

for by an insurance company.<sup>213</sup> In this regard, the Committee has opined that it is impermissible, under the Texas Disciplinary Rules of Professional Conduct, for a lawyer to agree with any insurance company restriction which interferes with the lawyer's exercise of his or her independent professional judgment in rendering such legal services to the insured-client.<sup>214</sup> As a practical matter, most billing guidelines do not interfere with the lawyer's ability to defend the client. This issue can come into play when an attorney's request for permission to do a certain activity on a case, such as hire an expert, is denied by the carrier. In such a case, the attorney has to weigh the issue and determine whether he believes it is essential to the defense. If it is, he will need to discuss the issue with the insured, and possibly go forward with the task of doing the activity even if it is not reimbursed by the carrier.

- 2) **Use of Third-Party Auditors for Attorney Bills.** The Texas Disciplinary Rules of Professional Conduct provide that a lawyer shall not undertake representation where someone else pays for a client's defense, such as in the insurer/insured context, unless: 1) the client consents; 2) there is no interference with the lawyer's independent professional judgment or with the client-lawyer relationship; and 3) information relating to representation of a client is protected as required by Rule 1.05. Rule 1.05 provides that a lawyer shall not knowingly reveal a client's confidential information. Because a lawyer's invoice or bill contains information describing the legal services rendered on behalf of the client, the Professional Ethics Committee for the State Bar of Texas has opined that attorneys in Texas are not permitted to forward any legal bills to an outside auditor without first obtaining the client's informed consent.<sup>215</sup> Accordingly, if a carrier requires an attorney to send his bills to an outside third-party auditor, the attorney is only able to send bills to the outside auditor if the insured-client consents to the disclosure. If the client will not consent to the disclosure, the attorney is required to send his bills directly to the carrier for payment.

## 12 **COVERAGE ISSUES AND THE INSURANCE POLICY.**

- A. **Texas Rules of Policy Interpretation.** Insurance contracts are generally subject to the same rules of construction as ordinary contracts.<sup>216</sup> When construing a written contract, a court is primarily concerned with ascertaining the true intent of the parties as expressed in the contract.<sup>217</sup> Contracts are considered as a whole with each clause

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<sup>213</sup> See Tex. Comm. on Prof'l Ethics, Op. 552, 67 TEX. B. J. 981 (2004); Tex. Comm. on Prof'l Ethics, Op. 533, 63 TEX. B. J. 806 (2000); Tex. Comm. on Prof'l Ethics, Op. 532, 63 TEX. B. J. 805 (2000).

<sup>214</sup> See Tex. Comm. on Prof'l Ethics, Op. 533, 63 TEX. B. J. 806 (2000).

<sup>215</sup> See Tex. Comm. on Prof'l Ethics, Op. 552, 67 TEX. B. J. 981 (2004); Tex. Comm. on Prof'l Ethics, Op. 532, 63 TEX. B. J. 805 (2000).

<sup>216</sup> See *Kelley-Coppedge, Inc. v. Highlands Ins. Co.*, 980 S.W.2d 462, 464 (Tex.1998); *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 823 (Tex. 1997); *State Farm Life Ins. Co. v. Beaston*, 907 S.W.2d 430, 433 (Tex.1995).

<sup>217</sup> See *National Union Fire Ins. Co. v. CBI Indus., Inc.*, 907 S.W.2d 517, 520 (Tex.1995).

being used to help interpret the others.<sup>218</sup> With respect to an insurance policy, the plain, ordinary, and generally accepted meaning of words is preferred unless the policy itself shows the terms have been used in a technical or different sense.<sup>219</sup> When a policy permits only one interpretation, Texas courts are to construe it as a matter of law and enforce it as written.<sup>220</sup> When terms or clauses within an insurance contract are capable of more than one reasonable interpretation, the contract may be ambiguous.<sup>221</sup> But an ambiguity does not arise with respect to a policy merely because the parties advance conflicting interpretations.<sup>222</sup> If an insurance contract is ambiguous, courts apply the “**contra-insurer**” rule by adopting the interpretation that favors coverage for the insured, and against the insurance company.<sup>223</sup> Whether a contract is ambiguous is a question of law for a court to decide by looking at the contract as a whole in light of the circumstances present when the contract was entered.<sup>224</sup> As with any contract, absent a finding of ambiguity, a court must interpret the meaning and intent of an insurance policy from the four corners of the policy without the aid of extrinsic evidence.<sup>225</sup> An insurance company’s intent to exclude coverage within an insurance contract must be expressed in clear and unambiguous policy language.<sup>226</sup>

- 1) **Separation of Insureds Clause.** If the policy contains separation of insureds clause, it requires the insurer to determine the coverage of each insured separately from that particular insured’s perspective.<sup>227</sup> Accordingly, care should be taken when deciding coverage issues as to third-party claims against multiple insureds under the same policy, as each insured’s coverage issues may need to be considered separately.

## B. Policy Defenses and Exclusions

- 1) **Misrepresentation in Policy Application.** The Texas Insurance Code provides that any insurance policy provision that makes the policy void or voidable if false statements are made in the policy application have no effect and are no defense in a lawsuit on the policy, unless at trial it is shown that the matter misrepresented was: 1) material to the risk, or 2) contributed to the contingency or event on which the policy became due and payable.<sup>228</sup>

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<sup>218</sup> See *Meza Operating Co. v. California Union Ins. Co.*, 986 S.W.2d 749, 753 (Tex. App.–Dallas, 1999, writ denied); *Western Indem. Ins. Co. v. American Physicians Ins. Exch.*, 950 S.W.2d at 185, 188 (Tex.App.–Austin 1997, no writ).

<sup>219</sup> See *Ramsay v. Maryland Am. Gen. Ins. Co.*, 533 S.W.2d 344, 346 (Tex. 1976).

<sup>220</sup> See *Upshaw v. Trinity Cos.*, 842 S.W.2d 631, 633 (Tex. 1992); *Hanson v. Republic Ins. Co.*, 5 S.W.3d 324, 327 (Tex. App.–Houston [1st Dist.] 1999, writ denied).

<sup>221</sup> See *Grain Dealers Mut. Ins. Co. v. McKee*, 943 S.W.2d 455, 458 (Tex. 1997).

<sup>222</sup> See *id.*

<sup>223</sup> See *id.* at 458; *Hartrick v. Great American Lloyds Ins. Co.*, 62 S.W.3d 270, 274 (Tex. App.–Houston [1st Dist.] 2001, no pet.).

<sup>224</sup> See *Kelley-Coppedge*, 980 S.W.2d at 464.

<sup>225</sup> See *Westchester Fire Ins. Co. v. Stewart & Stevenson Services, Inc.*, 31 S.W.3d 654, 658 (Tex. App. -- Houston [1st Dist.] 2000, pet. denied).

<sup>226</sup> See *State Farm Fire & Cas. Co. v. Weed*, 873 S.W.2d 698, 699 (Tex. 1993).

<sup>227</sup> See *King v. Dallas Fire Ins. Co.*, 85 S.W.3d 185 (Tex. 2002).

<sup>228</sup> See TEX. INS. CODE ANN. art. 21.16 (effective April 1, 2005 TEX. INS. CODE ANN. § 705.004).

- a. It is a question of fact as to whether a misrepresentation made in the application for the policy or in the policy itself was material to the risk or contributed to the contingency or event on which the policy became due and payable.<sup>229</sup>
  - b. A defendant may only use the misrepresentation in application defense if the defendant shows at trial that before the 91st day after the date the defendant discovered the falsity of the representation, the defendant gave notice to the insured or beneficiaries that the defendant refused to be bound by the policy.<sup>230</sup>
- 2) **Conditions Precedent.** Insurance policies typically provide conditions or duties for the insured, including an insured's duties after a loss or a covered event. Contractually these are known as conditions precedent, and if not complied with can form the basis of denial of coverage from the carrier.<sup>231</sup>
- a. **Lack of Notice.** Notice requirements are standard provisions in insurance contracts. A notice provision typically comes into play when the insured fails to timely notify the carrier of some event, and then seeks coverage for that event. The purpose of a notice requirement is to enable the insurer to investigate the circumstances of an accident while the matter is fresh in the minds of the witnesses so that it may adequately prepare to adjust or defend any claims that may be then or thereafter be asserted against persons covered by its policy.<sup>232</sup> Failure to comply with the insurance contract, such as failing to provide proper notice, is a condition precedent, the breach of which voids the contract coverage.<sup>233</sup> Accordingly, the failure to give timely notice is a breach of the insurance contract and can relieve an insurer of its obligations under the insurance contract.<sup>234</sup> But with respect to certain policies, an added requirement was made by the Texas Department of Insurance which required a showing carrier prejudice before the carrier could rely on a lack of notice as a full defense. The prejudice requirement was added pursuant to an order issued by The Texas Department of Insurance, which required mandatory endorsements be placed in general liability and automobile insurance policies stating that "unless the company is prejudiced by the insured's failure to comply with the requirement,

<sup>229</sup> See *id.*

<sup>230</sup> See TEX. INS. CODE ANN. art. 21.17 (effective April 1, 2005 TEX. INS. CODE ANN. § 705.005).

<sup>231</sup> See *State Farm Lloyds Ins. Co. v. Maldonado*, 963 S.W.2d 38, 40-41 (Tex., 1998).

<sup>232</sup> See *Employers Cas. Co. v. Glens Falls Ins. Co.*, 484 S.W.2d 570, 575 (Tex. 1972); *Bay Elec. Supply, Inc. v. Travelers Lloyds Ins. Co.*, 61 F. Supp.2d 611, 619 (S.D. Tex. 1999).

<sup>233</sup> See *Broussard v. Lumbermens Mut. Cas. Co.*, 582 S.W.2d 261, 266 (Tex. App. – Beaumont 1979, no writ); *Duzich v. Marine Office of Am. Corp.*, 980 S.W.2d 857, 866 (Tex. App. – Corpus Christi 1998, pet. denied).

<sup>234</sup> See *Assicurazioni Generali Spa v. Pipe Line Valve Specialties Co.*, 935 F.Supp. 879, 887 (S.D. Tex. 1996).

any provision of this policy requiring the insured to give notice of ... occurrence or loss ... shall not bar liability under this policy".<sup>235</sup> Now that trend has continued, and at least one Federal Court has recently declared that the prejudice requirement applies to notice conditions in all Texas insurance policies.<sup>236</sup>

- i **Claims Made policies.** While the holding in the *Ridglea* case appears to apply to all insurance policies, that very same Court, the Fifth Circuit Court of Appeals, in the *Singleentry.com* case decided a few months prior, held that a prejudice requirement was not required with respect to a claims made policy, as opposed to an occurrence policy.<sup>237</sup> At this time, it certainly appears the trend is to require a showing of carrier prejudice by the lack of notice before the carrier can get out of its obligations under the insurance contract. However, as shown in the *Singleentry.com* case, claims made policies may be immune to this requirement.
  - b. Other conditions precedent exist in insurance policies, such as the requirement that a property inventory be provided, that a sworn proof of loss be submitted, that the insured submit to an examination under oath, or that suit against the carrier be commenced after an actual trial against the insured.
- 3) **Waiver.** Waiver of a condition precedent by the insurer's actions can be a major problem in dealing with claims. The general rule is that when an insurer denies a claim for reasons unrelated to the condition precedent, such as a notice condition, the insurer waives any requirement that the insured comply with the condition precedent.<sup>238</sup> But there is an exception to this rule when the insurer's total denial of liability on any grounds, is made after the deadline for the insured to comply with the condition precedent.<sup>239</sup> Waiver of a condition precedent occurs when the insurer denies liability within the time limited for the insured to comply with the requirement, such as giving notice or filing a proof of loss. Conversely, a total denial of liability on any grounds after the time period for performing the condition precedent does not constitute a waiver of the insurer's defense of failure to comply with the condition precedent.<sup>240</sup> For example, if a claim is received late, the lack of

<sup>235</sup> See *Hanson Production Co. v. American Insurance Co.*, 108 F.3d 627, 629 (5th Cir.1997) (quoting Texas State Board of Insurance, Order No. 23080).

<sup>236</sup> See *Ridglea Estate Condominium Assoc. v. Lexington Ins. Co.*, 398 F.3d 332, 338 (5<sup>th</sup> Cir. 2005).

<sup>237</sup> See *Singleentry.com, Inc. v. St. Paul Fire & Marine Ins. Co.*, 117 Fed. Appx. 933, 2004 WL 2796534 (5th Cir. 2004).

<sup>238</sup> See *Farmers Ins. Exch. v. Nelson*, 479 S.W.2d 717, 721-22 (Tex. Civ. App. – Waco 1972, writ ref'd n.r.e.); *DeLaurentis v. United Services Auto. Ass'n*, 2005 WL 724893, p\* 4 (Tex. App. -- Houston [14th Dist.] 2005, no pet. h.).

<sup>239</sup> See *United States Fid. & Guar. Co. v. Bimco Iron & Metal Co.*, 464 S.W.2d 353, 357 (Tex.1971).

<sup>240</sup> See *Stonewall Ins. Co. v. Modern Exploration, Inc.*, 757 S.W.2d 432, 436 (Tex. App.– 1988, no writ) (unreasonably late notice); *DeLaurentis*, 2005 WL 724893 (failure to file proof of claim).

notice should always be included as justification for the denial so that the insured cannot raise waiver as defense to the lack of notice argument. The same is true for other conditions precedent such filing a sworn proof of loss. Waiver of a condition precedent is evaluated according to what the insured reasonably would have thought under the circumstances by the insurer's conduct<sup>241</sup>.

- 4) **Exclusions.** While an insured has the initial burden to establish that the claim comes within the scope of coverage provided by the policy, an insurer bears the burden to plead and prove that a claim comes within a policy exclusion or limitation of coverage.<sup>242</sup> In a coverage dispute over the application of an exclusion, a court must adopt the construction of the exclusionary clause urged by the insured as long as that 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.<sup>243</sup>
  
- 5) **Doctrine of Concurrent Causes.** When covered and non-covered event combine to create a loss, the insured is entitled to recover only that portion of the damage caused solely by the covered peril.<sup>244</sup> This rule embodies the basic principle that an insured is not entitled to recover under their insurance policy unless they prove their damage is covered.<sup>245</sup> An insured may only recover the amount of damage covered solely by the covered peril.<sup>246</sup> The burden is on the insured to present some evidence upon the fact finder can allocate the damages attributable to the covered peril.<sup>247</sup>
  
- 6) **Fortuity Doctrine.** The fortuity doctrine relieves insurers from covering certain behaviors that the insured undertook prior to purchasing the liability insurance policy.<sup>248</sup> "Because the purpose of insurance is to protect insureds against unknown, or fortuitous, risks, fortuity is an inherent requirement of all risk insurance policies."<sup>249</sup> Combining the principles of "known loss" and "loss in progress," the fortuity doctrine holds that insurance coverage is precluded where the insured is or should be aware of an ongoing progressive or known loss at the time the policy is purchased.<sup>250</sup> Essentially, if an insured

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<sup>241</sup> See *North River Ins. Co. v. Pomerantz*, 492 S.W.2d 312, 314 (Tex. App. – Houston [14th Dist.] 1973, writ refused n.r.e.)

<sup>242</sup> See TEX. INS. CODE ANN. art. 21.58(b) (effective April 1, 2005 TEX. INS. CODE ANN. § 554.002); *Evergreen Nat'l Indem. Co. v. Tan It All, Inc.*, 111 S.W.3d 669, 675 (Tex. App.– Austin 2003, no pet.).

<sup>243</sup> See *Nat'l Union Fire Ins. Co. v. Hudson Energy Co.*, 811 S.W.2d 552, 555 (Tex.1991); *Utica Nat'l Ins. Co. v. Am. Indem. Co.*, 141 S.W.3d 198, 202 (Tex.2004).

<sup>244</sup> See *Wallis v. United Services. Auto. Ass'n.*, 2 S.W.3d 300, 302-303 (Tex. App. – San Antonio 1999, pet, denied).

<sup>245</sup> See *id.* at 303.

<sup>246</sup> See *id.*

<sup>247</sup> See *id.*

<sup>248</sup> See *RLI Ins. Co. v. Maxxon Southwest Inc.*, 108 Fed. Appx. 194, 2004 WL 1941757, P\*3 (5th Cir. 2004).

<sup>249</sup> See *Scottsdale Ins. Co. v. Travis*, 68 S.W.3d 72, 75 (Tex. App.– Dallas 2001, pet. denied).

<sup>250</sup> See *id.* (citing *Two Pesos, Inc. v. Gulf Ins. Co.*, 901 S.W.2d 495, 502 (Tex. App.– Houston [14th Dist.] 1995, no writ).

knows, or should have known, at the time it purchased the insurance policy, that its current behavior is wrongful and could result in liability, it effectively removes the risk element inherent in insurance, and therefore, a Texas court will not require the insurer to pay the claim.<sup>251</sup>

C. **Basic Coverage Issues Involving The CGL Policy.**

- 1) The standard CGL policy provides:

**SECTION I - COVERAGES**

**COVERAGE A. BODILY INJURY AND PROPERTY DAMAGE LIABILITY**

1. Insuring Agreement.

- a. We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend any "suit" seeking those damages....
- b. This insurance applies to "bodily injury" and "property damage" only if:
- (1) The "bodily injury" or "property damage" is caused by an "occurrence" that takes place in the "coverage territory"; and
- (2) The "bodily injury" or "property damage" occurs during the policy period.

**SECTION V - DEFINITIONS ...**

13. Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions....

- 2) The typical CGL policy purchased by businesses is an occurrence-based policy, as opposed to a claims-made policy. In an occurrence-based policy, the insured is protected against covered claims occurring during the policy period, regardless of whether the claim or occurrence is brought to the attention of the insured or made known to the insurer during the policy period.<sup>252</sup> The claims-made policy, on the other hand, covers only injuries or damages that are made known to the insurer during the policy period.<sup>253</sup> The basic purpose behind the CGL policy is to provide coverage for damages arising from the insured's own tortious conduct, as opposed to non-tort claims, such as breach of contract.<sup>254</sup> The tort coverage offered under the CGL policy is identified under two basic types of liabilities: A) bodily injury and property damage, and B) personal injury and advertising injury. Coverage for bodily injury and property damage liability protects against "bodily injury" and "property damage" caused by an *occurrence during the policy period*. Coverage for personal injury and advertising injury, on the

<sup>251</sup> See *See RLI Ins. Co. v. Maxxon Southwest Inc.*, 108 Fed. Appx. 194, 2004 WL 1941757, P\*3 (5th Cir. 2004).

<sup>252</sup> See *Yancey v. Floyd West & Co.*, 755 S.W.2d 914, 925 (Tex. App.–Fort Worth 1988, writ denied).

<sup>253</sup> See *id.*

<sup>254</sup> See *Data Specialties, Inc. v. Transcontinental Ins. Co.*, 125 F.3d 909, 913 (5th Cir. 1997).

other hand, covers the specific torts or offenses found in the policy definitions of “personal injury” and “advertising injury.” Coverage for bodily injury and property damage tends to give rise to more coverage litigation.

- 3) **What is an “Occurrence”?** While the term “occurrence” as used in insurance policies has been construed by Texas courts for several decades,<sup>255</sup> courts are still faced with questions about whether particular claims against insureds amount to an occurrence. An “occurrence” under the standard CGL policy is defined as “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.” While the definition of occurrence uses the word accident, accident is not defined in the policy. Many Texas courts have construed the meaning of “accident” and have generally found it to mean negligently caused losses.<sup>256</sup> The Texas Supreme Court has held that an injury is accidental *if, from the viewpoint of the insured, it is not the natural and probable consequence of the action or occurrence which produced the injury; or in other words, if the injury could not reasonably be anticipated by the insured, or would not ordinarily follow from the action or occurrence which caused the injury, it is accidental.*<sup>257</sup> The mere fact that an actor intended to engage in conduct that gives rise to the injury does not mean that the injury was not accidental.<sup>258</sup> But, an injury which is caused by voluntary and intentional conduct, is not accidental just because the result or injury may have been unexpected, unforeseen, and unintended.<sup>259</sup> Therefore, the determination of whether an occurrence is accidental requires consideration of both the actor’s intent, and the reasonably foreseeable effect of the actor’s conduct.<sup>260</sup> One court considered these factors in a two step process.<sup>261</sup> First, a determination needs to be made of the specific acts alleged to be the cause of the plaintiff’s damages, and whether those acts were voluntary and unintentional.<sup>262</sup> If the acts are committed involuntarily and unintentionally, the acts are accidental, and no further analysis is necessary.<sup>263</sup> If the acts were committed voluntarily and intentionally, step two asks whether those acts naturally resulted in the claimed injuries.<sup>264</sup> The natural result of an act is the result that ordinarily

<sup>255</sup> See *Parker v. Gulf Ins. Co.*, 486 S.W.2d 610, 615 (Tex. Civ. App.—Fort Worth 1972), *affirmed*, 498 S.W.2d 676 (Tex. 1973).

<sup>256</sup> See *Glover v. National Ins. Underwriters*, 545 S.W.2d 755, 763 (Tex. 1997); *Argonaut Southwest Ins. Co. v. Maupin*, 500 S.W.2d 633, 635 (Tex. 1973); *Data Specialities, Inc. v. Transcontinental Ins. Co.*, 125 F.3d 909, 912 (5th Cir. 1997).

<sup>257</sup> See *Mid-Century Ins. Co. v. Lindsey*, 997 S.W.2d 153, 155 (Tex. 1999).

<sup>258</sup> See *Trinity Universal Ins. co. v. Cowan*, 945 S.W.2d 819, 828 (Tex. 1997).

<sup>259</sup> See *Argonaut Southwest Ins. Co. v. Maupin*, 500 S.W.2d 633, 635 (Tex. 1973); *see also Trinity Universal Ins. co. v. Cowan*, 945 S.W.2d 819, 826-28 (Tex. 1997); *Wessinger v. Fire Ins. Exch.*, 949 S.W.2d 834, 837 (Tex. App. – Dallas 1997, no writ).

<sup>260</sup> See *Mid-Century Ins. Co. v. Lindsey*, 997 S.W.2d 153, 155 (Tex. 1999).

<sup>261</sup> See *Folsom Invest., Inc. v. Amer. Motorists Ins. Co.*, 26 S.W.3d 556, 561 (Tex. App.—Dallas 2000, no pet.).

<sup>262</sup> *See id.*

<sup>263</sup> *See id.*

<sup>264</sup> *See id.*

follows, may be reasonably anticipated, and ought to be expected.<sup>265</sup> If the result is not the natural and probable consequence of the act or course of action, then it is produced by accidental means.<sup>266</sup>

- a. The Houston First District Court of Appeals, in *Hartrick v. Great American Lloyds Insurance Co*, was asked to make this type of determination, specifically, whether liability for breach of warranty is an occurrence under the CGL policy.<sup>267</sup> In the underlying liability suit at issue in *Hartrick*, Clairmont Building Corporation was sued for negligence, violations of the Texas DTPA, and breach of implied warranties of good and workmanlike construction and suitability for habitation arising out of the defective construction of a house foundation.<sup>268</sup> The plaintiffs claimed damage to the house and loss of market value because of pitching and heaving in the foundation. When the case went to trial, the jury found Clairmont liable only for the breach of warranty claims. Following the turnover of Clairmont's insurance coverage claim to the Plaintiffs, the Plaintiffs brought suit against Clairmont's insurance company arguing that Clairmont's CGL policy provided coverage for the Plaintiffs' judgment. At issue in the coverage lawsuit was whether the liability judgment for breach of warranty was covered under the CGL policy, that is, whether it was an "occurrence." Initially, the Houston First Court of Appeals noted that the broad form CGL policy does not insure a contractor because of faulty workmanship, but rather, provides coverage for damages that result from the contractor's performance, other than damage to the work itself. The Court then held, that when an injury results from voluntary and intentional conduct, such as not preparing the soil and not constructing the foundation in keeping with the promises the law implies to the contractor, the injury is not "an accident."<sup>269</sup> Even though the insured contractor did not intend the result, breach of an implied warranty is not an "occurrence" covered under the CGL policy.<sup>270</sup> The court found that the Plaintiffs' claimed damages were the reasonably foreseeable results that would ordinarily flow from a contractor's work not complying with its implied warranty to prepare the soil and clear the land properly, and its implied warranty to build a house on a foundation that is strong enough to support a house. The Court held that lack of compliance with implied warranties is not accidental, but results from one not

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<sup>265</sup> See *Wessinger v. Fire Ins. Exch.*, 949 S.W.2d 834, 837 (Tex. App.–Dallas 1997, no writ).

<sup>266</sup> See *id.*; see also *McKinney Builders II, Ltd v. Nationwide Mut. Ins. Co.*, 1999 WL 608851, pg 6. (N.D. Tex., 1999)(Builder's reliance on incorrect survey which resulted in builder's construction of house which encroached on neighbor's property was not the natural and probable consequences of the builder's reliance on survey which builder believed was correct).

<sup>267</sup> See *Hartrick v. Great American Lloyds Ins. Co.*, 62 S.W.3d 270, 275-276 (Tex. App.–Houston [1st Dist.] 2001, no pet.).

<sup>268</sup> See *id.* at 272.

<sup>269</sup> See *id.* at 277-278.

<sup>270</sup> See *id.*

doing what one what one must do.<sup>271</sup>

- b. The *Hartrick* opinion is consistent with the increasing number of decisions which have considered the meaning of “occurrence” in connection with non-negligent, intentional causes of action, holding that such claims as fraudulent promises, misrepresentation, and untrue statements do not fall within the plain meaning of the policy definition of an occurrence, and therefore, are not covered under the CGL policy.<sup>272</sup> The narrowing of the policy definition of occurrence has also extended to negligence claims that are related to and interdependent on claims of intentional conduct.<sup>273</sup> For example, in *Folsom Investments, Inc. v. American Motorists Ins. Co.*, the Dallas Court of Appeals determined that claims of negligent hiring, training, supervision, and retention against an employer, for an employee’s unwelcome sexual advances against another employee, did not allege an occurrence under the employer’s CGL policy.<sup>274</sup> When negligence claims, such as these, are related to and interdependent on intentional misconduct of an employee, the coverage issue is determined by whether the employee’s intentional misconduct falls within the policy definition of “occurrence,” which in this case, the court held, did not.<sup>275</sup> These recent court decisions signify that the policy term “occurrence” is construed narrowly by Texas courts, and that claims reasonably related to intentional and voluntary conduct, even those claims alleging negligence, should be carefully reviewed being a defense is provided.

- 4) **Coverage Trigger issues.** Another area of recent development with respect to coverage issues and the CGL policy relates to the issue of what it means to have a bodily injury or property damage occur *during the policy period*. The problem arises because the standard CGL policy does not specify when an occurrence takes place, only that an insurer has a duty to defend when bodily injury or property damage is caused by an occurrence during the policy period.<sup>276</sup> One difficulty with this issue is the fact that the CGL policy language “occurrence during the policy period” requires an actual injury or damage during the policy period, and not merely the occurrence of the negligent act or omission that is the ultimate cause of the injury during the

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<sup>271</sup> *See id.*

<sup>272</sup> *See Freedman v. CIGNA Ins. Co.*, 976 S.W.2d 776, 778 (Tex. App.–Houston [1st Dist.] 1998, no writ); *Houston Petroleum Co. v. Highlands Ins. Co.*, 830 S.W.2d 153, 156 (Tex.App.–Houston [1st Dist.] 1990, writ denied); *see also State Farm Lloyds v. Kessler*, 932 S.W.2d 732, 738 (Tex.App.–Fort Worth 1996, writ denied) (misrepresentations and failures to disclose are intentional acts, not accidents).

<sup>273</sup> *See Folsom Invest., Inc. v. Amer. Motorists Ins. Co.*, 26 S.W.3d 556 (Tex. App.–Dallas 2000, no pet.); *American States Ins. Co. v. Bailey*, 133 F3d 363 (5th Cir. 1998); *Cornhill Ins. PLC v. Valsamis, Inc.*, 106 F3d 80 (5th Cir. 1997).

<sup>274</sup> *See Folsom Invest., Inc. v. Amer. Motorists Ins. Co.*, 26 S.W.3d at 557-558.

<sup>275</sup> *See id.* at 562.

<sup>276</sup> *See* standard Commercial General Liability. Coverage A.

policy period.<sup>277</sup> Despite some prior Texas appellate decisions on the subject, the issue of when a specific damage or injury “occur(s) during the policy period” has been subject to debate since the Texas Supreme Court discussed, but declined to resolve, the issue in the 1994 case of *American Physicians Insurance Exchange v. Garcia*.<sup>278</sup> In *Garcia*, the Texas Supreme Court noted at least five different tests that could be applied to determine when a harm occurs that triggers coverage under an insurance policy.<sup>279</sup> The *Garcia* court declined to resolve the issue because it was not required for that particular case,<sup>280</sup> but it did discuss the three primary theories applied across the country to determine whether coverage has been triggered, which are the manifestation, exposure, and injury-in-fact theories. Prior to *Garcia*, there were only two decisions by Texas’ appellate courts on the subject, and both of those cases applied some form of the “manifestation rule,” which holds that coverage under the CGL policy is not triggered unless the damage or injury manifests itself or becomes apparent during the policy period.<sup>281</sup>

- a. One decision in this area was made in 2000 in *Pilgrim Enterprises, Inc. v. Maryland Casualty Company*.<sup>282</sup> The underlying liability lawsuits at issue in this coverage case involved personal injury and property damage claims against Pilgrim arising out of the use, spillage and leakage, of perchloroethylene, a chemical used in the dry cleaning process at several Pilgrim Cleaners, and which apparently over the course of many years contaminated soil and groundwater.<sup>283</sup> Pilgrim sought a defense from Maryland Casualty under its occurrence-based CGL policies spanning a four year period of time, approximately 9 years prior to the discovery of the soil contamination. After initially providing a defense, Maryland withdrew the defense provided to Pilgrim on the grounds that the claimed injuries were not alleged to have occurred, i.e. manifested, during any of Maryland’s policy periods.<sup>284</sup> Pilgrim argued that coverage was triggered by harm sustained from *exposure* to continuous pollution, even if the harm remained undiscovered when it initially occurred.<sup>285</sup> The trial court agreed with Maryland that the CGL language “which occurs during the policy period” means that coverage is triggered only when the injury or damage is discovered or manifests during the policy period, and held that Maryland had no

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<sup>277</sup> See *Guaranty Nat’l Ins. co. v. Azrock Industries, Inc.*, 211 F.3d 239, 244 (5th Cir. 2000).

<sup>278</sup> See *American Physicians Insurance Exchange v. Garcia*, 876 S.W.2d 842, 853 n. 20 (Tex. 1994).

<sup>279</sup> See *id.*

<sup>280</sup> See *id.*

<sup>281</sup> See *Dorchester Development Corp. v. Safeco Ins., Co.*, 737 S.W.2d 380, 383 (Tex. App.–Dallas 19878, no writ); *Cullen/Frost Bank v. Commonwealth Lloyd’s Ins., Co.*, 852 S.W.2d 252, 257 (Tex. App.– Dallas 19993, writ denied).

<sup>282</sup> See *Pilgrim Enterprises, Inc. v. Maryland Cas. Co.*, 24 S.W.3d 488 (Tex. App.–Houston [1st. Dist.] 2000, n.w.h.).

<sup>283</sup> See *id.* at 490.

<sup>284</sup> See *id.* at 491.

<sup>285</sup> See *id.* at 493.

duty to defend Pilgrim in the subject liability lawsuits.<sup>286</sup> On appeal, the Houston First District Court of Appeals found that the issue had been considered by other Texas courts, but that it was still an unresolved question in Texas jurisprudence. Looking at the policy language itself, the court noted that the CGL policies at issue did not use the word “manifest” with respect to occurrence, nor did it state that an injury must be discovered during the policy period. Rather, the policies contemplate that harm caused by continuous and repeated exposure during a policy period will be covered.<sup>287</sup> The court held that with respect to a CGL policy that defines an occurrence to include continuous or repeated exposure to conditions, injury or damage can occur as the exposure takes place.<sup>288</sup> In the Pilgrim case, the court found that Maryland’s CGL policies provided coverage for the Plaintiff’s allegations of physical injury and property damage caused by any exposure to PCE during the policy periods at issue.<sup>289</sup> The court also noted that this “exposure rule” is equally applicable to both physical injury and property damage.<sup>290</sup> This is a significant decision because it decides an issue that has been unsettled in Texas for years, and expands the scope of coverage for an insured by applying the exposure test to determine an occurrence as opposed to the more insurer-friendly manifestation test. For businesses with consecutive CGL coverage, this means that there is greater likelihood that multiple policies will be involved when dealing with a continuing occurrence claim which causes an indivisible injury.

5) **What is Property Damage under the CGL?** Property damage under the CGL policy is defined as:

- (1) Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or
- (2) Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the “occurrence” that caused it. ...

As can be seen the policy definition requires a physical injury to tangible property, or a loss of use of tangible property. Texas courts are in agreement with the courts of most other jurisdictions, by distinguishing between property damage and economic loss. Economic losses are not property damage and are not covered as property damage under the CGL policy.<sup>291</sup>

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<sup>286</sup> *See id.* at 491-2.

<sup>287</sup> *See id.* at 497.

<sup>288</sup> *See id.* at 497.

<sup>289</sup> *See id.* at 498.

<sup>290</sup> *See id.* at 497.

<sup>291</sup> *See* State Farm Lloyds v. Kessler, 932 S.W.2d 732, 737 (Tex. App.--Fort Worth 1996, writ denied); Houston Petroleum Co. v. Highlands Ins. Co., 830 S.W.2d 153, 156 (Tex. App.--Houston [1st Dist.] 1991, writ denied); Terra Int'l, Inc. v. Commonwealth Lloyd's Ins. Co., 829 S.W.2d 270, 272 (Tex. App.--Dallas 1992, writ denied); Gibson & Associates, Inc. v. Home Ins. Co., 966 F.Supp. 468, 473 -74 (N.D. Tex., 1997).

Courts consider the distinction between property damage and economic loss as the distinction between tangible and intangible property.<sup>292</sup> Tangible property is capable of being handled or touched and may be evaluated by the physical senses.<sup>293</sup> While intangible property, has no physical existence but may be evidenced by a document with no intrinsic value.<sup>294</sup> Contract damages, coverage rights under an insurance policy, or contribution damages are intangible property, and therefore, are not property damage that would be covered under the CGL policy.<sup>295</sup>

- 6) **What Damages are covered under the CGL Policy?** Questions are also often raised about whether certain types of damages are covered under a CGL policy. The insuring agreement under coverage A of the CGL policy provides, in part: “We will pay *those sums that the insured becomes legally obligated to pay as damages* because of “bodily injury” or “property damage” to which this insurance applies.”
- a. Damages are a form of substitutional redress which seek to replace the loss in value with a sum of money.<sup>296</sup> When analyzing a plaintiff’s prayer for relief, adjusters should determine whether damages, i.e. money damages, are sought, as opposed to equitable relief which is not covered as damages under the CGL policy.<sup>297</sup>
  - b. Additionally, as discussed above, economic losses are not property damage, but that does not necessarily mean that all economic damages related to a property damage or loss of use are not covered under the CGL policy. For example, economic damage claims, such as attorney’s fees, diminution in market value, and similar types of economic loss claims may be claims of consequential damages related to and arising out of the property damage or bodily injury. In such a situation, an argument can be made that these economic damages arise out of the property damage which are covered under the policy. Therefore, it is also important to determine whether any claims for economic loss stand alone, or are a measure of the consequential damages that accompany a property damage or bodily injury claim. If the economic damage stands alone, without any related property damage or bodily injury, it is likely not covered. If the economic loss is a consequential damage related to a property damage or bodily injury, then it will likely be covered as “damages because of bodily injury or property damage.” When in doubt, an insurer should always reserve its rights on a particular issue, so an insurer is not estopped to deny coverage as to that aspect of the claim

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<sup>292</sup> See Adams v. Great Am. Lloyd’s Ins. Co., 891 S.W.2d 769, 771 (Tex. App.–Austin 1995, no writ).

<sup>293</sup> See Lay v. Aetna Ins. Co., 599 S.W.2d 684, 685-86 (Tex. Civ. App.–Austin 1980, writ ref’d n.r.e.).

<sup>294</sup> See Adams v. Great Am. Lloyd’s Ins. Co., 891 S.W.2d 769, 771 (Tex. App.–Austin 1995, no writ).

<sup>295</sup> See *id.*; see also Gibson & Associates, Inc. v. Home Ins. Co., 966 F.Supp. 468 (N.D.Tex.,1997).

<sup>296</sup> See Mustang Tractor & Equipment v. Liberty Mutual Ins. Co., 1993 WL 566032, p.7 (S.D. Tex. 1993).

<sup>297</sup> See *id.*

in the future.

- c. *Bodily injury* as that term is used in liability policies does not include purely emotional injuries, and unambiguously requires an injury to the physical structure of the human body.<sup>298</sup>

- 7) **Recommendations relating to coverage issues.** Insurers should continue to: 1) carefully review all claims that are in any way related to an insured's defective work or service for coverage defenses; 2) for claims involving injury or damage caused by exposure to a condition over a period of time, remember that multiple policy periods may be invoked and that any exposure during your policy period will be an occurrence under the policy; 3) when coverage issues are apparent, timely send out a thorough reservation of rights letter to the insured that addresses all coverage defenses; 4) include in reservation of rights letter notice of any intent to seek reimbursement of defense costs for uncovered claims; 5) advise the insured to put all carriers on notice when dealing with a continuing tort over multiple policy periods; 6) engage and consult coverage counsel when significant claims arise.

- 13 **STOWERS LIABILITY.** *Stowers* is a Texas insurance term which refers to an insurance company's responsibility to an insured when responding to a settlement demand within policy limits. Since the 1929 case of *G.A. Stowers Furniture Co. v. American Indem. Co.*,<sup>299</sup> Texas law has required an insurer, when confronted with a claim against an insured and a settlement demand within policy limits, to exercise that degree of care and diligence which an ordinarily prudent person would exercise in the management of that person's own business.<sup>300</sup> If an ordinarily prudent person, as viewed from the standpoint of the insured, would have settled the case, but the insurer fails to do so, then the insurer may have liability for damages awarded against the insured, including damages in excess of the policy limits.<sup>301</sup> Although the *Stowers* concept is easy to understand, the task of analyzing the various *Stowers* issues for potential liability and response often proves difficult. Without a good understanding of the *Stowers* issues, insurers are prone to either overpay claims out of a mistaken fear of potential *Stowers* liability, or make themselves vulnerable to actual *Stowers* liability for failing to appreciate the true risk in a given case. Insurers do not need to leave the risk of *Stowers* liability up to a game of chance as to whether the insured is going to be found liable for damages in excess of policy limits at the underlying liability trial against the insured. A prompt and prudent analysis and response to the *Stowers* demand, can provide effective protection to an insurer even in cases where the *Stowers* demand is not accepted and the subsequent liability trial against the insured results in damages in excess of the policy limits. This section explores *Stowers* liability issues and Appendix G. is a worksheet to guide attorneys and adjusters in conducting a prudent analysis of the *Stowers* demand issues.

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<sup>298</sup> See *Trinity Universal v. Cowan*, 945 S.W.2d 819, 823 (Tex. 1997).

<sup>299</sup> 15 S.W.2d 544, 547 (Tex. Comm'n App. 1929, holding approved).

<sup>300</sup> See *American Physicians Ins. Exchange v. Garcia*, 876 S.W.2d 842, 848 (Tex. 1994);

<sup>301</sup> See *Stowers*, at 547.