

NO. 04-0429

IN THE SUPREME COURT
OF TEXAS

LEXINGTON INSURANCE COMPANY, LANDMARK INSURANCE
COMPANY, AND AMERICAN INTERNATIONAL SPECIALTY LINES
INSURANCE COMPANY

PETITIONERS

VS.

CAROLE KEETON STRAYHORN, COMPTROLLER OF PUBLIC ACCOUNTS
OF THE STATE OF TEXAS, AND GREG ABBOTT, ATTORNEY GENERAL OF
THE STATE OF TEXAS

RESPONDENTS

BRIEF OF AMICI CURIAE

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America, St. Paul Surplus Lines Insurance Company, Gulf Underwriters Insurance
Company, and General Star Indemnity Company*

IDENTITY OF AMICI CURIAE

Amici Curiae adopt the designation of the identities of the parties and their counsel as set forth in the Petition for Review. The following parties are the Amici Curiae: American Insurance Association, National Association of Professional Surplus Lines Offices, Property Casualty Insurers Association of America, St. Paul Surplus Lines Insurance Company, Gulf Underwriters Insurance Company, and General Star Indemnity Company.

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TABLE OF CONTENTS

IDENTITY OF AMICI CURIAE	i
TABLE OF CONTENTS	ii
STATEMENT OF INTEREST	v
I. STATEMENT OF THE CASE	vii
II. STATEMENT OF JURISDICTION	vii
III. ISSUE PRESENTED.....	viii
Whether an eligible surplus lines insurer who is authorized to place insurance in the State of Texas can also, simultaneously, be an "unauthorized insurer" when the Texas Insurance Code distinguishes surplus lines insurers from unauthorized insurers.....	viii
IV. STATEMENT OF FACTS	1
V. SUMMARY OF THE ARGUMENT	1
VI. ARGUMENT.....	2
A. Surplus Lines Insurance.....	2
B. Potential Consequences of Court of Appeals' Opinion.....	4
C. Eligible Surplus Lines Insurers Are Not Unauthorized Insurers	5
D. The Evolution of the Relevant Statutes Reveals a Legislative Intent to Distinguish Surplus Lines Insurers from Unauthorized Insurers	6
VII. CONCLUSION AND PRAYER	8

APPENDIX

TEX. INS. CODE ANN. ART. 1.14-1 (West 1993)	Tab 1
TEX. INS. CODE ANN. ART. 1.14-2 (West 1993)	Tab 2
HOUSE COMM. ON INSURANCE, BILL ANALYSIS, Tex. H.B. 958, 73 rd Leg., R.S. (1993)	Tab 3

INDEX OF AUTHORITIES

STATE CASES

<i>Fowler v. Jones</i> , 949 S.W.2d 442 (Tex. App.—Austin 1997), rev'd on other grounds 969 S.W.2d 429 (Tex. 1998)	6
<i>Strayhorn v. Lexington Insurance Co.</i> , 128 S.W.3d 772 (Tex. App.—Austin 2004, pet. filed)	4

STATUTES

TEX. ADMIN. CODE § 15.6(e)	3
TEXAS GOV. CODE § 22.001(a)(3)	vi
TEXAS GOV. CODE § 22.001(a)(6)	vi
TEX. INS. CODE art. 1.14-1	3, 4
TEX. INS. CODE art. 1.14-1 § 1	3
TEX. INS. CODE art. 1.14-1 § 11	3
TEX. INS. CODE ART. 1.14-2	3, 4
TEX. INS. CODE ART. 1.14-2 § 1	2
TEX. INS. CODE ART. 1.14-2 § 2	4, 5
TEX. INS. CODE ART. 1.14-2 § 7	4
TEX. INS. CODE ART. 1.14-2 § 8	4
TEX. INS. CODE ART. 1.14-2 § 12	2, 3
TEX. INS. CODE § 101.251(b)	6
TEX. INS. CODE § 101.201	6
TEX. INS. CODE § 101.105	7
TEX. INS. CODE § 101.106	7
TEX. INS. CODE § 101.202	7

TEX. INS. CODE § 101.353.....	7
TEX. INS. CODE § 101.354.....	7
TEX. R. APP. P. 56.1	1

STATEMENT OF INTEREST

The American Insurance Association ("AIA") is an insurance trade organization whose 450-plus property-casualty insurer members collectively wrote more than \$120 billion in direct U.S. premium in 2003, including over \$10.6 billion of premium in Texas. AIA, whose members include eligible surplus lines insurers in Texas, is headquartered in Washington, D.C., with a regional office in Austin, Texas.

The National Association of Professional Surplus Lines Offices ("NAPSLO") is an insurer and broker trade association interested in issues related to surplus lines and wholesale insurance marketing. NAPSLO's Texas broker/agent membership consists of 102 offices. NAPSLO is headquartered in Kansas City, Missouri.

The Property Casualty Insurers Association of America ("PCI") is composed of more than 1,000 member companies. PCI members write \$154 billion in annual premiums, 38 percent of the nation's property/casualty insurance. In Texas in 2002 (the last year for which data is available), forty PCI members also wrote nearly \$600 million in surplus lines insurance premiums. PCI is headquartered in Des Plaines, Illinois, with a regional office in Austin, Texas.

St. Paul Surplus Lines Insurance Company ("St. Paul") is an eligible surplus lines insurer in Texas, a member of both NAPSLO and AIA, and currently the plaintiff in *St. Paul Surplus Lines Insurance Company v. Rylander (Strayhorn), et al.*, Cause No. GN 102788, in the 200th Judicial District Court of Travis County, Texas. In its suit, St. Paul seeks a refund of taxes that it paid under protest after the Texas Comptroller wrongfully assessed unauthorized insurance premium taxes. Because the issues presented by this

petition for review and in St. Paul's lawsuit are the same, St. Paul's lawsuit has been stayed pending the outcome of this petition.

Gulf Underwriters Insurance Company and General Star Indemnity Company are eligible surplus lines insurers in Texas. They have, generally, a concern about the Comptroller's position that an eligible surplus lines insurer may be declared an "unauthorized insurer."

These Amici will be affected by the outcome of this petition for review. It is their position that the court of appeals erred in concluding that eligible surplus lines insurers may, on a transaction-by-transaction basis, be declared "unauthorized insurers" subject to unauthorized insurance premium taxes. The Amici submit this brief to explain the error in the court of appeals' reasoning and to demonstrate the potential adverse impact the court of appeals' opinion, if not reversed, will have on the surplus lines insurance industry and Texas citizens and businesses who depend on surplus lines insurance. The Amici, jointly, are paying the fee for preparing this brief.

I. STATEMENT OF THE CASE

Nature of the Case: Declaratory judgment action seeking a declaration that eligible surplus lines insurers are not "unauthorized insurers" and are not liable for payment of unauthorized insurance premium taxes.

Trial Court: District Court of Travis County, 250th Judicial District, Honorable Charles F. Campbell, Judge Presiding.

Trial Court's Disposition: Granted summary judgment for Petitioners.

Parties in Court of Appeals: **Appellants:** Carole Keeton Strayhorn, Comptroller of Public Accounts of the State of Texas; Gregg Abbott, Attorney General of the State of Texas (**Respondents in this Court**).
Appellees: Lexington Insurance Company, Landmark Insurance Company; American International Specialty Lines Insurance Company (**Petitioners in this Court**).

Court of Appeals: Third Court of Appeals; Justice Bea Ann Smith, joined by Chief Justice W. Kenneth Law and Justice Jan Patterson; published opinion, *Strayhorn v. Lexington Insurance Company*, No. 03-03-00169-CV, 128 S.W.3d 772 (Tex. App.—Austin 2004, pet. filed).

Court of Appeals' Disposition: Reversed and remanded.

II. STATEMENT OF JURISDICTION

The Supreme Court has jurisdiction over this appeal under Texas Government Code § 22.001(a)(3) because this case involves construction of statutes necessary to the determination of the case. The Supreme Court also has jurisdiction of this appeal under Texas Government Code § 22.001(a)(6) because the court of appeals committed an error of law important to the state's jurisprudence that is likely to recur.

III. ISSUE PRESENTED

Whether an eligible surplus lines insurer who is authorized to place insurance in the State of Texas can also, simultaneously, be an "unauthorized insurer" when the Texas Insurance Code distinguishes surplus lines insurers from unauthorized insurers.

IV. STATEMENT OF FACTS

The Amici Curiae adopt the statement of facts in the Petition for Review filed by the Petitioners: Lexington Insurance Company; Landmark Insurance Company; and American International Specialty Lines Insurance Company.

V. SUMMARY OF THE ARGUMENT

An eligible surplus lines insurer cannot, simultaneously, be a surplus lines insurer who is authorized to place insurance in Texas *and* an unauthorized insurer who is not authorized to do business in Texas. The court of appeals erroneously concluded that when an eligible surplus lines insurer is unable to establish that a particular surplus lines policy was placed through a licensed surplus lines agent, the surplus lines insurer somehow loses its eligibility and becomes an "unauthorized insurer" subject to an unauthorized insurance premium tax. Texas statutes clearly differentiate between eligible surplus lines insurers and unauthorized insurers, and the two are mutually exclusive. As well, the evolution of the statutes governing surplus lines insurers and unauthorized insurers reveals a legislative intent to distinguish surplus lines insurers from unauthorized insurers.

Under Texas Rule of Appellate Procedure 56.1, this Court should grant the Petition for Review because this case presents an important question of statutory construction, an error of law that is of such importance to this state's jurisprudence that it should be corrected, and an important question that should be, but has not been, addressed by this Court.

VI. ARGUMENT

A. Surplus Lines Insurance

A majority of insurance in Texas is underwritten by Texas-licensed ("admitted") carriers. If coverage is unavailable through the admitted market—for instance, if the risk to be insured is unusual or difficult to evaluate—Texas law permits the placement of coverage written by certain non-admitted companies on a "surplus lines" basis. The need for surplus lines insurance is obvious: it permits Texas residents to obtain insurance which would not otherwise be available. Notably, the Texas Legislature has expressly recognized the importance of the availability of surplus lines insurance, stating "[i]nsurance transactions . . . with eligible surplus lines insurers . . . as a result of difficulty in obtaining coverage *are a matter of public interest.*"¹

Surplus lines insurers are not directly regulated by the Texas Department of Insurance ("TDI"). Rather, TDI exercises limited oversight over the surplus lines market by, among other things, determining whether non-admitted companies are legally eligible to operate in Texas, maintaining a list of eligible surplus lines companies, and licensing surplus lines agents.

The regulatory scheme governing Texas surplus lines insurance requires an insured purchasing a surplus lines policy to pay a surplus lines insurance premium tax of 4.85% of the policy premium, which the surplus lines agent must collect and remit to the state. This tax is in lieu of all other insurance taxes.² All surplus lines insurance premium taxes collected by surplus lines agents are considered "trust funds" and an agent

¹ TEX. INS. CODE, ART. 1.14-2, § 1 (emphasis added) (West 1993).

² *Id.* at § 12(a).

who fails or refuses to remit the surplus lines premium receipts tax to the state commits theft.³ Surplus lines insurers bear no responsibility for collecting or remitting the premium receipts tax because surplus lines agents⁴ are prohibited from shifting, transferring, delegating, or assigning the responsibility to collect and remit the premium tax.⁵ This is in contrast to unauthorized insurers, who are neither authorized to do insurance business in Texas nor qualified as eligible surplus lines insurers.⁶ Unauthorized insurers who place insurance in Texas are subject to an unauthorized insurance premium tax of 4.85% on all unauthorized insurance policies placed, as well as other penalties.⁷

³ *Id.* at § 12(b).

⁴ Unlike agents for admitted companies, surplus lines agents are not required to be appointed by surplus lines insurers. *See* TEX. INS. CODE ART. 21.07 § 1(a) (stating "no such person who obtains a license shall engage in business as an agent until that person shall have been appointed to act as an agent by some duly authorized insurance carrier.")

⁵ TEX. ADMIN. CODE § 15.6(e).

⁶ Another category of insurance acknowledged by the court of appeals that may be placed by a non-admitted insurer is "independently procured insurance." Independently procured insurance is insurance procured by the insured from an insurance company that is not authorized to do business in Texas, through negotiations that take place outside of the state of Texas. TEX. INS. CODE § 101.053(b)(4). In addition, the policy must be reported and a premium tax paid to the State of Texas. *Id.* Independently procured insurance is subject to an independently procured insurance tax of 4.85 percent, which the insured must remit to the Comptroller. *Id.* § 101.252. Excluded from this tax are insurance transactions that take place entirely outside of the state—transactions where: (1) the policy is negotiated, paid for, and issued outside of the state; (2) all losses are adjusted and paid for outside of the state; (3) the insurer is not domiciled or licensed to do business in the state and has no agent or office in the state; and (4) the insured is not domiciled in the state. *Dow Chem. Co. v. Rylander*, 38 S.W.3d 741, 746-47 (Tex. App.—Austin 2001, pet. denied) (citing *State Bd. of Insurance v. Todd Shipyards Corp.*, 370 U.S. 451, 455 (1962)).

⁷ TEX. INS. CODE, ART. 1.14-1, § 11 (West 1993).

B. Potential Consequences of Court of Appeals' Opinion

Under Texas law, there are numerous penalties that can arise as a result of an unauthorized insurance transaction:

- Unauthorized insurers are statutorily barred from enforcing insurance policies.⁸ Accordingly, such insurers cannot assert contractual defenses to claims.
- Unauthorized insurers may be liable for a civil fine up to \$10,000 per transaction or day.⁹
- Unauthorized insurers may be liable for criminal penalties including a felony conviction.¹⁰
- Unauthorized insurers may be ordered to pay attorneys' fees incurred by an insured in any related litigation.¹¹
- Unauthorized insurers must post a bond, cash, or other security in an amount of any potential judgment before filing a pleading in a suit or in an administrative proceeding brought against them by an insured.¹²

The imposition of these consequences on eligible surplus lines insurers will make it more difficult for Texas citizens and businesses to obtain surplus lines insurance—a result contrary to the public policy expressed by the Texas Legislature. Moreover, these

⁸ See TEX. INS. CODE § 101.201.

⁹ See *id.* at § 101.105.

¹⁰ See *id.* at § 101.106.

¹¹ See *id.* at § 101.202.

¹² See *id.* at §§ 101.353, 101.354.

potential consequences are premised on an erroneous interpretation of the unauthorized insurance and surplus lines insurance statutes by the court of appeals.

C. Eligible Surplus Lines Insurers Are Not Unauthorized Insurers

An eligible surplus lines insurer who is unable to establish that a particular surplus lines insurance policy was placed through a licensed Texas surplus lines agent does not become an "unauthorized insurer." To the contrary, Texas statutes clearly differentiate between eligible surplus lines insurers and unauthorized insurers, and the two are mutually exclusive.

Article 1.14-1 of the Texas Insurance Code governs unauthorized insurers—those insurers who are "neither authorized to do insurance business in this state *nor qualified as eligible surplus lines insurers* as defined in Article 1.14-2."¹³ In contrast, Article 1.14-2 governs surplus lines insurers and defines "surplus lines insurers" as "unlicensed insurer[s] deemed eligible pursuant to Section 8 of this Article" to place surplus lines insurance policies.¹⁴

Section 8 of Article 1.14-2 reveals a number of criteria that an insurer must meet to be approved as an eligible surplus lines insurer. For instance, Section 8 requires an insurer to have minimum capital of \$15 million, maintain a trust fund of \$1.5 million in a Federal Reserve System member bank, and hold a current license from its domiciliary state or country.¹⁵ Once an insurer is approved as an eligible surplus lines insurer, the statute does not contain any procedure by which a surplus lines insurer may become

¹³ *Id.* at § 1.

¹⁴ TEX. INS. CODE, ART. 1.14-2, § 2(b) (West 1993).

¹⁵ *Id.* at § 8.

reclassified as a mixed surplus lines/unauthorized insurer. In fact, the statute suggests that a determination as to whether an insurer is "unauthorized" must be made *before* the insurance is issued, as Section 7 of Article 1.14-2 states "[t]he insurer must be an eligible surplus lines insurer *as of the inception date* . . . of every insurance contract."¹⁶

Ignoring the clear distinction in these statutes between "eligible surplus lines insurers" and "unauthorized insurers," the court of appeals erroneously concluded that:

surplus lines insurers who do not place surplus lines insurance through a licensed Texas surplus lines agent are not lawfully transacting surplus lines insurance. Such insurers have engaged in unauthorized insurance and become "unauthorized insurers" liable for the premium tax imposed by Former Article 1.14-1, section 11.¹⁷

In other words, the court of appeals concluded that a retroactive transformation occurs, and an eligible surplus lines insurer who is unable to establish that a particular policy was placed through a licensed surplus lines agent somehow loses its eligibility and becomes an unauthorized insurer. Not only is this conclusion negated by the express language of the Texas Insurance Code, the evolution of the relevant statutes also reveals a legislative intent to distinguish surplus lines insurers from unauthorized insurers.

D. The Evolution of the Relevant Statutes Reveals a Legislative Intent to Distinguish Surplus Lines Insurers from Unauthorized Insurers

Before 1993, a "surplus lines insurer" was defined as "an unauthorized insurer in which an insurance coverage is placed or may be placed under this Article."¹⁸ In 1993, the Texas Legislature amended the definition of "surplus lines insurer" to make it clear

¹⁶ *Id.* at § 7(c) (emphasis added).

¹⁷ *Strayhorn v. Lexington Ins. Co.*, 128 S.W.3d 772, 785 (Tex. App.—Austin 2004, pet. filed).

¹⁸ TEX. INS. CODE, ART. 1.14-2, § 2(b) (West 1993).

that a surplus lines insurer is not an "unauthorized" insurer, instead defining a surplus lines insurer as "an unlicensed insurer deemed eligible [to place surplus lines insurance] pursuant to Section 8 of this Article."¹⁹ The removal of the "unauthorized" nomenclature evidenced a clear intent to distinguish surplus lines insurers from unauthorized insurers, and the bill analysis for HB 958 drafted by the House Research Organization underscores this legislative intent, stating "*CSHB 958 would clarify that surplus lines insurers who are eligible to sell insurance in Texas are not unauthorized insurers*."²⁰ As a result, for all tax years at issue here, both before and after 1993, it was clear that the Legislature intended to distinguish eligible surplus lines insurers authorized to place insurance in Texas from "unauthorized insurers" and immunize surplus lines insurers from liability for payment of any unauthorized insurance premium tax.²¹

Tellingly, in 2003, within weeks of the trial court's summary judgment in favor of Petitioners in this case, the Legislature again amended the unauthorized insurer statute. The purpose of the amendment was to make *all* "insurers"—including surplus lines insurers—liable for payment of an unauthorized insurance premium receipts tax if the insurer is unable to prove that a particular policy was placed through a licensed Texas surplus lines agent.²² Clearly, the Legislature intended to *change* the law when it wrote

¹⁹ *Id.*

²⁰ HOUSE COMM. ON INSURANCE, BILL ANALYSIS, Tex. H.B. 958, 73rd Leg., R.S. (1993) (emphasis added).

²¹ Despite the apparent significance of the 1993 amendment, the court of appeals gave the amendment short shrift, belatedly adding a brief footnote addressing the 1993 amendment's elimination of the term "unauthorized" in its *revised* opinion. See *Strayhorn v. Lexington Ins. Co.*, 128 S.W.3d 772, 784 n.14 (Tex. App.—Austin 2004, pet. filed).

²² TEX. INS. CODE § 101.251(b).

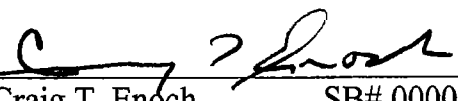
the amendment.²³ Therefore, one must conclude that, before 2003, under the then-existing statutory framework, an eligible surplus lines insurer was *not* an "unauthorized insurer" liable for the unauthorized insurance premium tax even if the eligible surplus lines insurer could not prove a particular policy was placed through a licensed surplus lines agent.

VII. CONCLUSION AND PRAYER

The court of appeals' opinion in this case conflates distinct provisions of the Texas Insurance Code by permitting the Texas Comptroller to assess a premium receipts tax on eligible surplus lines insurers. Accordingly, the opinion potentially exposes eligible surplus lines insurers to sanctions reserved for unauthorized insurers—a consequence that may well adversely impact the availability of surplus lines insurance in the State of Texas. For these reasons, Amici request that this Court grant the Petition for Review, sustain Petitioners' issues presented for review, and reverse the court of appeals.

²³ See *Fowler v. Jones*, 949 S.W.2d 442, 444 (Tex. App.—Austin 1997), *rev'd on other grounds*, 969 S.W.2d 429, 432 (Tex. 1998).

Respectfully submitted,

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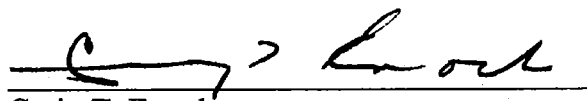
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CERTIFICATE OF SERVICE

By signature below, I certify that on this 6th day of August, 2004, the foregoing document was served via Certified United States Mail, Return Receipt Requested, on all parties or their attorneys of record listed below pursuant to the Texas Rules of Appellate Procedure:

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