

# Restatement of the Law: Liability Insurance

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# American Law Institute

**Restatements** are primarily addressed to courts and aim at clear formulations of common law and its statutory elements, and reflect the law as it presently stands or might appropriately be stated by a court. Although Restatements aspire toward the precision of statutory language, they are also intended to reflect the flexibility and capacity for development and growth of the common law. That is why they are phrased in the descriptive terms of a judge announcing the law to be applied in a given case rather than in the mandatory terms of a statute.

# CONFIDENTIALITY

## § 11. Confidentiality

(1) An insurer or insured does not waive rights of confidentiality with respect to third parties by providing to the insured or the insurer, within the context of the investigation and defense of a legal action, information protected by attorney-client privilege, work-product immunity, or other confidentiality protections.

(2) An insurer does not have the right to receive any information of the insured that is protected by attorney-client privilege, work-product immunity, or a defense lawyer's duty of confidentiality under rules of professional conduct, if that information could be used to benefit the insurer at the expense of the insured.

# CONFIDENTIALITY

## ILLUSTRATIONS:

2. Insured child is sued for property damage arising out of a fire allegedly started by the child at school. During a private meeting with the child and child's parents, the attorney obtains information indicating that the child may have intentionally set the fire for the purpose of damaging the school. The defense lawyer provides this information to the insurer without consent of the child or the parents.

That information is relevant to a potential coverage dispute between the insured and insurer and should not have been disclosed to the insurer under the circumstances. Nevertheless, the provision of that information to the insurer does not waive the confidentiality of that information with respect to the plaintiff in the underlying tort action.

# CONFIDENTIALITY

4. Insured child is sued for property damage arising out of a fire allegedly started by the child at school. Insurer hires a defense lawyer to defend the insured. During a deposition, the child provides testimony indicating that the child may have intentionally set the fire or purpose of damaging the school.

Upon request, the insurer has the right to a copy of the transcript of the deposition, even though the testimony could lead the insurer to refuse to cover the suit, because deposition testimony is not confidential.

# CONFIDENTIALITY- TEXAS

Texas law seems to fall in line with the Restatement. As set forth in *Employer's Cas. Co. v. Tilley*, 496 S.W.2d 552(Tex. 1973), defense counsel's ethical obligation runs to the insured and (s)he should not provide information to the insurance company which is detrimental to the insured with respect to coverage

# DUTY TO DEFEND

## § 13. Conditions Under Which the Insurer Must Defend

(1) An insurer that has issued an insurance policy that includes a duty to defend must defend any legal action brought against an insured that is based in whole or in part on any allegations that if proved, would be covered by the policy, without regard to the merits of those allegations.

(2) For the purpose of determining whether an insurer must defend the legal action is deemed to be based on:

(a) Any allegation contained in the complaint or comparable document stating the legal action; and

(b) Any additional allegation known to the insurer, not contained in the complaint or comparable document stating the legal action, that a reasonable insurer would regard as an actual or potential basis for all or part of the action.



# DUTY TO DEFEND

(3) An insurer ... must defend until its duty to defend is terminated under § 18 by declaratory judgment or otherwise, unless facts not at issue in the legal action for which coverage is sought and as to which there is no genuine dispute establish that:

(a) The defendant in the action is not an insured;

(b) The vehicle or other property involved in the accident is not covered property ...;

(c) The claim was reported late under a claims-made-and-reported policy;

(d) The action is subject to a prior-and-pending-litigation exclusion or a related-claim exclusion in a claims-made policy;

(e) ... [T]he insurance policy has been properly cancelled; or

(f) There is no duty to defend under a similar, narrowly defined exception to the complaint-allegation rule recognized by the courts in the applicable jurisdiction.

# DUTY TO DEFEND

## § 10. Scope of the Right to Defend

When a liability insurance policy grants the insurer the right to defend a legal action,

That right includes, unless otherwise stated in the policy or limited by applicable law:

(1) The authority to direct all the activities of the defense of any legal action that the insurer has a right to defend, including the selection and oversight of defense counsel; and

(2) The right to receive from defense counsel all information relevant to the defense or settlement of the action, subject to the exception for confidential information stated in § 11(2).

# DUTY TO DEFEND

## § 14. Duty to Defend: Basic Obligations

When an insurance policy obligates an insurer to defend a legal action:

(1) Subject to the insurer's right to terminate the defense under § 18, the insurer has a duty to provide a defense of the action that:

(a) Makes reasonable efforts to defend the insured from all of the causes of action ..., including those not covered by the liability insurance policy; and

(b) Requires defense counsel to protect from disclosure to the insurer any information of the insured ..., if that information could be used to benefit the insurer at the expense of the insured;

(2) The insurer may fulfill the duty to defend using its own employees, except when an independent defense is required;

# DUTY TO DEFEND

## § 20. When multiple Insurers Have a Duty to Defend

When more than one insurer has the duty to defend a legal action brought against an insured:

(1) The insured may select any of these insurers to provide a defense of the action;

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(3) The selected insurer must provide a full defense until the duty to defend ... until another insurer assumes the defense ... .

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(5) If neither the policies nor the insurance-market practice establish an order of priority:

(a) The duty to defend is independently and concurrently owed to the Insured by each of the insurers;

(b) Any nonselected insurer has the obligation to pay its pro rata share of the reasonable costs of defense of the action and the noncollectible shares of other insurers; and

(c) A selected insurer may seek contribution from any of the other insurers for the costs of defense.

# DUTY TO DEFEND- TEXAS

Basically comports with Texas law. Although not directly addressed by Texas case law, Restatement prohibits carrier from agreeing to provide defense by paying less than full pro-rata share based on carriers actually providing a defense.

# LIABILITY FOR DEFENSE

## § 12. Liability of Insurer for Conduct of Defense

(1) If an insurer undertakes to select counsel to defend a legal action against the insured and fails to take reasonable care in so doing, the insurer is subject to liability for the harm caused by any subsequent negligent act or omission of the selected counsel that is within the scope of the risk that made the selection of counsel unreasonable.

(2) An insurer is subject to liability for the harm caused by the negligent act or omission of counsel provided by the insurer to defend a legal action when the insurer directs the conduct of the counsel with respect to the negligent act or omission in a manner that overrides the duty of the counsel to exercise independent professional judgment.

# LIABILITY FOR DEFENSE-TEXAS

## TEXAS LAW

The Texas Supreme Court's decision in *State Farm Mut. Auto. Ins. Co. v. Traver*, 980 S.W.2d 625(Tex. 1998) is directly contrary to the Restatement. In *Traver*, the Court held that an carrier is not responsible for the acts of defense counsel. The Court reasoned that defense counsel is an independent contractor and the carrier does not exercise the requisite control to be vicariously liable.

# DUTY TO SETTLE

## § 24. The Insurer's Duty to Make Reasonable Settlement Decisions

(1) When an insurer has the authority to settle a legal action brought against the insured, or the insurer's prior consent is required for any settlement by the insured to be payable by the insurer, and there is a potential for a judgement in excess of the applicable policy limit, the insurer has a duty to the insured to make reasonable settlement decisions.

(2) A reasonable settlement decision is one that would be made by a reasonable insurer that bears the sole financial responsibility for the full amount of the potential judgment.

(3) An insurer's duty to make reasonable settlement decisions includes the duty to make its policy limits available to the insured for the settlement of a covered legal action that exceeds those policy limits if a reasonable insurer would do so in the circumstances.



# DUTY TO SETTLE- TEXAS

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

## THREE ELEMENTS

- (1) the claim against the insured is within the scope of coverage;
- (2) the amount of the demand is within the policy limits; and
- (3) the terms of the demand are such that an ordinary prudent insurer would accept it, considering the likelihood and the degree of the insured's potential exposure to an excess judgment.

# DUTY TO SETTLE- TEXAS

- Texas law is consistent with Restatement with respect to elements of cause of action. Texas law differs significantly with respect to duty. There is no duty under Texas law to negotiate or make settlement offers.

# MULTIPLE CLAIMANTS

## § 26. The Effects of Multiple Claimants on the Duty to Make Reasonable Settlement Decisions

(1) If multiple legal actions that would count toward a single policy limit are brought against an insured, the insurer has a duty to the insured to make a good-faith effort to settle the actions in a manner that minimizes the insured's overall exposure.

(2) The insurer may, but need not, satisfy this duty by interpleading the policy limits to the court, naming all known claimants . . . .

# MULTIPLE CLAIMANTS- TEXAS

*Texas Farmers Ins. Co. v. Soriano*, 881, S.W.2d 312 (Tex. 1994)

## HOLDING

- No *Stowers* exposure
- Can settle one of multiple claims, if:
  - No unreasonable refusal of other demand, or
  - Settlement of claim is reasonable when viewed in isolation.
- Sounds like “first come, first serve” but may not be

# MULTIPLE CLAIMANTS- TEXAS

Strong argument that Texas law is consistent with Restatement part 1 because *Soriano* does not address issue of whether you have to settle one at a time but only holds that it may be proper. Texas law does not allow interpleader unless you obtain agreement to provide full and final release before filing.

# COVERAGE DISPUTE

## § 25. The Effect of a Reservation of Rights on Settlement Rights and Duties

A reservation of the right to contest coverage does not relieve an insurer of the duty to make a reasonable settlement decisions stated in § 24, but the insurer is not required to cover a judgment on a noncovered claim.

# COVERAGE DISPUTE-TEXAS

*American Western Homes Ins. Co. v. Tristar Convenience Stores, Inc.*, 2011 WL 2412678 (S.D. Tex June 2, 2011)

## FACTS

- Settlement demand for policy limits for all defendants
- Carrier rejected demand because of coverage issues
- 2<sup>nd</sup> settlement demand for policy limits for 2 defendants
- Carrier accepted 2<sup>nd</sup> demand
- Carrier brings suit seeking declaration that policy exhausted and no duty to defend
- Insured argued that failure to accept 1<sup>st</sup> demand violates *Stowers*

## HOLDING

- Carrier not entitled to summary judgment
- *Garcia* states no *Stowers* if no coverage
- *Garcia* does not mean no *Stowers* if coverage dispute
- Existence of coverage dispute relevant to whether carrier acted reasonably

# COVERAGE DISPUTE-TEXAS

Texas law seems to conflict with the Restatement in that Texas law allows the coverage dispute to be considered in determining whether the carrier acted reasonably in declining the demand whereas the Restatement appears to make a coverage issue irrelevant to the inquiry.



# FAILURE TO SETTLE DAMAGES

## § 27. Damages for Breach of the Duty to Make Reasonable Settlement Decisions

(1) An insurer that breaches the duty to make reasonable settlement decisions is subject to liability for any foreseeable harm caused by the breach, including the full amount of damages assessed against the insured in the underlying legal action, without regard to the policy limits.

# FAILURE TO SETTLE DAMAGES- TEXAS

The Restatement clearly does not limit damages for a failure to settle to the amount of the excess verdict. In the comment section, it suggests that the damages include consequential damages similar to any other tort causes of action which would include mental anguish, financial damages and punitive damages. There is no Texas case which directly addresses the issue but the cases imply that the amount of the excess judgment may be the sole element of damage.

# ALLOCATION AMONG CARRIERS

## § 41. Allocation in Long-Tail Harm Claims Covered by Occurrence-Based Policies

(1) Except as stated in subsection (2), when indivisible harm occurs over multiple policy periods, the amount of any judgement entered in or settlement of any liability action arising out of that harm is subject to pro rata allocation under occurrence-based liability insurance policies as follows;

(a) For purposes of determining the share allocated to an occurrence-based liability insurance policy that is triggered by harm during the policy period, the amount of the judgement or settlement is allocated equally across years, beginning with the first year in which the harm occurred and ending with the last year in which the harm would trigger an occurrence-based liability insurance policy;

## ALLOCATION AMONG CARRIERS-TEXAS

Texas law is not settled on the issue whether vertical or horizontal exhaustion applies. The Restatement adopts horizontal exhaustion and provides a very straight forward and easy method to allocate among multiple policy periods and carriers.

# EXHAUSTION

## § 39. Excess Insurance: Exhaustion and Drop Down

When an insured is covered by an insurance policy that provides coverage that is excess to an underlying insurance policy, the following rules apply, unless otherwise stated in the excess insurance policy:

(2) The underlying policy is exhausted when an amount equal to the limit of that policy has been paid to claimants for a covered loss, or for other covered benefits subject to that limit, by or on behalf of the underlying insurer or the insured;

# EXHAUSTION- TEXAS

The Restatement defines exhaustion as payment of the policy limits to a claimant without requiring that the payment be made in connection with a judgment or settlement. This appears contrary to the plain language of the standard primary policy. Also, it would allow payment in exchange for a covenant not to execute while Texas law is unsettled on the issue.