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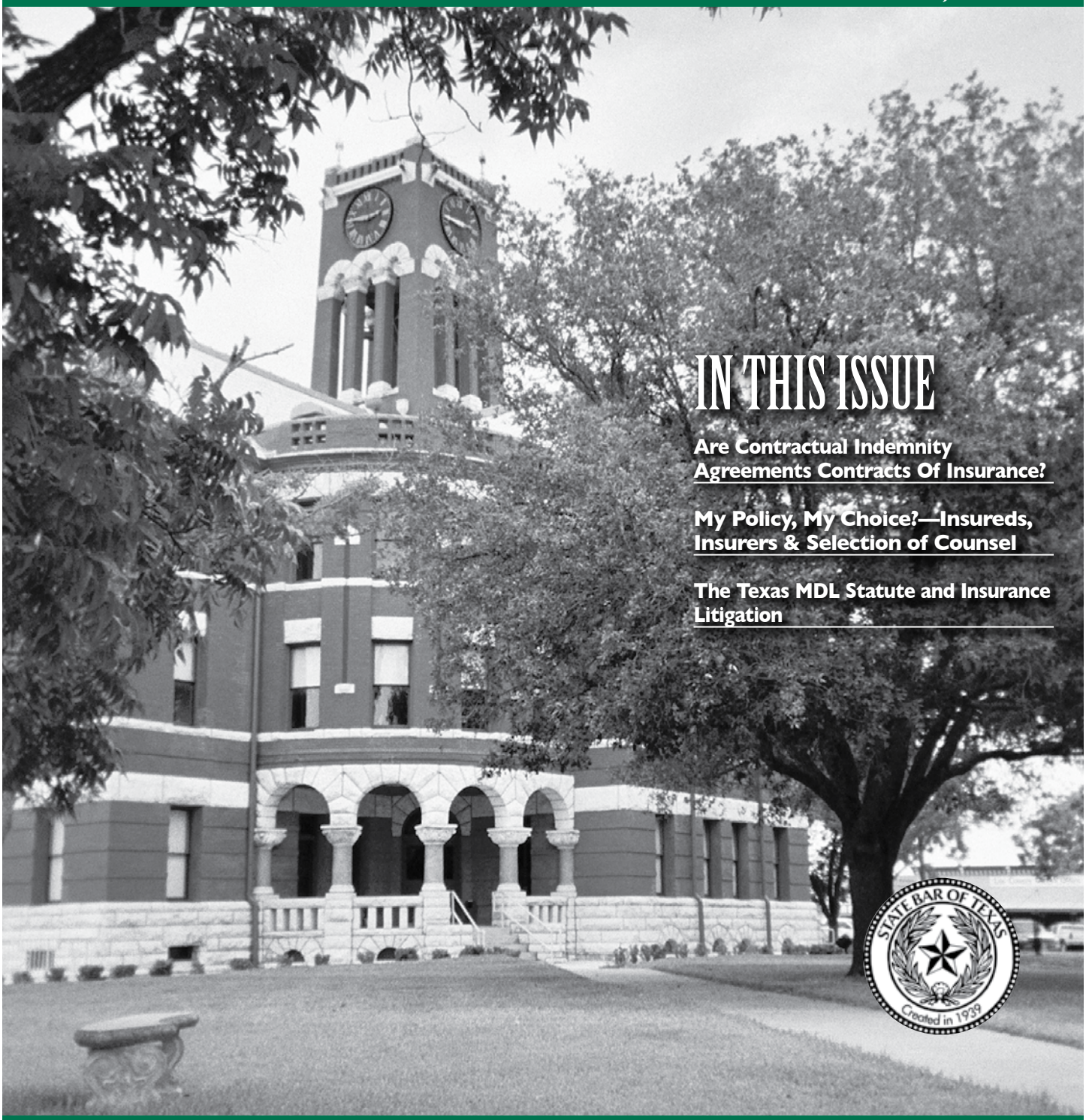

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Official publication of the Insurance Law Section of the State Bar of Texas

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Journal of Texas Insurance Law

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

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

On the Cover:

The first Lee County courthouse in Giddings burned in 1897 and was replaced in 1899 by the current structure. It was named a historic landmark in 1968. Restored in 1982, the architecture is described as "Richardsonian Romanesque Style."

Historical note: The District Courtroom on the second floor often provided "the best entertainment in town." The 1913 GIDDINGS NEWS reported a typical court docket included six cases of horse, hog, or cattle theft; four cases of assault with intent to murder; three cases of disposing of mortgaged property; one case each of murder, burglary, theft from person, and incest; and eleven divorce cases.

Photo by Bob Peretti

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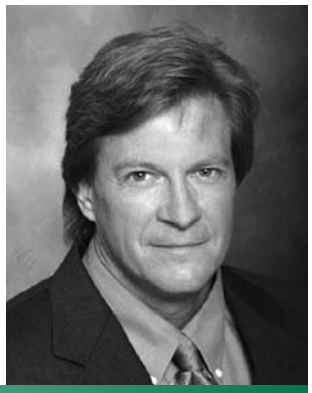

Comments FROM THE CHAIR

BY BRIAN S. MARTIN
Thompson, Coe, Cousins & Irons, L.L.P.

Benjamin Disraeli wrote that "The secret of success is constancy of purpose." His words apply perfectly to the ten year success of the Insurance Section and particularly its outgoing chair, Karen Keltz. Since this Section was founded a decade ago it has boasted an ever increasing membership while providing new and better services to its members. Karen's focus on building this legacy has greatly strengthened this Section. On behalf of the Section, I would like to express our gratitude to Karen for her singular efforts to the Section and the Bar.

This year we will continue the goal of increasing the quality of the Section's services to our members. As Karen pointed out in her comments in the last issue, we will be sponsoring several significant CLE programs, such as co-sponsoring the 2008 Insurance Law Institute with the University of Texas School of Law, as well as various other programs with the State Bar of Texas. We will present webcasts and telephone CLE programs to increase availability of quality programs to members across the state. We will also be facilitating communication between Section members through our list-serve project. One of my favorite projects is the Section's Ben Love Memorial Scholarship which will be presented this year to an outstanding insurance law student at SMU to honor our past council member and friend, Ben Love.

One of the most useful services of the Section is the weekly insurance case update e-mail from Jim Cornell, one of the Section's founders and a former Chair. Every week our members get the latest insurance cases from across the state in one e-mail. Way to go, Jim!

Finally, one of the most important services we provide every year is this excellent journal. Chris Martin has, year after year, expended incredible time and effort in producing one of the finest insurance law journals in the country, and certainly the best in the State of Texas.

With all this Section has to offer, I want to personally invite you this year to get involved. There are many opportunities available. We encourage you to attend the many programs, write articles for the journal or offer your services in connection with one of the many CLE or other projects the Section sponsors. In reality, this is your Section and we welcome your participation and appreciate your support. Let us hear from you.

Brian S. Martin
Chair, Insurance Law Section

BY DAVID CLAY WILKERSON

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Are Contractual Indemnity Agreements Contracts Of Insurance?

Contractual indemnity agreements are clauses within a larger contract in which one party (the indemnitor) agrees to indemnify, hold harmless and often defend the other (the indemnitee) against loss. Whether these provisions apply is often as important to litigants as the outcome of the original suit, yet significant questions exist as to the legal framework under which these provisions are properly analyzed. Specifically, does the concept from insurance coverage law of a broad duty to defend that is determined by the Eight-Corners Rule and justiciable before the underlying suit is resolved, apply to the interpretation of contractual indemnity agreements?

Three relatively recent Texas appellate decisions suggest a trend toward treating contractual indemnity agreements much like insurance policies, and indemnitors like insurance carriers. These courts have held or assumed that contractual indemnity agreements create separate duties to defend and indemnify, that the former duty is justiciable before the latter, and that courts must look to the pleadings and not the facts when determining whether an indemnity agreement is "triggered." Triggered here means whether the circumstances under which the parties intended the indemnity clause to apply are present. Typically this can mean whether a required causal nexus between the loss to be indemnified and the subject of the larger contract is present, or it can mean whether the liability results from the concurrent negligence or only the sole negligence of the indemnitee. This article will examine those opinions, as well as two Texas Supreme Court opinions that arguably suggest a different approach.

Any discussion of contractual indemnity agreements must begin with an understanding of the unique rule of contract interpretation that applies to them, the Express Negligence rule. The rule was established by the Texas Supreme Court in *Ethyl Corp. v. Daniel Construction Co.*[1] in order "to cut through the ambiguity" of indemnity provisions, thereby reducing the need for satellite litigation regarding their interpretation. When a party is seeking indemnity from the consequences of its own future negligence, that intent must be expressed in unambiguous terms within the four corners of the contract.[2] Unless the test is met, the agreement is not enforceable.

In *Fisk Elec. Co. v. Constructors & Assocs.*,[3] the Texas Supreme Court resolved a split among the courts of appeal over whether the Express Negligence rule was an affirmative defense or simply a rule of contract interpretation. *Fisk* concerned an indemnity obligation that all parties admitted did not pass the Express Negligence test. Instead, the indemnitee argued that the successful defense verdict in the negligence suit against it meant that it was not negligent and therefore the Express Negligence test simply did not apply. Since the test did not apply, went the argument, the indemnity agreement was enforceable and the indemnitor was liable for the indemnitee's defense costs. The underlying suit was already resolved, and the indemnitee was seeking only defense costs. The Texas Supreme Court rejected the indemnitee's argument, reversing the court below.

The *Fisk* court explained that "[t]he express negligence requirement is not an affirmative defense but a rule of contract interpretation. Issues of contract interpretation are determinable as a matter of law."[4] Later in the same paragraph the court wrote: "Fisk's obligation to pay attorney's fees arises out of its duty to indemnify. Absent a duty to indemnify there is no obligation to pay attorney's fees."[5] The court specifically disapproved of opinions holding otherwise, including one, *Construction Investments & Consultants, Inc. v. Dresser Industries, Inc.*[6], in which it was "held that an indemnitor's obligation to pay defense costs was a separate and distinct issue from the duty to pay a judgment."[7] The *Fisk* court went on to explain that:

> [e]ither the indemnity agreement is clear and enforceable or it is not. Such a determination should not depend on the outcome of the underlying suit, but should be established as a matter of law from the pleadings. The rule proposed by [the indemnitee] regarding defense expenses would leave indemnitors liable for a cost resulting from a claim of negligence which they did not agree to bear.[8]

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Fisk is clear on two points. First, enforceability under the Express Negligence rule is determined by reference to the terms of the indemnity agreement and to the pleadings – *not* to the outcome of the underlying suit. To the *Fisk* court, all that mattered was that negligence was *alleged* against the indemnitee. In this sense, the court's analysis seems at least *analogous* to an Eight Corners analysis, which limits the inquiry to the insurance policy and the pleadings. However, *Fisk* does not adopt the Eight-Corners rule, nor does it generally adopt the legal principles applicable to insurance coverage issues. Second, *Fisk* is clear that a contractual indemnitor's defense obligation is a *subpart* of its indemnity obligation, and rises or falls with the enforceability of the indemnity obligation. If the indemnity is not enforceable under the Express Negligence rule, then there is no enforceable obligation to pay attorney's fees. It is not a separate and independent duty, in the sense that liability insurance carriers' duties to defend and indemnify are separate and independent. In fact, the *Fisk* court carefully avoids even referring to an indemnitor's "duty to defend." Instead, it refers to an indemnitor's "obligation to pay attorney's fees."[9]

From express disapproval of the concept that contractual indemnitors owe separate and independent duties to defend and indemnify, it arguably follows that other aspects of insurance coverage law likewise do not apply. Specifically, if an indemnitor has no "duty to defend" in the sense that a carrier does, then neither the early justiciability of the "duty to defend" nor the application of the Eight-Corners rule to the "duty to defend" should be presumed. It is precisely the understanding of an insurance carrier's duty to defend as a separate, and broader, duty than the duty to indemnify that provides the rationale for the Eight-Corners Rule. As the Texas Supreme Court recently noted: "[t]he policy thus defined the duty to defend more broadly than the duty to indemnify. This is often the case in this type of liability policy and is, in fact, the circumstances assumed to exist under the eight-corners rule."[10]

The justiciability of the "duty to defend" in turn follows from the fact that the determination of the duty is based solely on the pleadings. Fisk's reliance on the pleadings to determine the enforceability of the *indemnity* agreement does not, however, necessarily imply that a right to indemnity is justiciable before the loss to be indemnified is "fixed and certain."[11] This was not at issue in *Fisk*, because the loss was in fact fixed and certain. Arguably, in an Express Negligence dispute in which the loss was not yet fixed and certain, a court could declare the language to pass the Express Negligence test and thus be enforceable, but refuse to enter an award for the indemnitee because its claim was not yet "fixed and certain" and thus not justiciable.

Fisk was concerned only with the Express Negligence Rule and not whether the indemnity agreement was "triggered," so it sheds no light on whether courts should look to the facts or only to the pleadings to decide if the obligation is "triggered." There is, however, one additional Texas Supreme Court case that may provide guidance. Four years before *Fisk* was decided, the Texas Supreme Court, in *Payne & Keller, Inc. v. P.P.G. Industries, Inc.*,[12] addressed "whether a sole negligence exception in an indemnity contract is triggered when the indemnitee's negligence is the only negligence found to have been a proximate cause of the occurrence in question."[13] The case arose from the death of the indemnitor, Payne & Keller's, employee while on the indemnitee, P.P.G.'s, premises. The family of the deceased, Leitten, sued the indemnitee, who filed a third party claim against the indemnitor based on the terms of the indemnity agreement. The jury found the indemnitee's negligence proximately caused the accident and awarded damages. The jury also found that the deceased had acted negligently, but failed to find his actions were a proximate cause of the accident. "No other jury questions as to [the indemnitor's] negligence were submitted."[14] After a brief discussion of its post-Ethyl decisions, the court ruled that the indemnity language met the Express Negligence test:

> The indemnity agreement in the instant case expressly provides for Payne & Keller to indemnify P.P.G. even if P.P.G. is concurrently negligent. The parties clearly expressed their intent that P.P.G. be indemnified for its own concurrent negligence. The indemnity provision satisfies the express negligence rule of Ethyl. [15]

The court went on to frame the key issue before it, which was whether a negligence finding without a finding of proximate cause created a situation of true concurrent negligence:

> The one exception to Payne & Keller's obligation was that it would not be liable for indemnity if P.P.G. were solely negligent. By the jury's findings, P.P.G.'s negligence was found to have been a proximate cause of the accident and Leitten's (Payne & Keller's) negligence was found not to have been a proximate cause.
>
> In order for a finding of negligence to have any effect, proximate cause must also be found. Since the jury did not find proximate cause as to Payne & Keller's employee, there is no concurrent negligence in this case as a matter of law. The jury's findings of negligence and proximate cause against P.P.G., but no one else, make this a case of sole negligence. The sole negligence exception in the indemnity agreement is thus triggered, and Payne & Keller was not required to indemnify.[16]

Thus, the court held that absent a proximate cause finding, there was no "negligence" and thus, based on the jury's verdict that the indemnitee was solely negligent, the indemnitee was not entitled to indemnification.

The *Payne & Keller* court clearly distinguished the issue of whether the indemnity clause was enforceable under the Express Negligence rule, which it decided based on the face of the agreement, from the issue of whether the indemnity clause was "triggered," which it decided based on the facts found by the jury. *Payne & Keller* only involved indemnity for a judgment, not attorneys' fees. However, since *Fisk* instructs that a contractual indemnitor has only one duty, indemnity, of which payment of attorneys' fees is but a sub-part, *Payne & Keller's* analysis may well also apply to questions regarding indemnity agreements that include a duty to pay attorneys' fees.

Thus, the Texas Supreme Court appears to have ruled that contractual indemnitors have no "duty to defend" similar to that of a liability insurance carrier, and that whether an indemnity agreement has been "triggered" depends on a review of the relevant facts, not a review of the pleadings. However, several post-*Fisk* Texas courts of appeal have held that the Eight-Corners rule applies to questions of whether contractual indemnity agreements are "triggered," despite the fact that the conceptual pre-condition for that rule's application -- separate and distinct duties to defend and indemnify -- is apparently not present. One, the case that follows, also adjudicated a contractual indemnitor's "duty to defend" before the indemnitee's claim for indemnity had become "fixed and certain."

English v. BGP Intern., Inc.[17] was a declaratory judgment suit between non-insurers, seeking, pursuant to a contractual indemnity agreement, a defense and indemnification against numerous lawsuits arising from seismic testing without landowners' permission. The landowners sued both indemnitor and indemnitee, alleging both negligence and trespass, and this liability suit remained unresolved at the time of the appeal in the declaratory judgment suit.[18] The trial court held against the indemnitee, English, reasoning that the suit was not ripe for adjudication until the underlying suits were resolved. On appeal, the indemnitee argued only that its right to a defense was ripe, not its right to indemnity. The indemnitor, BGP, countered that even this question was premature, and that in any event the indemnity agreement failed the Express Negligence test and was therefore unenforceable.

The indemnitor argued both that the Express Negligence test was not met, and that, the duty to defend was not justiciable because it was in essence merely a sub-part of the larger duty to indemnify, which itself was non-justiciable because the underlying liability suit remained unresolved.[19] Of course, this argument came directly from *Fisk*. The *English* court rejected the argument, explaining that "numerous courts have held that the duty to defend, unlike the duty to indemnify, is, in most situations, a justiciable issue" citing to seven insurance coverage cases.[20] The court explained that the duties to defend and to indemnify in the indemnification clause were separate duties and that the duty to defend was justiciable before the resolution of the underlying suits.

After deciding that authorities addressing liability insurance carrier's duties to defend controlled the question of justiciability of a contractual indemnitor's obligation to defend, the *English* court turned then to whether that "duty to defend" was triggered in the case before it, i.e. whether the required causal nexus was present. The relevant language in the contract was:

> BGP shall protect, indemnify, defend, and hold harmless [English]. . . [from] any claim or suit, including trespass . . . when BGP . . . commences field operations without the permit acquisition of 100% of the mineral owners and 100% of the surface owners.[21]

Again, the court looked to insurance cases for its analytical basis, specifically cases discussing the Eight-Corners rule. On that basis the court turned to a review of the pleadings, and held that the allegations therein, at least in part, fell within the terms of the contract and thus created a duty to defend.[22] Finally, the court addressed the Express Negligence rule. The court agreed with BGP that the indemnity agreement failed the Express Negligence test, but noted that the test did not apply to claims not based in negligence, citing its own holding in *DDD Energy v. Veritas Dgc Land*.[23] Referring to its earlier observation that the trespass claim was the "lynchpin" of the actions – "[i]n other words, remove the trespass and all other causes of action are negated,"[24] the court held that, even assuming that a separately viable negligence claim was asserted, English was entitled to a defense to the trespass claim. On this basis it distinguished the case before it from *Fisk*, which had concerned only negligence claims.[25] The court noted that in the insurance context carriers are obligated to defend the entire suit if any covered claims are alleged, and "[w]e see no reason to segregate the claims and require BGP to defend the trespass actions while separately requiring English to defend the remaining causes."[26] Thus, due to the presence of the trespass allegations, English was entitled to a defense under its contract with BGP, again, a non-insurer.

Clearly, the *English* court viewed the case before it as entirely distinct from *Fisk*, inasmuch as *Fisk* concerned only the Express Negligence Rule and that rule was, in the end, entirely irrelevant to the *English* court's holding. This distinc-

tion is valid to a point, but *Fisk* and *English* are difficult to reconcile insofar as their understanding of the nature of a non-insurer's undertaking to "defend" another party. The *English* court expressly imported from insurance coverage law the idea that the duties to defend and indemnify are separate and independent. However, the *Fisk* court expressly reasoned that, in the contractual indemnity context, the duty to defend is merely a sub-part of the duty to indemnify, and the enforceability of the former is bound entirely to the enforceability of the latter: "[a]bsent a duty to indemnify there is no obligation to pay attorney's fees."[27] According to the *Fisk* court contractual indemnitors have taken on only one duty. Per *English*, however, and the cases that follow, contractual indemnitors are treated like liability insurers.

In a decision released for publication on May 19, 2008, the San Antonio Court of Appeals cited the *English* case for the proposition that "[i]n determining whether a duty to defend arises under an indemnity provision, we focus on the facts alleged."[28] The *MRO Southwest* court assumed that the Eight-Corners rule applied to the interpretation of a contractual indemnity clause. While there is no real discussion of the issue, the facts of the case indicate that the court applied a fairly strict Eight Corners analysis.

MRO, the owner of a shopping mall, entered a development agreement with Target under which MRO was to construct a building pad to in turn be used by Target in the construction of a foundation for a store adjacent to the mall. The agreement required MRO to remove all utilities underlying the building pad. MRO failed to remove a storm drain, and Target built the foundation over it, thus blocking the drain with concrete. After heavy rains, the drain backed up into the mall causing property damage. MRO, its management wing, and one mall tenant all sued Target for negligence. Target counterclaimed against MRO for breach of the construction agreement by failure to remove the storm drain before turning the building pad over to Target. Target also sued for breach of the indemnity clause in the development agreement.[29]

The *MRO Southwest* court affirmed a summary judgment against MRO on its negligence claims and reversed and rendered on an award of $300,000 in attorneys fees awarded to Target by the trial court. Focusing on the facts alleged, the court held that MRO had no duty to defend or indemnify Target under the indemnity clause because the allegations against Target "alleged claims for damages arising out of *Target's* activities, not activities performed by [MRO]and thus no sufficient causal nexus was present."[30] Thus, even though the damage in question arguably "arose out of" MRO's failure to remove the storm drain as required by contract, which was the subject of Target's counterclaim in the very same proceeding, the court looked only to the four corners of the pleadings against the indemnitee, Target.

Coastal Mart, Inc. v. Southwestern Bell Telephone Co.[31] arose from the death of a child killed by a drunk driver while allegedly using a payphone at a gas station. The claims of the parents were resolved, leaving only a cross-claim brought by Coastal against Southwestern Bell. Coastal alleged that, under the licensing agreement between the parties, Southwestern Bell owed it both a duty to indemnify and to procure insurance. Indemnity was to apply to actions "arising from or connected with SWBT's obligations" under the licensing agreement.[32] Insurance was to be procured to "protect… against… claims… arising by reason of SWBT's access to Coastal's premises."[33]

While liability insurance carriers are in the business of managing litigation, the same cannot be said of contractual indemnitors.

The Corpus Christi Court of Appeals considered each issue separately, and held that "Coastal established a sufficient nexus between SWBT's obligations under the contract and the loss for which it seeks indemnity."[34] The *Coastal* court apparently based this decision solely on the pleadings. Although Southwestern Bell argued that "the duty to indemnify attaches only upon a finding of liability, not by virtue of mere allegations" the court refused to consider this argument as it was first made on appeal.[35] Thus the court refused to consider the issue of whether the causal nexus required for a contractual indemnity obligation to exist should be determined by reference to pleadings or facts. However, when it addressed the issue of whether the claim at issue was of the sort for which Southwestern Bell was obligated to procure insurance for Coastal, the court explained that since it was not interpreting an insurance policy it could not apply the Eight-Corners rule but went on to state, in effect, that it would indeed apply it:

> In this case, there is a license agreement, but there is no insurance policy. Consequently, we cannot apply the "Eight Corners" rule per se. Instead, we use the traditional rules of contract construction; however, because the duties to provide insurance and defend are triggered by the lawsuit, and not its

> ultimate outcome, we must consider the license agreement in light of the allegations of the petitions filed by Ordonez and Esparza. See *id*. at 75 ("[W]e have no business passing on the actual outcome of the ... litigation."); see also *Am. Alliance*, 788 S.W.2d at 154 ("The duty to defend is not affected by facts ascertained before suit, developed in the process of litigation, or by the ultimate outcome of the suit.").[36]

Thus, the court looked to the allegations of the underlying pleadings to determine whether Southwestern Bell had breached its agreement to maintain insurance that would defend Coastal against the particular underlying lawsuit in question.

Like *English, MRO Southwest* and *Coastal* appear to depart from the framework on which *Fisk* and *Payne & Keller* were decided. Both approaches raise questions from the standpoints of equity and practicality. Often, as in the case of injury to the employee of an indemnitor that is a workers compensation subscriber, there will be no allegation in the pleadings that the indemnitor had anything to do with the injury. Is the indemnitee thus without recourse even if the facts would show that the injury did have the required nexus with the indemnitor? Can the indemnitee file a third-party pleading against the indemnitor alleging the required causal nexus and thereby create an obligation? Conversely, should pleadings that falsely accuse the indemnitor of some connection to the injury when the facts would show otherwise be given effect? Are indemnitors in that situation stuck paying for the defense and indemnity of another that it did not bargain for?

Such scenarios do not raise concerns in the context of true liability insurance for several reasons For one, as the Texas Supreme Court recently noted in *GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church*,[37] the Eight-Corners rule is based in part on the common policy language under which carriers undertake to defend the insured against even "false or fraudulent claims." This type of undertaking is almost non-existent in contractual indemnity agreements. Furthermore, along with an insurance carrier's duty to defend comes a concurrent right to control that defense, which is also almost never the case in contractual indemnity agreements. Nor as a practical matter is it ever likely to be. While liability insurance carriers are in the business of managing litigation, the same cannot be said of contractual indemnitors. In fact, they are typically the less sophisticated contracting party, wield less negotiating power, and only accept indemnity obligations because they must in order to do business. This inferior bargaining position of the indemnitor is the exact opposite of an insurer/insured relationship, in which the party to be indemnified is the weaker in terms of bargaining power, the common justification for the particular brand of *contra proferentem*[38] applied in insurance decisions. Furthermore, if contractual indemnitors are understood to be accepting the kind of obligation that a liability insurance carrier has, where does the indemnitor's duty where stop? Are contractual indemnitors subject to *Stowers*[39] actions? Can they be sued for Insurance Code violations?

Some courts from other jurisdictions have had no problem adapting some but not all aspects of coverage law to contractual indemnity disputes.[40] Moreover, applying an Eight Corners analysis does have the benefit of avoiding a situation where a settlement of the original suit precludes a determination of whether a "sole negligence excepted" indemnity agreement, such as the one in *Payne & Keller*, is "triggered." Texas courts may well consider it pragmatic to have these issues decided up front, although absent a "true" duty to defend involving the right and duty to control the defense, it is not entirely clear why an indemnitee cannot be expected to wait until the resolution of the suit to be reimbursed for its attorneys' fees. Complicating this issue is the fact that indemnity obligations are often covered under the indemnitor's general liability coverage, and thus, as a practical matter, that carrier often handles the defense of the indemnitee just as it would its own insured's. This is despite the fact that the standard CGL language treats such "insured contract" coverage as coverage for the named insured's obligation, which erodes limits, and not as the carrier's duty to defend the indemnitee.

Furthermore, looking to the pleadings may help to avoid the prejudice to the indemnitee from an overlap in fact finding efforts, the same consideration that underlies the prohibition against consideration of "extrinsic evidence" when determining an insurer's duty to defend. However, the typical issue of whether the injured plaintiff's claims have a sufficient causal nexus to the subject of the contract between indemnitor and indemnitee will rarely overlap significantly with the elements of the plaintiff's claims, as generally only a very remote nexus, far from proximate causation, is required.

No Texas court has undertaken a full discussion of the legal and equitable considerations involved in whether and to what extent contractual indemnitors should be treated like liability insurers, and the cases discussed herein, without a doubt, leave many questions unanswered. Good arguments can be made on all sides. Until the right set of facts presents itself, the final word on these issues remains unwritten.

1. 725 S.W.2d 705, 708 (Tex.1987).

2. *Id*.

3. 888 S.W.2d 813, 815 (Tex. 1994).

4. *Fisk* at 814 (internal citations omitted).

5. *Id*. at 815.

6. 776 S.W.2d 790 (Tex. App.--Houston [1st Dist.] 1989, writ denied).

7. *Fisk* at 815.

8. *Id*.

9. *Id*. at 814.

10. *GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church*, 197 S.W.3d 305, 310 (Tex. 2006).

11. *Ingersoll-Rand Co. v. Valero Energy Corp*., 997 S.W.2d 203, 205 (Tex. 1999) ("We adhere to the longstanding rule that a claim based on a contract that provides indemnification from liability does not accrue until the indemnitee's liability becomes fixed and certain.").

12. 793 S.W.2d 956 (Tex. 1990).

13. *Id*. at 957.

14. *Id*.

15. *Id*. at 958 (see also *XL Specialty Ins. Co. v. Kiewit Offshore Servs*., 513 F.3d 146, 150 (5th Cir. 2008) (following *Payne & Keller* to find a similar indemnity agreement passed the Express Negligence test).

16. *Id*. at 958.

17. 174 S.W.3d 366 (Tex. App.-- Hou. [14 Dist.] 2005, no pet. hist.).

18. *Id*. at 369.

19. *Id*. at 371.

20. *Id*. at 371.

21. *Id*. at 373 (emphasis in original).

22. See *id*. at 373-4.

23. 60 S.W.3d 880 (Tex. App. – Hou. [14th Dist.] 2001, no pet.).

24. *English,* 174 S.W.3d at 373.

25. *Id*. at 375.

26. *Id*. at 374.

27. *Fisk,* 888 S.W.2d at 815.

28. *MRO Southwest, Inc. v. Target Corp*., 2007 Tex. App. LEXIS 9831, *9 (Tex. App.—San Antonio, December 19, 2007, pet. filed Feb. 19, 2008).

29. *Id*. at *2.

30. *Id*. at *9 (emphasis in original).

31. 154 S.W.3d 839 (Tex. App.—Corpus Christi, 2005, pet. granted, jdgmt. set aside w/o ref. to merits, 2006 Tex. LEXIS 874 (Tex., Sept. 15, 2006)).

32. *Id*. at 844.

33. *Id*. at 846.

34. *Id*. at 845.

35. *Id*. at 844 (quoting *Ingersoll-Rand Co. v. Valero Energy Corp*., 997 S.W.2d 203, 210 (Tex. 1999) in which the Texas Supreme Court stated at page 205 that "[w]e adhere to the longstanding rule that a claim based on a contract that provides indemnification from liability does not accrue until the indemnitee's liability becomes fixed and certain, as by rendition of a judgment.").

36. *Id*. at 846.

37. 197 S.W.3d 305, 311 (Tex. 2006).

38. "Language in a written contract of doubtful meaning will be construed most strongly against the person using the language or who has caused the uncertainty to exist." *Amory Mfg. Co. v. Gulf, C. & S. F. R. Co*., 89 Tex. 419 (Tex. 1896).

39. *G.A. Stowers Furniture Co. v. Am. Indem. Co*., 15 S.W.2d 544, 547 (Tex. Comm'n App. 1929, holdings approved).

40. See e.g., *George Sollitt Corp. v. Howard Chapman Plumbing & Heating, Inc*., 836 P.2d 851, 852-53 (Wash. Ct. App. 1992) (resolving duty to defend in contractual indemnity case at the time of the tender of a defense, but looking beyond the complaint allegations); *Tateosian v. State*, 2007 VT 136, P15 (Vt. 2007) (refusing to construe ambiguities against indemnitor under a contractual indemnity agreement, as insurance coverage law would have required).

BY TREVOR B. HALL[1] & JAMES L. CORNELL[2]

My Policy, My Choice? — Insureds, Insurers & Selection of Counsel

Imagine that one of your business clients has been sued by a third party for liability arising out of an accident or event. The lawsuit could be for an injury in the workplace, for property damage, or some other claim. Your client dutifully notifies the carrier of the claim and naively expects that the years of paying insurance premiums will pay off in an exuberant acknowledgement of coverage by the carrier and an unambiguous commitment to a vigorous defense. Instead, your client receives a twenty page, single-spaced "reservation of rights" letter that seems to copy the entire insurance policy verbatim and concludes with a cryptic "have-a-nice-day" statement to the effect that the carrier will agree to defend your business client, but reserves its rights to continue its investigation and may ultimately deny coverage altogether. Your client calls you, completely confused, looking for sound advice regarding its options and rights. What does this mean? What options can you offer? This scenario plays itself out across Texas every week. The purpose of this article is to provide you as a business lawyer with the knowledge and tools necessary to give your business client accurate and reassuring counsel in this complex and stressful situation.

I. OCCURRENCE V. CLAIMS MADE

There are two general types of general liability ("CGL") policies: occurrence and claims-made. With an occurrence policy, the coverage is triggered when there is an occurrence,[3] which is generally defined as an accident. (Some policies use event instead of an accident.) On the other hand, in a claims-made policy, the coverage is triggered when the claim is made (not when the accident occurred).[4] Some policies require that the claim be made and reported to the carrier before the policy is triggered.[5] Most CGLs are occurrence policies, although there are general liability policies which are claims made. Most director and officer liability policies, and professional liability policies are claims made policies.

II. DUTY TO DEFEND

A. Origin of the Duty to Defend

Most businesses carry CGL liability insurance coverage, among other insurance coverages. A typical[6] primary CGL policy provides two distinct benefits to the policyholder: (i) payment of covered claims and (ii) defense against third party claims that could potentially be covered. The former is referred to as the "duty to indemnify," and the latter as the "duty to defend." The language in the policy typically states that the carrier has the "right and the duty to defend" as the following form states:

> We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have the ***right and duty to defend*** any "suit" seeking those damages. However, we will have no duty to defend the insured against any "suit" seeking damages for "bodily injury" or "property damage" to which this insurance does not apply. We may, at our discretion, investigate any "occurrence" and settle any claim or "suit" that may result.[7]

The "duty to defend" has been held to encompass the right and the duty to select, retain and pay for defense counsel.[8]

B. Triggering the Duty to Defend

The duty to defend is triggered when the insured gives the carrier notice of the claim or suit that is potentially covered. There is no requirement in the insurance contract that the insured demand that the carrier defend the claim. Simply providing a copy of the suit suffices.[9] However, most carriers take the position that pre-tender fees are not covered.[10] Thus, it is very important for the insured to provide the carrier with notice of the claim as soon as possible.

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C. The Carrier's Duty to Defend

The carrier must defend if there is a potential for coverage. Texas follows the "eight corners" rule.[11] This means that the claims in the live petition are compared with the terms of the applicable policy, and, reading the pleading liberally, if there is the *potential* for coverage of any claim asserted, then the carrier must provide a complete defense to *all* of the claims, both covered and non-covered.[12] The claims are analyzed without regard to whether they are true, false, frivolous or groundless.[13] Only two documents are relevant to the court's analysis of the duty to defend, in most cases: (i) the insurance policy; and (ii) the live pleading of the third-party claimant.[14] The duty to defend is determined by examining the latest, and only the latest, amended pleadings. A complaint which does not initially state a cause of action under the policy, and so does not create a duty to defend, may be amended so as to give rise to such a duty.[15] Facts ascertained before suit, developed in litigation, or determined by the ultimate outcome of the suit are irrelevant to and do not affect the duty to defend.[16] All doubts concerning the duty to defend must be resolved in favor of the insured. Thus, under the "eight corners" doctrine, whenever the potential for coverage appears to any degree in any portion of the live complaint of the underlying action, the insurer must defend the insured for the entire suit. The carrier must defend the entire case if there is a possibility that any of the claims might be covered.[17] The duty to defend is broader than the duty to indemnify.[18]

D. The Retained Defense Counsel's Duty to Defend

1. Tri-Partite Relationship

Unless there is a reservation of rights (discussed more fully below), the defense counsel is selected, retained, and paid by the insurance carrier. In the usual case, carriers have "panel counsel" with whom they have established relationships, many times spanning years, and to whom they refer multiple cases or even entire books of business in exchange for reduced hourly rates and adherence to "litigation guidelines." The carrier pays the legal bills and has the right to control counsel.

Notwithstanding this financial arrangement, the carrier-selected defense counsel has an attorney-client relationship with the insured and owes the insured all of the ethical and legal duties inherent in the attorney-client relationship. The "panel counsel" hired by the carrier is "the attorney of record and the legal representative of the insured, and as such he owes the insured the same type of unqualified loyalty as if he had been originally employed by the insured. If a conflict arises between the interests of the insurer and the insured, the attorney owes a duty to the insured to immediately advise him of the conflict."[19] This arrangement, where the carrier selects the counsel, pays for the defense, and the retained counsel legally represents the policyholder, is frequently referred to as the "tri-partite relationship."

Tilley, the seminal case in this area, established that the defense counsel owes unconditional duties to the policyholder. In *Tilley*, the carrier instructed "panel counsel," whom it had hired to defend the insured, to develop evidence that would support the carrier's "late notice" coverage defense. In other words, the carrier was using the "panel counsel" assigned to defend the insured to develop facts that would defeat coverage for the counsel's client. The "panel counsel" was in a position of blatant conflict. The "panel counsel" obliged the carrier by interviewing the insured's employees and developing facts supporting the "late notice" coverage defense, never informing the insured that he had been paid by the carrier to develop evidence against his true client in order to defeat coverage, or disclosing the obvious conflict of interest. The Texas Supreme Court found that, in these circumstances, the carrier was estopped from denying coverage.[20]

Even though the "panel counsel" owes a duty of undivided loyalty to the insured client, *id*. at 558, the carrier still retains the right to control the "panel counsel." Paradoxically, despite the fact that the carrier may exercise the same level of control over the retained counsel as the client normally has, the carrier does not shoulder any vicarious liability for the acts or omissions of the defense counsel it has hired. In other words, although the defense counsel: (i) may be selected by the carrier without any input by the policyholder (as is often the case); (ii) may have a long-standing business relationship with the carrier; (iii) may be enticed by and in some cases even financially dependent upon, the prospect of future lucrative assignments from that carrier; and (iv) may be compelled by the carrier to observe strict litigation guidelines which are designed and intended to contain costs and constrain the defense counsel's actions, the carrier is not liable for any negligent acts or misdeeds committed by its hand-picked counsel.[21] According to the Texas Supreme Court, despite what is in many cases a long-standing relationship with, and intimate control by, the carrier, the defense counsel is an "independent contractor" vis-à-vis the carrier.

2. Three Parties, But Only One Client

Despite the tri-partite relationship, the retained defense counsel only has one client. In *Traver*, the Texas Supreme

Court analyzed the issue of the carrier's vicarious liability for the actions of its "panel counsel" in terms of the principal-agent relationship, and stated that in determining whether the:

> principal [i.e.-carrier] is vicariously responsible for the conduct of an agent [i.e.-panel counsel], the key question is whether the principal has the right to control the agent with respect to the details of that conduct. We have recognized that a liability policy may grant the insurer the right to take "complete and exclusive control" of the insured's defense.[22]

Somewhat confusingly, although the carrier by contract and case law has the right to "complete and exclusive control" of the defense, it bears no responsibility for and is legally shielded from liability for the actions of the attorney it has selected and imposed upon the policyholder. "Complete control" of the lawyer apparently is not "sufficient control" to make the carrier liable. Although it is black letter law that the principal is liable for the torts of the agent, for some reason, in this circumstance, the Texas Supreme Court has held that it is not.[23] According to *Traver*, the panel counsel represents the policyholder, not the carrier, and, although he is controlled by the carrier, the carrier owes no liability for his actions.[24]

E. The Carrier's Duty When Selecting Staff Counsel

In *Unauthorized Practice of Law Committee v. American Home Assurance Co.*,[25] the Texas Supreme Court addressed the use of staff counsel by insurance companies to represent their insureds. Staff counsel are not to be confused with captive counsel or regular insurance defense counsel. A captive firm is a separate law firm that has only one client—the carrier. On the other hand, staff counsel are actual employees of the carrier, receiving salary, benefits and promotions from the carrier's management. Challenges had been made to this arrangement on both ethical and legal grounds alleging that by using staff counsel, the carrier, as a corporate entity, was engaging in the unauthorized practice of law. American Home brought a declaratory judgment action against the Unauthorized Practice of Law Committee seeking a declaration that the use of staff counsel did not constitute the unauthorized practice of law by the insurance carrier.

The Texas Supreme Court held that the carrier may utilize staff counsel, as long as the interests of the carrier and the insured are "congruent." According to the court, their interests are congruent when they are aligned in defeating the claim and there is no conflict of interest between the insurer and the insured. A staff attorney, however, must fully disclose to an insured his or her affiliation with the insurer. In reaching its decision, the court found it significant that there was no evidence in the record of injury to private or public interest caused by a staff attorney's representation of an insured.

With regard to the imputation of confidential information received by the staff attorney from the client, the court noted that it could be argued that this knowledge would estop the insurer from using the information. The court concluded that while these problems present risks to the insurer in using staff counsel, they do not necessarily destroy the congruence of the insurer's and insured's interests.

The Texas Supreme Court held that the carrier may utilize staff counsel, as long as the interests of the carrier and the insured are "congruent."

The Texas Supreme Court also indicated that staff counsel could represent two clients – the carrier and the insured – simultaneously. This appears to be a departure from its pronouncements in *State Farm Mut. Auto. Ins. Co. v. Traver*,[26] where the court held that the insurance defense counsel only has one client – the insured. In contrast, in *UPLC*, the court stated that it had never held that an insurance defense lawyer *cannot* represent *both the insurer and the insured*, only that the lawyer *must* represent the insured and protect his interests from compromise by the insurer. The court also stated that "an insurer's right of control generally includes the authority to make defense decisions *as if it were the client* where no conflict of interest exists. Rule 1.06 of the Texas Disciplinary Rules of Professional Conduct allows a lawyer to represent more than one client in a matter if not precluded by conflicts between them."

Finally, the supreme court outlined some situations where the use of staff counsel could cross over into the unauthorized practice of law. This could occur if:

1. an insurer's interest conflicts with an insured's;
2. the insurer acquires confidential information that it cannot be permitted to use against the insured;
3. an insurer attempts to compromise a staff attorney's independent, professional judgment; or

4. in some other way the insurer's and insured's interests do not have the congruence they have in the many cases in which they are united in simple opposition to the claim.

In these cases, the insurer cannot use a staff attorney to defend the claim without engaging in the unauthorized practice of law.

If a carrier assigns the defense of its insured to staff counsel, then the carrier must disclose the relationship between the carrier and the staff counsel. In addition, if there is a conflict of interest, or the counsel acquires confidential information that cannot be used against the insured or the carrier attempts to compromise the counsel's judgment, then staff counsel cannot be used, and the insured has the right to demand independent counsel. As a practical matter, it may be difficult for the insured to know or recognize that the carrier is inappropriately attempting to influence the staff counsel's judgment.

III. CONDITIONAL V. UNCONDITIONAL DEFENSE

An unconditional defense is a defense in which the carrier does not reserve its rights, but offers a complete, unqualified defense.[27] The carrier does not assert any coverage defenses, and if liability is found, the carrier will pay for the loss. A conditional defense, on the other hand, occurs when the carrier "reserves it rights," by sending a letter stating in writing its potential defenses to coverage.[28] A carrier is obligated to articulate and disclose any defenses it may have to coverage which are known to the carrier at the time, and to update the reservation if facts become known to the carrier which would give rise to an additional coverage defense. Failure to state all grounds for a defense to coverage could result in the carrier being estopped from denying coverage, if in fact the insured can prove prejudice.[29] Thus, it behooves the carrier to disclose all grounds known to the carrier for any defense to coverage, or it risks waiving them.

A. Reservation of Rights

A "reservation of rights" is a letter in which the carrier agrees to defend the insured, but states that it is continuing to investigate and may deny coverage at a later date.[30] A carrier must reserve rights in a timely manner. Failure to do so is a violation of the Texas Insurance Code.[31] Carriers must also state all of the bases for the reservation known to the carrier at the time of the reservation. In other words, if there are four grounds upon which to reserve rights, the carrier must articulate them, or risk a finding that the carrier was waived a ground that is not set forth. Carriers can reserve rights for many reasons. If there is an exclusion that may apply to the claim, the carrier is obliged to reserve its rights. "If an insurer assumes the insured's defense without obtaining a reservation of rights or a non-waiver agreement and with knowledge of the facts indicating noncoverage, all policy defenses, including those of noncoverage, are waived, or the insurer may be estopped from raising them."[32]

Texas law recognizes that the reservation of rights may create a conflict between the carrier and the insured.[33] The carrier is seeking to deny the very insurance coverage that the insured has paid for and is expecting. Because of this conflict, Texas law holds that the carrier cannot select and control counsel in certain circumstances.

B. Selection of Counsel By the Policyholder: Two Key Cases

The issuance of a reservation of rights may create a conflict which entitles the policyholder to select its own counsel to be paid by the carrier.[34]

In *Northern County Mutual Insurance Co. v. Davalos*,[35] the Texas Supreme Court determined the parameters of the insured's right to select counsel when the carrier issues a reservation of rights. *Davalos* involved two lawsuits filed in connection with an automobile accident in Dallas County. Davalos, the insured driver, first filed suit in Matagorda County; subsequently, the other driver sued Davalos in Dallas County. Instead of tendering the Dallas County action defense to Davalos's insurer, Northern County Mutual Insurance ("Northern"), Davalos retained the attorneys hired in the Matagorda suit to assist in Dallas. In connection with that defense, Davalos's attorneys sought to transfer the Dallas action to Matagorda County. Meanwhile, Northern opposed Davalos' decision both to retain his own counsel and to seek a transfer of venue to Matagorda County. Northern instructed Davalos, in writing, to direct his own counsel to withdraw and to cooperate with Northern's panel attorneys; otherwise, said Northern, "liability protection under the policy might be threatened."

In response to Northern's "qualified defense" of the Dallas County suit, Davalos sued Nothern, claiming breach of the duty to defend, bad faith, and violations of the Texas Insurance Code. After adverse decisions at trial and before the court of appeals, Northern argued before the Texas Supreme Court that its dispute over venue was insufficient to defeat its contractual right to conduct the defense, and that only a dispute over coverage could entitle Davalos to select his own counsel. Thus, the *Davalos* opinion turned on determining the type of conflict that nullified the carrier's selection of counsel.

The court cautioned that "merely disagreeing with the insurer's proposed actions" is not enough. If the issue on which coverage turns is independent of the liability issues, then independent counsel selected by the policyholder is not required. There is no conflict of interest unless the outcome of the coverage issue can be controlled by counsel retained by the carrier who could try to steer the evidence in the direction of non-coverage.[36] This rule allows insurers to control costs while permitting policyholders to protect themselves from a carrier retained attorney who may be tempted to develop facts or legal strategy that could ultimately support the insurer's position that the underlying claim is excluded.[37]

Rather, the court delineated two criteria to measure whether an insured may choose its own defense attorney. Requisite circumstances are: (1) an insurer has issued a reservation of rights letter; and (2) the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends. Under these circumstances, the insurer loses its contractual right to conduct the defense. Additionally, if the carrier conditions its offer of a defense upon unreasonable or extracontractual demands, the insured may also refuse that defense. Expanding upon the latter concept, the court offered four scenarios that could excuse an insurer's cooperation:

1. when the defense tendered "is not a complete defense under circumstances in which it should have been,"
2. when "the attorney hired by the carrier acts unethically and, at the insurer's direction, advances the insurer's interests at the expense of the insured's,"
3. when "the defense would not, under the governing law, satisfy the insurer's duty to defend," and
4. when, though the defense is otherwise proper, "the insurer attempts to obtain some type of concession from the insured before it will defend."[38]

The Court found that these principles actually favored Northern because the choice of venue should not have an impact on the insured's legitimate policy interests; therefore, since Northern properly offered a defense to Davalos, the insured had no independent right to select his own counsel.

Despite the Court's failure to provide solid guidance in announcing the application of the Windt analysis to Texas insureds, opinions following *Davalos* offer glimpses into the analysis. The first case to apply *Davalos* was *Housing Authority of the City of Dallas, TX v. Northland Ins. Co.*[39] There, an insured government housing authority, DHA, retained its own counsel to defend against a covered lawsuit. DHA offered evidence that the insurer, Northland, failed even to acknowledge the claim until four days before the deadline to answer the petition. DHA further alleged that Northland's choice for defense counsel historically progressed slowly on lawsuits they defended on DHA's behalf. Northland insisted upon using its panel counsel because (1) the panel counsel had "more experience and lower hourly rates" than DHA's chosen lawyers, and (2) Northland had a potential conflict of interest with the firm that DHA chose. Accordingly, DHA claimed, *inter alia*, that Northland breached its contract "because it was not given 'an opportunity to confer' regarding the selection of defense counsel." DHA also alleged that "Northland's tender of a defense subject to a reservation of rights letter triggered its rights to select its own counsel."

DHA then sought summary judgment on its right to select counsel.

After considering *Davalos* and other opinions, the Court rejected Northland's assertion that there was no evidence that the facts could have been steered to exclude coverage. Rather, the Court squarely held that "because the liability facts and coverage facts were the same and *because a potential conflict of interest was created by the issuance of the reservation of rights letter,* a disqualifying conflict existed." (emphasis added) Accordingly, the *Davalos* holding applied, and DHA selected the counsel of its choosing, at that counsel's hourly rate.

Thus, Texas insureds may select counsel when a conflict exists between the insured and the insurer, whether that conflict is manifest, after a reservation of rights, by the coincidence of liability facts and coverage facts, or by conditions imposed by any unreasonable, extra-contractual demand that threatens the insured's independent legal rights.

1. The Effect of the Insured's Selection of Counsel When the Insurer Has Tendered an Unconditional Defense

The rights and obligations of the insurer are dictated by the terms of the contract for insurance itself. The standard general liability policy contains two terms that allow the carrier to assume control of the defense of a lawsuit against its insured. The first provision is commonly known as the "cooperation clause." By contract, the insured obligates itself to cooperate with the insurer that is investigating and responding to a claim. For example, if an insured seeks coverage for a loss, the insured must cooperate with the carrier's reasonable investigation of the loss. The insured must provide documentation or other proof to justify that the loss occurred and the amount of loss that the insured sustained.

In the same manner, when a carrier is accepting its obligations under the contract for insurance, the insured has a responsibility to allow the insurer to exercise its responsibili-

ties under the contract.[40] Not only must the carrier honor the contractual bargain, but so must the insured. Failure to do so can result in the insureds being in breach of the contract, thereby releasing the insurer from its obligations under the policy.[41]

2. *The Effect of a Policyholder's Selection of Counsel on the Insurer/Defense Counsel Relationship*

The policyholder's selection of counsel may impact the relationship between the insurer and defense counsel. Often, when an insurer assumes the defense, the insurer has a preexisting relationship with defense counsel, as discussed above. That relationship may not exist with the counsel the policyholder selects. This can impact the insurer/defense counsel relationship in a number of ways, such as: (1) the reasonableness of legal fees and rates; (2) control of billing procedures; and (3) the flow of information to the insurer. Texas courts have provided little guidance on how to resolve disagreements regarding these issues.

3. *The Effect on Defense Legal Fees and Rates*

Because many large insurers have legal counsel that will defend policyholders for reduced rates and fees, a question arises concerning the insurer's ability to demand that the selected counsel acquiesce to the same reduced rates and fees. No Texas cases provide precise guidance on this point.[42] However, in the *DHA v. Northland Ins. Co.* opinion discussed above, the carrier based part of its objection to DHA's counsel on the higher rates that DHA's counsel charged. Although the court did not address how (or if) non-panel counsel's billing rates effect the selection question, the question will likely arise before Texas courts.

Some states have addressed this issue statutorily. California limits attorney's fees to rates paid by insurers in defense of similar actions.[43] Similarly, Florida has a statute that requires all parties to agree to the fees; otherwise, the court sets the fees.[44] Texas courts have long held that legal fees must be reasonable.[45] The common standard does not account for discounted rates based upon case volume, which is often typical with the insurer-panel counsel relationship. If Texas courts attempted to adopt an approach that accounted for the deviation from standard billing practices, should the insured's counsel be willing to accept the case at a discounted rate when they are not typically subject to the benefits of that volume? And if so, would a court allow that discrepancy to nullify the guidelines set forth in *Davalos*? These questions will linger until the courts offer more clear guidance.

IV. ISSUES RELATED TO CONTROL

A. Control of Billing Procedures

Related to the question on legal rates and fees will be the insurer's ability to demand that defense counsel use specific billing procedures. Often, insurers instruct their hired defense counsel to bill in certain time increments, bill on a quarterly basis and use certain descriptions in their invoices. It remains unclear whether the insurer will be able to require policyholder-selected defense counsel to follow the insurer's established billing practices. Normally, the insurer's remedy would be either to cease retaining that attorney as defense counsel or withhold payment of disputed bills. However, where the attorney is selected by the policyholder, the insurer's refusal to pay bills that do not comply with a billing procedure could amount to an interference with the policyholder's right to select counsel. If the insurer's refusal to pay results in the attorney withdrawing, the insurer may find itself liable to the policyholder for interfering with the policyholder's right to select its own counsel. Because the policyholder has the right to select counsel, an argument exists that there is no reason to require defense counsel to comply with the insurer's billing procedures that do not impact the reasonableness of the fee charged or the service provided. The Texas Supreme Court has recognized that even with insurer-selected counsel, the insurer does not control the day-to-day details of the defense.[46] Thus, while the insurer may be entitled to determine whether the fees being charged are reasonable, there is no basis in most policies or under Texas law for the insurer to demand the legal fees be presented in some specific form or manner.

Because the policyholder has the right to select counsel, an argument exists that there is no reason to require defense counsel to comply with the insurer's billing procedures that do not impact the reasonableness of the fee charged or the service provided.

B. The Insurer's Right to Be Informed

Since the insurer needs to evaluate the case and any settlement demand, it must remain informed about the status of the case. While there is no guidance from Texas courts regarding whether the insurer is entitled to information regarding the case status, prudent defense counsel and

policyholders will want the insurer to remain informed. For example, in order for a *Stowers*[47] demand to be valid and to *Stower*ize the insurer, the demand must be "such that an ordinarily prudent insurer would accept it."[48] An insurer who is not kept informed of the status of the case could successfully argue against a *Stowers* claim by asserting that an ordinarily prudent insurer would not have accepted the demand with the information that the insurer had at the time. Therefore, counsel should keep the carrier informed in order to evaluate the case and any potential settlement.

C. Settlement

When an insurer properly reserves rights to later deny coverage and the insured elects to pursue its own defense and ultimately settles the case or an "Agreed or Consent Judgment" is entered, the insurer is bound to pay only damages up to the policy limits which (1) resulted from covered conduct; and (2) were reasonable and prudent (under the standard of the prudent uninsured).[49]

D. Issue of Right of Reimbursement

If the carrier provides a defense, does it have a right to be reimbursed if it is later determined that there was no coverage? In a landmark decision, the Texas Supreme Court has now held that an insurance carrier does not have a general right of reimbursement for the settlement of uncovered claims. *Excess Underwriters at Lloyd's, London v. Frank's Casing Crew & Rental Tools*.[50] This does not seem to apply, however, when the insured gives its unequivocal consent to reimburse those funds if a determination of non-coverage is made.

In *Frank's Casing*, the insured was sued by Arco Oil & Gas Company in the underlying suit when a platform that Frank's Casing had constructed for Arco collapsed. During trial, Arco made a $7.5 million settlement demand, which the Excess Underwriters accepted and paid, after Frank's Casing refused to contribute in any amount. The $7.5 million settlement demand was within the Excess Underwriters' $10 million policy limits. Excess Underwriters then brought a declaratory judgment action against Frank's Casing for reimbursement of the $7.5 million settlement payment. The trial court originally ruled in favor of Excess Underwriters, but then reversed and held for Frank's Casing after the Texas Supreme Court issued its opinion in *Texas Ass'n of Counties County Gov't Risk Management Pool v. Matagorda County*.[51] In that opinion, the court held that a carrier could only seek reimbursement if it obtained the policyholder's clear and unequivocal consent to both the settlement and the right to seek reimbursement. On appeal, the Fourteenth Court of Appeals reluctantly upheld the trial court judgment, stating that "this is a matter the underwriters must take up with the superior court."

Writing for the Texas Supreme Court majority, Justice O'Neill harkened to *Matagorda County*, phrasing the question presented as follows:

> [w]hether to recognize an exception to the rule in *Matagorda County* and imply a reimbursement obligation when the policy involves excess coverage, the insurer has no duty to defend under the policy, and the insured acknowledges that the claimant's settlement offer is reasonable and demands that the insurer accept it. Because none of these distinctions alleviates the concerns that drove the Court's analysis in *Matagorda County*, we decline to recognize such an exception.[52]

After re-stating its general rule as held in *Matagorda County*, the court turned to whether an implied-in-fact contract for reimbursement existed between Frank's Casing and the Underwriters. The carrier argued that Frank's Casing agreed to reimbursement by participating in settlement negotiations and demanding settlement of the claim. Emphasizing that no meeting-of-the-minds existed to establish a right of reimbursement, the court determined that no contract could be implied in fact: "Frank's Casing's agreement to reimburse the excess insurers cannot be implied in light of its consistent position that the insurers alone were responsible for the claims."[53]

Finally, the carriers argued for reimbursement on equitable theories of quantum meruit and assumpsit. Under quantum meruit, one who provides valuable services to another may establish that the service's recipient has an implied-in-law obligation to pay when the recipient has reasonable notice that the service provider expects to be paid. Under assumpsit, however, a cause of action arises when money is paid for the use and benefit of another.[54] The court rejected both lines of recovery for two primary reasons. First, an insurer may receive reimbursement only when it obtains the insured's clear and unequivocal consent to reimburse such funds. To do otherwise would force insureds "to choose between rejecting a settlement within policy limits or accepting a possible financial obligation to pay an amount that may be beyond its means, at a time when the insured is most vulnerable."[55] Second, allowing an equitable reimbursement right would rewrite the language of the parties' contract for insurance, which the courts refuse to do. Accordingly, the underwriters were not entitled to reimbursement.[56]

Given the holding in *Frank's Casing* that there is no extra-contractual right of reimbursement for settlement without an express agreement, is there a right to seek reimbursement of defense costs? Courts across the nation are split, with the majority finding a right of reimbursement. It is an open legal issue in Texas, but practically speaking, with the new *Frank's Casing* decision, it appears unlikely that there can be such a right without express agreement.

V. THE DUTY TO DEFEND AND MISCELLANEOUS ISSUES

A. The Duty to Defend and SIRs

Many large corporations use Self Insured Retentions (SIRs) to help control insurance costs. An SIR is an amount that the corporation agrees to pay for losses before the first layer of the insurance is triggered.[57] For example, if the corporation has a $1 million SIR, the corporation must pay the first $1 million before the claim triggers the primary insurance. Often, the SIR provides that the amount that is spent in defense is counted against the SIR. However, there is no standard form for an SIR; they vary widely. You and your client should read the SIR carefully to determine if the amount spent defending the claim can be subtracted from the SIR.

Most policies exclude from coverage any voluntary payment of claims made by the policyholder without the insurer's consent. However, two courts have indicated that the selection of counsel by a policyholder eliminates the carrier's control of the settlement.

B. Duty to Defend and Excess Insurance

Most excess policies do not contain a duty to defend.[58] However, as with SIRs, excess policies vary greatly in their coverage. Some excess policies provide for a defense, once the underlying primary policy has been exhausted by payment of covered claims.[59]

C. Duty to Defend and Appeals

The duty to defend generally encompasses the appeal of a case, including posting of the supersedeas bond and payment of appeal fees.[60]

D. When the Duty to Defend Ceases

The duty to defend is separate from and independent of the duty to indemnify.[61] Most standard form CGLs do not have a dollar limit on the duty to defend[62]; however, most policies provide that the policy coverage terminates upon the exhaustion of the policy limits. That means that at that point, the duty to defend ceases.[63]

E. Practical Implications: The Effect of a Policyholder's Selection of Counsel on the Policyholder's and Insurer's Rights

There is a question about what impact a policyholder's election to select its own counsel will have on the right to control settlement. Under most liability policies, the carrier controls the settlement. Likewise, most policies exclude from coverage any voluntary payment of claims made by the policyholder without the insurer's consent. However, two courts have indicated that the selection of counsel by a policyholder eliminates the carrier's control of the settlement.[64] Thus, under the language of these opinions, the policyholder gains not only selection of its defense counsel but also a greater voice in the settlement of claims made against it.

F. Duty to Defend Tips

Always notify the carrier of any claim, suit or demand as soon as possible. If the insured does not provide timely notice, it risks losing coverage because of a late notice. This is particularly true with "claims-made" or "claims-made and reported" policies.

When you review a petition or complaint against your client, look beyond the theories that are asserted to the underlying facts. Even if the Plaintiff's attorney did not specifically allege a covered claim, if the facts describe a potentially covered claim, the carrier will owe your client a defense.

Carefully review every reservation of rights. There may be more than one. The carrier may waive coverage defenses if it does not properly and timely reserve its rights. In addition, the carrier may argue that the reservation of rights may modify the coverage and create an agreement which is supplemental to, and changes the terms of, the policy if the insured accepts a benefit offered in the reservation.

If the carrier reserves its rights, and the reservation goes to the heart of the coverage, then a conflict exists, and your client is entitled to select its own counsel and require the carrier to pay. In that case, politely reject the carrier's retained counsel, and demand that the carrier pay your client's selected counsel.

Always send the carrier the amended petitions or complaints. If the carrier has denied a defense, a later amended petition or complaint may assert claims that could possibly be covered, thereby triggering a defense.

Provide the Plaintiff's attorney with your client's insurance policy and any reservation of rights. The Plaintiff's attorney may be able to modify or amend his/her pleadings to trigger a defense and/or coverage.

Keep the carrier informed about all settlement offers.

If you are defending the policyholder, provide the carrier with redacted copies of your invoices in a timely manner. Do not give the carrier privileged information, or information that could provide the carrier with grounds to deny coverage.

Do not acquiesce to the carrier's claim for reimbursement. If the carrier states that it will seek reimbursement of defense costs, respond immediately in writing and reject that claim.

Selection of counsel can be negotiated as part of the policy. When your client's policy is up for renewal, negotiate for the right to select counsel, or have your firm listed as one of the approved firms for your client.

In many cases, the selection of counsel comes down to an issue of fees. The carrier has negotiated a reduced rate with panel counsel in exchange for a steady stream of work. Your fees may be higher than the rate the carrier has negotiated. In that case, you can reduce your rate, you can accept the carrier's rate, or your client could make up the difference between your rate and the carrier's reduced rate.

VI. CONCLUSION

In summary, the defense obligation is one of the two primary benefits provided by your client's general liability policy. If the carrier issues a reservation of rights, and it goes to the heart of a coverage issue, then your client will be entitled to reject the carrier's defense and retain the counsel of its choice. In that instance, the carrier is obligated to pay your client's selected counsel. Texas courts have not decided whether the carrier can seek reimbursement for defense costs when the claim is not covered.

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3. *See, e.g., Pilgrim Enterprises, Inc. v. Maryland Cas. Co.*, 24 S.W.3d 488, 496 (Tex. App.—Houston [1st Dist.] 2000, no pet.).

4. *See, e.g., Pine Oak Builders, Inc. v. Great American Lloyds Ins. Co.*, ___ S.W.3d ___, 2006 WL 1892669 (Tex. App.—Houston [14th Dist.] 2006).

5. *See, e.g., Hirsch v. Texas Lawyers' Ins. Exchange*, 808 S.W.2d 561 (Tex. App.—El Paso 1991).
[6]Some liability policies do not provide a duty to defend, but rather provide that the carrier will reimburse or indemnify the policyholder for defense costs. 1 Windt, INSURANCE CLAIMS AND DISPUTES 4th § 6:20 (March 2007).

7. ISO Properties, Inc., 2001 Occurrence Form (CG 00 0110 01)(emphasis added).

8. *Northern County Mut. Ins. Co. v. Davalos*, 140 S.W. 3d 685, 688 (Tex. 2004); *State Farm Mut. Auto. Ins. Co. v. Traver,* 980 S.W.2d 625, 627 (Tex. 1998).

9. *See Cruz v. Liberty Mut. Ins. Co.*, 853 S.W.2d 714, 717 n.1 (Tex. App.—Texarkana 1993), *rev'd on other grounds*, 883 S.W.2d 164 (Tex. 1993) ("…forwarding of suit papers by an insured to his insurer …triggers the insurer's duty to defend").

10. *See, e.g., Ingalls Shipbuilding v. Federal Ins. Co.*, 410 F.3d 214, 233-34 (5th Cir. 2005), reh'g granted in part, 423 F.3d 522 (5th Cir. 2005); *Rodriquez v. Texas Farmers Ins. Co.*, 903 S.W.2d 499, 507 (Tex. App.—Amarillo 1995, writ denied).

11. *GuideOne Elite Ins. Co. v. Fielder Road Baptist Church*, 197 S.W.3d 305, 306-307 (Tex. 2006).

12. *Guideone Elite Ins. Co.*, 197 S.W.3d at 308; *Nat'l Union Fire Ins. Co. v. Merchants Fast Motor Lines, Inc.*, 939 S.W.2d 139, 141 (Tex. 1997); *Enserch Corp. v. Shand Morahan & Co., Inc.*, 952 F.2d 1485, 1492 (5th Cir. 1992), *citing Heyden Newport Chemical Corp. v. Southern Gen. Ins. Co.*, 387 S.W.2d 22, 25 (Tex. 1965).

13. *King v. Dallas Fire Ins. Co.*, 85 S.W.3d 185, 191 (Tex. 2002).

14. *King*, 85 S.W.3d at 187.

15. *Rhodes v. Chicago Ins. Co.*, 719 F.2d 116, 119 (5th Cir. 1983); *see also Steel Erection Co. v. Travelers Indem. Co.*, 392 S.W.2d 713, 715-16 (Tex. Civ. App.—San Antonio 1965, writ ref'd n.r.e.) (insurer liable only for that portion of defense costs incurred after plaintiff amended petition to state a covered claim).

16. *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 829 (Tex. 1997).

17. *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523, 528-535 (5th Cir. 2004).

18. *Utica Nat'l Ins. Co. v. Am. Indem. Co.*, 141 S.W.3d 198, 203 (Tex. 2004); *Farmers Tex. County Mut. Ins. Co. v. Griffin*, 955 S.W.2d 81, 82 (Tex. 1997).

19. *Employers' Cas. Co. v. Tilley*, 496 S.W. 2d 552, 558 (Tex. 1973).

20. *Id.* at 561.

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

22. *Id.* at 627. The Texas Commission on Professional Ethics has confirmed that defense counsel's loyalty flows to the insured. In Ethics Opinion No. 533, the Commission addressed whether defense counsel may "ethically comply with litigation/billing guidelines which place certain restrictions on how the lawyer should conduct the defense of the insured." Relying upon *Traver*, the Committee announced that "[l]oyalty to the client/insured demands that the lawyer must at all times protect the interests of the insured if those interests would be compromised by the insurer's instructions." Further, the Committee disapproved of any requirement regulating defense counsel's judgment or otherwise affecting counsel's responsibility to the insured.

In Ethics Opinion No. 532, the Committee analyzed whether defense counsel, absent the client's informed consent, may be "required by the insurance company to submit fee statements to a third-party auditor describing legal services rendered by the lawyer on behalf of the client." Relying upon *Tilley* and *Traver*, the Committee reaffirmed its position that defense counsel's "only client … is the insured." The Committee further explained that defense counsel "must at all times protect the interests of the insured if those interests would be compromised by the insurer's instructions." This opinion, in conjunction with *Tilley, Traver*, and Opinion No. 533, solidifies that in Texas, defense counsel represents the insured, and the insured alone.

23. Under Texas law, a principal "is vicariously liable for the torts of [his agents] committed in the course and scope of their employment." *Ross v. Marshall,* 426 F.3d 745, 763-64 (5th Cir. 2005); *GTE S.W., Inc. v. Bruce*, 998 S.W.2d 605, 617 (Tex. 1999).

24. *See also* Charles Silver, THE PROFESSIONAL RESPONSIBILITIES OF INSURANCE DEFENSE LAWYERS, 45 Duke L.J. 255 (1995); Charles Silver & Michael Quinn, *Wrong Turns on the Three-Way Street: Dispelling Nonsense about Insurance Defense Lawyers,* Coverage, Nov.–Dec. 1995.

25. ___ S.W.3d ___, 2008 WL 821034, 51 Tex. Sup. Ct. J. 590 (Tex. March 28, 2008).

26. 980 S.W.2d 625, 627 (Tex. 1998)

27. *See, e.g., Underwriters at Lloyd's of London v. Gilbert Texas Const., L.P.,* ___ S.W.3d ___, 2007 WL 4415636 (Tex. App.—Dallas Dec. 19, 2007)(noting that an insurer who provides an unconditional defense waives, and is estopped from asserting, any coverage defenses).

28. *See, e.g., American Eagle Ins. Co. v. Nettleton*, 932 S.W.2d 169 (Tex. App.—El Paso 1996, writ denied).

29. *See, e.g., Pennsylvania Nat. Mut. Cas. Ins. Co. v. Kitty Hawk Airways, Inc.* 964 F.2d 478, 481 (5th Cir. 1992).

30. *See, e.g., In re Madrid*, ___ S.W.3d ___, 2007 WL 2965782 (Tex. App.—El Paso Oct. 11, 2007, no pet.). The reservation of rights is a unilateral event. It is not to be confused with a "non-waiver agreement." A "non-waiver" agreement is a writing in which the carrier and the insured agree that the carrier can investigate the claim without waiving its right to deny coverage at a later date. A "non-waiver" agreement is signed by the carrier *and* the policyholder. 1 Windt, INSURANCE CLAIMS AND DISPUTES 4th § 2:19. As a practical matter, there is no benefit or advantage to the policyholder in signing a "non-waiver" agreement. In fact, by doing so, the policyholder may lose its ability to challenge a tardy assertion of a reservation.

31. TEX. INS. CODE § 541.060. UNFAIR SETTLEMENT PRACTICES. (a) It is 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:…

(4) failing within a reasonable time to:

(A) affirm or deny coverage of a claim to a policyholder; or

(B) submit a reservation of rights to a policyholder.

32. *Farmers Texas County Mut. Ins. Co., v. Wilkinson*, 601 S.W.2d 520, 521 (Tex. App.—Austin 1980, reh'g den'd).

33. *Northern County Mut. Ins. Co. v. Davalos*, 140 S.W. 3d 658, 689 (Tex. 2004).

34. *See Rhodes v. Chicago Ins. Co.*, 719 F.2d 116, 120 (5th Cir. 1983) ("When a reservation of rights is made, …the insured may properly refuse the tender of defense and pursue his own defense" and the "insurer remains liable for attorneys' fees incurred by the insured and may not insist on conducting the defense."); *Arkwright-Boston Mfrs. Mut. Ins. Co. v. Aries Marine Corp.*, 932 F.2d 442, 445 (5th Cir. 1991) ("The insured, confronted by notice of the potential conflict …, may then choose to defend the suit personally."); *American Eagle Ins. Co. v. Nettleton*, 932 S.W.2d 169, 174 (Tex. App.—El Paso 1996, writ denied) ("Upon receiving notice of the reservation of rights, the insured may properly refuse tender of defense and defend the suit personally.").

35. *Davalos*, 140 S.W.3d 658 (Tex. 2004).

36. *Id.* at 689.

37. *Housing Auth. of the City of Dallas, Tex. v. Northland Ins. Co.*, 333 F.Supp.2d 595, 601 (N.D. Tex. 2004).

38. Davalos, 140 S.W.3d at 689 (quoting 1 Allan D. Windt, INSURANCE CLAIMS AND DISPUTES § 4:25 at 393).

39. *Housing Auth. of the City of Dallas, Tex. v. Northland Ins. Co.*, 333 F. Supp. 2d 595 (N.D. Tex. 2004).

40. *See, e.g., Rodriquez v. Texas Farmers Ins. Co.*, 903 S.W.2d 499 (Tex. App.—Amarillo 1995).

41. *See, e.g., Progressive County Mut. Ins. Co. v. Trevino*, 202 S.W.3d 811 (Tex. App.—San Antonio 2006, pet. denied).

42. *But see Kirby v. Hartford Cas. Ins. Co.* 2003 WL 23676809, *2 (N.D. Tex. 2003) "In addition to its failure to offer any evidence to support its assertion that $135.00 per hour represents the only "reasonable and customary" rate for defense counsel in a matter like the Underlying Lawsuit, Hartford cites no authority for its conclusion that Kirby is obligated to accept defense counsel "appointed" by Hartford or be limited to any rate the insurer is able to negotiate with such counsel. Hartford cites one case confirming that the insurer is obligated to pay "reasonable and necessary" defense costs. (*citing Travelers Ins. Co. v. Chicago Bridge & Iron Co.*, 442 S.W.2d 888, 900 (Tex. Civ. App.—Houston [1st Dist.] 1969, writ ref'd n.r.e.). Neither that case, nor any other authority establishes, as Hartford contends, that "any rate above [$135 per hour] simply cannot be deemed as necessary." *See Ripepi v. American Ins. Cos.*, 234 F.Supp. 156, 158 (W.D. Pa. 1964) (insured "was not required to employ the cheapest lawyer he could get, or solicit competitive bids" after insurer failed to defend), *aff'd*, 349 F.2d 300 (3d Cir. 1965).

43. CAL. CIV. CODE § 2860(c).

44. FLA. STAT. § 627.426(2) (West 1995).

45. *See, e.g., Fort Worth v. Groves,* 746 S.W.2d 907, 918 (Tex. App.—Fort Worth 1988, no writ).

46. *State Farm Mut. Auto. Ins. Co. v. Traver*, 980 S.W.2d 625, 627 (Tex. 1998).

47. *G.A. Stowers Furniture Co. v. American Indem. Co.*, 15 S.W.2d 544 (Tex. Comm'n App. 1929, holding app'd). In this seminal case, the Court held that the carrier was liable for amounts in excess of the policy limits where an offer to settle within the policy limits had been made, but the carrier negligently refused to settle. A "*Stowers* demand" generally refers to a demand to settle within the policy limits in exchange for a complete and unconditional release.

48. *American Phys. Ins. Exch. v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994).

49. *Rhodes v. Chicago Ins. Co.*, 719 F.2d 116, 121 (5th Cir. 1983).

50. ___ S.W.3d ___, 2008 WL 274878 (Tex. Feb. 1, 2008).

51. 52 S.W. 3d 128 (Tex. 2000).

52. *Frank's Casing*, 2008 WL 274878 at *1.

53. *Frank's Casing*, 2008 WL 274878 at *5-6.

54. *Id.* at *6.

55. *Id.* at *7.

56. *Id.*

57. *See, e.g., Lennar Corp. v. Great American Ins. Co.*, 200 S.W.3d 651 (Tex. App.—Houston [14th Dist.] 2006).

58. *See, e.g., Roman Catholic Diocese of Dallas v. Interstate Fire & Cas. Co.,* 133 S.W.3d 887 (Tex. App.—Dallas 2004)(no defense duty in the excess policies).

59. *See, e.g., In re Consolidated Freightways, Inc.*, 75 S.W.3d 147 (Tex. App.—San Antonio 2002)(excess policy containing a duty to defend).

60. *See, e.g., Waffle House, Inc. v. Travelers Indem. Co. of Illinois,* 114 S.W.3d 601 (Tex. App.—Fort Worth 2003)(absent a contrary contractual provision, the duty to defend extends to appeals, so long as the policy limits are not exhausted); 1 Windt, INSURANCE CLAIMS AND DISPUTES 4th § 4:17.

61. *Gomez v. Allstate Texas Lloyds Ins. Co.*, ___ S.W.3d ___, 2007 WL 3203112 (Tex. App.—Fort Worth Nov. 1, 2007), *citing Farmers Tex. County Mut. Ins. Co. v. Griffin,* 955 S.W.2d 81, 82 (Tex. 1997).

62. There are occasions when the defense is limited to a specific amount by an endorsement. You should read endorsements carefully.

63. *Jankowiak v. Allstate Prop. & Cas. Ins. Co.*, 201 S.W.3d 200 (Tex. App.—Houston [14th Dist.] 2006).

64. *Rhodes*, 719 F.2d at 121 (stating that the insurer is "barred from enforcing voluntary assumption of liability and no action clauses" when the policyholder refuses a conditional defense); *Travelers Indem. Co. v. Equip. Rental Co.*, 345 S.W.2d 831, 835 (Tex. Civ. App.—Houston 1961, writ ref'd n.r.e.) (recognizing that the rule that an insurer is liable for settlements made by an insured when the insurer denies coverage "is effective even though the insurer offers the defend the suit and the offer is refused.").

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The Texas MDL Statute and Insurance Litigation

In 2003, Texas implemented, but has to date rarely utilized, a Multi-District Litigation Panel to allow for the pretrial consolidation of cases. This process is available to facilitate pretrial discovery in situations where there are multiple suits that give rise to "one or more" common factual issues. It is available where consolidation will "serve the convenience of the parties and witnesses and promote the just efficient conduct of the litigation." *See In Re Ad Valorem Tax Litigation*, 216 S.W.3d 83, 84 (Tex. M.D.L. Panel 2006); TEX. R. JUD. ADMIN. 13.2(f), 13.3(a), 13.3(l) *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. App. (West Supp. 2007). Used properly, this procedure can substantially facilitate and narrow pretrial discovery, especially in mass filings of bad faith cases against carriers arising from one mass disaster.

The framework for Texas MDL found in Rule 13 of the Texas Rules of Judicial Administration. Rule 13 allows for the pretrial transfer of cases involving "one or more common questions of fact." TEX. R. JUD. ADMIN. 13.3(a), *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. App. (West Supp. 2007). This standard is significant in that the legislature debated the standard and voted against the standard "common material issues of fact." Tex. H.B. 4, 78th Leg., R.W. §§ 3.02-.03(2003) (engrossed version amending the introduced version). As it stands, the burden to meet is not too high. Cases with "one or more common questions of fact" are considered "related" and may be transferred if other elements are met. Those elements are defined as:

> The MDL Panel may order transfer if three members concur in a written order finding that related cases involve one or more common questions of fact, and that transfer to a specified district court will be for the convenience of the parties and witnesses and will promote the just and efficient conduct of the litigation.

TEX. R. JUD. ADMIN. 13.3(l).

Mass disasters and toxic tort cases are prime targets for this type of consolidation. However, MDL status is not limited to these types of cases. The types of cases already granted MDL status include:

1. *In re Hurricane Rita Homeowners' Claims*, No. 08-0208 (Tex. M.D.L. Panel filed Mar. 13, 2008); *In re Delta Lloyds Ins. Co.*, No. 08-0142 (Tex. M.D.L. Panel filed Feb. 21, 2008); (Consolidation of multiple cases involving single accident granted status because liability facts were substantially the same);

2. *In re Cano Petroleum, Inc.*, No. 07-0593, 2008 Tex. LEXIS 196 (Tex. M.D.L. Panel Jan. 2, 2008); *In re Hurricane Rita Homeowners' Claims*, No. 08-0208 (Tex. M.D.L. Panel filed Mar. 13, 2008); *In re Delta Lloyds Ins. Co.*, No. 08-0142 (Tex. M.D.L. Panel filed Feb. 21, 2008); (Consolidation granted in grass fire case that caused substantial property damage and the deaths of several individuals and livestock. Consolidation granted because the cases were "related." "[The cases] will explore negligence and causation issues in one enormous event.");

3. *In re Ford Motor Co. Speed Control Deactivation Switch Litig.*, No. 07-0953, 2008 Tex. LEXIS 197 (Tex. M.D.L. Panel Feb. 19, 2008); *In re Hurricane Rita Homeowners' Claims*, No. 08-0208 (Tex. M.D.L. Panel filed Mar. 13, 2008); *In re Delta Lloyds Ins. Co.*, No. 08-0142 (Tex. M.D.L. Panel filed Feb. 21, 2008); (Multiple suits involving property damage and wrongful death cases arising out of the failure of speed control switches consolidated even though the suits involved three different switches, manufactured by three different companies, and failing in different ways);

4. *In re Steven E. Looper,* No. 06-1010, 2007 Tex. LEXIS 637 (Tex. M.D.L. Panel Apr. 10, 2007); *In re Hurricane Rita Homeowners' Claims*, No. 08-0208 (Tex. M.D.L. Panel filed Mar. 13, 2008); *In re Delta Lloyds Ins. Co.*, No. 08-0142 (Tex. M.D.L. Panel filed Feb. 21, 2008); (In this case, four separate law suits in Palo Pinto, Tarrant, Parker, and Johnson Counties were consolidated. These suits alleged the wrongful conduct in the assignment of overriding royalty interests. The court focused on the nearly identical pleadings and common issues of fact, the

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discovery necessary to litigate each one of the fours suits, and the four sets of identical discovery served on the defendants);

5. *In re Ocwen Loan Servicing, LLC Mortgage Servicing Litigation*, No. 07-0037, 2007 Tex. LEXIS 1180 (Tex. M.D.L. Panel Mar. 26, 2007); (In this case, the court consolidated nine related cases pending in seven counties arising out of plaintiffs' claims that defendants wrongfully charged borrowers delinquency-related fees and then wrongfully foreclosed on the borrowers' homes. The court noted that the plaintiffs' claims focused on the standard practices and procedures followed by Ocwen in servicing mortgage loans, and similar legal issues that would arise as to whether those standard practices will give rise to liability under the commonly alleged theories);

6. *In re Silica Products Liability Litigation*, 166 S.W.3d 3 (Tex. M.D.L. Panel 2004); (In this case, the transfer of 71 products liability cases was found to further the convenience of parties and witnesses and promote the just and efficient conduct of the litigation).

Transfer of "related cases" is available "even though in a given case the common issues might not outweigh the individual case-specific issues." *In re Silica Products Liability Litigation*, 166 S.W.3d 3, 6 (Tex. M.D.L. Panel 2004). The rule also extends to mixed questions of law and fact, which our system calls fact questions. *Id*. Consolidation is appropriate even if the cases are pending in the same county.

Pretrial consolidation under the Texas MDL statute does not deprive the plaintiffs of their venue for purposes of trial. It merely consolidates the cases for pretrial in a court selected by the Panel as appropriate. The pretrial issues include joinder, discovery, *Daubert/Robinson* challenges, motions for summary judgment, and other pretrial issues, such as motions in limine and preadmission of exhibits. However, when it comes time to seat a jury and present evidence, the cases will be transferred back to their trial courts.

Utilizing the MDL streamlined process may very well be the best course of action to minimize litigation expenses in first party property damage cases claims arising out of a mass disasters, such as weather related claims including hurricanes or tornadoes. It may also be the best course in large catastrophe claims involving building fires or the like.

Many first party bad faith cases assert the same causes of action and factual allegations of poor "standard practices and procedures." These claims also seem to gravitate to allegations of a predetermined investigation. Breach of contract claims, violations of the prompt payment statute, the unfair settlement practices act, deceptive trade practices, and fraud are now becoming the boilerplate claims to be asserted. In these first party cases, the petitions become boilerplate with no discernable difference in any of the allegations made against the carriers.

With this background, MDL treatment appears to be ideally designed to narrow the issues and streamline discovery. Transferring cases to a pretrial court helps "eliminate duplicative discovery, prevent inconsistent pretrial rulings, and conserve the resources of the parties, their counsel, and the judiciary." *In re Peanut Crop Ins. Litigation*, 342 F. Supp. 2d at 1354. *In re Hurricane Rita Homeowners' Claims*, No. 08-0208 (Tex. M.D.L. Panel filed Mar. 13, 2008); *In re Delta Lloyds Ins. Co*., No. 08-0142 (Tex. M.D.L. Panel filed Feb. 21, 2008) "We think it is undeniable that it is more convenient for witnesses and parties who find themselves involved in several related cases to litigate in one pretrial court instead of several." *In re Silica Products,* 166 S.W.3d at 6.

Two such motions are currently pending before the MDL panel. Cause No. 08-0208, *In re Hurricane Rita Homeowners' Claims*, No. 08-0208 (Tex. M.D.L. Panel filed Mar. 13, 2008); *In re Delta Lloyds Ins. Co*., No. 08-0142 (Tex. M.D.L. Panel filed Feb. 21, 2008). In these two motions, counsel for various carriers seeks to consolidate for pretrial at least eleven cases in which the pleadings, discovery and other issues are identical. The cases are currently pending in Jefferson, Orange, and Jasper Counties.

Plaintiffs' counsel argues that the cases are too localized and that the damages to each home are so different that consolidation would be inappropriate. Defense counsel believes the boilerplate allegations and duplicative discovery make these suits uniquely suited for MDL consolidation.

Once the panel decides if these first party bad faith claims are eligible for consolidation, the days of hundreds or thousands of independently run lawsuits may be numbered. The whole purpose of the MDL process is uniquely suited to substantially limit the overwhelming costs incurred by defense counsel in attempting to defend itself on the same issues in dozens (if not more) suits. Hopefully, the Panel will issue an opinion very soon. Regardless, it is certainly a procedure worth pursuing if the carrier finds itself in numerous lawsuits over the same event with the same causes of action. MDL is a great procedure, and hopefully, it will become a viable method for curbing unnecessary and burdensome litigation.

The MDL Panel ruled on three separate Motions to Transfer Under Rule 13 on Friday, September 5, 2008.

These motions were filed by insurance companies companies sued in multiple cases arising out of Hurricane Rita claims. The opinions are available on the Texas Supreme Court website and provide great insight into what the Panel considers in granting such requests. http://www.supreme.courts.state.tx.us/MDL_Orders/mdl08.asp.

In short, the Panel found that two of those applications had merit. In each of those Motions, a single carrier sought to consolidate various lawsuits brought against them. In each application brought by a single carrier, the Motion passed. The Panel has not yet determined which Court to appoint. That will be by separate order.

On the third application, which was brought on behalf of various carriers who were all related companies, the Panel did not find that they were sufficiently related. The Panel concluded that there is no commonality of how catastrophe adjusters deal with residential property claims following a hurricane. They did not feel that the causation issues, the overwhelming and duplicative discovery or the duplicative petitions were sufficient to demonstrate a "common fact question" for transfer. The Panel also found fault in the fact that they did not have common policy language. A Motion for Rehearing is underway, the evidence will be supplemented to the Panel, and hopefully this additional information will persuade them to grant this third motion. It should be filed by the time this article reaches publication.

Even if that Motion for Rehearing is not granted, the consolidation of approximately 16 cases (in the two actions) is a great victory for those carriers. Multiple trips to East Texas courtrooms to address the same repetitive discovery requests will be substantially minimized. One court will hear the discovery issues one time; there should be one challenge to experts; and one court will consider all the other pretrial issues. This is much more convenient for the parties and witnesses. It is a great vehicle for streamling litigation and narrowing costs for the carriers. MDL should be one tool for mass litigation should another Hurricane or other natural catastrophe strike.

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Comments FROM THE EDITOR

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

Initially, I want to thank Karen Keltz for the fantastic job she did over the past year as Chair of the Insurance Law Section. As a long-time member of the Section, she is acutely aware of all the issues facing the Section and she did a fantastic job addressing them and improving Section for the benefit of our members. Her commitment to member service was exemplary. Our Section is stronger because of her great efforts. Karen, thank you!

For those who read the *JTIL* carefully, you inevitably noticed several graphics problems with the summer issue. Even when problems are out of one's control, as Editor-in-Chief, I must take responsibility for them. A software problem at the printer resulted in a conversion glitch that occurred *after* I reviewed the final proofs and after our graphic artist did so as well. We realized the problem for the first time when we received our copies back from the printer, after the member copies were mailed, and after it was too late to change anything. This is the first time in the decade we have been publishing the *JTIL* we have had this problem. Regardless, now that we are aware of it, we will make sure it does not happen again. I apologize for the annoyance.

Finally, we do not yet have any articles for the 2009 issues of *The Journal*. As such, if you have written something or if you would like to write something worthy of publishing in the field of Insurance Law, please contact me by phone or email. Our publication is only as strong as the contributions from our members.

It is a privilege to serve the members of the Section in the capacity which I do. It is a labor of love and I appreciate the opportunity to do so. If I can do anything to make this publication better, please share your thoughts with me.

Christopher W. Martin
Editor-In-Chief

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