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## The Court of Appeals For The Fifth Circuit: A Review of 2007-2008 Insurance Decisions

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# THE COURT OF APPEALS FOR THE FIFTH CIRCUIT: A REVIEW OF 2007-2008 INSURANCE DECISIONS

Willy E. Rice\*

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## I. INTRODUCTION

The Fifth Circuit Court of Appeals decided a considerable number of insurance-related controversies between June 2007 and May 2008. Arguably, the most important, comprehensive decisions are discussed—nineteen insurance cases that originate in just five federal district courts.<sup>1</sup> Generally, the

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1. Three cases originated in the Eastern District of Louisiana. See *Stanley v. Trinchard*, 500 F.3d 411 (5th Cir. Sept. 2007); *House v. Am. United Life Ins. Co.*, 499 F.3d 443 (5th Cir. Sept. 2007), *cert. denied*, 128 S. Ct. 1309 (2008); *Arias-Benn v. State Farm Fire & Cas. Ins. Co.*, 495 F.3d 228 (5th Cir. Aug. 2007). One other case originated in the Northern District of Mississippi. See *Hartford Underwriters Ins. Co. v. Found. Health Servs. Inc.*, 524 F.3d 588 (5th Cir. Apr. 2008). Another two came from Mississippi’s Southern District. See *Broussard v. State Farm Fire & Cas. Co.*, 523 F.3d 618 (5th Cir. Apr. 2008); *Nationwide Mut. Ins. Co. v. Lake Caroline, Inc.*, 515 F.3d 414 (5th Cir. Jan. 2008). Five more cases originated in the Northern District of Texas. See *Advocare Int’l, LP v. Horizon Labs., Inc.*, 524 F.3d 679 (5th Cir. Apr. 2008); *Citibank Tex., N.A. v. Progressive Cas. Ins. Co.*, 522 F.3d 591 (5th Cir. Mar. 2008); *TIG Ins. Co. V. Aon Re, Inc.*, 521 F.3d 351 (5th Cir. Mar. 2008); *Allstate Ins. Co. v. Abbot*, 495 F.3d 151 (5th Cir. Aug. 2007); *Scottsdale Ins. Co. v. Knox Park Constr. Inc.*, 488 F.3d 680 (5th Cir. June. 2007). Finally, the most cases (eight) were appealed from Texas’s Southern District. See *Muñoz v. State Farm Lloyds of Tex.* (5th Cir. Mar. 2008); *Carrizales v. State Farm Lloyds*, 518 F.3d 343 (5th Cir. Feb. 2008) (*per curiam*); *Shearer v. Sw. Serv. Live Ins. Co.*, 516 F.3d 276 (5th Cir. Jan. 2008); *Henry v. Mutual of Omaha Ins. Co.*, 503 F.3d 425 (5th Cir. Oct. 2007) (*per curiam*); *Lincoln Gen. Ins. Co. v. De La Luz Garcia*, 501 F.3d 436 (5th Cir. Sept. 2007); *Wright v. Allstate Ins. Co.*, 500 F.3d 390 (5th Cir. Sept. 2007); *United Nat’l Ins. Co. v.*

Fifth Circuit decided familiar questions of law and fact. More specifically, the following types of procedural and substantive conflicts appear in the nineteen insurance decisions: (1) one case involving the constitutionality of a Texas insurance statute;<sup>2</sup> (2) two federal preemption and removal controversies involving the Employee Retirement Income Security Act (ERISA);<sup>3</sup> (3) two disagreements requiring the court of appeals to make “*Erie* guesses”;<sup>4</sup> (4) eight duty-to-indemnify conflicts;<sup>5</sup> (5) three duty-to-defend disputes;<sup>6</sup> (6) three cases surrounding whether insurers have a duty to pay proceeds in the wake of Tropical Storm Allison and Hurricane Katrina;<sup>7</sup> (7) one dispute involving a putative class action;<sup>8</sup> and (8) one case of first impression.<sup>9</sup>

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Hydro Tank, Inc., 497 F.3d 445 (5th Cir. Aug. 2007); Gasch v. Hartford Acc. & Indem. Co., 491 F.3d 278 (5th Cir. June 2007).

2. See discussion *infra* Part IV.

3. 29 U.S.C. §§ 1001-1461 (2000).

4. See *infra* Part II.C.3; see e.g., *Wentwood Woodside I, LP v. GMAC Commercial Mortg. Corp.*, 419 F.3d 310, 323 (5th Cir. 2005) (“Neither the Texas Supreme Court, nor indeed any of the courts of Texas, has ever considered whether a plaintiff like *Wentwood* belongs to the class that section 4012a protects. We must, therefore, make an *Erie* “guess” about how the Texas Supreme Court would answer this question.”); *Howe ex rel. Howe v. Scottsdale Ins. Co.*, 204 F.3d 624, 627 (5th Cir. 2000) (“To determine Louisiana law . . . this [c]ourt should first look to final decisions of the Louisiana Supreme Court. If the Louisiana Supreme Court has not ruled on this issue, then this [c]ourt must make an ‘*Erie* guess’ and ‘determine as best it can’ what the Louisiana Supreme Court would decide.” (quoting *Krieser v. Hobbs*, 166 F.3d 736, 738 (5th Cir. 1999))).

5. See *infra* Part III.A.3-4, B.1-3.

6. See *infra* Part III.A.2, B.1-3.

7. See *infra* Part II.C.1-3; see, e.g., John Tedesco, *Tropical Storm Makes Waves*, SAN ANTONIO EXPRESS-NEWS, June 6, 2001, at 1A, available at 2001 WLNR 11972334 (“The first tropical storm of the season was churning off the coast of Texas and Louisiana late Tuesday, packing heavy rain and wind gusts clocked at more than 60 mph. Tropical Storm Allison . . . prompt[ed] forecasters to warn of flash floods. . . . A tropical storm is a cyclone with sustained winds of 39 to 73 mph and is capable of becoming a full-fledged hurricane. Allison formed over a large swath of the Gulf of Mexico.”); Chad Terhune, *Katrina Begins March, Florida Braces*, WALL ST. J., Aug. 26, 2005, at A2 (“A weak Hurricane Katrina drenched densely populated South Florida . . . . Flooding was a major worry . . . . Sam Miller, executive vice president of the Florida Insurance Council, an industry trade group, said insurers are expecting a ‘two-punch hit’ from Katrina, with the more-severe blow coming if the storm comes ashore again in the state’s Panhandle region. Four hurricanes last year caused about \$23 billion in insured losses, and Hurricane Dennis inflicted additional losses of nearly \$1 billion last month, according to Insurance Services Office Inc., an insurance-consulting firm. In response, several small insurers left Florida this year, and some of the largest carriers are dropping policyholders or no longer issuing new policies. Floridians also are facing double-digit percentage increases on homeowners’ policies, and some mobile-home owners have been unable to find coverage in the private market.”).

8. See *infra* Part II.C.2.

9. See *infra* Part III.A.5.

## II. FIRST-PARTY INSURANCE CONTRACTS—STATE COMMON LAW CLAIMS & DECISIONS

### A. Disability & Health Insurance

#### 1. Procedural Question: Whether a Law Firm's Long-Term, Group Disability Insurance Contract Is an ERISA Employee-Benefits Plan That Preempts an Attorney from Receiving Long-Term Disability Benefits

To be sure, the increasing population of aging Baby Boomers includes members of the legal profession; therefore, the procedural and substantive questions in *House v. American United Life Insurance Co.* are extremely timely.<sup>10</sup> Even though the Fifth Circuit presented an intelligent analysis and reached the correct decision in *House*, the same questions are likely to reappear repeatedly in the foreseeable future.

In 1999, Walter House worked as a trial attorney for a firm where he was the founding partner and earned approximately \$350,000 per year.<sup>11</sup> In October of that year, House suffered a nonfatal heart attack at the age of forty-nine.<sup>12</sup> During that same month, House's law firm sought competitive proposals from several insurers.<sup>13</sup> The firm wanted to make life and disability insurance more affordable for the entire firm—including attorneys and staff.<sup>14</sup> Thus, the firm purchased a "group life and disability" plan from American United Life Insurance Company (AUL).<sup>15</sup>

Although the plan was a "group policy," it provided insurance coverage for four distinct classes of persons in the firm, and a life insurance provision covered every person in the firm.<sup>16</sup> There were, however, three classes of disability insurance.<sup>17</sup> Classes I, II, and III—respectively—covered partners, associate attorneys, and non-lawyers.<sup>18</sup> Significantly, the definition of "total disability" for lawyers and non-lawyers differed slightly.<sup>19</sup> Regarding partners and associates, AUL promised to pay total disability income if injury or sickness prevents the attorney from performing "the material and substantial duties of his regular occupation."<sup>20</sup> Under the contract, AUL also promised to pay up to \$10,000 of an attorney's pre-disability monthly income if the

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10. See *House v. Am. United Life Ins. Co.*, 499 F.3d 443 (5th Cir. Sept. 2007), *cert. denied*, 128 S. Ct. 1309 (2008).

11. *Id.* at 446.

12. *Id.*

13. *Id.*

14. *Id.*

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.* (internal quotation marks omitted).

attorney became totally disabled.<sup>21</sup> On the other hand, AUL promised to pay total disability income to non-lawyer employees if an individual could not “perform the material and substantial duties of any gainful occupation for which the Person is reasonably fitted by training, education, or experience.”<sup>22</sup>

House returned to his trial practice a few weeks after his October 1999 heart attack.<sup>23</sup> A year later, however, he had quadruple-bypass surgery.<sup>24</sup> He left the firm in November 2000 after returning briefly to wind up his trial practice and reassign his clients.<sup>25</sup> In October 2001, House became the executive counsel for the Louisiana Department of Economic Development.<sup>26</sup> That position paid \$100,000 per year, and it did not require House to litigate cases.<sup>27</sup>

When House left the law firm in November 2000, he submitted a claim to AUL stating that he was totally disabled.<sup>28</sup> For nine months, AUL sent total-disability payments to House, apparently while thoroughly evaluating his claim.<sup>29</sup> Ultimately, AUL denied the claim after reviewing House’s post-operative activities and his new employment.<sup>30</sup> It concluded that House was “capable of performing the sedentary occupation of an Attorney as it is normally performed in the national economy.”<sup>31</sup>

House filed a lawsuit against AUL in the United States District Court for the Eastern District of Louisiana, citing Louisiana law and asserting that the disability insurer acted in bad faith and misrepresented the terms of total-disability coverage.<sup>32</sup> The parties then filed a series of summary judgment motions.<sup>33</sup> In particular, AUL argued that federal preemption law prevented House’s recovery under the policy because the disability-insurance contract was an ERISA employee-benefits plan.<sup>34</sup> The district court judge disagreed and concluded, among other things, the following: (1) the insurance contract was not an ERISA plan; therefore, House’s state law claims were not preempted; (2) although House was still able to make substantial earnings as a lawyer, the policy language deemed him totally disabled; (3) House qualified for partial-disability income under the policy language; and (4) AUL had to

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21. *Id.*

22. *Id.* (internal quotation marks omitted).

23. *Id.* at 447.

24. *Id.*

25. *Id.*

26. *Id.*

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.* at 446-47.

33. *Id.* at 447.

34. *Id.* at 448; *see also* 29 U.S.C.A. § 1144(a) (2000) (“[ERISA’s provisions] supersede any and all State laws insofar as they may . . . relate to any employee benefit plan . . .”).

pay disability income after weighing a number of other factors.<sup>35</sup> Neither party was fully satisfied with the district court's conclusions and both appealed.<sup>36</sup>

Before the Fifth Circuit, AUL argued that ERISA governed AUL's disability policy; therefore, federal law preempted the adjudication of House's state-law causes of action.<sup>37</sup> AUL also challenged the district court's finding that House qualified for both total and partial-disability income under the policy.<sup>38</sup> In opposition, House argued that the district court should have awarded more disability benefits and damages for the insurer's bad faith and misrepresentation.<sup>39</sup> Although the appeals contained a number of issues, the court of appeals fashioned the central question this way: whether House's disability-income policy was an ERISA employee-benefit plan.<sup>40</sup>

Briefly put, various employees, beneficiaries, employers, and administrators are associated with an employee-benefits plan.<sup>41</sup> Therefore, ERISA outlines the parties' rights and obligations under the plan.<sup>42</sup> In

35. *House*, 499 F.3d at 447-48.

36. *Id.* at 448.

37. *Id.*

38. *Id.*

39. *See id.* at 447-48.

40. *Id.* at 448.

41. *See id.* at 450-52. Congress enacted the Employee Retirement Income Security Act (ERISA) to protect the rights of employees and their beneficiaries in employee-benefit plans. *See id.* at 452 n.7; *see also* Robertson v. Alexander Grant & Co., 798 F.2d 868, 870 (5th Cir. 1986) (stressing that Congress enacted ERISA to correct abuses occurring in the administration of private retirement plans (citing S. Rep. No. 93-127 (1973), reprinted in 1974 U.S.C.C.A.N. 4838, 4838-44)). ERISA preempts the application of state law remedies when an employee seeks redress under an employee benefit plan. *See* 29 U.S.C. § 1144 (2000), which reads:

(a) Supersedure; effective date

Except as provided in subsection (b) of this section, the provisions of this subchapter and subchapter III of this chapter shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a) of this title and not exempt under section 1003(b) of this title. This section shall take effect on January 1, 1975.

(b) Construction and application

.....

(2)(A) Except as provided in subparagraph (B), nothing in this subchapter shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities.

(B) Neither an employee benefit plan described in section 1003(a) of this title, which is not exempt under section 1003(b) of this title (other than a plan established primarily for the purpose of providing death benefits), nor any trust established under such a plan, shall be deemed to be an insurance company or other insurer, bank, trust company, or investment company or to be engaged in the business of insurance or banking for purposes of any law of any State purporting to regulate insurance companies, insurance contracts, banks, trust companies, or investment companies.

42. *See* § 1144. ERISA complainants may commence a number of contract- and tort-based actions in a court of law to secure various remedies. For an excellent review of various actions sounding in contract law, *see* George Lee Flint Jr., *ERISA: Reformulating the Federal Common Law for Plan Interpretation*, 32 SAN DIEGO L. REV. 955, 956-57 (1995) ("Under state contract law, litigants developed four recovery theories. Under contract laws gratuity theory, courts treated the employer's promise to pay benefits as a future gift . . . . Second, under the bilateral contract theory, the participant's continued employment constituted consideration for the employer's promise to pay the benefit . . . . Third, under the unilateral contract theory, the participant's benefit constituted deferred compensation, retention of which would result in unjust



addition, Congress amended ERISA under the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA).<sup>43</sup> COBRA was a congressional response to “reports of the growing number of Americans without *any* health insurance coverage and the decreasing willingness of . . . hospitals to provide care to those who cannot afford to pay.”<sup>44</sup> COBRA, therefore, attempts to prevent the loss of insurance coverage that could accompany any changes in employment and “to preserve employee’s medical insurance as they move from job to job.”<sup>45</sup>

Relying on an earlier Fifth Circuit decision, the district court decided that ERISA did not preempt House’s state law claims.<sup>46</sup> The lower court held that the disability coverage for partners in House’s law firm was a separate plan because employees generally could not receive Class I benefits.<sup>47</sup> The Fifth Circuit, however, reached a different conclusion. Citing the three-pronged test outlined in *Meredith v. Time Insurance Co.*, to determine whether ERISA governed the plan, the court asked (1) whether a plan exists, (2) whether the plan falls within the Department of Labor’s safe harbor rule, and (3) whether the employer intentionally established or maintained a plan for its employees’ benefit.<sup>48</sup>

The court of appeals held that the law firm established and maintained an employee benefits plan.<sup>49</sup> But to be exempt from ERISA, a plan must meet all four criteria under the Department of Labor’s safe harbor exclusion.<sup>50</sup> Specifically, a group or group-type insurance program is not an ERISA plan if (1) the employer or employee does not contribute to the plan, (2) the employee contribution is completely voluntary, (3) the employer’s role consists only of collecting premiums and remitting them to an insurer, and (4) the employer

enrichment of the employer . . . . Fourth, under the estoppel theory, the court held that the participant’s right to a plan benefit arose because of his reliance on the promise of benefits in continuing his work with that employer.”).

43. Consolidated Omnibus Budget Reconciliation Act of 1985, Pub. L. No. 99-272, § 10002, 100 Stat. 82 (1986) (codified as amended at 29 U.S.C.).

44. *Brock v. Primedica, Inc.*, 904 F.2d 295, 296 (5th Cir. 1990) (quoting H.R. Rep. No. 99-241, reprinted in 1986 U.S.C.C.A.N. 579, 622).

45. *Teweleit v. Hartford Life & Acc. Ins. Co.*, 43 F.3d 1005, 1006, 1008 (5th Cir. 1995); *accord* *Rettig v. Pension Benefit Guar. Corp.*, 744 F.2d 133, 155 n.54 (D.C. Cir. 1984); *Smith v. CMTA-IAM Pension Trust*, 746 F.2d 587, 589 (9th Cir. 1984); *see also* *McGee v. Funderburg*, 17 F.3d 1122, 1124 (8th Cir. 1994) (“ERISA, as amended by COBRA, is remedial legislation which should be liberally construed to effectuate Congressional intent to protect employee participants in employee benefit plans.”).

46. *House v. Am. United Life Ins. Co.*, 499 F.3d 443, 448 (5th Cir. Sept. 2007), *cert. denied*, 128 S. Ct. 1309 (2008); *see* *House v. Am. United Life Ins. Co.*, No. Civ. A. 02-1342, 2004 WL 856671, at \*7-8 (E.D. La. Apr. 20, 2004), *rev’d*, 499 F.3d 443 (5th Cir. Sept. 2007); *see also* *Robertson v. Alexander Grant & Co.*, 798 F.2d 868, 872 (5th Cir. 1986) (holding that the ERISA is not applicable to a separate retirement plan that only benefits partners).

47. *House*, 499 F.3d at 448; *House*, No. Civ. A. 02-1342, 2004 WL 856671, at \*9.

48. *House*, 499 F.3d at 448.

49. *Id.* at 451-52; *see also* 29 U.S.C. §1002(3) (2000) (defining the term “employee benefit plan”); *id.* § 1002(1) (defining “employee welfare benefit plan”).

50. *House*, 499 F.3d at 449.

receives no profit from the plan.<sup>51</sup> Applying this rule, the Fifth Circuit concluded that the firm's life and disability plan was not excluded under the safe harbor exclusion.<sup>52</sup> Participation was mandatory for all classes of employees, and the law firm paid 100% of the employees' premiums.<sup>53</sup>

But there is more. Even if a plan does not qualify for safe harbor, the insurance contract still might not be an ERISA plan.<sup>54</sup> Again, a plan that falls outside of the safe harbor exception will not fall under ERISA jurisdiction unless the plan satisfies *Meredith's* third prong: an employer must intentionally establish or maintain a plan for the employees' benefit.<sup>55</sup> In light of incontrovertible facts, the Fifth Circuit concluded that House's state law claims were preempted because the disability policy was an ERISA plan.<sup>56</sup>

## 2. Procedural Question: Whether an Employer's Health Insurance Contract Is an ERISA Employee-Benefits Plan That Preempts a Texas Court from Hearing a Multiple-Claims Lawsuit

ERISA was also the source of the controversy in *Shearer v. Southwest Service Life Insurance Co.*,<sup>57</sup> but the procedural question and facts differ from those appearing in *House*. In *Shearer*, the plaintiff-appellant, Lance Shearer, owned 50% of Intercontinental Materials Management, Inc. (IMM), where he was also an employee.<sup>58</sup> His mother, Christal Shearer, owned the other 50%.<sup>59</sup> In June 2004, Lance contacted Southwest Service Life Insurance Company (SWSL) to apply for health insurance, which IMM paid for.<sup>60</sup> Lance and members of his family were covered under the health insurance contract.<sup>61</sup>

During the policy period, Lance's son was injured, and the child required hospitalization and surgery, so Lance submitted claims to SWSL.<sup>62</sup> Initially, SWSL paid some of the claim, but it refused to pay all medical expenses.<sup>63</sup> Lance thus filed a multiple-claims, first-party lawsuit against SWSL and its agent, Richard Sanders, in a Texas state court.<sup>64</sup> Shortly thereafter, SWSL and Sanders removed the case to the United States District Court for the Southern

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51. *Id.*; 29 C.F.R. § 2510.3-1(j)(1)-(4) (2007).

52. *House*, 499 F.3d at 450.

53. *Id.* at 449.

54. *See supra* text accompanying note 50.

55. *See supra* text accompanying note 48.

56. *House*, 499 F.3d at 452-53.

57. *Shearer v. Sw. Serv. Life Ins. Co.*, 516 F.3d 276, 278 (5th Cir. Jan. 2008).

58. *Id.* at 277.

59. *Id.*

60. *Id.*

61. *Id.*

62. *Id.*

63. *Id.* at 277-78.

64. *Id.* at 278. The state law claims were "misrepresentation, breach of contract, unfair and deceptive trade practices, and unfair claim settlement practices." *Id.*

District of Texas pursuant to 28 U.S.C. § 1331.<sup>65</sup> To justify removal, SWSL claimed that the health-insurance contract was an ERISA plan, and so the federal preemption doctrine gave the district court subject matter jurisdiction.<sup>66</sup>

Lance then filed a motion to remand the case, arguing that the insurance contract was not an ERISA plan.<sup>67</sup> The federal district court denied the motion without comment.<sup>68</sup> In addition, the district court granted SWSL's motion for summary judgment, ruling that ERISA prevented Lance from securing relief.<sup>69</sup> Lance appealed the summary judgment ruling to the Fifth Circuit and argued that the federal district court lacked jurisdiction because the health insurance contract was not an ERISA plan.<sup>70</sup>

To determine whether IMM's health policy was an ERISA plan, the Fifth Circuit followed the methodology that it applied in *Meredith* and *House*.<sup>71</sup> Applying *Meredith*'s three-pronged test, the court of appeals asked again (1) whether the policy was a plan; (2) if so, whether the plan falls within the safe harbor rule; and (3) whether the employer intentionally established or maintained a plan for the employees' benefit.<sup>72</sup> To help the Fifth Circuit reach a swift and correct decision, Lance conceded that the health insurance contract was a plan that did not fall within the safe harbor provisions.<sup>73</sup> Lance insisted, however, that IMM did not establish or maintain the health insurance agreement for the employees' benefit.<sup>74</sup> Citing *MDPhysicians & Associates, Inc. v. State Board of Insurance*, Lance argued that a plan is not an ERISA plan simply because the plan exists.<sup>75</sup>

The Fifth Circuit agreed and highlighted three important facts: (1) IMM paid the premiums outlined in the health insurance contract on behalf of Lance and his family; (2) IMM paid the premiums for Lance's mother, who was insured under a different insurer's contract; and (3) IMM did not pay any insurance premiums for the benefit of IMM's other employees.<sup>76</sup> In light of those outstanding facts, the Fifth Circuit concluded that IMM did not intend to establish or maintain an ERISA plan.<sup>77</sup> Therefore, the Fifth Circuit vacated the district court's judgment and remanded the case to the state court, concluding that the lower court lacked sufficient subject matter jurisdiction over the case.<sup>78</sup>

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65. *Id.*

66. *See id.* at 277-78.

67. *Id.*

68. *Id.*

69. *Id.*

70. *Id.*

71. *See id.* at 279.

72. *Id.* (citing *Meredith v. Time Ins. Co.*, 980 F.2d 352, 355 (5th Cir. 1993)).

73. *See id.*

74. *Id.*

75. *See id.* (citing *MDPhysicians & Assocs. v. State Bd. of Ins.*, 957 F.2d 178, 183 (5th Cir. 1992)).

76. *Id.* at 279-80.

77. *Id.* at 280.

78. *Id.*

3. *Substantive Question: Whether a Health Insurer's Refusal To Pay for a Suicidal Victim's Medical Treatment Is Bad Faith Under Texas's Common Law and Deceptive Trade Practices Statute*

Without a doubt, the facts in *Henry v. Mutual of Omaha Insurance Co.* are exhaustive and clearly stated.<sup>79</sup> In addition, the various substantive questions are familiar and easy to comprehend.<sup>80</sup> The quality of the analysis in the opinion, however, is mixed. On the one hand, the discussions of "bad faith" and breach of the covenant of good faith and fair dealings are sound. On the other hand, the discussions of a wrongful death claim and causation are difficult to comprehend because both discussions are rather cryptic. Perhaps after reviewing the relevant facts and court's analysis, these initial conclusions will become more apparent.

Undeniably, the injury that fostered this controversy is tragic. Bradley Henry (Brad) purchased a health insurance policy from Mutual of Omaha Insurance Company (MOIC).<sup>81</sup> Under the contract, the insurer promised to pay benefits when Brad purchased services and supplies to treat a "medically necessary" injury or sickness.<sup>82</sup> But to qualify as "a medically necessary service or supply[.]" either or both "(a) [must be] appropriate and consistent with the diagnosis [according to] accepted standards of community practice; (b) [cannot be] experimental or investigative; (c) [cannot be] omitted without adversely affecting the insured person's condition or quality of medical care; and (d) [must be] delivered at the lowest and most appropriate level of care and not primarily for the sake of convenience."<sup>83</sup>

In December 2002, Dr. Michael Bullen examined Brad and concluded that he had a hypogammaglobulinemia-immunological deficiency.<sup>84</sup> The physician recommended intravenous immunoglobulin (IVIG) replacement therapy each month for one year.<sup>85</sup> A second opinion, from Dr. Glenn Bugay, confirmed Dr. Bullen's diagnosis and endorsed the IVIG treatment.<sup>86</sup> Later that month, Dr. Bullen began Brad's IVIG treatment and contacted MOIC immediately to verify that Brad's health insurance contract would cover the

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79. See *Henry v. Mut. of Omaha Ins. Co.*, 503 F.3d 425, 426-27 (5th Cir. Oct. 2007) (per curiam).

80. See *id.* at 427-30.

81. See *id.* at 426.

82. *Id.*

83. *Id.*

84. See *id.*; see also Dr. Saul Greenberg, Hypogammaglobulinemia, <http://www.utoronto.ca/kids/Hypogam.htm> (last visited Nov. 10, 2008) ("Hypogammaglobulinemia is a disorder that is caused by a lack of B-lymphocytes and a resulting low level of immunoglobulins (antibodies) in the blood. Immunoglobulins play a dual role in the immune response by recognizing foreign antigens and triggering a biological response that culminates in the elimination of the antigen. Antibody deficiency is associated with recurrent infections with specific types of bacteria. . . . There are 5 major types of immunoglobulins: immunoglobulin G, immunoglobulin M (IgM), immunoglobulin A (IgA), immunoglobulin D (IgD), and immunoglobulin E (IgE).").

85. *Henry*, 503 F.3d at 426.

86. *Id.*

IVIG treatment.<sup>87</sup> Because the cost of the therapy each month varied from \$10,000 to \$16,000, MOIC's initial oral response was non-committal.<sup>88</sup>

Ultimately, based on its in-house physician and independent immunologist's opinions, MOIC concluded that Brad's IVIG therapy was not medically necessary.<sup>89</sup> Shortly thereafter, MOIC contacted Dr. Bullen and disclosed that Brad's policy did not cover the IVIG treatments.<sup>90</sup> Despite MOIC's two official rejections of the claim, however, Dr. Bullen continued to administer monthly IVIG treatments and requested reimbursements from the health insurer.<sup>91</sup> MOIC mistakenly paid for four months of treatment, but the company informed Dr. Bullen that those were erroneous payments and that the company would not pay for any additional IVIG treatments.<sup>92</sup>

Still believing that the treatment was a medical necessity, Brad visited the Allergy and Immunology Clinic at Houston's Texas Children's Hospital.<sup>93</sup> One of the Clinic's specialists, Dr. Howard Rosenblatt, performed a thorough physical examination and ordered numerous tests.<sup>94</sup> Unlike Drs. Bugay and Bullen, however, Dr. Rosenblatt did not conclude unequivocally that the IVIG treatment was medically necessary.<sup>95</sup> But he did recommend IVIG therapy for Brad.<sup>96</sup> Brad then received his fifth IVIG treatment on May 1, 2003.<sup>97</sup> He also sent a copy of Dr. Rosenblatt's evaluation to MOIC, which stated that it needed a couple of weeks to review the information.<sup>98</sup> At that point, Brad threatened to sue MOIC if the health insurer continued to reject his claim.<sup>99</sup> Four days later and five days before his wedding, however, Brad committed suicide.<sup>100</sup>

Citing their rights under the Texas Survival Statute,<sup>101</sup> Brad's parents, Marion and Janet Henry (the Henrys), sued MOIC in a Texas state court.<sup>102</sup> Their complaint listed several causes of action: wrongful death, breach of contract, and violations of the Texas Insurance Code and the Texas Deceptive Trade Practices Act (DTPA).<sup>103</sup> Relying on Texas common law, they also

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87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.*

91. *Id.* at 427.

92. *Id.*

93. *See id.*

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.*

101. *See* TEX. CIV. PRAC. & REM. CODE ANN. § 71.021 (Vernon 2008).

102. *Henry*, 503 F.3d at 427-28; *see* § 71.021.

103. *Henry*, 503 F.3d at 427-28; *see* TEX. BUS. & COM. CODE ANN. §§ 17.46, 17.50 (Vernon 2002) (listing deceptive acts and consumers remedies, respectively); TEX. INS. CODE ANN. §§ 541.060(a), 542.003 (Vernon 2008) (formerly art. 21.21, § 4(10)). Under § 542.003(a)(4), prohibited conduct includes "not attempting in good faith to effect a prompt, fair, and equitable settlement of a claim submitted in which liability has become reasonably clear." § 542.003(a)(4).

asserted breach of good faith and fair dealing, alleging that MOIC acted in “bad faith.”<sup>104</sup> MOIC removed the case to the United States District Court for the Southern District of Texas, where the court granted MOIC’s motion for summary judgment.<sup>105</sup>

On appeal, two summary judgment questions were before the Fifth Circuit: (1) whether genuine issues of material fact existed regarding MOIC’s alleged “bad faith” in violation of the DTPA, Texas Insurance Code, and the Texas common law duty of good faith and fair dealing,<sup>106</sup> and (2) whether any

104. *Henry*, 503 F.3d at 428. Therefore, the Henrys sought damages for Brad’s physical pain and mental anguish; damages for their own pecuniary loss, mental anguish, and loss of companionship and society; and punitive damages. *Id.*

105. *Id.*

106. *See id.* at 428. The Fifth Circuit stated that

[t]he Henrys have advanced three discrete claims grounded in breach of the duty of good faith and fair dealing. Two of these claims are statutory, arising respectively under the DTPA and the Insurance Code; the third claim is based on the common law. . . .

The reasonable-basis test applies to all three of the Henrys’ *bad faith causes of action* against MOIC.

*Id.* at 428-29 (emphasis added). Here, the Fifth Circuit confuses keen readers of these opinions by using the phrase “bad faith causes of action.” *See id.* The Texas Supreme Court has recognized just one bad faith cause of action and that is the independent tort of bad faith. *See Viles v. Sec. Nat’l Ins. Co.*, 788 S.W.2d 566, 567 (Tex. 1990) (creating an independent tort of bad faith for breaching the common law duty of good faith and fair dealing). When there is an alleged breach of good faith and fair dealing, however, the resulting causes of action may sound in contract, in tort, as a separate bad-faith action, or as all three:

The relation which is essential to the existence of the duty to exercise care may arise through an express or implied contract. Accompanying every contract is a common-law duty to perform with care, skill, reasonable expedience and faithfulness the thing agreed to be done, and a negligent failure to observe any of these conditions is a tort, as well as a breach of the contract. In such a case, the contract is mere inducement creating the state of things which furnishes the occasion of the tort. In other words, the contract creates the relation out of which grows the duty to use care.

*Montgomery Ward & Co. v. Scharrenbeck*, 204 S.W.2d 508, 510 (Tex. 1947) (emphasis added) (quoting 38 AM. JUR. *Negligence* § 20 (1941)). Therefore, in the present case, it would have been more appropriate for the Fifth Circuit to have discussed summary judgment issues for each cause of action rather than discussing multiple causes of action under the unfortunate heading of “bad faith causes of action.” *See id.*

In addition, in the context of insurance law, one often discovers insureds alleging that an insurer breached Texas’s “common law duty of good faith and fair dealing.” *See Bartlett v. Am. Republic Ins. Co.*, 845 S.W.2d 342, 342 (Tex. App.—Dallas 1992, no writ). One also discovers insureds alleging that an insurer breached “implied covenant of good faith and fair dealing.” *See id.* (insureds commencing an action against health insurer for breach of contract, breach of duty of good faith and fair dealing, and breach of implied covenant of good faith and fair dealing). Actually, both of these are “claims” or “allegations,” and there is very little, if any, substantive difference between them. *See generally id.* More importantly, these are just claims and not causes of action. *See id.* A breach of either, however, allows an insured to commence an *action in tort, an action in contract, or actions under both theories of recovery*:

While this court has declined to impose an implied *covenant* of good faith and fair dealing in every contract, we have recognized that a duty of good faith and fair dealing may arise as a result of a special relationship between the parties governed or created by a contract.

In the insurance context a special relationship arises out of the parties’ unequal bargaining power and the nature of insurance contracts which would allow unscrupulous insurers to take advantage of their insureds’ misfortunes in bargaining for settlement or resolution of claims. In addition, without such a cause of action insurers can arbitrarily deny coverage and delay payment of a claim with no more penalty than interest on the amount owed. An insurance company has exclusive control over the evaluation, processing and denial of claims. For these reasons a duty is

of the causes of action survived Brad's death.<sup>107</sup> Addressing the first issue, the Fifth Circuit considered Texas's rules: "Under the common law, an insurer breaches the duty of good faith and fair dealing if it 'has no reasonable basis for denying or delaying payment of a claim.'"<sup>108</sup> Furthermore, a DTPA action for a bad-faith refusal to pay insurance proceeds "require[s] the same predicate for recovery."<sup>109</sup> Stated simply, an insurer will not be liable for refusing to pay a claim "if there [is] any reasonable basis for denial of that coverage."<sup>110</sup>

Reviewing the evidence, the Fifth Circuit held that MOIC had a reasonable basis for refusing to pay for Brad's IVIG treatment.<sup>111</sup> The court observed that the health insurer used several board-certified doctors and independent-specialist opinions to reach its decision.<sup>112</sup> Therefore, the Fifth Circuit embraced the district court's conclusion that MOIC acted in good faith because there was "a bona-fide dispute" about whether Brad's treatment was medically necessary.<sup>113</sup> And to resolve the dispute, MOIC used a methodology that was "sufficiently thorough and objective to satisfy the reasonable-basis standard."<sup>114</sup> Again, even though the court of appeals mischaracterized the aggregate of the tort-based causes of action as "bad faith actions,"<sup>115</sup> it applied Texas law and reached a fairly sound conclusion.

On the other hand, the Fifth Circuit's analysis of the second question was less than stellar. Once more, the court stated that it would decide "whether any of the Henrys' causes of action survived Brad's death."<sup>116</sup> But the court never discussed that question.<sup>117</sup> Instead, in a fairly short paragraph under the heading "Wrongful Death," the court reached some highly questionable conclusions without citing facts or Texas law.<sup>118</sup>

imposed that "[An] indemnity company is held to that degree of care and diligence which a man of ordinary care and prudence would exercise in the management of his own business."

A cause of action for breach of the duty of good faith and fair dealing is stated when it is alleged that there is no reasonable basis for denial of a claim or delay in payment or a failure on the part of the insurer to determine whether there is any reasonable basis for the denial or delay. *Arnold v. Nat'l County Mut. Fire Ins. Co.*, 725 S.W.2d 165, 167 (Tex. 1987) (citations omitted) (quoting *G.A. Stowers Furniture Co. v. Am. Indem. Co.*, 15 S.W.2d 544, 548 (Tex. Comm'n App. 1929)).

107. *Henry*, 503 F.3d at 428.

108. *Id.* at 429 (quoting *Higginbotham v. State Farm Mut. Auto. Ins. Co.*, 103 F.3d 456, 459 (5th Cir. 1997)).

109. *Id.* (quoting *Higginbotham*, 103 F.3d at 460) (internal quotation marks omitted).

110. *Id.* (quoting *Higginbotham*, 103 F.3d at 460) (internal quotation marks omitted).

111. *Id.* at 430.

112. *See id.*

113. *Id.* at 429 ("The question is not whether in the end MOIC's doctors were right or wrong in their diagnosis of Brad's condition and medical needs; the question is whether their methods and conclusions were reasonable, and whether MOIC was reasonable in relying on these conclusions.")

114. *Id.*

115. *See* discussion *supra* note 106.

116. *Henry*, 503 F.3d at 428.

117. *See id.* at 430.

118. *See id.*

First, the court simply cited a provision under the “Texas Wrongful Death Statute” that outlines a person’s liability for the death of another.<sup>119</sup> Then the court stated that “the Henrys cannot maintain a cause of action against MOIC under the Texas Wrongful Death Statute because MOIC’s denial of benefits to Brad was ‘not wrongful.’”<sup>120</sup> But even more surprising, the court concluded that “the Henrys cannot employ the Wrongful Death Statute for a claim against MOIC in which they cannot prove that MOIC denied their son’s coverage in *bad faith, viz., wrongfully.*”<sup>121</sup> Here, it suffices to say that under Texas law, a wrongful death action is not the same as an independent-tort-of-bad-faith cause of action.<sup>122</sup> Therefore, inserting this incomprehensible statement in the opinion does little to explain why the Henrys’ statutory, tort-based, and contract-based causes of action did not survive their son’s death.<sup>123</sup>

## B. Workers Compensation Insurance

### 1. Procedural Question: Whether Texas’s Statute of Limitations Bars a Workers Compensation Insurer’s Tort-Based Cause of Action Against Its Reinsurance Broker

After teaching and observing first-year law students for more than a quarter-century, I can state unequivocally that students who are enrolled in Torts and Civil Procedure courses do not rush to the aisles and celebrate when statutes-of-limitations discussions begin. But limitation statutes generate a considerable amount of serious interest among young practitioners—especially among those who represent insurers and insureds. The reason is not obscure: it is common to find multiple limitation-of-actions provisions or related phrases in an insurance contract.

For example, many insurance contracts have language regarding a “contractual limitation,”<sup>124</sup> “a legislatively designed” statute-of-limitation period,<sup>125</sup> and a statute-of-limitation period for mandatory arbitration between

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119. *Id.* (“A ‘person is liable for damages arising from an injury that causes an individual’s death if the injury was caused by the person’s or his agent’s or servant’s wrongful act, neglect, carelessness, unskillfulness, or default.’” (quoting TEX. CIV. PRAC. & REM. CODE ANN. § 71.002)).

120. *Id.*

121. *Id.* (emphasis added).

122. *See supra* note 121.

123. *See Henry*, 503 F.3d at 430.

124. *See, e.g., Schreiber v. Pa. Lumbermans Mut. Ins. Co.*, 23, 444 A.2d 647, 649 (Pa. 1982) (“[T]he limitation of suit provision in [the insurer’s] fire insurance policy was not ‘dictated by the insurance company to the insured.’ Rather, the Legislature has mandated that every policy of fire insurance issued in this Commonwealth shall contain the proviso that ‘[n]o suit or action on this policy for the recovery of any claim shall be sustainable in any court of law or equity . . . unless commenced within twelve months next after inception of the loss.’”).

125. *Id.* at 650 (Nix, J., dissenting) (“The difference between the legislatively designed statute of limitation period and that contracted between the parties is that the former represents a societal judgment [about] when the right of suit should no longer be permitted. In the latter instance, it merely represents the agreement of the parties based on the normal considerations attendant in contractual relationships.”).



insurers and insureds.<sup>126</sup> But more importantly, from time to time, serious conflicts erupt between insureds and insurers over whether a limitation period for mandatory arbitration tolls a contractual period of limitation.<sup>127</sup> Similar conflicts also appear between primary insurers and reinsurers as well as between insurers and their agents or brokers. *TIG Insurance Co. v. Aon Re, Inc.*, a recent Fifth Circuit case, is one such significant controversy in which these very statute-of-limitation issues were the focus of attention.<sup>128</sup>

TIG Insurance Co. (TIG), a California corporation with its principal place of business in Irving, Texas, sued its reinsurer broker, Aon Re, Inc. (Aon), an Illinois corporation with its principal place of business in Chicago, Illinois.<sup>129</sup> Because TIG is a large, multifaceted insurer who sells a variety of insurance services, including workers compensation coverage, to entities across the country,<sup>130</sup> it should be aware of various statute-of-limitation periods and how to use them effectively as affirmative defenses.

One facet of TIG's operations involves participating in the reinsurance business,<sup>131</sup> including having assumed Virginia Surety Company's reinsurance business.<sup>132</sup> To help generate more profits and minimize risks, TIG needed to prepare a package of underwriting information about its business and submit that information to various other reinsurers.<sup>133</sup> Thus, TIG retained Aon, a global reinsurance agency, as its broker in soliciting and negotiating proposals for reinsurance.<sup>134</sup>

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126. See *Closser v. Penn Mut. Fire Ins. Co.*, 457 A.2d 1081, 1086-87 (Del. 1983).

127. See generally *id.* at 1086-88.

128. *TIG Ins. Co. v. Aon Re, Inc.*, 521 F.3d 351, 354-57 (5th Cir. Mar. 2008). For coverage of *TIG Ins. Co.* in the civil procedure context, see Jason Johns, *Civil Procedure*, 41 TEX. TECH. L. REV. 863 (2009).

129. *Id.* at 352; Brief of Appellant TIG Insurance Co. at 1, *TIG Ins. Co.*, 521 F.3d 351 (No. 05-11450), 2006 WL 5952436.

130. See Brief of Appellant TIG Insurance Co., *supra* note 129, at 6; see also *TIG Ins. Co.*, 521 F.3d at 353 (noting the scope of TIG's business).

131. See *TIG Ins. Co.*, 521 F.3d at 352-53. Generally, TIG provides \$1-million-or-less coverage for each workers compensation claim and purchases excess-loss reinsurance under a treaty of reinsurance to cover claims exceeding that amount. *Id.* at 353; cf. *North River Ins. Co. v. Philadelphia Reinsurance Corp.*, 63 F.3d 160, 162 (2d Cir. 1995) ("A reinsurance treaty is an ongoing contractual relationship between two insurance companies in which the primary insurer agrees in advance to cede, and the reinsurer to accept, specified business that is the subject of the contract. Under a treaty, a reinsurer agrees to indemnify a primary insurer with respect to a portion of the primary insurer's liability in a designated line of business . . . . [T]ypical[ly], the reinsurance treaty involve[s] the participation of many reinsurers, each accepting a percentage of the total liability under a single treaty.").

132. *TIG Ins. Co.*, 521 F.3d at 353.

133. *Id.*; cf. *In re Ins. Antitrust Litig.*, 938 F.2d 919, 923 (9th Cir. 1991) ("Reinsurance is arranged by specialized brokers and underwriters. Much reinsurance is done by syndicates doing business through Lloyd's of London.").

134. *TIG Ins. Co.*, 521 F.3d at 353. Aon Re is a renowned reinsurance agency that sells its services worldwide. See *Aon.com*, Reinsurance, <http://www.aon.com/reinsurance/reinsurance.jsp> (last visited Nov. 12, 2008) ("Aon Re Global, the world's leading reinsurance broker and intermediary, provides clients with integrated capital solutions and services, delivering objective advice and fostering competition among highly rated reinsurers and an expanding array of new and alternative capital providers.").

TIG gave Aon information about its workers compensation business as well as Virginia Surety Company's "historical loss data."<sup>135</sup> In May 1998, using TIG's information, Aon prepared a package of underwriting documents and sent them to WEB Management LLC, an underwriter acting as an agent for United States Life Insurance Co. (USLife).<sup>136</sup> In the cover letter, Aon stated that the enclosed claims-loss computer disk contained Virginia Surety's loss data since 1994.<sup>137</sup> That same month, Aon also sent a copy of the packet of materials to TIG.<sup>138</sup>

In the following month, Aon's representatives met with TIG's in-house representatives to discuss quotes Aon had received.<sup>139</sup> At that meeting, TIG's representatives stated that Aon had submitted incomplete data about TIG to all potential reinsurers.<sup>140</sup> TIG reached this conclusion because WEB's quote was "out of line on the low side" when compared to other reinsurers' quotes.<sup>141</sup> Nevertheless, TIG accepted the WEB-USLife reinsurance bid, which covered a three-year period retroactively beginning on April 1, 1998.<sup>142</sup> Most importantly, during the parties' bargained-for-exchange sessions, they negotiated and inserted a mandatory arbitration clause in the treaty.<sup>143</sup>

For unknown reasons, TIG prospectively cancelled the reinsurance treaty on January 1, 1999.<sup>144</sup> The treaty, however, continued to cover claims stemming from losses that occurred between April 1, 1998 and January 1, 1999.<sup>145</sup>

During the summer of 2001, USLife became frustrated because TIG did not submit a complete audit of operations.<sup>146</sup> When USLife stopped paying claims, TIG demanded an arbitration hearing, claiming that USLife still had a contractual duty to pay nearly \$9 million in outstanding claims.<sup>147</sup> Over a year and a half later, in February 2003, the arbitration hearing began.<sup>148</sup> To defend its decision, USLife stated that it rescinded the reinsurance treaty because Aon had submitted "materially incomplete" loss data for Virginia Surety's insurance activities.<sup>149</sup> Ultimately, the arbitration panel decided in favor of USLife, finding specifically that TIG's agent—Aon Re—had omitted material

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135. *TIG Ins. Co.*, 521 F.3d at 353.

136. *See id.*

137. *Id.*

138. *Id.*

139. *Id.*

140. *Id.*

141. *Id.*

142. *See id.*

143. *See id.*

144. *Id.*

145. *Id.*

146. *See id.*

147. *See id.*

148. *Id.*

149. *See id.* at 353-54.

information about Virginia Surety's historical loss data.<sup>150</sup> Thus the panel declared that the treaty of insurance was "void *ab initio*."<sup>151</sup>

In June 2004, TIG sued Aon in the United States District Court for the Northern District of Texas.<sup>152</sup> Citing Texas law, the complaint listed breach of fiduciary duty and various negligence-based claims.<sup>153</sup> Aon filed a summary judgment motion, arguing that (1) the statutes of limitations barred TIG's negligence-based causes and (2) the discovery rule did not apply to defer the accrual of these causes of action.<sup>154</sup> The district court ultimately granted Aon's summary judgment motion on several grounds, including the statute-of-limitations defense and the applicability of the discovery rule.<sup>155</sup>

On appeal, TIG argued that the discovery rule did apply.<sup>156</sup> Specifically, it contended that its negligence, negligent misrepresentation, and breach of fiduciary duty claims accrued in February 2003 when it discovered legal injury.<sup>157</sup> From its perspective, the injury was USLife's unilateral rescission of the treaty of insurance because of Aon's misrepresentations.<sup>158</sup> Alternatively, TIG asserted that it did not suffer a legal injury and could not commence a lawsuit against Aon until the arbitration panel delivered the adverse ruling in May 2004.<sup>159</sup> Stating the latter argument another way, the insurer insisted that the statutes of limitations were tolled while the insurer was exercising its contractual rights under the mandatory arbitration clause and exhausting its remedies before the arbitration panel.

The Fifth Circuit reviewed the pertinent Texas laws: (1) negligence and negligent-misrepresentation causes of action must commence "not later than two years after the day the cause of action accrues";<sup>160</sup> (2) breach of a fiduciary duty actions must commence "not later than four years after the day the cause

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150. *Id.* at 354.

151. *Id.* After subtracting TIG's premiums from USLife's loss payments, the panel determined that USLife owed TIG a net payment of \$2,933,150. *Id.*

152. *See id.*

153. *See id.* TIG also filed a declaratory judgment action, claiming that Aon had a common law duty to reimburse and indemnify TIG for various unsatisfied claims. *Id.*

154. *Id.* TIG moved for a partial summary judgment, arguing that Aon should be collaterally estopped from relitigating issues resolved in arbitration; the district court denied the motion. *See id.*

155. *See id.* at 354. The district court also held in favor of Aon on the common law indemnity claim. *Id.*

156. *See id.* at 357.

Under Texas law, the discovery rule is an exception to the general rule that a cause of action accrues when a wrongful act causes some legal injury. [It] "defer[s] accrual of a cause of action until the plaintiff knew or, exercising reasonable diligence, should have known of the facts giving rise to a cause of action."

*Id.* (footnotes omitted) (quoting *HECI Exploration Co. v. Neel*, 982 S.W.2d 881, 886 (Tex. 1998)) (citing *S.V. v. R.V.*, 933 S.W.2d 1, 8 (Tex. 1996)); *see also* *Moreno v. Sterling Drug, Inc.*, 787 S.W.2d 348, 351 (Tex. 1990) (concluding that a court's determining whether the discovery rule applies to a particular cause of action is a question of law).

157. *See TIG Ins. Co.*, 521 F.3d at 355.

158. *Id.*

159. *Id.*

160. *Id.* at 354-55. (quoting *TEX. CIV. PRAC. & REM. CODE ANN.* § 16.003(a)) (internal quotation marks omitted).

of action accrues”;<sup>161</sup> (3) “a cause of action accrues when a wrongful act causes some legal injury, even if the fact of injury is not discovered until later, and even if all resulting damages have not yet occurred”;<sup>162</sup> and (4) “[a] cause of action generally accrues, and the statute of limitations begins to run, when facts come into existence that authorize a claimant to seek a judicial remedy.”<sup>163</sup> In light of those rules, “TIG could have sued Aon Re at any time from June 1998 and simultaneously [filed] a declaratory judgment or other action against U.S. Life to . . . determine the validity or extent of coverage [under] the treaty.”<sup>164</sup> Therefore, the Fifth Circuit affirmed the district court’s rulings because the discovery rule did not apply, and TIG’s legal injury was easily discoverable.<sup>165</sup>

Certainly, the Fifth Circuit’s analysis is fairly thorough and reasonable. But the court of appeals did not adequately address TIG’s “alternative” statute-of-limitation defense. Again, the insurer asserted that the duration of the mandatory-arbitration deliberations tolled the statutes of limitations.<sup>166</sup> Clearly, TIG thought the tolling argument was sound. Notably, it is a viable affirmative defense in California and Illinois, where TIG and Aon Re are incorporated.<sup>167</sup> In those two states, and others, contractual and mandatory arbitration proceedings toll statutes of limitations.<sup>168</sup> Arguably, TIG could have commenced its lawsuit in a district court in the Seventh or Ninth Circuit. And the most available evidence strongly suggests that TIG is a sophisticated insurer. Therefore, in light of California and Illinois’s more powerful statute-of-limitations defenses, one should ask: What compelled TIG to commence its lawsuit in the Fifth Circuit, citing Texas’s comparatively weaker statute-of-limitations defenses?

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161. *Id.* at 355 (quoting TEX. CIV. PRAC. & REM. CODE ANN. § 16.004(a)(5)) (internal quotation marks omitted).

162. *Id.* (quoting *S.V. v. R.V.*, 933 S.W.2d 1, 4 (Tex. 1996)) (internal quotation marks omitted).

163. *Id.* (quoting *Johnson & Higgins of Tex., Inc. v. Kenneco Energy, Inc.*, 962 S.W.2d 507, 514 (Tex. 1998)) (internal quotation marks omitted); *see also* *Jennings v. Burgess*, 917 S.W.2d 790, 793 (Tex. 1995) (stating that when a defendant moves for summary judgment on a statute of limitations defense, the defendant must conclusively (1) prove when the cause of action accrued, and (2) if the plaintiff pleaded a tolling provision, negate its application as a matter of law).

164. *TIG Ins. Co.*, 521 F.3d at 356.

165. *Id.* at 359.

166. *Id.* at 355.

167. *See* 215 ILL. COMP. STAT. ANN. 5/143.1 (West 2000) (“Whenever any policy or contract for insurance . . . contains a provision limiting the period within which the insured may bring suit, the running of such period is tolled from the date proof of loss is filed . . . until the date the claim is denied in whole or in part.”); *Johnson v. Santos*, 196 Cal. Rptr. 145, 150-51 (Ct. App. 1983) (rejecting the insurer’s defense and concluding that the time spent arbitrating the dispute extends the statute-of-limitation period under California law—CAL. CIV. PROC. CODE § 1141.17 (West 2007)).

168. *See, e.g.*, WIS. STAT. ANN. § 631.83(5) (West 2004) (“The period of limitation is tolled during the period in which the parties conducted an appraisal or arbitration procedure prescribed by the insurance policy or by law or agreed to by the parties.”)

*2. Procedural Question: Whether a Federal Court Has Subject Matter Jurisdiction Over a Removed, Survivor's Lawsuit in Which a Workers Compensation Insurer and Its Adjuster Were Joined as Defendants in a Texas Court*

In *Gasch v. Hartford Accident & Indemnity Co.*, a different workers compensation insurer was involved in another significant procedural controversy.<sup>169</sup> But this time, the insurer was the defendant in a third-party lawsuit rather than the more common worker-initiated first-party actions.<sup>170</sup> After examining the facts, however, it becomes readily apparent why the worker did not commence a first-party action.

Linnie Gasch, a maintenance worker, fell from a roof at his place of employment, fracturing his spine and becoming a paraplegic from the waist down.<sup>171</sup> Hartford Accident & Indemnity Company accepted his claim and paid workers compensation benefits under the Texas Workers Compensation Act.<sup>172</sup> When Linnie died four years later,<sup>173</sup> Hartford stopped the payments.<sup>174</sup>

Jennifer and Tammy Gasch (the Gasches) are Linnie's wife and minor child, respectively.<sup>175</sup> Following Linnie's death, they filed a survivors death-benefits claim.<sup>176</sup> The Gasches asserted that a "compensable injury," a myocardial infarction, caused Linnie's death.<sup>177</sup> Karen Frazier, a Texas resident and Hartford's insurance adjuster, initially denied the claim, concluding that the myocardial infarction was not related to Linnie's paraplegia.<sup>178</sup> But later, Hartford decided to pay death benefits after determining that a "covered" paraplegia-related pulmonary embolism caused Linnie's death rather than a myocardial infarction.<sup>179</sup>

Ultimately, the Gasches claimed that Frazier and Hartford's initial denial of death benefits was unwarranted.<sup>180</sup> They believed that Hartford failed to investigate the death-benefits claim in a reasonable manner.<sup>181</sup> Therefore, the Gasches brought suit against Hartford and Frazier in a Texas court, claiming that the defendants breached Texas's common-law duty of good faith and fair dealing, violated the DTPA, and engaged in bad faith conduct as proscribed in

169. *Gasch v. Hartford Acc. & Indem. Co.*, 491 F.3d 278 (5th Cir. Aug. 2007).

170. *Id.* at 279.

171. Brief for the Appellants at 2, *Gasch*, 491 F.3d 278 (No. 06-20498), 2006 WL 4878245; Brief of Appellees at 4, *Gasch*, 491 F.3d 278 (No. 06-20498), 2006 WL 4878246.

172. *Gasch*, 491 F.3d at 280.

173. *Id.*

174. Briefs for the Appellants, *supra* note 171, at 1.

175. *Gasch*, 491 F.3d at 279-80.

176. *Id.* at 280.

177. *Id.*

178. *Id.* at 279-80.

179. *Id.*

180. *Id.*

181. *Id.*

Article 21.21 of the Texas Insurance Code.<sup>182</sup> Because Hartford's principal place of business is in Connecticut, it removed the case to federal court under diversity jurisdiction.<sup>183</sup> Hartford then claimed that Frazier, a Texas resident, was improperly joined by the Gasches.<sup>184</sup>

Hartford and Frazier filed a motion for summary judgment, arguing that (1) neither the Texas Insurance Code nor the DTPA provided the Gasches standing, (2) the plaintiffs had not presented sufficient evidence to raise a material issue of fact, and (3) Frazier was not a proper defendant because she was Hartford's employee, and employees are not individually liable for violating provisions of the Texas Insurance Code.<sup>185</sup>

The district court held that the Gasches had standing to sue and that Frazier was a properly joined defendant.<sup>186</sup> But the court did grant Frazier and Hartford's summary judgment motion and dismissed the suit.<sup>187</sup> The court concluded that a reasonable jury would have difficulty finding that Hartford, through Frazier, failed to investigate the Gasches insurance claim in a reasonable manner, or that the insurer's initial failure to pay death benefits was unreasonable.<sup>188</sup> The Gasches appealed without raising the jurisdictional issue.<sup>189</sup>

At the outset, the Fifth Circuit correctly observed that Hartford and Frazier cited diversity jurisdiction and improper joinder as the basis for removing the case from state to federal court.<sup>190</sup> Yet the district court neither addressed the issue nor explained why it retained jurisdiction over the controversy.<sup>191</sup> Because a removal deprives a state court from hearing an action that is properly before that court, a "removal raises significant federalism concerns."<sup>192</sup> Removal statutes, therefore, must "be strictly construed, and any doubt about the propriety of removal must be resolved in favor of remand."<sup>193</sup>

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182. *Id.*; Brief for the Appellants, *supra* note 171, at 2; *see also* TEX. BUS. & COM. CODE ANN. § 17.50(a)(4) (Vernon 2007); TEX. INS. CODE ANN. § 541.060(a)(2)(A) (Vernon 2007); *supra* notes 103-04, 109 and accompany text (discussing DPTA and Insurance Code violations).

183. *Gasch*, 491 F.3d at 280; The Hartford: Contact Us, <http://www.thehardford.com> (follow "contact us" hyperlink) (last visited Dec. 31, 2008).

184. *Gasch*, 491 F.3d at 280. Hartford asserted that the Gasches "failed to allege any valid state law cause of action and [that the Gasches would] not be able to demonstrate that Karen Frazier individually violated any statutory provision." *Id.*

185. *Id.*

186. *Id.* at 280-81.

187. *Id.* at 281.

188. *Id.*

189. *Id.*

190. *Id.*

191. *Id.* at 280-81. The Gasches did not file a motion to remand, and the district court never dismissed Frazier as improperly joined. *Id.* at 279.

192. *Id.* at 281 (quoting *Carpenter v. Wichita Falls Indep. Sch. Dist.*, 44 F.3d 362, 365-66 (5th Cir. 1995)) (internal quotation marks omitted).

193. *Id.* at 281-82 (citing *Acuna v. Root Inc.*, 200 F.3d 335, 339 (5th Cir. 2000); *Carpenter*, 44 F.3d at 365-66).

Federal law is clear: a defendant may remove from state to federal court any civil action over which federal courts would have original jurisdiction.<sup>194</sup> When diversity citizenship is the basis for federal jurisdiction, however, the following proviso applies: a defendant may remove the action to federal court only if none of the properly joined and defending parties in interest are citizens of the state in which the action commenced.<sup>195</sup> Furthermore, to demonstrate an improper joinder, the removing defendants must demonstrate either “(1) actual fraud in the pleading of jurisdictional facts, or (2) inability of the plaintiff to establish a cause of action against the non-diverse party in state court.”<sup>196</sup>

Considering those principles, the Fifth Circuit began its analysis by highlighting an incontrovertible fact: the Gasches and Frazier are citizens of Texas.<sup>197</sup> Therefore, the central question was whether the Gasches improperly joined Frazier.<sup>198</sup> To reach its answer, the court relied on its en banc holding in *Smallwood v. Illinois Central Railroad*, which emphasized the importance of applying a reasonable basis test to all defendants: “[w]hen the only proffered justification for improper joinder is that there is no reasonable basis for predicting recovery against the in-state defendant, and that showing is equally dispositive of all defendants rather than to the in-state defendants alone, there is no improper joinder.”<sup>199</sup> Rather, “there is only a lawsuit lacking merit.”<sup>200</sup>

Because the allegations against Frazier were identical to those against Hartford and because the defendants asserted that the Gasches lacked sufficient evidence to support their claim against Frazier, the defendants were really attacking the merits of the claim, not the joinder of a party.<sup>201</sup> And a meritless claim against a local defendant is not equivalent to improper joinder.<sup>202</sup> Thus, the court vacated and remanded the case, concluding that joinder was proper and that federal courts lacked jurisdiction over the controversy.<sup>203</sup>

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194. *Id.* at 281 (discussing 28 U.S.C. § 1441(a) (2000)).

195. *Id.* (discussing 28 U.S.C. § 1441(b)).

196. *Id.* (quoting *Crockett v. R.J. Reynolds Tobacco Co.*, 436 F.3d 529, 532 (5th Cir. 2006)) (internal quotation marks omitted). For a discussion of *Crockett* and misjoinder principles, see William E. Marple, *Removal to Federal Court Based on Misjoinder of Parties*, 41 TEX. TECH L. REV. 551 (2009).

197. *See Gasch*, 491 F.3d at 279-80.

198. *See id.* at 282-84.

199. *Id.* at 283 (quoting *Smallwood v. Ill. Cent. R.R.*, 385 F.3d 568, 575 (5th Cir. 2004) (en banc)) (emphasis omitted).

200. *Id.* at 283 (quoting *Smallwood*, 385 F.3d at 574) (internal quotation marks omitted).

201. *Id.* at 283-84.

202. *Id.* at 284 (citing *Smallwood*, 385 F.3d at 573).

203. *Id.*

### C. Flood & Homeowner's Insurance

#### 1. Procedural Question: Whether the National Insurance Flood Act Expressly or Impliedly Permits an Insured Flood Victim in Texas To Commence a Private Right of Action Against an Insurer That Sells Flood Insurance

The Fifth Circuit's 2007 decision in *Wright v. Allstate Insurance Co. (Wright II)* is a follow up to its 2005 *Wright I* decision.<sup>204</sup> Given that I have critiqued *Wright I*,<sup>205</sup> this review begins by liberally paraphrasing relevant facts that appeared in the earlier review.

It is worth repeating that flood insurance is too expensive or unavailable for many property owners.<sup>206</sup> To help correct the problem, Congress enacted the National Flood Insurance Act of 1968 (NFIA).<sup>207</sup> This Act authorizes the Federal Emergency Management Agency (FEMA) to establish a National Flood Insurance Program (NFIP),<sup>208</sup> which has a flood insurance component and a unified national plan for flood management.<sup>209</sup> Accordingly, FEMA has enacted regulations and created the Standard Flood Insurance Policy (SFIP).<sup>210</sup> To make flood insurance accessible and affordable, FEMA encourages private insurers, so-called "Write Your Own" (WYO) insurers, to sell SFIP contracts.<sup>211</sup>

This litigation involved Dr. Thomas Wright, a resident of Houston, Texas, who purchased a SFIP insurance contract from Allstate Insurance Co., a WYO flood insurer.<sup>212</sup> In 2001, Tropical Storm Allison, which struck Houston and caused massive flooding, damaged Wright's home.<sup>213</sup> Briefly put, Wright

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204. *Wright v. Allstate Ins. Co. (Wright II)*, 500 F.3d 390, 393 (5th Cir. Sept. 2007); *Wright v. Allstate Ins. Co. (Wright I)*, 415 F.3d 385 (5th Cir. 2005).

205. See Willy E. Rice, *The Court of Appeals for the Fifth Circuit: A Legal Analysis and Statistical Review of 2005-2006 Insurance Decisions*, 39 TEX. TECH. L. REV. 843, 869-73 (2007).

206. *Id.* at 869; cf. 42 U.S.C. § 4001(b) (2000) ("[M]any factors have made it uneconomic for the private insurance industry alone to make flood insurance available to those in need of such protection on reasonable terms and conditions.")

207. See National Flood Insurance Act of 1968, Pub. L. No. 90-448, 82 Stat. 587 (codified as amended at 42 U.S.C. §§ 4001-4129 (2000)).

208. 42 U.S.C. § 4011(a) (2000); see also *id.* § 4001(d) (authorizing a flood insurance program).

209. *Id.* § 4001(b)-(c).

210. 44 C.F.R. §§ 61.4(b), 61.13(d) (2007).

211. See 42 U.S.C. §§ 4071(a)(1), 4081(a). Furthermore, WYO insurers may sell SFIP contracts in their own names. See United Policyholders, Insurance Advice—Flood Insurance, [http://www.unitedpolicyholders.org/claimtips/tip\\_flood.html](http://www.unitedpolicyholders.org/claimtips/tip_flood.html) (last visited Oct. 21, 2008). FEMA reimburses the benefits that the private insurers pay under flood insurance policies using funds from the U.S. Treasury. *Id.* Insurers often subcontract policy administration and claims handling to outside companies. *Id.* The private insurer's name may appear on the policy, yet the insurer had nothing to do with the policy or the claim handling, even if the private insurer sold the insured the policy. *Id.* Consequently, outside companies, including mere data processing businesses, have the authority to administer policies and handle claims. *Id.*

212. *Wright v. Allstate Ins. Co. (Wright II)*, 500 F.3d 390, 392 (5th Cir. Sept. 2007).

213. *Id.*



filed a proof-of-loss claim and Allstate refused to pay.<sup>214</sup> Allstate argued that Wright refused to cooperate under the terms of the policy and refused to file an adequate proof-of-loss statement in a timely manner under FEMA's regulations.<sup>215</sup>

Wright then sued Allstate and one of its employees, Guy Chapman, in *Wright I*, commencing the suit in the Southern District of Texas.<sup>216</sup> The complaint listed a variety of state law causes of action, including breach of contract, fraud, and negligent-misrepresentation.<sup>217</sup> Wright also petitioned the district court for leave to amend his complaint.<sup>218</sup> He wanted to include federal common law claims for fraud and negligent misrepresentation.<sup>219</sup>

In *Wright I*, the district court, concluding that federal law preempted the state law causes, dismissed every state law claim, except the breach of contract action.<sup>220</sup> And because Wright could not prove that flooding caused all of his property loss, the court awarded \$24,029, plus costs and attorneys' fees.<sup>221</sup> Without explanation, however, the district court also declared that Wright could not amend his complaint to include the federal common law causes of action.<sup>222</sup> On appeal, the Fifth Circuit agreed that the NFIA did preempt Wright's state law causes.<sup>223</sup> But the court remanded the case, instructing the district court to explain why Wright's motion to amend was denied.<sup>224</sup>

On remand, the district court again rejected Wright's motion.<sup>225</sup> On that occasion, the court stated that it was unaware of any federal common law claims that could be asserted by Wright.<sup>226</sup> Unsatisfied with that explanation, Wright appealed again.<sup>227</sup>

In *Wright II*, the Fifth Circuit addressed two variations of a single procedural question: (1) whether the NFIA expressly creates private rights of action for Wright's fraud and negligent misrepresentation claims, and alternatively, (2) whether NFIA implicitly authorizes federal common law claims for fraud and negligent misrepresentation.<sup>228</sup>

Concerning the first question, Wright asserted that NFIA creates private causes of action because his standard flood insurance policy stated that "disputes arising from the handling of an insurance claim shall be governed by

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214. *See id.*

215. *Id.*

216. *Id.*; *Wright v. Allstate Ins. Co. (Wright I)*, 415 F.3d 385, 386 (5th Cir. 2005).

217. *Wright II*, 500 F.3d at 392; *Wright I*, 415 F.3d at 386.

218. *Wright II*, 500 F.3d at 392; *Wright I*, 415 F.3d at 391.

219. *Wright II*, 500 F.3d at 392; *Wright I*, 415 F.3d at 391.

220. *Wright II*, 500 F.3d at 392; *Wright I*, 415 F.3d at 386.

221. *Wright I*, 415 F.3d at 386-87; *see Wright II*, 500 F.3d at 392.

222. *Wright I* at 391; *see Wright II*, 500 F.3d at 392.

223. *Wright I* at 392; *see Wright II*, 500 F.3d at 392.

224. *Wright I* at 391; *see Wright II*, 500 F.3d at 392.

225. *Wright II*, 500 F.3d at 392-93.

226. *Id.*

227. *Id.* at 393.

228. *See id.*

federal common law.”<sup>229</sup> The court of appeals disagreed. While accepting the fact that a policyholder may sue a WYO insurer to collect legitimate proceeds under the contract, the Fifth Circuit concluded that Congress did not explicitly create private causes of action for extra-contractual claims:

Faced with the total absence of indicia of congressional intent to support his position, Wright attempts to rescue his argument by advancing that he is not asking us to create a new cause of action; he argues that federal courts have already recognized federal common law claims for fraud and negligent misrepresentation. Yet Wright fails to present a single example of such claims in the context of a hazard insurance policy.<sup>230</sup>

The court of appeals also refused to embrace Wright’s alternative implied right of action theory. The Fifth Circuit reached that conclusion by applying the four-part test outlined in *Cort v. Ash*.<sup>231</sup> In *Cort*, the Supreme Court declared that federal courts must answer four questions before creating a private cause of action by implication: (1) whether the plaintiff is of the class for whose “special benefit” the statute was created, (2) whether Congress indicated a legislative intent to create or deny a remedy, (3) whether the remedy would be inconsistent with the underlying legislative purpose, and (4) whether the cause of action is one traditionally relegated to state law.<sup>232</sup> Of course, while all four factors are important, the question of whether Congress intended to create a private right of action for the plaintiff is determinative.<sup>233</sup>

Examining the facts and applying these rules, the Fifth Circuit held the following: (1) Wright was not an especial beneficiary because “the primary purpose of the NFIA is to reduce the financial burden on the federal fisc,” and (2) “Congress expressly provided a private remedy for policyholders in 42 U.S.C. §§ 4053 and 4072 . . . [which] allow a policyholder to sue in federal court if he is dissatisfied with the amount of a claim payment.”<sup>234</sup> Because Congress, in other sections of the NFIA, expressly authorizes private causes of action, Wright’s theory that Congress implicitly intended courts to create causes of action was weakened.<sup>235</sup> After finding no congressional intent to allow courts to fashion extra-contractual causes of action for flood-related insurance cases, the Fifth Circuit did not address the last two prongs of the *Cort*

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229. *Id.*

230. *Id.* at 394.

231. *Id.* at 395-398 (discussing *Cort v. Ash*, 422 U.S. 66, 78 (1975)).

232. *See id.* at 395 (quoting *Till v. Unifirst Fed. Sav. & Loan Ass’n*, 653 F.2d 152, 157 (5th Cir. 1981) (citing *Cort*, 422 U.S. at 78)).

233. *Id.* (citing *California v. Sierra Club*, 451 U.S. 287, 293 (1981)).

234. *Id.* at 396-97 (5th Cir. Sept. 2007). “A plaintiff is an ‘especial beneficiary’ if the statute creates a federal right in favor of the particular plaintiff. ‘[T]he right- or duty-creating language of the statute has generally been the most accurate indicator of the propriety of implication of a cause of action.’” *Id.* at 395 (quoting *Cannon v. Univ. of Chicago*, 441 U.S. 677, 690 n.13 (1979)).

235. *See id.*

test.<sup>236</sup> Accordingly, the court affirmed the district court in *Wright II*.<sup>237</sup>

2. *Substantive Question: Whether an Insurer Has a Duty To Compensate Homeowners for Property Losses Under the Common and Statutory Laws of Louisiana and Mississippi in the Wake of Hurricane Katrina*

Hurricane Katrina's three-year anniversary was August 29, 2008.<sup>238</sup> Following Katrina's devastation, many adverse legal and extralegal consequences continue to plague citizens as well as victims' lawyers and property insurers along the Louisiana-Mississippi coast. Newspapers are replete with articles describing devastating losses,<sup>239</sup> tense emotions,<sup>240</sup> acts of bribery by attorneys representing Katrina victims,<sup>241</sup> lawsuits against public officials,<sup>242</sup> insurance company settlement agreements,<sup>243</sup> and lawsuits against insurance companies that refuse to settle claims.<sup>244</sup>

236. *Id.* (concluding that it was unnecessary to address the last two questions because the court found a lack of congressional intent).

237. *Id.* at 398.

238. See Editorial, *Three Years After Katrina*, NY TIMES, Aug. 12, 2008, at A20.

239. Cf. Editorial, *Taxpayers Get Soaked*, WALL ST. J., May 24, 2006, at A14 ("The federal government says some 120,000 properties nationwide have received 'multiple' taxpayer subsidized flood insurance payments—at a cost of \$7.25 billion. . . . We're not casting aspersions on . . . New Orleans residents who will soon be getting billions of dollars in flood insurance checks, even though their homes had suffered flood losses before Hurricane Katrina hit. The real villain here is Congress for allowing this free lunch to continue.").

240. See Liam Plevin & Peter Lattman, *Rulings Bolster Insurers—Landscape Is Changing As Katrina Cases Move Through Higher Courts*, WALL ST. J., Dec. 7, 2007, at C1 ("Hurricane wind and surging water from the Gulf of Mexico caused catastrophic damage in the August 2005 storm. Many insurers rejected claims contending that damage was caused by water, as opposed to wind. . . . 'It's not rocket science to understand that emotions run very high on the coast over Hurricane Katrina,' says Sheila Birnbaum, a lawyer for State Farm.").

241. See *id.* ("The indictment of plaintiffs attorney Richard 'Dickie' Scruggs . . . isn't the only [problem] facing Gulf Coast homeowners in their battle with insurers over Hurricane Katrina claims. . . . Mr. Scruggs [was indicted] along with four others on federal charges of conspiring to bribe a state-court judge. . . . [O]ther plaintiffs lawyers have said they plan to take over his Hurricane Katrina cases."); see also *Zach Scruggs Gets 14 Months in Prison*, WALL ST. J., July 3, 2008, at B5 ("The son of anti-tobacco lawyer Richard 'Dickie' Scruggs has been sentenced to 14 months in prison for knowing about a judicial bribery scandal and failing to report it to authorities. Zach Scruggs was sentenced by the same federal judge who sent his father to prison for five years for planning to bribe a Mississippi judge. . . . Zach Scruggs, his father and a law partner were indicted in November after an associate secretly recorded conversations about a plan to bribe a judge. The law partner, Sidney Backstrom, was sentenced to 28 months in prison.").

242. See, e.g., Paulo Prada, *New Orleans Group Sues Over Katrina-Tied Demolitions*, WALL ST. J., Aug. 24, 2007, at A11 ("A group of homeowners filed suit against the City of New Orleans and Mayor Ray Nagin, seeking damages for houses they say were illegally targeted for demolition as part of the city's drive to clean up properties damaged by Hurricane Katrina. Attorneys for the group, the owners of five houses and one church razed since August 2006 and two homes still believed to be on the city's demolition list, filed notice in the U.S. District Court for the Eastern District of Louisiana. . . .").

243. See *Allstate Will Settle Katrina Claims*, WALL ST. J., June 26, 2007, at B8 ("Allstate Corp. agreed to a mass settlement of claims by a group of Mississippi policyholders who sued the insurer over damage to their homes from Hurricane Katrina . . ."); Plevin & Lattman, *supra* note 240.

244. See, e.g., *Katrina Verdict Goes Against Allstate*, WALL ST. J., Apr. 17, 2007, at B2 ("The first Hurricane Katrina policyholder lawsuit against Allstate Corp. to go to a jury returned a \$2.8 million verdict against the insurer, in a case that hinged largely on whether it was Katrina's winds or storm surge that wiped

But even more relevant, the Fifth Circuit has received some highly negative coverage in newspapers for its pro-insurer, Katrina-related decisions. For example, the following appeared in a recent Wall Street Journal article:

Rulings by the [Fifth Circuit] . . . [have] favored the [insurance] industry. . . .

. . . .

. . . While [plaintiffs lawyers] scored some lower-court victories, some of those rulings have been overturned by the appeals court, which legal scholars say is one of the nation's most conservative federal appeals courts.

. . . .

The rulings "are going to make it much more difficult for an individual with a claim to be successful . . ." says . . . one of the attorneys representing the homeowners who won the \$1 million judgment against State Farm . . . .

The rulings could also bolster insurers' positions in future catastrophes.<sup>245</sup>

For sure, I will let commentators and jurists establish whether the Fifth Circuit is more or less conservative than other federal appellate courts, or whether it is a pro-insurer or pro-insured court. But in light of Hurricane Katrina's destruction in Louisiana and Mississippi, astute reporters and columnists for national newspapers have correctly identified one of the major substantive questions "at the heart of the litigation from the start: whether [flood-exclusion] provisions in homeowners' contracts . . . are enforceable."<sup>246</sup> In fact, during the 2007-2008 term, the Fifth Circuit decided two Katrina-related cases.<sup>247</sup> Without doubt, for those who believe the Fifth Circuit is a "pro-insurer court," the discussions of the outcomes and opinions in those cases will do very little to dispel that perception.

The first case is *Arias-Benn v. State Farm Fire & Casualty Insurance Co.*<sup>248</sup> As mentioned earlier, Hurricane Katrina caused significant and

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out his house. . . . [T]he verdict includes a \$1.5 million penalty for the company's failure to pay damages quickly enough. Wind damage is covered by the typical homeowner's policy, but flood damage isn't. [Allstate's] lawyer argued . . . that the winds that hit Mr. Weiss's Home weren't strong enough to do the damage. She said Mr. Weiss already had received more than \$400,000 in insurance payments, including \$350,000 in federal flood insurance. . . . [Mr. Weiss's] home was northeast of New Orleans [an area that is allegedly] too high above sea level to have been destroyed by Katrina's storm surge."); Plevin & Lattman, *supra* note 240 ("There are lawsuits pending. State Farm faces 180 lawsuits that were filed by Scruggs Katrina Group [in Mississippi]. . . . There are also many cases pending in Louisiana . . .").

245. Plevin & Lattman, *supra* note 240; see also *Politics & Economics: Insurers Don't Owe for Katrina Harm*, WALL ST. J., Aug. 3, 2007, at A4 ("Hurricane Katrina victims . . . cannot recover money from insurance companies for the damage, [the Fifth Circuit] ruled. 'This event was excluded from coverage under the plaintiffs insurance policies, and under Louisiana law, we are bound to enforce the unambiguous terms of their insurance contracts,' Judge Carolyn King wrote for a three-judge panel . . .").

246. Plevin & Lattman, *supra* note 240.

247. See *Broussard v. State Farm Fire & Cas. Co.*, 523 F.3d 618 (5th Cir. Apr. 2008); *Arias-Benn v. State Farm Fire & Cas. Ins. Co.*, 495 F.3d 228 (5th Cir. Aug. 2007); *infra* notes 248-314 and accompanying text.

248. See *Arias-Benn*, 495 F.3d 228.

extensive power outages in the Gulf region of the United States.<sup>249</sup> And after property owners and others fled for safety, “governmental directives [prevented many] residents from returning to . . . the affected area for extended periods of time.”<sup>250</sup> Spoiled perishables in thousands of refrigerators, putrefied contents in freezers, and residents’ inability to mitigate damages were additional adverse consequences of electrical-power failure in the affected area.<sup>251</sup>

When Katrina struck and power outages occurred, the perishables in the refrigerator of New Orleans resident Maria Arias-Benn spoiled and putrefied.<sup>252</sup> At the time, State Farm Fire & Casualty Insurance Company (State Farm) insured Benn’s residence under a homeowner’s insurance contract.<sup>253</sup> She submitted a claim to State Farm, asking the insurer to replace her damaged refrigerator.<sup>254</sup> State Farm denied the claim.<sup>255</sup>

In response, Benn filed a putative class action against State Farm in a Louisiana state court.<sup>256</sup> She alleged that State Farm breached various property-insurance contracts by refusing to replace insured’s refrigerators and freezers.<sup>257</sup> The complaint also listed other causes of action: negligence, breach-of fiduciary duty, fraud and misrepresentation, and a violation of Louisiana’s Unfair Trade Practices and Consumer Protection Law.<sup>258</sup> State Farm then removed the case to the Eastern District of Louisiana, where it argued that the class action complaint failed to state a cognizable claim and should therefore be dismissed.<sup>259</sup> Granting State Farm’s motion, the district court dismissed the case with prejudice.<sup>260</sup> Benn appealed the ruling.<sup>261</sup>

To determine whether the lower court’s ruling was proper, the Fifth Circuit examined a copy of Benn’s homeowner’s policy.<sup>262</sup> The language in the pertinent coverage clause stated in relevant part:

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249. Brief for Appellants at 6, *Arias-Benn*, 495 F.3d 228 (No. 2006-30771), 2006 WL 5082917; *see also Arias-Benn*, 495 F.3d at 229 (noting that the hurricane “resulted in an extended loss of electrical power”).

250. Brief for Appellants, *supra* note 249, at 6.

251. *See id.*; *see also Arias-Benn*, 495 F.3d at 229 (“[M]any residents of the affected areas experienced refrigerator and freezer damage due to the spoilage and putrefaction of the contents.”).

252. *Arias-Benn*, 495 F.3d at 229; *see also* Brief for Appellants, *supra* note 249, at 6.

253. *Arias-Benn*, 495 F.3d at 229.

254. *See id.*

255. *See id.*

256. *See id.*

257. *Id.*

258. *Id.*; *see* Unfair Trade Practices and Consumer Protection Law, LA. REV. STAT. ANN. § 51:1401-1426 (2003) (permitting a complainant to bring a private cause of action for damages under § 51:1409).

259. *See Arias-Benn*, 495 F.3d at 229. The Federal Rules of Civil Procedure state that, in any pleading, every defense to a claim must be asserted in the responsive pleading given that one is needed, but a party may defend itself by motioning that the other party failed to state a claim upon which relief could be granted. FED. R. CIV. P. 12(b)(6).

260. *Arias-Benn*, 495 F.3d at 229.

261. *Id.*

262. *See id.* at 229-32.

We insure for *accidental direct physical loss* to property described in Coverage B caused by . . . [w]indstorm or hail. This *peril does not include loss* to property contained in a building caused by rain, snow, sleet, sand or dust. This limitation does not apply when the direct force of wind or hail damages the building causing an opening in a roof or wall and the rain, snow, sleet, sand or dust enters through this opening.<sup>263</sup>

Coverage also appeared under two additional specified-risks clauses—“power interruption” and “refrigerated products.”<sup>264</sup> The former provision stated in pertinent part:

POWER INTERRUPTION. We cover *accidental direct physical loss caused directly or indirectly* by a change of temperature which results from power interruption that takes place on the *residence premises*. The power interruption must be caused by a Loss Insured occurring on the *residence premises*. *The power lines off the residence premises must remain energized.*<sup>265</sup>

However, the second specified-risk clause stated:

REFRIGERATED PRODUCTS. Coverage B is extended to *cover the contents of deep freeze or refrigerated units on the residence premises for loss due to power failure or mechanical failure*. If mechanical failure or power failure is known to you, all reasonable means must be used to protect the property insured from further damage or this coverage is void.<sup>266</sup>

Benn asserted that the insurance contract covered “all personal property in a building” if windstorm or hail caused an “accidental direct physical loss.”<sup>267</sup> Citing the Louisiana Supreme Court’s “efficient proximate cause” rule in *Lorio v. Aetna Insurance Co.*, Benn maintained that Hurricane Katrina was the efficient proximate cause of the power outage and residents’ inability to mitigate their losses in refrigerators and freezers.<sup>268</sup> Conversely, State Farm insisted that the language in the “refrigerated products” provision should determine the outcome of the controversy.<sup>269</sup>

263. *Id.* at 231 (emphasis added).

264. *See id.* at 229-32.

265. *Id.* at 232 (emphasis added).

266. *Id.* (emphasis added).

267. *Id.* at 231 (internal quotation marks omitted).

268. Brief for Appellants, *supra* note 249, at 14-15 (“Moreover, since in a great number of factual situations it has been shown that wind is often not the sole contributing cause of the loss or damage, acceptance has been accorded the view that it is sufficient, in order to recover upon a windstorm insurance policy not otherwise limited or defined, that the wind was *the proximate or efficient cause* of the loss or damage, notwithstanding other factors contributing thereto. This is in line with the jurisprudence of our own State.” (emphasis added) (quoting *Lorio v. Aetna Ins. Co.*, 232 So. 2d 490, 493 (La. 1970)) (internal quotation marks omitted)).

269. *See Arias-Benn*, 495 F.3d at 232.

The court of appeals embraced State Farm's argument and stressed that the first priority was determining whether class members' losses were accidental direct physical losses.<sup>270</sup> If they were, determining whether Hurricane Katrina was the efficient proximate cause of those losses would be addressed.<sup>271</sup> To reach a just conclusion, the court applied Louisiana's doctrine of ambiguity<sup>272</sup> and traditional rules of contract construction and interpretation.<sup>273</sup> Without mincing words, the court declared that State Farm did not intend to cover the losses because power outages outside of the class members' residences caused perishables in refrigerators and freezers to spoil.<sup>274</sup> Therefore, the Fifth Circuit affirmed the district court's ruling and concluded that Benn failed to state any claim upon which relief could be granted.<sup>275</sup>

In the second case, *Broussard v. State Farm Fire & Casualty Co.*, Norman and Genevieve Broussard were plaintiffs who owned a home approximately one-fourth of a mile from the Gulf of Mexico, in Biloxi, Mississippi.<sup>276</sup> When Hurricane Katrina arrived on August 29, 2005, storm surge flooding from the Gulf swept away the Broussard's home.<sup>277</sup> Like the homeowners in *Arias-Benn*, State Farm insured the Broussard's residence under a homeowner's insurance policy.<sup>278</sup> The Broussard's, however, did not have flood insurance.<sup>279</sup> Hurricane Katrina left only the house's foundation slab and totally destroyed the Broussard's personal property and dwelling.<sup>280</sup> Therefore, the value of their personal property and dwelling met or exceeded the policy limits.<sup>281</sup>

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270. *Id.*

271. *Id.*

272. *Id.* at 231 (“[A]n insurance contract is to be construed as a whole, and one portion thereof should not be construed separately at the expense of disregarding another.” (quoting *Pareti v. Sentry Indem. Co.*, 536 So. 2d 417, 420 (La. 1988)) (internal quotation marks omitted); *id.* (“Any ambiguity should be construed against the insurer.” (citing LA. CIV. CODE ANN. art. 2056 (1985))).

273. *Id.* (“Under Louisiana law, an insurance policy is a contract between the parties, and it should be construed according to the general rules of contract interpretation set forth in the Civil Code.” (quoting *Riverwood Int'l Corp. v. Employers Ins. of Wausau*, 420 F.3d 378, 382 (5th Cir. 2005)) (internal quotation marks omitted); *id.* (“According to the Civil Code, contract interpretation is the determination of the common intent of the parties.” (citing LA. CIV. CODE ANN. art. 2045 (1985))); *id.* (“[I]ntent is to be determined in accordance with the general, ordinary, plain and popular meaning of the words used in the policy, unless the words have acquired a technical meaning.” (quoting *La. Ins. Guar. Ass'n v. Interstate Fire & Cas. Co.*, 630 So. 2d 759, 763 (La. 1994)) (internal quotation marks omitted)).

274. *Id.* at 232.

275. *Id.*

276. *Broussard v. State Farm Fire & Cas. Co.*, 523 F.3d 618, 622 (5th Cir. Apr. 2008); Brief of State Farm Fire & Casualty Co. at 3, *Broussard*, 523 F.3d 618 (No. 07-60443), 2007 WL 4285863.

277. *Broussard*, 523 F.3d at 622.

278. See *Arias-Benn*, 495 F.3d at 228; *Broussard*, 523 F.3d at 622.

279. *Broussard*, 523 F.3d at 622.

280. See *id.* at 622-23.

281. *Id.* at 623.

Citing both personal- and residential-property losses, the Broussards submitted two claims to State Farm.<sup>282</sup> After inspecting the site, a claims adjuster concluded that flooding rather than wind was the principal cause of the losses.<sup>283</sup> State Farm, therefore, denied the claim.<sup>284</sup>

The Broussards then filed suit in a Mississippi state court against State Farm, seeking extra-contractual and punitive damages for the insurer's alleged breach of contract and bad-faith conduct.<sup>285</sup> State Farm later removed the case to the Southern District of Mississippi.<sup>286</sup>

The case was tried before a jury in two parts—the causation stage and the damages stage.<sup>287</sup> After presenting evidence in the causation phase, each side orally moved for a judgment as a matter of law (JMOL).<sup>288</sup> The district court granted the Broussard's JMOL motion on their personal-property and residential-property claims.<sup>289</sup> And regarding the loss-of-dwelling claim, the court concluded that State Farm had the burden of proving that the excluded peril—flooding—was the cause of the loss of the structure.<sup>290</sup> During the damages stage of the trial, the district court gave a punitive damages charge to the jury.<sup>291</sup> The jury awarded \$2.5 million in punitive damages, which the district court remitted to \$1 million.<sup>292</sup>

State Farm appealed the district court's adverse JMOL ruling and asked the Fifth Circuit to reverse or reduce the jury's punitive damages award.<sup>293</sup> Examining the facts, the court of appeals discovered that the Broussard's homeowner's policy contained two types of coverage.<sup>294</sup> The "open peril" clause covered any accidental direct physical loss to the insured's dwelling.<sup>295</sup> On the other hand, the "named peril" clause covered personal property when specified perils—including windstorm—caused an accidental, direct physical

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282. *Id.*

283. *Id.* at 622-23.

284. *Id.* at 623.

285. *Id.*

286. *Id.*

287. *Id.*

288. *Id.*

289. *Id.* ("[T]he district court found . . . that State Farm was liable under the 'named peril' personal property coverage because windstorm was a named peril.").

290. *Id.* ("The district court noted that State Farm's expert admitted that he could not distinguish between the wind and water damage to the Broussard's home with any reasonable degree of probability. In light of this admission, the district court found that 'there was no sound evidence upon which the finder of fact could rationally determine that [State Farm] had met its burden of proof' and entered JMOL for the Broussards.").

291. *Id.*

292. *Id.*

293. *Id.* ("State Farm also appeal[ed] the district courts denial of [a] motion to strike the testimony of the Broussards' expert, James Slider, a structural engineer who testified that wind or a tornado destroyed the Broussards' home before the Katrina storm surge arrived. Finally, State Farm appeal[ed] the district courts denial of its motion for change of venue.").

294. *Id.*

295. *Id.*



loss.<sup>296</sup> The policy limits for the “open peril” and “named peril” coverage were \$120,698 and \$90,524, respectively.<sup>297</sup>

Notably, two other clauses limited the scope of coverage. An exclusion clause excluded water-related losses:<sup>298</sup>

We do not insure under any coverage for any loss which would not have occurred in the absence of one or more of the following excluded events. . . . Water Damage, meaning: (1) flood, surface water, waves, tidal water, tsunami, seiche, overflow of a body of water, or spray from any of these, all whether driven by wind or not[.]<sup>299</sup>

And the “open peril” and “named risk” coverages were subject to an “Anti-Concurrent Cause” (ACC) clause:

We do not insure under any coverage for any loss which would not have occurred in the absence of one or more of the following excluded events. We do not insure for such loss regardless of: (a) the cause of the excluded event; or (b) other causes of the loss; or (c) whether other causes acted concurrently or in any sequence with the excluded event to produce the loss . . . .<sup>300</sup>

The Fifth Circuit began its analysis by emphasizing that it had decided Katrina-related conflicts involving the same homeowners insurance contract.<sup>301</sup> More importantly, the court noted the clarity of JMOL standards:

[M]otions for JMOL should be granted “only if ‘the facts and inferences point so strongly and overwhelmingly in favor of one party [such that] . . . reasonable men could not arrive at a contrary verdict . . . . On the other hand if there is substantial evidence . . . of such quality and weight that reasonable and fair-minded men in the exercise of impartial judgment might reach different conclusions, the motions should be denied . . . .”<sup>302</sup>

Applying the JMOL standard, the court held that State Farm presented sufficient evidence to withstand a JMOL.<sup>303</sup> Although the Broussards argued

296. *Id.*

297. *Id.*

298. *Id.*

299. Brief of State Farm Fire & Casualty Co., *supra* note 276, at 3-4.

300. *Broussard*, 523 F.3d at 623.

301. *Id.* at 624 (citing *Tuepker v. State Farm Fire & Cas. Co.*, 507 F.3d 346, 350-53 (5th Cir. Nov. 2007) (interpreting a State Farm policy with provisions identical to the Broussards’ policy in all significant respects); *Leonard v. Nationwide Mut. Ins. Co.*, 499 F.3d 419, 423 (5th Cir. Aug. 2007) (holding Nationwide Mutual homeowners insurance policy, including an ACC clause, to be valid and enforceable under Mississippi law).

302. *Broussard*, 523 F.3d at 624 (second and fourth omissions in original) (quoting *Brown v. Bryan County*, 219 F.3d 450, 456 (5th Cir. 2000)).

303. *Id.* at 625.

that “tornadic” winds destroyed their home,<sup>304</sup> “[a] rational jury could conclude, based on the testimony of State Farm’s experts, that the Broussards’ home and personal property were destroyed by water.”<sup>305</sup>

To reach that general conclusion, the court of appeals considered several bits of relevant information.<sup>306</sup> First, the parties had “stipulated that the Broussards’ property was destroyed during Hurricane Katrina [and] that Hurricane Katrina was a windstorm.”<sup>307</sup> But the Fifth Circuit declared that the stipulation “is insufficient to establish that [the property] was destroyed by a windstorm, since Hurricane Katrina unleashed both wind and water forces.”<sup>308</sup> Furthermore, two State Farm experts testified that the storm surge damaged the actual structure of the Broussards’ home.<sup>309</sup> One expert, noting that Katrina’s winds were too weak to cause structural damage to the home, stated “that it was ‘75% likely’ that wind caused a relatively small amount of damage to the Broussards’ roof before the storm surge arrived.”<sup>310</sup>

Thus, the Fifth Circuit held that the district court erred by (1) finding that “windstorm”—a “named peril” under one coverage clause—destroyed personal property simply because the Broussards totally lost their personalty during Hurricane Katrina,<sup>311</sup> and (2) concluding “that State Farm failed to meet its burden of proof under the dwelling coverage was clear error.”<sup>312</sup> Therefore, the court of appeals reversed the district court’s JMOL ruling and vacated the jury’s award of punitive damages.<sup>313</sup> It also remanded the case for a new trial to permit the Broussards to prove that a “covered peril” or a “peril insured against” efficiently and proximately caused the destruction of their personal property.<sup>314</sup>

### 3. *Substantive Question: Under Texas Common Law, Does an Insurer Have a Contractual Duty To Compensate Homeowners for Mold Removal and Remediation*

Mold infestation continues to be a major concern for homeowners in Texas.<sup>315</sup> As a result, insureds are continuing to ask their insurers to pay for

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304. *Id.* at 623-24.

305. *Id.* at 625 (citing *Wall v. Swilley*, 562 So. 2d 1252, 1256 (Miss. 1990)).

306. *Id.* at 624-25.

307. *Id.* at 623.

308. *Id.* at 624-25.

309. *Id.* at 625.

310. *Id.*

311. *Id.* at 624.

312. *Id.* at 625.

313. *Id.* at 631.

314. *Id.* at 625.

315. See, e.g., Ken Rodriguez, *Final Four Fact: No Plan B If Grand Hyatt Fails To Open*, SAN ANTONIO EXPRESS-NEWS, Feb. 20, 2008, at B1, available at 2008 WLNR 3319995 (“The Valley Morning Star reported that Landmark paid \$11 million to settle a 2002 mold lawsuit . . . .”); Traci Shurley, *Lawsuit Blames City for Water Damage & Ailments*, FORT WORTH STAR-TELEGRAM, Jan. 1, 2008, at B1, available at 2008 WLNR

mold remediation and related costs. But fairly often, property insurers refuse to indemnify or pay homeowners, so mold-related controversies continue to appear in state and federal courts.<sup>316</sup> *Carrizales v. State Farm Lloyds* is one of the latest conflicts.<sup>317</sup> Javier and Eva Carrizales purchased a Texas Standardized Homeowners Policy-Form B (Form B) from State Farm Lloyds.<sup>318</sup> During the policy period, plumbing in their garage began to leak.<sup>319</sup> Apparently, the damage was considerable because the Carrizales filed several claims.<sup>320</sup> Ultimately, after inspecting the property and investigating whether any of the Carrizales claims were sound, State Farm paid \$107,724.30.<sup>321</sup>

During the next year and a half, the Carrizales vacated their home and lived in an apartment.<sup>322</sup> State Farm paid an additional \$60,154.52 for those living expenses.<sup>323</sup> While the house was vacant, however, significant repairs did not occur.<sup>324</sup> In fact, the air conditioner and other utilities were turned off.<sup>325</sup> Mold developed, which allegedly generated more than \$200,000 in losses.<sup>326</sup> Therefore, Carrizales submitted three mold-remediation claims to State Farm—all of which were denied.<sup>327</sup>

The Carrizales then sued State Farm in Texas state court, alleging that the insurer violated the Texas Insurance Code, breached the insurance contract, and breached the common law duty of good faith and fair dealing.<sup>328</sup> State Farm removed the case to the Southern District of Texas.<sup>329</sup> Ultimately, the district court granted in part and denied in part the parties' summary judgment

1790586 ("City officials say that they aren't responsible for the damage to the Wards' home and that the 42-inch main was not the cause. . . . In the lawsuit, the Wards say that someone representing the city told them . . . that there was a leak. They and their children have had numerous respiratory ailments, and the family has been advised to move from the home until mold remediation can be performed . . .").

316. See, e.g., *Carrizales v. State Farm Lloyds*, 518 F.3d 343, 345 n.1 (5th Cir. Feb. 2008) (per curiam) ("At least fourteen other suits, by other plaintiffs, were filed against State Farm concerning the mold issue."); Janet Elliott, *Court Says Mold Wasn't Covered / Policy Ruling Is Win for State Farm*, HOUS. CHRON., Sept. 1, 2006, at 1, available at 2006 WLNR 15194115 ("Standard insurance policies used by homeowners to recover billions of dollars in mold losses actually didn't cover mold, the Texas Supreme Court ruled . . . . The Fiesses . . . contended that a significant percentage of the mold had been caused before the flood by leaks in the roof, plumbing, ducts, doors and windows. State Farm paid the couple \$34,425 for mold remediation, but the couple sued in state court, contending the payment was inadequate . . . . State Farm moved the case to federal court, which concluded that the policy excluded mold damage. The Fiesses appealed, and the U.S. 5th Circuit Court of Appeals posed a certified question to the Texas Supreme Court.").

317. *Carrizales*, 518 F.3d at 343.

318. *Id.* at 345.

319. *Id.*

320. *Id.*

321. *Id.*

322. *Id.*

323. *Id.*

324. *Id.*

325. *Id.*

326. *Id.*

327. *Id.*

328. *Id.*; see also *supra* note 106 (discussing Texas's common law duties).

329. *Carrizales*, 518 F.3d at 345.

motions.<sup>330</sup> Granting State Farm's motion for summary judgment, the district court concluded that mold was an excluded peril under Form B.<sup>331</sup> On the other hand, the court granted the Carrizales' summary judgment motion regarding merit of their common law and statutory good faith claims.<sup>332</sup>

After the court barred all evidence of mold or mold-related losses, a jury heard the case.<sup>333</sup> At the close of evidence, the court fashioned a controversial jury charge.<sup>334</sup> In essence, it stated that the Carrizales' mitigation of damages was a condition precedent for State Farm's duty to pay under Form B.<sup>335</sup> In the end, State Farm prevailed.<sup>336</sup> The Carrizales appealed, asking the Fifth Circuit to address three issues: (1) whether the district court's summary judgment in favor of State Farm was proper, (2) whether the district court's preventing jurors from considering mold-related evidence was proper, and (3) whether the district court's mitigation-of-damages jury charge was erroneous.<sup>337</sup>

As a threshold matter, however, the court of appeals observed that the Texas Supreme Court has never addressed an overriding question: whether plumbing-related mold contamination is a covered risk under Form B.<sup>338</sup> The Fifth Circuit, therefore, made an "Erie guess" by reviewing two doctrines that Texas courts employ to construe words and phrases in insurance contracts: (1) the general rules of contract construction<sup>339</sup> and (2) the doctrine of ambiguity.<sup>340</sup>

Examining Form B, the court of appeals found coverage and exclusion provisions that were similar to the homeowners' insurance contract in *Broussard*.<sup>341</sup> In particular, Form B divided coverage into two parts: (1) "Coverage A" insured the Carrizales' dwelling against "all-risks," and (2) "Coverage B" insured the Carrizales' personal property against enumerated "specific perils," including leaks in the plumbing.<sup>342</sup> The specific-risks clause read as follows:

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330. *Id.*

331. *Id.*

332. *Id.*

333. *Id.*

334. *Id.*

335. *Id.*

336. *Id.*

337. *Id.*

338. *Id.*

339. *Id.* at 345-46 (noting that insurance contracts are subject to normal rules of contract construction (citing *Nat'l Union Fire Ins. Co. v. CBI Indus., Inc.*, 907 S.W.2d 517, 520 (Tex. 1995))); *id.* at 346 (noting that all parts of a contract must be read together to give effect to the parties' intent (citing *State Farm Life Ins. Co. v. Beaston*, 907 S.W.2d 430, 433 (Tex. 1995))).

340. *Id.* ("Ambiguities in insurance contracts giving rise to two reasonable interpretations, one providing and the other denying coverage, are read . . . in favor of the insured." (citing *Puckett v. U.S. Fire Ins. Co.*, 678 S.W.2d 936, 938 (Tex. 1984))).

341. *See id.*; *supra* text accompanying notes 295-96.

342. *Carrizales*, 518 F.3d at 346.

*Accidental Discharge, Leakage or Overflow of Water or Steam* from within a Plumbing, Heating or Air Conditioning System or Household Appliance. A loss resulting from this peril includes the cost of tearing out and replacing any part of the building necessary to repair or replace the system or appliance. But this does not include loss to the system or appliance from which the water or steam escaped.<sup>343</sup>

Like the plan in *Broussard*,<sup>344</sup> however, an exclusion clause placed limitations on the “all-risk” and “specific-risks” coverages: “We do not cover loss [under Coverage A or Coverage B] caused by . . . rust, rot, mold or other fungi.”<sup>345</sup>

Again, the overriding question was whether plumbing-related mold contamination was a covered risk under Form B.<sup>346</sup> Clearly, the exclusion clause stated that mold was not a covered risk under either Coverage A or Coverage B.<sup>347</sup> Under Coverage B, however, the insurer contracted to pay insurance proceeds if an accidental discharge, leakage or overflow of water from within the plumbing system damaged the Carrizales’ personal property.<sup>348</sup> Thus, did State Farm have a duty to pay if a leak in the plumbing caused mold to grow throughout the dwelling as well as on personal property?<sup>349</sup> And was the mold-exclusion clause confusing when read in conjunction with the “specified-risk” clause?<sup>350</sup>

The Carrizales thought so. Citing the doctrine of ambiguity and the Texas Supreme Court’s holding in *Balandran v. Safeco Insurance Co.*, they argued that coverage should be extended anytime an ambiguous provision may be interpreted to provide coverage.<sup>351</sup> But embracing the Texas Supreme Court’s analysis and decision in *Fiess v. State Farm Lloyds*, rather than in *Balandran*, the Fifth Circuit concluded that the two provisions in Form B did not create any ambiguity when read together.<sup>352</sup> The court of appeals noted that the Texas Supreme Court decided this very question in *Fiess* and reached the same conclusion holding that “[w]hile other parts of the policy sometimes make it difficult to decipher, [the court could not] hold that mold damage is covered when the policy says it is not.”<sup>353</sup> Therefore, the court did not resolve the

343. *Id.* at 346 n.2.

344. *See supra* notes 298-300 and accompanying text.

345. *Carrizales*, 518 F.3d at 346 n.3.

346. *Id.* at 344.

347. *See id.* at 346 n.3.

348. *Id.* at 346; *see supra* note 343 and accompanying text.

349. *Carrizales*, 518 F.3d at 345.

350. *See id.* at 346.

351. Brief of Appellants at 12, *Carrizales*, 518 F.3d 343 (No. 06-40286), 2006 WL 5721817 (“Where an ambiguity involves an exclusionary provision of an insurance policy, [courts] must adopt the construction urged by the insured as long as the construction is not unreasonable, even if the construction urged by the insurer appears to be more reasonable or a more accurate reflection of the parties intent.” (quoting *Balandran v. Saveco Ins. Co.*, 972 S.W.2d 738, 741 (Tex. 1998))); *see Carrizales*, 518 F.3d at 346-47.

352. *See Carrizales*, 518 F.3d at 347-48.

353. *Id.* at 347-48 (“First, the [Texas Supreme Court] noted that the words ‘we do not cover loss caused

second issue regarding whether the trial court properly excluded mold-related evidence because Form B did not cover mold.<sup>354</sup>

But the court did address the last issue regarding whether the jury instruction required the Carrizales to mitigate damages in order to be able to recover.<sup>355</sup> The Carrizales argued that mitigation of damages was not a condition precedent—and therefore an affirmative defense—to liability, but rather that it was an issue that the jury should decide when determining the amount of damages to award.<sup>356</sup>

The Fifth Circuit agreed.<sup>357</sup> First, the court observed that “the duty to mitigate damages is an equitable doctrine, and means a reduction in the amount of damages, not an affirmative defense.”<sup>358</sup> But the court of appeals discovered that Texas courts had not yet decided whether the duty to mitigate damages is an offset to reimbursement under the generic homeowners’ policy or a condition precedent to recovery.<sup>359</sup> Making an *Erie* guess, the Fifth Circuit concluded that under Texas law mitigation of damages is an offset, not a condition precedent.<sup>360</sup> Therefore, the appellate court reversed and remanded the case for consideration of the Carrizales’ breach of contract action.<sup>361</sup>

#### 4. *Substantive Question: Under Texas Common Law, Does a Property Insurer Have a Contractual Duty To Pay for Losses After an Intentional Fire Destroyed the Insured’s House and Personal Property*

Arguably, the average layperson in Texas would find the disagreement in *Muñoz v. State Farm Lloyds of Texas* easy to understand.<sup>362</sup> The underlying facts are not intricate, and the legal questions are not novel. That same awareness, however, might cause property owners in Texas to find more than a bit of irony in the Fifth Circuit’s opinion. The insurer in *Muñoz* maintained

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by mold’ in Section I are plain and unambiguous. Second, the ensuing loss provision did not rewrite the first line to say ‘we *do too* cover loss caused by mold.’ With respect to what exactly the ensuing loss provision accomplished, the court reaffirmed that the only reasonable construction of this clause was that it applied when an excluded risk was followed by an intervening occurrence that in turn caused an ensuing loss.’ Notwithstanding *Balandran, Fiess* shows an obvious direction in the Texas Supreme Court’s mold jurisprudence that is easier to reconcile with the result we reach in this case than with the result plaintiffs ask us to announce.” (citations omitted) (quoting *Fiess v. State Farm Lloyds*, 202 S.W.3d 744, 745, 748 (Tex. 2006)).

354. *Id.* at 348 (“The question in this case is not whether insurers should provide mold coverage in Texas, a public policy question beyond our jurisdiction as a court. The question instead is whether the language in an insurance policy provides such coverage—no more and no less.’ Here it does not.” (citations omitted) (quoting *Fiess*, 202 S.W.3d at 745)).

355. *Id.* at 348-51.

356. *Id.* at 348-49.

357. *Id.* at 349.

358. *Id.* at 350 (citing *Hygeia Dairy Co. v. Gonzalez*, 994 S.W.2d 220, 225 (Tex. App.—San Antonio, 1999)).

359. *Id.*

360. *Id.*

361. *Id.*

362. See *Muñoz v. State Farm Lloyds of Tex.*, 522 F.3d 568, 570 (5th Cir. Mar. 2008).

that the insured's conduct "prejudiced" the insurer's decision to perform.<sup>363</sup> Yet without citing or applying an iota of Texas law, the Fifth Circuit applied the law of the circuit and concluded that the insurer was indeed "prejudiced."<sup>364</sup> Put simply, the analysis in *Muñoz* is less than stellar, and the decision is highly questionable.<sup>365</sup> Without a doubt, those attributes do very little to dispel a prevailing view that the Fifth Circuit is a pro-insurer court.<sup>366</sup>

Here are the most salient facts—many of which were omitted from the opinion. Luis and Carmela Muñoz lived in Raymondville, Texas, where Luis owned a profitable roofing and construction company.<sup>367</sup> They and the Cavazos, their next-door neighbors, had an on-going dispute over a remodeling contract, which required the police to visit the residences at least twenty-one times.<sup>368</sup> Additionally, the Muñozes and the Cavazos had an on-going court battle.<sup>369</sup> This animosity culminated in Carmela's receiving anonymous phone threats, stating that the Muñozes' house would be burned down.<sup>370</sup> Then on January 1, 2003, when Carmela was out of town on vacation and Luis was at his place of business, someone intentionally started a fire at the Muñozes' residence.<sup>371</sup>

For ten years, State Farm Lloyds insured the Muñozes' residential property under a homeowner insurance contract, which insured against fire and other perils.<sup>372</sup> The day after the fire, Luis called State Farm and filed a claim, and the following day, State Farm employee inspected the Muñozes' residence.<sup>373</sup> Ten days later, on January 13, 2003, the Muñozes answered various questions on a Personal Property Inventory Form and returned the form to the insurer.<sup>374</sup>

Under the terms of the policy, State Farm had a duty to notify the Muñozes in writing within thirty days whether the company would pay or deny the claim, or whether more information was needed.<sup>375</sup> State Farm did not request additional information until March 18, 2003—more than sixty days after State Farm received the Muñozes' Personal Property Inventory Forms.<sup>376</sup> State Farm also referred the claim to its special investigations unit, and

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363. *Id.* at 571.

364. *Id.* at 574-75.

365. *See id.*

366. *See supra* notes 245-46 and accompanying text.

367. *See* Brief for Appellees/Cross-Appellants at 4, *Muñoz*, 522 F.3d 568 (No. 06-40827), 2007 WL 5356672.

368. *Id.* at 5.

369. *Id.*

370. *Id.*

371. *Id.*

372. *Id.*; *see Muñoz v. State Farm Lloyds of Tex.*, 522 F.3d 568, 571 (5th Cir. Mar. 2008).

373. Brief for Appellees/Cross-Appellants, *supra* note 367, at 5.

374. *Id.*

375. *Id.* at 6.

376. *Id.* at 6-7.

between April 22, 2003, and June 10, 2003, State Farm requested, and the Muñozes delivered, very personal information to the insurer.<sup>377</sup>

After responding to State Farm's demands and receiving no financial assistance for nearly two years, the Muñozes sued the insurer in a Texas state court on May 11, 2004.<sup>378</sup> The complaint alleged that State Farm breached the insurance contract, violated the Texas Insurance Code, and breached the common law duty of good faith and fair dealing.<sup>379</sup> State Farm removed the case to the Southern District of Texas, asserting that (1) the Muñozes breached a condition precedent in the insurance contract by refusing to deliver requested documents to State Farm and (2) the Muñozes intentionally destroyed their house, which was not a covered peril under the policy.<sup>380</sup>

Before the jury trial, the parties stipulated that someone intentionally started the fire.<sup>381</sup> During trial, however, State Farm presented evidence that Luis failed a polygraph exam.<sup>382</sup> The Muñozes countered with evidence that a grand jury did not indict Luis for arson.<sup>383</sup>

Ultimately, the jury returned a verdict overwhelmingly in favor of the Muñozes. First, it found that the Muñozes did not breach any conditions precedent in the insurance policy, State Farm breached the insurance contract, the Muñozes did not intentionally set the fire, and the Muñozes' damages were \$148,000 for home repairs and \$82,700 to repair or replace the contents.<sup>384</sup> Second, the jury found that State Farm breached the common law duty of good faith and fair dealing.<sup>385</sup> And despite concluding that State Farm's alleged deceptive trade practices and bad faith did not cause any economic damages, the jury still ordered the insurer to pay \$20,000 for the Muñozes' mental anguish.<sup>386</sup> Finally, the "jury found that State Farm did knowingly engage in the deceptive trade practices" but awarded no additional damages.<sup>387</sup> After

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377. *Id.* at 7-8 ("The first set of documents . . . was delivered to State Farm on April 22, 2003. Thereafter, the Muñozes delivered a second set of documents to State Farm in June of 2003. [One document requested an] authorization to obtain the Muñozes credit reports and [the other requested] an authorization to obtain Mrs. Muñoz's W-2 forms from employers. . . . Moreover, the Muñozes [gave the insurer permission to review] numerous bank records and business records." (citations to the record omitted)).

378. *Id.* at 2.

379. *Muñoz v. State Farm Lloyds of Tex.*, 522 F.3d 568, 571 (5th Cir. Mar. 2008); *see also supra* note 106 (discussing Texas's common law duties).

380. *Muñoz*, 522 F.3d at 571.

381. *Id.*

382. *Id.*

383. *Id.*

384. *Id.*

385. *Id.*; *see also* Brief for Appellees/Cross-Appellants, *supra* note 367, at 10 (noting, more specifically, that the jury found that State Farm did not attempt, "in good faith, to effectuate a fair settlement after its liability had become reasonably clear; [did not] affirm or deny coverage of the claim within a reasonable time; and [refused] to pay the claim without conducting a reasonable investigation").

386. *Muñoz*, 522 F.3d at 571; Brief for Appellees/Cross-Appellants, *supra* note 367, at 10.

387. Brief for Appellees/Cross-Appellants, *supra* note 367, at 10; *see Muñoz*, 522 F.3d at 571.



adjusting some of the damages the district court entered judgment on the jury's verdict.<sup>388</sup>

On appeal, State Farm insisted that it had been the victim of "prejudice" before and during the trial.<sup>389</sup> Therefore, State Farm presented two questions for review: (1) whether State Farm had to prove that the Muñozes' breach of a condition precedent prejudiced State Farm's benefit of the bargain under the insurance contract, or alternatively whether State Farm was prejudiced as a matter of law;<sup>390</sup> and (2) whether the district court issued an erroneous and prejudicial ruling when it admitted evidence of a grand jury's failure to indict Luis Muñoz for arson.<sup>391</sup>

Unfortunately, several factors prevented the Fifth Circuit's analysis in *Muñoz* from being a well-reasoned decision. For unknown reasons, the decision's most obvious defect is that the court did not address whether the Muñozes' alleged breach of a condition precedent prejudiced State Farm's ability to protect its rights under the contract. To be sure, this was a serious omission for several reasons.

For one, the insurance contract required the Muñozes to satisfy a condition precedent—deliver various documents to State Farm—before receiving insurance proceeds.<sup>392</sup> But the facts are indisputable: the Muñozes delivered the requested documents for nearly two years.<sup>393</sup>

More importantly, the court's failure to address the "materiality" of the alleged breach of the condition is a serious oversight for another reason: Texas law clearly states that a condition precedent or subsequent in an insurance contract "will not operate to discharge the insurer's obligations under the policy unless the insurance company is actually prejudiced or deprived of a valid defense by the actions of the insured."<sup>394</sup> But there is more. Under Texas law, an insured's "immaterial breach" of a condition in an insurance contract "does not deprive the insurer of the benefit of the bargain and thus cannot relieve the insurer of the contractual coverage obligation."<sup>395</sup> Stated more specifically, if an insurer cannot establish that an insured's inaction produces

388. Brief for Appellees/Cross-Appellants, *supra* note 367 at 11; see *Muñoz*, 522 F.3d at 571-72. The district court reduced the damage award for contents by \$2,500, and added \$79,451.11 in penalty interest, \$26,976.96 in pre-judgment interest, and \$130,860.17 in costs and attorneys fees. Brief for Appellees/Cross-Appellants, *supra* note 367 at 11.

389. Appellant's Brief at 31, *Muñoz*, 522 F.3d 568 (No. 06-40827), 2007 WL 5356671.

390. *Id.* at 17.

391. *Id.* at 35. A fair reading of the decision also indicates that State Farm wanted the Fifth Circuit to address a third question: whether State Farm had a duty to pay, even though the Muñozes intentionally set fire to their house. See *Muñoz v. State Farm Lloyds*, 522 F.3d 568, 571 (5th Cir. Mar. 2008) ("State Farm removed the case to federal court, asserting . . . [that] the Muñozes could not recover because they had set fire to their house."). But the court did not address this issue, even though the court mentioned the "intentionally set fire" several times. *Id.* Notably, the parties briefs do not discuss this question.

392. See *Muñoz*, 522 F.3d at 571.

393. See *id.*

394. See *McGuire v. Commercial Union Ins. Co.*, 431 S.W.2d 347, 353 (Tex. 1968).

395. *PAJ, Inc. v. Hanover Ins. Co.*, 243 S.W.3d 630, 631 (Tex. 2008) (citing *Hernandez v. Gulf Group Lloyds*, 875 S.W.2d 691, 692 (Tex. 1994)).

“prejudice,” an insured’s failure to comply with a condition precedent does not defeat coverage under an insurance contract.<sup>396</sup>

But perhaps most importantly, the Texas Supreme Court has embraced a multi-pronged test to determine whether a breach of a condition in an insurance contract is “material”:

(i) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived; (ii) the extent to which the party failing to perform or to offer to perform will suffer forfeiture; (iii) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances; and (iv) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.<sup>397</sup>

Once more, the court of appeals completely overlooked this body of law.

Instead, the Fifth Circuit then discussed State Farm’s second issue of whether the district court erred by admitting evidence of a grand jury’s failure to indict Luis Muñoz for arson.<sup>398</sup> But that analysis is not thorough either. Even more troubling, the court of appeals reached its conclusion without citing, discussing, or applying any Texas law. Rather, the court tersely stated that it would rely on the holdings of its sister courts:

Several of our sister circuits have considered the issue of introducing evidence of non-prosecution or acquittal of arson in a civil case regarding insurance proceeds. They have uniformly held that such evidence is impermissible because it is highly prejudicial. . . . We agree with our sister circuits and find that the court below committed reversible error.<sup>399</sup>

This decision is less than ideal. Citing Rules 401 and 403 of the Federal Rules of Evidence, State Farm timely objected to the non-indictment evidence.<sup>400</sup> A careful reading reveals that Rule 403 requires a federal court to find “unfair prejudice” which is “an undue tendency to suggest decision on an

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396. *See id.* at 636-37.

397. *Id.* at 693 n.2 (citing RESTATEMENT (SECOND) OF CONTRACTS §241 (1981)). “In determining the materiality of a breach, courts will consider, among other things, the extent to which the nonbreaching party will be deprived of the benefit that it could have reasonably anticipated from full performance.” *Id.* at 693 (citing RESTATEMENT (SECOND) OF CONTRACTS § 241(a) (1981)).

398. *Muñoz v. State Farm Lloyds*, 522 F.3d 568, 572-74 (5th Cir. March 2008).

399. *Id.* at 572-73 (citations omitted).

400. *Id.*; *see* FED. R. EVID. 401 (““Relevant evidence’ means evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence.”); FED. R. EVID. 403 (“Although relevant, evidence may be excluded if its probative value is substantially outweighed by the danger of *unfair prejudice*, confusion of the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence.” (emphasis added)).

improper basis, commonly, though not necessarily, an emotional one.”<sup>401</sup> But in *Muñoz*, the court of appeals concluded that jurors heard “prejudicial evidence.”<sup>402</sup> The appellate court did not apply any test to determine whether that prejudice was “unfair.”<sup>403</sup> To be sure, that is a significant omission because federal courts, and the Fifth Circuit in particular, have held that “Rule 403 [is] an extraordinary remedy, [which should] be used cautiously and sparingly.”<sup>404</sup>

Arguably, this last observation really underscores the problems with the court of appeals analysis in *Muñoz*. Rule 403 of the Texas Rules of Evidence is very similar to the Federal Rule of Evidence 403.<sup>405</sup> Omitting the phrase “waste of time,” the Texas rule states, “Although relevant, evidence may be excluded if its probative value is substantially outweighed by the danger of *unfair prejudice*, confusion of the issues, or misleading the jury, or by considerations of undue delay, or needless presentation of cumulative evidence.”<sup>406</sup> Although Rule 403 gives courts a considerable amount of discretion, courts may exclude evidence only if the danger of unfair prejudice exceeds the evidence’s probative value.<sup>407</sup> The Fifth Circuit should have thoroughly researched and applied Texas law before reversing the district court’s judgment, remanding the case, and ordering a new trial. Without a doubt, the district court’s judgment and rulings were more sound than the Fifth Circuit’s analysis in *Muñoz*.

401. *Steger v. Gen. Elec. Co.*, 318 F.3d 1066, 1079 (11th Cir. 2003) (quoting FED. R. EVID. 403 advisory committee’s note) (internal quotation marks omitted).

402. *See Muñoz*, 522 F.3d at 573-74 (“State Farm was presented with the fact that Mr. Garza intended to reference the non-indictment evidence during closing argument. The district court asked State Farm for the ‘language of the instruction it desired.’ In requesting that Mr. Garza not be permitted to mention the evidence, State Farm was merely attempting to prevent further prejudicial error. . . . State Farm did not abandon, waive, or otherwise sanction the district court’s initial error of admitting the non-indictment evidence. . . . State Farm timely objected and was overruled. *Given the highly prejudicial nature of the non-indictment evidence*, we find that the district court abused its discretion and committed reversible error, notwithstanding its good faith attempt to remedy its mistake.” (emphasis added)).

403. *See id.*

404. *Christophersen v. Allied-Signal Corp.*, 939 F.2d 1106, 1135 (5th Cir. 1991) (Reavley, J., dissenting) (“The advisory committee notes to Rule 403 define ‘unfair prejudice’ as ‘an undue tendency to suggest decision on an improper basis.’ . . . We have viewed Rule 403 as an extraordinary remedy to be used cautiously and sparingly” (citing *United States v. McRae*, 593 F.2d 700, 707 (5th Cir. 1979); *Dollar v. Long Mfg., N.C. Inc.*, 561 F.2d 613, 618 (5th Cir. 1977))); *see also United States v. Thevis*, 665 F.2d 616, 634 (5th Cir. Unit B 1982) (“[T]he application of Rule 403 must be cautious and sparing.”).

405. *See Shields v. Dretke*, 122 F. App’x 133, 149 (5th Cir. 2005) (“Under both the Federal Rules of Evidence and the Texas Rules of Evidence, relevant evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice. The advisory committees notes to Rule 403 define ‘unfair prejudice’ as ‘an undue tendency to suggest decision on an improper basis, commonly though not necessarily, an emotional one,’ and we have adopted this definition.”).

406. *Compare TEX. R. EVID. 403* (emphasis added), *with FED. R. EVID. 403*.

407. *See Aragon v. State*, 229 S.W.3d 716, 724 (Tex. App.—San Antonio 2007) (“[B]efore Rule 403 requires an exclusion of evidence, there must be a marked distinction between the evidence’s probative value and any danger of unfair prejudice. Unfair prejudice is defined as the undue tendency of the evidence to suggest a decision on an improper basis.” (internal citations omitted)).

### III. THIRD-PARTY INSURANCE CONTRACTS—STATE COMMON LAW CLAIMS & DECISIONS

#### A. *Third-Party Liability Claims—Injury to Persons*

##### *1. Substantive Question: Whether Louisiana Law Gives Standing to a Bankruptcy Trustee To Commence a Legal-Malpractice Action Against an Insurance-Defense Law Firm as Well as a Right To Collect Damages from the Errors and Omission Liability Insurer That Hired the Law Firm To Represent the Debtor-Insured*

*Stanley v. Trinchar*d is a truly fascinating case because the controversy involves multiple areas of federal and state law—civil rights, bankruptcy, insurance, legal malpractice, common law breach of contract, and statutory violations.<sup>408</sup> Furthermore, the opinion is thoughtful and thorough. But even more importantly, the opinion is populated densely with challenging facts, multiple levels of intricate rules, and exceptions to rules. Therefore, it presents a clear illustration of why law schools should always encourage students to think critically about overlaying issues and applying rules intelligently instead of just memorizing and enumerating rules on law examinations.

This controversy involves four lawsuits with three underlying lawsuits—a criminal trial, a civil rights trial, and a bankruptcy proceeding.<sup>409</sup> The present suit is a legal-malpractice action filed against the insurer and an insurance-defense law firm.<sup>410</sup> It all started on October 17, 1980, when Douglas Frierson was murdered in St. Tammany Parish in Louisiana.<sup>411</sup> Gary Hale was a detective in the St. Tammany Parrish Sheriff's Office at the time, and spending seven days investigating the murder, his information implicated Gerald Burge, who was subsequently arrested for the murder.<sup>412</sup>

Concluding that there was insufficient evidence to secure a conviction, however, the St. Tammany Parish District Attorney (TPDA) decided against prosecuting Burge.<sup>413</sup> But when Burge was incarcerated in a Mississippi correctional facility on an unrelated criminal conviction, he was indicted for murdering Frierson after a fellow inmate reported that Burge was “the trigger man.”<sup>414</sup> He was then tried and sentenced to prison.<sup>415</sup> After petitioning for

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408. *Stanley v. Trinchar*d, 500 F.3d 411 (5th Cir. Sept. 2007).

409. *See id.* at 415.

410. *See id.*

411. Original Brief of Defendant-Appellee, Northwestern National Insurance Co. at 3, *Stanley*, 500 F.3d 411 (Nos. 06-30120, 06-30299), 2006 WL 5012891.

412. *Id.* at 3-4.

413. *Id.* at 4-5.

414. *Id.* at 4.

415. *Id.* at 5.

post-conviction remedies, Burge secured a second trial.<sup>416</sup> Ultimately, the second jury concluded that Burge was not guilty of murdering Frierson.<sup>417</sup>

Before the first criminal trial began, Burge's attorney had asked the state to turn over all exculpatory materials, and the prosecution responded.<sup>418</sup> But allegedly the state did not turn over copies of reports that Hale prepared during his investigation—reports that purportedly implicated Burge's inmate rather than Burge.<sup>419</sup> Therefore, Burge filed a § 1983 civil rights suit against the sheriff of St. Tammany Parish, the St. Tammany Parish Sheriff's Office, and detective Hale.<sup>420</sup> Because Northwestern National Insurance Company (NNIC) insured the Sheriff's Office under a liability-insurance contract, Burge also listed NNIC as a defendant.<sup>421</sup> Stated simply, Burge sought damages for the defendant's alleged breach of his federal constitutional rights.<sup>422</sup> He asserted that the state withheld exculpatory evidence at his first trial, which would have prevented his conviction and incarceration for the death of Frierson.<sup>423</sup>

NNIC retained Trinchard & Trinchard law firm to represent the sheriff and Hale.<sup>424</sup> Later, NNIC retained separate counsel to represent NNIC's interests in the litigation.<sup>425</sup> Shortly before the civil rights suit began, NNIC's counsel reached a partial settlement with Burge.<sup>426</sup> In exchange for \$75,000, Burge agreed to release NNIC from all liability under insurance policies.<sup>427</sup> Burge also gave the sheriff and Hale partial releases for any civil rights violations that occurred during the policy period.<sup>428</sup> But Burge expressly reserved his right to sue the sheriff and Hale for punitive damages and for violations that occurred outside of the policy period.<sup>429</sup>

Hale consented to the settlement and signed a separate "Release and Acknowledgment," which absolved NNIC from "any and all liability" under the insurance contracts—including "claims for indemnification, defense, legal

416. *Id.*

417. *Id.*

418. *Id.* at 4.

419. *Id.* at 4-5.

420. *Id.* at 5; see *Stanley v. Trinchard*, 500 F.3d 411, 415-416 (5th Cir. Sept. 2007) (summarizing the facts briefly); see also 42 U.S.C. § 1983 (2000). Section 1983 does not create federal, substantive rights. *Jackson v. Atlanta, Tex.*, 73 F.3d 60, 63 (5th Cir. 1996). Instead, it creates a private right of action and provides a possible remedy whenever anyone, acting under color of state law, deprives a person of federal rights, privileges, or immunities; violation of state law, by itself, does not allow for relief under § 1983. See *id.*

421. *Stanley*, 500 F.3d at 416 ("In 1980, American Druggists Insurance Company (ADIC) issued a liability insurance policy . . . to the Louisiana Sheriffs Association. . . . When ADIC became insolvent in 1986, its reinsurer, NNIC, assumed responsibility for any coverages under the ADIC policies pursuant to a 'cut-through' reinsurance endorsement.").

422. Original Brief of Defendant-Appellee, *Northwestern National Insurance Co.*, *supra* note 411, at 5-6.

423. *Id.* at 6.

424. *Stanley*, 500 F.3d at 417.

425. *Id.*

426. *Id.*

427. *Id.*

428. *Id.*

429. *Id.*

fees and costs, [and] bad faith.”<sup>430</sup> The release did not outline the terms of the settlement, and therefore, Hale did not know that Burge reserved his right to sue Hale for conduct occurring outside of the policies’ periods.<sup>431</sup> After securing Hale’s consent to release NNIC, Trincharde’s lawyers stopped representing Hale and the sheriff.<sup>432</sup> But again, at that point, Hale was still exposed to a potential lawsuit for his conduct beyond coverage under the liability insurance contracts.<sup>433</sup>

Five months after the settlement, Burge exercised his right under the partial release agreement and sued the sheriff and Hale.<sup>434</sup> A different law firm represented the sheriff, and Hale defended himself.<sup>435</sup> A federal district court jury decided in favor of Burge and awarded \$4,000,000 in compensatory damages.<sup>436</sup> After the court entered the judgment, Hale did not appeal, and a month later, that judgment forced Hale into involuntary bankruptcy.<sup>437</sup> The U.S. Bankruptcy Court for the Southern District of Mississippi appointed H.S. Stanley, Jr., as Trustee of the Bankruptcy Estate of Gary Hale.<sup>438</sup> Burge was Hale’s only creditor, and ultimately, Hale was discharged from bankruptcy.<sup>439</sup>

Six months after becoming the trustee, however, Stanley filed a legal malpractice action against the attorneys in Trincharde & Trincharde law firm and NNIC.<sup>440</sup> The action commenced in the District Court for the Eastern District of Louisiana, and the complaint alleged that (1) Trincharde’s attorneys negligently represented Hale, and (2) NNIC had breached its fiduciary duty of good faith and fair dealing when the insurer partially settled the civil rights suit.<sup>441</sup> Granting Trincharde and NNIC’s respective motion for summary judgment, the district court reached two holdings: (1) Hale’s bankruptcy discharge made it impossible for Stanley to establish that the attorneys’ alleged malpractice caused the judgment against Hale, and (2) Stanley failed to produce any evidence of NNIC’s alleged breach of a fiduciary duty of good faith and fair dealing under Louisiana law.<sup>442</sup> Stanley appealed the district

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430. *Id.*

431. *Id.*

432. *Id.*

433. *Id.*

434. *Id.*

435. *Id.*

436. *Id.* Citing prosecutorial immunity, a federal district court dismissed Burge’s claims against the District Attorney’s Office and individual prosecutors. *Id.* at 416 n.2 (citing *Burge v. Parish of St. Tammany*, Civ. A. No. 91-2321, 1994 WL 86694 (E.D. La. Mar. 9, 1994), *affd on other grounds*, 187 F.3d 452 (5th Cir. 1999)). “Burge voluntarily dismissed the Sheriff’s Office as a defendant early in the case, but continued to pursue his claims against the Sheriff in his official capacity.” *Id.*

437. *See id.* at 417-18.

438. Original Brief of Defendant-Appellee, *Northwestern National Insurance Co.*, *supra* note 411, at 7.

439. *Stanley*, 500 F.3d at 418.

440. *Id.*

441. *Id.*

442. *Id.*

court's rulings in the legal malpractice suit, arguing that those rulings were based on erroneous interpretations of the law.<sup>443</sup>

The Fifth Circuit structured the first appellate issue this way: whether Hale's bankruptcy discharge barred Stanley from commencing a legal malpractice action against Trinchard's attorneys, because Hale's alleged injury occurred before Hale filed for bankruptcy.<sup>444</sup> The district court concluded that it did, but the Fifth Circuit refused to embrace that conclusion.<sup>445</sup>

The court of appeals began its analysis by stressing that the district court failed to distinguish between Hale's individual interests and the interests of the bankruptcy estate.<sup>446</sup> Unquestionably, this distinction is important for several reasons. Under federal bankruptcy law, a bankruptcy estate comprises all "legal or equitable interests [of the debtor] in property as of the commencement of the [bankruptcy] case."<sup>447</sup> Thus, the estate includes any causes of action belonging to the debtor when the bankruptcy proceeding begins,<sup>448</sup> a trustee of the bankruptcy estate may pursue any claims that are the estate's property.<sup>449</sup> Further, these pre-petition rights in property are determined according to state law.<sup>450</sup>

Applying these rules, the Fifth Circuit concluded that the district court's summary judgment ruling was erroneous because, among other reasons, Hale's legal malpractice action against Trinchard accrued at least a month before the civil rights judgment forced Hale into bankruptcy.<sup>451</sup> As a consequence, Stanley had a right to sue the insurance defense lawyers because Hale's right to commence a legal malpractice action became part of the bankruptcy estate.<sup>452</sup>

Moving to the second issue, Stanley asked the Fifth Circuit to address whether the district court erred by concluding Stanley's evidence was insufficient to prove that NNIC breached its statutory duty of good faith and fair dealing.<sup>453</sup> This statutory duty from La. Rev. Stat. Ann. § 22:1220(A) states in pertinent part:

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443. *Id.*

444. *Id.* at 421.

445. *See id.* at 421-22.

446. *See id.* at 422.

447. *See id.* at 418 (alteration in original) (quoting *In re Segerstrom*, 247 F.3d 218, 223 (5th Cir. 2001)).

448. *See id.* (quoting *In re Segerstrom*, 247 F.3d at 223).

449. *See id.* (citing 11 U.S.C. § 323; *Wieburg v. GTE Sw. Inc.*, 272 F.3d 302, 306 (5th Cir. 2001) ("Because the claims are property of the bankruptcy estate, the Trustee is the real party in interest with exclusive standing to assert them.")).

450. *See id.* (quoting *In re Segerstrom*, 247 F.3d at 224).

451. *Id.* at 419.

452. *See id.* at 425 ("[W]e hold that, at the time bankruptcy proceedings commenced, Hale had incurred a legal injury—in the form of an adverse money judgment—sufficient to allow Stanley to assert a legal malpractice claim against the Trinchard defendants on behalf of Hale's bankruptcy estate and that Hale's subsequent discharge from personal liability for that judgment had no effect on the right and duty of the trustee to pursue that claim.")

453. *See id.* at 426.

An insurer . . . owes to his insured a duty of good faith and fair dealing. The insurer has an affirmative duty to adjust claims fairly and promptly and to make a reasonable effort to settle claims with the insured or the claimant, or both. Any insurer who breaches these duties shall be liable for any damages sustained as a result of the breach.<sup>454</sup>

In addition, subsection (B) of the statute lists a variety of acts that constitute a breach of an insurer's duties.<sup>455</sup>

Although the district court concluded that the bankruptcy trustee failed to identify NNIC's prohibited conduct under § 22:1220(B), the Fifth Circuit disagreed.<sup>456</sup> After examining the facts and the contract, the court of appeals held that Stanley actually accused NNIC of breaching an implied covenant of good faith and fair dealing.<sup>457</sup> To reach that conclusion, the court cited *Theriot v. Midland Risk Insurance Co.*, in which the Louisiana Supreme Court declared that § 22:1220(A) "recognizes the *jurisprudentially* established duty of good faith and fair dealing [that an insurer owes an] insured, which is an outgrowth of the contractual and fiduciary relationship between the insured and insurer."<sup>458</sup> The supreme court also held that the second sentence in that section applies "to both insureds and claimants."<sup>459</sup>

Turning to Stanley's allegations, the Fifth Circuit noted that the trustee had multiple examples of NNIC's misconduct: (1) NNIC's failure to adequately represent Hale's interest before, during, and after the civil rights suit;<sup>460</sup> (2) NNIC's conflicts of interest and ethical breaches that Trincharad created during the firm's joint representation of Hale, the Sheriff, and NNIC;<sup>461</sup> (3) NNIC's breach of fiduciary duty of good faith and fair dealing by settling the civil rights suit "without negotiating a full release for Hale";<sup>462</sup> and (4) NNIC's breach of fiduciary duty of good faith and fair dealing by failing

454. LA. REV. STAT. ANN. § 22:1220(A) (2006).

455. See LA. REV. STAT. ANN. § 22:1220(B) (2006). Insurers are prohibited from engaging in the following acts:

- (1) Misrepresenting pertinent facts or insurance policy provisions relating to any coverages at issue.
- (2) Failing to pay a settlement within thirty days after an agreement is reduced to writing.
- (3) Denying coverage or attempting to settle a claim on the basis of an application which the insurer knows was altered without notice to, or knowledge or consent of, the insured.
- (4) Misleading a claimant as to the applicable prescriptive period.
- (5) Failing to pay the amount of any claim due any person insured by the contract within sixty days after receipt of satisfactory proof of loss from the claimant when such failure is arbitrary, capricious, or without probable cause.

*Id.*

456. See *Stanley*, 500 F.3d at 428.

457. See *id.* at 429.

458. See *id.* at 427 (quoting *Theriot v. Midland Risk Ins. Co.*, 694 So. 2d 184, 188 (La. 1997)) (internal quotation marks omitted).

459. *Id.* (quoting *Theriot*, 694 So. 2d at 188) (internal quotation marks omitted).

460. See *id.* at 428.

461. See *id.*

462. See *id.* at 429.



“to truthfully and accurately communicate essential information” to Hale, especially regarding coverage and limits under the liability insurance contract.<sup>463</sup>

Again, Stanley sued the lawyers for legal malpractice and NNIC for breaching its duty of good faith and fair dealing. The Fifth Circuit concluded that those actions were sound because Stanley—as a bankruptcy trustee rather than a third-party victim—stood “in the shoes of NNICs insured.”<sup>464</sup> In the end, the Fifth Circuit remanded the case after reversing the district court’s summary judgment in favor of Trinchard’s attorneys and NNIC.<sup>465</sup>

*2. Substantive Question: Whether a Federal Court Should Apply Mississippi or Louisiana Substantive Choice-of-Law Rules To Resolve a Duty-To-Defend Controversy Between a Liability Insurer and Its Insured Nursing Home, After the Latter Paid Independently Retained Attorneys To Defend the Nursing Home Against Multiple Lawsuits*

Fundamentally, *Hartford Underwriters Insurance Co. v. Foundation Health Services Inc.* is a choice-of-law case.<sup>466</sup> But the underlying substantive conflict between the parties concerns whether an insurer has a contractual duty to pay for its insureds’ retained lawyers.<sup>467</sup> Foundation Health Services, Inc., is a Louisiana non-profit corporation that owns and manages healthcare facilities and nursing homes in seven states.<sup>468</sup> Magnolia Healthcare, Inc., a Mississippi corporation, is one of Foundation’s several wholly-owned subsidiaries.<sup>469</sup> Magnolia owns and operates four nursing homes in Mississippi.<sup>470</sup> Its corporate offices, however, are located in Louisiana.<sup>471</sup>

Briefly put, alleged third-party victims filed fourteen civil actions against Magnolia in Mississippi state courts.<sup>472</sup> Each suit arose out of Magnolia’s operation of its Mississippi nursing homes.<sup>473</sup> Hartford insured Magnolia under two liability insurance contracts, each of which included a duty-to-defend clause.<sup>474</sup> In light of the policies’ duty-to-defend clauses and

463. *See id.* at 428.

464. *See id.* at 427.

465. *See id.* at 431.

466. *See Hartford Univ. Ins. Co. v. Found. Health Servs., Inc.*, 524 F.3d 588, 593 (5th Cir. Apr. 2008).

467. *See id.*

468. *Id.* at 591.

469. *Id.*

470. *Id.*

471. *Id.*

472. *Id.*

473. *Id.*

474. *Id.* Although Hartford issued only two of the policies named in Magnolia’s original complaint, it “does not dispute that those policies insured the underlying risks and triggered the duty to defend.” *Id.* at 591 n.1.

reservation of rights,<sup>475</sup> Hartford secured lawyers to defend Magnolia against each lawsuit.<sup>476</sup> But Magnolia also retained independent counsel to defend the company's interest in the fourteen lawsuits.<sup>477</sup> When Magnolia asked Hartford to pay the retained lawyers' fees, however, Hartford refused.<sup>478</sup>

Asserting that Hartford breached the insurance contract and committed various torts, Foundation sued Hartford in a Mississippi state court.<sup>479</sup> Hartford then removed the case to the Northern District of Mississippi.<sup>480</sup> But following a customary practice among liability insurers,<sup>481</sup> Hartford already had filed a declaratory-judgment action, even before learning about Foundation's lawsuit.<sup>482</sup> Having filed its lawsuit in Louisiana, Hartford asked a different federal district court to declare that Hartford had no duty to pay for Magnolia's independently-retained counsel's representation.<sup>483</sup> Pursuant to a motion from Foundation, the Louisiana court transferred Hartford's suit to the Northern District of Mississippi, where Foundation's lawsuit was pending.<sup>484</sup>

The Mississippi district court simultaneously considered the two cases, in which both Hartford and Foundation had filed motions for partial summary judgment.<sup>485</sup> Concluding that Mississippi, rather than Louisiana, law controlled the disposition of the two cases, the district court granted Foundation's motion for partial summary relief and denied Hartford's motions

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475. "When an insurer provides a defense for an insured under a reservation of rights, the insurer defends the insured 'while at the same time reserving the right to deny coverage in [the] event a judgment is rendered against the insured.'" *Id.* at 592 n.2 (alteration in original) (quoting *Moeller v. Am. Guar. & Liab. Ins. Co.*, 707 So. 2d 1062, 1069 (Miss. 1996)); *see also* 14 LEE R. RUSS & THOMAS F. SEGALLA, *COUCH ON INSURANCE* § 202:38 (3d ed. 2007) ("A 'unilateral reservation of rights' is a notice given by the insurer that it will defend but reserves all rights it has based on noncoverage under the policy . . .").

476. *Hartford Underwriters Ins. Co.*, 524 F.3d at 591-92.

477. *Id.*

478. *Id.*

479. *Id.*

480. *Id.*

481. *See St. Paul Ins. Co. v. Trejo*, 39 F.3d 585, 590-91 (5th Cir. 1994) (listing seven factors for a court to consider when dismissing a declaratory judgment action (quoting *Travelers Ins. Co. v. La. Farm Bureau Fed'n*, 996 F.2d 774, 778 (5th Cir. 1993)); Willy E. Rice, *Insurance Contracts and Judicial Discord Over Whether Liability Insurers Must Defend Insured's Allegedly Intentional and Immoral Conduct: A Historical and Empirical Review of Federal and State Courts' Declaratory Judgments—1900-1997*, 47 AM. U. L. REV. 1131, 1156 (1998); *see also Shell Oil Co. v. AC & S, Inc.*, 649 N.E.2d 946, 949 (Ill. App. Ct. 1995) (noting that under state law, an "insurer must either (1) seek a declaratory judgment as to its rights and obligations before or pending trial or (2) defend the insured under a reservation of rights"); *Am. Employers Ins. Co. v. Crawford*, 533 P.2d 1203, 1207 (N.M. 1975) (concluding that companies may sue for a declaratory judgment, before undertaking a defense, to determine their liability).

482. *See Hartford Underwriters Ins. Co.*, 524 F.3d at 592; *see also* 28 U.S.C. § 2201 (2000) ("In a case of actual controversy within its jurisdiction . . . any court of the United States . . . may declare the rights and other legal relations of any interested party seeking such declaration . . . . Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.").

483. *Hartford Underwriters Ins. Co.*, 524 F.3d at 592.

484. *Id.*

485. *Id.*

in both cases.<sup>486</sup> Hartford then appealed the adverse rulings to the Fifth Circuit.<sup>487</sup>

After examining Louisiana and Mississippi laws, the Fifth Circuit noted a significant conflict and determined that Hartford's reservation of right created a choice-of-law issue.<sup>488</sup> Under Mississippi law, if an insurer defends an insured under a reservation of rights, the insurer must provide the insured with an independent counsel to circumvent the inherent or "built-in" conflict of interests.<sup>489</sup> Louisiana law, however, does not require an insurer to provide independent legal representation for an insured simply because an insurer defends an insured under a reservation of rights.<sup>490</sup> Instead, Louisiana requires separate counsel only when an insured establishes that a concurrent conflict of interest exists.<sup>491</sup> Since Foundation had a viable cause of action to recover attorney's fees under the laws of only one state, the court of appeals had to conduct an exhaustive choice-of-law analysis.<sup>492</sup>

First, the Fifth Circuit had to identify the "forum state," because federal law requires federal courts sitting in diversity to apply the forum state's choice-of-law rules to determine which state's substantive laws govern.<sup>493</sup> The court of appeals simply concluded that Mississippi was the "forum state," presumably because Magnolia, the subsidiary, is a Mississippi corporation, and the underlying third-party lawsuits commenced in Mississippi.<sup>494</sup> A more elaborate discussion of this issue, however, would have been enlightening because (1) Foundation, the plaintiff of record, operates in seven states, (2) Foundation is a Louisiana corporation, (3) Magnolia's corporate offices are located in Louisiana, and (4) Hartford also insures Foundation's business activities in Louisiana.<sup>495</sup>

Having concluded that Mississippi's choice-of-law analysis governed, the court noted that Mississippi resolves choice-of-law issues by applying a three-pronged test.<sup>496</sup> First, courts must determine whether substantive or procedural rules are the focus of attention.<sup>497</sup> Second, if substantive laws are involved, the court must determine whether the controversy commenced under tort, property,

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486. *Id.*

487. *Id.*

488. *See id.* at 592-94.

489. *See id.* at 592-93 (citing *Twin City Fire Ins. Co. v. Madison*, 309 F.3d 901, 905 (5th Cir. 2002) (applying *Moeller v. Am. Guar. & Liab. Ins. Co.*, 707 So. 2d 1062, 1069 (Miss. 1996))).

490. *See id.* at 593 (citing *Trinity Universal Ins. Co. v. Stevens Forestry Serv., Inc.*, 335 F.3d 353, 356 (5th Cir. 2003) (applying Louisiana's law)).

491. *See id.* at 593 n.3 (citing *Belanger v. Gabriel Chems., Inc.*, 787 So. 2d 559, 565 (La. Ct. App. 2001); *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Circle, Inc.*, 915 F.2d 986, 991 (5th Cir. 1990)).

492. *See id.* at 593 (citing *Zurich Am. Ins. Co. v. Goodwin*, 920 So. 2d 427, 432 (Miss. 2006) ("Choice of law analysis arises only when there is a true conflict between the laws of two states, each having an interest in the litigation."); *Chapman v. Thrasher Trucking Co.*, 729 F. Supp. 510, 510 (S.D. Miss. 1990)).

493. *See id.* (citing *In re Katrina Canal Breaches Litig.*, 495 F.3d 191, 206 (5th Cir. 2007)).

494. *See id.*

495. *Id.*

496. *Id.* (citing *Zurich*, 920 So. 2d at 433-34).

497. *Id.* (citing *Zurich*, 920 So. 2d at 433-34).

or contract principles.<sup>498</sup> Finally, the court must consult the Restatement (Second) of Conflict of Laws and apply the appropriate section.<sup>499</sup>

Regarding the first two prongs, the Fifth Circuit concluded that Foundation and Hartford's disagreement involved substantive law:

While this dispute generally involves reimbursement for attorney's fees, the more precise issue is whether an insurer must provide an insured with independent counsel when defending them under a reservation of rights. Because resolution of this issue determines whether Foundation "has a viable cause of action," and not merely whether a party is entitled to attorneys fees for prevailing in a particular case, the issue is substantive.<sup>500</sup>

The court also concluded, and the parties agreed, that Foundation's cause of action sounded in contract.<sup>501</sup>

For the third prong, Mississippi's methodology requires a highly sophisticated analysis by determining "the 'center of gravity' of a dispute and apply[ing] 'the law of the place which has the most significant relationship to the event and parties or which . . . has the greatest concern with the specific issues.'"<sup>502</sup> To achieve that end, Mississippi embraces the Restatement (Second) of Conflict of Laws.<sup>503</sup> Looking to the Restatement, the court found three relevant sections: §§ 6, 188, and 193.<sup>504</sup>

Section 193 applies to all kinds of insurance contracts, except life insurance contracts.<sup>505</sup> It focuses on the principal location of the insured risk:

[An individual's rights under contract] are determined by the local law of the state which the parties understood . . . to be the principal location of the insured risk during the term of the policy, unless with respect to the particular issue, some other state has a more significant relationship under the principles stated in § 6 to the transaction and the parties, in which event the local law of the other state will be applied.<sup>506</sup>

On the other hand, § 188 states that courts should apply the law that "has the most significant relationship to the transaction and the parties."<sup>507</sup> To determine which state has the most substantial connection with the parties and the dispute, § 188 outlines several factors: "(a) the place of contracting, (b) the place of negotiation of the contract, (c) the place of performance, (d) the

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498. *Id.* (citing *Zurich*, 920 So. 2d at 433-34).

499. *Id.* (citing *Zurich*, 920 So. 2d at 433-34).

500. *Id.* (quoting *Hancock v. Watson*, 962 So. 2d 627, 629 (Miss. Ct. App. 2007)).

501. *Id.*

502. *Id.* at 593-94 (emphasis added) (quoting *Zurich*, 920 So. 2d at 433).

503. *See id.* at 594 (quoting *Ingalls Shipbuilding v. Fed. Ins. Co.*, 410 F.3d 214, 230 (5th Cir. 2005)).

504. *See id.*

505. *See id.* (citing *Boardman v. United Servs. Auto. Ass'n*, 470 So. 2d 1024, 1033 (Miss. 1985)).

506. *Id.* (quoting RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 193 (1971)).

507. *Id.* at 595 (quoting RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188 (1971)) (internal quotation marks omitted).

location of the subject matter of the contract, and (e) the domicile, residence, nationality, place of incorporation and place of business of the parties.”<sup>508</sup>

Initially, the court focused on the first two factors by noting that “the place of contracting and [the] place of negotiation are often relevant to disputes involving contract interpretation.”<sup>509</sup> Interestingly, the Fifth Circuit embraced Hartford’s and the district court’s conclusions that the place of contracting was most likely Louisiana.<sup>510</sup> And even more surprising, it stated that “the contract negotiation, to the extent there was any, likely occurred in Louisiana.”<sup>511</sup> The court then recognized that “to some extent, whether Hartford has a duty to provide independent counsel to Magnolia is related to the scope of Hartford’s contractual duty to defend.”<sup>512</sup>

But ultimately the court of appeals placed more emphasis on the place of performance than on other factors in § 188:

[T]his case is different from the typical contract interpretation case . . . because the issue of whether Hartford owed a duty to provide . . . independent counsel is closely connected to the court where the “defending” took place. The court where a case is tried has a substantial interest in preventing conflicts of interest.<sup>513</sup>

Thus, a “de facto presumption” suggested applying Mississippi law.<sup>514</sup>

Before firmly holding that Mississippi law applied, however, the court assessed whether the principles § 6 could rebut that initial presumption.<sup>515</sup> Section 6 focuses on the policies underlying choice-of-law doctrine:

[T]he factors relevant to the choice of the applicable rule of law include (a) the needs of the interstate and international systems, (b) the relevant policies of the forum, (c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue, (d) the protection of justified expectations, (e) the basic policies underlying the particular field of law, (f) certainty, predictability and uniformity of result, and (g) ease in the determination and application of the law to be applied.<sup>516</sup>

508. *Id.* (quoting RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188(2) (1971)).

509. *Id.*

510. *Id.*

511. *Id.*

512. *Id.*

513. *Id.* at 595-96.

514. *Id.* at 597.

515. *Id.* at 597-60. “[T]he factors enumerated in Restatement § 6 will from case to case be given such relative weight as they are entitled, consistent with the general scheme of the center of gravity test.” *Id.* at 598 (quoting *Boardman v. United Servs. Auto Ass’n*, 470 So. 2d 1024, 1032 (Miss. 1985)) (internal quotation marks omitted).

516. *Id.* at 597-98 (quoting RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6(2) (1971)).

The “place of performance” rule, the needs of the interstate system, the relevant policies of the forum, and the justified expectations of the parties caused the Fifth Circuit to embrace the district court’s conclusion: Mississippi’s law governs this dispute.<sup>517</sup>

*3. Substantive Question: Whether Under Texas Law a Liability Insurer Has a Contractual Duty To Indemnify a Manufacturer Who Settled Numerous Personal Injury Suits After Selling a Defective Nutrition and Weight-Loss Product*

Basically, *AdvoCare International, L.P. v. Horizon Laboratories, Inc.*, is another duty-to-defend/indemnify controversy between an insurer and its insured.<sup>518</sup> Again, the Fifth Circuit encountered a choice-of-substantive-law issue as in *Foundation*.<sup>519</sup>

AdvoCare International L.P. is a Texas corporation with corporate offices in Carrollton, Texas.<sup>520</sup> It receives orders for nutritional and skincare products and ships those goods to national and international distributors.<sup>521</sup> Its adversary, Horizon Laboratories, Inc., is a manufacturer and a California corporation with a sole place of business in Chatsworth, California.<sup>522</sup> These two companies are tied to one another through Richard Scheckenbach, who wholly owns R-Squared Nutrition, Inc.,<sup>523</sup> a Washington State corporation.<sup>524</sup> Scheckenbach and R-Squared were AdvoCare consultants who both allegedly sold raw materials to Horizon for use in AdvoCare’s products.<sup>525</sup>

Under two consecutive contracts, Horizon agreed to manufacture products for AdvoCare.<sup>526</sup> Both contracts required Horizon to purchase products liability insurance and list AdvoCare as an additional “named insured” under the insurance policy.<sup>527</sup> Under the second contract, AdvoCare also agreed to purchase a minimum amount of Horizon’s products each month.<sup>528</sup> As part of the exchange, Horizon agreed to become certified under the Dietary Supplement Verification Program (DSVP) within 180 days.<sup>529</sup>

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517. See *id.* at 599.

518. See *AdvoCare Int’l, L.P. v. Horizon Labs., Inc.*, 524 F.3d 679, 680 (5th Cir. Apr. 2008).

519. See *id.* at 690; see also *Hartford Underwriters*, 524 F.3d at 592-93.

520. See *AdvoCare International L.P.*, <http://www.advocare.com> (last visited on Oct. 17, 2008).

521. See Brief of Appellee Advocate International, L.P. at 53, *AdvoCare Int’l*, 524 F.3d 679 (No. 06-11157), 2007 WL 5356999.

522. See Brief of Appellant, Horizon Laboratories, Inc. at 17, *AdvoCare Int’l*, 524 F.3d 679 (No. 06-11157), 2007 WL 5356997.

523. See *AdvoCare Int’l L.P. v. Horizon Labs., Inc.*, No. 3:04-CV-1988-H, 2005 WL 1832116, at \*1 n.1 (N.D. Tex. Aug 2, 2005).

524. See Brief of Defendants-Appellants Scheckenbach and R-Squared at 11, *AdvoCare Int’l*, 524 F.3d 679 (No. 06-11157), 2007 WL 5356998; see also *AdvoCare Int’l*, 2005 WL 1832116, at \*8-9.

525. Brief of Appellee Advocare International, L.P., *supra* note 521, at 23, 31.

526. See *AdvoCare Int’l*, 524 F.3d at 683.

527. *Id.* at 683.

528. See *id.*

529. See *id.*

Horizon, however, never secured a DSVP certification.<sup>530</sup> Thereafter, AdvoCare terminated the second contract, but Horizon continued to ship products and send invoices to AdvoCare, emphasizing that AdvoCare would owe 18% interest for all outstanding debt.<sup>531</sup> Previously, consumers had filed approximately eleven personal injury and wrongful death lawsuits against AdvoCare for allegedly selling weight loss products that contained ephedra or ephedrine.<sup>532</sup> Because Horizon did not help AdvoCare defend against or settle the ephedra-related lawsuits, AdvoCare refused to pay its delinquent bills.<sup>533</sup> During this period, Lexington Insurance Company insured Horizon under various liability insurance contracts.<sup>534</sup> It too refused to pay for Horizon's legal defense.<sup>535</sup>

Ultimately, AdvoCare sued Horizon, Scheckenbach, and R-Squared in a Texas state court.<sup>536</sup> AdvoCare claimed that Scheckenbach and R-Squared conspired with Horizon to inflate the cost of the raw materials used in AdvoCare's products.<sup>537</sup> Although stipulating that it owed Horizon approximately \$3.4 million for unpaid bills, AdvoCare also filed a breach of contract action against Horizon for the manufacturer's failure to obtain a DSVP certification and provide adequate insurance coverage for AdvoCare.<sup>538</sup> In response, Horizon counterclaimed with a breach of contract action against AdvoCare.<sup>539</sup> It claimed that AdvoCare wrongfully terminated the 2002 contract and neglected to purchase the minimum monthly supply of products.<sup>540</sup>

Horizon then removed the case to the Northern District of Texas.<sup>541</sup> In that same federal district court, Horizon filed a declaratory-judgment action against Lexington, asking the district court to declare that Lexington had a duty to indemnify Horizon for ephedra-related claims.<sup>542</sup> Both AdvoCare and Horizon filed summary judgment motions.<sup>543</sup> The district court granted partial summary judgment to AdvoCare; it found that by failing to obtain DSVP certification within 180 days, Horizon breached the 2002 contract, and by failing to insure AdvoCare under a liability insurance contract, Horizon breached the 1997 and 2002 contracts.<sup>544</sup> The court also granted Lexington's

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530. *See id.*

531. *See id.*

532. *See id.* at 685.

533. *See id.* at 683.

534. *See* Brief of Appellant, Horizon Laboratories, Inc., *supra* note 522, at 17.

535. *See AdvoCare Int'l*, 524 F.3d at 683.

536. *See id.*

537. *See id.*

538. *See id.* at 683-84.

539. *See id.*

540. *See id.*

541. *See id.* at 683.

542. *See id.* at 684.

543. *See id.*

544. *See id.*

motion for summary judgment and dismissed Horizon's declaratory judgment lawsuit regarding the duty to indemnify.<sup>545</sup> Finally, finding that AdvoCare did not fraudulently fail to buy a minimum amount of products each month, the court denied Horizon's summary judgment motion.<sup>546</sup>

Ultimately, a jury awarded AdvoCare breach of contract damages of \$2.8 million and \$500,000 for present and future damages, respectively.<sup>547</sup> In turn, the jury awarded Horizon approximately \$3.5 million for AdvoCare's unpaid bills.<sup>548</sup> Applying Texas law, the district court computed a 6% interest rate and attached that amount to AdvoCare's outstanding debt.<sup>549</sup> After the judgment, Horizon challenged the application of the 6% interest rate by arguing that an 18% interest rate under California law was more appropriate.<sup>550</sup> But the district court refused to amend the judgment.<sup>551</sup> Horizon appealed the adverse rulings.<sup>552</sup>

Resolving the interest-rate question, the Fifth Circuit looked to which state had the most significant relationship and concluded that the district court properly denied Horizon's challenge to the Texas interest rate:

Because we find no agreed-upon choice-of-law provision governing the interest issue, the "most significant relationship" test applies. This test provides that "the law of the state with the most significant relationship to the particular substantive issue will be applied to resolve that issue." . . .

Both California and Texas would reasonably have a policy interest in limiting the interest rate that can be charged for amounts overdue, although Texas has a strong interest, as the payments were made in Texas.<sup>553</sup>

Next, Horizon argued that the district court erred by granting Lexington's motion for summary judgment.<sup>554</sup> But before addressing that conflict, the court of appeals found that Lexington insured both Horizon and AdvoCare, the additional "named insured, under a liability insurance contract."<sup>555</sup> Thus,

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545. *See id.*

546. *See id.* at 684 n.4.

547. *See id.* at 684.

548. *See id.*

549. *See id.* "The Final Judgment included the following awards for Horizon: actual damages of \$66,796 from AdvoCare (resulting from a \$3,429,253.70 [sic] recovery on the stated account, plus interest, less the \$3,396,399 jury award to AdvoCare for Horizon's breach of contract) prejudgment interest of \$158,054 from AdvoCare, and postjudgment interest at a rate of 4.91% per annum." *Id.* at 684 n.7.

550. *See id.* at 684. Horizon presented this argument even though the contract had a Texas choice-of-law provision. *See id.* at 684 n.1.

551. *See id.* at 690.

552. *See id.* at 685, 688, 691.

553. *Id.* at 691-92 (quoting *Duncan v. Cessna Aircraft Co.*, 665 S.W.2d 414, 421 (Tex. 1984)).

554. *See id.* at 685.

555. *See id.* at 683. The contract was an "occurrence" policy where an occurrence was defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." *See id.* at 685.



under the liability insurance contract, Lexington was obligated to cover legitimate third-party injuries that occurred during the policy period.<sup>556</sup>

The contract's Weight Management Pharmaceutical Exclusion stated that the insurance did not apply to bodily injury, property damage, personal injury, or advertising injury "arising out of any pharmaceutical used for the treatment of obesity, weight control, and/or weight management, including but not limited to Dexfenfluramine, Phentermine and Ephedra."<sup>557</sup> Horizon insisted that the policy ambiguously excluded coverage for ephedra and argued that the exclusion clause only applied to pharmaceuticals.<sup>558</sup> Citing California's legal definition of pharmaceuticals, Horizon stressed that its herbal products are dietary supplements, or "food," rather than pharmaceuticals.<sup>559</sup> Conversely, Lexington argued that the plain language interpretation in the exclusion clause indicated that Lexington did not cover diet pills containing ephedra.<sup>560</sup>

To resolve this conflict, the Fifth Circuit observed that California has embraced the plain meaning rule and the doctrine of ambiguity to interpret insurance contracts.<sup>561</sup> Under the former rule, "[w]ords in an insurance policy must be understood in their ordinary sense unless given special meanings by the policy."<sup>562</sup> And under the latter, "[a]ny ambiguity or uncertainty in an insurance policy [must] be resolved against the insurer."<sup>563</sup> Nevertheless, "[a] policy provision will be considered ambiguous when it [has] two or more [reasonable] constructions"; therefore, "exclusionary clauses are interpreted narrowly against the insurer."<sup>564</sup>

Applying the doctrine of ambiguity, the Fifth Circuit held that the district court did not err by granting Lexington's motion for summary judgment.<sup>565</sup> The court of appeals embraced the district court's conclusion that the insurance policy unambiguously excluded defense costs for ephedra-related lawsuits.<sup>566</sup> Applying Texas law and the doctrine of ambiguity, the Fifth Circuit concluded that Horizon breached the contract when it failed to buy products liability insurance to cover ephedra-related products because the contract unambiguously required Horizon to purchase the insurance.<sup>567</sup> Unquestionably,

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556. *See id.*

557. *Id.*

558. *See id.* at 686.

559. *Id.* (citing CAL. HEALTH & SAFETY CODE § 117747(a) (West 2006) (defining pharmaceutical as "a prescription or over-the-counter human or veterinary drug"); CAL. HEALTH & SAFETY CODE § 109925(c) (West 2006) (defining drug as "any article other than food")).

560. *See id.*

561. *See id.*

562. *Golden Eagle Ins. Co. v. Ins. Co. of the W.*, 121 Cal. Rptr. 2d 682, 686 (Ct. App. 2002) (quoting *Md. Cas. Co. v. Nationwide Ins. Co.*, 76 Cal. Rptr. 2d 113, 117 (Ct. App. 1998).

563. *Crane v. State Farm Fire & Cas. Co.*, 485 P.2d 1129, 1130 (Cal. 1971).

564. *Advocare Int'l*, 524 F.3d at 686 (quoting *TRB Invs., Inc. v. Fireman's Fund Ins. Co.*, 145 P.3d 472, 477 (Cal. 2006)).

565. *Id.* at 688-89.

566. *Id.* at 686.

567. *Id.*

this latter holding is fairly significant. In light of the facts, Horizon raised several arguably sound defenses—the doctrines of impossibility and waiver.<sup>568</sup> In the end, however, they were not sound enough.<sup>569</sup>

*4. Substantive Question: Whether Under Texas Law a Comprehensive General Liability Insurer Has a Contractual Duty To Indemnify an Owner-Operator of a Petroleum-Based, Sludge-Removal Company Who Settled a Personal Injury Suit After Workers Were Exposed to Toxic Levels of Various Chemicals and Vapors*

In 1980, Congress enacted the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA).<sup>570</sup> The anti-pollution statute is a response to widespread concerns about (1) the production and careless disposal of hazardous wastes in the United States and (2) the severe effects hazardous substances have on the environment and citizens' health.<sup>571</sup> CERCLA has two stated purposes: (1) to ensure the "prompt cleanup of hazardous waste sites" and (2) to "[impose] all cleanup costs on the responsible party."<sup>572</sup>

To achieve the stated goals, CERCLA authorizes the Environmental Protection Agency (EPA) to take immediate action, if necessary, to remove hazardous spills and prevent the release of hazardous substances "which may present an imminent and substantial danger to the public health or welfare."<sup>573</sup> The agency may commence a remedial action to prevent or minimize the release and migration of hazardous substances.<sup>574</sup> But even more relevant, the EPA has "[designed] cleanup plans and [sought] payment from responsible parties and, by extension, their insurers."<sup>575</sup>

In 1998, liability insurers paid \$2.9 billion for pollution remediation and environmental losses.<sup>576</sup> A year later, insurers paid \$1.5 billion.<sup>577</sup> In recent years, insurers' exposure to environmental-pollution claims have continued to decline.<sup>578</sup> Improved and cheaper remediation techniques partially explain the decreasing costs.<sup>579</sup> A more proactive business decision, however, probably explains the decreasing exposure more than any other factor. From the 1940s to the mid-1980s, liability insurance contracts did not contain absolute-

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568. *See id.* at 687.

569. *See id.*

570. Comprehensive Environmental Response, Compensation, and Liability Act of 1980, Pub. L. No. 96-510, 94 Stat. 2767 (codified as amended at 42 U.S.C. §§ 9601-9675 (2000 & Supp. V 2005)).

571. *See Eagle-Picher Indus. v. EPA*, 759 F.2d 922, 925-26 (D.C. Cir. 1985).

572. *Gen. Elec. Co. v. Litton Indus. Automation Sys., Inc.*, 920 F.2d 1415, 1422 (8th Cir. 1990).

573. § 9601(23); § 9604(a)(1).

574. § 9601(24)

575. *See John Seward, Insurers and Environmental Icebergs*, WALL ST. J., June 16, 2004, at B9D.

576. *Id.*

577. *Id.*

578. *Id.*

579. *Id.*

pollution-exclusion clauses.<sup>580</sup> Of course, in 1986, pollution exclusion provisions began to appear.<sup>581</sup>

Therefore, one should expect insurers' liability for pollution remediation to decline precipitously as the pre-1986 policies expire. But now, insurers are facing a different type of exposure. Increasingly, insureds and third-party victims are asserting that absolute pollution-exclusion clauses do not exclude coverage for toxic-fumes injuries. This controversial issue has divided the courts over whether insurers must pay damages for toxic-fumes injuries. Although, a few state courts have ordered insurers to compensate toxic-fumes victims,<sup>582</sup> the greater majority of state courts have not forced insurers to pay.<sup>583</sup> In addition, federal courts addressing this issue have concluded that pollution-exclusion clauses exclude coverage for toxic-fumes injuries.<sup>584</sup>

The litigants in *United National Insurance Co. v. Hydro Tank, Inc.* asked the Fifth Circuit to decide a rather complex pollution exclusion, toxic-fumes question.<sup>585</sup> Here are the basic facts in the underlying third-party lawsuit: Motiva Enterprises, L.L.C. (Motiva) "refines, distributes, and markets oil products in the eastern and southern U.S."<sup>586</sup> It hired Hydro Tank, Inc. (Hydro)

580. *Id.*

581. *Id.*

582. See *Richardson v. Nationwide Mut. Ins. Co.*, 826 A.2d 310, 340 (D.C. 2003) (concluding that the absolute pollution exclusion did not exclude coverage injuries arising from carbon monoxide poisoning after tenant inhaled fumes from an allegedly malfunctioning furnace in an apartment complex), *vacated by settlement*, 844 A.2d 344 (D.C. 2004); *Freidline v. Shelby Ins. Co.*, 774 N.E.2d 37, 43 (Ind. 2002) (finding that absolute pollution-exclusion clause did not exclude coverage for employee's injuries after the employee inhaled toxic fumes from carpet glue because toxic fumes are not pollutants under the insurance contract); *Belt Painting Corp. v. TIG Ins. Co.*, 742 N.Y.S.2d 332, 333 (App. Div. 2002) (concluding that employer's insurance contract's absolute pollution exclusion did not exclude coverage for an employee's injuries after the employee released paint and paint solvent fumes).

583. See *Deni Assocs. of Fla., Inc. v. State Farm Fire & Cas. Ins. Co.*, 711 So. 2d 1135, 1137 n.2 (Fla. 1998) (noting that insurers and amici cited more than 100 cases from thirty-six other states that had applied the plain language of the exclusion clause and denied coverage); *Cincinnati Ins. Co. v. Becker Warehouse, Inc.*, 635 N.W.2d 112, 118 (Neb. 2001) (listing cases); *Bituminous Cas. Corp. v. Cowen Constr., Inc.*, 55 P.3d 1030, 1035 (Okla. 2002) (finding similar language excluded coverage for property damage or bodily injury regardless of whether there was damage to the general environment); *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. CBI Indus., Inc.*, 907 S.W.2d 517, 521-22 (Tex. 1995) (finding that the absolute pollution exclusion clause excluded coverage for personal injuries and property damage that arose out of the accidental release of a large cloud of hydrofluoric acid from an oil refinery); *Quadrant Corp. v. Amer. States Ins. Co.*, 110 P.3d 733, 744 (Wash. 2005) (finding that that the plain language of the absolute pollution exclusion clause excluded coverage for a tenants injuries after the tenant inhaled waterproofing-material fumes that were used in tenants apartment).

584. See, e.g., *Nat'l Elec. Mfrs. Ass'n v. Gulf Underwriters Ins. Co.*, 162 F.3d 821, 825-26 (4th Cir. 1998) (concluding that the pollution exclusion should be enforced as written because it excluded coverage for atmospheric, environmental and other forms of pollution); *Technical Coating Applicators, Inc. v. U.S. Fid. & Guar. Co.*, 157 F.3d 843, 846 (11th Cir. 1998) (holding similar language unambiguously excluded coverage for bodily injuries sustained by breathing vapors emitted from roofing products); see also *Owners Ins. Co. v. Farmer*, 173 F. Supp. 2d 1330, 1333-34 (N.D. Ga. 2001) ("The unambiguous language of the policy excludes all pollutants and does not exclude pollutants based on their source or location.").

585. *United Nat'l Ins. Co. v. Hydro Tank, Inc.*, 497 F.3d 445, 446-47 (5th Cir. Aug. 2007).

586. Welcome to Motiva, [http://www.motivaenterprises.com/home/Framework?siteId=motiva-en&FC2=motiva-en/html/iwgen/leftnavs/zzz\\_lhn1\\_0\\_0.html&FC3=motiva-en/html/iwgen/welcome.html](http://www.motivaenterprises.com/home/Framework?siteId=motiva-en&FC2=motiva-en/html/iwgen/leftnavs/zzz_lhn1_0_0.html&FC3=motiva-en/html/iwgen/welcome.html) (last visited

to clean a tank at its Port Arthur, Texas refinery.<sup>587</sup> When two Hydro workers entered a mixing tank at the refinery to remove sludge, they were injured.<sup>588</sup> A third worker was also injured while attempting to rescue the workers inside the tank.<sup>589</sup> Each worker was hospitalized.<sup>590</sup> The workers then sued Motiva in a Texas state court, alleging that Motiva's negligence and exposure to "toxic levels of hydrogen sulfide and/or other chemicals and vapors" caused their severe brain and cardio-pulmonary injuries.<sup>591</sup>

The contract between Motiva and Hydro required Hydro to indemnify Motiva against claims arising out of Hydro's work.<sup>592</sup> Hydro also agreed to purchase liability insurance and list Motiva as an additional "named insured" under the policy.<sup>593</sup> Hydro purchased a \$5 million umbrella policy from United National Insurance Company (National), which was current when the workers were injured.<sup>594</sup> After settling the workers' state court suit, Motiva asked National to pay the settlement costs up to the policy's limit, and they refused.<sup>595</sup>

To determine whether it had a contractual obligation to indemnify Motiva, National filed a declaratory-judgment action in the District Court for the Southern District of Texas.<sup>596</sup> National argued that hydrogen sulfide gas caused the workers' injuries.<sup>597</sup> Because hydrogen sulfide gas is a pollutant under the insurance contract's pollution exclusion provision, the insurer insisted that it had no duty to indemnify.<sup>598</sup> Conversely, Motiva maintained that the pleadings in the *Workers Suit* allowed one to conclude that the chemicals covered under the insurance contract caused the workers' injuries.<sup>599</sup> Thus, the insurer had a duty to reimburse the settlement expenditures.<sup>600</sup> After examining the policy's pollution exclusion clause, the district court declared that National had no duty to indemnify and Motiva appealed.<sup>601</sup>

The Fifth Circuit reviewed the pollution exclusion provision in National's insurance contract. It reads in relevant part:

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Nov. 12, 2008). Although its refinery is located in Port Arthur, Texas, Motiva's principal place of business is Houston, Texas. *Id.*

587. *See United*, 497 F.3d at 447.

588. *Id.*

589. *Id.*

590. *Id.*

591. *Id.*

592. *Id.*

593. *Id.*

594. *Id.*

595. *Id.*

596. *Id.*

597. *Id.*

598. *Id.* at 448.

599. *Id.*

600. *Id.*

601. *Id.* at 447-48.

EXCLUSIONS — This insurance does not apply to: . . . F. (1) "Bodily injury" or "property damage" which would not have occurred in whole or in part but for the actual, alleged or threatened [sic] discharge, seepage, migration, dispersal, release or escape of "pollutants" at any time . . . . "Pollutants" means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste. "Waste" includes materials to be recycled, reconditioned or reclaimed.<sup>602</sup>

The court of appeals also considered the workers' state court pleading.<sup>603</sup> In the underlying suit, the injured workers alleged that they "sustain[ed] serious injuries . . . in a tank when they were exposed to toxic levels of hydrogen sulfide *and/or* other chemicals and vapors."<sup>604</sup> As a consequence, Motiva's "chemicals and toxins . . . [caused their] brain injury and damage."<sup>605</sup> Motiva argued that the conjunction "and/or" creates two plausible outcomes: an event in which a pollutant—hydrogen sulfide gas—caused the workers' injuries, and an event in which other pollution-free "chemicals and vapors" caused the injuries.<sup>606</sup> Motiva asserted that the latter scenario epitomizes what happened to the workers.<sup>607</sup>

The Fifth Circuit disagreed, stating that Motiva's interpretation ignored the contract's plain language and Texas law.<sup>608</sup> The exclusion clause excludes coverage for "bodily injury . . . which would not have occurred *in whole or in part* but for the . . . alleged . . . release . . . of pollutants."<sup>609</sup> Accordingly, a liability insurance contract does not cover a "bodily injury" if a claim alleges that the injury arose in part from the release of a pollutant.<sup>610</sup>

But Motiva raised another argument the Fifth Circuit did not address decisively.<sup>611</sup> "Shortly after entering the tank, two of the workers were overcome by fumes and fell face first into the sludge."<sup>612</sup> Stated simply, the refining company argued that it was "properly stored," petroleum-based sludge in the mixing tank, rather than hydrogen sulfide gas, that caused the injuries.<sup>613</sup> The court of appeals called this argument "clever" and dismissed it.<sup>614</sup>

602. *See id.* at 488 n.3.

603. *See id.* at 488.

604. *Id.* (emphasis added).

605. *Id.*

606. *Id.*

607. *Id.*

608. *Id.*

609. *Id.* (emphasis added).

610. *See, e.g., Amoco Prod. Co. v. Hydroblast Corp.*, 90 F. Supp. 2d 727, 732-33 (N.D. Tex. 1999) (concluding that an allegation of a pollutant-related injury is sufficient to trigger the pollution-exclusion clause); *Bituminous Cas. Corp. v. Kenworthy Oil Co.*, 912 F. Supp. 238, 241 (W.D. Tex. 1996) (concluding the same).

611. *United*, 497 F.3d at 447.

612. *Id.*

613. *Id.* at 449-50 ("Motiva claim[ed] that since the workers do not allege the particular mechanism of their exposure to hydrogen sulfide, it is possible that they were injured by skin-to-sludge contact, rather than by inhalation of a gas.").

614. *Id.* at 450.

Focusing solely on Motiva's properly stored argument, the Fifth Circuit concluded: "[A] pollution exclusion clause applies whenever a pollutant causes harm . . . irrespective of where the injury took place or whether the pollutant was released into the environment."<sup>615</sup>

The definition of a pollutant in the pollution exclusion clause, however, is exceedingly clear: A pollutant is "any solid, liquid, gaseous or thermal *irritant or contaminant*."<sup>616</sup> Motiva asserted that the sludge was not a pollutant.<sup>617</sup> Sludge is a petroleum byproduct—like plastics,<sup>618</sup> naphtha,<sup>619</sup> some synthetic polymers,<sup>620</sup> some oxygen additives,<sup>621</sup> and asphalt.<sup>622</sup> But no reasonable person would seriously conclude that these latter products are pollutants, per se. And without knowing more, no reasonable trier of facts should conclude that petroleum-based sludge is a pollutant. Thus, the Fifth Circuit's failure to address this issue intelligently and thoroughly was a serious omission.

But even more unsettling, the court of appeals never explained or decided whether hydrogen sulfide is a pollutant.<sup>623</sup> Instead, the Fifth Circuit assumed that the gas is a pollutant—a "toxic fume."<sup>624</sup> If the court had been a bit more inquisitive, however, it would have discovered these relevant facts:

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615. *Id.* (citing *Hamm v. Allstate Ins. Co.*, 286 F. Supp. 2d 790, 794-95 & n.2 (N.D. Tex. 2003) (pollution exclusion barred insurers duty to defend when injury resulted from indoor accumulation of toluene fumes during an office renovation); *Zaiontz v. Trinity Universal Ins. Co.*, 87 S.W.3d 565, 571-72 (Tex. App. 2002) (injury caused by "odor eliminator" chemical that was confined to its proper area of application triggered pollution exclusion)).

616. *Id.* at 448 (emphasis added).

617. *Id.* at 451.

618. See Jason Booth, *Asias Drillers Get Lift from Surge in Oil Prices; Some Analysts Bet on Them in Event of Tech Skid*, WALL ST. J., Mar. 10, 2000, at C14 ("High oil prices are typically bad economic news. Transport costs go up, and inflation can be pushed higher as the cost of anything made from petroleum byproducts, such as plastics, increases.").

619. See Geraldo Samor, *Braskem Looks to Mine Profit in Geopolitics—As Latin America Moves to the Left, Brazil's Petrochemical Giant Seeks Raw Materials*, WALL ST. J., Feb. 3, 2006, at B2 ("Braskem . . . lowered its tax bill, reduced overhead costs and made the plant's operations more efficient. . . . If oil continues to trade at lofty prices, it will push up prices for naphtha, a petroleum byproduct and Braskem's main raw material.").

620. See Valerie Bauerlein & Mary Jacoby, *Other Ways to Deter Floods*, WALL ST. J., Sept. 21 2005, at A15 ("Some engineers favor expanding existing levees with a type of super dirt, reinforced with a synthetic polymer made of a petroleum byproduct. These 'geogrids' create a strengthened soil that has been used to build roads on weak ground and retaining walls.").

621. See Scott Kilman, *California Gets No Exemption On Gas Rules—Building of Ethanol Plants May Experience a Boost In Wake of EPA Order*, WALL ST. J., June 12, 2001, at A6 ("Federal regulations require cities plagued by air pollution to put oxygen additives in gasoline. The oxygen helps the fuel burn more thoroughly, leaving less carbon monoxide in the air. The two most popular additives are corn-derived ethanol and methyl tertiary butyl ether, or MTBE, a petroleum byproduct.").

622. See Chad Terhune, *Asphalt Waste Poses No Risk, Study Shows*, WALL ST. J., June 3, 1998, at F1 ("Contrary to the worst fears of environmentalists and regulators, new research shows that those growing stockpiles of recycled asphalt . . . don't pose a serious pollution hazard after all. . . . Road asphalt, a petroleum byproduct mixed with rocks and sand could be considered a clean fill material like rock and gravel.").

623. See *United Nat'l Ins. Co. v. Hydro Tank, Inc.*, 497 F.3d 445, 450 (5th Cir. Aug. 2007).

624. See *id.* at 450.

Hydrogen sulfide occurs . . . naturally and from human-made processes. It is . . . in crude petroleum and natural gas. Hydrogen sulfide also is associated with municipal sewers and sewage treatment plants, swine containment and manure-handling operations. . . . Industrial sources of hydrogen sulfide include petroleum refineries, natural gas plants, petrochemical plants, coke oven plants, food processing plants, and tanneries. Bacteria . . . in your mouth and gastrointestinal tract produce hydrogen sulfide during the digestion of . . . vegetable or animal proteins. . . . Hydrogen sulfide is produced by the natural bacteria in your mouth and is a component of bad breath (halitosis).<sup>625</sup>

Even more importantly, the Agency for Toxic Substances and Disease Registry (ATSDR) does not list hydrogen sulfide as a pollutant or a “toxic fume.”<sup>626</sup> ATSDR only applies those labels when the concentration of hydrogen sulfide reaches a certain level.<sup>627</sup> Regarding the level of hydrogen-sulfide fumes in Motiva’s mixing tank, the court of appeals simply noted: “[The workers alleged that] ‘they were exposed to such high levels of toxic substances [to cause] brain damage . . . [and] not a slight exposure that would ordinarily cause no harm.’”<sup>628</sup> In the end, the Fifth Circuit declared that National had no duty to indemnify Motiva because a pollutant caused the workers’ injuries.<sup>629</sup> Nevertheless, the opinion is seriously flawed because the court of appeals never established, *as a matter of law*, with probative evidence or otherwise, whether hydrogen sulfide is a pollutant or whether “high levels of a pollutant” were the proximate cause of the workers’ injuries.<sup>630</sup>

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625. AGENCY FOR TOXIC SUBSTANCES AND DISEASES, DEP’T OF HEALTH AND HUMAN SERVS., PUBLIC HEALTH STATEMENT FOR HYDROGEN SULFIDE 1 (2008), available at <http://www.atsdr.cdc.gov/toxprofiles/phs114.html>.

626. *Id.* “The Agency for Toxic Substances and Disease Registry (ATSDR), based in Atlanta, Georgia, is a federal public health agency of the U.S. Department of Health and Human Services. ATSDR serves the public by using the best science, taking responsive public health actions, and providing trusted health information to prevent harmful exposures and diseases related to toxic substances.” Agency for Toxic Substance and Disease Registry, <http://www.atsdr.cdc.gov/> (last visited Aug. 23, 2008).

627. Public Health Statement: Hydrogen Sulfide, <http://www.atsdr.cdc.gov/toxprofiles/phs114.html> (last visited Oct. 21, 2008) (“People usually can smell hydrogen sulfide at low concentrations in air, ranging from 0.0005 to 0.3 parts per million . . . . [H]owever, at high concentrations, a person might lose their ability to smell it. This can make hydrogen sulfide very dangerous. . . . The levels of hydrogen sulfide in air and water are typically low.”).

628. *United*, 497 F.3d at 450.

629. *See id.* at 451.

630. *See id.*

5. *Substantive Question: Whether Under Texas Law a Federally Mandated Endorsement in a Motor-Carriers Liability Insurance Contract Requires an Insurer To Pay Damages for Third-Party Personal Injuries That Occurred in Mexico*

Unlike the highly litigated issue in *Motiva*, the question in *Lincoln General Insurance Co. v. De La Luz Garcia* presents a case of first impression.<sup>631</sup> Maria De La Luz Garcia resides in Houston, Texas, and she owns Garcia's Tours, which has a bus route between Houston, Texas, and Celaya, Mexico.<sup>632</sup> On April 7, 2004, a Garcia's Tours bus collided with another vehicle in Monterrey, Mexico.<sup>633</sup> Jesus Escoto (Escoto), an employee of Garcia's Tours, was driving the bus.<sup>634</sup> The other driver was a member of the Morquecho family (the Morquechos).<sup>635</sup> Two Morquechos were killed and six were injured.<sup>636</sup>

Three months after the accident, the Morquechos sued Garcia's Tours and Escoto in a Texas state court by alleging several negligence-based claims—negligent hiring, negligent entrustment, and negligent retention.<sup>637</sup> When the accident occurred, Lincoln General Insurance Company (Lincoln) insured Garcia's Tours under a motor carriers liability insurance contract.<sup>638</sup> But Lincoln refused to defend Garcia's Tours in the state court action, and after Garcia's Tours was found liable for over \$1.2 million in damages, Lincoln also refused to indemnify its insured.<sup>639</sup>

In fact, while the state court suit was pending, Lincoln had already filed a declaratory-judgment action in the Southern District of Texas.<sup>640</sup> Lincoln asked the district court to declare that it had no duty to defend or indemnify Garcia's Tours under the terms of the policy.<sup>641</sup> Given their interest in the outcome of the declaratory-judgment action, the Morquechos intervened.<sup>642</sup> They wanted the court to declare that the motor-carriers policy covered the accident and that an endorsement covered every judgment against Garcia's Tours in the Morquechos underlying suit.<sup>643</sup> Ultimately, the lower federal court concluded that an endorsement to the insurance contract did not cover

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631. See *Lincoln Gen. Ins. Co., v. De La Luz Garcia*, 501 F.3d 436, 437 (5th Cir. Sept. 2007).

632. *Id.*

633. *Id.*

634. *Id.*

635. *Id.*

636. *Id.*

637. See *id.* at 438.

638. See *id.* at 437.

639. See *id.* at 438.

640. *Id.*

641. See *id.*

642. See *id.*

643. See *id.* Both Lincoln and the Morquechos filed motions for summary judgment. See *id.* Ultimately, the district court granted Lincoln's motion. See *id.*



the accident.<sup>644</sup> Therefore, Lincoln had no duty to pay any judgment against Garcia's Tours.<sup>645</sup> The Morquechos appealed.<sup>646</sup>

Again, this is a case of first impression for the Fifth Circuit because the liability insurance contract in this case is unique. Like many policies, Lincoln's policy stated in pertinent part: "[The insurer] will pay all sums an insured legally must pay as damages because of bodily injury or property damage to which this insurance applies, *caused by an accident and resulting from the ownership, maintenance or use of a covered auto.*"<sup>647</sup> The insurance contract also had a territorial-restriction clause that provided that Lincoln "will cover accidents and losses occurring *only within . . . the United States, the territories and possessions of the United States, Puerto Rico, and Canada.*"<sup>648</sup>

Under the Regulatory Reform Act of 1982, Congress requires for-hire motor carriers to purchase third party insurance to satisfy the Act's minimum financial responsibility requirements.<sup>649</sup> Therefore, unlike most motor vehicle insurance contracts, the federally mandated MCS-90B endorsement was attached to Lincoln's policy.<sup>650</sup> "For carriers with a seating capacity of sixteen passengers or more, such as Garcia's Tours, the minimum level of financial responsibility is \$5 million."<sup>651</sup>

To be sure, the MCS-90B endorsement is very long; thus, only the most relevant portions appear here:

In consideration of the premium stated in the policy to which this endorsement is attached, the insurer (Lincoln) agrees to pay, within the limits of liability described herein, any final judgment received against the insured for public liability resulting from negligence in the operation, maintenance or use of motor vehicles subject to financial responsibility requirements of Section 18 of the Bus Regulatory Reform Act of 1982 regardless of whether . . . such negligence occurs on any route or in any territory authorized to be served by the insured or elsewhere. . . .

It is understood and agreed that no condition . . . in the policy . . . shall relieve the company from liability or from the payment of any final judgment, within the limits of liability. . . . However, all terms, conditions and limitations in the policy . . . shall remain in full force and effect as binding between the insured and the company.<sup>652</sup>

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644. *See id.* at 438-39.

645. *See id.* at 439.

646. *See id.*

647. *Id.* at 437-38 (emphasis added).

648. *See id.* at 438 (emphasis added).

649. *See* 49 U.S.C.A. § 31138(a) (West Supp. II 2008). The corresponding regulations may be found at 49 C.F.R. §§ 387.31(a), (d)(1), 387.33, 387.39 (2007).

650. *See Lincoln*, 501 F.3d at 438.

651. *Id.* at 438 n.1; *see also* 49 U.S.C.A. § 31138 (b)(1).

652. *See* FED. MOTOR CARRIER SAFETY ADMIN., U.S. DEP'T OF TRANSP., ENDORSEMENT FOR MOTOR CARRIER POLICIES OF INSURANCE FOR PUBLIC LIABILITY UNDER SECTION 18 OF THE BUS REGULATORY REFORM ACT OF 1982, OMB No.: 2126-0008 [hereinafter ENDORSEMENT FORM], available at <http://www>.

Also, regarding the minimum financial responsibility for transporting passengers, 49 U.S.C. § 31138(a)(1) states:

The Secretary of Transportation shall prescribe regulations to require minimum levels of financial responsibility sufficient to satisfy liability amounts established by the Secretary covering public liability and property damage for the *transportation of passengers* for compensation by motor vehicle in the United States *between a place in a State and—*

- (A) a place in another State;
- (B) another place in the same State through a place outside of that State; or
- (C) a place outside the United States.<sup>653</sup>

After reviewing the insurance contract, the MCS-90B endorsement, and § 31138(a)(1), the district court found that “form MCS-90B only applies to transportation that occurs within the United States, [rather than] to transportation occurring outside of the United States.”<sup>654</sup> As a consequence, the district concluded that Lincoln had no duty to pay the final judgment that the Morquechos won against Garcia’s Tours.<sup>655</sup> Remarkably, the Fifth Circuit embraced the district court’s findings and conclusion.<sup>656</sup>

The court of appeals explained:

Reading [U.S.C. § 31138(a)(1)(C)] in conjunction with the MCS-90B endorsement, the minimum levels of financial responsibility requirements apply to the transportation of passengers in the United States; thus the endorsement does not require an insurer to pay judgments recovered against the insured if the transportation of passengers by motor vehicle does not occur in the United States.<sup>657</sup>

The Fifth Circuit then applied the plain meaning rule: “[A]lthough [§ 31138(a)(1)(C)] recognizes that a commercial motor vehicle may be transporting passengers ‘to a place outside the United States,’ it requires minimum levels of financial responsibility *only* for the part of the transportation that occurs ‘in the United States.’”<sup>658</sup>

Indisputably, a federal court’s employing plain-meaning rules to interpret a controversial insurance statute is highly warranted because the process is an efficient way to resolve a dispute quickly and fairly. But the doctrine of plain meaning comprises a set of very clear rules and a federal court should carefully

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fmcsa.dot.gov/documents/forms/part\_387.pdf.

653. 49 U.S.C. § 31138(a)(1) (emphasis added).

654. *Lincoln*, 501 F.3d at 439.

655. *See id.*

656. *See id.* at 442.

657. *Id.* at 441 (emphasis added).

658. *Id.* at 440–41 (“[By its plain language,] the endorsement does not cover the Morquechos’s accident in Mexico because the accident occurred in a place where the motor vehicle was not subject to the minimum financial responsibility requirements [under] § 31138.”).

consider and apply those principles, especially if the court has exercised diversity jurisdiction. The Supreme Court of Texas is exceedingly clear that the paramount objective of statutory construction is to determine and give effect to the legislature's intent.<sup>659</sup> First, the court must construe the statute as written and, if possible, determine the legislature's intention from the statute's language.<sup>660</sup> To reach that end, courts must examine the plain meaning of words in the statute, and if the meaning is unambiguous, the court's interpretation must harmonize with the plain meaning of the words and phrases in the statute.<sup>661</sup> Second, a court should read every word, phrase, and expression in a statute as if the legislature deliberately inserted them into the statute.<sup>662</sup> Finally, courts must presume that a legislature wanted the words and phrases in a statute to be read and applied in their entirety rather than in isolation.<sup>663</sup>

In the present case, the court of appeals clearly did not adhere to the statutory construction rules. Again, the Fifth Circuit stated that the statute "requires minimum levels of financial responsibility only for . . . the transportation that occurs 'in the United States.'"<sup>664</sup> Bluntly put, that statement does not appear in § 31138(a)(1)(C).<sup>665</sup> But even more importantly, if the MCS-90B endorsement only covers bus routes "in the United States;" the court of appeals should have explained why Congress inserted the phrase "a place outside the United States" in the statute.<sup>666</sup> The Fifth Circuit did not; therefore, the analysis of endorsement controversy is critically unsound.<sup>667</sup>

There is one final issue the court of appeals did not address completely. The Morquechos filed a negligence-based cause of action against Garcia's Tours.<sup>668</sup> They asserted that the bus company negligently hired and retained Escoto—the bus driver.<sup>669</sup> In addition, the Morquechos alleged that Garcia's Tours negligently entrusted Escoto to operate the bus that was involved in the accident.<sup>670</sup> Without elaborating, however, the Fifth Circuit simply state that

[i]t is undisputed that the operational negligence of Escoto, the bus driver, occurred in Mexico. Thus, the negligent hiring, retention, and entrustment would not exist 'but for' the bus crash in Mexico, for which we have

659. See *Cont'l Cas. Co. v. Downs*, 81 S.W.3d 803, 805 (Tex. 2002).

660. See *Del Indus., Inc. v. Tex. Workers Comp. Ins. Fund*, 973 S.W.2d 743, 745 (Tex. App.—Austin 1998), *aff'd*, 35 S.W.3d 591 (Tex. 2000).

661. See *City of San Antonio v. City of Boerne*, 111 S.W.3d 22, 25 (Tex. 2003); *St. Luke's Episcopal Hosp. v. Agbor*, 952 S.W.2d 503, 505 (Tex. 1997).

662. See *City of Austin v. Quick*, 930 S.W.2d 678, 687 (Tex. App.—Austin 1996), *aff'd*, 7 S.W.3d 109 (Tex. 1998).

663. See *Jones v. Fowler*, 969 S.W.2d 429, 432 (Tex. 1998).

664. *Lincoln Gen. Ins. Co. v. De La Luz Garcia*, 501 F.3d 436, 441 (5th Cir. Sept. 2007).

665. See 49 U.S.C.A. § 31138(a)(1)(C) (West Supp. II 2008).

666. *Lincoln Gen. Ins. Co.*, 501 F.3d at 441; see 49 U.S.C. § 31138(a)(1)(C).

667. See *Lincoln Gen. Ins. Co.*, 501 F.3d at 436.

668. See *id.* at 438.

669. See *id.*

670. See *id.*

concluded there is no coverage under the endorsement. That the Morquechos alleged the negligence occurred in Texas is irrelevant because the cause of action against them arises out of the bus crash in Mexico, which does not fall within the coverage of the endorsement.<sup>671</sup>

Arguably, if the Fifth Circuit had read the territorial condition clause in the liability contract and the MCS-90B endorsement more carefully, the court would have discovered a gross ambiguity and reached a different conclusion. Without a doubt, the contract's condition provision stated that Lincoln would pay judgments only for accidents that occurred in Puerto Rico, Canada, the United States, and the territories and possessions of the United States.<sup>672</sup> But the endorsement stated that Lincoln would "pay, within the limits of liability . . . any final judgment . . . against the insured for public liability resulting from *negligence in the operation, maintenance or use of motor vehicles . . . regardless of whether . . . such negligence occurs on any route or in any territory authorized to be served by the insured or elsewhere.*"<sup>673</sup> Arguably the last phrase is an ambiguity, which the court should construe in favor of Garcia's Tours and by extension in favor of the third party victims.<sup>674</sup>

But there is more. The MCS-90B endorsement reads: "[N]o condition . . . in the policy . . . shall relieve the company from liability or from the payment of any final judgment . . ." <sup>675</sup> The endorsement, however, also reads: "[A]ll . . . conditions . . . in the policy . . . shall remain in full force and effect as binding between the insured and the company."<sup>676</sup> Does this mean that Lincoln may not use the territorial restriction condition as an affirmative defense and walk away from its financial obligation under the endorsement? If the answer is yes, this leads to the next question: Does the endorsement effectively allow Garcia's Tours and the Morquechos to establish coverage for the accident by effectively invoking the unpopular doctrine of estoppel into coverage?<sup>677</sup> The

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671. *Id.* at 443.

672. *Id.*

673. See ENDORSEMENT FORM, *supra* note 652 (emphasis added).

674. *Cf. Gonzalez v. Mission Am. Ins. Co.*, 795 S.W.2d 734, 737 (Tex. 1990) ("[I]t is well-established law that where an ambiguity exists in a contract, the contract language will be construed strictly against the party who drafted it since the drafter is responsible for the language used."); *Republic Nat'l Bank v. Nw. Nat'l Bank*, 578 S.W.2d 109, 115 (Tex. 1978) (concluding that any ambiguous writing in contract—including an endorsement—must be construed strictly against the party who drafted it since the drafter is responsible for the language).

675. See ENDORSEMENT FORM, *supra* note 652.

676. See *id.*

677. See *Ulico Cas. Co. v. Allied Pilots Ass'n*, 187 S.W.3d 91, 98 (Tex. App.—Fort Worth, 2005), *rev'd*, 262 S.W.3d 773 (Tex. 2008) ("In a proper case, estoppel can prevent an insurer from asserting policy defenses. This can occur when an insurer undertakes defense of a case without qualification or reservation of the right to later deny its obligation to provide indemnity if its insured is found liable. Generally, estoppel cannot be used to create insurance coverage when none exists under the policy. An exception to this general rule—commonly called the *Wilkinson* exception—provides that an insurer undertaking or continuing defense of a claim while having knowledge of facts indicating the claim is not covered under its policy, without an effective reservation of rights, may waive or be estopped from asserting all policy defenses, including the defense of noncoverage. . . . Although the Texas Supreme Court has never addressed this exception, it has

endorsement is ambiguous, and the Fifth Circuit should have construed the confusion in favor of the third-party victims and the insured.

### *B. Third-Party Liability Claims—Injury to Property*

#### *1. Substantive Question: Whether Under Mississippi Law a Liability Insurer Has a Duty To Defend and Indemnify an Insured Residential Developer After the Owners-Operators of a Golf Course Commenced a Slander-of-Title Lawsuit Against the Insured*

Very likely, the overwhelming majority of jurists are familiar with an action for slander of person. Stated simply, a defendant is liable for damages if the plaintiff establishes that the defendant orally communicated a defamatory statement about the plaintiff to a third person without a legal excuse.<sup>678</sup> On the other hand, an action for slander of title is probably less familiar. Essentially, a person who has an interest in property may sue a wrongdoer and receive special damages if the wrongdoer's slanderous statements "injure" or "undermine" a plaintiff's interest in property.<sup>679</sup>

Among numerous reasons, a slander-of-title action lies against a person for (1) placing a judicial lien on someone's homestead impairing or clouding the owner's rights under a title;<sup>680</sup> (2) disparaging one's title to property and thus causing special damages by making a false statement with malice;<sup>681</sup> (3) forging a signature on a mortgage and publishing a foreclosure notice with an intent to annoy or injure a person's property;<sup>682</sup> or (4) negligently, intentionally, or unjustifiably interfering with a business owner's mail, even if

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been utilized, recognized, or both by several Texas courts of appeals and federal courts applying Texas law." (citing *Farmers Tex. County Mut. Ins. Co. v. Wilkinson*, 601 S.W.2d 520, 522 (Tex. Civ. App.—Austin 1980, writ ref'd n.r.e.)).

678. See, e.g., *Duran v. Furr's Supermarkets, Inc.* 921 S.W.2d 778, 792 (Tex. App.—El Paso 1996, no writ). A defamatory statement injures a person's reputation and exposes that person to public hatred, contempt, ridicule, or financial injury. *Id.*

679. See *Walley v. Hunt*, 54 So. 2d 393, 396 (Miss. 1951) ("Slander of title" is a phrase commonly employed to describe words or conduct which bring or tend to bring in question the right or title of another to particular property, as distinguished from the disparagement of the property itself. The slander may consist of a statement in writing, printing, or by word of mouth, and may relate to personal as well as real property. . . . [T]he general rule of liability for slander of title is stated as follows: 'One who falsely and maliciously publishes matter which brings in question or disparages the title to property, thereby causing special damage to the owner, may be held liable in a civil action for damages. . . .' Words spoken of property are not in themselves actionable. But the publication of false and malicious statements, disparaging of plaintiffs property or the title thereto, when followed, as a natural, reasonable and proximate result, by special damage to the owner, are actionable. The false statement may consist of an assertion that plaintiff has no title to the property of which he is the ostensible owner, or that his title is defective, or that defendant has an interest in or lien upon the property. . . . Whatever be the statement, however, in order for it to form the basis of a right of action it must have been made, not only falsely, but maliciously.").

680. See *In re Henderson*, 18 F.3d 1305, 1309 (5th Cir. 1994).

681. See *Jeanes v. Henderson*, 703 F.2d 855, 860 (5th Cir. 1983).

682. See *Proctor v. Gissendaner*, 579 F.2d 876, 880, 883 (5th Cir. 1978).

the interference does not affect the owners benefit of a bargain.<sup>683</sup> This term, the Fifth Circuit decided *Nationwide Mutual Insurance Co. v. Lake Caroline, Inc.*<sup>684</sup> The underlying conflict involved a slander-of-title action.<sup>685</sup> The central question in *Nationwide*, however, was whether the insurer had a duty to defend the insured against a slander-of-title lawsuit.<sup>686</sup> Because the facts in the underlying lawsuit were fairly simple, the Fifth Circuit easily and intelligently resolved the insurance-related controversy.<sup>687</sup>

Lake Caroline, Inc. (LCI) developed a subdivision (Lake Caroline) in Madison County, Mississippi.<sup>688</sup> LCI created the Lake Caroline Planned Unit Development (PUD).<sup>689</sup> A&F Properties (AFP) wanted to construct and operate a golf course within the boundaries of Lake Caroline.<sup>690</sup> Therefore, LCI gave AFP 154 acres of land in exchange for AFP's promise to build and maintain a golf course for at least ten years.<sup>691</sup> The Board adopted a master plan for the LCI PUD, which included a golf course at Lake Caroline.<sup>692</sup> Several years later, AFP wanted to build residential units on the golf course.<sup>693</sup> LCI and hundreds of individual homeowners opposed the idea.<sup>694</sup> Consequently, the Board denied AFP's petition to redevelop the golf course.<sup>695</sup>

Shortly thereafter, AFP sued LCI in a Mississippi state court, and the complaint listed several causes of action: breach-of-contract, breach-of-warranty-deed, and slander-of-title.<sup>696</sup> When the underlying lawsuit commenced, Nationwide Mutual Insurance Company (Nationwide) insured LCI under a liability insurance contract.<sup>697</sup> Thus, after discovering the lawsuit, Nationwide filed a declaratory-judgment action in the District Court for the Southern District of Mississippi.<sup>698</sup> Nationwide contended that it had no duty to defend LCI against AFP's lawsuit.<sup>699</sup> The court found that AFP's lawsuit was, in essence, an action for slander-of-title.<sup>700</sup> Because slander involves intentional conduct, the district court declared that the insurance contract did not cover calculated acts, and LCI appealed.<sup>701</sup>

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683. See *Kelite Prods. v. Binzel*, 224 F.2d 131, 138 (5th Cir. 1955).

684. *Nationwide Mut. Ins. Co. v. Lake Caroline, Inc.*, 515 F.3d 414 (5th Cir. Jan. 2008).

685. *Id.* at 420.

686. *Id.* at 418-20.

687. *Id.* at 420-21.

688. *Id.*

689. *Id.*

690. *Id.*

691. *Id.*

692. *Id.*

693. *Id.*

694. *Id.*

695. *Id.*

696. *Id.*

697. *Id.* at 417.

698. *Id.*

699. *Id.*

700. *Id.*

701. *Id.*

The Fifth Circuit agreed that AFP's suit was basically a slander-of-title action because APF alleged that LCI intentionally and/or maliciously (1) withheld material information about the Board's proposed and implemented master plans; (2) failed to disclose to the Board that AFP had a right to use the golf course land for another purpose after the contract expired; and (3) led the Board to believe that AFP was not a developer who had a legal right to develop the property.<sup>702</sup>

To determine whether Nationwide had a duty to defend LCI, the court of appeals reviewed the insurance coverage provisions under the "occurrence" liability insurance contract.<sup>703</sup> The "property loss" provision read in pertinent part:

[Nationwide] will pay those sums that the insured becomes legally obligated to pay as damages because of . . . "property damage" to which this insurance applies. [Nationwide] will have the right and duty to defend the insured against any "suit" seeking those damages. However, we will have no duty to defend the insured against any "suit" seeking damages for . . . "property damage" to which this insurance does not apply.<sup>704</sup>

The insurance contract's "personal and advertising injury" clause stated in pertinent part:

[Nationwide] will pay those sums that the insured becomes legally obligated to pay as damages because of "personal and advertising injury" to which this insurance applies. [Nationwide] will have the right and duty to defend the insured against any "suit" seeking those damages. However, [Nationwide] will have no duty to defend the insured against any "suit" seeking damages for "personal and advertising injury" to which this insurance does not apply.<sup>705</sup>

In addition, the contract defined "property damage" as a "[p]hysical injury to tangible property including loss of use of that property" and "[l]oss of use of tangible property that is not physically injured."<sup>706</sup> The policy also defined "personal and advertising injury" to include "[o]ral or written publication . . . of material that slanders or libels a person or organization or disparages a person's or organization's goods, products or services."<sup>707</sup>

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702. *Id.* at 420.

703. *Id.* (limiting coverage to property damage that was "caused by an occurrence" within the "coverage territory."). The contract defined an occurrence as being "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." *Id.*

704. *Id.*

705. *Id.*

706. *Id.*

707. *Id.* at 417-18.

Finally, the insurance contract also contained two pertinent exclusion clauses.<sup>708</sup> The “expected or intentional conduct” provision excluded coverage for property damage that was “expected or intended from the standpoint of the insured.”<sup>709</sup> A “knowledge of falsity” clause excluded coverage for any “[p]ersonal and advertising injury” arising out of oral or written publication of material, if done by or at the direction of the insured with knowledge of its falsity.<sup>710</sup>

The Fifth Circuit noted that AFP alleged that LCI’s conduct was intentional and malicious.<sup>711</sup> Under Mississippi law, a party’s reckless disregard for the truth can be malicious.<sup>712</sup> A reckless disregard for the truth requires plaintiff to show that the defendant had serious doubts about the truth of the publication.<sup>713</sup> Additionally, in a prior case applying Mississippi law, the Fifth Circuit concluded that the knowledge of falsity exclusion does not exclude coverage when allegedly offensive conduct involves “gross and reckless disregard of the truth.”<sup>714</sup> Therefore, because AFP alleged that some of LCI’s actions were malicious, the court of appeals concluded that the knowledge of falsity exclusion did not preclude coverage.<sup>715</sup>

Under the liability contract, however, Nationwide promised to defend its insured only if a third-party accused the insured of slandering a person or an organization.<sup>716</sup> When the Fifth Circuit wrote the opinion, Mississippi courts had not decided whether a slander-of-title action allows a complainant to secure damages for both real and personal property injuries.<sup>717</sup> But, among other courts, the law is unanimous: An action for slander-of-title provides no relief for injury to persons, organizations, goods, or services.<sup>718</sup> Concluding that Mississippi courts would reach the same conclusion, the Fifth Circuit declared

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708. *Id.*

709. *Id.* at 417.

710. *Id.* at 418.

711. *Id.* at 417.

712. See *Eckman v. Cooper Tire & Rubber Co.*, 893 So. 2d 1049, 1053 (Miss. 2005); *Bulloch v. City of Pascagoula*, 574 So. 2d 637, 642 (Miss. 1990).

713. See *Journal Publ’g Co. v. McCullough*, 743 So. 2d 352, 361 (Miss. 1999) (quoting *Harte-Hanks Commc’ns, Inc. v. Connaughton*, 491 U.S. 657, 688 (1989)).

714. See *Am. Home Assur. Co. v. United Space Alliance, LLC*, 378 F.3d 482, 488 (5th Cir. 2004) (“[I]f liability can be imposed without proving that the false statements were made with the knowledge that they were false, the knowledge of falsity exclusion will not apply to preclude coverage.”) (applying Texas law); *EEOC v. S. Publ’g Co., Inc.*, 894 F.2d 785, 790-91 (5th Cir. 1990) (emphasis removed).

715. *Nationwide*, 515 F.3d at 420.

716. *Id.*

717. *Id.* at 420-21.

718. See, e.g., *ABM Indus., Inc. v. Zurich Am. Ins. Co.*, 2006 WL 2595944, at \*26-27 (N.D. Cal. Sept. 11, 2006); *U.S. Fid. & Guar. Co. v. Saddle Ridge, L.L.C.*, 1999 WL 1072905, at \*5 (D. Kan. Sept. 27, 1999); *Kickham Group, Inc. v. Am. Nat’l Fire Ins. Co.*, 1997 WL 600710, at \*2-3 (N.D. Tex. Sept. 24, 1997); *Etchison v. Westfield Ins. Co.*, 2006 U.S. Dist. LEXIS 71467, at \*25-29 (N.D. W. Va. Sept. 29, 2006); *Thompson v. Md. Cas. Co.*, 84 P.3d 496, 506-07 (Colo. 2004); *Wysin v. Auto Owners Ins. Co.*, 2005 WL 2656642, at \*5 (Mich. Ct. App. Oct. 16, 2005); *Acme Constr. Co., Inc. v. Cont’l Nat’l Indem. Co.*, 2003 WL 194879, at \*6-7 (Ohio Ct. App. Jan. 30, 2003); *Bank One, Milwaukee, NA v. Breakers Dev., Inc.*, 559 N.W.2d 911, 912-13 (Wis. 1997).



that AFP's slander-of-title claims did not trigger coverage under the liability insurance contract.<sup>719</sup> Therefore, Nationwide did not have a duty to defend LCI against AFP's lawsuit.<sup>720</sup>

*2. Substantive Question: Whether Under Texas Law an Insured Electrical Contractor's Primary and Excess Insurer Has a Duty To Defend and a Duty To Indemnify After a Third Party Commenced a Multiple-Claims, Tort-Based Lawsuit Against the Contractor*

*Scottsdale Insurance Co. v. Knox Park Construction, Inc.* also presents a duty-to-defend controversy.<sup>721</sup> In *Scottsdale*, however, the conflict is between two liability insurers rather than an insured and its insurer.<sup>722</sup> The underlying facts are brief and familiar. Knox Park Construction Company (Knox Park) hired Shade Tree Electric, Inc. (Shade Tree) to do construction work.<sup>723</sup> After Knox Park discovered construction defects, the construction company sued Shade Tree in a Texas state court.<sup>724</sup> The complaint listed several causes of action: negligence, breach-of-warranty, and breach-of-contract.<sup>725</sup>

When Shade Tree performed the construction work, Landmark Insurance Company (Landmark) and Scottsdale Insurance Company (Scottsdale) insured the contractor under two liability insurance contracts.<sup>726</sup> Respectively, Scottsdale and Landmark were the primary and secondary/excess insurers.<sup>727</sup> Ultimately, Scottsdale, Shade Tree, and Knox Park settled the state court action.<sup>728</sup> Under the settlement agreement, Scottsdale agreed to pay and Knox Park accepted \$535,000.<sup>729</sup> In return, Knox Park released Shade Tree and Scottsdale from all liability.<sup>730</sup> Knox Park, however, retained the right to collect the difference between \$535,000 and \$1.2 million from Landmark.<sup>731</sup> Similarly, Scottsdale retained its right to recoup part of the \$535,000 from Landmark.<sup>732</sup>

Therefore, the primary insurer filed a declaratory-judgment action in the District Court for the Northern District of Texas.<sup>733</sup> Scottsdale asked the district court to declare that Landmark had a contractual duty to defend or

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719. *Nationwide*, 515 F.3d at 420.

720. *Id.* at 424.

721. *Scottsdale Ins. Co. v. Knox Park Constr., Inc.*, 488 F.3d 680, 682 (5th Cir. 2007).

722. *Id.* at 683.

723. *Id.* at 682.

724. *Id.*

725. *Id.* at 683.

726. *Id.* at 682-83.

727. *Id.*

728. *Id.*

729. *Id.*

730. *Id.*

731. *Id.*

732. *Id.*

733. *See id.*

indemnify (or both) Shade Tree.<sup>734</sup> Scottsdale and Landmark filed motions for summary relief.<sup>735</sup> Landmark presented three arguments: (1) Scottsdale did not establish an “ultimate defined loss”—which exceeded the limits of liability under Scottsdale’s policy and triggered Landmark’s contractual duty to defend or indemnify (or both) under the excess-liability policy; (2) Scottsdale’s breach of every condition precedent precluded Landmark’s duty to defend or indemnify (or both); and (3) Scottsdale failed to prove that Shade Tree was the insured under Landmark’s insurance contract.<sup>736</sup> After considering Landmark’s first argument, the district court granted and denied respectively Landmark’s and Scottsdale’s summary judgment motions.<sup>737</sup>

After the federal judge found that Landmark had no duty to defend Shade Tree and that the excess liability policy did not cover the third-party claims, Scottsdale appealed.<sup>738</sup> Before the Fifth Circuit, Scottsdale argued that Landmark’s—rather than Scottsdale’s—insurance contract covered Knox Park’s breach-of-warranty action.<sup>739</sup> Thus, from the primary insurer’s perspective, Landmark had a duty to pay for a portion of the \$535,000 settlement cost.<sup>740</sup> To help determine whether Landmark had a duty to indemnify, the court of appeals reviewed the excess insurer’s policy.<sup>741</sup> In relevant part, Landmark’s insurance contract stated:

We will pay those sums the insured becomes legally obligated to pay for “ultimate net loss” in excess of the “retained limit” because of “bodily injury” or “property damage” to which this insurance applies.<sup>742</sup>

The policy defined “ultimate net loss” as the insured’s total legal liability for causing third-party “bodily injury,” “property damage” or “advertising injury.”<sup>743</sup> “Retained limit” was defined as proceeds from “underlying insurance” or from “other collectible primary insurance.”<sup>744</sup> And “underlying insurance” was defined as “coverage(s) afforded under [designated] insurance policies.”<sup>745</sup>

According to Scottsdale, Landmark’s insurance contract provided for horizontal coverage if Scottsdale’s policy did cover a given claim.<sup>746</sup> Alternatively, Scottsdale argued that the coverage clause in Landmark’s policy

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734. *Id.* at 683.

735. *See id.*

736. *See id.*

737. *Id.*

738. *See id.* at 685.

739. *Id.*

740. *See id.*

741. *See id.* at 686.

742. *Id.*

743. *Id.* at 686 n.2.

744. *Id.* at 686.

745. *Id.* (emphasis in original).

746. *See id.* at 687.

was ambiguous, because “coverage(s) afforded” could mean insurance that Scottsdale’s policy did not exclude.<sup>747</sup> Under Texas law, if an insurance contract has more than one reasonable interpretation, courts must resolve the ambiguity by adopting the construction that favors coverage.<sup>748</sup> Applying that rule, the Fifth Circuit affirmed the district court’s holding and declared that Landmark’s policy conceivably required the excess insurer to indemnify Scottsdale.<sup>749</sup>

Did Landmark also have a duty to defend Shade Tree against Knox Park’s multiple-action lawsuit?<sup>750</sup> The court of appeals said no.<sup>751</sup> Landmark’s liability insurance contract stated in relevant part:

We have a duty to defend the insured[, Shade Tree,] against any “suits” to which this insurance applies: (a) But which *are not covered by any “underlying insurance”* . . . or (b) If the applicable limit of “underlying insurance” is exhausted.<sup>752</sup>

In light of the duty-to-defend clause, the Fifth Circuit correctly found that Scottsdale’s insurance contract covered some of Knox Park’s claims in the underlying lawsuit.<sup>753</sup> This finding was significant because Texas law is exceedingly clear: If an insurer has a duty to defend a single claim against its insured, the insurer has a duty to defend the insured against all third-party claims in the suit.<sup>754</sup> Consequently, the court of appeals declared that Scottsdale—the primary insurer—had a contractual duty to defend Shade Tree against the entire underlying suit, and reversed the district court’s ruling.<sup>755</sup>

### *3. Substantive Question: Whether Under Texas Law a Fidelity and Guaranty Insurer Has a Duty To Defend and Indemnify a Bank Against a Depositor Conversion-of-Funds Lawsuit After the Bank Allowed a Third-Party To Endorse Checks and Use the Depositor’s Funds in an Unauthorized Manner*

Homeowners’ policies are widespread and quite familiar. On the other hand, a financial institution bond is less well-known.<sup>756</sup> But like a homeowners’ policy, a fidelity or surety bond is a contract of insurance. In

747. See *id.* at 686-87.

748. See, e.g., *Nat’l Union Fire Ins. Co. v. Hudson Energy Co.*, 811 S.W.2d 552, 555 (Tex. 1991).

749. *Scottsdale*, 488 F.3d at 687.

750. See *id.* at 689.

751. See *id.*

752. *Id.* (emphasis added).

753. See *id.*

754. See *Utica Nat’l Ins. Co. v. Am. Indem. Co.*, 141 S.W.3d 198, 203 (Tex. 2004).

755. *Scottsdale*, 488 F.3d at 689.

756. See *Lynch Props., Inc. v. Potomac Ins. Co. of Ill.*, 140 F.3d 622, 627 (5th Cir. 1998) (observing the Surety & Fidelity Association of America developed Form 24—on which many financial institution bonds are modeled).

addition, like the typical homeowners' insurance contract, a bond has both first-party and third-party coverages.<sup>757</sup> In recent years, fidelity and surety insurers have not asked the Fifth Circuit to settle many duty-to-defend or duty-to-indemnify disputes involving institutional bonds; however, the court of appeals recently decided a bond case—*Citibank Texas, N.A. v. Progressive Casualty Insurance Co.*—a timely and important decision given the variety of ways that consumers may transact business with various financial institutions.<sup>758</sup>

Although these are the few underlying facts in *Citibank*, the financial institution and the third parties interrelationships are moderately complex. First, Todd P. Lindley (Lindley) is an exceedingly corrupt attorney.<sup>759</sup> He formed GoldenLife/Richardson L.P. (GoldenLife), a Texas limited partnership.<sup>760</sup> GoldenLife's stated goal was to develop and operate a skilled nursing facility in Richardson, Texas.<sup>761</sup> Additionally, Lindley was the president, director, and sole owner of Pilatus Company.<sup>762</sup> Furthermore,

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757. See The Surety & Fidelity Association of America, Surety, <http://www.surety.org/content.cfm?lid=70&catid=2> (last visited Nov. 11, 2008). The standard Form 24, Financial Institution Bond contains four basic coverage agreements: (1) an employee dishonesty/fidelity clause, (2) an on-the-premises loss of property provision, (3) an in-transit loss of property provision, and (4) a counterfeit-currency clause. Scott Simmonds, *Bank Insurance-Financial Institution Bond*, [http://www.scottsimmonds.com/content/financial\\_institution\\_bond.html](http://www.scottsimmonds.com/content/financial_institution_bond.html) (last visited Nov. 11, 2008). In addition, under most standard policies, a financial institution may purchase "optional coverage" for agents, audit-related expenses, losses from automated teller machines, check-kiting fraud, computer-systems fraud, data-processing services, debit-card fraud, destruction-of-data/hacker fraud, computer-viruses generated losses, losses from forgeries, unauthorized-signatures losses, and losses from fraudulent mortgages. *Id.* Also, additional riders or endorsements maybe added to cover other risks. See *id.*

758. See *Citibank Tex., N.A. v. Progressive Cas. Ins. Co.*, 522 F.3d 591 (5th Cir. Mar. 2008).

759. See Press Release, U.S. Dept. of Justice Dallas, Lawyer Pleads Guilty To Mail Fraud (Nov. 26, 2006), [http://www.usdoj.gov/usao/txn/PressRel06/lindley\\_ple\\_pr.html](http://www.usdoj.gov/usao/txn/PressRel06/lindley_ple_pr.html) (last visited on Aug. 31, 2008). ("Todd Patrick Lindley, a lawyer residing in Highland Park, Texas, pled guilty today to one count of mail fraud . . . Lindley, who was originally charged in a multi-count federal indictment returned by a grand jury in January, faces a maximum statutory sentence of 20 years imprisonment, a \$250,000 fine and restitution. He is scheduled to be sentenced on February 15, 2007, by United States District Judge Ed Kinkeade. Lindley's sole practitioner law office is located . . . in Dallas. Lindley was also the sole owner and director of Pilatus Company, Inc., which he ran from the same office on Preston Road. Pilatus was the general partner and managing partner for GoldenLife/Richardson I, L.P. which Lindley ran out of the Preston Road office. Lindley represented to investors that the purpose of GoldenLife/Richardson was to build a senior care center, also called a skilled nursing facility, in Richardson, Texas. Acting on behalf of Pilatus, Lindley represented that investor funds would be used to construct the project. He solicited money from investors by sending them a business plan in which he, as the President of Pilatus, proposed to construct the project. Lindley admitted that from November 15, 2000 to July 25, 2003, he devised a scheme to defraud investors of their money and property by representing to the investors that all the money he solicited would be used to acquire, own, develop, manage, lease, finance and operate, as well as build the project. However, Lindley admits that he converted investor money to his own purpose, among other things, to finance his prosecution of personal injury litigation. The amount of the fraud is approximately \$1.5 million.").

760. *Citibank*, 522 F.3d at 592.

761. *Id.*

762. *Id.*

“Pilatus was the general and managing partner for GoldenLife.”<sup>763</sup> The attorney also created Lindley Properties, Inc. (Properties).<sup>764</sup>

Put simply, Lindley developed the entire corporate web “to defraud investors of their money” so that he could finance his personal-injury law practice.<sup>765</sup> In fact, GoldenLife’s limited partners invested \$2,570,000 in the partnership.<sup>766</sup> Both GoldenLife and Properties had separate accounts at Citibank Texas, N.A. (Citibank).<sup>767</sup> And although Lindley was an authorized signatory on both accounts, Properties’ account was essentially Lindley’s personal account.<sup>768</sup> Therefore, to reach his fraudulent goal, Lindley endorsed sixteen “payable to GoldenLife” checks.<sup>769</sup> The face value of the checks was \$1,170,000.<sup>770</sup> He deposited those funds into the Properties account and used them in an unauthorized manner.<sup>771</sup>

After discovering Lindley’s misappropriations, GoldenLife filed an action for conversion against Citibank in a Texas state court.<sup>772</sup> Eventually, the state court decided in favor of GoldenLife.<sup>773</sup> However, before determining GoldenLife’s damages, Citibank and GoldenLife settled the dispute for \$845,000.<sup>774</sup> When the conversion occurred, Progressive Casualty Insurance Co. (Progressive) insured Citibank under a Financial Institution Bond (Bond).<sup>775</sup> The Bond covered the bank’s losses up to \$7,000,000, if forgeries, “unauthorized” signatures, fraud, and other acts of dishonesty caused the losses.<sup>776</sup> Citibank asked Progressive to reimburse the \$845,000; however, the fidelity insurer refused.<sup>777</sup>

Citibank sued Progressive in the District Court for the Northern District of Texas.<sup>778</sup> The complaint alleged that the fidelity insurer breached the contract and violated the Texas Insurance Code by acting in bad faith.<sup>779</sup> Citibank wanted reasonable settlement funds and attorneys’ fees for defending itself against GoldenLife’s lawsuit.<sup>780</sup> The bank also wanted damages for the insurer’s breach of the duty of good faith and fair dealing.<sup>781</sup> Progressive

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763. *Id.*

764. *Id.*

765. *Id.*

766. *Id.*

767. *See id.*

768. *Id.*

769. *Id.*

770. *Id.*

771. *Id.*

772. *Id.*

773. *Id.*

774. *Id.*

775. *Id.*

776. *Id.*

777. *Id.*

778. *Id.*

779. *Id.* at 593.

780. *Id.*

781. *Id.*

asserted that the Bond did not cover any of the claims in the underlying state-court lawsuit.<sup>782</sup> However, the district court concluded that Progressive breached the fidelity contract by failing to pay the settlement costs.<sup>783</sup> But the district court held that Progressive did not act in bad faith but did not owe attorneys' fees, and Progressive appealed.<sup>784</sup>

The Fifth Circuit fashioned the question presented this way: "whether the district court correctly held that Lindley's [check] endorsements were unauthorized under the Bond."<sup>785</sup> Under the Bonds Insuring Agreement D, Progressive promised to indemnify Citibank for "[a loss] resulting directly from . . . [f]orgery or alteration of, on or in any Negotiable Instrument."<sup>786</sup> The Bonds Unauthorized Signature Rider (Rider), however, modified the Insuring Agreement D.<sup>787</sup> The Rider stated in relevant part: "Accepting, paying or cashing any Negotiable Instruments or Withdrawal Orders that bear *unauthorized* signatures or *endorsements* shall be . . . a [f]orgery under this Insuring Agreement."<sup>788</sup>

The district court read the same clauses, but concluded that Progressive was liable for Citibank's loss.<sup>789</sup> The lower federal court found that Lindley's endorsements were "unauthorized" and therefore covered under the Bond.<sup>790</sup> To arrive at that conclusion, the district court embraced the definition of "unauthorized endorsement" under the Texas Business & Commerce Code: An endorsement is unauthorized when a party makes it "without actual, implied, or apparent authority."<sup>791</sup> But the Fifth Circuit determined that the state court's use of the definition of unauthorized endorsement under Texas law was irrelevant, and concluded that the district court's interpretation was "overly expansive."<sup>792</sup> Therefore, the court of appeals fashioned a new definition out of thin air: "[A]n endorsement is unauthorized if the person signing . . . had no authority . . . to endorse negotiable instruments for the named payee . . . or . . .

782. *Id.*

783. *Id.* at 593 n.4 (noting the district court awarded (1) \$695,000—the \$845,000 for the settlement less the Bond's \$150,000 deductible; (2) \$48,540 pre-judgment interest, and (3) \$79,591.84 in attorneys fees for prosecuting its claim on the Bond against Progressive). The total judgment was \$823,132.35—plus post-judgment interest at the rate of 4.99% per annum. *Id.*

784. *Id.* at 593.

785. *Id.* at 595.

786. *Id.* at 593.

787. *Id.*

788. *Id.* (emphasis added).

789. *Id.* at 592-93.

790. *Id.* at 592.

791. *Id.*; see TEX. BUS. & COM. CODE ANN. § 1.201(b)(41) (Vernon Supp. 2008).

792. *Citibank*, 522 F.3d at 595 ("The Bond's terms and definitions were not before the state court in the suit between Citibank and GoldenLife, so that court applied the definition of unauthorized endorsement found in the Uniform Commercial Code (UCC). . . . The state court's determination that Lindley's endorsements were unauthorized under the UCC definition is neither in dispute nor legally relevant to this appeal. Rather, we must decide whether the district court correctly held that Lindley's endorsements were 'unauthorized' under the Bond.").

had some authority to endorse for the named payee but exceeded the scope of his endorsement authority."<sup>793</sup>

Citibank argued, and the district court found, that Lindley fraudulently endorsed the sixteen checks for his personal use, and he did so without securing any actual, implied, or apparent authority from GoldenLife.<sup>794</sup> But citing its newly fabricated definition of an "unauthorized endorsement," the Fifth Circuit stressed that "even though Lindley exceeded the scope of his endorsement authority," he still had some authority to endorse the checks.<sup>795</sup> Therefore, from the court of appeals perspective, because Lindley was "an authorized endorser of GoldenLife checks for some purposes," his endorsement of the checks was not a covered peril.<sup>796</sup> Stated slightly differently, since Lindley "had some authority to endorse" the negotiable instruments, his endorsements—for better or worse—were authorized.<sup>797</sup> Consequently, the court of appeals declared that the Bond did not cover the losses.<sup>798</sup>

Unquestionably, the Fifth Circuit's decision in *Citibank* is the most unduly strained, decisively unfair, and needlessly bothersome ruling of all the decisions appearing in this review. The reasons for this conclusion are not terribly complex. First, the Fifth Circuit decided *Citibank* without applying any existing Texas law.<sup>799</sup> What is more disturbing is that, although a plain reading of an on-point Texas statute would have resolved the controversy decidedly and fairly, the Fifth Circuit chose the more difficult path by creating a rule out of whole cloth and applying it to reach a strained and arguably predetermined result.<sup>800</sup>

Second, the Texas Supreme Court has embraced five doctrines to interpret insurance contracts.<sup>801</sup> However, without citing a single Texas case, the Fifth Circuit concluded that the doctrine of ambiguity did not apply.<sup>802</sup> Citing its own decisions, the court concluded that the language in *Citibank*'s Bond could not be construed against Progressive because the American Bankers Association and the Surety & Fidelity Association of America often negotiate and jointly draft financial institution bonds.<sup>803</sup> But there is a major

793. *Id.* at 596.

794. *See id.*

795. *Id.*

796. *Id.* (emphasis added).

797. *See id.*

798. *See id.* at 596-97.

799. *See id.* at 595-97.

800. *Id.*

801. *See* sources cited *supra* notes 525-59. Again, those doctrines include the following: the general rules of contract construction, the doctrine of ambiguity, the qualified reasonable expectation doctrine, the doctrine of plain meaning, and the adhesion doctrine. Insurance contract rules have also been applied to such things as fidelity and surety bonds. *See Great Am. Ins. Co. v. Langdeau*, 379 S.W.2d 62, 65 (Tex. 1964) (stating that when construing fidelity bonds and surety bonds, courts follow the rules applicable to insurance contracts and not strict rules of suretyship).

802. *See Citibank*, 522 F.3d at 595-97.

803. *See id.* at 596 n.12 ("The general rule that ambiguities in insurance contracts are to be construed strictly against the underwriter does not apply in this case. . . . '[B]anker's blanket bonds'. . . are often

problem with the Fifth Circuit's conclusion: In *Citibank*, there was no evidence that Citibank, Progressive, or members of the insurers and bankers associations negotiated and drafted the Bond.<sup>804</sup>

#### IV. CONSTITUTIONALITY OF A STATE STATUTE THAT REGULATES INSURERS' BUSINESS ACTIVITIES—SUBSTANTIVE QUESTION: WHETHER A TEXAS STATUTE VIOLATES THE CONSTITUTION'S DORMANT COMMERCE CLAUSE AND THE FIRST AMENDMENT FOR PREVENTING AUTOMOBILE INSURERS FROM OWNING AND OPERATING AUTOMOTIVE BODY SHOPS

Increasingly, insurers are trying to “manage” auto repairs like they manage health care.<sup>805</sup> Therefore, to reduce costs, liability insurers encourage their insureds to use a shop whose name appears on an approved list of auto body repair shops.<sup>806</sup> “According to the National Association of Independent Insurers, a trade group, about 22% of customers offered a direct-repair option take it.”<sup>807</sup> For nearly 20 years, Allstate Corporation has operated its Priority Repair Option (PRO) program.<sup>808</sup> And the explanation is simple: “Repairing cars is a huge business. In a typical year, [insureds file] 25 million to 30 million auto claims. . . . [Those include] collisions and weather-related claims such as hail damage.”<sup>809</sup>

Without doubt, PROs have been controversial, because “[under] conventional direct-repair programs, customers [may] choose from a broader list of shops or [they may] elect not to participate.”<sup>810</sup> But again, insurers want

drafted by the joint efforts of associations represented by insurers and insureds. If the banks and the insurers are equally responsible for the language in the ‘Standard Form’ Bond, the general principle that our interpretation of ambiguous contract language favor the insured would be inapt.” (citing *Calcasieu-Marine Nat’l Bank v. Am. Employers Ins. Co.*, 533 F.2d 290, 295 n.6 (5th Cir. 1976)); see also *Nat’l Bank of Commerce in New Orleans v. Fid. & Cas. Co. of N.Y.*, 312 F. Supp. 71, 74 (E.D. La. 1970) (concluding that since a banker’s blanket bond evolves from the American Bankers Association and the Surety Association and the Surety Association of America’s joint efforts and negotiation, the terms in a bond should not be applied hostilely against the insurer), *aff’d*, 437 F.2d 96 (5th Cir. 1971).

804. Cf., *Shoals Nat’l Bank of Florence v. Home Indem. Co.*, 384 F. Supp. 49, 54 (N.D. Ala. 1974) (noting that bankers’ blanket bonds can evolve from the efforts of insurers and bankers, but concluding that ambiguities in the insurance contracts must be construed against the insurer because there was no evidence in the record indicating that the bank, or any association acting on its behalf, negotiated the language in the bond with the insurer).

805. See Anne Colden, *Insurers Try “Managed Care” for Autos—Interest in Using Prescribed Repair Shops Increases*, WALL ST. J., Aug. 25, 1995, at A5C.

806. *Id.*

807. *Id.*

808. *Id.* (“Geico Corp. participates, as do nonstandard insurers Progressive Corp. and Integon Corp. Multiline insurers IIT Hartford . . . and St. Paul Companies also take part, although St. Paul’s program . . . is limited to glass repair.”).

809. See Christopher Oster, *Car Insurers Get Into the Repair Business—To Control Costs, Carriers Take Over the Fix-It Work; But Will They Cut Corners?*, WALL ST. J., Apr. 8, 2003, at D1 (“In 2001, the most recent year for which statistics are available, the total damage from such claims was \$35.4 billion, according to the Insurance Information Institute, a trade group.”).

810. Colden, *supra* note 805.



more control over how insurance proceeds are spent.<sup>811</sup> And that explains in part why Allstate—the nations second-largest auto insurer—purchased a chain of auto repair shops in 2001.<sup>812</sup> In the wake of consumers' complaints, however, regulators in New York ordered Allstate to terminate its PRO program.<sup>813</sup> But a federal district court reversed a part of the order, concluding that it violated Allstate's freedom of speech under the First Amendment.<sup>814</sup>

Allstate's PRO program also has generated a lot of controversy in Texas.<sup>815</sup> And that program caused the constitutional conflict that Allstate asked the Fifth Circuit to address in *Allstate Insurance Co. v. Abbott*.<sup>816</sup> Allstate acquired Sterling Collision Centers, Inc. (Sterling), a multi-state chain of repair shops.<sup>817</sup> At the time, Sterling operated "approximately 60 auto body repair shops in 14 states, including 15 shops in the state of Texas."<sup>818</sup> After the acquisition, Allstate instructed its telephone service representatives to use a specific script when discussing auto repairs with their insureds.<sup>819</sup> Stated briefly, the agents encouraged consumers to use Allstate's PRO services at the Sterling shops, without disclosing that policyholders also had a right use a different auto-repair shop.<sup>820</sup>

In 2003, the Texas Legislature heard testimony from consumers and auto-repair associations, detailing the dangers of allowing insurance companies to own auto body repair shops.<sup>821</sup> Those opponents argued that such arrangements would produce conflicts of interest, elevate the risk of illegal steering, and encourage body shops to make shoddy repairs to reduce costs to the insurers.<sup>822</sup>

After considering those concerns and others, the Legislature enacted H.B. 1131—The Insurer Interests in Repair Facilities Act.<sup>823</sup>

H.B. 1131 has several relevant provisions.<sup>824</sup> First, it prohibits an insurer from owning or acquiring an interest in an auto repair facility.<sup>825</sup> But it exempts body repair facilities that were open before the statute was enacted.<sup>826</sup>

811. *Id.*

812. *See* Oster, *supra* note 809.

813. *See id.*

814. *See* Allstate Ins. Co. v. Serio, No. 97CIV.0670(RCC), 2000 WL 554221, at \*3 (S.D.N.Y. May 5, 2000).

815. *See* Colden, *supra* note 805 ("[T]he Automotive Service Association—based in Bedford, Texas—said its membership is also split on whether direct repair is a good idea. In a survey in 1994, about 55% of its 5,500 collision division members said they took part in direct-repair programs, said spokeswoman Monica Buchholz.").

816. *See* Allstate Ins. Co. v. Abbott, 495 F.3d 151, 154-55 (5th Cir. Aug. 2007).

817. *Id.*

818. *Id.* at 155.

819. *See id.*

820. *See id.*

821. *See id.* at 156.

822. *See id.*

823. TEX. OCC. CODE ANN. § 2307.002 (Vernon 2005); *Abbott*, 495 F.3d at 156.

824. *See* § 2307.002.

825. *Id.*

826. *Id.*

Most notably, H.B. 1131 prevents an insurer from entering into a “favored facility agreement exclusively with its tied repair facilities.”<sup>827</sup> Put simply, an insurer must establish an identical “referral program” with at least one unaffiliated body shop.<sup>828</sup> Shortly after the legislature enacted H.B. 1131, Allstate filed suit.<sup>829</sup> The insurer claimed that H.B. 1131 violated the dormant Commerce Clause of the Constitution and the First Amendment.<sup>830</sup>

More specifically, Allstate argued that the bill’s purpose and effect discriminated irrationally against interstate commerce because the bill prevented Sterling from opening additional body shops in Texas.<sup>831</sup> Allstate claimed that the bill violated the First Amendment because the insurer’s ability to promote the Sterling shops—using truthful and non-deceptive commercial speech—was contingent on Allstate promoting other body shops.<sup>832</sup> The district court concluded that the bill did not violate the dormant Commerce Clause; therefore, Texas could prevent Allstate from acquiring additional auto body repair shops.<sup>833</sup> On the other hand, the district court held that H.B. 1131’s speech provisions violated the First Amendment.<sup>834</sup> Both Allstate and the State of Texas appealed.<sup>835</sup>

The Fifth Circuit conducted a *de novo* review because the district court’s judgment concerned the constitutionality of a statute.<sup>836</sup> Federal constitutional law is clear: “A [state] statute violates the dormant Commerce Clause where it discriminates against interstate commerce either facially, by purpose, or by effect.”<sup>837</sup> A discriminatory statute may be valid “if the state ‘can demonstrate, under rigorous scrutiny, that it has no other means to advance a legitimate local interest.’”<sup>838</sup> Furthermore, a non-discriminatory statute may violate the dormant Commerce Clause if the statute’s burden on interstate commerce is “clearly excessive” when compared to the local benefits.<sup>839</sup> Applying those principles and citing an array of probative facts, the Fifth Circuit embraced the district court’s conclusion and held that H.B. 1131 did not violate the dormant Commerce Clause.<sup>840</sup>

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827. TEX. OCC. CODE ANN. § 2307.006(11) (Vernon 2005).

828. *Abbott*, 495 F.3d at 157.

829. *See id.*

830. *See id.*

831. *Id.*

832. *Id.*

833. *Id.* at 158.

834. *Id.*

835. *Id.*

836. *Id.* at 160 (citing *Castillo v. Cameron County*, 238 F.3d 339, 347 (5th Cir. 2001)).

837. *See id.* (quoting *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 270 (1984)).

838. *Id.* (quoting *C & A Carbone, Inc. v. Town of Clarkstown, N.Y.*, 511 U.S. 383, 392 (1994)).

839. *Id.* (citing *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970)).

840. *Id.* at 160-64 (“Allstate and Sterling have failed to demonstrate a clear and consistent pattern of discriminatory action by the Texas Legislature . . . . Allstate has failed to establish a history of hostility towards Allstate singularly or towards out-of-state companies in general. . . . Moreover, much of Allstate’s evidence of ‘discrimination’ towards out-of-state companies is simply evidence of a legislative desire to treat differently two business forms—independent auto body shops on the one hand and insurance-company-owned

The district court also declared that H.B. 1131 violated the First Amendment's protection of truthful and non-deceptive commercial advertising.<sup>841</sup> The district court found a violation in light of another settled constitutional principle: If commercial speech is not false, deceptive, or misleading, the First Amendment protects the speech from unwarranted governmental regulation.<sup>842</sup> The Supreme Court fashioned a multi-pronged test to determine whether a statute could regulate commercial speech.<sup>843</sup> Applying the *Central's* test in *Abbott*, the Fifth Circuit concluded that (1) H.B. 1131 prohibited advertisements that were not misleading; (2) H.B. 1131 did not directly and materially advance Texas's asserted interest of protecting consumers and ensuring fair competition; and (3) Texas could have chosen a more narrowly tailored restriction to advance the state's interest.<sup>844</sup>

## V. CONCLUSION

This Article has reviewed nineteen of the Fifth Circuit's 2007-2008 insurance law decisions.<sup>845</sup> Generally, the lucidity and thoroughness of the analyses ranged from very good to less than ideal. On one hand, the opinions were well-reasoned and the Fifth Circuit diligently applied Louisiana, Mississippi, and Texas common law and statutes. Furthermore, when comparing this year's opinions to those decided five years ago, the result is undisputable: Rather than awarding or denying summary relief without an explanation, both the district courts' and the Fifth Circuit's panels discussed

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auto body shops on the other—a distinction based not on domicile but on business form. . . . Allstate and Sterling [also] argue[d] that H.B. 1131 has a discriminatory *effect* because it favors in-state body shops and will cause these services to shift from an out-of-state provider (i.e., Sterling) to in-state providers. . . . [However, that] argument is unpersuasive. As an initial matter, H.B. 1131 does not require Allstate to shut any Sterling stores. Thus it is unclear how the new regulations would affect any shift in the current level of business presently enjoyed by out-of-state suppliers of body shops to in-state shops. However, even if we were to assume that H.B. 1131 would act to reduce Sterling's ability to attract new business, which local body shops would then capture, this would still not establish a Commerce Clause violation. . . . Further, even if we were to characterize Sterling's inability to expand as a burden on interstate commerce, that burden would not be clearly excessive as compared to H.B. 1131's putative local benefits. . . . [Thus] we conclude H.B. 1131 does not violate the dormant Commerce Clause[.]”)

841. *Id.* at 157-58.

842. *Id.* at 165 (citing *Zauderer v. Office of Disciplinary Counsel*, 471 U.S. 626, 628 (1985)).

843. *Id.* (citing *Cent. Hudson Gas & Elec. Corp., v. Pub. Serv. Comm'n of N.Y.*, 447 U.S. 557, 564-66 (1980)) (“[A court must ask] whether the commercial speech concerns unlawful activity or is misleading. If so, . . . the speech is not protected . . . . If the speech concerns lawful activity and is not misleading, however, a court [must] ask whether the asserted governmental interest is substantial. If it is, . . . [the] court [must determine] whether the regulation directly advances the governmental interest . . . and . . . whether it is not more extensive than is necessary to serve that interest. Each of these latter three inquiries must be answered in the affirmative for the regulation to be found constitutional.”); see *Thompson v. Western States Med. Ctr.*, 535 U.S. 357, 367 (2002)).

844. *Id.* at 165-68.

845. See *supra* note 1 and accompanying text.

facts carefully, applied the five doctrines of contract construction and interpretation, and explained their rulings.<sup>846</sup>

On the down side, the Fifth Circuit continues to ignore states' settled principles in far too many instances. This is especially true, when the Fifth Circuit decides controversies involving a resident of Texas and a foreign litigant.<sup>847</sup> During the 2007-2008 session, the court of appeals created a rule out of thin air and applied it, while ignoring an on-point Texas principle.<sup>848</sup> Even more troublesome, the Fifth Circuit completely ignored Texas law and applied the laws of the Fifth Circuit and its panels.<sup>849</sup> To be sure, correcting these unsettling practices would make the decisions more predictable, intelligible, and arguably, more fair.

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846. *See supra* Parts I-IV.

847. *See supra* Part II.C.3-4.

848. *See supra* Part III.B.3.

849. *See supra* Part II.C.3-4.

