NO. 02-0730

IN THE SUPREME COURT OF TEXAS

EXCESS UNDERWRITERS AT LLOYD'S LONDON, AND CERTAIN COMPANIES SUBSCRIBING SEVERALLY BUT NOT JOINTLY TO POLICY NO. 548/TA4011F01,

Petitioners,

v.

FRANK'S CASING CREW & RENTAL TOOLS, INC.,

Respondent.

Appeal from the Court of Appeals of Texas, 14th District, Houston No. 14-01-00349-CV

BRIEF OF *AMICUS CURIAE* COMPLEX INSURANCE CLAIMS LITIGATION ASSOCIATION IN SUPPORT OF EXCESS UNDERWRITERS ON REHEARING

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COMPLEX INSURANCE CLAIMS LITIGATION ASSOCIATION'S CORPORATE DISCLOSURE STATEMENT

The Complex Insurance Claims Litigation Association ("CICLA") is a trade association of property/casualty insurance companies. These member companies, and their relationship to publicly owned corporations, are listed below.

1. AIG member insurance companies are wholly owned subsidiaries of AIG, Inc., a publicly held company that is not an insurance company.

2. Chubb & Son, a Division of Federal Insurance Company, is a subsidiary of Chubb Corporation, a publicly held company.

3. Farmers Insurance Group of Companies is a federally registered trade name representing Farmers Insurance Exchange, Fire Insurance Exchange and Truck Insurance Exchange, three California domiciled reciprocal insurers, their respective subsidiaries and affiliates, and the insurers owned by Farmers Group, Inc., a Nevada corporation.

4. The Hartford Insurance Group companies are subsidiaries of The Hartford Financial Services Group, Inc., a publicly held company.

5. Liberty Mutual Group Inc. owns 100% of the stock of Liberty Mutual Insurance Company. LMHC Massachusetts Holdings Inc. owns 100% of the stock of Liberty Mutual Group Inc. Liberty Mutual Holding Company Inc. owns 100% of the stock of LMHC Massachusetts Holdings Inc. No publicly traded entity owns any stock of any of the above-named entities.

6. St. Paul Fire and Marine Insurance Company is a wholly-owned subsidiary of The St. Paul Travelers Companies, Inc., a publicly held company.

7. Selective Insurance Company of America is a publicly held company.

8. The Travelers Indemnity Company and Travelers Casualty and Surety Company, formerly known as The Aetna Casualty and Surety Company, are wholly-owned subsidiaries of Travelers Insurance Group Holdings Inc., which is a wholly-owned subsidiary of Travelers Property Casualty Corp., which is in turn wholly-owned by The St. Paul Travelers Companies, Inc., a publicly held company.

9. Zurich American Insurance Company (hereinafter "ZAIC") is a wholly owned subsidiary of Zurich Holding Company of America Inc., a Delaware corporation. Zurich Holding Company of America, Inc., is a 99.8711%

owned subsidiary of Zurich Insurance Company, a Swiss corporation. (The remaining 0.1289% is owned by ZGA US Limited.) Zurich Insurance Company is a wholly owned subsidiary of Zurich Group Holding, a Swiss Corporation. Zurich Group Holding is owned 43% by Allied Zurich p.l.c. and 57% by Zurich Financial Services. Allied Zurich p.l.c. is a wholly owned subsidiary of Zurich Financial Services. Zurich Financial Services is the only publicly traded parent company, with a primary listing on the Swiss stock exchange and a secondary listing on the London stock exchange, and a further trading of American Depositary Receipts.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

MISCELLANEOUS

INTEREST OF *AMICUS CURIAE*

The Complex Insurance Claims Litigation Association ("CICLA") is a trade association of major property and casualty insurance companies. CICLA members write a substantial percentage of the liability coverage placed in Texas. CICLA members have entered into liability insurance contracts in Texas and throughout the nation. Accordingly, CICLA is vitally interested in the legal issues presented in this case. CICLA appears as *amicus curiae* to assist the Court in determining the standards applicable to an insurer's ability to seek reimbursement from its policyholder for payment made to settle claims later determined to be non-covered.

CICLA has participated in numerous cases throughout the country, including cases in the Texas Supreme Court and the Texas Court of Appeals. In particular, CICLA has appeared in this matter. In addition, CICLA's predecessor in interest, the Insurance Environmental Litigation Association ("IELA"), has participated as an *amicus* in the following cases in Texas: *Grapevine Excavation, Inc. v. Maryland Lloyds*, 35 S.W.3d 1 (Tex. 2000); *Kelley-Coppedge, Inc. v. Highlands Insurance Co.*, 980 S.W.2d. 462 (Tex. 1998); *National Union Fire Insurance Co. v. CBI Industries, Inc.*, 907 S.W.2d 517 (Tex. 1995); *Gulf Metals Industries, Inc. v. Chicago Insurance Co.*, 993 S.W.2d 800 (Tex. App.—Austin 1999, pet. denied); *Tri County Service Co. v. Nationwide Mutual Insurance Co.*, 873 S.W.2d 719 (Tex. App.—San Antonio 1993, writ denied); *Estate of*

H.H. Coffield v. Maryland Insurance Co., No. 22,769 & 22,770 (20th Dist. Ct., Milan County, Tex. 1993).[1]

SUMMARY OF ARGUMENT

This case presents an issue of universal importance to insurers—whether an insurer is entitled to seek reimbursement of settlement funds paid to resolve claims subsequently determined to be non-covered under an insurance contract. The Court's prior decision in this matter should be affirmed for the reasons stated in the Court's opinion. The parties to an insurance contract do not reasonably expect the insurer to indemnify the insured for non-covered claims. Permitting recoupment of such costs therefore upholds the reasonable expectations of the parties while also protecting the insurance underwriting process. Allowing reimbursement also ensures that the insurer and policyholder stand on a level playing field when an underlying plaintiff makes a reasonable settlement offer. Otherwise, the insurer would be presented with a no win situation—it can refuse to settle, subjecting it to potentially massive *Stowers* liability, or it can settle the claim with no right of recourse, potentially granting a windfall to the policyholder. In addition, permitting reimbursement preserves the status quo as to the policyholder, while transferring the risk that the insured will be unable to pay the judgment from the injured party to the insurer.

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[1] This brief is submitted on behalf of CICLA member companies: AIG; Chubb & Son; Farmers Insurance Group; The Hartford Insurance Group; Liberty Mutual Group Inc.; St. Paul Fire and Marine Insurance Company; Selective Insurance Company of America; The Travelers Indemnity Company and Travelers Casualty and Surety Company; and Zurich American Insurance Company.

Despite these and other laudable benefits recognized by the Court in its opinion, Frank's Casing and *Amici* suggest that allowing reimbursement under the circumstances of this case will somehow turn Texas insurance law on its head. Their arguments are clearly misguided. Foremost, the *Stowers* doctrine is unaffected by the Court's decision. Insurers will continue to have a potent incentive to accept reasonable settlement demands within policy limits. Additionally, the Court's decision promotes, rather than discourages, an early settlement of coverage disputes because it removes a significant hurdle to the coverage settlement process—the prospect for insureds to obtain coverage for non-covered claims through the back door. Declining to allow reimbursement would not alleviate the serious issues created by last minute settlement demands within policy limits. While insurers will often diligently pursue a judicial resolution of the coverage issues, it is often unlikely that a judicial determination of coverage issues will be reached by the time a settlement offer expires in the underlying action. Moreover, under Texas law, many coverage disputes may not be ripe for resolution while the underlying action remains pending. Finally, the Court's decision would not adversely affect the tripartite relationship. Rather, allowing reimbursement rights preserves the status quo while immediately resolving the underlying litigation.

ARGUMENT

I. THIS COURT SHOULD STAND ON ITS DECISION.

It is a fundamental tenet of insurance law that an insurer assumes specifically defined risks under an insurance contract while a policyholder retains those risks that are beyond the scope of the contract. Texas courts have therefore long recognized that where

an insurer has no duty to defend or indemnify, it has no liability under the policy. *See, e.g., Farmers Texas County Mut. Ins. Co. v. Griffin*, 955 S.W.2d 81 (Tex. 1997). Thus, the Court's opinion does not set in motion a "sea change" in Texas insurance law. Instead, it merely reinforces the very foundation of Texas insurance law—insurance coverage should not be created where none exists under the insurance contract. *See, e.g., Yancey v. Floyd W. & Co.*, 755 S.W.2d 914, 918 (Tex. App.—Fort Worth 1988, writ denied) ("courts will neither create ambiguity in an insurance policy where none exists nor make a new contract for the parties") (citation omitted). This Court should therefore decline to alter its decision that permits carriers to seek reimbursement of settlement funds under the circumstances specified.

A. The Court's Opinion Ensures A Level Playing Field.

In its opinion, the Court recognized that declining to permit reimbursement would place an insurer in an inequitable Catch-22 situation when presented with a reasonable settlement offer from an injured party:

> As pointed out by the California Supreme Court and our own court of appeals in the present case, denying a right of reimbursement once an insured has demanded that an insurer accept a reasonable settlement offer from an injured party can significantly tilt the playing field. The insurer would have only two options. It could refuse to settle and face a bad faith claim if it is later determined there was coverage. Or it could settle the third-party claim with no right of recourse against the insured if it is determined there was no coverage, which effectively creates coverage where there was none.

Slip Op. at 11, *citing Blue Ridge Ins. Co. v. Jacobsen*, 22 P.3d 313, 321 (Cal. 2001); *Excess Underwriters at Lloyd's v. Frank's Casing Crew & Rental Tools, Inc.*, 93 S.W.3d

178, 180 (Tex. App.—Houston [14th Dist.] 2002, pet. granted). The Court therefore correctly determined that "[w]hether the insurer or insured ultimately bears the cost of a reasonable settlement with a third party should depend on whether there is coverage." Slip Op. at 11.

The need to allow insurers the right to seek reimbursement for non-covered claims is particularly compelling because the *Stowers* duty imposed under Texas law requires insurers to accept reasonable demands to settle covered claims that are within policy limits. *See American Physicians Ins. Exch. v. Garcia,* 876 S.W.2d. 842, 849 (Tex. 1994) (defining *Stowers* duty under Texas law). If the insurer fails to accept a reasonable settlement demand, the policyholder may thereafter recover from the insurer the entire amount of the judgment in excess of the policy limits. *Stroman v. Fid. & Cas. of N.Y.*, 792 S.W.2d 257, 260 (Tex. App.—Austin 1990, writ denied). Declining to permit reimbursement where coverage is in doubt would not only create a no-win situation for insurers but would also give policyholders every incentive not to consent to reasonable settlement demands. Indeed, given the insurer's duty to accept reasonable settlement offers under the *Stowers* doctrine, policyholders would be encouraged to withhold consent in hopes of obtaining coverage for doubtful claims through the backdoor. The Court should not countenance such dubious incentives.

B. The Court's Opinion Preserves The Status Quo While Promoting Settlement Of The Underlying Action.

Significantly, the Court recognized that requiring reimbursement will not prejudice the insured:

> The insured's substantial exposure to a judgment against it greater than the settlement amount has been eliminated, at its insistence, and by its own admission the settlement amount was reasonable. The insured is in the same, or at least no worse, position than it would have been in if there had been no policy.

Slip Op. at 10. Reimbursement therefore preserves the status quo, allowing the parties to resolve the coverage dispute after the injured plaintiff has been compensated.

The Court also correctly observed that reimbursement rights will "encourage insurers to settle cases even when coverage is in doubt" because the Catch-22 for insurers will be removed. Slip Op. at 11. Allowing reimbursement therefore promotes the public policy favoring settlements:

> Public policy favors the amicable settlement of controversies. Settlements are favored because they avoid the uncertainties regarding the outcome of litigation, and the often exorbitant amounts of time and money to prosecute or defend claims at trial.

Transport Ins. Co. v. Faircloth, 898 S.W.2d 269, 280 (Tex. 1995) (citation omitted). Here, settlement of the underlying claims inures to the benefit of all involved. "When an insurer settles a claim for which coverage is in doubt, the risk that the insured lacks the resources to fund a settlement is shifted to the insurer and is lifted from the injured plaintiff who sued the insured." Slip Op. at 11. Similarly, the insurer and insured both avoid the risk of a judgment greater than the settlement amount as well as the "exorbitant amounts of time and money" required to defend claims at trial. The public is also spared the expense associated with a trial of the underlying claims and any further proceedings thereafter.

C. The Court's Opinion Ensures Insurance Stability.

Permitting reimbursement under the circumstances of this case also preserves the vital role of insurance to society. Insurers assume certain contractually defined risks in return for premiums, which are calculated through actuarial science. Insurers are able to respond to random catastrophes because, on a large scale, the frequency of such events is reasonably predictable. By evaluating and distributing risks in this fashion, insurance allows individuals and businesses to engage in socially useful activities that would be impossible to undertake if the associated risks had to be borne alone. *See, e.g.*, ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW 12-13 (1988). This important economic and social function is accomplished by means of the risk-for-premium exchange that is essential to the integrity of the underwriting process. Expanding the risk assumed by the insurer beyond that upon which the premium calculation was based necessarily undermines this process and impedes the public risk-spreading role insurers carry out.

Indeed, declining to permit reimbursement would place insurers at risk for liabilities for which they have collected no premiums and established no reserves. In such an environment, the price of insurance would increase for all policyholders and its availability would decrease. *See Garvey v. State Farm Fire & Cas. Co.*, 770 P.2d 704, 711 (Cal. 1989) (disregarding policy terms would "requir[e] ordinary insureds to bear the expense of increased premiums necessitated by the erroneous expansion of their insurers' potential liabilities.") (citation omitted). Most notably, individuals and small businesses could be priced out of the market and forced to directly bear liabilities they are ill prepared to face. *See* Jonathan I.J. Goldberg, *An Uncertain Future: Retroactivity,*

Insurance, and the EC's Attempts at Environmental Liability Legislation, 33 VA. J. INT'L L. 685, 708 (1993).

II. THE APOCALYPTIC PREDICTIONS OF FRANK'S CASING AND *AMICI* ARE CLEARLY OVERSTATED.

A. The *Stowers* Doctrine Remains Intact And Unaffected By The Court's Opinion.

Amici argue that the Court's opinion somehow ushers in a dramatic change to the *Stowers* doctrine under Texas law. However, it has long been clear that the touchstone of the *Stowers* reasonableness inquiry is an objective assessment based on the merits of the plaintiff's claim and the insured's potential exposure. *See, e.g., Texas Farmers Ins. Co. v. Soriano*, 881 S.W.2d 312, 316 (Tex. 1994) (a claimant must show that a reasonable insurer would have settled the claim based solely on the merits of the claim and the potential liability of the insured); *Garcia*, 876 S.W.2d at 849 (under the *Stowers* reasonableness inquiry, the issue is whether "the terms of the demand are such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to an excess judgment") (citation omitted).

Frank's Casing and *Amici* also make a mountain out of the Court's passing reference to the insured's "*Stowers*ization" of the excess carriers in this case. Specifically, Frank's Casing and *Amici* argue that the Court's opinion creates confusion regarding *Stowers* procedures because the doctrine has generally not been triggered by the actions of the insured. However, Frank's Casing and *Amici* ignore the key fact that the settlement offer at issue was solicited and received solely by in-house counsel for Frank's Casing. Slip Op. at 3-4. The excess insurers were not a party to those settlement

discussions and may not have otherwise been aware of the offer had Frank's Casing not communicated the offer to the excess carriers while demanding that it be accepted. Clearly, an insurer cannot be subject to the *Stowers* doctrine if it is unaware of a pending settlement offer. *See Garcia*, 876 S.W.2d at 849 ("the *Stowers* remedy of shifting the risk of an excess judgment onto the insurer is inappropriate absent proof that the insurer was presented with a reasonable opportunity to prevent the excess judgment by settling within the applicable policy limits").

Additionally, the opinion expressly limits its holding to situations where the insured has either demanded that its insurer accept the settlement offer, or expressly agreed that the offer should be accepted. *Id.* at 8. The Court's opinion therefore cannot be characterized as shifting the primary burden of evaluating and accepting settlements to the insured.

In short, the *Stowers* doctrine remains intact and unaffected by the Court's opinion. Accordingly, the *Stowers* doctrine will continue to operate as a compelling disincentive for insurers to reject reasonable settlement offers.

B. The Court's Opinion Promotes The Early Resolution of Coverage Disputes.

Frank's Casing and *Amici* baldly contend that the Court's opinion discourages the early resolution of coverage disputes, signaling the end of *State Farm Fire & Casualty Co. v. Gandy*, 925 S.W.2d 696 (Tex. 1996). In so arguing, Frank's Casing and *Amici* suggest that all insurers will unfailingly refuse to seek an early resolution to disputed insurance claims for the sole purpose of extracting an agreement to reimburse from the

insured at the eleventh hour. These dire predictions ignore the commercial realities. Foremost, insurers will continue to try and resolve coverage disputes early in the process for many reasons, including fairness, reputational interests, their obligations under the law, the need for certainty, and the avoidance of costs and expenses relating to prolonged claim-handling. Insurers will therefore continue to seek to resolve disputed coverage claims before resolving the underlying claim.

In fact, the Court's opinion fosters a prompt coverage resolution process because it encourages both parties to the dispute to actively participate in settlement discussions. Otherwise, declining to permit reimbursement would have the unintended consequence of creating incentives for a policyholder to avoid resolving disputed coverage claims given the prospect of obtaining coverage for non-insured risks through the back door. The Court's opinion removes this deterrent to the coverage settlement process, ensuring that both parties have incentives to actively pursue a fair and prompt resolution of the coverage dispute.

C. Prompt Judicial Resolution Will Rarely Alleviate The Issues Created By *Stowers* Demands.

Frank's Casing and *Amici* suggest that an insurer's timely pursuit of a declaratory judgment action could promptly resolve all coverage disputes with sufficient time to act upon reasonable settlement offers in underlying tort actions. These arguments ignore reality. Insurers have no control over when claimants will make an offer or how long an offer will remain open. In most cases, offers to settle are temporally limited. Nor do insurers have any control over how promptly a court may rule if a declaratory action is

pursued. Coverage litigation is often time consuming, absent settlement. The parties must file pleadings, commence discovery, and file motions for summary judgment. If the court determines that a material issue of fact exists, the parties must then go to trial. Even after the trial court resolves the dispute, the losing party likely may appeal, first to an intermediate appellate court and then to this Court. Once the appeal process begins, the possibility remains that an appellate court may remand the action to the trial court, only to start the process over again. In short, it is impossible to imagine a scenario where a claimant will patiently stand on its offer while the judicial process of resolving a coverage dispute runs its course.

Furthermore, many coverage disputes may not be ripe for resolution while the underlying action remains pending. As this Court has recognized:

> It may sometimes be necessary to defer resolution of indemnity issues until the liability litigation is resolved. In some cases, coverage may turn on facts actually proven in the underlying lawsuit.

Griffin, 955 S.W.2d at 84 (holding that under certain circumstances, an insurer may pursue a declaratory judgment prior to resolution of the underlying claim). Insurers and insureds alike have an interest in not proceeding with a declaratory judgment action that could prejudice the rights of an insured in the underlying action. The Court has therefore correctly recognized that a declaratory judgment action may not be appropriate for all coverage disputes while an underlying action remains pending.

D. Permitting Reimbursement Does Not Create A Material Conflict Between The Insurer And Its Policyholder.

Frank's Casing and *Amici* contend that the Court's opinion will foster new conflicts within the tripartite relationship. Such dire predictions plainly overstate the issue. Defense counsel owes a duty to both parties to refrain from manipulating the defense to favor one party or the other with respect to the coverage issues. *See, e.g., Employers Cas. Co. v. Tilley*, 496 S.W.2d 552 (Tex. 1973). Thus, in the *Stowers* context, defense counsel must evaluate the reasonableness of the settlement based solely on the merits of the underlying claim without consideration of the insurance coverage implications. To the extent the insured desires advice regarding the coverage implications of a settlement offer, the insured is free to consult separate coverage counsel.

Moreover, permitting reimbursement for non-covered claims gives effect to the parties' expectations and protects the integrity of the insurance underwriting process. Indeed, it is a reasonable and desirable way to ensure that the policyholder's interests are protected until the coverage issues can be resolved. As this Court noted, permitting reimbursement protects the insured against a judgment in excess of the settlement while also leaving the insured "in precisely the same position it would have been in absent any insurance policy." Slip Op. at 10. Accordingly, the characterization of reimbursement as some new and distinct liability of the insured that will have a chilling effect on the advice imparted by defense counsel plainly misstates the situation.

Additionally, if an insurer is able to recover amounts related to the settlement non-covered claims, the insurer will have every incentive to provide the policyholder with a defense for questionable claims. As the California Supreme Court observed, allowing insurers to seek reimbursement of settlement amounts paid for non-covered claims "encourages insurers to defend and settle cases for which insurance coverage is uncertain." *Jacobsen*, 22 P.3d at 321. As a result, it transfers the risk that the insured may not be financially able to pay the injured party's damages to the insurer. *Id.*; *see also* Slip Op. at 11. Thus, far from placing the insurer and its policyholder at odds, the right to reimbursement eliminates an unfair windfall to the policyholder whose conduct was not insured and who is financially able to pay absent insurance coverage. Reimbursement also protects the rights of the insurer who steps forward to provide a defense to the underlying action and to indemnify a settlement when coverage is unresolved.[2]

E. Express Reimbursement Provisions Are Unnecessary.

Finally, Frank's Casing and *Amici* contend that reimbursement should be denied because the policy language does not expressly provide for reimbursement, even though it contemplates payment only for covered claims. It is well-established that liability policies afford coverage only for certain defined risks. It is therefore self-evident that an insurer has not agreed to insure non-covered risks. Thus, neither party reasonably expects the insurer to pay for all claims (covered or not) where a settlement demand is

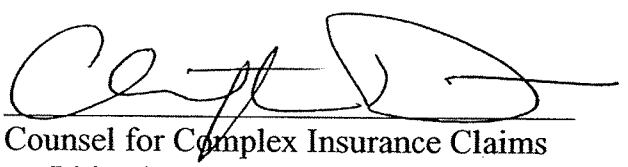
[2] Tellingly, Frank's Casing and *Amici* proffer no anecdotal evidence that the tripartite relationship has been unduly strained in those states that permit insurers to seek reimbursement.

made before the coverage dispute can be resolved. Accordingly, when construed as a whole, as required under Texas law, the policy cannot reasonably be interpreted to preclude reimbursement of amounts paid to resolve doubtful claims subsequently determined to be non-covered. This Court should therefore adhere to its existing determination, which is fully consistent with the policy terms and intent.

CONCLUSION

For the foregoing reasons, *amicus curiae*, Complex Insurance Claims Litigation Association respectfully requests that the Court affirm its prior decision in this matter.

Respectfully submitted,



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I certify that this Brief of Amicus Curiae was served on all parties and *amici* on the 6th day of February, 2006.

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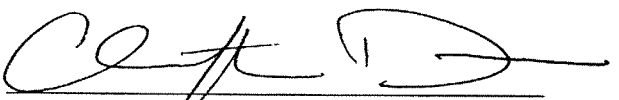

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