

The Defense Chronicles

A Newsletter Update from Thornton, Biechlin, Segrato, Reynolds & Guerra, L.C.

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Internet Updates

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NO DUTY TO DEFEND OR INDEMNIFY FOR NEGLIGENT MISREPRESENTATIONS MADE BY INSURED WHO WAS DEFRAUDED BY THIRD PARTY

Federal Insurance Company v. Ace Property & Casualty Company, ___ F.3d ___, 2005 WL 2687196 (5th Cir. (Tex.) October 21, 2005).

In this coverage dispute between two insurance companies, Federal and Ace, the issue was whether Ace had a duty to defend or to indemnify its insured, Electronic Data Systems Corporation (“EDS”), in a lawsuit arising out of negligent misrepresentations allegedly made by EDS. The Fifth Circuit Court of Appeals ultimately held no coverage existed for EDS under its CGL policies with Ace because there was no “occurrence” within the meaning of the policies.

EDS, a global technology services company that regularly provided computer and electronic services for the North Atlantic Treaty Organization (“NATO”), started doing business with someone who identified himself as “Colonel West.” Colonel West told EDS that he was in charge of a covert NATO procurement project that would involve the purchase of sophisticated electronic equipment with expenditures of eighty to one hundred billion dollars, and Colonel West engaged EDS to become general contractor of that endeavor. In turn, EDS invited Akai Musical Instrument Corporation and Pioneer New Media Technologies, Inc. to bid on the project. EDS represented to Akai and Pioneer that the bidding process required them to ship sample products to NATO representatives, who would have the right to destroy the products as part of their testing procedures. Relying on EDS’s representations, and hoping they would be chosen as providers who would reap profits in the billions of dollars from the NATO project, Akai and Pioneer signed “Test to Destruction Authorization Agreements” and shipped property worth millions of dollars – supposedly to NATO representatives.


After shipments had occurred over the course of three years, EDS, Akai, and Pioneer discovered that the NATO operation was a fraud perpetrated by Colonel West, who was neither a military officer nor affiliated with NATO. The equipment shipped by Akai and Pioneer was not received or used by NATO personnel, but was used or sold by Colonel West for commercial purposes for his private gain. Thereafter, Akai, and Pioneer sued EDS for negligent misrepresentations regarding the fraudulent scheme. EDS called on Ace to provide its defense, but Ace refused, asserting the alleged misrepresentations to Akai and Pioneer were not “occurrences” under the CGL policies. EDS eventually settled the underlying lawsuit, and its excess professional liability insurance carrier, Federal, paid the defense and indemnity costs in excess of EDS’s deductible.

Asserting subrogation rights, Federal brought this lawsuit against Ace, seeking declaratory relief and damages of more than five million dollars because

of Ace's allegedly wrongful refusal to defend or cover the claims in the underlying lawsuit.

The CGL policies provided that Ace would "pay those sums that the insured becomes legally obligated to pay as damages because of . . . 'property damage' to which this insurance applies." "Property damage" caused by an "occurrence" was covered. An "occurrence" was defined in the policies as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." The term "accident" was not otherwise defined in the policies.

The trial court ruled in Ace's favor, concluding that the negligent misrepresentations did not constitute an "accident" and, therefore, were not an "occurrence" under the CGL policies. Federal appealed.

The Fifth Circuit affirmed the trial court's ruling. Relying on Texas Supreme Court precedent, the Fifth Circuit held that "none of EDS's conduct nor any of its alleged omissions was an 'accident' within the meaning of the policy." The Fifth Circuit reasoned, "EDS fully intended and expected that the property shipped by Akai and Pioneer would never be returned to [Akai and Pioneer] . . . the fact that EDS was mistaken about the true use to which the property would be put and was unaware of the scam being perpetrated upon it when it made representations to Akai and Pioneer does not render EDS's conduct an accident." 


UNDER PROFESSIONAL LIABILITY, CLAIMS-MADE POLICY, NOTICE TO INSURER OF CLAIMS AGAINST MEDICAL PRACTICE GROUP'S PHYSICIANS DID NOT CONSTITUTE NOTICE OF CLAIM AGAINST MEDICAL PRACTICE GROUP

First Professionals Insurance Company v. Heart & Vascular Institute of Texas, ___ S.W.3d ___, 2005 WL 2438527 (Tex. App. – San Antonio October 5, 2005).

The issue in this lawsuit was whether, under a claims-made policy, timely notice of separate claims made against two physicians practicing in the same medical group constituted timely notice of a claim against the medical group.

The medical group, Heart & Vascular Institute of Texas, bought a claims-made policy from First Professionals Insurance Company. Heart & Vascular was the named insured under the policy, and physicians in the group were listed as additional insureds. During the policy period, First Professionals received notice from two of the medical group's doctors in the form 4590i letters – letters the physicians had received from the attorney for a medical malpractice claimant – asserting claims against the doctors regarding the medical care they provided. Subsequently, and also during the policy period, the claimant filed a lawsuit against the doctors, alleging they provided negligent medical care. The suit also named the medical group as a defendant based only on vicarious liability for the acts of its doctors. First Professionals did not receive notice from the medical group of service of the lawsuit on it until shortly after the policy period, so, while it assumed the defense of the two doctors, First Professionals denied the medical group's request for a defense against the lawsuit.

The medical group filed suit against First Professionals, seeking a declaratory judgment that the insurer had a duty to defend the medical group in the underlying lawsuit, and arguing the 4590i letters constituted notice to First Professionals of a claim against the medical group. The trial court declared First Professionals had a duty to defend the medical group. First Professionals appealed.

The San Antonio Court of Appeals reversed, holding, "[b]ecause no claim was asserted against Heart & Vascular in the 4590i notice letters sent to [the two doctors], the notice provided to First Professionals regarding those letters was not notice of a claim against Heart & Vascular." 

POLICY DID NOT REQUIRE INSURER'S APPROVAL OF LIFE INSURED'S REQUEST TO CHANGE BENEFICIARY

State Farm Life Insurance Company v. Martinez, ___ S.W.3d ___, 2005 WL 1981439 (Tex. App. – Waco August 17, 2005).

This case involved a dispute over the proceeds of a life insurance policy and the issue of the effectiveness of a policy owner's change of beneficiary shortly before he died. Ed Martinez owned a

\$500,000 life insurance policy with State Farm. After his death, Mr. Martinez's widow, daughter, and ex-wife claimed the proceeds of the policy. His widow filed suit against State Farm. State Farm then filed a separate interpleader suit against the widow, ex-wife, and daughter, and both of those lawsuits were consolidated.

After Ed and Linda (ex-wife) were married in 1981, Ed obtained the life insurance policy, designating Linda as the beneficiary. When they divorced in 1994, their Agreement Incident to Divorce ("AID") required Ed to make monthly alimony payments to Linda of \$5,000, and to designate Linda as primary beneficiary on his life insurance policy to cover the alimony in the event of Ed's death. Ed so designated Linda in 1994, "in accordance with divorce decree dated 09-15-1994." Ed married Toni (widow) in 1996 and on August 1, 2002, he signed and sent to State Farm a Change of Beneficiary form naming Toni as primary beneficiary.

With regard to a change of beneficiary, Ed's State Farm policy read:

Change of Beneficiary Designation. You may make a change while the Insured is alive by sending us a request. The change will take effect the date the request is signed, but the change will not affect any action we have taken before we receive the request. We have the right to request your policy to make the change on it.

Request. A written request signed by the person making the request. Such request must be sent to us and be in a form acceptable to us.

In a letter dated August 16, 2002, State Farm wrote Ed, stating, "[w]e received a request to change the beneficiary on the above mentioned life insurance policy. We are unable to process this request since it is prohibited by the insured's divorce decree dated 9/15/94." Days later, on August 25, 2002, Ed died. At the time of his death, he was still obligated to pay alimony to Linda for two years.

Following Ed's death, Ed's daughter (Lisa), ex-wife, and widow each filed an application with State Farm to receive the proceeds of Ed's life insurance policy. In addition to seeking the policy proceeds, Ed's widow (Toni) also sought statutory penalties under Article 21.55(prompt

payment of claims provisions) of the Texas Insurance Code, attorney's fees, and prejudgment interest. The trial court held that Toni (widow) was the beneficiary, subject to a constructive trust on the portion of the policy proceeds for the amount of alimony unpaid to Linda (ex-wife). Ed's daughter (Lisa) and State Farm appealed.

On appeal, State Farm and Lisa argued Ed's August 1, 2002, change of beneficiary request to Toni was ineffective because it did not comply with the divorce decree and because State Farm rejected the request.

The Waco Court of Appeals disagreed, and affirmed the trial court's judgment. The appeals court held, pursuant to the express language of the policy regarding changing beneficiary designations, "Ed's designation of Toni as the beneficiary was effective on the date that Ed signed the request, subject to Linda's interest in the policy proceeds to the extent that they serve as security for the monthly alimony payments owed by Ed's estate." The policy did not require any acceptance by State Farm of the request. And relying on the trial court's

finding that State Farm did not pay Toni within 60 days, the appeals court affirmed the award under Article 21.55 of statutory penalties, attorney's fees and interest to Toni because "State Farm's refusal to accept Ed's August 1, 2002, beneficiary change to Toni was 'unreasonable' and that State Farm 'should not have had any reasonable doubt' that Toni was the primary beneficiary." 📖

AUTOMOBILE ACCIDENT CLAIMANT COULD NOT COLLECT HER DEFAULT JUDGMENT FROM LIABILITY INSURER FOR OTHER CAR'S OWNER AND DRIVER DUE TO FAILURE OF INSUREDS TO GIVE PROMPT NOTICE OF LOSS

Villarreal v. Texas Farmers Insurance Company, 2005 WL 2138174 (Tex. App. – San Antonio September 7, 2005)

This lawsuit confirms the validity and enforceability of the "notice of loss" provision in an automobile liability policy.

After Virginia Villarreal was injured in an automobile accident, she obtained a default judgment against the driver of

the other car and its owner. After the trial court's plenary power over the default judgment had expired, Villarreal served notice of the judgment on the insurer for the other car's driver and owner – Farmers – and filed this lawsuit asserting she was a third-party beneficiary of, and entitled to recover under, the insurance contract pursuant to *Allstate Insurance Company v. Watson*, 876 S.W.2d 145, 150 (Tex. 1994). Farmers moved for summary judgment on the basis that its insureds (the other car's owner and driver) breached the "notice of loss" provision by failing to give Farmers prompt notice that a suit had been filed against them, they had been served with citation, or that a default judgment had been rendered against them. Villarreal argued, among other things, the notice of loss provision was void as against public policy. The trial court granted summary judgment to Farmers. Villarreal appealed.

The San Antonio Court of appeals affirmed, stating, the "[notice of loss] provision has been upheld under established Texas law for too long for this Court to now hold it is void as against public policy." 📖

- Richard C. Harrist

The Counselor Is In: Richard J. Reynolds, III



Richard J. Reynolds, III is the managing partner of Thornton, Biechlin, Segrato, Reynolds & Guerra, L.C.; based out of the San Antonio office, Rich oversees the four branches, comprised of 36 attorneys and 78 staff members,

combined. In addition to operating the firm as a successful business; addressing administrative issues; attending birthday luncheons; and volunteering at pro bono events, he also has an active legal practice. Although his forte is legal and professional malpractice, Rich is well versed and knowledgeable in all areas of the law. Keeping abreast of current events and issues, as well as taking the time to personally know each attorney as an individual, cognizant of his/her strengths, better enables Rich to assign lawsuits within the firm, thereby providing clients with the most capable and experienced lawyer for their particular case.

Within the same 24 hour confines as the rest of us, Rich has a life, separate and apart from his day job. Originally from New Jersey, Rich moved to Texas after high school, ultimately receiving

his undergraduate degree from Texas Christian University and his juris doctor from St. Mary's University School of Law. Rich has been married to his wife Claire for 26 years; they are the proud parents of three children. While Texas is now considered home, and he follows Longhorn football and the San Antonio Spurs, Rich maintains a steadfast, east coast passion from his youth—the New York Yankees. Time permitting, Rich is an avid golfer and also enjoys snow skiing. 📖

- Mary M. Strauss

The Defense Chronicles is proud to introduce this new section, "The Counselor is In." Each quarterly printing will spotlight a different attorney, offering our readership insight into the real people who are the building blocks of our firm.

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