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## TORT REFORMERS PLAN TO BUILD ON SUCCESS

“Tort Reform” is an ambiguous promise, like “Common Sense” or “Tax Reform.” It always sounds good. The argument for tort reform often goes something like this: Litigation is inherently wasteful, lawyers are congenitally corrupt, the legal system is biased in plaintiffs’ favor, and we had better do something about it or we’ll all be out of business. In reality, the arguments for ideas labeled “tort reform” are not always so clear-cut. Tort reform – depending on the shape it takes – can simply involve shifting risks from one group to another: From defendants to plaintiffs, from doctors to patients, from businesses to governments, or from insurers to the public.

For years, Texas has had a reputation for excessive litigation, and the state still holds several notoriously plaintiff-friendly venues. For this reason, Texas has often served as a sort of laboratory for tort reform. That was certainly true in the mid-1990s, when Governor George Bush and the Texas Legislature collaborated on an extensive tort reform package. Although not unprecedented, that package was one of the broadest the country had seen, and, in retrospect, the most successful.

Bush’s reforms were designed to remove some of the procedural advantages enjoyed by Texas plaintiffs, and to wring some of the perceived excesses from the system. The package, which became effective in September of 1995, modified venue rules, altered joint and several liability law, elevated the standard for recovery of exemplary (i.e. punitive) damages, capped some punitive awards, altered recovery under the Deceptive Trade Practices Act, and made it possible for defendants to recuperate attorney’s fees in suits deemed “frivolous.”

At the time, the punitive damages cap grabbed most of the headlines, followed closely by the provision allowing the award of attorneys’ fees to defendants when plaintiffs filed “frivolous litigation.” These changes answered two of the most widely-perceived problems in Texas courts: Runaway juries and groundless lawsuits. If juries award too much, cap them, the argument went. If attorneys bring bad cases, fine them. These were simple, black-letter solutions.

In retrospect, the punitive damages cap and the “frivolous litigation” penalties have had less impact than other, less-heralded reforms. The Texas Department of Insurance has collected some anecdotal evidence that insurance companies now feel less threatened by punitive damages in Texas, and therefore tend to offer less money during settlement negotiations. However, 1995’s punitive damages cap does not apply in intentional tort cases – the cases where such damages are (and have always been) most likely to be awarded. As one plaintiff’s attorney remarked, “We get very little in exemplary damages, and when we do it usually involves a drunk, or some intentional tort, and the cap doesn’t apply to that.” Simply put, the punitive damages cap responded to a perceived fear of jury excesses that turned out to be, by and large, a mirage. The drunken backhoe operators of the world still face a tough day in Texas courthouses – and they should.

The effect of “frivolous litigation” reform was similarly muted. As a practical matter, judges already had the power to sanction frivolous litigators before 1995. According to one view, 1995’s “frivolous litigation” reform was not so much a true reform as it was a goad, intended to encourage judges to use a power they already possessed. (According to a more jaded view, “frivolous litigation” reform was just an attempt to appeal to voters.) In any case, many judges have proved just as reluctant to use their “new” sanctioning power as they had been before 1995. Motions for Sanctions are sometimes filed in Texas, but they are seldom granted. Again, TDI’s anecdotal evidence suggests that the “frivolous litigation” measures have had little effect.

The blandest of the 1995 reforms turned out to be the most productive. 1995’s changes in venue rules, together with new rules governing joint and several liability, have been a net benefit to defendants. The new venue statute (Chapter 15) requires that most cases be brought in (1) the county where the defendant resides; (2) the county where the defendant keeps its principal office; or (3) the county where the events giving rise to the claim occurred. This amendment put the brakes on traditional venue-shopping. Before 1995, plaintiffs tended to find some reason – any reason – to file their cases in plaintiff-

friendly counties like Hidalgo, Starr, or Jefferson. Such improperly filed suits are now subject to transfer or dismissal. If filed in the proper venue, where juries are often more conservative, many cases have a lower settlement value; small-dollar cases tend to settle for small dollars and marginal cases tend to drop out of the system.

The joint and several liability rules have been equally beneficial to wealthy defendants. In the past, plaintiffs could often use Texas' liberal joint and several liability laws to seek an entire judgment from one defendant, even though several defendants were actually responsible for an injury. This saddled deep-pocketed but peripheral defendants with entire judgments, with no ability to collect a share from defunct or absent co-defendants.

Now, in most cases, a defendant can only be held jointly and severally liable if he is more than 50% liable for the plaintiff's injury. This means that, in suits involving multiple defendants, Defendant 1 cannot be required to pay Defendant 2's portion of a judgment unless the jury determines Defendant 1's "proportionate responsibility" is greater than 50%. Where Defendant 1 is 70% responsible for an injury, the plaintiff can recover its entire judgment from him; where Defendant 1 is 45% responsible, that defendant can only be made to pay 45% of the judgment.

#### THE RESULTS OF THE 1995 REFORMS

Most tort reform advocates believe the 1995 reforms have vastly improved Texas' legal system. Citizens for a Sound Economy, a reform-minded advocacy group co-chaired by Rep. Dick Arney, recently commissioned a study to determine the results of reform. Economist Ray Perryman concluded that the 1995 tort reform package had been profoundly beneficial to consumers: According to Dr. Perryman, consumers realized annual savings in reduced inflation of \$1.796 billion, or \$216 per household. Dr. Perryman further concluded that the reforms were directly responsible for creating nearly 200,000 new jobs in the state, and that far fewer lawsuits were filed as a result of the reforms, relieving over-burdened courts.

The Texas Department of Insurance is equally sanguine about reform. The TDI has estimated that passage of the 1995 tort reform package led to \$2.9 billion in rate reductions from 1996-2000. That meant, in essence, that Texans paid \$3 billion less in insurance premiums over that period than they would have without reform. If the TDI's findings are accurate, tort reform released billions of consumer dollars to be spent on other purchases.

Tort reform is not without its critics, however. The Center for Economic Justice has alleged that insurance companies reaped an additional \$2.8 billion dollars in "windfall profits" during the 1996-1998 period, profits created by a decline in the number and value of lawsuits, while insurance premiums remained relatively high. Few would argue with the contention that insurers benefitted from the reforms. In fact, insurers were among the principal advocates of such reform, and were expected to benefit; the fact that they did so is neither surprising nor a particularly persuasive argument against reforms. The numbers appear to show that *both* insurers and insurance consumers have benefitted from tort reform, as was intended.

#### NEW PROPOSALS FOR REFORM

A second round of tort reforms is now on the table. House Bill 4 – a combination of a traditional tort reform package and a medical malpractice reform package – proposes changes as sweeping as Bush's 1995 reforms. Among other things, the Bill promises to:

- Allow the Supreme Court to hear interlocutory appeals of a trial court's certification of a class in a class action.
- Allow juries to assess fault to all responsible entities, not just those entities made a party to a lawsuit.
- Expand the current 15 year statute of repose applicable to manufacturing equipment to include all products.
- Cap exemplary damages. As proposed, judges, rather than juries, would calculate exemplary damages according to "a formula." This would enable the judge to adjust the actual damages award downward before calculating the maximum amount of exemplary damages – in effect, reducing the amount of exemplary damages.
- Prohibit the award of prejudgment interest on future damages and amend the current parameters for variable post-judgment interest rates to a floor of 5% and a ceiling of 15% in non-health care liability claims.
- Limit the amount of a superseded bond to the amount of compensatory damages awarded in the judgment.
- Allow evidence of the use or non-use of a seat belt to be admissible to the same extent other acts of a plaintiff are admissible under the Texas Rules of Evidence.

In addition, the Bill sets out a solution to a perceived health care crisis, brought on by the increasing cost of physicians' malpractice insurance. These proposed reforms include:

- A \$250,000 per-defendant cap on non-economic damages in health care cases.
- New provisions addressing the payments of future medical expenses and compensation for loss of earning capacity, to wit, periodic payments rather than lump sum payments in cases where the award is \$100,000 or more. If the recipient of periodic payments died, all payments except loss of earnings would cease.
- A limitation on plaintiffs' attorneys contingency fee contracts. The proposed limits are as follows: 40% of the first \$50,000 recovered; 33.3% of the next \$50,000 recovered; 25% of the next \$500,000 recovered; 15% of any additional amount.
- A provision relating to emergency care, including instructions to the jury and changing the burden of proof in cases involving emergency care.
- A 10-year statute of repose on all health care liability claims.
- A provision extending the collateral source rule to include Social Security benefits, workers' compensation payments, accident, health, or sickness policies, and disability insurance. Evidence of these benefits would be admissible; the insurer paying the collateral benefits would be barred from recovering from a claimant.
- A provision allowing the Supreme Court on motion of

any party to assign a more specialized judge to a health care liability claim.

But don't start licking your lips just yet, defense attorneys. While some proposed changes – like preventing plaintiffs from recovering pre-judgment interest on future damages – are sensible amendments that few would contest, opponents say that other aspects of the Bill overreach. The Bill's cap on "pain and suffering" damages in medical malpractice cases has drawn most of the fire, and a litany of plaintiffs' attorneys have gone to Austin to voice their opposition. These opponents argue that jurors, not legislators, are best-placed to determine the value of a limb, loss of speech, or forty years in a wheel chair. It might just be true. Few would be willing to trade their sight for \$250,000 plus lost wages, though the consequences of medical malpractice are sometimes far worse than blindness.

On April 15, Rep. Barry Telford (DeKalb)voiced the concerns of many of the Bill's opponents, writing:

The House debated this legislation for more than a full week before passing it. After listening to the debate and voting on the more than 300 proposed amendments, I chose to vote against the bill. This was not a decision I made lightly; however, in the end, I had to do what I thought was best for my constituents.

Doctors have rightfully demanded that insurance premiums be brought in line, and I strongly believe that the legislature should take action to address the rising cost of premiums doctors are forced to pay; however, H.B. 4 does not do that.

The insurance industry and the business lobby are using Texas doctors to meet their objectives by claiming that frivolous lawsuits are the sole reason that premiums are on the rise. Frivolous lawsuits represent part of the problem, and these suits should be contained; however, this legislation overreaches by closing the courtroom doors to people with legitimate grievances against corporate wrongdoers. Insurance companies have seen their bottom lines diminish as the stock market falls, and they are making up profit losses by raising premiums on their customers. I supported tort reform measures in 1987 and 1995. Both times, the stock market was down and premiums were high. We were told by the insurance industry that premiums would fall after the legislature enacted tort reform legislation. Instead, we have seen the cost of insurance rise steadily.

Such criticism may have the desired effect. The Bill still has to fight its way through the Senate, where it is subject to amendment.

Throughout this week and into the next, we can expect a parade of medical malpractice victims to testify against the Bill's central provision, caps on "pain and suffering" damages. According to one source, Senators are split "about fifty/fifty," with no clear picture of H.B. 4's chances expected before April 25th.

## THE TDI REPORTS ON HOMEOWNERS' INSURANCE RATES

The Texas Department of Insurance believes that Homeowners' Insurance rates are finally leveling off. In a report issued on March 28<sup>th</sup>, the TDI found homeowners' rates had increased by an average of 45% since 2000. While every homeowner in Texas is probably aware of the rate increases, opinions have differed on the cause of the growing cost of homeowners' insurance. Most have pointed at the spate of mold claims filed early in the decade, but others have laid part of the blame at the feet of insurance companies, who were thought to have suffered investment losses in the declining equities market – and to have passed these losses on to consumers.

In 2002, the TDI modified the Homeowners' B (HO-B) form to address the problems caused by an exponential increase in the number of mold claims. Current HO-B policies exclude coverage for mold testing and remediation, wiping future losses off insurers' books. These changes should have relieved some of the upward pressure on homeowners' rates. However, the TDI has determined that homeowners' insurance rates are still high. Therefore, homeowners are now paying more money for less coverage. Why?

The TDI surveyed the rate models and other financial data for insurers comprising more than 87% of the homeowners' insurance market in Texas. As a product of that survey, the TDI determined that the real culprit for continued high prices was a defect in forecasting: Many insurance companies have not yet adjusted their loss trend analyses downward to account for the elimination of mold coverage.

## AROUND THE CIRCUIT

### - VENDOR ENDORSEMENTS

Home Depot contracted to sell rugs manufactured by Beaulieu. Under the agreement, Beaulieu would carry a general liability insurance policy that named Home Depot as

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an additional insured. On October 3, 2000, one of Home Depot's customers was injured when a Beaulieu rug display cabinet tipped over on her. Home Depot requested defense and indemnification under Beaulieu's policy, but Federal Insurance Company denied coverage.

Federal's denial was based on policy language that limited coverage for injuries resulting from Beaulieu's "products." In essence, Federal felt that the rugs in the display cabinet were for "display," not for "sale," and were therefore not used in the "distribution or sale" of Beaulieu "products." In an opinion demonstrating remarkable restraint, Judge Leonard Davis of the Eastern District simply granted Home Depot's Motion for Summary Judgment and ordered Federal to pay for the company's defense and the cost of its (already entered) settlement. Display racks are, apparently, used in the distribution and sale of products. Duh.

**-“PARTICULAR PARTS”**

Southwest Tank, a contractor, was hired to modify a storage tank. While cutting a hole through the tank's steel skin, a fire broke out and the tank exploded. The tank's owner sued Southwest, and Southwest looked to its insurer, Mid-Continent, for defense.

Mid-Continent's policy did not cover property damage to "that particular part of any property that must be restored, repaired or replaced because 'your work' was incorrectly performed on it," but did cover damages to other property that resulted from such work. Since Southwest Tank

had been hired to improve the entire tank, the Court found that the "particular part" exclusion applied to the whole vessel, and therefore all of the damages alleged were excluded under the policy.

**-MORE ON CONTRACTOR LIABILITY**

In *Jim Johnson Homes v. Mid-Continent*, a custom home builder got into a dispute with the home's purchaser during construction. According to the purchaser, the home's foundation was not constructed according to the plans. As a result of the dispute, the builder walked off the site, refusing to complete construction unless the purchaser paid an additional \$17,000. The builder's demand was not met, he removed his equipment, and the purchaser cancelled the contract. When suit erupted, the builder sought defense from his insurer.

The Court recounted the applicable law as uniformly holding "that a liability policy containing [a particular part] exclusion does not insure the policyholder against liability to repair or replace his own defective work or product, but it does provide coverage for the insured's liability for damages to other property resulting from the defective condition of the work, even though injury to the work product itself is excluded." Nevertheless, the Court found that the homeowner's claim against the builder was essentially one for breach of contract. Because the builder's departure from specification could not be termed accidental, it did not qualify as an "occurrence" under the policy. The insurer owed no duty to defend.

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