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A Service of Martin, Disiere, Jefferson & Wisdom L.L.P.
Principal Office 808 Travis, 20th Floor Houston, Texas 77002 713.632.1700 FAX 713.222.0101
900 S Capital of Texas Hwy, Suite 425 Austin, Texas 78746 512.610.4400 FAX 512.610.4401
16000 N Dallas Parkway, Suite 800 Dallas, Texas 75248 214.420.5500 FAX 214.420.5501

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ALLEGED MISHANDLING OF THIRD PARTY LIABILITY CLAIMS DOES NOT EXPOSE CARRIER TO CERTAIN TORT CLAIMS

Recently, the Houston First Court of Appeals addressed the validity of various tort claims against a liability insurer arising out of the insurer's handling of a third party tort claim against its insured. In *Taylor v. Allstate Ins. Co.*, 2011 WL 1233331(Tex.App. – Houston [1st Dist.] March 31, 2011), Robert Taylor was involved in an automobile accident in which the passenger of the other vehicle was catastrophically injured. The family of the injured passenger brought suit against Taylor. Allstate retained outside counsel John Causey as defense counsel for Taylor. At mediation, Taylor settled the automobile accident suit for an amount that exceeded his insurance coverage. Allstate tendered policy limits. Taylor then filed a lawsuit against Allstate to recover the additional costs paid by Taylor to settle the case. Allstate moved for summary judgment, alleging that a *Stowers* claim is the only common law claim cognizable under Texas law for an insurer's alleged mishandling of a third party claim against its insured. The trial court granted Allstate's motion.

The Houston First Court of Appeals found Taylor's vicarious liability claims failed as a matter of law. Specifically, the court held that the vesting of control and responsibility in the attorney precludes an insurer from exercising control over the attorney's representation of the insured to the degree necessary to justify the imposition of vicarious liability. And, with respect to Taylor's negligence claim, the Court held that Texas law does not recognize a negligence claim by an insured against his insurer based on alleged mishandling of the defense of a third party claim.

The Court further noted that Taylor's claims for tortious interference were based on alleged conduct which fell within Causey's legal representation of Taylor. The Court explained that recognizing potential liability on the part of an insurer for advocating a defense strategy with which the insured disagrees undermines the balance between the attorney's loyalty to his or her client and the insurance company's right to control the defense. The Court concluded that, under the given circumstances, Texas law does not recognize a cause of action by an insured against his insurer for tortious interference with the insured's relationship with his attorney arising out of the insured's handling of the defense of a third party claim.

With respect to Taylor's breach of contract claims, the Court explained that the nature and extent of the duties owed under a contract are determined by the contract's terms. Because Allstate provided no analysis of the terms of Taylor's insurance contract with Allstate and did not file the contract with its traditional motion for summary judgment, the Court concluded Allstate had not met its burden of proving it was entitled to summary judgment on Taylor's breach of contract claims. The Court further disagreed with Allstate's argument that the *Stowers* doctrine supplants *all* statutory causes of action an insured might theoretically have against its insurer in the context of defending third party claims. Because

Allstate asserted only a general "no cause of action" basis for summary judgment on Taylor's statutory claims without attacking any of the elements of the statutory claims Taylor asserted, the Court concluded Allstate had not met its burden of proving that it was entitled to summary judgment on Taylor's statutory causes of action.

NO COVERAGE BASED ON KNOWN-LOSS EXCLUSION

Last Thursday, in *Colony National Insurance Company v. Unique Industrial Product Company, L.P.*, No. 4:10-cv-01234, a federal District Court judge in the Southern District of Texas held that the known-loss exclusion excluded coverage for a claim involving a "batch" of faulty swivel nuts and brass fittings. In 2002 and 2003, Unique Industrial Product Company supplied Uponer Incorporated with swivel nuts and brass fittings. In June 2004, Uponer notified Unique that the nuts were failing and damaging houses. In addition, before August 2006, Uponer was aware of failed fittings that had caused damage to houses. On August 24, 2006, Unique agreed to pay Uponer current and future damages arising from the defective nuts and fittings. Colony was not a party to the agreement, nor was it notified. In November 2006, Uponer notified Unique that Ryan Homes had made claims for failed fittings and that Palm Harbor demanded replacement nuts. Uponer paid Ryan Home's damages. Uponer unsuccessfully sought reimbursement from Unique pursuant to their August 2006 agreement.

In September 2005, Unique requested coverage from Colony National Insurance Company and, in its application, disclosed its knowledge of the failed fittings, fifty-six pending claims against it, and reported that additional claims were expected. Colony issued a general liability policy to Unique, effective from October 2005 through October 2006, and was renewed until October 2007. But, Colony cancelled the policy in February 2007.

Uponer sued Unique, and Unique tendered its defense to Colony, which declined payment. In addition, a class action was brought against Uponer; Uponer notified Unique that Unique would be added as a third-party defendant. Unique tendered the defense to Colony, but Colony declined. Colony subsequently filed a motion for summary judgment seeking an order that Colony did not have a duty to defend or indemnify Unique in the underlying lawsuits.

The Court explained that Unique knew that an entire supply of nuts and fittings were defective before seeking coverage from Colony and, therefore, "[t]he entire universe of failures arising from this batch of failed nuts and failed fittings is excluded from coverage by the plain language of the policy." The Court held that the occurrences described in the underlying lawsuits were excluded from coverage by the known-loss exclusion in the policy, because Unique knew of the failures prior to inception of the policy, which was evidenced by the disclosure of such knowledge in its insurance application. The Court, therefore, found Colony had no duty to defend Unique in the underlying lawsuits.

With respect to Unique's argument that the affidavit relied on by Colony, which discussed the insurance application, should not be considered under the "eight-corners rule," the Court explained that the application was the foundation of the insurance policy and revealed facts that determined coverage. The Court held that the evidence *could be considered*, because it addressed only the "fundamental issue" of coverage.

Finally, the Court held that, because Colony owed no duty to defend, and the duty to indemnify is narrower than the duty to defend, Colony did not owe Unique a duty to indemnify.

DEMAND LETTER IS SUFFICIENT NOTICE UNDER TEXAS PRODUCTS LIABILITY ACT

Recently, in *Hartford Underwriters Insurance Co., et al v. Elite Spice, Inc*., No. 3:10-cv-00466, a federal District Court judge in the Northern District of Texas held that a demand letter to a seller seeking recovery for damages allegedly caused by a defective product is sufficient to trigger a manufacture's duty to indemnify the seller under the Texas Products Liability Act. Illes Food Ingredients purchased the spice basil from Elite Spice, Inc. to put into a spice mix used for Pilgrim's Pride Chicken that is then sold to Nestle for use in Lean Cuisine Dinners. USDA inspectors found pieces of plastic in Lean Cuisine Dinners that were traced back to Elite's basil. The USDA issued a hold order on the chicken and Nestle and Lean Cuisine rejected the chicken and demanded payment from Illes for the damaged product. Hartford, Illes' insurer, put Elite on notice of the claim and sought to include Elite's participation in a settlement with Nestle and Pilgrim's Pride. Elite refused to participate in a settlement and Hartford settled the Nestle and Pilgrim's Pride claims. Then Hartford filed a subrogation suit against Elite under §82.002(a) of the Texas Civil Practice and Remedies Code, a/k/a the Texas Products Liability Act for the losses it incurred in the settlement. The Texas Products Liability Act requires manufacturers to indemnify innocent sellers in product liability cases except in circumstances where the seller is independently liable. Elite alleged that under §82.002(a), Illes was not entitled to indemnification because no underlying lawsuit was filed against Illes.

The Court determined that a demand letter to a seller from its customer seeking recovery for damages allegedly caused by a defective product is sufficient to trigger a manufacture's duty to indemnify the seller. The Court explained that the manufacture's duty to indemnify applies without regard to the manner in which the underlying action is concluded and, therefore, a pre-litigation settlement is covered under this duty. The Court further explained that, although §82.002(a) presumes litigations will ensue, it does not specifically state that litigation is a prerequisite for indemnification. The Court also pointed out that public policy favors voluntary settlement, and that parties that settle without accruing court costs should not be barred from indemnification. The Court, therefore, denied Elite's motion to dismiss.