# Journal of Texas Insurance Law

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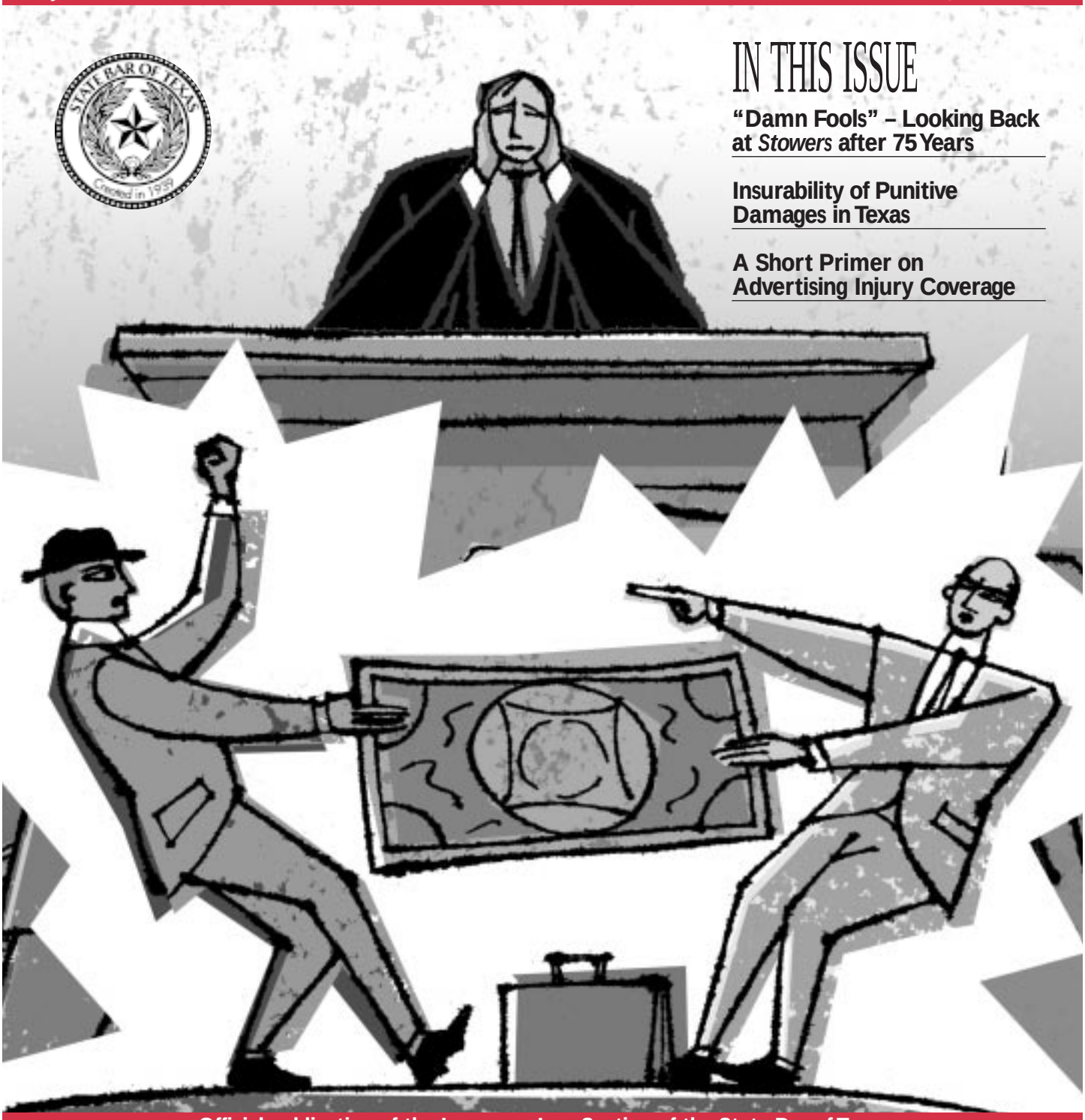

## IN THIS ISSUE



Official publication of the Insurance Law Section of the State Bar of Texas

# Journal of Texas Insurance Law

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***The Journal of Texas Insurance Law*** is published by the Insurance Law Section of the State Bar of Texas. The purpose of the ***Journal*** is to provide Section members with current legal articles and analysis regarding recent developments in all aspects of Texas insurance law, as well as convey news of Section activities and other events pertaining to this area of law.

Anyone interested in submitting a manuscript for publication should contact Christopher W. Martin, Editor of ***The Journal of Texas Insurance Law***, at 713-632-1701 or by email at martin@mdjwlaw.com. Manuscripts for publication must be typed double-spaced with endnotes (PC-compatible disks are appreciated). Replies to articles published in the ***Journal*** are welcome.





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Journal of
# Texas Insurance Law
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The Insurance Law Section of the State Bar of Texas
is pleased to present

# Our Annual Meeting with 2.75 hours of CLE at the State Bar of Texas Annual Convention

June 23, 2005
Wyndham Anatole Hotel
Dallas, Texas

The Insurance Law Section Annual Business Meeting will begin at 1:30 p.m. and will be followed by continuing legal education sessions from 2:00 p.m. – 5:15 p.m.

Learn what every lawyer needs to know about Disability Insurance and ERISA.
Hear updates on changes made during the Legislative Session and from recent insurance cases.
Find out what's new and what's not in the punitive damages area after Fairfield.
Discover what the hot topics are in property, liability and auto insurance.
One of the topics appealing to all lawyers practicing in the insurance industry will be "Turning Up the Heat and Deepening the Pocket - The Elliot Spitzer Approach to Handling Insurance Cases."

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Moderated by The Honorable Catharina Haynes
191st Judicial District, Dallas

Featured Speakers include:

David Disiere, Houston
Mike Huddleston, Dallas
Rusty McMains, Corpus Christi
David Pruessner, Dallas
Roger Tafel, Dallas
Mark Ticer, Dallas
Steve Walraven, San Antonio

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In addition we are delighted to have the local judiciary join us
for a reception with Section members following the program at 5:15 pm.

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**DON'T MISS THIS ANNUAL EVENT**

***Sponsored by***
The Insurance Law Section of the State Bar of Texas

You may indicate your interest in attending this program on the registration form
for the State Bar of Texas Annual Convention.

# Comments FROM THE CHAIRMAN

BY PATRICK J. WIELINSKI
Cokinos, Bosien & Young

I had the opportunity to hear a presentation by Kelly Frels, our State Bar President, at a recent State Bar Council of Chairs meeting. While he spoke on several matters, his primary topic was the improvement of the standing of the legal profession in today's society. According to Kelly, frivolous lawsuits and highly publicized multimillion dollar jury verdicts are one of the primary reasons for the negative perception of lawyers by the public. Take the much-publicized McDonald's scalding coffee case that was widely perceived as a frivolous claim for damages by a lady having spilled coffee on her lap. What was often lost in news reports was the fact that the plaintiff suffered third degree burns requiring skin grafts, that the coffee was at 183º, much higher than at most restaurants and that the defendant knew of 700 similar claims over the past ten years and that the plaintiff made a settlement demand of $20,000 that was rejected. Of course, the result was the much-publicized $2.9 million verdict including $2.7 million in punitive damages. Most importantly, what was eventually overlooked was the fact that on appeal the jury award was reduced to $640,000 with the plaintiff assigned 20 per cent of the fault. A similar example, somewhat closer to home is the *Ballard v. Farmers Insurance* case in which a $32,000,000 judgment for toxic mold infestation of a home was awarded, but was subsequently reduced on appeal to $4,000,000 in actual damages.

Kelly Frels cites these cases as examples of where the American justice system eventually worked—after appeal. As lawyers, we need to take every opportunity to set the record straight as to such publicized examples.

These examples not only negatively affect the legal profession, they also affect the insurance industry. Readers of this journal are most likely connected to the insurance industry, whether as insurance defense counsel, coverage counsel for insurers and insureds alike, inhouse counsel, insurance regulators, or as counselors to commercial clients as to insurance and risk management matters. While the justice system may have worked on appeal, the costs of defense and appeal in defending these suits, usually by a liability insurer for the defendant, can cause premiums to drastically increase and in some instances, coverage to contract or disappear.

Aside from the costs of defending new, innovative and sometimes admittedly frivolous lawsuits, the public perception of the insurance industry has also suffered as a result of the reporting of scandals relating to collection of contingent commissions recently and alleged bid rigging in the placement of insurance. The investigation spearheaded by Attorney General Eliot Spitzer in New York is likely to spread to the rest of the country. Like the legal profession, the image of the insurance industry, as a whole, has suffered because of the reported conduct of the few.

As lawyers with some connection to the insurance industry, we have a dual obligation, not only to uphold the integrity of the legal profession, but also the insurance industry in the face of attacks that often are a reaction to publicity that provides an incomplete picture. Whether we represent insureds or insurers, the integrity of the insurance industry is central to our practice. Our friends and acquaintances need to be reminded that if verdicts such as those discussed in this commentary, and scandals in the insurance industry were not so rare, they would not be newsworthy.

A PowerPoint setting out the comments of Kelly Frels can be accessed at www.texasbar.com/BOD. Scroll down to "Outreach Center" and click on "The Role of Lawyers in Today's World." In addition, the fallout of the Spitzer investigation will be a topic at our section CLE at the State Bar of Texas Annual Meeting on June 23, 2005 in Dallas.

Patrick J. Wielinski

BY VINCENT MORGAN AND MICHAEL QUINN

# "Damn Fools" – Looking Back at *Stowers* after 75 Years

## INTRODUCTION

It was a dark and stormy night.[3] When this classic story began on the evening of January 23, 1920, Mamie Bichon was a passenger in a taxi that collided with a truck owned by the G.A. Stowers Furniture Company. The legal principle resulting from this chain of events, a defending liability insurer's duty to accept reasonable settlement demands within policy limits, is known to virtually all lawyers, adjusters and other insurance professionals who routinely deal with liability issues in Texas. To think of the rule another way, it has stood as a cornerstone of Texas law for so long[4] that virtually every current practitioner (young and old alike) who knows of its existence learned the *Stowers* doctrine soon after their entry into the field.[5] While they have seen other aspects of Texas insurance law change over the course of time, this particular doctrine remains largely – or at least mostly – unaltered from its original form.[6] Because of its importance, *Stowers* and its progeny have been the subject of countless demand letters and status reports, numerous judicial decisions,[7] CLE speeches and law school classes, a host of scholarly writings,[8] and probably more than a few sleepless nights. Many of these examples have centered around the contours of the *Stowers* doctrine and its application in various scenarios.

Our focus is a bit different. This past spring, *Stowers* quietly celebrated its seventy-fifth anniversary as a landmark of Texas law.[9] In light of this occasion, we thought it might be useful to take a step back in time and revisit the original case from a number of different angles. Because *Stowers*-type cases necessarily involve "litigation about litigation," we will begin by examining the facts and people involved in both the underlying personal injury lawsuit as well as the insurance dispute. We will then review the arguments put forth by the parties, and in one instance, by a lawyer who filed an amicus brief. This topic will be followed by an analysis of the resolution of those arguments by the various courts involved. Part of this analysis will include some surprise data – there was a dissent written in the (nearly) controlling court, and we have run across no one who was aware of its existence. Thus, the primary approach will be a historical one. We wish to shed light on the case not only because it is vitally important to the insurance jurisprudence of Texas, but also because it is an interesting story that is worthy of being told. It is our hope that by engaging in this retrospective look at the case, some new insights can be gained into the legal doctrine and that interested readers can get a brief look at the colorful history of this case, not to mention the State of Texas, along the way.[10]

## THE ACCIDENT

Today, the intersection of Austin Street and Capitol Avenue[11] in Houston is unremarkable. Three corners are surface parking lots, while a nondescript low rise building of recent vintage occupies the fourth. There are two streetlights, and the intersection is very well lit. About five blocks away at the corner of Walker and Fannin sits the old Stowers building.[12]

In contrast to today, the intersection was likely very different eighty-four years ago. Again, it was raining very heavily that night. Bichon's petition described the events as follows:

> That about the 23rd day of January 1920 and about the hour eight forty five P M (8:45 P M) defendant, G.A. Stowers Furniture Company had … left… one of its large furniture vans… on Austin Street in… such a way as to obstruct a portion of said street on which it had placed no lights, that the night was dark and… a very heavy rain was falling which made it difficult for anyone driving on said Austin street to see said furniture van… [or much else, perhaps]
>
> . . . .
>
> …[a] few minutes prior to the hour of 8:45 P M [plaintiff] left her place of business on the corner



Vince Morgan[1] is with the Houston office of Pillsbury Winthrop. His practice has concentrated on litigating insurance coverage disputes, as well as advising clients on insurance and risk management issues.

Michael Sean Quinn[2] is the founder of his own boutique law firm in Austin. He both practices law and testifies on various subjects, including insurance coverage and professional malpractice.

> of Main Street and Congress Avenue… and entered [a] rent car [presumably something like a taxi], belonging to defendant, Jamail, for the purpose of going to her home in the southern portion … of Houston.
>
> . . . .
>
> Plaintiff would further show that the driver of defendant, Jamail, was going in a southerly direction on Austin Street and that about the 700 block on said street the said driver… was going at a tremendous rate of speed, being some twenty or thirty miles an hour,[xiii] and that while so running at said tremendous rate of speed he drove into and came into collision with the said furniture van… hitting the said van with tremendous force, throwing this plaintiff from said rent car… under the said furniture van thereby injuring this plaintiff…

Bichon's Original Petition, at 1-3. Clearly, "tremendousness" was thought of differently in 1920 and was very important to Bichon, or her lawyer.

The liability theory against Stowers had two basic components: (a) the truck's obstruction of the road; and (b) the fact that the truck had no operating warning lights or watchman at the time of the accident, as we shall presently see.

In her Original Petition, Bichon made only brief remarks concerning the truck. In her Amended Petition, she alleged:

> [The truck] had no lights upon it of any character and especially had no red light in the rear thereof and was left without anyone being in charge thereof and without any warning or signal of any character around the same to warn approaching vehicles of the presence of such automobile truck.

Bichon's Amended Petition, at 4. Like many lawsuits, however, the plaintiff's petition told only part of the story. In responsive pleading, Stowers:

> [a]nswered by a general demurrer and general denial, and further specifically pleaded that… the driver[14] of its truck, while driving his truck in a careful manner, ran into a wagon that had been left by its owner on the streets without a light on it of any sort; that [the] force of the collision with the wagon damaged the defendant's truck so that the motor was disabled to such an extent that the engine could not run and that the fender was bent down upon the tire so that it was impossible for the driver to move the truck; that the truck in question was a Ford truck, with the lights connected directly to the motor, and that the electricity that furnished the lights to the truck was generated by the motor, and therefore, since the engine or motor was disabled so that it could not run, the lights would not burn;[15] that the driver of the truck, as soon as he discovered the condition, went as quickly as possible to the nearest telephone for help, and, although gone from the truck only a few minutes, the rent car in which plaintiff was riding ran into the truck which was still standing immediately behind and against the wagon in question. The defendant further pleaded that the fact that the truck was on the streets without a light at the time and place in question was not due to any act of this defendant, but to the act of the unknown owner of the wood wagon. [S]towers Furniture Company further pleaded that the rent car in which plaintiff was riding would have struck the wagon in question if the defendant's truck had not previously hit it, and on account of the damages received remained immediately behind the wagon.

*Bichon*, 254 S.W. at 608. Stowers's answer set up the key factual dispute in the case. Bichon pleaded that Stowers was negligent for abandoning the truck and not leaving a watchman at the scene to warn oncoming traffic of the hazard. As set forth in its answer, however, Stowers maintained that its driver "went as quickly as possible to the nearest telephone for help," and was "gone from the truck only a few minutes."[16] Stowers also pleaded causation, arguing that the taxi would have hit the wagon anyway had the truck not done so beforehand.

## BICHON'S INJURIES

As for damages, Bichon pleaded that her back and kidneys were injured, and that she received abrasions to her face and head. More importantly, it was also alleged that she:

> [s]uffered a bad wound which cut and lacerated her throat, injuring the thyroid glands and [that] some sharp instrument cut or penetrated her throat to a depth of nearly an inch, cutting some arteries, which caused her a great loss of blood[17]…
>
> . . . .
>
> She further shows that she is informed by her physician and charges the truth to be that the force with which she was thrown from said automobile was such that it inflicted either a strain or rupture

> on one of the valves of her heart and said injury is very dangerous as it is liable to prove fatal at nearly any time and she fears the same is incurable.

Bichon's Original Petition, at 3-4. Thus, Bichon alleged cuts, bruises, arterial bleeding of the neck, and heart damage, at least some of which was a consequence of being thrown from the cab.

Her medical expenses, including a one week stay in St. Joseph's hospital along with a surgical procedure and follow-up visits by two doctors, amounted to $174.[18] Additionally, she claimed to suffer swelling, heart palpitations, and chest pains. Lastly, she alleged that the accident resulted in a heart murmur that ultimately led to valvular disease. Bichon's Amended Petition, at 6. In her prayer, she sought $20,000 as damages for the injuries, $174 in medical expenses, and $33 for her clothes that were destroyed. She did not specifically seek lost wages, although they probably occurred. Hence, most of the damages she sought would today be categorized as compensation for pain and suffering.

## THE PLAYERS

### The Parties

#### 1. Mamie Bichon

Mamie Bichon worked at Cockrell's Drug Store, located on the corner of Main Street and Congress Avenue in Houston. In her First Amended Original Petition, she was referred to as a "feme sole." [19] She was repeatedly described in the pleadings and testimony as a pleasant woman and a "respectable white business lady."[20] There is no question that she sustained injuries in the accident, although just how severe they actually were remains unclear.

#### 2. The G.A. Stowers Furniture Company

George Arthur Stowers founded the G.A. Stowers Furniture Company. Mr. Stowers died in 1917 at the age of 50, about three years before Ms. Bichon's accident. Born in Georgia just after the close of the Civil War, he was a remarkably successful businessman. The HANDBOOK OF TEXAS ONLINE, published by the Texas State Historical Association, offered this biography:

> Out of his savings from a two-dollar-a-week job in a candy company he was able at seventeen to start his own furniture store in Birmingham, Alabama, with $500 capital. By the time he was twenty-three he was operating ten stores in Alabama, Tennessee, and Texas; San Antonio, Dallas, Waco, and Fort Worth were the Texas outlets. Stowers moved his business from Birmingham to Dallas in 1889, but soon thereafter he located in San Antonio, where his business succeeded to the extent that it eventually changed the city's skyline. His first furniture stores were on West Commerce Street; by 1910 he had one of the largest retail businesses in San Antonio and had built a ten-story building (a "skyscraper" at that time) at the corner of Main and Houston streets. He also opened furniture stores in Houston and Laredo. Stowers's ranch holdings outside San Antonio were extensive.[21]

*…Mr. Stowers did not live long enough to see his business change the landscape of Texas insurance law.*

Unfortunately, while his business may have "changed [San Antonio's] skyline," Mr. Stowers did not live long enough to see his business change the landscape of Texas insurance law.[22]

#### 3. American Indemnity Company

Based in Galveston, the American Indemnity Company was incorporated in 1913 by Joseph F. Seinsheimer. His son, Joseph F. Seinsheimer, Jr. took over the company in 1951.[23] During the 1990's, Joseph F. Seinsheimer III ran the company until its acquisition by the United Fire & Casualty Company in 1999.[24] Thus, it lasted seventy-six years as an independent entity.

### The Lawyers

There were many lawyers involved, but a handful in particular played key roles.

#### 1. Norman Atkinson

Mr. Atkinson, along with his father (who later became a Harris County judge), represented Ms. Bichon in the personal injury lawsuit. Subsequently, he served as co-counsel with John Freeman in the lawsuit against American Indemnity following the final resolution of Bichon's case.

#### 2. John H. Freeman

Freeman was a partner in Campbell, Myer & Freeman, and was regular counsel to the Stowers Furniture Company. In 1924, he became the third partner in the law firm of Fulbright, Crooker & Freeman, which is still well-known in

Houston and now elsewhere.[25] He later served as city attorney for Houston in 1928-1929 and also prepared the legal documents setting up the M.D. Anderson Foundation, which funded the beginnings of the Texas Medical Center.[26]

### 3. Ben Campbell

Born in 1858, Ben Campbell was mayor of Houston from 1913-1917. Given the seriousness of the case, Freeman turned over the lead role of defending Stowers to Campbell, who was the senior litigator in their firm. Campbell tried Bichon's case alongside Mr. Patterson, who was engaged by the insurer. During his tenure as mayor, Houston's first parks were established and Campbell's administration was credited with paving the way for the development of the Port of Houston.[27] In fact, his daughter christened the port during its opening ceremony on November 10, 1914.[28] Campbell died in 1942, survived by his wife and six children.

### 4. R.C. Patterson

Robert Clendening Patterson was appointed by American Indemnity to defend the underlying case for Stowers. Once Stowers brought suit against American Indemnity, he was again engaged by American Indemnity. Patterson defended the carrier in the insurance lawsuit. Prior to forming the firm of Fouts & Patterson, he was an attorney with Baker Botts (then known as Baker, Botts, Parker & Garwood). Educated at Vanderbilt, Patterson was a distinguished lawyer. After practicing with Elwood Fouts for about fifteen years, he finished his career as a solo practitioner from 1935 until his retirement in 1951. Patterson died in 1952.[29]

## The Jurists

### 1. Judge Monteith

Walter E. Monteith, who presided over the trial of the *Stowers* case as judge of the 61st Judicial District Court of Harris County, was quite an extraordinary fellow. Born in 1877, he served in the Boer War and ran rubber and banana plantations in Nicaragua.[30] Attending both college and law school at The University of Texas, he played football on the first undefeated Longhorn team. Monteith even took a leave of absence from the bench to serve as a private in field artillery in World War I.[31] He went on to become mayor of Houston from 1929-1933.[32] Later, he served on the First District Court of Civil Appeals from 1939 until his death in 1953.[33]

### 2. Justice Critz

Richard Critz, the author of the key opinion, spent much of his legal career in public service. Born in Mississippi, he worked as a farmhand and teacher before becoming a lawyer. He held various positions such as city attorney in Granger and judge in Williamson County, where he was instrumental in the construction of a new courthouse.[34] Critz also assisted Georgetown district attorney Daniel Moody in prosecuting members of the Ku Klux Klan in the 1920's.[35] In 1927, Moody became governor and appointed him to the Commission of Appeals.

Critz served in that capacity until 1935 when Justice William Pierson was brutally murdered by his son.[36] Governor Allred appointed him to succeed Pierson on the Texas Supreme Court.[37] During his tenure, Critz wrote hundreds of opinions and was considered both industrious and influential.[38] After losing a heated election battle, he left that bench in 1944 and returned to private practice in Austin with Lloyd Mann, Emmett L. Bauknight, F.L. Kuykendall, and Pierce Stevenson.[39] Dying on April 1, 1959 at the age eighty-one, Critz was survived by his wife of fifty-three years and three of his four children.[40]

### 3. Judge Nickels

Born in 1882,[41] Nickels went to law school at The University of Texas. He served as a member of the Texas House of Representatives and Assistant Attorney General. Before and after his service on the Commission of Appeals from 1925 until 1929, Nickels was in private practice in Dallas with former U.S. Senator Joseph W. Bailey and his son, U.S. Congressman Joseph W. Bailey, Jr., at Bailey, Nickels & Bailey. Nickels died relatively young in 1933 at the age of 51, but like Justice Critz, he also passed away on April 1. *Id.*

He served on the Commission of Appeals with Richard Critz and J.D. Harvey.[42] Collectively, these three judges comprised Section "A" of the Commission of Appeals in the year that *Stowers* was decided. Judge Nickels wrote the dissenting opinion in the *Stowers* case that, for reasons unknown to us, never made it into the *South Western Reporter*. The reporter contains no dissenting opinion; neither do the online versions available from Westlaw and Lexis. The majority opinion gives no hint of a dissent. It was only through reviewing the files of the Texas State Archives that this opinion was discovered, and it will be discussed below.

## THE OUTCOME OF THE UNDERLYING LAWSUIT

Bichon sought a total of $20,207 in her lawsuit. Her lawyers extended two settlement offers. The first was for $5,000, and the second was for $4,000. Neither offer was accepted. Settlement negotiations having failed, the case went to trial. On appeal, the court held that the evidence was sufficient for the jury to conclude:

> This truck, the motor of which had been so damaged by a collision with a broken-down wagon, which had been left in the street by some unknown person, that the truck could not be moved and its lighting system could not be operated, was left in this condition by its driver for more than an hour before the car in which appellee was riding collided therewith.[43]

Therefore, the Court upheld the jury's factual findings and apparently their decision to disregard the driver's testimony concerning the length of time he was gone. The jury awarded Bichon $12,207.[44] With costs of suit and interest, the judgment came to $14,103.15.[45] Following an unsuccessful appeal and denial of review by the Supreme Court, Stowers paid Bichon and then brought suit against American Indemnity for the full amount of the judgment.

## THE *STOWERS* CASE[46]

### The Policy

Interestingly, this was a "lost policy" case, as the original was "misplaced."[47] Using the following year's policy, Stowers proved up the contents of the missing one. In exchange for a premium of $607, Stowers obtained an "Automobile Public Liability and Property Damage Policy."[48] Although there are some differences from modern policies, the basic structure is largely the same. It began with the insuring agreements, followed by certain conditions (including the exclusions), and then concluded with a number of schedules and endorsements. The relevant defense obligation stated:

> AMERICAN INDEMNITY COMPANY
>
> * * * *
>
> DOES HEREBY AGREE
>
> * * * *
>
> Defense. (A) TO DEFEND in the name and on behalf of the Assured any suits even if groundless, brought against the Assured to recover damages on account of such happenings as are provided for by the terms of the preceding paragraphs.[49]

The policy also spoke to the rights and obligations of the parties concerning settlements:

> [T]he Assured shall not voluntarily assume any liability, settle any claim or incur any expense, except at his own cost, or interfere in any negotiation for settlement or legal proceeding without the consent of the Company previously given in writing. The Company reserves the right to settle any such claim or suit brought against the Assured.[50]

It was against this backdrop that the insurance case unfolded.

### The Pleadings

Worth remembering is the fact that this case arose prior to the onset of "notice pleading." Consequently, the pleadings on both sides were fairly elaborate.[51] One interesting point is that Stowers said its truck hit the wagon "at about the hour of seven o'clock p.m." Stowers's Second Amended Petition, at 3. It also stated that Jamail's car hit the truck "at about 8:30 or 8:40 p.m. . . ." *Id.* at 4. Stowers got to the heart of the case with the following allegation:

> [D]efendant[,] who was conducting plaintiff's defense in said underlying cause, had to rely for this defense upon the naked statement of this plaintiff's said servant who was a *Negro boy*[52] and interested in clearing or showing himself guilty of no wrong, whereas the said Mamie Bichon had *two reputable white witnesses* who were in nowise interested in the suit who testified in their behalf that they saw the truck standing where it had collided with the wagon at about seven o'clock that night… and the undisputed evidence showed that the accident did not occur until more than an hour later – all of which facts were well known to defendant long prior to said trial, or could have been known by it by the exercise of ordinary care and diligence.

Stowers's Second Amended Petition, at 8 (emphasis added).[53] By way of legal allegations, Stowers stated:

> [I]t became the duty of the defendant… on taking charge of plaintiff's defense in the aforesaid suit to conduct same in good faith and for this plaintiff's interest as well as for the defendant's own interest and without negligence on the part of said defendant; and that it further became the duty and obligation of said defendant to conduct said suit and to make such settlement with … Miss Bichon or her attorneys as the reasonably prudent person would have made under the same or similar circumstances for the protection of this plaintiff's interest…

*Id.* at 9.[54] This position, modified and narrowed somewhat, became the *Stowers* doctrine.

American Indemnity responded with its own lengthy and elaborate pleading. As to the legal duty, it argued that the petition failed to state a claim. With respect to the relative worth of the testimony of the driver versus the two disinterested witnesses, American Indemnity pleaded:

> Defendant specially excepts to that part… for the reason that this court will not consider that white witnesses are more truthful than black or that a negro boy was interested, as he was not a party to the suit, or that a negro boy may not be as reputable as a white witness, and that said allegations are prejudicial and inflammatory and improper…

American Indemnity's Second Amended Original Answer, at 2. Thus, the insurer "accused" Stowers's lawyers of racism. In addition to failure to state a claim, American Indemnity also pleaded that the case did not justify a settlement of $4,000. Further, American Indemnity claimed that even if it did breach a duty, it was a contractual one, and hence, Stowers was put to the election of either kicking the insurer out of the defense and suing it or continuing to allow performance through trial and appeal. Since Stowers allowed American Indemnity to continue to defend the case through trial and the appellate process, American Indemnity contended that Stowers had therefore waived, or was estopped from asserting, what in American Indemnity's view was at most a breach of contract claim. At its core, American Indemnity's position was that it did all that it was required to do by faithfully and reasonably defending its insured until the Supreme Court's denial of review and then offering to pay the full limits of its policy. Freeman testified that he argued with Patterson on this issue, pointing out the unfairness of this position to the insured. Unfortunately, the testimony makes no other reference to this point.[55]

*We wish to shed light on the case because it is an interesting story that is worthy of being told.*

## The Trial

Six witnesses testified at the trial. Stowers called Norman Atkinson, I.P. Walker (the manager of its Houston store), and John Freeman. American Indemnity called Ben Campbell, R.C. Patterson, and W.L. Hartung, the last of whom was the head of American Indemnity's claims department. Seven witnesses were excluded, including Bichon, her employer, the two witnesses who first saw the truck at the accident site, the doctor who examined her for life insurance before and after the accident, and her treating physicians at the hospital. These witnesses were the "Irrelevant Seven." Although the trial court and the Court of Civil Appeals held their testimony was irrelevant, the Commission of Appeals later reversed this ruling.[56]

Mr. Atkinson was the first witness. While testifying, he recalled discussing the case with Patterson and Freeman many times prior to the trial of Bichon's suit:

> Mr. Patterson's contention was that the Stowers Furniture Company's truck had been disabled,… a few minutes before the accident by running into a wagon that had been left there, and that the negro driver had gone to secure assistance by telephone; and that the truck at the time of the accident had only been there just a few minutes, some ten, fifteen or possibly twenty minutes, the accident having taken place at about eight or eight twenty. I told Mr. Patterson we had two reputable white men who would testify they had seen that truck there at around or just before seven o'clock, about an hour and a half before the accident.

SF at 15-16. Thus, the length of time the truck sat unattended was a key factual dispute in the underlying case. The defense contended it was only a short time, just long enough to go and summon help via telephone. Bichon, on the other hand, contended that the truck was there for more than an hour, giving the driver ample time to summon help and return to the truck to warn oncoming traffic. Not only was this an important factual dispute, but the racial backdrop was a constant issue in both the underlying case and the subsequent insurance case.

Atkinson also testified about Bichon's injuries, stating that Dr. Alvis E. Greer conducted an independent medical evaluation of Bichon. Dr. Greer's report, which was introduced into evidence,[57] indicated that she told him she was rendered unconscious for about forty-five minutes after the accident. Ultimately, he concluded that she had pre-existing valvular disease, but that the accident may have aggravated the condition. *Id.* at 18-19. Bichon had her own doctor, though, who examined her for a life insurance policy before the accident and re-examined her after the accident. It was expected that this doctor would have testified that he detected a heart murmur in the subsequent examination that was not present prior to the accident. *Id.* at 19-20. Thus, there was a conflict in the medical opinions.

As noted before, Bichon's lawyers made two offers of settlement. The first, of $5,000, was summarily rejected. Subsequently, a $4,000 offer was made and rejected. Atkinson testified:

> It is true that the American Indemnity Company was not willing to pay as much as we demanded in settlement, leaving a difference between what it was willing to pay and what we were willing to accept. Mr. Patterson's attitude was that he was going to put it up to Stowers, and if Stowers wanted to pay the balance they would be able to put the settlement over, otherwise not.[58]

Mr. Walker, the manager of Stowers's Houston store, testified next. He explained that, the morning after the accident, Stowers gave notice of the matter to its insurance agent, and Patterson was engaged "the next day or two after the accident." *Id.* at 48-49. After suit was filed, the insurance company gave Stowers the opportunity to have its counsel assist with the defense, and at that point, Freeman and Campbell became involved.[59] SF at 50. Walker testified that "the first communication I had with Mr. Patterson was when he wrote me a letter, telling me that he was representing the American Indemnity Company." *Id.* at 54. As for the $4,000 settlement offer, Walker stated:

> Mr. Patterson… came by the store one morning and discussed with me a proposition of settlement, claiming that Atkinson & Atkinson had come to him and offered to settle for $4,000.00, and asked if we would be willing to put up fifteen hundred dollars of that amount, stating that the American Indemnity Company was willing to pay twenty-five hundred dollars,[60] but would not go any further than that. I discussed it with Mr. Patterson quite a bit, and he impressed on me that this was going to be a pretty serious case…

SF 26-27. Walker then testified as follows:

> I told Mr. Patterson that I thought we had insured with a pretty good company, and that they should take care of us without bringing us into court, in as much as it could be settled for less than the amount of the policy, and that we would not put up any part of it in settlement. Mr. Patterson said if the case was not settled it would go to trial, and they were only liable for five thousand dollars and that it was so near the amount of their policy they were willing to take a chance on it.

SF at 27. On redirect, he testified about the following exchange:

> I told Mr. Patterson I thought his company should go ahead and settle this claim without bringing us in to any kind of litigation; that it was a crime for us to carry insurance and pay for it, and then they would not pay what little claims we might have. He told me he thought that was a fair settlement, a good settlement, and the thing should be settled, but they would not put up over twenty-five hundred dollars.

SF at 64. He also testified that Patterson said "the case was dangerous, and he thought [the insurer] ought to settle…" Id. at 28.[61] Interestingly, in a letter to Jamail's attorneys, Walker stated his view of the matter:

> The night of this accident the police were called to the scene and they immediately exonerated our driver, stating that he was not to blame under the circumstances, and if there is really anybody who is to blame… it should be the man who left his wagon in the street without a light of any kind…

SF at 52. If the police did indeed exonerate Stowers, it is curious to us why the defense did not make this a central point of their case. Nevertheless, it is also interesting that Stowers's manager found fault with the wagon on the same basis that Bichon found fault with Stowers.[62]

> Finally, Walker testified that after the conclusion of Bichon's case:
>
> [The insurance company] offered to pay the five thousand dollars with interest on it up to that time, providing we would give them a release. I refused to give them a release and they would not pay me. I would not give them a full release of their liability under this policy in connection with

*Following an unsuccessful appeal and denial of review by the Supreme Court, Stowers paid Bichon and then brought suit against American Indemnity for the full amount of the judgment.*

> this accident because we were figuring on suing them; immediately after the case was affirmed we figured on doing that.[lxiii]
>
> Freeman was the next witness. As to the conflict in the testimony, he stated:
>
> [T]he facts as contended by our negro driver and the plaintiff's facts supported by their two witnesses; we were conscious there was going to be a conflict there. In discussion [of the matter] we took into consideration the fact that the plaintiff's witnesses were reputable white men.

*Id*. at 76. Continuing, Freeman also noted that if the plaintiff's witnesses were correct, "then our defense simply was not a defense." *Id*. at 79. After discovering what the testimony of these witnesses was expected to be, "[Mr. Patterson and I] went to work a little more seriously trying to get a settlement of the case." *Id*. at 80.

> Ultimately, he characterized the case as one:
>
> [I]n which there probably would be no recovery, or else a recovery very considerably in excess of the five thousand dollars that had been discussed as the limit of this insurance policy, dependent upon how the jury viewed this conflicting testimony, and based further upon how the jury considered the injuries that this young lady had received.

*Id*. at 81. Freeman and Patterson each went back to their respective counterparts to inquire about the prospect of putting together a settlement fund for the plaintiff. Stowers's position was that it should not pay any amount of a settlement less than five thousand dollars, and they were of the "impression that it was the duty of the insurance company to make settlement of that case if it could be settled for less than five thousand dollars, and relieve them of any liability of loss over five thousand dollars." *Id*. at 83. Freeman then stated:

> To be perfectly frank, Mr. Patterson and I told each other that both of our clients were damn fools . . . [T]hat his insurance company was foolish in not coming up a little above twenty-five hundred dollars, and that [Stowers] was foolish if it could get rid of a law suit with the potentialities this one had by putting up some amount not to do it. Just as a broad proposition, that a suit of this kind had potentialities and I think our language was that they were damn fools not to do it.[64]

American Indemnity's first witness was Stowers's lead trial lawyer, Ben Campbell. He thought Stowers had a good case below. He believed Perry's story, and he doubted that Bichon was as injured as she had claimed. Nevertheless, he was cognizant of the disadvantage a corporation had when defending itself against the claims of an injured woman who was faultless. Remember that Bichon was merely a passenger in what was essentially a taxi-cab. In fact, Campbell went on to state that he "knew that [the underlying action] was a dangerous case." SF at 100. He knew this before it went to trial.

Perhaps the most telling indicator of Campbell's view of the case was given at the close of his cross-examination. Here is what he said:

> Assuming that a suit was brought by a young lady against a corporation, and that the principal defense of the corporation was based on the testimony of a colored boy in their employ; and assuming that the evidence of the colored boy was that it was only fifteen minutes from the time of the collision between the truck and the wagon, and the accident, and that the testimony of two reputable white men was that they saw that truck in the position where it was at the time of the accident from an hour to an hour and a half before the accident could have occurred, they saw it there at about seven o'clock at that place and the accident didn't occur until about eight twenty, *I would say under those circumstances there would be [a] very serious danger of losing the case, because it was a negro, and the circumstances detailed.*

SF at 101-02 (emphasis added). Race thus played a significant role in this lawyer's thinking. How else might it have been relevant?

The head of American Indemnity's claims department, W.L. Hartung, testified as the last witness in the case. On cross-examination, the Stowers attorneys[65] pressed him to identify cases in which the company paid more than fifty-percent of the limit of a given policy. In response to this line of questioning, he testified:

> It is pretty hard for me to recall the particular instances and the style of a case where the company paid the full limit of their policy without anybody contributing anything, because in handling claims for the company for a period of ten years I could not recall that…
>
> . . . .

> I don't know that I can name you a single case where my company paid the full limit of their liability under the policy without trial and without somebody else contributing something to that settlement. I said there was such a case but I could not give you the name of it. I will state here under my oath that to the best of my recollection there have been such instances but I cannot recall a specific case now.
>
> . . . .
>
> I cannot give you the name of any specific case where the company paid more than half, I could not tell you in what town it happened or when it happened. I could not tell you the name of the assured nor the agent who handled it. All I can tell you about that matter is that such a case happened. I don't know the place where it occurred, what court it was in, the name of the fellow that got the money nor the company to whom the policy was issued in any single instance. Instead of my having a recollection about such an instance it may be an impression.

SF at 168-69.[66] This, from the head of the insurance company's claims department. Today, most lawyers would find such testimony shocking. Viewed under current standards, Hartung is probably admitting that American Indemnity violated TEX. INS. CODE ANN. art. 21.21(4)(10)(a)(ii), and perhaps in every case in the company's history until that point.

Following the closing of the evidence, Judge Monteith withdrew the case from the jury and rendered judgment in favor of American Indemnity. Thus, the insurer won the trial handily, as a matter of law. Stowers appealed.

## THE APPEALS

### The Court of Civil Appeals

As we shall see, an intermediate appellate court ruled twice on this case. We turn now to the first ruling.

#### 1. Stowers's Arguments

Stowers put forth two propositions in the beginning of its opening appellate brief. When taken together, these propositions form the basis of the *Stowers* doctrine. They were:

> FIRST PROPOSITION
>
> Where an insurance company for a valuable consideration to it in hand paid undertakes to insure one against loss and stipulates that it is to have the sole settlement of any cases, if any settlement is made, and also stipulates that it has the sole right to appear and defend on the behalf of the assured, then such insurance company is held to that reasonable degree of care and diligence which a prudent man would exercise in the management of his own business.
>
> SECOND PROPOSITION
>
> Where it is manifest to the insurance company during the progress of the litigation that a trial of the cause is practically certain to result in a verdict and judgment against the assured in excess of the liability of the policy, it is the duty of the insurance company to make a settlement of said cause, if the same can be done within the limits of the amount of its liability as fixed in its policy.

Stowers's Brief, at 7-8. The first proposition focuses upon the key element of control of the defense and settlement, and it speaks in terms of negligence. The second proposition addresses the potential for excess judgments that may be avoided where settlement can be had for an amount within the limits of the policy. It does not, however, formulate the standard by which that duty should be judged. Thus, only when these two propositions are taken together can the full contours of the *Stowers* doctrine be seen.

After setting out its view of the case, Stowers went through a lengthy summary of the testimony from the trial to paint a picture of Bichon's case as well as the events surrounding the defense and failure to settle. It began its arguments with this:

> To hold that one, who, for a valuable consideration, enters into a contract with another by which he has exclusive control of all litigation that may arise and which litigation he agrees to defend on behalf of the person with whom he has contracted, has a right to disregard the interest of the one with whom he has made a contract and consult his own interest only, seems to us to be utterly abhorrent to the plainest principles of justice.[67]
>
> For the present, we confine this discussion to the question of whether the acts of the Indemnity Company in this litigation fulfilled its obligation to the Stowers Furniture Company or constituted a fraud upon said company.

*Id*. at 44. Both sides took liberties with the facts, as litigants occasionally do. Stowers argued:

> The evidence of Mr. Hartung also authorizes the conclusion that it was the fixed policy of defendant company not to pay more in any case than one-half of the amount of liability on its policy.

*Id*. at 46. This was a fair inference from Hartung's testimony, but it was only an inference. Stowers varied between arguing that the evidence supported this conclusion and that it established it as a fact, which was central to its pleading of fraud. In other words, Stowers argued that American Indemnity had an unwritten settlement sublimit of half of the policy limits.

Stowers then cited a handful of cases from around the country (since none existed in Texas at the time) with similar facts and in which the insurers were held liable for failing to make reasonable settlements within the limits of their respective policies, as well as an A.L.R. annotation. It then concluded with a brief argument:

> The meaning of the policy in controversy may be a little obscure where in effect it provides that the insurance company shall pay where lawfully liable. We think a fair interpretation of the meaning of this provision of this policy is that if under all the circumstances, it is the duty of the insurance company to settle the loss, it is certainly lawfully liable to do so.

Stowers's Brief, at 51. Note the insured's use of the word "fair." Its final paragraph stated:

> In this cause, the defendant insurance company has, by its conduct, inflicted on the Stowers Furniture Company, a loss of thousands of dollars. It did this rather than pay Fifteen Hundred Dollars for which it was legally liable or at least the evidence of its legal liability was certainly sufficient to go to a jury to be heard and determined by them.

*Id*.

**2. American Indemnity's Response**

American Indemnity began with a number of counter arguments. The first three in particular are noteworthy:

> FIRST COUNTER PROPOSITION
>
> In a policy of indemnity insurance against loss resulting from liability imposed by law, such as is involved in this suit, the undertaking of the insurance company in the contract is to defend and pay a judgment, and, in the absence of fraud, there can be no liability on the part of the insurance company for refusing to settle a case, the company never having agreed… to settle the same in the contract.
>
> SECOND COUNTER PROPOSITION
>
> The provision for settlement involved in this case is a mere option to be exercised by the insurer, should it elect to do so for its own benefit, as distinct from that of the assured and the insurance company is under no obligation to exercise it otherwise than for its own benefit.
>
> THIRD COUNTER PROPOSITION
>
> As long as there is even a remote chance of recovering a verdict or securing a judgment for less than the amount of the policy, there can be no duty upon the insurance company to settle upon the policy.

American Indemnity's Brief, at 4.[68] In contrast to Stowers's negligence approach, American Indemnity took the position that this was a contractual issue. Its argument began:

> Every case must be tried upon some legal theory that will support a recovery. The relation of the parties is wholly governed by the contract. If plaintiff has a case and if there has been any breach of any duty, it must be of an express or implied contractual duty resulting from the relations of the parties, as evidenced by the contract or read into the contract by operation of law because of the relation of the parties resulting therefrom. In other words, the duty must be a contractual one, or what is legally termed a quasi-contractual one.

*Id*. at 16. Noting that it agreed to defend any suit but did not agree to settle every suit, it stated:

> Naturally, having undertaken the defense in the contract and having contracted to defend, there are duties in connection with the defense of a law suit to use care,[69] but there is no such duty in connection with the settlement under the policy, there having been no agreement, either express or implied, to settle.

*Id*. at 17. American Indemnity then argued:

> If an insurance company has such duties as appellants claim, they would necessarily settle

> all cases, for they would have no hope of convincing a jury after judgment that they had acted with reasonable care.[70]

By characterizing it as a contractual issue,[71] American Indemnity set up the defenses of waiver and estoppel. It correctly noted that, by virtue of Stowers having its own lawyers in the case, the insured knew all the facts surrounding Bichon's lawsuit. It also correctly noted that Stowers did not sue at the time of the failure to settle, but instead allowed American Indemnity to continue performing under the contract by paying Patterson to defend the case through trial and even through the appellate process. Of course, the insurer pleaded these defenses below.

> As a result of these facts, American Indemnity argued:
>
> [T]he G.A. Stowers Furniture Company is attempting, and, if successful in this case, will have done two things. First: It will have reaped the benefit of the representation in the defense of the case by the insurance company and its lawyers and the other services in the way of investigation, payment of costs, and all other matters. Secondly: In addition to securing the full performance of the contract, it will secure damages for a breach thereof. In other words, if their position is good law, the G.A. Stowers Furniture Company can sit idly by and await final outcome of their lawsuit. If the Insurance Company is successful in its defense, or does not have to pay more than $5,000.00, it gets off scot free.[72] If, on the other hand, the suit is ultimately lost, although the contract of defense has been carried to completion, yet the insurance company must pay a sum of money far in excess of the amount it agreed to pay, and the Stowers Furniture Company in addition to having secured the performance of the agreements of the company recovers in addition for a supposed breach of the contract.

American Indemnity's Brief, at 54-55. Continuing, it made the following analogy:

> [I]f an insurance company undertakes the defense of a policy it would waive the fact that the accident was not covered by the policy or that there had been some prior breach of it by the insured. Why is it not equally true that when the insured goes ahead with the performance of the contract and permits the insurance company to do so and by its actions permits it to defend said insured has not waived any breach that existed and is it not also estopped from asserting it?

American Indemnity's Brief at 56-57. In sum, American Indemnity's position was that no duty was owed, no duty was breached, and even if a duty was owed and breached, then Stowers had waived the right to complain about it.

### 3. The Court's Opinion

In the Court of Civil Appeals, American Indemnity again won outright. After thoroughly stating Stowers's position, the court held:

> We do not think the Indemnity Company was, by the terms of the policy, under any obligation to do more than faithfully defend the suit. [I]t had not agreed to settle the suit, but had reserved the right to do so.

*Stowers I*, at 261. Continuing, the court went on to state:

> Under the facts shown, the Indemnity Company had the right to refuse the proffered settlement and to defend the suit against a larger recovery or any recovery whatever, no matter how slender its chances of success. It was not under obligation to abandon what it believed to be a defense to the suit because there was a strong probability that a refusal of a settlement would result in the rendition of a judgment in excess of its liability under its policy, and settle the suit for $4,000 so as to assure the Furniture Company against loss.

*Id.*73 Thus, the judgment of the trial court was affirmed. *Id.* at 261-62.

## The Commission of Appeals

Before continuing, a short discussion of the history of this institution is worthwhile. First created by the Legislature in the late 1870's, the Commission of Appeals was established to assist the Supreme Court.[74] As the Supreme Court had only three members at the time, the Commission was designed to help relieve an ever-increasing caseload. After being revived in 1918, the Commission took the form it was in when *Stowers* was decided, having two sections with three judges each.[75] All decisions by the Commission required approval or adoption by the Supreme Court. The court was effectively disbanded in 1945, when an amendment to the Texas Constitution increased the number of Supreme Court justices from three to nine, and

the Commissioners then in office were automatically elevated to fill the new places on the Supreme Court. *Id*.

**1. Stowers's Brief**

Stowers first filed a petition for writ of error, with a thirty-odd page brief in the Supreme Court. Later, it filed a comparatively short brief in the Commission of Appeals, at less than ten pages. It repeated most of its original points, but it also expressed its arguments in new ways. For instance, Stowers summarized its position as follows:

> [The insurance company] was bound to do two things by its contract: one was to defend on behalf of the Company and the other was its implied obligation to make a settlement if that seemed to be the wise and prudent thing to do. When the Indemnity Company bound itself by its contract to defend against any suit or claim on behalf of the insured, it certainly obligated itself to do something more than to permit the insured to be dragged into a hopeless lawsuit or one in which there was great danger of losing.

Stowers's Brief, at 3. Continuing, Stowers argued:

> Of course, if the agreement to defend in behalf of the insured does not mean anything and is merely a delusion and a snare, then the decisions of the trial court and of the Court of Civil Appeals are right, but if that agreement means that good faith should be exercised by the Indemnity Company in protecting the insured and that the Indemnity Company will not knowingly pursue a course by which it will lose the insured many thousands of dollars in order to save itself a few hundred dollars, then the decisions of the lower courts are wrong.

*Id*. at 5.

**2. American Indemnity's Response**

Unfortunately, we were unable to locate a copy of American Indemnity's response to Stowers's principal brief. One can guess what it probably said, given the success of the insurer's brief in the Court of Civil Appeals.

3. The Majority Opinion

Justice Critz's majority opinion began by noting:

> This case involves issues that are questions of first impression in this court, and are so important to the jurisprudence of this state that we deem it advisable to make a very full and complete statement of the issues involved.[76]

*Stowers*, at 544. After reciting the facts, the court held:

> We are of the opinion that the plaintiff's petition states a cause of action against the defendant for the amount sued for, and that the evidence in the case raised an issue of fact to be submitted to the jury by the trial court under proper instructions.

*Id*. at 546. Continuing, it adopted Stowers's position, stating:

> Certainly, where an insurance company makes such a contract; it, by the very terms of the contract, assumed the responsibility to act as the exclusive and absolute agent of the assured in all matters pertaining to the questions in litigation, and, as such agent, it ought to be held to that degree of care and diligence which an ordinarily prudent person would exercise in the management of his own business; and if an ordinarily prudent person, in the exercise of ordinary care, as viewed from the standpoint of the assured, would have settled the case, and failed or refused to do so, then the agent, which in this case is the indemnity company, should respond in damages.
>
> . . . .
>
> The provisions of the policy giving the indemnity company absolute and complete control of the litigation, as a matter of law, carried with it a corresponding duty and obligation, on the part of the indemnity company, to exercise that degree of care that a person of ordinary care and prudence would exercise under the same or similar circumstances, and a failure to exercise such care and prudence would be negligence on the part of the indemnity company.

*Id*. at 547. After discussing various cases from other jurisdictions, the court concluded:

> In our opinion the other authorities… sustain the rule announced by us, and, while there are authorities holding the contrary rule, we are constrained to believe that the correct rule under the provisions of this policy is that the indemnity company is held to that degree of care and diligence which a man of ordinary care and prudence would exercise in the management of his own business.

*Id*. at 548. The court agreed with Stowers on the evidentiary points as well, noting that "all the facts and circumstances surrounding [Bichon's] injury, are material as bearing on the question of negligence on the part of the indemnity company in failing and refusing to make the settlement." *Id*. Lastly, the court held that the testimony concerning American Indemnity's "rule" of never making a settlement for more than half the amount of the policy should have been admitted as bearing on the issue of negligence on the part of the insurer. *Id*. All of these holdings were in turn approved by the Supreme Court.[77]

**4. The Lost Dissent**

Countless lawyers, scholars, adjusters and other insurance professionals have read Justice Critz's opinion and thought this was all there was to the case. As previously noted, however, Judge Nickels wrote a dissenting opinion. Beginning as many opinions do by stating the case and the relevant facts, Judge Nickels did so succinctly:

> Accident transpired; suit followed; defense was conducted by the Company and the assured; "trial of the issue" was had; final judgment declaring liability in excess of "indemnity" stipulated resulted. The Company's obligation to pay $5,000, plus interest from "entry of judgment" and costs, matured and payment thereof is required in the judgment before us.

Dissenting Opinion, at 3.

Continuing, the opinion addressed the heart of the case by noting that the insurance company's "obligation… is sought to be extended…" because of the facts involved in the handling of the underlying lawsuit.[78] After reciting these facts, Judge Nickels responded:

> But the very gamble which was made by the Company and by the assured in declining the offer was by them left open when their contract was made. The possibility that a judgment in any suit for damages for personal injuries (especially internal ones) may be for a sum either more or less than the amount of indemnity named affords a probable reason for lack of contractual terms specifically requiring a settlement by either party.

*Id*. The dissent argued that, "for aught that appears," the contract was negotiated at arm's length, and "its terms cannot be re-cast so as to impose that liability sought to be established in this case." *Id*. Next, the dissent went through each case Stowers cited as authority for its position, painstakingly distinguishing them from the instant case. Following this analysis, Judge Nickels seized on a distinction between a duty to pay "upon ascertainment of liability" and a duty to pay after liability is established at trial. He felt that the *Stowers* case was more like the latter type rather than the former, and for this reason he recommended that the Court of Civil Appeals be affirmed. We will not dwell on it further, but as it was left out of the published reporter and lost to history, this dissenting opinion is at least worth a passing discussion.

**5. Subsequent Developments**

Following the decision, American Indemnity filed a Motion for Rehearing in the Commission of Appeals, and then filed a motion directly with the Supreme Court asking it to withdraw the motion from the Commission of Appeals and decide the matter itself.

In support of this Motion for Rehearing, J.W. Gormley filed an amicus brief. A lawyer at the Dallas firm of Touchstone, Wight, Gormley & Price,[79] he was very interested in the outcome of the Stowers case, and asked the Clerk of the Texas Supreme Court to:

> [P]lease remind [the Chief Justice] for me that if the Court adheres to the opinion as written by Judge Critz, it will put us insurance lawyers out of business.

Gormley letter, at 1. Continuing, he stated:

> In this case the Commission [of Appeals] simply elected to follow a line of minority decisions without carefully examining their *rationes decidendi*. This is a pardonable error, but if it is not corrected, a new and intolerable burden will be placed upon us Texas lawyers, – a burden that will take all the fight out of us; and a lawyer without courage, yea, without even daring, is of little help, either to clients or to courts.

*Id*. He concluded:

> [W]e are really fighting for our bread and butter as lawyers in this matter, as well as for the interests of several clients, who will be very much embarrassed if the original opinion in this case is suffered to stand.

*Id*. In contrast to Gormley's prediction that the decision would "put us insurance lawyers out of business," American Indemnity's motion for direct review by the Supreme Court argued it was:

> A matter of so much importance to the people of this State and involves untold sums of money and will cast upon the Courts of this State great volumes of litigation hitherto not tried…

Motion to Withdraw, at 2. Where Gormley saw a drought, American Indemnity saw a flood.[80]

As for his amicus brief, Gormley wrote it on behalf of Standard Accident Insurance Company, which was subsequently merged into Reliance Insurance Company in 1963.[81] Like his letter, Gormley's brief is filled with sensational prose. It is an entertaining read, filled with quotations from Cardozo and Lord Westbury.[82] In it, Gormley advances two main points. First, the duty is based in terms of the "reasonable person," when, according to Gormley, it should be couched in terms of the "reasonable lawyer."[83] His second point is that a case with uninsured exposure is really two lawsuits – one below the limit and one above it. Thus, Gormley suggests that a contribution scheme like the one American Indemnity proposed to Stowers is proper in such cases. Gormley's first point is incorrect because the duty really should be measured from the standpoint of a reasonable person, as lawyers can only recommend to clients that settlements be accepted or rejected, but ultimately the decision is the client's to make (or the insurer's, in the case of most liability policies). Either way, it is not a lawyer's decision. Gormley's second point is unworkable, as even back then parties knew that the vast majority of all lawsuits settled for amounts less than their true potential.[84] Furthermore, after seventy-five years of Stowers, parties have come to rely on it.[85] By way of example, insureds rely on it when determining the amount of liability limits they should purchase, how closely they should monitor cases with excess exposure, and sometimes how a corporation should report such lawsuits in public filings. Even excess carriers have come to rely on it when dealing with cases that should be settled by underlying carriers.[86] Gormley's arguments were untenable back then, and this is even more true seventy-five years later.

After the case was remanded to the trial court following the decision in *Stowers II*, and now that it was deemed a negligence action by the Commission of Appeals, American Indemnity filed another Second Amended Answer. In its second Second Amended Original Answer, American Indemnity changed its contract defenses of waiver and estoppel into a negligence defense of contributory fault. It alleged that Stowers, having had its lawyers working side by side with the insurance company's lawyers, knew all the facts of Bichon's lawsuit as well, and if the underlying case were as bad as Stowers later made it out to be (*i.e.* one that should have been settled), then Stowers was itself guilty of negligence for not capping the exposure by settling within policy limits. Thus, it set up a contributory fault/failure to mitigate defense.[87]

## THE FINAL CHAPTER

More than ten years after Bichon's accident, Stowers finally got the chance to take its case to a jury. Here is what happened.

### "Gentlemen of the Jury"[88]

Following retrial in the 11th Judicial District Court of Harris County, the judgment recited the sole special issue and the jury's answer, which were:

> "Special Issue No. 1.
>
> Would a person in the exercise of ordinary care in the management of his own business under the facts and circumstances known to the American Indemnity Company or its counsel in charge of the case, prior to the trial of the suit of *Mamie Bichon v. Stowers Furniture Company*, have settled said suit for Four Thousand Dollars? Answer Yes or No as you may find."
>
> To which Special Issue the jury answered: "Yes."

Judgment, at 1.[89] The jury submission raises at least three interesting questions.

First, it refers to "facts and circumstances known…" In Bichon's case, the facts were very well known. What about cases in which certain key facts are unknown? Should the carrier treat unknowns as if they would be adverse to the insured in the underlying lawsuit? Can the carrier disregard unknowns altogether? Can it guess as to what it thinks the truth really is?

Second, it refers to facts "known to the American Indemnity Company or its counsel." What if counsel knew of certain problems, such as his own failure to designate expert witnesses in a technical dispute, but he failed to inform the carrier? Under this formulation, the carrier would be responsible in any event because "its counsel" was aware.[90]

Third it speaks only in terms of "prior to the trial…" Suppose a case looks defensible prior to trial, and then a surprise witness comes forward in the middle of trial who brings new evidence to light that completely negates the defense's theory. Does the duty to settle apply then? Or can the carrier rest comfortably, knowing that it did not need to settle it "prior to the trial?"

Some of these questions are obvious and have already been answered, but some remain open to this day. In any event, Stowers prevailed at the retrial, and it ultimately obtained a judgment for $19,309.85.[91]

## One Last Appeal

American Indemnity appealed when it lost this time, re-urging its arguments from before. This time, the Court of Civil Appeals rejected American Indemnity's position, noting that the jury verdict in the second trial "finally settled this controversy." *Stowers III*, at 956. As they have been amply discussed, we do not repeat these arguments here. We note only one item worth mentioning from Stowers's Reply Brief – its response to American Indemnity's "have your cake and eat it too" argument:

> The appellant attempts… to set up some kind of waiver by appellee… on the ground that the appellant did certain things after the breach complained of, from which the appellee received benefits. We have sought earnestly to see what benefits appellee has received from the so-called performance of appellant in the trial of the Bichon case, and the only thing that we find is that the case was so managed by the appellant, (American Indemnity Company) that appellee had to pay out some $14,000.00. A few more performances like that and appellee would cease to exist. It is a new proposition for a party to a lawsuit to so conduct it as to cause its clients to be mulcted in a sum in excess of $14,000.00, and then claim it has acquired merit…[92]

Following its unsuccessful appeal, American Indemnity's writ of error was refused.[93] Thus, the case was finally at an end, more than a decade after Bichon's accident.

## VISTAS IN RESEARCH[94]

In the course of our work on this project, a number of issues appeared worthy of further exploration. While there are many, we identify only a handful of possibilities:

1. A thorough treatment of the racial issues involved in this case and others of this type. Our space limitations did not permit us to examine the topic beyond this article's scope, but these issues clearly warrant careful study.

2. An investigation of the evolution of the *Stowers* doctrine from the "ordinarily prudent *person*" standard set forth in the original opinion, to more recent formulations that occasionally speak in terms of an "ordinarily prudent *insurer*…"[95] Was this evolution purposeful, or simply accidental?

3. A discussion of the various perspectives from which the duty can be measured. An ordinarily prudent person? An ordinarily prudent attorney? An ordinarily prudent insurer? Although we touched on this point, a more thorough analysis of each position would be worthwhile in our view.

4. An analysis of the roles of the lawyers in this case. From all we have seen, they were lawyers of eminent skill, reputation and integrity. Nevertheless, they switched clients and testified at trials where their firms were acting as counsel. On top of these points, there is always the thorny issue of the tripartite relationship, a problem that continues to vex lawyers, litigants and courts even to this day.[96] Exploring this in connection with the evolution of modern professional responsibility rules would be interesting.

5. An analysis of Patterson's role in particular is enough for a short paper. Walker testified that at "…the trial of the case… Mr. Patterson [was] representing the insurance company and working with Mr. Campbell who represented us, and the[y] cooperated with each other in the trial of the case." SF at 62. Freeman testified that "Mr. Patterson was representing the insurance company…" *Id*. at 78. Campbell remarked that he "took part in the defense of that Bichon case, Mr. Patterson and I together; I represented the Stowers Furniture Company and Mr. Patterson represented the insurance company." *Id*. at 98. Patterson even thought he represented the insurer, stating that "I do not remember how many letters I wrote to my client, the American Indemnity Company…" *Id*. at 146. Later, however, Patterson went on to blur the line, stating that "the insurance company undertook to and did furnish the lawyers, my firm, to contest the case and represent the Stowers Furniture Company, in conjunction with their lawyers." *Id*. at 150.

6. An empirical analysis of the accuracy of American Indemnity's prediction that if the *Stowers* duty exists, then insurance companies "would necessarily settle all cases, for they would have no hope of convincing a jury after judgment that they had acted with reasonable care."[97]

7. Similar studies of other landmark insurance cases. Our own insights into the *Stowers* doctrine have deepened because of this process, and we hope it will encourage like ventures with other important cases. *Tilley*[98] may be an appropriate candidate for the next such project.

## CONCLUSION

As seventy-five years have passed since the *Stowers* doctrine was first laid down, now seemed like a good time to step back and review this historic case. In light of what we learned, we wondered who among the parties involved in the case are left standing today. Of course, Fulbright & Jaworski is stronger than ever.[99] American Indemnity, though it has since been sold, is still licensed to sell insurance in Texas. The Stowers Furniture Company remains in business today, noting on its website that it has been "creating beautiful homes in San Antonio since 1890."[100] We found nothing current on Fouts & Patterson, and no word on Gormley's firm, either.

We have seen how the case came about by examining the facts surrounding both the personal injury lawsuit and the subsequent insurance litigation. We also discussed the arguments put forth by the parties and the resolution of the competing positions by the courts involved. While those who deal with Stowers know its doctrine well, hopefully the readers of this article will come away with a deeper appreciation of the case itself.

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2. Michael Sean Quinn is the founder of his own boutique law firm in Austin. He both practices law and testifies on various subjects, including insurance coverage and professional malpractice. He is a former Chair of the Insurance Law Section of the State Bar of Texas, and has taught at the University of Texas School of Law, Southern Methodist University Dedman School of Law and the University of Houston Law Center.

3. Actually, the court said the night was dark and rainy, though we feel comfortable that it was also stormy. *G.A. Stowers Furniture Co. v. Bichon*, 254 S.W. 606, 609 (Tex. Civ. App.—Galveston 1923, writ dism'd w.o.j.)("That appellee was injured… on a dark, rainy night… is shown by the undisputed evidence."). In fact, it was the heaviest rainfall in Houston's recorded history for a 24 hour period in January at the time. *Expect Cold Wave to Follow Heavy Downpour of Rain*, HOUSTON CHRONICLE, Jan. 24, 1920 at 1. As an aside, the newspaper had another article reporting the accidents that resulted from the storm. Notably, Ms. Bichon's accident was not among them. *Slippery Streets Cause Accidents*, HOUSTON CHRONICLE, Jan. 24, 1920 at 8.

4. The first judicial reference to the "*Stowers* doctrine" that we found was in 1960. *F.M. Chancey v. New Amsterdam Cas. Co.*, 336 S.W.2d 763, 766 (Tex. Civ. App.—Amarillo 1960, writ ref'd n.r.e.). It was referred to as a "landmark case in this state" as early as 1963. *Bostrom v. Seguros Tepeyac*, S.A., 225 F. Supp. 222, 224 (N.D. Tex. 1963).

5. Sometimes it is learned sooner than that. The case is regularly studied in courses on insurance law, and it is even discussed in some first-year tort classes.

6. So-called "*Stowers* demands" may now have to be slightly more explicit than they did in the past.

7. A search performed using Westlaw's Keycite program on October 6, 2004, showed that *Stowers* has been cited in 216 cases, with 445 references in total. Candidly, we expected this figure to be higher. One possible explanation could be that courts now cite to more recent expositions of the *Stowers* doctrine, such as *Am. Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 847 (Tex. 1994). There is some breadth to the citations, though, with decisions from more than two dozen jurisdictions, including courts in Alabama, Arkansas, Connecticut, Florida, Georgia, Illinois, Kentucky, Massachusetts, Mississippi, Missouri, Montana, New York, Ohio, Oklahoma, Oregon, Rhode Island, Utah, Washington, Wisconsin, Vermont, the Virgin Islands, and the U.S. Courts of Appeals for the 5th, 7th, 8th, and 10th Circuits. *Id.*

8. THE JOURNAL OF TEXAS INSURANCE LAW routinely publishes significant articles on this important subject. *See, e.g.* Brent Cooper, *Essential Requirements to Trigger a Duty under the Stowers Doctrine and Unfair Claims Settlement Practices Act*, 4:2 J. TEX. INS. L. 7 (June 2003); Randall L. Smith & Fred A. Simpson, *The Liability Insurer's Dilemma: Should a Good Faith But Mistaken Belief There is No Coverage Absolve an Insurer of "Stowers" Liability?*, 4:3 J. TEX. INS. L. 2 (November 2003).

9. To be precise, the decision was handed down on March 27, 1929, making its seventy-fifth anniversary March 27, 2004. As an aside, March 27 is a particularly significant date in Texas history generally. On that day in 1836, the Mexican army executed hundreds of Texas revolutionaries at Goliad, *available at* http://www.historychannel.com/tdih/tdih.jsp? month=10272955 &day=10272992&cat=10272948 (last visited Apr. 21, 2004).

10. A brief note about the conventions we will use is in order. This article discusses four key decisions (which comprise a total of five opinions with the "lost" dissent included), including the appeal of the underlying lawsuit and the three appeals in the insurance action. We refer to the appeal of the underlying lawsuit, reported in *G.A. Stowers Furniture Co. v. Bichon*, 254 S.W. 606, 609 (Tex. Civ. App.—Galveston 1923, writ dism'd w.o.j.), simply as *Bichon*. We refer to the first appeal of the insurance suit, reported in *G.A. Stowers Furniture Co. v. Am. Indem. Co.*, 295 S.W. 257, 261 (Tex. Civ. App.—Galveston 1927), as *Stowers I*. The second appeal of the insurance suit, which is the opinion cited for the *Stowers* doctrine and reported in *G.A. Stowers Furniture Co. v. Am. Indem. Co.*, 15 S.W.2d 544 (Tex. Comm'n App. 1929, holding approved), is referred to as either *Stowers* or *Stowers II*. Finally, there was a third appeal after the re-trial of the insurance lawsuit, reported in *Am. Indem. Co. v. G.A. Stowers Furniture Co.*, 39 S.W.2d 956 (Tex. Civ. App.—Galveston 1931, writ ref'd), and this decision is referred to as *Stowers III*. Also, we will draw heavily from the testimony at the trial of the *Stowers* case, and our citations to the Statement of Facts will be prefaced with the abbreviation "SF." Pleadings, briefs or other papers from the cases are identified as appropriate. As these pleadings were prepared on typewriters for the most part, we have taken the liberty of editing typographical errors in the passages we quoted. Thus, while some excerpts were not reproduced quite verbatim, they are substantively the same and any changes are purely cosmetic.

11. When we began this project, we thought the accident occurred at the corner of Austin and Leeland, some nine blocks southwest of Austin and

Capitol. In preparation for the 2003 Annual State Bar Meeting, *Texas Lawyer* provided a map of noteworthy points of interest for attendees who might be so inclined. Among these was the "*Stowers* Case Accident Scene," listed as being at the corner of Austin and Leeland. Kelly Pedone, *Get Ready for Hot Hip History: Houston State Bar's Annual Meeting Offers Sightseers Plenty to Do*, TEXAS LAWYER, June 9, 2003 at 20. However, after reading the trial transcript and other materials we obtained in researching this article, we later became convinced that the accident actually took place at the corner of Austin and Capitol. The amended petition in the underlying lawsuit lists the accident scene as happening at the 700 block of Austin, which is the corner of Austin and Capitol. Bichon's Amended Petition, at 4. Further, the bill of exceptions filed by Stowers in response to the exclusion of Bichon's testimony states that she would have testified the accident happened "near the corner of Austin Street and Capitol Avenue." Transcript, at 29.

12. This ten-story building, located at 820 Fannin, still has the word "Stowers" emblazoned on it. Long vacant, it is currently undergoing renovation and seeking occupants, *available at* http://www.stowersbuilding.com (last visited Nov. 30, 2004). Perhaps an enterprising mediator with a flair for irony will move in and use history as an extra incentive to encourage reluctant parties into settling.

13. At the time of the accident, the applicable speed limit was 10 miles per hour. Bichon's Original Petition, at 2.

14. The truck driver's name was Otis Perry. SF at 64. Mr. Perry was about twenty years old at the time. *Id.* at 101. We have discovered nothing else about his life.

15. Consequently, the issue was not that the truck was missing the required lights, but that the lights were disabled because the engine was rendered inoperable as a result of the collision with the wagon. The tongue on the back of the lumber wagon went through the truck's radiator and disabled the motor. SF at 77. Though attempts were made to determine the identity of the wagon's owner, they were unsuccessful. *Id.* at 88, 104. An interesting question is whether, at any time in Texas legal history, Bichon might have had a cause of action against Ford for say, strict liability? The rule laid down in *MacPherson v. Buick Motor Co*., 111 N.E. 1050 (N.Y. 1916), was in existence at the time of Bichon's accident. However, it was not cited by a Texas court until 1922. *Tex. Drug Co. v. Caldwell*, 237 S.W. 968, 976 (Tex. Civ. App.—Dallas 1922, writ ref'd).

16. At the trial of Bichon's lawsuit, the driver testified that he went two to three blocks to the nearest telephone, and that he was gone for only 10 to 15 minutes. *Bichon*, 254 S.W. at 609. There was even a possibility that the driver was within earshot of the accident, and that he may have actually heard Bichon's crash. Finally, there was at least some speculation that the driver lived near the accident scene, and that he might have gone home or gone to visit a lady friend while he went to seek help. SF at 139. These alternative theories are possible explanations for the time discrepancy.

17. She later alleged that because of this cut, she "came very nearly bleeding to death…" Bichon's Original Petition, at 4.

18. Among these expenses, we note that the doctor charged $3 for a weekday visit, and $5 for a Sunday visit. *Id.*

19. Bichon's First Amended Original Petition, at 1. Interestingly, the archives of the Harris County courts also contained a file in an action for divorce filed by Leon Bichon against "Mammie J. Bichon" in 1918, two years before the *Stowers* accident. The defendant's answer spells the name as "Mamie," which is consistent with the spelling of the first name of the plaintiff in *Bichon*. Whether this is the same person is speculation, but interesting nonetheless. In any event, the marriage apparently was an unsuccessful one, as the plaintiff-husband alleged that she was "a woman of a high and ungovernable temper and disposition…," that she "made most indecent remarks about the plaintiff's dead mother…," and that she "almost constantly nagged and found fault with every thing that the plaintiff did…" Ultimately, the plaintiff alleged that the "constant ill treatment and abuse of the defendant… keeps [the plaintiff]… in such [an] unsettled state of mind that his life [is] a Hell on Earth…" *Bichon v. Bichon*, Original Petition, at 1. (Perhaps Stowers felt the same way about the plaintiff suing it.).

20. *Stowers I*, 295 S.W. at 261. But consider the immediately preceding note.

21. HANDBOOK OF TEXAS ONLINE (Ron Tyler et al. eds., 1996), *available at* http://www.tsha.utexas.edu/handbook/online/articles/view/SS/fst69.html (last visited Feb. 6, 2004). As for his ranch holdings, they remain in the hands of his grandchildren and great-grandchildren to this day. The ranch is about 25 miles west of Kerrville, in Hunt, Texas. It is open to guests for recreational usage such as hunting, hiking, and wildlife observation, *available at* http://www.stowersranch.com (last visited Apr. 26, 2004).

22. Ironically, it turned out that Stowers left a more permanent mark on Texas insurance law than he did on the San Antonio skyline. The "skyscraper" he built in San Antonio was apparently dynamited in 1981. San Antonio Conservation Society's "Milestones," *available at* http://www.saconservation.org/about/milestones_4.htm (last visited Oct. 22, 2004). Perhaps it is more fitting that only the Houston building now remains.

23. HANDBOOK OF TEXAS ONLINE (Ron Tyler et al. eds., 1996), available at http://www.tsha.utexas.edu/handbook/online/articles/view/AA/djatk.html (last visited Apr. 22, 2004). The middle Seinsheimer graduated from Tulane University in 1936 with a bachelor of business administration degree. He later became a generous supporter of Tulane's business school and endowed a professorship, *available at* http://www.tulane.edu/~akc/seins.html (last visited Oct. 18, 2004). Continuing the family tradition, the youngest Seinsheimer graduated from Tulane in 1962, *available at* http://www.freeman.tulane.edu/freemanmag/summer04/gwded.pdf (last visited Oct. 23, 2004).

24. United Fire Group, *available at* http://www.unitedfiregroup.com/investorrelations/news/19990304.asp (last visited Apr. 22, 2004).

25. Of course, this firm ultimately became what is today known as Fulbright & Jaworski.

26. HANDBOOK OF TEXAS ONLINE (Ron Tyler et al. eds., 1996), *available at* http://www.tsha.utexas.edu/handbook/online/articles/print/FF/ffr29.html (last visited Feb. 23, 2004).

27. *Memorials*, 5 TEX. B.J. 134 (1942).

28. The Port's Past, available at http://www.portofhouston.com/geninfo/overview2.html (last visited Oct. 23, 2004).

29. *Memorials*, 16 TEX. B.J. 609 (1953).

30. *Id*.

31. *Id*. That he would leave his job on the bench in order to volunteer for combat duty speaks volumes about his patriotism, or perhaps the job satisfaction of the judiciary during that era, or possibly both.

32. L. Patrick Hughes, *Beyond Denial: Glimpses of Depression-era San Antonio*, *available at* http:// www.austin.cc.tx.us/lpatrick/denial.htm (last visited Feb. 23, 2004).

33. Justice Robert W. Calvert, *Judicial System of Texas: The Appellate Courts of Texas – History, in* 361-362 S.W.2d 1-18 (1963).

34. These facts were drawn from a biography prepared by Critz's surviving daughter, Genevieve. Genevieve Critz Atkin & Brenda A. Rice, *A Biographical Sketch of Richard Critz, Texas Judge* (Dec. 1959)(unpublished manuscript, on file with the Austin History Center).

35. Ken Anderson, *How Dan Moody, '14 Destroyed the Klan in Texas*, The Alcalde (July/August 2000), available at http://www.texasexes.org/alcalde/issue-2000.07.html#feature (last visited May 4, 2004).

36. Justice Pierson and his wife were beaten and shot to death by their son Howard just outside of Austin. Howard even shot himself in the arm in an effort to cover up his crime, although he later confessed and offered a number of conflicting reasons behind the gruesome killings. Declared insane, he did not stand trial initially and was instead sent to the Austin State Hospital, from which he twice escaped. Twenty eight years after the slayings, he was pronounced medically sane and the case was later reopened for trial. Jerry Pillard, *Motive Still Obscure in Pierson's Slayings*, HOUSTON POST, Sept. 8, 1963 at 10. Prior to the confession, a young Walter Cronkite reported Howard's original story in the student newspaper for the University of Texas. Walter Cronkite, THE DAILY TEXAN, April 25, 1935 at 1.

37. At the time, the Court had only three members. It was physically located in the Capitol building, and the justices wore suits rather than robes. As a young attorney, Joe Greenhill clerked for the Supreme Court during Critz's tenure. Justice Greenhill later quipped:

> To say we served under Justice Critz is a slight exaggeration. He would have nothing to do with a law clerk. He didn't want any "boy" telling him what the law was. (laughter) He could have used the help. (laughter)

*Salute to the Honorable Clarence A. Guittard*, February 27, 1987, in 741-742 S.W.2d at XLVI, LII.

38. The memorial services held in his honor at the Supreme Court were chronicled in the Texas Bar Journal. 22 TEX. B.J. 557-58, 586 (1959).

39. Judge Mark Davidson & Kent Rutter, *The Colonel versus the Judge*, 65 TEX. B.J. 142 (2002). *See also Memorials*, 22 TEX. B.J. 545 (1959).

40. HANDBOOK OF TEXAS ONLINE (Ron Tyler et al. eds., 1996), *available at* http://www.tsha.utexas.edu/handbook/online/articles/view/CC/fcr22.html (last visited Feb. 6, 2004). His fourth child, Ella Nora (known as "Sugar"), married J.J. "Jake" Pickle before dying of cancer in 1952. He and Critz remained friends after her death, and a touching biographical piece can be found in Congressman Pickle's book, "Jake." JAKE PICKLE & PEGGY PICKLE, JAKE 197-200 (1997).

41. *Struck Down by Heart Attack, Luther Nickels Dies Suddenly*, DALLAS MORNING NEWS, Apr. 2, 1933 at 1.

42. Judge Harvey was the presiding judge of Section "A." Born in Austin County in 1873, Harvey served on the Commission of Appeals from 1925 until 1943. As an aside, Leon Bichon's 1918 divorce petition mentioned in note 19, *supra*, was filed in the 80th J.D. of Harris County, Texas and was addressed to "the Hon. J.D. Harvey, Judge of said Court." *Bichon v. Bichon*, Original Petition at 1. Harvey is listed as having served as "District Judge, 80th Judicial District, 1915-1925" in the 1937 edition of the Bench and Bar of Texas. BENCH AND BAR OF TEXAS, Vol. 1 (Horace Evans 1937). While we can only speculate, it appears that Judge Harvey may have had the opportunity to be associated with two cases involving Ms. Bichon.

43. *Bichon*, 254 S.W. at 609.

44. The judgment was against all defendants jointly and severally. Unfortunately, Jamail and his surety company were insolvent. Interestingly, at some point during this case, the name of Patterson's firm changed from Fouts & Patterson to Fouts, Amerman, Patterson & Moore. Patterson's partner, Mr. A.E. Amerman, served as mayor of Houston from 1918 until 1921. In that capacity, he approved the very bond that later turned out to be worthless. *See* Exhibit "A" to Bichon's Original Petition.

45. *Stowers I*, 295 S.W. at 258. In 2004 dollars, this figure would be worth $147,570.95. See Federal Reserve Bank of Minneapolis, *available at* http://woodrow.mpls.frb.fed.us/research/data/us/calc (last visited Apr. 22, 2004).

46. Adjusters, lawyers and judges instantly recognize the issues involved in a *Stowers*-type case, including whether an underlying lawsuit should be settled instead of tried. However, juries tend to view things through a different prism. Accordingly, it is important to keep in mind the difficulty insureds sometimes face in winning over the jury in this type of case. An excellent trial lawyer once observed that the trouble with trying to recover under a liability policy is that the insured has to prove its wrongdoing was bad enough to warrant settlement with the plaintiff(s) but not so bad that it should not be covered. There is a distinction, of course, between conduct that is *very injurious* as opposed to that which is *quite intentional*.

47. SF at 29. To recover on a lost or missing policy, the Fifth Circuit has held:

> Where the actual policy is not available, the terms of the contract can also be shown by secondary evidence. This alternative requires evidence of the policy terms, not just evidence of the existence of the policy.

*Bituminous Cas. Corp. v. Vacuum Tanks, Inc.*, 975 F.2d 1130, 1132 (5th Cir. 1992). Notably, the opinion from the Commission of Appeals mentions but does not discuss this issue. *Stowers*, 15 S.W.2d at 545-46.

48. SF at 47, 30.

49. *Id*. at 31.

50. *Id*. at 38.

51. In addition to the pleadings, the lawyers spoke with a certain eloquence as well. For example, when asked about his experience as a trial lawyer, Campbell responded:

> My experience has been largely that of a trial lawyer in all kinds of litigation. [I] couldn't tell you how many such cases I have tried, but I suppose about the average number that a lawyer tries who has been in the practice as long as I have.

SF at 98.

52. Regrettably, the racial composition of the people involved in this case was an issue during this litigation. As a result, the briefs, opinions and other materials we reviewed in researching this article contain racial epithets of this type. While we do so with much reluctance, we repeat these terms only in the quotations in order to maintain historical accuracy.

53. The petition thus laid bare the more sinister aspect of the case lurking in the background. The Court of Civil Appeals also categorized the individuals by race. *Stowers I*, 295 S.W. at 261 (referring to Perry, Bichon, and her liability witnesses by their respective races). The other courts, though, did not. *See, e.g. Stowers*, 15 S.W.2d at 545 (referring to Perry simply as one of the "…furniture company's servants…").

54. Stowers mixed bad faith and negligence together in its pleadings. For example, it stated that it was compelled to pay Bichon's excess judgment "by

reason of said defendant's lack of good faith and negligence in refusing to make settlement of said suit for $4,000 . . ." Stowers's Second Amended Original Petition, at 11. Although both are torts, one is pure negligence, the other is bad faith. In part because of *Stowers*, the Texas Supreme Court has held that there is no common-law duty of good faith duty and fair dealing in the third party context. *Maryland Ins. Co. v. Head Indus. Coatings & Servs., Inc.*, 938 S.W.2d 27, 28-29 (Tex. 1996)(per curiam).

55. SF at 85.

56. This was one of the points of dispute on appeal, but it was not a central part of Stowers's initial brief. American Indemnity's brief argued that the exclusion of these witnesses was proper because the only relevant testimony was what the lawyers and parties knew at the time the settlement was refused, which of course was prior to trial. However, since the *Stowers* doctrine is designed to avoid excess judgments, it should not be limited only to pre-trial settlement offers. Thus, if settlement at a certain sum appeared unwise before trial, but became reasonable as the trial progressed, there is no reason to think that the *Stowers* doctrine should not apply. Consequently, any evidence up to the entry of an excess judgment should be relevant. Ultimately, this position prevailed. *Stowers*, 15 S.W.2d at 548 ("[W]e are of the opinion that the serious nature of Miss Bichon's injuries and all the facts and circumstances surrounding her injury, are material as bearing on the question of negligence on the part of the indemnity company in failing and refusing to make the settlement.").

57. It is curious to us why the report was admitted if the witnesses were excluded. Perhaps no objection was made.

58. SF at 21.

59. Freeman testified that Patterson "said… that there was sufficient question in the case that there might possibly be a judgment over and above the five thousand dollars, and that it would be wise for Stowers Furniture Company to be in the case with attorneys of their own selection in addition to the attorneys representing the insurance company." SF at 71.

60. The limit was $5,000. Thus, American Indemnity was willing to pay no more than half of the limit in settlement.

61. Patterson denied that this conversation ever took place. SF at 116.

62. Apparently, the distinction between "no lights" and "non-working lights" worked for Walker, but not the jury.

63. SF at 63.

64. SF at 83. At trial, Patterson testified first that "I don't remember who said it." *Id*. at 127. Later, he testified that he had "no recollection of making that statement." *Id*. at 144.

65. Although it is not expressly clear, it appears that Freeman's partner, John H. Crooker, tried the case on behalf of the Stowers Furniture Company. Crooker was the co-founder of the Fulbright firm.

66. There was some discussion about one other case in particular where the company paid 75% of its limits to settle, but it was reinsured for half of the limit of the policy, so American Indemnity's net out of pocket was no more than half of the policy's limit. Hartung also testified concerning other cases about which he could not identify the particulars, but was certain that they had paid more than half of the limits of the policy.

67. At one point, Stowers argued that, when it issued the policy, American Indemnity Company "created the relation of attorney and client…" Stowers's Brief, at 44.

68. This last point makes little sense as virtually any case can draw an adverse jury verdict, a directed verdict, or other similar outcome that results in no recovery. Thus, if this were the standard, then the duty would likely never be triggered. It occurs to us that a duty which is almost never triggered is worth very little.

69. Curiously, American Indemnity acknowledged that it would be liable for botching the defense, stating:

> We do not contend for a second that in proper cases negligence in the defense of a suit, the failure to plead proper defense, etc., will not make the [insurer] liable under a policy of this nature.

American Indemnity's Brief, at 18. Contrast this view with *State Farm Mut. Auto. Ins. Co. v. Traver*, 980 S.W.2d 625, 627 (Tex. 1998)(prohibiting recovery against the insurer for the conduct of an independent attorney it selects to defend the insured.).

70. *Id*. at 19. Obviously, this prediction is not absolutely true. Nevertheless, as the jury verdict in Stowers's favor shows, there is probably at least some merit to this contention. This could partially explain why there has been a large amount of litigation as to whether the duty was properly triggered. *See, e.g. Am. Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 853-55 (Tex. 1994)(whether demand was within policy limits); *Trinity Universal Ins. Co. v. Bleeker*, 966 S.W.2d 489 (Tex. 1998)(whether demand offered to fully release insured). Nevertheless, there are many cases where the insured has difficulty in convincing a jury that it should be indemnified for its own culpable conduct. An interesting empirical study would be to analyze the reported cases involving the *Stowers* duty to determine what percentage of jury verdicts is won by insurers and what percentage is won by policyholders. This would only be a rough estimate at best given the small fraction of cases that actually reach the appellate process, and this limitation is particularly relevant here since the very purpose of *Stowers* is to encourage settlement.

71. Why did it ultimately evolve as an action in tort instead of one in contract? It might be that because Stowers pleaded it that way, and since it ultimately prevailed, perhaps the court naturally adopted Stowers's approach. It might also be that since the standard is couched in terms of "ordinary care," the logical response is to call it a negligence claim. Interestingly, if the duty sounds in contract, then a breach would subject the insurer to liability for attorneys' fees. But, since the duty ultimately was couched as a tort, then there is no exposure to attorneys' fees under TEX. CIV. PRAC. & REM. CODE ANN. § 38.001 as a result of a breach of the duty to settle. However, since it is a tort, it theoretically opens an insurer up to the possibility of exemplary damages. Accordingly, the nature of the evolution of this doctrine both narrowed and broadened the available remedies in this context. Fortunately (or unfortunately), this issue has now been resolved by the Texas Supreme Court's decision in *Rocor Int'l, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa*, 77 S.W.3d 253, 255 (Tex. 2002)(allowing recovery under TEX. INS. CODE ANN. art. 21.21 for breach of the Stowers duty). Thus, in a proper case, an insured would be allowed to recover attorneys' fees and exemplary damages under art. 21.21.

72. Of course in this situation, the insured would not "get off scot free" as American Indemnity claimed. Instead, it would receive exactly what it paid for – indemnity up to the policy limits, if necessary.

73. Curiously, it seems that the court found significance in the fact that Stowers itself refused to put up $1,500 to settle the suit. Apparently, the

court felt that this was evidence of Stowers's belief in the strength of the defense. Stowers took issue with this point in its Motion for Rehearing, noting that the testimony revealed that Stowers simply believed it was not obligated to contribute anything to a settlement below the limits of its insurance. In effect, Stowers was unwilling to insert a deductible or self-insured retention into the policy after it was issued, as American Indemnity was trying to force it to do.

74. Catherine K. Harris, *A Chronology of Appellate Courts in Texas*, 67 Tex. B.J. 668, 671 (2004).

75. Justice Robert W. Calvert, *Judicial System of Texas: The Appellate Courts of Texas – History, in* 361-362 S.W.2d 2-3 (1963).

76. At the time, there were only a handful of other states that had considered the matter. Thus, this was not only an issue of first impression in Texas, it was one in which there was very little guidance from other jurisdictions as well. In its briefing, Stowers reported the decisions to be more or less evenly split as to whether the insured should be allowed to recover in claims of this type.

77. Chief Justice Cureton signed the order approving of the holding of the Commission of Appeals. Aside from Chief Justice of the Supreme Court of Texas, Cureton held other public posts, including state legislator and attorney general. He was appointed to the Court in 1921 by Governor Pat M. Neff, and served continuously until his death in 1940, *available at* http://www.tsha.utexas.edu/handbook/online/articles/print/CC/fcu26.html (last visited Nov. 14, 2004).

78. Interestingly, Judge Nickels referred to these as "facts." Among the facts identified were that a reasonable offer within the policy limits was extended, an excess judgment was possible if not probable, and the insurer refused to contribute more than $2,500.

79. Gormley's firm provided the founding partners of what is today known as Strasburger & Price, *available at* http://www.strasburger.com/nav/directory.htm (last visited May 5, 2004). Gormley's prediction may have turned out correct after all, at least with respect to his own firm going out of business. With the defection of the lawyers who formed Strasburger & Price in 1939, the firm dissolved. Gormley then became a partner in the new firm of Touchstone, Wight, Gormley & Touchstone, where he practiced until his retirement in 1945. Gormley passed away in 1949, at the age of 74. *Memorials*, 12 Tex. B.J. 482 (1949).

80. Contrast American Indemnity's position here with its earlier prediction that if the *Stowers* duty remained, insurance companies "would necessarily settle all cases…" American Indemnity argued both extremes, despite the inconsistency. In a motion for additional time to file an extra brief, American Indemnity suggested that the effect of the case "will be so drastic and cause such losses as to put out of business many companies, and to make it unprofitable to write this character of policy for many companies . . ." Motion for Additional Time, at 1. Of course, American Indemnity still has a current license to sell insurance in Texas to this day, and thankfully, liability insurance remains widely available as well.

81. Texas Department of Insurance, *available at* https://wwwapps.tdi.state.tx.us/pcci/pcci_how_profile.jsp? tdiNum=3808&companyName=Standard+Accident+Insurance+Company&sysTypeCode=CL&optCaller=Caller+Info&optExplanation=Explanation (last visited May 4, 2004). The struggles of Reliance are well known. A simple summary of this complex case is *available at* http://www.relianceinsurance.com (last visited May 4, 2004).

82. Apparently Gormley was known for being widely read in literary classics and history, and for quoting such works in his arguments. He was very proud of his membership in the Texas Philosophical Society. *Memorials*, 12 Tex. B.J. 482 (1949).

83. Whether the term "reasonable lawyer" is an oxymoron is a question best left for another day.

84. In its Motion for Rehearing in the Court of Civil Appeals, Stowers argued that "[i]n our modern time . . . the statistics show that more than ninety per cent of all disputes are . . . settled." Motion for Rehearing, at 8.

85. *See, e.g. Bawcom v. State*, 78 S.W.3d 360, 363 (Tex. Crim. App. 2002)(noting that stare decisis fosters reliance on judicial decisions, and that under the doctrine, it is often "better to be consistent than right.").

86. *See Am. Centennial Ins. Co. v. Canal Ins. Co*., 843 S.W.2d 480, 482-83 (Tex. 1992)(referring to the *Stowers* doctrine as a "clear right" of the insured, and extending this right to allow excess carriers to pursue equitable subrogation claims against primary carriers for mishandling a claim).

87. The pleading made clear that the mitigation defense was directed only to that portion of the judgment in excess of the limits, so it would not apply to the difference between the $4,000 demand and the $5,000 limit, but it would apply to every dollar in excess of the $5,000 policy limit. While Stowers had the financial resources to make such a settlement (it did pay the judgment in full), this creative argument fails when one considers insureds without such resources. Certainly an insurance company should not obtain a windfall for its own negligence simply because its insured has sufficient resources to pay where the insurance company refuses. Perhaps this was merely a throw-away claim back in the days when contributory negligence was still a complete bar to recovery. *See Signal Oil & Gas Co. v. Universal Oil Prods*., 572 S.W.2d 320, 327 n.12. (Tex. 1978)("Contributory negligence no longer bars recovery in a negligence cause of action in Texas since Texas enacted Article 2212a, Texas Revised Civil Statutes Annotated, which became effective on September 1, 1973.").

88. The jury charge begins with this salutation. It appears, therefore, that the jury was all-male. We do not know if it was also all-white, although we suspect it may have been.

89. It is important to note that, on the second appeal, the Court of Civil Appeals expressly approved of this submission. *Stowers III*, at 936-37.

90. Again, there is an interesting question as to the impact, if any, of *Traver* on this point.

91. This was the $14,103.15 paid to Bichon, plus interest during the pendency of the suit against American Indemnity.

92. Stowers's Reply Brief, at 6.

93. That the writ was refused means the opinion in *Stowers III* has precedential value equal to a decision from the Texas Supreme Court. *See* Appendix "A" to the *Texas Rules of Form* (10th ed. 2003).

94. The title for this section of the paper comes from Judge Posner's excellent biography of Justice Cardozo, wherein he suggests alternative areas for further study on one of the towering figures in American law. RICHARD A. POSNER, CARDOZO: A STUDY IN REPUTATION 144 (1990). Posner's treatment of Cardozo's life and work is scholarly, engaging and insightful. In short, it is worth the reader's time.

95. *See, e.g. Rocor*, 77 S.W.3d 253, 264-65 ("To establish liability, the insured must show that… (4) the demand's terms are such that an ordinarily prudent insurer would accept it."). In truth, recent cases can be found on both sides. To compound the problem further, *Garcia* uses both formulations, and even in the very same paragraph. There are other cases using both as well, including *Texas Farmers Ins. Co. v. Soriano*, 881 S.W.2d 312, 314 (Tex. 1994), and *St. Paul Fire & Marine Ins. Co. v. Convalescent Servs., Inc.*, 193 F.3d 340, 342 (5th Cir. 1999). In *Garcia*, the court first stated that the carrier "was required to exercise 'that degree of care and diligence which an ordinarily prudent *person* would exercise…'" *Garcia*, 876 S.W.2d at 848 (emphasis added). In the same paragraph, it then stated that the *Stowers* duty "is not activated… unless… the terms of the demand are such that an ordinarily prudent insurer would accept it…" *Id*. at 849 (emphasis added). Adding to the mystery, its second formulation cites a law review article written by Judge Keeton in 1954. This issue was raised in both *Rocor* opinions from the San Antonio Court of Appeals and, after determining that that the Texas Supreme Court had not addressed which formulation was more appropriate and that *Stowers* remained good law, the court found no error with the use of "person" instead of "insurer" in the jury charge. In the first opinion, the court also relied on the use of "person" by the Corpus Christi Court of Appeals in *Trinity Universal Ins. Co. v. Bleeker*, 944 S.W.2d 672, 680 (Tex. App.—Corpus Christi 1997). *See Rocor*, 1998 WL 9505 (Tex. App.—San Antonio Jan. 14, 1998). Curiously, the *Bleeker* citation is absent from the substituted opinion following rehearing *en banc*. *Rocor*, 995 S.W.2d at 814-15.

96. *See, e.g. State Farm Mut. Auto. Ins. Co. v. Traver*, 980 S.W.2d 625, 627 (Tex. 1998); *Employers Cas. Co. v. Tilley*, 496 S.W.2d 552, 558 (Tex. 1973); *American Home Assurance Co., Inc. v. Unauthorized Practice of Law Committee*, 121 S.W.3d 831 (Tex. App.—Eastland 2003, pet. filed); *Safeway Managing Gen. Agency v. Clark & Gamble*, 985 S.W.2d 166, 168 (Tex. App.—San Antonio 1998, no pet.); *Bradt v. West*, 892 S.W.2d 56, 77 (Tex. App.—Houston [1st Dist.] 1994, writ denied).

97. As we noted previously, American Indemnity's dire prediction is not literally true. Regardless, it reminds us of the words of Justice Holmes:

> [F]or the rational study of the law the black-letter man may be the man of the present, but the man of the future is the man of statistics…

OLIVER WENDELL HOLMES, JR., COLLECTED LEGAL PAPERS 187 (Harcourt, Brace & Co. 1921). Here, we have analyzed the black-letter law (as well as the facts of the case that led to its creation). We leave it to others to analyze the statistics in order to evaluate the true accuracy of American Indemnity's prediction.

98. *Employers Cas. Co. v. Tilley*, 496 S.W.2d 552 (Tex. 1973).

99. We would like to express our sincere thanks to the many individuals who assisted us in preparing this article. In particular, however, we are grateful to Gray Miller of Fulbright & Jaworski for searching his firm's archives and locating several briefs that served as the inspiration for this paper. Interestingly, the firm's website identifies a number of engagements involving the *Stowers* doctrine in describing its insurance expertise, but the *Stowers* case itself is not among the listed matters, *available at* http://www.fulbright.com/index.cfm?fuseaction=local.detail site_id=334&link_name=Experience (last visited Apr. 27, 2004).

100. Stowers Furniture Company, *available at* http://www.stowersfurniture.com/index.php (last visited Apr. 27, 2004).

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# Insurability of Punitive Damages in Texas

## INTRODUCTION

The insurability of punitive damages is one of the hottest issues in Texas insurance law. The Supreme Court is currently addressing the issue in an employers liability case, *Fairfield Ins. Co. v. Stephens Martin Paving*, Cause No. 04-0728 (Tex. Sup. Ct.), which was certified by the Fifth Circuit Court of Appeals, *Fairfield Ins. Co. v. Stephens Martin Paving*, 381 F.3d 435, 437 (5th Cir., Aug. 11, 2004). The issue is also before the Court on Petition for Review in *Westchester Fire Ins. Co. v. Admiral Ins. Co.*, 2004 WL 2793239 (Tex. App.--Fort Worth, Dec. 2, 2004)(on rehearing en banc).

The development of punitive damages law has been one of progressively more restriction. Many would say that after the application of severely limited caps, a significantly heightened definition of triggering conduct, the use of a clear and convincing burden of proof, a concomitant heightened standard of appellate review, bifurcation, de novo review of the amount of punitive awards, etc., the message is clear: the Texas courts and the legislature do not like punitive damage claims. Is the final straw in the attack on punitives a decision to make insurance coverage for such damages contrary to public policy? Is the real deterrent behind this approach to deter plaintiffs from even pursuing such damages? Mixed into this morass is the question of whether the Supreme Court considers whether the venue, the judge and the jury pool are still sufficiently unpredictable that there remains a significant and legitimate litigation risk sufficient justify such coverage? Is not a duty to defend necessary and fair since the defendant is only alleged to have committed heinous acts of gross negligence and/or malice? Will the Court favor business interests in such coverage over insurance interests? Finally, the Court will face an extraordinarily thorny separation of powers issue as to who is the best judge of public policy regarding the impact of coverage on a cause of action that has now been adopted, modified and exists by the grace of legislative act.

This paper seeks to address several different issues related to punitive damage claims under current Texas law. It will address the statutory bars to punitive coverage. It will also discuss the recent oral argument and briefing in *Fairfield* and the decision in *Westchester* and the issues before the Supreme Court in that case.

## GROSS NEGLIGENCE ISSUES

Texas law regarding "gross negligence" has dramatically changed in the past five years. Understanding the alteration in the legal definition of "gross negligence" and the stated purpose of punitive damages emphasized in recent Supreme Court decisions is crucial in understanding the overall historical development of Texas law regarding coverage for punitive damages.

The mental state necessary to establish "gross negligence" has shifted closer to that required for intentional acts. As a result, the "accident" requirement of some policy definitions of "occurrence" and the intended/expected harm exclusion may be used to bar such coverage. Moreover, the purpose has now been limited solely to deterrence and punishment, thus opening the door to arguments that coverage for punitive damages is against public policy.

### A. Definition and Purpose of Gross Negligence

The Texas courts have not addressed whether punitive damages are covered under either *Transportation Ins. Co. v. Moriel*, 879 S.W.2d 10, 23 (Tex. 1994), or TEX. CIV. PRAC. & REM. CODE § 41.007(7) (Vernon 1997). In *Moriel*, the court held that "gross negligence" required proof of two elements:

> (1) viewed objectively from the standpoint of the actor, the act or omission must involve an extreme degree of risk, considering the probability and magnitude of the potential harm to others, and
>
> (2) the actor must have actual, subjective awareness of the risk involved, but nevertheless proceed in conscious indifference to the rights, safety and welfare of others.



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*Id*. The statutory definition of "malice," which replaces "gross negligence," with subsection (B), is identical to the *Moriel* definition:

> (A) a specific intent by the defendant to cause substantial injury to the claimant; or
>
> (B) an act or omission
>
> (i) which when viewed objectively from the standpoint of the actor at the time of its occurrence involves an extreme degree of risk, considering the probability and magnitude of potential harm to others; and
>
> (ii) of which the actor has actual, subjective awareness of the risk involved, but nevertheless proceeds with conscious indifference to the rights, safety or welfare of others.

TEX. CIV. PRAC. & REM. CODE § 41.001 (7) (Vernon 1997).

The purpose of punitive damages is to punish and deter the wrongdoer. *Moriel*, 879 S.W.2d at 16-17. The court clearly recognized that criminal law invades the law of torts in the theory behind awarding punitive damages in civil cases. *Id*. While some earlier cases, such as *Hofer v. Lavender*, 679 S.W.2d 470 (Tex. 1984), suggested punitive damages had some limited compensatory aspect, this notion was clearly rejected in *Moriel*. In *Owens-Corning Fiberglas Corp. v. Malone*, 972 S.W.2d 35, 40-41 (Tex. 1998), the court expressly held that punitive damages are "not designed or intended to compensate" victims. Indeed, § 41.001 (5) defines "exemplary damages" as "any damages awarded as a penalty or by way of punishment."

*Moriel* clearly states that it was really not redefining "gross negligence," but was in fact seeking a "functional interpretation" that aids in applying the no evidence standard of appellate review. The court characterized its opinion as a "substantial clarification" of the gross negligence standard and the standard of review for legal insufficiency of the evidence. Thus, it was not intended to be an organic change that would alter prior legislation. The question of whether the legislature intended a substantial alteration is another question entirely.

## B. Gross Negligence Under the New Standard

As noted above, in *Transportation Ins. Co. v. Moriel*, 879 S.W.2d 10 (Tex. 1994), the Texas Supreme Court adopted a more harsh standard for "gross negligence." This standard was later adopted by the legislature and codified in TEX. CIV. PRAC. REM. & REM. CODE section 41.000 et seq.:

> · viewed objectively from the standpoint of the actor, the act or omission must involve an extreme degree of risk, considering the probability and magnitude of potential harm to others, and
>
> · the actor must have actual, subjective awareness of the risk involved, but nevertheless proceed in conscious indifference to the rights, safety and welfare of others.

It should be noted that this standard and the caps in this statue are inapplicable to DTPA. claims. TEX. CIV. PRAC. REM. & REM. CODE sec. 41.002(d).

Under the statute, punitive damages are capped at the greater of "(1)(A) two times the amount of economic damages; (B) plus an amount equal to any noneconomic damages, not to exceed $750,000; or (2) $200,000." *Id*. at 41.008(b). No cap or limitation is applicable if the defendant is shown to have committed one the of specified felonies, such as murder, sexual assault, commercial bribery, etc., and that such conduct "was committed knowingly or intentionally," as defined by the Texas Penal Code. *Id*. at 41.008(c). The court and the parties may not inform the jury of the applicability of the caps. *Id*. at 41.008(e). The jury is to be instructed that the purpose of "exemplary damages" is "as a penalty or by way of punishment." *Id*. at 41.00010(a), 41.001(5). The jury may consider the following types of evidence: "(1) the nature of the wrong; (2) the character of the conduct involved; (3) the degree of culpability of the wrongdoer; (4) the situation and sensibilities of the parties concerned; (5) the extent to which such conduct offends a public sense of justice and propriety; and (6) the net worth of the defendant."

In *St. Paul Surplus Lines Ins. Co. v. Dal-Worth Tank Co*., 917 S.W.2d 29 (Tex. App.—Amarillo 1995), *aff'd in part, rev'd in part on other grounds*, 974 S.W.2d 51 (Tex. 1998), the Court explained the difference between pre-*Moriel* gross negligence and "knowingly" as used in the DTPA and the Texas Insurance Code:

> "Actual awareness" does not mean merely that a person knows what he is doing; rather, it means that a person knows that what he is doing is false, deceptive, or unfair. In other words, a person must think to himself at some point, "Yes, I know this is false, deceptive, or unfair to him, but I'm going to do it anyway."…In sum, there is evidence of misconduct by St. Paul, but there is no evidence, circumstantial or otherwise, that St. Paul knew it was acting falsely, deceptively, or unfairly toward Dal-Worth. The award of statutory damages under the DTPA and the Insurance Code must therefore be reversed.

*Id*. at 54. Clearly, the Court appears to be equating "knowingly" and the modern definition of "gross negligence" or malice. On the Court's own continuum, the conduct is closer to intended harm than to negligence.

## PUBLIC POLICY ARGUMENTS

### A. Texas History As To Punitive Coverage

The Texas courts initially found that coverage for punitive damages was not contrary to public policy. The courts reasoned that at least in automobile policies the forms had been approved by the State Board of Insurance, which indicated a sanctioned regulatory body had approved of such coverage. *See, e.g., American Home Assur. Co. v. Safway Steel Prods. Co.*, 743 S.W.2d 693 (Tex. App.—Austin 1987, no writ); *Home Indem. Co. v. Tyler*, 522 S.W.2d 594 (Tex. Civ. App.—Tyler 1975, writ ref'd n.r.e.); *Dairyland County Mut. Ins. Co. v. Wallgren*, 477 S.W.2d 341 (Tex. Civ. App.—Austin 1972, writ ref'd n.r.e.). The precedential value of these cases must be seriously questioned in light of the fact that *Transportation Ins. Co. v. Moriel, supra*, altered the meaning of gross negligence and the statutory definition of "malice," TEX. CIV. PRAC. & REM. CODE § 41.001(7) (Vernon 1997), which have so significantly heightened the mental state necessary to recover punitive damages.

*If coverage for punitive damages is permitted, then how can it not be considered by the jury in assessing punishment?*

It should also be noted that the court in *Safway* reasoned that it was doubtful punitive damages would actually deter because Texas juries at the time that case was decided did not permit evidence of a defendant's wealth to be admitted into evidence. 743 S.W.2d at 704. Subsequently, the Texas Supreme Court held in *Lunsford v. Morris*, 746 S.W.2d 471 (Tex. 1988), that net worth evidence is in fact admissible.

The *Safway* court also held that punitive damage awards had a doubtful deterrent effect in general. As one commentator has observed, "Something is wrong here. Logic has taken a holiday." M. Quinn, *Punitive Damages and Liability Insurance: Whither Texas?* INS. LITIG. RPTR., 121 (March 1996).

The definition of "gross negligence" prior to *Moriel* was truly more akin to ordinary negligence. *See, e.g., Freeman v. City of Pasadena*, 744 S.W.2d 923 (Tex. 1988). As noted above, *Moriel* adopted a much more strict definition of "gross negligence" or "malice." The standard requires actual conscious indifference to an extreme and probable risk of bodily harm. It is a quasi-criminal standard according to the Texas Supreme Court. The new standard requires an "aggravated mental state." *Id*. at 19. Section 41.003(b) provides that "malice" must be shown by "clear and convincing evidence" and that this burden of proof "may not be shifted to the defendant or satisfied by evidence of ordinary negligence, bad faith or deceptive trade practices." Indeed, the Texas Supreme Court has recently held in *Southwestern Bell Tele. Corp. v. Garza*, No. 01-1142 (Tex., Dec. 31, 2004), that because gross negligence findings are subject to an elevated burden of proof – clear and convincing evidence – the standard of appellate review must be elevated as well. Thus, review under the old "scintilla" standard is insufficient. The decision reflects yet another stake in the heart of punitive damage awards.[1] Another example of the application of the *Garza* standard of review can be found in the recent decision of *Diamond Shamrock Co., L.P. v. Hall*, No. 02-0566 (Tex., Jan. 21, 2005).

Given this heightened mental state, strong arguments can be made that irrespective of the language used by the parties or their intent, insurance coverage for punitive damages is against public policy. Obviously, one cannot punish or deter if insurance is available. It is equally true that a wrongdoer with this type of aggravated mental state should not be rewarded for his or her wrongful conduct. *See, e.g. Peeler v. Hughes & Luce*, 868 S.W.2d 823 (Tex. App.—Dallas 1993), *aff'd*, 909 S.W.2d 494 (Tex. 1995).

Importantly, as noted, *Moriel* recognized that because Texas permits the introduction of evidence of net worth, bifurcation of the punitive damages phase of the trial was required. *See also* TEX. CIV. PRAC. & REM. CODE sec. 41.011(6). Net worth is considered to assess punishment of the insured and to provide greater assurance of a deterrence. If coverage for punitive damages is permitted, then how can it not be considered by the jury in assessing punishment? *See* Quinn, *supra*, at 135-36, for an excellent discussion of this issue and its ramifications with respect to the insurability of punitive damages.

### B. Hartford v. Powell

In *Hartford Cas. Ins. Co. v. Powell*, 19 F. Supp. 2d 678 (N.D. Tex. 1998), the court held that coverage for punitive damages under a general liability policy was against the public policy of the State of Texas. The court's opinion presents a scholarly and comprehensive history and analysis of the public policy debate in Texas and across the country. In brief, the

court found that Texas law has significantly changed with respect to the level of conduct necessary to obtain punitive damages and the stated purpose of punitive damages has so clearly focused solely on punishment and deterrence. Thus, *Wallgren* and its progeny no longer accurately reflect Texas law.

The court first focused on the type of conduct involved with a gross negligence allegation under Texas law. *Id*. at 682. The court noted that the standard announced in *Moriel* and now incorporated in TEX. CIV. PRAC. & REM. CODE § 41.001(7) is significantly higher than the prior standards for gross negligence. *Id.*

The court focused on the purpose of punitive damages. The court noted that while deterrence has always been a primary purpose of punitive damages, at times the Texas courts have found that such damages "play a compensatory role as well as a punishment role…" Id. at 683. The court found that the Texas Supreme Court altered this vacillation in *Moriel* and firmly stated that the "only purpose served by a punitive damages award under Texas law is the 'public purpose of punishment and deterrence.'" *Id*. The court noted that the Supreme Court had equated legal justification for punitive damages to that used for criminal punishment. *Id.* Indeed, the court added that the Supreme Court had spoken even more clearly in *Owens-Corning Fiberglas Corp. v. Malone,* 972 S.W.2d 35, 40-41 (Tex. 1998), when it remarked that punitive damages are "'not designed or intended to compensate or enrich individual victims' but, "[i]nstead, the purpose of punitive damages is to punish a party… and deter it and others from committing the same or similar acts in the future.'" *Id.* at 684. Finally, the court observed that the legislature had itself changed the definition of exemplary damages to mean "'any damages awarded as a penalty or by way of punishment. Exemplary damages includes punitive damages.'" *Id.* (quoting TEX. CIV. PRAC. & REM. CODE § 41.001(5) (Vernon 1997)).

The court quoted at length the reasoning of the Fifth Circuit in *Northwestern Casualty Co. v. McNulty,* 307 F.2d 432, 440-42 (5th Cir. 1962)(Florida and Virginia law), which is one of the most influential decisions on the side of finding punitive damages coverage contrary to public policy:

> "[W]here a person is able to insure himself against punishment he gains a freedom of misconduct inconsistent with the establishment of sanctions against such misconduct. It is not disputed that the insurance against criminal fines or penalties would be void as violative of public policy. The same public policy should invalidate any contract of insurance against the civil punishment that punitive damages represent.
>
> * * *
>
> Considering the theory of punitive damages as punishment and as a deterrent and accepting as common knowledge the fact that death and injury by automobile is a problem far from solved by traffic regulations and criminal prosecutions, it appears to us that there are especially strong public policy reasons for not allowing socially irresponsible automobile drivers to escape the element of personal punishment in punitive damages when they are guilty of reckless slaughter or maiming on the highway."

19 F. Supp. 2d at 684-85.

The court presented an extensive discussion of the prior Texas case law regarding coverage for punitive damages. The court recognized that *Wallgren* and its progeny had found coverage for punitive damages to be consistent with Texas public policy. But, the court noted that after *Moriel* these decisions were of limited precedential value. Moreover, several cases involving UM policies had strongly suggested that coverage for punitive damages was in fact inconsistent with public policy. *Id*. at 690.

The *Powell* court recognized that the "vast majority" of courts have held punitive damages coverage to be against public policy. *Id*. at 691 (quoting ANNOT. "Liability Insurance as Covering Accident, Damage, or Injury Due to Wanton or Willful Misconduct or Gross Negligence," 16 A.L.R. 4th 11, 17 (1982)). Nineteen jurisdictions are identified as holding that punitive coverage is against public policy. 19 F. Supp. 2d at 691.

The court concluded that the changes brought by *Moriel* and section 41.007 made it clear that the public policy of punitive damages awards is to punish and deter. The court reasoned that coverage for the level of conduct necessary to recover punitive damages would prevent the purposes of punishment and deterrence from being brought into effect. *Id*. at 694-96.

### C. Fairfield – Oral Argument Before the Supreme Court

The Supreme Court recently heard oral argument in *Fairfield Ins. Co. v. Stephens Martin Paving,* Cause No. 04-0728 (Tex. Sup. Ct.). This case was certified by the Fifth Circuit to answer whether Texas "public policy prohibit[s] a liability insurance provider from indemnifying an award for punitive damages imposed on its insured because of gross negligence?" 381 F.3d 435, 437 (5th Cir., Aug. 11, 2004).

The underlying suit against the insured in that case was a workers compensation death action. The workers compensation act was long ago found to have in no way altered the Texas constitutional right to recover for death resulting from a grossly negligent act or omission. Such actions seek only recovery punitive damages because the benefits under the workers compensation act are intended to compensate for ordinary, actual damages, and thus the workers compensation bar applies to such claims for actual damages. *See* TEX. LABOR CODE ANN. sec. 408.001(b), (c) (Vernon 2004).

The policy in *Fairfield* was, therefore, a Worker's Compensation and Employer's Liability Policy. Part B or II of that policy provided coverage for so-called "employer's liability." Such coverage is intended to cover claims not otherwise subject to the workers compensation bar, such as claims for wrongful death and punitive damages.

The carrier brought a federal declaratory judgment action seeking a determination that it had no duty to defend and thus no duty to indemnify based on Texas public policy claims solely for punitive damages such as that in the underlying suit.

**1. The Issues**

The carrier first urged in its motion for summary judgment that there was no duty to indemnify for punitive damages based on public policy. The carrier admitted that the court might very well have concerns about barring a duty to defend based on mere *allegations* of wrongful conduct. In short, the carrier admitted that the duty to defend and a public policy defense presented a unique situation that did not readily fit the ordinary rules for determining the duty to defend. The carrier note, however, that the majority of courts addressing the issue have also found that there is no duty to defend.

Strangely, the *policyholder* decided to concede in its response to the motion for summary judgment that it was in fact contrary to Texas public policy to allow indemnification for an award of punitive damages. Needless to say, the policyholder has since changed its view and contests both indemnity and defense being barred by public policy concerns.

It should be noted that the claimant, made a party to the declaratory action, urged that indemnity was not justiciable prior to resolution of the underlying suit. No questions were posed at argument regarding this point.

The carrier conceded that in the ordinary case involving claims for negligence and gross negligence, there would be a duty to defend because there were alternatively pled claims, one covered and one contrary to public policy. In *Fairfield*, the suit was a workers compensation wrongful death case, in which only punitive damages may be awarded. Thus, it presents the potential for a determination that there is no duty to defend at all.

One of the justices asked about whether the carrier attorney had a position regarding how the public policy rule would work where the carrier was allowed to allocate and pay only for those claims covered under the policy, apparently as in *Busse*. Counsel stated no authority existed in Texas for allowing allocation in this fashion, to which the justice responded that this issue was the "next case down the line."

In short, the policy form in *Fairfield* presents the best possible case for policyholders to have before the court. This policy form is subject to some very strong practical arguments: (a) disallowing coverage would potentially render the policy illusory, (b) premiums were clearly paid for the coverage, and (c) the state board approved form is broad enough to include coverage for such claims. Interestingly, an Amicus Brief filed by Texas Mutual Insurance Company, arguing that the employers liability coverage was clearly intended to cover punitives, reflects the public policy choice of the Texas Department of Insurance and is the only interpretation that gives meaning to the policy.

Texas Mutual Insurance Company argues in its Amicus Brief that *Fairfield* is gutting the EL policy of any real meaning. Texas Mutual Insurance noted that *Fairfield* took the position that the EL coverage is not illusory without punitive coverage since the carrier would still have a duty to defend. Only baseless claims in derogation of the workers compensation bar and subject to prompt dismissal would require a defense.

**2. The Public Policy Conflict**

*Fairfield* clearly poses a conflict between the public policy behind the concept of freedom of contract and the public policy of punitive damages to punish the wrongdoer. The Court's questions during oral argument show that it is acutely aware of this conflict. The questions primarily focused on whether the allowance of coverage would encourage and/or reward bad behavior and thus negate the deterrent effect of punitive damage awards.

The strength of the carrier argument lies in what some refer to as the "hypocrisy" principle. The Texas Supreme Court and the United States Supreme Court have worked very, very hard to develop methods of preventing and or limiting punitive damages awards, including making it based on quasi-criminal conduct, limited by very severe caps, subject to special protections such as de novo review, bifurcation, a heightened burden of proof, and a specialized, heightened standard

of appellate review, discussed below in a separate section. If someone is audacious enough to navigate all of these hurdles and convince a jury that malicious acts were committed and then defend that ruling on appeal, would it not, the argument goes, be the height of hypocrisy for the courts to allow insurance coverage for such acts?

The counter to this carrier argument is that if punitives are so hard to get and so limited by caps, etc., then the burden on carriers and other policyholders to share the risk is much more limited. Therefore, that burden does not justify involving public policy to rewrite the contract.

An additional policy conflict appeared from questioning, and that is whether allowing coverage for punitives in one case might lead to the depletion of coverage and thus reduce the opportunities for other claimants to be compensated.

Also, Texas Mutual urged as Amicus that there is an additional policy consideration: disallowing coverage for punitive damages will make opting into the workers compensation system less desirable. This is a bit confusing since alternative opt-out arrangements would also not be able to get stop-loss or other forms of coverage for punitives under an alternative plan.

During oral submission, the carrier argued that allowing punitive damages to be insured blunts the deterrent effect of those damages. Incidental to this argument, the insurer emphasized the fact that after *Transportation Indemnity Ins. Co. v. Moriel*, 879 S.W.2d 10, 29-30 (Tex. 1994), the common law and later statutory definitions of gross negligence/malice make such acts or omissions a form of quasi-criminal act. The policyholder's response is that it is punished even where punitive damages are covered because it is subject to (a) an outright refusal by carriers to provide future coverage and (b) increased premiums. *See, e.g., The Philadelphia Indemnity Ins. Co. v. Stebbins*, 2004 WL 210636, slip op. at *8-9 (N.D. Tex., Jan. 27, 2004)(Lynn, J.)(Texas law). The Court noted that the record was silent on these alleged "punishments."

Importantly, the carrier in *Fairfield* was not contesting whether the basic terms of the policy would allow for coverage or not of punitive damages. It appeared to concede that this state approved form was intended by the Texas Board of Insurance to cover punitives. Under Texas law, the acts of regulatory bodies can be used to determine the public policy of the state.

The carrier also did not urge that a finding of gross negligence or malice would defeat coverage for actual damages. Some have urged that the current definition of malice/gross negligence is such that it fails to involve accidental conduct within the requirements of the definition of "occurrence" in liability policies. The winner-take-all approach was argued by the carrier and rejected by the court in *Westchester Fire Ins. Co. v. Admiral Ins. Co.*, 2004 WL 2793239 (Tex. App.—Fort Worth, Dec. 2, 2004)(on rehearing en banc).

Some members of the Court clearly believe that the conduct involved with a gross/malice finding is sufficiently egregious to cause a public policy concern. At least one member asked for confirmation that criminal negligence is not as onerous in terms of the elements of proof required for gross negligence/malice.

*…intentional acts are at the highest level of egregiousness, with gross negligence/malice somewhere below that level.*

Other questions posed by the Court in the *Fairfield* argument indicate that at least some members of the Court recognize a distinct difference in quality between acts that are intentional and those that are malicious or grossly negligent. In other words, intentional acts are at the highest level of egregiousness, with gross negligence/malice somewhere below that level.

Some justices indicated that they were concerned that the policies actually were intended to cover punitive damages. One justice noted that the employers liability policy actually excludes punitive damages, but only in a very, very narrow area: cases involving illegal employment. The policyholder argued that the exclusion of punitive damages in cases of illegal employment would be superfluous if such damages were not intended to be covered.

According to one Justice, insurance is intended to pool everyone's premiums to pay the losses of a few. Thus, allowing coverage for punitives, according to the carrier's lawyer, in effect punishes the entire liability insurance buying public, which undoubtedly shares a large part of the carrier's efforts to recover monies paid for punitive damages.

**3. Has the Legislature Spoken?**

The carrier urged that the legislature mandated that the amount of punitive damages was to be awarded based on consideration of net worth, which clearly does not include insurance coverage. Thus, to allow coverage for punitive damages would be to create an absurd situation in which the jury would be rendering a fictional decision based on net worth that had no contact with the reality of the fact insurance coverage was available.

The Court confronted the carrier counsel with the fact that the legislature has, in the Medical Liability and Insurance Improvement Act, found that punitive damages are not insurable for certain specified types of health carriers. If the legislature believed that coverage for punitive damages were barred by public policy, there would hardly be any need for a specific provision disallowing such coverage. Thus, article 5.15-1 of the Texas Insurance Code clearly reflects a very limited determination to bar coverage for punitive damages in a very limited area.

Some members of the Court expressed concern that the record was incomplete in that there was no information regarding premium rates and how, if at all, the insured would suffer and thus be punished if punitive damages were covered. Other members appeared to want to let this issue be decided by the legislature, noting that collecting and evaluating evidence, such as the impact and amount of premiums, was something the legislature was well-suited to do.

Strangely, no one involved in the argument seemed to recognize that allowing coverage for punitive damages actually would result in a depletion of coverage otherwise available to at least fully compensate injured parties. For example, in a multi-claimant case, allowing punitive coverage could result in one claimant cashing in for all or most of the coverage, leaving injured parties uncompensated.

It appeared that a number of members of the Court were not satisfied that the record was complete for purposes of determining if the deterrent or punishment purposes of punitive damages would be served if coverage was provided. Moreover, some members indicated that they thought this was a matter best left to the legislature for study and review. Given that punitive damages are now a creature of statute, rather than a purely common-law creature, deference to the legislature may be an appealing resolution. In short, the Court may very well seek to avoid the issue and wait to resolve it another day or wait for the legislature to act.

## CONCLUSION – A MOVING TARGET OR A MATTER OF TIMING

The Fort Worth Court of Appeals, sitting en banc, recently held that coverage for punitive damages was not contrary to public policy under a healthcare liability policy involving torts committed in and subject to the 1987 punitive damages statue. *Westchester Fire Ins. Co. v. Admiral Ins. Co.*, 2004 WL 2793239 (Tex. App.—Fort Worth, Dec. 2, 2004)(on rehearing en banc).

The Petition for Review addressing this and *Stowers* issues raised in that case are in the process of being filed at this time.

The primary policy at issue was a medical professional liability policy. The court first addressed a constructional argument that a finding of "gross negligence" or malice under current Texas involves expected or intended harm and thus is excluded. The policy at issue included a CGL section including a standard intended harm exclusion. Moreover, the policy's "occurrence" definition required an "accident." The court noted that hospital professional coverage was not subject to the occurrence/accident requirement. *Id* at *6.

Strangely, the court concluded that the claim below was for the failure to provide care; i.e., leaving the decedent in a urine-soaked bed. Without any significant analysis, the court concluded that this involved a professional medical service and thus was not subject to the "occurrence"/accident requirement. The court based its reasoning, in part, on a sort of off-the-cuff conclusion that Admiral had not reserved rights regarding whether the policy terms allowed coverage for punitive damages or not. *Id*. *7.

The court emphasized that public policy comes from acts of the legislature and the Supreme Court. In any event, the court noted that when the injury in the underlying claim occurred, the Medical Liability and Insurance Improvement Act prohibited coverage for punitive damages for some health care providers, but not a "for-profit" nursing home, like that operated by the insured. TEX. INS. CODE art. 5.15-1, sec. 2. This provision was amended in 1987 to allow a hospital to obtain coverage for punitive damages. In 1997, the provision was again amended, allowing not-for-profit nursing homes to obtain such coverage and expressly authorizing the Insurance Commission to adopt an endorsement providing such coverage. *Id*. at *14. It was not until 2001 that "for-profit" nursing homes were added to the list of insureds barred from getting punitive damages coverage. *See* Act of May 27, 2001, 77th Leg., R.S., ch. 1284, sections 5.01, 5.02, 2001 TEX. GEN. LAWS 3083, 3085.

It is obviously very difficult for anyone to argue that punitive damages coverage is contrary to public policy when the legislature has specifically determined specific categories of insureds not entitled to get such coverage, thus, implicitly recognizing the propriety of such coverage for others. Indeed, if such coverage were contrary to public policy, it would not be available to anyone nor would the state board be able to draft or approve a policy form ostensibly providing such coverage.

Strangely, the court then turned to the purpose of punitive damages at the time of the incident in question. The court concluded that the stated purpose of punitive damages under the 1987 statutory provisions regarding such damages was to set an example for others. It was not until 1995 that the statutory purpose of punitive damages was changed to be solely for

purposes of punishment and deterrence. The court concluded that making the insured pay from its own pocket for punitive damages had nothing to do with "making an example to others." Thus, under the scheme in place at the time of the tort, allowing coverage for punitives would not affect the purpose of an award of such damages. Accordingly, for this additional reason, the court found coverage for punitives in the case before it was not contrary to public policy. The court expressed no opinion about other cases involving other statutory schemes.

Given the pendency of Admiral's petition for review, the issue of insurability of punitive damages may be hard for the Supreme Court to avoid this term.

1. The Court had previously approved a heightened burden of proof only in cases involving issues as to which a clear and convincing burden of proof was a constitutional necessity. The Court emphasized that a "higher quality of evidence" is necessary to pass muster under the clear and convincing standard. *Id*. at 18. The proof must be reviewed in terms of proof of gross negligence and as to whether the proof was of such a quality that the fact-finder could reasonably form a firm conviction or belief about whether the defendant was grossly negligent. *Id*.

Rejecting arguments that its ruling allowed reweighing of evidence, the Court emphasized that issues of credibility and demeanor unapparent on the face of the appellate record would still be resolved in favor of the fact-finder. Even credibility issues revealed by the written record would require deference to the act-finder's determination, so long as the determination was not itself "unreasonable."

As with factual sufficiency rulings, a clear and convincing finding requires review of all the evidence. *Id*. The evidence must still be viewed "in the light most favorable to the finding," in order to determine "whether a reasonable trier-of-fact could have formed a firm belief or conviction that its finding was true." *Id*. at 19. The reviewing court "must assume that the factfinder resolved disputed facts in favor of its finding if a reasonable factfinder would do so. A corollary to this requirement is that a court should disregard all evidence that a reasonable factfinder could have disbelieved or found to have been incredible." Importantly, the court may not disregard undisputed facts that do not support a finding.

The Court side-stepped arguments that it was exceeding its jurisdiction to decide only questions of law as related to jury findings.

The Court of course concluded that under the proper standard of review, the evidence was legally insufficient to support the jury's finding of malice/gross negligence against Southwestern Bell.

BY J. ALEXANDER JOHNSON

# A Short Primer on Advertising Injury Coverage

## WHAT PRACTITIONERS SHOULD KNOW ABOUT ADVERTISING INJURY

### INTRODUCTION

Insurance coverage for advertising injury liability is provided by the advertising injury provisions in the Commercial General Liability (CGL) policy. The CGL policy is the primary risk-transfer method used by most businesses and is the most frequently litigated policy. The CGL policy provides coverage for liability and defense cost resulting from injury or damage to third parties caused by the insured. The standard CGL policy typically covers four categories of liability: property damage, bodily injury, personal injury and advertising injury. For advertising injury coverage to attach the insured must establish that the injury arose out of an enumerated offense, the offense was committed during the policy period, in the course of the insured's advertising and a causal connection between the injury complained of and the insured's advertising.

The purpose of this article is to provide guidance to general practitioners, insurance professionals and intellectual property lawyers on advertising injury claims. In the Insurance Service Office (ISO) CGL policy form, advertising injury includes one or more of the following offenses:

1. Oral or written publication of material that slanders or libels a person or organization or disparages a person's or organization's goods, products or services;

2. Oral or written publication of material that violates a person's right of privacy;

3. Misappropriation of advertising ideas or style of doing business;

or

4. Infringement of copyright, title or slogan.

### ATTACHMENT POINTS

The ***operative event*** for this coverage is advertising. The injury must occur during the course of the named insured's advertising activities. This causal nexus must be established before an advertising injury offense can trigger coverage. What are advertising activities?[1] Its common meaning is to announce, give notice of, make known, call attention to or publish to the attention of the public. Nonetheless courts differ on this issue from widespread dissemination to the public at large[2] to one – on – one solicitation.[3] Advertising activity can be fact-specific and jurisdictional. However, most courts hold that patent infringement cannot occur in the course of advertisement. The consensus is that patent infringement cannot have a causal connection to the policyholder's advertising activities. The tort of patent infringement occurs when the patent idea is used and not when advertised. And, patent infringement is not an enumerated offense. Thus, patent infringement claims do not satisfy the prerequisites for advertising injury coverage.[4]

The above reasoning also applies to trademark coverage. Trademarks can be any word, name, slogan, symbol, design, device or any combination thereof that identifies products or services.[5] The primary function of trademark law is to protect consumers from confusion and deception. To constitute infringement, the unauthorized use must create a likelihood of public confusion as to the source of the goods or services. Trademark infringement, in the insurance coverage context, requires that the infringer advertise the trademark during the course of the infringement. Unlike patent infringement, it is not possible to allege a claim for trademark, service mark, trade name or trade dress infringement without the infringing mark being used to identify the goods or services to the public. Allegations of trademark and trade dress infringement inherently involve advertising activity.[6]

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But, trademark and service marks are not slogans or titles. Nor do they come within the scope of misappropriation of advertising ideas or the style of doing business.[7] Where a lawsuit alleges only patent infringement generally and not a predicate offense, it is insufficient to establish the requisite advertising injury.[8] Now, compare *Hudson Universal v. Aetna Ins. Co*.[9] opining that the unauthorized use of a trademark constituted infringement of title and slogan with *Advance Watch Co. v. Kemper National Ins. Co*.,[10] holding that trademark infringement did not arise in the course of advertising.

After digesting *Hudson* and *Advance Watch*, applying New Jersey and Michigan law respectively, consider *Energex Systems Corp. v. Fireman's Fund Ins. Co*.[11] The New York court held that there was no coverage for alleged patent infringement claim, but trademark claims based on the same facts were covered. The Energex Systems court rejected the narrow construction of the term "misappropriation of advertising ideas or style of doing business" and found the requisite nexus communication was satisfied by Energex's direct mail advertisements.

In Texas under the 1976 ISO CGL policy with a broad form endorsement, the Corpus Christi Court of Appeals reversed the trial court in *CIGNA Lloyds' Ins. Co. v. Bradley's Electric, Inc*.[12] The Court of Appeals held that CIGNA, Texas Pacific and United National did not owe a duty to defend in a patent infringement lawsuit. Texas follows the complaint allegations rule and does not require an inquiry beyond the four corners of the complaint to ascertain whether the express allegations for inducement of patent infringement is based on the insured's advertising activities.

## CYBERSPACE QUESTIONS

The paramount question today is whether e-mail (advertisement) solicitation or a website owner providing information or content posting on the Internet triggers advertising injury coverage under the standard CGL policy? And what part, if any, of a company's website constitutes advertising about the policyholder's goods, products or services when mixed with entertainment or news?

Again, to resolve any question of coverage requires the analysis of three principle issues:

1. Whether the policyholder's alleged misconduct occurred in the course of its advertising,

2. Whether the policyholder's alleged misconduct qualifies as one or more of the predicate offenses,

and

3. Whether there is a sufficient causal connection between the advertising and the alleged injury.

## CONCLUSION

Advertising is the quintessential commercial speech and advertising injury is a tort that quintessentially consists of advertising. There is not much uniformity between jurisdictions or circuits on advertising injury coverage under the standard CGL policy. If a lawsuit is filed you should plead with specificity one or more of the covered offenses together with the ***operative advertising activity***. It is absolutely necessary for counsel to read and understand the case law in his or her jurisdiction. Moreover, insurance policies are contracts and unless you read them carefully you will not focus on the important facts and issues of your case. With the information in this article, practitioners and insurance professionals will have an advanced starting point.

1. *Ekco Group Inc. v. The Travelers Indemnity Co. of Illinois* 273 F.3d 409 (1st Cir. 2001) – selling of replicas is not advertising; *GAF Sales & Serv. v. Hastings Mut. Ins.* 568 N.W.2d 165 (Mich. App. 1997) – policyholder's use of the claimants trade secrets and customer lists were not advertising activities; *Smart Foods, Inc. v. Northbrook Prop. & Cas. Co.* 35 Mass. App. Ct. 239, 618 N. E. 2d 1365 (Mass. App. 1993). – proposal to a particular company to do business together not advertising.

2. *International Insurance Co. v. Florists' Mutual Insurance Co.*, 559 N.E. 2d 7, 10 (Ill. App. 1990).

3. *New Hampshire Insurance Co. v. Foxfire, Inc*, 820 F. Supp. 489, 494 (N.D. Cal. 1993); *See Farmington Cas. Co. v. Cyberlogic Tech., Inc.* 996 F. Supp. 695, 700-02 (E.D. Mich. 1998).

4. *Maxconn Inc. v. Truck Insurance Exchange* 88 Cal Rptr. 2d 750 (Cal. App. 6th Dist.1999); *Westfield Insurance Co. v. Argonics Inc.* 1999 U.S. Dist. Lexis 19397 (D. Mich., Dec. 13, 1999).

5. Lanham Act, 45 U.S.C. §§1127.

6. *Poof Toy Products, Inc. v. United States Fidelity & Guaranty Co.*, 891 F. Supp. 1228, 1235 – 1236 (E.D. Mich. 1995); *El –Com Hardware, Inc. v. Fireman's Fund Insurance Co.*, 111 Cal.Rpt. 2d 670 (Cal. Ct. App. 2001); *See also R.C. Bigelow Inc. v. Liberty Mut. Ins. Co.* 287 F. 3d 242 (2nd Cir. 2002) – duty to defend where allegations came within the plain meaning of the policy, where complaint stated trade dress infringement by copying its packaging then using that packaging in published ads, even though the competitor did expressly plead an advertising injury claim.

7. *Advance Watch Co., Ltd. v. Kemper National Insurance Co.* 99 F. 3d 795 (6th Cir.1996), 878 F. Supp. 1034, 1042 (E.D. Mich. 1995); *Sholodge, Inc. v. Travelers Indemnity Co. of Illinois*, 168 F. 3d 256 (6th Cir. 1999).

8. *United National Insurance Co. v. STT Fitness Corp.*, 182 F. 3d 447 (6th Cir. 1999); *See also, Konami v. Hartford Ins. Co. of Illinois* 761 N. E. 2d 1277 (2002) – patent infringement claims are not covered under the advertis-

ing injury provisions absent express allegations that the insured had induced patent infringement in its advertising; *CIGNA Lloyd's Insurance Co. v. Bradley's Electric, Inc.*, 33 S.W. 3d 102 (Tex. App. 2000) –no duty to defend patent infringement lawsuit where allegations of inducement were beyond the four corners of the complaint to ascertain if based on the insured's advertising activities.

9. 987 F. Supp 377 (D. N. J. 1997).

10. Supra, note 7.

11. 1997 WL 358007 (S. D. N. Y. 1997).

12. 33 S.W. 3d 102 (Tex. App. — Corpus Christi 2000, pet. den'd).

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# Comments FROM THE EDITOR

BY CHRISTOPHER W. MARTIN
Martin, Disiere, Jefferson & Wisdom, L.L.P.

I want to thank Michael Quinn and Vince Morgan for the wonderful historical insight they provided to us in their historical reflection on the *Stowers* case. The Court's file in *Stowers* was recently located thanks to the commitment to preserving historical files shared by the Harris County Clerk's Office, particularly the District Clerk, Charles Bacarisse. But for the hard work of Charles Bacarisse and Judge Mark Davidson of the 11th District Court in Harris County, many historical court files from Harris County – including the *Stowers* file – would have already been lost to the ravages of time. Saving historical court records takes both money and man power and, unfortunately, the courts of our state are short on both. Let me use this opportunity to encourage you to contact your local Clerk's office and see what you or your firm might be able to do to help preserve this rich tradition of our profession from being lost forever due to the lack of any effort to save historical court records.

Let me also use this forum to thank Jim Cornell for the great job he does week after week keeping all of us current on the latest insurance decisions from Texas courts. Jim's constant review of the cases each week and his weekly emails to all of the members of the Insurance Law Section provide one of the greatest benefits to being a member of this Section. No other Section of the State Bar of Texas that I know of consistently provides such a service to its members week after week and year after year. Jim, thanks for your hard work to keep all of us informed of the new case developments regarding Texas insurance law.

Christopher W. Martin,
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Editor-In-Chief



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