# Sticky Situations: New Decisions Create New Risks in Defending and Settling Third-Party Liability Claims

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The fundamental principles surrounding litigation of third-party liability claims in Texas have remained fairly constant. Indeed, the Texan nomenclature for a cause of action based on failure to settle derives its name from a case decided in 1929 involving the Stowers furniture store in San Antonio, Texas. *See G.A Stowers Furniture Co. v. American Indemnity Co.*, 15 S.W.2d 544, 547–48 (Tex. Comm'n App. 1929, holding approved). While the elements of a *Stowers* claim have been consistent, however, both the Texas Supreme Court and the Fifth Circuit have had occasion to address "novel" *Stowers* issues in decisions issued just this year alone. Both decisions create additional pitfalls for navigating settlement in third-party liability claims.

Likewise, practitioners who have relied on the seminal holding in *Maryland Insurance Co. v. Head Industries Coatings & Services, Inc.*, 938 S.W.2d 27 (Tex. 1996)—that "Texas law recognizes only one *tort* duty in this context, that being the duty stated in *Stowers*"—may be surprised to learn that Texas courts have created new causes of action. Covering both breach of the duty to defend and duty to indemnify, the decisions insert additional complexities in the, at times, contentious relationship between and among insureds and insurers.

## Duty To Indemnify and the *Stowers* Duty To Accept In-Limits Demand

The *Stowers* decision recognized the risk that an insured faces with an insurer's control over claims settlement where a claim has exposure near or over the policy limits. To curb the incentive to "gamble with the insured's money," *Stowers* imposes a duty on an insurance carrier to act rea-

sonably in responding to a settlement demand within policy limits. Specifically, *Stowers* requires that an insurer responding to a settlement demand within policy limits must exercise that degree of care and diligence that an ordinary prudent person would exercise in the management of their own affairs. *American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 848–49 (Tex. 1994). The consequence of breaching the *Stowers* duty is steep—imposition of liability on the carrier for the amount of the excess judgment or settlement, regardless of policy limits.

This duty is not limited to Texas, as several jurisdictions recognize similar causes of action to avoid subjecting the insured to judgments in excess of limits. For example, the failure to settle in California is based on the following:

> In each policy of liability insurance, California law implies a covenant of good faith and fair dealing. This implied covenant obligates the insurance company, among other things, to make reasonable efforts to settle a third party's lawsuit against the insured. If the insurer breaches the implied covenant by unreasonably refusing to settle the third party suit, the insured may sue the insurer in tort to recover damages proximately caused by the insurer's breach.

*PPG Industries, Inc. v. Transamerica Ins. Co.* (1999) 20 Cal.4th 310, 312, 84 Cal.Rptr.2d 455, 975 P.2d 652, 654.

An insurer who breaches this duty is liable for all of the insured's damages proximately caused by the breach, without regard to the policy limits. *Wolkowitz v. Redland Ins. Co.* (2003) 112 Cal.App.4th 154, 162, 5 Cal.Rptr.3d 95. As articulated by California courts, the duty requires that "the insurer must settle within policy limits when there is substantial likelihood of recovery in excess of those limits." *Murphy v. Allstate Ins. Co.* (1976) 17 Cal.3d 937, 941, 132 Cal. Rptr. 424, 553 P.2d 584, 586); *see also Isaacson v. California Ins. Guarantee Assn.* (1988) 44 Cal.3d 775, 792, fn. 12 [244 Cal. Rptr. 655, 750 P.2d 297] ("reasonableness of a settlement offer is to be evaluated by considering whether, in light of the victim's injuries and the probable liability of the insured, the ultimate judgment is likely to exceed the amount of the settlement offer").

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Similarly, Illinois courts impose similar limitations. If an insurer's refusal to settle a claim amounts to bad faith, the insurer may be held liable for the entire judgment against the insured, including the amount of the judgment in excess of the policy limits. *Mid-America Bank & Trust Co. v. Commercial Union Ins. Co.,* 224 Ill. App. 3d 1083, 587 N.E.2d 81, 84, 167 Ill. Dec. 199 (Ill. App. Ct. 1992). An insurer is not required to hold an insured's interest paramount to its own, however. *See Adduci v. Vigilant Ins. Co.,* Inc., 98 Ill. App. 3d 472, 424 N.E.2d 645, 650, 53 Ill. Dec. 854 (Ill. App. Ct. 1981) (declining to adopt rule that insured's interests are paramount to insurer's in settling claims). "In investigating, defending, considering questions of settlement, and on the question of appeal, the insurance company must give the interests of the insured equal consideration with its own interests and it must in all respects deal fairly with the insured." *West Side Salvage Inc. v. RSUI Indem. Co.,* 215 F. Supp. 3d 728, 740 (S.D. Ill. 2016).

## The *Stowers* Formulation

The elements of a Texas *Stowers* claim are formulaic, limiting the types of settlement demands that may trigger excess liability. For a *Stowers* demand to be valid it must:

(1) include a claim against the insured within the scope of coverage;
(2) state a demand within policy limits;
(3) the demand must unconditionally offer to fully release the insured of all claims, and
(4) the terms of the demand are such that an ordinary and prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to a judgment in excess of policy limits.

*Rocor Intern., Inc., v. Nat'l Union Fire Ins. Co. of Pittsburg, PA,* 77 S.W.3d 253, 262 (Tex. 2002).

## Medical/Other Liens

The offer of settlement must be unconditional and offer a full and complete release of the insured, including any liens. *See Rocor Intern., Inc. v. Nat'l Union Fire Ins. Co. of Pittsburg, PA,* 77 S.W.3d 253, 262 (Tex. 2002).

## Is an Excess Judgment Required?

A brand new decision by the Texas Supreme Court has addressed liability for negligent failure to settle within the policy limits. The Court held that a *Stowers* claim requires evidence of liability in excess of policy limits, although such liability could be established by either a settlement or a judgment. *In re Farmers Texas County Mut. Ins. Co.,* Appeal No. 19-0701 (Tex. April 23, 2021).

## Navigating *Stowers* in Numerous Claims/Insureds/Insurer Scenarios

Although well known in theory, the *Stowers* duty can be tricky to navigate in complex claims with multiple carriers and/

or multiple claimants. Further, a *Stowers* case is fact-intensive, focusing on evaluations and judgment calls. However, one important principle that runs throughout the decisions is a results-minded outcome that focuses on facilitating the public policy of **settlement of claims**.

## Multiple Claimants

What happens when there are multiple Plaintiffs and only one has made a valid *Stowers* demand? The Texas Supreme Court answered that question in *Farmers Insurance Company v. Soriano.*, 881 S.W. 2d 312 (Tex. 1994). In that case, the court held that "when faced with a settlement demand arising out of multiple claims and inadequate [insurance] proceeds, an insurer may enter into a reasonable settlement with one of the several claimants even though such settlement exhausts or diminishes the proceeds available to satisfy other claims." *Id.* at 315.

## Multiple Insureds

The Fifth Circuit has held that carriers can likewise enter into reasonable settlements when there are multiple defendants. The court held that there is no *Stowers* claim against a carrier for accepting a *Stowers* offer to settle with some but not all defendants so long as such decision was reasonable. *Pride Transp. v. Continental Cas. Co.*, 511 Fed. Appx. 347, 352-353 (5th Cir. 2013).

In contrast, the *Patterson* decision caused considerable consternation when issued by the Houston Court of Appeals in 2014. *Patterson v. Home State County Mut. Ins. Co.*, 2014 Tex. App. LEXIS 4460 (Tex. App.—Houston [1st Dist.] 2014, pet. denied) (memorandum opinion). *Patterson* involved a wrongful death suit against truck driver Charles Hitchens and owner Brewer Leasing, which allegedly negligently hired and supervised Hitchens. The husband of the deceased, Marcus Patterson, also asserted negligent hiring and supervision against affiliated company Texas Stretch, Inc. *See id.* at *1-2. Brewer's insurer Home State County Mutual Insurance Co. ("Home State") defended Brewer and Hitchens.

Patterson made two in limits demands to Home State, one in which the full limits would be paid to the Patterson's two children; the second letter proposed settlement but payable solely to Marcus. Home State denied both demands and subsequently deposited the limits into the court's registry as part of an interpleader action, asserting that additional individuals had made claims arising out of the same accident. *See id.* at *2-*3.

The interpleader court disbursed $770,004 of the $1,000,004 limits to the Patterson claimants and the remaining limits to other claimants. Home State ceased its defense of Hitchens and Brewer in the wrongful death suit, which Patterson settled for payment of $474,000 in exchange for his release of Brewer, individually, and Stretch, but not Hitchens. He also agreed not to execute any judgment he obtained against Brewer in return for Brewer's assignment of any claims it had against Home State. *See id.* at *5.

Home State defended the *Stowers* suit on the basis that Patterson's in limits demand did not propose a release of both Brewer and driver Hitchens and pointed to Brewer's opposition to any settlement without a release of Hitchens. *See id.* at *8. The Court agreed, noting that Patterson's first demand did not include an unconditional release of claims against Hitchens, nor did it release his claims individually; the second letter also failed to include the release of claims against Hitchens or the claims of Patterson on behalf of his children. *See id.* at *21-23. The court reasoned that *Stowers* required a settlement offer that is both "unconditional and propose[s] to release the insured fully," and because Home State could have left Brewer exposed to an excess judgment by one of the other claimants, Patterson's offers never implicated the *Stowers* duty. *See id.* at *23-24.

Notably, the Fifth Circuit Court of Appeals expressly considered and declined to follow *Patterson* in *OneBeacon Insurance Co. v. T. Wade Welch Associates*, 841 F.3d 669 (5th Cir. 2016). The Court observed its prior decision in *Travelers Indemnity Co. v. Citgo Petroleum Corp.,* 166 F.3d 761, 764 (5th Cir. 1999), in which it applied *Soriano*'s multiple claimants holding to the scenario presented with multiple insureds: "[W]hen faced with a settlement demand over a policy with multiple insureds, an insurer fulfilling its *Stowers* duty 'is free to settle suits against one of the insureds without being hindered by potential liability to co-insured parties who have not yet been sued.'" *OneBeacon Ins. Co.*, 841 F.3d at 678 (quoting *Citgo,* 166 F.3d at 765). The Court observed as follows:

> Instead of following *Citgo,* OneBeacon urges us to follow a recent Texas appellate decision in which the court found no valid *Stowers* demand where only the insured employer and not the employee (an additional insured) would have been released. *Patterson v. Home State Cty. Mut. Ins. Co.,* No. 01-12-00365-CV, 2014 Tex. App. LEXIS 4460, 2014 [*679] WL 1676931, at*10 (Tex. App.—Houston [1st Dist.] Apr. 24, 2014, pet. denied) (mem. op.). However, in that case, the insured employer had explicitly indicated to its attorney that it "did not want 'any settlement demands to be accepted that didn't involve a release of all of the claims against both [the employer and the employee.]'" *Id.* We conclude that the district court did not err in holding that DISH's July 14, 2011, letter demanding policy limits in exchange for a full release of its claims against the Welch Firm was a valid *Stowers* demand which OneBeacon rejected.

*Id.* at 678-79. *Patterson* has not been relied on by subsequent courts addressing multiple insureds and *Stowers* demands.

## Multiple Insurers: *Stowers* Claim by Excess Carrier Against Primary Carrier

The Fifth Circuit recently affirmed an $8 million judgment in favor of an excess carrier against a primary carrier for *Stowers*

liability. *See American Guar. & Liab. Ins. Co. v. ACE Am. Ins. Co.,* 990 F.3d 842, 2021 U.S. App. LEXIS 6402 (5th Cir. 2021). Such claims are not new, as the Texas Supreme Court has long held that an excess carrier is equitably subrogated to an insured's *Stowers* claims in cases involving excess coverage. *See American Centennial Ins. Co. v. Canal Ins. Co.,* 843 S.W2d 480 (Tex. 1992). However, in *ACE,* the Fifth Circuit considered new issues arising out of a wrongful death action involving multiple plaintiffs and primary-excess carriers.

The Court made an *Erie*-guess as to ACE's primary argument of whether a potential conflict of interest among the plaintiffs and court approval of settlement precluded the policy limit demand from triggering *Stowers* liability. The Court rejected the argument in an opinion that includes a technical discussion of Texas procedural law concerning guardian ad litems and court approval of settlement involving minors. *See ACE Am. Ins. Co.,* 990 F.3d at 848-849.

The Court also rejected ACE's "novel" argument that *Stowers* liability should consider the defendant's chance of reversing one or more of the trial court's rulings on appeal. *Id.* at 851-52 (based on evidence, primary carrier violated its *Stowers* duty by failing to reevaluate the settlement value of the case).

## Does *Stowers* Foreclose All Other Exposure in Settlement of Third-party Claims?

As of April of 2021, the answer is unequivocally "No." The Texas Supreme Court in the 1996 *Maryland v. Head* decision seemingly foreclosed all claims against insurers in handling settlement other than *Stowers*. However, the Court has now distinguished *Head*, and in turn, *Stowers,* as strictly applying tort liability principles. The Court held that an insurer may still face liability for breach of contract in settlement decisions. *See In re Farmers Texas County Mut. Ins. Co.,* Appeal No. 19-0701 (Tex. April 23, 2021).

The insured brought claims both for *Stowers* and breach of the duties to defend and indemnify following settlement of a car accident case in which Farmers conditioned payment of an in-limits settlement on the insured's contribution. Farmers moved to dismiss on the grounds the suit did not state either a *Stowers* claim or breach of contract. Although the Court held that the absence of an excess judgment negated *Stowers*' liability (see above), it also held that the insured stated a viable claim for breach of the **duty to indemnify** where Farmers conditioned settlement of a covered loss on the insured's

contribution of $100,000 of a $350,000 settlement. *See In re Farmers Texas County Mut. Ins. Co.,* slip opin. at 1-2. ("[T]he insured can pursue her claim that the insurer breached its obligation to indemnify her for amounts she was legally responsible to pay under the settlement.").

The Court expressly limited *Head* in that the Court declined to recognize any other "tort cause of action for mishandling a claim … **but … we did not determine that a claim for breach of contract is precluded by *Stowers* or any other Texas law**. Slip opin. at 19 (emphasis added).[1]

The *Farmers* decision removes the risk of *Stowers* liability and potential tort damages by limiting the insured to a breach of contract claim. However, when it comes to breach of the duty to defend, the Court's 2018 *USAA Texas Lloyd's Company v. Menchaca* decision continues to create extra-contractual damages for what had been viewed as contractual claims, as discussed next. 545 S.W.3d 479, 498 (Tex. 2018)

## Extra-Contractual Exposure for Breach of Duty To Defend

*USAA Texas Lloyd's Company v. Menchaca*, 545 S.W.3d 479 (Tex. 2018) was a significant decision because it resolved a split that had emerged between Texas federal and state courts: **Are policy proceeds actual damages for violations of the Texas Insurance Code?** The Court held **yes**, if the claim is covered under the policy. *Menchaca*, 545 S.W.3d at 484. The Court thus breathed new life into unfair claim settlement claims by eliminating the need to show "separate and independent damage." *Id.* at 484.

Whereas *Menchaca* involved a first-party claim under a property policy, the Fifth Circuit swiftly applied its holding in a third-party coverage action concerning the duty to defend. *See Lyda Swinerton Builders, Inc. v. Oklahoma Surety Co.*, 903 F.3d 435 (5th Cir. 2018). The Court held that breach of the duty to defend may be actionable as a misrepresentation of the policy under the Texas Insurance Code, allowing recovery of up to three times actual defense costs as damages. 903 F.3d 435 (5th Cir. 2018) (relying on *Menchaca*, 545 S.W.3d at 484. The court specifically held that evidence of independent injury was not required after *Menchaca:*

> In this case, LSB was entitled to a defense from OSC as a benefit of the OSC Policy. Consequently, if LSB establishes that OSC's alleged misrepresentations caused it to be deprived of that benefit, LSB can recover the resulting defense costs it incurred as actual damages under Chapter 541—without limitation from the independent-injury rule. *Furthermore, if LSB proves that OSC committed the statutory violation "knowingly," it may recover treble that amount.*

[1] Note that the decision solely addresses whether the insured had stated a claim and does not reach ancillary questions including reasonableness of settlement and coverage. *See id.* at 1-2.

*Lyda Swinerton Builders, Inc.*, 903 F.3d 453 (emphasis added); *but see Tex. Disposal Sys. v. Fcci Ins. Co.,* 2021 U.S. App. LEXIS 13394, *14-15, ___ Fed. Appdx.___ (5th Cir. May 5, 2021) (insured did not prove loss of defense caused by statutory violation or harm loss beyond loss of policy benefits; accordingly, district court properly granted insurer summary judgment on extra-contractual claims).

## Conclusion

The *Stowers* duty recognized over 90 years ago continues to govern the complex relationships among insureds and insurers, with new wrinkles presented by new fact patterns. More recent cases both limit *Stowers* but expand other claims and, with them, potential new liability. Texas coverage law thus continues to evolve beyond *Stowers*.