

Federal Court in Texas Holds No Breach of Stowers Duty; Prejudgment Interest Is "Damages"

November 2003

The United States District Court for the Northern District of Texas, applying Texas law, has held that an insurer that issued a malpractice policy to a podiatrist and then refused to accept a settlement offer within settlement limits was not liable for extra-contractual damages after the trial court in the underlying action awarded a judgment of more than double the policy limits. *Gulf Ins. Co., et al., v. Jones, et al.*, 2003 WL 22208551 (N.D. Tex. Sept. 24, 2003). The court also held that prejudgment interest is considered to be "damages" and that the insurer therefore had no contractual duty to pay for prejudgment interest once the policy limits were expended. Finally, the court held that the insurer had not violated the Texas Deceptive Trade Practices Act.

The insurer had issued a professional liability policy to the podiatrist that provided coverage "for damages which you become legally obligated to pay...." The policy contained an "Additional Benefits" provision that provided coverage for amounts beyond the policy's limits for, among other things, "all costs of defending a suit, including interest on that part of any judgment that does not exceed the limit of your coverage." The policy also contained a provision giving the insurer "the right to investigate, to negotiate and to settle any suit or claim if we think that it is appropriate."

The coverage action arose after a medical malpractice claim was filed against the podiatrist. The insurer defended the podiatrist in the malpractice action, and, during the course of the litigation, rejected an offer to settle the lawsuit for policy limits. At the time the settlement offer was made, the podiatrist was informed of the offer and stated that he did not want to settle the case. The suit subsequently ended in a verdict against the podiatrist for over twice the policy limits, plus prejudgment and post-judgment interest. The insurer paid policy limits as well as post-judgment interest on that amount. The podiatrist assigned his rights against the insurer to the underlying plaintiff, who then sought to recover the entire amount of the judgment from the podiatrist.

The district court held that the insurer had no extra-contractual liability for refusing to accept the settlement demand, rejecting the argument that the insurer had violated its obligations under *Stowers Furniture Co. v. American Indemnity Co.*, 15 S.W.2d 544 (Texas Comm'n App. 1929). The court reasoned that, although the first two elements of *Stowers* had been met because the claim was within the scope of coverage and the

underlying plaintiff had made a demand within the policy limits, the third element of *Stowers* necessary to establish extra-contractual liability had not been satisfied. That prong of the *Stowers* test requires that "the terms of the demand are such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to the excess judgment." The court rejected the podiatrist's argument that the insurer's claims adjuster had failed to identify the weaknesses in the podiatrist's defenses. The court explained that the record reflected that the claims adjuster was aware of all of the evidence. In addition, the podiatrist had testified that the claims in the lawsuit were defensible. The court noted that the insurer's decision not to settle did not arise from an erroneous belief that it needed the podiatrist's assent to do so, but rather from its independent belief that the suit was not worth policy limits. The court next rejected as speculative the podiatrist's argument that he might have settled if the attorney chosen by the insurer had been more experienced and had convinced him to settle. In addition, the court noted that even if the attorney was at fault, "an insurer is not vicariously responsible for the conduct of an independent attorney it selects to defend an insured." The court also rejected the argument that the insurer had breached a contractual obligation to settle, reasoning that the policy provision giving the insurer "the right to investigate, to negotiate and to settle any suit or claim if we think that it is appropriate" did not create a duty to settle, but only a right to do so.

The district court next held that the insurer had not breached the contract by failing to pay for prejudgment interest in excess of the policy limits. The court held that prejudgment interest unambiguously was covered as "damages" under the policy's insuring clause and not as "interest" under the Additional Benefits provision of the policy, because "[p]rejudgment interest falls within the common-law meaning of damages." By contrast, the court reasoned that post-judgment interest "is not an element of the measure of damages," and thus falls under the Additional Benefits provision. In doing so, the court distinguished *Embrey v. Royal Insurance Co.*, 22 S.W.3d 414 (Tex. 2000), which contained dicta referencing a 1984 state insurance bulletin that the policyholder maintained required the insurer to provide coverage for prejudgment interest exceeding the policy limits. The court reasoned that even if the bulletin still applied, "it cannot supplant that whole body of law which defines prejudgment interest as part of damages." Furthermore, the court noted that any such required coverage would derive only from an amendment to the policy providing such coverage, and no evidence of such an amendment existed. Since the insurer had already paid the policy limits, the court held that the insurer did not breach the policy by failing to pay for prejudgment interest.

The court also held that the insurer did not breach the policy by failing to reimburse the policyholder for time that the policyholder spent assisting in his defense. The court reasoned that although the policy provided coverage for those costs, the podiatrist had not submitted a claim for them. In doing so, the court rejected the podiatrist's argument that the insurer had a duty to inform him of this policy benefit, noting that each party is obligated to read the policy.

Finally, the court held that the insurer had not violated the Texas Insurance Code and Deceptive Trade Practices Act by failing to settle the suit and by not paying prejudgment interest or reimbursing the policyholder for time spent assisting with the defense. Noting that the Texas Supreme Court had adopted the *Stowers* standard in determining the liability standard under the Deceptive Trade Practices Act for insurers that

allegedly failed to make reasonable attempts to settle a claim, the court held that its conclusion that the insurer had no liability under *Stowers* required a similar result under the Deceptive Trade Practices Act. Similarly, the court held because the insurer had already paid the policy limits and the podiatrist had not submitted a claim for the time spent assisting with the defense, no other grounds for statutory liability existed. In so holding, the court dismissed the podiatrist's additional allegation that the insurer had misrepresented that prejudgment interest was covered, reasoning that such an allegation was unsupported by the evidence.

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