



Insurance Law



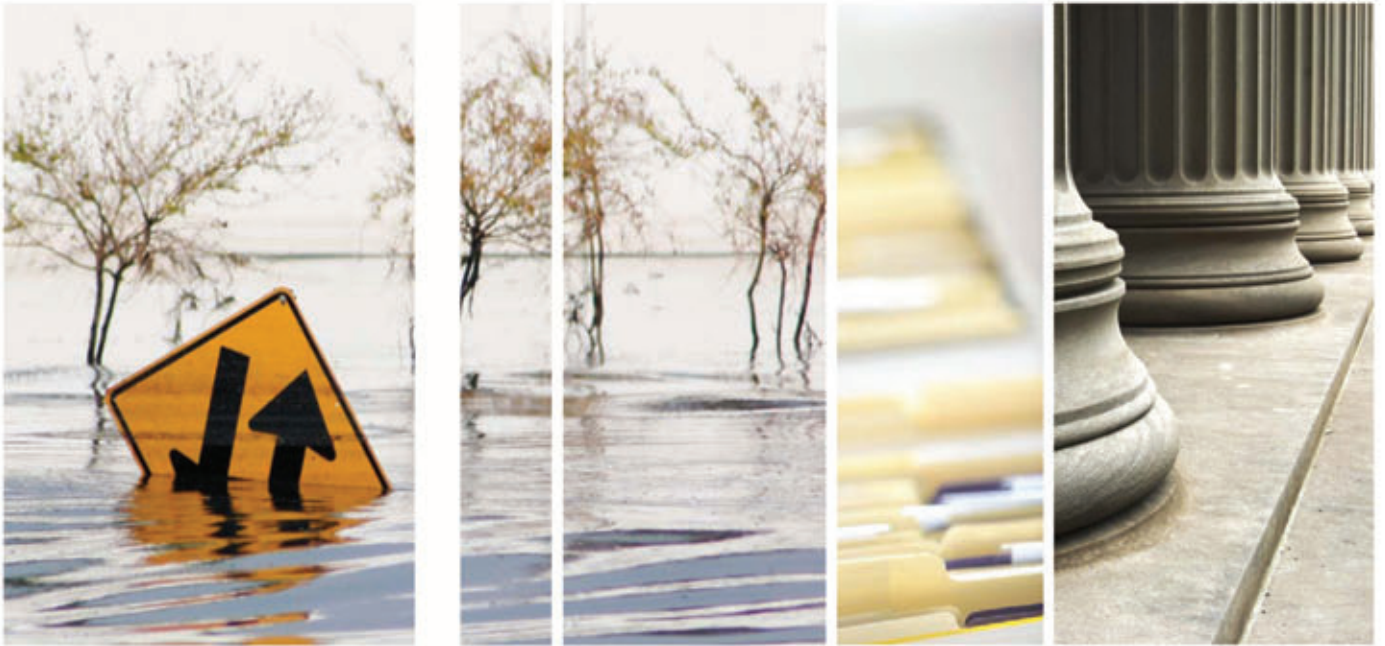
R. BRENT COOPER



PATRICK M. FORD



MICHAEL W. HUDDLESTON



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From hurricanes Ike and Rita, to construction cases and coverage issues, there is plenty to discuss in insurance law. To flesh out these topics and many more, Texas Lawyer's business department hosted an insurance law roundtable with top insurance law and coverage experts. The following discussion has been edited for length and style.

MIKE ANDROVETT, moderator, attorney, owner of Androvett Legal Media & Marketing, Dallas: . . . *Panelists, would you please introduce yourself and talk a little bit not only about who you are and where you work, but the nature of your work.*

PATRICK M. FORD, specialty claims zone technician, Chubb Group of Insurance Companies, Dallas: I've been in the insurance industry for over 20 years now with multiple employers, two of which are still in business, three aren't. So I have to give a call out to Chubb for sticking around for the eight years that I've been with them. Most of my business has been handling what we call specialty claims, medical malpractice, legal malpractice, and currently, specialty claims, such as banking, insurance company, professional liability, product liability, and directors and officers items. I graduated from business school in Western Washington University in '84, and then went to law school at the University of Houston in '87. So over the 20 years, I've had experience in a fairly narrow niche, but in an industry that is ever changing, as most of you are familiar with, and certainly you will pick up more details in the presentation today.

R. BRENT COOPER, named shareholder, Cooper & Scully, P.C., Dallas: I have primarily trial and appellate practice, probably two-thirds trial, one-third appellate. Of that practice, we do a lot

of insurance coverage and bad faith litigation. Probably most of it is from the insurer standpoint where we do some insured representation as well. I do some regulatory work as well, and I've been doing this, this month, I guess actually next week, will be some 33 years. So I've seen a lot of changes and developments. It's happening in Texas. And one good thing I think I can say is nothing ever stays the same. It always changes. Insurance companies are always changing. The law, it's always changing. Juries are always changing. So nothing really stays the same.

MIKE W. HUDDLESTON, senior partner, Shannon, Gracey, Ratliff & Miller, LLP, Dallas: I've been doing insurance work for 27 years, licensed in 1983. I started out representing carriers primarily, but over the last approximately 10 years or so, I've moved towards representing commercial and professional policyholders against insurance companies. Certainly when I first came out, when I was working with Brent, it seemed like almost all the cases involved liability policies. We were in the middle of the '80s, the Supreme Court was very liberal and expanding liability insurer exposure exponentially, so extra contractual exposure for a liability carrier seemed to be the focus. Now it's very different. My practice involves much more than liability policies now. Broad based commercial insurance practice requires work on a wide variety of specialty coverages, such as product recall policies, fidelity policies, directors and officers' policies, reinsurance, various oil and gas specialty lines, as well as commercial property policies. I do some work as an expert witness involving these various lines of insurance and also as a mediator of complex insurance disputes.

ANDROVETT: *As I am prone to do in preparing for discussions such as this one, I tend to revisit the last one a year ago. And Brent and Mike, you were part of that discussion. Part of that discussion was the impact of the whole financial scandal on jurors. There was also a discussion about a lack of loyalty on the part of insurance companies towards the lawyers who represent them. This has been brought on by a lot of the changes in the insurance industry, and also a generalized move by the courts*

towards the policyholder and also in favor of business against the insurance companies. So here we are now, coming into the end of 2010, would you give us sort of a snapshot of what the hot topics are and what are the things that are occupying time in your office?

COOPER: Well, obviously, one thing that is very hot right now are Hurricane Ike cases. They're being filed literally by the thousands. The first case, the trial was completed last week in Houston with a fairly large verdict in that case, but they're going to be around for a long time. So a lot of the policyholder lawyers are spending a lot of time addressing those cases, the bad faith components, things like that. We're also seeing, frankly, a big upsurge in workers' compensation bad faith. There's a case now before the Supreme Court, the *Ruttiger* case, it was argued in April, that's going to define really what the parameters are, how far will we go on that, and there's a lot of those cases being tried. There's been some tried in San Antonio, some tried in Galveston with some very, very large verdicts, which again, I think is a symptom or a sign of the times that we're in. I think juries now, when we have an economic crisis, according to some, a lot of the jurors may be brought about by the financial industry, which insurance companies tend to get lumped into that group. Jurors tend not to be very sympathetic. If they're unemployed, they're even less sympathetic to that. So as a result, I think the whole economic crisis has spawned more bad faith litigation primarily because of the attitudes of jurors and their willingness to go in there and give higher awards. Plus if you also look, plaintiff's lawyers are very creative. Over the tort reform in 2003, a lot of the areas where they had previously made their money either was dramatically limited or went away, and so they're naturally going to migrate into other areas where they can make money, and one of the areas they have migrated into is bad faith litigation.

HUDDLESTON: I think the one thing that I probably see more than anything, at least in reviewing decisions as they've come out and seeing what the courts are doing, is that it is probably more diffi-

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cult now to predict what a court is going to do when a given piece of policy language is presented to them. In my 27 years of practice, many good things and bad things have been done under the rubric of seeking the “plain meaning” of a given policy. And I think in particular the Supreme Court of Texas has taken some very unusual approaches in the pursuit of “plain meaning.” It looks like there is a much greater emphasis now, than perhaps there has ever been, on connecting the dots between all the different terms and provisions of the policies, and it’s almost as though the courts, and particularly Supreme Court, seem to think an insurance policy is planned out by some master theoretician, sort of like a Moriarty who is creating this Rubik’s cube, and what you turn on one side affects a piece on the other side. We saw a little bit of that in the *Lamar Homes*, where the Court seemed to take exclusions and treat them as grants of coverage by implying coverage existed because otherwise there was no need to exclude it. That was something that we had never seen happen before; it seemed logical, but it’s a very different approach. And so I think what you see time and again is a great deal more reliance on seeing what other provisions of the policies say and seeking some form of overall consistency. It’s just that ultimately, I’m not sure that this approach really achieves the ultimate goal of determining the intent of the parties. One of the things that we are fighting about on a daily basis is the duty to defend rules. And you would think that at this point we wouldn’t have that much confusion about those rules, but I would submit that we’ve got two very diametrically opposed rules based on conflicting Supreme Court authorities and courts of appeals decisions involving situations where pleadings are silent or vague as to a given issue regarding coverage. The so-called strict rule says that if a given coverage requirement does not affirmatively appear in the underlying allegations, then there is no duty to defend and we’re not going to take the silence of the pleadings and construe it in light of what’s favorable to the insured. This rule is epitomized by the famous buzz line, repeated in many of the decisions, that



in determining the duty to defend the court may not imagine factual scenarios that were not necessarily pled and that don’t necessarily exist under the terms of the pleadings. Juxtaposed against this rule is the “liberal construction” rule reflected in cases such as *Gehan Homes* decision. Under this rule, a duty to defend is effectively presumed to exist unless the pleadings affirmatively take the case out of coverage. The *Nokia* and the *Samsung* decisions seem to adopt this approach. We specifically argued in those cases that the *Gehan* approach, which is what was used by the Court of Appeals in those cases, was the was improper because it presumed the existence of a duty to defend where the pleadings failed to allege critical facts invoking coverage. And quite simply, I think it’s probably the best illustration of the liberal rule or liberal construction rule. In *Nokia*, the court said we have an issue as to whether or not there was an injury within the policy period sufficient to invoke coverage. We know that there was an allegation of bodily injury that occurred prior to filing the lawsuit. We know when the underlying lawsuit was filed and we know that all the policies were issued prior to that time. And so therefore, there is at least the possibility that some of that bodily injury hit some of these policies, and therefore there’s a duty to defend. So I

think this issue is a very hot one. Get used to it. It’s come up in numerous construction defect cases. Construction defect is a very significant area in insurance litigation this year, given particularly the decision expanding the use of the contractual liability exclusion in *Gilbert Construction*. And finally, I think D&O is a very hot area of insurance practice, especially given the numerous decisions in connection with the Stanford scandal and numerous recent decisions on critical exclusions in cases such as *Brown v. Clarendon* from Judge Godbey.

FORD: From my perspective, we’re still dealing with the fallout from the Great Recession. It didn’t quite make a depression. A lot of claims are still coming from that. Obviously, the bank failures, the bank bailouts, a large number of companies went bankrupt during that period of time, probably the greatest number of bankruptcies and large bankruptcies in our history, and the fallout from that are D&O claims. A lot of those companies had stock in their 401(k) and other plans, so fiduciary claims coming from having that stock in the plan. You should have gotten out of it. Obviously, hurricanes, Ike, Katrina, Rita, those are still working through their systems. Interestingly, we talked about it earlier, Harris County, Jefferson County, have instituted manda-

tory ADR for the residential claims, and so most of those are being resolved outside the litigation environment, but commercial claims are not subject to that. So I think one of the factors we've seen is the cases that are coming out, are getting reported, have larger numbers because you're dealing with large damages to hospitals having to rebuild wings, lost business, and that's really one of the largest components of those commercial insurance claims. Was our refinery shut down for 60 days. Oil was \$75 a barrel, et cetera. So those are the claims. And finally, regulatory claims. FDIC was shutting down a record number of banks. Now, I handle a southwest territory that extends into Florida, so Florida, Georgia, two of the primary areas, and Nevada with its housing boom. So regulators are taking over banks, stepping into the claims being brought against the banks, and then also bringing claims against the directors, officers, loan officers, and they're talking about other insurance issues. It gets interesting when a bank forecloses on a developer, the developer counterclaims, basically saying, "You never should have loaned me money for this project." And then the FDIC takes over the bank and there's sort of this paralysis of: Well, what do you do with that? And we're waiting for the FDIC to step in, do a king's X to say, "Well, your counterclaims are gone." But the FDIC is so busy with all these banks — what is it, up to several hundred now?

COOPER: A few more last week.

FORD: Yes. And my worst day is Saturday morning, because Friday after 5:00 is when they post who they've closed. And I hate to say it, first thing I do on Saturday morning is I go in and see if it's one of my insureds because it's going to happen. So there's a large tail that's still being wagged by the financial meltdown.

ANDROVETT: *Patrick, you're a lawyer. And your job title is claims examiner. I went to an HR site and I gathered up a job description for a claims examiner. It's pretty impressive. You cover a lot of ground. And this is not your job description, but just one generally, but number one is: Investigate, evaluate and settle claims, applying techni-*

cal knowledge and human relation skills. Sound accurate so far?

FORD: Fairly accurate.

ANDROVETT: *It's the human relations skills part that I want to ask you about. Mike's answer to the previous question brought home again to me as a business owner the complexity of this thing called insurance generally. Are there any ways to guarantee that what we think is covered is covered?*

FORD: Yes. First of all, there are no guarantees in life other than death and taxes. And I'll go back to a CLE seminar I had 15 years ago and it was about legal malpractice. The speaker said, "Who here has read your homeowners insurance policy? Who here has read your auto policy?" And then finally, "Who here has read your E&O policy?" And hands went down. Because of my industry, I am one of those sick people that have actually read my homeowners policy and my auto policy. Most of those policies are fairly uniform. One of the things that pops up between expectation of coverage and the actual coverage is in a business or a corporate setting, you may have a CFO who is in charge of acquiring the insurance. That's a money side of things. You have a risk management department that is in charge of handling those claims. And then you may have the general counsel get involved in certain types of claims. A lot of times, when the CFO, the CEO are meeting with an agent or broker, the Willis, Marsh, all these sort of people, there's a lot of discussion about what coverage they want to obtain, what they're looking for, comparison of different policies between, Chartis, Chubb, et cetera. And again, this is a function of the economy we're having right now. A lot of people are looking for the lowest cost. And they might get GCL coverage from Insurance Company A. They might get EPL, employment practices liability, from Company B. They may get another package through a third company. And unfortunately, there are gaps between those coverages, and sometimes there's overlaps. In fiduciary claims, you might have a separate, stand-alone fiduciary policy, and buried within a CGL policy is some-



R. Brent Cooper, named shareholder of Cooper & Scully, P.C., focuses his practice on appellate law, insurance, and commercial litigation. He has had significant experience in the representation of clients before federal and state trial and appellate courts, as well as in arbitration proceedings. He has tried numerous cases covering areas of products liability, toxic torts and asbestos, business litigation, construction litigation, wrongful death, catastrophic personal injuries, complex litigation, breach of contract, and business tort cases. For over 30 years, he has been at the forefront of Texas law particularly in the area of bad faith. Cooper is board certified by the Texas Board of Legal Specialization in Personal Injury Trial Law. A native of Dallas, Cooper earned his B.B.A., summa cum laude, from Texas A&M University in 1974, and his J.D., cum laude, from SMU in 1977. Cooper is a frequent lecturer, having spoken on insurance litigation, coverage, and bad faith at seminars for the State Bar of Texas, University of Houston Law Center, South Texas College of Law, and the University of Texas School of Law.

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thing called employee benefits liability coverage. And that's when your claims rep calls you back working a claim we're going to ask you: Do you have this coverage, because there may be an exclusion under one line of coverage that's available in another. And so I think sometimes the breakdown can take place is the person making the financial decision about buying insurance may not be in line with the risk management department or the corporate legal department.

ANDROVETT: *Brent and Mike, I'm sure you don't see that with your sophisticated general counsel clients, right? They've read every word? They can faithfully report to their CEO, CFO exactly what's covered and what's not?*

COOPER: One of the problems with a lot of large businesses — and I'm thinking of one now, and they do a lot of business. The person in charge of their risk management is a person who started off early in the company at a fairly cleric position, has been there and sort of has been brought along, and now is in charge of really decisions that affect multimillions of dollars. And, that happens sometimes, you'll see with companies where the person has been around and they just come along and work their way up, and so, sometimes they just don't catch it. Now, one of the things Patrick said is that auto policies, homeowners' policies are sort of functionable. They're the same, Allstate, State Farm, whoever, and that used to be really true. But one of the things that you can see now is that, I believe it was in 2003, the legislature changed the law where pretty much companies could submit their forms, get them approved, and if you get a quote for a homeowners policy from Allstate, and you get another quote for a homeowners policy from State Farm or somebody else, there may be a dramatic difference. Even though they're saying it's a homeowner's policy, or an auto policy or whatever, they are not all the same anymore. A lot of companies now are putting on their policies specialized forms, endorsements, or changing the policies where it can dramatically affect the coverage. And for everybody in here who got auto coverage, homeowners, you really do need to read



it because they do it differently. They're not all the same and a lot of people are getting surprised when they realize, well, this one has this endorsement, this one over here doesn't. But the state board of insurance, the legislature said we can vary now. They don't all have to be the standard forms approved by DEI.

HUDDLESTON: I think the one thing in the corporate setting that I've seen more than anything, particularly in the last couple of years, is that general counsel are in many instances not dictating the handling of insurance claims. Rather, the general counsel are taking a role more as the director of a team that includes risk management and some upper level management. Risk management knows more about policy history, the original intent of the company in terms of the insurance needs sought to be fulfilled, and is sensitive to ongoing relationships with the carriers and its impact on the bottom line. Coverage counsel needs to tap into that resource and reality of corporate life. It's a very different environment from your homeowners' and other personal lines claims. As a coverage lawyer, you can't come in like a wrecking ball intent on confrontation and threats. There are existing business relationships between risk management, the broker and the carriers. There are existing relationships

between broker and the insurance company. In addition, general counsel are especially attuned to cost issues involved with protracted coverage fights. I am also seeing more active involvement of brokers and agents as a form of mediator and sometimes as an advocate to seek resolution of coverage conflicts. The additional involvement helps because you cannot think of everything. The coverage counsel has to help modulate the message when there are so many possible cooks involved in the claim process.

FORD: I would second what Mike has said about a lot of the broker/agents have people that act as a claims advocate, coverage advocate, and do get involved in these sort of disputes, especially when there's a change in coverage from Carrier A to Carrier B. It is like, "Well, we thought this was going to continue. That's what they had on the fire policy." So, there are those discussions that take place.

ANDROVETT: *When you talk to many business owners, and you talk about them eliminating their liability and as it relates to insurance, and you start to dig a little deeper, what you find is they typically possess a commercial general liability policy, and they'll tell you, "Hey, I'm covered." But it strikes me as a layperson that there are a lot of specialized industries and a lot of specialized skills and levels of expertise that*

companies have. Is a general liability policy really protection? Or can you talk to me a little bit about what specialized companies and specialized industries can do to make sure they've got adequate protection?

FORD: I'll come out and say I'm not a CGL specialist. CGL does provide what I call "base coverage" in any business. If you're an architect or a lawyer, most of what you do is that professional activity. So at minimum, you need to have E&O coverage for your professional activity. An architect can get sued in an automobile accident because they designed a bridge with a limited view of oncoming traffic, whatever the case may be. And then if you're a business owner and you want to protect your management, at a minimum, you have to have D&O coverage. And let's also face it, there's been a strong change in our government's attitude towards employment and employment issues, and EPL coverage, I think, is essential. If you employ anybody, you need that coverage. So those would be the minimum that I would advocate.

ANDROVETT: *What do you see in the trenches when you're getting involved in these cases and these issues arise?*

COOPER: It's impossible to give a pat answer. If it is a big company, I say you need to get a good broker and you need to sit down with that person and fully inform them of what your business is about, what risk you have and we're going to talk about liability, but there's a lot of first-party risk, property, business interruption, there's a ton of exposures companies have, and it's impossible without really going into details of the business to know what all insurance you really need. Electronic data processing, I mean, there's all sorts of things. And generally, I feel get a good broker to fully explain it to them where they're fully aware and get their recommendations on that, because it's in their interest, obviously, to sell you insurance, but they have knowledge of what's out there, what insurance can be available to protect your needs and talk to them and get their recommendations.

HUDDLESTON: I think most companies are approaching it in terms of looking at internal needs as well as external

needs. From an external standpoint, general liability is pretty complete. But if you're in a specialized industry such as oil and gas, I think we're now seeing now more specialized policies, all sorts of different policies to provide coverage for much of what general liability policies traditionally do not cover. If companies see a deal that looks to be too good to be true, it probably is. And I see that more and more. Additionally, coverages are, in my opinion, becoming more complex. As a result, there's more confusion in determining what an insured needs and what they are getting for their money. I had one client who thought that they were getting coverage that was identical to a prior year where there were no sublimits applicable to the multiple parts of their operation and no coinsurance penalty. When the claim came, they were told that they had both. More importantly, they never dreamed that the policy included some form an arbitration provision that would put them in London under English law to determine any coverage controversy. A fight Lloyd's is a horrendously tough fight. The fight against agents failing to procure the right coverage is equally vexing. So insureds should be aware when they're getting into specialized areas and make sure they a broker that really is savvy in dealing with the key issues in determining the needed coverage and placing it. I don't know how much you're seeing problem with renewals, Brent. I know we're seeing issues right now for the first time in homeowners cases on the change in mold language where some creative plaintiff's policyholder counsel are basically urging changes from the old form, which some argue provided some mold coverage, to new forms with more limited coverage for any water damage related events, are subject to the rules as the enforceability of new language added on renewal. They're challenging whether or not the renewals were lawfully done, because in Texas, depending on the type policies, you've got regulations that deal with how the renewals are to be done. The same situation is presented with the avalanche of new exclusions and endorsements added by construction carriers after *Lamar Homes* found coverage for



Patrick M. Ford, specialty claims zone technician at Chubb Group of Insurance Companies was born in Hawaii on October 3, 1961. He obtained a business degree from Western Washington University in 1984 and his J.D. from the University of Houston in 1987. Over the intervening 20+ years, Ford has worked for a number of carriers handling specialty claims. With prior employers, he was involved with adjusting medical malpractice and legal malpractice claims. Ford has been with Chubb Group of Insurance Companies for over eight years and is currently involved in handling claims with the Specialty Claims unit including D&O, E&O and EPL claims. Ford is married with one teenage daughter.

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construction defect. The insured argues that because the renewal was improper, the new or added provision is a nullity. These rules can be a real magic trick if you've got a problem and a helpful solution.

FORD: Yeah, I'd like to follow up with two things that Mike commented on. One is when I started eight years ago with Chubb, the first time I saw a policy that had limits to \$500 million, half a billion dollars, I choked. And it's just like, "Good Lord!" Insurance towers — again, this is working with your insurance agent or broker — are very important, not just your primary coverage, because it used to be there was almost an industry-wide pleading, you got a half billion dollars, you're good. You know, [if] BP out in the Gulf had a half a billion dollar tower and it does them nothing. The excess tower is an integral part of protecting your company, no matter what the size. And honestly, once you get past your primary and the first excess layer, the proportionate cost for obtaining that extra coverage is fairly cheap. The other thing that Mike was talking about was the change in coverage forms. A lot of the litigation that came out of Katrina in Louisiana was they actually have a regulation as to the size type that certain changes had to be in, and some of the carriers didn't follow it, and because of that, it created liability issues for them. So taking aside any sort of claims issues, if you're involved with a company and you're going to be undertaking some changes, you need to meet with your general counsel, your risk managers, and see if you're following those guidelines, because the failure to follow that guideline, in this case, [can] wipe out limitations of coverage. Now, that's an insurance specific area, but if you have warranties for your manufacturing business and you put the warranty in the wrong place, the wrong type, et cetera, you may be picking up contractual warranty coverage if you had no idea that was for sale. So that's it.

HUDDLESTON: Brent was involved in a case, *VRV Development v. Mid-Continent*, where essentially the insured lost their coverage because they went through a conversion that under Texas law didn't



really change the entity at all. It's the same entity, but because the names didn't match up between the policy and the new name of the entity and entity actually getting sued, they wound up losing coverage. And we see that a lot in litigation sort of after the fact. But mergers and acquisitions are one place coverage lawyers are being called upon more often.

ANDROVETT: *You've set a nice predicate for the rest of our conversation. I appreciate that. This is a really good snapshot. Mike, you said something that was very interesting to me, but I want to make sure I understand it. You were talking about the Supreme Court of Texas of late seems to be trying to connect the dots. Do I understand you to say that in the old days, instead of maybe looking at a specific provision within a policy, now they're looking at the policy in its entirety and trying to determine what was intended?*

HUDDLESTON: They've always professed that they're looking at the policy as a whole, but I think *Lamar Homes* is probably the best example of where the court basically went searching all over the policy to determine whether or not something that was essentially a contract claim or that could be brought as a contract claim would be covered on the policy.

ANDROVETT: *And that was a landmark*

case. Briefly, could I ask you to describe the circumstances?

HUDDLESTON: It was a construction defect. There were multiple questions: Whether there was an occurrence or a breach of contract? Was that an accident? Whether there was property damage. It is a construction defect or problem that causes damage to the product itself. Is that really property damage or is that just economic loss? And then you had the question of whether there were business risk exclusions that would apply. And what the court basically did was to go through the policy and focus on the fact that you had a work product exclusion that excluded coverage for work product. If coverage for construction defect wasn't provided in the first place, then why was there an exclusion? Now, strangely enough, they didn't look at the other side. The Court emphasized that it did not matter whether you called it breach of contract or tort, coverage existed for construction defect, thus answering the question of whether there was property damage and whether there was an occurrence. The *Lamar* Court ignored the contractual liability exclusion, which was recently addressed in *Gilbert*. That exclusion bars coverage for liability under a contractual assumption of liability. In *Gilbert*, the Court found this exclusion

applied to essentially all contract claims, not just indemnity claims. If that were true, the *Lamar* incorrectly concluded that it did not matter whether the claim was brought in contract or tort. *Gilbert* finds that any breach of contract claim where no tort exists independent of the existence of the contract is excluded. Now, *Gilbert* is on rehearing. It certainly seems to be erroneous. Most of us who have been at this business for a while assumed that this exclusion, dealing with assumptions of liability, dealt only with indemnity contracts, not to your standard run-of-the-mill contract. So we've got a real conflict between those two decisions that will have to be resolved on rehearing.

ANDROVETT: *Patrick, as an examiner, are you forced to try to distill the meaning of these rulings and how they apply to your everyday work? How does that change in court jurisprudence affect you in your everyday work?*

FORD: Well, obviously, we start with our familiarity with our policy, and as an area, you have your viewpoint of what your policy means or what it's intended to cover. And as courts come out with decisions that affect that. We do have to factor that into a whole book of things. And, frankly, there are instances where whatever carrier I've been with we did consistently over a period of time, because we drafted this policy and we changed it from the fire policy to address this issue, and then a court comes down with a decision. Well, we're charged with handling claims in a proper and fair manner, and if a new court provides a direction that our policy doesn't mean what we think it does, then we have to adjust our handling of that claim. And typically, when you get into something where the Supreme Court makes a pronouncement on a policy and there's such variance between language that I think one of the things we had was the determination-in-fact. Well, there are about 100 different variations of a finding in fact, a determination-in-fact, a final determination, an unappealable adjudication, et cetera. So when these decisions come down, as an examiner, obviously, I know. But then, in our company we have a general coun-

sel office. We have questions like: How does this impact us? Because we need to be able to apply those uniformly. And frankly, that's why, frankly Brent Cooper and Mike Huddleston have jobs. What's the phrase, bad laws made with bad facts? A court decides that this interpretation is extreme, so they make an interpretation not realizing the effects that come after that. But, yeah, we do have to try and fill that in.

ANDROVETT: *Along the lines of extreme events leading to extreme regulation in this area of bad faith, what's likely to result from all of this litigation arising out of Ike, Rita, and financial services? I know you talked earlier about jurors, but where do you think it leads for the courts and possibly for legislators?*

COOPER: Well, obviously, I'm not sure the legislators will act on that, but from the courts, they're looking to do a couple of things. One is to streamline the process. Patrick talked about the mandatory AER. There's also mandatory discovery that Harris County has already adopted. And from the insurance company's perspective, I think they're going to look at, you know, some way to resolve all these claims, because most of them, particularly when you talk about homeowners, there may not be that great a difference in the party's position, and if you want to work those cases up and try them you could very easily spend more than what's at risk. So a lot of them are looking for ways to effectively essentially work them through the system, because otherwise, they're going to be in the court system for four, five, six years, and that's not going to be good for insurance. It's not going to be good for insurers, or it's not going to be good for the courts. Now, as far as the bad faith issues, our Supreme Court is wrestling with several issues. One of the issues that is being developed now that they talk about a bid in the past is the whole damage models or bad faith. Can you get your contractual damages or not? So we will see, I think, over the next four or five years, with the number of bad faith cases that are being filed, with our Supreme Court really making some rules to give some guidance to the insurers and to the insureds, but also trying to make



Michael W. Huddleston is a senior partner with Shannon, Gracey, Ratliff & Miller, LLP, and practices primarily in Dallas, Fort Worth, Austin and Houston. He provides counsel and litigates insurance coverage and bad faith cases involving all lines of insurance. Huddleston also handles appeals in insurance cases and other matters involving catastrophic losses, including a number of landmark appellate decisions including *State Farm v. Gandy* (Tex. 1996); *Christophersen v. Allied-Signal* (5th Cir. 1990)(en banc); *Rose v. Doctors Hospital* (Tex. 1990); *St. Paul Fire v. Convalescent Services* (5th Cir. 1999); *State Farm v. Williams* (Tex. App.—Dallas 1990, writ denied). Huddleston has also served as an expert witness and a mediator/arbitrator in complex insurance cases. Huddleston was recently selected as a "Top-Notch" insurance lawyer for inclusion in the *Texas Lawyer "Go-To Guide."* He is a frequent lecturer and speaker, and has served as the Course Director for a number of Texas insurance law seminars.

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it where they can essentially work these cases through the system without creating this huge bottleneck.

HUDDLESTON: Well, I think probably the single most important bad faith issue that is still coming up time and again is whether or not contract damages are “actual damages” for purposes of the insurance code and for purposes of extra contractual liability under the insurance code. Certainly the *Castaneda* decision of the Supreme Court seems to say that contract damages are not “additional damages” for purposes of the trebling provisions of the Insurance Code. But, many argue the decision conflicts with *Vail*. I believe that the law has already been affected by judicial responses to post-hurricane litigation with decisions such as *State Farm v. Johnson*. In that case, the Court seemed to greatly expand the availability of appraisal in order to provide a mechanism that might lessen the load on the courts from first-party insurance conflicts. The *Stanford* cases provide an amazing example of bad cases making bad law. With this type of vortex, normal rules seem to be affected and bent to achieve the final result that is most satisfying to the courts. If there is an officer or director out there who doesn't know about that case and its impact on the D&O coverage, whether it's money laundering “in fact” or a final adjudication of money laundering that invokes the policy exclusion, they'd better get with it very quickly because presents critical issues regarding the scope of protection for officers and directors.

ANDROVETT: *Let's talk about that now. Stanford was the high-flying entrepreneur now accused of orchestrating a Ponzi scheme. If you poll the courts at all in Houston, it has been quite a circus. There have been a lot of questions about who pays for the defense. There are the codefendants who are corporate officers in Stanford's business entity. So let's open that thing a little bit. What scares you, shocks you or amuses you about that case? And what are the lessons for directors and officers who might ultimately be affected by what happens in that court in Houston?*

HUDDLESTON: Well, I think the first practical effect that you can look at from

the case that's not apparent from looking at the circuit court is that this is a paid-as-incurred policy. This is not a traditional duty to defend policy. There was basically indemnity for defense costs. Insureds always want to try to get an advance with this type of coverage, at least initially. Some insurance companies agree to provide an advance. In *Stanford*, they basically denied it, so you ultimately had a fight. The long and short of it is that, all the way through, up until the decision by Judge Hall in October of this year, defense costs were advanced. So even though it looks like a terrible defeat for the side seeking coverage on behalf of the policyholder, the overall tactics, in fact, were a significant success because millions of dollars in fees were apparently obtained. In terms of the lessons to corporate officers, it is a critical example of how just a little difference in wording can make a critical difference in terms of what coverage you get. It's also another lesson in bad cases make bad law or bad facts can put you in a different position. When you have criminal acts alleged and you have, as in this case, one of the actors who pled guilty in the midst of it, you know things are not going to go well for you in federal court. In this case, we had a money laundering exclusion which required a finding in fact determination that there was money laundering. Other provisions in the policy required a final adjudication. What the circuit held was that this was first and foremost not a traditional duty to defend policy. It was an indemnity policy, and that's not subject to the eight-corners rule. Judge Godbey reached a similar conclusion in a case I'm involved in called *Brown v. Clarendon*. Next, the court went on to say that “in fact” is a determination that requires the involvement of a court, but it does not require the parties to wait on a determination of the criminal proceeding on which the excluded conduct is based. The court found that a coverage trial before resolution of the criminal case involved sufficient judicial involvement. So the insured can be hauled into court, and was hauled into court for a very short, like three-, four-month period of discovery to get ready and try the coverage case so

that the court can find whether there was “in fact” money laundering. Thus, the insured was forced to fight that fight, while at the same time, they've got a criminal action they are fighting as well. And indeed, originally, the criminal action and the coverage action were both in front of the same judge, Judge Hittner. Eventually, I believe it was the Fifth Circuit that separated the cases. And so basically, you have all sorts of extrinsic evidence discovered and placed in evidence to determine if there was excluded conduct and thus confirm the duty to defend or not. There were a number of fascinating issues presented in the trial, including burden of proof; whether “in fact” in the coverage case would be subject to the same standard as the criminal standard, because we know in the criminal case, the money laundering charge, that would be beyond a reasonable doubt. Judge Atlas used the preponderance of the evidence standard. The other key question for the insureds was whether an inference could be drawn from the assertion of the Fifth Amendment privilege against self-incrimination. This is permitted under some Texas state authority. That's something that happens in arson cases and any case involving a criminal act. Rather than resolve this thorny issue, Judge Atlas chose to decide that there was sufficient evidence of money laundering without having to reach the issue of whether an inference could be drawn from the assertion of the privilege. Now, one of the interesting things is that with this “in fact” issue, you're not always done when that fact finding is made. If money laundering is not found in the criminal trial, then is the can of worms is reopened? Judge Atlas suggested as much in her decision. It really is a very interesting decision with lots to think about.

ANDROVETT: *Mike, is there any suggestion by anyone in the know that that case will be appealed to the U.S. Supreme Court?*

HUDDLESTON: I haven't heard anything as to that. I seriously doubt it would be successful. A part of the problem is that Judge Atlas rejected an attempt to stay this matter on appeal. It started with an injunction against the carrier to advance defense costs. Of course, the

recent decision vacated the injunction. The court refused to stay the vacation of the injunction because it found that there was little chance that there would be success on merits of appeal. So, no, I seriously doubt that it's going to go anywhere else. Although, again, certainly, the issue is there as to whether this entire process places a penalty on the assertion of a Constitutional right.

ANDROVETT: *And in a second, I want to talk about some of the trends in the construction defect litigation, because it forms the law in Texas in a lot of ways. Before I do, though, many times these issues, Patrick, are about coverage — what's covered and who paid for what. Are there ever issues that arise that pose problems for lawyers or for the businesses they represent and just when an insurance company is notified of a loss? If so, what are those issues?*

FORD: I think we started to see some cases come out with respect to late notice. One of the first things I'm going to look at is when did we receive notice of the lawsuit or the claim? And one of the things that come about is a failure to notify the carrier. This becomes important in several contexts, one, if there's a change in carriers, from Carrier A to Carrier B. One of the key elements is the policy will have an insuring clause and it's basically going to start from there as to what's covered, and typically requires that a claim be brought. And I'm talking D&O context. Unfortunately, again, with multiple people handling things in the company, people are surprised that see a DTPA demand letter will actually qualify as a claim. You may have a risk manager, somebody else who thinks, "Oh, this is just the lawsuit." So the lawsuit comes in, you read it and a plaintiff has nicely laid out that "in December of 2008, we sent a demand letter for \$1.2 million. You didn't respond, and now we're bringing this lawsuit." I've got the coverage that starts in 2010, so we immediately have a notice issue. Again, it can come out from the fact that somebody doesn't know what the definition of claim is. In the EPL context, one of your employees goes to the EEOC and files a charge, says, "I was disciplined because of my ethnicity." And the company handles

it. It might involve a counsel. They take care of the issue. They think it's all done. Then that same employee brings a lawsuit. Oh, now we report it to our carrier. Well, the EEOC charge itself is a claim. It invokes coverage, and essentially when you have a change in carriers, the new carrier is going to say, "Wait a minute; your coverage is over there." So as a lawyer, whether you're in-house counsel, or external counsel, if your client involves you in one of these things one of the first questions would be: Have you reported this to your carrier? And in 20 years of doing this, I have told anybody who's ever called saying, "Well, we're really not certain. Should this be reported? Should it not?" Report it. If there's no coverage, Mike will let you know. The carrier is going to let you know they don't think there's any coverage. And a lot of times, you may not think there's coverage, but because we handle so many of these things, we know what the Fifth Circuit decision in such-and-such was, what the Texas Supreme Court said in final adjudication. Oh, it's a suit about fraud, and there's an exclusion for fraud, but when you read it, it's a final adjudication, non-appealable decision, which means you're going to get a defense. And what, 95 percent of cases never see a courthouse, so you're not going to see a law finding. And after all, one of the big benefits, one of the things you do for your clients is the defense costs. So, you know, where notice becomes an issue, changing of carriers and really not having appreciation for what's going to trigger that policy.

COOPER: Another area I want to bring up on construction particularly is you may have a great risk management of the party and they have drafted the contracts very well where all my subcontractors have got to indemnify me, they've got to name me as additional insured in order to do all these risk text reports. What we're seeing quite often is, the insured gets sued and you don't put the insurer who's named you as an additional insured on notice. There's a case that's going to be argued next week in the Supreme Court: *American Home v. Maryland Casualty*. That situation, you had a general contractor was named as additional insured



Mike Androvett is in business to make sure that his lawyer clients get positive news coverage and their law firms are marketed effectively through advertising and public relations. Androvett is the founder of Androvett Legal Media & Marketing, the largest public relations and advertising firm in the Southwest exclusively devoted to lawyers and the legal profession. Established in 1995, Androvett Legal Media serves the specialized needs of law firms in communications with outside audiences, including news media coverage, brochures and Web sites, and sophisticated advertising of all kinds. Androvett's firm assists lawyers in virtually all areas of practice while observing the highest ethical standards. Lawyers and their clients who receive media training from Androvett Legal Media are much better prepared to deal with reporters and TV camera crews. And, as a former chairman of the State Bar of Texas Advertising Review Committee, his expertise and experience is essential to firms seeking to comply with the state rules governing lawyer advertising. Androvett and his team take the mystery out of public relations and advertising by recognizing law firms' true goals and providing the know-how to make them happen. He can be reached at 214-559-4630 or mike@legalpr.com.

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by a sub. People got killed, got sued, they settled. And then after they settled, they went through the insurer for the sub and said, "Look, I'm additional insured with you. We want our money back." And the carrier said, "Well, the lawsuit is settled. The lawsuit is gone. You paid. You violated notice. You violated no voluntary assumption of liability. You get nothing." In that case, the trial court said, "Well, there's really no prejudice. We're going to give you the money." The Houston Court of Appeals said, "No." Under *National v. Crocker* and some of the other cases they said a demand is necessary to trigger the duty to defend and you never made a demand, therefore, you never triggered the duty to defend. You get nothing. The Supreme Court is looking at this next week and the issue they're going to decide is: Are we going to apply a prejudice requirement in this situation? And you can argue two different things. One is that there's been a demand, but it's late. But here, when you're talking about particularly the duty to defend, our Supreme Court has said previously that the notice of demand is necessary to trigger the obligation. And so that will be argued, I think, next Wednesday or next Thursday. But in construction cases, we're seeing that as a big issue with respect to timely notice. You give notice timely to your own carrier, but you failed to give notice timely to carriers who may have named you as an additional insured.

HUDDLESTON: Yeah. You can't depend on your carrier to do your job for you, as much as you'd like to. And typically, a lot of them will, if they're experienced, but it just doesn't always happen. If you have a notice issue that's coming up — a lot arise with health care professionals because they change policies fairly frequently. Such professionals would be well-advised that the minute there is a serious incident, notify your carrier. I mean, it's a medical incident. We've got one case involving right now where the doctor did not give notice. There was a 4590(i) letter that was sent to one doctor in the care and to the hospital, but none was sent to the other doctor. And the notice letter for the other doctor one doesn't come till the next policy. There is

no coverage if notice of a medical incident according to Policy Number 2 was given to the carrier on policy number 1.

AUDIENCE MEMBER: *What are some of the things that you like to see a company do before they select the policy? What are the things that when they come to you and say, "We've been denied coverage." What are the some of the things that you like to have seen done before that time? When they're visiting with that agent, should they make a list in writing and get some kind of receipt of that? What are the things that when you see it, you look at it and go, "Boy, they did this right and this right and this right?"*

HUDDLESTON: Well, documenting and following the agent is critical, and additional insured (AI) cases are good examples of that. I mean, if you've got a particular contract that has insurance requirements and they're stipulating a particular AI endorsement, or even if they're not, I want my client to have an e-mail where they have presented the contract language and their requirements to the insurance agent. The key is to make clear what coverage is desired and that there is clear reliance upon the agent's expertise to get it in the policy. A clear paper trail is critical. And so having the policies, applications, and all of the material in one place where you can get a chance to look at it, work with it, is very helpful. On all types of claims, early involvement of coverage counsel is critically important and well worth the cost. When an accident or loss has occurred, early involvement of counsel smoothes the process and sends a message to the carrier that they are going to have to follow the rules. With experienced carriers, a cooperative relationship can be achieved that builds trust that helps move the claim forward more quickly. Early involvement also helps with preserving evidence and making related decisions regarding handling the damaged goods. It helps in terms of coordinating subrogation and/or business interests the company may have.

ANDROVETT: *Let's expand that inquiry. Brent, is there anything when you heard that question that you thought to yourself that Mike didn't cover? And, Patrick, obviously, it's different for you maybe, but it really goes to just best practices generally. Any*

other advice for that gentleman?

COOPER: One of the things particularly that came back to construction issues, when we have a construction case one of the first things we do with our insureds is we sit down and we say, "We want to see your contracts. We want to see all the insurance policies." And the first thing we do is try to put anybody on notice that should be put on notice to avoid in this case, this situation that comes about. And, if you don't know who it is, get your discovery, get it out, and make that one of your first priorities to collect as much insurance as possible. If you're the defense lawyer, you have that obligation to your client as well to make sure that there is plenty of insurance out there. If you're the insurance company, and you've hired me, Patrick, to defend the insured, you want me to bring in other insurance because it will eliminate your exposure or at least will minimize your exposure. But that's one of the first things we do is go to the contract documents, go through the certificates of insurance, go through the policies we have, look for as much coverage is out there and put everybody on notice early on so it's not an issue.

FORD: I would agree. A couple of additional points: Your agent or broker is your friend in any of these coverage items. We deal with anything from a local to a regional broker to nationwide brokers. A lot of insureds in specific industries deal with specific agents or agencies because they know if you're in auto manufacturing or whatever your area is, you don't just need GL, you need the D&O, you need this, you need a tower for this, you have employment liability, you have special issues. Where I'd like to build upon what Mike said about the documentation is especially when you're changing coverages from carrier to carrier, or you're changing the type or amount of coverage you have, your interaction with your agent or broker is extremely important. I work in an industry where there tends to be a lot of turnover. We have people that move on for better opportunities. They go from the carrier to the agency. They come back from the agency. You get into a case where the policy was written two years ago, that underwriter may not be

there. Your risk manager may not be there and you start getting into these questions of what was intended. Great piece of advice, if you are changing from Carrier A to Carrier B, have it documented that with your agent that your goal is to mirror the coverage you have with the prior carrier, because then if there are gaps, if something slips through those changes in carriers and policies, there's that trail of saying, "What were you intending to do? What were you looking for?" And that's where Mike comes in and says, "Look, this is what the intent was. This didn't happen. We need to work this out."

ANDROVETT: *We've got 15 minutes and I want to cover two topics, which is unfair because you could both talk about these topics probably for two hours. But the lessons we are learning as you are studying the construction defect cases that are coming out of various courts, and we can take this as a separate category, but so everyone knows, I'd also like your input in what cases you are watching over the next year or 18 months that you think will be significant to know about. So, Mike, I know initially you had introduced this topic. Talk to us a little bit about the key issues in the construction defect area and what lessons we're learning from them as they come out.*

HUDDLESTON: I think probably the single most important construction defect case pending right now is *Gilbert*. And *Gilbert* involves the issue of whether or not the contractual liability exclusion sort of applies across the board in construction defect setting. And besides the coverage issue that Brent was talking about this morning, there is also a rather strange set of statements in the Court's original opinion, which hopefully they'll clarify or eliminate on rehearing. But there was a very odd thing that happened in the case to make it a pure breach of contract case. There was there a sovereign immunity argument that existed, and one of the carriers insisted that a summary judgment be brought to eliminate the tort claim based on immunity. This carrier had apparently not sent a reservation of rights identifying the contractual liability exclusion prior to this summary judgment being moved forward. The Court strangely suggested that might be

a breach of cooperation for an insured's counsel to refuse to move for summary judgment in such circumstances, even if it resulted in the deprivation of any duty to defend and/or indemnify. This is a very suggestion. I think that the other thing that we're seeing continually are issues involving how to determine the duty to defend. We talked about the liberal rule versus the strict rule. Intertwined are trigger issues raised by *Don's Building*. If the pleadings are silent as to when actual damage occurred, then how is the duty to defend determined? We've also seen a lot of action this year with the interpretation and limiting of the particular part exclusions, which also requires consideration of when damage occurs. One of these exclusions includes an exception for damage occurring after the operation is completed, as that term is defined by the policy. The Fifth Circuit has issued a number of decisions in that area, JHP and several others. The Fifth Circuit has drawn a very tight line that says that the particular part exclusions really only apply to the piece of property that's being worked on. So if there's damage to other work that was not defective, then that's not going to be subject to the exclusion. I think in the indemnity area — and Brent and I spent a long time talking about this — the *Don's Building* puts a very heavy burden of proof on insureds to show when actual injury occurred. What remains as a key issue to be resolved is how the court's will treat and measure the proof offered by insureds to try to show the time of actual injury, such as proof regarding when rust turns into damage or whether rust is damage.

COOPER: I think we can draw some broad conclusions with what our Supreme Court has been doing, whether it's construction cases or any insurance cases. And if you look back over the last three or four years, there's several common threads. One is: Around 80 percent of the insurance opinions that are coming out of the Supreme Court are being made by Justice Willett. I don't know when he became the new guy on the court they said, "Okay. You get to write the coverage opinions." And he sort of went downhill or what, but he's the one that's been do-

ing it. Number 2 is: In his opinions, he and the court are saying, "Whether it's the insured or the insurer, if they want a particular meaning or a particular application of a term, you need to define it. If you don't define it, then what we are going to do is we are going to apply the plain, ordinary meaning, which means we're going to look in the dictionary." The most recent case came out October 1st, was a case *Mid-Continent v. Global Intercom*, in which there was a contractual liability provision and there was coverage — there was an indemnity provision and there was coverage that said, "We will provide coverage for indemnity agreements so long as the indemnity agreements were executed before the accident." Well, this was a case where they were working on a cellular tower up in Arkansas, and they had a pulley hooked up and then they hooked the rope to the back of the pickup and then they had this big old headache ball and they had three guys that were on the headache ball, and the pickup was raising them 280 feet off the ground when the rope broke. And unfortunately, all three of these gentlemen lost their lives.

HUDDLESTON: Where was the risk manager?

COOPER: Where was the risk manager? Where was the safety manager or where was anybody?

FORD: I don't think that's an OSHA-approved method either.

COOPER: It's called an Arkansas elevator. But anyway, one of the parties in the sub had signed the contract and mailed it back to the GC. The accident happened on January 2nd. And then on January 3rd, lo and behold, the GC says, "You know, it would probably be a good idea for me to sign this because they're going to be protected by comp and I'm going to be the one that's going to get sued. And so the question then before the court was whether or not the contract had been executed before the loss had occurred. The sub had signed it before, clearly. The GC had signed it afterwards, clearly. And so the question was: Was it executed? And what the Supreme Court said that the contract itself did not define when execu-

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tion was presumed or when it occurred. The insurance policy, it doesn't define what execute is. Therefore, we're going to look to the dictionary. They looked at Black's Dictionary and they said you can have execution by performance. Everybody was performing. Both sides said that now we have this contract. And the Supreme Court in that case said that there was a contract. And they said that Mid-Continent was the insured and if you had wanted it to mean when both parties had signed the contract, you should have put it in the contract. You didn't put it in the contract. Therefore, we're going to apply the plain, ordinary meaning. Now, the third thing I want to draw from what the Supreme Court has been doing is that they've applied this rule both ways. There have been some cases where the application of this rule has helped the insured, as in the *Global Intercom* case — and there have been other cases where it's actually helped the insured. The *Pine Oaks* case was a homebuilder case where the homebuilder got sued. The question was whether there was a duty to defend, whether this property damage occurrence, but the issue was whether or not the work had been done by subcontractors. And the allegations in this were that the work was done by the general contractor. But the Pine Oaks said that everyone knew they had subs. Here are the contracts. Here are the paychecks. And the Court said that it was not what the insurance policy said. The insurance policy said that you have to go by the allegations, and there are no allegations of work being done by subs. Therefore, you don't have a duty to defend. And so in that case, if you'd wanted to be able to use intrinsic evidence or look beyond that, the Court said you should have put it in there. So it goes both ways, but the Supreme Court time and time again is saying: Both parties, insured and insurer, if you want it to say certain things, go ahead, and define it. Put it in the policy. Otherwise, we're not going to supply it for you. We're going to imply the plain, ordinary meaning.

ANDROVETT: *What are some cases you're watching over the next 12 to 18 months?*

COOPER: The big case Mike has already talked about was the *Gilbert* case. That

was already decided. It's been on rehearing now for almost five months. There are a lot of briefs being filed. It will be interesting to see what comes out of that. *Texas Mutual v. Ruttiger*, what is going to be the extent of bad faith in workers' compensation cases in Texas? It is a very big case for workers' compensation writers. Everybody is watching for that. Prediction is we are going to have some form, but the question is: What is going to be the extent of that? There's the *Mary Homer v. Kaplan* case coming out next week, I think will be a significant case on whether not you can go all the way through the process, sub the case, and then sue your carrier. Who is your additional insured? For coverage, I think that's going to be a big one as well.

HUDDLESTON: I think in addition to those, there is a very important appraisal case *In re Universal Underwriters*, that is pending before the court right now. In *State Farm v. Johnson* world, the Supreme Court said didn't want to encourage satellite litigation over appraisal. As a result, the Court warned parties not to litigate through enforcement and mandamus actions over whether there was a right to appraisal. If in doubt, appraise. If appraisal was inappropriate, then it could be challenged after the fact. The problem is that this ruling encouraged "advisory" appraisals, which involve the resolution of coverage and causation issues that cannot be the subject of a legitimate appraisal. Appraise first and unwind later has proven to encourage a new and different type of satellite litigation. Now, the litigation seems to be primarily focused on unwinding. But even more importantly than that, I think all of South Texas is abuzz with waiver and whether or not, in a given a set of circumstances, the carrier has waived the appraisal provision. Waiver is important to the policyholders because they do not wish to trade the right to trial by jury for a *Johnson* trial by roofing contractor, especially in jurisdictions with jurors favoring policyholders. In *Johnson*, we urged on behalf of State Farm that appraisal was intended to be limited because otherwise it interfered with the role of the courts in reaching ultimate decisions. The process

is informal and no substitute for a trial or arbitration for that matter. And we urged the court to not take the right to trial by jury away and supplant it with the right to trial by contractor/appraiser. The struggles of carriers and insureds to deal with the awkward notion of advisory appraisals on impermissible issues, such as coverage and causation, continues. Appraisal is probably the hottest topic in first party coverage, both for commercial property as well as for personal lines.

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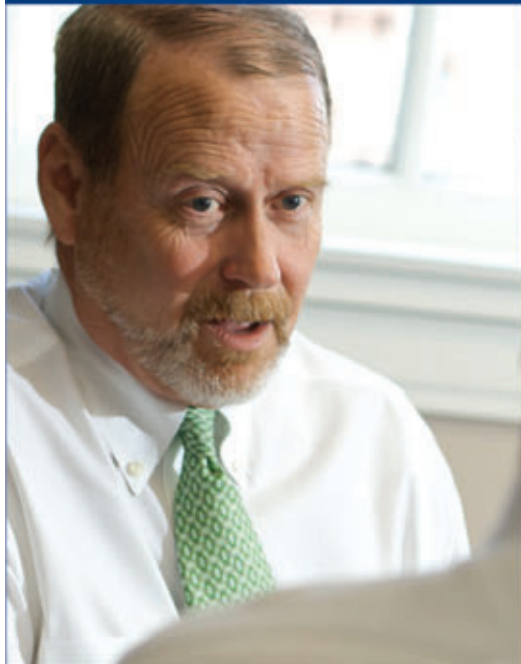
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