

## **UNINSURED MOTORIST COVERAGE: THE CHALLENGE OF PUTTING THIRD-PARTY COVERAGE IN A FIRST-PARTY BOX**

By: Catherine L. Hanna and Eric Peabody, *Hanna & Plaut, LLP*

### **INTRODUCTION**

Most everyone knows Saul Steinberg's famous cartoon drawing *View of the World from 9th Avenue*, which appeared on the cover of the March 29, 1976, edition of the *New Yorker* magazine and which has since become a symbol of not only Manhattanites' geocentric perception of life but a metaphor for every commentator's inherent myopia. Like the cartoon, this article could be entitled "A View of Uninsured Motorist Coverage from Texas," because the authors practice in Texas and the impetus for the article comes from a trio of recent Texas Supreme Court cases that address the recovery of attorneys' fees and prejudgment interest in uninsured/underinsured motorist ("UM") cases. See *Brainard v. Trinity Universal Ins. Co.*, 216 S.W.3d 809 (Tex. 2006); *State Farm Mut. Auto. Ins. Co. v. Nickerson*, 216 S.W.3d 823 (Tex. 2006); *State Farm Mut. Auto. Ins. Co. v. Norris*, 216 S.W.3d 819 (Tex. 2006). These cases illustrate the unique tension created by a first-party insurance that depends on third-party tort principles for coverage. Because this tension is universal, the manner in which individual jurisdictions approach these issues – particularly the question of prejudgment interest – says a lot about the jurisdiction's view of UM insurance as a strict first-party or hybrid third-party coverage, which can have an impact on the insurer's extracontractual duties. This article uses Texas as a point of comparison to explore that tension, the approaches various jurisdictions have taken to address it, and some potential repercussions of those approaches.

### **THE CONDITION PRECEDENT: "LEGALLY ENTITLED TO RECOVER"**

UM coverage (which in this article includes underinsured motorist coverage in those jurisdictions where it is available) is designed to pay an insured for damages that the insured would have been "legally entitled to recover" from the negligent owner or operator of an uninsured/underinsured vehicle had that owner or operator had liability insurance. Most UM policies employ the phrase "legally entitled to recover" in their insuring agreements, and most jurisdictions have held that this phrase constitutes a "condition precedent" to coverage. See, e.g., *Pontius v. State Farm Mut. Auto. Ins. Co.*, 915 So.2d 557, 560-61 (Ala. 2005); *Ireland v. Worcester Ins. Co.*, 826 A.2d 577, 579 (N.H. 2003); cf. *National Mut. Ins. Co. v. Hatfield*, 122 S.W.3d 36, 38-39 (Ky. 2003) (construing "damages . . . due by law" under Kentucky UM policy). This condition precedent means that, unlike other first-party insurance, UM coverage utilizes third-party tort law concepts to determine the insured's right to recover under the policy. As in a thirdparty liability case, the insured must prove the fault of the uninsured driver and the damages suffered before any indemnity obligation is triggered. UM insurance therefore creates an adversarial relationship between the insured and UM carrier; even if the UM carrier is prohibited from directly defending the uninsured motorist, the condition precedent allows the carrier to "put the insured to his or her proof" before the contractual duty to pay is triggered.

Because the insured contracts for UM coverage with and receives benefits from his or her own insurer, however, UM coverage has the other hallmarks of first-party insurance. The existence of a contractual relationship has prompted most jurisdictions to hold that, absent an express limitation in the contract or statutory provision to the contrary, the limitations period applicable to contract actions applies to direct actions against a UM insurer. *See, e.g., Shelter Mut. Ins. Co. v. Brooks*, 184 S.W.3d 425, 427-28 (Ark. 2004) (adopting and citing cases for majority position that contract limitations period applies to UM suits); *but see Brown v. Lumbermens Mut. Cas. Ins. Co.*, 204 S.E.2d 829, 833-34 (N.C. 1974) (holding that tort limitations period applied because “action is actually one for the tort allegedly committed” despite the contractual relation between the parties). As discussed *infra*, some jurisdictions also treat UM coverage as first-party insurance for purposes of prejudgment interest and the recovery of attorneys’ fees. Texas has split the difference – while it follows the majority “contract” rule on limitations, the prejudgment interest and attorneys’ fees otherwise recoverable in insurance breach-of-contract cases are not available in UM suits. Instead, Texas allows prejudgment interest to be recovered at the rate and via the method available in third-party tort suits. This position on prejudgment interest and attorneys’ fees puts Texas in line with jurisdictions that strictly construe the condition precedent, acknowledge the adversarial tension created by the condition, and treat UM coverage more like “hybrid” third-party liability insurance. *Compare Quick v. State Farm Mut. Auto. Ins. Co.*, 429 So.2d 1033, 1035 (Ala. 1983) (describing UM coverage as a “hybrid” coverage and the relationship between UM carrier and claimant as “adversarial”) *with State Farm Mut. Auto. Ins. Co. v. Shrader*, 882 P.2d 813, 826-27 (Wyo. 1994) (disagreeing with *Quick’s* descriptions).

## THE VIEW FROM TEXAS: PREJUDGMENT INTEREST AND ATTORNEYS’ FEES

For years, the intermediate Texas appellate courts struggled with the first-party/third-party dichotomy presented by UM coverage. Some courts held that, regardless of the condition precedent to coverage, an insured who was ultimately successful on a UM claim was entitled to recover attorneys’ fees and prejudgment interest available for breach-of-contract actions as in other first-party claims. *E.g., Novosad v. Mid-Century Ins. Co.*, 881 S.W.2d 546, 552 (Tex. App.— San Antonio 1994, no writ) (attorneys’ fees); *Potomac Ins. Co. v. Howard*, 813 S.W.2d 557, 558 (Tex. App.— Houston [14th Dist.] 1991, no writ) (prejudgment interest). Other courts held that these damages were not available because there could be no “breach” of the contract before the claimant satisfied the conditions precedent to coverage. *E.g., Sikes v. Zuloaga*, 830 S.W.2d 752, 753-54 (Tex. App.—Austin 1992, no writ). The Texas Supreme Court resolved this split of authority with its decision in *Brainard v. Trinity Universal Ins. Co.*, 216 S.W.3d 809 (Tex. 2006), which held that: (1) UM claimants are not entitled to recover attorneys’ fees pursuant to the Texas statutory provision that permits recovery of those fees in contract actions; and (2) UM claimants are not entitled to statutory prejudgment interest for breach of contract, but may recover prejudgment interest owed by the tortfeasor within policy limits.

Edward Brainard was killed in a collision with a rig owned by Premier Well Service. In addition to the wrongful death action brought against Premier, Brainard’s family sought UM benefits from their own insurer, Trinity. Trinity had paid \$5,000 in personal injury protection (“PIP”) benefits, but requested further information to support the UM claim. The Brainards joined Trinity in their action against Premier on causes of action for breach-of-contract and common-law and statutory extra-contractual damages.

The Brainards settled their claim against Premier for the \$1 million limits of Premier's policy. Trinity countered the Brainards' demand for its own \$1 million UM limits with an offer of \$50,000. The jury found that Premier's negligence was the sole cause of the accident and awarded the Brainards \$1,010,000 in damages and \$100,000 in attorneys' fees. After offsetting the \$1,005,000 received by the Brainards from Premier's liability insurance and the Trinity PIP benefits, the trial court entered judgment for \$5,000 in damages and awarded the Brainards attorneys' fees but denied prejudgment interest. The court of appeals reversed the award of attorneys' fees but affirmed denial of prejudgment interest.

The Texas Supreme Court held that an insured is not entitled to recover attorneys' fees for its contract action against a UM carrier. To recover under the Texas statute, a plaintiff must show:

- (1) the plaintiff was represented by counsel;
- (2) the plaintiff presented the claim to the defendant;  
and
- (3) the defendant failed to pay the "just amount owed" within thirty days of presentment.

Brainard argued that "presentment" of the "just amount owed" occurred when she made her claim for UM benefits. Trinity countered that UM coverage is fundamentally different from other breach-of-contract cases because the insurer's duty to pay does not arise until the tortfeasor's liability and the insured's damages are established by judgment or agreement. Adopting Trinity's position, the court held that "the UIM insurer is under no contractual duty to pay benefits until the insured obtains a judgment establishing the liability and underinsured status of the other motorist. Neither requesting UIM benefits nor filing suit against the insurer triggers a contractual duty to pay." *Brainard*, 216 S.W.2d at 818. The court further noted that neither a settlement with the tortfeasor nor an admission of liability from the tortfeasor establishes UM coverage because a jury could reach a different decision on fault or damages: "The UIM contract is unique because, according to its terms . . . UIM insurance utilizes tort law to determine coverage." *Id.* Therefore, the court concluded there could be no "just amount owed" or "presentment" under the statute until the insured first obtains judgment.

Consistent with its position on attorneys' fees, the court reaffirmed its earlier holding in *Henson v. Southern Farm Bureau Cas. Ins. Co.*, 17 S.W.3d 652 (Tex. 2000), that the prejudgment interest recoverable in breach-of-contract claims was not available to the Brainards. However, because prejudgment interest in Texas is recoverable in cases of wrongful death, personal injury or property damage, Premier would have been liable for tort prejudgment interest based on the jury verdict. Noting that prejudgment interest has consistently been interpreted to fall within the commonlaw meaning of "damages," the court held that such interest was covered by the UM policy up to policy limits. Rejecting a narrower interpretation of the UM statute and policy offered by Trinity, the court reasoned that allowing recovery of tort prejudgment interest was consistent with both the compensatory nature of prejudgment interest and the legislative intent of protecting conscientious motorists from financial loss caused by financially irresponsible motorists.

With *Brainard* the Texas Supreme Court has recognized UM coverage as “unique” among first-party insurance. In fact, *Brainard’s* holdings with regard to attorneys’ fees and prejudgment interest demonstrate a fairly strict “third-party view” of UM insurance and strict adherence to the conditions precedent to coverage.

### . . . AND BEYOND

In reviewing UM authority from different jurisdictions it is important to bear in mind that the statutory and common-law schemes for the recovery of prejudgment interest and attorneys’ fees vary greatly. Some states provide for the recovery of prejudgment interest only in contract actions; others only in personal injury tort actions; in some jurisdictions the award is mandatory; in others, purely discretionary. Similar variation exists for the award of attorneys’ fees. Despite these differences and the equities involved, however, a court’s treatment of prejudgment interest and attorneys’ fees gives some indication of the balance the jurisdiction strikes in resolving the first-party/third-party tension of UM claims.

Like *Brainard*, several recent decisions from other jurisdictions have held that prejudgment interest is recoverable as an element of damages owed by the tortfeasor and is capped by the UM policy limits. See, e.g., *Parker v. USAA*, — P.3d —, 2007 WL 1289614 (Colo.App. May 3, 2007); *Thurman v. Harkins*, 2005 WL 1215959 (Tenn. Ct. App. May 23, 2005); *Tschaggeny v. Milbank Ins. Co.*, —P.3d—, 2007 WL 1225395 (Utah April 27, 2007). While the triggers of prejudgment interest and methods of calculating this interest differ, the view of prejudgment interest as an element of the damages recoverable from the tortfeasor, not as an element of damages recoverable as a result of the UM carrier’s breach of contract, signals a thirdparty view of UM claims similar to that of *Brainard*.

In contrast, several jurisdictions have taken a stricter first-party view of UM claims and awarded prejudgment interest for breach of contract over and above policy limits. In Alaska, that award is expressly authorized by rule and statute, and the insurer is therefore on notice at the time of policy issuance that prejudgment interest is covered in addition to policy limits. See *State Farm Mut. Auto. Ins. Co. v. Lestenkof*, 155 P.3d 313, 317-18 (Alaska 2007). New Jersey has determined that prejudgment interest can be awarded on top of the full policy limits as an element of the contract claim rather than “damages” recoverable from the tortfeasor. See *Dilley v. Agway Ins. Co.*, 2006 WL 3543020, slip op. at \*4 (N.J.Super.A.D. Dec. 11, 2006) (discretionary award of prejudgment interest “is allowable, not under [rule on tort judgments], but on contract principles”). South Dakota has also adopted a “contract view” with regard to prejudgment interest, and has held that a trial court has discretion to award prejudgment interest on the contract claim from the date of the insured’s demand. *Dakota, Minnesota & Eastern Railroad Corp. v. Acuity*, 720 N.W.2d 655, 663 (S.D. 2006) (also rejecting UM carrier’s argument that no prejudgment interest available until the jury verdict).

The California Supreme Court’s reasoning is emblematic of the first-party view of UM coverage. See *Pilimai v. Farmers Ins. Exch. Co.*, 137 P.3d 939 (Cal. 2006). In *Pilimai*, the court held that the California statute providing for prejudgment interest on rejected settlement offers made “[i]n any action brought to recover damages for personal injury” did not apply to UM claims. 137 P.3d at 947. The insured argued that the action against the UM carrier satisfied the statutory requisites because it sought to recover compensation for personal injury

caused by the uninsured motorist. *Id.* Rejecting this argument, the court held that “even though . . . the insurance policy was compensating plaintiff for personal injuries, the money the insurer owed the insured was not the result of personal injury inflicted by the insurer but of a contractual obligation that the insurer assumed.” *Id.* at 948.

Even when a jurisdiction generally adheres to particular view of UM coverage, confusion can result. In *Miller v. Gunckle*, 775 N.E.2d 475 (Ohio 2002), the Ohio Supreme Court held that prejudgment interest was recoverable pursuant to a statute allowing “[i]nterest on a judgment, decree, or order for the payment of money . . . based on tortious conduct.” *Id.* at 480. While the statute references interest on tort judgments, the court treated the interest as interest recoverable for breach of contract and held that an insured is entitled to recover the prejudgment interest in addition to the damages award, even if the interest exceeds policy limits. *Id.* at 481. A recent decision of an Ohio appellate court called the statutory reference in *Miller* “puzzling” and regarded the citation as dicta since it was inconsistent with prior statements from the Ohio Supreme Court treating UM claims as contract-based for purposes of prejudgment interest. See *Lehrner v. Safeco Ins./American States Ins. Co.*, —N.E.2d—, 2007 WL 589126, slip op. at \*13 (Ohio App. Feb. 23, 2007).

Cases on recovery of attorneys’ fees for UM claims offer similar insights, but are more difficult to classify because the statutory schemes are so diverse. Some jurisdictions do not allow for recovery of attorneys’ fees in breach of contract cases at all, or allow only limited recovery of these fees in cases that do not include UM claims by definition. See, e.g., *Miller v. Allstate Ins. Co.*, 631 So.2d 789, 792 (Miss. 1994) (noting that there is no contractual or statutory authority for granting attorneys’ fees in UM actions). Some jurisdictions mandate the recovery of attorneys’ fees in UM cases. Other jurisdictions, while denying attorneys’ fees for breach of contract, have held nonetheless that the UM claims are subject to prompt payment statutes or consumer protection statutes that provide for the recovery of attorneys’ fees. See, e.g., *State Farm Mut. Auto. Ins. Co. v. Shrader*, 882 P.2d 813, 835 (Wyo. 1994) (prompt payment statute allowed award of attorneys’ fees); *Gaston v. Tennessee Farmers Ins. Co.*, 2007 WL 1775967, slip op. at \*12 (Tenn. Ct. App. June 21, 2007) (consumer protection statute). Therefore, in attempting to divine a jurisdiction’s view of UM claims as first-party or third-party, these decisions may not always be as useful, but still warrant review.

## LOOKING AHEAD – AND BACK TO TEXAS

Taken together, cases on the recovery of attorneys’ fees and prejudgment interest in UM actions provide a barometer of the jurisdiction’s treatment of UM claims as first-party or third-party coverage. This treatment can have significant consequences, particularly for extra-contractual “bad faith” or “prompt payment” liability. In Texas, these extra-contractual causes of action are generally limited to first-party insurance. Based on *Brainard*, one intermediate appellate court has subsequently rejected the application of the Texas prompt payment statute to UM claims. *Mid-Century Ins. Co. v. Daniel*, — S.W.3d—, 2007 WL 414330, slip op. at \*1 (Tex. App.—Amarillo Feb. 7, 2007, pet. denied). *Brainard* may also have an effect on the viability of bad faith causes of action in UM cases. Twenty years ago the Texas Supreme Court first recognized a commonlaw bad faith cause of action in a case for UM benefits. See *Arnold v. National County Mut. Ins. Co.*, 725 S.W.2d 165 (Tex. 1987). Since that time, however, the court has refined the law of bad faith

for failure to pay or delaying benefits to require an accompanying breach of contract. Because *Brainard* holds that the carrier has no contractual duty to pay until the insured satisfies the conditions precedent to coverage, bad-faith-failure-to-pay principles now appear incompatible with UM claims in Texas. States that take a similarly strict view of the condition precedent appear to preclude or severely limit the availability of bad faith causes of action for UM claims. See, e.g., *Pontius v. State Farm Mut. Auto. Ins. Co.*, 915 So.2d 557, 564-65 (Ala. 2005); *Allstate Ins. Co. v. McCall*, 305 S.E.2d 413, 414-15 (Ga. App. 1983) (holding that subjecting UM insurer to bad faith before condition precedent is satisfied “defies logic”).

In sum, the hybrid nature of UM coverage provides a challenge to courts and fertile ground for argument on almost every topic that depends on a contract/tort or first-party/third-party distinction for its resolution. Holdings on prejudgment interest and attorneys’ fees may serve as an indicator of the jurisdiction’s view of UM coverage on the first-party/third-party continuum and a possible predictor on extra-contractual issues the jurisdiction has yet to address.

Catherine L. Hanna, partner, and Eric S. Peabody, senior associate, with the law firm of *Hanna & Plaut, LLP*, focus their practice on insurance coverage and insurance bad faith litigation, including automobile insurance coverage and UM issues. Catherine is a graduate of Stanford Law School. Prior to obtaining his law degree from the University of Texas School of Law, Eric worked in the automobile industry in Germany, Japan, and the United States.