INSURANCE:
COVERAGE, *STOWERS* AND ETHICAL ISSUES

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INSURANCE: COVERAGE, *STOWERS*, AND ETHICAL ISSUES

Introduction: My paper will address insurance coverage issues that regularly confront the civil practitioner. The ability to prosecute or defend a first party or third party[1] insurance claim depends upon a thorough analysis of the insurance policy underlying the claim. "First party" insurance claims are those made by an insured directly against his own insurance carrier. Extracontractual liability for first party claims may be based upon common law and statutory principles. "Third party" claims are those asserted by a third party against a person protected by a liability policy of insurance. In Texas, extracontractual liability may be founded upon common law principles, now principally founded upon the so-called *Stowers*[2] doctrine as well as statutory principles. A detailed discussion of the statutory bases for extracontractual liability as well as the liability based upon the common law duty of good faith and fair dealing is outside the scope of this particular paper.

I. The Basics of Contractual Coverage:

A. The insurance contract is read as a whole.

The insurance contract is read and construed like any other contract: the court must read all parts of the contract together in order to ascertain the agreement of the parties. The policy must be read as a whole and each part of the policy must be given effect. *See Forbau v. Aetna Life Insurance Co.*, 876 S.W.2d 132, 133 (Tex. 1994). The insurance contract is construed against the drafter of the policy—the insurance company. In the case of *National Union Fire Insurance Company v. Hudson Energy Company*, 811 S.W.2d 552, 555 (1991), the court made it clear that if an insurance policy is susceptible to more than one reasonable interpretation, the court *must* resolve the uncertainty of coverage in favor of the construction that confers coverage; that is, the construction in favor of the insured. See id. at 555.

B. Coverage is determined by reading the insurance agreement together with any applicable exclusion and conditions.

1) The risk covered.

It is the burden of the insured to demonstrate such matters as he is an insured under the policy, that the loss occurred within the policy period and the loss is one contemplated by the parties within the risk covered. *See Employers Casualty v. Block,* 744 S.W.2d 940, 944 (Tex. 1988).

The ***risk covered*** by the insurance policy is expressed in the insuring agreement read in conjunction with applicable exclusions from coverage. *See National Union Fire Ins. Co. v. Hudson Energy Co., supra* at 555. In the first party context, the insured must affirmatively plead and prove that a loss is covered within the policy. *See Employers Insurance Co. v. Block*, 744 S.W.2d 940, 944 (Tex. 1988). In the third party context, this means the insured must show that the claim or petition presents facts that bring the loss within coverage. *See Trinity Universal Insurance v. Cowan,* 945 S.W.2d 819, 821 (Tex. 1997).

For example, the Texas Personal Auto Policy provides a first party coverage in the Uninsured/Underinsured Motorist provision of the policy. An exclusion to coverage exists when an owned but unlisted vehicle is provided for the regular use of the insured. When the carrier properly demonstrates that the loss the subject of the insured's claim falls outside of coverage because of such exclusion the insured has failed to meet his burden of demonstrating that the loss is within the risk covered by the policy and therefore a covered loss. *See Texas Farmers Insurance Co. v McGuire*, 744 S.W.2d 601, 603 (Tex. 1988).

One of the most effective attacks upon insurance coverage comes from the construction of terms within the insuring agreement. This attack has

[1] WINDT, ALLAN D., *Insurance Claims and Disputes* Section 6.05 (3rd ed. 1995) contains a good general discussion of the nature of first and third party insurance claims.

[2] *Stowers Furniture Co. v. American Indemnity* Co., 15 S.W.2d 544 (Tex. Comm'n App. 1929, holding approved).

been clearly demonstrated in the third party context. In construing whether a liability policy provides a defense or indemnity to an insured, the court in *Trinity Universal v. Cowan*, 945 S.W.2d 819 (Tex. 1997) construed the term "occurrence" and "bodily injury" in a Texas Homeowner's Policy.

In *Cowan*, the insured, Gage, was working at an H.E.B. Photo Place when he came across some provocative photos of a young lady and decided to make a few extra copies for himself. He then circulated the photos to some of his friends. All of this was done without the consent of the young lady, Ms. Cowan, of course.

Cowan filed suit against Cage alleging that his conduct was negligent and grossly negligent. Cage's homeowner's carrier defended under reservation of rights initially, but later withdrew its defense. In a trial before the court, in which Gage did not appear, the trial court found Gage negligent and grossly negligent. *See id*. at 821. Cowan, as Gage's assignee then filed suit against Trinity Universal, the homeowner's insurance carrier. The lower court held that the homeowner's policy provided coverage for the loss since "pure mental anguish" claims are "bodily injuries" as those terms are defined in the policy. *See id*. at 821.

While this case contains many important points of law critical for various coverage issues, at this point we are concerned with the use of defined terms in the policy defining the parameters of the risk covered by the policy. Recall that it is the insured's burden to demonstrate that the loss falls within the parameters of the risk covered.

The supreme court held that "pure mental anguish" without associated physical manifestations did not constitute a "bodily injury" as defined by the policy.[3] *See id*. at 824. In this way the loss was outside the scope of the insuring agreement; that is, the risk covered, and there was no insurance coverage for the loss. *See id*. at 826.

The court also considered whether Cage's conduct constituted an "occurrence"[4] under the policy. The court's pronouncements on this aspect of the insurance policy are important in nearly every coverage opinion dealing with negligent torts. The competing arguments were thus:

> "It is undisputed that Gage intentionally made the copies of Cowan's photographs and showed them to his friends, although Gage testified that he did not intend for Cowan to learn of his actions. Relying on *Republic National Life Insurance Co. v. Heyward, 536 S.W,2d 549 (Tex. 1976)*, other cases, the court of appeals held that an "accident" includes the unforeseen and unexpected consequences of otherwise intentional acts and consequently, that an "occurrence" takes place when the resulting injury or damage was unexpected or unintended, regardless of whether the insured's acts were intentional. 906 S.W.2d at 129. Applying this standard, it held that there was an "occurrence" because Gage did not intend that Cowan learn of his actions. *Id*. We disagree."

See Trinity Universal v. Cowan, supra at 827. The court rejected Cowan's contention and held that determining whether an event was caused by accidental means depends upon its *effect*. The court stated, "An effect which the actor did not intend to produce and which *he cannot be charged with the design of producing*, is produced by accidental means." *See id*. at 827 (emphasis in the original). Since Gage intended to remove the photos from the workplace and circulate them among his friends, his conduct was *not* accidental even though he protested that he did not intend that Cowan learn of his actions. *See id*. at 826. The court finds, in effect, that Gage could be charged with the design of producing the resulting effect of his conduct.

[3] The policy defined "bodily injury" as "bodily harm, sickness or disease." *See id*. at 822.

[4] Defined in the policy as "an accident, including exposure to conditions, which results in bodily injury or property damage during the policy period." *See id*. at 826.

The implications on a contractual coverage analysis are enormous. The analysis should begin with whether the *factual basis* for the claim constitutes a covered loss.[5] **In the civil trial arena, the question becomes, "Was there an *accidental* loss within the policy period that produced *bodily injury* or *property damage?"*** Since these matters fall within the ambit of the risk covered by the insuring agreement, it is the insured's burden to establish these facts. *See Government Employees Insurance v. Lichte, 792 S.W.2d 546, 548* (Tex. App.—El Paso 1990), *writ denied per curiam*, 825 S.W. 2d 431 (Tex. 1991).

While Cowan established that "pure mental anguish" claims do not constitute a "bodily injury" under the definition found in the homeowners policy, there now is an issue an issue concerning whether punitive damages are covered under the terms of most liability policies. One court has taken the position that punitive damages are not covered by terms of the insuring agreement in the Unisured/Underinsured Motorist provision of the Texas Auto Policy since such damages are not incurred "because of bodily injury." *See Government Employees Insurance v. Lichte, supra* at 549. The supreme court specifically reserved judgment on this issue. *See Lichte v. Government Employees Insurance* 825 S.W.2d 431.[6]

2) Exclusions from coverage.

While the burden is upon the insured to demonstrate that a loss falls within the terms of the insuring agreement, the risk covered, ***it is the carrier's burden*** to demonstrate that a risk is one removed from coverage by virtue of a contractual exclusion. *See Employers Insurance v. Block, supra* at 944. The carrier must plead and prove such an exclusion to coverage. *Love of God Holiness Church v. Union Standard Insurance Co.*, 860 S.W.2d 179, 181 (Tex. App.—Texarkana 1993, no writ); TEX. INS. CODE ANN. Art. 21.58 (2000).

Surprisingly, the language of the courts is enthusiastically "pro-insured" when it comes to the construction of *exclusions*. The supreme court has stated:

> "The court must adopt the construction of an exclusionary clause urged by the insured as long as that construction is not unreasonable, *even if the construction urged by the insurer appears to be more reasonable or a more accurate reflection of the parties' intent*

See National Union Fire Ins. Co. v. Hudson Energy Co., supra at 555 (emphasis supplied). These exceptions and limitations on coverage are strictly construed against the carrier. *See id.* In the *Hudson Energy* case the court held that since there was no clear exclusion in an aircraft liability policy that clearly excluded coverage when a plane was been piloted simultaneously by an approved and unapproved pilot, there was liability coverage for ensuing damages after a crash. *See id.* at 555-56.

The intentional injury exclusion is one that is often encountered in civil litigation. The exclusion provides no coverage for "bodily injury or property damage caused intentionally by or at the direction of the Insured." *See State Farm Fire & Casualty Co. v. SS & GW*, 858 S.W.2d 374, 377 (Tex. 1993) (construing the exclusion in the Texas Homeowners policy). This exclusion is distinct from any analysis

[5] The court is constrained to examine the factual allegations contained in the petition or complaint and not the characterization of conduct. See

[6] The courts of appeal have conflicting opinions on this issue of coverage for punitive damages in uninsured/underinsured policies. *American Home Assurance Co. v. Safway Steel Product Co.*, 743 S.W.2d 693, 701-05 (Tex. App.—Austin 1987, writ denied) holds that punitive damages are covered in a liability policy providing for the payment of "all sums" for which the insured may be legally liable to pay. See also *Manriquez v.Mid-Century Ins. Co*., 779 S.W.2d 482, 483 (Tex. App.—El Paso 1989, writ denied). To the contrary *are Milligan v. State Farm Mutual Automobile Ins. Co*., 940 S.W.2d 28, 231 (Tex. App.—Houston 14th Dist.] 1997, writ denied) and *State Farm Mutual Ins. Co. v. Shaffer*, 888 S.W.2d 146 (Houston [1st Dist.] 1994, writ denied). These cases do not contain a coverage analysis of "bodily injury;" rather, they simply hold that providing such insurance coverage for punitive damages violates public policy. There is likewise federal authority supporting this point of view. *See Hartford Casualty Ins. Co. v. Powell*, 19 F. Supp. 678 (N.D. Tex. 1998).

involving whether conduct is an "occurrence" or accidental under the policy. *See Trinity Universal Ins. Co. v. Cowan, supra* at 828.

In *SS & GG*, the court considered whether the bodily injury damages the insured's transmission of herpes to his female companion was excluded from coverage by virtue of the intentional injury exclusion.. *See id*. at 375-76. While it was undisputed that the insured intentionally engaged in sexual intercourse with his companion, he did so while he suffered from no active lesions and he believed that the disease could not be transmitted without an active lesion. *See id.*

The court noted first that the determination of whether insured acted intentionally is a question of fact. *See id*. at 378. It held that an insured intends to injure or harm another if *he intends the consequences of his act, or believes that they are substantially certain to follow. See id*. 378.[7] On reviewing the propriety of a summary judgment in favor of the carrier, the court held that evidence that evidence that the insured did not intend to injure the plaintiff created a fact issue on the applicability of the intentional injury exclusion. *See id.* at 379. [8]

The moral of the story is that reliance upon the intentional injury exclusion is less favorable to carriers. This is because of the presumption in favor of coverage attendant to the construction of exclusions. The parties to such litigation should be aware that the carrier's reliance upon terms affecting the scope of the risk covered is much more effective in restricting or excluding coverage.

Note that where there are concurrent causes of a loss, one that is covered and one that is not covered, the resolution of the insurance coverage issue depends upon whether the damage may be attributed to the covered loss separate and independent from the non-covered loss. *See Burlington Insurance Co. v. Mexican American Unity Council*, 905 S.W.2d 359, 363-64 (Tex. App.—San Antonio 1995, no writ). In the *Mexican American Unity Council* case, the court found that the carrier did not have to defend the Council against allegations that it negligently supervised one of its teen residents so as to allow her to escape and then while off premises, suffer a sexual assault. The court held that without the assaultive conduct, the non-covered cause, the bodily injury damages would not have been sustained. Since the non-covered loss was not separate and distinct from the covered claim (negligent supervision), the carrier was not obligated to defend the Council. *See id*. at 363. *See also, Canutillo Independent School District v. National Fire Ins.*, 99 F.3d 695 (5th Cir. 1996). Note, however, that at least one case holds that allegations that an insured negligently failed to supervise or monitor persons on their premises who sexually molested minors did not take them outside coverage. *See State Farm General Ins. Co. v. White*, 955 S.W.2d 474, 477 (Tex. App.—Austin 1997, no writ)(construing the intentional injury exclusion).

3) Conditions affecting coverage.

Conditions are acts or events other than a lapse of time which, unless the condition is excused, must occur before a duty to perform arises (condition precedent) or which discharge a duty of performance that has already arisen (condition subsequent). See Calamari and Perillo, *Contracts* Section 11-2 at 439 (3rd ed. 1987. Conditions do not affect the risk covered by the policy. *Love of God Holiness Temple v. Union Standard Ins. Co.*, 860 S.W.2d 179, 180 (Tex. App.—Texarkana 1993, no writ). The carrier must plead and prove facts demonstrating reliance upon a condition of coverage in order to effectuate a forfeiture of coverage. *See id.* at 180.

Some common conditions include notice of claim or loss[9] settlement with third parties,[10] and

[7] Recall that the intention of the insured to cause injury to the plaintiff was not a pivotal concern to the court in determining whether an "occurrence" was accidental. *See Trinity Universal Insurance v. Cowan, supra* at 826.

[8] There are certain sexual acts that the courts regard as intentional acts and are thereby excluded as a matter of law. *See J.E..M. v. Fidelity & Casualty of New York*, 928 S.W.2d 668, 676 (Tex. App.—Houston [1st Dist.] 1996, no writ)(sexual molestation of a minor by an adult).

[9] *See Liberty Mutual Ins. Co. v. Cruz*, 883 S.W.2d 164 (Tex. 1993)(carrier must establish that the failure to provide notice has prejudiced its defense of the claim—final default judgment established such prejudice).

cooperation clauses.[11] As noted, these conditions may form the basis of an affirmative defense of coverage forfeiture; however, the carrier must demonstrate that the insured's conduct prejudiced legal rights of the carrier. See Notes 9-11, *infra.*

C. The doctrines of waiver and estoppel generally do not expand contractual coverage.

Waiver and estoppel do not create insurance coverage where none existed in the contract of insurance. These doctrines may operate to avoid a forfeiture of coverage; that is, they may nullify conditions that might operate to deny coverage, but the doctrines cannot be used to "rewrite" the policy. These principles were illustrated in the landmark case of *Texas Farmers Insurance v. McGuire*, 744 S.W.2d 601, 603 (Tex. 1988).

McGuire involved a third party claim. McGuire was sued for damages arising out of an automobile accident. He was driving a truck owned by his employer at the time of the accident. He reported the accident to his personal insurance carrier that then took a statement from him that indicated noncoverage for the accident.[12] The insurance representative later took a second statement that solidified the fact of noncoverage. It defended the third party claim under reservation of rights but post judgment refused to indemnify the insured on the basis of the regular use exclusion. *See id* at 603. The court of appeals held, on the authority of *Employers Casualty Company v. Tilley*, 496 S.W.2d 552 (Tex. 1973), that the carrier was estopped to deny coverage since it did not advise McGuire to seek another attorney before it took the second statement. *See id*. at 603.

The supreme court disagreed and held that estoppel could not be used to enlarge the scope of coverage in this situation. It relied upon reasoning from *Washington National Insurance v. Craddock*, 109 S.W.2d 165 (Tex. 1937):

> Waiver and estoppel may operate to avoid a forfeiture of a policy, but they have consistently been denied operative force to change, re-write and enlarge the risks covered by a policy. In other words, waiver and estoppel cannot create a new and different contract with respect to risks covered by the policy.

See Texas Farmers Insurance v. McGuire supra at 603. The court found that reliance upon *Tilley* was misplaced since that case involved a forfeiture of coverage.[13]

The court did note **one exception** to the general rule that waiver and estoppel do not create coverage: **the *Wilkinson* exception.**

> If an insurer, with knowledge of facts indicating noncoverage, assumes or continues the defense of its insured without obtaining a non-waiver agreement or a reservation of rights, it waives all policy defenses, including

[10] *See Guaranty County Mutual Ins. Co. v. Kline*, 845 S.W.2d 810, 811 (Tex. 1992). The failure to obtain an uninsured/underinsured motorist carrier's consent to settle with a third party is a condition of coverage, the violation of which will forfeit coverage if carrier can establish that its subrogation rights have been impaired.

[11] *See e.g., Members Ins. Co. v. Branscum*, 803 S.W.2d 462 (Tex. App.—Dallas 1990, no writ); *Employers Liability Assurance Corp. v. Mosely*, 460 S.W.2d 201, 203 (Tex. Civ. App.—Houston [14th Dist.] 1970, no writ).

[12] The vehicle had been provided to McGuire for his regular use and was not listed on his personal policy. Any damages arising out of the use of the vehicle would have been excluded by the "personal use" exclusion in the auto policy. *See id.* at 602.

[13] At issue was the late notice defense—a condition of coverage; see Page 5, *infra;* and the case did not involve the scope of the risk covered by the policy. *See Texas Farmers Insurance v. McGuire, supra* at 603. In *Tilley*, the supreme court held that an attorney who is hired by a carrier to defend its insured in a third party case owes a duty of loyalty to the insured such that the attorney may not develop facts that permit the carrier to deny coverage to the insured. The violation of such a duty estops the carrier from relying upon the late notice provision to deny coverage. *See Employers Casualty Co. v. Tilley, supra* at 561.

> those of noncoverage, or it may be estopped from raising them.

Farmers County Mutual Insurance Co. v. Wilkinson, 601 S.W.2d 520, 521-22 (Tex. Civ. App--Austin 1980, writ ref'd n.r.e.). While the supreme court in *McGuire* mentioned the *Wilkinson* exception in dicta,[14] the case has been cited nonetheless as a viable exception to the general rule of *McGuire*. *See State Farm Lloyds v. Williams*, 791 S.W.2d 542, 553 (Tex. App.—Dallas 1990, writ denied); *Pennsylvania National Mutual Casualty Ins. Co. v. Kitty Hawk Airways*, 964 F.2d 478, 481 (5th Cir. 1992).[15]

D. The terms of the insurance contract may be enforced by a declaratory judgment action.

Parties[16] to a written contract may seek a judicial declaration of their rights in state or federal court. *See generally*, Dorsaneo Texas Litigation Guide Section 45.02. The parties must present a "justiciable controversy" to the court for determination; that is, there must be a real controversy and the controversy must be resolved by the declaration sought. *Id.*

In the third party context there are two distinct duties an insurance carrier owes to an insured: the duty to defend and the duty to indemnify. *See Trinity Universal Ins. Co. v. Cowan, supra* at 821-22. The duty to defend is determined by the complaint allegation rule[17]. *See Heyden Newport Chemical Co. Corp. v. Southern general Ins. Co.*, 387 S.W.2d 22, 24 (Tex. 1965). This means the duty is established by examining the allegations contained in the petition or complaint, *irrespective of their truth or falsity*, to determine whether the allegation fall within the coverage of the insurance. In considering such allegations, "a liberal interpretation of their meaning should be indulged." *See id*. at 26; *see also National Union Fire Ins. Co. v. Merchant Fast Motor Lines, Inc..*, 939 S.W.2d 139,141 (Tex. 1997). [18] The obligation to defend extends to both covered and non-covered claims; *see Steel Erection Co. v. Travelers Indemnity Co.*, 392 S.W.2d 713, 716 (Tex. Civ. App.—San Antonio 1965, writ ref'd n.r.e.); and the duty extends until such time as the claims are confined to non-covered losses. *See Travelers Ins. Co. v. Volentine*, 578 S.W.2d 501, 505 (Tex. 1979).

The duty to indemnify is the carrier's duty to pay a claim. *See generally* WINDT, ALLAN D., *Insurance Claims and Disputes* Section 6.01, et seq.

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[14] *See Texas Farmers Insurance v. McGuire, supra* at 603 n.1.

[15] The Fifth Circuit has explained that the exception "trumps" the "no-expanded coverage" rule when the insured shows the following:

> a. That the insurer had sufficient knowledge of facts indicating ncoverage;
>
> b. But the insurer assumed or continued to defend without obtaining an effective reservation of rights or a nonwaiver agreement;
>
> c. *And as a result, the insured suffered some type of harm.*

See Pennsylvania National Mutual Casualty Ins. Co. v. Kitty Hawk Airways, 964 F.2d 478, 481 (5th Cir. 1992). The relevant inquiry appears to be, "*Did counsel manipulate facts developed in defense of the insured in such a way as to defeat coverage?"* Development of facts irrelevant to the coverage determination does not constitute harm. *See id*. at 481.

[16] The proper parties in determining the duty to defend are the insured and the insurance carrier. *See Slinker v. Superior Insurance Co*, 440 S.W. 2d 730, 732 (Tex. App.—Dallas 1969, no writ); the same is true for the duty to indemnify. *See Gracida v. Tagle*, 946 S.W.2d 504, 506 (Tex. App.—Corpus Christi 1997, no writ).

[17] The duty is defend is much broader than the duty to indemnify since the latter is based only upon those facts found by the trier of fact. *See Heyden Newport Chemical Corp. v. Southern General Insurance Co., supra* at 25.

[18] The general rule is that reference to matters extraneous to the petition is not considered in determining the duty to defend. *See State Farm Fire and Casualty v. Wade*, 827 S.W.2d 448, 454 (Tex. App.—Corpus Christi 1992)(Dorsey, J., concurring), citing, Couch on Insurance 2d (rev. ed) Section 51.42 (1982). *See also Tri-Coastal Contractors Inc. v. Hartford Underwriters Inc. 981 S.W2d 861, 863 n. 1.*The federal practice allows reference to extraneous matters. *See Western Heritage Ins. Co. v. Rive Entertainment*, 998 F.2d 311, 313 (5th Cir. 1993)(following *dicta* in *Wade* that would permit reference to extraneous matters).

(3rd ed. 1995). It is determined by reference to the facts established by the fact finder and the burden is upon the insured to demonstrate that a loss is a covered loss. *See Paulson v. Fire Insurance Exchange*, 393 S.W.2d 315, 319 (Tex. 1965).

The duty to defend becomes ripe for the purposes of determining a justiciable controversy upon the presentation of a petition for money damages. *See Fireman's Insurance Co. v. Burch*, 442 S.W.2d 331, 332 (Tex. 1968). The duty to indemnify generally becomes justiciable only *after* a final judgment has been taken against the insured since it is at this point the facts that underlie the judgment have become established. *See id*. at 333.

The Texas practice *now* permits a prejudgment determination of the duty to indemnify under certain circumstances. In *Farmers Texas County Mutual Ins. Co. v. Griffin*, 995 S.W.2d 81, 84 (Tex. 1997) the court held that a prejudgment declaration on the duty to indemnify was proper when "the same reasons that negate the duty to defend likewise negate the duty any possibility the insurer will ever have a duty to indemnify." Griffin involved coverage under an auto policy for a drive-by shooting. The declaratory judgment was proper under such circumstances since the court found that no facts could be developed that would turn a drive-by shooting into an auto accident. *See id* at 84. *See also, National Union Fire Ins. Co. v. Merchant Fast Motor Lines, Inc.*, 939 S.W.2d 139 (Tex. 1997).

The federal practice has allowed the prejudgment determination of the duty to indemnify prior to the supreme court's rulings in *Griffin* and *National Union v. Merchant Fast Motor Lines*. See Western Heritage Ins. Co. v. River entertainment, 998 F.2d 311, 312 (5th Cir. 1993).

E. Attorneys fees are recoverable for the enforcement of a written contract of insurance; they are likewise recoverable incident to the state and federal declaratory judgment acts.

Attorney's fees are recoverable for the enforcement of a written contract. See TEX. CIV. PRAC. & REM. CODE ANN. Section 38.01 (2000). They are also recoverable in an uninsured/underinsured motorist case when the following elements are established:

1. Recovery of a valid claim on a written contract;
2. Representation by an attorney;
3. Presentation of the claim to the opposing party; and
4. Failure to pay the just amount owed within 30 days.

See id. at 552. A condition precedent to the recovery of UM/UIM benefits is that the carrier there must be evidence of a judgment or agreement that the uninsured driver was liable and legally obligated to pay the insured. *See id* at 552. In *Novosad* the carrier stipulated in opening statement that they owed the plaintiff-insured something, they just did not know how much they owed. Under these facts, attorney's fees were properly recoverable. *See id* at 552. Note that without a predetermination of the liability of the uninsured tort feasor and the amount of damages, attorney's fees are not recoverable. *See Sikes v. Zuloaga*, 839 S.W.2d 752, 753 (Tex. App.—Austin 1992, no writ).

Recall that attorney's fees and costs may be awarded under the state declaratory judgment statute. *See* TEX. CIV. PRAC. & REM. CODE 37.009 (2000). *See generally*, Dorsaneo, TEXAS LITIGATION GUIDE Section 45.06 (2000).

II. The *Stowers* Doctrine

A. The Stowers doctrine is a negligence cause of action.

An insurer that negligently fails to settle a liability claim within its insured's policy limit after having been given the specific unconditional opportunity to do so, may be liable for extracontractual damages under a common law doctrine known in Texas as the *Stowers* doctrine.

See American Physician's Insurance Exchange v. Garcia, 876 S.W.2d 842, 847 (Tex. 1994). The *Stowers* duty is not triggered unless the following elements are established:

1. The claim against the insured is within the scope of coverage;
2. The demand is within the policy limits; and
3. The terms of the demand are such that an ordinarily prudent *insurer* would accept it considering the likelihood and degree of the insured 's potential exposure to an excess judgment.

See id. at 840. A demand above policy limits does not trigger the *Stowers* duty. *See State Farm Lloyds v. Maldonado*, 963 S.W.2d 38, 44-45. Additionally, a demand letter that does not offer to unconditionally offer to release the defendant from all liability—including hospital or other medical liens—is not effective to trigger the *Stowers* duty. *See Trinity Universal Insurance Co. v. Bleeker*, 966 S.W.2d 489, 491 (Tex. 1998).

B. *Stowers* is the sole remedy available to an insured for the carrier's mishandling of a third party claim against him.

The *Stowers* cause of action is the only one available to an insured who believes the insurance company or its lawyer mishandled a third party claim filed against the insured. In the case of *Maryland Insurance Co. v. Head Industrial Coatings*, 938 S.W.2d 27 (Tex. 1996), the supreme court stated:

> Texas law recognizes ***only one tort duty*** in this context [the third party context] that being the one stated in *Stowers*. . . ..

See id. at 28 (emphasis supplied). The court refused to recognize a common law duty of good faith and fair dealing in this regard and likewise refused to recognize any causes of action based upon the Deceptive Trade Practices Act or Insurance Code.

The supreme court reaffirmed its commitment to the rule announced in *Maryland Insurance Co. v. Head* in the case of State *Farm Mutual Automobile Insurance Co. v. Traver*, 980 S.W.2d 625 (Tex. 1997). [19] In that case the insured sought to hold the carrier responsible for the malpractice of the attorney the carrier hired to defend the insured. While declining to hold the carrier vicariously liable to the acts of the "independent counsel" it hired to defend the insured,[20] it reiterated the fact that "it was unnecessary to recognize a duty of good faith and fair dealing in the context of third party liability insurance because the duty of reasonable care adopted in *Stowers* already offered greater protection for the insured." *See id*. at 629. The court likewise affirmed the proposition that the *Stowers* doctrine, in addition to the contractual rights of the insured fully protected the insured against an insurance company's erroneous *refusal to defend* a third party liability claim. *See id* at 625.

Traver did leave an opening for the prosecution of extra-contractual claims where the insured alleges that the insurer committed some misconduct of its own, such as in *Traver*, where he alleged that the insurer *consciously undermined the defense of the insured*. The case was remanded to allow Traver to pursue any remaining claims. *See id*. at 629.

[19] Traver was the personal representative of Davidson, State Farm insured who was sued in a serious accident case. Another defendant was also sued—and this other defendant was also a State Farm insured. A jury found Davdison solely responsible for the accident and a judgment of close to $500,000 was entered against him. Davidson subsequently died and his personal representative brought suit against State Farm alleging that State Farm "deliberately caused malpractice in the defense of one of its insured's to protect itself from excess liability of one of its insureds in the same litigation." That is, the carrier "orchestrated a vigorous defense of the insured with *Stowers* exposure and an inept defense of its other insured [i.e., Davidson—Traver]." *See id*. at 630 (Gonzalez, J., dissenting).

[20] This is an issue will discuss at greater in the ethics portion of this outline.

C. *Stowers* demands must be unconditional and must offer complete release of the insured defendant.

The landmark case of *American Physician's Insurance Exchange v. Garcia*, made it clear that a *Stowers* demand, no matter how reasonable in relation to the value of the case, is ineffective if it is one outside the policy limits available in the case. *See American Insurance Physician's Exchange v. Garcia, supra* at 849. The supreme court also made it clear that the to trigger a Stowers duty, the demand be one that unequivocally offers to relieve the insured of any responsibility for hospital liens. *See Trinity Universal Insurance Co. v. Bleeke*r, 966 S.W. 2d 489 (Tex. 1998). The *Stowers* demand letter should offer to release the defendant insured fully—from liens and expenses incurred in the course of the suit.

III. Ethical Considerations in the Representation of Insurers and Insureds.

A. No one can serve two masters. He will either hate one and love the other, or be devoted to one and despise the other. [21]

Although no one has said it better than that—let's review Texas view the law concerning the service of two masters. Our rules of professional responsibility provide that we, as attorneys, should not represent a person if it that representation reasonably appears to be or becomes *adversely limited by the lawyer's or law firm's responsibility to another client. See* Texas Disciplinary Rules of Professional Conduct, 1.06.[22] On the plaintiff's side of the docket the problem of serving two masters appears in the representation of multiple plaintiffs all bringing suit against a defendant for damages arising out of a particular event. The plaintiffs attorney must be careful to advise his clients that there may not be enough insurance to satisfy *all* of their claims *completely*. The supreme court made it very clear in the *Soriano* case that an insurer may properly pay a *Stowers* demand to particular claimants arising out of a accident involving multiple claimants even though such payments would exhaust the policy limit and leave no coverage for the remaining

[21] See Matthew 6:24, New American Bible. To the same effect is the Gospel of Luke. See Luke 6:13, New American Bible. A secular translation might read: "He who pays the piper calls the tune." *See State Farm Mutual Automobile Insurance Co. v. Traver supra* at 633 (Gonzales, J., dissenting).

[22] The complete Rule provides:

Rule 1.06. Conflict of Interest: General Rule

(a) A lawyer shall not represent opposing parties to the same litigation.

(b) In other situations and except to the extent permitted by paragraph (c), a lawyer shall not represent a person if the representation of that person:

(1) involves a substantially related matter in which that person's interests are materially and directly adverse to the interests of another client of the lawyer or the lawyer's firm; or

(2) ***reasonably appears to be or become adversely limited by the lawyer's or law firm's responsibilities to another client or to a third person or by the lawyer's or law firm's own interests.***

(c) **A lawyer may represent a client in the circumstances described in (b) if:**

(1) ***the lawyer reasonably believes the representation of each client will not be materially affected; and***

(2) each affected or potentially affected client consents to such representation after full disclosure of the existence, nature, implications, and possible adverse consequences of the common representation and the advantages involved, if any.

(d) A lawyer who has represented multiple parties in a matter shall not thereafter represent any of such parties in a dispute among the parties arising out of the matter, unless prior consent is obtained from all such parties to the dispute.

(e) If a lawyer has accepted representation in violation of this Rule, or if multiple representation properly accepted becomes improper under this Rule, the lawyer shall promptly withdraw from one or more representations to the extent necessary for any remaining representation not to be in violation of these Rules.

(f) If a lawyer would be prohibited by this Rule from engaging in particular conduct, no other lawyer while a member or associated with that lawyer's firm may engage in that conduct.

claims. *See Texas Farmers Insurance Co. v. Soriano,* 881 S.W.2d 312, 315 (Tex. 1994). When we as plaintiff's counsel represent, for example, an entire family that was injured in an auto accident, it is our professional responsibility to disclose and discuss the potential of such a conflict. *See* Rule 1.06(c)(2). A meaningful disclosure would include the fact that the while an individual claimant may use certain procedural devices to maximize the recovery for a single claimant,[23] the lawyer will not be able to use this device to the detriment of his other clients. My experience has been that family members regularly agree that the lawyer may proceed with the representation after such disclosure. It is the better practice, however, to get such consent in writing. Absent such consent, refer the case to a competent attorney.

The defense side of the docket presents a very challenging conflict of interest situation at this time. Over a quarter of a century ago the supreme court clearly established the duty of loyalty owed by the attorney hired by the insurer. That duty is one of complete loyalty to the insured—not the insurer. *See Employers Casualty Co. v. Tilley,* 496 S.W.2d 552, 558 (Tex. 1973).[24] This rule allowed, in one jurist's opinion, the defense attorney "to provide a single minded defense to the insured." *See State Farm Mutual Automobile Insurance Co. v. Traver,* 980 S.W.2d 625, 633 (Tex. 1998)(Gonzales, J., dissenting).

Judge Gonzales accurately described the "uneasy alliance" between insurance company and the lawyers they hire to defend their insureds. *See State Farm Mutual Automobile Insurance Co. v. Traver supra* at 633 (Gonzales, J., dissenting). He described the tension thus:

> The duty to defend in a liability policy at times makes for an uneasy alliance. The insured wants the best defense possible. The insurance company, always looking at the bottom line, wants to provide a defense at the lowest possible cost. The lawyer the insurer retains to defend the insured is caught in the middle. ***There is a lot of wisdom in the old proverb: He who pays the piper calls the tune.*** The lawyer wants to provide a competent defense, yet knows who pays the bills and who is most likely to send new business. This so-called tripartite relationship has been well documented as a source of unending ethical, legal, and economic tension [citations omitted].
>
> *See id*. at 633 (Gonzales, J., dissenting).

In this day of in-house counsel, captive counsel, and decreased demand for the services of "insurance defense" firms, the opportunity for conflicts of interest is omnipresent. Judge Gonzales did a good job of describing the realities of the market that presently affects our brothers and sister on the defense side of the docket. *See id*. at 634. His suggestions for strengthening the ability of the attorney to insist on providing services consistent with *Tilley* is the imposition of vicarious liability upon the carrier for the malpractice of the attorney it hires, the provision of a direct action against the carrier[25] and the applicability of Texas common law actions and statutory actions for carrier misconduct. *See id*. at 634. All of these are good suggestions, but they do not alleviate *the present* ethical problem facing defense lawyers.

B. Modest Proposals

1. Disclosure of facts of potential conflict cures many sins. The disciplinary rules expressly absolve the lawyer who believes he may represent client with potential conflicts if the lawyer believes that his representation will not *materially* affect the

[23] That is—a *Stowers* demand for policy limits pursuant to *Soriano* for particular clients that exhausts the policy limits.

[24] In *Tilley* the attorney hired to defend the insured in a tort action also developed evidence detrimental to the preservation of the insured's coverage. The attorney actively developed evidence that established the insured failed to give the carrier timely notice of the occurrence—a condition under the liability policy. The supreme court held that the carrier was estopped from relying upon such a condition by virtue of the undisclosed conflict of interest. *See Texas Employers Casualty Co. v. Tilley, supra* at 560-61.

[25] *See State Farm Mutual Automobile Ins. Co. v. Traver, supra* at 634. He describes the

representation and he fully discloses the facts of a potential conflict to his client. *See* Rule 1.06 9(c) (1) and (2), *infra*.

2. Don't bite the hand that feeds you—but don't feed the one that continues to bite you. If a particular carrier upon which you depend for a good percentage of your work insists on having audits (by non-legal personnel particularly), controlling the details of your work (what depositions to take, what witnesses to locate and produce at trial, what discovery will or will not be done), document these facts carefully. Recall that the majority in the *Traver* opinion refused to find vicarious liability because there was no evidence that the attorney hired was anything other than an "independent lawyer." Making a record to demonstrate that the carrier was in fact controlling the details of your work may well allow the circumvention of the imposition of vicarious liability upon the carrier.

During the mid-nineties, when the Texas supreme court was effectively emasculating leverage plaintiffs had over the insurance industry, many of my friends on the defense side of the bar chuckled with delight. Those are the very people who now, if they have jobs at all, are plagued with unreasonable audits and restrictions upon their ability to represent their insured consistent with their ethical obligations. The result is that since the insurance industry no longer needs to fear the plaintiff's bar—it no longer has any respect for the defense bar. The defense lawyer *is simply the tool* the carrier must use in a court of law.

3. Consider the Jerry Maguire proposition: take fewer clients, make less money. As outrageous as it might seem, once I decided to do both plaintiff and defense work, and not to rely upon one particular company for the bulk of my work—several different insurance companies who needed, for whatever reason, a truly independent lawyer, hired me on various cases. The amazing thing is that I would quote rates above the going "insurance defense rates" (which were reasonable and more in line with commercial practitioners) and I was hired nonetheless! [26] A beneficial by-product was that I also began getting hired by businesses and professionals who needed to be protected against their carrier in *Stowers* and other situations. Some years I make less money, some years more—but I don't lose sleep over ethical dilemmas.

IV. Conclusion

While my paper has not been exhaustive of the topic, I do hope that you will find here the major precedents to guide you in your research in the area. In the area of ethics, my advice to those who serve in the trenches is: think of our profession as a *vocation*—and not a business. Remember that your loyalty lies with your client—the one who has entrusted his livelihood to you.

[26] Recall that in Texas, once there exists a conflict of interest with the insured over the issue of coverage, the insured has the right to proceed to defend the case with the *insured's choice* of counsel. *See Steel Erection Co, Inc. . v. Travelers Indemnity Co*., 392 S.W.2d 713, 716 (Tex. Civ. App.—San Antonio 1965, n.r.e.). *See generally*, WINDT, ALLAN D., *Insurance Claims and Disputes* Section 4.22 at p. 228 n. 253 for a listing of those jurisdictions following this line of thought. This section also contains a good general description of the "six lines" of cases addressing what the insurer must do when it has a duty to defend and there is a conflict between it and the insured regarding the conduct of the insured's defense.