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INSURANCE LAW

R. Brent Cooper*
Michael W. Huddleston**

THIS Article discusses significant decisions of the Texas Supreme Court and Texas courts of appeals during this Survey period.

I. BAD FAITH

A. ARTICLE 21.21 DUTY TO THIRD PARTIES

In *Watson v. Allstate Insurance Co.*¹ the Fort Worth court of appeals addressed the issue of what rights, if any, a third-party claimant has under a liability policy prior to the time when either a judgment is obtained or the insurer agrees to a settlement in writing. *Watson* was involved in a motor vehicle collision with an Allstate insured. Suit was filed by *Watson* against Allstate prior to obtaining any judgment or settlement. Summary judgment was granted by the trial court in favor of Allstate. On appeal, *Watson* contended that the trial court erred in granting the summary judgment and in holding that (1) Allstate owed no duty of good faith and fair dealing; (2) *Watson* was not a consumer under the Deceptive Trade Practices Act;² and (3) *Watson* was not entitled to bring an action under article 21.21 of the Texas Insurance Code.³

With respect to the duty of good faith and fair dealing issue, *Watson* contended that she was an intended third-party beneficiary of the liability policy, and such relationship gave rise to a duty of good faith and fair dealing. *Watson* first argued that under prior Texas case law, the duty of good faith and fair dealing should be extended to third-party claimants under a liability policy.⁴ The court of appeals rejected this argument, noting that in *Chaffin v. Transamerica Insurance Co.*⁵ the Houston court of appeals had held

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1. 828 S.W.2d 423, 425 (Tex. App.—Fort Worth 1991, writ granted).

2. TEX. BUS. & COM. CODE ANN. §§ 17.41-63 (Vernon 1987).

3. TEX. INS. CODE ANN. art. 21.21 (Vernon 1981).

4. *Watson* relied primarily on the cases of *Arnold v. National County Mutual Fire Ins. Co.*, 725 S.W.2d 165 (Tex. 1987); *Sentry Ins. v. Siurek*, 748 S.W.2d 104 (Tex. App.—Houston [1st Dist.] 1987, no writ); and *Chaffin v. Transamerica Ins. Co.*, 731 S.W.2d 728 (Tex. App.Houston [14th Dist.] 1987, writ ref'd n.r.e.).

5. 731 S.W.2d 728 (Tex. App.—Houston [14th Dist.] 1987, writ ref'd n.r.e.).

that the duty of good faith and fair dealing was not owed by a liability insurer to an injured third party.⁶

Watson also sought to rely upon *Dairyland County Mutual Insurance Co. v. Childress*⁷ in support of her assertion that the duty of good faith and fair dealing should extend to a claimant in her position.⁸ This argument was rejected by the court of appeals because Watson did not have a mature claim under the policy by reason of having obtained a judgment or settlement agreed to in writing, unlike the claimant in *Childress*.⁹

The court of appeals also rejected Watson's claim for relief under the Texas Deceptive Trade Practices Act (DTPA). It noted that in order to have standing under the DTPA, one must be a "consumer."¹⁰ To be a "consumer" under the act, a person must have sought or acquired, by purchase or lease, goods or services.¹¹ Because Watson had neither sought nor acquired, by purchase or lease, goods or services from Allstate, she had no standing to maintain an action under the DTPA.¹² Watson sought to circumvent this result by arguing that she was seeking to acquire insurance proceeds, pursuant to the mandatory automobile liability scheme of the Texas Motor Vehicle Safety Responsibility Act. The court of appeals rejected this argument, noting that insurance proceeds are neither goods nor services.¹³

The final issue before the court of appeals was whether Watson had stated a valid claim under article 21.21, section 16 of the Texas Insurance Code¹⁴. Watson contended that Allstate had violated that section with respect to the unfair claims settlement practices rule contained in section 21.203(4) of the Texas Administrative Code.¹⁵ The court noted that an action under section 16 of article 21.21 may be maintained by "a person," and that the person is

6. 828 S.W.2d at 426. At least two of the courts of appeals have also held that an insurer does not owe a duty of good faith and fair dealing to an insured third party. *Hart v. Aetna Cas. & Sur. Co.*, 756 S.W.2d 27, 28 (Tex. App.—Amarillo 1988, no writ); *Caserotti v. State Farm Ins. Co.*, 791 S.W.2d 561, 566 (Tex. App.—Dallas 1990, writ denied). Indeed, the rule adopted is in line with the majority rule in other jurisdictions. See *Dickey v. Alabama Farm Bureau Mut. Ins. Co.*, 447 So. 2d 693, 694 (Ala. 1984); *Murphy v. Allstate Ins. Co.*, 553 P.2d 584, 588 (Cal. 1976); *Eichler v. Scott Pools, Inc.*, 513 N.E.2d 665, 667 (Ind. Ct. App. 1987); *Linscott v. State Farm Mut. Auto. Ins. Co.*, 368 A.2d 1161, 1163 (Me. 1977); *Magalski v. Maryland Cas. Co.*, 318 A.2d 843, 848 (Md. Ct. Spec. App. 1974); *Chavez v. Chenoweth*, 553 P.2d 703, 709 (N.M. Ct. App. 1976); *D. H. Overmyer Telecasting Co. v. American Home Assurance Co.*, 502 N.E.2d 694, 698 (Ohio Ct. App. 1986); *Tank v. State Farm Fire & Cas. Co.*, 715 P.2d 1133, 1140 (1986); see also R. B. Cooper & Michael W. Huddleston, *Insurance Law, Annual Survey of Texas Law*, 45 Sw. L.J. 461, 470 (1991).

7. 650 S.W.2d 770 (Tex. 1983).

8. In *Dairyland County Mut. Ins. Co. v. Childress*, 650 S.W.2d 770, 775-76 (Tex. 1983), the Texas Supreme Court held that a third-party claimant under an automobile financial responsibility liability policy had the right to sue for damages under the policy and for attorney's fees once a judgment had been obtained.

9. *Watson*, 828 S.W.2d at 426.

10. *Id.* at 427.

11. TEX. BUS. & COM. CODE ANN. § 17.45 (4) (Vernon 1987).

12. 828 S.W.2d at 427.

13. *Id.*

14. TEX. INS. CODE ANN. art. 21.21, § 16 (Vernon 1981).

15. 28 TEX. ADMIN. CODE § 21.203(4) (West 1988). That section makes it an unfair claims settlement practice for a company not to attempt "in good faith to effectuate prompt,

not required to be a consumer as defined by the DTPA.¹⁶ The court did note, however, that a claim brought under article 21.21 must be related to the "business of insurance."¹⁷ While the court originally defined "business of insurance" according to federal law,¹⁸ on rehearing the court withdrew this holding and inferred that the phrase as defined by section 2(a)(6) of article 1.14-1 of the Texas Insurance Code would control.¹⁹ The court held that Watson's claim satisfied the definition because the "settlement of claims made by third parties arising out of the policy between the insurer and its insured is so closely related to the policy so as to constitute the 'business of insurance.'"²⁰ The court held on rehearing that this was true regardless of the standard used, either state or federal.²¹ Because Watson's claim under section 21.203(4) of the Texas Administrative Code satisfied the requirements of article 21.21 of the Insurance Code, the trial court erred in granting Allstate's summary judgment.²²

Several flaws in the *Watson* decision are readily apparent. First, the court noted decisions contrary to its own opinion and made no attempts to distinguish them. The most prominent decision was *Chaffin v. Transamerica Insurance Co.*²³ In *Chaffin*, an attempt was made by a third-party claimant to assert a cause of action under article 21.21 against a liability carrier. The court in *Chaffin* noted the definition of "a person" contained in Section 2 of article 21.21 in ruling that "we find no authority for extending the construction of 'person' beyond one who is either an insured or a beneficiary of the policy."²⁴

A second flaw in the decision is in the court's statutory construction of the unfair claims settlement practices rules.²⁵ In order to maintain an action under those rules, one must possess a "claim" as that term is defined by the Administrative Code. Section 21.202 defines "claim" as "[a] request or de-

fair and equitable settlements of claims submitted in which liability has become reasonably clear."

16. 828 S.W.2d at 427. The court, however, does not discuss the definition of "person" as contained in article 21.21. Section 2(a) of article 21.21 defines a person as "any individual, corporation, association, partnership, reciprocal exchange, inter-insurer, Lloyds insurer, fraternal benefit society, and any other legal entity engaged in the business of insurance, including agents, brokers, adjusters, and life insurance counselors." TEX. INS. CODE ANN. art. 21.21(2)(a) (Vernon 1987) (emphasis added). Clearly, Watson was not engaged in the insurance business and would not constitute a person as that term is defined by article 21.21. However, the supreme court in *Ceshker v. Bankers Commercial Life Ins. Co.*, 568 S.W.2d 128, 129 (Tex. 1978), disapproved of a construction of the word "person" as limited to one "engaged in the business of insurance," even though the legislature had so limited the construction by its definition.

17. *Watson*, 828 S.W.2d at 428.

18. *Id.*

19. *Id.* at 432.

20. *Id.* at 428.

21. *Id.* at 432.

22. *Id.* at 428.

23. 731 S.W.2d 728 (Tex. App.—Houston [14th Dist.] 1987, writ ref'd n.r.e.); see R. B. Cooper & Michael W. Huddleston, *Insurance Law, Annual Survey of Texas Law*, 42 Sw. L.J. 395 (1988).

24. *Id.* at 731.

25. 28 TEX. ADMIN. CODE §§ 21.201-30 (West 1988).

mand reduced to writing and filed by a Texas resident with an insurer for payment of funds or the providing of services *under the terms of a policy, certificate, or binder of insurance.*"²⁶ In its motion for rehearing, the court addressed the term "claim" as defined in the code and pointed out that Watson was a Texas resident.²⁷ However, the court completely ignored the requirement that the claim be requested under the terms of the policy. Under the terms of the policy issued by Allstate to Watson, Watson had no rights until she had obtained a judgment or a settlement agreed to in writing. Until such time as one of these two events occur, the insurer has no duty to make any payment to the injured party and, in fact, is immune to suit from the injured party.²⁸ In effect, the Fort Worth court of appeals held that a carrier can be liable for failing to make prompt, fair and equitable settlements of claims when there is no legal or contractual duty to make such a settlement.²⁹

The *Watson* decision raises other policy considerations that were not addressed by the court of appeals. First, in creating duties owed to a third-party claimant, the court in effect places the insurer in a conflict-of-interest situation. A liability insurer's duty of loyalty ought to be owed to its policyholder. Here, however, the court creates other duties to third-party claimants. This forces the liability insurer to balance the interests of the third-party claimant against the interests of the insured. If, for example, the insured does not want the claim settled and the third-party claimant does, whose interest does the insurer represent? *Watson* totally fails to address this important potential conflict.

Second, the decision fails to recognize that certain types of policies require the insured's consent to settle. For example, many professional liability policies specifically state in the policy that the insurer may not settle a claim without the consent of the insured. Again, under the *Watson* decision, an insurer is exposed to a bad-faith lawsuit when it is prohibited from settling with the claimant under the terms of its agreement with its insured. In addition, many policies are written over large self-insured retentions. If the insured is unwilling to pay the self-insured retention, the insurer may effectively be prevented from settling the case. Thus, the insurer may be exposed to liability under the unfair claims settlement practices rule for circumstances over which it has no control.

A final internal inconsistency in the *Watson* decision is its conflict with other decisions holding that a liability carrier owes no duty of good faith and fair dealing to the claimant. Several Texas cases have held that a liability

26. 28 TEX. ADMIN. CODE § 21.202 (West 1988).

27. *Watson*, 828 S.W.2d at 429.

28. *Id.* at 425.

29. An analogous situation would exist under the typical homeowners policy. Under the forms prescribed by the Department of Insurance, there is no duty to make payment until sixty days after a proof of loss has been filed with the insurer. Under the *Watson* rationale, the insurer could potentially be liable for failing to pay prior to the time a proof of loss has been filed or prior to the expiration of sixty days, even though it had no obligation under the policy. Such a rule is totally insupportable by logic and would, in effect, allow the court or jury to rewrite a contract based upon what was reasonable at that particular point in time.

insurer owes no duty of good faith and fair dealing to a third-party claimant for the reason that no special relationship exists between the insurer and the claimant.³⁰ As a result, the liability carrier and the third-party claimant are at arms-length and may deal with each other as such. To hold that a liability insurer holds statutory duties to such a claimant, but not the tort duty of good faith and fair dealing, is to ignore the sound basis and reasoning for the denial of such a duty to third parties under the tort duty cases.

The Texarkana court of appeals in *CNA Insurance Co. v. Scheffey*³¹ reached an opposite result from the Fort Worth court of appeals' decision in *Watson*. CNA was a worker's compensation insurance carrier for numerous employers in the state of Texas. Scheffey was an orthopedic surgeon whose practice included treatment of injured workers whose employers provided worker's compensation insurance coverage through CNA. Scheffey filed a slander and libel suit in which he claimed that CNA employees falsely spread information. One claim raised by Scheffey was that he was a third-party beneficiary and consumer under the policies of insurance that CNA had issued to employers and that CNA had violated various insurance rules and regulations under article 21.21 of the Insurance Code.³² The court noted that Scheffey did not have standing to sue under the Unfair Claims Settlement Practices Act³³ because the act does not create a private cause of action.³⁴ As a result, the only way in which standing might exist was if Scheffey was a "person" under article 21.21.³⁵ The court held that there was no authority for extending the meaning of the term "person" as found in article 21.21, beyond one who is either an insured or an intended beneficiary of the policy.³⁶ As a result, Scheffey had no standing to maintain a private cause of action under article 21.21 under the circumstances of the case.³⁷

B. ESTOPPEL COVERAGE

In *State Farm Fire & Casualty Co. v. Taylor*³⁸ State Farm's insured, Anglin, shot and killed Taylor in an argument over the repair of Anglin's lawn mower by Taylor. State Farm initiated a lawsuit seeking a declaratory judgment that it would not have any liability for any judgment obtained against its insured because the shooting was intentional and thereby excluded from coverage under the terms of its homeowners policy. While the declaratory judgment was pending, the underlying lawsuit went to trial and resulted in a judgment against State Farm's insured based upon findings of negligence in

30. *Caserotti v. State Farm Ins. Co.*, 791 S.W.2d 561, 566 (Tex. App.—Dallas 1990, writ denied); *Hart v. Aetna Cas. & Sur. Co.*, 756 S.W.2d 27, 28 (Tex. App.—Amarillo 1988, no writ); *Chaffin v. Transamerica Ins. Co.*, 731 S.W.2d 728, 731-32 (Tex. App.—Houston [14th Dist.] 1987, writ ref'd n.r.e.).

31. 828 S.W.2d 785 (Tex. App.—Texarkana 1992, writ denied).

32. TEX. INS. CODE ANN. art. 21.21 (Vernon 1981).

33. *Id.* art. 21.21-2.

34. 828 S.W.2d at 791.

35. *Id.*

36. *Id.*

37. *Id.* at 792.

38. 832 S.W.2d 645 (Tex. App.—Fort Worth 1992, writ denied).

the insured's shooting of Taylor.³⁹ State Farm defended Anglin in that lawsuit.

The trial court found that State Farm was estopped from proceeding with the declaratory judgment because it did not seek to abate the pending wrongful death action until the declaratory judgment action was determined.⁴⁰ The court of appeals rejected this contention, noting that the Texas Supreme Court has held that a declaratory judgment as to the insurer's liability for a judgment against its insured may not be rendered prior to the entry of any judgment against the insured.⁴¹ Any opinion prior to that time is purely advisory and beyond the power of the district court to render.⁴² As a result, the court of appeals found that State Farm was not estopped from prosecuting the declaratory judgment action following the entry of judgment against the insured.⁴³

The Taylors next contended that State Farm was estopped from proceeding with the declaratory judgment action by having defended its insured while at the same time contesting coverage by means of the declaratory judgment action. This contention was likewise rejected. The court of appeals held that Texas law recognizes the right of an insurer to defend an insured under a reservation of rights while at the same time reserving unto itself all of its policy defenses in the event that the insured is found to be liable by the jury in the underlying case against him.⁴⁴

C. EXISTENCE OF INSURANCE CONTRACT STATUTORY VIOLATIONS

In *Maccabees Mutual Life Insurance Co. v. McNiel*⁴⁵ an agent for Maccabees persuaded the Dallas County Hospital District to switch its group life insurance coverage from Hartford to Maccabees. The agent assured the hospital district that he had the authority to bind coverage as a representative of Maccabees and that coverage would be in force the next day. On October 26, 1987, an active employee of the hospital, Vivian McNiel, died. On November 17, 1987, Maccabees sent a letter to the Dallas County Hospital District declining the application based on a provision in the application that the coverage was subject to home office approval. Approval had been withheld because the list of inactive employees was incomplete. McNiel's beneficiary sued Maccabees and the hospital district. The case was tried to the court, and judgment was entered in favor of McNiel.⁴⁶ Included in the judgment was an award of \$4,548 as penalty under article 3.62 of the Insurance Code.⁴⁷ Under article 3.62, an insured may recover, in addition to the

39. *Id.* at 647.

40. *Id.*

41. *Id.* at 648.

42. *Id.*; see also *Fireman's Ins. Co. of Newark, New Jersey v. Burch*, 442 S.W.2d 331, 333 (Tex. 1968).

43. *Taylor*, 832 S.W.2d at 648.

44. *Id.* (citing *Farmers Texas County Ins. Co. v. Wilkinson*, 601 S.W.2d 520, 522 (Tex. Civ. App.—Austin 1980, writ ref'd n.r.e.)).

45. 836 S.W.2d 229 (Tex. App.—Dallas 1992, n.w.h.).

46. *Id.* at 231.

47. 836 S.W.2d at 231; see TEX. INS. CODE ANN. art. 3.62 (Vernon 1981) (repealed).

amount of the loss, twelve per cent damages and attorneys fees when an insurance carrier fails to pay a life insurance claim within thirty days after the claim is made.⁴⁸ Maccabees argued that since no policy of insurance had been in effect between it and the hospital district, no award could be made under article 3.62. The trial court had found for McNiel on grounds of estoppel.⁴⁹ The Dallas court of appeals found that the language of article 3.62 requires the existence of an insurance policy before the twelve per cent penalty can be imposed.⁵⁰ However, the court of appeals found that no such requirement existed with respect to section 16 of article 21.21 and that statutory damages could be recovered under that statute.⁵¹

D. EXTRACONTRACTUAL LIABILITY INADEQUATE DEFENSE BY INSURED

In *Laster v. American National Fire Insurance Co.*⁵² and *Warren v. American National Fire Insurance Co.*,⁵³ which involved the same fact situation, a federal district court and the Fort Worth court of appeals were each faced with the question of what obligation an insured owes to an insurer when the insured has rejected a defense pursuant to a reservation of rights letter. In the underlying case, Laster had filed an action in the state district court against Warren claiming that in September 1983 he was injured as a result of having been struck by the swinging chute of a concrete truck owned by Inter-County Concrete. At the time suit was filed, the primary insurer for Inter-County had become insolvent. In February 1987, Warren tendered his defense to American National, the excess insurer. American National offered to provide a defense to Warren, but insisted upon reserving its rights with respect to the liability for the first million dollars of any recovery, which had been covered under the insolvent insurer's policy. This offer was rejected by Warren. In November 1988, Warren's attorney withdrew. Six days after Warren's attorney withdrew, request for admissions were served on Warren, who failed to respond. Thereafter, a summary judgment was entered and eventually a verdict of almost three million dollars was entered against Warren.⁵⁴

48. TEX. INS. CODE ANN. art 3.62.

49. *Maccabees*, 836 S.W.2d at 233.

50. *Id.* at 235. Article 3.62, repealed effective September 1, 1991, provided:

In all cases where a loss occurs and the life insurance company, or accident insurance company, or life and accident, health and accident, or life, health and accident insurance company liable therefor shall fail to pay the same within 30 days after demand therefor, such company shall be liable to pay the holder of such policy, in addition to the amount of the loss, twelve (12%) per cent damages on the amount of such loss together with reasonable attorney fees for the prosecution and collection of such loss. Such attorney fee shall be taxed as a part of the costs in the case. The Court in fixing such fees shall take into consideration all benefits to the insured incident to the prosecution of the suit, accrued and to accrue on account of such policy.

51. 836 S.W.2d at 235.

52. 775 F. Supp. 985 (N.D. Tex. 1991), *aff'd*, 966 F.2d 676 (5th Cir. 1992).

53. 826 S.W.2d 185 (Tex. App.—Fort Worth 1992, writ denied).

54. 775 F. Supp. at 987.

In both actions, American National asserted that it had no liability under its policy because Warren had failed to provide an adequate defense. Both courts held that when an insured rejects a defense pursuant to a reservation of rights, there is an obligation on the part of the insured to take reasonable steps to avoid or minimize legal liability.⁵⁵ Both the *Laster* and *Warren* courts characterized the defense of the case as follows: "A more glaring case of lack of cooperation by an insured and of calculated disregard of an excess insurer's rights would be difficult to find. Improper collusive conduct on the part of Warren and his counsel, to the detriment of American, is strongly indicated by the summary judgment record."⁵⁶

The result in these cases is a fair one, as the duty to properly defend is logically a mutual one. If an insured rejects a defense by the insurer under reservation of rights, he should be held to a duty to conduct a reasonable defense, just as the insurer that assumes the defense of an insured is held to a duty to defend properly. The insured who rejects a reservation of rights and then does not put on a reasonable defense should not be permitted to recover under the policy.

E. STANDARD OF REVIEW

One of the more significant questions remaining in the area of bad faith is the standard of review to be employed by trial and appellate courts in reviewing the evidence concerning bad faith. The San Antonio court of appeals in *State Farm Lloyds, Inc. v. Polasek*⁵⁷ presented an excellent discussion of the different standards of review available to the courts and adopted one that not only protects the rights of the insured but also affords insurers some measure of predictability as to the result of their decisions.

The *Polasek* case arose out of a fire at Polasek's video rental business, which was insured by State Farm. The claim was denied on the grounds that the fire was the result of arson. The case was tried before a jury, which found that the insureds had not started the fire and that State Farm had acted in bad faith in denying the claim.⁵⁸ On appeal, the San Antonio court of appeals reversed the holding as to bad faith.⁵⁹ The court noted that, under *Aranda v. Insurance Co. of North America*,⁶⁰ carriers still have the right to deny invalid or questionable claims and not be subject to liability for an erroneous denial of a claim.⁶¹ As a result, the *Polasek* court held that a bad faith cause of action requires much more demanding proof than a claim on the insurance policy.⁶²

55. *Warren*, 826 S.W.2d at 188; *Laster*, 775 F. Supp. at 995 (citing *Britt v. Cambridge Mut. Fire Ins. Co.*, 717 S.W.2d 476 (Tex. App.—San Antonio 1986, writ ref'd n.r.e.); *Harville v. Twin City Fire Ins. Co.*, 885 F.2d 276 (5th Cir. 1989); *Fidelity & Cas. Co. v. Gault*, 196 F.2d 329 (5th Cir. 1952)).

56. 775 F. Supp. at 999; 826 S.W.2d at 188 (quoting *Laster*, 775 F. Supp. at 999).

57. No. 04-92-00100-CV (Tex. App.—San Antonio, Dec. 16, 1992, n.w.h.).

58. *Id.*, slip op. at 1.

59. *Id.* at 19.

60. 748 S.W.2d 210 (Tex. 1988).

61. No. 04-92-00100-CV, slip op. at 15.

62. *Id.* at 6.

Courts of appeals in the state have adopted at least two standards for reviewing evidence in bad faith cases. Under one line of authority, the focus of the inquiry has been whether or not there is "some evidence" that there was not a reasonable basis for the denial.⁶³ Under this line of authority, the court will apply the traditional standard of review with respect to legal sufficiency of the evidence.⁶⁴ The court would disregard all evidence supporting the insurer's decision to deny the claim and determine if there was probative evidence to support the jury's finding.⁶⁵ The problem with this standard is that it often equates an incorrect denial of a claim with bad faith. If there is undisputed evidence before the carrier at the time it denies the claim, then there should be no liability for bad faith denial of the claim as a matter of law.

The second test employed by the courts of appeals is the reasonable basis test. Under this test, if the record indicates that the insurer possessed evidence reasonably showing that the insured's claim might not be valid, as a matter of law, there can be no bad faith cause of action.⁶⁶ The insured is required to show that no reasonable basis existed for denying the claim.⁶⁷ To meet this burden, the insured must prove that there were no facts before the insured which, if believed, would result in denial of the claim.⁶⁸ Under this line of authority, the trier of fact does not weigh the conflicting evidence.⁶⁹ Rather, it decides whether the evidence existed and whether, standing alone, it constituted a reasonable ground for denying the claim.⁷⁰ Under this standard of review, an insurer will not be required to pursue every possible avenue of investigation.⁷¹ The Polaseks argued that an insurer has the duty to "leave no stone unturned,"⁷² but the court of appeals rejected this argument.⁷³ If the insurer had before it evidence that would constitute a reasonable basis for denial of the claim, then, as a matter of law, the insurer cannot be liable for bad faith damages.⁷⁴

63. *Commonwealth Lloyds Ins. Co. v. Thomas*, 825 S.W.2d 135, 144 (Tex. App.—Dallas 1992, writ dismissed). *State Farm Mutual Auto. Ins. Co. v. Zubiata*, 808 S.W.2d 590, 598 (Tex. App.—El Paso 1991, writ denied); *Automobile Ins. Co. v. Davila*, 805 S.W.2d 897, 905-06 (Tex. App.—Corpus Christi 1991, writ denied); *National Union Fire Ins. Co. v. Dominguez*, 793 S.W.2d 66, 70 (Tex. App.—El Paso 1990, writ granted); *Allied General Agency, Inc. v. Moody*, 788 S.W.2d 601, 607 (Tex. App.—Dallas 1990, writ granted).

64. *Polasek*, No. 04-92-00100-CV, slip op. at 10.

65. *Id.*

66. *St. Paul Lloyds Ins. Co. v. Fong Chun Huang*, 808 S.W.2d 524, 526 (Tex. App.—Houston [14th Dist.] 1991, writ denied); *St. Paul Guardian Life Ins. Co. v. Luker*, 801 S.W.2d 614, 618 (Tex. App.—Texarkana 1990, no writ); *Miller's Cas. Ins. Co. v. Lyons*, 798 S.W.2d 339, 343-44 (Tex. App.—Eastland 1990, writ granted); *National Union Fire Ins. Co. v. Hudson Energy*, 780 S.W.2d 417, 426-27 (Tex. App.—Texarkana 1989), *aff'd*, 811 S.W.2d 552 (Tex. 1991); *Fuentes v. Texas Employers Ins. Assoc.*, 757 S.W.2d 31, 33-34 (Tex. App.—San Antonio 1988, no writ).

67. No. 04-92-00100-CV, slip op. at 9.

68. *Id.*

69. *Id.* slip op. at 11.

70. *Id.*

71. *Id.* slip op. at 18.

72. *Id.*

73. *Id.*

74. *Id.*

F. DUTY WHERE DENIAL WAS REASONABLE

Several cases during the Survey period have involved the issue of whether an insured may obtain extracontractual damages for breach of the duty of good faith and fair dealing even if the court determines that the insurer was correct in its coverage position.⁷⁵ In *Snug Harbor, Ltd. v. Zurich Insurance*⁷⁶ a former condominium development owner, Snug Harbor, brought a state court action against a general liability insurer and its insured, First South, a mortgagee. First South had foreclosed on the condominium development and had allegedly mishandled the petition and citation that was to be served on Snug Harbor, thereby causing a default judgment to be entered against Snug Harbor in the state court.⁷⁷ After a settlement in which Snug Harbor took an assignment of First South's cross-claim against the insurer for breach of the duty to defend, the federal district court found that Zurich, the general liability insurer, had a duty to defend First South.⁷⁸ A jury then found that Zurich had acted in bad faith in failing to defend First South.⁷⁹ A judgment in the amount of \$700,000 in actual damages (the amount of the settlement), \$30,000 in attorney's fees and \$1.5 million in exemplary damages was entered against Zurich.⁸⁰ Coverage issues in the case were (1) whether Snug Harbor suffered "property damage," (2) whether, if "Snug Harbor did suffer 'property damage,' such damage was caused by an 'occurrence' within the policy period, and (3) [whether] any coverage otherwise applicable was excluded by the policy's 'care, custody, control' and exclusion clause."⁸¹

The Fifth Circuit, after finding that the loss did not constitute "property damage" and that there was no "occurrence" during the policy period, found that Zurich had no duty to defend its insured.⁸² It then found that Zurich did not breach a duty of good faith and fair dealing by refusing to defend First South.⁸³ The court reasoned that Snug Harbor's claim of bad faith was an appendage to its assertion that Zurich breached a contractual duty to defend, a duty the Fifth Circuit found to be nonexistent, so the bad faith claim was without merit.⁸⁴ The court stated that "[a] finding of bad faith could not be premised solely on the breach of a contractual duty, such as the duty to defend," and that "delays or refusals to pay are not unreasonable where there is a legitimate question of policy construction."⁸⁵

75. See, e.g., *Koral Industries, Inc. v. Security-Connecticut Life Ins. Co.*, 788 S.W.2d 136 (Tex. App.—Dallas), writ denied per curiam, 802 S.W.2d 650 (Tex. 1990).

76. 968 F.2d 538 (5th Cir. 1992).

77. *Id.* at 540. Subsequent to the default judgment, the insured was placed in conservatorship. The Federal Savings and Loan Insurance Corporation (FSLIC) and the Federal Deposit Insurance Corporation (FDIC) intervened as defendants and removed the case to federal court. *Id.* at 540-41.

78. *Id.* at 541.

79. *Id.*

80. *Id.*

81. *Id.* at 540.

82. *Id.* at 544-46. See discussion *infra* at notes 158-60.

83. 968 F.2d at 546-47.

84. *Id.*

85. *Id.* at 546 (quoting *National Union Fire Ins. v. Hudson Energy*, 780 S.W.2d 417, 427

In *Beaumont Rice Mill, Inc. v. Mid-American Indemnity Insurance Co.*,⁸⁶ after finding that the exclusion for injuries covered under the United States Longshore and Harbor Workers' Compensation Act applied to preclude coverage, the Fifth Circuit⁸⁷ reached the issue of the award of damages by the trial court for breach of the duty of good faith and fair dealing by the excess carrier, Mid-American.⁸⁸ The court held that even assuming that an excess carrier owed such a duty, Mid-American could not have breached it because its denial of the claim was reasonable.⁸⁹ The Fifth Circuit noted that an insurer "maintains the right to deny an invalid or questionable claim without becoming subject to liability for bad faith denial of the claim."⁹⁰ The court therefore reversed the discretionary damage award under the DTPA and the Insurance Code because Mid-American did not act in bad faith and because the validity of the insured's claim never became reasonably clear.⁹¹ It also reversed the award for exemplary damages in tort, holding that the reasonableness of Mid-American's position precluded such a recovery: "[I]f failing to pay was justifiable, it could not be negligent, malicious, or grossly negligent."⁹²

Similarly, the Fifth Circuit in *Pennsylvania National Mutual Casualty Insurance Co. v. Kitty Hawk Airways, Inc.*⁹³ stated that it was unnecessary to address whether the claimant could recover double damages from the insurer pursuant to section 16 of article 21.21 of the Texas Insurance Code because of the court's holding that the insurer's non-coverage defense barred damages arising from the insured's defamation of the claimant.⁹⁴

G. WORKERS' COMPENSATION

The Fort Worth court of appeals in *Transportation Insurance Co. v. Archer*⁹⁵ declined to extend the right to sue for the breach of a duty of good faith and fair dealing to the spouse of an injured worker. In *Archer* the insurer argued that the wife of the injured worker was not entitled to either actual or exemplary damages because she lacked standing to sue under either the duty of good faith and fair dealing or the Texas Insurance Code. The insurer cited *Aranda v. Insurance Co. of North America*⁹⁶ as authority for its

(Tex. App.—Texarkana 1989), *aff'd*, 811 S.W.2d 552 (Tex. 1981); *Plattenburg v. Allstate Ins. Co.*, 918 F.2d 562, 563-64 (5th Cir. 1990) ("where evidence shows justifiable reason existed for action of insurer, action cannot, as a matter of law, constitute bad faith").

86. 948 F.2d 950 (5th Cir. 1991).

87. See discussion *infra* notes 136-386.

88. 948 F.2d at 952.

89. *Id.* at 952 (citing *Arnold v. National County Mut. Fire Ins. Co.*, 725 S.W.2d 165, 167 (Tex. 1987) ("lack of reasonable basis or failure to determine whether there was reasonable basis for denial of claim under policy is an element of claim for breach of duty of good faith and fair dealing")).

90. *Id.* (citing *Aranda v. Insurance Co. of N. America*, 748 S.W.2d 210, 213 (Tex. 1988); *Plattenburg v. Allstate Ins. Co.*, 918 F.2d 562, 563 (5th Cir. 1990)).

91. *Id.*

92. *Id.*

93. 964 F.2d 478 (5th Cir. 1992).

94. 964 F.2d at 483 n.18.

95. 832 S.W.2d 403, 405-06 (Tex. App.—Fort Worth 1992, writ granted).

96. 748 S.W.2d 210, 212-13 (Tex. 1988).

proposition that the wife had no standing to sue for the breach of the common law duty of good faith and fair dealing. The wife, on the other hand, asserted the cases of *Torchia v. Aetna Casualty & Surety Co.*⁹⁷ and *Underwriters Life Insurance Co. v. Cobb*⁹⁸ as Texas authority for the right of a spouse to join the injured worker in a claim against an insurer for breaching the duty of good faith and fair dealing. The Fort Worth court of appeals distinguished *Torchia* and *Cobb* as having no bearing on the present case, because whether or not a spouse has an independent right of recovery under the duty of faith and fair dealing was not discussed in either opinion.⁹⁹

As almost a side note, the court of appeals denied that the wife had a direct right of recovery under the duty of good faith and fair dealing for her loss of consortium since only damages for interference with family relationships, rather than loss of consortium, was pled.¹⁰⁰ The court also declined to rule on whether or not a spouse has standing to sue for violations of the Insurance Code for allegations of wrongful claims handling.¹⁰¹ The court tersely noted that since the wife did not elect to recover under the Insurance Code, there was no issue to be addressed.¹⁰²

H. DEFENSE COUNSEL'S DUTIES TO EXCESS CARRIER

In *Stonewall Surplus Lines Insurance Co. v. Drabek*¹⁰³ Stonewall Surplus was the excess carrier for several insureds in a wrongful death suit. After the suit was settled, Stonewall sued the law firm of Hirsch, Glover, the defense attorneys hired by the primary carrier, for allegedly negligent actions, which caused Stonewall to pay substantially more to settle the case than it should have had to pay. During the course of the underlying suit, the trial court found substantial discovery abuse, struck the defendant's pleadings and rendered a partial default judgment.¹⁰⁴ The trial court determined that the only issues remaining for trial would be: "(1) the amount of actual damages; (2) whether the insureds were grossly negligent; and (3) the amount of exemplary damages which would be assessed against them upon a finding of gross negligence."¹⁰⁵ After the imposition of the sanctions, the primary carrier paid its limit of \$500,000, while Stonewall contributed \$1.3 million to the settlement. Stonewall sued the law firm, alleging that the firm's negligence had caused the court to strike the pleadings, resulting in the insurer's damages. In the malpractice claim, the trial court granted Hirsch, Glover's motion for summary judgment, finding that the law firm did not represent Stonewall and did not owe it a duty.¹⁰⁶ At the outset of the opinion, the court noted that Texas has a well-settled principle that persons outside the

97. 804 S.W.2d 219, 225 (Tex. App.—El Paso 1991, writ denied).

98. 746 S.W.2d 810, 819 (Tex. App.—Corpus Christi 1988, no writ).

99. *Archer*, 832 S.W.2d at 406.

100. *Id.* at 405-06.

101. *Id.* at 406.

102. *Id.*

103. 835 S.W.2d 708 (Tex. App.—Corpus Christi 1992, writ denied).

104. *Id.* at 709.

105. *Id.* at 709-10.

106. *Id.* at 710.

attorney-client relationship do not have a cause of action for injuries that they sustain due to an attorney's failure to perform or the negligent performance of a duty owed to a client.¹⁰⁷ The court also recognized that in the absence of privity of contract, an attorney owes no duty to a third-party non-client.¹⁰⁸ However, the *Stonewall* court held that this rule did not apply in this case.¹⁰⁹ Specifically, the court stated that the primary carrier, pursuant to its contract, hired Hirsch, Glover to defend the case on behalf of its insureds.¹¹⁰ As such, the attorneys owed the defendants the unqualified duty to conscientiously and adequately represent them.¹¹¹ The excess carrier argued that in the face of the excess liability coverage contract, the excess insurer stood in the place of the insureds and that it was subrogated to their rights by reason having been required to pay more money in settlement of the wrongful death case because of the negligence of the defense attorneys. The court noted that the principles of equitable subrogation applied to the facts of the *Stonewall* dispute.¹¹²

Hirsch, Glover attempted to argue that *American Centennial Insurance Co. v. Canal Insurance Co.*¹¹³ supported its position that no duty was owed to the excess insurer and that equitable subrogation was not an appropriate theory for adoption under the circumstances of the case. However, the Fort Worth court of appeals disagreed, stating that *American Centennial* was distinguishable because (1) the excess carrier's suit against the primary carrier in this case had been severed from the suit against the defense attorneys and (2) the insured's claim in *American Centennial* was barred by the two-year statute of limitations, thus barring any claim the excess carrier might have against the defense counsel in that case by equitable subrogation.¹¹⁴

In *American Centennial Insurance Co. v. Canal Insurance Co.*¹¹⁵ the underlying claim involved an automobile accident caused by a tire blow-out on a rental car. The parents of the two girls who died in the accident sued the rental company, which was insured by a primary carrier and two excess carriers. Apparently, during the course of defense, the primary carrier's attorney mishandled the suit, and the insurers paid \$3.7 million to settle the case.¹¹⁶

After the settlement, the two excess carriers brought suit against the primary carrier and the defense counsel for negligence, gross negligence, breach

107. *Id.* (citing *Dickey v. Jansen*, 731 S.W.2d 581, 582 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.)).

108. *Id.* (citing *Draper v. Garcia*, 793 S.W.2d 296, 301 (Tex. App.—Houston [14th Dist.] 1990, no writ)); see also *First Mun. Leasing Corp. v. Blankenship, Potts, Aikman, Hagin, & Stewart*, 648 S.W.2d 410, 413 (Tex. App.—Dallas 1983, writ ref'd n.r.e.); *Bell v. Manning*, 613 S.W.2d 335, 339 (Tex. Civ. App.—Tyler 1981, writ ref'd n.r.e.).

109. *Stonewall*, 835 S.W.2d at 710.

110. *Id.*

111. *Id.*

112. *Id.*

113. 810 S.W.2d 246 (Tex. App.—Houston [1st Dist.] 1991), *aff'd in part, rev'd in part*, 843 S.W.2d 480 (Tex. 1992).

114. 835 S.W.2d at 711.

115. 843 S.W.2d 480 (Tex. 1992).

116. *Id.* at 481.

of the duty of good faith and fair dealing and violations of the DTPA and Insurance Code. At trial, the court granted summary judgment, denying all of the claims under the statute of limitations, while also finding that the primary carrier owed no duty of care to the excess carriers.¹¹⁷ The Houston court of appeals (First District) reversed the summary judgment as to the primary carrier, but affirmed as to the defense counsel based on the statute of limitations.¹¹⁸ In its decision, the Supreme Court of Texas affirmed the part of the court of appeal's opinion pertaining to the primary carrier, but reversed the portion of the court's decision precluding the excess carrier's suit against the defense counsel.¹¹⁹ At the outset of its opinion, the supreme court noted that the *Stowers* doctrine¹²⁰ gives an insurer the right to sue a primary carrier for the wrongful refusal to settle a claim within policy limits.¹²¹ The court reiterated that the standard of an ordinarily prudent person in business management applies to an insurer in claims investigation, trial defense and settlement negotiations.¹²² Noting that other states have found that the doctrine of equitable subrogation permits a claim by an excess carrier against a primary carrier for the breach of a *Stowers*-type duty, the court wrote that

the insurer paying a loss under a policy becomes equitably subrogated to any cause of action the insured may have against a third party responsible for the loss. The excess insurer would thus be able to maintain any action that the insured may have against the primary carrier for mishandling of the claim.¹²³

The court claimed that if the excess carrier could not bring such an equitable subrogation type of claim, then the primary carrier would have less incentive to settle within policy limits.¹²⁴ The court declined to recognize the existence of a direct action by excess carriers against primary carriers, approving instead the same result through the equitable subrogation theory.¹²⁵ The court went on to find that the excess carrier's claims for negligence, gross negligence and violations of the DTPA and Insurance Code against the primary carrier were barred by the statute of limitations, although the equitable subrogation claim on the *Stowers* action against the primary carrier was not so barred.¹²⁶ However, the court found that the excess carrier's claims against the attorneys were erroneously dismissed by the court of appeals, which held that the claim accrued at the time of the attorneys' alleged malpractice.¹²⁷ The court found that the court of appeals' holding conflicted

117. *Id.* For a discussion of the court of appeals' decision on these issues, see *American Centennial*, 810 S.W.2d at 250-56.

118. *American Centennial*, 843 S.W.2d at 482.

119. *Id.* at 485.

120. *G.A. Stowers Furniture Co. v. American Indem. Co.*, 15 S.W.2d 544 (Tex. Comm'n App. 1929, holding approved).

121. 843 S.W.2d at 482.

122. *Id.*

123. *Id.*

124. *Id.* at 483.

125. *Id.*

126. *Id.* at 483-84.

127. *Id.*

with *Hughes v. Mahaney & Higgins*,¹²⁸ which held that the statute of limitations in an attorney malpractice claim is tolled until all appeals on the underlying claim are exhausted.¹²⁹ The court further found that allowing equitable subrogation actions by the excess insurer against defense counsel did not interfere with the attorney-client relationship or result in additional conflicts of interest.¹³⁰ Thus, the supreme court's decision is clearly in line with the *Stonewall* decision issued by the Fort Worth court of appeals.

I. MULTIPLE CLAIMANTS AND INSUFFICIENT INSURANCE

In *Texas Farmers Insurance Company v. Soriano*¹³¹ the San Antonio court of appeals addressed for the first time the standard by which an insurer's conduct is to be gauged in those situations in which it has multiple claims that exceed its policy limits. This suit arose out of an automobile accident between a vehicle driven by Soriano and a vehicle driven by Medina. Soriano and his passenger, Lopez, had been drinking prior to the accident. As a result of the accident, Lopez and Medina and his children suffered severe injuries. Medina's wife was killed in the accident. Soriano was insured under his parents' policy with Farmers, which had limits of \$10,000 per person and \$20,000 per occurrence. Farmers initially offered \$20,000 for the Medina claims. The limits were refused. Thereafter, suit was filed by the Medinas and by Lopez' parents against Soriano. Prior to trial, Farmers settled with Lopez for \$5,000 and offered the remaining \$15,000 of insurance to the Medinas. The offer was refused and a demand was made for the original policy limits of \$20,000.

The case went to trial and a judgment was entered against Soriano in the amount of \$172,187.¹³² Soriano then assigned his cause of action to the Medinas in exchange for a covenant not to execute. In their suit against Farmers, the jury found that Farmers was negligent in the handling of the settlement negotiations and rendered judgment of actual damages in the amount of \$520,577.24 and exemplary damages of \$5 million.¹³³

The primary issue on appeal was what standard was to be applied in gauging the conduct of Farmers in attempting to settle several claims with insufficient policy limits. Three possible standards were identified by the majority and the dissent. The plaintiffs contended that the court should adopt the comparative seriousness rule. Under this rule, an insurer can be held liable even though the first settlement was reasonable and entered into in good faith when viewed apart from exposure in the second case.¹³⁴ An insurer must measure the proportional merits of each claimant and then settle the cases accordingly.¹³⁵ If the insured is wrong in its assessment, then it be-

128. 821 S.W.2d 154 (Tex. 1991).

129. *American Centennial*, 843 S.W.2d at 483.

130. *Id.* at 484.

131. 844 S.W.2d 808 (Tex. App.—San Antonio 1992, n.w.h.).

132. *Id.* at 813.

133. *Id.* at 813-14.

134. *Id.* at 840 (Peoples, J., dissenting).

135. *Id.*

comes liable beyond its policy limits.¹³⁶ Applying the rule, the plaintiffs argued that it was unreasonable for Farmers to settle with Lopez because the Medina cases were more serious and posed a greater threat to Soriano. The comparative seriousness rule is contrary to the second standard identified by the court and followed in most jurisdictions, that an insurer can settle with some claimants in good faith even though the settlement may exhaust the insurance coverage or deplete the limits such that a subsequent creditor may have insufficient funds in which to satisfy its judgment.¹³⁷

Farmers and the dissent urged the adoption of the "viewed by itself" rule.¹³⁸ Under this rule, the conduct of an insurer in a multiple-claim case would escape liability if any settlement made by the insurer when viewed by itself was not unreasonable, considering the other unsettled claims.¹³⁹ The dissent set forth several reasons for the adoption of this rule. First, the insurer has a duty to the insured to use care in handling all claims against the insured, not just those that are more serious.¹⁴⁰ Second, such a rule would facilitate settlements.¹⁴¹ According to the dissent, the comparative seriousness rule would inhibit settlement in at least two ways. It would make settlement with one or more but less than all claimants more risky for insurers because of the lack of any defined standard.¹⁴² Also, such a rule would motivate multiple claimants who are faced with inadequate insurance to attempt to set up the insurer in order to remove the limits of liability from the insurance.¹⁴³

II. GENERAL LIABILITY

A. AUTOMOBILE EXCLUSION

In *Centennial Insurance Co. v. Hartford Accident & Indemnity Co.*¹⁴⁴ the Fourteenth District Court of Appeals in Houston found that allegations of negligent hiring and negligent entrustment fell within the general liability policy exclusion for injuries "arising out of the ownership, maintenance, operation, use, loading or unloading of an automobile." The court noted that the Texas Supreme Court had previously held in *Fidelity & Guaranty Insur-*

136. *Id.*

137. *Id.* at 840-41; see *Voccio v. Reliance Ins. Co.* 703 F.2d 1, 3 (1st Cir. 1983); *Harmon v. State Farm Mut. Auto. Ins. Co.*, 232 So. 2d 206, 207-08 (Fla. Dist. Ct. App. 1970); *Haas v. Midamerica Fire and Marine Ins. Co.* 343 N.E.2d 36, 38 (Ill. App. Ct. 1976); *Castoreno v. Western Indem. Co.*, 515 P.2d 789, 792-95 (Kan. 1973); *Holtzclaw v. Falco, Inc.*, 355 So.2d 1279, 1283-87 (La. 1978); *Liguori v. Allstate Ins. Co.*, 184 A.2d 12, 15-17 (N.J. Super. Ch. Div. 1962); *Negron v. Eveready Ins. Co.*, 385 N.Y.S.2d 87, 88 (N.Y. App. Div. 1976); *Duprey v. Security Mut. Cas. Co.*, 256 N.Y.S.2d 987, 989 (N.Y. App. Div. 1965); *Alford v. Textile Ins. Co.*, 103 S.E.2d 8, 13 (1958); *Scharnitzki v. Bienenfeld*, 534 A.2d 825, 827 (Pa. Super. Ct. 1987).

138. *Soriano*, 844 S.W.2d at 816.

139. *Id.*

140. *Id.* at 841 (Peoples, J., dissenting).

141. *Id.* at 841-42.

142. *Id.* at 842.

143. *Id.*

144. 821 S.W.2d 192, 194, 196 (Tex. App.—Houston [14th Dist.] 1991, no writ).

ance *Underwriters, Inc. v. McManus*¹⁴⁵ that the automobile exclusion in a standard homeowners policy specifically applied to claims of negligent entrustment because entrustment involves the core issue of whether the "use" of the vehicle was negligent.¹⁴⁶ The court rejected attempted distinctions between negligent hiring and negligent entrustment.¹⁴⁷ The court emphasized that the negligent hiring by itself, "without the fatal injury . . . caused by the instrumentality of an automobile," would not even rise to the level of a cause of action against the insured.¹⁴⁸ The court refused to find the distinction urged by the insured to be supported by cases from other jurisdictions involving two separate instrumentalities.¹⁴⁹ The court also refused to rely upon the decision of the Corpus Christi court of appeals in *Warrilow v.*

145. 633 S.W.2d 787 (Tex. 1982).

146. *Centennial*, 821 S.W.2d at 194. In *Fidelity & Guaranty Ins. Underwriters, Inc. v. McManus*, 633 S.W.2d 787 (Tex. 1982), the supreme court had the opportunity to consider whether an allegation of negligent entrustment of an automobile would fall under the automobile exclusion, thereby barring coverage for the allegation. The supreme court rejected the two theories developed by other jurisdictions, which hold that negligent entrustment is a distinct and specific cause of action based on either 1) the act of negligent entrustment itself or 2) the more general concepts of ownership and use of a vehicle. *Id.* at 789. The court stated that to recover for negligent entrustment in Texas it is essential that the owner or custodian have negligently entrusted the vehicle and that the vehicle have been negligently operated or used by the trustee. *Id.* at 790. The court determined that whether the entrustment was to an insured or a non-insured was immaterial because the plaintiffs still had to show negligent operation or use by the trustee as an element of the cause of action. *Id.* "In other words there would have been no accident in this case without the negligent operation or use of a recreational motor vehicle," the court stated. *Id.* "The homeowner's policy excludes coverage for claims arising out of the ownership, use or operation of a recreational motor vehicle. [The insurer] is under no duty to defend [the insured] under facts excluded from coverage under the policy." *Id.*

The courts in other jurisdictions have reached similar conclusions to that in *McManus* in a variety of circumstances. For example, in *Louis Marsch, Inc. v. Pekin Ins. Co.*, 491 N.E.2d 432 (Ill. App. Ct. 1985), the claimant was injured by a dump truck driven by an employee of Marsch. The court held that a negligent-hiring theory of recovery was not covered under a homeowners policy. *Id.* at 437. The court held that under such a theory it is "necessary to establish such negligence as the proximate cause of the damages to the third person, and this requires that the third person must have been injured by some negligent or otherwise wrongful act of the employee so hired." *Id.* The court added:

Thus, liability on the part of the employer to the third party cannot be predicated upon the mere fact that the employer hired and retained in his employment a servant whom he knew or should have known to have been incompetent . . . [T]here is no liability on Marsch's part under the negligent-hiring count unless Clark's negligent or otherwise wrongful conduct in operating the dump truck is also established. This instrumentality is the subject of the specific exclusion in the Aetna policy. We hold that the Aetna policy does not potentially afford coverage under the negligent-hiring (count VII), and Aetna has no duty to defend upon it.

Id. (citations omitted); see also *Massey v. Century Ready-Mix Corp.*, 552 So.2d 565, 568 (La. Ct. App. 1989) (failure to warn); *Picou v. Ferrara*, 412 So.2d 1297, 1300 (La. 1982) (entrustment/vicarious liability); *Jones v. Louisiana Timber Co., Inc.*, 519 So.2d 333, 336-37 (La. Ct. App. 1988) (negligent maintenance); *Scarf v. Aetna Cas. & Sur. Co.*, 559 A.2d 459, 461-63 (N.J. Super. Ct. App. Div. 1989) (negligent hiring and training); *Ruggerio v. Aetna Life & Cas. Co.*, 484 N.Y.S.2d 106, 106-07 (N.Y. App. Div. 1985) (negligent hiring).

147. 821 S.W.2d at 194-96.

148. *Id.* at 195.

149. *Id.* at 195 (discussing *State Farm Mut. Auto. Ins. Co. v. Partridge*, 514 P.2d 123 (Cal. 1973) (involving use of an automobile and a handgun)).

Norrell^{150, 151} The court noted that two instrumentalities, an automobile and a pistol, were involved in *Warrilow* as well.¹⁵² The court concluded that its decision was supported by the overwhelming majority of other jurisdictions addressing the question.¹⁵³

B. OCCURRENCE/BODILY INJURY/PROPERTY DAMAGE/PERSONAL INJURY

In *Houston Petroleum Co. v. Highlands Insurance Co.*¹⁵⁴ suit was brought against the insured for fraud and misrepresentation with respect to the sale of limited partnership units. First, the court held that an allegation of fraud and false representation, coupled with additional allegations of "mental distress," fell within the policy definition of "bodily injury," which included "mental injury, mental anguish, shock, fright, disability or death at anytime resulting therefrom."¹⁵⁵ The court's decision appears to completely ignore the fact that the "mental anguish" covered in the definition must "result from" a "bodily injury, sickness or disease."¹⁵⁶

Second, the court held that allegations of "fraudulent promises, false representations, and untrue statements" did not, as a matter of law, satisfy the definition of "occurrence," which was defined as "an accident . . . which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured."¹⁵⁷ The court found the language of the insurance contracts to be unambiguous, and to hold otherwise would extend the definition of "conditions", and consequently, "bodily injury" beyond their natural meanings.¹⁵⁸ Third, the court held that loss of use of investment funds, based upon the fraud and false representation allegations and racketeering allegations, involved mere economic loss that did not fall within the definition of "property damage" in the policy.¹⁵⁹

Finally, the court held that allegations that the claimant's "personal and business reputation and standing in the community" had been harmed as a result of the accident in question were outside of the policy coverage for "personal injury."¹⁶⁰ The court emphasized that there were no allegations

150. 791 S.W.2d 515 (Tex. App.—Corpus Christi 1989, writ denied).

151. *Centennial*, 821 S.W.2d at 195-96.

152. *Id.* at 195.

153. *Id.* at 196 (citing *Standard Mut. Ins. Co. v. Bailey*, 868 F.2d 893 (7th Cir. 1989)).

154. 830 S.W.2d 153 (Tex. App.—Houston [1st Dist.] 1990, writ denied).

155. *Id.* at 155-56.

156. *Id.* at 155.

157. *Id.* at 155-56.

158. *Id.* at 156.

159. *Id.* The policy defines "property damage" as:

(1) [P]hysical injury to or destruction of tangible property which occurs during the policy period, including the loss of use thereof resulting therefrom or (2) *the loss of use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an occurrence during the policy period.*

Id. at 156.

160. *Id.* at 156-57. The policy included coverage for "personal injury," which is defined in part as including "the publication or utterance of a libel or slander or of other defamatory or disparaging materials." *Id.* at 156.

that the insured had "discriminated against or humiliated the [claimants]." ¹⁶¹ Further, the court held that the complaint did not allege any form of actual defamation action. ¹⁶²

C. RESERVATION OF RIGHTS

In *Pennsylvania National Mutual Casualty Insurance Co. v. Kitty Hawk Airways, Inc.* ¹⁶³ the court held that Exclusion (c) in a general liability policy providing personal injury coverage, which stated that the insurance did not cover "personal injury sustained by any person as a result of an offense directly or indirectly related to the employment of such person," was unambiguous and barred any coverage for the employment-related defamation claims in the underlying suit. ¹⁶⁴ The court then addressed whether an approximate fourteen-month delay on the part of the insurance company in providing a reservation of rights setting forth Exclusion (c) as a policy defense resulted in the application of waiver and estoppel. ¹⁶⁵

First, the court held that there is an exception to the general rule that waiver and estoppel cannot be used to create insurance coverage where none otherwise exists under the terms of the policy. ¹⁶⁶ This exception, the court held, applies where the insurer defends the insured without a reservation of rights or non-waiver agreement. ¹⁶⁷

Second, the court held that the first element of the exception, proof that the insurer had sufficient knowledge to raise the coverage defense, was satisfied in the case before it. ¹⁶⁸ The court then focused on the defense exception requirement, which states that the insured must show harm or prejudice as a result of the insurance company's defending the suit without a reservation of rights or non-waiver agreement. ¹⁶⁹ The court, quoting *State Farm Lloyd's, Inc. v. Williams*, ¹⁷⁰ noted that the insured must prove that "clear and unmistakable" harm has been suffered as a result of the insurer's defense. ¹⁷¹ The court added that "the insured must show 'how he was harmed.'" ¹⁷² The court found that the *Williams* test for harm was the one most likely to be adopted by the Texas Supreme Court. ¹⁷³

The court found that the evidence presented on motion for summary judg-

161. *Id.* at 157.

162. *Id.*

163. 964 F.2d 478 (5th Cir. 1992). The author prosecuted the appeal on behalf of Pennsylvania National.

164. *Id.* at 480-81 (quoting Record Excerpts of Appellee Kitty Hawk Airways, Inc. at tab 1, p.55, Pennsylvania Nat'l Mut. Cas. Ins. Co. v. Kitty Hawk Airways, Inc., No. 91-1123 (5th Cir. filed Aug. 14, 1991)).

165. *Id.* at 481-82.

166. *Id.* at 481.

167. *Id.* (discussing *State Farm Lloyds, Inc. v. Williams*, 791 S.W.2d 542, 550 (Tex. App.—Dallas 1990, writ denied)).

168. *Id.*

169. *Id.* at 481-82.

170. 791 S.W.2d 542 (Tex. App.—Dallas 1990, writ denied).

171. 964 F.2d at 482 (quoting *Williams*, 791 S.W.2d at 553).

172. *Id.* (quoting *Williams*, 791 S.W.2d at 553).

173. *Id.*

ment established the lack of harm or prejudice as a matter of law.¹⁷⁴ The court stated that the insured produced no evidence that the attorneys hired by the insurer committed wrongful acts in the defense of the case or otherwise acted unethically.¹⁷⁵ Importantly, the court noted that, as in *Williams*, the coverage defense based on Exclusion (c) was not one that was subject to being manipulated either toward or away from coverage; the court stated that the exclusion did not involve factual issues that were material to the underlying tort suit.¹⁷⁶

One of the most important aspects of the decision in *Kitty Hawk* is the emphasis placed by the court on the fact that the insured had more than two years after the insurer sent the tardy reservation of rights letter within which to retain its own counsel.¹⁷⁷ The court noted that the summary judgment evidence included the letter from Kitty Hawk in which Kitty Hawk admitted that it did not in fact have any complaints about the "able and competent manner in which the defense ha[d] been handled to date."¹⁷⁸ Thus, the court concluded: "the fact that [the insured] may have voluntarily relinquished rights associated with the control of its defense [did] not establish that it suffered any harm."¹⁷⁹ The court in *Kitty Hawk*, like the court in *Williams*, refused to find that harm was to be presumed as a matter of law where a defense was provided to the insured and a conflict of interest existed based on the existence of the potential coverage defense.

The court's holding that the lack of prejudice was established as a matter of law, considered in light of the arguments actually raised by the insured in that case, shows the impact of *Kitty Hawk*. First, the court rejected arguments that an affidavit of the insured's president, stating that "some information" was passed on to the insurer by defense counsel, was evidence of prejudice.¹⁸⁰ Second, the court rejected the insured's argument that it did not discover the conflict of interest as a result of the late reservation of rights until too late in the litigation process to hire its own counsel.¹⁸¹ The record established that the reservation of rights letter was sent almost two years prior to the actual trial in the underlying case. Third, the *Kitty Hawk* court, like the *Williams* court, rejected arguments that the entry of judgment in the underlying suit against the insured somehow evinces prejudice.¹⁸² The court apparently reasoned that the entry of judgment was not evidence of harm because there was no further evidence to establish that the judgment resulted from detrimental reliance.

The underlying theme of *Kitty Hawk* is that the insured's *acquiescence* in the continued defense of the suit by the insurer after receipt of a late reserva-

174. *Id.* at 482-83.

175. *Id.* at 482.

176. *Id.*

177. *Id.* at 483.

178. *Id.* (quoting Second Supplemental Record on Appeal, Vol. II, at 289-99, *Kitty Hawk*, No-91-1123 (5th Cir. filed Aug. 26, 1991)).

179. *Id.*

180. *Id.* at 482-83.

181. *Id.*

182. *Id.*

tion of rights letter negates the existence of prejudice as a matter of law. The insured knew of the timeliness issue, its own ability to demand an unconditional defense and its ability to defend itself. Where a party recognizes a transaction as existing, "or acts in a manner inconsistent with its repudiation, or lies by for a considerable time and knowingly permits the other party to deal with the subject matter under the belief that the transaction has been recognized, or freely abstains for a considerable length of time from impeaching it, so that the other party is thereby reasonably induced to suppose that it is recognized, there is acquiescence, and the transaction, although originally impeachable, becomes unimpeachable in equity."¹⁸³ In such circumstances, counter-estoppel applies as well as waiver. Thus, the insured knowingly relinquished its right to defend the case itself and could not claim that it was prejudiced after acquiescing to the late reservation of rights.¹⁸⁴

D. SEXUAL HARASSMENT

In *Old Republic Insurance Co. v. Comprehensive Health Care Associates, Inc.*,¹⁸⁵ an action was brought against the insured for sexual harassment by former employees. The claims included: "(1) gender-based discrimination, (2) sexual harassment and discrimination leading to acute emotional distress,

183. 2 POMEROY'S EQUITY JURISPRUDENCE, § 965 (1907). See *De Boe v. Prentice Packing and Storage Co.*, 20 P.2d 1107, 1110 (Wash. 1933).

184. For example, in *Winters v. Government Employees Ins. Co.*, 209 S.E.2d 32, 33-34 (Ga. Ct. App. 1974), the insurer sent a general reservation of rights with knowledge of specific coverage defenses; a specific letter was not sent until five months after the defense was undertaken by the insurer. Even though a general reservation is wholly ineffective, the court held that a fact issue was presented as to whether the insured "knowingly accepted" the defense subject to reservation so as to exonerate the insurer of the five-month delay. *Id.* at 34. The court held that a question of the intent of the parties was presented. *Id.* An even more persuasive set of facts requiring reversal of summary judgment is presented in the instant case. Clearly, where an insured makes no attempt to take over the defense or repudiate the reservation, it is impliedly assenting to the reservation. See *Connolly v. Standard Cas. Co.*, 73 N.W.2d 119, 122 (S.D. 1955). This is a mere reflection of the rule that "where parties, by their conduct and action recognize contracts as subsisting and binding, they thereby affirm the contracts after acquiring knowledge of the facts which entitled them to rescind. This is the equivalent of [f] ratification . . ." *Spellman v. American Universal Inv. Co.*, 687 S.W.2d 27, 29 (Tex. App.—Corpus Christi 1984, writ ref'd n.r.e.). Even when a party has been actually defrauded, such ratification waives any right to complain and or repudiate the agreement. *Id.* Any act recognizing an agreement as subsisting, or conduct inconsistent with an intention to avoid it, waives the right of repudiation. *Id.* at 30. Acceptance of benefits under such an agreement, such as accepting continued defense under a reservation arrangement, recognizes the agreement so as to *waive or abandon* the right to attack the agreement as invalid. *Id.*

"[U]nder Texas law, the equitable doctrines of laches, estoppel and waiver are all grounded in the principle that a party with full knowledge of facts which entitle him to rescind a contract will be barred from asserting his right where he fails to act promptly upon this right to the detriment of another." *Regional Properties, Inc. v. Financial & Real Estate Consulting Co.*, 752 F.2d 178, 182 (5th Cir. 1985). Equity will not hear a party "stultify himself by complaining against acts . . . of which he has demonstrated his approval by sharing in their benefits . . . [This is] particularly true where the acquiescence relates to rights of the assenting party that are contractual in nature." *Frank v. Wilson & Co.*, 9 A.2d 82, 86 (Del. Ch. 1939) (holding a stockholder with notice was barred from asserting a corporate amendment was void because of acquiescence). "[A]ssent is a necessary inference from acquiescence, and estoppel was [is] the necessary consequence of assent." *Id.* at 88 (quoting *Lowndes v. Wicks*, 36 A. 1072, 1079 (Conn. 1897)).

185. 786 F. Supp. 629 (N.D. Tex. 1992).

(3) ratification of the discriminatory conduct by [the insured], (4) retaliation for pursuing the claims, (5) violation of the Equal Rights Amendment of the Texas Constitution, (6) violation of the Texas Human Rights Commission Act, (7) negligence per se, and (8) negligent hiring."¹⁸⁶ The court found that there was no duty on the part of the general liability insurer to defend the suit on behalf of the insured.¹⁸⁷ The court reasoned that all of the allegations arose out of the alleged acts of sexual harassment.¹⁸⁸ The court reasoned that the allegations were not mutually exclusive, but in fact were "related and interdependent."¹⁸⁹ The court noted that without sexual harassment, there would have been no basis for any suit against the insured, much less the suit for negligence.¹⁹⁰ The court noted that acts of sexual harassment are intentional and that such terms typically do not fall within the definition of "occurrence" commonly used in insurance policies.¹⁹¹ Additionally, the court also noted that a multitude of cases had consistently interpreted "occurrence" to exclude coverage for such intentional acts.¹⁹² The court noted that at least one Texas case, *Aberdeen Insurance Co. v. Bovee*,¹⁹³ had found that there was no provision in the policy that obligated an insurer to defend a claim for sexual harassment.¹⁹⁴ The court in *Bovee* decided the case on the basis of the employment exclusion in the policy, which bars coverage for bodily injury arising out of or in the course of employment by the insured.¹⁹⁵

E. THE LHWCA EXCLUSION

In *Beaumont Rice Mill v. Mid-American Indemnity Insurance Co.*,¹⁹⁶ the court addressed whether coverage existed despite two exclusions in the policy, one dealing with claims under the Longshore and Harbor Workers' Compensation Act ("LHWCA") and the other dealing with claims arising out of or in the course and scope of employment by the insured. The LHWCA exclusion was found to be unambiguous.¹⁹⁷ The court rejected arguments that the underlying negligence claim was the controlling factor in determining whether the exclusion applied.¹⁹⁸ The court reasoned that the only policy requirements necessary to bar coverage focused on whether the loss arose out of the injury and whether the injury was covered under the

186. *Id.* at 632.

187. *Id.* at 633.

188. *Id.* at 632.

189. *Id.*

190. *Id.*

191. *Id.* at 633 (discussing *Argonaut Southwest Ins. Co. v. Maupin*, 500 S.W.2d 633, 635 (Tex. 1973); *Baldwin v. Aetna Cas. & Sur. Co.*, 750 S.W.2d 919, 921 (Tex. App.—Amarillo 1988, writ denied)).

192. *Id.* at 633.

193. 777 S.W.2d 442, 443-44 (Tex. App.—El Paso 1989, no writ).

194. 786 F. Supp. at 633.

195. 777 S.W.2d at 444.

196. 948 F.2d 950 (5th Cir. 1991).

197. *Id.* at 951.

198. *Id.*

LHWCA.¹⁹⁹ The court also found that language in the exclusion limiting its applicability to claims brought by the injured “employee or any third party” does not require that the individual in question actually be an employee of the insured.²⁰⁰ The court noted that the policy terms contain only a general reference to the type of claimant and that to interpret the policy as suggested by the insured would result in the failure of the court to follow the rules of contract construction to the effect that the language must be given its ordinary meaning.²⁰¹

The court also found that Exclusion (j) under the policy²⁰² was “specifically tailored to injuries sustained in the course of employment by the insured.”²⁰³ The court found that this exclusion in the policy served to reinforce that the LHWCA exclusion was applicable to all potential injured employees, regardless of whether they were employees of the insured or not.²⁰⁴

F. PROPERTY DAMAGE/DUTY TO DEFEND

In *Terra International, Inc. v. Commonwealth Lloyd's Insurance Co.*²⁰⁵ suit was brought against the insurer for violations of the Texas Deceptive Trade Practices Act, common law fraud, negligence and declaratory relief. Several insurance policies were at issue in *Terra*. Each of the policies had similar requirements that there be “property damage.”²⁰⁶ The court emphasized that the focus of review in determining the duty to defend was on the “*factual* allegations in the complaint, not on the *legal* theories asserted.”²⁰⁷

The underlying suit against the insured asserted that the insured had sold land that was not disclosed to be within the county flood control district. The insured then caused the sale of flood control bonds by the district, which resulted in enormous increases in the claimant's taxes and enormous decreases in the value of the claimant's land. The court held that there were no allegations in the complaint showing potential liability for “physical injury to or destruction of tangible property,” the operative terms of the definition of “property damage.”²⁰⁸ The court also found that there were no claims of

199. *Id.*

200. *Id.*

201. *Id.* at 952.

202. This exclusion provided coverage that did not apply to “any obligation for which the Insured or any carrier as his insurer may be held liable under any workman's compensation, unemployment compensation or disability benefits law, or under any similar law.” *Id.*

203. *Id.*

204. *Id.*

205. 829 S.W.2d 270 (Tex. App.—Dallas 1992, writ denied).

206. The definition of “property damage” was as follows:

(1) Physical injury to or destruction of *tangible* property which occurs during the policy period, including the loss of use thereof at any time resulting therefrom, or (2) loss of use of *tangible* property which has not been physically injured or destroyed provided such loss of use is caused by an occurrence during the policy period.

Id. at 272.

207. *Id.* (emphasis added) (citing *Continental Cas. Co. v. Hall*, 761 S.W.2d 54, 56 (Tex. App.—Houston [14th Dist.] 1988, writ denied, *cert. denied*, 495 U.S. 932 (1990)).

208. *Id.* at 273.

"loss of use of tangible property" within the meaning of the term.²⁰⁹ The court noted that numerous other jurisdictions had refused to find that the mere fact that a negligent misrepresentation theory was asserted against the insurer somehow satisfied the "property damage" requirements of the policy.²¹⁰

The court's discussion of the standard for determining the duty to defend in *Terra* is troubling and incorrect. The court uses a "potential liability" test for determining the duty to defend. While this test did not affect the result, the reference to "potential liability" in prior case law, relied upon by the court in *Terra*, was in no way intended to adopt the "clairvoyance" rule followed in other jurisdictions.²¹¹ Under the clairvoyance or "spandex" approach, if the facts alleged could potentially be used to develop a theory that would in fact be covered under the policy, even though that specific legal theory has not been plead, there is a duty to defend.²¹² This approach has been specifically rejected by Texas courts and other courts applying Texas law.²¹³ A dissenting opinion in *Terra* was entered by Justice Kinkeade, seizing upon the "potential liability" language utilized by the court.²¹⁴ Without question, the dissent relies on the "spandex" or clairvoyance rule. The dissent reasoned that because allegations of wrongful acts other than misrepresentation, particularly negligent performance of flood control work on the property in question, could result in a claim for "physical injury to or destruction of tangible property," there was a duty to defend.²¹⁵ It is of vital importance that the Texas Supreme Court resolve the loose and imprecise use of the "potential liability" language found in some prior cases. Courts in other jurisdictions have found the clairvoyance or "spandex" approach to be both impractical and devastating.²¹⁶

The Fifth Circuit's opinion in *Snug Harbor Ltd. v. Zurich Insurance*²¹⁷

209. *Id.* (citing *Lay v. Aetna Ins. Co.*, 599 S.W.2d 684, 686, 687 (Tex. Civ. App.—Austin 1980, writ ref'd n.r.e.) (holding that allegations of economic loss resulting from the negligent failure to locate an oil well on land did not involve "property damage"); *General Ins. Co. of America v. Western American Dev. Co.*, 603 P.2d 1245, 1246 (1979) (holding that allegations of misrepresentation about the nature and extent of a public easement, resulting in a reduction of the value of the property purchased, was not within the policy coverage)).

210. *Id.* (discussing *McCullum v. Ins. Co. of N. America*, 644 P.2d 283, 285 (Ariz. Ct. App. 1982) (holding that negligent misrepresentation allegations were not within the policy coverage); *Hawaiian Ins. & Guar. Co. v. Blair, Ltd.*, 726 P.2d 1310, 1313 (1986) (holding that allegation of diminution of "product-line" did not involve "loss of use of tangible property")).

211. R. B. Cooper & Michael W. Huddleston, *Insurance Law, Annual Survey of Texas Law*, 44 Sw. L.J. 329, 344-45, n.112 (1990).

212. *Id.*

213. *Brooks, Tarleton, Gilbert, Douglas & Kressler v. U.S. Fire Insurance Co.*, 832 F.2d 1358, 1367-68 (5th Cir. 1987) (Texas law) ("the proper question is not what could . . . successfully have [been] pled," but what was "in fact pled"). See generally *Baldwin v. Aetna Cas. & Sur. Co.*, 750 S.W.2d 919, 920-21 (Tex. App.—Amarillo 1988, writ denied) (pleadings permeated with allegations of "intentional" wrongdoing, which is not covered under the policy, could not be negated by broad allegations of nuisance, which is covered under the policy as a negligence-type claim).

214. 829 S.W.2d at 273-74.

215. *Id.* at 274.

216. Cooper & Huddleston, *supra* note 213, at 345 n.112.

217. 968 F.2d 538 (5th Cir. 1992); see also discussion *supra* notes 76-86.

closely paralleled the *Terra International* opinion. The insured, Snug Harbor, was sued by a person who was stabbed by a Snug Harbor employee while at his home in a condominium project owned by Snug Harbor. On the same day that notice of the suit was allegedly served on Snug Harbor, First South, the holder of a mortgage on the Snug Harbor property, held a foreclosure sale and took possession of the Snug Harbor premises. Snug Harbor asserted that as a result of First South taking possession, it never received a copy of the petition, resulting in a default judgment against it in the amount of \$500,000. Snug Harbor sued First South and its insurer, Zurich. First South demanded that Zurich assume its defense and pay the default judgment, but Zurich refused, asserting that Snug Harbor did not suffer "property damage" within the meaning of the general liability policy. Zurich also asserted that, even if Snug Harbor did suffer such property damage, the damage was not caused by an "occurrence" within the policy period. Zurich further asserted that any coverage otherwise applicable was excluded by the policy's "care, custody and control" exclusion.²¹⁸ The trial court concluded that Zurich's failure to defend was a bad faith breach of the duty to defend.²¹⁹

The Fifth Circuit noted that it faced a question of first impression: whether the mishandling of a document leading to the entry of a default judgment constitutes "property damage."²²⁰ It nevertheless found that the volumes of case law interpreting the phrase showed that purely economic loss was not "the loss of use of tangible property" under the policy.²²¹ Snug Harbor relied on *Lay v. Aetna Insurance*,²²² arguing that the *Lay* court's statement that "tangible property" is commonly understood to be "property that is capable of being handled or touched"²²³ indicated that the petition constituted "tangible property." The Fifth Circuit rejected this reading of *Lay*. "Snug Harbor overlooks the fact that the *Lay* court, after making this statement, went on to hold that purchase of an assignment of drilling rights and payment of attorney and surveyor fees do not constitute injury to, destruction of, or loss of use of tangible property," the court stated.²²⁴ The Fifth Circuit reasoned that the "petition and citation had no intrinsic value or use beyond notifying Snug Harbor that legal action had commenced against it," and therefore "[t]he substantive loss resulting from the alleged mishandling of th[e] document was loss of th[e] notice," not a property loss for purposes of the general liability policy.²²⁵

The court also found that there was no "occurrence" during the policy

218. *Id.* The Fifth Circuit did not reach this issue.

219. *Id.* at 541.

220. *Id.* at 542.

221. The policy definition of "property damage" is the same definition as that in *Terra International, Inc. v. Commonwealth Lloyd's Ins. Co.*, 829 S.W.2d 270, 272 (Tex. App.—Dallas 1992, writ denied). See *supra* note 208.

222. 599 S.W.2d 684 (Tex. Civ. App.—Austin 1980, writ ref'd n.r.e.) (action brought against insured for negligent location of oil well).

223. *Snug Harbor*, 968 F.2d at 543 (quoting *Lay*, 599 S.W.2d at 686).

224. *Id.* (citing 599 S.W.2d at 686).

225. *Id.*

period because 1) the alleged misplacement of the petition and citation occurred two weeks before First South added itself to the Zurich policy that had been originally purchased by Snug Harbor, and 2) the misplacement did not become apparent until after the default judgment was entered, which was more than two months after First South cancelled the Zurich policy.²²⁶ The court reasoned that Texas courts had concluded that the time of an occurrence was when a claimant sustains actual damages, not necessarily when the act or omission causing the damage is committed.²²⁷ It held that, because the alleged loss of use of the citation and petition occurred during the policy period, the manifestation of the loss did not, and therefore there was no occurrence during the policy period.²²⁸

Judge Kent's dissent is similar to the troubling reasoning of the *Terra* court with regard to the "potential liability" language found in some prior cases. The dissent reasoned that, at the time Zurich decided not to defend First South, Zurich did not have the benefit of the Fifth Circuit's decision on whether it had a duty to defend Snug Harbor.²²⁹ Additionally, there was little if any case law available to guide Zurich's decision because the issue, whether the mishandling of a legal document was "property damage," was one of first impression.²³⁰ He concluded that Snug Harbor's claim was at least "potentially" covered by the Zurich policy and that, therefore, Zurich had a duty to defend.²³¹

G. RELITIGATION AND JURISDICTION

In *Royal Insurance Co. v. Quinn-L Capital Corp.*²³² the Fifth Circuit dealt with the collusive efforts of insureds and parties claiming damages against them to avoid a prior declaratory judgment that held that the insurer had no duty to defend or provide coverage for the claimants' allegations against the insureds. The suit involved claims by investors against numerous Quinn-L entities, the insureds, alleging that the investors had lost money in various real estate investments offered or managed by Quinn-L. The investors asserted claims under federal securities and anti-racketeering laws as well as Texas law. These claims were consolidated into a single federal liability suit. Quinn-L asked Royal, the insurer, to defend the suit. Royal agreed but reserved its right to contest coverage and subsequently filed a declaratory judgment action. While Royal's motion for summary judgment was pending, the investors and Quinn-L's sole shareholder, Lovell, entered into a settlement agreement. Lovell promised to cooperate with the investors in the litigation against Quinn-L and to assign them any claims he might have against Royal, while the investors in return, promised not to pursue any claims against him.

226. *Id.* at 544.

227. *Id.* (citing *Dorchester Dev. Corp. v. Safeco Ins.*, 737 S.W.2d 380, 383 (Tex. App.—Dallas 1987, no writ)).

228. *Id.*

229. *Id.*

230. *Id.*

231. *Id.*

232. 960 F.2d 1286 (5th Cir. 1992).

The court granted Royal's partial summary judgment motion, concluding that Royal's policies did not impose any duty to defend or indemnify Quinn-L because there was no injury to tangible property that could constitute an "occurrence," none of the losses constituted "property damage" as required by the policy, and personal injuries in the form of mental anguish were not shown to have been caused by an "occurrence."²³³ Thereafter, the investors dismissed the federal liability suit. The federal claims were dismissed with prejudice and the pendant state claim without prejudice.²³⁴ Five days after the final judgment was entered on the declaratory judgment action, the investors again filed suit against Quinn-L in state court in Dallas County, based on the same events and conduct as in the just-dismissed federal liability suit. Quinn-L rejected Royal's offer of a defense under reservation of rights. Quinn-L cooperated with the investors, resulting in deemed admissions and a default judgment against Quinn-L in the amount of \$741,000,000.²³⁵ The judgment recited that this amount consisted of damages for bodily injury including mental pain, suffering and anguish that had manifested itself physically.²³⁶ Quinn-L then assigned its rights and causes of action against Royal to the investors, and the investors sued Royal in state court in Cameron County as assignees of Quinn-L, bringing tort, waiver and estoppel claims based upon Royal's handling of the previous state court litigation, and as judgment creditors for recovery of the Dallas County judgment under the insurance policies. Royal again filed suit in a federal court seeking a declaratory judgment that it had no duty to defend or indemnify Quinn-L in the Dallas County litigation. On Royal's motion, the federal court issued a preliminary injunction against further prosecution of the Cameron County litigation.²³⁷

The Fifth Circuit considered whether the preliminary injunction violated the Anti-Injunction Act.²³⁸ The court had relied on two exceptions to the Anti-Injunction Act in entering the injunction: (1) the exception for injunctions necessary in aid of its jurisdiction with regard to the coverage issues decided in the first declaratory judgment action, and (2) the exception for injunctions to protect or effectuate its judgments with regard to the post-declaratory judgment claims, which depended upon conduct and events that occurred after the issuance of the first judgment.²³⁹ The Fifth Circuit determined that the district court properly relied on the relitigation exception with regard to the coverage claims, finding that minor differences in the pleadings did not remove the new action from the ambit of the prior judg-

233. *Id.* at 1289.

234. *Id.* at 1290.

235. *Id.*

236. *Id.*

237. *Id.* at 1291.

238. 960 F.2d at 1293; see 28 U.S.C. § 2283 (West 1978). This statute provides: "A court of the United States may not grant an injunction to state proceedings in State court except as expressly authorized by Act of Congress, or for necessary in aid of its jurisdiction, or to protect or effectuate its judgments."

239. *Quinn-L*, 960 F.2d at 1293.

ment and holding that there was no coverage.²⁴⁰ The court rejected the appellants' construction of the declaratory judgment as "artificial and unnecessarily formalistic" and gave the decision "a more natural reading."²⁴¹ The court stated:

Based upon the language of the policy, there must be an occurrence and an injury in order for there to be coverage. In this case, the district court found that the investors' injury — as alleged in the complaint — were not caused by an occurrence. Without an occurrence, there could be no coverage, and thus there was no duty to defend. In sum, the district court did not simply decide whether the investors had alleged "injury" caused by an "occurrence" but instead necessarily to determine that the investors' allegations did not fit within the coverage of the policy language.²⁴²

Acknowledging the "complaint-allegation" rule followed by Texas courts, the court stated that "simply because the duty to defend [was] to be determined on the face of the complaint, [] not with reference to the truth or falsity of the allegations contained therein, d[id] not mean that the preclusive effect of a declaration of no duty to defend must be limited to the precise allegations contained in the pleadings."²⁴³ The Fifth Circuit held that the district court's determination of the issue of coverage, that no "occurrence" had befallen the investors within the terms of the policy, could be applied to allegations in subsequent complaints.²⁴⁴ Finding that the allegedly improper acts on Quinn-L's part remained constant from the federal liability suit to the Dallas County suit, the Fifth Circuit held that the district court's determination of the coverage issue disposed of the appellants' claim to recover under the policy language, and therefore affirmed the district court's injunction of the direct contractual claims under the relitigation exception.²⁴⁵

The court found, however, that the post-declaratory judgment claims were improperly enjoined based on the "in aid of jurisdiction" exception.²⁴⁶ Royal argued that, due to the collusive behavior involved, the district court should have been able to temporarily enjoin the Cameron County litigation until the district court had an opportunity to sort through the complex claims before it. While the Fifth Circuit stated that it was sympathetic to Royal's position, the court held that the exception could not be stretched that far.²⁴⁷ That exception was properly limited to situations where a state proceeding threatened to dispose of property that formed the basis for federal in rem jurisdiction or where the state proceeding threatened the continuing superintendence by a federal court.²⁴⁸

While the injunction was in effect, however, the district court had dis-

240. *Id.*

241. *Id.* at 1294-95.

242. *Id.* at 1295 (footnotes omitted).

243. *Id.* at 1295-96.

244. *Id.* at 1296.

245. *Id.* at 1297.

246. *Id.* at 1300.

247. *Id.*

248. *Id.* at 1298.

posed of the post-declaratory judgment claims adversely to the investors,²⁴⁹ and they asked the Fifth Circuit to vacate all orders entered by the court below during the pendency of the improperly issued preliminary injunction. The Fifth Circuit declined to vacate the orders, noting that there had "always [been] the possibility that the federal court would win the race to judgment," and that the equities did not weigh in the investors' favor, because they had created "this tangled web of litigation by seeking to evade the effect of the first declaratory judgment action" by bringing their claims to state court and collusively obtaining a default judgment there.²⁵⁰

H. ADDITIONAL INSURED ENDORSEMENT

In *Granite Construction Co. v. Bituminous Insurance Cos.*²⁵¹ the court addressed a case of first impression regarding the interpretation of an additional insured endorsement. Under the terms of the endorsement, Granite Construction Company was named as a "person insured" but only "with respect to liability arising out of operations performed for such insured [Granite] by or on behalf of the named insured [Brown]."²⁵² The court found that the endorsement unambiguously supported the proposition that Granite was to be afforded coverage for claims against it based upon the actions of Brown.²⁵³ Here, the claims were based solely on the obligation and acts of Granite. Accordingly, the court found that there was no coverage under the endorsement.²⁵⁴ Further, the court rejected arguments that the certificate of insurance somehow created an ambiguity.²⁵⁵ The certificate stated that Granite was an additional named insured for all of its work in Texas. The court concluded that this certificate could not create an ambiguity because the insurance afforded to Granite was provided by the insurance policies, not by the certificate of insurance.²⁵⁶

I. SETTLEMENT

In *Judwin Properties, Inc. v. United States Fire Insurance Co.*²⁵⁷ USF began a defense of its insured, Judwin, in lawsuits for personal injuries allegedly caused by Judwin's application of chlordane in its rental properties. Two years after assuming the defense, USF advised Judwin that it would continue to provide a defense to the lawsuit, but that the defense would be subject to a reservation of rights. USF never refused to defend Judwin and provided defense counsel through settlement. USF settled two of the lawsuits in 1990 for \$6,000,000, in return for a covenant not to execute against Judwin and the other insureds under the policy, a covenant not to execute

249. *Id.*

250. *Id.* at 1300-01.

251. 832 S.W.2d 427 (Tex. App.—Amarillo 1992, n.w.h.).

252. *Id.*

253. *Id.* at 430.

254. *Id.*

255. *Id.*

256. *Id.* at 434.

257. 973 F.2d 432 (5th Cir. 1992).

against USF, and a release of bad faith claims against USF. The plaintiffs in those lawsuits had received the bad faith claims against USF from Judwin in a settlement several months before, which Judwin had made because it believed USF to be derelict in its duty to defend and settle with those plaintiffs. Judwin retained a monetary interest in the outcome of the bad faith lawsuits. After USF settled with those plaintiffs, Judwin filed suit against USF alleging that USF breached its insurance contract by failing to defend Judwin properly and failing to settle with the plaintiffs at an earlier time. A federal district court entered a take-nothing summary judgment in favor of USF.²⁵⁸ The court held that USF acted properly in paying its policy limits to settle the cases against all of its insureds, including Judwin, and that it had no obligation to defend Judwin after it had paid its policy limits.²⁵⁹

J. DECLARATORY JUDGMENT AND EXTRINSIC EVIDENCE

In *State Farm & Casualty Co. v. Wade*²⁶⁰ the Corpus Christi court of appeals reversed the dismissal of State Farm's petition for declaratory relief. State Farm had sought to obtain (1) an interpretation of a business pursuit exclusion in a personal boatowner's liability policy and (2) a declaration that State Farm did not owe a duty to defend a lawsuit pending against the estate of one of its insureds. The exclusion precluded coverage for an occurrence that took place while the boat was being used for business pursuits. The petition stated that the boat was being used at the time of the accident, but made no reference to whether it was being used for business purposes or not. The court found that, where the pleadings were silent or neutral about facts that would establish the applicability or inapplicability of a policy exclusion, the court could consider extrinsic evidence of those facts.²⁶¹ The court also held that the trial court erred in dismissing State Farm's suit because its petition stated a cause of action for which relief may be granted.²⁶² It noted that Texas courts "recognize an insurance company's ability to bring a declaratory judgment action to determine whether it has a duty to defend an insured prior to determination of liability in the underlying lawsuit."²⁶³ Thus, the insured's special exceptions were improperly sustained.²⁶⁴

258. *Id.* at 434.

259. *Id.* at 436.

260. 827 S.W.2d 448 (Tex. App.—Corpus Christi 1992, writ denied).

261. *Id.* at 452-53. The court cited *International Serv. Ins. Co. v. Boll*, 392 S.W.2d 158 (Tex. Civ. App.—Houston [1st Dist.] 1965, writ ref'd n.r.e.) (suit brought by insurance company following defense in underlying suit, not declaratory judgment action); *Cook v. Ohio Cas. Ins. Co.*, 488 S.W.2d 712 (Tex. Civ. App.—Texarkana 1967, no writ) (where an auto policy contained an exclusion for damages arising when insured drove automobile owned by a relative residing in the same house, the court could look at extrinsic evidence to determine whether the driver was a relative residing in the insured's house).

262. 827 S.W.2d at 453.

263. *Id.* at 450 (citing *Fidelity & Guar. Ins. Underwriters, Inc. v. McManus*, 633 S.W.2d 787, 788 (Tex. 1982); *Firemen's Ins. Co. v. Burch*, 442 S.W.2d 331, 332 (Tex. 1968)).

264. *Id.*

III. HEALTH AND LIFE INSURANCE

A. DATE OF OCCURRENCE OR TRANSACTION

Determining the date of the occurrence or transaction upon which a suit is based was the issue before the court in *Jackson v. Downey*.²⁶⁵ *Jackson* was a mandamus proceeding where the underlying suit involved a claim for breach of a duty of good faith and fair dealing against an insurer for the denial of health benefits to its insured. The guardian for the insured was seeking benefits under the policy for severe and irreparable brain damage. Through witness discovery, the insurer sought a number of documents that predated the mailing of the benefit denial letter to the insured. The insurer asserted the party communications privilege to various claim file notes pursuant to Rule 166b(3)(d) of the Texas Rules of Civil Procedure.²⁶⁶

The court then determined whether these notes fell within the party communications privilege of Rule 166b(3)(d). The court accepted the insurer's assertion, concluding that the date of the occurrence or transaction upon which the suit is based was the date of the insurer's letter denying coverage.²⁶⁷ Relying upon the Austin court of appeals' opinion in *Gilbert v. Black*,²⁶⁸ the court held that the *refusal of coverage* is the occurrence or transaction upon which a bad faith cause of action or denial of benefits is based.²⁶⁹ Specifically, the court held that [t]he decision making process of the insurer in deciding to deny the coverage, which may not be assignable to a date certain, cannot itself be the occurrence since, unless and until the insured is notified of the decision, there could be no possibility of litigation."²⁷⁰

B. MEDICAL BENEFITS FOR "ARTIFICIAL LIMBS"

*Irion v. Prudential Insurance Co. of America*²⁷¹ involved the definition of an "artificial limb," as it applied to a claim brought under the Employee Retirement Income Security Act (ERISA)²⁷² for medical benefits. The beneficiary of the group health plan suffered from an illness that required her to

265. 817 S.W.2d 858 (Tex. App.—Houston [1st Dist.] 1991, orig. proceeding).

266. TEX. R. CIV. P. 166(b)(3)(d). This rule contains the "party communications privilege," which is comprised of three express elements:

d. Party Communications. Communications between agents or representatives or the employees of a party to the action or communications between a party and that party's agents, representatives or employees, when made subsequent to the occurrence or transaction upon which the suit is based and in connection with the prosecution, investigation or defense of the particular suit, or in anticipation of the prosecution or defense of the claims made a part of the pending litigation. This exemption does not include communications prepared by or for experts that are otherwise discoverable.

267. 817 S.W.2d at 859.

268. 722 S.W.2d 548 (Tex. App.—Austin 1987, orig. proceeding).

269. 817 S.W.2d at 859.

270. *Id.* at 860.

271. 964 F.2d 463 (5th Cir. 1992).

272. 29 U.S.C. §§ 1001-1461.

wear a wig.²⁷³ The district court concluded that hair is a "limb" and that, therefore, a wig would be an "artificial limb." The Fifth Circuit disagreed, relying upon the common definition of "hair" and the medical definition of "limb."²⁷⁴ Because the group benefit plan did not specifically include wigs within its scope of coverage, the court held that no coverage was afforded for the subject claim.²⁷⁵

The claimant then argued that Prudential had extended coverage beyond the specific provisions of the policy because of an internal memorandum listing expenses for which benefits had been paid that were not expressly itemized in the policy. This memorandum, however, did not identify wigs as an additional benefit. The court therefore concluded that no act by Prudential had extended coverage to the subject claim.²⁷⁶

C. LIFE INSURANCE BENEFICIARY DESIGNATIONS

In *Medlin v. Medlin*²⁷⁷ the court was faced with apportioning insurance proceeds upon the death of the owner of a life insurance policy and one of the beneficiaries. The life insurance policy specifically listed two beneficiaries who, upon the death of the insured, would each receive fifty percent of the proceeds. One beneficiary was the insured's wife and the other was his mother. The insured and his wife died at approximately the same time. The question was whether the remaining proceeds went to the other beneficiary, the insured's mother, or his children.²⁷⁸ The children argued that because the mother was specifically listed as having a fifty percent interest in the insurance proceeds, that it was the intent of the insured to give his mother only fifty percent. They therefore argued that they were entitled to the remaining proceeds.

The court construed the beneficiary clause of the policy as providing that the proceeds were to be payable to a designated beneficiary, and because the mother was the only remaining beneficiary, she was entitled to the entire proceeds.²⁷⁹ The court therefore concluded that the fifty percent designation in the policy was surplusage, because if both beneficiaries had survived the

273. The illness is known as alopecia areata totalis, which resulted in the total loss of hair on the beneficiary's head.

274. 964 F.2d at 464-65 (citing WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 1020 (1981); STEDMAN'S MEDICAL DICTIONARY 877 (25th ed. 1989); DORLAND'S ILLUSTRATED MEDICAL DICTIONARY 936 (27th ed. 1988)).

275. 964 F.2d at 465.

276. *Id.*

277. 830 S.W.2d 353 (Tex. App.—Amarillo 1992, writ denied).

278. *Id.* at 354.

279. *Id.* at 353-54. The beneficiary clause of the policy provided in part:

Any sum becoming due on account of the death of an insured employee shall be payable to the beneficiary or beneficiaries designated by the employee . . . provided that if any designated beneficiary predeceases the employee, the share which such beneficiary would have received if living shall, *except as may be otherwise specifically provided* by the employee, be payable equally to the remaining designated beneficiary or beneficiaries, if any, who survive the employee.

Id.

deceased, each would automatically have been entitled to one-half of the proceeds.²⁸⁰ Accordingly, the court awarded the entire proceeds to the mother.²⁸¹ The court noted that this was a case of first impression in Texas, but relied upon *Osborn v. Insurance Company of North America*²⁸² in making its decision.

D. LAPSE OF LIFE POLICY FOR NON-PAYMENT OF PREMIUM

In *Walker v. Federal Kemper Life Assurance Co.*²⁸³ the issue was whether a life insurance policy had lapsed because a monthly premium was not paid when due.²⁸⁴ Kemper had issued an insurance policy to Jimmy Walker, the plaintiff's late husband. The plaintiff was named as the beneficiary in the policy. Walker elected to pay premiums monthly under Kemper's pre-authorized draft policy, under which Kemper would draw a draft on Mr. Walker's designated bank account for the premium. The premiums had been paid through November 30, 1986. When the next draft for the December payment was made, the bank did not pay the draft, and returned the request to Kemper with the notation "Payment Stopped."

Testimony at trial indicated that Kemper initially accepted the draft, but then reversed the transaction when there were not sufficient funds to fulfill the draft. Plaintiff argued that this initial acceptance by Kemper resulted in an acceptance of the draft and therefore the policy did not lapse. However, the premium was not paid within the 31-day grace period. Plaintiff also argued that because there was no provision for the policy to forfeit ipso facto for non-payment, the policy was in force and effect. The court of appeals affirmed the trial court's ruling that the policy had terminated as a matter of law because the premium had not been paid in accordance with the provisions of the policy.²⁸⁵ The court relied upon the well-settled rule in Texas that payment of premiums in accordance with the provisions of a life insurance policy is a condition precedent to the insurer's liability.²⁸⁶

E. EXPERIMENTAL TREATMENT

In *Holder v. Prudential Insurance Co. of America*²⁸⁷ the Fifth Circuit held that evidence was sufficient to support a finding that high-dose chemotherapy coupled with autologous bone marrow transplantation to treat a patient's breast cancer was an experimental treatment and therefore fell within a health insurance policy's exclusion for treatment that was not reasonably

280. *Id.* at 355.

281. *Id.*

282. 490 P.2d 726 (Utah 1971).

283. 828 S.W.2d 442 (Tex. App.—San Antonio 1992, writ denied).

284. *Id.* at 445.

285. *Id.* at 449.

286. *Id.* (citing *Zuniga v. Allstate Ins. Co.*, 693 S.W.2d 735, 738 (Tex. App.—San Antonio 1985, no writ); *Schultz v. American Nat'l Ins. Co.*, 142 S.W.2d 275, 277 (Tex. Civ. App.—Beaumont 1940, writ dism'd); *National Aid Life Ass'n v. Driskill*, 138 S.W.2d 238, 240 (Tex. Civ. App.—Eastland 1940, no writ)).

287. 951 F.2d 89 (5th Cir. 1992).

necessary for medical care. For the treatment to be reasonably necessary, the policy required that a treatment be ordered by a doctor, customarily recognized as appropriate, and not experimental in nature. The procedure in question was not considered experimental in the treatment of certain other cancers, but it was still being investigated for the treatment of stage IV metastatic breast cancer at the time it was used in the patient's treatment. Also, the evidence showed that the protocol used on this patient was given to only twenty or thirty women nationwide and was regulated by the FDA. Moreover, the patient had signed a consent form describing the treatment as an "experimental study." The Fifth Circuit found that the trial court's decision in favor of the insurer was not clearly erroneous.²⁸⁸

F. FORFEITURE OF LIFE INSURANCE PROCEEDS

In *Metropolitan Life Insurance Co. v. White*²⁸⁹ a widower who had been convicted of his wife's murder appealed a federal district court decision that held that under Texas law the widower had forfeited his interest in the policy due to the murder conviction. The wife had been the named insured under a group life insurance policy issued by Metropolitan under the Federal Employees Group Life Insurance Act (FEGLIA),²⁹⁰ and the widower contended that Texas law could not be used to disqualify him from a federal statutory right granted him under the FEGLIA. The Fifth Circuit stated that the FEGLIA should be interpreted consistent with state terms defining domestic relations.²⁹¹ The court held that "[e]ven if the homicide forfeiture rule were not the type of state domestic relations law that supplements the FEGLIA, that would not be dispositive . . . because the federal common law provides the same bar to recovery of life insurance proceeds by the murderer of the insured."²⁹²

G. STATUTE OF LIMITATIONS AND ERISA

In *Hogan v. Kraft Foods*²⁹³ a former employee and his wife sued an insurer who had issued five annuity insurance policies to the trustees of the employer's employee pension plan to fund accrued retirement benefits, complaining of the insurer's denial of his request to cash in or receive a lump sum payment on the policies. They asserted that several co-employees had been allowed to take such payments and alleged violations of the ERISA,²⁹⁴ contending that the insurer had denied them rights under the terms of the plan and breached its fiduciary duties. They also asserted pendent state

288. *Id.* at 91.

289. 972 F.2d 122 (5th Cir. 1992), *cert. denied*, No. 92-7281, 1993 WL 23029 (March 8, 1993).

290. 5 U.S.C. §§ 8701-8716 (1988).

291. 972 F.2d at 124 (citing *Spearman v. Spearman*, 482 F.2d 1203 (5th Cir. 1973); *see also De Sylva v. Ballentine*, 351 U.S. 570 (1956)).

292. 972 F.2d at 124 (citing *New York Mut. Life Ins. Co. v. Armstrong*, 117 U.S. 591 (1886); *Moore v. Moore*, 186 S.E.2d 531 (1971); Annotation, 27 A.L.R.3d 794, 802 (1969)).

293. 969 F.2d 142 (5th Cir. 1992).

294. 29 U.S.C. §§ 1001-1461.

claims including breach of contract, violation of article 21.21 of the Texas Insurance Code,²⁹⁵ violation of the DPTA,²⁹⁶ a breach of duty of good faith and fair dealing, negligence, and intentional infliction of emotional distress. The court held that the state law claims were pre-empted by ERISA because all of the state law claims were based on the insurer's refusal to make a lump sum payment of benefits under the Employee Pension Benefit Plan, and thus were analogous to other state law claims that had previously been found to have been pre-empted by ERISA.²⁹⁷ The court then held that the ERISA claims were barred by the applicable statute of limitations for raising a breach of fiduciary duty, applying the state statute of limitations most analogous to the cause of action raised, which the court determined to be the four year Texas statute governing a suit sounding in contract.²⁹⁸ Because the claimants had actual notice of the breach when the claim for a lump sum payment was denied in March 1985 and did not file suit until August 1989, their claim was time-barred.²⁹⁹

IV. PROPERTY

A. SUBROGATION

In *Interstate Fire Insurance Co. v. First Tape, Inc.*³⁰⁰ an insurer of leased premises paid \$600,000 to its insured, the lessor of leased premises, after a fire loss. The lease entered into by lessor and the lessee, First Tape, provided that the parties released each other from any and all claims for fire loss to premises that were insurable, including loss caused by the negligence of the parties to the lease. The lease also included a clause stating that the parties to the lease agreed that their respective insurance companies would have no right of subrogation against the other on account of such a loss. The insurer alleged that First Tape lost all right to assert the waiver of subrogation clause because it had assigned the lease to another party before the loss.

The Houston court of appeals rejected this argument. It held that a "lessee-assignor transfers title and the entire interest in the leasehold estate, destroying the privity of estate between the lessor and the lessee-assignor . . . [but] the assignor's liability on the contract remains, unless [the assignor] is expressly released from the obligation by the lessor."³⁰¹ The court stated that the lessor had no claim to assert, and so the insurer had no claim to which it could be subrogated.³⁰²

295. TEX. INS. CODE ANN. art. 21.21 (Vernon 1981).

296. TEX. BUS. & COM. CODE ANN. § 17.50 (Vernon 1988).

297. 969 F.2d at 144 (citing *Ramirez v. Inter-Continental Hotels*, 890 F.2d 760 (5th Cir. 1989); *Boren v. N.L. Indus., Inc.*, 889 F.2d 1463 (5th Cir. 1989), *cert. denied*, 497 U.S. 1029 (1990); *Hermann Hospital v. M.E.B.A. Medical & Benefit Plan*, 845 F.2d 1286 (5th Cir. 1988)).

298. 969 F.2d at 144 (citing TEX. CIV. PRAC. & REM. CODE ANN. § 16.004 (Vernon 1986)).

299. 969 F.2d at 145.

300. 817 S.W.2d 142 (Tex. App.—Houston [1st Dist.] 1991, writ denied).

301. *Id.* at 145.

302. *Id.*

B. INSURABLE INTEREST

In *Watts v. St. Katherine Insurance Co.*³⁰³ the owner of an apartment building had a judgment entered against it in a tax suit. The property was damaged in a fire three days after it was sold at a sheriff's sale. The insurer asserted that the former owner did not have an insurable interest in the property, either because its interest was limited to a right of redemption after the sheriff's sale or because there was a change in ownership and an increased hazard to the property, both of which were conditions that suspended or restricted coverage under the policy.

The Beaumont court of appeals rejected both of these arguments. It held that even a right of redemption was an interest in property, the value of which was affected by destruction of the property, and therefore the former owner continued to have an insurable interest.³⁰⁴ The court also rejected the argument that the sheriff's sale was an increased hazard to the property as a matter of law, stating that such an assertion presupposed that an insured would commit a first-degree felony in the event of a tax sale.³⁰⁵ Finally, the court also rejected the argument that a change of ownership had occurred for the purpose of triggering a contract clause requiring notice of a change of ownership to be given to the insurer because the contract clause was not triggered until the previous owner's redemption period expired.³⁰⁶

C. PROOF OF LOSS

The Dallas court of appeals held in *Commonwealth Lloyd's Insurance Co. v. Thomas*³⁰⁷ that a defective proof of loss was not a basis for denying a claim where the disputed proof of loss applied only to the contents of the house, and where the house itself, which was also insured under the same policy, had been destroyed by the fire. Even if the proof of loss was defective, the insurer had no basis for denial of the entire claim, the court held.³⁰⁸

D. ARSON AND COMMUNITY PROPERTY INTEREST

In *Webster v. State Farm Fire & Casualty Co.*³⁰⁹ the court considered whether an innocent spouse could collect one-half of the insurance proceeds for the fire loss of a house when the other spouse committed arson, where the couple was divorced after the fire but before suing the fire insurer. In 1987, one year after the Websters separated, their home was destroyed by fire. The house and contents were still community property. They filed a claim with State Farm, which was denied. Their divorce, which was filed during the claims process, became final in 1988 and the decree awarded them each one-half undivided interest in the realty where the house had been

303. 820 S.W.2d 259 (Tex. App.—Beaumont 1991, writ denied).

304. *Id.* at 260-61.

305. *Id.* at 261.

306. *Id.* at 261-62.

307. 825 S.W.2d 135 (Tex. App.—Dallas 1992, n.w.h.).

308. *Id.* at 144.

309. 953 F.2d 222 (5th Cir. 1992).

located and one-half the net insurance proceeds from the fire loss. Later they sued State Farm for breach of contract. Mrs. Webster contended that, whether or not her husband was responsible for the fire, she was entitled to recover her half of the proceeds.

The Texas Supreme Court partially abandoned its long-standing rule prohibiting co-insureds from recovering insurance proceeds when one of them deliberately destroyed jointly owned property in *Kulubis v. Texas Farm Bureau Underwriters Insurance Co.*³¹⁰ in 1986. *Kulubis* held that "the illegal destruction of jointly owned property by one co-insured shall not bar recovery under an insurance policy by an innocent co-insured."³¹¹ The *Kulubis* case, however, involved a wife who owned an undivided one-half interest in the house in question as separate property. The Fifth Circuit subsequently addressed the issue of an innocent spouse's right to recover when the property was community property in *Norman v. State Farm Fire & Casualty Co.*³¹² In that case the Fifth Circuit denied recovery to the innocent co-insured whose community property was destroyed by her husband due to the potential for wrongdoers to benefit from their wrongs.³¹³

Noting that because the Websters were divorced, Mr. Webster would receive no benefits should State Farm reimburse Mrs. Webster for her loss, the Fifth Circuit nevertheless followed *Norman* in refusing recovery for Mrs. Webster.³¹⁴ It pointed out that at all points of time pertinent to State Farm's decision to deny recovery, including the date the policy was issued, the date of the fire, the date the Websters filed their claim and the date the claim was refused, the property was community property, and the husband and wife never filed individual proofs of loss or requested that the insurer consider their interests as separate.³¹⁵ Although it conceded that the result was harsh, the court held that the insurer had no means of predicting marital failures, and did not breach its contract by denying coverage.³¹⁶

E. RES JUDICATA

In *Valley Forge Insurance Co. v. Ryan*³¹⁷ an insurance company sued its insured, seeking to recover from him money it had paid to his mortgagee following a fire loss to his home. In a previous lawsuit, the insurer had obtained a judgment that the insured intentionally set the fire and that it had no obligation to indemnify him. During the course of the prior suit, the mortgagee had intervened, seeking payment as a loss payee, and the insurer had paid the money into the district court's registry. Following the judgment, this money was paid to the mortgagee. In the insurer's subsequent suit for recovery of that money from the insured, the insured argued that the

310. 706 S.W.2d 953 (Tex. 1986).

311. *Id.* at 955.

312. 804 F.2d 1365 (5th Cir. 1986).

313. 804 F.2d at 1366.

314. 953 F.2d at 223.

315. *Id.*

316. *Id.* at 224.

317. 824 S.W.2d 236 (Tex. App.—Fort Worth 1992, n.w.h.).

insurer could not seek the money at that time because it could have sought an award of that sum in the original lawsuit.

The Fort Worth court of appeals reversed the trial court's summary judgment for the insured.³¹⁸ It held that the cause of action asserted by the insurer in the second case was quite different from its earlier claim, in that its purpose in the original proceeding was to determine whether the insured intentionally set fire to his insured house, while in the second the purpose was to recover money from the insured based on the insurer's subrogation rights.³¹⁹ Moreover, the court noted, the issue of the insured's mortgage debt was never raised against him in the original proceeding, and therefore was never adjudicated.³²⁰ The court also rejected the argument that the subrogation claim was a compulsory counterclaim to the original action, because, it reasoned, the action was not mature and owned by the insurer at the time of the filing of the answer in that suit, because it had not even paid the mortgagee at that time.³²¹ Thus, the court held, the subrogation claim was merely a permissive counterclaim with regard to the earlier action.³²²

V. AGENCY

A. CANCELLATION OF CONTRACTS

The San Antonio court of appeals upheld a court order dismissing a former insurance agent's cause of action against an insurer that canceled his agency contract in *Linick v. Employers Mutual Casualty Co.*³²³ The court applied article 21.11-1, section 5, of the Texas Insurance Code,³²⁴ relating to the cancellation of agency contracts by fire and casualty insurance companies, in its determination that the dismissal of the agent's suit by the trial court was not error because the agent had failed to obtain a finding by the State Board of Insurance that Employers had violated article 21.11-1 prior to the filing of his lawsuit.³²⁵

The *Linick* court noted that the business of insurance has long been closely regulated in the State of Texas, and that such regulation is within the state's police power because that business is affected by public interest.³²⁶ Also, the legislature has assumed control of the contractual relationship between insurance agents and companies. Further, the legislature may dele-

318. *Id.*

319. *Id.* at 238.

320. *Id.*

321. *Id.* at 239.

322. *Id.*

323. 822 S.W.2d 297 (Tex. App.—San Antonio 1991, no writ).

324. TEX. INS. CODE ANN. art. 21.11-1, § 5 (Vernon 1981).

325. This section reads as follows:

If it is found, after notice and an opportunity to be heard as determined by the board, that an insurance company has violated this article, the insurance company shall be subject to a civil penalty of not less than \$1,000 nor more than \$10,000, and it shall be subject to a civil suit by the agent for damages suffered because of the premature termination of the contract by the company.

Id.

326. 822 S.W.2d at 299-300.

gate its police power to administrative agencies such as the State Board of Insurance. The court held that a reading of the clear terms of article 21.11-1 requires a preliminary finding by the State Board of Insurance as a prerequisite to the institution of a suit for damages resulting from a statutory cause of action.³²⁷

B. NATURE OF CONTRACT AND RELATIONSHIP

In *Johnson v. Walker*³²⁸ the Fort Worth court of appeals considered a dispute between an agent, Johnson, and the owner of an insurance business, Walker, who were the parties to a general agent's contract. Walker filed suit for declaratory judgment to determine the contractual rights of the parties, and Johnson counterclaimed for fraud, violations of the Texas Deceptive Trade Practices Act, violations of the Texas Insurance Code, breach of fiduciary duty and breach of contract. Johnson also sought to pierce the corporate veil. The trial court granted summary judgment for Walker.³²⁹

Johnson asserted that his claims were not barred by the statute of limitations because his suit on the agency contract was a suit on an open account, as payments were to be made monthly and, he argued, the contract was divisible. The court observed that the agency contract was one whereby Johnson was to market Walker's insurance policies, similar to an employment contract wherein an employee receives commissions, as opposed to one where the performance by one party consists of several distinct items, with the price apportioned to each item.³³⁰ Under such a contract, the court noted, the breach occurs when the employee is demoted or terminated, not when the letter of termination is received.³³¹ The court also determined that Johnson's contract with Walker was not divisible since it contemplated agreement to the entire bundle of rights and duties.³³² The court concluded, therefore, that Johnson's claim was barred by the statute of limitations.³³³

Johnson also argued that the summary judgment was error because he was a "consumer" under the terms of the Texas Deceptive Trade Practices Act.³³⁴ The Court rejected this argument because Johnson was simply Walker's agent in selling insurance policies and did not contract with Walker to purchase goods or services.³³⁵

C. SCOPE OF AGENCY FOR TITLE INSURER

A lender brought a lawsuit against Stewart Title, a title insurer, for dam-

327. *Id.* at 299.

328. 824 S.W.2d 184 (Tex. App.—Fort Worth 1991, writ denied).

329. Initially, the trial court granted partial summary judgment to Walker based on all of Johnson's counterclaims with the exception of his breach of contract claim. However, because Johnson failed to replead his breach of contract claim as requested by the trial court, the court eventually entered an amended final judgment disposing of all of Johnson's claims. *Id.* at 186.

330. *Id.* at 187.

331. *Id.*

332. *Id.*

333. *Id.*

334. TEX. BUS. & COM. CODE ANN. § 17.45(4) (Vernon 1987).

335. 824 S.W.2d at 187.

ages the lender sustained when a buyer defaulted on a real estate loan in *Cameron County Savings Association v. Stewart Title Guaranty Co.*³³⁶ The lender's position was based on the argument that Valley Abstract, the title company that closed the transaction, was the agent for Stewart Title.³³⁷ Stewart Title argued that Valley Abstract was only its agent for the issuance of the Stewart Title insurance policy. The lender's case was based on allegations that Valley Abstract had manipulated the closing documents to hide the fact that the buyer made no down payment. The trial court entered summary judgment in favor of the title insurer.³³⁸

The lender argued that a title company is a title insurer's agent because a title insurance agent's duties in the escrow process and in facilitating the closing of real estate transactions are an integral part of the business of title insurance. The lender asserted that article 9.02(b) of the Texas Title Insurance Code³³⁹ mandates that the duties of an agent's escrow officer in closing the real estate transaction is part of its responsibilities as an agent of the title insurer. However, the court held that, as a matter of law, the statute does not impose liability on the title insurer beyond the title insurance policy's coverage.³⁴⁰

The court also considered whether there was a fact issue as to whether Valley Abstract had actual or apparent authority from Stewart Title to close the entire real estate transaction. It found that Valley Abstract did not have actual authority to do so based on an affidavit by a Stewart Title representative stating that Valley Abstract was never an agent for Stewart Title for any purpose other than execution of its title insurance policies.³⁴¹ In addition, the court held that Stewart Title did not hold Valley Abstract out to the public as trustworthy or reliable in closing real estate transactions, and that the only business conducted by Stewart Title was title insurance.³⁴² Furthermore, the only authority given to Valley Abstract in the contract between the parties was the authority to execute title insurance policies.³⁴³ The court, relying on deposition testimony of a loan officer for the lender and the closer for Valley Abstract, also held that Valley Abstract had no apparent authority from Stewart Title to close the entire real estate transaction.³⁴⁴ Therefore, the court held that summary judgment for the title insurer was proper.³⁴⁵

336. 819 S.W.2d 600 (Tex. App.—Corpus Christi 1991, writ denied).

337. A default judgment was taken against the title company that closed the transactions. However, the title insurer was the only defendant involved in the appeal.

338. 819 S.W.2d at 601.

339. TEX. INS. CODE ANN. art. 9.02(b) (Vernon 1981).

340. 819 S.W.2d at 602.

341. *Id.*

342. *Id.* at 603.

343. *Id.*

344. *Id.*

345. *Id.* at 605.

D. MISREPRESENTATIONS

In *State Farm Fire & Casualty Co. v. Gros*³⁴⁶ the insured homeowners, Lee and Sharon Gros, brought a lawsuit against their homeowners insurer to recover for damages their home sustained as a result of a landslide. After a jury trial, judgment was rendered for the insureds. State Farm and its agent, Goss, appealed.³⁴⁷

The key issue in the litigation related to representations made by Goss.³⁴⁸ Initially, the court considered whether the evidence was legally and factually insufficient to support a finding that Goss misrepresented the benefits or terms of the homeowner's policy. The insured testified that when he had made an earlier claim under the policy for removal of boulders that had fallen into the driveway but had not damaged the house, agent Goss told him that there was no coverage for removal of the boulders but that the policy *would* have covered the damage if the boulders had actually "hit" the house. Agent Goss denied making this statement but failed to make a written record of her version of the conversation. After their house was damaged at a later date by a landslide that actually hit the house, the insureds testified, they called in the claim to State Farm, using the language agent Goss had told them would invoke coverage under the policy. However, State Farm denied the claim based on the landslide exclusion, the inherent vice exclusion and the surface waters exclusion. Based on this evidence, the court held that there was sufficient evidence to support the jury finding that Goss misrepresented the benefits or terms of the homeowners policy.³⁴⁹

The court also considered whether there was sufficient evidence to support the jury finding that State Farm committed an unfair or deceptive act or practice by misrepresenting the benefits or terms of the policy.³⁵⁰ Holding that the evidence revealed that Goss was acting as an agent for State Farm and that State Farm was therefore bound by her actions, the court determined that there was sufficient evidence to support the jury finding that State Farm misrepresented the terms or benefits of the homeowner's policy.³⁵¹ Further, the court found that the misrepresentation evidence was sufficient to support a finding that State Farm engaged in an unconscionable action or course of action.³⁵²

State Farm also challenged the legal and factual sufficiency of the evidence supporting the jury findings that the unconscionable course of conduct and misrepresentations by State Farm and Goss were a producing cause of the damages sustained by the insured. State Farm argued that even if Goss had misrepresented the coverage of the insured's homeowner's policy, such misrepresentation was not a producing cause of damage because the insured would have been unable to obtain insurance coverage covering this type of

346. 818 S.W.2d 908 (Tex.App.—Austin 1991, no writ).

347. *Id.* at 910.

348. *Id.*

349. *Id.* at 912.

350. *Id.*

351. *Id.*

352. *Id.* at 913.

claim from any other insurance company. However, the court held, it was not necessary for the insureds to prove that the promised coverage could have been obtained from another insurer in order to establish producing cause where a suit alleges violations of the DTPA³⁵³ as well as article 21.21 of the Texas Insurance Code.³⁵⁴ Further, the court noted, had the insureds known that they would not be covered for damages caused by a landslide, the insureds might have taken other steps to prevent their loss, such as testing the retaining wall before it collapsed and caused the landslide.³⁵⁵

E. AUTHORITY TO BIND COVERAGE

In *Maccabees Mutual Life Insurance Co. v. McNeil*³⁵⁶ an insurer argued that the trial court erred in concluding that its agent, who allegedly represented to a would-be insured hospital district that he had authority to bind group life insurance coverage as a representative of the insurer, acted with actual, apparent and implied authority and that he possessed the authority to bind coverage as the insurer's employee or agent. The insurer asserted that the agent should be classified as a person soliciting an application for life insurance without the power to waive, change or alter policy terms under article 21.04 of the Insurance Code.³⁵⁷ The court noted that the actual authority of a soliciting agent to make representations on behalf of an insurance company is much more limited than the authority possessed by a local recording agent, which is co-extensive with the company's authority.³⁵⁸

The court found that the record did not support the classification of the agent as either a soliciting agent or a local recording agent, and held that the trial court correctly classified him as an "agent of the company" under article 21.02 of the Insurance Code.³⁵⁹ The court stated that the record established that the agent received an application, collected the premium and acted in the course of negotiation of the insurance contract in the course of his employment with the insurer.³⁶⁰ It stated that the statutory authority granted to an agent under article 21.02 does not authorize the agent to misrepresent the policy coverage and bind the insurance company to his misrepresentations unless the insurance company approves the agent's conduct by

353. TEX. BUS. & COM. CODE ANN. §§ 17.41-17.63 (Vernon 1987).

354. 818 S.W.2d at 912.

355. *Id.* at 914.

356. 836 S.W.2d 229 (Tex. App.—Dallas 1992, n.w.h.).

357. TEX. INS. CODE ANN. art. 21.04 (Vernon Supp. 1985).

358. 836 S.W.2d at 232 (citing *Royal Globe Ins. Co. v. Bar Consultants, Inc.*, 577 S.W.2d 688, 692-93 (Tex. 1979)).

359. 836 S.W.2d at 232. The court cited the relevant portion of the insurance code in a footnote:

Any person who solicits insurance on behalf of any insurance company, whether incorporated under the laws of this or any other state or foreign government, or who takes or transmits other than for himself any application for insurance or any policy of insurance to or from such company . . . shall be held to be the agent of the company for which the act is done, or the risk is taken, as far as relates to all the liabilities, duties, requirements and penalties set forth in this Chapter.

Id. at n.5 (quoting TEX. INS. CODE ANN. art. 21.02 (Vernon 1981)).

360. 836 S.W.2d at 232.

authorizing his wrongful acts or subsequent ratification of those acts.³⁶¹ The court also noted that if an agent or employee of an insurer is clothed with the apparent authority to do an act or make a representation, then that insurer cannot later escape liability by asserting that the agent or employee lacked the authority to engage in those acts.³⁶² Noting that the apparent authority theory is based on the doctrine of estoppel, the court stated that in order to successfully argue such a theory, the plaintiff must establish that the principal's conduct would lead a reasonably prudent person to believe that the agent actually possessed the authority which he purported to exercise.³⁶³

The court, however, concluded that in the case before it there was no evidence that the agent had actual, apparent, or implied authority to bind insurance coverage or to waive policy provisions.³⁶⁴ The court agreed with the insurer that the trial court erred by concluding that the agent possessed authority to bind coverage and had actual, apparent and implied authority to do so.³⁶⁵ The court further found that absent actual, apparent or implied authority to bind coverage, the agent could not enter into a contract that bound the insurer, and therefore there was no contract existing between the insurer and the applicant.³⁶⁶ It also concluded, however, that there was sufficient evidence to support the trial court's judgment awarding damages under section 16 of article 21.21 of the Insurance Code.³⁶⁷ It stated that in article 21.02 agent of an insurance company who misrepresents coverage may render the insurance company he represents vicariously liable for the misrepresentations under the DTPA and article 21.21, section 16 of the Insurance Code.³⁶⁸ It noted that a State Board of Insurance regulation provided that the regulation's purpose was to further define and state the standards necessary to prohibit deceptive acts or deceptive practices by insurers and insurance agents irrespective of "whether the person is acting as an insurer, principal, agent, employer or employee, or in other capacity or connection with such insurer."³⁶⁹

VI. MISCELLANEOUS

A. IN PERSONAM JURISDICTION

It is now axiomatic that due process prevents a state court from exercising personal jurisdiction over non-resident defendants who otherwise have no continuous and systematic presence in that state unless that defendant has established "minimum contacts" with the forum and the exercise of personal jurisdiction does not otherwise offend "traditional notions of fair play and

361. *Id.* (citing *Royal Globe*, 577 S.W.2d at 693).

362. 836 S.W.2d at 232.

363. *Id.* at 232-33.

364. *Id.* at 235.

365. *Id.*

366. *Id.*

367. TEX. INS. CODE ANN. art. 21.21, § 16 (Vernon 1981).

368. 836 S.W.2d at 233.

369. *Id.* at 234 (quoting State Bd. of Ins., 28 TEX. ADMIN. CODE § 21.1 (West July 21, 1988)).

substantial justice.”³⁷⁰ Equally settled is the idea that “minimum contacts” require that the non-resident purposefully evoke the benefits of the forum state’s law by performing some act or consummating some transaction within or purposefully directed to that state.³⁷¹ The Texas Supreme Court recently issued two significant opinions applying the “minimum contacts” analysis to non-resident insurers.³⁷²

Guardian Royal Exchange Assurance, Ltd. v. English China Clays, P.L.C. involved an American insurer’s action against an English insurer for reimbursement of sums paid by the American insurer to settle a wrongful death claim against a common insured arising from an on-the-job accident in Texas.³⁷³ It was undisputed that the English insurer’s liability policy was negotiated, issued and, prior to the events involved in the underlying suit, performed only in England. However, the policy named two American subsidiaries as additional insureds and identified these entities as domiciled in the United States. The policy also afforded all insureds coverage anywhere in the world. Emphasizing the element of foreseeability of defending an action in the forum state for purposes of deciding whether a non-resident insurer established “minimum contacts” in a jurisdiction where it otherwise conducted no business activity, the Texas Supreme Court ruled that whether amenability to suit was “foreseeable” depended on the nature of the insurance coverage and the insurer’s “awareness that it was responsible to cover losses arising from a substantial subject of insurance regularly present in the forum state.”³⁷⁴ Under this test, the court concluded that the English insurer had established minimum contacts with Texas for the purposes of that action because the additional insured’s principal place of business was located in Texas and because the claim at issue had arisen out of such additional insured’s business activities in Texas.³⁷⁵ The court reasoned that because the liability policy obligated the English insurer to defend and indemnify covered claims anywhere in the world and because one of many additional insureds was located in Texas, it could have reasonably anticipated the resolution of coverage disputes with and suits against the additional insured in Texas.³⁷⁶

Nevertheless, the court declined to permit the trial court to exercise personal jurisdiction over the non-resident insurer on grounds rarely employed to defeat potential in personam jurisdiction: It deemed the exercise of personal jurisdiction inconsistent with traditional notions of fair play and sub-

370. *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 475-76 (1985); *Helicopteros Nacionales de Columbia v. Hall*, 466 U.S. 408, 414 (1984).

371. *Burger King Corp.*, 471 U.S. at 474-75; *Schlobohm v. Shapiro*, 784 S.W.2d 355, 358 (Tex. 1990); *U-Anchor Advertising v. Burt*, 553 S.W.2d 760, 762 (Tex.), *cert. denied*, 434 U.S. 1063 (1977).

372. *Guardian Royal Exchange Assurance, Ltd. V. English China Clays*, 815 S.W.2d 223 (Tex. 1992); *El Paso Reyco, Inc. v. Malaysia British Assurance*, 830 S.W.2d 919 (Tex. 1992).

373. *Guardian Royal*, 815 S.W.2d at 225.

374. *Id.* at 227.

375. *Id.* at 232.

376. *Id.*

stantial justice.³⁷⁷ The court determined that the interest of Texas in adjudicating the dispute was "minimal" because the action was between two insurers rather than an insurer and a Texas insured.³⁷⁸ The court conceded that had this been an insured-insurer dispute, the state would have had a substantial interest in adjudicating the dispute in order to provide its residents with an effective means of redress against foreign insurers.³⁷⁹ Indeed, the court noted that because insurance is a subject regulated by the state for the benefit of its insured citizens, a lesser degree of "contact" would nevertheless support the exercise of personal jurisdiction over the non-resident insurer.³⁸⁰ However, the court apparently concluded that a co-insurer was not within the scope of persons protected by state regulations and, therefore, the interests of Texas in this insurer-versus-insurer dispute did not outweigh the burden on the foreign insurer of defending the reimbursement claim in Texas.³⁸¹

Citing the holding in *Guardian Royal* that liability insurers establish "minimum contacts" in any jurisdiction where the insured is amenable to personal jurisdiction for an insured claim, the El Paso court of appeals extended this rule to non-resident reinsurers to hold them amenable to suit in Texas when the claim arises from circumstances where the reinsured's insured is subject to personal jurisdiction.³⁸² Deeming reliance on *Guardian Royal* a "misunderstand[ing of] the nature of reinsurance," the Texas Supreme Court by per curiam opinion in *Malaysia British Assurance v. El Paso Reyco, Inc.* reversed the court of appeals and held that the non-resident reinsurer was not amenable to jurisdiction in Texas solely on the basis of the amenability of the reinsured's insured to suit in this state.³⁸³ The reinsurer in *Malaysia British* had reinsured the liability risks underwritten by a Pakistani insurer for a Texas insured. A Texas resident asserted a liability claim against the insured which the Pakistani insurer refused to defend and, following judgment against the insured, to pay on the insured's behalf.

Both the insured and the judgment creditor sued the Pakistani insurer to impose contractual and extracontractual liability claims and obtained a judgment by default against the Pakistani insurer after it was placed in receivership. The judgment creditor and insured then brought suit against the

377. *Id.* at 233.

378. *Id.* at 232-33.

379. *Id.* at 233.

380. *Id.* at 229.

381. *Id.* at 229, 233. Justice Mauzy dissented from this portion of the opinion. *Id.* at 233-34. He urged quite cogently that the American insurer who contributed to the settlement should be treated as if it were the insured Texas citizen because the American insurer had, upon contribution to the settlement, been subrogated, to the extent of the contribution, to the rights of the insured. *Id.* at 234. Under Justice Mauzy's analysis, because the rights being asserted were the same rights as those that the state's insurance regulations were designed to protect, the identity of the person asserting those rights should have no bearing upon the decision whether the state's regulatory interests outweighed the burden on the non-resident insurer to defend the action in a remote jurisdiction. *Id.*

382. *El Paso Reyco, Inc. v. Malaysia British Assurance*, 808 S.W.2d 529, 530-31 (Tex. App.—El Paso 1991), *rev'd per curiam*, 830 S.W.2d 919 (Tex. 1992).

383. 830 S.W.2d at 921.

reinsurer alleging that it breached its reinsurance treaty with the Pakistani insurer and that such conduct breached the duty of good faith and fair dealing as well as violated the consumer protection provisions of article 21.21 of the Insurance Code³⁸⁴ and the Texas Deceptive Trade Practices Act.³⁸⁵ By affidavit, the reinsurer established that it had no connection with Texas whatsoever other than its agreement executed outside the United States to reinsure some of the insurer's policies, including that issued to a Texas domiciliary.³⁸⁶ Holding that this agreement was inadequate to establish "minimum contacts" between the reinsurer and Texas, the Texas Supreme Court explained that the reinsurer only agreed to cover losses sustained by the Pakistani insurer, not the losses sustained by that insurer's insureds.³⁸⁷ Accordingly, the court concluded that, unlike an insurer who insures a Texas resident, the reinsurer engaged in no activity purposefully directed to Texas.³⁸⁸ Instead, it deemed the activity of the reinsured Pakistani insurer the type of "unilateral activity of a third person" insufficient to confer personal jurisdiction over the reinsurer.³⁸⁹

B. FIDELITY & PERFORMANCE BONDS

Fidelity and performance bonds were the subject of two cases decided under Texas law in 1992.³⁹⁰ In *Fidelity & Deposit Co. v. Concerned Taxpayers, Inc.*,³⁹¹ a bonding company issued statutory public official bonds to five trustees of a purported hospital district. A taxpayer's group prevailed in a suit in which the hospital district was found to have been formed in violation of the Texas constitution and the trustees were declared to have violated the Open Meetings Act.³⁹² In addition, the trial court awarded attorney's fees to the taxpayer's group.³⁹³ Because the hospital district had no funds, the taxpayer's group sought to recover the attorney's fee award under the public officials' bond, which obligated the bonding company to pay up to the stated limits of the bond damages based upon "the unfaithful performance of the trustees in their official capacities."³⁹⁴

The bonding company first urged that it was not liable because surety bonds have historically been construed to impose no obligation to reimburse the claimant for attorney's fees absent a statutory or contractual provisions to the contrary. The court rejected this contention because the award of attorney's fee was specifically authorized under the Declaratory Judgment

384. TEX. INS. CODE ANN. art. 21.21 (Vernon 1981).

385. TEX. BUS. & CODE ANN. §§ 17.41-17.63 (Vernon 1987).

386. 830 S.W.2d at 920.

387. *Id.* at 921.

388. *Id.*

389. *Id.* (citing *Burger King Corp.*, 471 U.S. at 475; *Guardian Royal*, 815 S.W.2d at 475).

390. *Geters v. Eagle Ins. Co.*, 834 S.W.2d 49 (Tex. 1992); *Fidelity & Deposit Co. v. Concerned Taxpayers, Inc.*, 829 S.W.2d 923 (Tex. App.—Austin 1992, no writ).

391. 829 S.W.2d 923.

392. 829 S.W.2d at 925; *see* TEX. REV. CIV. STAT. ANN. art. 6252-17 (Vernon Supp. 1993).

393. *Id.*

394. *Id.*

Act.³⁹⁵ Further, the court rejected the notion that the precepts of interpreting surety bonds were applicable to the broad language and purpose of fidelity bonds because the latter are construed under the more liberal rules of construction applicable to insurance contracts.³⁹⁶ The court also rejected the bond issuer's contention that the trustees never performed, unfaithfully or otherwise, any statutory duties because of the irregular formation of the board.³⁹⁷ The court, without explanation of how a public body, never delegated powers in violation of the constitution, could acquire statutory authority, held that each meeting of the trustees convened in violation of the open meetings law was an "unfaithful act" which invoked the issuer's liability under its bond.³⁹⁸ However, although the court held that the taxpayers could recover under the bonds for their attorney's fees in the underlying declaratory judgment suit, the bonds imposed no obligation on the bond issuer because the taxpayer's group was neither a donee nor a creditor third-party beneficiary of the bond contract between the officials and the bond issuer.³⁹⁹

*Geters v. Eagle Insurance Company*⁴⁰⁰ involved a motor vehicle dealer's bond. The claimant purchased an automobile from a dealer who failed to transfer title. After the claimant was arrested on suspicion of driving a stolen vehicle because of the dealer's failure to transfer title, the claimant obtained a default judgment in excess of \$150,000 against the dealer for DTPA violations. The claimant then sought to recover \$25,000 of this judgment under the \$25,000 motor vehicle dealer's bond required by statute.⁴⁰¹ The court held, however, that the language of the bond and the legislative history of the statutory requirement indicated that coverage under the bond was limited for each claimant for the amount of "contractual recessionary damages" rather than tort or other extracontractual damages.⁴⁰² The court's express rationale for this interpretation was to limit each claimant's potential recovery so as to maximize the number of claimants protected under the dealer's bond.⁴⁰³

The Texas Supreme Court granted Geters' petition for writ of error and reversed this decision in a unanimous *per curiam* opinion.⁴⁰⁴ The Supreme Court rejected the limited interpretation of damages relied upon by the court of appeals and held instead that the unqualified use of the word "damages" in the Motor Vehicle Dealers' Bond Statute⁴⁰⁵ manifested an intent that the bond be available to compensate all damage awards and not merely "reces-

395. 829 S.W.2d at 926; see TEX. CIV. PRAC. & REM. CODE ANN. § 37.009 (Vernon 1987).

396. *Id.* (citing Great American Ins. Co. v. Langdeau, 739 S.W.2d 62, 65 (Tex. 1964); *Brown v. Sneed*, 77 Tex. 471, 14 S.W. 248, 252 (1890)).

397. *Id.* at 927.

398. *Id.*

399. *Id.* at 928.

400. 824 S.W.2d 664 (Tex. App.—Houston [14th Dist.]), *rev'd per curiam*, 834 S.W.2d 49 (Tex. 1992).

401. TEX. REV. CIV. STAT. ANN. art. 6686(a)(1-A)(vii) (Vernon Supp. 1993).

402. 824 S.W.2d at 666.

403. *Id.*

404. *Geters v. Eagle Ins. Co.*, 834 S.W.2d 49 (Tex. 1992) (*per curiam*).

405. See *supra* note 41.

sionary" damages.⁴⁰⁶

In *First Texas Savings Association v. Reliance Insurance Co.*,⁴⁰⁷ the issue was whether the loan exclusion clause under a savings and loan blanket bond precluded recovery by the institution for losses sustained as the result of a customer's check kiting scheme. The bond at issue specifically excluded any "loss resulting directly or indirectly from the . . . non-payment of, or default upon any loan . . . whether . . . procured in good faith or through trick, artifice, fraud or false pretenses . . ." ⁴⁰⁸ Although the Fifth Circuit had previously held that a check-kiting scheme was not a "loan" for purposes of this bond exclusion,⁴⁰⁹ the court held this rule inapplicable because in the instant case the institution did not rely on previously deposited checks, but rather the customer's express promise to immediately pay overdrafts.⁴¹⁰ Accordingly, the court held that the loss caused by the customer's prearranged overdraft authority constituted a "loan" for which the bond provided no coverage.⁴¹¹

C. STATUTORY AND ADMINISTRATIVE REGULATIONS

In *Durish v. Texas State Board of Insurance*,⁴¹² the court held unconstitutional article 21.79D of the Texas Insurance Code⁴¹³ on the ground that the statute violated the prohibition against *ex post facto* laws. The stricken statute was enacted in 1989 and permitted an insurer to bring suit to prevent or redress another's fraudulent insurance practice.⁴¹⁴ The costs and attorney's fees incurred in such an action could be used by the insurer to offset amounts that the insurer owed the state.⁴¹⁵ Moreover, this act related back to suits commenced after 1986 so long as no final judgment had been rendered in that action.⁴¹⁶ Concluding that the State Board of Insurance had standing to assert the constitutional prohibition against retroactive laws, the court held that the statute impermissibly impaired the state's vested right to payment.⁴¹⁷

In *MDPhysicians & Associates Inc. v. State Board of Insurance*,⁴¹⁸ the issue was whether a self-funded multiple employer welfare arrangement was a qualified ERISA benefit plan exempted by federal statute from state regulation.⁴¹⁹ The plan at issue offered medical and health benefits to the subscribing employers' employees, but was neither created nor administered on a

406. 834 S.W.2d at 50.

407. 950 F.2d 1171 (5th Cir. 1992).

408. *Id.* at 1175.

409. *Calcasieu-Marine Nat'l Bank v. American Employer's Ins. Co.*, 553 F.2d 290, 294 n.4 (5th Cir.), *cert. denied*, 429 U.S. 922 (1976).

410. 950 F.2d at 1177.

411. *Id.* at 1178.

412. 817 S.W.2d 764 (Tex. App.—Texarkana 1991, no writ).

413. TEX. INS. CODE ANN. art. 27.79D (Vernon Supp. 1991).

414. 817 S.W.2d at 766.

415. *Id.*

416. *Id.*

417. *Id.* at 766-67.

418. 957 F.2d 178 (5th Cir.), *cert. denied*, 113 S. Ct. 179 (1992).

419. *Id.* at 181.

daily basis by the subscribing employers. Instead, the plan was created by the administrator who profited from its operation. Further, there was no other connection between the participating employers other than their participation in the plan. Because the administrator was deemed to be acting on its own behalf, rather than directly as an employer or indirectly on behalf of the employers,⁴²⁰ the Fifth Circuit concluded that the administrator failed to qualify as an employer welfare benefit plan exempt from state insurance regulations under ERISA.⁴²¹

D. PROFESSIONAL LIABILITY — PROFESSIONAL SERVICES

An issue with great currency under a wide variety of policies was addressed in the context of a medical malpractice insurance policy in *Cluett v. Medical Protective Co.*⁴²² In that case, an insurer brought a declaratory judgment action to determine whether allegations that a physician alienated the affection of, and became sexually involved with, the plaintiff's spouse were based on the physician's rendition of a professional service.⁴²³ It was undisputed that the physician and spouse first became acquainted with each other because the physician served as pediatrician to the spouse's children. The court canvassed the authorities from other jurisdictions and concluded that sexual relations between a physician and a patient or a patient's parent do not, as a matter of law, arise from the rendition of professional services except when such conduct results from the displacement of the patient's feelings toward another onto the health care provider during psychotherapeutic treatment.⁴²⁴

420. *Id.* at 186.

421. 957 F.2d at 186.

422. 829 S.W.2d 822 (Tex. App.—Dallas 1992, writ denied).

423. *Id.* at 829.

424. *Id.* at 828-30.

