

STOWERS: 2012 UPDATE

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THE *STOWERS* DOCTRINE: NEW GUIDANCE FROM THE COURTS

Three new cases highlight that *Stowers* litigation is alive and well in Texas. The first case provides plaintiffs guidance on how to make a valid *Stowers* claim when a hospital lien exists. The second discusses the *Stowers* duty in litigation involving multiple claims and multiple insureds under a primary and excess policy, and concludes, among other things, that insurers' *Stowers* duties are triggered even though a settlement demand asks for the entire policy limits while only offering to extinguish the claims against a single insured. Finally, the third case addresses the element of the *Stowers* duty as to whether a reasonable insurer would accept a settlement at the time it was offered.

A. *McDonald v. Home State County Mutual Insurance Company*

In a memorandum opinion, the First District Court of Appeals in Houston recently decided an accident plaintiff's demand letter, as written, did not impose a *Stowers* duty when a hospital lien existed that was not specifically mentioned in the demand.¹

1. The Background Facts

On August 4, 2001, Francisco Rangel struck Edward McDonald with his vehicle while McDonald walked on the grass along a service road. As a result of the accident, McDonald suffered serious injuries and was treated at Memorial Hermann Hospital, which subsequently filed a "Notice of Hospital Lien," stating that the accident occurred on August 5, 2001 and that the Hospital admitted McDonald within 72 hours after the accident. The Lien also contained the following passage: "The name of the person alleged to be liable for damages arising from the injury is any and all responsible parties. The lien is for the amount of the hospital charges for services provided to the injured

individual during the first 100 days of the injured individual's hospitalization."²

At the time of the accident, Rangel was insured by Home State County Mutual Insurance Company, who utilized the Paragon Insurance Company and the Paragon Insurance Group (collectively, the "Insurers") to manage the claim's adjustment. The Insurers all agreed at oral argument that they were similarly situated in terms of the appeal.³

After the Hospital filed the Lien, McDonald's lawyer informed Paragon in writing that McDonald was represented by counsel. On June 5, 2002, McDonald's lawyer sent Paragon a settlement demand with a deadline for acceptance of June 14, 2002. The front page of the demand contained the following notice:

NOTICE

THIS CORRESPONDENCE CONTAINS A SETTLEMENT OFFER WITH RESPECT TO THE ABOVE-REFERENCED CLAIM. PLEASE BE ADVISED, PURSUANT TO THE TERMS HEREIN, THERE IS A TIME LIMIT WITHIN WHICH PARAGON INSURANCE GROUP MAY ACCEPT THIS SETTLEMENT OFFER. THE SETTLEMENT OFFER EXTENDED HEREIN IS THE TYPE WHICH IS COMMONLY KNOWN AS A "*STOWERS*" OFFER. See, *G.A. Stowers Furniture Co. v. American Indemnity Co.*, 15 S.W.2d 544 (Tex. Comm. App. 1929, holding approved); *American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842 (Tex. 1994). PLEASE TAKE NOTICE, IN THE EVENT THAT PARAGON INSURANCE GROUP FAILS TO ACCEPT THIS SETTLEMENT OFFER BY 5:00 P.M. ON FRIDAY JUNE 14, 2002, THIS SETTLEMENT OFFER WILL BE DEEMED TO HAVE BEEN REJECTED BY PARAGON

¹ See *McDonald v. Home State County Mut. Ins. Co.*, 2011 WL 1103116, at *1, *6 (Tex. App.—Houston [1st Dist.] Mar. 24, 2011, pet. denied).

² *Id.* at *1.

³ *Id.*

INSURANCE GROUP.
FURTHERMORE, ANY COUNTER-
OFFER SUBMITTED ON BEHALF
OF PARAGON INSURANCE
GROUP'S INSURED WILL BE
DEEMED AS A REJECTION OF THIS
SETTLEMENT OFFER.⁴

The demand letter included an explanation supporting the demand, and stated that a full and final settlement of the claim could be made “in exchange for payment to Edward McDonald” of the “total amount of liability insurance available to cover your insured in this matter.” The demand letter then specified that the payment be made to McDonald, care of his attorney.⁵

As part of investigating McDonald's claim, Paragon's adjuster contacted the known healthcare providers, learning that at least one purported lien existed. On the day before the settlement demand expired, the adjuster received a letter from the Hospital's counsel notifying him that the Hospital had filed a lien and that, to date, McDonald had incurred \$26,150.25 in expenses. Based on his review of the medical records and billing statements, the adjuster testified at a deposition that he thought McDonald's medical expenses exceeded \$54,000 at that time. According to the record, no indication existed that the adjuster or the adjuster's supervisor actually saw the Lien. On June 14, 2002, the deadline day set by McDonald in the demand letter, the adjuster called McDonald's attorney's office. Unable to speak with McDonald's attorney, the adjuster left a message with the receptionist, offering to settle the claim for Rangel's full policy limits. The adjuster's call never was returned.⁶

Three days later, McDonald's lawyer sent a letter to Paragon in which McDonald asserted that Paragon breached its *Stowers* duty and that settlement negotiations were terminated. In late June and early July, Paragon offered the full policy limits to settle McDonald's claim.

Paragon's July settlement offer mandated that McDonald sign a document, which would expressly release the Lien. McDonald rejected both settlement offers.⁷

The case was tried in 2004, and McDonald ultimately was awarded \$828,453.71 in actual damages, accompanied by \$500,000 in exemplary damages. In 2008, McDonald procured an order granting him Rangel's right to sue his insurers for their failing to settle McDonald's claims, including any *Stowers* claims. McDonald filed suit against the Insurers less than a month after obtaining Rangel's rights.⁸

McDonald and the Insurers filed cross-motions for summary judgment. In his motion, McDonald contended the Insurers breached common-law and statutory duties owed to Rangel regarding settlement. McDonald argued the Insurers owed this duty because the settlement demand letter implied a release of the Hospital's Lien and because, regardless, the Lien facially was invalid. In essence, McDonald argued a reasonably prudent insurer would have accepted his demand that was within policy limits. The Insurers countered by saying they had no duty to establish the Lien's validity and that the demand letter did not address the Lien, thus precluding a reasonably prudent insurer from accepting the settlement offer. The trial court ruled in the Insurer's favor, and McDonald appealed.⁹

2. The Primary Issue and Arguments on Appeal

The primary issue argued on appeal was whether the demand letter proposed a full and final settlement adequate to impose a *Stowers* duty on the Insurers when the letter omitted any reference to the Hospital's Lien. The Insurers claimed McDonald's settlement demand did not impose a *Stowers* duty because the letter did not address the Lien. In opposition, McDonald

⁴ *Id.*

⁵ *Id.* at *2.

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

argued the demand letter implied the Lien's release and that the Lien was legally invalid because it incorrectly reflected the accident date, it did not name Rangel as the responsible party, and it had an incorrect address for McDonald. He also contended that the Insurers understood the Lien's release was implied because they knew it existed and failed to mention it before the settlement demand letter expired and also continued to ignore its necessity in future correspondence. In addition, McDonald argued that the Insurers had violated a statutory duty to attempt settlement. *Id.*¹⁰

a. The Stowers Doctrine

Before analyzing the parties' arguments, the court of appeals addressed the basics of the *Stowers* doctrine, explaining that insurers have a duty to exercise ordinary care in settling claims to protect their insureds against judgments exceeding their policy limits.¹¹ A settlement demand made to an insurer triggers this *Stowers* duty if: (1) the claim against the insured is covered under the policy; (2) the demand is within policy limits; and (3) an ordinarily prudent insurer would accept the terms of the demand, considering how likely and to what degree the insured had a potential exposure to a judgment in excess of policy limits.¹² The settlement demand must offer to release the insured fully in exchange for a stated sum of money.¹³

b. Statutory Duty to Attempt Settlement

The court also delineated the relevant statutory duty, explaining that when an insurer's liability becomes reasonably clear, the insurer has a statutory duty to make a good faith attempt to effectuate a "prompt, fair, and equitable

settlement."¹⁴ Similar to the common law duty, the statutory duty is triggered when an insurer is presented a settlement offer within policy limits that an ordinarily prudent insurer would accept.¹⁵ To be a proper settlement demand and trigger this duty, it generally must offer to release the insured fully in exchange for a stated sum.¹⁶

c. The Court of Appeals' Analysis

The Houston court of appeals disagreed with McDonald's positing, finding the settlement demand insufficient to trigger a *Stowers* duty because it did not include a release of the Lien, and, therefore, an ordinarily prudent insurer would not accept the settlement demand. Specifically, the court found that the demand did not explicitly offer any release of potential claims against Rangel.¹⁷ Further, the court found the settlement demand did not imply that the Hospital's Lien would be released as part of the settlement offer.¹⁸ The court observed that the demand instructed the Insurers to pay McDonald directly, and, therefore, no provision existed for the Hospital to be a payee on a settlement and any counteroffer remedying this deficiency would have constituted a rejection under the language of the demand letter. The court also noted that if the Insurers had complied with the demand's terms, which contained no provision for the Lien's release, they risked making an incomplete settlement.¹⁹ In addition, the court rejected McDonald's contention that the Insurers impliedly accepted a *Stowers* duty here by not discussing the Lien's release with McDonald in its settlement discussions. Instead, the court reasoned that the Insurers still could have required the release as part of any later formal settlement.²⁰ In rejecting McDonald's belief that

¹⁰ *Id.*

¹¹ See *Philips v. Bramlett*, 288 S.W.3d 876, 879 (Tex. 2009); *G.A. Stowers Furniture Co. v. American Indemnity Co.*, 15 S.W.2d 544 (Tex. Comm. App. 1929, holding approved).

¹² See *Philips*, 288 S.W.3d at 879.

¹³ See *Trinity Universal Ins. Co. v. Bleeker*, 966 S.W.2d 489, 491 (Tex. 1998).

¹⁴ See TEX. INS. CODE ANN. § 541.060(a)(2)(A).

¹⁵ See *Rocor Int'l, Inc. v. Nat'l Union Fire Ins. Co.*, 77 S.W.3d 253, 262 (Tex. 2002).

¹⁶ *Id.*

¹⁷ See *McDonald*, 2011 WL 1103116, at *6.

¹⁸ *Id.*

¹⁹ *Id.* (citing *Bleeker*, 966 S.W.2d at 491).

²⁰ *Id.*

the Insurers' actions purportedly showed the release was implied in the settlement demand, the court noted the Insurers' actions are "necessarily subsidiary to the ultimate issue" of whether an ordinarily prudent insurer would accept McDonald's demand.²¹ Lastly, with little discussion, the court found that the Lien's validity was irrelevant to whether the demand letter triggered a *Stowers* duty.²² Accordingly, the court concluded:

As discussed above, the terms of McDonald's settlement demand included neither express nor implied protections against hospital liens. To the extent the demand was intended to invoke the *Stowers* doctrine, its terms should have either made express reference to the liens or at least should not have instructed express terms for acceptance which left the insurer exposed to the risk of liability to the hospital. *See Bleeker*, 966 S.W.2d at 491. McDonald's demand letter therefore failed to propose reasonable terms such that an ordinarily prudent insurer would have accepted them and assumed for itself the risk that the liens would be enforced. *See Phillips*, 288 S.W.3d at 879.²³

Finally, the court rejected McDonald's contention that by merely entering into settlement negotiations, the insurers should be held liable for failing to exercise reasonable care in those discussions.²⁴ The court found such an argument to imply an additional common-law duty separate from the *Stowers* doctrine—a duty that does not exist in Texas law.²⁵

²¹ *Id.* (citing *Am. Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994)).

²² *Id.*

²³ *Id.*

²⁴ *Id.* at *7.

²⁵ *Id.* (citing *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d 765, 776 (Tex. 2007) (confirming "*Stowers* is the only common-law tort duty in the context of third-party insurers responding to settlement demands"))).

For similar reasons, the court found that the Insurers did not violate their statutory duty to attempt to settle in good faith. The court reasoned that had the Insurers accepted McDonald's demand, they and Rangel still could have been liable to the Hospital because of the existing Lien. Thus, the demand letter's terms were not such that an ordinarily prudent insurer would have accepted them.²⁶

B. *Pride Transportation v. Continental Casualty Company*

A federal district court in Fort Worth recently granted two insurers' summary judgment motions in a case where a primary and excess carrier settled for the policy limits for one insured, leaving the other insured without coverage.²⁷

1. Background Facts

On October 11, 2006, Krystal Harbin drove a truck, owned by Pride Transportation, into the rear end of a pickup truck driven by Wayne Hatley on U.S. Highway 287 near Decatur, Texas. As a result, Hatley suffered significant injuries, rendering him a paraplegic. Hatley and his wife, Linda, subsequently filed suit against Pride and Harbin in the 271st Judicial District Court in Wise County, Texas. Pride, a Utah corporation and a large fleet interstate motor carrier, employed Harbin when the accident occurred.²⁸

The Hatleys' suit alleged negligence against both Harbin and Pride, claiming Pride was vicariously liable for Harbin's negligence and further liable under various federal and state motor-carrier safety regulations. The Hatleys sought damages for past and future medical expenses, lost earnings and future loss of earning capacity, past and future physical impairment, past and future disfigurement, past and future pain and mental anguish, past and

²⁶ *Id.*

²⁷ *See Pride Transp. v. Cont'l Cas. Co.*, 804 F. Supp. 2d 520 (N.D. Tex. Mar. 31, 2011).

²⁸ *Id.* at 523.

future loss of household services, past and future loss of consortium, and property damage to the Hatleys' vehicle.²⁹

When the accident occurred, Pride was covered under a primary policy issued by Continental Casualty Company with a \$1,000,000 policy limit. Pride also was insured by Lexington Insurance Company for \$4,000,000 in excess coverage. Harbin was an additional insured on both policies, and each policy stated that the respective insurer's duty to defend or settle terminated when the policy limits were exhausted by judgments or settlements.³⁰

On June 6, 2007, the Hatleys made a \$5,000,000 (combined policy limits) settlement demand to Harbin alone. The demand did not contain an offer to release any claims against Pride, but did purport to release all the Hatleys' claims against Harbin. A week after the Hatleys' demand, Pride insisted that Continental tender its policy limits to Lexington. Although Continental initially undertook Pride's and Harbin's defense, it complied with Pride's demand about a month later, tendering its policy limits to Lexington and letting Lexington take over the settlement negotiations.³¹

During the negotiations, Lexington sought permission to make a counteroffer that would settle the Hatleys' claims against both Pride and Harbin. The Hatleys refused to include Pride in the settlement. Meanwhile, Harbin demanded Lexington accept the Hatleys' existing offer. On July 20, 2007, Lexington acceded, agreeing to the Hatleys offer to release all claims against Harbin in exchange for Continental's and Lexington's (the "Insurers") combined policy limits. Having exhausted its policy limits, Lexington withdrew from Pride's defense after the Hatleys signed a formal settlement agreement releasing all claims against Harbin.³²

Shortly after the settlement, Pride filed a cross-claim for common law indemnity against Harbin in the Hatleys' lawsuit. Pride eventually settled with the Hatleys for \$2,000,000, plus notes payable to the Hatleys contingent on any recovery from a products-liability suit or any recovery from the Insurers. Pride subsequently sued the Insurers in a Utah state court, alleging they breached the insurance contracts by failing to provide a full, complete, and adequate defense. Pride additionally alleged the Insurers breached the covenant of good faith and fair dealing and violated the Texas Insurance Code. The suit was removed to federal court, and Continental then successfully had the case transferred, for the convenience of parties and witnesses, to the Northern District of Texas. After the transfer, the Insurers moved for summary judgment on Pride's claims, arguing they had a *Stowers* duty to accept the Hatleys' reasonable settlement demand under Texas law.³³

2. The *Stowers* Duty

In evaluating the Insurers' summary judgment motions, the trial court first recognized that an insurer has liability in Texas for negligently failing to settle a claim within policy limits.³⁴ Thus, the court noted, Texas law requires the insurer to exercise a similar degree of care as an ordinarily prudent person.³⁵ The court continued by stating that a settlement demand activates this *Stowers* duty when "three prerequisites are met: (1) the claim against the insured is within the scope of coverage, (2) the demand is within the policy limits, and (3) the terms of the demand are such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to an excess judgment."³⁶ The court also noted that the

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

³² *Id.* at 524.

³³ *Id.*

³⁴ *Id.* at 525 (citing *Stowers*, 15 S.W.2d at 547).

³⁵ *Id.*

³⁶ *Id.* (quoting *Am. Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994)).

settlement demand must offer to fully release the insured from any claims.³⁷

After acknowledging the difficulty applying the *Stowers* doctrine when multiple claimants or insureds are involved, the court cited *Travelers Indemnity Co. v. Citgo Petroleum Corp.*, 166 F.3d 761, 764 (5th Cir. 1999), for the proposition that Texas law allows an insurer to favor a claim by one claimant over another.³⁸ The court further found that an insurer may enter into a reasonable settlement with one of several claimants even though it would exhaust or diminish the money available to satisfy the other claims, as doing so “promotes settlement of lawsuits and encourages claimants to make their claims promptly.”³⁹ And, similarly, a valid *Stowers* demand mandates that an insurer settle on behalf of a single insured even if it exhausts the policy limits and thereby exposing the remaining insureds.⁴⁰ The court concluded that this result prevents an insurer from settling on behalf of one insured and having to choose between continuing to defend a non-settling insured beyond policy limits or facing liability for treating the non-settling insureds unequally.⁴¹ The court also noted that it should view the reasonableness of the settlement by reviewing the initial settlement demand in isolation,⁴² considering only the merits of the settled claim and the potential liability of the insured on that claim.⁴³

3. Choice of Law

Pride contended that the court should apply Utah state law because Texas law clearly was unfavorable to it. The court noted, however, that

while the choice of law rules would be dictated by Utah law because the transferor court was in Utah, both Texas and Utah apply the same choice of law test.⁴⁴ This test examines the “most significant relationship” when determining which state law should apply.⁴⁵ The court then demonstrated that the test applies differently in contract disputes and in tort cases. In a contract dispute, courts generally consider “(1) the place of contracting, (2) the place of negotiation of the contract, (3) the place of performance, (4) the location of the subject matter of the contract, and (5) the domicile, residence, nationality, place of incorporation and place of business of the parties.”⁴⁶ In tort cases, on the other hand, courts consider “(a) the place where the injury occurred, (b) the place where the conduct causing the injury occurred, (c) the domicile, residence, nationality, place of incorporation and place of business of the parties, and (d) the place where the relationship, if any, between the parties is centered.”⁴⁷ According to the court, whether it is a contract dispute or a tort case, a court has to determine which state law is most significantly related to the substantive issue being resolved.⁴⁸

With those principals in mind, Pride made the following arguments that Utah law should control: (1) Pride is located in Utah; (2) it has no place of business in Texas; and (3) that it negotiated its policy and paid the premiums in Utah. The court would have agreed with Pride if the case’s issues arose from negotiating the policy, paying the premiums, or interpreting the policy. Instead, the court noted that Pride’s claims concern the Insurers action in defending and resolving claims in a Texas lawsuit, in which Texas residents sued in a Texas state court over an accident occurring in Texas. Thus,

³⁷ *Id.* (citing *Garcia*, 876 S.W.2d at 848–49).

³⁸ *See Pride*, 2011 WL 1197306, at *3.

³⁹ *Id.* (quoting *Tex. Farmers Ins. Co. v. Soriano*, 881 S.W.2d 312, 315 (Tex. 1994)).

⁴⁰ *Id.* at 525–26 (citing *Travelers*, 166 F.3d at 768).

⁴¹ *Id.* at 526 (citing *Millers Mut. Ins. Ass’n of Ill. v. Shell Oil*, 959 S.W.3d 864, 870 (Mo. Ct. App. 1997)).

⁴² *Id.* (citing *Travelers*, 166 F.3d at 765).

⁴³ *Id.* (citing *Soriano*, 881 S.W.2d at 316).

⁴⁴ *Id.*

⁴⁵ *Id.* (citing *Salt Lake Tribune Publ’g Co. v. Mgmt. Planning, Inc.*, 390 F.3d 684, 693 (10th Cir. 2004)).

⁴⁶ *Id.* (quoting *Salt Lake Tribune*, 390 F.3d at 693).

⁴⁷ *Id.* at 526–27 (quoting RESTATEMENT (SECOND) OF CONFLICTS OF LAW § 145).

⁴⁸ *Id.*

the court concluded Texas had the most significant relationship to the issues.⁴⁹

4. Breach of Contract

The Insurers sought summary judgment on the following claims Pride alleged in an amended complaint: “(1) hiring the same counsel to defend both Pride and Harbin; (2) discontinuing their defense of Pride after settling the Hatleys’ claims against Harbin alone; (3) failing to allow Pride’s self-retained defense counsel to hire and pay experts; (4) failing to provide Harbin a defense in the indemnity action Pride filed against her after the settlement with the Hatleys; and (5) using the policies’ limits to settle the Hatleys’ claims against Harbin without obtaining a settlement of the claims against Pride when no valid *Stowers* demand had been made.”⁵⁰

In its analysis, the court reasoned the lion share of Pride’s contractual claims could be resolved by determining whether the Insurers lawfully withdrew their defense after settling Harbin’s claims—i.e., whether the Insurers had a *Stowers* duty and fulfilled it. The Insurers contended Texas law imposed a *Stowers* duty on them when the Hatleys’ made their settlement demand, and the duty was fulfilled by settling for policy limits.⁵¹

Pride countered by arguing the demand did not impose a *Stowers* duty. At the outset, Pride claimed the demand was insufficient to trigger a *Stowers* duty because the demand did not propose to completely release all claims against Harbin, specifically any potential contribution or indemnity claims—like the one Pride already had filed against Harbin. The court disagreed, however, noting that all the Hatleys’ claims against Harbin would be released and no Texas authority supports the position that an insurer

subjects itself to liability by failing to settle every potential claim against an insured.⁵²

Pride also argued that neither insured agreed to the settlement, precluding the triggering of any *Stowers* duty. While the court acknowledged Pride claimed in its brief that Harbin told the insurers not to accept the settlement, Pride cited no evidence to support its contentions. Instead, the evidence actually revealed that several times Harbin’s counsel specifically demanded that the offer be accepted.⁵³

Pride then contended the Hatleys’ demand was not a valid *Stowers* demand because neither insurer would have been liable for a judgment greater than the policy limits. Pride claimed the Insurers accepted the settlement solely to avoid additional defense costs and expenses.⁵⁴ The court noted, though, that Pride cited no authority suggesting that such motivation breached the insurance policies or otherwise was unlawful, “at least where, as here, all parties agreed that the Hatleys’ claims were ‘policy-limits’ claims.”⁵⁵

Lastly, Pride complained the settlement demand exceeded each individual policy limit and, therefore, was not a valid *Stowers* demand.⁵⁶ In distinguishing *AFTCO*, the court noted that in that case the amount sought in settlement was an aggregate of multiple policies that exceeded the insurer at issue’s policy limits.⁵⁷ Thus, no *Stowers* duty was triggered in *AFTCO* because

⁴⁹ *Id.* at 527.

⁵⁰ *Id.* at 527–28.

⁵¹ *Id.* at 528.

⁵² *Id.* (finding such position contrary to the holdings in *Soriano* and *Travelers*).

⁵³ *Id.* at 529.

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ See *id.* (citing *AFTCO Enterprises, Inc. v. Acceptance Indem. Ins. Co.*, 321 S.W.3d 65, 67, 71–72 (Tex. App.—Houston [1st Dist.] 2010, pet. denied) (finding a demand did not trigger a *Stowers* duty when the demand did not specify an individual policy, the demand exceeded all the individual policy limits, and the insurers had not tendered their policies at that time)).

⁵⁷ *Id.* (citing *AFTCO*, 321 S.W.3d at 71).

there was not an offer to release the plaintiffs' claims against the insureds under a policy in exchange for the limits available under that policy.⁵⁸ To the contrary, under the facts before the court in *Pride*, Continental had tendered its policy limits to Lexington before the \$5 million demand expired.⁵⁹ "At that point, with combined policy proceeds equaling the amount of the Hatleys' demand, Lexington's *Stowers* duties came into play."⁶⁰

Moreover, the court found *Pride* incorrectly focused on whether the Insurers had a *Stowers* duty to settle, instead of the overarching question of whether an ordinarily prudent insurer would have accepted the Hatleys' demand. The court affirmatively answered that question, highlighting that the claim would far exceed the combined policy limits. "Consequently, *Stowers*-duty bound or not, the insurers[] acted reasonably in accepting the Hatleys' demand despite the fact that *Pride* remained exposed."⁶¹

Finally, *Pride* failed to demonstrate that its defense was discontinued prematurely—i.e., before the policy limits were paid to settle the Hatleys' claims against Harbin. After that point, the insurers' refusal to hire experts for *Pride* was consistent with the policies' terms, which terminated the duty to defend on exhaustion of the policy limits paid in settlement.⁶² Moreover, *Pride*'s contention that a conflict of interest between Harbin and *Pride* should have been apparent to the Insurers at the outset and entitled *Pride* to separate counsel fell on deaf ears, as the evidence did not support that suggestion. And, when the conflict was clear, separate counsel was assigned. As such, the court denied *Pride*'s

breach-of-contract claims, granting summary judgment in favor of the Insurers.⁶³

5. Breach of the Covenant of Good Faith and Fair Dealing & Unfair Settlement Practices under Texas Insurance Code § 541.060

At the outset, the court noted that, in the context of third-party insurance claims, Texas does not recognize a claim for breach of the covenant of good faith and fair dealing.⁶⁴ The court found, however, that Section 541.060 of the Texas Insurance Code permits insureds to file suit against an insurer for unfair claims settlement practices.⁶⁵

Pride made several arguments utilizing this statutory provision. First, *Pride* claimed the Insurers violated this code provision by settling the Hatleys' claims against Harbin only, leaving it exposed. Second, *Pride* contended that Continental unreasonably delayed attempting to settle the Hatleys' suit despite defense counsel's suggestion to Continental that it was worthwhile to settle months before Continental tendered its policy limits to Lexington. Lastly, *Pride* complained that the insurers failed to allow defense counsel to pursue the manufacturer of Wayne Hatley's driver's seat.⁶⁶

Weighing *Pride*'s arguments, the court ruled that the Insurers' settlement for Harbin's claims was not an unfair settlement practice because it was lawful and required under Texas law.⁶⁷ The court also dismissed *Pride*'s unreasonable delay argument, finding that Continental's statutory duty could not be triggered until the Hatleys made a policy limits demand, and no such demand was made during the time period about

⁵⁸ *Id.*

⁵⁹ *Id.* at 529–30

⁶⁰ *Id.* at 530 (citing *AFTCO*, 321 S.W.3d at 70 (citing *Keck, Mahin & Cate v. Nat'l Union Fire Ins. Co.*, 20 S.W.3d 692 (Tex. 2000), for the proposition that "the *Stowers* duty does not arise for an excess insurer until the primary insurer has tendered its limits").

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.* at 530–31.

⁶⁴ *Id.* at 531 (citing *Maryland Ins. Co. v. Head Indus. Coatings*, 938 S.W.2d 27, 28 (Tex. 1996) (noting Texas only recognizes the *Stowers* duty)).

⁶⁵ *Id.* (citing TEX. INS. CODE ANN. § 541.060(a)(2)(A)).

⁶⁶ *Id.*

⁶⁷ *Id.*

which Pride complained.⁶⁸ Further, Pride omitted defense counsel's statement accompanying its call for an early settlement, which said settling would be premature without additional discovery.⁶⁹ The court also found Pride's claim that the Insurers violated the statute by failing to allow Pride's defense counsel to pursue the manufacturers of Mr. Hatley's seat to be without merit, noting that defense counsel was free to pursue a claim and that some evidence suggests that it was investigating such a claim.⁷⁰

6. Breach of Fiduciary Duty/Texas Insurance Code § 542

In closing, the court noted that Pride had abandoned its claim for breach of fiduciary duty and, in any event, Texas law imposed no such fiduciary duties. According to the court, Pride also failed to address its Section 542 claim.⁷¹ As such, the court did not address these claims in detail.

C. *American Western Home Insurance Co. v. Tristar Convenience Stores, Inc.*

Judge Ewing Werlein, Jr. issued an order on June 2, 2011 denying an insurer's motion for summary judgment that it did not have *Stowers* liability to its insured.⁷² Judge Werlein ultimately ruled that a fact issue precluded summary judgment on the issue of whether a reasonable insurer would have accepted a settlement offer at the time it was made.

1. Background Facts

Tristar Convenience Stores, Inc. was sued in Texas state court by the parents of Jesse

Miranda, who was shot by an unknown assailant while Miranda was working a convenient store. Tristar was an additional named insured on a \$1 million CGL policy issued by American Western Home Insurance Co. ("American Western") to Bhanu, LLC. The Mirandas sued Tristar, Bhanu, Gulshan Enterprises, Inc., Motiva Enterprises and Shell Oil Co. as well. Pursuant to a marketing contract between Bhanu and Tristar, American Western agreed to defend Bhanu, Tristar, Gulshan and Motiva in the underlying lawsuit subject to a reservation of rights.⁷³

In March 2009, the underlying plaintiffs offered to settle all their claims against all the defendants in exchange for payment of American Western's \$1 million policy limits. Believing the claims were not covered, American Western rejected the settlement offer. *Id.* Thereafter, the underlying plaintiffs made a second demand for \$4 million on Tristar's and Gulshan's insurers for their aggregate limits of insurance. Tristar's insurer contended its policy was excess to American Western, so American Western was responsible for responding to the offer. Tristar and Gulshan both demanded that American Western make a counter-offer to settle with the underlying plaintiffs for \$1 million. American Western did so, offering the \$1 million in exchange for a full release of all defendants. That offer was rejected, however, and the underlying plaintiffs offered to release only Bhanu in exchange for American Western's \$1 million. Bhanu's counsel demanded that the offer be accepted. In doing so, in July 2010, American Western convinced counsel for the underlying plaintiffs to include Motiva in the release. Gulshan and its carrier settled out as well, and it was unclear what happened with Shell. Regardless, Tristar ultimately remained as the only defendant in the underlying lawsuit.⁷⁴

American Western continued to provide a defense to Tristar despite the exhaustion of its policy limits, but filed the instant lawsuit seeking a declaration that it did not owe a duty

⁶⁸ *Id.* (citing *Rocor Int'l, Inc. v. Nat'l Union Fire Ins. Co.*, 77 S.W.3d 253, 262 (Tex. 2002)).

⁶⁹ *Id.*

⁷⁰ *Id.* at 532.

⁷¹ *Id.*

⁷² See *Am. W. Home Ins. Co. v. Tristar Convenience Stores, Inc.*, 2011 WL 2412678 (S.D. Tex. June 2, 2011).

⁷³ *Id.* at *1.

⁷⁴ *Id.*

to defend nor indemnify Tristar. Tristar counterclaimed that American Western is subject to both common-law and statutory liability due to its unreasonable refusal to settle the underlying lawsuit when the initial offer was made to settle on behalf of all defendants. American Western moved for summary judgment on its claims, but Tristar did not.⁷⁵

2. *Stowers* Duty

After setting forth the summary judgment standard, the district court addressed an insurer's "tort duty" owed to its insured where the insurer's policy does not allow an insured to settle without its consent.⁷⁶ The court explained that an insurer "must accept an offer of settlement from a third party to whom the insured may be liable 'when it appears that an ordinary prudent person in the insured's situation would have settled.'"⁷⁷

However, a settlement demand only triggers a *Stowers* duty when: "(1) the claim against the insured is within the scope of coverage; (2) the demand is within the policy limits; and (3) the terms of the demand are such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to an excess judgment."⁷⁸

Regarding its *Stowers* duty, American Western argued that it did not breach any duty in its handling of settlement offers, focusing on its July 2010 exhaustion of its policy limits in settling the claims against Bhanu and Motiva to the exclusion of the other insured entities.⁷⁹ In

other words, the insurer claimed that because it acted reasonably in achieving that settlement, it could not be held liable for breaching a duty to Tristar.⁸⁰

The court noted, though, that Tristar's counterclaim against American Western was based not on the *second settlement* offer, but on the *first* settlement offer—in March 2009—in which American Western could have settled all the claims against all the parties—including Tristar—for its \$1 million policy limits.⁸¹ "Indeed, it is the rejection of that offer that may subject American Western to *Stowers* liability to Tristar."⁸²

In its defense, American Western argued that it was justified in rejecting the initial offer because "there were serious questions about coverage" at that time.⁸³ But, as the court explained, "*Stowers* liability is avoided under the coverage element when there is *no coverage*, not where there is uncertainty regarding coverage."⁸⁴ The court noted, however, that whether "questions" about coverage exist at the time the settlement offer is

⁷⁵ *Id.* at *2.

⁷⁶ *Id.* (citing *Ford v. Cimarron Ins. Co., Inc.*, 230 F.3d 828, 831 (5th Cir. 2000) (citing *G.A. Stowers Furniture Co. v. Am. Indem. Co.*, 15 S.W.2d 544 (Tex. Comm'n App. 1929, holding approved))).

⁷⁷ *Id.* (citing *Ford*, 230 F.3d at 831).

⁷⁸ *Id.* (quoting *Am. Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994)).

⁷⁹ *Id.* at *3.

⁸⁰ *Id.* (citing *Travelers Indem. Co. v. Citgo Petroleum Corp.*, 166 F.3d 761, 768 (5th Cir. 1999) ("[U]nder Texas law an insurer is not subject to liability for proceeding, on behalf of a sued insured, with a reasonable settlement . . . once a settlement demand is made, even if the settlement eliminates (or reduces to a level insufficient for further settlement) coverage for a co-insured as to whom no *Stowers* demand has been made.")).

⁸¹ *Id.* at *4.

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.* (citing *Excess Underwriters at Lloyd's, London v. Frank's Casing Crew & Rental Tools, Inc.*, 246 S.W.3d 42, 46 (Tex. 2008) (noting "the dilemma faced by both insurer and insured when a claimant presents a settlement demand within policy limits and coverage is uncertain," because, in part, "an insurer that rejects a reasonable offer within policy limits risks significant potential liability for bad-faith insurance practices if it does not ultimately prevail in its coverage contest"))).

made is different than establishing as a matter of law that no coverage exists for the claim.⁸⁵

The court explained that American Western's contention that questionable coverage existed is better addressed to the third *Stowers* liability element—namely, “whether a reasonable insurer would have accepted the settlement at the time it was offered.”⁸⁶ American Western's later decision to pay its limits for only two defendants, according to the court, raised a genuine issue of material fact regarding its reasonableness in *not* settling the case on behalf of all the defendants when the initial offer was made in March 2009. Because American Western could not carry its summary judgment burden, the court denied its motion.⁸⁷

Commentary:

These recent decisions are the latest to address the all-important *Stowers* duty to settle imposed on insurers under Texas law. The *McDonald* decision highlights the importance of offering a complete release and, in doing so, noting specifically that any release includes hospital liens, if any, that exist. In other words, as has been the case, the failure to provide a complete release remains fatal to any *Stowers* claim, and the courts will not find that a complete release is implied in a demand. Thus, plaintiffs should take heed that their demands be specific and clear.

The *Pride Transportation* decision seemingly answers the question as to how to *Stowerize* an excess carrier—although doing so requires the assistance of the primary carrier in the first instance. More specifically, in the event an insured has multiple layers of coverage, a settlement demand within the total limits of insurance does not appear to *Stowerize* a primary carrier, as such a demand would not be within that insurer's policy limits. Similarly, the excess carrier also is not *Stowerized* for the same reason. Nevertheless, if the primary carrier tenders its limits to the excess carrier and the

demand is within the sum of the two carriers' limits, then the excess carrier is *Stowerized* (assuming, of course, all the other requirements of a *Stowers* demand are satisfied). Moreover, *Pride Transportation* emphasizes again that an insurer can elevate the interests of one insured over another so long as it acts as an ordinarily prudent insurer would in the same situation. In other words, an insurer will not be liable under *Stowers* merely because one insured is left without insurance following acceptance of a policy limits demand on behalf of another insured (again, so long as all the other requirements of a *Stowers* demand are satisfied).

Finally, the *Tristar Convenience Stores* decision emphasizes that the mere fact that an insurer believes that coverage is questionable does not absolve the insurer of its *Stowers* duty. Under the second element of the *Stowers* duty, questions as to coverage are not the same as finding that *no coverage* exists. Along the same lines, an insurer's later decision to settle a case under less favorable terms than initially offered, as occurred in *Tristar* where one insured was left without coverage, also can serve as an influential factor in determining whether an insurer acted reasonably in rejecting a settlement demand.

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ *Id.*