

**THE *STOWERS* STANDARD—
THE REASONABLE CARRIER STANDARD
AND OTHER OXYMORONS**

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State Bar of Texas
**3RD ANNUAL ADVANCED
INSURANCE LAW COURSE**
March 30-31, 2006
Dallas

CHAPTER 5

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Recent Seminars

University of Texas Law School 10th Annual Insurance Law Institute
December 2005 Planning Committee and Faculty Member
Topic: The Legacy of the *Stowers* Doctrine - How Far Does It Go?

State Bar of Texas Second Annual Advanced Insurance Law Course March 2005 Faculty Member
Topic: Self-Insured Retentions and the Golden Rule - What Duties are Owed by the Insured?

University of Texas Law School 9th Annual Insurance Law Institute November 2004 Planning Committee and Faculty Member
Topic: Completing the Unfinished Picture - *Soriano* and the Problem of Having So Many Claims and So Little Coverage

State Bar of Texas First Annual Advanced Insurance Law Course
March 2004 Faculty Member
Topic: Managing the Crowd - Making Sense of Self-Insured Retentions, Fronting Policies, Matching Deductibles, Captive Policies and Loss Runs

University of Texas Law School 8th Annual Insurance Law Institute November 2003 Faculty Member
Topic: Determining Coverage for Class Actions - The Current State of the Law Governing Class Actions and Basic Coverage Issues They Create

Published Opinions

Nationwide Mutual Insurance Company v. Unauthorized Practice of Law Committee, 2004 WL 2805841 (Tex. App. - San Antonio, Dec. 8, 2004, pet. filed)

Nationwide Mutual Insurance Company v. Unauthorized Practice of Law Committee, 283 F.3d 650 (5th Cir. 2002)

North v. Winterthur Assurances (In re North), 279 B.R. 845 (Bankr.D. Ariz. 2002)

Harken Exploration Co. v. Sphere Drake Ins. Plc. 261 F.3d 466 (5th Cir. 2001)

Folsom Inv., Inc. v. American Motorists Ins. Co., 26 S.W.3d 556 (Tex. App.-Dallas 2000, no pet.)

In re Continental Ins. Co., 990 S.W.2d 941 (Tex. App. Waco 1999, orig proceeding), reh'g denied, 994 S.W.2d 423 (Tex. App. — Waco 1999), overruled sub nom. 22 S.W.3d 338 (Tex. 1999)

Published Articles

"Excess Liability Insurance and Reinsurance: General Principles and Current Issues"
1 The Journal of Texas Insurance Law 15 (Winter 1999)

"Comparative Bad Faith — Its Time Has Come In Texas"
55 Texas Bar Journal 792 (September 1992)

"The American Inns of Court — A Return to Civility in the Practice of Law"
52 Texas Bar Journal 1306 (December 1989)

Admittances

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THE *STOWERS* STANDARD–THE REASONABLE CARRIER STANDARD AND OTHER OXYMORONS

I. OVERVIEW

From the plaintiff’s perspective, the only genuine concern in “assisting” defendants-insureds in obtaining or actuating potentially applicable insurance coverage is to facilitate collection of the plaintiff’s ultimate judgment or settlement. Thus, in cases wherein the prime defendants are sufficiently solvent to satisfy the plaintiff’s claims or demands, then the impetus to distort an otherwise straightforward claim in order to assist defendant-insureds is significantly lessened. But even in these situations, plaintiffs would frequently be well-served by the involvement of insurers in the litigation arena. This is so because defendant-insureds are naturally more inclined toward settlement if such can be accomplished with someone else’s money. Additionally, the size of any potential settlement or claim is somewhat less troubling if the litigation outcome with the plaintiff has little or no effect on the named defendant’s bottom line.

II. THE EIGHT CORNERS RULE–PLEADING INTO COVERAGE

The activation of the duty to defend (assuming there is one) is well-established (though sometimes strangely convoluted). As the Amarillo Court of Appeals recently noted in *Allstate Ins. Co. v. Hicks*, 134 S.W.3d 304, 308 (Tex.App.–Amarillo 2004, no pet.)

If a petition does not allege facts within the scope of coverage, an insurer under a liability policy is not required to defend a suit against its insured. *National Union Fire Ins. Cov. v. Merchants Fast Motor Lines*, 939 S.W.2d 139, 141 (Tex. 1997). To determine an insurer’s duty to defend, we apply the “eight-corners” rule, comparing the factual allegations in the pleadings with the language of the insurance policy. *Id.* In applying that rule, the court must focus on the factual allegations that show the origin of the damages rather than on the legal theories alleged, give a liberal interpretation to the allegations in the petition and resolve doubts in favor of coverage. *Id.* However, the court may not read facts into the pleadings, may not look outside the pleadings, and may not “imagine factual scenarios which might trigger coverage.” *Id.* at 142; *St. Paul Ins. Co. v. Texas Dept. of Transp.*, 999 S.W.2d 881, 885 (Tex.App.–Austin 1999, pet. denied). An insurer’s duty to defend arises if the factual

allegations against the insured, when fairly and reasonably construed, state a cause of action potentially covered by the policy. *National Union*, 939 S.W.2d at 141. A duty to defend any of the claims against an insured requires the insurer to defend the entire suit. *Stumph v. Dallas Fire Ins. Co.*, 34 S.W.3d 722, 728 (Tex.App.–Austin 2000, no pet.)

Despite this insured-favorable statement of the guiding principles for determining an insurer’s duty to defend the *Hicks* opinion determined that there was no duty to defend in that case.

Thus, a plaintiff needs to heed the basic principle that pleading theories, as distinguished from facts demonstrating the origin or cause of the claimed injuries, may be insufficient to activate the duty to defend and the concomitant duty to settle.

The activation of that duty is essential to any claim for excess liability that might be accomplished by application of the *Stowers* doctrine. See *Amer. Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 145, 150 (Tex. 1994).

III. INSURER’S COMMON LAW DUTY WITH REGARD TO SETTLEMENT DEMAND

A. The *Stowers* reasonable care doctrine

1. Applicability of doctrine to rejected settlement offers within policy limits

When a liability insurance provider defends an insured against a covered claim made by a third party, the insurer has a common law duty to exercise reasonable care in responding to a settlement demand that is within the policy’s limits. This duty of reasonable care is known as the *Stowers* doctrine or *Stowers* duty. See *G.A. Stowers Furniture Co. v. American Indemnity Co.*, 15 S.W.2d 544, 544-46 (Comm’n App. 1929, *holding approved*). An insurer’s decision to reject a settlement demand within the policy’s limit, if that decision leads to a judgment against the insured for damages in excess of the policy’s limits, will be measured against that degree of care and diligence that ordinarily prudent persons would exercise in the management of their own businesses. See *American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 848 (Tex. 1994); *G.A. Stowers Furniture Co. v. American Indemnity Co.*, 15 S.W.2d 544, 544-46 (Comm’n App. 1929, *holding approved*). A breach of this duty may give the insured a cause of action for the damages exceeding policy limits commonly referred to as a *Stowers* action.

2. No Duty To Solicit Settlement Proposals

The *Stowers* duty now applies only to an insurer’s refusal of a demand for settlement within the policy limits; it does not obligate the insurer to make or solicit

a settlement proposal. *American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 849-51 (Tex. 1994); *Birmingham Fire Ins. v. American Nat. Fire*, 947 S.W.2d 592, 597-99 (Tex. App.–Texarkana 1997, writ denied) (no duty to negotiate); *Insurance Corp. of Am. v. Webster*, 906 S.W.2d 77, 79 (Tex. App.–Houston [1st Dist.] 1995, writ denied). Although the Texas Supreme Court had once said that an insurer owes its insured a duty of ordinary care that includes “investigation, preparation for defense of the lawsuit, trial of the case, and reasonable attempts to settle,” *Ranger County County Mut. Ins. v. Guin*, 723 S.W.2d 656, 659 (Tex. 1987), the Court later explained in *Garcia* that that statement was to be taken in the limited context of examining the insurer’s fulfillment of its *Stowers* duty. The Court said that evidence concerning claims investigation, trial defense, and the insurer’s conduct during settlement negotiations is “necessarily subsidiary to the ultimate issue of whether the claimant’s demand was reasonable under the circumstances, such that an ordinarily prudent insurer would accept it.” *American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994).

Some commentators and cases refer to “triggering” a *Stowers* duty. The duty lasts only so long as the offer can be accepted, and is not a duty to negotiate or make other offers. To create more than one potential *Stowers* violation, the plaintiff must make successive offers.

3. No Duty To Consider Insured's Potential Exposure To Non-Covered Claims

The issue of whether the *Stowers* duty encompasses consideration of an insured’s exposure for claims not covered under the policy has not been directly addressed by the Texas Supreme Court. But the Fifth Circuit faced this issue in *St. Paul Fire & Marine Ins. Co. v. Convalescent Serv., Inc.*, 193 F.3d 340, 343 (5th Cir. 1999), and concluded that an insurer does *not* have a duty to consider an insured’s potential exposure for non-covered claims during settlement negotiations. The court in *St. Paul* noted that the Texas Supreme Court has expressly left open the question of “when, if ever, a *Stowers* duty may be triggered if an insured provides notice of his or her willingness to accept a reasonable demand above the policy limits, and to fund the settlement, such that the insurer’s share of the settlement would remain within the policy limits.” *Id.* (quoting *Garcia*, 876 S.W.2d at 849 n.13. However, in light of the proposition in *Garcia* that “an insurer has no duty to settle a claim that is not covered under its policy,” *Garcia*, 876 S.W.2d at 848, the court in *St. Paul* projected that the Texas Supreme Court would not find a *Stowers* duty triggered by an insurer’s knowledge of an insured’s willingness to pay a portion of a settlement

demand based on potential exposure for *non-covered* claims. *St. Paul*, 193 F.3d at 343.

a. The duty to settle extends only to covered damages
While the duty to defend a case extends to both covered and non-covered damages, the same is not true with respect to the duty to settle or indemnify. *Rhodes v. Chicago Ins. Co.*, 719 F.2d 116 (5th Cir. 1983).

b. Offer to settle only covered claims

One issue that has arisen in limited circumstances in the past is whether a *Stowers* duty arises if the plaintiff makes an offer within the policy limits only to settle covered claims while, at the same time, leaving the insured exposed to non-covered claims. Clearly, under the *Garcia* and *St. Paul* cases, the carrier has no duty to settle uncovered claims. However, it is equally clear under *Garcia* and *Bleeker* that any settlement must result in a full and complete release for the insured. These two legal statements are not as inconsistent as they seem. Under the current law, if the insurer fails to accept a *Stowers* demand, its conduct will only be reviewed in the context of covered damages. However, in order to create a *Stowers* duty, there must be an offer of a full release of all liability of the insured according to *Garcia*.

4. No Applicability to Settlements Made Within Policy Limits

The *Stowers* duty does not apply to settlements made within a policy’s limits. The insurer’s conduct in accepting a demand to settle a claim against the insured is not subject to challenge under the *Stowers* doctrine. One court of appeals has reasoned that the insurer has the absolute right to settle a claim and its conduct in that regard can be no breach of duty. *Dear v. Scottsdale Ins. Co.*, 947 S.W.2d 908, 915 (Tex. App.–Dallas 1997, pet. denied) (holding no breach of duty even though settlement allegedly caused loss of business, damage to reputation, and ability to obtain insurance coverage). But if the settlement was the result of the insurer’s breach of some other duty, such as the statutory duty to conduct a reasonable investigation under Tex. Ins. Code § 541.060(a)(7) (2005), an argument could be made that the insured is entitled to sue for harm stemming from the insurer’s acceptance of the settlement demand. *See Wood Truck Leasing v. American Auto Ins. Co.*, 526 S.W.2d 223, 224-225 (Tex. Civ. App.–San Antonio 1975, no writ) (increased premiums resulting from settlement allegedly brought about by faulty investigation). But if, as in *Dear* and as is normally the case, the contract of insurance gives the insurer the right to settle the third-party claim when it “deems expedient,” there is little or no room for a *Wood Truck* duty not to settle.

5. No Duty After Limits Are Exhausted

Under the standard provision in most CGL policies, the carrier has no duty to defend or to indemnify after it has exhausted its limits by payment of judgments or settlements. The exhaustion of policy limits as to one insured is exhaustion as to all. *American States Ins. Co. v. Arnold*, 930 S.W.2d 196, 200-01 (Tex. App. – Dallas 1996, writ denied). See also *Mid-Century Ins. Co. v. Childs*, 15 S.W.3d 187, 190 (Tex. App. – Texarkana 2000, no pet.) (exhaustion of limits by settlement ends duty to defend); *Travelers Indem. Co. v. Citgo Petroleum Corp.*, 166 F.3d 761 (5th Cir. 1999).

B. Activation of the Stowers Duty

1. How the Stowers Duty is Activated

The duty imposed under the *Stowers* doctrine is activated when a third party seeking to impose liability on an insured makes a demand to settle the claim and the following circumstances exist:

1. the claim against the insured is within the scope of the policy's coverage;
2. the settlement demand is for the policy's limits or a stated sum of money within the policy's limits;
3. the proposed settlement is one that will result in a full release of the insured; and
4. the third party's proposal to settle is on such terms that an ordinarily prudent insurer would have accepted it, considering the likelihood and degree of the insured's potential exposure to an excess judgment.

See *American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 848-49 (Tex. 1994); *Texas Farmers Ins. Co. v. Soriano*, 881 S.W.2d 312, 314 (Tex. 1994); *Rocor Intern. v. National Union Fire Ins.*, 77 S.W.3d 253, 262 (Tex. 2002). The *Stowers* duty is a duty to respond to the offer made. Thus, the question that should be put to the jury in the *Stowers* action is whether the insurer was negligent in not accepting the settlement demand. It is not a general negligence duty related to the value of the case, but rather a specific duty related to the particular demand. "Consequently, an insurer's settlement duty is not activated until a settlement demand within policy limits is made, and the terms of the demand are such that an ordinarily prudent insurer would accept it." *Rocor*, 77 S.W.3d at 262. In discussing *Rocor's* theory that it could recover under a general negligence theory, the Court held:

Whether or not Rocor can recover delay damages under a common-law negligence theory based on the facts presented, which we do not decide, it must first establish that

National Union was presented with a proper settlement demand within policy limits that an ordinarily prudent insurer would have accepted. As we have said, there is no evidence that National Union was presented with such a demand, and this failure of proof is fatal to *Rocor's* common-law claim.

Id. at 264.

2. Requirement Of Demand Within Policy's Limits

To initiate the *Stowers* duty, the third party's offer to settle the claim against the insured must be for a sum of money that is equal to or within the limits of the insurer's liability under the insurance contract. *American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 848-49 (Tex. 1994). A settlement demand that is in excess of the policy's limits might be considered to be within the limits if the insured notifies the insurer of the insured's willingness to fund the excess. However, in a case in which the claimant made a demand in excess of the policy limits and the insured agreed to pay the excess, but did not inform the insurer of his willingness to do so, the Texas Supreme Court held that the demand did not trigger the *Stowers* duty. See *State Farm Lloyds Ins. Co. v. Maldonado*, 963 S.W.2d 38, 41 n.6 (Tex. 1998). The Court left open the question of whether the demand would have triggered the duty if the insured had notified the insurer of the willingness to fund the excess. *Id.*

3. Requirement Of Full Release From Claimant

The *Stowers* duty does not come into play unless the proposed settlement will result in a full release of the insured's liability to the claimant. If, for example, the claimant's offer does not include releases of the hospital liens securing the claimant's medical expenses, the *Stowers* duty is not activated. *Trinity Universal Ins. Co. v. Bleeker*, 966 S.W.2d 489, 491 (Tex. 1998). Similarly, the duty is not triggered by an offer by the claimant to accept a sum equal to or within the policy's limits from the primary carrier so that the claimant can pursue the insured's excess carrier if it is not accompanied by a promise to release the insureds. *Birmingham Fire Ins. v. American Nat. Fire*, 947 S.W.2d 592, 599 (Tex. App.–Texarkana 1997, pet. denied). Further, an insurer may be relieved of its *Stowers* duty to respond to a settlement demand when the deadline for responding to the demand is unreasonably short under the circumstances of the case. See *Allstate Ins. Co. v. Kelly*, 680 S.W.2d 595, 608 (Tex. App.–Tyler 1984, ref. n.r.e.).

4. Multiple Claims

a. Release of all insureds

Where there are multiple insureds who are insured under different policies, the insurer must treat each

insured as if the other did not exist. The *Stowers* obligation will be judged as to each insured under that insured's policy. See *Caserotti v. State Farm Ins. Co.*, 791 S.W. 2d 561 (Tex. App.–Dallas 1990, no writ). If the limits of liability are not sufficient to extinguish the exposure of both or all insureds, the insurer is faced with a dilemma. Obviously, the insurer should first attempt to settle the combined exposure of both insureds for the limits of the policy. Having failed this, the insurer is faced with the situation of how to approach settlement. No Texas case has given precise guidelines as to how an insurer should approach settlement. Where an insurer has a single insured faced with multiple claims and inadequate proceeds, the insurer may enter into a reasonable settlement with less than all the claimants. *Id.* at 315. The same should be true with respect to multiple insureds with less than adequate limits. If the insurer cannot extinguish the liability of all insureds, then the insurer should not be held liable under the *Stowers* doctrine so long as the settlement that it enters into is reasonable and is in good faith.

b. Effect of multiple claims against insured on *Stowers* duty

In cases in which there is more than one claim lodged against the insured, the liability carrier's duty to accept a reasonable settlement offer is examined by viewing each claim separately. Ordinarily, the insurer may, without breaching the *Stowers* duty, enter into a reasonable settlement with one of several claimants even if the settlement exhausts or diminishes the proceeds available to satisfy other claims. See *Texas Farmers Ins. Co. v. Soriano*, 881 S.W.2d 312, 315 (Tex. 1994) (noting that this approach promotes settlement of lawsuits and encourages claimants to make their claims promptly). In *Soriano*, a liability carrier faced multiple claims from its insured's negligent operation of a motor vehicle. The insurer settled one of the wrongful death claims, the Lopez claim, for \$ 5,000, thus reducing the \$ 20,000 liability coverage to \$ 15,000, which was tendered to but rejected by the remaining claimants who insisted on payment of the \$ 20,000 policy limit. After a trial, the verdict was against the insured and greatly in excess of the remaining insurance coverage. When the ensuing *Stowers* action reached the Supreme Court, the Court held that the insurer would breach its *Stowers* duty only if a reasonably prudent insurer would not have settled the Lopez claim, considering solely its merits and the potential liability of the insured on that claim. If the settlement was reasonably made, the limits were properly reduced. Thereafter, there was no demand to settle the other claims within the remaining policy limits so as to activate the *Stowers* duty on those claims. *Texas Farmers Ins. Co. v. Soriano*, 881 S.W.2d 312, 315-16 (Tex. 1994).

5. Multiple Policies

a. Stacked policies

The situation when settlement requires funding from multiple insurers and no single insurer can fund the settlement within the limits that apply under a particular policy has not yet been addressed by the supreme court. *Garcia*, at 849 n.13. When the insured has a primary policy and an excess policy stacked on top and the demand is within the primary limits, the primary insurer has the ability on its own to accept the demand and bring about an end to the litigation, a *Stowers* duty can be triggered. The cause of action for the breach of this duty may belong to the excess carrier by subrogation. On the other hand, when the demand is in excess of the primary limit, the primary insurer cannot end the litigation by accepting the settlement offer. In this situation a *Stowers* duty may not be triggered on the part of the primary carrier, because it is not within that carrier's power to settle, and the excess carrier often has no duty until the primary has paid. Various ways of implicating both carriers in a *Stowers* duty have been tried. The Supreme Court, in *Keck, Mahin & Cate v. National Union*, 20 S.W.3d 692 (Tex. 2000), adopted the majority rule that "[w]here the insured maintains both primary and excess policies, ... the excess liability insurer is not obligated to participate in the defense until the primary policy limits are exhausted." *Id.* at 700; accord, *Schneider Nat'l Transp. v. Ford Motor Co.*, 280 F.3d 532, 538 (5th Cir. 2002). Justice Hecht, concurring in *Keck Mahin*, said he was not so sure that an excess carrier never had a duty to defend or settle prior to the primary's exhaustion. *Id.* at 705. He was alone in that opinion; but only one of the justices in the eight-member majority are still on the Court.

b. Concurrent policies

The Supreme Court has not addressed the situation where there are multiple policies available to pay a claim and they are concurrent primary policies (instead of vertically stacked). A reconciliation of "other insurance" clauses in the policies is necessary. If the policies have other insurance clauses typical in most general liability policies, they will provide for a contribution by limits or equal shares. While an insurer's duty to defend is not limited by the existence of other insurance, the insurer's duty to indemnify is. The obligation of insured to contribute toward a judgment or settlement is restricted by the "Other Insurance" clause. The insurer has no legal obligation to contribute toward a settlement more than its percentage of the settlement as determined by the "Other Insurance" clause.

On the other hand, where there is a demand within the limits of any concurrent policy, the insurer has the ability to settle the case and end the litigation. There has been no guidance by the high court; the better course is

for the insurer to pay the policy limit to settle the case and seek subrogation against the other insurer.

C. *Stowers* Duty Owed By Primary Insurer To Excess Carrier

It is often the case that a party will acquire insurance protection against its legal liability to others by getting a primary policy to cover the first part of that liability and an excess policy to cover its liability for damages beyond the limits of the primary coverage. The primary carrier may unreasonably refuse to accept a settlement offer that would absolve the insured from further exposure to liability and the excess carrier from possible payment of damages over the primary coverage. Under the theory of equitable subrogation, the excess carrier is entitled to enforce the insured's cause of action under the *Stowers* doctrine. See *Rocor Intern. v. National Union Fire Ins.*, 77 S.W.3d 253, 260 (Tex. 2002); *Keck, Mahin & Cate v. National Union*, 20 S.W.3d 692 (Tex. 2000); *American Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480, 483 (Tex. 1992); *Birmingham Fire Ins. v. American Nat. Fire*, 947 S.W.2d 592, 597 (Tex. App.–Texarkana 1997, writ denied).

The excess carrier must establish, however, the same prerequisites for the primary carrier's liability as the insured would have to do in the traditional *Stowers* case. Certainly, there must have been an offer to settle the claim in full within the limits of the primary coverage and that would have resulted in a release of the insured's potential liability. A demand from the third-party claimant that the primary carrier pay its limits so that the third party can pursue the excess carrier is not such an offer of settlement that will trigger the primary carrier's *Stowers* duty. *American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 848-49 (Tex. 1994).

D. Reasonable Time to Accept

The *Stowers* remedy of shifting the risk of an excess judgment onto the insurer is inappropriate absent proof that the insurer was presented with a reasonable opportunity to prevent the excess judgment by settling within the applicable policy limits. The issue remains "what is a reasonable time." This period will vary depending upon at what stage of the case the demand is made. If a demand is made at the inception of the case, before any investigation has been conducted, in all probability a deadline of seventy-two hours will be insufficient. However, if discovery has been completed, and the case is set for trial on Monday, a twenty-four hour deadline on Friday may well be reasonable.

E. Conditional Settlement

As a general rule, a conditional offer does not constitute a *Stowers* demand. Many plaintiffs counsel will condition a *Stowers* demand to one insured to the

payment of policy limits by another insured by the same carrier or by another defendant. Under *Webster*, these offers are not unconditional and would be highly suspect. *Webster*, 906 S.W.2d at 81. However, in order to be conditional, in the context of *Webster*, the condition must not be one that can be met. Otherwise, the "condition" would be immaterial.

IV. INTERPLAY OF LIABILITY INSURER'S COMMON LAW AND STATUTORY DUTIES

A. Basic Principles of Liability

In the context of third-party coverage, such as the typical automobile policy's provisions protecting the insured against legal liability to others arising out of the insured's use of a motor vehicle, no cause of action is provided for any third party who asserts a claim against the insured, pursuant to Tex. Ins. Code § 541.060(b) (Vernon's 2005).

In *Rocor Intern. v. National Union Fire Ins.*, 77 S.W.3d 253, 255, 259-65 (Tex. 2002), the Texas Supreme Court held that an insured may assert a cause of action against its liability insurer under the pre-1995 version of Article 21.21 for failing to attempt settlement of a third-party claim once liability has become reasonably clear. In doing so, however, the Court harmonized the statute with the common-law duties of reasonable care in responding to a settlement offer as expressed in the *Stowers* doctrine, discussed above in Part II. See *G.A. Stowers Furniture Co. v. American Indemnity Co.*, 15 S.W.2d 544, 548 (Comm. App. 1929, holding approved).

The *Rocor* opinion strongly suggests that, like its predecessor, Tex. Ins. Code § 541.060(a)(2)(A) (Vernon's 2005) is not limited to first-party insurance claims for unfair settlement practices. See *Rocor*, 77 S.W.3d at 258 n.3, 260. The Texas Supreme Court noted that the 1995 amendments "expressly allow" an insured to bring a claim for unfair claim settlement practices, a cause of action previously permitted through order of the State Board of Insurance. *Id.* at 255 n.1, 258 & n.3. The Court reasoned that it could not "identify a principled basis upon which to draw a distinction between first-party and third-party claims when the insured has been directly injured as a result of its insurer's unfair claim settlement procedures," and that it could not find any legislative intent to limit the statute to first-party claims. *Id.* at 260; but see *id.* at 265-68 (Hecht, J., concurring) and *Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48, 53 n.2 (Tex. 1997) (distinguishing between first-party and third-party claims for purposes of common-law bad faith liability).

Prior to *Rocor*, Texas Supreme Court decisions did suggest that a liability insurer's duties to its insureds are limited to the insurer's contractual liabilities and the *Stowers* doctrine. In *Garcia*, for example, the Court

stated that “[b]reach of the *Stowers* duty does not constitute a violation of article 21.21 or the DTPA.” *American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 847 (Tex. 1994). The Court’s apparent rejection of statutory liability in *Garcia* was necessarily changed when the legislature amended article 21.21 in 1995 to add the section on unfair claim settlement practices. The amended Article 21.21 § 4(10) included items only relevant to claims under liability policies (like issuing a reservation of rights letter) and expressly excluded any cause of action by a third party suing an insured (which would be surplusage if there was no possible claim on a liability policy). *Rocor* was the Court’s first – and to date only – opportunity to write on what the new statute might mean. Rather than rejecting the imposition of a statutory duty, (which would not then apply to the new statute) the Court interpreted the pre-1995 Code provisions to embrace “well-established common-law precepts,” including the *Stowers* doctrine. *Id.* Under this approach, the Court held that to trigger an insurer’s statutory duty to reasonably attempt settlement of a third-party claim against its insured, the policy must cover the claim, the insured’s liability must be reasonably clear, the third-party claimant must have made a proper settlement demand within policy limits, and the terms of the demand must be terms that an ordinarily prudent insurer would accept. *Id.* at 261-62. Thus, the statutory duty is not materially different from the *Stowers* duty. It is likely that this approach will also be applied to the interpretation of the current statute, since the wording is nearly identical to that of the board rules incorporated into the previous statute.

Similarly, where third-party coverage is involved, the statutory duties of liability insurers do not appear to extend beyond a *Stowers* duty. *See Rocor*, 77 S.W.3d at 260-62 (interpreting pre-1995 Insurance Code in light of “well-established common law precepts”; *Mid-Century Ins. Co. v. Boyte*, 80 S.W.3d 546, 549 (Tex. 2002). Under the common law, a liability carrier owes no duty of good faith to its insured when dealing with a third party who seeks recovery for some wrong committed by the insured. *See Maryland Ins. v. Head Indus.*, 938 S.W.2d 27, 28-29 (Tex. 1996). The common law requires only that the insurer exercise reasonable care in deciding to accept or reject certain offers of settlement made by the third party and does not require the insurer to make a settlement offer to the third party. *See American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994). Although Tex. Ins. Code § 541.060(a)(2)(A) (Vernon’s 2005) likely does impose on liability insurers, the duty to attempt in good faith to effectuate a prompt, fair, and equitable settlement of the liability claims with respect to which the *insurer’s liability* has become reasonably clear, the statute does not explain under *what circumstances* the insurer’s liability

becomes reasonably clear. At a minimum, this must mean that the insured’s liability has become reasonably clear and that the claim is covered under the terms of the policy. As noted above, it is likely that this provision will be completely harmonized with the common law *Stowers* duty once the Supreme Court directly addresses the current statute. Though an unpublished opinion, one court recognized in *Chickasha Cotton Oil Co. v. Houston General Ins. Co.*, 2002 WL 1792467 (Tex.App.–Dallas, 2002) that:

Reasonable clarity of coverage is not one of the elements under *Rocor* and §4(10)(ii).

An insurance carrier commits an unfair practice under Tex. Ins. Code § 541.060(a)(2)(A) (Vernon’s 2005) if it refuses to pay a claim without conducting a reasonable investigation. Under common-law principles, the investigation of a claim in the third-party coverage context is viewed by the courts as conduct subsidiary to the ultimate issue of whether the third party’s demand against the insured was reasonable under the circumstances, such that an ordinarily prudent insurer would have accepted it. *See American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994) (restricting broader statements previously made in *Ranger County Mut. Ins. Co. v. Guin*, 723 S.W.2d 656, 658 (Tex. 1987)). Thus, if this provision of the insurance code applies to the handling of third-party claims, the statute could elevate a carrier’s subpar claim investigation from evidence of a breach of the *Stowers* common-law duty to a separate statutory unfair practice.

An insurer’s common-law and statutory duties of good faith and fair dealing do not extend beyond entry of judgment for its insured. Specifically, the Texas Supreme Court has held that a judgment requiring only the payment of a sum of money extinguishes the insurer’s duty of good faith because the only legal relationship between the parties following entry of judgment is that of judgment creditor and judgment debtor. *See Mid-Century Ins. Co. v. Boyte*, 80 S.W.3d 546, 548 (Tex. 2002) (rejecting insured’s argument in unfair settlement practices cases that insurer’s ability to supersede judgment creates disparity in power that requires continued application of duty of good faith).

B. Remedial and procedural differences between common law and statutory claims

A party harmed by an unfair practice cannot recover damages and penalties for the same practice under both the Insurance Code and a common-law tort theory. However, it remains important to note the differences in the procedures and the recovery allowed under the statute and under the common law.

In an action under the Insurance Code, the plaintiff need only establish that the unfair act was a “producing” cause of the damages suffered, whereas in a common-law action, there must be proof that the conduct was a “proximate” cause of the harm. *Provident American Ins. Co. v. Castaneda*, 988 S.W.2d 189, 193 n.13 (Tex. 1998). The primary difference between the causation standards is that proximate cause includes the element of foreseeability of harm.

Although the measure of actual damages recoverable under a statutory action is the same as that applicable for an action based on a common-law theory, there is a difference in the rules governing recovery of enhanced or exemplary damages. Under the Insurance Code, recovery of up to three times the amount of actual damages is authorized if the insurer is found to have “knowingly committed” the actionable conduct. Tex. Ins. Code § 541.152(b)(Vernon’s 2005). The common-law action allows for exemplary damages awards that do not exceed the greater of (1) up to two times the amount of economic damages plus an amount, not to exceed \$ 750,000, equal to the non-economic damages, or (2) \$ 200,000, regardless of the amount of exemplary damages awarded by the jury. TEX. CIV. PRAC. & REM. CODE § 41.008(b). Moreover, a plaintiff seeking punitive damages under a common-law theory must show that the insurer’s conduct was fraudulent, malicious, or grossly negligent, TEX. CIV. PRAC. & REM. CODE § 41.003(a). The gross negligence standard was added in 2003 for actions filed on or after September 1, 2003. TEX. CIV. PRAC. & REM. CODE § 41.003(a); Acts 2003, 78th Leg., R.S. ch. 204, §§ 13.04, 23.02(a).

Tex. Ins. Code § 541.152(a)(1) (Vernon’s 2005) expressly authorizes an award of attorney’s fees for the successful prosecution of an unfair practices action. A common-law tort action provides no recovery for attorney’s fees, although a successful insured can recover attorney’s fees for the prosecution of the cause of action on the insurance contract. *See* TEX. CIV. PRAC. & REM. CODE § 38.001; *Barnett v. Aetna Life Ins. Co.*, 723 S.W.2d 663, 667 (Tex. 1987) (holding that the exception from attorney’s fees statute for insurance companies applies only to exclude actions against insurers in which recovery of attorney’s fees is otherwise provided).

From a procedural standpoint, recovery under the Insurance Code involves steps not required for common-law claims. For example, unlike the common law, the Insurance Code requires that a pre-suit notice of the complaint of unfairness, and a statement of damages must be delivered to the prospective defendant. The defendant is entitled to make a settlement offer that may serve as a limit on the plaintiff’s eventual recovery. Further, the defendant is expressly given the right to recover attorney’s fees if a lawsuit brought under the

Insurance Code is found to be groundless and brought in bad faith or for the purposes of harassment.

V. DANGERS OF ASSIGNMENTS, AGREED JUDGMENTS AND COVENANT NOT TO EXECUTE

A. When assignment is void as against public policy

Ordinarily, a cause of action can be assigned from its holder to another party. However, Texas courts have made some exceptions, limiting alienability for public policy reasons. *See, e.g., Zuniga v. Groce, Locke & Hebdon*, 878 S.W.2d 313, 317-18 (Tex. App.—San Antonio 1994, writ ref’d) (legal malpractice); *Elbaor v. Smith*, 845 S.W.2d 240, 250 (Tex. 1992) (Mary Carter agreement); *International Proteins Corp. v. Ralton-Purina Co.*, 744 S.W.2d 932, 934 (Tex. 1988) (plaintiff’s assignment of claim to one of multiple tortfeasors). The Texas Supreme Court has observed that in such invalidated assignments, two major problems were present: (1) the assignments tended to increase rather than curtail litigation; and (2) the arrangements had a tendency to distort the litigation that followed by causing the parties to take inconsistent positions, *State Farm Fire and Cas. Co. v. Gandy*, 925 S.W.2d 696, 711 (Tex. 1996).

In *Gandy*, when squarely faced with an insured party’s assignment to an injured party of the insured’s common-law causes of action against its liability insurer, the Texas Supreme Court found that the arrangement between the insured and the victim was designed to prolong as well as distort litigation. *Id.* at 712-14. Accordingly, the Court declared the assignment invalid, affording the injured party no right to sue on the insured’s behalf. *See id.* However, the Court was careful to limit its holding to those situations in which the same or similar problems were present. The Court summed up by saying that an insured’s assignment of actions against the insurer to the injured party is invalid if the following facts exist:

1. the assignment is made prior to an adjudication of the injured party’s claim against the insured in a fully adversarial trial;
2. the insurer has tendered a defense; and
3. the insurer has either (a) accepted coverage or (b) made a good faith effort to adjudicate coverage issues prior to the trial of the third party’s claim.

Id. at 714. The Court in *Gandy* expressly did *not* address whether an assignment is invalid if one or more of these elements is missing. *Id.*

If the insurer has tendered a defense, whether or not under a reservation of rights, since the tender even under

a reservation is not a breach of the duty to defend, it would seem that:

1. the insured has no right to assign claims and may violate the policy's no-action clause by doing so; and
2. the insured may have no claim that could be assigned in the absence of a breach of the policy.

It is likewise unclear what the Court means in the third listed factor by "accepting coverage." If the carrier has accepted coverage by defending without a reservation of rights, what action would the insured have to assign? It could only be a *Stowers* action that presumes a judgment in excess of the policy limits. This scenario presumes a fully adversarial trial.

Perhaps the Court was unsure of how all of the possibilities would present themselves. The effect of the ruling is to make it very risky for a plaintiff to accept an assignment and give up the right to collect from the defendant. If the assignment is invalidated, will the release or covenant not to execute likewise be invalidated, or will the plaintiff end up getting nothing for the release or covenant? See *Stroop v. Northern County Mutual Ins. Co.*, 133 S.W.3d 844 (Tex.App.–Dallas 2004).

B. Full Adversarial Trial Required to Bind Insurer

Even though an insured's assignment is not necessarily invalid under the rule in *Gandy*, a judgment based on a less-than-fully-adversarial trial of the injured party's claim and without the insurance company's involvement is not binding on the insurer. First, unless the insurer breached the insurance contract by wrongfully refusing to defend, the insurer is entitled to insist on the insured's compliance with all the contract terms. The injured party, as the insured's assignee, can gain no greater rights than those held by the insured. Thus, if the judgment was not based on an actual trial of the liability and damages issues, the insured may have violated the "no action" clause, common to most liability insurance policies, and forfeited any right to sue on the contract. See *State Farm Lloyds Ins. Co. v. Maldonado*, 963 S.W.2d 38, 40 (Tex. 1998) (holding that *Stowers* claim assigned after brief hearing on plaintiff's claim violated policy term).

Even if the insurer has breached the contract by failing to defend the insured, and is therefore not entitled to insist on compliance with the policy's terms, a judgment rendered after less than a proper adversarial trial is neither binding on nor admissible in evidence against the insurer. *Gandy*, 925 S.W.2d at 714, 719 (insurer's liability must be litigated on strength of injured party's claims rather than the "generosity of [the

insured's] concessions."). Reviewing courts view with suspicion any "shenanigans" by the injured party and the insured that result in a large verdict and an assignment of the insured's rights so that the injured party can sue the insurance company. Short of declaring the assignment void as against public policy, courts have applied the rule that the liability insurer is not bound by a judgment rendered after less than a full, adversarial trial. See *First Gen. Realty Corp. v. Maryland Cas. Co.*, 981 S.W.2d 495, 500 (Tex. App.–Austin 1998, pet. denied); *American Eagle Ins. Co. v. Nettleton*, 932 S.W.2d 169, 177 (Tex. App.–El Paso 1996, writ denied) (finding that the insurer's tendered defense was rejected by the insured).

C. Validity of Assignment In Exchange For A Covenant Not to Execute

Ordinarily, a party against whom a judgment has been or is certain to be rendered is entitled to protect its assets by obtaining the judgment holder's promise to refrain from certain collection efforts. Commonly referred to as a "covenant not to execute," such an agreement may be and usually is very broad, with the judgment creditor promising never to seek execution against any asset of the judgment debtor or otherwise attempt to collect the debt. In return for that promise, the judgment debtor may pay money or deliver a thing of value, usually a cause of action against another party. In the context of an injured party's own post-judgment action against the liability insurer of the tortfeasor, it has been said that a covenant against execution has no effect on the insurer's liability to pay the judgment up to the limits set out in the insurance policy, at least when it is obtained in an arm's length, good faith transaction. See *Young Men's Christian Ass'n v. Commercial Standard Ins. Co.*, 552 S.W.2d 497, 504-505 (Tex. App.–Fort Worth 1977) *ref. n.r.e. per curiam* 563 S.W.2d 246 (Tex. 1978).

In the context of an injured party's suit as assignee of the insured's causes of action against the liability insurer, however, the covenant against execution may have an effect on the assignee's subsequent attempt to recover more than the policy's limits against the insurer. The Texas Supreme Court has declined to decide just what effect a covenant not to execute may have on the insured's damages and, consequently, any recovery available to the insured's assignee. See *State Farm Lloyds Ins. Co. v. Maldonado*, 963 S.W.2d 38, 39 n.4 (Tex. 1998); see also *American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 867-72 (Tex. 1994) (holding assignment invalid as collusive attempt to "set up" insurer's liability, thus not reaching decision on covenant's effect). However, when faced with this issue in *Whatley v. City of Dallas*, the Dallas Court of Appeals held that a covenant against execution effectively

eliminated any harm to the insured resulting from the excess portion of the judgment, at least in the absence of proof of the insurer's negligence or bad faith as a proximate cause of the excessive judgment. *Whatley v. City of Dallas*, 758 S.W.2d 301, 310 (Tex. App.–Dallas 1988, writ denied); see also *William M. Mercer Inc. v. Woods*, 717 S.W.2d 391, 398 (Tex. App.–Texarkana 1986), *aff'd in part and rev'd in part on other grounds*, 769 S.W.2d 515 (Tex. 1988) (holding that excess judgment was not damages as matter of law when, due to non-execution agreement, insured was never threatened with having to pay the judgment). Justice Hightower, dissenting in *Garcia*, emphasized that *Whatley* did not rule on the effect of a non-execution covenant when the insurer was guilty of negligence or bad faith. He reasoned that a covenant not to execute, made as part of a reasonable, good faith resolution of the third party's claim against the insured, should not jeopardize the value of the insured's tort causes of action for damages against the insurance carrier. *American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 867-72 (Tex. 1994) (J. Hightower, dissenting).

The dangers intrinsic to "invalid" assignments, agreed judgments and covenants (or worse, releases) is illustrated in the attached case of *Stroop v. Northern County Mut. Ins. Co.*, 133 S.W.3d 844 (Tex.App.–Dallas 2004).

VI. THE PROBLEM OF "ALLOCATION" AND SUBMISSION

Perhaps the most perplexing problem in the submission of insurance-related cases involves the determination of a liability insurer's obligation to pay in circumstances where the insurer's coverage issue differs from the third party's submitted basis for insured liability.

This issue was recently address in *Swicegood v. Medical Protective*, 2003 WL 22234928 (N.D. Tex) by the Honorable Judge Fitzwater with somewhat remarkable observations. After rejecting several summary judgments connected with a coverage case that proceeded after trial of the underlying liability issue against the insured, the Court ultimately holds at 2003 WL 22234928 at pp. 12, 13-14:

The court predicts that the Texas Supreme Court will hold that new evidence can be introduced at a coverage trial when the proof is necessary to resolve a controlling coverage question that was not conclusively decided in the indemnity suit. By "not conclusively decided" the court means the issue was not determined in a way that binds all affected parties in the coverage case (e.g., via collateral estoppel). An undecided issue could include

one that the parties in the indemnity case had no reason to litigate, e.g., an exclusion from coverage, where the burden of proof would be on a non-party insurer.

The court also holds that if the coverage question is one of law that can be decided on the record of the underlying suit, no new evidence is admissible.

* * *

Applying the court's *Erie*-guess to the present case, it holds that the proof to be admitted at trial will consist of historical evidence from the Underlying Lawsuit and expert testimony to assist the jury in allocating or apportioning covered and non-covered damages. In other words, the evidence to be admitted will be limited to historical documents such as the Swicegood and Clinic Policies, the court's opinion in *Swicegood I*, the pleadings, trial transcript, jury charge, verdict, and judgment in the Underlying Lawsuit, the briefs and opinion in *Swicegood II*, and the expert testimony to help the jury understand this evidence and decide whether the damages in the Underlying Lawsuit should be allocated between covered and non-covered conduct and, if so, how. For example, Dean may call expert witnesses to opine that no allocation is necessary because, based on their review of the proceedings in the Underlying Lawsuit, the damages awarded were necessarily limited to covered acts of medical malpractice. Medical Protective's experts may testify, for example, that some or all of the damages were necessarily awarded based on the romantic/sexual relationship between Dean and Dr. Swicegood and not covered.

Perhaps a more carefully crafted charge in the underlying case might have prevented the rather serpentine approach taken after verdict.

As to allocation issues recently discussed, see *Utica National Insurance Company of Texas v. American Indemnity Co.*, 141 S.W.3d 198 (Tex. 2004) and *Comsys Inf. v. Twin City Fire Ins.*, 130 S.W.3d 181 (Tex.App.–Houston [14th Dist.] 2003, no pet).

VII. CONCLUSION

From pleading to submission there are legal obstacles that must be overcome or avoided from the plaintiff's perspective. They must be recognized and anticipated before they can be sidestepped. There are

few shortcuts to success. Patience and attention to detail are required.