

**TRENDS IN THE TEXAS SUPREME COURT  
“RIDE THE ROLLER COASTER WITH  
THE INSURANCE INDUSTRY”**



**RICHARD C. HARRIST  
MATTHEW C. KAWALEK  
COOPER & SCULLY, P.C.  
900 JACKSON STREET, SUITE 100  
DALLAS, TEXAS 75202**

**Telephone: 214/712-9500  
Facsimile: 214/712-9540**

**16<sup>TH</sup> ANNUAL INSURANCE SYMPOSIUM  
APRIL 3, 2009**

**TABLE OF CONTENTS**

	<b><u>Page</u></b>
I. Introduction.....	1
A. “Insured Friendly” Cases From the 1980s .....	1
B. “Insurer Friendly” Opinions from the 1990s .....	2
C. “Insured Friendly” Opinions from the 2000s.....	3

**TABLE OF AUTHORITIES**

<b><u>Cases</u></b>	<b><u>Page(s)</u></b>
<i>Allstate Ins. Co. v. Watson</i> , 876 S.W.2d 145 (Tex. 1994).....	2
<i>Arnold v. National County Mutual Fire Insurance</i> , 725 S.W.2d 165 (Tex. 1987).....	1
<i>Don's Building Supply, Inc. v. OneBeacon Ins. Co.</i> , S.W.3d 51 Tex. Sup. Ct. J. 1367 (Tex. 2008).....	4
<i>Evanston Insurance Co. v. ATOFINA Petrochem</i> , 2008 Tex. LEXIS 575 (Tex. 2008).....	5
<i>Excess Underwriters at Lloyd's London v. Frank's Casing Crew &amp; Rental Tools</i> , 246 S.W.3d 42 (Tex. 2008).....	4
<i>Fairfield Insurance Company v. Stephens Martin Paving, LP</i> , 246 S.W.3d 653 (Tex. 2008).....	4
<i>GuideOne Elite Insurance Co. v. Fielder Road Baptist Church</i> , 197 S.W.3d 305 (Tex. 2006).....	4
<i>Lamar Homes, Inc. v. Mid-Continent Casualty Company</i> , 242 S.W.3d 1 (Tex. 2007).....	4
<i>Mayes v. Massachusetts Mutual Life Insurance Co.</i> , 608 S.W.2d 612 (Tex. 1980).....	1
<i>Provident Am. Ins. Co. v. Castaneda</i> , 988 S.W.2d 189 (Tex. 1998).....	3
<i>State Farm Mut. Auto. Ins. Co. v. Traver</i> , 980 S.W.2d 625 (Tex. 1998).....	3
<i>Trans. Ins. Co. v. Moriel</i> , 879 S.W.2d 10 (Tex. 1994).....	2
<i>Union Bankers Ins. Co. v. Shelton</i> , 889 S.W.2d 278 (Tex. 1994).....	1

**Other Sources**

Danny Ashby, <i>et al</i> , <i>Appeals Plus: The Appellate Practice of the 21st Century</i> , 33 Dallas Bar Association Headnotes 4, at p.....	4
J. Caleb Rackley, <i>A Survey of Sea-Change on the Supreme Court of Texas and Its Turbulent Toll on Texas Tort Law</i> , 48 S. Tex. L. Rev. 733 (2007).....	1

## TRENDS IN THE TEXAS SUPREME COURT – RIDE THE ROLLER COASTER WITH THE INSURANCE INDUSTRY

### I. INTRODUCTION

As with politics in Texas in general, the political tide of the Texas Supreme Court ebbs and flows. The pendulum swings one way and inevitably swings back the other way. This is not surprising since Texas elects its jurists. The 1980s saw what many called a crisis in tort litigation, in which insurance premiums tripled in just five years. And Texans witnessed litigation generally of “gargantuan proportions.” By the mid-1980s, the Supreme Court of Texas had succeeded in revamping tort law to the point where, for the first time in the state’s history, plaintiffs had the upper hand and juries responded with astounding monetary awards. J. Caleb Rackley, *A Survey of Sea-Change on the Supreme Court of Texas and Its Turbulent Toll on Texas Tort Law*, 48 S. TEX. L. REV. 733 (2007). By 1989, the expansion of rights and remedies in the Texas court system reached its height.

With the Republican landslide elections in 1992, the composition of the Texas Supreme Court began to shift back to the right and the Democratic majority of the 1980s was unseated. Republicans won a majority on the Texas Supreme Court in the 1994 elections, held seven of the nine seats by 1996, and never looked back. *Id.* By the mid-1990s, statistics showed the court sided with defendants “about three-fourths of the time.” *Id.* Furthermore, in 1996 and 1997, either partially or entirely, insurance companies won almost all of their substantive cases. *Id.*

In the most recent decade, the pendulum appears to be swinging back to the left as many recent Texas Supreme Court decisions have sided in favor of coverage and in favor of the insured.

#### A. “Insured Friendly” Cases From the 1980s

***Mayes v. Massachusetts Mutual Life Insurance Co.*, 608 S.W.2d 612 (Tex. 1980).**

When an insured deliberately misrepresents facts on an application for insurance, the insurer has a difficult burden to carry in order to rescind the policy issued in reliance on such misrepresentation. In 1980, the Texas Supreme Court held an insurer must prove the insured’s “intent to deceive” as an additional element required to avoid liability under an insurance policy on the basis of a misrepresentation by the insured. According to *Mayes*, which is still good law today, the insurer must plead and prove the following five elements:

(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 the same; and (5) the materiality of the representation.

This standard for policy avoidance set a high bar for the insurer because the majority rule has been that a material representation need not have been fraudulently made in order to be available to avoid a policy. *See Union Bankers Ins. Co. v. Shelton*, 889 S.W.2d 278, 285 (Tex. 1994) (Phillips, C.J., concurring) (observing that Texas has “adopted the minority position that intent to deceive is required for cancellation of an insurance policy on the ground of a misrepresentation”).

***Arnold v. National County Mutual Fire Insurance*, 725 S.W.2d 165 (Tex. 1987).**

*Arnold v. National County Mutual Fire Insurance* radically changed Texas law in favor of insureds by “inserting the duty of good faith and fair dealing into contract law.” *Arnold* raised “the issue of whether there is a duty on the part of insurers to deal fairly and in good faith with their insureds.”

An uninsured motorist struck and injured motorcyclist Glen Arnold. Arnold, who was insured by National County Mutual (“NCM”), had a policy that included uninsured motorist protection up to \$10,000. He made timely demand for payment under this uninsured motorist provision. Despite this timely demand and a recommendation for payment by an independent insurance adjusting firm, NCM refused to pay Arnold the benefits. After filing suit against NCM, Arnold collected the policy limit; however, he then brought a subsequent claim that included a “common law cause of action for NCM’s breach of its duty of good faith and fair dealing in its handling of his claim.” The trial court granted summary judgment in NCM’s favor, but on review the Texas Supreme Court found that “an issue of fact was raised as to NCM’s reasonableness in failing to settle the claim and forcing Arnold to trial.”

Thus, a new common law tort duty and cause of action was born. The Texas Supreme Court held that “a duty on the part of insurers to deal fairly and in good faith with their insureds” existed in first-party insurance contracts. According to the Texas Supreme Court, this duty arose as a result of the “special relationship” created by a first-party insurance contract. Specifically, “in the insurance context a special relationship arises out of the parties’ unequal bargaining power and the nature of insurance contracts which would allow unscrupulous insurers to

take advantage of their insureds' misfortunes in bargaining for settlement or resolution of claims." In other words, two primary concerns motivated the courts to recognize this duty in the insurance context: (1) a disparity in bargaining power, and (2) no limitations on the insurance companies' power inherent in the relationship. Clearly, the court intended for this new cause of action to limit the power of insurance companies thereby bringing balance to the relationship between an insured and his carrier.

Moreover, the court held that a breach of such a duty made exemplary and mental anguish damages recoverable. As such, plaintiffs had one more arrow in their quiver, as another breach of contract claim had been transformed into a tort claim.

#### **B. "Insurer Friendly" Opinions from the 1990s**

When the Republicans took over the majority of the Texas Supreme Court, the pendulum of insurance law began swinging back toward the insurer. The following opinions are illustrative of the new insurer-friendly court that began to take shape in the 1990s.

#### ***Allstate Ins. Co. v. Watson*, 876 S.W.2d 145 (Tex. 1994).**

The issue before the court was whether section 16 of article 21.21 of the Texas Insurance Code provided a third-party claimant with a direct cause of action against an insurer for unfair settlement practices. *Watson* brought suit against a driver for negligence in a motor vehicle accident and *Allstate*, the driver's insurer. She alleged that *Allstate* violated section 16 of article 21.21. of the Texas Insurance Code by participating in unfair settlement of her claims and unreasonably delaying payment of her claim. She brought suit in accordance with the Texas Deceptive Trade Practices Act.

The statute in question gave "any person" a right of action against any person causing them damages by participating in unfair or deceptive practices or acts as defined by section 17.46 under the DTPA. The court found that, despite the statute giving any person a cause of action for unfair practices, *Watson* could not bring such an action under article 21.21 because she was not the insured but a third-party claimant. The court reasoned that insurers would be faced with conflicting duties to their insureds and potential third-party claimants if they broadened the language of the Insurance Code. Therefore, *Watson* did not have standing to bring a cause of action against her insurer.

#### ***Trans. Ins. Co. v. Moriel*, 879 S.W.2d 10 (Tex. 1994).**

This case provided the court with the opportunity to address the standard for gross negligence claims and to determine when punitive damages are appropriate in bad faith insurance litigation. The opinion was authored by current U.S. Senator John Cornyn, a noted Republican.

The plaintiff brought suit against the insurer for improperly delaying payment of his medical bills after previously authorizing such medical expenses for the insured. In some cases, payments were delayed over a year. At the trial, the jury found that the insurer delayed paying *Moriel* without a reasonable basis and acted with reckless disregard towards his rights. They awarded *Moriel* \$1,000 in actual damages, \$100,000 in mental anguish damages, and \$1,000,000 in punitive damages, and *Moriel* obtained findings of bad faith against *Transportation*.

Prior to this case, Texas law had a "no-evidence" standard of review for punitive damages. The court, however, changed this review to a legally sufficient evidence standard. The court found that punitive damages are only allowed in a bad faith case when corresponding gross negligence accompanies the bad faith. The court found that the type of harm giving rise to punitive damages in bad faith claims must be independent and qualitatively different from injuries that typically result from bad faith or breach of contract. The standard for awarding such damages was established as an objective standard showing that the tortfeasor committed an act or omission that involved an extreme degree of risk of harm and a subjective standard that the tortfeasor had actual knowledge of the risk of harm involved. The court reviewed the evidence in the case and determined there was legally insufficient evidence to support an award of punitive damages against the insurer.

The court also established new procedural standards for trials which raise punitive damages. First, the court determined that bifurcated trials were required to separate an award for punitive damages from the remainder of a plaintiff's claims for actual damages. Second, as noted above, the court changed the evidentiary review from no-evidence to legally sufficient evidence. However, the court required the courts of appeals to detail why the evidence before it supports or does not support the punitive damages in the trial court.

The concurring opinion in *Moriel* noted the court's new-found transition to being pro-insurer. Justice Doggett noted that it appeared the majority's mission was to dismantle the insured-friendly laws that were previously available to the insureds. He stated: "It is as if, to borrow a phrase from Will Rogers, this majority never met an insurance company it didn't like."

***State Farm Mut. Auto. Ins. Co. v. Traver*, 980 S.W.2d 625 (Tex. 1998).**

In this case, two motorists insured by State Farm were sued by an injured passenger to one of the insured's involved in an automobile collision. State Farm retained separate attorneys for each of their insureds, and only one of the drivers was found 100% responsible for the accident. This insured died shortly after a trial where the plaintiff was awarded almost \$475,000 in damages. The executor of the insured's estate brought a suit against State Farm for several causes of action, including negligence, breach of the duty to defend, breach of the *Stowers* duty, breaching the duty of good faith and fair dealing, and DTPA violations. The executor brought the claims because he alleged State Farm committed these acts by hiring an attorney that committed malpractice in the insured's underlying case and acting in its own best self-interest. The executor also sued the attorney, but the attorney filed bankruptcy shortly thereafter.

The trial court granted summary judgment for State Farm on all claims against it, but the court of appeals reversed in part, holding that State Farm was responsible for any malpractice committed by the attorney it retained for its insured. The supreme court reversed the court of appeals. It reasoned that the defense attorney was an independent contractor and not necessarily subject to its client's control on day-to-day issues. The defense attorney must at all times protect the interests of the insured, even if those interests run contrary to the insurer's instructions. The court found that a liability insurer is not vicariously liable for the conduct of an independent attorney it selects to defend an insured.

***Provident Am. Ins. Co. v. Castaneda*, 988 S.W.2d 189 (Tex. 1998).**

The Castaneda family applied for a health insurance policy with Provident. Prior to applying for the policy and, Guillermo Castaneda was treated by a physician for jaundice, anemia, and suspected hepatitis. Guillermo did not disclose this to Provident. His daughter, Denise, was treated for jaundice and hepatitis several years prior to the application for the policy. Provident issued the policy to the Castanedas,

and the policy contained two limitations. First, it did not cover expenses resulting from sickness that manifested itself within thirty days of the policy's effective date. Second, it excluded diseases of the internal organs unless the loss occurred more than six months after the policy's effective date.

Less than 30 days after the policy issued, the Castanedas learned that Denise's uncle was diagnosed with a spleen disease ("HS") which caused symptoms of anemia, jaundice, and gallstones. The treatment was to remove the spleen and the gallbladder if gallstones were present. Denise and her little brother went to a physician 33 days after the policy's effective date and were diagnosed with HS. Less than three weeks later, Denise and her little brother had their spleens and gallbladders removed. The Castanedas submitted their claims to Provident, which were denied. Provident originally denied the claims based on the six-month limitation language but later denied the claims based on HS manifesting itself within 30 days of the policy's effective date. The Denise sued under Article 21.21 and the DTPA. The jury found in favor of Denise and awarded her \$50,000 in damages.

The supreme court found that there was no evidence of no reasonable basis for Provident's denial of Denise's claim. The court found that a coverage dispute does not constitute evidence of a bad faith denial. The court found that Denise and her brother exhibited symptoms prior to her father's application for insurance coverage. The court found the original application which contained references to Denise's jaundice and yellowish skin provided enough information for Provident to rely on the 30-day limitation period. Therefore, the court found there was no bad faith on the part of Provident in relying on these symptoms to deny a claim for a disease which was not diagnosed until after the 30-day exclusion period.

Denise also claimed that Provident's pre-approval of her surgery represented to her that her surgery was covered. The court found that, because the insurer was not privy to all of the information regarding her history and her familial diagnoses, the pre-approval amounted to no more than "an uninformed conclusion." It was not a false or misleading statement on behalf of the insurer.

**C. "Insured Friendly" Opinions from the 2000s**

Very recently, in the 2000s, The Texas Supreme Court has issued several notable decisions in favor of policyholders.

For example, the Texas Courts of Appeals were split on whether the prompt payment of claims statute applied when an insurer failed to provide a defense to a policyholder. The Texas Supreme Court resolved this split in favor of the insured in *Lamar Homes, Inc. v. Mid-Continent Casualty Company*, 242 S.W.3d 1, 7-10 (Tex. 2007). The Court held that the insured's right to recover defense costs is a first-party claim subject to the requirements of the prompt-payment statute and its 18 percent penalty and right to attorneys' fees. The supreme court also held the insurer had duty to defend under commercial general liability (CGL) policy because allegations of contractor's negligent performance of construction contract were "occurrence" resulting in "property damage," and there was no allegation that contractor intended or expected to damage home through its alleged negligence.

In *Excess Underwriters at Lloyd's London v. Frank's Casing Crew & Rental Tools*, 246 S.W.3d 42 (Tex. 2008), the Texas Supreme Court rejected an insurer's claim for reimbursement of a settlement payment it had made on behalf of its insured with respect to an uncovered claim. The Court originally issued an opinion on May 27, 2005 in favor of the insurer's right to reimbursement, but subsequently granted Frank's Casing's Motion for Rehearing, withdrew its previous opinion and issued its new opinion on February 1, 2008, affirming the judgment of the 14th Court of Appeals rejecting any right of reimbursement under the policy.

The insurer argued that it had an equitable right to reimbursement because the insured took an active role in procuring the settlement offer, in demanding that the insurer settle the claim and also participated in the drafting and negotiation of the settlement agreement. However, in rejecting these arguments the Court declared that to recognize an equitable right to reimbursement would require the Court to rewrite the parties' insurance contract, which did not provide for a right of reimbursement in favor of the insurer.

***GuideOne Elite Insurance Co. v. Fielder Road Baptist Church*, 197 S.W.3d 305 (Tex. 2006).**

In a 2006 Texas Supreme Court decision favorable to the insured, *GuideOne* dealt with the issue of whether there should be any exception to the "eight-corners," or "complaint-allegation," rule that would permit the consideration of extrinsic evidence in determining an insurer's duty to defend. The eight-corners rule holds that only two documents are ordinarily relevant to determining the insurer's duty to defend: the policy and the pleading of the third-party claimant. Under this rule, the allegations of the

pleadings are

considered in light of the policy provisions without regard to their truth or falsity. And facts outside the pleadings are ordinarily not material to the determination of the duty to defendant, and allegations against the insured are liberally construed in favor of coverage.

In *GuideOne*, the claimant filed a sexual misconduct lawsuit against the insured church and its minister, alleging in her pleadings that, from 1992 to 1994, the minister was employed by and was under the church's direct supervision and control when he sexually exploited and abused her. The church demanded a defense and indemnification from the insurer, which agreed to defend under a reservation of rights. The insurer filed a declaratory judgment action asking for a declaration that it had no duty to defend and/or indemnify the church. Through discovery during the coverage action, the insured advised the insurer that the minister had ceased working for it on December 15, 1992, before the insurer's policy took effect. The trial court rendered summary judgment in favor of the insurer, declaring that it had no duty to defend. However, the court of appeals reversed the judgment, concluding that the trial court had erred in considering extrinsic evidence to defeat the duty to defend.

A claimant's factual allegations that potentially support a covered claim is all that is needed to invoke the insurer's duty to defend; conversely, the facts actually established in the underlying suit control the duty to indemnify. Applying these principles, the Texas Supreme Court affirmed the court of appeals decision, deciding that the claimant's allegations, that the minister assaulted her during the policy period and was a minister at the church at the time, were enough to trigger the insurer's duty to defend.

Because complaint alleged that property damage occurred during policy period, insurer had duty to defend, and neither potential availability of limitations defense nor fact that damage may have been inherently undiscoverable until after policy expired excused insurer from duty to defend. *Don's Building Supply, Inc. v. OneBeacon Ins. Co.*, -- S.W.3d --, 51 Tex. Sup. Ct. J. 1367, 1374-1375 (Tex. 2008).

***Fairfield Insurance Company v. Stephens Martin Paving, LP*, 246 S.W.3d 653 (Tex. 2008).**

In *Fairfield*, a long-awaited decision on a certified question from the U.S. Court of Appeals<sup>1</sup>, Fifth

---

<sup>1</sup> Notably, in the past three years, the Fifth Circuit has certified no less than seven questions of Texas insurance

Circuit, the Texas Supreme Court considered the issue of whether Texas public policy precludes coverage for punitive damages. Although it expressly considered whether public policy precludes insurance coverage of punitive damages in the workers' compensation regime, *Fairfield* has the potential of expanding coverage for insureds beyond that context, guided by the two-step process the Texas Supreme Court established for courts to determine whether punitive damages are insurable. The court first asks whether the plain language of the policy covers the punitive damages in the underlying suit against the insured. Second, if the court determines that the policy provides coverage, it determines whether Texas public policy allows or prohibits such coverage. At the second step of the inquiry, the court looks to express statutory provisions to determine whether the Legislature has made a policy decision; if the Legislature has not made an explicit policy decision, the court will then consider general public policies.

The underlying suit was brought by survivors of a deceased employee, and because the survivors had received workers' compensation benefits, they were barred by statute from recovering actual damages and sought only exemplary damages. After examining the statutory scheme and accompanying insurance regulations of the Texas workers' compensation system, the supreme court concluded, based on the Legislature's expressed intent, that Texas public policy did not prohibit insurance coverage for gross negligence in the instant case.

Accordingly, in response to the certified question, the supreme court answered that Texas public policy does not prohibit insurance coverage of exemplary damages for gross negligence in the workers' compensation context. The supreme court, however, emphasized that "without clear legislative intent to generally prohibit or allow the insurance of exemplary damages arising from gross negligence," it was "declining to make a broad proclamation of public policy," but was "instead offering some considerations applicable to the analysis in other cases." Consequently, while *Fairfield* provides some guidance regarding insurability of punitive damages, this issue has not been finally resolved and will likely continue to be litigated.

***Evanston Insurance Co. v. ATOFINA Petrochem*, 2008 Tex. LEXIS 575 (Tex. 2008).**

In another significant case decided in 2008 in favor of the insured, on rehearing, the Texas Supreme court held in *Evanston Insurance Co. v. ATOFINA Petrochemicals, Inc.* that a liability insurer that wrongfully denies coverage is barred from challenging the reasonableness of the amount of the insured's settlement with the third-party claimant. In *ATOFINA*, the insured was sued and requested coverage from its liability insurer, which denied coverage based on the policy's terms. The insured then brought the insurer into the underlying suit as a third-party defendant, seeking a declaration of coverage. After the insurer continued to deny coverage in its pleadings, the insured settled with the underlying plaintiffs. The insured then continued the litigation of the coverage dispute against the insurer, and it was ultimately decided that the insurer had wrongfully denied coverage.

---

law – a remarkable number – to the Texas Supreme Court. Danny Ashby, *et al*, *Appeals Plus: The Appellate Practice of the 21<sup>st</sup> Century*, 33 DALLAS BAR ASSOCIATION HEADNOTES 4, at p. 9 (April 2009).