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**INSIDE THIS ISSUE...**

p.1 American International Specialty Lines Ins. Co. v. Res-Care, Inc.

p.2 Upcoming Events

***American International Specialty Lines Ins. Co. v. Res-Care, Inc.***

By: R. Brent Cooper

This past week, the 5th Circuit Court of Appeals handed down a decision again addressing the issue of whether Texas public policy would allow punitive damages to be insured under a liability insurance policy. This case involved a 37-year old woman with cerebral palsy and mental disabilities who was living at an assisted living facility. On April 12, 1998, she fell in the hallway and defecated on the floor. One of the employees of the facility poured a mixture of undiluted bleach and another cleaner on the floor and escorted the other residents outside. The resident was later found clad only in a T-shirt and lying in the feces and the bleach, where she had been left for over one hour while the employee ate pizza outside. She was later found to have severe burns over 40% of her body. She died from complications due to the severe burns. The employee was later convicted in state court of recklessly calling bodily injury to a disabled individual.



The family later sued the facility for wrongful death and survival. Prior to the settlement, American International and Res-Care executed a separate non-waiver agreement that authorized American to seek a settlement of the right to suit. This suit was settled for \$9 million and was paid by American International.

American International then sought recovery in District Court under the non-waiver agreement. The trial court conducted a bench trial to apportion the settlement between covered and uncovered claims. American International contended at trial that the actual damages were between \$2 million and \$3.5 million while Res-Care contended the entire \$9 million settlement represented actual damages. The District Court allocated \$4 million of the settlement to actual damages and \$5 million to punitive damages. The District Court entered a judgment in favor of American International for \$5 million.

Numerous issues were presented on appeal. One was whether there could be coverage for the punitive damages. The umbrella policies had an exclusion for punitive damages. However, the primary policies had no such exclusion. Res-Care argued that the Texas Supreme Court had decided in *Fairfield Ins. Co. v. Stephens Martin Paving, LP*, 246 S.W.3d 653 (Tex. 2008), that Texas public policy did not preclude the insurability of punitive damages.

The court noted that the Legislature has precluded the insurability of punitive damages for healthcare providers in Texas. However, the facility operated by Res-Care was an intermediate-care facility for the mentally retarded and was not included in the definition of "healthcare providers" found in the Insurance Code. Tex.Ins.Code §1901.001. The court held that in the absence of any specific legislative policy directives, the court should determine whether an agreement is unenforceable on public policy grounds "by weighing the interest in enforcing the agreement versus the public policy interest against such

Continued on page 2

enforcement.” The court noted that in the Fairfield decision, that there were “extreme circumstances” where “extreme and avoidable conduct that causes injury” may not allow coverage for punitive damages. The court concluded that the case at hand was such an instance. The court noted that Res-Care was grossly negligent in its action not only for direct participation in the bleach incident, but also for failing to take reasonable steps to prevent the situation from occurring and failure to alleviate the harm that occurred during the incident.

There were allegations and reports from the state of Texas that showed Res-Care was poorly operating other facilities, thereby establishing a course of conduct warranting punitive damages. The court concluded that the circumstances of the individual's injury and death were indicative of a systemic problems of care and were so extreme that the purposes of punishment and deterrents of conscious indifference outweighed the normally strong public policy permitting the right of contract between insurer and insured.

It should also be noted that on June 6, 2008, the Supreme Court denied the petition for review in *Admiral Ins. Co. v. Westchester Ins. Co.* This was an appeal from the Fort Worth Court of Appeals where in that particular situation, the Fort Worth Court had held that providing insurance coverage for punitive damages in those particular circumstances was not against public policy. ●

## UPCOMING EVENTS...

**Transportation Seminar -  
June 20, 2008 Dallas, Texas**

**Appellate Seminar -  
September 19, 2008, Dallas,  
Texas**

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