 (Tex. 1982).

2. The policy contained the standard language with respect to Fidelity's duty to defend:

Coverage D—Personal Liability

To pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury or property damage, and the company shall defend any suit against the insured alleging such bodily injury or property damage and seeking damages which are payable under the terms of this policy, even if any of the allegations of the suit are groundless, false or fraudulent; but the company may make such investigation and settlement of any claim or suit as it deems expedient.

Id. at 788.

3. The policy stated: "Exclusions—coverage D shall not apply; 4. a. to the ownership, maintenance, operation, use, loading or unloading of; (3) any recreational motor vehicle owned by any insured, if the bodily injury or property damage occurs away from the resident premises." *Id.*

4. 615 S.W.2d 877, 881 (Tex. Civ. App.—Houston [1st Dist.] 1981). The court of ap-

The supreme court reversed, holding the exclusion applicable.⁵ The court noted that the issue of whether negligent entrustment arises out of ownership, operation, maintenance, or use of a vehicle or results from permission to use a vehicle had never been before the Texas Supreme Court, although it had been vigorously litigated in foreign jurisdictions.⁶ These jurisdictions are squarely divided into two opposing lines of authority regarding the insurer's duty to defend.⁷

The first line of cases holds that under the basic homeowner's policy the insurer is obligated to defend the insured against an allegation of negligent entrustment.⁸ The Kansas Supreme Court in *Upland Mutual Insurance, Inc. v. Noel*⁹ found that the insurer has a duty to defend even though the immediate cause of injury and death was the operation of a motor vehicle, and the homeowner's policy had expressly excluded liability coverage for the use of automobiles away from the premises.¹⁰ In the words of the Kansas court, the theory of negligent entrustment "is not directly related to the ownership, maintenance, operation, use of the vehicle."¹¹

Conversely, in a second line of cases, the majority of jurisdictions recognizes negligent entrustment as a distinct and specific cause of action that is derived from, or is related to, the more general concepts of ownership, operation, and use of a vehicle.¹² The leading case advancing this view is *Cooter v. State Farm Fire & Casualty Co.*¹³ In *Cooter* the Alabama Supreme Court stated that an trustee's negligent use is essential to the maintenance of a negligent entrustment action.¹⁴ If, therefore, the instrumentality negligently used is expressly excluded from policy coverage, the duty to defend does not arise.¹⁵

peals also emphasized the broad language of the coverage clause and found that the exclusion, by virtue of its limited language, was intended to be construed more narrowly. *Id.* at 880-81.

5. 633 S.W.2d at 789.

6. *Id.* at 788-89.

7. *Id.* at 789.

8. The court cited a number of cases reaching this result. 633 S.W.2d at 789 n.1.

9. 214 Kan. 145, 519 P.2d 737 (1974).

10. 519 P.2d at 741. The Upland policy stated: "[T]his policy does not apply . . . to the ownership, maintenance, operation, use, loading and unloading of . . . automobiles." *Id.* at 739.

11. *Id.* at 741. Significantly, the court also stressed the broad policy language and the narrow limitations of the exclusionary clause. *See supra* note 4.

12. *See, e.g.,* *Lumbermen's Mut. Casualty Co. v. Kosies*, 124 Ariz. 136, 602 P.2d 517 (1979) (automobile exclusion in homeowner's policy applies when the accident involved the use or operation of an automobile); *Gargano v. Liberty Mut. Ins. Co.*, 384 So. 2d 220 (Fla. Dist. Ct. App. 1980) (cause of action of negligent entrustment of a motor vehicle to a minor child arises from the ownership, operation, or use of the vehicle; motor vehicle exclusion in policy thus applies); *Hanover Ins. Co. v. Granden*, 119 N.H. 394, 402 A.2d 174 (1979) (use of the instrumentality is negligent act, not the entrustment).

13. 344 So. 2d 496 (Ala. 1977).

14. *Id.* at 499. The court further noted that a logical extension of the *Upland* rationale would permit recovery by the injured party without a showing of negligence or fault on the trustee's part. *Id.*

15. The court's focus was sharply drawn on the elements of the negligent entrustment tort. Citing negligent use by the trustee as an element of the tort, the court concluded that negligent entrustment arose from the ownership or use of a motor vehicle. *Id.*

After examining each of the two alternative lines of cases the Texas Supreme Court chose to adopt the majority view.¹⁶ The court held that in order to recover under a negligent entrustment action the plaintiff must prove: (1) entrustment by the owner or custodian; (2) an trustee whom the owner knew, or should have known, was reckless and incompetent; and (3) negligent operation of the vehicle proximately causing damage to a third party.¹⁷ The elements essential to recovery in a negligent entrustment action, therefore, include not only the actual entrustment by the owner or custodian, but also the trustee's negligent operation or use of the vehicle. Thus, reasoning that liability arises from the negligent operation or use of a vehicle, the supreme court held the homeowner's policy exclusion clause applicable.¹⁸

*Gonzales v. American States Insurance Co.*¹⁹ was a declaratory judgment action that American States Insurance Company filed against its insured, Herby Gonzales. Gonzales had been sued by Perez who had suffered injuries after his leg became entangled in an ice auger at a company where Gonzales had previously installed a protective grate. Perez's petition alleged that Gonzales owned the ice auger. American States refused to defend Gonzales on the grounds that its investigation had revealed that Gonzales did not own the ice auger, and therefore, the events giving rise to the suit came within the "completed operation hazard" exclusion in the policy.²⁰ Gonzales argued that the plaintiff's allegations in his petition determined the insurer's duty to defend without reference to the truth or falsity of such allegations.

The trial court rendered judgment in favor of American States, but the court of appeals reversed, finding that the carrier had a duty to defend.²¹ The court developed a two-part rule for determining when an insurer must defend an action. In situations in which an insurance company bases its refusal to defend on grounds that the insured is not liable to the claimant, the allegations in the claimant's petition control, and facts not stated in the petition may not be used to controvert the allegations.²² When the company declines to defend on grounds that the events giving rise to the suit are outside the coverage of the insurance policy, however, facts extrinsic to the plaintiff's petition may be used to determine whether a duty to defend

16. 633 S.W.2d at 790.

17. *Id.*; accord *supra* notes 14-15 and accompanying text (Alabama Supreme Court used same rationale in holding insurer has no duty to defend a negligent entrustment action).

18. 633 S.W.2d at 790.

19. 628 S.W.2d 184 (Tex. Ct. App.—Corpus Christi 1982, no writ).

20. The policy defined "completed operations hazard" as follows:

"[C]ompleted operations hazard" includes bodily injury and property damage arising out of operations or reliance upon a representation or warranty made at any time with respect thereto, but only if the bodily injury or property damage occurs after such operations have been completed or abandoned and occurs away from premises owned by or rented to the named insured.

Id. at 185.

21. *Id.* at 187.

22. *Id.*

exists.²³

Since the plaintiff's original petition in *Gonzalez* contained a general allegation that the equipment involved in the injury was owned by all of the defendants, the court found the issue to be whether the insured was liable to the claimant, rather than whether the suit involved events outside the coverage of the policy.²⁴ Under the two-part rule, therefore, even though the evidence tended to show that Gonzales did not own the equipment in question, this evidence could not be considered in order to defeat the insurer's duty to defend.²⁵ The court thus held that American States was obligated to defend the suit against Gonzales.²⁶

Construction of Policy Exemption Clauses. In *Aetna Fire Underwriters Insurance Co. v. Southwestern Engineering Co.*²⁷ Southwestern filed suit on a liability insurance policy to recover the costs of defense and settlement of three property damage suits. Southwestern was a consulting engineering firm that entered into a contract with the Fort Ben Telephone Company to design facilities in Waller County. Fort Bend contracted with Sandidge Construction Company to construct the facilities designed by Southwestern. While digging a trench for a telephone cable, Sandidge personnel struck an underground pipeline owned by Phillips Pipeline Company. Phillips brought suit for damages against Sandidge and Southwestern.

Aetna refused to defend the damage suits, contending that the damages asserted in the underlying suits arose out of engineering services Southwestern had performed, and that the policy clearly excluded "engineering services."²⁸ Aetna argued that the locations of the underground pipelines was one of the contractual obligations Southwestern had undertaken in its contract with Fort Bend, and as such should be considered "engineering services." Aetna further contended that the term "engineering services" in the exclusion was clearly unambiguous, so that Aetna was absolved of the duty to defend Southwestern.

The court of appeals disagreed with Aetna's position, however, and held that the term "engineering services" was ambiguous.²⁹ The court, therefore, strictly construed the policy in favor of Southwestern, concluding that

23. *Id.*

24. *Id.*

25. *Id.*

26. *Id.* The court's holding, in effect, requires that the plaintiff's factual allegations comprising his cause of action be accepted as true. Thus, to avoid its duty to defend, the insurer must show that notwithstanding the truth of the plaintiff's factual allegations some independent ground justifies its refusal to defend.

27. 626 S.W.2d 99 (Tex. Ct. App.—Beaumont 1981, writ ref'd n.r.e.).

28. The exclusion in the Comprehensive General Liability Policy issued by Aetna stated the following:

It is agreed that the insurance does not apply to bodily injury or property damage arising out of any professional services performed by or for the named insured, including (1) the preparation or approval of maps, plans, opinions, reports, surveys, designs or specifications and (2) supervisory, inspection or engineering services.

Id. at 101.

29. *Id.* Significantly, however, the court noted that the insurance policy did not define

the act of locating underground pipelines was not included within the term "engineering services" in the exclusionary clause.³⁰ The court thus assessed Aetna with the cost of the defense and settlement in all three suits.³¹

Effect of Government Medical Benefits on Insurance Company Liability. *Government Employee Insurance Co. v. Vail*³² involved a claim for benefits due under the personal injury protection (PIP) endorsement on an automobile insurance policy. Daniel Vail, a minor, was injured while a passenger in a car driven by Michael Gray. Vail received extensive medical and hospital treatment at Brooke Army Hospital as part of the benefits to which Vail's father was entitled as a retired member of the Air Force.

In a primary lawsuit against Michael Gray and others Vail's attorney also represented the United States Government in its claim for recovery of the medical and hospital costs it expended in Daniel Vail's treatment. The parties settled the primary lawsuit for \$40,000, with the Government Employees Insurance Company (GEICO) also contributing to the gross settlement. The executed releases specifically excepted the claim for PIP benefits that might be due the Vails because of the GEICO policy issued to Vail's father. Additionally, the settlement required Vail to set aside escrow in excess of \$10,000 to reimburse the Government for the expenses incurred. GEICO contended that because the Government had paid for the treatment, the plaintiff did not incur any medical expenses within the meaning of the insurance policy in issue and, therefore, had no right to recover.³³

The court of appeals disagreed, finding that Vail had incurred medical expenses within the policy's provisions.³⁴ The critical issue in the dispute was the interpretation of the word "incurred." The court noted that the precise question had not come to the attention of an appellate court in Texas, although both appellee and appellant presented several relevant cases from federal and foreign jurisdictions.³⁵ The court chose to adopt

the term "engineering services." Thus, if Aetna had defined the term rather than relying on extrinsic sources, the court's conclusion likely would have been different. *Id.*

30. *Id.* at 101-02. The court noted the well recognized rule that exceptions and rules of limitation in an insurance policy must be strictly construed against an insurer. *Id.* at 101.

31. *Id.* at 102.

32. 623 S.W.2d 170 (Tex. Ct. App.—Beaumont 1981, writ ref'd n.r.e.).

33. The personal injury protection endorsement required the insurer to pay: "any member of the insured's household who sustains bodily injury, caused by accident, in a motor vehicle accident . . . for losses incurred by such injured person within three years of the date of such accident for: (1) all reasonable and necessary medical expenses incurred for services furnished . . . during the period of such injured person's disability." *Id.* at 171.

34. *Id.* at 172.

35. Courts that have decided the issue have reached conflicting results. Compare *Lefebvre v. Government Employees Ins. Co.*, 110 N.H. 23, 259 A.2d 133 (1969), and *Sanner v. Government Employees Ins. Co.*, 150 N.J. Super. 488, 376 A.2d 180 (Super. Ct. App. Div. 1977) (holding that insured did not incur any medical expense under insurance policy when treatment was administered without charge by the Federal Government at military hospital), with *Criterion Ins. Co. v. Starkes*, 249 Md. 694, 241 A.2d 707 (1968), and *Smith v. United Services Automobile Ass'n*, 52 Wis. 2d 672, 190 N.W.2d 873 (1971) (holding that insured who received free government medical treatment did incur medical expenses under insurance policy).

the rule articulated in a Wisconsin decision, *Smith v. United Services Automobile Association*.³⁶ In *Smith* the Wisconsin Supreme Court reasoned that the medical benefits available to retired military personnel and dependents are not gratuitous, but rather are an entitlement provided by Congress and earned by performing a job in the armed forces.³⁷ Following this reasoning, the court of appeals held that the medical benefits Vail received were not free of charge and, therefore, Vail in fact incurred medical expenses under the terms of the policy.³⁸ Because Vail had been required to escrow the cost of the hospitalization medical expenses when he settled with the tortfeasor and his insurer, he was entitled to reimbursement from GEICO.³⁹

II. DECEPTIVE TRADE PRACTICES ACT AND TEXAS INSURANCE CODE

Deceptive Trade Practices. In *McKnight v. Ideal Mutual Insurance Co.*,⁴⁰ a diversity case, the federal district court followed several Texas cases in holding that the Unfair Claims Settlement Practices Act⁴¹ does not create a private cause of action for damages resulting from an insurer's unfair acts,⁴² and that mere denial of an insurance claim is not a violation of the Texas Deceptive Trade Practices Act (DTPA)⁴³ or its counterpart in the Texas Insurance Code, article 21.21.⁴⁴ McKnight obtained an insurance policy from Ideal that protected against the direct loss of an aircraft. The policy, however, excluded coverage for loss by conversion. In January 1980 McKnight leased the insured aircraft to Green, who flew it to South America. Green never returned the plane, claiming that it had been confiscated. Upon learning of the loss, McKnight filed a claim with Ideal. The company ultimately denied liability, claiming that Green had converted the aircraft, and that the conversion exclusion thus applied. McKnight then sued on the policy and, additionally, charged DTPA violations. He alleged that during the investigation of the loss the insurer's agent had informed him that Ideal was concerned about the possibility of collusion between McKnight and Green and had assured him that Ideal would pay the claim if McKnight would file theft charges against Green. When McKnight filed the charges, Ideal denied the claim, citing McKnight's criminal theft complaint against Green as support for the denial. McKnight charged that Ideal's action in encouraging him to file charges against Green tricked him into providing a basis for denial of the claim and was a violation of section 17.50(a)(4) of the DTPA and articles 21.21 and 21.21—2 of the Texas Insurance Code.

36. 52 Wis. 2d 672, 190 N.W.2d 873 (1971).

37. 190 N.W.2d at 874-75.

38. 623 S.W.2d at 172.

39. *Id.*

40. 534 F. Supp. 362 (N.D. Tex. 1982).

41. TEX. INS. CODE ANN. art. 21.21—2 (Vernon 1981).

42. 534 F. Supp. at 364.

43. Deceptive Trade Practices—Consumer Protection Act, TEX. BUS. & COM. CODE § 17.41-.62 (Vernon Supp. 1982-1983).

44. 534 F. Supp. at 364-65; *see* TEX. INS. CODE ANN. art. 21.21 (Vernon 1981).

The district court granted the insurer's motion for partial summary judgment on all statutory claims.⁴⁵ The court first considered the plaintiff's claim that article 21.21—2, which sets forth various acts that constitute unfair claim settlement practices by an insurer, creates a private cause of action against an insurer.⁴⁶ Although the plaintiff conceded that article 21.21—2 does not authorize individual actions, he contended that section 17.50(a)(4) of the DTPA, which provides a private cause of action for violation of article 21.21 of the Texas Insurance Code, refers to article 21.21—2 as well. The court disagreed with the plaintiff's claim, however, holding that article 21.21—2 was intended only to authorize the State Insurance Board to investigate and sanction unfair claim settlement practices, and could not be read in conjunction with section 17.50(a)(4) to create a private cause of action for such unfair practices.⁴⁷

The court next turned to the plaintiff's claim that he was entitled to recover under section 17.50(a)(4) of the DTPA and sections 4(1) and 4(2) of article 21.21, which prohibit misinterpretations and false advertising about insurance policies. The court noted, initially, that in order to recover under these sections, the plaintiff would have to prove that the alleged conduct caused him damage.⁴⁸ The court then held that neither the denial of the claim nor the agent's alleged misstatement produced damage to the plaintiff because he retained his right to sue upon the policy and to recover his loss if the aircraft was found not to have been converted.⁴⁹

In *American Insurance Co. v. Reed*⁵⁰ the court of appeals similarly rejected an insured's attempt to recover treble damages because of an insurer's alleged wrongful denial of a claim.⁵¹ Reed purchased insurance coverage for his truck under a group policy issued by Bellefonte Insurance Company and allowed Nail to operate the truck for \$500.00 per month. While in Nail's possession, the truck was vandalized and damaged to the extent of \$8,585.25. The insurer denied liability for the loss, claiming that because the truck had been leased to Nail, a conditional sale and bailment lease exclusion in the policy applied.

Reed sued on both the policy and various statutory provisions, including the DTPA, Texas Insurance Code article 21.21, and the rules the State Board of Insurance promulgated under article 21.21, alleging that Bellefonte wrongfully denied his claim. The trial court rendered judgment for Reed upon a jury verdict for \$665,814.26, which represented three times the sum of actual damages plus attorneys' fees. The damages included not only the estimated repair cost, but also consequential and incidental dam-

45. 534 F. Supp. at 363.

46. *Id.* at 364-65.

47. *Id.* at 365.

48. *Id.* at 365. Section 17.50(a) requires that the alleged wrongful conduct "constitute a producing cause of actual damages." TEX. BUS. & COM. CODE ANN. § 17.50(a) (Vernon Supp. 1982-1983).

49. 534 F. Supp. at 366.

50. 626 S.W.2d 898 (Tex. Ct. App.—Eastland 1981, no writ).

51. *Id.* at 906.

ages for loss of use of the truck, storage, and past and future mental anguish. The court of appeals reversed and rendered judgment for the insurer on all claims except the claim on the policy, which was remanded.⁵²

The court rejected Reed's DTPA claim, holding that he had no standing to sue under that Act.⁵³ In order to recover under the DTPA, a plaintiff must be a consumer,⁵⁴ defined in the Act as a purchaser of goods or services.⁵⁵ When he obtained coverage in February 1977, Reed was not a consumer under the DTPA because he had purchased the policy for commercial use and, at that time, services for commercial use were excluded from the Act's scope.⁵⁶ Although the insurer denied the claim and made certain other representations after the Act was amended to cover commercial services,⁵⁷ the court held that Reed was not a consumer with respect to these statements because they were not made in connection with the purchase of goods or services.⁵⁸

The court of appeals similarly rejected the plaintiff's other theories of recovery.⁵⁹ The court stated that the claims based on violations of the State Board of Insurance rules could not support a judgment because Reed failed to introduce the rules into evidence.⁶⁰ The court refused to take judicial notice of these rules, holding that they must be proved.⁶¹ The court further held, as a matter of law, that the insurer's failure to furnish a copy of the group policy to Reed before the loss, or to inform him of the conditional sale exclusion was not a violation of article 21.21 of the Insurance Code.⁶² Neither of those acts, stated the court, is defined as a deceptive act under article 17.46(b) of the DTPA, so as to be actionable conduct.⁶³ The court concluded that, as a matter of law, the insurer's mere denial of the claim does not give rise to liability for treble damages under the DTPA or article 21.21, but merely forms the basis for plaintiff's claim for enforcement of contractual rights under the policy.⁶⁴

52. *Id.*

53. *Id.* at 902.

54. TEX. BUS. & COM. CODE ANN. § 17.50(a) (Vernon Supp. 1982-1983).

55. TEX. BUS. & COM. CODE ANN. § 17.45(4) (Vernon Supp. 1982-1983) defines consumer as "an individual, partnership, corporation, or governmental entity who seeks or acquires by purchase or lease, any goods or services."

56. In February 1977 when Reed's policy was issued, § 17.45(2) of the DTPA defined "services" as "work, labor, or service purchased or leased for use, *for other than business or commercial use*, including services furnished in connection with the sale or repair of goods." 1975 Tex. Gen. Laws, ch. 62, § 1, at 149 (emphasis added).

57. The Act now defines services to be "work, labor, or service purchased or leased for use, including services furnished in connection with the sale or repair of goods." TEX. BUS. & COM. CODE ANN. § 17.45(2) (Vernon Supp. 1982-1983).

58. 626 S.W.2d at 902.

59. *Id.* at 902-05.

60. *Id.* at 903.

61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.* at 905.

*Texas Catastrophe Property Insurance Association v. Miller*⁶⁵ is a case of first impression that involves the relationship between the DTPA and the Texas Catastrophe Property Insurance Pool Act.⁶⁶ The plaintiff, Miller, owned a condominium in Galveston that two companies insured under a windstorm and hail policy issued through the statutory Texas Catastrophe Property Insurance Association. The condominium was damaged during a tropical storm, and Miller accordingly filed a claim with the association. When the claim was denied, Miller sued the association and both insurers in Harris County, asserting his policy claim and also DTPA violations. The association filed a plea of privilege to be sued in Travis County. The trial court concluded that Miller had established venue in Harris County under article 17.56 of the DTPA⁶⁷ and overruled the plea of privilege.

The court of appeals reversed and remanded with instructions to dismiss the suit as to the association, holding that the Harris County court lacked jurisdiction.⁶⁸ The court found the appeals procedure set forth in the Texas Catastrophe Property Insurance Pool Act to be controlling.⁶⁹ The Act, which created the Texas Catastrophe Property Insurance Association in 1971, requires that each insurer authorized to sell property insurance in Texas be a member of the association and underwrite policies in high risk areas.⁷⁰ The court found that the Act specified the procedure for appealing an "act, ruling, or decision of the association"⁷¹ including a claim denial.⁷² A person aggrieved by the association's adverse decision may appeal to the State Board of Insurance within thirty days after the decision.⁷³ A person dissatisfied with a board decision may thereafter appeal only to the district court of Travis County.⁷⁴ Miller, however, had circumvented all of the procedural requisites by suing in Harris County. The appellate court thus held that the trial court was without jurisdiction to entertain the lawsuit or the plea of privilege as to the association.⁷⁵

The Court also observed that the association could not be liable under the DTPA for representations that the local recording agent who originally took Miller's application for insurance may have made.⁷⁶ The association is not responsible for the representations of a local agent because the association consists of all property insurers and does not have its own agents.⁷⁷ The court also noted that mere denial of liability under an insurance policy would not give rise to liability under the DTPA.⁷⁸

65. 625 S.W.2d 343 (Tex. Ct. App.—Houston [14th Dist.] 1981, writ *dism'd*).

66. TEX. INS. CODE ANN. art. 21.49 (Vernon 1981).

67. TEX. BUS. & COM. CODE ANN. § 17.56 (Vernon Supp. 1982-1983).

68. 625 S.W.2d at 345.

69. *Id.* at 346.

70. TEX. INS. CODE ANN. art. 21.49, §§ 1, 4, 6 (Vernon 1981).

71. *Id.* § 9.

72. 625 S.W.2d at 346.

73. TEX. INS. CODE ANN. art. 21.49, § 9 (Vernon 1981).

74. *Id.*

75. 625 S.W.2d at 347.

76. *Id.*

77. *Id.*

78. *Id.*

Nondiscoverability of Insurer's Claims File. In *Maryland American General Insurance Co. v. Blackmon*⁷⁹ the Texas Supreme Court decided a discovery issue of paramount importance in litigation involving an insured's claim that an insurance company has handled claims deceptively or in bad faith. The suit arose from losses First State Bank of Bishop sustained that had allegedly resulted from the bank president's dishonest activity. First State Bank sought to recover the loss by collecting on its bankers' blanket bond that Maryland American had issued and filed suit when the company denied liability. The bank sought to recover compensatory and punitive damages beyond the amount of the bond claim, alleging that Maryland General had acted in bad faith by failing to properly investigate and pay the claim.⁸⁰

In connection with its bad faith claims the bank sought, through discovery, all documents relating to the insurance company's investigation and its decision not to pay the claim. The bank also requested that the insurance company's attorney appear for deposition and produce all his files relating to the disputed claim. The trial court ordered the insurer to make the requested discovery, overruling objections made on the basis of attorney-client privilege.

The insurer applied to the Texas Supreme Court for a writ of mandamus to compel the trial judge to vacate his order, urging the applicability of the work product privilege set out in rule 186a⁸¹ and the attorney-client privilege. The bank argued that the privilege did not apply to the bad faith claims because the material sought constituted the operative facts forming the basis of those claims. The court rejected this position, holding that the privileges were fully applicable.⁸² Without determining the validity of the plaintiff's bad faith allegations, the court held that the insurer could assert the work product privilege so long as its liability on the bond remained undetermined.⁸³ The court noted that the attorney-client privilege exists so long as a party's right to defend a suit exists and may continue even after the termination of the original controversy or the attorney-client relationship.⁸⁴ The court also recognized that disclosure of the information requested by First State Bank would severely prejudice Maryland General's right to defend the action.⁸⁵ Furthermore, the court concluded that if a mere allegation of bad faith suffices to secure all of the insurer's investigative files, all suits against insurers would contain such allegations as a matter of course.⁸⁶

Uninsured/Underinsured Motorist Coverage. Muller v. Allstate Insurance

79. 639 S.W.2d 455 (Tex. 1982).

80. The bank also charged violations of the DTPA and the Texas Insurance Code.

81. TEX. R. CIV. P. 186a.

82. 639 S.W.2d at 458.

83. *Id.*

84. *Id.*

85. *Id.*

86. *Id.*

Co.⁸⁷ construed article 5.06—1 of the Texas Insurance Code, the uninsured or underinsured motorist statute.⁸⁸ In that case a wrecker truck struck and injured Muller's son. A company covered by a \$10,000 personal injury liability owned the wrecker truck. An Allstate policy containing a \$10,000 underinsured motorist provision covered Muller and his family. Although Muller's medical expenses exceeded \$275,000, he settled his claim against the wrecker driver's liability carrier for its policy limit of \$10,000. Muller then sued Allstate for recovery under the \$10,000 underinsured motorist provision in his own policy, claiming that the \$10,000 settlement he obtained from the wrecking company should be deducted from the total \$275,000 damages incurred. Allstate, on the other hand, contended that article 5.06—1 and the policy required that the \$10,000 settlement be deducted from the \$10,000 underinsured coverage. The trial court rendered summary judgment in favor of Allstate, and the appellate court affirmed.⁸⁹

The court held that because the tortfeasor's liability coverage was equal to Muller's underinsured motorist coverage, the tortfeasor's vehicle was not underinsured within the definitions of the statute and the policy.⁹⁰ Accordingly, the underinsured motorist coverage was wholly inapplicable and unavailable to Muller.⁹¹ As an alternative holding, the court noted that Muller would be entitled to no recovery even if the statute was applicable because the policy required reduction of the underinsured motorist recovery by the amount recovered from the tortfeasor's liability carrier.⁹² In Muller's case, deducting \$10,000 from \$10,000 would result in a net recovery of zero.

In *Montanye v. TransAmerica Insurance Co.*,⁹³ another case involving an uninsured motorist provision, the court reached a similar result. Montanye, the plaintiff, was injured while riding as a passenger in von Drak's automobile. Von Drak was covered by an insurance policy that provided liability coverage of \$10,000 per person and uninsured/underinsured coverage in the same amount. Montanye sustained injuries with a stipulated value of \$22,500, and she settled with von Drak's liability carrier for \$10,000. Montanye then sued the same carrier, von

87. 627 S.W.2d 775 (Tex. Ct. App.—Houston [1st Dist.] 1982, no writ).

88. TEX. INS. CODE ANN. art. 5.06—1 (Vernon 1981). Specifically, the court interpreted the provisions in article 5.06—1(2)(b) that define an underinsured motor vehicle as:

[A]n insured motor vehicle on which there is valid and collectable liability insurance coverage with limits of liability for the owner or operator which were originally lower than, or have been reduced by payment of claims arising from the same accident to, an amount less than the limit of liability stated in the underinsured coverage of the insured's policy. *Id.*

89. 627 S.W.2d at 777.

90. *Id.* at 776-77.

91. *Id.*

92. *Id.* at 777. The insurance contract itself stated that "[a]ny amount payable under the terms of this insurance . . . shall be reduced by . . . the amount recovered or recoverable from the insurer of an underinsured motor vehicle." *Id.* at 776.

93. 638 S.W.2d 518 (Tex. Ct. App.—Houston [1st Dist.] 1982, no writ).

Drak's insurer, for the remainder of her damages under the uninsured/underinsured motorists endorsement to von Drak's policy.

The parties submitted the case on agreed facts to the trial court, which rendered a take-nothing judgment in favor of the insurer. The court of appeals affirmed, holding that the policy's clear and unequivocal language specifically defeated recovery by Montanye.⁹⁴ The policy provided that any amounts payable under the uninsured/underinsured coverage would be reduced by sums paid under any applicable liability policy and by amounts recovered or recoverable from the insurer of an underinsured motor vehicle. The court, therefore, concluded that, under the clear language of the policy, the \$10,000 settlement Montanye received under the liability portion of the policy should be subtracted from the \$10,000 underinsured motorist limit, leaving Montanye with no additional recovery.⁹⁵

In *El-Habr v. Mountain States Mutual Casualty Co.*⁹⁶ the court determined the applicability of the 1977 statutory amendment to the uninsured/underinsured motorist provision of the Texas Insurance Code⁹⁷ to policies issued before the effective date of the amendment. Before the 1977 amendment the uninsured/underinsured motorist statute required that all automobile policies contain uninsured motorist coverage for personal injury, but not for property damage.⁹⁸ In 1977, however, the Texas Legislature amended article 5.06—1 to require that all automobile policies contain uninsured motorist coverage for property damage as well as for personal injury, unless the insured expressly rejected such coverage.⁹⁹

On July 19, 1977, before the effective date of the amendment, the plaintiff, El-Habr, purchased a Mountain States policy from an independent agent. The policy provided liability coverage and uninsured motorist coverage for bodily injury, but not for property damage. In March 1978 El-Habr bought a van and informed his agent that he wanted the van "to be covered." The agent added the vehicle to El-Habr's policy by endorsement, but failed to add uninsured motorist property damage coverage to the existing policy. Furthermore, the agent never gave El-Habr an opportunity to reject the uninsured motorist coverage. Subsequently, El-Habr's van collided with an uninsured motorist, destroying over \$18,000 in property El-Habr was transporting in the vehicle. El-Habr filed a claim with Mountain States for recovery of the loss, but the company denied liability because the policy provided no uninsured motorist property coverage.

The trial court granted a summary judgment for Mountain States, which

94. *Id.* at 520.

95. *Id.* In reaching its decision, the court relied upon *American Gen. Fire & Casualty Co. v. Oestreich*, 617 S.W.2d 833 (Tex. Ct. App.—Eastland 1981, no writ), and *Lick v. Dairyland Ins. Co.*, 258 N.W.2d 791 (Minn. 1977) (both holding that the amount paid by the tortfeasor's insurance carrier must be deducted from underinsured motorist coverage). 638 S.W.2d at 520-21.

96. 626 S.W.2d 171 (Tex. Ct. App.—Fort Worth 1981, writ ref'd n.r.e.).

97. TEX. INS. CODE ANN. art. 5.06—1 (Vernon 1981).

98. 1967 Tex. Gen. Laws, ch. 202, § 1, at 448.

99. TEX. INS. CODE ANN. art. 5.06—1, § 1 (Vernon 1981).

the court of appeals affirmed.¹⁰⁰ The court held that the March 1978 endorsement that added the van to the policy became a part of the original policy and did not create a new contract of insurance.¹⁰¹ The agent and Mountain States were, therefore, under no duty to El-Habr to provide him automatically with uninsured motorist property damage coverage or to see that he affirmatively rejected such coverage.¹⁰² To hold otherwise, stated the court, would constitute a retroactive application of the statute.¹⁰³

III. PROPERTY INSURANCE

Measure of Damages for Partial Loss by Fire. In *Imperial Insurance Co. v. National Homes Acceptance Corp.*¹⁰⁴ the court permitted recovery for fire damage to a dwelling on the basis of repair cost, when neither party offered evidence of the fair market value of the house before and after the fire.¹⁰⁵ The court also approved the form in which the trial court submitted the issue of increased hazard.¹⁰⁶ In this case Imperial Insurance Company provided a standard fire policy on the dwelling in 1974 and issued a renewal policy for greater coverage effective February 7, 1977. A fire occurred the day after the effective date of the renewal policy. Imperial denied the insured's claim under the vacancy and increased hazard provisions of the policy, and the insured filed suit. The evidence at the jury trial showed that the utilities had been disconnected in 1976 and that a squatter had been living in the house shortly before the fire. The insured presented evidence that the reasonable cost to repair the fire damage was \$9,930.43. Neither party offered evidence of the diminution in the fair market value of the house. Based upon the jury's verdict, the trial court rendered judgment for the insured in the amount of \$9,930.43, and the court of appeals affirmed.¹⁰⁷

The court of appeals recognized that the usual measure of damages for partial loss of a building is the difference between the value of the property immediately before the fire and its value immediately after the fire.¹⁰⁸ The court held that the policy provision specifying that the insurer's liability should not exceed actual cash value or repair cost did not prescribe the measure of damages but only limited the insurer's liability.¹⁰⁹ Thus the court allowed the insured to recover on the basis of repair cost because neither party offered evidence of diminution in value, and the insurer failed to object to the evidence of repair cost.¹¹⁰

The court also approved the form of the trial court's submission of the

100. 626 S.W.2d at 172.

101. *Id.*

102. *Id.*

103. *Id.*

104. 626 S.W.2d 327 (Tex. Ct. App.—Tyler 1981, writ ref'd n.r.e.).

105. *Id.* at 331.

106. *Id.* at 332.

107. *Id.*

108. *Id.* at 329.

109. *Id.*

110. *Id.* at 330.

increased hazard issue. The special issue, as submitted, asked the jury whether an increase in hazard had occurred between the effective date of the renewal policy and the date of the fire, and the jury answered in the negative. The court rejected the insurer's contention that the issue should have inquired whether the hazard had increased between the date of the original policy and the loss date.¹¹¹ The court stated that the insurer had no right to assume that the risk of loss under the renewal policy was identical to the risk of loss under the original policy because of the differences in the terms of the original policy and the renewal policy. The court, therefore, held that the issue had properly inquired whether the hazard had increased after the renewal date.¹¹²

Proof of Business Interruption Damages. In *Royal Indemnity Co. v. Little Joe's Catfish Inn, Inc.*¹¹³ the insurer denied fire loss coverage, claiming that the insured had committed arson, but the jury resolved the arson issue in favor of the insured. The trial court awarded \$11,400 in damages to the insured for business interruption losses. The insurer successfully challenged the award on appeal.

The evidence showed that the insured had made no profit during the months preceding the fire. The potential business interruption recovery, therefore, was limited to actual rent and salary expenses for the period of time required to repair or replace the property with due diligence and dispatch. The evidence indicated, however, that the insured had made no rent or salary payments after the fire, although it had set up these items on its books as accounts payable. The court further found that the insured had no obligation to pay rent or salaries after the fire.¹¹⁴ The insured argued that it would have paid the expenses but for the insurer's wrongful refusal to pay the claim, but the court stated that liability for business interruption loss did not arise in the absence of actual monetary loss.¹¹⁵ Thus, the court held that under the terms of the policy no basis existed for the award of expenses that the insured never incurred.¹¹⁶

Scope of Coverage and Exclusions. In *Blaylock v. American Guarantee Bank Liability Insurance Co.*¹¹⁷ the court construed four exclusions in a standard homeowners policy. Mrs. Blaylock sought payment under her homeowners policy for damage that occurred when her swimming pool equipment froze. On December 31, 1978, the City of Dallas suffered a freezing rainfall and the temperature reached twenty-three degrees Fahrenheit. Because the ice storm eliminated electrical service to her home, Mrs. Blaylock spend the night at her son's house. When she returned the next

111. *Id.* at 332.

112. *Id.*

113. 636 S.W.2d 530 (Tex. Ct. App.—San Antonio 1982, no writ).

114. *Id.* at 535.

115. *Id.*

116. *Id.*

117. 632 S.W.2d 719 (Tex. 1982).

morning she discovered that the swimming pool circulation system had frozen due to the failure of the circulating pumps to operate during the power outage. Damage to the system amounted to \$2,292.

The insurer denied liability on the basis of four specific exclusions in the homeowners policy. The Texas Supreme Court construed each of the exclusions in the insured's favor. The court first considered exclusion "e," which applied to "[l]oss caused by or resulting from freezing while the building is unoccupied unless the Insured shall have exercised due diligence with respect to maintaining heat in the building or unless plumbing, heating and air-conditioning systems had been drained and the water supply shut off during such unoccupancy."¹¹⁸ The court observed that the exclusion by its terms applied only when the house was unoccupied.¹¹⁹ The policy did not define the term "unoccupied," but the court stated that the term's established meaning in insurance law referred to a place that is not customarily used for human habitation.¹²⁰ The court held that Mrs. Blaylock's temporary absence on the night of the power outage had not rendered the house unoccupied within the meaning of the policy, and thus the exclusion did not apply.¹²¹

The court next considered exclusion "k," which precluded recovery for "[l]oss . . . caused by settling, cracking, bulging, shrinkage, or expansion of foundations, wall, floors, ceilings, roof structures, walks, drives, curbs, fences, retaining walls or swimming pools."¹²² The insurer argued that the exclusion applied because the loss resulted from expansion due to freezing pipes. The court held the exclusion inapplicable, however, because it clearly applied only to structural components, and the circulation system motors were not structural components of the swimming pool or of the house itself.¹²³

Thirdly, the court construed exclusion "a," which applied to "[l]oss to electrical appliances, devices, or wiring caused by electricity, other than lightning."¹²⁴ The loss involved no power surge, but resulted instead from a power failure. The court held that the phrase "caused by electricity" did not encompass damage caused by lack of electricity, and, accordingly, the court held the exclusion inapplicable to the loss.¹²⁵

Finally, the court held that exclusion "i," which excluded coverage for "[l]oss caused by . . . extremes of temperature,"¹²⁶ did not apply.¹²⁷ The term "extremes of temperature," the court indicated, refers to an unusual or unexpected temperature.¹²⁸ The uncontroverted testimony of a meter-

118. *Id.* at 720.

119. *Id.* at 721.

120. *Id.*

121. *Id.*

122. *Id.* at 720.

123. *Id.* at 721-22.

124. *Id.* at 720.

125. *Id.* at 722.

126. *Id.* at 721.

127. *Id.* at 723.

128. *Id.* at 722-23.

ologist established that a temperature of twenty-three degrees was within the normal range of recurring temperatures for Dallas in late December. The court, therefore, held that the damage did not result from an extreme temperature, and thus the exclusion did not apply.¹²⁹

*Cambridge Mutual Fire Insurance Co. v. Newton*¹³⁰ involved the occupancy condition to dwelling coverage in a homeowners policy and the applicability of the policy's limitations paragraph to a mortgagee's claim under a homeowners policy. Five months before a fire damaged their home, the Newtons moved to New Mexico temporarily to assist a relative with his business. They removed some of their personal property from their Dallas home and allowed Bright, a family friend, to occupy the dwelling in their absence. Bright promised to make periodic mortgage payments for the Newtons for two of the months of his absence, however, Newton made the mortgage payments himself. Additionally, Mr. Newton returned to his Dallas home on one occasion during Bright's occupancy. Bright ultimately abandoned the insured dwelling, stealing some of the Newtons' property, and on the following day the home caught fire. After the fire Newton and his wife decided to reside permanently in New Mexico. The Newtons and the mortgagee sued under the homeowners policy for the fire damage to the dwelling.

Cambridge asserted as a defense that the Newtons were not occupying the residence principally for dwelling purposes at the time of the fire.¹³¹ The trial court did not submit the occupancy question to the jury. The Newtons recovered a judgment in the trial court after a jury trial, and the court of appeals affirmed the portion of the judgment awarding the Newtons damages under the terms of the policy.¹³²

The principal issues on appeal were whether Cambridge established unoccupancy as a matter of law, and, if not, whether the occupancy issue could properly be found in support of the judgment. Rejecting Cambridge's contention that as a matter of law, the Newtons were not occupying the residence principally for dwelling purposes on the date of the loss, the court distinguished two cases cited by Cambridge, *Bryan v. United States Fire Insurance Co.*¹³³ and *Fisher v. Indiana Lumbermen's Mutual Insurance Co.*,¹³⁴ from the case before it. Unlike the insured in *Bryan*, the Newtons never declared that the insured house was a tenant dwelling and never entered into a formal rental agreement with a third party. Bright

129. *Id.*

130. 638 S.W.2d 75 (Tex. Ct. App.—Dallas 1982, writ ref'd n.r.e.).

131. The homeowners policy applied only to owner-occupied dwellings. It provided coverage for the "[d]welling . . . while occupied by the Insured principally for dwelling purposes." *Id.* at 78.

132. *Id.* at 82. The court reversed a portion of the judgment awarding damages for loss of unscheduled personal property and expenses. *Id.*

133. 456 S.W.2d 702 (Tex. Civ. App.—Corpus Christi 1970, writ ref'd n.r.e.) (recovery denied when insured's tenant occupied insured dwelling at time of fire under month-to-month rental agreement).

134. 456 F.2d 1396 (5th Cir. 1972) (recovery denied when insured dwelling was undergoing renovation and was uninhabitable at time of fire).

functioned more as the caretaker of the insured dwelling than as the Newtons' tenant.¹³⁵ The court also emphasized the Newtons' ability to occupy the insured residence at will regardless of Bright's occupancy.¹³⁶ Furthermore, in contrast to *Fisher*, the Newtons had actually occupied the house as their residence prior to moving to New Mexico. The court held, therefore, that the evidence was sufficient to create a fact issue with regard to the occupancy question.¹³⁷

The trial court announced before submitting the case to the jury that it was granting Cambridge's motion for instructed verdict on the ground that as a matter of law the Newtons were not occupying the house principally for dwelling purposes at the time of the fire. The trial court did not render judgment on the instructed verdict; rather it submitted a three-issue charge to the jury. The jury found for the insured on all three issues, and the trial court rendered judgment on the verdict. Cambridge urged on appeal that the trial court erred in not submitting to the jury its requested special issues on the occupancy question. The court of appeals noted that the record failed to show that Cambridge ever obtained a ruling from the court on its requested special issues, and thus that no reversible error was shown.¹³⁸ Since a fact issue existed regarding the occupancy question, but the trial court did not submit the question to the jury, the court sought to determine whether it must deem the occupancy question to support the judgment. Because the record failed to disclose either a request for the occupancy issue or an objection to its omission, or a request for a written finding by the trial court on the omitted issue, the court concluded that it must deem the trial court to have found the occupancy issue in such a manner as to support the judgment.¹³⁹

In *Cambridge* the Newtons' mortgagee appealed the portion of the trial court's judgment denying its claim against Cambridge for the unpaid balance of the mortgage debt. The trial court held the mortgagee's suit barred by the policy's limitations provision.¹⁴⁰ The mortgagee contended that the limitations clause did not bar its claim because the timely filing of the Newtons' suit also tolled the limitations on the mortgagee's behalf. The court stated, however, that while a mortgagee has an insurable interest in the mortgaged property to the extent of the debt secured, its cause of action is not derivative of the mortgagor's claim; thus, the mortgagee must assert

135. 638 S.W.2d at 79.

136. *Id.*

137. *Id.*

138. *Id.* at 80.

139. *Id.* at 80-81; see TEX. R. CIV. P. 279.

140. The limitations paragraph contained in the policy provided as follows:

Action Against The Company. No suit or action on this policy for the recovery of any claim shall be sustainable in any court of law or equity unless all the requirements of this policy shall have been complied with, nor as respects claim under:

Section 1—Property Section: unless commenced within two years and one day next after cause of action accrues

638 S.W.2d at 81.

its claim within the limitations period specified in the policy.¹⁴¹

In *Adrian Associates, General Contractors v. National Surety Corp.*¹⁴² the court reached the remarkable conclusion that the phrase "water below the surface of the ground" as used in a policy exclusion did not include water from a artificial source, such as a ruptured underground water pipe. A concrete slab that a contractor had laid in constructing a warehouse subsided and settled into the ground when an underground water main rupture created a cavern between the slab and the soil upon which it had been poured. The contractor sued under its all risks policy for the amount required to tear out and reconstruct portions of the slab. The trial court granted the insurer's motion for summary judgment on the basis of the underground water exclusion and two other exclusions. On appeal the insurer abandoned its argument as to one of the exclusions, so that the appellate court's decision turned on its interpretation of the underground water exclusion and the settlement of foundation exclusion.

The court of appeals reversed, holding that the phrase in the policy "water below the surface of the ground" was ambiguous.¹⁴³ Although the insurer contended that the exclusion applied to all subsurface water whatever the source, the court concluded that if the exclusion was intended to apply to all water the insurer would have said so.¹⁴⁴ The court, therefore, applied the rule that ambiguities in insurance policies must be construed in favor of the insured.¹⁴⁵ The court recognized that its holding conflicted with the holding in *Park v. Hanover Insurance Co.*,¹⁴⁶ an Amarillo court of civil appeals decision, but supported its holding with an Oregon case that construed a similar clause in favor of the insured.¹⁴⁷ The court also concluded that the settlement of foundation exclusion did not apply by reason of its holding regarding the underground water exclusion.¹⁴⁸

*Appraisal. Mays v. Foremost Insurance Co.*¹⁴⁹ illustrates the importance of

141. *Id.* at 81-82.

142. 638 S.W.2d 138 (Tex. Ct. App.—Dallas 1982, writ ref'd n.r.e.).

143. *Id.* at 140.

144. *Id.*

145. *Id.*

146. 443 S.W.2d 940 (Tex. Civ. App.—Amarillo 1969, no writ). In *Park* the court stated that damage to the foundation of a residence resulting from a ruptured underground water line was clearly within an exclusion containing language identical to the language in *Adrian Associates*. *Id.* at 941.

147. 638 S.W.2d at 139-40 (citing *Hatley v. Truck Ins. Exch.*, 261 Or. 606, 495 P.2d 1196 (1972)). The court in *Hatley* stated the following:

Subterranean waters are usually divided into two principal classes, namely:

(1) underground bodies or streams of water flowing in known and defined or ascertainable channels or courses, and (2) waters which ooze, seep, or percolate through the earth, or which flow in unknown or undefined channels, generally referred to as "percolating waters."

495 P.2d at 1197 n.3 (quoting 56 AM. JUR. *Waters* § 102 (1947)). The court held that an exclusion for water below the surface of the ground did not apply to water maliciously sprayed against the insured's property. 495 P.2d at 1198.

148. 638 S.W.2d at 141.

149. 627 S.W.2d 230 (Tex. Ct. App.—San Antonio 1981, no writ).

adhering to policy provisions regarding proceedings to appraise the amount of a loss fairly and impartially. While the insured was away on vacation, his mobile home sustained water damage from leaky plumbing. The insured filed a claim under his policy, but a dispute developed over the amount of damages. The insurer demanded appraisal. In accordance with the policy language, each party appointed an appraiser, and the court appointed a third appraiser designated as the umpire. The umpire and the insurer's appraiser rendered an appraisal in the amount of \$923.93, and the insurer tendered that amount, less the deductible, to the insured. The insured rejected the tender and brought suit.

The trial court granted summary judgment to the insurer. Affidavits filed in the trial court reflected that the insurer's appraiser and the umpire had excluded the insured's appraiser from some of their discussions. The affidavits also indicated that the umpire had privately conferred and had reached an agreement with a representative of the insurer, and that the insurer's appraiser had a long standing business relationship with the insurer. The appellate court held that these affidavits raised fact issues as to whether the parties carried out the appraisal provisions "fully, fairly and without undue influence" by the insurer.¹⁵⁰ The court therefore reversed the summary judgment.¹⁵¹

Rights of Lienholders. In *Don Chapman Motor Sales, Inc. v. National Savings Insurance Co.*¹⁵² the court allowed a lienholder to recover for property damage to a vehicle under an automobile policy's loss payable clause, even though the use of the vehicle at the time of the accident was clearly within a policy exclusion. The insured purchased a used Chevrolet from Don Chapman Motor Sales, which financed the sale and retained a lien on the Chevrolet. The insured obtained an insurance policy from National covering both her interest and that of the lienholder. The insurer cancelled the policy for nonpayment of premiums, subsequently reinstated the policy, and then cancelled it again. The insurer did not notify the lienholder of the second cancellation, and the cancellation was therefore ineffective as to the lienholder. After the second cancellation the insured permitted her son to drive the automobile, although the son did not have a driver's license. The car was wrecked while the son was driving. The lienholder subsequently repossessed the vehicle when the insured failed to make timely payments, and, at that time, the lienholder discovered the damage to the automobile. The lienholder sold the vehicle for salvage and then made demand upon the insurer for the unpaid balance on the note. The insurer denied coverage on the ground that the policy did not apply to losses occurring "while the automobile is operated by . . . any person under the minimum age required to obtain a license to operate a private passenger automobile."¹⁵³ The trial court agreed with the insurer's conten-

150. *Id.* at 234.

151. *Id.*

152. 626 S.W.2d 592 (Tex. Ct. App.—Austin 1981, writ ref'd n.r.e.).

153. *Id.* at 594.

tion and rendered judgment accordingly.

The court of appeals reversed on the basis of the loss payable clause in the policy.¹⁵⁴ The clause provided that as to the mortgagee's interest the insurance would "not be invalidated by an act or neglect of the . . . mortgagor."¹⁵⁵ The court recognized that this was a "union mortgage clause" rather than an open loss payable clause. A union mortgage clause creates a new and independent contract between the insurer and the lienholder, whereas an open loss payable clause subjects the lienholder to the defenses that are available against the owner.¹⁵⁶ Under the clause in question, therefore, the owner's acts or neglect did not defeat the lienholder's rights.¹⁵⁷

The insurer argued that notwithstanding the union mortgage clause, the policy did not cover the loss because an unlicensed driver was operating the vehicle at the time of the loss, in violation of a specific exclusion. In support of its argument the insurer cited *U.S. Trust & Guaranty Co. v. West Texas State Bank*.¹⁵⁸ The court in *U.S. Trust* denied recovery to a lienholder under a union mortgage clause because at the time of the loss the owner was driving outside the United States, in violation of a policy exclusion.¹⁵⁹ The court in *Don Chapman Motor Sales* declined to follow *U.S. Trust*, holding that the unlicensed driver exclusion did not defeat the lienholder's rights.¹⁶⁰ The court reasoned that the purpose of the union mortgage clause was to protect the mortgagee's interest in property that it did not possess or control, and that it would be inconsistent with that purpose to deny recovery when the mortgagor by his act alone breached an exclusionary provision.¹⁶¹

In *Helmer v. Texas Farmers Insurance Co.*¹⁶² the court held that an insurer was obligated to pay only \$25.70 to a mortgagee on an outstanding indebtedness of \$6,725.70 when the mortgagee purchased the insured property at a foreclosure sale for \$6,700.¹⁶³ Helmer and Hockert purchased a house and sold it one week later to the Robertsons for \$6,750, retaining a vendor's lien. Texas Farmers issued a policy to the Robertsons as named insureds and to Helmer and Hockert as mortgagees.¹⁶⁴ The

154. *Id.* at 597.

155. *Id.*

156. *Id.* at 595.

157. *Id.* at 595-96.

158. 272 S.W.2d 627 (Tex. Civ. App.—Eastland 1954, writ *dism'd*).

159. *Id.* at 629-30.

160. 626 S.W.2d at 597.

161. *Id.*

162. 632 S.W.2d 194 (Tex. Ct. App.—Fort Worth 1982, no writ).

163. *Id.* at 198.

164. The mortgagee clause provided:

This policy is in the interest of the mortgagee only therein, shall not be invalidated by any act or neglect of the mortgagor or owner of the within described property nor by any foreclosure or other proceedings relating to the selling of the property, nor by any change of the title or ownership of the property, nor by the occupation of the premises for purposes more hazardous than are permitted by this policy; provided that the mortgagee shall notify this company of

Robertsons became delinquent in their mortgage payments, and shortly thereafter a fire of suspicious origin severely damaged the house. Helmer and Hockert posted notice of a foreclosure sale and subsequently placed the high bid of \$6,700 at the sale. Thereafter, they attempted to collect \$6,725.70, the full amount of the indebtedness, from Texas Farmers. Texas Farmers denied liability to the mortgagees beyond the \$25.70 deficiency. The insurer contended that the mortgagees' only interest in the property was to secure payment of the mortgage debt, and that the payment of the \$6,700 at the foreclosure sale extinguished all but \$25.70 of the debt, even though the payment came from the mortgagees themselves.

The trial court agreed with the insurer's arguments. It withdrew the case from the jury and rendered judgment for the mortgagees in the amount of the \$25.70 deficiency. The court of appeals affirmed, observing that the purpose of the mortgagee clause was to protect the mortgagee's security interest in the mortgaged property.¹⁶⁵ Because the purchase at the foreclosure sale had satisfied the indebtedness, the insurer was not liable to the mortgagees under the policy except for the \$25.70 deficiency.¹⁶⁶

IV. HEALTH, LIFE AND ACCIDENT INSURANCE

In *Aetna Life & Casualty Co. v. Gunn*¹⁶⁷ Raymond Gunn filed suit to collect the proceeds of a group life insurance policy and a group accidental death and disability policy upon the death of his wife, Phyllis Gunn. On September 2, 1982, Phyllis Gunn interviewed for employment as a file clerk with Fisher Scientific Company. She underwent a physical examination and executed a W4 Form, an Aetna Life & Casualty Insurance card, and an employment contract with Fisher on September 3, but she did not commence her duties as a file clerk until September 7. On December 5, she was injured in an automobile accident, and she died on December 6. The Aetna group policy in question provided that each employee would become eligible for coverage on the date on which he or she completed "three months of continuous service."¹⁶⁸ The trial court granted summary judgment in favor of Aetna, finding that Mrs. Gunn did not complete three months of continuous service prior to her death. The court of appeals reversed, however, and held that the term "three months of continuous service" was ambiguous because the meaning of the word "service" was not clearly ascertainable.¹⁶⁹

The Texas Supreme Court reversed the appeals court, finding that the

any change of ownership or increase of hazard which shall come to the knowledge of said mortgagee.

Id. at 196.

165. *Id.*

166. *Id.* at 197-98.

167. 628 S.W.2d 758 (Tex. 1982).

168. *Id.* at 759.

169. *Gunn v. Aetna Life & Casualty Co.*, 629 S.W.2d 59, 61 (Tex. Civ. App.—Dallas 1981).

policy was unambiguous.¹⁷⁰ The court stated that the rule for determining whether a contract is ambiguous requires consideration of the contractual language in light of the surrounding circumstances.¹⁷¹ If in light of the surrounding circumstances the language of the contract appears to be capable of only a single meaning, the court can then confine its inquiry to the four corners of the writing.¹⁷² In considering the circumstances surrounding Mrs. Gunn's commencement of employment, the court noted that Mrs. Gunn executed the employment documents herself and inscribed on the insurance form in her own hand that she would begin employment on September 7. Furthermore, the court found that she had not performed any duties for Fisher prior to her first day of work. The court therefore held that Mrs. Gunn commenced work on September 7, 1976 and, consequently, that the policy did not cover her death, which occurred less than three months from the day she commenced work.¹⁷³

*American Diversified Mutual Life Insurance Co. v. Texas State Board of Insurance*¹⁷⁴ involved the issue of the authority of the Texas State Board of Insurance to disapprove for use in Texas a life insurance policy requiring premiums and benefits to be paid in foreign currency. In 1978 American Diversified submitted to the board of insurance a policy form specifying the payment of premiums and benefits in Swiss francs. The commissioner disapproved the policy form, and the board of insurance subsequently affirmed the commissioner's order pursuant to article 3.42(f) of the Texas Insurance Code.¹⁷⁵

The court of appeals found no specific provision in the Insurance Code that authorized the issuance of a life insurance policy using foreign currency.¹⁷⁶ Conversely, however, the court also determined that no provision expressly prohibited the issuance of a policy in a medium of exchange other than dollars.¹⁷⁷ In fact, the court observed, the Insurance Code did not explicitly authorize the standard U.S. currency policy.¹⁷⁸ The court noted, however, that article 3.01, section 1 of the Insurance Code defined a life insurance company as "a corporation doing business under any charter

170. 628 S.W.2d at 759.

171. *Id.* at 760.

172. *Id.* (citing *Sun Oil Co. v. Madeley*, 626 S.W.2d 726 (Tex. 1981)).

173. 628 S.W.2d at 759.

174. 631 S.W.2d 805 (Tex. Ct. App.—Austin 1982, writ ref'd n.r.e.).

175. TEX. INS. CODE ANN. art. 3.42(f) (Vernon 1981).

176. 631 S.W.2d at 807. The court noted that art. 3.42(f) limits the power of the board of insurance to regulate forms used in the industry. *Id.* Article 3.42(f) provides:

The State Board of Insurance shall forthwith disapprove any such form, or withdraw any previous approval thereto *if, and only if,*

- (1) It is in any respect in violation of or does not comply with this Code.
- (2) It contains provisions which encourage misrepresentation or are unjust, unfair, inequitable, misleading, deceptive or contrary to law or to the public policy of this State.
- (3) It has any title, heading or other indication of its provisions which is misleading.

TEX. INS. CODE ANN. art. 3.42(f) (Vernon 1981) (emphasis supplied).

177. 631 S.W.2d at 807.

178. *Id.* at 807-08.

involving [a] *payment of money or other thing of value*, conditioned on the continuance or succession [sic] of human life, or involving an insurance[,] guaranty[,] contract or pledge for the payment of endowments or annuities."¹⁷⁹ On the basis of this definition, the court held that the Insurance Code did not prohibit the issuance of life insurance policies denominated in Swiss francs.¹⁸⁰ To the contrary, the court stated that the phrase "money or other thing of value" appeared to authorize foreign currency policies and to render such contracts fully enforceable.¹⁸¹

In *McDonald v. McDonald*¹⁸² a dispute arose over the rights to the proceeds of two life insurance policies. The controversy involved the decedent's former wife, who was the named beneficiary, and the administrator of the decedent's estate. The named beneficiary and the decedent were divorced twenty-five days before the decedent's accidental death, and the divorce decree awarded the life insurance policies to the decedent as his separate property. The decedent neglected to designate a new beneficiary prior to his death. The trial court nevertheless found that the former wife was still the beneficiary, holding that the divorce decree had not divested her of her contingent rights to the insurance proceeds.

The court of appeals reversed, holding that the unmatured rights to the insurance proceeds belonged to the community on the date of the divorce.¹⁸³ The divorce proceedings disclosed great animosity between the parties, rendering it obvious that the decedent did not intend to give the insurance proceeds to his wife. The court found sufficient evidence to rebut the ordinary presumption that a decedent intends a gift to the named beneficiary of a life insurance policy.¹⁸⁴ The court therefore held that the divorce decree had divested the former wife of her rights to the proceeds of the policies.¹⁸⁵

*Duty v. Ignasiak*¹⁸⁶ involved a dispute over life insurance proceeds between the decedent's parents and his fiancée. The insured shot himself, but before doing so he left a handwritten note in which he directed that the insurance proceeds should go to his fiancée.¹⁸⁷ The policy provided that if

179. *Id.* at 808 (quoting TEX. INS. CODE ANN. art. 3.01, § 1 (Vernon 1981) (emphasis supplied)).

180. 631 S.W.2d at 808.

181. *Id.*

182. 632 S.W.2d 636 (Tex. Ct. App.—Dallas 1982, no writ).

183. *Id.* at 638-39.

184. *Id.* at 638.

185. *Id.* at 638-39; *see also* *Brewer v. Brewer*, 239 Ark. 614, 390 S.W.2d 630 (1965) (decedent's divorced wife held divested of right to proceeds of decedent's life insurance policy although named as beneficiary when wife, in divorce settlement agreement, released all interest in policy); *Romero v. Melendez*, 83 N.M. 776, 498 P.2d 305 (1972) (award of insurance policy to husband in divorce decree divested former wife of rights to proceeds although wife remained named beneficiary); *Dudley v. Franklin Life Ins. Co.*, 250 Or. 51, 440 P.2d 363 (1968) (divorce settlement agreement awarding life insurance policy to husband divested wife of right to proceeds of policy although wife remained beneficiary).

186. 633 S.W.2d 654 (Tex. Ct. App.—Houston [14th Dist.] 1982, no writ).

187. *Id.* at 655. The note stated, in part: "Vicki, you are my beneficiary and will bury me. And someone make sure she gets my money out of my checking account and keeps the money from my insurance." *Id.*

no beneficiary had been designated, the insured's parents would be entitled to the proceeds.¹⁸⁸

The court held that the beneficiary portion of the policy was an alternate means of determining a beneficiary that was operative only if the insured did not specifically designate a beneficiary.¹⁸⁹ Because the insured had not designated a beneficiary prior to writing the note in question, his parents would be the beneficiaries under the terms of the policy unless the suicide note constituted a proper beneficiary designation. The court stated that the general rule regarding a change of beneficiary is that the insured must do all he reasonably can do to comply with the terms set out in his policy for effecting such a change, and that the insured's intent in that regard is irrelevant.¹⁹⁰ This rule does not apply, the court noted, when an original designation of beneficiary is at issue. In such a case the insured's intent is controlling, as it is in construing testamentary documents.¹⁹¹ In so holding, the court followed decisions from other jurisdictions.¹⁹²

Applying this rule, the court held that the insured had properly designated his fiancée as the beneficiary.¹⁹³ The policy required only that the insured file a written request with the policy owner or at the insurer's home office. The policy did not require that the designation be on an approved form, be approved by the insurer, or be endorsed on the policy. The court

188. *Id.* The policy stated that the insured could:

designate a beneficiary or change his designation or [sic] beneficiary, from time to time by written request filed with the Policyowner or at the Home Office of the Company. Such designation or change shall take effect as of the date of execution of such request, whether or not the Individual be living at the time of such filing, but without prejudice to the Company on account of any payments made by it before receipt of such request to its Home Office.

Id. The policy also provided as follows:

BENEFICIARY: The amount payable by reason of the death of an Individual shall be paid to the beneficiary or beneficiaries designated by the Individual . . .

Except as may be otherwise specifically provided by the individual,

(b) if no designated beneficiary survives the Individual, or if no beneficiary has been designated, payment shall be made to . . . the Individual's parents

Id. at 655-56.

189. *Id.* at 656.

190. *Id.*; see *Kotch v. Kotch*, 151 Tex. 471, 478-79, 251 S.W.2d 520, 524-25 (1952) (failure to comply substantially with policy provisions precluded effective change of beneficiary despite insured's intent to make the change); *Tips v. Security Life & Accident Co.*, 144 Tex. 461, 464, 191 S.W.2d 470, 471 (1945) (insured must comply substantially with method designated in policy for change of beneficiary); *Adams v. Adams*, 78 S.W.2d 664, 665 (Tex. Civ. App.—San Antonio 1935, writ *dism'd*) (if insured does all that he reasonably could do to comply with policy provisions for change of beneficiary, change is effective even if change application arrives at insurer's home office after insured's death).

191. 633 S.W.2d at 656.

192. *Id.* (citing *Wheaton Nat'l Bank v. Aarvold*, 38 Ill. App. 3d 658, 348 N.E.2d 520 (1976); *Dennis v. Modern Bhd. of America*, 119 Mo. App. 210, 95 S.W. 967 (1906)).

193. 633 S.W.2d at 657.

held that the insured's note substantially complied with the policy requirements, and therefore, the note constituted a proper beneficiary designation entitling the insured's fiancée to the policy proceeds.¹⁹⁴

194. *Id.* at 656-57.

