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Stowers—A Modest Proposal

Before a liability carrier incurs any exposure under either Chapter 541 of the Insurance Code or the *Stowers* doctrine,[1] the claimant must make a technically perfect demand. Any flaws in this demand will jeopardize the insured and block any further inquiry into the carrier's handling of the claim. This strict rule should be relaxed.

The rule was created in *American Physician's Insurance Exchange v. Garcia*[2] as a prerequisite for *Stowers* liability and incorporated into 541 of the Insurance Code by the *Rocor International, Inc. v. National Union Fire Insurance Co. of Pittsburgh, PA*[3] decision. Prior to *Garcia*, there was no firm requirement under Texas law for a demand letter from the claimant in order to trigger a *Stowers* duty. In fact, *Ranger*, decided seven years earlier, specifically rejected this trigger.[4] Since *Garcia*, the courts have focused more and more on the claimant's demand letter and, less and less on the original purpose of the *Stowers* doctrine— protection of the insured. Under increasing scrutiny, the demand letter must now address all liens,[5] cover all insureds,[6] and offer an unconditional release to the insured.[7] Certainly no argument is made that these are not desirable, even necessary requirements for the protection of the insured. The problem is, under our current law, the claimant must precisely address these matters in his demand letter or the carrier has no accountability for harm to its insured outside of the policy limits.

I. How We Got Here—A Brief History of the *Stowers* Doctrine

***Stowers Furniture Co. v. Am. Indem. Co.*, 15 S.W.2d 544 (Tex. Comm'n App. 1929, holding approved).** An insured has a negligence cause of action, based on agency, against its liability carrier for failing to reasonably settle a claim. The damage is the amount of the resulting excess judgment.

***Hernandez v. Great Am. Ins. Co. of New York*, 464 S.W.2d 91 (Tex. 1971).** The *Stowers* cause of action accrues when the excess judgment becomes final, whether paid or not.

***Ranger County Mut. Ins. v. Guin*, 723 S.W.2d 656 (Tex. 1987).** The *Stowers* doctrine encompasses the entire claims handling process, not just the refusal to settle within policy limits. An unconditional settlement demand is not required to trigger the duty.[8]

***Street v. Honorable Second Court of Appeals*, 756 S.W.2d 299 (Tex. 1988).** Expanding on *Hernandez*, the court holds that for a *Stowers* cause of action, "the statute of limitations will not begin to run until all appeals have been exhausted. Regardless of whether the judgment is superseded, an insured who so wishes may still wait until the underlying action has been completely resolved before bringing a *Stowers* suit."[9]

***Am. Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480 (Tex. 1992).** An excess carrier may pursue the primary carrier for negligently failing to settle within the primary limits. Cause of action arises through the insured's *Stowers* rights. The excess carrier has an equitable subrogation right to pursue that action.

***Am. Physician's Ins. Exch. v. Garcia*, 876 S.W.2d 842 (Tex. 1994).** For the first time, in this 5–4 opinion, the Texas Supreme Court imposes the requirement that a settlement demand be made before the *Stowers* duty is triggered. The majority treat the contrary language in *Ranger County Mutual Insurance* as dicta. The rule announced is:

> Generally, a *Stowers* settlement demand must propose to release the insured fully in exchange for a stated sum of money, but may substitute "the policy limits" for a sum certain. The *Stowers* duty is not activated by a

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> settlement demand unless three prerequisites are met: (1) the claim against the insured is within the scope of coverage, (2) the demand is within the policy limits, and (3) the terms of the demand are such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to an excess judgment.[10]

The court also holds that a *Stowers* violation does not trigger an Insurance Code or DTPA cause of action.

***Texas Farmers Ins. Co. v. Soriano*, 881 S.W.2d 312 (Tex. 1994).** When faced with multiple claimants, the carrier has considerable leeway without running afoul of *Stowers.*

> We conclude 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 though such settlement exhausts or diminishes the proceeds available to satisfy other claims.[11]

***Maryland Ins. Co. v. Head Indus. Coatings and Servs., Inc.*, 938 S.W.2d 27 (Tex. 1996).** *Stowers* is the exclusive remedy for the insured in a third party claim.

***Trinity Universal Ins. Co. v. Bleeker*, 966 S.W.2d 489 (Tex. 1998).** A *Stowers* demand must include the release by the claimant of all hospital liens. Without this release, the offer to settle is not "unconditional."[12]

***State Farm Mut. Auto Ins. Co. v. Traver*, 980 S.W.2d 625 (Tex. 1998).** The agency theory on which *Stowers* is based does not extend to defense counsel hired by the insurance carrier. Carrier has no vicarious liability for attorney's actions.

***Keck, Mahin & Cate v. Nat'l Union Fire Ins. Co.*, 20 S.W.3d 692 (Tex. 2000).** An excess carrier has no duty to act until the primary carrier tenders its limits. While not strictly a *Stowers* case, this opinion has been relied on by at least one lower court in restricting the effect of a multi-policy demand under *Stowers*.[13]

***Rocor Int'l, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 77 S.W.3d 253 (Tex. 2002).** The court recognizes changes in the Insurance Code that overrule *Maryland Insurance Co. v. Head Industrial Coatings and Services, Inc.* The Insurance Code, as amended, gives an insured a cause of action for unfair claims handling once "liability is reasonably clear." The court then goes on to hold that, despite the absence of such language in the Code, the other *Stowers* requirements still apply. In other words, unless a proper *Stowers* demand has been received, **and** "liability is reasonably clear," the unfair settlement cause of action under the Insurance Code does not benefit the insured in third party claims.[14]

***Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d 765 (Tex. 2007).** Both parties are co-insurers. Liberty Mutual settles, Mid-Continent does not. Liberty Mutual sues Mid-Continent for contribution. The court refuses the claim, holding there was no direct duty between the carriers, and Liberty Mutual can not make an equitable claim, in part, because the claimant had not made "a settlement offer within Mid–Continent's policy limits."[15]

***Phillips v. Bramlett*, 288 S.W.3d 876 (Tex. 2009).** Malpractice case allows *Stowers* claim against the carrier, despite the statutory cap that protected the insured. The statute since has been amended to eliminate any similar claim.[16]

II. Where We Are Now

At the end of this road, the insured is left in a more vulnerable position and the original purpose of the *Stowers* doctrine is eroded. By the court's focus on the claimant's demand letter, rather than the fundamental protection of the insured from an excess judgment, the following inequities have resulted:

-The insured is exposed to a risk over which he has no control;

-No inquiry is made into the carrier's conduct until an artificial condition precedent is met;

-Multiple carriers are allowed to escape responsibility altogether;

-When a single insured has multiple coverages, the reasonable carrier is penalized.

A. The insured has no control over the Stowers risk.

Liability insurance involves selling a risk. Once a claim covered by the policy is made, that risk comes home to roost, and the insurer's duty is triggered. In most policies that duty includes the duty to defend and negotiate. Most policies also give this job exclusively to the carrier, with the risk of jeopardizing coverage if the insured interferes. Obviously the insured has no control over the claimant's demand, how liens are addressed, or whether all of the insureds under the policy are included in the demand. Under our current law, if the claimant's demand letter is flawed in some way, the insured's assets are at risk. One must hope for a skilled opponent.

B. The requirement of a proper demand letter creates an artificial condition precedent.

Let's consider a hypothetical. Joe has a minimum limits policy on his car. He runs a red light and hurts Paul, badly. Paul calls Joe's insurance company and indicates that he might be willing to settle. He needs money. No firm offer, no mention of liens and, so far, no attorney. Knowing that no *Stowers* obligations have been triggered, Joe's carrier ignores the call. Finally, Paul hires an attorney who recognizes the value of the case, and gets an excess judgment against Joe. Joe's carrier is off the hook. No proper *Stowers* demand, no liability for the excess judgment. Under our hypothetical, Paul would have taken the policy limit if it had been offered. What's wrong with a rule that at least allows Joe to explore the reasonableness of his carrier's conduct? Many states reject the bright line rule that the claimant's demand begins the carrier's negotiation and settlement duties.[17] Texas should as well.[18]

Certainly, the contents of the plaintiff's demand should be relevant in a *Stowers* inquiry, and in many cases controlling. A clear intention by the plaintiff to not accept the policy limits or to not pay off liens that attach to the case are just reasons for a carrier to reject a demand.[19] Also, if a release is not offered to all of the insureds, the carrier is likely obligated to refuse the demand. But that is the nature of negotiations. They go back and forth. A rule that halts the analysis with the original demand stops too far short. The Texas Supreme Court acknowledged as much in *Ranger*.[20]

C. The Garcia demand requirement allows multiple carriers for the same insured to escape responsibility altogether.

A responsible defendant will have insurance. A very responsible defendant will have lots of insurance. If this very responsible defendant is the object of a claim that may exceed all of his policies, he probably is on the hook for the excess no matter how willing the plaintiff is to accept the combined limits. If the carrier refuses the claimant's reasonable settlement offers and things go badly in trial, the insured will pay a price for carrying extra insurance. This inequity was exposed most recently in *AFTCO*.[21] The claimant cannot offer to "fully release" the insured for the primary limits without also releasing him from liability for the excess limits.[22] Under the current law, there is no clear way for a claimant to effectively make a *Stowers* demand when there are multiple layers of coverage. Under our current law, more is less.

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D. Under the Garcia demand requirement, when two carriers share the same coverage, the reasonable one is penalized.

Mid-Continent v. Liberty Mutual[23] is the poster child for this problem. In this well-known case, both parties are co-insurers. Liberty Mutual comes forward and settles the underlying case while Mid-Continent balks. When Liberty Mutual seeks to recover its proportionate share from Mid-Continent, it is denied equitable subrogation because of the restrictive *Stowers* rule in place. The claimant's demand was within the combined primary policy limits, but exceeded each individual limit. Consequently, the court holds that "Mid–Continent did not breach a *Stowers* duty to Kinsel [insured] because the Boutins [plaintiff] did not make a settlement offer within Mid–Continent's policy limits."[24] The *Garcia* demand requirement, again, produced an unjust result, this time to the carrier.

III. Where We Should Go From Here

Here is a modest proposal. Let's turn away from a bright line rule that focuses extensively on the demand letter, and simply say:

> "An insurer has a duty to reasonably negotiate and settle a claim within its policy limits in order to protect its insured against an excess judgment or excessive litigation costs."

This is not so different from the rule originally announced in *Stowers*:

> *Certainly, where an insurance company makes such a contract; it, by the very terms of the contract, assumed the responsibility to act as the exclusive and absolute agent of the assured in all matters pertaining to the questions in litigation, and, as such agent, it ought to be held to that degree of care and diligence which an ordinarily prudent person would exercise in the management of his own business; and if an ordinarily prudent person, in the exercise of ordinary care, as viewed from the standpoint of the assured, would have settled the case, and failed or refused to do so, then the agent, which in this case is the indemnity company, should respond in damages.*[25]

Our judges and juries can sort out facts and apply broad rules in a fair manner. With multiple layers of coverage, each carrier's conduct is judged individually. No carrier should be penalized for another's recalcitrance. In a case such as *AFTCO*, if an excess carrier reasonably evaluates the case as one that dips into its coverage, it can make an offer of that amount no matter what the other carriers do.

Under this analysis, many of the prior *Stowers* holdings would remain unchanged. If the insured is not exposed to an excess judgment or unnecessary defense costs, the carrier may proceed as it sees fit.[26]

IV. How We Can Get There

The court created the *Stowers* rule and all of its permutations. The court can change it on its own volition if the rule has become unworkable or unjust in the light of changes in society.[27] The legislature could as well. Since *Rocor*, our courts have acknowledged that third party claims trigger duties to the insured under the Texas Insurance Code.[28] Section 541.060 currently reads:

> § 541.060. Unfair Settlement Practices
>
> (a) It is an unfair method of competition or an unfair or deceptive act or practice in the business of insurance to engage in the following unfair settlement practices with respect to a claim by an insured or beneficiary:
>
> * * *
>
> (2) failing to attempt in good faith to effectuate a prompt, fair, and equitable settlement of:
>
> (A) claim with respect to which the insurer's liability has become reasonably clear; or
>
> (B) a claim under one portion of a policy with respect to which the insurer's liability has become reasonably clear to influence the claimant to settle another claim under another portion of the coverage unless payment under one portion of the coverage constitutes evidence of liability under another portion;

The *Rocor* court read into this language the *Garcia* demand requirements.[29] That requirement could be written back out of the Code with the following amendment to 541.060:

> (C) In a liability claim, an insurer's duty under this section is not precluded by the absence of a demand by the person making the claim against the insured or beneficiary.[30]

With this change, many of the inequities discussed above would be addressed. To specifically address the *Mid-Continent v. Liberty Mutual* issue, we might also want to add the following:

> (D) In any claim where two or more insurers have primary coverage on the claim, if a carrier settles with the claimant, that carrier has a right of contribution against any other primary carrier which does not settle. In such

> an action, the settling carrier or carriers must show that the amount settled for was reasonable, and upon such showing shall be entitled to recover a pro rata share of the settlement from the non-settling carriers up to the amount of the non-settling carriers' policy limit.

The world will not end. Insurance companies will not flee the State. Most carriers will go on adjusting claims in the same manner they always do, but if in that process the carrier behaves unreasonably it will not have the absolute shield of a flawed demand letter. Responsible people purchase liability insurance to shield themselves and others from their own negligence. It is fair to hold liability carriers responsible for their own negligence, as well, without the insured being at the mercy of the claimant's demand letter.

1 *Stowers Furniture Co. v. Am. Indem. Co.*, 15 S.W.2d 544 (Tex. Comm'n App. 1929, holding approved).

2 "The *Stowers* duty is not activated by a settlement demand unless three prerequisites are met: (1) the claim against the insured is within the scope of coverage, (2) the demand is within the policy limits, and (3) the terms of the demand are such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to an excess judgment." *Am. Physician's Ins. Exch. v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994).

3 "In sum, we hold that an insured may assert a cause of action against its insurer under article 21.21 [now 541] for failure to attempt settlement of a third-party claim once liability has become reasonably clear. To establish liability, the insured must show that (1) the policy covers the claim, (2) the insured's liability is reasonably clear, (3) the claimant has made a proper settlement demand within policy limits, and (4) the demand's terms are such that an ordinarily prudent insurer would accept it." *Rocor Int'l, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 77 S.W.3d 253, 264–65 (Tex. 2002).

4 *Ranger County Mut. Ins. v. Guin*, 723 S.W.2d 656, 659 (Tex. 1987).

5 *Trinity Universal Ins. Co. v. Bleeker*, 966 S.W.2d 489, 491 (Tex.1998).

6 *Home State County Mut. Ins. Co. v. Horn*, No. 12-07-00094-CV, 2008 WL 2514332 (Tex. App.—Tyler 2008, pet. denied) (mem. op.).

7 "[A] settlement demand must propose to release the insured fully in exchange for a stated sum of money." *Texas Farmers Ins. Co. v. Soriano*, 881 S.W.2d 312, 314 (Tex. 1994).

8 *Ranger*, 723 S.W.2d at 660 (Gonzalez, J., dissenting).

9 *Street*, 756 S.W.2d at 302.

10 *Garcia*, 876 S.W.2d at 848–49.

11 *Soriano*, 881 S.W.2d at 315.

12 *Bleeker*, 966 S.W.2d at 491.

13 *AFTCO Enters., Inc. v. Acceptance Indem. Ins. Co.*, 321 S.W.3d 65, 71 (Tex. App.—Houston [1st Dist.] 2010, pet. denied).

14 This statute has been expanded since *Rocor* to reinforce the holding. The relevant portions of Chapter 21.21 are now re-codified as Tex. Ins. Code § 541.060 and § 541.151.

15 *Mid-Continent Ins. Co*, 236 S.W.3d at 776.

16 Tex. Rev. Civ. Stat. art. 4590i, §§ 11.02(a) & (c) (repealed 2003). The statute in question has been amended and re-codified as Tex. Civ. Prac. & Rem. Code § 74.303 and includes this language:

> (d) The liability of any insurer under the common law theory of recovery commonly known in Texas as the "*Stowers* Doctrine" shall not exceed the liability of the insured.

17 14 Couch on Insurance § 203:21.

18 "The better view is that the insurer has an affirmative duty to explore settlement possibilities." *Am. Physician's Ins. Exch. v. Garcia*, 876 S.W.2d 842, 864 (Doggett, J., dissenting) (Tex. 1994).

19 Tex. Prop. Code Ann. § 55.007.

> (a) A release of a cause of action or judgment to which a lien under this chapter may attach is not valid unless:
>
> > (1) the charges of the hospital or emergency medical services provider claiming the lien were paid in full before the execution and delivery of the release;
> >
> > (2) the charges of the hospital or emergency medical services provider claiming the lien were paid before the execution and delivery of the release to the extent of any full and true consideration paid to the injured individual by or on behalf of the other parties to the release; or
> >
> > (3) the hospital or emergency medical services provider claiming the lien is a party to the release.
>
> (b) A judgment to which a lien under this chapter has attached remains in effect until the charges of the hospital or emergency medical services provider claiming the lien are paid in full or to the extent set out in the judgment.

20 "An insurer's duty to its insured is not limited to the narrow boundaries contended by Ranger, rather it extends to the full range of the agency relationship. In this case, that includes investigation, preparation for defense of the lawsuit, trial of the case and reasonable attempts to settle." *Ranger*, 723 S.W.2d at 659.

21 *AFTCO Enters., Inc. v. Acceptance Indem. Ins. Co.*, 321 S.W.3d 65 (Tex. App.—Houston [1st Dist.] 2010, pet. denied).

22 *Id.* at 71.

23 *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d 765 (Tex. 2007)

24 *Id.* at 776.

25 *Stowers*, 15 S.W.2d at 547.

26 While the plaintiff often is the beneficiary of a *Stowers* breach, that is not the focus of the doctrine. The duties owed under a liability policy run exclusively to the insured. *Allstate v. Watson*, 876 S.W.2d 145 (Tex. 1994).

27 *Sabine Pilot Service, Inc. v. Hauck*, 687 S.W.2d 733, 735 (Tex. 1985).

28 *Rocor*, 77 S.W.3d at 260

29 "We see no reason why an insurer's duty to its insured under article 21.21 [now § 541.060] should not be similarly circumscribed. Accordingly, we hold that an insurer's statutory duty to reasonably attempt settlement of a third-party claim against its insured is not triggered until the claimant has presented the insurer with a proper settlement demand within policy limits that an ordinarily prudent insurer would have accepted. *See id.* A proper settlement demand generally must propose to release the insured fully in exchange for a stated sum, although it may substitute the "policy limits" for that amount. *See id.* at 848–49. At a minimum, the settlement demand must clearly state a sum certain and propose to fully release the insured." *Rocor*, 77 S.W.3d at 262.

30 Thanks to Mark Kincaid and Mark Ticer for reviewing this proposed statutory language.