

QUILLING SELANDER,
LOWNDS, WINSLETT &
MOSER, P.C.
Dallas, Texas
www.gslwm.com

Marcie L. Schout
mschout@gslwm.com

Texas

REGULATORY LIMITS ON CLAIMS HANDLING

Timing for Responses and Determinations

Texas Insurance Code § 542.051, *et. seq.* is the Prompt Payment of Claims Act. Section 542.055 mandates that an insurer must, not later than the fifteenth dayⁱ after receipt of notice of a claim:

- acknowledge receipt of the claim;
- commence any investigation of the claim; and
- request from the claimant all items, statements, and forms that the insurer reasonably believes, at that time, will be required from the claimant.

With some stated exceptions, § 542.056 provides that an insurer has a duty to notify a claimant in writing of the acceptance or rejection of a claimⁱⁱ no later than the fifteenth business day after the date the insurer receives all items, statements, and forms required by the insurer. If an insurer cannot determine whether it will accept or reject the claim, it must notify the claimant, not later than the fifteenth day after the insurer receives all relevant items and must give the reasons the insurer needs additional time. § 542.056(d). Not later than the forty-fifth day after the date an insurer notifies a claimant that it needs additional time to evaluate the claim, the insurer must reject or accept the claim. *Id.* Once an insurer notifies an insured that it will pay a claim or part of a claim, an insurer shall pay the claim not later than the fifth business day after the notice, unless the payment is conditioned on the performance of an act by the claimant, in which case the deadline runs from the performance of the act. Tex. Ins. Code § 542.057.ⁱⁱⁱ

Except as otherwise provided, if an insurer delays payment of a claim following its receipt of all necessary items for a period exceeding the period specified in other applicable statutes or, in the absence of any other specified period, for more than sixty days, the insurer shall pay damages and other items as provided by § 542.060. Section 542.060 provides for the payment of interest at the rate of 18% per annum, plus attorney's fees. However, for claims governed by Chapter 542A (applicable to claims of property damage caused wholly or partly by forces of nature) the penalty interest rate is the judgment rate (the prime rate, subject to a minimum of 5% and maximum of 15%), plus 5%. Tex. Ins. Code § 542.0060(c). In Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1, 16-18 (Tex. 2007), the Texas Supreme Court held that the Prompt Payment of Claims Act applies to an insured's claim for defense costs in a third-party action.

The prompt payment statute entitles physicians and providers to swift payment of undisputed healthcare claims, yet it requires contractual privity between the providers and health maintenance organizations ("HMOs") in order to be enforced. See Christus Health Gulf Coast v. Aetna, Inc., 397 S.W.3d 651 (Tex. 2013). In Christus, the plaintiffs, a group of hospitals, entered a contract with an intermediary of a Medicare health

maintenance organization (HMO). The court held that plaintiffs could not sue the HMO instead of the intermediary, because there was no contract between the plaintiffs and the HMO. There was only a contract between the plaintiffs and the HMO's intermediary. Similarly, there are arguments that prompt payment interest penalty is only recoverable by the insured—it cannot be enforced by an assignee or a subrogee. Am. S. Inc. Co. v. Buckley, 748 F.Supp.2d 610, 626 (E.D. Tex. 2010); but see Berkley Reg'l Ins. Co. v. Philadelphia Indem. Ins. Co., A-10-CA-362-SS, 2011 WL 9879170, at *9 (W.D. Tex. Apr. 27, 2011), rev'd on other grounds, 690 F.3d 342 (5th Cir. 2012) (permitting subrogee to pursue Chapter 542 interest).

Standards for Determination and Settlements

Claims handling standards are set forth in Chapter 541 of the Texas Insurance Code, with Unfair Settlement Practices specifically set forth in § 541.060. § 541.060 makes it an unfair method of competition or an unfair or deceptive act or practice in the business of insurance to engage in the following unfair settlement practices with respect to a claim by an insured or beneficiary (this list is *not* exhaustive):

- misrepresenting a material fact or policy provision relating to coverage at issue;
- failing within a reasonable time to either affirm or deny coverage of a claim or submit a reservation of rights to the policyholder;
- refusing to pay a claim without conducting a reasonable investigation; or
- failing to promptly provide to a policyholder a reasonable explanation of the basis in the policy, in relation to the fact or applicable law, for the insurer's denial of a claim or offer of a compromise settlement of a claim.

With regard to an insurer's conduct in paying or settling claims, § 541.060 (2)(A) requires an insurer to "attempt in good faith to effectuate a prompt, fair, and equitable settlement of a claim with respect to which the insurer's liability has become reasonably clear." The Texas Supreme Court held that article 21.21 (now, Chapter 541) of the Texas Insurance Code gives an insured a private cause of action against its liability insurer for unfair practices in settling third-party claims. Rocor International, Inc. v. National Union Fire Insurance Co., 77 S.W.3d 253 (Tex. 2002) (insurer's unreasonable delay in settling the case caused the insured, which had self-insured retention, to incur more attorney's fees than necessary). A third-party beneficiary or a third party with a tort claim against an insured does not have standing under Chapter 541 to sue the insurer directly. Allstate Ins. Co. v. Watson, 876 S.W.2d 145, 150 (Tex. 1994).

Under the Texas Insurance Code a person seeking damages must provide written notice to the other person not later than the 61st day before the date the action is filed. Tex. Ins. Code 541.154(a). The notice must advise the recipient of the specific complaint and the amount of actual damages and expenses, including attorney's fees. The purpose of the notice requirement is to discourage litigation and encourage settlements of consumer complaints. Hines v. Hash, 843 S.W.2d 464 (Tex. 1992).

PRINCIPLES OF CONTRACT INTERPRETATION

Texas courts construe insurance policies according to general rules of contract construction to ascertain the parties' intent. Don's Bldg. Supply, Inc. v. OneBeacon Ins. Co., 267 S.W.3d 20, 23 (Tex. 2008). When construing a contract, courts will strive to give effect to the written expression of the parties' intent through the written language of the policy. *E.g.*, State Farm Lloyds v. Page, 315 S.W.3d 525 (Tex. 2010) (citing State Farm Life Ins. Co. v. Beaston, 907 S.W.2d 430, 433 (Tex. 1995)).

The court will first look at the *language* of the policy because it will presume the parties intend what the words of their contract say. See Don's Bldg. Supply, 267 S.W.3d at 23. The court will then examine the entire agreement and seek to harmonize and give effect to all provisions so that none will be meaningless. See MCI Telecomms. Corp. v. Tex. Utils. Elec. Co., 995 S.W.2d 647, 652 (Tex. 1999).

The policy's terms are given their ordinary and generally-accepted meaning unless the policy shows the words were meant in a technical or different sense. Anadarko Petro. Co. v. Houston Cas. Co., 573 S.W.3d 187, 193 (Tex. 2019); see also Don's Bldg. Supply, 267 S.W.3d at 23; see also Sec. Mut. Cas. Co. v. Johnson, 584 S.W.2d 703, 704 (Tex. 1979). Texas courts strive to honor the parties' agreement and not remake their contract by reading additional provisions into it. See Nat'l Union Fire Ins. Co. of Pittsburg, PA v. Crocker, 246 S.W.3d 603, 606 (Tex. 2008).

If an insurance policy remains ambiguous despite these canons of interpretation a court should construe its language against the insurer in a manner that favors coverage. See, e.g., National Union Fire Ins. Co. v. Hudson Energy Co., 811 S.W.2d 552, 555 (Tex. 1991); Evanston Ins. Co. v. Legacy of Life, Inc., 370 S.W.3d 377, 380 (Tex. 2012). If a contract for insurance has a clear and definite meaning, then it is not ambiguous as a matter of law, even if the parties interpret a policy differently. Gilbert Tex. Constr., L.P. v. Underwriters at Lloyd's London, 327 S.W.3d 118 (Tex. 2010).

CONTRACT INTERPRETATION

Common Issues

1. Faulty Workmanship as an "Occurrence" [What is the state of the common law in your state on this subject?]

In a seminal 2007 opinion, the Texas Supreme Court held that faulty workmanship or defective construction that caused a foundation to shift, thereby resulting in cracks in the interior and exterior of a house, was "property damage" caused by an "occurrence." Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1, 16, 20 (Tex. 2007). An occurrence is defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions, which results during the policy period, in: 'bodily injury';" In the context of the definition of occurrence, "an accident is generally understood to be a fortuitous, unexpected and unintended event." *Id.* at 8. "[A] deliberate act, performed negligently is an accident if the effect is not the intended or expected result; that is, the result would have been different had the deliberate act been performed correctly." *Id.*

The corollary question is whether faulty workmanship is "property damage". Although defective products or construction can cause "property damage," the Texas Supreme Court has expressed skepticism that the mere incorporation of a defective workmanship or product into a larger thing—without something more—constitutes property damage. The Court stated in dicta that "faulty workmanship that merely diminishes the value of the home without causing physical injury or loss of use does not involve 'property damage.'" *Id.* at 10. That said, if there is "resulting damage" from the faulty workmanship to things other than the insured's work, there is likely to be "property damage" caused by an "occurrence".

2. **Does Your State Have an Anti-Indemnity Statute? [And if so, does it have any notable peculiarities?]**

Texas has two primary anti-indemnity statutes: The Texas Oilfield Anti-Indemnity Act (Tex. Civ. Prac. & Rem. Code § 127.001 *et seq.*) and the Texas Anti-Indemnity Act (Tex. Ins. Code § 151.101 *et. seq.*).

The Texas Oilfield Anti-Indemnity Act (TOAIA) applies to agreements pertaining to a well for oil, gas, or water or to a mine for a mineral. Tex. Civ. Prac. & Rem. Code § 127.002 ; *see* §127.001 for definitions of what qualifies as an agreement pertaining to a well for oil, as, or water or to a mine for a mineral. Under the TOAIA, a contractual indemnity obligation is void if it provides indemnity for the sole or concurrent negligence of the indemnitee. *Id.* § 127.003. The exception to that rule is if the agreement provides that the contractual indemnity obligation will be supported by liability insurance coverage furnished by the indemnitor. *Id.* § 127.005. In that case, if the indemnity obligation is mutual—both parties have the same indemnity obligation—then the contractual indemnity provision is enforceable, but it is limited to the limits provided by the insurance. If the indemnity obligation is unilateral—the parties do not have reciprocal obligations—then the contractual indemnity provision is enforceable, but it is limited to \$500,000 of insurance coverage for same. *Id.* Exclusions in TOAIA provide that it does not apply to (1) injury from radioactivity, (2) property injury from pollution, (3) property injury from reservoir or underground damage, (4) injury resulting from performance of services to control a wild well, and (5) costs to control a wild well. *Id.* § 127.004.

The Texas Anti-Indemnity Act (“TAIA”) applies to post January 1, 2012 construction contracts, which are broadly defined to include all aspects and levels of a construction project, but not to include a “single family house, townhouse, duplex, or land development directly related thereto.” Tex. Ins. Code § 151.001 (definition); §151.101 (applicability). The TAIA voids a contractual indemnity provision in a construction contract “to the extent that it requires an indemnitor to indemnify, hold harmless, or defend a party, including a third party, against a claim caused by the negligence or fault, the breach or violation of a statute, ordinance, governmental regulation, standard, or rule, or the breach of contract of the indemnitee, its agent or employee, or any third party under the control or supervision of the indemnitee, other than the indemnitor or its agent, employee, or subcontractor of any tier.” Tex. Ins. Code § 151.102. Similarly, the TAIA voids a provision in the construction contract that requires the purchase of additional insured coverage, and the endorsement or provision in the insurance policy providing such additional insured coverage “to the extent that it requires or provides coverage the scope of which is prohibited under this subchapter for an agreement to indemnify, hold harmless or defend.” Tex. Ins. Code §151.104. The nuances of how these provisions apply and how they impact an insurer’s duty to defend and duty to indemnify in situations where there is concurrent negligence of both the indemnitor and indemnitee is largely undeveloped in Texas case law since the passage of the TAIA in 2012.

The TAIA does not apply to a provision requiring “a person to indemnify, hold harmless, or defend another party to the construction contract or a third party against a claim for the bodily injury or death of an employee of the indemnitor, its agent, or its subcontractor of any tier.” Tex. Ins. Code § 151.103. In addition, there are numerous exclusions from the TAIA including (1) consolidated insurance programs, (2) warranty obligations independent of indemnity, (3) indemnity in loan and financing documents, (4) sureties and construction bonds, (5) worker’s compensation,

(6) governmental immunity, (7) agreements subject to TOAIA, (8) particular railroad licenses, (9) indemnity pertaining to copyright infringement, (10) construction contracts for single family house, townhouse, duplex or land development directly related therefor to a public works project of a municipality, or (11) joint defense agreements entered into after a claim is made. Tex. Ins. Code §151.105.

CHOICE OF LAW

If there is a choice of law provision, Texas courts must make an initial determination of whether that provision should be controlling. The Texas Supreme court has held that a contractual choice of law should generally be enforced. DeSantis v Wackenhut Corp., 793 S.W.2d 670, 677-78 (Tex. 1990). Otherwise, a court in Texas must evaluate whether an insurance contract meets the requirements of Tex. Ins. Code Ann. art. 21.42 and if it does, the contract is subject to Texas law. If the insurance contract does not meet the requirements of art. 21.42, then a court is to apply the "most significant relationship" test of the Restatement (Second) of Conflict of Laws, § 6, to determine which state's law should control the dispute. Commer. Underwriters Ins. Co. v. Royal Surplus Lines Ins. Co., 345 F. Supp. 2d 652 (S.D. Tex. 2004). The relevant contacts are those the state has with the insurance dispute, and not with the underlying lawsuit. Reddy Ice Corp. v. Travelers Lloyds Ins. Co., 145 S.W.3d 337, 345 (Tex. App.—Houston [14th Dist.] 2004, pet. denied).

Article 21.42 provides that Texas law applies to an insurance policy when (1) the proceeds are payable to any citizen or inhabitant of Texas, (2) the policy was issued by an insurer doing business in Texas, and (3) the policy was issued in the course of the insurer's business in Texas. TEX. INS. CODE ANN. art. 21.42 (Vernon 1981); Reddy Ice Corp., 145 S.W.3d at 341; see Hefner v. Republic Indem. Co. of Am., 773 F. Supp. 11, 13 (S.D. Tex. 1991). If article 21.42 does not mandate application of Texas law. Consequently, Texas will apply the "most significant relationship" test. See Reddy Ice Corp., 145 S.W.3d at 340.

In a class action matter the court should also consider whether laws in states in which class members reside would provide them greater relief, or whether those states have a particular interest in the claims being made, especially considering a state's interest in regulating the business of insurance as reflected in section 192 of the *Restatement of Conflict of Laws (Second)*, which states: The validity of a life insurance contract issued to the insured upon his application and the rights created thereby are determined, in the absence of an effective choice of law by the insured in his application, by the local law of the state where the insured was domiciled at the time the policy was applied for, unless, with respect to the particular issue, some other state has a more significant relationship to the transaction and the parties, in which event the local law of the other state will be applied. See, Nat'l W. Life Ins. Co. v. Rowe, 164 S.W.3d 389, 391-92 (Tex. 2005)

DUTIES IMPOSED BY STATE LAW

Duty to Defend

1. Standard for Determining Duty to Defend

An insurer's duty to defend is determined by the "complaint allegation rule" or the "eight corners rule," which limits review to the four corners of the insurance policy and the four corners of the plaintiff's petition in the underlying lawsuit. Pine Oak Builders, Inc. v. Great Am. Lloyds Ins. Co.,

279 S.W.3d 650, 654 (Tex. 2009); GuideOne Elite Ins. Co. v. Fielder Road Baptist Church, 197 S.W.3d 305 (Tex. 2006); Trinity Universal Ins. Co. v. Cowan, 945 S.W.2d 819, 821 (Tex. 1997). Thus, if the *facts alleged* in the petition do not fall within the scope of coverage, an insurer is not legally required to defend a lawsuit against its insured. *Id.*; National Union Fire Ins. Co. of Pittsburg, P.A. v. Merchants Fast Motor Lines, Inc., 939 S.W.2d 139, 141 (Tex. 1997); Collier v. Allstate County Mut. Ins. Co., 64 S.W.3d 54, 59 (Tex.App.—Fort Worth 2001, no pet.) (explaining that an insurer's "duty to defend is determined by the factual allegations of the pleadings, considered in light of the policy provisions and without reference to the truth or falsity of the allegations). In reviewing the pleadings, the court must focus on the facts alleged, not on the legal theories asserted. Merchants Fast Motor Lines, 939 S.W.2d at 141; Collier, 64 S.W.3d at 59. Further, the allegations should be considered "without reference to the truth or falsity of such allegations." King v. Dallas Fire Ins. Co., 85 S.W.3d 185, 191 (Tex. 2002) (citing Argonaut Southwest Ins. Co. v. Maupin, 500 S.W.2d 633, 635 (Tex. 1973)). Courts have applied the eight corners rule "somewhat liberally in favor of the insured by resolving all doubts regarding the duty to defend in favor of the duty and by recognizing the duty if the petition alleges facts that potentially support a covered claim." Pharr-San Juan-Alamo Indep. Sch. Dist. v. Tex. Political Subdivisions Prop./Cas. Joint Self Ins. Fund, 642 S.W.3d 466, 472 (Tex. 2022).

In 2022, the Texas Supreme Court recognized a narrow exception for the consideration of extrinsic evidence in analyzing the duty to defend. Monroe Guar. Ins. Co. v. BITCO Gen. Ins. Corp., 640 S.W.3d 195, 197 (Tex. 2022). The Court will allow consideration of extrinsic evidence only if the extrinsic evidence (1) goes solely to the issue of coverage and does not overlap with the merits of liability, (2) does not contradict facts alleged in the pleading, and (3) conclusively establishes the coverage fact to be proved. *Id.* The Court takes an expansive view of what overlaps with the merits. *Id.* (holding that evidence of when damage occurred overlapped with the fact that damage occurred at all, such that extrinsic evidence of when construction defect related property damage occurred could not be considered). The Texas Supreme Court also permits consideration of extrinsic evidence if there is "conclusive evidence that groundless, false, or fraudulent claims against the insured have been manipulated by the insured's own hands in order to secure a defense and coverage where they would not otherwise exist." Loya Insurance Co. v. Avalos, 610 S.W.3d 878 (Tex. 2020).

2. Issues with Reserving Rights

An insurer's reservation of rights is the notification to the insured that the insurer will defend the insured, but that the insurer is not waiving any defenses it may have under the policy, and it protects an insurer from a subsequent attack on its coverage position on waiver or estoppel grounds. Texas Ass'n of Counties County Gov't Risk Mgmt. Pool v. Matagorda County, 52 S.W.3d 128, 133 (Tex. 2000). An insurer may undertake an insured's defense and later deny coverage by reserving its rights, so long as the insured is advised that the insurer may use a policy defense to later void its duty to defend. American Eagle Ins. Co. v. Nettleton, 932 S.W.2d 169, 174 (Tex. App.—El Paso 1996, writ denied). The insurer properly reserves its rights only when it has a good-faith belief that the complaint alleges conduct that may not be covered by the policy. *Id.*

A reservation of rights should be sent as soon as reasonably possible. Generally, if there is no coverage under an insurance policy as a matter of law, coverage cannot be created through theories of waiver or estoppel. In Ulico Cas. Co. v. Allied Pilots Assoc., 262 S.W.3d 773, 781 (Tex. 2008) the court held that an insurer's policy is not expanded simply by the insurer assuming the

insured's defense without a reservation of rights letter. However, if the insurer's actions prejudice the insured, the lack of coverage does not preclude the insured from asserting an estoppel theory to recover damages is sustains because of the insurer's actions.

State Privacy Laws; Insurance Regulatory Issues; Arbitration/Mediation

Texas common law and statutory law provide for privacy protections in addition to the federal laws generally applicable to Texas residents. For example, Texas recognizes the tort of intrusion. See Valenzuela v. Aquino, 853 S.W.2d 512, 513 (Tex. 1993). This tort occurs when one intrudes on the private affairs or solitude of another, and a reasonable person would be highly offended by such an intrusion. See *id.* Coercive collection practices may give rise to an action for intrusion of a debtor's privacy. See Household Credit Serv. Inc. v. Driscoll, 989 S.W.2d 72, 84 (Tex.App.—El Paso 1998, pet. denied); Ledisco Fin. Serv v. Viracola, 533 S.W.2d 951, 957 (Tex.Civ.App.—Texarkana 1976, no writ). Texas also recognizes the tort of disclosure when one publicly discloses private facts, the matter publicized is not of legitimate public concern, and the publication of those facts would be highly offensive to a reasonable person of ordinary sensibilities. See Star-Telegram, Inc. v. Doe, 915 S.W.2d 471, 473-74 (Tex. 1995); Industrial Found. of the South v. Texas Indus. Accident Bd., 540 S.W.2d 668, 682-85 (Tex. 1976).

Statutory laws relating to privacy include the Interception of Communication provisions in the Texas Civil Practice and Remedies Code (Tex. Civ. Prac. & Rem. Code Ann. § 123.001, *et seq.* (Vernon 1997)) and Article 18.20 of the Texas Code of Criminal Procedure (Tex. Rev. Civ. Stat. Ann. art. 18.20 (Vernon Supp. 2002)) which protect against eavesdropping and wiretapping; the Texas Open Records Act (Tex. Govt. Code ch. 552 (Vernon 1994)); and Chapters 601 (Privacy) and §602 (Privacy of Health Information) of the Texas Insurance Code, which governs privacy in the insurance context. Under the Texas Insurance code, you must obtain authorization to disclose nonpublic personal health information. Yet, there are 31 enumerated exceptions which include underwriting, loss control, case management, investigation or reporting of actual or potential fraud, etc.

1. Criminal Sanctions

Sec. 602.051 of the Texas Insurance Code prohibits the disclosure of nonpublic personal health information to any person without a separate authorization from the individual or their legally authorized representative. However, a covered entity may disclose information without an authorization if the disclosure is made to another covered entity defined in Section 181.001 of the Act or to an insurance company, HMO or insurance agent as defined in Section 602.001 of the Texas Insurance Code; and, so long as the disclosure is for the purpose of treatment, payment of a claim, health care operations, performance of an HMO function or as otherwise permitted by state or federal law.

If one knowingly or willfully violates this chapter, the attorney general may bring an action for injunctive relief to restrain a violation of this chapter or bring an action for a civil penalty. A civil penalty assessed under this section may not be less than \$3,000 for each violation. If the court finds that the violations have occurred with a frequency as to constitute a pattern or practice, the court may assess a civil penalty not to exceed \$250,000.

Chapter 181 of the Texas Health and Safety Code was enacted in an effort to expand HIPPA's protections for use of certain medical records. It also prohibits the disclosure of nonpublic personal health information to any person without a separate authorization from the individual or their legally authorized representative.

Under §522.002 of the Texas Business and Commerce Code it is a Class B misdemeanor to use a scanning device or re-encoder to access, read, scan, store, or transfer information encoded on the magnetic strip of a payment card without the consent of an authorized user of the payment card and with intent to harm or defraud another. But, it is a state jail felony if the information accessed, read, scanned, stored, or transferred was protected health information as defined by the Health Insurance Portability and Accountability Act and Privacy Standards, as defined by Section 181.001, Health and Safety Code.

2. The Standards for Compensatory and Punitive Damages

Actual damages or compensatory damages are awarded to repair a wrong or to compensate for an injury. Actual damages are classified as either economic or noneconomic damages. Economic damages are intended to compensate a claimant for actual economic or pecuniary loss. Noneconomic damages are awarded to compensate the claimant for physical pain and suffering, mental or emotional pain or anguish and all other nonpecuniary losses. Noneconomic damages are left to the discretion of the jury.

To prove gross negligence or malice, a party must present evidence that demonstrates the act or omission, when viewed objectively from the standpoint of the actor, involved an extreme degree of risk, considering the probability and magnitude of the potential harm to others. Transp. Ins. Co. v. Moriel, 879 S.W.2d 10, 23 (Tex. 1994). The “extreme degree of risk” showing is “a threshold significantly **higher** than the objective ‘reasonable person’ test for negligence.” Moriel, 879 S.W.2d at 22.

Moreover, the Plaintiff must present evidence showing the Defendants had actual, subjective awareness of the risk involved, but nevertheless proceeded in conscious indifference to the rights, safety, or welfare of others. *Id.* at 23; Emmons, 50 S.W.3d at 127.

3. State Arbitration and Mediation Procedures

- Arbitration

The Texas Arbitration Act can be found at Chapter 171.001 to 171.098 of the Texas Civil Practice & Remedies Code. Texas law favors settling disputes by arbitration. *See* L. H. Lacy Co. v. City of Lubbock, 559 S.W.2d 348, 351 (Tex. 1977). Arbitration agreements offer a permissible choice to tradition. *Id.* at 352. There is nothing per se unconscionable about arbitration agreements. Moreover, assuming unequal bargaining power exists does not establish grounds for defeating an agreement to arbitrate. Unconscionability is to be determined in light of a variety of factors, which aim to prevent oppression and unfair surprise; in general, a contract will be found unconscionable if it is grossly one-sided. Judicial review of an arbitration award is extraordinarily narrow.” E. Tex. Salt Water Disposal Co. v. Werline, 307 S.W.3d 267, 271 (Tex. 2010).

- Mediation

Mediation is normally a voluntary, flexible, economic, fast and confidential procedure. If an agreement is reached, everyone wins. Yet, a court on its own or the motion of a party may order the parties to attend mediation. However, the court cannot compel the parties to negotiate in “good faith.” *See* In re Acceptance Ins., 33 S.W.3d 443, 452 (Tex.App-Fort Worth 2000, orig. proceeding).

4. State Administrative Entity Rule-Making Authority

The Texas Department of Insurance (TDI) mission is to protect insurance consumers by:

- Regulating the insurance industry fairly and diligently
- Promoting a stable and competitive market
- Providing information that makes a difference.

TDI is authorized by statute to enact rules and regulations necessary for the successful regulation of the insurance industry fairly and diligently.

The determining factor in deciding whether TDI has exceeded its **rule-making authority** is whether the rules are "in harmony" with the general objectives of the legislation involved. Railroad Comm'n of Tex. v. Lone Star Gas Co., 844 S.W.2d 679, 685 (Tex. 1992); Gulf Coast Coal. of Cities v. Public Util. Comm'n, 161 S.W.3d 706, 711 (Tex. App.—Austin 2005, no pet.). For an administrative rule to be "in harmony" with legislative objectives, it must not impose additional burdens, conditions, or restrictions in excess of or inconsistent with relevant statutory provisions. Gulf Coast Coal. of Cities, 161 S.W.3d at 712.

EXTRACONTRACTUAL CLAIMS AGAINST INSURERS: ELEMENTS AND REMEDIES

Bad Faith Claim Handling/Bad Faith Failure to Settle Within Limits

The Texas Supreme Court first recognized the existence of the duty of good faith and fair dealing in the insurance context in Arnold v. National County Mutual Fire Insurance Co., 725 S.W.2d 165, 167 (Tex. 1987). It held that the duty arises from the special relationship that is created by the contract between the insurer and the insured. *Id.*; see also, Viles v. Security Nat'l Ins. Co., 788 S.W.2d 566, 567 (Tex. 1990) (recognizing that the duty arises "not from the terms of the insurance contract, but from an obligation imposed in law" as a result of the special relationship). A claim for breach of the duty of good faith and fair dealing is separate from any claim for breach of the underlying insurance contract, Viles, 788 S.W.2d at 567, and the threshold of bad faith is reached only when the breach of contract is accompanied by an independent tort. Transportation Ins. Co. v. Moriel, 879 S.W.2d 10, 17 (Tex. 1994).

Bad-faith liability in the insurance context arises out of the contractual relationship between the insured and the insurer. Aranda v. Insurance Co. of N. Am., 748 S.W.2d 210, 212 (Tex. 1988). The duty of good faith and fair dealing is separate and distinct from the insurer's settlement duties that arise under Chapter 541 of the Texas Insurance Code.

3. First Party

Those who wish to sue an insurance company for bad faith relating to the handling of a first-party claim generally have two causes of action available: (1) a common law claim for breach of the duty of good faith and fair dealing; and (2) a statutory claim for Unfair Claims Settlement Practices under Texas Insurance Code Section 541.060(a). While the common law and statutory standards of liability are generally combined, there are some differences in the type of damages that can be recovered under each and what it takes to get those damages.

Under the common law tort theory, an insurer fails to comply with its duty of good faith and fair dealing when, it has no reasonable basis for denial or delay of payment or fails to reasonable

investigate its basis for denying a claim that was covered by the policy. See Arnold v. National County Mutual Fire Insurance Co., 725 S.W.2d 165, 167 (Tex. 1987); Universe Life Ins. Co. v. Giles, 950 S.W.2d 48, 50-51 (Tex. 1997). Yet, the meaning of “reasonably clear liability” and “reasonable basis for denial” is continually being litigated. An insurer may also violate its duty by canceling a policy without a reasonable basis. Union Bankers Ins. Co. v. Shelton, 889 S.W.2d 278, 283 (Tex. 1994). A cause of action is stated by alleging that the insurer had no reasonable basis for the cancellation of the policy and that the insurer knew or should have known of that fact. *Id.*

Notably, an insurer cannot be held liable for bad faith if it erroneously denies a claim, so long as there is a valid basis for denying the claim that existed at the time of the denial. See Republic Ins. Co. v. Stoker, 903 S.W.2d 338, 340 (Tex. 1995). This does not, however, relieve an insurance carrier of its obligation to promptly investigate and process claims. See *id.*

In USAA Texas Lloyd’s Co. v. Menchaca, 545 S.W.3d 479 (Tex. 2018), the Texas Supreme Court addressed the issue of whether and when an insured can recover policy benefits as actual damages caused by an insurers violation of the Insurance Code, absent a finding that the insured had a contractual right to benefits under its insurance policy. And after two lengthy opinions, the decision and holding is simply “It Depends.” Deciding when and under what rule is allowed will depend on the facts of each case.

The Menchaca II court provided guidance and clarified the following five rules that govern the relationship between insureds’ policy claims and tort claims under the Insurance Code:

- The General Rule—An insured generally cannot recover policy benefits as damages for an insurer’s statutory violation if the policy does not provide the insured a right to receive those benefits.
- The Entitled-to-Benefits Rule—An insured who establishes a right to receive benefits under the policy can recover those benefits as actual damages under the Insurance Code if the insurer’s statutory violation causes the loss of the benefits.
- The Benefits-Lost Rule—Even if the insured cannot establish a present contractual right to policy benefits, the insured can recover benefits as actual damages under the Insurance Code if the insurer’s statutory violation caused the insured to lose that contractual right.
- The Independent-Injury Rule—If an insurer’s statutory violation causes an injury independent of the loss of policy benefits, the insured may recover damages for that injury even if the policy does not grant the insured a right to benefits. What constitutes “independent injury” is developing.
- The No-Recovery Rule—An insured cannot recover any damages based on an insurer’s statutory violation if the insured had no right to receive benefits under the policy and sustained no injury independent of a right to benefits.

4. Third-Party

In Maryland Ins. Co. v. Head Indus. Coatings & Servs., 938 S.W.2d 27, 28-29 (Tex.1996)(per curiam), the Texas Supreme Court held that an insurer owes its insured no common law duty of good faith and fair dealing to investigate and defend claims made by a third party against the insured. In refusing to recognize a duty of good faith and fair dealing under the facts before it, the Supreme

Court held that “Texas law recognizes only one tort duty in [third-party insurance cases], that being the duty stated in [G.A] Stowers Furniture Co. v. American Indemnity Co., 15 S.W.2d 544 (Tex. Comm’n App. 1929, holding approved).” More recently, the Court has stated *Stowers* is the only common law tort duty in the context of third party insurers responding to settlement demands. Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co., 236 S.W.3d 765, 776 (Tex. 2007). *Stowers* imposes a duty on an insurance company to use reasonable care to avoid a judgment against its insured which is in excess of policy limits. The Texas Supreme Court has stated that the requirements for a valid *Stowers* demand include the following: (1) the claim against the insured must be within the scope of coverage; (2) the demand is within the policy limits; and (3) the terms of the demand “are such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured’s potential exposure to an excess judgment.” American Physicians Ins. v. Garcia, 876 S.W.2d 842 (Tex. 1994).

The statutory duty to settle recognized under § 541.060(a)(2) of the Texas Insurance Code, is limited to the duty required under *Stowers*. Rocor Intern., Inc. v. National Union Fire Ins. Co. of Pittsburgh, PA, 77 S.W.3d 253, 262 (Tex. 2002) (“An insurer’s statutory duty to reasonably attempt settlement of a third -party claim against its insured is not triggered until the claimant has presented the insured with a proper settlement demand within policy limits that an ordinarily prudent insurer would have accepted.”)

A third party can gain standing to bring an extra-contractual claim against an insurer through an assignment of rights from the policyholder. The assignment must be made after an adjudication of plaintiff’s claim against the defendant in a fully adversarial trial. State Farm Fire & Cas. Co. v. Gandy, 925 S.W.2d 696, 714 (Tex. 1996).

Fraud

Fraud occurs when:

- a party makes a material misrepresentation;
- the misrepresentation is made with knowledge of its falsity or made recklessly without any knowledge of the truth and as a positive assertion;
- the misrepresentation is made with the intention that it should be acted on by the other party; and
- the other party acts in reliance upon the misrepresentation and thereby suffers injury.

See also Johnson v. Brewer & Pritchard, P.C., 73 S.W.3d 193, 211 n.45 (Tex. 2002); Johnson & Higgins, Inc. v. Kenneco Energy, 962 S.W.2d 507, 524 (Tex. 1998).

Fraud can also occur when:

- a party [conceals or] fails to disclose a material fact within the knowledge of that party;
- the party knows that the other party is ignorant of the fact and does not have an equal opportunity to discover the truth;
- the party intends to induce the other party to take some action by [concealing or] failing to disclose the fact; and
- the other party suffers injury as a result of acting without knowledge of the undisclosed fact.

See also New Process Steel Corp. v. Steel Corp. of Texas, 703 S.W.2d 209, 214 Tex.App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.).

Intentional or Negligent Infliction of Emotional Distress

The Texas Supreme Court considers the tort of intentional infliction of emotional distress (IIED) to be a “gap filler.” Thus, an IIED claim is available only when a person intentionally inflicts severe emotional distress in a manner so unusual that the victim has no other recognized theory of redress, such cases are rare. The elements are as follows:

- The plaintiff is a person.
- The defendant acted intentionally or recklessly;
- The emotional distress that the plaintiff suffered was severe.
- The defendant’s conduct was extreme and outrageous;
- The defendant’s actions proximately caused the plaintiff’s emotional distress; and
- No alternative cause of action would provide a remedy for the severe emotional distress caused by the defendants’ conduct

See Hersh v. Tatum, 526 S.W.3d 462, 468 (Tex. 2017)(per curium); Twyman v Twyman, 855 S.W.2d 619, 621 (Tex. 1993)(adopting RESTATEMENT (SECOND) OF TORTS § 46 (1965)).

There is no general duty in Texas *not* to negligently inflict emotional distress. A claimant may recover mental anguish damages only in connection with a breach of some other legal duty. Boyles v. Kerr, 855 S.W.2d 593, 594 (Tex. 1993).

State Consumer Protection Laws, Rules and Regulations

Significant consumer protection laws include the Texas Deceptive Trade Practices Act (Tex. Bus & Com. Code Ann. § 17.41, *et seq.* (Vernon 2000)); Deceptive Insurance Actions under Texas Insurance Code Chapter 541; Late Payment of Claims under Texas Insurance Code Chapter 542; and Title 28 of the Texas Administrative Code contains additional regulations that further define the foregoing statutes.

DISCOVERY ISSUES IN ACTIONS AGAINST INSURERS

Discoverability of Claims Files Generally

- Claims file in same suit.

Non-privileged portions of the claim file of a party’s insurance company (when the insurance company is not a party) is generally discoverable in the same suit. See *e.g.*, In re Ford Motor Co., 988 S.W.2d 714, 719 (Tex. 1998). However, if the insurance carrier is a party or in a first party claim, if the claim file is exempt from discovery under one cause of action, the party cannot get it for another cause in the same suit. Maryland Am. Gen. Ins. Co. v. Blackmon, 639 S.W.2d 455, 457-58 (Tex. 1982). An insurer is entitled to assert privilege to protect its claim file so long as its liability under the policy remains undetermined.

- Claims file in separate suit.

The claim file of an insurance company is sometimes discoverable in another suit. *See, e.g., Turbodyne Corp. v. Heard*, 720 S.W.2d 802, 804 (Tex. 1986); *Eddington v. Touchy*, 793 S.W.2d 335, 337 (Tex.App.—Houston [1st Dist.] 1990, orig. proceeding); *but see Humphreys v. Caldwell*, 888 S.W.2d 469, 471 (Tex. 1994)(after first suit, Defendant in that suit sued Plaintiff's carrier; claim file in first suit was not discoverable). Further, under most circumstances a trial court would abuse its discretion if it ordered an insurer to produce evidence related to insurance claims other than the claimant's. *In Re Nat'l Lloyds Ins. Co.*, 449 S.W.3d 486 (Tex. 2014).

Discoverability of Reserves

Federal district courts in Texas have held that loss reserves are discoverable in bad faith insurance cases, including Stowers cases. *O'Donnell v. Avis Rent A Car Sys. LLC*, No. 3:19-CV-2687-S-BK, 2021 WL 5282694, at *3 (N.D. Tex. Apr. 14, 2021); *Brabo Int'l Group, Inc. v. United Fire & Cas. Co.*, No. 5:19-CV-66, 2020 WL 6440717, at *4 (S.D. Tex. Aug. 17, 2020). One intermediate appellate court in Texas has granted mandamus relief as to an order requiring production of reserves. *In re Am. Home Assur. Co.*, 88 S.W.3d 370, 377 (Tex. App.—Texarkana 2002, orig. proceeding). Another court has refused to grant mandamus relief to require redaction of reserve information. *In re General Agents Ins. Co. of Am., Inc.*, 224 S.W.3d 806, 822 (Tex. App.—Houston [14th Dist.] 2007, orig. proceeding). The trend in Texas seems to be toward requiring production of reserves where bad faith claims are asserted against the insurer.

Discoverability of Existence of Reinsurance and Communications with Reinsurers

As noted above when a party seeks information beyond the insurance agreement's contents — such as the amount of available coverage remaining on a policy — courts will rely on the general discovery standard to determine if the information requested must be produced. As to the existence of reinsurance the same rule applies, ie 1) it must not be privileged; and 2) it must be relevant to the subject matter of the pending action, claim, or defenses. As to communications the same rationale as noted in section D below would apply.

Attorney/Client Communications

The lawyer-client privilege is found under Texas Rule of Evidence 503. The attorney-client privilege protects confidential communications between a lawyer and a client or their respective representatives made to facilitate the rendition of professional legal services to the client. The privilege may be invoked if the information or documents were prepared after a lawsuit had been filed or it there was good cause to believe that a lawsuit was likely.

An adjuster's handwritten notes can qualify as privileged. *See In Re Certain Underwriters at Lloyd's*, 294 S.W.3d 891 (Tex.App.—Beaumont 2009, no pet.). Underwriters hired and adjusting company to assist with the investigation. *Id.* At 895. The adjusting company's employee made handwritten notes of conversations that he had with the underwriters' representatives or attorneys. *Id.* In response to a subpoena, the company produced its file, which contained these handwritten notes *Id.* The underwriters then sought the return of the notes, arguing that they were privileged. *Id.* At 896. The trial court denied the motion, and this mandamus petition followed. *Id.* In conditionally granting relief, the appellate court determined that the documents were privileged. *Id.* At 900. The court held that the underwriters had a reasonable basis for the belief that there was a substantial chance of litigation during the time period covered by the notes. *Id.* Next, the court held that the substantial need and undue

hardship exceptions did not allow the policyholders to retain the notes. *Id.* At 901.

As to the Tripartite Relationship between the Insurer, Insured and Insurance Defense Counsel, the liability policy may grant the insurer the right to take “complete and exclusive control” of the insured’s defense. G.A. Stowers Furniture Co. v. American Indemnity Co., 15 S.W.2d 544, 547 (Tex. Comm’n App. 1929, holding approved); When defending unconditionally, the insurer has complete control of the defense. This control of the insured’s defense includes authority to accept or reject settlement offers and, where no conflict of interest exists, to make other decisions that would normally be vested in the client, here the insured.

A defense attorney, as an independent contractor, has discretion regarding the day-to-day details of conducting the defense, and is not subject to the client’s control regarding those details. The attorney may not act contrary to the client’s wishes, the attorney is in complete charge of the minutiae of court proceedings and can properly withdraw from the case, subject to the control of the court, if he is not permitted to act as he thinks best. Moreover, because the lawyer owes unqualified loyalty to the insured, see Employers Cas. Co. v. Tilley, 496 S.W.2d 552, 558 (Tex. 1973), the lawyer must at all times protect the interests of the insured even if those interests would be compromised by the insurer’s instructions. “An insurer is not vicariously liable for the malpractice of an independent attorney it selects to defend an insured.” State Farm Mut. Auto. Ins. Co. v. Traver, 980 S.W.2d 625, 626 (Tex. 1998).

DEFENSES IN ACTIONS AGAINST INSURERS

Misrepresentations/Omissions: During Underwriting or During Claim

An insurer may avoid liability under a policy if it issued the policy in reliance on a false representation that was material to the risk. It is a question of fact whether a misrepresentation made in the application for the policy or in the policy itself was material to the risk or contributed to the contingency or event on which the policy became due and payable. TEX. INS. CODE ANN. § 705.004; see also Odom v. Insurance Co. of Pennsylvania, 455 S.W.2d 195, 198 (Tex. 1970) (affirming cancellation of automobile liability policy based on materially false statements in the policy application). “It is now settled law in this state that these five elements must be pled and proved before the insurer may avoid a policy because of the misrepresentation of the insured: (1) the making of the representation; (2) the falsity of the representation; (3) reliance thereon by the insurer; (4) the intent to deceive on the part of the insured in making same; and (5) the materiality of the representation.” Mayes v. Massachusetts Mut. Life Ins. Co., 608 S.W.2d 612, 616 (Tex. 1980). In 2023, in the face of a challenge to whether intent to deceive should still be required, the Texas Supreme Court reaffirmed these as the elements that must be proved for rescission. American National Ins. Co. v. Arce, ---S.W.3d ---, 2023 WL 3134718 (Tex. Apr. 28, 2023).

If a insurer intends to use misrepresentation as a defense or as a basis to rescind a policy, It must show “that before the 91st day after the date the defendant discovered the falsity of the representation, the defendant gave notice [to the insured] that the [insurer] refused to be bound by the policy.” Tex. Ins. Code § 705.005(b); Arce v. Am. Nat’l Ins. Co., 633 S.W.3d 228, 236–37 (Tex. App.—Amarillo 2021, pet. filed) (reversing summary judgment on rescission where notice was given beyond the 90 day requirement).

Failure to Comply with Conditions

In order to enforce a condition precedent to coverage, an insurer must prove that it was prejudiced by the insured’s failure to comply with the relevant condition. See Hernandez v. Gulf Group Lloyds, 875 S.W.2d 691, 692–94 (Tex. 1994); Hanson Prod. Co. v. Americas Ins. Co., 108 F.3d 627 (5th Cir. 1997). By demanding that an insurer prove prejudice, Texas law requires that only a material breach of a contract excuses performance. See

Hernandez, 875 S.W.2d at 693. This prejudice requirement clearly applies to occurrence-based policies. See PAJ, Inc. v. The Hanover Ins. Co., 243 S.W.3d 630 (Tex. 2008) (holding that an insured's failure to timely notify its insurer of a copyright infringement claim or suit does not defeat coverage under the advertising injury coverage of an occurrence-based CGL policy if the insurer was not prejudiced by the delay). The prejudice requirement also applies to claims-made policies as long as notice is given within the policy period or other specified reporting period. See Prodigy Communications Corp. v. Agricultural Excess & Surplus Insurance Co., 288 S.W.3d 374, 382 (Tex. 2009); and Financial Industries Corp. v. XL Specialty Insurance Co., 285 S.W.3d 877, 879 (Tex. 2009).

The assistance and cooperation of the insured is normally a condition precedent of almost every insurance policy and a requirement of the insured for defense and indemnity. But even if there is no evidence that the condition precedent of cooperation was satisfied, an insurer will not escape liability unless it was prejudiced by the lack of cooperation. See Harwell v. State Farm Mutual Automobile Insurance Company, 896 S.W.2d 170 at 173-74

In PAJ, Inc. v. The Hanover Insurance Co., 243 S.W.3d 630, 636-37 (Tex. 2008), the court held that "an insured's failure to timely notify its insurer of a claim or suit does not defeat coverage if the insurer was not prejudiced by the delay." *PAJ* involved an occurrence-based commercial general liability ("CGL") policy with a prompt-notice provision that required the insured to notify the insurer of "an occurrence or an offense that may result in a claim 'as soon as practicable.'" *Id.* at 631-32. *PAJ*'s untimely notice did not defeat coverage in the absence of prejudice to the insurer. *Id.* at 636-37. In a claims-made policy, when an insured gives notice of a claim within the policy period or other specified reporting period, the insurer must show that the insured's noncompliance with the policy's "as soon as practicable" notice provision prejudiced the insurer before it may deny coverage. See Prodigy Commc'ns Corp. v. Agric. Excess & Surplus Ins. Co., 288 S.W.3d 374, 382 (Tex. 2009).

Challenging Stipulated Judgments: Consent and/or No-Action Clause

The leading case in this area is State Farm Fire & Cas. Co. v. Gandy, 925 S.W.2d 696 (Tex. 1996). The court held that the amount of any agreed judgment between a plaintiff and an insured, rendered without a "fully adversarial" trial, would neither bind the carrier nor be admissible as evidence of the amount of the insured's damages. *But see* Evanston v. Atofina, 256 S.W.3d 660 (Tex. 2008) (liability insurer that wrongfully denies coverage is precluded from challenging reasonableness of settlement paid by its insured). Additionally, the *Gandy* court held that a pre-judgment assignment of an insured's rights against its liability carrier is invalid, at least where the carrier has tendered a defense and made a good faith attempt (*e.g.*, filing of a declaratory judgment action) to determine coverage.

In Great Am. Ins. Co. v Hamel, 525 S.W.3d 655 (Tex. 2017), the court found that the parties' pretrial agreement removed the alleged negligent party's (insured) stake in the outcome and any corresponding incentive to defend itself. After the agreement was executed, the Damage Suit no longer involved opposing parties, and the trial that followed was not fully adversarial. The court stated that a formal, written pretrial agreement that eliminates the insured's financial risk creates a strong presumption that the judgment did not result from an adversarial proceeding, while the absence of such an agreement creates a strong presumption that it did. An insurer may overcome the presumption by demonstrating that, even though the plaintiff and insured defendant did not enter into any formal, written agreement, the evidence nonetheless establishes that the defendant had no meaningful stake in the outcome of the underlying litigation. Conversely, the plaintiff (acting as the defendant's assignee) may overcome the presumption by submitting evidence demonstrating that the defendant retained a meaningful incentive to defend the underlying suit despite an agreement that eliminated the defendant's financial risk.

In the context of a consent to settle provision, a carrier who denies a defense cannot rely on the provision. But, even where a carrier can rely on the consent to settle provision, it must show it was prejudiced as a result of the

failure to obtain consent. Motiva Enterprises, LLC v. St. Paul Fire & Marine Ins. Co., 445 F.3d 381, 386 (5th Cir. 2006). In Motiva, the Fifth Circuit concluded, “[w]hen, as in this case, the insurer is not consulted about the settlement, the settlement is not tendered to it and the insurer has no opportunity to participate in or consent to the ultimate settlement decision, we conclude that the insurer is prejudiced as a matter of law.” Id. at 386. However, a Texas intermediate court of appeals applied a narrow prejudice analysis and refused to find prejudice based on the insurer being deprived of the opportunity to participate in the defense and settlement process. Coastal Ref. & Mktg., Inc. v. U.S. Fid. & Guar. Co., 218 S.W.3d 279, 295 (Tex. App.—Houston [14th Dist.] 2007, pet. denied). The Court considered evidence about the reasonableness of the settlement and whether a more favorable settlement would have been achieved if the insurer participated. Id. at 295-96. The Court further noted that the insurer speculated it might have settled for less, but there was no indication the insurer intended to offer any settlement amount and there was no evidence that the plaintiffs would have accepted less. Id. at 296. The Court acknowledged that prejudice could be non-monetary, but concluded there was no evidence of non-monetary damage. Id.

Preexisting Illness or Disease Clauses

The Patient Protection and Affordable Care Act of 2010 purports to eliminate preexisting clauses but, at this time, there has been no challenges or case law interpreting this mandate. Subject to future ruling based upon the “Affordable Care Act” current pre-existing condition clauses are, arguably, still in the books as valid and enforceable. See Abel v. Occidental Life Ins. Co., 410 S.W.2d 451, 452 (Tex. Civ. App. – Ft. Worth 1966, writ ref d n.r.e.). However, the pre-existing condition must materially contribute to the claim on the policy before it will bar recovery. See Mutual Benefit Health and Accident Ass’n v. Hudman, 398 S.W.2d 110, 114 (Tex. 1965). When disease or sickness contributes to the loss “directly or indirectly,” a previous medical condition will preclude recovery only when it was the proximate rather than the indirect or remote cause of the loss. See Stroburg v. Ins. Co. of N. Am., 464 S.W.2d 827, 829 (Tex. 1971). This analysis is subject to future court decisions, interpretations and congressional action, amendments and changes based upon the “Affordable Care Act”, which forbids an insurer from denying coverage because of a person’s pre-existing health condition.

Statutes of Limitations and Repose

The statute of limitations for an action for breach of good faith and fair dealing is two (2) years from the date the cause of action accrued. Tex. Civ. Prac. & Rem. Code § 16.003(a); Murray v. San Jacinto Agency, Inc., 800 S.W.2d 826, 827 (Tex. 1990). Generally, the limitations period accrues when the insurer denies coverage. Id.

The statute of limitations for contract actions is four (4) years. Tex. Civ. Prac. & Rem. Code § 16.004. Homeowner’s policies, however, commonly provide that suit must be brought against the insurer within two (2) years and one (1) day after the cause of action accrues. See also Tex. Civ. Prac. & Rem. Code § 16.070 (stating that contracts which establish a limitations period that is shorter than two (2) years is void in Texas).

The statute of limitations for personal injury actions is two (2) years. Tex. Civ. Prac. & Rem. Code § 16.003(a).

Texas has Statutes of Repose concerning only Architects, Computer Data Failure, Construction or Repair of Improvements, Engineers, Medical Malpractice, Products Liability and Suits Against Surveyors.

TRIGGER AND ALLOCATION ISSUES FOR LONG-TAIL CLAIMS

Trigger of Coverage

Texas follows the "actual injury" or "injury-in-fact" approach, that the insurer must defend any claim of physical property damage that occurred during the policy term. The court declined to recognize a manifestation rule or exposure rule for the property damage claims alleged under this policy. It was recognized that pinpointing the moment of injury retrospectively is sometimes difficult but would not exalt ease of proof or administrative convenience over faithfulness to the policy language. Further, looking to the date of actual injury, besides being consistent with the policy terms, is also consistent with scholarly authority. established. Those principles include construing the policy according to general rules of contract construction to ascertain the parties' intent. Don's Bldg. Supply, Inc. v. OneBeacon Ins. Co., 267 S.W.3d 20, 23 (Tex. 2008). The relevant inquiry is when the injury happens and when damage comes to pass, not when damage comes to light. Vines-Herrin Custom Homes, L.L.C. v. Great American Lloyd Ins. Co., 357 S.W.2d 166 (Tex.App.--Dallas 2011, no pet.)

As to bodily injury claims they present a more complex problem in that Texas has not specifically adopted any trigger theory. The best authority is from the Fifth Circuits' *Erie* guess as to what Texas would choose as the event that triggers the insurer's duty to defend in an asbestos lawsuit. In Guar. Nat'l Ins. Co. v. Azrock Indus. Inc., 211 F.3d 239, 243-47 (5th Cir. 2000), the Fifth Circuit decided, for the purposes of determining an insurer's *duty to defend* its insured in claims alleging personal injury from continuous exposure to asbestos products a court need only examine the face of the underlying plaintiff's complaint. To trigger a duty to defend, the pleading must allege (1) exposure to asbestos-containing products during the policy period and (2) that such exposure caused bodily injury -- even if the particular asbestos-related disease was not diagnosed until sometime after the policy expired.

Allocation Among Insurers

Texas courts have not provided much in the way of guidance on how insurers were to allocate cost amongst themselves regarding cost of defense or indemnity. Where multiple insurers have a duty to provide a complete defense, neither must pay all of the defense costs because they share the duty until one has either exhausted its policy limits or is declared impaired. See Utica Nat'l Ins. Co. v. Tex. Prop. & Cas. Ins. Guar. Assoc., 110 S.W.3d 450, 458 (Tex. App.-Austin 2001), *rev'd on other grounds*, Utica Nat'l Ins. Co. v. Am. Indem. Co., 141 S.W.3d 198, 47 Tex. Sup. Ct. J. 845 (Tex. 2004).

Allocating indemnity payments among multiple carriers requires a different calculation and will look to the trigger question of when the bodily injury or property damage occurs. If a single occurrence triggers more than one policy, covering different policy periods, then different limits may have applied at different times. In such a case, the insured's indemnity limit should be whatever limit applied at the single point in time during the coverage periods of the triggered policies when the insured's limit was highest. The insured is generally in the best position to identify the policy or policies that would maximize coverage. Once the applicable limit is identified, all insurers whose policies are triggered must allocate funding of the indemnity limit among themselves according to their subrogation rights.

A commentator has noted that the court in *Garcia* did not address or adopt a specific allocation approach, nor did it express when such allocation among carrier should take place, but at least provided a framework under Texas law for the proposition that any one insurer should not be burdened with an undue or unfair share of the indemnity obligation. When allocating defense cost and indemnity payments among multiple policy periods and insurers, equity is the theme that unites the holdings rendered by various Texas courts. "The Mathematics of Insurance Coverage" Alex Shilliday, Journal of Texas Insurance Law, Volume 12 Number 1, Summer 2012.

CONTRIBUTION ACTIONS

Claim in Equity vs. Statutory

Under Texas law contribution is a method for determining how much each defendant who is liable for the plaintiff's damages must pay the other liable defendants. If one defendant pays more than its share of the plaintiff's damages, that defendant has a right to be reimbursed by another liable defendant for the overpayment. This right to reimbursement is called a right of contribution. Tex. Civ. Prac. & Rem. Code §§33.015.

In *Mid-Continent*, the Texas Supreme Court held that any "direct claim for contribution between co-insurers disappears when the insurance policies contain 'other insurance' or 'pro rata' clauses." Mid-Continent Insurance Co. v. Liberty Mutual Insurance Co., 236 S.W.3d 765 (Tex. 2007). Additionally, the Supreme Court held that because the right of subrogation is based on a situation where the insurer "stands in the shoes" of its insured, if the insured is fully indemnified it will have no right to pass to the insurer for the insurer to enforce. Since *Mid-Continent*, it appears that federal and state courts are split with regard to the proper scope of *Mid-Continent* as applied to contribution and subrogation claims by co-insurers.

In 2010, the Fifth Circuit noted that "*Mid-Continent* left open the separate question of whether a co-insurer that pays more than its share of defense costs may recover such costs from a co-insurer who violates its duty to defend a common insured." Trinity Universal Ins. Co. v. Emp'rs Mut. Cas. Co., 592 F.3d 687, 694 (5th Cir. 2010). This decision was subsequently criticized by the Third Court of Appeals in Austin which held that the question of whether a co-insurer may recover when it pays more than its proportionate share of defense costs, finding instead that the contribution claim for defense costs was barred as a matter of law.

Finally, a recent decision by the 14th Court of Appeals in Houston re-examined *Mid-Continent* as it applied to contractual subrogation and held that *Mid-Continent* does not prohibit a co-insurer from bringing a subrogation claim against another co-insurer where the insured was not fully indemnified and the "other insurance" clauses were mutually repugnant and did not limit the co-insurer's indemnity obligations. U.S. Fid. & Guar. Co. v. Coastal Ref. & Mktg., Inc., 369 S.W.3d 559 (Tex. App. -Houston[14th Dist.] 2012, no pet.).

Elements

A party may seek contribution when a judgment is entered finding that party to be a joint tortfeasor, and when such party makes a subsequent payment of a disproportionate share of the common liability. The right to contribution is predicated upon a legally enforceable judgment; "a mere settlement agreement which was not reduced to judgment form would not satisfy the prerequisites to recovery under TEX. CIV. PRAC. & REM. CODE sec. 32.001, et seq.

DUTY TO SETTLE

The duty of an insurer to accept reasonable settlement demands is known as the *Stowers* duty. The *Stowers* duty is the only common law tort duty that an insurer owes its insured when handling a third-party claim. See Texas Farmers Ins. Co. v. Soriano, 881 S.W.2d 312, 314 (Tex. 1994); G.A. Stowers Furniture Co. v. American Indemn. Co., 15 S.W. 2d 544, 547 (Tex. Comm'n App. 1929, holding approved). The *Stowers* duty applies only to third-party claims, it does not apply to first-party claims. American Physicians Ins. Exch. v. Garcia, 876 S.W.2d 842, 847 n.10

Texas

(Tex. 1994).

In *Rocor*, the Texas Supreme Court recognized that there exists statutory liability from an insurer to its insured for failing to settle a third-party claim, at least where the insurer's unreasonable delay in settling the case caused the insured (with a self-insured retention) to incur more attorney's fees than necessary. *Rocor Int'l v. National Un. Fire Ins. Co.*, 77 S.W.3d 253 (Tex. 2002). To establish liability for the insurer's failure to reasonably attempt settlement of a claim against the insured under either Texas Insurance Code or *Stowers*, the insured must show that:

- the policy covers the claim;
- the insured's liability is reasonably clear;
- the claimant has made a proper settlement demand within policy limits, and;
- the demand's terms are such that an ordinarily prudent insurer would accept it.

Id. There is no obligation on an insurer "to accept a settlement demand in excess of policy limits or make or solicit settlement proposals." *American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994).

In Texas, an insurer that settles a claim against its insured when coverage is disputed, and then is later found not to exist, may only seek reimbursement from the insured if the policy expressly provides that right or the insured gives "clear and unequivocal consent" to a reimbursement claim. *Excess Underwriters at Lloyd's v. Frank's Casing Crew & Rental Tool, Inc.*, 246 S.W.3d 42 (Tex. 2008); *Tex. Ass'n of Counties County Gov't Risk Mgmt. Pool v. Matagorda County*, 52 S.W.3d 128, 135 (Tex. 2000).

LH&D BENEFICIARY ISSUES

Change of Beneficiary

Proceeds of an insurance policy are by statutory definition nontestamentary in nature." *Tramel v. Estate of Billings*, 699 S.W.2d 259, 262 (Tex. App.--San Antonio 1985, no writ); *see also* *Patrick v. Patrick*, 182 S.W.3d 433, 438 (Tex. App.--Austin 2005, no pet.) (stating "life-insurance policies are non-probate assets and are generally transferred upon the death of the decedent through the terms of the policy, not a will"); *see also* TEX. ESTATES CODE ANN. §111.051. Because an insurance policy is statutorily characterized as nontestamentary, "the instrument does not . . . have to be probated, nor does the personal representative have any power or duty with respect to the assets involved." *Holley v. Grigg*, 65 S.W.3d 289, 293 (Tex. App.--Eastland 2001, no pet.) (quoting with approval, UNIF. PROBATE CODE 6-201 cmt. (1997)). "It is plain the right to the proceeds does not accrue as a testamentary right to those who will take under the laws of descent and distribution."

Policy requirements for designating or changing the beneficiary are primarily for the benefit of the insurance company, and compliance with them may be waived by the insurance company during the lifetime of the insured. *Fidelity Union Life Insurance Company v. Methven*, 162 Tex. 323, 346 S.W.2d 797 (1961).

The Texas Insurance Code also places limitations on the potential liability of an insurance company who pays the proceeds of a policy to the named beneficiary. Articles 1103.102 and 1103.103 of the Texas Insurance Code discharges an insurance company for paying the proceeds of its policy directly to a named beneficiary in the absence of the receipt by it of notice of an adverse claim to the proceeds of the policy from one having a bona fide legal claim to such proceeds or a part thereof.

A beneficiary named under a life-insurance policy has no standing to recover under the policy unless his interest has vested. See Cates v. Cincinnati Life Ins. Co., 947 S.W.2d 608, 614 (Tex. App.--Texarkana 1997, no writ), *op. on remand from* 927 S.W.2d 623, 39 Tex. Sup. Ct. J. 916 (Tex. 1996). As explained in *Cates*, settled Texas law holds that a named beneficiary has no vested interest in the policy proceeds unless one of the following conditions occurs: (1) a contract--separate from the policy itself--proscribes any change in the designation of the beneficiary, *id.*; see O'Neill v. Conn. Mut. Life Ins. Co., 544 S.W.2d 741, 744 (Tex. Civ. App.--Houston [1st Dist.] 1976, writ ref'd n.r.e.); (2) the policy itself does not authorize the owner of the policy to change the beneficiary, *Cates*, 947 S.W.2d at 614 (citing McNeill v. Chinn, 45 Tex. Civ. App. 551, 101 S.W. 465, 467 (Tex. 1907)); or (3) the insured dies. *Cates*, 947 S.W.2d at 614; see Volunteer State Life Ins. v. Hardin, 145 Tex. 245, 197 S.W.2d 105, 107 (Tex. 1946) (restating "well settled" rule that no rights to proceeds of life policy vest in named beneficiary when policy authorizes change of beneficiary). Unless one of these events occurs to vest the beneficiary's rights, the insurer may not prevent the owner of the policy from exercising his right to change the beneficiary. See State Farm Life Ins. Co. v. Martinez, 174 S.W.3d 772, 781 (Tex. App.--Waco 2005), *rev'd on other grounds*, 216 S.W.3d 799, 50 Tex. Sup. Ct. J. 406, 2007 WL 431043 (Tex. Feb. 9, 2007).

Effect of Divorce on Beneficiary Designation

The Texas Family Code changes the above long-standing precedent. By statute, if an insured's spouse is designated as a life-insurance beneficiary but the couple later divorces or their marriage is annulled, the earlier designation of the spouse as a policy beneficiary is ineffective. See Tex. Fam. Code Ann. § 9.301(a) (West 2006). If that happens, then the policy proceeds are payable to the named alternative beneficiary, or if there is none, then the proceeds are payable to the insured's estate. The same statute provides three exceptions to this rule. The earlier designation of a former spouse as a life-insurance beneficiary is not rendered ineffective if (1) the former spouse is designated as the beneficiary in the divorce decree; (2) the insured redesignates the former spouse as a beneficiary after the divorce; or (3) the former spouse is designated to receive the insurance proceeds in trust for, on behalf of, or for the benefit of a child or a dependent of either of the former spouses. Branch v. Monumental Life Insurance Co., 422 S.W.3d 919 (Tex.App.—Houston [14th Dist.] 2014, no pet.).

INTERPLEADER ACTIONS

Availability of Fee Recovery

An Interpleader stakeholder, in both State and Federal Court, is entitled to recover attorney fees from the tendered funds unless there were no rival claimants, or the stakeholder unreasonably delayed in filing the action for interpleader. State Farm Life Ins. v. Martinez, 216 S.W.3d 799, 803 (Tex. 2007); Corrigan Dispatch Co. v. Casa Guzman, S.A., 696 F.2d 359 (5th Cir. 1983). In Texas State court, a stakeholder is entitled to attorney's fees if it had reasonable doubts about which party was entitled to funds and it interpleaded the claimants in good faith, U.S. v. Ray Thomas Gravel Co., 380 S.W.2d 576 (Tex. 1964), and you were not the party responsible for the conflicting claims to the funds. In Federal Court attorney's fees are normally awarded to the interpleader who (1) is disinterested, (2) concedes its liability in full, (3) deposits the disputed stake with the court clerk, (4) seeks discharge, and (5) is not in some way culpable with respect to the subject matter of the interpleader proceeding. See Septembertide Publ'g, B.V. v. Stein & Day, 884 F.2d 675, 683 (2d Cir. 1989). A stakeholder may not be entitled to attorney fees if it was the party responsible for the conflicting claims to the funds.

Differences in State vs. Federal

There are no significant differences if an Interpleader is filed in State or Federal court, other than the procedural rules. If you file your Interpleader in Federal court a stakeholder will need to establish either diversity jurisdiction or establish a Federal question.

ⁱ For eligible surplus lines insurers, the deadline is extended to not later than the 30th business day after the date an insurer receives notice of a claim.

ⁱⁱ “Claim” is a “first party claim,” that is, when an insured seeks recovery for the insured’s own loss as opposed to when an insured seeks coverage for injuries to a third party. Evanston Insurance Co. v. ATOFINA Petrochemicals, Inc., 256 S.W.3d 660 (Tex. 2008).

ⁱⁱⁱ For eligible surplus lines insurers, the deadline is extended to not later than the 20th business day after the notice or performance of the act.