

THE STATE OF NEW HAMPSHIRE

MERRIMACK, SS.

SUPERIOR COURT

BEFORE THE COURT-APPOINTED REFEREE
IN RE THE LIQUIDATION OF THE HOME INSURANCE COMPANY
DISPUTED CLAIMS DOCKET

In Re Liquidator Number: 2008-HICIL-41
Proof of Claim Number: CLMN712396
Claimant Name: Harry L. Bowles
Policyholder Account: Class II

ORDER ON THE MERITS

This dispute arises out of a claim by Mr. Bowles against his counsel, Bishop, Peterson & Sharp, P.C. ("BPS"). Mr. Bowles has filed a Proof of Claim asserting a third party claim for alleged professional malpractice on the part of BPS and Attorney George Bishop. In addition, Mr. Bowles also asserts that Home and Texas Property and Casualty Insurance Guaranty Association ("TPCIGA") improperly provided a defense to BPS and its shareholders in the malpractice action Mr. Bowles brought against them in the Texas state courts. Mr. Bowles alleges first that the Home professional liability policy does not allow for defense of BPS or its attorneys. His argument is that he did not sue BPS until after the policy period, that Attorney Bishop was not an insured during the Home policy period and that the intentional acts exclusion bars coverage for BPS. Mr. Bowles argues that res judicata and collateral estoppel do not apply to his claims against Home and he is entitled to recovery both in the Texas courts and in this dispute.

The Liquidator asserts that Mr. Bowles is not entitled to recover on his malpractice claims because they were compulsory counterclaims that he did not assert in the underlying 1991 litigation in the Texas state courts. Therefore, the Liquidator argues Mr. Bowles is precluded by res judicata from asserting these claims as a third party in the Home liquidation. In addition, the Liquidator argues that collateral estoppel also bars Mr. Bowles from challenging the res judicata effect of the judgments in the 1991 litigation because Mr. Bowles litigated those issues in his 1995 malpractice action and suffered an adverse judgment. Finally, the Liquidator asserts Mr. Bowles cannot recover from Home on his improper provisions of a defense claim because he fails to state any such claim against Home, and, in addition, the claims made against the Home's insureds are potentially covered and therefore triggered a duty to defend under the Home professional liability policy.

RELEVANT FACTS

The Home Policy

Home issued to BPS a professional liability insurance policy LPL-F871578-1 (hereinafter "the Policy") which was in effect for the period January 24, 1993 to January 24, 1994. The insureds under the policy included BPS and its shareholders George M. Bishop and David E. Sharp.

The Home policy stated that Home agreed:

To pay on behalf of the Insured all sums...which the Insured shall become legally obligated to pay as damages as a result of claims first made against the Insured during the policy period and reported to the company during the policy period caused by any act, error or omission for which the Insured is legally responsible, and arising out of the rendering or failure to render professional services for others in the Insured's capacity as a lawyer or notary public.

The policy also provides for a defense. The pertinent clause states that Home:

...shall defend any claim against the Insured including the appeal thereof seeking damages to which this insurance applies even if any of the allegations of the suit are groundless, false or fraudulent.

The policy provides coverage for any suits brought against the insured that are based on circumstances about which the insured notifies Home during the policy period. The policy specifically states:

If, during the policy or any optional Reporting Period purchased hereunder, the Insured first becomes aware that an Insured has committed a specific act, error or omission in professional services for which coverage is otherwise provided hereunder, and if the Insured shall during the policy period or the optional Reporting Period purchased hereunder give notice to [Home] of:

- (a) The specific act, error or omission; and
- (b) The injury or damage which has or may result from such act, error or omission; and
- (c) The circumstances by which the Insured first becomes aware of such act, error or omission

then any claim that may subsequently be made against the Insured arising out of such act, error or omission shall be deemed for the purposes of this insurance to have been made during the policy period.

In December 1993, Home informed BPS that the Policy would be cancelled due to "recent claims activity and past claim frequency." That policy cancellation was effective February 6, 1994.

Notification to Home by BPS

Prior to the cancellation of the policy, by letter dated December 29, 1993, Attorney Bishop informed Home, on his own behalf and that of BPS, that Mr. Bowles might file a claim against him or the firm based on the allegations of fraud and deceit. By letter dated January 10, 1994, Home Insurance informed Attorney Bishop that Home acknowledged receipt of the notice of a potential claim.

The Prior Litigation in the Texas State Courts

The 1991 Litigation In 1991, Mr. Bowles brought suit against his former business partners in the District Court of Harris County, Texas, entitled Bowles et al v. Schwartz et al, Cause No. 1991-25939 (later together with Cause 1991-25939-A). Mr. Bowles hired the law firm BPS and specifically Attorney Bishop to represent him in this litigation. Apparently, during the course of the 1991 litigation, BPS dissolved. Attorney Bishop continued to represent Mr. Bowles. Also during the course of the 1991 litigation, by letter dated December 22, 1993, Mr. Bowles accused Attorney Bishop of conspiracy and fraud.

On April 8, 1994, Attorney Bishop moved to withdraw as counsel of record for Mr. Bowles. The court granted that motion to withdraw on April 11, 1994. On April 18, 1994, Attorney Bishop and BPS intervened in the 1991 litigation seeking attorneys' fees relating to Attorney Bishop's representation of Mr. Bowles in this action. Mr. Bowles objected to the motion.

On May 27, 1994, Attorney Bishop and BPS moved for summary judgment on their claims for attorney's fees. The motion was granted on July 18, 1994. Attorney Bishop and BPS then moved to sever their claim from the original 1991 litigation and for entry of final judgment. The Court granted the motion on April 10, 1995 and the severed action was designated Cause 1991-25939-A. On May 15, 1995, the Court set aside the April 10, 1995 severance order. By order dated February 12, 1996, the Court granted final summary judgment in the 1991 litigation. On April 26, 1996, the Court reinstated the severance order for the claims for attorney's fees by Attorney Bishop and BPS by vacating the May 15, 1995 order. On August 30, 1996, the District Court ordered the disbursement of funds in the 1991 litigation to BPS and Attorney Bishop, with specific instructions on the disbursement. On March 21, 2005, the District Court barred Mr. Bowles from making any further filings in the 1991 litigation.

The 1995 Action On August 31, 1995, Mr. Bowles filed a malpractice suit against BPS, Attorney Bishop, Attorney Peterson, and Attorney Sharp, alleging malpractice in representing him in the 1991 litigation. This action was filed in the District Court of Harris County Texas 151st Judicial District and captioned Bowles v. Bishop, et al., Cause 95-043235.

In January 2006, BPS moved for summary judgment. The Court requested additional briefing on the issue of whether the February 12, 1996 order in the 1991 litigation was a final judgment as to that litigation, and what, if any, effect that order had on Mr. Bowles' malpractice claim filed on August 31, 1995, since the claims in the 1995 action were not made as compulsory counterclaims in the main lawsuit. The Court granted BPS' motion for summary judgment by order on June 27, 2006. The Court ruled that final judgments had been entered in the underlying cases, Causes 1991-25939 and 1991-35939-A and therefore, the Court held that Mr. Bowles' cause of action for legal malpractice was barred by res judicata. The Court specifically stated that because Mr. Bowles' cause of action for legal malpractice was a compulsory counterclaim that he failed to assert, he was barred by res judicata from asserting that claim in the 1995 action.

Mr. Bowles moved for rehearing on the issues. On August 30, 2006, the Court rejected the motion for rehearing and severed the claims against BPS from the remainder of the 1995 litigation.

Attorney Bishop filed a motion for summary judgment. The Court granted that motion on April 12, 2007, again ruling that because Mr. Bowles' cause of action for legal malpractice was a compulsory counterclaim that he failed to assert, he is now barred by res judicata from asserting it.

Attorney Sharp moved for summary judgment in the 1995 litigation on June 19, 2009 based on the statute of limitations, res judicata, the absence of any duty running from Attorney Sharp as a shareholder of BPS to Mr. Bowles, and waiver due to the fourteen year delay between filing of the 1995 litigation and service on Attorney Sharp. On July 21, 2009, Attorney Sharp's motion was granted. Attorney Sharp then moved to sever the claims against him and the Court granted that motion on September 29, 2009.

Mr. Bowles challenged the authority of TPCIGA to provide Attorney Sharp with a defense in the course of the 1995 litigation. The Court rejected Mr. Bowles' argument that TPCIGA could not provide Attorney Sharp with a defense on October 12, 2009.

The Federal Litigation Mr. Bowles has also filed and dismissed two actions against Home and TPCIGA in the United States District Court for the Western District of Texas, numbered 07-cv-00740 and 08-cv-00808. Ronald Barta of Home and Amber Walker of TPCIGA filed affidavits in those proceedings. Those affidavits have been referenced by Mr. Bowles in this litigation.

The Liquidation Proceeding Home was declared insolvent and on June 13, 2003, an Order of Liquidation was entered by the Merrimack County Superior Court. On June 26, 2003, the Commissioner of Insurance of the State of Texas officially designated Home as an impaired insurer under Texas Insurance Code based upon the Order of Liquidation. Immediately, the Liquidator transferred claim files that would likely be subject to guaranty association protection to the appropriate guaranty associations for handling. By the time the Liquidator filed its second report dated August 14, 2003, Home's claims file on the 1995 Litigation, referenced above, was shipped to TPCIGA.

The Liquidator received Mr. Bowles' Proof of Claim in the Liquidation on February 7, 2008.

LEGAL ANALYSIS

Now before the Referee are the following issues:

- A. Whether the disallowance of Mr. Bowles' claim by the Liquidator was proper based on the language of the Home policy issued to Bishop, Peterson and Sharp, P.C.;
- B. Whether Mr. Bowles is entitled to recovery on his claim that Home improperly provided a defense to Bishop, Peterson and Sharp, P.C.; and
- C. Whether the principle of res judicata bars any claim by Mr. Bowles.

The Referee addresses the first two issues together.

- I. The disallowance of Mr. Bowles' claim by the Liquidator was proper based on the language of the Home professional malpractice policy and Mr. Bowles is not entitled to recover from Home.

Mr. Bowles alleges that Home should not have provided a defense to BPS in his claims against the firm and its attorneys for three reasons. First, Mr. Bowles argues he did not sue BPS until after the policy period. Second, Mr. Bowles argues that Attorney Bishop was not an insured during the policy period. Third, Mr. Bowles asserts that the intentional acts exclusion bars coverage for BPS.

The Home policy is a claims-made policy. It provides coverage for claims made during the policy period regardless of when the events out of which the claim arose occurred. In this case, as with most claims-made policies, the policy required not only that the claim be made, but also that it be reported to the insurer within the policy period. See 7 L. Russ & T. Segalla, Couch on Insurance 3d §102:20 at 102-45 to 102-46 (1997). It is common for insureds, when faced with the termination of a claims made policy, to inform the insurer of any and all facts or allegations which could potentially result in a claim in the future. In fact, the policy requires such notification by the insured.

The discovery clause of the Home policy is clear: where the insured first becomes aware of a potential claim and gives notice to Home during the policy period, any claim subsequently made against the insured arising out of the alleged acts reported to Home is deemed to have been reported during the policy period. Those are the circumstance here. Attorney Bishop reported a potential claim to Home by letter in December 1993. His report was based on allegations made by Mr. Bowles related to actions taken by Attorney Bishop during the Home policy period. In 1995, after the policy terminated, Mr. Bowles filed suit against BPS and its shareholders. The basis for the allegations were acts which took place during the policy period and were reported to Home during the policy period and therefore Home was required to defend the claim.

Between the time when Attorney Bishop put Home on notice of a potential claim and the time Mr. Bowles filed suit against BPS the Liquidation began. The Liquidator sent files of potential claims to various Guaranty Associations after the liquidation. In doing so, the Liquidator was complying with statutes and the Liquidation Order. Pursuant to statute, TPCIGA was required to act on Home's behalf once Home was placed in liquidation. Therefore, when the claims were filed by Mr. Bowles against BPS, it was TPCIGA which was required to, and did, provide a defense to BPS and its shareholders.¹

Mr. Bowles also argues that Attorney Bishop was not an insured under the policy for the purpose of the 1995 litigation because BPS was dissolved in the summer of 1993 and Attorney Bishop thereafter provided services to Mr. Bowles as representative of a different legal entity or law firm. Mr. Bowles apparently contends that the dissolution of the firm, and continued work as an attorney by Attorney Bishop, means that there was no coverage for Attorney Bishop under the Home policy. Regardless of when BPS dissolved, and what Attorney Bishop did after the dissolution of the firm, he was an insured under the Home policy, as was BPS itself, and any other lawyers who worked for BPS during the policy period, for actions taken during the policy

¹ In his Brief dated October 27, 2009, Mr. Bowles asserts that there was no defense owed because the policy does not define "potential covered claims." Mr. Bowles reviews again the language used by Ron Barta and Amber Walker in affidavits filed in the Texas suits referenced above. Mr. Bowles ignores the plain language of the policy, specifically the insuring agreement and discovery clause.

period and reported during the policy period, even if the claims related to those actions were made after termination of the policy. See infra.

Mr. Bowles' third claim is that the 1995 litigation and his claims against BPS are excluded from coverage because his allegations are that BPS engaged in false and fraudulent professional misconduct when acting as Mr. Bowles' legal counsel.

The terms of the policy make clear that Home had a duty to defend Attorney Bishop and BPS for those claims for false and fraudulent misconduct. First, even if Mr. Bowles made some allegations in the 1995 litigation that would not have been covered by the Home policy, where a complaint potentially includes at least one covered claim, the insurer is required to defend the entire suit. See Zurich America Ins. Co. v. Nokia, 268 S.W.3d 487, 490 (Tex.2008) and 14 Couch on Insurance, §200:1. Second, the terms of the policy are clear and unambiguous. The policy states that it does not apply to any judgment or final adjudication based upon or arising out of any dishonest, deliberately fraudulent, criminal, maliciously or deliberately wrongful acts or omissions committed by the insured. (Emphasis added). The language of the exclusion makes clear that it does not operate until after a judgment or final adjudication in which there is a finding by the court that the potentially covered actions were undertaken dishonestly or were deliberately wrongful acts. In this case, there was no final adjudication or finding of such dishonest or deliberately wrongful acts. Therefore Home could not have relied upon the policy exclusion to deprive BPS of a defense for the 1995 litigation.

A defense was properly provided to BPS for the claims against it by Mr. Bowles. Therefore, the Liquidator properly disallowed Mr. Bowles' claim based on the terms of the policy. Mr. Bowles is not entitled to recover from Home or the Liquidator.

II. Res judicata Applies to Mr. Bowles' Claims in the Liquidation.

Mr. Bowles argues that res judicata does not apply to his claims because the decisions of the Texas Courts were based on fraud. Mr. Bowles also asserts that the order for summary judgment for BPS was not a final judgment on the merits and can't be the basis for a claim of res judicata.

The Liquidator argues that Mr. Bowles is barred from asserting malpractice claims against Home's insureds because of the res judicata effect of the judgment in the 1991 litigation. The Liquidator argues that malpractice claims are compulsory counterclaims to BPS' claims for attorney's fees and because Mr. Bowles did not make those claims in the 1991 litigation, they cannot provide a basis for a claim in the Home liquidation. Moreover, the Liquidator argues that Mr. Bowles is collaterally estopped from challenging the res judicata effect of the judgment of the 1991 litigation because he previously litigated and lost that issue in the 1995 litigation.

Texas law applies to determine the res judicata effect of a Texas judgment in this proceeding. *In Re Estate of Rupert*, 139 N.H. 273, 275 (1994). Texas law requires that a defendant bring as a counterclaim any claim arising out of the transaction or occurrence that is the subject matter of the opposing party's suit. *State and County Mut. Fire Ins. Co. v. Miller*, 52 S.W.3d 693 (Tex. 2001). Under Texas law, a claim of attorney malpractice is a compulsory counterclaim to a claim for attorneys' fees so that if a client chooses not to counterclaim for these actions, all

claims are barred by res judicata. *Goggin v. Grimes*, 969 S.W.2d 135 (Ct.App.Tex. 14th Dist. 1998). Therefore, when BPS intervened in the 1991 litigation seeking attorneys' fees, Mr. Bowles' claims for malpractice became compulsory counterclaims. He was required to bring them in the 1991 litigation. While Mr. Bowles disputed the attorneys' fees, he did not allege malpractice. Therefore, he failed to assert his compulsory counterclaims. The Texas Court agreed in the 1995 litigation, reaching the same conclusion. *Order of the District Court for Harris County, Texas, Cause No. 1995-43235 dated April 12, 2007*.

Having determined that Mr. Bowles' claims for malpractice were compulsory counterclaims, the Referee turns to whether res judicata applies in this dispute. Under Texas law, res judicata precludes relitigation of claims that have been finally adjudicated, or that arise out of the same subject matter and that could have been litigated in the prior action. *Amstadt v. Kochie*, 919 S.W.2d 644 (Tex. 1996). Texas law contemplates three elements of res judicata: (1) a prior final judgment on the merits by a court of competent jurisdiction; (2) identity of the parties or those in privity with them; and (3) a second action based on the same claims as were raised or could have been raised in the first action. *Id.* at 652, citations omitted.

As to the first element, there is a final judgment on the merits in the 1991 litigation. The claim for attorneys' fees was decided in favor of BPS and was severed. That judgment became final and appealable when the trial court signed the order severing into a separate case the claims for attorneys' fees between BPS and Mr. Bowles. *See Pilgrim Enters, Inc. v. Maryland Cas. Co.*, 24 S.W.3d 488 (Ct. App.Tex. 1st Dist. 2000). Turning to the second elements, Mr. Bowles was a party to the litigation in the Texas state courts and he is the party here; the parties are the same. Third, in this action Mr. Bowles raises the claim of malpractice in his POC, therefore, the claims in this proceeding are the same claims Mr. Bowles could have raised, and was required to raise, in the 1991 litigation. Res judicata applies to preclude Mr. Bowles from proceeding on a claim against the Liquidator.

Mr. Bowles raises several other arguments contending he is entitled to proceed against the Liquidator. First, he claims there was not a final order in the 1991 litigation because the order severing the summary judgment on attorneys' fees was vacated, a final judgment was entered, and then the summary judgment was severed again. The Texas Court specifically recognized that the claim for attorneys' fees was resolved and the judgment was final. *Amended Order of the District Court of Harris County, Texas, Cause No. 1995-43235 dated June 27, 2006*.

Mr. Bowles also argues that he filed the 1995 litigation before there was a final judgment in the 1991 litigation. Regardless of the timing of the filing of the 1995 litigation, once final judgment was entered in the 1991 litigation, it had preclusive effect. *Ellis v. Amex Life Ins. Co.*, 211 F. 3d 935 (5th Cir. 2000) and Restatement (Second) of Judgments §14 (1982).

Finally, as to the actions of Attorney Bishop and BPS, Attorney Sharp and Attorney Peterson were shareholders in the firm and therefore in privity with both BPS and Bishop. Therefore, the final judgment in the 1991 litigation also bars claims against Attorneys Peterson and Sharp under the doctrine of res judicata as adopted by the Texas courts.

The Liquidator also asserts that the judgment in the 1991 litigation precludes Mr. Bowles from relitigating the preclusive effect of the 1991 litigation. In the 1995 litigation the Texas Court

determined that final judgment had been entered in the 1991 litigation and that the cause of action for malpractice was barred by res judicata.

In *Sysco Food Service v. Trapnell*, 890 S.W.2d 796 (Tex. 1994), the Court said that a party seeking to assert the bar of collateral estoppel must establish that: (1) the fact sought to be litigated in the second action were fully and fairly litigated in the first action; (2) those facts were essential to the judgment in the first action; and (3) the parties were cast as adversaries in the first action. *Id.* at 801, citations omitted. In this case, the Liquidator is asserting collateral estoppel against Mr. Bowles. The issue being litigated in this proceeding is that which Mr. Bowles litigated in the 1995 litigation, the preclusive effect of the 1991 litigation. In addition, the Texas Court ruled in the 1991 litigation that there was a final order in the 1991 litigation and therefore Mr. Bowles' claims for legal malpractice were barred by res judicata. This determination required the Court to have found that the subject matter of both the 1991 and 1995 litigation included Mr. Bowles' malpractice claims and that there had been a final determination in the 1991 litigation. Finally, Mr. Bowles was clearly an adversary if BPS and Attorney Bishop in the prior litigation. It is irrelevant that the Liquidator is not the same as the parties in the prior litigation, it is "only necessary that the party against whom the doctrine is asserted was a party or in privity with a party in the first action." *Id.*

III. Other Pending Motions And Pleadings

Mr. Bowles has filed Proposed Findings of Fact and Rulings of Law in this dispute. The Referee does not address them individually. To the extent they are relevant to this dispute and they are granted, the proposed findings of fact and rulings of law are incorporated into this Order.

Mr. Bowles has also filed two motions for summary judgment. The allegations and claims in those motions are addressed in this Order and those motions are denied.

CONCLUSION

For the reasons set forth above, the Referee finds that the Liquidator properly disallowed Mr. Bowles' claim based on the language of the Home policy issued to Bishop, Peterson and Sharp, P.C. In addition, Mr. Bowles is not entitled to recovery on his claim that Home improperly provided a defense to Bishop, Peterson and Sharp, P.C. Defense of BPS was proper. In addition, the principles of res judicata and collateral estoppel bar any claim by Mr. Bowles against BPS and the Liquidator.

Because the Liquidator properly disallowed Mr. Bowles' claims, there is no need for additional briefing on any other issues in this dispute. Any issues not decided by the Referee are moot.

So ordered.

June 4, 2010
Date

Melinda S. Gehris
Referee, Melinda S. Gehris