TEXAS BAD FAITH BULLETIN

VOLUME IV / ISSUE III JULY 1992

EXCESS CARRIERS' COMPLAINTS ABOUT PRIMARY CARRIERS' CLAIMS HANDLING: THE *STOWERS* DOCTRINE IN A NEW FRONTIER

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Recently, there has been an explosion of litigation between excess and primary insurance carriers. Much of this litigation involves the primary carrier's handling of claims against mutual insureds of the primary and excess carriers. In 1991, a Texas appellate court, for the first time in a published opinion, directly confronted the various issues raised in a claims handling dispute be-

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tween two excess carriers and a primary carrier in *American Centennial Ins. Co. v. Canal Ins. Co.*, 810 SW2d 246 (Tex.App.–Houston [1st Dist.] 1991, writ granted). The Texas Supreme Court granted the Applications for Writ of Error in *American Centennial* and heard oral arguments on January 28, 1992. As of June 1, 1992, however, the court had not issued its opinion in this cause.

This article first discusses the fundamental theories of Texas law involved in disputes between excess and primary carriers pertaining to the primary carrier's claims handling. Next, this article analyzes the *American Centennial* matter. Finally, it surveys the different schools of thought that have developed in the various jurisdictions in this area of insurance law.

Primary Liability Insurance Coverage

For purposes of this article, primary liability insurance ("primary") coverage refers to the first layer of liability insurance coverage provided to a policyholder. Aside from certain manuscript and surplus lines policies, primary policies issued in Texas are typically uniform for the type of coverage provided (e.g., automobile liability policies, homeowners liability policies, general liability policies, errors and omissions liability policies). This uniformity is a result of general insurance practices and the Texas Department of Insurance's close regulation over the issuance of standardized policies.

Normal characteristics of primary coverage include a duty to investigate claims made against a policyholder, a duty to defend the policyholder in suits containing allegations that invoke coverage, and control of settlement negotiations within the limits of liability contained within the primary policy. [*Ranger County Mut. Ins. Co. v. Guin*, 723 SW2d 656, 659 (Tex. 1987)] Very significantly, the duty to defend under the usual primary policy is separate and distinct from the duty to pay. [*Rhodes v. Chicago Ins. Co.*, 719 F2d 116, 119 (5th Cir. 1983)]

It is also very common that the expenses incurred in defending lawsuits on behalf of a policyholder do not reduce the aggregate limits contained in primary policies. Thus, situations sometimes arise where the costs in defending a lawsuit impose a greater financial burden on the primary carrier than the amounts paid to satisfy covered judgments or settlements. As a result of these duties and the fact that primary policies provide "first dollar" coverage (above the policyholder's deductible or self-insured retention), primary policies are more expensive than excess liability insurance policies for the amount of coverage provided by the policy. [See *Certain Underwriters of Lloyd's v. General Acc. Ins. Co. of Am.*, 909 F2d 228, 232 (7th Cir. 1990)]

Excess Liability Insurance Coverage

In contrast to primary policies, excess liability insurance ("excess") policies are much less standardized. In fact, there are several different types of excess policies. Also, it is possible for a primary policy to provide excess coverage "by coincidence," if the "Other Insurance Clauses" contained in multiple primary policies transforms a primary policy into an excess policy for a particular risk. [See *Employer's Mut. Cos./Illinois Emcasco Ins. Co. v. Country Cos.*, 570 NE2d 528, 530 (Ill.App.Ct. 1991)]

Umbrella Liability Insurance Policies

A fairly common insurance policy form providing excess coverage is an "umbrella liability policy." Typically, an umbrella liability policy has two coverage parts.

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EDITORIAL OFFICES:
201 MAIN STREET, SUITE 600
FORT WORTH, TX 76102

The first part provides coverage that is triggered upon the exhaustion of the coverage provided by the underlying primary policy. The second part provides coverage for risks not covered by primary coverage. For the coverage provided by an umbrella liability policy that is not covered by an underlying primary policy, coverage is triggered by the payment of a "Self Insured Retention," which is usually much lower than the limits contained in the primary policy. The "umbrella" is created because the coverage provided is both directly above the primary policy (similar to excess coverage) and it expands and drops down on the sides of the primary coverage (i.e., coverage which is provided by the umbrella liability policy for areas not covered by the underlying primary policy).

In Texas, the Department of Insurance has required the inclusion of a Texas Amendatory Endorsement on umbrella liability policies issued since 1970. The Texas Amendatory Endorsement makes "drastic" changes to the standard form umbrella liability insurance policy, especially as it relates to the duty to defend. [*Laster v. American Nat'l Fire Ins. Co.*, 775 F.Supp. 985, 994 (N.D.Tex. 1991)] For example, the Texas Amendatory Endorsement changes the standard umbrella liability policy from a "pay on behalf of" policy to an "indemnity" policy. Also, the Texas Amendatory Endorsement specifically negates the defense obligation in the basic umbrella liability policy and instead gives the umbrella carrier the option or right to defend. [See *Id.*; *Warren v. American Nat'l Fire Ins. Co.*, 826 SW2d 185, 187 (Tex.App.–Fort Worth 1992, n.w.h.)]

Pure Excess Liability Insurance Policies

In addition to umbrella liability insurance policies, "pure excess" policies are also quite common. In the normal pure excess policy, the coverage provided "follows form" to the coverage contained in the underlying primary policy. The underlying primary policy is usually identified in a "Schedule of Underlying Insurance" attached as an Endorsement to the excess policy. Often, a pure excess liability insurance policy will specifically negate an obligation to defend or investigate claims. To the extent defense costs are a covered loss invoking an indemnity obligation, payment of defense costs will usually reduce the excess policy limits.

BASIC DUTY OF PRIMARY CARRIER TO MAKE REASONABLE ATTEMPTS TO SETTLE CASES WITHIN ITS LIMITS

A policyholder's cause of action against its liability insurance carrier for failing to make reasonable attempts to settle cases within its policy limits, when appropriate, is a fundamental and universally accepted principle in insurance law. [J. Douthett and B. Gotthelf, "Double Your Money, Double Your Fun: Bringing and Defending Claims for Excess Liabilities Arising Out of Insurer's Refusals to Settle," 2 Coverage 56, 56-57 (Fall 1991)] Although different legal standards may be applied for imposing liability on an insurance carrier to pay for amounts of judgments in excess of its policy limits (ranging from negligence to fraud), all jurisdictions recognize a cause of action for an insurer's wrongful failure to settle. [*Id.*] The basic Texas rule is set out in the seminal opinion of *G.A. Stowers Furniture Co. v. American Indem. Co.*, 15 SW2d 544 (Tex. Comm'n App. 1929, holding approved).

Stowers Doctrine

In *Stowers*, a furniture company possessing a $5,000 liability insurance policy was sued for personal injuries suffered by a passenger in a car that collided with the furniture company's truck. [*Id.* at 545] Pursuant to the insurance policy, the insurance company took control over the defense of the furniture company and entered into settlement negotiations with the injured plaintiff. Prior to trial, plaintiff offered to settle her case for $4,000; however, the insurance company refused to pay more than $2,500. When a judgment, based on a jury verdict in favor of plaintiff, was entered for $14,107.15, the insurance company tendered its $5,000 policy limits and refused to contribute any additional money to satisfy the excess portion of the judgment.

This led to a suit by the furniture company against its insurance company contending the insurance company should be responsible for the excess portion of the judgment because it misused its control of the litigation, creating a conflict of interest between the insurance company and the policyholder. The Texas Commission of Appeals agreed with the policyholder and issued an opinion that was approved by the Texas Supreme Court,

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giving birth to the *Stowers* doctrine. The Texas *Stowers* cause of action is significant in that it applies a general negligence standard of care obligation (as opposed to fraudulent conduct or lack of good faith) on the insurance carrier. [*Id.* at 547]

Recent Expansion of *Stowers* Doctrine

In the first 50 years after the *Stowers* decision, the application of the *Stowers* doctrine was basically limited to an insurance carrier's negligent failure to settle cases in response to unconditional offers to settle cases within the insurance carrier's policy limits. [See, e.g., *Hernandez v. Great Am. Ins. Co. of New York*, 464 SW2d 91, 92 (Tex. 1971); *Danner v. Iowa Mut. Ins. Co.*, 340 F2d 427, 430 (5th Cir. 1964); Kronzer, "The Present Status of the Stowers Doctrine in Texas," 1 S.Tex.L.J. 167, 168 (1954); Nations, "Excess Liability Damages: The *Stowers* Doctrine," 18 S.Tex.L.J. 465, 466-467 (1977)] In the past decade, however, there has been a significant expansion in the *Stowers* doctrine in which policyholders have succeeded in broadening the range of the insurance carrier's duties. Also, utilization of the Deceptive Trade Practices Act and Insurance Code have expanded the *Stowers* doctrine from solely that of the common law into the realm of statutory law as well.

Common Law *Stowers* Doctrine

In the past seven years, the Texas Supreme Court in *Ranger County Mut. Ins. Co. v. Guin*, 723 SW2d 656 (Tex. 1987) and the United States Court of Appeals for the Fifth Circuit in *Texoma AG-Products, Inc. v. Hartford Acc. & Indem. Co.*, 755 F2d 445 (5th Cir. 1985) have greatly expanded the scope of the *Stowers* doctrine.

In *Ranger County Mut. Ins. Co. v. Guin*, the insurance carrier defended the *Stowers* action against it by taking the position that the *Stowers* doctrine is limited to the insurance carrier's refusal to settle in response to an unconditional offer to settle all claims against the policyholder within the policy limits. On the other hand, the policyholder claimed that *Stowers* stands for the proposition that an insurance carrier can be liable to the policyholder simply for negligent claims handling. With respect to this issue, the Texas Supreme Court sided with the policyholder and held that:

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

[*Id.* at 659] Also, the Texas Supreme Court approved a jury instruction that characterized insurance defense counsel as a subagent of the insurance company for whose conduct the insurance carrier is responsible. [*Id.* at 658, 660]

Another expansion of the common law *Stowers* doctrine occurred in *Texoma A.G.-Products, Inc. v. Hartford Acc. & Indem. Co.* This case concerned the insurance carrier's claims handling after one of the policyholder's trucks was involved in an accident giving rise to serious injuries suffered by the driver of another vehicle. According to the Fifth Circuit, the carrier did not diligently investigate the claim and it did not pursue settlement opportunities occurring prior to the filing of the lawsuit. Eventually, a settlement was achieved in which the carrier paid its $100,000 policy limits and the policyholder paid $35,000 of its own money.

In the *Stowers* lawsuit that ensued, the district court rendered judgment for the policyholder and against the carrier for $40,000 in actual damages and $125,000 in punitive damages. In affirming the trial court judgment, the Fifth Circuit rejected Hartford's argument that *Stowers* liability would not lie in the absence of a judgment (as opposed to a settlement) against the insured in excess of policy limits. Further, the Fifth Circuit held that, depending on the circumstances, the insurance carrier might have to initiate settlement negotiations, even prior to litigation if appropriate. [755 F2d at 447]

Statutory *Stowers* Cause of Action

The controversial case of *Allstate Ins. Co. v. Kelly*, 680 SW2d 595 (Tex.App.–Tyler 1984, writ ref'd n.r.e.) highlights a policyholder's ability to utilize provisions of the Deceptive Trade Practices Act and Insurance Code in a *Stowers* situation. Although the current versions of the Deceptive Trade Practices Act and Insurance Code are different from the versions analyzed in *Allstate Ins. Co. v. Kelly*, policyholders are still able to utilize certain provisions of the Deceptive Trade Practices Act and Insurance Code in *Stowers* situations. [*Vail v. Texas Farm Bureau Mut. Ins. Co.*, 754 SW2d 129, 133-136

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(Tex. 1988)] Certain Board Orders promulgated by the Department of Insurance, especially 28 Tex.Admin.Code §§21.3 (entitled: "Unfair Trade Practices Prohibited") and 21.203 (entitled: "Unfair Claim Settlement Practices"), can give rise to Insurance Code causes of actions in *Stowers* actions. Also, "knowing" violations of the Insurance Code give rise to mandatory treble damages. [Tex.Ins.Code Art. 21.21 §16(b)(1)] This can be quite significant in matters involving large actual damages, because the mandatory treble damages could very well give rise to a greater recovery than the discretionary additional damages awarded under the Deceptive Trade Practices Act, Tex.Bus.& Comm.Code §17.50(b)(1), or a common law punitive damage award.

AMERICAN CENTENNIAL INS. CO. V. CANAL INS. CO.

In *American Centennial Ins. Co. v. Canal Ins. Co.*, 810 SW2d 246 (Tex.App.–Houston [1st Dist.] 1991, writ granted), the Texas Supreme Court is expected to declare the Texas rule on whether an excess carrier can maintain a *Stowers* cause of action against a primary carrier for tortious conduct in handling a claim. *American Centennial v. Canal* arises from a personal injury, wrongful death and survivorship lawsuit filed against General Rent-A-Car International, Inc. as a result of a fatal car accident involving one of its rental cars. The attorney retained by the primary carrier, Canal, to represent General Rent-A-Car filed responses to Requests for Admissions that admitted a defective tire caused the accident.

Based on this admission, the wrongful death/survivorship plaintiffs then nonsuited all other defendants except General Rent-A-Car and filed a Motion for Summary Judgment based on the admission of liability. About this time, the excess carriers retained attorneys to analyze the claims handling by the primary carrier and the defense of the case by the law firm retained by Canal to represent General Rent-A-Car. Not surprisingly, these attorneys identified numerous problems caused by the primary carrier's handling of the lawsuit against General Rent-A-Car.

Shortly thereafter, General Rent-A-Car's general counsel demanded that all of the carriers, primary and excess, tender their policy limits ($4 Million total) to settle the case. In response, the excess carriers demanded the primary carrier to settle the case with its own funds; however, the primary carrier refused to pay any more than its $100,000 policy limits. Next, the excess carriers negotiated with the plaintiffs and reached an agreement to settle the lawsuit for an amount close to the policies' collective policy limits.

The excess carriers eventually filed suit against the primary carrier and the law firm retained by the primary carrier to represent General Rent-A-Car. This lawsuit alleged that the primary carrier and the defense counsel breached common law and statutory duties owed to the excess carriers. The primary carrier and the attorneys filed Motions for Summary Judgment based on the statute of limitations and their position that primary carriers and the defense attorneys do not owe any duties to excess carriers for tortious claims handling. The trial court granted these Motions for Summary Judgment, and the excess carriers appealed to the Houston First District Court of Appeals.

Court of Appeals Opinion

The court of appeals analyzed the case law generated from the several jurisdictions that have addressed the issue and determined there are three theories recognized by American courts allowing excess carriers a right of recovery from primary carriers. First, the court recognized that the majority of jurisdictions permit an excess carrier to be "equitably subrogated" to the rights of the policyholder, so that under appropriate circumstances the excess carrier can recover for the wrongful acts of the primary carrier. [*Id.* at 251 fn. 4] Second, the court of appeals noted there is a growing trend in the law and a significant minority view that imposes a "direct duty" flowing from the primary carrier to the excess carrier. [*Id.* at 251 fn. 2] Finally, the court noted a critically acclaimed version of the direct duty theory advanced by a California court entitled "triangular reciprocity." [*Id.* at 251 fn. 3]

The Houston First Court of Appeals adopted "equitable subrogation" as the method by which aggrieved excess carriers can pursue a cause of action against primary carriers for wrongful claims handling. [*Id.* at 252] Significantly, however, the court specifically stated that it need not reach the question of whether Texas law should recognize a direct duty flowing from the primary carrier to an excess carrier because "equitable subrogation" provided the excess carrier with adequate protection under the facts of the case. In so doing, the court of appeals reserved the right to address the "direct duty" concept under a proper fact situation.

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The court then explored whether defense counsel retained by the primary carrier owes any duties to an excess carrier. In the normal situation, an excess carrier does not retain defense counsel to represent the policyholder because that is part of the primary carrier's duty to defend. Nonetheless, an excess carrier is vulnerable to mistakes made by counsel representing the policyholder if the mistakes result in liability and/or an increase of damages that penetrates the layer of coverage provided by the excess policy. Other courts analyzing this situation have ruled that the lack of privity between the excess carrier and counsel for the policyholder precludes any duty flowing from defense counsel for the policyholder to the excess carrier. [See *Continental Cas. Co. v. Pullman, Comley, Bradley & Reeves*, 929 F2d 103 (2nd Cir. 1991)] In *American Centennial v. Canal*, the court of appeals rejected the excess carriers' cause of action against counsel for the policyholder; however, it did not base its ruling on a lack of privity. Instead, the court held that a *Stowers* cause of action is only available against an insurance carrier itself and not any other participant to the claims handling process. [*Id.* at 254]

Texas Supreme Court Agrees to Decide *American Centennial v. Canal*

American Centennial v. Canal raises a complex myriad of procedural and substantive insurance legal issues. Some unique factual aspects of *American Centennial v. Canal* may make it difficult for the Texas Supreme Court to declare an all-encompassing rule that will govern all disputes between excess carriers and primary carriers for wrongful claims handling. First, the relatively low limits of the primary policy ($100,000) in the context of a double fatality lawsuit that had damage potential far in excess of the primary carrier's limits may be a factor in the opinion to be issued by the Texas Supreme Court. Also, the court of appeals' observation that equitable subrogation provided adequate protection to the excess carrier may mean the Texas Supreme Court will have to wait to analyze the "direct duty" theory until such time as a case reaches the Texas Supreme Court in which an excess carrier suffers damages but equitable subrogation cannot provide it with adequate relief. Additionally, the primary carrier's and the defense counsel's alleged mishandling of the lawsuit first occurred in October 1984; however, the excess carriers did not file their suit until January 1988. Accordingly, it is possible that the case could be decided on procedural statute of limitations grounds, thereby preventing the Texas Supreme Court from reaching the merits.

RECOGNIZED LEGAL THEORIES GOVERNING DISPUTES BETWEEN EXCESS AND PRIMARY CARRIERS

As noted by the *American Centennial* opinion, three schools of thought have developed concerning duties owed by primary carriers to excess carriers–i.e., equitable subrogation, direct duty and triangular reciprocity. While the *American Centennial* court of appeals selected equitable subrogation, apparently believing it is the most narrow workable rule under the facts, the Texas Supreme Court could select any one of the three theories or perhaps develop its own rule.

Equitable Subrogation

The majority of jurisdictions that have analyzed excess carriers' claims against primary carriers for the wrongful handling of a claim or lawsuit of a mutual insured have adopted the doctrine of equitable subrogation. [See, e.g., *Certain Underwriter's of Lloyd's v. General Acc. Ins. Co. of Am.*, 909 F2d 228, 233 (7th Cir. 1990) (and cases cited therein)] Under the theory of equitable subrogation, the excess carrier *steps into the shoes* of the policyholder and is able to assert whatever causes of action may be available to the policyholder as if the policyholder paid the loss and suffered damages therefrom. Allowing an excess carrier to be equitably subrogated to the rights of the policyholder prevents the unjust enrichment of the primary carrier. Accordingly, if a judgment of settlement exceeds the applicable primary policy limits due to the actionable wrongful conduct in the primary carrier's claims handling, then upon payment of the excess amount, the excess carrier stands in the shoes of the policyholder and can assert whatever cause of action that would have been available to the policyholder. Under Texas law, equitable subrogation could allow an excess carrier to assert the policyholder's *Stowers* cause of action against the primary carrier.

In extolling the virtues of equitable subrogation, the *American Centennial v. Canal* court of appeals noted the following characteristics:

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(1) A *Stowers* duty arises because of the insurance policy and that duty is not reduced merely because of the existence of another contract between the policyholder and the excess carrier;

(2) Allowing an excess carrier to enforce the *Stowers* duty does not increase the scope of the primary carrier's duty nor the potential extent of its liability;

(3) The duty the primary carrier owes to the excess carrier through equitable subrogation is identical to the duty the primary carrier owes to its policyholder;

(4) Equitable subrogation should not have any effect on the premiums for primary coverage because an excess carrier will not be able to force the primary carrier to accept any settlement that the primary carrier's duty to the policyholder would not require it to accept;

(5) Whereas the primary carrier's interests are largely unaffected by the existence of actions of the excess carrier, the excess carrier's interests are very much affected by the actions of the primary carrier.

[810 SW2d at 252-254]

Criticisms of Equitable Subrogation

The equitable subrogation theory is not without its critics. [See Ashley, "The Peculiar Fate of Excess Carriers in the Law of Bad Faith," 3 Bad Faith Law Report 197, 199 (Nov. 1987)] As a fundamental matter, there is no privity of contract between excess and primary carriers. Usually, the policyholder enters into two separate insurance contracts: one with the excess carrier and one with the primary carrier. Many times, the primary carrier does not know the identity of the excess carrier until a loss is sustained by the policyholder. [See Butler and Porter, "The Primary Carriers Caught in the Middle with Bad Faith Exposure to its Insureds, Excess Carriers and Reinsurers," 24 Tort & Ins.L.J. 118, 123 (1988)]

Also, a primary carrier that rejects a settlement offer for less than its policy limits is still forced by its own rejection to pay its policy limits in the event of an excess judgment or settlement. Some primary carriers have argued that, in light of this, a primary carrier is not unjustly enriched when an excess carrier pays the excess amount of a judgment or settlement. [See *Fireman's Fund Ins. Co. v. Continental Ins. Co.*, 308 Md. 315, 519 A2d 202 (1987)–rejecting this argument by holding primary carrier is truly unjustly enriched by the amount it would have had to pay on a bad faith claim, if the policyholder did not possess excess insurance]

Other criticisms of equitable subrogation arise because the excess carrier must "stand in the shoes" of the policyholder. A policyholder with excess insurance, however, may have little or no financial interest in the outcome of the lawsuit. If the policyholder's position has flaws, the excess carrier must contend with them. Sometimes, the problems created by the policyholder's conduct can be insurmountable for an excess carrier utilizing equitable subrogation. [See *Puritan Ins. Co. v. Canadian Universal Ins. Co.*, 775 F2d 76, 80 (3rd Cir. 1985)–where insured concurred with primary carrier's decision not to settle and try the lawsuit; and *Hartford Acc. & Indem. Co. v. Commercial Union Ins. Co.*, 772 F.Supp. 741, 743 (E.D. N.Y. 1991)–where insured released primary carrier from liability in excess of primary policy limits]

Direct Duty

In light of the limitations on equitable subrogation, "[c]ourts across the country are increasingly amenable to recognizing that a primary carrier owes a direct duty in tort to an excess carrier." [*Ranger Ins. Co. v. Home Indem. Co.*, 714 F.Supp. 956, 961 (N.D. Ill. 1989)] Indeed, courts applying Illinois, New York, New Jersey and California law have recognized a direct tort cause of action by an excess carrier against a primary carrier from wrongful claims handling, without resorting to subrogation principles. [See *American Centennial Ins. Co. v. American Home Assur. Co.*, 729 F.Supp. 1228 (N.D. Ill. 1990); *Ranger Ins. Co. v. Home Indem. Co.*, 714 F.Supp. 956 (N.D. Ill. 1989); *Hartford Acc. & Indem. Co. v. Commercial Union Ins. Co.*, 772 F.Supp. 741 (E.D. N.Y. 1991); *Hartford Acc. & Indem. Co. v. Michigan Mut.*

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Ins. Co., 61 NY2d 569, 475 NYS2d 267, 463 NE2d 608 (1984); *Western World Ins. Co. v. Allstate Ins. Co.*, 150 N.J.Super. 481, 376 A2d 177, 180 (N.J.App. 1977); *Transit Cas. Co. v. Spink*, 94 Cal.App.3d 124, 156 Cal.Rptr. 360 (Cal.App. 1979), distinguished in part *Commercial Union Ass. Cos. v. Safeway Stores, Inc.*, 26 Cal.3d 912, 164 Cal.Rptr. 709, 610 P2d 1038 (1980)] Also, courts in Michigan, Maryland, Arizona and now Texas have adopted equitable subrogation; however, they do not reject direct duty and indicate a willingness to examine the direct duty concept when afforded with an appropriate case to do so. [See, *American Centennial Ins. Co. v. Canal Ins. Co.*, 810 SW2d 246, 253-254 (Tex.App.–Houston [1st Dist.] 1991, writ granted); *Twin City Fire Ins. Co. v. Superior Court*, 792 P2d 758, 759 (Ariz. 1990); *Fireman's Fund Ins. Co. v. Continental Ins. Co.*, 308 Md. 315, 519 A2d 202, 205 (1987); *Commercial Union Ins. Co. v. Medical Protective Co.*, 426 Mich. 109, 393 NW2d 479, 485 (1986)]

Courts imposing a direct duty apply basic tort principles requiring parties to use ordinary skill in the management of their activities when the negative consequences of their conduct are reasonably foreseeable and policy considerations justify placing the risk and burden of care on the tortfeasor. [See *Ranger Ins. Co. v. Home Indem. Co.*, 714 F.Supp. 956, 961 (N.D. Ill. 1989)] These courts reason that a primary carrier can reasonably foresee that its mishandling of a claim can injure an excess carrier, if the mishandling causes a judgment or settlement in excess of the primary policy limits. [*Id.* at 961] Public policy considerations relied on by direct duty proponents include:

(1) Encouragement of settlements when an offer exists at or near the policy limits;
(2) Discouraging gambling with the excess carrier's money;
(3) Maintenance of low premiums for excess coverage;
(4) Reducing the necessity for the excess carrier to participate in the defense of the action to protect its rights; and,
(5) Reflecting the duties of the primary carrier to perform the duty which it has delegated to itself, that is, providing primary coverage.

[*Id.* at 961]

Triangular Reciprocity

Triangular Reciprocity is the California version of direct duty that, while applauded by some commentators, may have been called into question by the California Supreme Court. [See *Transit Cas. Co. v. Spink*, 94 Cal.App.3d 124, 132-135, 156 Cal.Rptr. 360, 365-367 (Cal.App. 1979); S. Ashley, "The Peculiar Fate of Excess Carriers in the Law of Bad Faith," 3 Bad Faith Law Report 197, 200-201 (Nov. 1987); A. Windt, "Insurance Claims and Disputes 2d," §7.08 at 412-413 (1988); but see *Commercial Union Ass. Co. v. Safeway Stores, Inc.*, 26 Cal.3d 912, 164 Cal.Rptr. 709, 610 P2d 1028 (1980)] The triangular reciprocity theory espoused in *Transit Cas. Co. v. Spink* arises because equitable subrogation fails to achieve even handed justice. [94 Cal.App.3d at 132-133, 156 Cal.Rptr. at 365] Under triangular reciprocity, duties of ordinary care flow from each member of the excess insurance relationship (i.e., policyholder, primary carrier and excess carrier) to the other members. This creates a system of reciprocal rights and duties between three different parties, or "triangular reciprocity."

Shortly after the California Court of Appeal's decision in *Transit Cas. Co. v. Spink*, another district of the California Court of Appeal decided *Commercial Union Ass. Cos. v. Safeway Stores, Inc.*, 158 Cal.Rptr. 97 (Cal.Ct.App. 1979). In *Commercial Union v. Safeway Stores, Inc.*, an excess carrier sued a self-insured policyholder for a bad faith refusal to settle within the policyholder's self-insured retention. In rejecting the excess carrier's argument, the *Commercial Union v. Safeway Stores* court of appeal partially criticized the decision in *Transit Cas. Co. v. Spink* and lambasted the *Spink* court's rationale for abandoning equitable subrogation as the basis for the excess carrier's cause of action.

Subsequently, the California Supreme Court agreed to hear the *Commercial Union v. Safeway Stores* case.

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ARTICLE 21.42 AND CHOICE OF LAW IN INSURANCE CASES

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INTRODUCTION

Nonresident insurers frequently issue policies of insurance to Texas residents. They also issue policies of insurance to nonresident insureds where the policies ultimately benefit Texas residents. Invariably, in this multi-state context, the interpretation of the insurance contract depends on a choice of law determination. Choice of law principles mandate the substantive law that a forum court must apply to a particular issue. The differences between states' insurance regulatory statutes and the differences in the interpretations that various jurisdictions give to identical policy language exemplify the importance of a choice of law determination. Indeed, how a choice of law question is resolved will often determine whether and to what extent coverage will be afforded under a policy of insurance.

DUNCAN AND TEXAS CHOICE OF LAW PRINCIPLES

With certain limited exceptions, Texas follows the rule that the choice of law principles of the forum state apply to a cause of action. [*Duncan v. Cessna Aircraft Co.*, 665 SW2d 414 (Tex. 1984)] However, a choice of law issue will arise only when there is a "true conflict" between the laws of the states which have an interest in having their law applied to a particular issue. A "true conflict" occurs where the laws of the interested states, if applied, would produce conflicting results in some

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THE *STOWERS* DOCTRINE IN A NEW FRONTIER *CONTINUED*

While the California Supreme Court specifically adopted much of the *Commercial Union v. Safeway Store* court of appeal's opinion as its own, the California Supreme Court specifically omitted the lower court's criticism of the *Spink* court's discussion of the weaknesses and problems inherent in equitable subrogation. [Compare *Commercial Union Assur. Cos. v. Safeway Stores, Inc.*, 158 Cal.Rptr. 97, 101-102 (Cal.Ct.App. 1979) with *Commercial Union Assur. Cos. v. Safeway Stores, Inc.*, 26 Cal.3d 912, 164 Cal.Rptr. 709, 714, 610 P2d 1038, 1043 (1980)] This careful editing supports the inference that the California Supreme Court did not intend to reject the *Spink* court's criticism of equitable subrogation and its recognition of direct duty. [S. Ashley, "The Peculiar Fate of Excess Carriers in the Law of Bad Faith," 3 Bad Faith Law Report 197, 201 (Nov. 1987)]

CONCLUSION

The Texas Supreme Court's anticipated decision in *American Centennial Ins. Co. v. Canal Ins. Co.*, will set the stage for resolving claims handling disputes between excess carriers and primary carriers under Texas law. It will be interesting to see whether the Texas Supreme Court adopts the majority equitable subrogation rule and, if so, whether it specifically rejects the direct duty theory. Conceivably, the Texas Supreme Court could follow the lead of the Michigan, Maryland and Arizona Supreme Courts and leave the direct duty issue open until such time as a case comes before it in which equitable subrogation does not provide an adequate remedy to the excess insurer. ✦

material way. [See *Phillips Petroleum Co. v. Shutts,* 472 US 797, 105 S.Ct. 2965, 86 L.Ed.2d 628 (1985)]

The seminal case in Texas on choice of law in contract cases is *Duncan v. Cessna Aircraft Co.,* 665 SW2d 414 (Tex. 1984). In *Duncan,* the Texas Supreme Court rejected the traditional *lex loci contractus* rules set forth in *Fidelity Mut. Life Ass'n v. Harris,* 57 SW 635 (Tex. 1900) for resolving choice of law issues and adopted the test as set forth in Restatement (Second) of Conflicts of Laws §6. Section 6 provides as follows:

> (1) A court, subject to constitutional restrictions, will follow a statutory directive of its own state on choice of law;
>
> (2) When there is no such directive, the factors relevant to the choice of the applicable rule of law include:
>
> (a) the needs of the interstate and international systems;
> (b) the relevant policies of the forum;
> (c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue;
> (d) the protection of justified expectations;
> (e) the basic policies underlying the particular field of law;
> (f) certainty, predictability, and uniformity of result; and
> (g) ease in the determination and application of the law to be applied.

Under *Duncan,* this test applies in "all choice of law cases except those contract cases in which the parties have agreed to a valid choice of law clause." [665 SW2d at 421] *Duncan* also stands for the proposition that choice of law principles will be applied on an issue-by-issue basis, a practice referred to as "depecage," as opposed to a global application to the entire case. *Duncan* indicated that a choice of law decision should be made by issue, stating "the law of the state with the most significant relationship to *the particular substantive issue* will be applied to resolve *that issue.*" [665 SW2d at 421 (emphasis added); see also *Faloona v. Hustler Magazine, Inc.,* 607 F.Supp. 1341, 1352 (N.D.Tex. 1985), aff'd 799 F2d 1000 (5th Cir. 1986), cert.den. 479 US 1088 (1987); *American Home Assur. Co. v. Safeway Steel Products Co., Inc., a division of Figgie Int'l, Inc.,* 743 SW2d 693, 698-701 (Tex.App.–Austin 1987, writ denied); and Restatement (Second) Conflict of Laws §188 comment "d"–"Each issue is to receive separate consideration if it is one which would be resolved differently under the local law of two or more of the potentially interested states"]

Section 6 of the Restatement (Second) of Conflicts of Laws, adopted and applied in *Duncan,* is composed of two parts, 6(1) and 6(2). According to §6(1), if a forum statutory provision would control disposition of the choice of law issue, that statute must be applied, provided the application would not have an unconstitutional effect. Only when no such forum statute exists, or if application of that statute would be unconstitutional, should the "interest-analysis" set forth in §6(2) be applied. [See *American Home Assur. Co. v. Safeway Steel Prods, Co., Inc., a division of Figgie Int'l, Inc.,* 743 SW2d 693, 697 (Tex.App.–Austin 1987, writ denied) and Restatement (Second) Conflicts of Laws §6 comment "a"]

APPLICATION OF ARTICLE 21.42

Texas Insurance Code Article 21.42 provides the statutory directive for Texas courts considering choice of law issues relating to insurance contracts. In accordance with §6(1) of the Restatement (Second), Texas courts must first consider Article 21.42 in determining the choice of law issue. Article 21.42 provides as follows:

> Any contract of insurance payable to any citizen or inhabitant of this state by any insurance company or corporation doing business within this state shall be held to be a contract made and entered into under and by virtue of the laws of this state relating to insurance and governed thereby, notwithstanding such policy or contract of insurance may provide that the contract was executed and the premiums and policy (in case it becomes a demand) should be payable without this state or at the home office of the company or corporation issuing the same.

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Article 21.42 thus sets forth a two-prong test: First, the contract of insurance must be payable to a citizen or inhabitant of Texas. Second, the insurance company making the payment must be doing business in Texas. If this test is met, Texas law will govern the contract.

Payable to any Citizen or Inhabitant of Texas

This first prong appears to be met under either of two circumstances. First, it is clearly met when the proceeds are payable to the insured, who is a Texas resident or citizen. Second, because the statute does not limit payment to "insureds," this prong is met when the beneficiary is a Texas resident or citizen.

Several opinions support the proposition that the insured need not be a Texas resident so long as the beneficiary is a Texas resident when the proceeds are payable. For example, *Zorn v. Aetna Life Ins. Co.*, 260 F.Supp. 730 (E.D.Tex. 1965), aff'd 368 F2d 1013 (5th Cir. 1966), involved a group life contract, the master policy of which was issued to an Oklahoma insured. In *Zorn,* the court determined that Article 21.42 required the application of Texas law because "the plaintiffs . . . the named beneficiaries in the policy, were residents of the state of Texas at the time any rights they may have to payment under the proceeds of the policy accrued . . ." [*Id.* at 732; see also *General Am. Life Ins. Co. v. Rodriguez,* 641 SW2d 264 (Tex.App.–Houston [14th Dist.] 1982, no writ); *Rockwood Ins. Co. v. Williamson,* 596 F.Supp. 1524 (N.D.Tex. 1984)]

American Home Assur. Co. v. Safeway Steel Products Co., 743 SW2d 693 (Tex.App.–Austin 1987, writ denied), the most recent Texas state case construing Article 21.42, required the application of Texas law to two liability insurance contracts because "at the moment the Texas juries . . . returned a verdict legally obligating [the insureds] to pay the respective plaintiffs certain sums . . . both insurance policies became 'payable' under their own terms." [743 SW2d at 697] (The Fifth Circuit recognized the apparent "boot-strapping" tendency of this statute: "First, in order to apply the statute, we must determine the very issue which application of the statute is intended to resolve . . . [w]e cannot determine if the policy here is a 'contract of insurance payable to any citizen or inhabitant of [Texas]' without first deciding who the beneficiary is." [*New York Life Ins. Co. v. Baum,* 700 F2d 928, 933 (5th Cir. 1983)].) Although in *American Home* the court does not expressly state the determining factor is the plaintiff-beneficiary's citizenship, the context of the court's opinion makes this clear: The policies were issued to insureds whose principal places of business were located outside of the state of Texas, whereas both plaintiffs were apparently Texans. [See also *Gulf Ins. Co. v. Plasky,* 326 SW2d 216 (Tex.Civ.App.–Austin 1959), rev'd on other grounds 335 SW2d 581; and *Hefner v. Republic Indem. Co. of Am.,* 773 F.Supp. 11 (S.D.Tex. 1991)]

American Home, however, was distinguished by the Fifth Circuit in *W.R. Grace & Co. v. Continental Cas. Co.,* 896 F2d 865 (5th Cir. 1990), another case involving liability insurance. In *Grace,* the nonresident insured settled a lawsuit with a Texas resident and then sought to recover from its insurer. The court seized upon this distinction and found *American Home* inapposite:

> [*American Home*] held that when an insurer paid the claim of a Texas resident but reserved the right to contest coverage with its insurer [sic], art. 21.42 required the application of Texas law . . . We do not belive that the Texas Supreme Court would expand the interpretation of art. 21.42 beyond that broad reading to require the application of Texas law in this case where there has been no payment by the insurer to the Texas resident.

[*Id.* at 883]

Doing Business in Texas

Courts have had more difficulty applying this second prong of Article 21.42. They have struggled with determining whether this prong requires finding a nexus between the insurance contract in question and the insurer's business in Texas. The literal language of the statute does not require such a nexus. However, courts have labored to find one, perhaps based upon constitutional concerns. [See *Aetna Life Ins. Co. v. Dunken,* 266 US 389, 45 S.Ct. 129, 69 L.Ed.2d 342 (1924); but see *Clay v. Sun Ins. Office, Ltd.,* 377 US 179, 84 S.Ct. 1197, 12 L.Ed.2d 229 (1964); *Allstate Ins. Co. v. Hague,* 449 US 302, 101 S.Ct. 633, 66 L.Ed.2d 521 (1981)–*constitutional restrictions* serve to ensure the choice of law is neither arbitrary nor fundamentally unfair; Robert A. Leflar, "The

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Nature of Conflicts Law," 81 Colum.L.Rev. 1080 (1981); see also *International Brotherhood of BIH v. Huval*, 166 SW2d 107 (Tex. 1942)]

Particularly interesting is the treatment the courts have given to group insurance contracts where the master policy was issued to a nonresident but a certificate of insurance was issued to a Texas resident. Early decisions apparently viewed the issuance of the certificate as "doing business in Texas"; see, e.g., *Metropolitan Life Ins. Co. v. Worton*, 70 SW2d 216 (Tex.Civ.App.–Fort Worth 1934) and *Metropolitan Life Ins. Co. v. Wann*, 81 SW2d 298 (Tex.Civ.App.–Fort Worth 1935), rev'd 109 SW2d 470 (Tex. 1937), an approach whereby issuance of the certificate, by definition, related to the insurer's Texas business. [See *Howell v. American Live Stock Ins. Co.*, 483 F2d 1354, 1359, fn. 4 (5th Cir. 1973)–"Texas courts consistently held that when the group insurers issued and delivered the group policy to a Texas beneficiary, the insurer, by the acts of issuance and delivery, was 'doing business' in Texas for the purpose of art. 21.42"] In 1937 in *Boseman v. Connecticut Gen. Life Ins. Co.*, 301 US 196, 57 S.Ct. 686, 81 L.Ed. 1036 (1937), the United States Supreme Court refused to follow that interpretation and held the applicable law to be that of the state where the group contract was *made*.

Immediately after the *Boseman* decision, *Metropolitan Life Ins. Co. v. Wann* went up to the Texas Commission of Appeals. That court, "in deference to" *Boseman*, announced the new rule that, at least with respect to group insurance policies, for Texas law to apply, the insurer must have been doing business in Texas at the time the group policy was issued. [109 SW2d at 472 (Tex. 1937)] Although *Wann* requires no nexus between the "business being done" and the issuance of the certificate, it is narrower than the pre-*Boseman* rule, which required *no* business being done prior to the issuance of the certificate. One court suggested "the possibility that Texas might shrug off the shackles assumed in *Wann* . . . " (*John Hancock Ins. Co. v. Schroder*, 349 F2d 406, 408 (5th Cir. 1965)), but apparently that has not happened. [See *General Am. Life Ins. Co. v. Rodriguez*, 641 SW2d 264 (Tex.App.–Houston [14th Dist.] 1982, no writ); *Zorn*, 260 F.Supp. 730; and *Rockwood Ins. Co. v. Williamson*, 596 F.Supp. 1524 (N.D.Tex. 1984)]

Constitutional restrictions on Article 21.42 were considered in *Austin Building Co. v. National Union Fire Ins. Co.*, 432 SW2d 697 (Tex. 1968), where the Texas Supreme Court held Article 21.42 could not be given "extra-territorial effect" so as to regulate business in another state. In *Austin Building*, a Kansas corporation obtained builder's risk insurance for a Texas corporation through National Union's representative in Kansas. The Kansas corporation agreed to pay and did pay the premiums for coverage on both parties. In a dispute with National Union, the Texas corporation argued that, under Article 21.42, the law of Texas rather than the law of Kansas controlled the interpretation of the insurance policy. The Texas corporation contended Article 21.42 required only that the policy be issued (note that the operative language of Article 21.42 requires the policy be "payable," not "issued") to a citizen of Texas by a foreign corporation doing business in Texas. National Union countered, however, that the insurance contract was made in Kansas with a Kansas corporation and insured a risk located in Kansas. The court held Article 21.42 could not be given extra-territorial effect and that Kansas law was controlling because both the Kansas corporation and National Union's agents contracted in Kansas with regard to virtually every aspect of the policy. [*Id.* at 701]

The Fifth Circuit has elaborated on the *Austin Building* holding somewhat. In *Howell v. American Live Stock Ins. Co.*, 483 F2d 1354 (5th Cir. 1973), the Fifth Circuit, relying on *Austin Building*, refused to apply Article 21.42. The court held Article 21.42 applied "when and only when [the insurance contracts in issue] are made in the course of the [insurance] company's Texas business." [*Id.* at 1359] The court found the insurance contract at issue was not made in the course of the insurer's Texas business because the contract was made and executed in New Mexico, and the object of the insurance policy, a horse, was kept at all times in New Mexico. [*Id.*]

In *Butler v. Mutual Life Assur. Co. of Canada*, 600 F2d 532 (5th Cir. 1979), the Fifth Circuit again refused to apply Article 21.42 to an insurance contract because, although the parties stipulated that the insurer was doing business in Texas during the relevant time period, the policy was not made in the course of the company's Texas business. In making this determination, the court found the following factors relevant: The application for the insurance was signed in Canada; the policy was described as "an Ontario contract"; the document designating the beneficiary was signed in Ontario; the medical examination upon which the policy was predicated took place in Ontario and was conducted by a Canadian medical doctor; and the policy was executed and issued in Ontario. [*Id.* at 534]

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The same result was reached in both *New York Life Ins. Co. v. Baum*, 700 F2d 928 (5th Cir. 1983) and *Singer v. Lexington Ins. Co.*, 658 F.Supp. 341 (N.D.Tex. 1986). In *Baum*, the Fifth Circuit held Article 21.42 applied only when the insurance contract at issue was made in the course of the insurance company's Texas business and that the subject life insurance policy was made in New York for the following reasons: The application for the insurance policy was accepted in New York; the insurance policy was issued in New York; the insurance policy was mailed in New York; the premiums were paid in New York; all the essential documents entitling the beneficiary to payment were to be presented in New York; and all payments under the policy were payable in New York. [*Id.* at 933] In *Singer*, the district court held Article 21.42 was inapplicable to an insurance policy issued to a Texas resident by an insurer when all of plaintiff's dealings with respect to the policy were conducted solely with an Arizona broker; the broker placed the insurance with Lexington in Massachusetts through a London broker; and at no time did the plaintiff or its Arizona broker deal directly with the insurer or the insurer's representative in Texas. [658 F.Supp. at 344]

The Texas Supreme Court, by denying application for writ of error in *American Home Assur. Co. v. Safeway Steel Prod. Co.*, 743 SW2d 693 (Tex.App.–Austin 1987, writ denied), perhaps indicated its intent to broaden the interpretation of Article 21.42 made in *Austin Building, Howell, Butler, Baum* and *Singer*. In *American Home*, the most recent Texas case applying Article 21.42, the Austin Court of Appeals stated with respect to the second prong, "Here both [insurers] were at all times 'doing business' in Texas," and "We have considered and rejected the argument that application of Texas law would in essence regulate business outside of our State." [*Id.* at 697] Unlike *Austin Building, Howell, Butler, Baum* and *Singer*, which carefully analyzed whether the insurance contract was made in the course of the insurance company's Texas business, *American Home* made no effort to find a nexus between the contracts and the insurers' Texas business. Further, the court stated, "The fact that the respective insurance policies were negotiated, executed and premiums paid elsewhere in no way alters the tenor placed on the litigation when the instigating events arose in Texas." [*Id.*]

Interestingly, the *American Home* court went on to engage in a "most significant relationship" analysis, despite its prior conclusion that "Texas has adequate contacts to sustain the choice of forum law under art. 21.42." [*Id.*] Although the court indicated this extensive interest analysis was dicta, this could be construed to mean the additional analysis is expedient to ensure constitutional application of the statute.

MOST SIGNIFICANT RELATIONSHIP

Assuming the statutory requirements of Article 21.42 are not met, the forum court will apply the most significant relationship test as set forth in §6(2) of the Restatement (Second) Conflicts of Law. Although *Duncan* only adopted §6 of the Restatement (Second), the *Duncan* court actually used the Restatement (Second) Conflicts of Laws §188 factors, specifically addressing contract actions, in its §6 analysis. [665 SW2d at 421-422] Section 188(2) of the Restatement (Second) states the following factors should be taken into account when determining which state has the most significant relationship to a contract:

(1) the place of contracting;
(2) the place of negotiation of the contract;
(3) the place of performance;
(4) the location of the subject matter of the contract, and
(5) the domicile, residence, nationality, place of incorporation and place of business of the parties.

Section 188 also instructs that:

These contracts are to be evaluated according to their relative importance with respect to the particular issue and if the place of negotiating the contract and the place of performance are in the same state the local law of this state will usually be applied.

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CHOICE OF LAW IN INSURANCE CASES *CONTINUED*

The 188(2) factors, in addition to any other relevant factors, should be used in conjunction with a §6 interest analysis. The number of contacts with a particular state is not determinative; some contacts are more important than others because they implicate state policies underlying the particular substantive issue. [*Id.* at 421] Consequently, selection of the applicable law depends on the qualitative nature of the particular contact. [*Id.*] Once these contacts have been identified, they should be evaluated according to the policies or "governmental interests," if any, of each state in having its rule applied. [*Id.*]

CONCLUSION

The initial inquiry in a choice of law question involving an insurance contract must begin with Article 21.42. This statutory directive requires the application of Texas law when (1) the contract of insurance is payable to a Texas citizen (or inhabitant) (2) by an insurer doing business in Texas. Of these two tests, however, the second one is somewhat problematic, perhaps because there is no express requirement that there be any connection between the insurance contract and the insurer's Texas business. Yet, because of constitutional restrictions on applying a state's substantive law to an insurer having minimal contacts with Texas, courts have strained to find a nexus between the insurance contract in question and the insurer's Texas business. Although not clearly enunciated by the courts, it appears that the constitutional concern is of overriding importance in determining the application of Texas law under Article 21.42. ✦

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RECENT CASES

IMPACT:

Duty of good faith and fair dealing, owed under joint operating agreement, does not give rise to separate cause of action for breach of that duty.

CITE:

Taylor v. GWR Operating Co., 820 SW2d 908 (Tex.App.–Houston [1st. Dist.] 1991, writ denied).

FACTS:

GWR (operating owner of interest in oil and gas well drilling operation) brought suit against Taylor (nonoperator) in connection with Taylor's alleged refusal to pay his share of costs of drilling a well. GWR sued Taylor, alleging causes of action on a sworn account, breach of contracts, foreclosure of operator's lien, breach of fiduciary duty and conversion. Taylor counterclaimed for overcharging, alleging violation of the DTPA, breach of contract, breach of fiduciary duty and breach of the duty of good faith and fair dealing. The trial court granted GWR's motion for summary judgment with the following findings: (1) A nonoperating interest owner is not a "consumer" within the meaning of the DTPA; (2) an operating interest owner does not owe a nonoperating interest owner a fiduciary duty; and, (3) Texas law does not recognize a duty of good faith and fair dealing under a joint operating agreement. This appeal followed.

The court of appeals first agrees with the trial court that GWR's summary judgment evidence was sufficient to establish as a matter of law that Taylor was not a "consumer" under the DTPA. The court explains that when an operator is a "front man" which incurs debts for the others and which is entitled to reimbursement, the nonoperator is not a "consumer."

The court also agrees with the trial court that a duty of good faith and fair dealing owed under a joint operating agreement does not give rise to a separate cause of action for breach of that duty. Though the court agrees that an operator is obligated to operate the property in good faith because of complete control of operations, the court agrees with a recent Corpus Christi Court of Appeals opinion holding that "parties in a joint operating agreement do not generally owe each other the duty of utmost good faith and fair dealing."

The court ultimately reverses the summary judgment by sustaining Taylor's point regarding the existence of a fiduciary relationship. The court explains that though the question of fiduciary relationship is a question of law, the underlying elements of fiduciary duty are questions for the fact finder. "Because GWR plead that a fiduciary relationship existed between them, and GWR did not disprove it as a matter of law, at a minimum, there is a fact question on that issue."

[**Ed. Note:** For other recent oil and gas cases, see also *Crowder v. Tri-C Resources, Inc.*, 821 SW2d 393 (Tex.App.–Houston [1st Dist.] 1991, n.w.h.)–no special relationship existed between parties to joint operating agreement and agreement for exploration and development of oil and gas interests that would give rise to duty of good faith and fair dealing; and *Dearing, Inc. v. Spiller*, 824 SW2d 728 (Tex.App.–Fort Worth 1992, n.w.h.)–holder of executive rights to lease or develop minerals owed duty of "utmost good faith" to holders of mineral interests]

IMPACT:

An adjusting firm has the same duty of good faith and fair dealing that an insurance company has to a workers' compensation claimant.

CITE:

Natividad v. Alexsis Inc., No. 08-91-00344-CV, SW2d (Tex.App.–El Paso 1992, n.w.h.).

FACTS:

Natividad, while an employee of Revco, sustained accidental injuries in the course of her employment on October 27, 1987 and on June 14, 1988. Both claims were settled following appeals of board awards to the district court. This suit for breach of the duty of good faith and fair dealing and for various other causes of action arising from allegedly improper claims settlement practices was subsequently filed against the workers' compensation carrier, the employer, and Alexsis, Inc., an independent adjusting firm, and Bill Steen, an employee of Alexsis. After settlements were reached with the insurance company and the employer, the claims against Alexsis were disposed of by summary judgment. This appeal followed.

In reversing and remanding the cause to the trial court, the court of appeals holds the duty of good faith and fair dealing which an insurer owes to its insureds should also apply to a company which does not issue insurance policies but does the adjusting of claims for insurance companies. The court explains that though there was no contract between Natividad and Alexsis, and no contract between the employer and Alexsis, there was a contract whereby Alexsis agreed to handle the claims of the employees under the policy of insurance. Though claims were to be paid by the insurance company, the responsibility to see that the claims were properly and timely paid rested upon Alexsis under its contractual obligation to adjust claims. The failure to extend the duty of good faith and fair dealing to independent adjusting firms could allow these firms to create obstacles to prompt payments. Alexsis' employee, however, had no duty of good faith and fair dealing because he did not issue an insurance policy and did [not] contract with the carrier which issued the policy to provide any adjusting services.

[Ed. Note: Though the opinion indicates this is an issue of first impression, see *Wm. H. McGee & Co., Inc. v. Schick*, 792 SW2d 513 (Tex.App.–Eastland 1990), writ granted 34 Tex.Sup.Ct.J. 285 (Jan. 26, 1991) (summarized for Texas Bad Faith Bulletin, Vol. III, Iss. I, p. 20 (TRG Jan. 1991)), and *Hartford Cas. Ins. Co. v. Walker County Agency, Inc.*, 808 SW2d 681 (Tex.App.–Corpus Christi 1991, n.w.h.) (summarized for Texas Bad Faith Bulletin, Vol. III, Iss. IV, p. 24 (TRG Oct. 1991)), and *Vickers v. Gray & Co., Ins.*, 761 F.Supp. 37, 39 (ED TX 1991); *see also* Jose and Carson, "*McGee* and *Hartford*: The Murky Waters of Extending Bad Faith Liability to Nonparties Under an Insurance Contract," Texas Bad Faith Bulletin, Vol. IV, Iss. II (TRG April 1992); and see *GAB Business Services, Inc. v. Moore*, No. 6-91-103-CV, SW2d (Tex.App.–Texarkana 1992, n.w.h.)– jury verdict against independent adjusting firm for unreasonable denial of workers' compensation benefits; issue of whether independent firm owed duty of good faith and fair dealing not raised]

IMPACT:

Collateral estoppel, judicial admissions and judicial estoppel did not bar a suit for breach of the duty of good faith and fair dealing because the underlying workers' compensation case was settled before Texas recognized the existence of the duty of good faith in the handling of workers' compensation claims.

CITE:

Mroz v. United States Fire Ins. Co., No. B14-90-00833-CV, SW2d (Tex.App.–Houston [14th Dist.] 1992, n.w.h.).

FACTS:

On February 22, 1987, the court entered a judgment pursuant to a settlement agreement in Mroz's workers' compensation case. Shortly thereafter, Mroz filed this cause of action against the insurance company for breach of the duty of good faith and fair dealing. Summary judgment was rendered for the insurance company on the grounds of collateral estoppel, judicial admissions and judicial estoppel.

In reversing the summary judgment, the court of appeals holds the supreme court's opinion in *Marino v. State Farm Fire & Cas. Ins. Co.*, 787 SW2d 948 (Tex. 1990) is controlling. Because at the time the judgment was rendered in Mroz's underlying compensation case, Texas had not recognized a cause of action against an insurer for breach of the duty of good faith and fair dealing in the handling of a workers' compensation case, Mroz's bad faith claim is not barred by collateral estoppel, judicial admissions and judicial estoppel.

IMPACT:

Amended pleading alleging breach of the duty of good faith and fair dealing "relates back" to time of filing of original petition for breach of contract and prevents this amended claim from being barred by statute of limitations.

CITE:

Long v. State Farm Fire & Casualty Co., No. 01-91-00526-CV, SW2d (Tex.App.–Houston [1st Dist.] 1992, n.w.h.).

FACTS:

On November 8, 1984, Long brought a breach of contract suit against State Farm, asserting State Farm had wrongfully denied Long's claim for coverage after two fires destroyed his home. State Farm denied Long's claim on November 23, 1983. Nearly three years later, on July 7, 1984, Long amended his original petition to include claims for violations of the DTPA and the Insurance Code and for breach of the duty of good faith and fair dealing. The trial court bifurcated the case, and

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a jury held State Farm breached its contract by wrongfully refusing to pay Long's claim. The trial court then granted State Farm's motion for summary judgment on the remaining claims on the ground the claims were barred by the statute of limitations. This appeal followed.

In reversing and remanding the judgment, the court first notes Long's Insurance Code cause of action was timely filed because the applicable limitations period was the four-year limitations period in effect on November 23, 1983 when State Farm denied Long's claim for coverage, rather than the current two-year limitations period.

The court next finds Long's DTPA claims were timely filed because of the doctrine of "relation back." In other words, Long's DTPA claims were not barred by the statute of limitations because the DTPA claims were based upon the same transaction or occurrence as his cause of action for breach of contract which was contained in Long's original petition.

Finally, the court notes a two-year statute of limitations applies to an action for breach of the duty of good faith and fair dealing. Since the cause of action accrues when the claim for coverage is denied, the claim in this case is barred unless "relation back" applies. The court ultimately holds that Long's amended pleading, asserting breach of State Farm's duty of good faith and fair dealing, relates back to the time of the filing of Long's original petition. "This claim does not arise from a wholly new, distinct, or different transaction or occurrence."

[**Ed Note:** See also *Guajardo v. Liberty Mut. Ins. Co.*, No. 13-91-354-CV, SW2d (Tex.App.–Corpus Christi 1992, n.w.h.)–amended petition alleging "bad faith" related back to the filing date of the original petition and was within the two-year limitations period]

IMPACT:

The relation between attorney and client is highly fiduciary in nature, and their dealings with each other are subject to the same scrutiny as a transaction between trustee and beneficiary.

CITE:

Perez v. Kirk & Carrigan, 822 SW2d 261 (Tex.App.–Corpus Christi 1991, n.w.h.).

FACTS:

Perez was employed by Valley Coca-Cola as a truck driver when he was involved in an accident with a school bus. On the morning of the accident, Perez attempted to stop his truck at a stop sign along his route, but the truck's brakes failed to stop the truck, which collided with the school bus. The bus was knocked into a pond and 21 children died. Perez was hospitalized. While in the hospital, Perez was visited by Kirk & Carrigan, lawyers who had been hired to represent Valley Coca-Cola. The lawyers told Perez they were his lawyers too and that anything he told them would be kept confidential. Thereafter, Kirk & Carrigan made arrangements for a criminal defense attorney (Connors) to represent Perez. Some time later, Kirk & Carrigan, without telling either Perez or Connors, turned Perez' statement over to the District Attorney's office. Partly on the basis of the statement, a grand jury indicted Perez for involuntary manslaughter. Perez sued Valley Coca-Cola and Kirk & Carrigan on a variety of claims, including breach of fiduciary duty, negligent and intentional infliction of emotional distress, violation of the DTPA and conspiracy to violate article 21.21 of the Texas Insurance Code. The trial court granted summary judgment for defendants and this appeal followed.

In reversing and remanding the cause back to the trial court, the court of appeals holds: (1) Disclosure of the statement to the district attorney may have been a

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breach of the attorneys' fiduciary duty; (2) Perez may have been a consumer under the DTPA; and (3) summary judgment was erroneously entered on the Insurance Code civil conspiracy claim. Specifically, with regard to the breach of fiduciary duty claim, the court explains the "relation between attorney and client is highly fiduciary in nature, and their dealings with each other are subject to the same scrutiny as a transaction between trustee and beneficiary." The relationship between an attorney and client is "one of most abundant good faith requiring absolute and perfect candor, openness and honesty, and the absence of any concealment or deception."

IMPACT:

Local recording agent and agent's secretary did not have the authority to bind the insurer to post-loss coverage representations after cancellation of an automobile policy for failure to pay premiums.

CITE:

Mid Century Ins. Co. v. H & H Meat Products Co., Inc., 822 SW2d 747 (Tex.App.–Corpus Christi 1992, n.w.h.).

FACTS:

Ramirez purchased a six-month auto liability insurance policy from Mid Century (a Farmers Insurance Group company) effective September 1, 1981. After making two premium payments, Ramirez failed to pay for the following two months and was sent notice of cancellation effective December 31, 1981. On January 11, 1982, Ramirez' fiancee, also covered by the policy, was involved in an accident with an H & H Meat Products truck. Ramirez contacted a Farmers Insurance representative whose name she found in the phone book. Though the agent was not in his office, the agent's secretary told Ramirez, "Don't worry about it. You have insurance, you're covered; it's just going to take time to process it." Ramirez also spoke with another unidentified Farmers representative who assured her of coverage. Vasquez, Ramirez' fiancee, assigned the claim he presumed he had against Mid Century to H & H, and H & H sued Mid Century to recover under the policy. A jury found Mid Century waived its right to cancel the subject insurance policy and this appeal followed.

In reversing and rendering the case, the court of appeals finds the offices which Ramirez contacted following the accident were offices of Local Recording Agents. The court cites several Texas cases and holds a recording agent has no authority to bind the insurer via statements made after a loss occurs.

IMPACT:

The decision of the Texas Supreme Court recognizing a cause of action for breach of insurer's duty of good faith and fair dealing is to be applied retroactively.

CITE:

Commonwealth Lloyd's Ins. Co. v. Thomas, 825 SW2d 135 (Tex.App.–Dallas 1992, n.w.h.).

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FACTS:

In February 1981, fire destroyed the Thomases' house. Commonwealth was the insurer of the home and its contents. Commonwealth hired Loss Research and Analysis, Inc. (LRA) to investigate the fire. LRA's report concluded arson was the cause of the fire. Commonwealth rejected the Thomases' proofs of loss and informed the Thomases it was "continuing to investigate other apparent policy violations concerning the true origin of the fire." The Thomases sued on the policy and a jury found for the Thomases. The trial court rendered judgment for the Thomases in July of 1983. Shortly after the supreme court rendered its decision in *Arnold v. National County Mut. Fire Ins. Co.*, 725 SW2d 165 (Tex. 1987), the Thomases sued Commonwealth for breach of the duty of good faith and fair dealing. A jury rendered a verdict for the Thomases for $708,800 in actual damages, $2,000,001 in exemplary damages, and $1,000,637.60 in prejudgment interest. Commonwealth timely filed a motion for judgment n.o.v. and a motion for new trial. More than 30 days after the judgment was signed, the supreme court issued its opinion in *Murray v. San Jacinto Agency, Inc.*, 800 SW2d 826 (Tex. 1990). Commonwealth filed an amended motion for judgment n.o.v., asserting the Thomases' claim was barred by the statute of limitations under *Murray*. The trial court denied all of Commonwealth's postjudgment motions and this appeal followed.

In affirming the judgment in all respects except for the award of prejudgment interest, the court of appeals first examines and rejects Commonwealth's argument that the Thomases' claim for breach of the duty of good faith and fair dealing was barred by the statute of limitations. The court notes that at the time the Thomases filed their "bad faith" action, the *Arnold* opinion was controlling and provided that the two-year limitations period on a claim alleging an insurer's breach of the duty of good faith and fair dealing accrues when the underlying insurance contract claims are finally resolved. On April 18, 1990, the *Murray* court held a claim accrues when the insurer wrongfully denies coverage. Under either rule, the Thomases' claim should have been barred by the statute of limitations if the defense had been properly raised. The court holds the point was not preserved for appellate review because Commonwealth's amended motion for judgment n.o.v. was untimely filed. An amended motion to modify, correct, or reform the judgment must be filed within 30 days after the judgment is signed.

The court also rejects Commonwealth's argument that the supreme court's opinion in *Arnold*, which first recognized a cause of action for breach of an insurer's duty of good faith and fair dealing, should not be applied retroactively. The court notes that generally a decision of the supreme court applies retroactively, but considerations of fairness and policy may preclude retroactive application. The court explains that reliance on the former rule is not in issue and the supreme court's opinion in *Arnold* was foreseeable. Because they "can conceive of no policy consideration that 'favors shielding a party from liability for bad faith'," the court holds *Arnold* should be applied retroactively.

In rejecting Commonwealth's insufficiency of the evidence points, the court explains it is not the law in Texas that if there is an issue of fact or conflicting evidence on whether the insurer had a basis for denying its insured's claim, an insurer is not liable for breach of the duty of good faith. Rather, the question is whether or not there is no *reasonable* basis for denying the claim and whether the insurer knew or should have known that there was no reasonable basis for denying the claim.

Finally, the court of appeals holds the trial court erred insofar as it calculated prejudgment interest from May 4, 1981, the date of Commonwealth's denial of the Thomases' proofs of loss. Instead, the court should have calculated prejudgment interest from six months after the cause of action accrued or from November 4, 1981, by following the supreme court's opinion in *Cavner v. Quality Control Parking, Inc.*, 696 SW2d 549, 554 (Tex. 1985).

IMPACT:

Trial court did not abuse its discretion by ordering an insurer to answer interrogatories seeking disclosure of "bad faith" lawsuits filed against the insurer within the past five years in view of evidence the insurer could program its computer to produce the information.

CITE:

State Farm Mut. Auto. Ins. Co. v. Engelke, 824 SW2d 747 (Tex.App.–Houston [1st Dist.] 1992, n.w.h.).

FACTS:

Cheryl Reed sued State Farm for "bad faith" conduct in connection with State Farm's handling of her personal injury claims arising from an automobile accident. In this suit, Reed propounded the following interrogatory to State Farm:

> Identify fully each and every lawsuit filed against you in the past five (5) years involving an allegation of "bad faith," Deceptive Trade Practices, unfair practices in the business of insurance, unconscionable action or course of action, violations of Article 21.22 of the Texas Insurance Code, breach of the duty of good faith and fair dealing, or any violation of any statute, rule or regulation relating to the business of insurance, or any similar claim, state the following:
>
> a) the style, cause number, court, county, and state of the lawsuit;
>
> b) the identity of the person(s) bringing suit against you;
>
> c) the identity of the attorney representing the person(s) who brought suit against you;
>
> d) the nature of the claims against you;
>
> e) the resolution, if any, to such lawsuit (e.g., the type of judgment rendered, the amount of any judgment, or the amount of any settlement);
>
> f) whether or not Dr. Gary C. Freeman had performed independent medical examination in the case.

State Farm objected to the interrogatory on the basis that it was overbroad, burdensome, and harassing. The trial court ordered that State Farm answer the interrogatory and this mandamus proceeding followed.

The court of appeals notes that testimony indicated that the requested information could be computer-generated with proper programming. The court of appeals holds the trial court did not abuse its discretion in ordering State Farm to answer the interrogatory insofar as the order requires State Farm to provide the requested information "for the state of Texas in the form of a computer generated response."

Reed had also propounded an interrogatory requesting the identities of persons involved in complaints about State Farm to the State Board of Insurance. State Farm

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objected to the interrogatory on the basis that it did not keep records of this information and the information could be obtained from public records. Noting that State Farm's representative also testified this information was stored on computer, the court of appeals holds that since it would be less burdensome for State Farm to produce the information than it would be for the plaintiff to search the public records, the trial court did not abuse its discretion in ordering State Farm to answer the interrogatory.

The court of appeals also holds the trial court did not abuse its discretion in ordering State Farm to respond to a series of requests for production. The requests included requests for documents relating to company guidelines and procedures, manuals and training materials used in training State Farm claims handling personnel, and advertisements State Farm had used in Texas in the past five years. The testimony of State Farm's representative in support of sustaining State Farm's objections to these requests included conclusory testimony that "she did not know how the information could possibly be relevant to any issue in the Reed case or how it could lead to the discovery of relevant evidence." The court of appeals finds this testimony insufficient to establish abuse of discretion on the part of the trial court.

Finally, the court of appeals examines Reed's request for the complete claim file for the underlying suit and Reed's request for information regarding the amount of loss reserves that were set aside by State Farm in the underlying suit. State Farm objected to these requests on the basis of the work product privilege. Reed responded that the work product privilege does not protect documents from discovery in litigation separate from the pending litigation. The court of appeals holds that the trial court should have the opportunity to reconsider its rulings in light of the supreme court's opinion in *Owens-Corning Fiberglas Corp. v. Caldwell,* 818 SW2d 749 (Tex. 1991), in which the supreme court held the work product privilege is of continuing duration and materials covered by the work product privilege in one case will not be discoverable in another case.

[**Ed. Note:** The discovery phase is extremely important in litigation involving allegations of breach of the duty of good faith and fair dealing. This case illustrates the type of information plaintiff's lawyers should attempt to obtain through discovery, and also illustrates the importance for defendants of a clear understanding of the rules of discovery (i.e., preservation of objections, proper objections, the *type* and *quality* of testimony required to prove objections).]

IMPACT:

A physician who treats injured workers is not in such close nexus with the injured employees that he is entitled to the same status as a third-party beneficiary to the workers' compensation insurance contract and, as a result, the physician is not owed a common law duty of good faith and fair dealing by the insurance company.

CITE:

CNA Ins. Co. v. Scheffey, No. 6-91-081-CV, SW2d (Tex.App.–Texarkana 1992, n.w.h.).

FACTS:

Scheffey is an orthopedic surgeon whose practice includes treatment of injured workers whose employers provided workers' compensation insurance coverage through CNA. Scheffey claimed CNA employees had falsely informed others that Scheffey had been arrested for selling cocaine, which disparaged Scheffey's professional reputation. Scheffey sued CNA, claiming he was a

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third-party beneficiary and consumer under the policies of insurance that CNA issued to employers; that CNA had exercised bad faith in the settlement of claims and had failed to pay and settle claims which he submitted after treatment of workers whose employers carried workers' compensation insurance with CNA; and that CNA breached its contract of insurance with the insured companies and the companies' workers, which also amounted to a breach of contract with Scheffey. Scheffey also maintained CNA had violated various provisions of the Insurance Code and the DTPA. A judgment for approximately $34 million in damages was rendered against CNA and this appeal followed.

In reversing and remanding the judgment, the court first concludes CNA's defensive evidence regarding Scheffey's claim of injury to reputation was improperly excluded.

Next, with regard to Scheffey's claim of breach of the duty of good faith and fair dealing, the court rejects Scheffey's argument that "as physician of choice to CNA's third-party insureds–the employees of the companies insured by CNA–he is in such close nexus with the injured employees that he is entitled to the same status as a third-party beneficiary to the insurance contract." The court explains "[n]o Texas court has extended the insurer's duty of good faith and fair dealing to persons in Scheffey's position. Scheffey did not have any special relationship with CNA, and he was not a person to whom CNA owed a duty of good faith and fair dealing."

Finally, the court holds Scheffey did not have standing to sue under the Insurance Code. Though a private cause of action under the Insurance Code may be created through incorporation in a DTPA action, Scheffey's cause of action under the DTPA incorporating Article 21.21 was severed before trial. "While whether a private cause of action under Article 21.21 may be maintained (apart from by incorporation in a DTPA action) may be an open question, Scheffey may not maintain a private cause of action under Article 21.21 under the circumstances of this case."

WRIT HISTORIES

Watson v. Allstate Ins. Co., No. 02-90-170-CV, SW2d (Tex.App.—Fort Worth 1992) (on rehearing). The court withdraws those portions of its original opinion which hold that federal law controls the determination of what constitutes the "business of insurance" in causes of action brought under article 21.21, §16 of the Texas Insurance Code. The court also further explains the portions of the original opinion which remain unchanged. For a discussion of the original opinion, see *Texas Bad Faith Bulletin*, Vol. IV, Iss. I, p. 19 (TRG Jan. 1992).