

STOWERS: OLD AND NEW

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A. PRACTICAL APPLICATION

When a carrier or defense counsel receives a letter from a claimant or plaintiff offering to settle for policy limits, there are several considerations that should be kept in mind before and in preparation of the response to the demand letter. Most importantly, please remember that the demand letter and its response will be exhibits 1 and 2 to any subsequent *Stowers* lawsuit.

You should first consider whether the demand letter meets the basic requirements under the doctrine. In other words, make sure that the letter contains an unconditional demand within the policy limits which offers a full and final release. Additionally, the plaintiff's claims must be covered under the policy of insurance. If there is any question as to whether the requirements are met, you should consider corresponding with the plaintiff's attorney to resolve any of the ambiguities in the demand letter. It is certainly better to clear up any ambiguities than to operate under the assumption that it was not a proper *Stowers* demand and have a court subsequently tell you that you were wrong.

In drafting the actual response, you certainly want to be as courteous as possible. You need to make sure that you comply with the time limit imposed upon the demand. If you need additional time, do not hesitate to request additional time from plaintiff's counsel shortly after receiving the settlement demand. Counsel's failure to provide you additional time will certainly indicate to a jury that the first time limit was unreasonable and the letter was merely an attempt to trap the insurance company.

If you are rejecting the demand, make the letter as specific as possible with respect to the reasons for the denial. The

settlement demand and your response should not be admissible in the liability action and therefore you need not be concerned with divulging any defense strategy or privileged information.

B. THE OLD

1. Elements

G.A. Stowers Furniture Co. v. American Indemnity Co., 15 S.W.2d 544 (Tex.Comm'n.App. 1929, holding approved) is the landmark Texas case imposing a duty on an insurer to exercise reasonable care on behalf of the insured. The *Stowers* case first recognized that the insurer had a duty to exercise ordinary care in the handling of a settlement demand. The Court based its decision on the fact that the insurance company controlled the defense and settlement of a claim or lawsuit. Along with that control, comes responsibility. These duties became known as the "Stowers Doctrine."

The apparent expansion of the *Stowers* Doctrine ended with the Texas Supreme Court's decision in *American Physicians Insurance Exchange v. Garcia*, 876 S.W.2d 842 (Tex. 1994). *Garcia* arose out of a medical malpractice action filed against American Physicians Insurance Exchange's insured, Dr. Roman A. Garcia. In determining that the carrier had not violated any duty, the Texas Supreme Court set forth, for the first time, the necessary elements in order to establish a violation of the *Stowers* Doctrine. Those elements were:

- (1) The claim against the insured must be within the scope of the insurance coverage;
- (2) The settlement demand must be within the policy limits; and

- (3) The terms of the demand must be such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to an excess judgment.

2. Full Release

In *Trinity Universal Insurance Company v. Bleeker*, 966 S.W.2d 489 (Tex. 1998), the insured was involved in an automobile accident in which 14 individuals were injured, including one death. The policy of insurance contained only \$20,100 per person and \$40,000 per accident coverage. The plaintiffs' counsel, at the beginning of the litigation, only represented 5 of the 14 plaintiffs. He testified in the *Stowers* lawsuit that he made repeated oral offers to settle the claims of his clients for \$20,000. He eventually provided a written offer to settle the five clients' claims in exchange for interpleading the \$40,000 policy limits into the registry of the court. After that offer expired, the attorney was subsequently hired to represent the remaining victims of the accident. Although Trinity repeatedly offered to tender the \$40,000 to settle all 14 claims, that tender was repeatedly rejected and a judgment in excess of \$13,000,000 was entered against the insured.

The Texas Supreme Court focused its discussion on whether the settlement demands offered to provide a full and final release. The Court noted that at the time the settlement demands were made, there existed hospital liens in excess of the policy limits. Based upon the hospital lien statute, the Court concluded that the plaintiffs could not offer a full and final release unless that release included the hospital liens. The only evidence in the case was that the hospitals were not willing to release their liens and therefore the Court concluded that the

plaintiffs could not offer a full and final release and therefore a *Stowers* duty was never triggered. This is a very important case from the carrier's perspective because in most minimal limits circumstances, the hospital liens may exceed the policy limits and therefore the plaintiffs counsel must first work with the hospital before being able to *Stowerize* the carrier.

3. Multiple Claimants

One situation commonly encountered by insurers is when multiple claimants attempt to settle with an insured with insufficient policy limits to settle all claims. In 1994, the Texas Supreme Court addressed the manner in which an insurer should respond to a situation where there are multiple claimants claiming under a policy with insufficient limits. *Texas Farmers Ins. Co. v. Soriano*, 881 S.W.2d 312 (Tex. 1994).

In *Soriano*, Richard Soriano caused an automobile accident in which Carlos Medina was severely injured, Medina's wife was killed, Medina's two children were injured, and Adolfo Lopez was killed. Soriano had minimum insurance coverage of \$20,000 per occurrence through Farmers. Farmers initially offered the policy limits to the Medinas. This offer was refused. Thereafter, the Medinas and Lopez filed suit against Soriano. Just prior to trial, Farmers settled with Lopez for \$5,000. Farmers then offered the Medinas the remaining \$15,000. The Medinas rejected the offer and a demand was made for the original policy limits of \$20,000. The Medinas' claims went to trial, and the jury awarded them \$172,187.

The Texas Supreme Court rendered judgment in favor of Farmers. The Texas Supreme Court held that when faced with a settlement demand arising out of multiple claims and inadequate proceeds, an insurer may enter into a reasonable settlement with

one of the several claimants, even when that settlement exhausts or diminishes the proceeds available to satisfy other claims.

Thus, the Texas Supreme Court concluded that Farmers could not be liable for negligently failing to settle the Medinas' claim unless there was evidence that either (1) Farmers negligently rejected an offer by the Medinas to settle within policy limits or (2) that the Lopez settlement was itself unreasonable. The court found that there was no evidence of either. First, the Medinas did not demand the \$20,000 until after the Lopez settlement. Farmers was under no obligation at that time to offer to settle in excess of the remaining \$15,000 policy limits. Second, the Court stated that to show that a settlement is "unreasonable," the claimant must show that a reasonably prudent insurer would not have made the settlement when solely considering the merits of the first claim and the potential liability of the insured on that claim. The court concluded that there was no evidence that Farmer's decision to settle the Lopez claim for \$5,000 was unreasonable. The Court reasoned that this approach would promote settlements of lawsuits and encourage claimants to make their claims promptly.

4. Multiple Insureds

Another commonly encountered situation is where there are multiple insureds under a policy. Unfortunately, there are very few cases which address the appropriate method of handling claims which may result in the settling of one insured's claim but not another's. The Fifth Circuit Court of Appeals addressed the issue in *Travelers Indemnity Company v. Citgo Petroleum Corp.*, 166 F.3d 761(5th Cir. 1999). In *Citgo*, Traveler's issued a primary and an umbrella business auto policy to Wright Petroleum under which Citgo was an

additional insured. One of Wright's tanker trucks was involved in an automobile accident which resulted in the death of the occupants of the other vehicle. A wrongful death action was brought against Wright. Citgo was not originally named as a defendant in that lawsuit. The claims against Wright were eventually settled for payment of both the primary and umbrella policy limits. After the settlement was consummated, Citgo was added as a party. Citgo demanded that Travelers provide it a defense and indemnification in the lawsuit. Travelers declined Citgo's request on the basis that the policy limits had been exhausted.

In the coverage lawsuit, Citgo contended that Travelers breached the policy of insurance with respect to Citgo by exhausting all the policy limits and settling the claims against Wright. The Fifth Circuit Court of Appeals rejected Citgo's position. After acknowledging the lack of case law in the area, the Fifth Circuit determined that the Texas Supreme Court's decision in *Soriano* was as easily applicable to multiple insureds as multiple claimants. The Fifth Circuit concluded that, especially where the second insured is not a party at the time of the settlement, the propriety of the carrier's action is judged on its own merits without consideration of the potential a claim against a second insured.

C. THE NEW

1. Full Release

The First District Court of Appeals of Houston addressed the issue of what constituted a "full release" in *McDonald v. Home State County Mutual Insurance Company*, 2011 WL 1103116 (Tex.App. – Houston [1 Dist.] March 24, 2011, rev. denied). In *McDonald*, the insured was involved in an automobile accident which

resulted in serious injuries to the other driver. Shortly after the accident, Memorial Hermann Hospital filed a “Notice of Hospital Lien.” After the lien was filed, the injured party’s attorney sent a settlement demand letter to the insured’s carrier. The letter provided, in pertinent part:

The settlement offer extended herein is the type which is commonly known as a “*Stowers*” offer... any counter-offer submitted... will be deemed as a rejection of this settlement offer.... A full and final settlement of the claims could be made in exchange for payment to [plaintiff’s counsel] the total amount of liability insurance available to cover your insured in this matter.

A day before the settlement demand expired, the adjuster received a letter from counsel for Memorial Hermann advising of the lien. On the date the offer expired, the adjuster contacted Plaintiff’s counsel’s office and left a message with the receptionist offering to settle the claim and request to speak to the attorney. The Plaintiff’s counsel took the position that that was not an acceptance of the offer and the case proceeded to trial. The Houston Court of Appeals determined that the demand was not a proper *Stowers* offer. The Court held that the demand failed to offer a full and final release. The Court reasoned that the demand did not explicitly offer the release of any potential claims against the insured nor did it make reference to the hospital lien. It also eliminated the carrier’s right to place the hospital on the settlement draft because that would have been considered a counter-offer because the demand required payment directly to the counsel. The Court stated:

To the extent the demand was intended to invoke the *Stowers* doctrine, its terms should have either

made express reference to liens or at least should not have instructed express terms for acceptance which left the insured exposed to the risk of liability to the hospital.

2. Multiple Insurers

It is somewhat common to have multiple primary carriers involved in a claim or a primary and excess carrier. The carriers’ *Stowers* liability in that situation was addressed in *Aftco Enterprises, Inc. v. Acceptance Indemnity Insurance Company*, 321 S.W.3d 65 (Tex.App. – Houston [1 Dist.] 2010, rev. denied). In *Aftco*, the insured was covered either directly or as an additional insured by two primary and two excess policies. The insured brought suit against one of the primary and one of the excess carriers claiming that the delay in settling the matter required the insured to incur additional attorney’s fees and damage to their business reputation. During the pendency of the underlying lawsuit, the plaintiff made an original settlement demand to the primary carriers and first level excess carrier in the total amount of the available policy limits. The settlement offer was subsequently amended to include the total of the policy limits under all four policies. As acknowledged by the Court, the issue on appeal was whether a settlement offer triggers a duty to settle when the terms require funding from multiple insurers and no single insurer can fund the settlement within its policy limits. The Court recognized that the issue had not been expressly answered by the Texas Supreme Court. With respect to the co-primary carriers, the Court concluded that no *Stowers* obligation exists where, although the demand was within the combined policy limits with two carriers, the demand was not within any one carrier’s policy limits. The Court followed the same line of reasoning with respect to the primary-excess situation.

The Court concluded that an excess carrier can have no *Stowers* exposure unless settlement demand is within its policy limits and the primary carrier has tendered its policy limits.

3. Multiple Insureds

Stowers and multiple insureds was addressed in *Pride Transportation v. Continental Casualty Company*, 804 F.Supp.2d 520 (N.D. Tex. 2011). In *Pride*, a trucking company and its driver were sued as a result of an accident. The policy provided coverage to the trucking company as the named insured and to the driver as an additional insured. During the litigation, the plaintiff sent a settlement demand to the driver only for the total of the policy limits. After the primary carrier tendered the limits to the excess carrier, the excess carrier contacted plaintiff's counsel seeking permission to make a counter offer settling all claims against both defendants. The plaintiff's counsel refused to expand the proposed settlement to include the trucking company. The excess carrier accepted the settlement demand and the case proceeded against the trucking company, which was eventually settled. The trucking company brought suit against the carriers claiming that the settlement in favor of one insured to the exclusion of another violated the *Stowers* doctrine. The Court concluded that the carrier acted properly. In essence, the Court went back to *Soriano* and concluded that the settlement had to be viewed in isolation. If settlement of the claim against a single insured is reasonable, in and of itself, the carrier can proceed with that settlement although it does not resolve the claims against the other insured. Interestingly, the Court also relied upon *Travelers* but did not address the distinction that *Travelers* appeared to be limited to situations where the second insured was not a party at the time of the settlement. The Court also noted

that the excess carrier had no *Stowers* obligation until the underlying limits were tendered to it.

4. Coverage Dispute

As stated in *Garcia*, the *Stowers* doctrine only applies to covered claims. The issue arises whether a coverage dispute will eliminate any *Stowers* exposure. The Southern District Court addressed the issue in *American Western Home Insurance Company v. Tristar Convenience Stores, Inc.*, 2011 WL 2412678 (S.D. Tex. June 2, 2011). In *Tristar*, the carrier provided coverage either directly or as additional insured for four defendants. In March 2009, the plaintiffs made a settlement demand in the amount of the policy limits for all four defendants. The carrier rejected the offer asserting that the policy did not provide coverage for the claims. A second settlement demand was made for the policy limits in exchange for release of only two of the defendants. That offer was accepted. The carrier then brought suit seeking a declaration that it owed no duty to defend or indemnify the other insureds. The insureds brought a counterclaim asserting that the carrier's failure to accept the original offer violated *Stowers* and therefore, it had a continuing duty to the insured. The carrier defended the claim by asserting that there was a legitimate coverage dispute at the time of the original demand. The Fifth Circuit concluded that there was a fact issue with respect to whether the *Stowers* doctrine had been violated. In reaching its conclusion, the Court noted that, under *Garcia*, there is no *Stowers* liability where there is no coverage. That does not equate to no *Stowers* liability when there is a question regarding coverage. Instead, the coverage issue factors into whether the carrier reasonably rejected the demand. In the case, the carrier's acceptance of the second demand created a fact issue regarding

whether it was reasonable in rejecting the first demand which would have settled on behalf of all the insureds.