



# Legal Beat

By MICHAEL SEAN QUINN

## Article 21.21 and Insurance Brokerage

Thirty years ago, or so, tort liability expanded radically. Some blame this on the adoption of strict liability of product defects. Others blame it on the post-modern welfare mentality. Many believe there was an ideological shift from *For every wrong there is a legal remedy* to *For every injury there is a legal remedy*. Unquestionably, in any case, the legal liability of businesses has expanded enormously.

This huge change made the commercial world more complex, more dangerous and more fragmented. Significantly, the expansion of tort liability has touched off a war between policyholders and insurance companies. The fighting became more acute with the arrival of liability for pollution. Once policyholders and insurers were at each others throats, it became inevitable that insurance intermediaries would become part of the fight.

One of the most powerful weapons available to policyholders is Art. 21.21 of the Texas Insurance Code. It is a broad prohibition on various forms of unfairness and deception found in the insurance business. The act reaches all persons who are engaged

in the business of insurance, so its scope includes agents, brokers and adjusters. (Thus, while common law insurer bad faith regulates only insurers, and does not apply to either employed or independent adjusters, Art. 21.21 reaches adjusters of all sorts.) So far as agents are concerned, one of the most important statutory prohibitions focuses upon misrepresentations about insurance contracts.

Article 21.21 § 4(11) states that saying materially false things about insurance policies, or failing to say true and material things about them, both constitute deceptive acts. Similarly, misrepresenting an insurance policy by making a material misstatement of law is a deceptive act. If any deception is performed knowingly, and somebody suffers an injury, the trier of fact may award up to triple damages.

On April 14, 1998, the Texas Supreme Court decided a case about who could be sued under this statute. By a vote of 7 to 2, the court held that an insurance agent, who was also an employee of an insurance company, could be sued for violating 21.21. To put the matter technically, the majority held that the word "person" as defined in that statute included an agent who is employed by an insurer.

In *Liberty Mutual v. Garrison Contractors*, a policyholder purchased a package of insurance including comp, GL, and auto liability from Liberty Mutual after meeting

with an employee-agent. Part of the agent's responsibility was to explain how a retrospective premium plan worked. When the policy period ended, Liberty billed Garrison nearly \$160,000 in retrospective premiums, having already billed them more than four times that amount during the policy period. Gar-

risson refused to pay, and a lawsuit followed. The key factual issue was whether the employee-agent had told Garrison's representative the truth. The key legal issue was whether the employee-agent was subject to the reach of Art. 21.21. Justice Spector, writing for the majority, treated only the legal issue. She saw the case as a simple one. The statute says that it is designed to regulate all unfair or deceptive practices in the business of insurance. In addition, the definition of "person" specifically includes both individuals and agents.

Liberty Mutual and its employee-agent contended that the definition of "person" only reaches business entities and does not reach their employees. Such employees, they contended, do not engage in the business of insurance, but engage only in their employer's business. Moreover, the insurer and its employee argued that no purpose would be served by making employees liable, since their insurer-employers would always be liable for the employees' activities, so long as they were undertaken within the course and scope of employment.

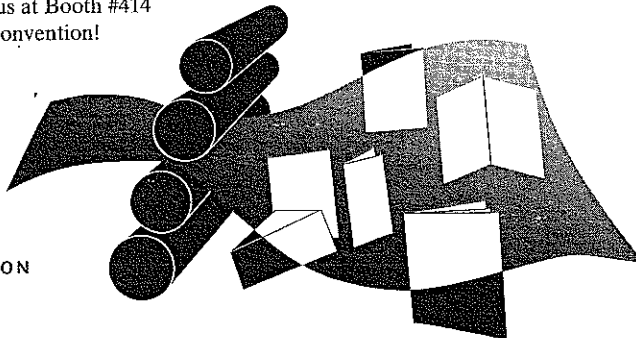
The Supreme Court rejected all these arguments and observed it would be anomalous to make individuals who were independent agents subject to the act but not individuals who were employee-agents. Thus, the majority rejected the suggestion that no person employed by an insurer is engaged in the business of insurance but is,

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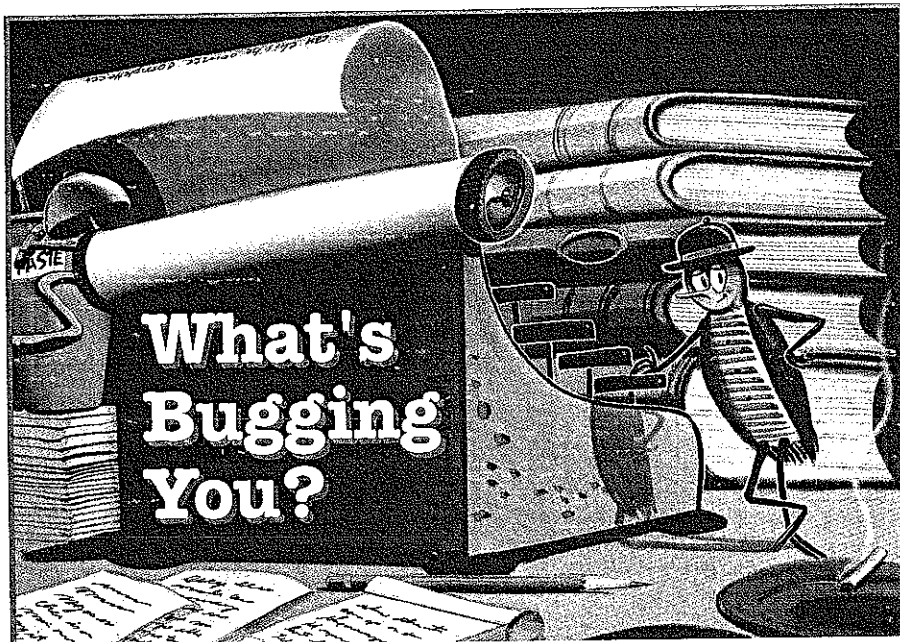
rather, engaged only in the business of his employer.

And rightly so: it is a silly suggestion. If Lilith works for an insurance company and either sells or services insurance policies, it is absurd to suppose that she is not engaged in the business of insurance. On the other hand, there are many people who work for insurance companies who are not engaged in the business of insurance: janitors, landscapers, stock market analysts, window washers, analysts of the real estate market, secretaries, and lawyers in the general counsel's office who are concerned purely with corporate matters (as opposed to lawyers in "Claims-Legal" who are concerned with adjustment matters). Underwriters, agents, and adjusters are all—fairly obviously—involved in the business of insurance. Many others are not.

Justice Baker, writing for himself and one other, dissented. He pointed out that the definition of "person" included "[a]ny individual, corporation, association..., and any other legal entity engaged in the business of insurance...." He took the phrase "legal entity" to include all of the individual items on the list, and he rejected the proposition that a natural person constituted a "legal entity." "Not just any 'person' fits the definition. Instead, only a 'person' that acts as a 'legal entity' in the insurance business can be held liable," he wrote. According to Justice Baker, natural persons who are employees are not functioning as legal entities. They are, therefore, outside the definition of "person" to be found in Art. 21.21. They are, therefore, outside the scope of the statute.

The majority's understanding of the definition of "person" is better than Justice Baker's. The majority's definition says that any individual who is engaged in the business of insurance may be liable, any corporation (etc.) which engages in the business of insurance may be liable, and so may any other type of legal entity (which the legislature has not thought to name). The phrase "legal entity" and the word "other," therefore, do not exclude natural persons which are employed by legal entities.

This case is a teapot in a teapot. It changes the economics of liability for misrepresentation not one iota. Everyone has always agreed that individuals who are independent insurance agents are included within 21.21's definition of "person" and therefore suable under that statute. If an agent-employee of an insurer is liable under 21.21, his employer will be as well, so the employer will have to stand-in for the employee's liability. But the insurer was vicariously liable already. The Garrison case implies that employees of large corporate insurance brokerage houses may be indi-



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vidually liable under Art. 21.21. But if this is true, their employers will be liable anyway. And they already were.

So what, then? Big deal! Who cares? Why did the *Wall Street Journal* carry a longish article about this case on April 28, 1998? Why did the article carry the headline "High Court Deals Blow to Insurers"? What "blow"? Nothing changed. Not really.

There are several legally significant aspects of this case, even so. First, it implies that the professional underwriting, sales and adjustment employees of brokerage houses—as well as insurers—may be

reached by Art. 21.21. That was a pretty obvious point before the case was decided. Second, under some circumstances, the result in *Garrison* may be useful to policyholders in defeating federal removal jurisdiction and so keeping cases in state court. Perhaps this same lawyer-trick might sometimes be useful against large out-of-state brokerage houses. At a practical level, *Garrison's* principal use is here.

Third, *Garrison* clearly implies that employee-adjusters will be treated the same as employee-agents. This means that policyholders will be able to sue employee-

adjusters under Art. 21.21. Employee-adjusters may not be sued for common law insurer bad faith. That was the holding in *Alexis v. Natividad* four years ago. Obviously, if adjusters can be sued under Art. 21.21, it will be fairly easy to destroy diversity in all sorts of bad faith cases. When common law bad faith can be pleaded, so can statutory bad faith. (Of course this implication of *Garrison* is quite irrelevant to the concerns of insurance agents. Neither does it directly affect the economics of insurer bad faith controversies.)

In the end, this case leaves everything pretty much as it was with a vast majority of insurance agents. Agents are exposed to liability under Art. 21.21. That liability can be for treble damages, as well as for attorneys' fees. The statute is quite dangerous because exposure to actual damages for misrepresentations does not require lying. It only requires a false statement which is material to the understanding of the policy. In theory, innocent misrepresentations generate liability.

This feature of Art. 21.21 creates an essential but very dangerous unfairness. Suppose an agent makes a statement about the contents of an insurance policy based upon some authoritative source she has read. Now suppose this source contained an error. The agent's mistake is completely innocent. The agent might well be liable under Art. 21.21 for actual damages, but it is doubtful that he would have an action against the author or publisher of the book upon which he relied. Is that fair?

The real significance of *Garrison* is deeper and more subtle than the specifics suggest. First, the court has said that it will not use black-letter rules in deciding who is in the business of insurance. Rather, it will look to facts. This is a subtle and worthy point. It's the kind of point only a lawyer could love, however.

The second message of *Garrison* is that the Texas Supreme Court will defer to the legislature. It will—by golly!—defer even in the area of insurance bad faith. The court will defer even though it is deeply suspicious of that whole constellation of ideas. But aren't both of these messages just right? Aren't courts supposed to study language and fix meaning on the basis of reality and not convenience? Aren't courts supposed to construe the language of statutes and not torture it? In a democracy, if we don't like a statute, or even some definition in a statute, don't we know how to change it? ■

*Quinn is an Austin-based attorney with the law firm of Sheinfeld, Maley & Kay. He was recently selected to receive the 1998 Outstanding Law Journal Article Award by the Texas Bar Foundation.*

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