IN THE SUPREME COURT OF TEXAS

No. 05-0832

LAMAR HOMES, INC., PETITIONER,

v.

MID-CONTINENT CASUALTY COMPANY, RESPONDENT

ON CERTIFIED QUESTIONS FROM THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

ON MOTION FOR REHEARING

JUSTICE BRISTER, joined by JUSTICE HECHT and by JUSTICE WILLETT, dissenting.

Since Reconstruction, prompt-payment penalties applied to some insurance claims in Texas, but never to a liability carrier's duty to defend.[1] Now the Court discovers the Legislature accidentally changed all that when it tinkered with the statute in 1991, although no one apparently recognized it at the time. Nor could anyone have done so, as the three words the Legislature added in 1991 ("first-party claim") have never been used by anyone familiar with the insurance business to refer to the duty to defend.

[1] *See State Farm Life Ins. Co. v. Martinez*, 216 S.W.3d 799, 803 (Tex. 2007) (citing statutes).

I would not have reached this question in this case, as the builder's claim here was never one for "property damage" and thus is not covered. But because the Court's answer to this question strays far beyond what anyone in the Legislature could have intended or even foreseen in 1991, I respectfully dissent to the Court's denial of rehearing.

The Texas prompt-payment statutes have never applied to all insurance claims. The 1874 statute (passed shortly after Governor Richard Coke took over the Capitol from former Governor Edmund J. Davis)[2] applied only to life insurance.[3] The 1909 statute (effective for the next 82 years) covered only life, accident, and health insurance claims, though its effort to detail every possible combination thereof made the statute hard to read:

> In all cases where a loss occurs and the life insurance company, or accident insurance company, or life and accident, health and accident, or life, health and accident insurance company liable therefor shall fail to pay the same within thirty days after demand therefor, such company shall be liable to pay the holder of such policy, in addition to the amount of the loss, twelve per cent damages on the amount of such loss together with reasonable attorney fees.[4]

In 1991, the Legislature recodified the statute, raised the interest rate, and omitted the cumbersome list of covered insurance companies:

> In all cases where a claim is made pursuant to a policy of insurance and the insurer liable therefor is not in compliance with the requirements of this article, such insurer

[2] *See* 2 THE NEW HANDBOOK OF TEXAS 195 (Ron Tyler et al. eds., 1996).

[3] Act approved May 2, 1874, 14th Leg., R.S., ch. 145, § 9, 1874 Tex. Gen. Laws 197, 200.

[4] Act of Mar. 22, 1909, 31st Leg., R.S., ch. 108, § 35, 1909 Tex. Gen. Laws 192, 204. Although amended in 1931 and in 1951, the language remained almost identical to the 1909 statute. *See* Act of Apr. 27, 1931, 42d Leg., R.S., ch. 91, § 1, 1931 Tex. Gen. Laws 135; Act approved June 28, 1951, 52d Leg., R.S., ch. 491, art. 3.62, 1951 Tex. Gen. Laws 868, 920.

> shall be liable to pay the holder of the policy . . . 18 percent per annum of the amount of such claim as damages, together with reasonable attorney fees . . . .[5]

But in committee hearings on the proposed bill, objections were raised that this language, without more, could be interpreted to apply even to third-party claims and the duty to defend.[6] Accordingly, before final passage the following definition was added to the bill to limit the statute's coverage:

> "Claim" means a first-party claim made by an insured or a policyholder under an insurance policy or contract or by a beneficiary named in the policy or contract that must be paid by the insurer directly to the insured or beneficiary.[7]

Given this sequence of events, reasonable minds cannot possibly conclude that legislators intended the 1991 changes to extend the prompt-payment statute for the first time to a liability insurer's duty to defend.

While the 1991 statute did not include a more specific definition of "first-party claim," there is no question what "first-party" and "third-party" mean when the subject is "an insurance policy or contract." As the Court concedes, liability policies have always been considered "third-party" policies, while "first-party" has traditionally referred to life, accident, or health claims in which the initial loss was suffered by the insured rather than someone else.[8]

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[5] Act of May 2, 1991, 72d Leg., R.S. ch. 242, § 11.03(a), 1991 Tex. Gen. Laws 1043, 1045 (currently codified as TEX. INS. CODE §§ 542.058, 542.060).

[6] *See* Tex. H.B. 2, 72d Leg., R.S. (1991) (as introduced); *Formal Meeting on Tex. H.B. 2 Before the House Comm. on Insur., Subcomm. on H.B. 2*, 72d Leg., R.S. (March 12, 1991) (statement of Robert Sneed, Texas Ass'n of Life Ins. Officials & Tex. Land Title Ass'n) (Tape 1, Side 2, available from the House media office) (explaining, using title and malpractice insurance as examples, that "[t]he obligation of the insurer is to indemnify and defend. . . . Now that cannot be accomplished within the 30-day period. It's very difficult to try to handle this other than to separate it.").

[7] Act of May 2, 1991, 72d Leg., R.S., ch. 242, § 11.03(a), 1991 Tex. Gen. Laws 1043 (currently codified as TEX. INS. CODE § 542.051(2)).

[8] ___ S.W.3d at ___.

That being the case, the Code Construction Act specifically instructs us to apply the technical or particular meaning customarily used with respect to insurance policies:

> Words and phrases that have acquired a technical or particular meaning, whether by legislative definition or otherwise, shall be construed accordingly.[9]

We cannot adopt a definition of "first-party claim" that those in the insurance industry would not recognize.

We would have to reach the same result were we to look to the Insurance Code as a whole, as the Court also concedes we must do.[10] This is not the only time "first-party claim" appears in the Code. It also appears in the Property and Casualty Insurance Guaranty Act,[11] which clearly does not intend "first-party claims" to include liability policies because it lists them separately:

> "Claimant" means an insured making a first-party claim *or* a person instituting a liability claim.[12]

This provision limits coverage of the Act to the indemnity part (and not the duty-to-defend part) of a third-party policy; elsewhere, the Act expressly authorizes the guaranty association to undertake (rather than reimburse) any duty to defend,[13] and expressly excludes claims for attorney's fees.[14] By

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[9] TEX. GOV'T CODE § 311.011(b).

[10] ___ S.W.3d at ___.

[11] *See* TEX. INS. CODE §§ 462.004(4), 462.201, 462.254(b).

[12] *Id.* § 462.004(4) (emphasis added).

[13] *Id.* § 462.306(a) ("The association shall discharge an impaired insurer's policy obligations, including the duty to defend insureds under a liability insurance policy, to the extent that the policy obligation is a covered claim under this chapter.").

[14] *Id.* § 462.302(c) ("The association is not liable for any other claim or damages against . . . an impaired insurer . . . including a claim for: (1) recovery of attorney's fees . . . .").

redefining the duty to defend as a first-party claim, the Court has undermined the Legislature's design of the Guaranty Act as well.

The Court's definition of "first-party claim" is also at odds with the use of this term in the courts. Courts around the nation uniformly refer to the duty to defend as a "third-party claim."[15] This Court has routinely referred to liability policy claims as arising in a "third-party context."[16] The same year the Legislature amended the prompt-payment statute, the Fourteenth Court of Appeals held that non-lawyers could represent clients in presenting "first-party claims" to insurers,[17] something they surely could not do if the term includes the duty to defend. Even when we have held first-party and third-party claims should be treated the same, we have never before suggested that the two terms overlap.[18]

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[15] *See, e.g.*, *Pension Trust Fund for Operating Eng'rs v. Fed. Ins. Co.*, 307 F.3d 944, 951 (9th Cir. 2002) ("Reliance on cases construing first-party indemnity insurance policies is thus misplaced when evaluating the defense duty."); *A & E Supply Co., Inc. v. Nationwide Mut. Fire Ins. Co.*, 798 F.2d 669, 676 n.8 (4th Cir. 1986) ("An insurer's first-party insurance obligation is its duty to compensate the insured for direct losses within the policy coverage. An insurer's third-party insurance obligation is its duty to defend the insured against claims by another, injured party and to indemnify the insured for losses sustained through such claims."); *Farmers Group, Inc. v. Williams*, 805 P.2d 419, 421 (Colo. 1991) ("When the benefit derives from the insurer's duty to defend the insured against third-party actions, that relationship is characterized as a 'third-party claim.'").

[16] *See, e.g.*, *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, ___ S.W.3d ___ (Tex. 2007) ("[Liability insurer] adds that its only common law duty to [insured] in this third party context was the *Stowers* duty . . . ."); *Rocor Int'l, Inc. v. Nat'l Union Fire Ins. Co.*, 77 S.W.3d 253, 260 (Tex. 2002) ("Nor can we identify a principled basis upon which to draw a distinction between first-party and third-party claims when the insured has been directly injured as a result of its insurer's unfair claim settlement practices."); *Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48, 53 n.2 (Tex. 1997) ("We recently declined to extend the bad-faith cause of action to the third-party context, in which an insured seeks coverage for injuries to a third party.") (citation omitted); *Tex. Farmers Ins. Co. v. Soriano*, 881 S.W.2d 312, 317 (Tex. 1994) ("Significantly, each of these cases involves the insurer's duty to its insured in handling first-party claims. We have never held and do *not* hold today that either of these two standards applies to insurers in responding to third-party claims.") (emphasis in original).

[17] *Unauthorized Practice of Law Comm. v. Jansen*, 816 S.W.2d 813 (Tex. App.—Houston [14th Dist.] 1991, writ denied).

[18] *See, e.g.*, *Rocor Int'l*, 77 S.W.3d at 260.

The common custom and usage of "first-party claim" would of course have to yield if the prompt-payment statute defined it otherwise. But three accompanying parts of the statutory definition explicitly prove that it does not.

First, the statute applies only to claims "that must be *paid* by the insurer."[19] First-party insurers promise to pay life, auto, or health claims, but liability insurers promise only to defend. One can imagine first-party "litigation insurance" that promises to pay an insured for all its litigation costs, but this is not such a policy. This policy promises services, not payment. As its name implies, the prompt-payment statute is limited to insurance claims that must be paid.

Second, claims for reimbursement like the one here are not claims "under an insurance policy or contract,"[20] but a damages claim for breach of contract. Under most liability policies, it is entirely up to the insurer how much it will pay for defense, as it picks the attorney and controls the litigation.[21] Insurers commonly negotiate lower rates with lawyers and law firms in return for frequent business. By contrast, if an insurer wrongfully refuses to defend, it must reimburse reasonable and necessary fees under contract law — an amount often substantially higher than what it would pay "under the policy." Unless the builder's counsel here has agreed to accept the insurer's standard rates, this suit is for something more than payment "under the policy."

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[19] TEX. INS. CODE § 542.051(2)(b) (emphasis added).

[20] *Id*. § 542.051(2)(a).

[21] *See N. County Mut. Ins. Co. v. Davalos*, 140 S.W.3d 685, 688 (Tex. 2004).

Third, the statute applies only to claims "that must be paid by the insurer directly to the insured."[22] An insured whose home has been damaged by wind or fire may demand direct payment under a first-party policy, or may ask the insurer to forward payment to repairmen. But under a third-party liability policy, an insured cannot demand that defense costs be paid to it directly; how defense costs are paid is entirely up to the insurer. This is hardly "a distinction without a difference" as the Court says;[23] the statute is explicitly limited to claims that a policy requires "*must* be paid by the insurer directly to the insured."[24]

Furthermore, the very operation of the statute precludes applying it to the duty to defend here. The prompt-payment statutory deadlines only begin to run from the date "the insurer receives all items, statements, and forms required by the insurer, in order to secure *final* proof of loss."[25] Obviously, there can be no final proof of loss under a liability policy until the underlying case is settled or adjudicated. Without explanation, the Court simply decrees that final proof of loss is unnecessary: the deadlines now run seriatim as each legal bill is received by the carrier.[26] This is liberal creation, not liberal construction.

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[22] TEX. INS. CODE § 542.051(2)(b).

[23] ___ S.W.3d at ___.

[24] TEX. INS. CODE § 542.051(2)(b) (emphasis added).

[25] *Id.* § 542.056(a) (emphasis added).

[26] ___ S.W.3d at ___.

Nevertheless, the Court says we must entirely separate first-party *claims* from first-party *insurance*, even though neither the Insurance Code nor this Court have ever made such a distinction. The Court gives only two reasons.

First, the Court says we must do so because this "more accurately reflects the Legislature's purpose for enacting the prompt-payment statute."[27] In other words, the test for a "first-party claim" is whether penalty interest would encourage insurers to pay faster. This of course proves too much — insurers would probably pay rent, property taxes, and their own contents insurance faster if penalty interest applied, but that does not make any of these a "first-party claim."

Second, the Court says we must focus on whether the claim is for "the insured's own loss."[28] But this again proves too much. At the moment an insurer rejects coverage under a liability policy, the insured has suffered no loss; it simply may have to pay things (defense costs or a judgment) in the future. If an insured suffers its "own loss" by paying defense costs, surely it would do the same when it pays the underlying claim. Thus, by the Court's logic an insured can convert *everything* in a third-party policy into a "first-party claim" by simply paying it. This effectively strikes "first-party claim" completely from the statute.

Recognizing as much, the Court attempts to fix this last problem by adding something else to the prompt-payment statute that it does not contain. The Court redefines "first-party claim" to

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[27] *Id.* at ___.

[28] *Id.* at ___.

include only those that are "in no way derivative of any loss suffered by a third party."[29] And where is this in the Insurance Code? Nowhere. We cannot simply make these things up as we go along.

For its novel, even revolutionary distinction between first-party claims and first-party insurance, the Court has a single citation to Texas law — a footnote in a plurality opinion in *Universe Life Ins. Co. v. Giles.*[30] But there are big problems with the Court's logic here.

First, the plurality opinion in *Giles* made no distinction between first-party claims and first-party insurance. To the contrary, the *Giles* plurality used the two interchangeably:

> We are in the mainstream in recognizing a bad-faith tort in the context of *first-party claims* . . . . Only four state courts of last resort have rejected a tort of bad faith in *first-party insurance* cases.[31]

Far from considering "first-party claims" and "first-party insurance" to be distinct, the plurality in *Giles* obviously considered them to be identical.

Second, *Giles* concerned the boundaries of a bad-faith tort, a common-law claim as to which courts generally define terms as they see fit. We cannot do the same with statutes. No matter how we might define "first party" for our own purposes, the question here is only what the Legislature meant.

Third, the Court's opinion apparently reverses the one point of unanimous agreement in *Giles* — that the tort of bad faith does not apply to claims under a liability insurance policy.[32] In *Maryland Insurance Co. v. Head Industrial Coatings and Services, Inc.*, the court of appeals had found this tort

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[29] *Id.* at ___.

[30] 950 S.W.2d 48, 54 n.2 (Tex. 1997).

[31] *Id.* at 52–53 (emphasis added).

[32] *See id. at* 60 (Hecht, J., concurring in judgment).

applies to all insurance claims, as an insured faces unequal bargaining power whether a loss was initially its own (a first-party claim) or someone else's (a third-party claim).[33] We reversed, holding the tort did not apply to third-party claims because insureds are sufficiently protected by an insurer's *Stowers* duty.[34] *Stowers*, of course, applies to the duty to indemnify but not the duty to defend. As the Court holds the duty to defend is a first-party claim, and as *Stowers* does not apply, it is hard to see how *Maryland Insurance* and the unanimous part of *Giles* survive.

There are many differences between first-party and third-party claims. For one thing, a duty-to-defend claim is construed more broadly than any other insurance claim, as courts tend to apply it not only to covered claims but to potentially covered claims or even claims that are merely artfully pleaded.[35] It is hard to foresee all the consequences that may follow from the Court's effort in this case to mix them together.

Perhaps it is a good idea to penalize insurers that refuse to defend a claim like the one here — one that most state courts have held the standard CGL policy does not cover. But this is a decision for the people of Texas to make through legislative proposals and debate, not for this Court to make out of whole cloth. Because the Court gives the prompt-payment statute a "plain meaning" that would have been news to any legislators reading it when it was passed, I respectfully dissent.

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Scott Brister
Justice

OPINION DELIVERED: December 14, 2007

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[33] 906 S.W.2d 218, 226 (Tex. App.—Texarkana 1995), *rev'd*, 938 S.W.2d 27 (Tex. 1996) (per curiam).

[34] 938 S.W.2d at 28–29; *see also G.A. Stowers Furniture Co. v. Am. Indem. Co.*, 15 S.W.2d 544, 547 (Tex. Comm'n App. 1929, holding approved).

[35] *GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church*, 197 S.W.3d 305, 310–11 (Tex. 2006).