

APPEALS INVOLVING IMPAIRED INSURERS

Presented by

SCOTT P. STOLLEY
Thompson & Knight LLP
1700 Pacific Avenue, Suite 3300
Dallas, Texas 75201-4693
(214) 969-1678
scott.stolley@tklaw.com

Paper by

GRETCHEN NEUSEL
Thompson & Knight LLP
98 San Jacinto Blvd., Suite 1200
Austin, Texas 78701-4081
(512) 469-6100
gretchen.neusel@tklaw.com

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SCOTT P. STOLLEY
THOMPSON & KNIGHT LLP
1700 Pacific Avenue, Suite 3300
Dallas, Texas 75201-4693
(214) 969-1678 (direct dial)
(214) 969-1751 (fax)
e-mail: scott.stolley@tklaw.com

EXPERIENCE

Thompson & Knight LLP, Dallas, Texas (1996-present) (senior partner in the Appellate Practice Group)
Thompson, Coe, Cousins & Irons, L.L.P., Dallas, Texas (1982-95)

EDUCATION

J.D. (with distinction), University of Iowa, Iowa City, Iowa (1981)
B.A. in Sociology (with distinction), Iowa State University, Ames, Iowa (1978)

CERTIFICATIONS & HONORS

Board Certified in Civil Appellate Law, Texas Board of Legal Specialization (1995-present)
Named in a *D Magazine* poll as one of the top five appellate lawyers in Dallas (May 2001)
Fellow, Texas Bar Foundation

BAR MEMBERSHIPS

American Bar Association
State Bar of Texas
Dallas Bar Association
Treasurer, Appellate Section
Texas Association of Defense Counsel
Amicus Curiae Committee (1995-present)
Defense Research Institute
founding editor – Appellate Advocacy Committee newsletter, *Certworthy* (1998-2003)
Bar Association of the Fifth Federal Circuit
SCRIBES – American Society of Writers on Legal Subjects

PUBLICATIONS AND PRESENTATIONS

Author of approximately 20 published articles on legal-writing, appellate, and insurance topics
Speaker at approximately 40 seminars — mostly on legal-writing, appellate, and insurance topics

SELECTED CASES

Provident Am. Ins. Co. v. Castaneda, 988 S.W.2d 189 (Tex. 1999)
Clayton W. Williams, Jr., Inc. v. Olivo, 952 S.W.2d 523 (Tex. 1997)
Maryland Ins. Co. v. Head Indus. Coatings & Servs., Inc., 938 S.W.2d 27 (Tex. 1996)
Golden Spread Council, Inc. v. Akins, 926 S.W.2d 287 (Tex. 1996)
Spencer v. Eagle Star Ins. Co. of Am., 876 S.W.2d 154 (Tex. 1994)
Lyons v. Millers Cas. Ins. Co., 866 S.W.2d 597 (Tex. 1993)
Duer Wagner & Co. v. City of Sweetwater, 2003 WL 21398287 (Tex. App.—Eastland June 18, 2003, no pet. h.)
In re Toyota Motor Corp., 94 S.W.3d 819 (Tex. App.—San Antonio 2002, orig. proceeding)
JHC Ventures L.P. v. Fast Trucking, Inc., 94 S.W.3d 762 (Tex. App.—San Antonio 2002, no pet.)
Dallas County Med. Soc’y v. Ubiñas-Brache, 68 S.W.3d 31 (Tex. App.—Dallas 2001, pet. denied)
Transcontinental Gas Pipeline Co. v. Texaco Inc., 35 S.W.3d 685 (Tex. App.—Houston [1st Dist.] 2000, pet. denied)

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APPEALS INVOLVING IMPAIRED INSURERS

Under the federal bankruptcy code, the filing of a bankruptcy petition effectively stays all judicial proceedings against the debtor. 11 U.S.C.S. § 362(a)(1) (2003). The Texas Insurance Code, which governs insolvent insurance carriers, contains an analogous provision:

All proceedings in which an impaired insurer is a party or is obligated to defend a party in any court in this state, except proceedings directly related to the receivership or instituted by the receiver, shall be stayed for six months and any additional time thereafter as may be determined by the court from the date of the designation of impairment or an ancillary proceeding is instituted in the state, whichever is later, to permit proper defense by the receiver or the association of all pending causes of action.

TEX. INS. CODE ANN. art. 21.28-C, § 17 (2003). This provision, rather than the automatic stay of the bankruptcy code, applies when an insurance company that is involved in a lawsuit is in receivership.

Section 17 is worthy of notice by appellate lawyers because it operates to stay appellate as well as trial level proceedings. *Burrhus v. M & S Mach. & Supply Co., Inc.*, 897 S.W.2d 871, 873 (Tex. App.—San Antonio 1995, no writ) (explaining that the prosecution of an appeal is a “judicial proceeding” and is therefore subject to the section 17 stay). This article focuses on how a section 17 stay affects appellate litigation. It will explain the receivership process in Texas and the role played by the Texas Property and Casualty Insurance Guaranty Association (the “Association”). It will discuss how to obtain a stay and how long the stay will last. It will examine the relationship between section 17 and the Texas Rules of Appellate Procedure. Finally, it will discuss why the stay may not be binding on federal courts.

I. RECEIVERSHIP PROCEEDINGS AND THE TEXAS PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION

Receivership proceedings of insurance companies transacting business in Texas are governed by articles 21.28 and 21.28-C of the Texas Insurance Code. Whenever a court of competent jurisdiction in Texas

determines that a domestic insurer is insolvent, the court will enter an order placing the insurer in receivership and will appoint a receiver to take charge of the insurer’s assets. TEX. INS. CODE ANN. art. 21.28, § 2, art. 28.21-C, § 5(9)(A); *see, e.g., Berkel v. Texas Prop. & Cas. Ins. Guar. Ass’n*, 92 S.W.3d 584, 586 (Tex. App.—Austin 2002, pet. denied). If the insurer is domiciled in another state, and that state has appointed a receiver, the court will institute an ancillary receivership in Texas. TEX. INS. CODE ANN. art. 21.28, § 13; *see Day v. State*, 489 S.W.2d 368, 371 (Tex. Civ. App.—Austin 1973, writ ref’d n.r.e.). The ancillary receiver has the same rights, duties, and liabilities as a domiciliary receiver. *Moody v. State*, 539 S.W.2d 354, 356 (Tex. Civ. App.—Beaumont 1976, writ ref’d n.r.e.). Once receivership proceedings have been instituted, the Commissioner of Insurance will designate the insurer “impaired,” triggering a stay of judicial proceedings under section 17. TEX. INS. CODE ANN. art. 21.28-C, § 5(9)(A), § 17; *see, e.g., Berkel*, 92 S.W.3d at 586; *In re Consolidated Freightways, Inc.*, 75 S.W.3d 147, 150 (Tex. App.—San Antonio 2002, no pet.)

The duties and responsibilities of a receiver in liquidating an insolvent insurance company are comparable to those of a bankruptcy trustee. *Texas Prop. & Cas. Ins. Guar. Ass’n v. Webb*, 2000 Tex. App. LEXIS 905, *3-4 (Tex. App.—Austin Feb. 10, 2000, no pet.). The receiver administers the insurer’s assets in accordance with the court’s direction and the powers granted him or her by the Insurance Code. TEX. INS. CODE ANN. art. 21.28, § 2(a); *Berkel*, 92 S.W.3d at 588. One of the receiver’s responsibilities is to approve or reject claims brought against the impaired insurer. TEX. INS. CODE ANN. art. 21.28, § 3(e); *Berkel*, 92 S.W.3d at 588. Third-party claimants having a cause of action against the impaired insurer’s policyholder may file a claim with the receiver, even if the claim is unliquidated or undetermined. TEX. INS. CODE ANN. art. 21.28, § 3(e); *see Bailey v. Brodhead*, 838 S.W.2d 922, 924 (Tex. App.—Austin 1992, no pet.); *Horton v. State Dep’t of Ins.*, 905 S.W.2d 59, 61-62 (Tex. App.—Austin 1995, no pet.). If the receiver approves the claim, a party may object. *Berkel*, 92 S.W.3d at 588. After notice and a hearing, the receivership court will resolve the disputed claim in the receivership proceeding itself. *Id.* On the other hand, if the receiver rejects the claim, the claimant has three months to file a separate suit against the receiver in the receivership court. There, the issue will be resolved in a trial *de novo*, like an ordinary civil case. *Id.*; *Brodhead*, 838 S.W.2d at 924. “The filing of a claim with [the] receiver is a prerequisite to suing on a

claim against the insolvent insurer.” *Bailey*, 838 S.W.2d at 924.

The Legislature intended article 21.28 of the Texas Insurance Code to operate *in pari materia* with article 21.28-C. *Berkel*, 92 S.W.3d at 588. The latter provision, which created the Texas Property & Casualty Insurance Guaranty Association, was enacted to provide funds for the receiver to draw upon to pay covered claims when the assets of the receivership estate are insufficient. *Id.* The Association is comprised of all property and casualty insurers licensed to operate in Texas. TEX. INS. CODE ANN. art. 21.28-C, § 6. Each of these member insurers is required to contribute money to a guaranty fund, which covers the obligations of insolvent members with respect to statutorily defined “covered claims.” *Id.* § 5(8). For each claim the Association pays in connection with a particular insolvent insurer, it has a corresponding claim against that insurer’s assets. *Webb*, 2000 Tex. App. LEXIS 905 at *1.

Unfortunately for many litigants, however, article 21.28-C does not guarantee full recovery of the amount the insured would have received from its insurer had the insurer remained solvent. *Scherer v. Texas Prop. & Cas. Ins. Guar. Ass’n*, 958 S.W.2d 413, 414 (Tex. App.—Austin 1997, pet. denied). Covered claims are limited to \$300,000. TEX. INS. CODE ANN. art. 21.28-C, § 5(8). Claims exceeding this amount are, by definition, not “covered claims.” *Id.*; *Scherer*, 958 S.W.2d at 414. Also, the following are not considered “covered claims”: (1) attorney’s fees, expenses, court costs, interest and penalties, and interest and bond premiums incurred before the determination that the insurer is impaired; (2) prejudgment and post-judgment interest accruing subsequent to that determination; and (3) claims for the recovery of punitive, exemplary, extracontractual, or bad-faith damages awarded in a court judgment against an insured or insurer. TEX. INS. CODE ANN. art. 21.28-C, § 5(8); *see Berkel*, 92 S.W.3d at 589.

Before 1992, the receiver was responsible for administering, evaluating, and paying claims against the impaired insurer with the money provided by the Association. *Webb*, 2000 Tex. App. LEXIS 905 at *6. The receiver was not required to provide for the defense of the insurer’s policyholders in pending or subsequent litigation. *Id.* In 1991, the receiver’s duties to administer, evaluate, and pay claims transferred to the Association – and in 1993, the Legislature revised article 21.28-C to require the Association to provide a defense to insureds when such a defense would constitute a “covered claim.” *Id.* The Association, then, must provide for the defense of an insured when the impaired insurer would be obligated to do so under the insurance policy, to the

extent that this policy obligation constitutes a “covered claim.” TEX. INS. CODE ANN. art. 21.28-C, § 8(b).

The section 17 stay facilitates the transition of an insured’s defense from the impaired insurer to the Association. *Burrhus*, 897 S.W.2d at 873; *Willard*, 881 S.W.2d at 911. The stay does not affect the substantive rights of a creditor in any way, nor does it take away an aggrieved party’s cause of action. *Willard v. Davis*, 881 S.W.2d 907, 911 (Tex. App.—Fort Worth 1994, no writ). It is simply a procedural delay, providing the association with enough time to access the records of the insurer and to prepare a proper defense. *Id.* It was designed to protect *all* claimants and policyholders from potential financial loss occasioned by the insurer’s impairment; therefore, it may not be waived by a policyholder. *Consolidated Freightways*, 75 S.W.3d at 153.

II. OBTAINING A SECTION 17 STAY

A movant must establish by competent evidence that he or she is entitled to a stay under section 17. Once this has been demonstrated, the stay is mandatory, and the court has no choice but to recognize it. *Willard*, 881 S.W.2d at 911; *In re Wolfe*, 2003 Tex. App. LEXIS 3814, at *3 (Tex. App.—Fort Worth Apr. 30, 2003, no pet.). To establish his or her entitlement to a stay, the movant must demonstrate that the insurer (1) is impaired, and (2) is a party to the lawsuit or is obligated to defend a party. It is not enough to conclusively state that these conditions exist; corroborating evidence must be presented. *See, e.g., Willard*, 881 S.W.2d at 909.

For example, in *In re Wolfe*, the relator petitioned for writ of mandamus, arguing that the trial court had entered several orders while an automatic stay was in effect. 2003 Tex. App. LEXIS at *2. The relator attempted to demonstrate the existence of the stay by proffering a Notice of Automatic Stay of Proceedings filed by the guaranty association. In the notice, the association’s attorney stated that the relator was insured by an impaired insurer. *Id.* at *4. But the relator offered no evidence in the mandamus record that the impaired insurer was obligated to defend the relator in the lawsuit. *Id.* Because the relator failed to establish by competent evidence that he was entitled to a stay, the appellate court denied mandamus relief. *Id.*

In contrast, the mandamus record in *Willard* included oral testimony by the relator that the impaired insurer had defended him up until the time it became insolvent. 881 S.W.2d at 909. In addition, the relator tendered copies of the insurance contract, the Order of Liquidation, and the Order of Impairment. *Id.* The court declared this to be sufficient evidence that the relator was entitled to the stay. *Id.* at 911.

If the insurer is designated impaired during an appellate proceeding, then the insurer or the insured party shall file a motion with the appellate court requesting that it take notice of the impairment designation and impose the stay. *Builders Transport, Inc. v. Grice-Smith*, 63 S.W.3d 822, 823 n.1 (Tex. App.–Waco 2001, no pet.). For example, in *Builders Transport*, the defendant’s insurer was deemed insolvent by a Pennsylvania court while appellate proceedings involving the defendant were underway in Texas. *Id.* at 823. The defendant filed a motion with the appellate court requesting that it take notice of the Pennsylvania court order declaring the insurer to be insolvent and the impairment designation issued by the Texas Commissioner of Insurance. *Id.* The court did so, imposing a stay retroactively to the date of the impairment designation. *Id.* at 824.

III. LENGTH OF THE STAY

Section 17 provides that a stay shall endure for “six months and any additional time thereafter as may be determined by the court.” A six-month stay is mandatory if the movant demonstrates by competent evidence that he or she is entitled to it. *Willard*, 881 S.W.2d at 911. The court has no discretion to refuse the stay or to grant a stay for a lesser period. Unlike a bankruptcy stay, the duration of which is at the discretion of the bankruptcy court, section 17 stays are generally fixed at six months. *Id.*

However, the court in which a delinquency proceeding is pending has the power to extend a stay past the mandatory six-month period. TEX. INS. CODE ANN. art. 21.28-C, § 17; see *Consolidated Freightways*, 75 S.W.3d at 153. An extension may be granted at the request of one of the parties, *Builders Transport*, 63 S.W.3d at 823 n.1, or may come about by the parties’ mutual agreement. See *Tibbetts v. Gagliardi*, 2 S.W.3d 659, 664 (Tex. App.–Houston [14th Dist.] 1999, pet. denied); *Int’l Elevator Co., Inc. v. Garcia*, 73 S.W.3d 420, 422 (Tex. App.–Houston [1st Dist.] 2002, no pet.) (ordering appellant to “notify the Court immediately if the stay is extended”). The purpose of the section 17 stay – to enable the Association to access the records of the impaired insurer and prepare an adequate defense to the lawsuit – presumably factors into the court’s decision to grant an extension.

Unlike the bankruptcy stay of 11 U.S.C.S. § 362, which may be lifted “for cause,” the section 17 stay is mandatory for at least six months. *Willard*, 881 S.W.2d at 911. After six months (or any additional amount of time required by the court), the stay is automatically lifted. Section 17 contains no “cause” provision analogous to that of the bankruptcy code by which a

party could persuade the court to lift the stay before the expiration of the six-month period.

IV. INTERFACE BETWEEN SECTION 17 AND THE TEXAS RULES OF APPELLATE PROCEDURE

A. A section 17 stay tolls the T.R.A.P. deadlines.

Once a movant has demonstrated by competent evidence that an impaired insurer is itself a party or is obligated to defend a party in the appellate proceeding, section 17 calls for a mandatory stay to be issued retroactively to the date of the Commissioner’s impairment designation. Any action taken while the stay is in effect is void. *Builders Transport*, 63 S.W.3d at 823. The stay does not affect the substantive rights of parties on appeal, but does alter the deadlines in the Texas Rules of Appellate Procedure. An understanding of section 17 is therefore important in some appellate contexts. *Id.*; *Int’l Elevator*, 73 S.W.3d at 421.

When a section 17 stay is issued during an appellate proceeding, the time limits are calculated by counting the days from the date a deadline began running up to the present time, excluding the period of the stay. See *Burrhus*, 897 S.W.2d at 875. *Gould v. Sea Link Helicopters, Inc.*, provides an illustration. 982 S.W.2d 29 (Tex. App.–Houston [1st Dist.] 1998), *appeal dismissed*, 1999 Tex. App. LEXIS 2827 (Tex. App.–Houston [1st Dist.] April 8, 1999). The trial court in that case signed a judgment on November 10, 1997. Normally, the parties would have had 30 days from that date to file a notice of appeal. However, the trial court extended the time period by 15 days. Thus, the parties had 45 days from the November 10 judgment, or until December 29 (because of the Christmas holiday), to file a notice of appeal. *Gould*, 982 S.W.2d at 30. On December 22, Sea Link’s insurer was designated impaired, and the section 17 stay kicked in. Since only 42 days had elapsed between the signing of the judgment and the December 22 impairment designation, the court determined that Sea Link still had 3 days after the stay was lifted to timely file its notice of appeal. *Id.* at 31.

B. Section 17 has the same effect on the appellate timetables as Rule 8.2.

Under the new Texas Rules of Appellate Procedure, the filing of a bankruptcy petition suspends appellate proceedings until the appellate court reinstates or severs the appeal in accordance with federal law. TEX. R. APP. P. 8.2. Under Rule 8.2, a document filed during a bankruptcy stay is not considered ineffective, but is instead deemed filed on the day the court reinstates or severs the appeal. *Id.* There is no similar provision with

respect to insurance receivership proceedings. However, at least one court has analogized the section 17 stay to the bankruptcy stay of Rule 8.2, finding them to have an equivalent effect on the appellate timetables. *See Sea Link*, 982 S.W.2d at 31.

It is telling that the interpretation of section 17 changed once Rule 8.2 was enacted in 1997. Before that time, section 17 was construed as invalidating any document filed during a stay. *See Burrhus*, 897 S.W.2d at 873. For example, in *Burrhus*, the court voided a cash deposit filed during a section 17 stay, holding that an appeal could not be perfected by a deposit filed during that period. *Id.* *Burrhus* was decided in 1995, two years before Rule 8.2 came into effect.

In 1998, the First District Court of Appeals of Houston resolved a similar case with different results. By that time, Rule 8.2 had been enacted, and the court relied on that rule to suggest that a notice of appeal filed during a section 17 stay, rather than being struck, would be considered filed on the date the stay was lifted. *See Sea Link*, 982 S.W.2d at 31. The court stated:

[B]y way of analogy, this Court notes that under Tex. R. App. P. 8.2, a document filed by a party while a proceeding is suspended because of the automatic stay under the federal bankruptcy laws, is deemed filed on the same day, but after, the court of appeals reinstates or severs the appeal and is not considered ineffective because it was filed while the proceeding was suspended. Similarly, should *Sea Link* desire to file its notice of appeal now, this Court would consider it to be filed on the date the automatic stay under [Tex. Ins. Code] article 21.28-C, section 17 is lifted.

Id. To date, the Texas Supreme Court has not ruled on this issue. Accordingly, to ensure that an appeal is timely perfected, a party who files a notice of appeal during a stay should always file a second notice immediately after the stay is lifted.

V. EFFECT OF SECTION 17 IN FEDERAL COURT

At least one court has suggested that section 17 may not apply to federal court proceedings. *Jones v. Hoel*, 211 F. Supp. 2d 823 (E.D. Tex. 2002). The *Jones* court examined both the language of section 17 and the McCarran-Ferguson Act in its attempt to determine whether federal courts are bound by section 17 to stay appeals involving impaired insurers. Section 17 calls for

a stay when “an impaired insurer is a party or is obligated to defend a party in any court *of this state*.” According to the *Jones* court, this language could be interpreted as applying only to Texas state courts, or requiring a stay in any court physically located in Texas, including federal courts. *Id.* at 826. The statute then provides that “[a] deadline imposed under the Texas Rules of Civil Procedure or the Texas Rules of Appellate Procedure is tolled during the stay.” No mention is made of the federal rules, indicating that the Legislature intended section 17 to stay only state court proceedings. *Id.* Understandably, the *Jones* court was unable to conclude with certainty from the statutory language that section 17 applies to federal courts. *Id.*

Unable to draw a conclusion from the language of the statute, the court next examined the McCarran-Ferguson Act (“Act”), which provides that:

the business of insurance, and every person engaged therein, shall be subject of the laws of the several States which relate to the regulation or taxation of such business...No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating business, unless such Act specifically relates to the business of insurance.

15 U.S.C.S. § 1012 (2003). The Act was adopted in response to fears of a federal takeover of insurance companies and to restore the power of insurance regulation to the states. *Jones*, 211 F. Supp. at 826. The *Jones* court analyzed section 17 to determine whether it constituted a “regulation of the business of insurance” under the McCarran-Ferguson Act. *Id.* If it did, the federal court would be bound to follow it.

The *Jones* court found that section 17 was not a “regulation of the business of insurance” under the circumstances existing in that case for several reasons. *Id.* at 828. First, the defendant in the lawsuit was a policyholder of an impaired insurer rather than the impaired insurer itself. *Id.* at 827. Second, the court was not being asked to dole out a fixed sum of money, but was instead charged with determining liability and assessing damages. These substantive determinations would be profoundly affected by a section 17 stay. *Id.* Third, there was no parallel state proceeding at which the liability of the policyholder could be determined. *Id.* Fourth, staying the case would severely strain a federal proceeding that related only tangentially to the business of insurance. *Id.* at 828. Fifth, by refusing to enter a stay, the court would not undermine the receivership

action that was pending in another state. *Id.* Finally, the trial date fell outside the time period that would have been encompassed by the stay were it observed. *Id.* For these reasons, the court determined that a section 17 stay would not amount to a “regulation of the business of insurance” in this particular situation.

It is important to note that the *Jones* court’s determination that section 17 may not apply to federal proceedings was carefully limited to the facts presented in that case. The court left open the possibility that section 17 could bind federal courts under different circumstances.

VI. CONCLUSION

The section 17 stay can significantly affect appellate proceedings, particularly appellate timetables. All a party has to do to secure a stay is show that an impaired insurer is itself a party to the litigation or is obligated to defend a party. Once this is established, the appellate court must stay the proceedings for at least six months. The nonmovant’s only potential remedies are to petition the Texas Supreme Court for writ of mandamus, which is not likely to be granted, or to move to sever the insurer from the proceedings. Because the six-month stay is mandatory, and severance may not always be in the best interest of your client, you might have to just sit back, relax, and enjoy the stay.