



Legal Beat

By MICHAEL SEAN QUINN

The Stowers Doctrine—An Agent's Primer

The administration of liability insurance contracts can be bizarre. Agents are frequently sucked into this turbulence, so there is lots they need to know. Recently I saw an insured try to get rid of his insurance defense counsel, and he asked his agent to help. Obviously, there is plenty agents need to consider before getting involved.

Under many types of liability insurance agreements, when someone makes a claim or files a suit against an insured, the insurance company takes over. Often the claim is settled more or less cooperatively. This happens when liability and coverage are clear, and damages are probably within policy limits.

Other times liability is not clear, and the insurer provides the insured a defense. The insurer hires the lawyers and instructs them. The insurer has the right to settle such suits within policy limits. It also has the duty to

settle within policy limits, under many circumstances. It is that duty which sets up the venerable Stowers Doctrine.

This infamous doctrine, named after a case decided many years ago, began as a routine roadway collision. Coverage was not an issue; the insurer declined to settle the case, and a judgment was entered against the insured in excess of policy limits. The Stowers Furniture Company, which still exists today, was the insured. It had a

\$5,000 policy, but the plaintiff recovered a shade over \$14,000. In other words, the plaintiff took a judgment for nearly three times policy limits. In 1929, the Commission of Appeals, and then the Supreme Court of Texas, held that when a liability insurer is negligent in failing to settle within policy limits, it commits a tort and must pay the entire judgment against its insured.

The plaintiff had offered to settle within



A routine auto accident served as the starting point for the now venerable Stowers Doctrine.

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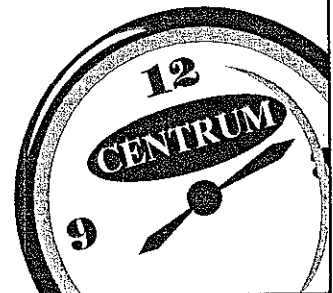
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policy limits; indeed, she had offered to settle for 80 percent of the policy limits. Consequently, over the years, the Stowers Doctrine has come to be this: when a liability insurer which is defending its insured receives an unequivocal offer to settle the whole case within policy limits, the insurer must use reasonable care in determining whether or not to settle, and if it negligently fails to settle, then it is liable in tort for the entire judgment.

For a while, in the 1980s, the Stowers Doctrine expanded, so that an insurer might be liable if it negligently failed to settle a

case within policy limits, even if it had not received an unequivocal, unconditional demand to settle within policy limits. The Texas Supreme Court thought that this rule was too mushy and made too many shenanigans possible, so after a couple of years it went back to the old rule.

Sweetheart deals turn sour

Even the old rule has given rise to ugly manipulations of the system. The most significant is the so-called "Sweetheart Deal." In this gambit, the insurance company expresses some doubt about the exist-

tence of full coverage and issues a reservation of rights letter. The insured rejects the reservation and demands a full defense. The insurance company declines, so the insured refuses to accept the lawyer appointed by the insurance company and hires its own lawyer. Sometimes the insurance company pays for this lawyer; sometimes not.

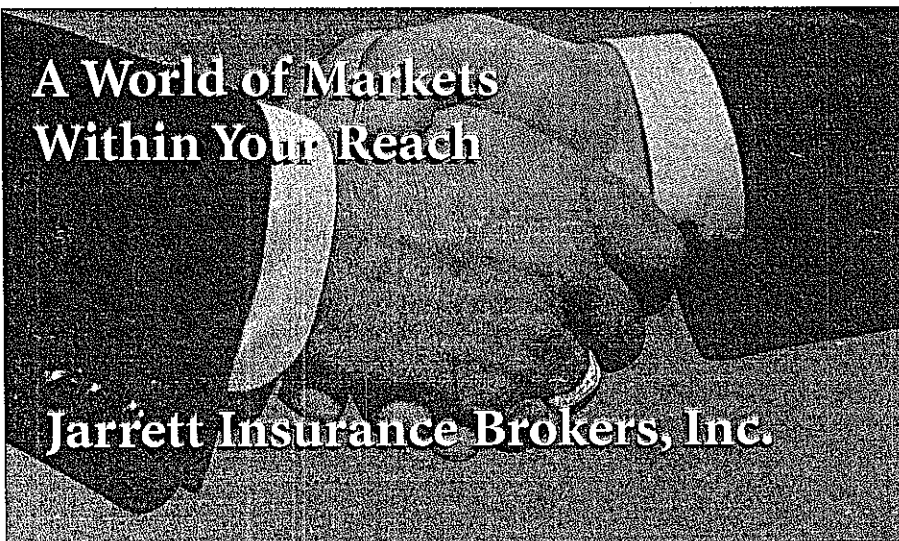
At this point, the plaintiff and the defendant-insured begin cooperating. After the insurance company has been fired by the insured, the plaintiff offers to settle for policy limits. Occasionally an amended petition is filed. The offer is conveyed to the insurance company with a demand for settlement. Usually, the insurance company is given only a very short time in which to decide what to do. Often, the parties to the suit cooperate in discouraging the insurer from taking the offer. The wording and tone of the demand letter can effect this. Sometimes, the insurer lets the time demand lapse, or rejects it.

The plaintiff-claimant and the defendant-insured then enter into an agreed assignment. It conveys all of the insured's rights against the insurance company to the plaintiff. The underlying tort case is there upon set for trial. The defendant puts up no—or, at most, token—resistance at trial. Perhaps the defendant doesn't even show up. At the end of the trial, a sympathetic—carefully selected—jurist enters a huge judgment against the defendant, far in excess of policy limits. The plaintiff then tries to enforce that judgment against the insurance company. Sometimes cowardly—or, perhaps, just overly worried—insurers settle.

Courts don't like "Sweetheart Deals," and they have been undermining them for a while. The most interesting Stowers case in decades, *State Farm v. Maldonado*, was decided earlier this year. The plaintiff had been a bookkeeper for a long time. She quit. Shortly thereafter, her former boss circulated stories that Maldonado was a thief and a woman of questionable virtue. Because of these statements, Maldonado did not get a promotion from her new employer, and her reputation within the community was ruined.

Maldonado sued the former employer for defamation. Defense counsel advised the insurer that the plaintiff's case against the insured was "horrible" and predicted that a substantial verdict would be returned. Apparently, neither liability nor coverage was in question. The defendant-insured had coverage of \$300,000 for defamation claims. Maldonado made a \$1.3 million time-sensitive demand. State Farm did not accept the demand by the deadline.

The former employer, however, agreed



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to pay Maldonado \$1 million. In exchange, she agreed not to seek any more money from him individually. The trial was a "put up job." The defense lawyer did not present evidence on behalf of the former employer; he did not cross-examine any witnesses; he did not present either an opening or closing argument. State Farm attempted to intervene in the case to prevent just this from happening, but the trial judge refused its application. In the end, the trial judge entered a judgment in favor of Maldonado for \$2 million.

Maldonado and her former employer both sued State Farm for negligence, gross

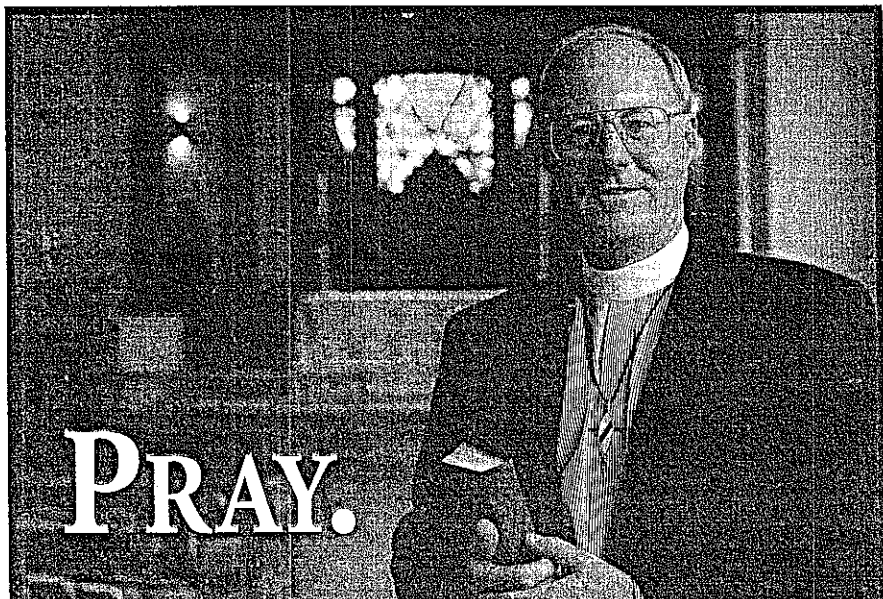
negligence, violations of the insurance code, breach of contract and bad faith. The court found State Farm liable on every theory except gross negligence. The trial court awarded the former employer over \$6 million and Maldonado over \$1.5 million. (The two of them had an agreement to split the proceeds.)

Supreme Court speaks

When the case got to the Supreme Court, State Farm defeated the recovery. First, virtually all liability policies contain a condition preventing recovery under the policy

unless there has been a judgment entered pursuant to "an actual trial." The court held that there was no actual trial in the underlying defamation case. Consequently, there could be no recovery under the policy.

Second, there could be no Stowers recovery. No demand above policy limits triggers the Stowers Doctrine, even if that offer is reasonable. An insurer has no duty to negotiate. Maldonado, of course, had not made a demand within policy limits. She took the position that the \$1.3 million demand was always "bifurcated." She contended that everyone understood that \$1 million was to come from the former employer and that \$300,000 was to come from State Farm. The Supreme Court rejected this gambit. It said that there was no evidence that State Farm knew that the former employer was willing to pay the \$1 million. One wonders if State Farm's duty to pay would have been triggered even if it had understood the bifurcated nature of the offer.



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The Stowers Doctrine contains many unsettled twists and turns. Must all Stowers demands be in writing?

The Stowers Doctrine requires that the plaintiff's offer be unconditional, as well as within policy limits. Surely, Maldonado's bifurcated offer was merely a conditional offer. Still, this point was not decided.

Conceiving the Stowers Doctrine as a species of the tort of negligence was a mistake right from the start. It should have been conceptualized as a breach of contract. Surely, as a party to the insurance contract, the insurer had a duty to conduct the defense in a prudent manner. This duty encompasses a duty to settle. This way of conceiving the Stowers paradigm would have avoided the threat of punitive and mental anguish damages but would have permitted insureds to recover attorneys' fees. The tort-instead-of-contract-concept is a very old mistake, so there is little chance things will ever be set right. The common law worships age and stability perhaps more than truth, especially if rough justice is done anyway.

The Stowers Doctrine as we know it contains many unsettled twists and turns. Must

all Stowers-demands be in writing? Probably not: only reasonable ones. Are all offers to settle within policy limits sufficient to trigger Stowers? Probably not. Must a written Stowers-demand state specifically that the claimants will release the insured? Probably not, if that intent is clear from the context. How should a Stowers-demand be made when the limits on the policy are being steadily diminished by defense expenses?

How long must a plaintiff give a defendant and its insurer to think about the Stowers-demand? Thirty days is almost always reasonable, unless the plaintiff is

hiding facts. In a simple case, probably two weeks, or even a week might be reasonable. (Sometimes, a shorter time might be appropriate. Suppose there have been extensive settlement negotiations; the case has gone to the jury; a Stowers-offer is made, and it remains open until the jury comes in. Such a time interval might be bona fide. Everything depends upon context.)

If there are multiple claimants, each making demands upon policy proceeds, can the insurance company pay one of them, and thereby circumvent having to pay any of the others, as well as avoid liability under

the Stowers Doctrine? The answer is affirmative, so long as the insurance company is acting in good faith and the demand is reasonable.

There are many other unresolved problems related to the Stowers Doctrine. What if some of the plaintiffs' claims are covered and some are not? What if the plaintiff offers to settle covered claims within policy limits, but not the uncovered claims? Does this sound like an unconditional offer? What if there are genuine coverage questions across the board which have not been resolved? Does the insurer assume the complete risk of being wrong? Even when the facts are in the hands of the insured? What if the underlying judgment is unforeseeably large?

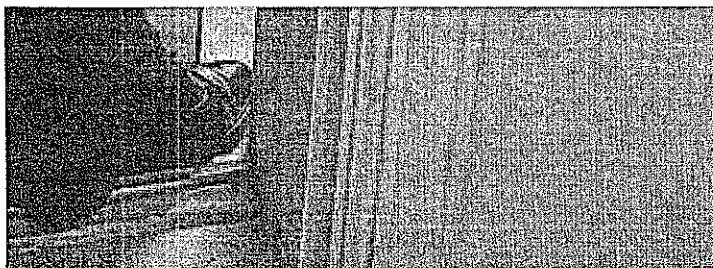
Ramifications for agents

The "Stowers situation" can be important to the insurance agent. Insureds will occasionally ask their agents to support their Stowers-demands. Such requests present ticklish economic, relationship, and (possibly even) legal problems for the agent. Often, having been asked, agents submit short letters in support of the Stowers-demand, without realizing that this letter will have almost no influence but might have repercussions for the author. Of course agents want to help their customers.

But what agent wants to have to produce his file and withstand a potentially lengthy deposition—all on account of a barely considered letter? Such depositions can be embarrassing. The alert lawyer will inquire why the agent thought the case should be settled. She will inquire what analysis the agent did in support of his demand. There may be a request to produce other, similar letters. And it should be kept in mind that communications between insurance agents and insureds are not privileged. What if the agent's letter—perhaps suggested or even drafted by the insured—contains a false statement. Not good!

At the same time, sometimes, the agent's customer—the insured defendant—may be leery of the defense lawyer, and her explanations of the Stowers Doctrine. The defense lawyer, after all, is in the pay of—and may be in league with—the insurance company. So, the insured comes to the agent for sympathy, fellowship dialogue, counsel and even advice. At the same time, agents don't usually want to practice law. Yet, inevitably, there will be significant topical conversations. These too can lead to depositions, or worse. ■

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



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