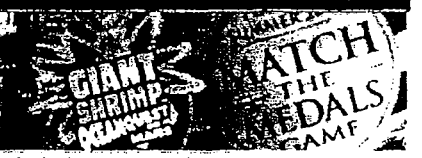
SCA
our risk, your reward.

SCA NEWS



Choose A Contest/Product

A risky biz - From hole-in-one shootouts to basketball shots at halftime, lots of cash is on the line for fans and insurance companies

By Mark Zeigler

San Diego Union Tribune Staff Writer

Dallas, TX – February 12, 2005 – Tom Gray was sitting in the outfield seats at Houston's Minute Maid Park last summer, minding his own business, eating a hot dog, soaking up the batting-practice vibe of baseball's All-Star Game. He was 41. He owned a car lot in south Houston. He was with his family.

Someone tapped him on the shoulder.

"Excuse me, sir."

An hour later Gray was on the mound, limbering up his arm. At home plate was an 8-foot wooden Taco Bell sign with a 25-inch hole. Next to Gray was a basket of baseballs.

A few months earlier Major League Baseball had approached SCA Promotions, a Dallas company that specializes in staging sports contests and insuring them, about creating an All-Star Game contest it could pitch to national sponsor Taco Bell. The result: "Ring the Bell," a rapid-fire baseball throw from the mound.

One lucky fan would get 30 seconds to throw as many baseballs as he could through the hole. Make one and get free Taco Bell food for a year. Make three and get $10,000. Make five and get $1 million.

Todd Overton, a longtime account manager with SCA, headed the project. He got an 8-foot board, cut out a 25-inch hole and hauled it to a nearby park one afternoon, along with a dozen or so folks from the office. They started chucking baseballs at it and recording the statistics.

"We figured the odds of someone being picked out of the crowd and doing it at the All-Star Game was north of 100-to-1," Overton says. He set the insurance premium on the million-dollar prize at about $35,000 and sent a proposal to Major League Baseball and Taco Bell. They agreed to randomly select 10 seat locations at Minute Maid Park before the game.

The first one had no one in it. They went to the second location and found Gray.

Gray's 8-year-old son, Matthew, told his father what his father always tells him when they play catch: "Point at the target." Gray nodded and grabbed the first baseball and fired it at the 8-foot board. It sailed completely over it.

Gray grabbed another ball and fired it right through the hole.

Gray threw another over everything again.

Standing nearby was Overton, whose company and its insurance underwriters were on the hook for the $1 million if Gray made five.

"At this point I'm thinking, 'No way,'" Overton says. "I'm feeling pretty good. But then he makes a second and a third and fourth. The clock is ticking down and he's got enough time for one more ball. I was with another guy from our office and I remember saying to him: 'If this one goes, we're hit.'"

Gray reached for the ball and threw it. There was one second left on the clock.

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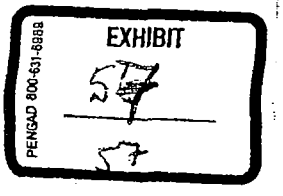
Overton slides open his desk drawer at his Dallas office. Inside is a stack of photos.

"Our Hall of Fame and Hall of Shame," he says.



CL EX 57

Nelson Liriano, a light-hitting second baseman, is in the Hall of Fame. SCA insured a million-dollar contest in 1989 that hinged on Nolan Ryan, then with the Texas Rangers, throwing a no-hitter. On April 23, Ryan carried one into the ninth inning against the Toronto Blue Jays. He got the first out. Then Liriano tripled.

The Chargers are in the Hall of Shame.

SCA had a deal with a Kansas City electronics store in 1999 wherein if you bought $395 or more of equipment and the Chiefs shut out their next opponent, you got your money back. More than 300 customers bought a combined $450,000 worth of merchandise.

The Chargers had first-and-goal in the fourth quarter, and couldn't get in on first, second or third down. Overton was screaming at his TV for them to kick the chip-shot field goal on fourth down from the 1. Trailing 34-0, the Chargers went for it.

The Chiefs blitzed, and Chargers quarterback Jim Harbaugh fumbled.

Overton pulls out a picture of Ted Popson and smiles.

A year earlier, SCA had put together a "Monday Night Football" promotion with sports bars to encourage patrons to stay for the second half. A fan in each bar was randomly selected at halftime. If the second-half kickoff was returned for a touchdown, the fan won $10,000.

SCA had about $500,000 worth of these deals across the country. And sure enough, in Week 8, Kansas City's Joe Horn returned the second-half kickoff 95 yards for a touchdown.

But wait. A penalty flag was on the field. Popson, a backup tight end for the Chiefs, was caught holding. No touchdown.

"Ted Popson," Overton says, "happens to be SCA's favorite football player of all time."

It is that crazy, that capricious a business, fueled by Corporate America's desire to promote its products at sporting events and governed by the vagaries of Lady Luck. Millions of dollars are at stake, often riding on the arm of a complete stranger plucked out of the stands an hour earlier. A backup tight end can save your bacon, or fry it.

"It's huge financial swings," says Chris Codington, whose Carmel Valley marketing company, Sports Strategies, organized the $1 million rapid-fire football contest at the 2004 Holiday Bowl for Dr Pepper. "At the end of the day, it boils down to gambling, and in some cases poorly studied gambling. When you go into a casino, you know the odds are stacked in their favor. They've rolled the dice and flipped the cards trillions of times. They know what's going to happen.

"But how many times have people set up a target and had someone throw a baseball or football at it in front of 60,000 people and a national television audience? So you end up guessing a lot of the time. Sometimes you guess right, sometimes you guess wrong."

Enter the insurer, who takes the risk for you.

Or as Bob Hamman once said: "Instead of worrying about whether the $1 million is won, (companies) can root madly for the contestant to win the prize, take Bob's money and force me to start checking the prices on the wine list."

Hamman is considered the father of the industry, a world champion bridge player and an insurance broker from Texas who was asked to write a policy for a local hole-in-one contest in the mid-1960s. A light bulb clicked on.

"After years of insuring acts of nature," Hamman says, "I like the challenge of analyzing a created risk."

Sports Contests Associates was born. In 1986 it generated $100,000 in sales. A decade later it was doing $20 million annually. SCA says over its history it has insured $12 billion in prizes, and paid out $126 million in claims.

The company motto: "Our risk, your reward."

The backbone of the contest business is hole-in-one insurance, and one of Hamman's partners left SCA in the late '80s to form National Hole-in-One. It has since handled 300,000 hole-in-one events and

paid out more than $40 million in claims, including five million-dollar winners. On average, the company is responsible for about 40 events per day.

From the hole-in-one came the halfcourt basketball shot, and from the halfcourt shot came the 35-yard field goal at halftime. And then the hockey shot through a shrunken goal and the soccer kick through the open door of an SUV and the Del Monte "Can of Corn" pop-fly contest at minor league baseball parks, even an olive toss into a martini glass. The upshot: An estimated 50 companies specialize in prize indemnification, and the halftime contest has become a staple of modern-day sporting events.

"They really help the fan get past the rest of the marketing clutter at the venue," says David Carter, a Los Angeles-based sports marketing expert who runs The Sports Business Group and is a professor at USC's Marshall School of Business. "It has become a stop, look and listen event at an arena otherwise dominated by all kinds of promotional events going on. I'm not sure how strong the brand recall is, but it's costing these sponsors so little that it might be cost effective."

And here's the key point: They're not stuck paying a semester's tuition if the liquored-up student sinks the halfcourt shot. Or burying a half-million dollars worth of hot tubs.

SCA's Overton flips through his stack of pictures. Here's a team photo of the Minnesota Vikings from 1998.

"Definitely Hall of Shame," he says.

A home improvement center in Minneapolis offered a deal to customers who purchased sun rooms, hot tubs or gazebos between Nov. 1 and 25: If the Vikings won their final five regular-season games by at least a touchdown, the customers would get their money back. Twenty customers met the criteria for a total of $433,000 in merchandise; SCA insured it.

Then the Vikings beat Dallas by 10 points, Chicago by 26, Baltimore by 10, Jacksonville by 40. The Vikings played at Tennessee in the regular-season finale and were tied 16-16 late in the third quarter ... before Randall Cunningham connected with Cris Carter on a 38-yard touchdown pass and Gary Anderson made a 30-yard field goal for a 26-16 victory.

"Yeah," Overton says, "there are hot tubs across Minnesota compliments of SCA."

On Sept. 11, 1998, the Glynns Creek Golf Club outside Davenport, Iowa, hosted a charity tournament to benefit the anti-drug campaign D.A.R.E. It included a contest in which the golfer who sank a 40-foot putt would win $10,000 cash.

Bruce Horack of Bettendorf, Iowa, drained the putt.

The local sponsor had signed a contract with Golf Marketing Inc., a Connecticut-based company specializing in sports contests, to insure the contest for a $250 premium. It collected the required affidavits and filed a claim for the $10,000. Golf Marketing refused to pay. The sponsor sued.

The sponsor ultimately received a default judgment in its favor after, court records show, the attorney hired by Golf Marketing to represent it in Iowa withdrew from the case because he wasn't paid.

"We discovered this guy was working out of the basement of his parents' home in Connecticut," Iowa attorney Tom Waterman says of Kevin Kolenda, Golf Marketing's founder and CEO. "It was a fly by-night operation where he was basically collecting money for events, not reinsuring them and hoping he didn't have any claims. And if he did get any claims, he'd either ignore them or deny them."

The default judgment was for the $10,000 plus $100,000 in punitive damages, but Waterman says Kolenda claimed he had "no assets to pay us." After nearly three years of legal wrangling, court records show, the two sides settled for $15,000.

"About this same time, I was getting contacted by these other attorneys representing huge firms in similar cases," Waterman says. "I figure they'd wipe him out, so I better call it a day and take the $15,000."

There also was a 35-yard field goal for $100,000 - $10,000 a year for 10 years – that a UCLA political science student drilled at halftime of a 1999 game at the Rose Bowl. The university said Golf Marketing had insured the event, and when Golf Marketing denied the claim UCLA began paying Gaston Kulos his money. It also sued.

UC attorneys won a $345,000 judgment in Los Angeles two years ago. The university is still trying to collect from Kolenda and Golf Marketing, with interest pushing the amount to nearly $450,000.

In addition, the district attorney went after Golf Marketing's Southern California representative, Scott Veitch. UC attorneys say Veitch agreed to pay $25,000 in restitution to the university in a plea agreement.

"It's my understanding," says UC attorney Michael Goldstein, "that they had obtained reinsurance for the business at one time and at some point made a reassessment that they could run the business without any underlying insurance. Then they ran into a stretch of bad luck."

Connecticut court records show a half-dozen lawsuits against Golf Marketing. In 2001, the Connecticut Insurance Department issued a cease and desist order against Kolenda and Golf Marketing for "conducting the business of insurance without a license." At least two other states, North Carolina and Washington, have issued similar orders in the past 14 months.

Kolenda cheerfully answers the phone at his Connecticut headquarters and denies most of the allegations against Golf Marketing.

"Our company has been in business for 20 years and we've done 90,000 of these events," Kolenda says. "We've had some issues in the past. We've denied a few people for claims. They happen. It's unfortunate, but we have to do it because they don't abide by the rules of the contest or for fraud. We've had very valid reasons for denying them."

Kolenda confirms he once operated out of his parents' home but says he now has offices in three states. He says the UCLA case was a misunderstanding involving a broker in Georgia and that Golf Marketing never officially agreed to insure the event. As for the orders from insurance commissioners, he says they are the result of a misinformation campaign by a jealous competitor – and the insurance commissioners issued the orders before investigating the facts.

"An issue may come up, but again, these are far and few between," Kolenda says. "It's less than 1 percent of our business. Every other company has them, too, so you can't say it's only us. That's not fair to us . . . . We are the New York Yankees of the industry. We have set the standard on payments and claims."

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Todd Overton joined SCA 13 years ago. He remembers his first claim vividly – a halfcourt shot at an Air Force Academy basketball game.

He remembers walking into Hamman's office to give him the news, not sure what his boss' reaction would be. Hamman shrugged and told him to cut the check.

"He's a world champion bridge player," Overton says. "He understands odds more than any person I know. He understands that things happen, that your number comes up sooner or later."

Of the numerous incarnations of sports contests, the one the industry has dialed in the most, it turns out, is the one with the longest odds: the hole-in-one. Doug Serkert, the president of National Hole-in-One, can tell you that an *amateur golfer* from 160 yards stands a 12,600-1 chance of holing it. For a PGA touring pro, it's closer to 2,500-1.

When your company has done 300,000 hole-in-one events, you have a fairly comprehensive database.

The 35-yard field goal is at the other end of the spectrum, closer to a 7-1 proposition.

Premiums generally range from 3 to 12 percent, Overton says, and the contest companies will reinsure most or all the prize money with large underwriters such as Lloyd's of London. When it comes to $1 million kicks or throws, companies will go the insurance premium route; some, however, have been known to decline coverage and "self-insure," gambling with their own money that a fan won't hit paydirt.

Most of the larger contest companies have actuaries on staff whose sole job is to crunch the numbers that are the basis for the premiums. The odds vary depending on the difficulty of the task, the number of contestants, the selection procedure (do they know in advance what they're doing?), and experience restrictions (the Taco Bell promotion, for instance, excluded current or former pro baseball players).

But as companies become more creative with their contests, actualizing the risk becomes well, riskier.

"When it's not pure math, it gets tricky," Overton says. "A lot of it is guesswork. If we can't make an educated guess, we pass on it because we can't put our underwriters in that position. I know some of our competitors have taken them just because they want to generate cash flow.

"We've seen those companies come and go, though. They don't understand the business. They don't understand the odds. They look at it from afar and say, 'That'll never happen.' And that's just death. Over time, you can't win doing that. It's not that we always see it correctly, it's just that we've been doing it for so long that we understand the numbers.

"We've been around long enough to learn from our mistakes."

In Houston last summer, Tom Gray reached for the ball and threw it at the 8-foot target. There was one second left on the clock.

Right down the middle.

One million dollars.

Gray began celebrating wildly with Nolan Ryan, the event's celebrity coach. Minute Maid Park was roaring. Overton smiled and shook Gray's hand.

"I guess we've got a bunch of rubber-armed employees, because they couldn't do it," Overton says. "We had them try it over and over, and we thought it was worth the risk. You just go back to the office and say, 'Well, we learned on that one. Pay the claim and move forward.'

"We got that one wrong, but I promise you, we won't next time."

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Office of the Attorney General
State of Texas

DAN MORALES
ATTORNEY GENERAL

July 25, 1997

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Office of the Secretary of State of Texas
P.O. Box 12697
Austin, Texas 78711-2697

Commissioner Elton Bomer
Texas Department of Insurance
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Opinion No. DM-445

Re: Whether the Automobile Club Services Act, Transportation Code chapter 722, authorizes automobile clubs to contract to reimburse members for expenses incurred in obtaining services (RQ-917)

Dear Secretary Garza and Commissioner Bomer:

You ask whether the Automobile Club Services Act, Transportation Code chapter 722 (the "act"), authorizes automobile clubs to contract to reimburse members for expenses they incur obtaining services an automobile club is authorized to provide under the act. You suggest that the act does not authorize an automobile club to contract to reimburse members for expenses other than legal fees incurred in the defense of traffic offenses. You also suggest that a contract to reimburse a member for expenses incurred obtaining a service constitutes the business of insurance rather than the provision of a service, and that the act, with the exception of reimbursement of legal fees, does not authorize automobile clubs to engage in the business of insurance. We agree.

Section 722.002 of the Transportation Code defines an "automobile club" as follows:

> [A] person who, for consideration, promises the membership assistance in matters relating to travel, and to the operation, use, or maintenance of a motor vehicle, by supplying services such as services related to:
>
> (A) community traffic safety;
>
> (B) travel and touring;
>
> (C) theft prevention or rewards;
>
> (D) maps;
>
> (E) towing;

(F) emergency road assistance;

(G) bail bonds and legal fee reimbursement in the defense of traffic offenses; and

(H) purchase of accidental injury and death benefits insurance coverage from an authorized insurance company.

Transp. Code § 722.002(2).

A person may not engage in business as an automobile club unless the person meets the requirements of chapter 722 and obtains an automobile club certificate of authority from the secretary of state. *Id.* § 722.003. An automobile club is required to file a copy of its service contract with the secretary of state. *Id.* § 722.010(a). Section 722.008 authorizes the secretary of state to revoke or suspend an automobile club's certificate of authority if the secretary determines that the club has, among other things, violated chapter 722 or is not acting as an automobile club. *Id.* § 722.008(a)(1)(A), (B).

Chapter 722 contains two provisions regarding insurance. Section 722.012 prohibits an automobile club from advertising or describing "its services in a manner that would lead the public to believe that the services include automobile insurance." *Id.* § 722.012(2). Section 722.013 provides that an automobile club "is exempt from the insurance laws of this state, except that accidental injury and death benefits furnished to club members must be covered by a group policy issued to the club for the benefit of its members." *Id.* § 722.013(a).

You ask whether the phrase "supplying services" found in the definition of "automobile club" includes reimbursement for any service identified in the definition, other than legal fee reimbursement, which is expressly listed as a service in section 772.002(2)(G) and is clearly within the authority of an automobile club. Your letter states that "[r]egulatory questions have arisen when an applicant [for an automobile club certificate of authority] proposes to provide reimbursement for an enumerated service for which reimbursement has not been expressly authorized." You state that the Department of Insurance "has historically viewed contracts providing for the indemnification or reimbursement against specified loss upon the happening of certain, fortuitous events as constituting the business of insurance within the meaning of [Insurance Code article 1.14-1]."

The letter provides towing as an example: "Rather than provide the service or contract with others to do so, the applicant [for an automobile club certificate of authority] offers to reimburse or indemnify a member, up to a fixed amount, for expenses incurred by the member who has independently arranged for his or her own towing with a third party contractor." The Department of Insurance has promulgated forms and rates for towing reimbursement as a rider to the Texas *Personal Auto Policy*. Your letter states that while the current rate approved by the Department of Insurance "for towing reimbursement is $2.00 per automobile for a $40 limit per disablement [s]ome auto clubs typically charge sums between 20 and 100 times greater than the approved rate."

Your letter suggests that a contract to reimburse members for expenses or to indemnify members for expenses incurred obtaining services other than legal fees exceeds the statutory authority of an automobile club. We agree. Chapter 722 was codified by the legislature in 1995.[1] The statutory predecessor to chapter 722, now-repealed article 1528d, V.T.C.S.,[2] defined "automobile club" in section 2(a) as follows:

> [A]ny person who in consideration of dues, assessments, or periodic payments of money, promises its members or subscribers to assist them in matters relating to travel and the operation, use or maintenance of a motor vehicle in the supplying of services which by way of illustration and not by way of limitation may include such services as community traffic safety *service*, travel and touring *service*, theft or reward *service*, map *service*, towing *service*, emergency road *service*, bail bond *service* and legal fee reimbursement *service* in the defense of traffic offenses, and the purchase of accidental injury and death benefits insurance coverage from a duly authorized insurance company. [Emphasis added.]

Act of May 15, 1963, 58th Leg., R.S., ch. 250, § 2(a), 1963 Tex. Gen. Laws 678, 678.[3] The codification of chapter 722 in the Transportation Code was part of a nonsubstantive revision,[4] and any construction of chapter 722 must be consistent with the former statute. *See Johnson v. City of Fort Worth*, 774 S.W.2d 653, 654-55 (Tex. 1989) (stating that, when conflict exists between former statute and nonsubstantive revision, former statute controls); Attorney General Opinion JM-1230 (1990) at 8 (quoting *Johnson*, 774 S.W.2d at 654-55).

The repeated use of the word *service* in former section 2(a) indicates that the legislature intended automobile clubs to provide services directly, not to contract to reimburse members for expenses incurred in obtaining these services. In addition, the description of reimbursement for legal fees as a service is notable. We believe that the fact that the legislature described legal fee reimbursement as a service supports our view that the legislature did not intend generally to permit automobile clubs to contract to reimburse to members for expenses incurred in obtaining any other services.

It appears that the legislature decided to permit automobile clubs to reimburse members for legal fees in response to a specific legal ruling. In 1962, some months before article 1528d was

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[1]*See* Act of May 1, 1995, 74th Leg., R.S., ch. 165, § 1, 1995 Tex. Gen. Laws 1025, 1814, 1817.

[2]*See* Act of May 15, 1963, 58th Leg., R.S., ch. 250, § 2(a), 1963 Tex. Gen. Laws 678, 678, *repealed by* Act of May 1, 1995, 74th Leg., R.S., ch. 165, § 24, 1995 Tex. Gen. Laws 1025, 1870.

[3]*See also* note 5 *infra*.

[4]*See* Act of May 1, 1995, 74th Leg., R.S., ch. 165, § 25, 1995 Tex. Gen. Laws 1025, 1871 ("This Act is intended as a recodification only, and no substantive change in law is intended by this Act.").

enacted, an appellate court had determined that an incorporated association that agreed to reimburse members for attorneys fees incurred in the defense of a moving traffic violation was engaged in the business of insurance. *See Texas Ass'n of Qualified Drivers, Inc. v. State*, 361 S.W.2d 580 (Tex. Civ. App.--Austin 1962, no writ). The legislature appears to have intended to change the result of this opinion by defining reimbursement of legal fees in this context as a service. Given the court's holding and the legislature's subsequent action, the legislature appears to have been well aware that an agreement to reimburse members for expenses incurred obtaining other services would also constitute the business of insurance. The legislature did not act, however, to expressly authorize automobile clubs to contract to reimburse members for expenses other than legal fees. For this reason, we believe that the statutory definition of the phrase "automobile club" indicates legislative intent to preclude automobile clubs from agreeing to reimburse members for expenses incurred in obtaining other services.

The two provisions of chapter 722 regarding insurance, sections 722.012(2) and 722.013(a), are consistent with our construction of section 722.002 to preclude an automobile club from agreeing to reimburse its members for expenses incurred obtaining services other than legal fees. The relationship between these two provisions is more apparent from the original statutory language, section 8 of former article 1528d, which provided in pertinent part:

> (a) Automobile Clubs operating hereunder [shall not] advertise or describe their services in such a manner as would lead the public to believe such services include automobile insurance.
>
> (b) All Automobile Clubs operating pursuant to a certificate of authority issued hereunder shall be exempt from the operation of all insurance laws of this State, except that accidental injury and death benefits furnished members of such Automobile Clubs shall be covered under a group policy issued to the Automobile Club for the benefit of its members and such policy shall be issued by a company licensed to write such insurance in this State.

Act of May 15, 1963, 58th Leg., R.S., ch. 250, § 8, 1963 Tex Gen. Laws 678, 680. Former subsection (a) suggests that, with the exception of reimbursement for legal fees, the legislature did not intend for automobile clubs to provide insurance. The exemption from insurance laws in former subsection (b) appears to have been predicated on former subsection (a) and to have assumed that automobile clubs would not engage in the insurance business.

This construction of the relevant statutory language is supported by the legislative history of former article 1528d. The legislation at issue, House Bill 172, as introduced, contained definitions of various services. These definitions appear to have been intended to authorize "motor

clubs" to provide a broad array of services. The definition of the term "motor club service" may have been intended to expressly authorize a motor club to reimburse its members for services:

> "Motor club service" means the rendering, furnishing or procuring of towing service, emergency road service, bail bond service, discount service, buying and selling service, theft service, map service, touring service, license service and reimbursement of legal service, as herein defined, to any person, in connection with the ownership, operation, use or maintenance of a motor vehicle by such person, in consideration of such other person being or becoming a member of any company *rendering, procuring, furnishing, or reimbursing the same*, or being or becoming in any manner affiliated therewith, or being or becoming entitled to receive membership or other motor club service therefrom by virtue of any agreement or understanding with any such company.

See H.B. 172, 58th Leg., R.S. (1963) (filed version; emphasis added). In addition, House Bill 172, as introduced, defined the term "insurance service" to mean "any act by a company . . . selling or giving . . . a policy of accident insurance covering loss by the holder of a service contract . . . as the result of injury or death . . . following an accident resulting from the ownership, maintenance, operation or use of a motor vehicle." *Id.* We believe the fact that the legislature deleted these provisions from subsequent versions of House Bill 172 supports the position that the legislature did not intend to permit an automobile club to reimburse members for services, other than legal services, or to engage in the business of insurance. *See Transportation Ins. Co. v. Maksyn*, 580 S.W.2d 334, 337-38 (Tex. 1979) ("The deletion of a provision in a pending bill discloses the legislative intent to reject the proposal. . . . Courts should be slow to put back that which the legislature has rejected."); 2A NORMAN J. SINGER, SUTHERLAND STATUTORY CONSTRUCTION § 48.18 (5th ed. 1992) (adoption of amendment is evidence that legislature intends to change provisions of original bill).

Our construction of chapter 722 is further supported by a prior opinion of this office, Attorney General Opinion M-994, which considered whether the secretary of state should issue a certificate of authority to an automobile club that agreed to collect and hold membership fees that would be available to the member to draw on "to reimburse an insurance carrier the amount of any deductible it pays out in settlement of claims under a policy of deductible automobile insurance, and

to pay the increased cost of insurance when a policy must be obtained at higher than normal rates." Attorney General Opinion M-994 (1971) at 1.[5] In the view of this office, by offering this service the association was engaging in the insurance business:

> An insurance contract arises when, for a stipulated consideration, whether called a premium or a fee or something else, one party undertakes to compensate another party for loss on a specified subject by a specified peril or contingency .... When the association, in consideration of a membership fee, obligates itself to honor the member's draft for the amount of the deductible, which otherwise would be lost by the member, in the event of a collision, the association is engaging in the insurance business.

Id. at 3. This office concluded that this membership provision, if approved by the state, "would authorize the association to do business as an insurance carrier without a certificate of authority, in violation of Article 1.14 of the Texas Insurance Code, and that the club is not authorized by Article 1528d to engage in the insurance business." *Id.*

The conclusion in Attorney General Opinion M-994 that an automobile club is not authorized to engage in the insurance business has stood unquestioned since 1971. We believe that a Texas court would hold that Attorney General Opinion M-994 correctly concluded that an automobile club is not authorized to engage in the business of insurance. We also believe that a court would determine that an agreement by an automobile club to reimburse its members for costs incurred obtaining automobile-related services constitutes the business of insurance. *See Qualified Drivers*, 361 S.W.2d at 581-82 (defining "insurance" as contract by which one party for consideration assumes particular risks of other party and promises to pay him or someone named by him a certain sum on a specified contingency).

In sum, we construe chapter 722 to authorize an automobile club to contract to reimburse members for legal fees incurred in the defense of traffic offenses and to preclude an automobile club from agreeing to reimburse its members for expenses incurred obtaining any other service. An agreement to reimburse members for expenses incurred obtaining any other service exceeds the statutory authority of an automobile club under chapter 722 and constitutes the business of insurance. Given the language of chapter 722 and its statutory predecessor, the legislative history, and the 1971 opinion of this office, we can reach no other conclusion.[6] If the legislature wishes to

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[5]After former article 1528d was enacted in 1963, it was only amended twice, in 1983 and 1987, before it was codified in the Transportation Code in 1995. *See* Act of April 21, 1983, 68th Leg., R.S., ch. 69, § 12, 1983 Tex. Gen. Laws 310, 318; Act of May 23, 1987, 70th Leg., R.S., ch. 1007, §§ 11, 12, 1987 Tex. Gen. Laws 3404, 3408. Those amendments increased the amount of certain fees set by the act. They are not relevant to this opinion and do not affect the continued validity of Attorney General Opinion M-994.

[6]Given our conclusion that an automobile club is not authorized to agree to reimburse members for expenses incurred obtaining any service other than legal services, we do not believe it is necessary to address your second

(continued...)

amend chapter 722 to authorize automobile clubs to contract to reimburse members for expenses incurred obtaining other services and to exempt such contractual terms from regulation by the Department of Insurance, however, it is within the legislature's power to do so.

SUMMARY

Chapter 722 of the Transportation Code authorizes an automobile club to contract to reimburse members for legal fees incurred in the defense of traffic offenses. An agreement to reimburse a member for expenses incurred obtaining any other service exceeds the statutory authority of an automobile club under chapter 722 and constitutes the business of insurance.

Yours very truly,

Dan Morales

DAN MORALES
Attorney General of Texas

JORGE VEGA
First Assistant Attorney General

SARAH J. SHIRLEY
Chair, Opinion Committee

Prepared by Mary R. Crouter
Assistant Attorney General

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[6](...continued)
question about the authority of an automobile club to agree to reimburse members for services not listed in section 722.002(2). Our conclusion applies to both listed and unlisted services.

C

Court of Civil Appeals of Texas, Austin.
TEXAS ASSOCIATION OF QUALIFIED DRIVERS, INC., Appellant,
v.
The STATE of Texas, Appellee.
No. 10996.

Oct. 17, 1962.

Quo warranto proceedings instituted by state against automobile association for forfeiture of its charter and a permanent injunction. The 53rd District Court, Travis County, Charles O. Betts, J., ordered judgment for the state and the association appealed. The Court of Civil Appeals, Richards, J., held that association, which had no authorization to transact insurance business, was engaged in casualty insurance business by providing for reimbursement of attorneys' fees incurred for defense of moving traffic violation charges against persons subscribing to services of association.

Affirmed.

West Headnotes

Insurance ⇐1571
217k1571 Most Cited Cases
(Formerly 217k6)
Automobile association, not authorized to engage in insurance business by State Board of Insurance, was engaged in writing of "casualty insurance" in violation of law by providing for reimbursement of attorneys' fee incurred for defense of moving traffic violation charges against subscribers to service. V.A.T.S. Insurance Code, arts. 1.14, 3.01, 8.01, subd. 12.

***580** Joseph R. Darnall, Jr., Austin, for appellant.

Will Wilson, Atty. Gen., Bob E. Shannon, Asst. Atty. Gen., Austin, for appellee.

RICHARDS, Justice.

The State of Texas, appellee, instituted quo warranto proceedings against Texas Association of Qualified Drivers, Inc., appellant, seeking the forfeiture of its charter and a permanent injunction restraining it from engaging in the business of writing general casualty insurance under the provisions of Chapter 8, Texas Insurance Code, Vernon's Civil Statutes, without having been authorized to transact such business by the State Board of Insurance. The charter of the corporation contained no purpose clause authorizing it to engage in the insurance business in any manner or form.

Upon trial before the Court without the intervention of a jury, the facts being stipulated, the Trial Court held that the activity of the corporation in providing reimbursement of attorneys' fees incurred for defense of moving traffic violation charges ***581** against persons subscribing to the services of the corporation constituted the writing of general casualty insurance as defined in Chapter 8, Texas Insurance Code, V.C.S., and rendered judgment for the State of Texas as prayed for from which this appeal has been perfected.

For its sole point of error appellant contends that the Trial Court should not have held as a matter of law that it was engaged in the business of writing general casualty insurance as defined in Chapter 8, Texas Insurance Code, since its activity in providing reimbursement of attorneys' fees for defense of moving traffic violation charges against its subscribers does not constitute the writing of insurance as defined in the statute.

Appellant is a corporation organized under the Texas Business Corporation Act as an association of automobile drivers and solicits and sells memberships in the association. Among the benefits received by such members is

reimbursement for attorneys' fees incurred by them when involved in a moving traffic violation as follows:

'1) Up to $10 for counsel when the case is not contested;

'2) Up to $50 per day for services in a justice court or traffic court;

'3) Up to $75 per days for services in a County Court or County Court-at-Law;

'4) Up to $150 per day for services in a District Court;

'5) Up to $250 per day for services in the Texas Court of Criminal Appeals;

'6) Whenever a member shall plead not guilty in a justice, corporation, or traffic court, appeals to the County Court or County Court-at-Law, and the case is dismissed on motion of the County Attorney, the association shall, for such procedure, reimburse member for attorneys' fees not to exceed $25.00.'

The provisions for reimbursement do not include court costs, fines, costs of appeal, bonds and other expenses other than attorneys' fees and the Association does not reimburse its members for attorneys' fees in the defense of any charge involving the member's use of alcohol or narcotics, leaving the scene of an accident, or failure to stop and render aid.

The sole question for decision is whether the reimbursement to members for attorneys' fees incurred by them as above set forth constitutes insurance. If so, since appellant admittedly has not been authorized by the State Board of Insurance to engage in the writing of insurance as provided in Art. 1.14, Texas Insurance Code, it has been violating the insurance laws of the State of Texas.

Chapter 8, Texas Insurance Code, provides for the incorporation of general casualty insurance companies. Section 12, Art. 8.01, authorizes the incorporation of such companies 'To insure against any other casualty or insurance risk specified in the articles of incorporation which may be lawfully made the subject of insurance, and the formation of a corporation for issuing against which is not otherwise provided by this article, excepting fire and life insurance.' The Trial Court held that the reimbursement for attorneys' fees paid by the association to its members constituted a general form of casualty insurance within the provisions of Art. 8.01.

There is no statutory general definition of the word 'insurance' in Texas. [FN1] However, insurance has been defined by the Appellate Courts of Texas as "An undertaking by one party to protect the other party from loss arising from named risks, for the consideration and upon the terms and under the conditions recited.' * * * Whether or not a contract is one of insurance is to be determined by its purpose, *582 effect, contents, and import, and not necessarily by the terminology used, and even though it contain declarations to the contrary.' National Auto Service Corporation v. State, Tex.Civ.App., 55 S.W.2d 209, 211, err. dism. It has also been defined as 'a contract by which one party for a consideration assumes particular risks of the other party and promises to pay him or someone named by him a certain or ascertainable sum of money on a specified contingency.' Denton v. Ware, Tex.Civ.App., 228 S.W.2d 867, 870, no writ history.

> FN1. The types of insurance which may be written by life, accident and health companies are defined in Art. 3.01, Texas Insurance Code.

Here the purpose of the contract made by appellant with its members for a stated consideration was to indemnify or reimburse the holder of a membership certificate for payments incurred by the member for attorneys' fees in the defense of a moving traffic violation in which the member was involved under certain conditions and within the limitations set forth in the certificate. Under the above definitions of insurance it is clear that the contract between appellant and its members constitutes an insurance contract.

Whether reimbursement for attorneys' fees constitutes insurance does not seem to have been passed upon directly by the appellate courts of Texas. The Supreme Court of Michigan in

361 S.W.2d 580

(Cite as: 361 S.W.2d 580)

Continental Auto Club, Inc. v. Navarre, 337 Mich. 434, 60 N.W.2d 180, has construed a contract of an automobile club which furnished reimbursement for attorneys' fees to its members under a provision somewhat similar to the one here involved. The Michigan Insurance Code, like the Texas Insurance Code, contained no general definition of insurance. However, there was a definition of the term 'automobile insurance' which stated that such insurance covered 'against any loss, expense, and liability resulting from the ownership, maintenance or use of any automobile or other vehicle.' Comp. Laws 1948, § 543.3. The Court held that:

> 'In view of the use of the word insurance in general in the insurance code, and as the word is generally used in cases that deal with the subject of insurance, we are of the opinion that by engaging in the business of furnishing its members under its contract the benefits hereinbefore recited, the plaintiff corporation was and is in fact engaging in the business of insurance.'

Appellants' point of error is overruled and the judgment of the Trial Court is in all things affirmed.

Affirmed.

361 S.W.2d 580

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H

Briefs and Other Related Documents

Supreme Court of Texas.
DALLAS FIRE INSURANCE COMPANY, Petitioner,
v.
TEXAS CONTRACTORS SURETY AND CASUALTY AGENCY, Tom Young and Fred Thetford, Respondents.
No. 04-0215.

Dec. 17, 2004.
Rehearing Denied March 11, 2004.

Background: Bond agents brought action against surety to recover for breach of contract and violation of Insurance Code through misrepresentations in violation of Deceptive Trade Practices Act (DTPA). Surety counterclaimed for unjust enrichment, breach of contract, and breach of fiduciary duty. The 348th District Court, Tarrant County, Dana Womack, J., entered judgment on jury verdict awarding agents actual damages and attorney fees under Insurance Code. Surety appealed. The Fort Worth Court of Appeals, Anne Gardner, J., 128 S.W.3d 279, affirmed. Review was granted.

Holding: The Supreme Court held that the claims arose in the business of suretyship, not the "business of insurance," within the meaning of statute providing a private cause of action for unfair or deceptive acts or practices in the business of insurance.
Reversed and rendered.

West Headnotes

Insurance 3417
217k3417 Most Cited Cases
Bond agent's claims against surety arising out of commission dispute arose in the business of suretyship, not the "business of insurance," within the meaning of statute providing a private cause of action for unfair or deceptive acts or practices in the business of insurance; the "business of insurance" is defined differently in different sections of the Insurance Code, and it did not matter that the surety's primary line of business was commercial liability insurance, its surety bonds were "insurance products" for the purpose of licensing, and that the agents were licensed by the Department of Insurance. V.A.T.S. Insurance Code, arts. 21.02, 21.21, § 16(a).

*895 Bernard R. Suchocki, Jerry D. Bullard, and Scott A. Cummings, Suchocki, Bullard & Cummings, Fort Forth, for Petitioner.

James Lanter, Lanter Westermann, P.C., Fort Worth, Jefferson W. Autrey, Keith Gregory Hopkinson, Kevin Norton, Cantey & Hanger, L.L.P., Austin, for Respondents.

PER CURIAM.

Article 21.21 of the Insurance Code provides a private cause of action for unfair or deceptive acts or practices in the business of insurance. Tex. Ins.Code art. 21.21, § 16(a). In *Great American Insurance Co. v. North Austin Utility District No. 1*, we held that suretyship was not included in the scope of this provision. 908 S.W.2d 415, 424 (Tex.1995). The court of appeals here interpreted that holding to apply only to suits between sureties and their bondholders, and thus affirmed a judgment under article 21.21 in a suit between a surety and its sales agents. 128 S.W.3d 279, 288-89, 304. Because our previous opinion excluded the business of suretyship rather than the particular parties involved, we hold the court of appeals' opinion conflicts with ours, [FN1] and reverse the court of appeals' *896 judgment and render judgment that respondents take nothing.

FN1. Tex. Gov't Code § 22.001(a)(2).

In December 1993, Texas Contractors Surety and Casualty Agency (TCSCA) signed an Agency-Company Agreement to issue surety, performance, and bid bonds on behalf of **Dallas Fire Insurance** Company. For each surety bond TCSCA sold, Dallas Fire agreed to pay a straight commission, [FN2] plus a contingency profit commission based on premiums collected adjusted by a loss ratio reflecting losses and expenses. [FN3]

FN2. While the Agreement was in effect, TCSCA earned in excess of $800,000 in such commissions.

FN3. The Agreement called for a contingent

> profit commission of 5 percent on all earned bond premiums, decreasing 1/2 percent for each 1 percent increase in the "loss ratio" above 20 percent. Therefore, if the "loss ratio" increased by 10 percent or more, no contingent profit commission was owed.

For the years 1994 and 1995, Dallas Fire calculated the contingency commission using only *direct* expenses (such as legal and consulting fees) incurred in handling bond claims, and paid respondents on that basis. But for 1996, Dallas Fire calculated the contingency commission to reflect its own *indirect* expenses (such as salaries, rent, and other overhead) as well, thus denying respondents any contingency commission. Dallas Fire also recalculated the contingency commission for previous years, and demanded reimbursement on that basis.

TCSCA filed suit, and Young intervened for breach of his separate agreement incorporating similar terms. Both respondents alleged breach of the Agency-Company Agreement and deceptive acts in violation of article 21.21. *See* Tex. Ins.Code art. 21.21, § 16(a) (defining deceptive acts to include violations of Texas Business & Commerce Code section 17.46(b)); Tex. Bus. & Comm.Code 17.46(b)(12) (defining deceptive acts to include representing that an agreement confers or involves rights, remedies, or obligations which it does not have or involve, or which are prohibited by law). The jury found for Dallas Fire on the breach of contract question, but for respondents under article 21.21, and awarded $56,641.02 in damages to TCSCA and $82,641.02 to Young.

Dallas Fire asserts that respondents have no article 21.21 claim because *Great American* excludes the business of suretyship from the "business of insurance" under that article, and the parties' relationship consisted of nothing else. As this was the only basis for respondents' recovery, Dallas Fire asserts we must reverse and render judgment against them. We agree.

As we have previously noted, the Insurance Code is somewhat different from Texas's other statutory codifications in that it is not a formal, unified Code containing uniform definitions. *Great Am.*, 908 S.W.2d at 424. Thus, "the business of insurance" has meant different things in different sections of the Code. For example, at all times applicable here, suretyship was expressly *included* in the "doing an insurance business" in former article 1.14-1, [FN4] but expressly excluded in article 21.55, section 5(a)(4). *Id.* at 423-24.

> FN4. Act of May 28, 1987, 70th Leg., R.S., ch. 254, § 1, 1987 Tex. Gen. Laws 1573, 1573, *repealed by* Act of May 17, 1999, 76th Leg., R.S., ch. 101, § 1, 1999 Tex. Gen. Laws 486, 525-26 (current version at Tex. Ins. Code § 101.051).

While acknowledging our holding in *Great American* that the "business of insurance" in article 21.21 does not include suretyship, the court of appeals read that case narrowly to apply only to disputes between a surety and its obligee. 128 S.W.3d at 289. It is true that we pointed *897 out particular difficulties that would arise in the surety-obligee relationship if article 21.21 applied. *Great Am.*, 908 S.W.2d at 422-23. But we also noted that the suretyship business predated the insurance business "by thousands of years" and had different characteristics. *Id.* at 424 (noting that insurance involves spreading risks with no right of indemnity, while suretyship involves risk of initial payment with full right of indemnity).

More important, our holding in *Great American* was not limited to *parts* of the business of suretyship:

> Given the unique character, rights, and obligations of suretyship, and the complexities that would result by the imposition of liability under 21.21, we cannot conclude that the Legislature intended to include suretyship in the definition of the business of insurance under article 21.21. Absent a clear legislative directive, we conclude that suretyship, as historically understood in the insurance and suretyship fields, does not constitute the business of insurance under article 21.21.

Id. This holding leaves no room for applying article 21.21 to parts of the surety business.

The court of appeals also relied on evidence that Dallas Fire's primary line of business (though not through TCSCA) was commercial liability insurance, that its surety bonds were "insurance products" for the purpose of licensing under article 21.02, and that TCSCA sold surety bonds through agents licensed by the Texas Department of Insurance. 128 S.W.3d at 291. But as already noted, the business of insurance is defined differently in different sections of the Insurance Code, and all that is involved here is a commission dispute involving the sale of surety bonds. *See Ins. Co. of N. Am. v. Morris*, 981 S.W.2d 667, 672 (Tex.1998) (holding surety bonds to be insurance products for purposes of article 21.02, though not for article 21.21). Here, TCSCA's claims

arose in the business of suretyship, not the business of insurance. [FN5]

> FN5. Respondents contend that in *Crown Life Insurance Co. v. Casteel*, we extended the reach of article 21.21 beyond claims between an insured and insurer. 22 S.W.3d 378, 385 (Tex.2000). But *Casteel* involved a claim against a life insurance carrier and its agent based on inaccurate language and illustrations contained in life insurance policies sold by Crown's agent, William Casteel. *Id.* at 381-82. Thus, *Casteel* clearly involved the "business of insurance" and not the business of suretyship, which is implicated in this case.

By limiting the scope of article 21.21 to the business of insurance, the Legislature intended it to apply to a species of economic enterprise, not to particular contracts on a piecemeal basis. Accordingly, without hearing oral argument, we grant the petition for review, reverse the judgment of the court of appeals and render judgment that respondents take nothing. Tex.R.App. P. 59.1.

159 S.W.3d 895, 48 Tex. Sup. Ct. J. 200

Briefs and Other Related Documents (Back to top)

• 2004 WL 1959017 (Appellate Brief) Petitioner's Reply Brief (Aug. 17, 2004)Original Image of this Document (PDF)

• 2004 WL 1881590 (Appellate Brief) Respondents' Brief on the Merits (Aug. 02, 2004)Original Image of this Document (PDF)

• 2004 WL 555186 (Appellate Petition, Motion and Filing) Petition for Review (Mar. 05, 2004)Original Image of this Document with Appendix (PDF)

• 04-0215 (Docket) (Mar. 05, 2004)

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Supreme Court of Texas.
GREAT AMERICAN INSURANCE COMPANY, Petitioner,
v.
NORTH AUSTIN MUNICIPAL UTILITY DISTRICT NO. 1, Respondent.
No. D-3889.

Argued Jan. 19, 1995.
Decided June 15, 1995.
Rehearing Overruled Nov. 16, 1995.

Utility district filed suit against commercial surety on payment and performance bonds, principal contractor and others after walls collapsed on buried dry well installed by contractor at waste water station. The 98th District Court, Travis County, John K. Dietz, J., entered judgment in favor of district. Surety appealed. The Court of Appeals, 850 S.W.2d 285, affirmed. On application for writ of error, the Supreme Court, Owen, J., held that: (1) surety owed no common-law duty of good faith and fair dealing to bond obligee; (2) article of Insurance Code providing cause of action for unfair or deceptive acts or practices in business of insurance did not apply to commercial sureties; and (3) attorneys fee award was improperly calculated.

Affirmed in part, reversed in part and remanded.

West Headnotes

[1] Principal and Surety ⇐136
309k136 Most Cited Cases
There is no common law duty of good faith and fair dealing between surety and bond obligee comparable to that between liability insurer and its insured; imposing common law duty on surety because it is allegedly in position to delay paying claims could directly contravene surety's express statutory right to require obligee to file suit against principal, obtain judgment, and execute on that judgment. V.T.C.A., Bus. & C. § 34.04.

[2] Principal and Surety ⇐1
309k1 Most Cited Cases

[2] Principal and Surety ⇐136
309k136 Most Cited Cases
Suretyship involves tripartite relationship between surety, its principal, and bond obligee, in which obligation of surety is intended to supplement obligation of principal owed to bond obligee; obligation of surety to bond obligee is secondary to obligation owed by its principal.

[3] Principal and Surety ⇐136
309k136 Most Cited Cases
Commercial surety on performance, payment and maintenance bonds did not owe common law duty of good faith and fair dealing to utility district as bond obligee, and thus could not be held liable for alleged delay in making payment under bonds or for insisting that obligee pursue action against surety's principal.

[4] Insurance ⇐3417
217k3417 Most Cited Cases
(Formerly 217k11)

[4] Principal and Surety ⇐136
309k136 Most Cited Cases
Section of Insurance Code creating private cause of action for injuries caused by practices declared to be "unfair or deceptive" does not apply to commercial sureties; phrase "business of insurance" as used in article does not include commercial suretyship. V.A.T.S. Insurance Code, art. 21.21, §§ 4, 16.

[5] Contracts ⇐198(1)
95k198(1) Most Cited Cases
Principal contractor was not relieved of responsibility for work done by subcontractor with

respect to failure to sufficiently thicken walls of dry well to withstand lateral pressures; contract specifically provided that contractor was subject to liability for work done by subcontractors; article relieved contractor from responsibility for design defects, but only for those means, methods, techniques or procedures of construction that were required in contract of documents, and contract document specifically required that sides of dry well be of sufficient thickness to support depth of burial.

[6] Damages ⇐62(4)
115k62(4) Most Cited Cases
Doctrine of "mitigation of damages" prevents party from recovering for damages resulting from breach of contract that could be avoided by reasonable efforts on part of plaintiff.

[7] Damages ⇐214
115k214 Most Cited Cases
No instruction regarding mitigation damages was required in utility district's suit against surety absent evidence that utility district could have mitigated damages caused by inward collapse of walls in dry well by repairing, rather than completely replacing lift station for waste water.

[8] Principal and Surety ⇐66(1)
309k66(1) Most Cited Cases
Performance bond is enforceable only to extent of obligee's actual damages.

[9] Principal and Surety ⇐73
309k73 Most Cited Cases
Where obligee's actual damages exceed penal amount of performance bond, surety's liability is limited to penal amount of bond.

[10] Principal and Surety ⇐73
309k73 Most Cited Cases
Commercial surety was not liable for bond obligee's actual damages caused by principal contractor's breach in excess of face amount of bond, where performance bond specifically stated that surety's liability was limited to that amount.

[11] Principal and Surety ⇐73
309k73 Most Cited Cases
Surety was not liable to bond obligee for attorneys' fees assessed against its principal in excess of bond amount under terms of surety bond itself.

[12] Principal and Surety ⇐73
309k73 Most Cited Cases
Since bond obligee had right to sue on surety bond issued by surety, it was entitled under Civil Practice and Remedies Code to recover attorneys fees incurred as result of surety's own default on terms of bond. V.T.C.A., Civil Practice & Remedies Code § § 38.001, 38.005.

[13] Principal and Surety ⇐162(4)
309k162(4) Most Cited Cases
Jury award of attorneys fees to bond obligee expressed as percentage of bond obligee's recovery was not defective for failing to find attorneys fees segregable by parties and claims, where bond obligee's recovery from each defendant could be determined from jury's answer to other damages issues and attorneys fees could be calculated as to each defendant on claims for which it was actually found liable. V.T.C.A., Civil Practice & Remedies Code §§ 38.001, 38.005.

[14] Principal and Surety ⇐73
309k73 Most Cited Cases
In suit brought by bond obligee against commercial surety on performance bond, jury award of 33 1/3 % of bond obligee's recovery as attorney fee would be calculated on basis of penal amount of bond, not amount of judgment. V.T.C.A., Civil Practice & Remedies Code §§ 38.001, 38.005.
***416** David C. Wenholz, Dallas, Arthur F. Selander , Dallas, for petitioner.

Scott R. Kidd, Austin, for respondent.

OWEN, Justice, delivered the opinion of the Court in which all the Justices join.

The issues in this case involve the duties and liabilities of a commercial surety to its bond obligee. We hold there is no common law duty of good faith and fair dealing between the surety and the bond obligee comparable to that between a

liability insurer and its insured. We further hold that article 21.21 of the Insurance Code is inapplicable to a commercial surety, and accordingly, reverse the judgment of the court of appeals in part. 850 S.W.2d 285, 902 S.W.2d 488. [FN1] We affirm the holding of the court of appeals that the surety in this case is liable under the terms of the bond for the default of the principal.

> FN1. Only part of the court of appeals' decision was published pursuant to Texas Rule of Appellate Procedure 90. Because we consider issues that were disposed of in unpublished portions of that opinion, the entire opinion is ordered published by this Court.

I

This case arises out of a construction project for a municipal wastewater lift station in which Great American Insurance Company ("Great American") issued payment, performance, and maintenance bonds in favor of the North Austin Municipal Utility District No. 1 ("MUD"). In 1986, MUD determined that it needed to upgrade a wastewater lift station located at Rattan Creek to consist of a wet well/dry well configuration. A wet well is a concrete structure poured into the ground which serves as a holding tank for the wastewater being collected by the station, ***417** while a dry well is a large, metal cylinder buried in the ground which contains the pumps and electrical equipment necessary to pump wastewater. In planning the facility at Rattan Creek, MUD considered two alternatives: the construction of a new dry well or the refurbishment and relocation of an existing dry well at another lift station that was to be closed.

MUD consulted with an engineering firm, Dippel Ulmann, who prepared bid documents that requested contractors to submit separate bids for the construction of a new dry well and for the refurbishment of the existing well. The specifications, plans, and drawings included in the bid documents, however, were the same for either project and did not contain requirements specifically related to the refurbishment of the existing dry well. The specifications required the thickness of the sides of the dry well to be determined by the structural requirements for the depth of burial, but at a minimum to be 1/4 inch thick.

Underground Utilities Company ("Underground") was awarded the contract on the basis of its bid for the refurbishment and relocation of the existing dry well. Underground removed the dry well and shipped it to a subcontractor, Smith Pump Company, for refurbishment. Smith Pump submitted drawings indicating the manner in which it would refurbish the dry well to Dippel Ulmann, who approved them. The drawings did not include any indication that Smith Pump would thicken the sides of the dry well. After the modifications were completed, the dry well was installed at Rattan Creek and began operating in April of 1988. MUD formally accepted the refurbished lift station as "substantially complete" in December, 1988.

On March 10, 1989, nearly one year after being installed at Rattan Creek, the metal sides of the dry well collapsed inward by approximately three inches. MUD notified Underground and retained a structural engineer to evaluate the cause of the failure. Although the sides of the dry well met the minimum 1/4 inch thickness required by the contract specifications, the engineer determined that the sides were nonetheless not thick enough to withstand the lateral earth pressure created by the depth of burial of the well.

MUD demanded that Underground correct the problem. Underground refused, claiming that it had performed all work according to the plans and specifications approved by MUD's design engineer and that MUD had approved the work. Underground further claimed that Smith Pump, rather than Underground, was liable on the warranty included in the contract documents. Smith Pump denied liability for the inward buckling of the dry well, asserting that an outside force caused the buckling, and pointing out that the dry well was in place at its previous location for over three years without buckling inward and had been operating at Rattan Creek for nearly one year.

On April 4, 1989, MUD first sent notice of the defect to the construction surety, Great American, who had issued a performance bond in the amount of $397,503.20 and a one-year maintenance bond in the amount of $386,431.98 on the project. MUD advised Great American of Underground's refusal to correct the problem with the dry well, and demanded performance under the terms of the bonds.

Thereafter, Great American consulted with MUD and Underground about the problem, obtained copies of the report of MUD's engineer, and reviewed copies of the contract documents and specifications. On April 26, 1989, Great American sent a letter to MUD stating that the problem with the dry well appeared to be one relating to its design, and requested evidence that its principal, Underground, had failed to conform with the plans and specifications in the contract. Great American also asked MUD for legal authority holding a contractor liable for an engineering design defect. MUD replied several months later by sending a letter demanding payment on the bonds. Great American once again responded by requesting additional information. The dry well continued in operation during this time.

MUD filed suit against Dippel Ulmann, Smith Pump, Underground, and Great American. Based on liability findings by a jury against all the defendants, the trial court ***418** rendered judgment in favor of MUD. Specifically as to Great American, the jury found that it had knowingly committed deceptive acts in violation of article 21.21 of the Insurance Code and had breached a common law duty of good faith and fair dealing. The jury also found that reasonable attorneys' fees would be 33 1/3 % of MUD's recovery. Accordingly, based on an actual damages finding by the jury of $411,400, the court entered judgment against Great American by adding prejudgment interest to that amount and trebling that sum under article 21.21, § 16(b) for damages in the amount of $1,558,804.80. The court additionally awarded $779,402.40 in attorneys' fees against Great American. Great American alone appealed the judgment of the trial court, and the court of appeals affirmed.

II

The jury found that Great American failed to deal fairly and in good faith with MUD and that the amount of damages proximately caused by this failure was $411,400. Great American contends that the court of appeals erred in failing to hold that the contractual relationship between a commercial surety and its bond obligee does not give rise to a common law duty of good faith and fair dealing. In response, MUD asserts that the special relationship between a surety and its obligee justifies the judicial imposition of this extracontractual duty.

[1] In *English v. Fischer,* 660 S.W.2d 521, 522 (Tex.1983), this Court held that a duty of good faith and fair dealing does not exist in the context of all contractual relationships. Such a duty is owed by a liability insurer to its insured, however, because of the special relationship between them. *Arnold v. National County Mut. Fire Ins. Co.,* 725 S.W.2d 165, 167 (Tex.1987). Likewise, this duty is owed by workers' compensation carriers to injured workers. *Aranda v. Insurance Co. of N. Am.,* 748 S.W.2d 210, 212-13 (Tex.1988). At issue, then, is whether the relationship between a surety and its bond obligee is such that it owes a duty of good faith and fair dealing to the bond obligee.

In finding a special relationship between a liability insurer and its insured, factors this Court has considered include unequal bargaining power between the insurer and its insured, the nature of insurance contracts (which permit unscrupulous insurers to take advantage of insureds' misfortunes in negotiating claim resolution), and the insurance company's exclusive control over the claim evaluation process. *Arnold,* 725 S.W.2d at 167. None of these factors is present in this case.

First, the unequal bargaining power that concerned this Court in *Arnold* did not exist here. Great American had no control over the form of the bond used in this case. In fact, state law, which required a contractor entering into a formal contract in excess of $25,000 with any governmental or quasi-governmental authority to provide both

performance and payment bonds in favor of the governmental entity, mandated that the form of the required bonds "shall be approved by the Attorney General" or the "governmental awarding authority concerned." Tex.Rev.Civ.Stat.Ann. art. 5160, *repealed by* Acts 1993, 73rd Leg., R.S., ch. 268, § 46(1), 1993 Tex.Gen.Laws 583, 986 (current version at Tex.Gov't Code § 2253.021(e)). MUD therefore had the ability to exercise control over the form of the bonds. Moreover, the bonds incorporated the terms of the contract between MUD and Underground. It is undisputed that MUD controlled the contract documents at issue here.

[2] Second, concerns that a surety may take advantage of a bond obligee in the claims resolution process ignore the fundamental differences between a liability insurance contract and a surety bond. While a liability insurance contract involves only two parties, the insurer and the insured, suretyship involves a tripartite relationship between a surety, its principal, and the bond obligee, in which the obligation of the surety is intended to supplement an obligation of the principal owed to the bond obligee. Clark, *Suretyship in the Uniform Commercial Code,* 46 TEX.L.REV. 453 (1968). Unlike a liability insurance contract, in which the obligation of the insurer to the insured is the primary obligation of indemnity to the insured for loss, the obligation of a surety to a bond obligee is secondary to the obligation ***419** owed by its principal. A party sustaining a loss covered under a liability insurance contract can look only to its insurer for recourse. A bond obligee has a remedy against its principal.

Another significant distinction between sureties and an insurer is that sureties traditionally are entitled to rely upon all defenses available to their principal as to the debt owed to the bond obligee. *See Wright Way Constr. Co. v. Harlingen Mall Co.,* 799 S.W.2d 415, 426 (Tex.App.--Corpus Christi 1990, writ denied) (liability of surety is derivative in nature and depends upon principal's liability); *Stephens v. First Bank & Trust of Richardson,* 540 S.W.2d 572, 574 (Tex.Civ.App.--Waco 1976, writ ref'd n.r.e.) ("A surety or guarantor can assert any defense to a suit on a note available to the principal."); *Scarborough v. Kerr,* 70 S.W.2d 607, 607 (Tex.Civ.App.-- Beaumont 1934, no writ) (any plea by a principal which would release it from liability on a bond releases the surety); *Girard Fire & Marine Ins. Co. v. Koenigsberg,* 65 S.W.2d 783, 786 (Tex.Civ.App.--Dallas 1933, no writ) ("Unless a cause of action exists against the principal, it cannot exist against the surety."). Indeed, the Texas Business and Commerce Code expressly allows a surety to *require* a bond obligee to sue upon a written contract before the surety is liable. Tex.Bus. & Com.Code § 34.02. Under section 34.02, if a bond obligee who has received written notice from a surety requiring it to sue upon the contract fails to prosecute a suit to judgment and execution, the surety's liability on the contract may be discharged. *Id.* [FN2] Imposing a common law duty on a surety because it is allegedly in a position to delay paying claims could directly contravene a surety's express statutory right to require an obligee to file suit against the principal, obtain a judgment, and execute on that judgment.

> FN2. Specifically, section 34.02 provides
> (a) When a right of action has accrued on a contract for the payment of money or performance of an act, a surety on the contract may require by written notice that the obligee forthwith sue on the contract.
> (b) A surety who gives notice to an obligee under Subsection (a) of this section is discharged from all liability on the contract if the obligee
> (1) is not under a legal disability; and either
> (2) fails to sue on the contract during the first term of court after receiving the notice, or during the second term showing good cause for the delay; or
> (3) fails to prosecute the suit to judgment and execution.
> Tex.Bus. & Com.Code § 34.02.

Great American has not invoked section 34.02 of the Texas Business and Commerce Code, and we do not address its application to the facts of this case. An argument could be made that the parties to a

bond may expressly exclude a surety's rights under section 34.02. We do not reach that issue. The pertinent point is that recognition of a common law duty comparable to that in *Arnold* and *Aranda* would be inconsistent with rights available under section 34.02 to sureties.

We recognize that some jurisdictions have imposed a duty of good faith and fair dealing upon commercial sureties in favor of bond obligees. *See, e.g., Dodge v. Fidelity & Deposit Co.,* 161 Ariz. 344, 346-47, 778 P.2d 1240, 1242- 43 (1989); *Board of Directors of Ass'n of Apartment Owners of the Discovery Bay Condominium v. United Pac. Ins. Co.,* 77 Hawai'i 358, 884 P.2d 1134, 1137 (1994); *Szarkowski v. Reliance Ins. Co.,* 404 N.W.2d 502, 504-06 (N.D.1987). However, the imposition of the duty of good faith and fair dealing in these cases generally is premised on the conclusion that suretyship is insurance under the applicable state statutes or case law. For example, in *Dodge,* the court held that because suretyship was specifically listed as a type of insurance in two different state statutes, the legislature intended to include suretyship within the coverage of insurance statutes. *Dodge,* 161 Ariz. at 346, 778 P.2d at 1242. Because that court found the legislative intent to be clear, it explicitly refused to consider the inherent differences between suretyship and insurance. *Id.* The court then concluded that as insurers, sureties owe the same duty to act in good faith as other insurers. *Id. But see Tacon Mechanical Contractors, Inc. v. Aetna Cas. & Sur. Co.,* 860 F.Supp. 385, 388 (S.D.Tex.1994), concluding that there is no special relationship ***420** between a bond obligee and a payment bond surety and that such a surety does not owe a common law duty of good faith and fair dealing akin to that in *Arnold.*

We conclude in section III, *infra,* that the Texas Legislature did not intend to include suretyship as the "business of insurance" for all purposes under the Insurance Code. The differences between suretyship and insurance merit consideration, and we therefore find the reasoning of *Dodge* and similar cases unpersuasive. *United Pac. Ins. Co.,* 884 P.2d at 1137 (assuming without discussion that sureties owe duty of good faith in reliance on *Dodge*); *Szarkowski,* 404 N.W.2d at 504-06 (holding without discussion that compensated sureties should be treated as insurers and that all insurers owe a duty of good faith and fair dealing).

[3] The contract between MUD and Underground in this case was an arm's length transaction, entered into after an open bidding process. No special relationship between MUD and Underground exists. The derivative nature of a surety's liability and its right to rely upon the defenses of its principal compel the conclusion that a surety, like its principal, should be entitled to test the merits of an obligee's claim without the imposition of extracontractual duties to the bond obligee. This Court has held that a surety bond is subject to "the common law of contracts, which is not punitive in nature." *State v. Alpha Oil & Gas, Inc.,* 747 S.W.2d 378, 379 (Tex.1988). We therefore hold that Great American did not owe a common law duty of good faith and fair dealing to MUD.

III

[4] Great American next contends that the court of appeals erred in holding that article 21.21 of the Texas Insurance Code applies to commercial sureties.

Article 21.21 of the Insurance Code creates a private cause of action for injuries caused by practices declared to be "unfair or deceptive" in section 4 of article 21.21, the rules and regulations of the State Board of Insurance adopted under article 21.21, or section 17.46(b) of the Texas Deceptive Trade Practices Act. Tex.Ins.Code art. 21.21, § 16; *Allstate Ins. Co. v. Watson,* 876 S.W.2d 145, 147 (Tex.1994). The action may be maintained against "the person or persons engaging in such acts or practices." Tex.Ins.Code art. 21.21, § 16. For purposes of article 21.21, the term "person" means "any individual, corporation, association, partnership, reciprocal exchange, inter-insurer, Lloyds insurer, fraternal benefit society, *and any other legal entity engaged in the business of insurance,* including agents, brokers, adjusters and life insurance counselors." *Id.* § 2(a) (emphasis added). The "business of insurance" has

never been defined in article 21.21; however, the version of article 21.21 that is applicable to this case declared that its purpose was

> to regulate trade practices in the business of insurance in accordance with the intent of Congress of March 9, 1945 (Public Law 15, 79th Congress), by defining, or providing for the determination of, all such practices in this state which constitute unfair methods of competition or unfair or deceptive acts or practices and by prohibiting the trade practices so defined or determined.

Acts 1985, 69th Leg., R.S., ch. 22, § 1, 1985 Tex.Gen.Laws 395, 395, *amended by* Acts 1993, 73rd Leg., R.S., ch. 685, § 20.17, 1993 Tex.Gen.Laws 2559, 2704 (current version at Tex.Ins.Code art. 21.21, § 1(a)). [FN3]

> FN3. The reference in this section to the "Act of Congress of March 9, 1945" is to 15 U.S.C. §§ 1011-1015 (1945), popularly known as the McCarran-Ferguson Act. Section 1 of article 21.21 was amended after this case was filed to delete the reference to the McCarran-Ferguson Act. Acts 1993, 73rd Leg., R.S., ch. 685, § 20.17, 1993 Tex.Gen.Laws 2559, 2704 (current version at Tex.Ins.Code art. 21.21, § 1(a)).

Our primary goal in construing article 21.21 is to give effect to the intent of the Legislature. *Monsanto v. Cornerstones Mun. Util.,* 865 S.W.2d 937, 939 (Tex.1993). When a statute is unambiguous, a court generally must seek the intention of the legislature as found in the plain and common meaning of the words and terms used. *RepublicBank Dallas, N.A. v. Interkal, Inc.,* 691 S.W.2d 605, 607 (Tex.1985).

***421** In keeping with this rule, chapter 312 of the Texas Government Code, which deals with the rules of construction for civil statutes, directs us to give words their ordinary meaning, *unless* such a word is connected with and used with reference to a particular trade or subject matter, in which case it shall have the meaning given by experts in that particular trade. Tex.Gov't Code § 312.002. The phrase "business of insurance" refers to a particular trade, permitting us to consider the meaning of the phrase as used by "experts in the trade." Further, chapter 312.005 of the Government Code directs that a court interpreting a statute shall attempt to ascertain the legislative intent and "shall consider at all times the old law, the evil, and the remedy." *Id.* § 312.005. Therefore, in determining whether the phrase "business of insurance" as used in article 21.21 includes commercial suretyship, we consider the legislative history of the Insurance Code.

Great American argues that the Legislature did not intend commercial suretyship to be included within the business of insurance regulated by article 21.21. It contends that the phrase "to regulate trade practices in the business of insurance in accordance with the intent of Congress as expressed in the [McCarran-Ferguson Act]" indicates that the Legislature intended federal law under the McCarran-Ferguson Act to control the definition of the business of insurance as used in article 21.21. Great American contends that the definition of the business of insurance under federal law is very narrow and is limited to those contracts which involve the spreading and underwriting of a policyholder's risk. *See Group Life & Health Ins. Co. v. Royal Drug Co.,* 440 U.S. 205, 211, 99 S.Ct. 1067, 1073, 59 L.Ed.2d 261 (1979). Suretyship is not insurance, the argument runs, because it does not involve the spreading of a bond holder's risk.

The McCarran-Ferguson Act was passed by Congress in 1945 in response to *United States v. South-Eastern Underwriters Ass'n,* 322 U.S. 533, 64 S.Ct. 1162, 88 L.Ed. 1440 (1944), in which the United States Supreme Court held that the business of insurance involves interstate commerce. *Royal Drug Co.,* 440 U.S. at 217, 99 S.Ct. at 1076. The decision in *United States v. South-Eastern Underwriters Association* cast some doubt on the constitutionality of state regulation and taxation of the insurance industry under the Commerce Clause. Congress reacted quickly to preserve state regulation of the activities of insurance companies. *Royal Drug Co.,* 440 U.S. at 217-18 nn. 16-18, 99 S.Ct. at 1076-77 nn. 16-18. Thus, the primary concern of Congress, reflected in sections 1 and

2(a) of the Act, was to enact legislation that would assure that the states have the ability to tax and regulate the business of insurance. *Id.* Sections 1 and 2(a) of the McCarran-Ferguson Act operate to assure that states are free to regulate insurance companies without fear of attack under the Commerce Clause. *Id.* at 218, 99 S.Ct. at 1076. A secondary concern was the applicability of antitrust laws to the insurance industry, which Congress resolved by providing that antitrust laws would be applicable to the business of insurance only to the extent such business is not regulated by state law. *Id.* at 218-20, 99 S.Ct. at 1076-78.

Given this background, it is clear that the Legislature's expressed intent in article 21.21 to "regulate trade practices in the business of insurance in accordance with the intent of Congress as expressed in the [McCarran-Ferguson Act]" is to utilize the broad grant of power to the states under sections 1 and 2(a) of the McCarran-Ferguson Act to regulate the business of insurance free from challenges under the Commerce Clause of the United States Constitution. The reference to the McCarran-Ferguson Act is an attempt to exercise this grant of power, not to narrow the scope of the regulations. While federal case law may have narrowly construed the "business of insurance" for purposes of determining if a particular activity is exempted from the antitrust laws, these cases have no application to the protection afforded state regulation from attack under the Commerce Clause. *See Royal Drug Co.,* 440 U.S. at 218 n. 18, 99 S.Ct. at 1077 n. 18. Therefore, we are unpersuaded by the argument that the Legislature's reference to the McCarran-Ferguson Act evidences its intent to incorporate a definition of the business of insurance under federal antitrust law in article 21.21.

***422** MUD argues that the Legislature's intended definition of the phrase "business of insurance" as used in article 21.21 can be found in article 1.14-1 of the Insurance Code, which lists acts that constitute the "doing of an insurance business" and includes certain contracts of suretyship. [FN4] The court of appeals agreed, finding it significant that article 21.21 did not specifically exclude suretyship from its scope. Great American concedes that its surety activities constitute the "doing of an insurance business" under article 1.14-1, section 2(a). It contends vigorously, however, that article 1.14-1 has no application to the scope of activities regulated by article 21.21 and points out that article 1.14-1 was enacted after article 21.21.

> FN4. Specifically, the applicable version and portions of article 1.14-1 state
> Sec. 2. (a) Any of the following acts in this State effected by mail or otherwise is defined to be doing an insurance business in this state.... Unless otherwise indicated, the term insurer as used in this Article includes all corporations, associations, partnerships and individuals engaged as principals in the business of insurance and also includes interinsurance exchanges, mutual benefit societies, and insurance exchanges and syndicates as defined by rules promulgated by the State Board of Insurance.
> 1. The making of or proposing to make, as insurer, an insurance contract.
> 2. The making or proposing to make, as guarantor or surety, any contract of guaranty or suretyship as a vocation and not merely incidental to any other legitimate business or activity of the guarantor or surety....
> Acts 1987, 70th Leg., R.S., ch. 254, § 1, 1987 Tex.Gen.Laws 1573, 1573 (current version at Tex.Ins.Code art. 1.14-1, § 2(a)).

An overview of the legislative history of the Insurance Code is instructive in resolving this issue. The Code was enacted in 1951, with a preamble stating

> An Act arranging the Statutes of this State affecting the business of insurance in appropriate Chapters and Articles into a consistent whole and under a single Code; making such editorial changes that are necessary to that accomplishment; preserving the substantive law as it existed immediately before the passage of this Act....

Acts 1951, 52nd Leg., R.S., ch. 491, 1951 Tex.Gen.Laws 868, 868. The 1951 codification

"was merely a formal revision" with little substantive change to the various statutes which it repealed and reorganized. Goodrum and Gordon, *Substantive Law Revision in Texas,* 37 TEX.L.REV. 740 (1959). The new Code did not contain a definition of "the business of insurance" anywhere within its provisions. Portions of the Code did refer to suretyship: the Code provided for a Board of Insurance Commissioners, one of whom was to have "general supervision of matters relating to casualty, motor vehicle, workmen's compensation, fidelity, guaranty, title, and miscellaneous insurance." Acts 1951, 52nd Leg., R.S., ch. 491, § 1, 1951 Tex.Gen.Laws 868, 869 (current version at Tex.Ins.Code art. 1.02). Article 7 (now repealed) specifically regulated fidelity, guaranty, and surety companies. Acts 1951, 52nd Leg., R.S., ch. 491, § 1, 1951 Tex.Gen.Laws 868, 955, *repealed by* Acts 1957, 55th Leg., R.S., ch. 388, § 1, 1957 Tex.Gen.Laws 1162, 1162.

Although the 1951 codification included article 21.21, the statute then primarily concerned anti-discrimination practices. In 1957, article 21.21 was amended to regulate unfair methods of competition and unfair or deceptive acts or practices in the business of insurance. Acts 1957, 55th Leg., R.S., ch. 198, § 1, 1951 Tex.Gen.Laws 401, 401. The phrase "business of insurance" remained undefined by that article or any other in the Code. Significantly, the predecessor to section 34.02 of the Texas Business and Commerce Code, which explicitly granted sureties the right to give notice to a bond obligee that it must prosecute a suit on the underlying written contract to judgment and execution, was in effect when article 21.21 was amended to regulate against unfair and deceptive practices. *See* Tex.Rev.Civ.Stat.Ann. arts. 6244, 6245, *repealed by* Acts 1967, 60th Leg., R.S., ch. 785, § 4, 1967 Tex.Gen.Laws 2608, 2619 (current version at Tex.Bus. & Com.Code § 34.02). For the same reasons discussed in Part II, there would be tension between section 34.02 of the Business and Commerce Code and article 21.21 of the Insurance Code if the latter were applicable to sureties.

In 1967, the Legislature added article 1.14-1 to the Code. Article 1.14-1 is titled "Unauthorized Insurance" and its avowed ***423** purpose is "to subject certain persons and insurers to the jurisdiction of the State Board of Insurance, of proceedings before the Board, and of the courts of this state in suits by or on behalf of the state and insureds or beneficiaries under insurance contracts." Acts 1967, 60th Leg., R.S., ch. 185, § 1, 1967 Tex.Gen.Laws 401, 401 (current version at Tex.Ins.Code art. 1.14-1, § 1). [FN5]

> FN5. Section 1 of article 1.14-1 in its entirety states
> The purpose of this Article is to subject certain persons and insurers to the jurisdiction of the State Board of Insurance, of proceedings before the Board, and of the courts of this state in suits by or on behalf of the state and insureds or beneficiaries under insurance contracts. The Legislature declares that it is a subject of concern that many residents of this state hold policies of insurance issued by persons and insurers not authorized to do insurance business in this state, thus presenting to such residents the often insuperable obstacle of asserting their legal rights under such policies in forums foreign to them under laws and rules of practice with which they are not familiar. The Legislature declares that it is also concerned with the protection of residents of this state against acts by persons and insurers not authorized to do an insurance business in this state by the maintenance of fair and honest insurance markets, by protecting the premium tax revenues of this state, by protecting authorized persons and insurers, which are subject to strict regulation, from unfair competition by unauthorized persons and insurers and by protecting against the evasion of the insurance regulatory laws of this state. In furtherance of such state interest, the Legislature herein provides methods for substituted service of process upon such persons or insurers in any proceeding, suit or action in any court and substitute service of any notice, order,

> pleading or process upon such persons or insurers in any proceeding before the State Board of Insurance to enforce or effect full compliance with the insurance and tax statutes of this state, and declares in doing so it exercises its power to protect residents of this state and to define what constitutes doing an insurance business in this state, and also exercises powers and privileges available to this state by virtue of P.L. 79-15 (1945), (Chapter 20, 1st Sess., S. 340), 59 Stats. 33, as amended, which declares that the business of insurance and every person engaged therein shall be subject to the laws of the several states.
>
> Acts 1967, 60th Leg., R.S., ch. 185, § 1, 1967 Tex.Gen.Laws 401, 401 (current version at Tex.Ins.Code art. 1.14-1, § 1).

Section 1 of article 1.14-1 catalogues the concerns that the Legislature intended to remedy by its enactment, which primarily include the protection of state residents from the acts of unauthorized insurers, the protection of state tax revenues, and the provision of a local forum in which state residents may confront unauthorized insurers. *Id.* To address these concerns, the Legislature provides for substituted service of process on unauthorized insurers, and "in doing so exercises its power to protect residents of this state and to define what constitutes doing an insurance business in this state...." *Id.*

Nowhere in the "purpose" clause of article 1.14-1 did the Legislature indicate that the list of acts contained therein which constitute "doing an insurance business" was to apply throughout the Code. Rather, the purpose clause of article 1.14-1 points out that in defining "what constitutes doing an insurance business," the Legislature was exercising its power to address its explicitly listed concerns. The expressed concerns do not evidence an intention to promulgate a uniform definition of the acts which constitute doing an insurance business; rather, they indicate concern that particular parties may escape the jurisdiction of the State Board of Insurance and evade suit by contractual beneficiaries. We cannot conclude that the enactment of article 1.14-1 altered the scope of the term "business of insurance" as it was used in article 21.21. In fact, in the same legislative session that article 1.14-1 was enacted, the Legislature formally codified Texas Revised Civil Statute articles 6244 and 6245 as section 34.02 of the Business and Commerce Code, thereby reaffirming the right of a surety to require its obligee to file suit against its principal. *See* Acts 1967, 60th Leg., R.S., ch. 785, § 1, Tex.Gen.Laws 2608, 2608. (Again, we do not reach the question of whether the terms of a specific bond may exclude this statutory right, and specifically, whether the performance bond at issue here did so.)

In any case, while the Legislature collected the statutes relating to insurance and arranged them into a "consistent whole" in 1951, the collection presented little substantive change. Goodrum, *supra* at 743. The Code is not a result of the Legislature's continuing statutory revision program of the state's civil statutes that has resulted in such codes as the Business and Commerce Code *424 and the Civil Practice and Remedies Code. It is certainly not a formal, unified Code such as the Uniform Commercial Code, which, from its inception, contained uniform definitions. While we agree with MUD that the Insurance Code is not merely a "hodgepodge," we cannot conclude that the Legislature intended article 1.14-1, enacted some ten years after article 21.21, to govern the scope of the term "business of insurance" as used in article 21.21. [FN6]

> FN6. Article 21.21 has been amended several times since the enactment of article 1.14-1. None of these amendments have referred to or incorporated any portion of article 1.14-1.

Similarly, the express inclusion or exclusion of suretyship as the "business of insurance" in other sections of the Code is not determinative of the scope of article 21.21. The fact that section 5 of article 21.55 of the Code, which was enacted in 1991, expressly excludes surety bonds from its scope does not provide insight to the Legislature's

intention when it amended article 21.21 to regulate unfair or deceptive practices in 1957. *See* Acts 1991, 72nd Leg., R.S., ch. 242, § 11.03(a), 1991 Tex.Gen.Laws 939, 1043 (current version at Tex.Ins.Code art. 21.55).

Historically, the origins of suretyship predate the advent of insurance by thousands of years. Woods, *Historical Development of Suretyship,* LAW OF SURETYSHIP 1-5, 10 (Gallagher ed. 1993). As discussed in Section II, *supra,* the characteristics of suretyship are different from those of insurance. Insurance involves the pooling and spreading of risk of the insureds, with no right of indemnity possessed by the insurer. Suretyship, on the other hand, allows a surety full rights of indemnity against its principal. *Commercial Standard Ins. Co. v. Ebner,* 149 Tex. 28, 228 S.W.2d 507, 509 (1950); *see also* Tex.Bus. & Com.Code § 34.04. Imposition of liability on a surety under article 21.21 would raise an odd dilemma: would a surety, traditionally entitled to indemnity from its principal, be entitled to indemnity for an article 21.21 violation? If so, a principal who owed no extracontractual duties to an owner would be in the position of paying tort-based extracontractual damages. If not, the ability of sureties to rely upon the defenses of their principal, a fundamental right of suretyship, would be undermined.

Given the unique character, rights, and obligations of suretyship, and the complexities that would result by the imposition of liability under 21.21, we cannot conclude that the Legislature intended to include suretyship in the definition of the business of insurance under article 21.21. Absent a clear legislative directive, we conclude that suretyship, as historically understood in the insurance and suretyship fields, does not constitute the business of insurance under article 21.21. We therefore hold that Great American is not liable to MUD under article 21.21.

IV

[5] Great American next contends that the court of appeals erred in failing to hold that its principal, Underground, was contractually relieved from liability in this case because the defects in the dry well were the result of the negligence of Smith Pump or Dippel Ulmann in designing the dry well. The standard specifications in the contract documents state

> The thickness of the sides shall be determined by the structural requirements for the depth of burial involved but shall be a minimum of 1/4 inch thick.

Although the sides of the dry well were 1/4 inch thick, the jury found that Underground failed to install a lift station with sides determined by the structural requirements for the depth of burial of the well. In arguing that it is contractually released from liability for this defect, Great American relies upon article 6.1 of the general conditions of the contract between MUD and Underground, which provides:

> CONTRACTOR [Underground] shall supervise and direct the Work competently and efficiently, devoting such attention thereto and applying such skills and expertise as may be necessary to perform the Work in accordance with the Contract Documents. CONTRACTOR shall be solely responsible for the means, methods, techniques, sequences and procedures of construction, but CONTRACTOR shall not be responsible for the negligence of others ***425** in the design or selection of a specific means, method, technique, sequence or procedure of construction which is indicated in and required by the Contract Documents. CONTRACTOR shall be responsible to see that the finished Work complies accurately with the Contract Documents.

Great American argues that the method of construction required by the contract documents was the refurbishment of an existing dry well, and that Smith Pump negligently completed the design of the method of refurbishment by failing to thicken the sides of the dry well. It contends that the design error was compounded by Dippel Ulmann when it approved Smith Pump's drawings, which did not indicate that the sides of the well would be thickened as part of the refurbishment process. Essentially, Great American is arguing that it is contractually relieved of responsibility for design defects.

This interpretation of the contract, however, broadens the scope of article 6.1 and ignores other provisions of the contract subjecting Underground to liability for the work done by its subcontractors. The contract states only that "[c]ontractor shall not be responsible for the negligence of others in the design or selection of a specific means, method, technique, sequence or procedure of construction *which is indicated in and required by the [c]ontract [d]ocuments.*" On its face, article 6.1 does not relieve Underground from responsibility for *all* design defects, but instead only for those *means, methods, techniques, or procedures of construction that are required in the contract documents.* The contract documents require that the sides of the dry well be of sufficient thickness for the depth of burial. The documents do not specify a means, method, technique, sequence, or procedure of construction to accomplish this goal. Underground is not relieved of responsibility for the work done by Smith Pump or Dippel Ulmann under this section.

Moreover, other provisions of the contract affirm Underground's ultimate responsibility to see that the finished work conforms with the contract documents. Article 6.9 of the general conditions of the contract holds Underground responsible for the work done by its subcontractors such as Smith Pump:

> CONTRACTOR shall be fully responsible to OWNER and ENGINEER for all acts and omissions of the Subcontractors, Suppliers and other persons or organizations performing or furnishing any of the Work under a direct or indirect contract with CONTRACTOR, just as CONTRACTOR is responsible for CONTRACTOR's own acts and omissions.

Likewise, Underground is not relieved of responsibility for the finished product by Dippel Ulmann's approval of Smith Pump's shop drawings. Article 6.27 provides that approval by the engineer of the drawings does not relieve the contractor for any errors or omissions in the drawings. [FN7] Simply stated, the contract required the sides of the dry well to be sufficient for its depth of burial; the fact that neither Smith Pump nor Dippel Ulmann designed or built a refurbished well with thickened sides does not absolve Underground from its contractual obligation to furnish a dry well in compliance with the contract specifications. We therefore affirm the court of appeals' judgment that Underground was not contractually relieved of liability to MUD.

> FN7. Article 6.27 states
> ENGINEER's review and approval of Shop Drawings or samples shall not relieve CONTRACTOR from responsibility for any variation from the requirements of the Contract Documents unless CONTRACTOR has in writing called ENGINEER's attention to each such variation at the time of submission as required by paragraph 6.25.2 and ENGINEER has given written approval of each such variation by a specific written notation thereof incorporated in or accompanying the Shop Drawing or sample approval; nor will any approval by ENGINEER relieve CONTRACTOR from responsibility for errors or omissions in the Shop Drawings or from responsibility for having complied with the provisions of paragraph 6.25.1.

V

In connection with MUD's claim for damages against Underground, Great American next contends that the trial court erred in refusing to submit an instruction regarding MUD's duty to mitigate damages. In answering the question relating to damages ***426** caused by Underground, the court instructed the jury to find damages based upon "the reasonable and necessary cost to replace or repair" the lift station and refused Great American's tendered instruction regarding MUD's duty to mitigate its damages. Great American contends that the record contains some evidence that MUD could "mitigate" its damages in a reasonable fashion by repairing the lift station rather than completely replacing it, and that the trial court's refusal to so instruct the jury was harmful error.

[6][7] However, the doctrine of mitigation of damages is inapplicable to this case. This doctrine prevents a party from recovering for damages resulting from a breach of contract that could be avoided by reasonable efforts on the part of the plaintiff:

> Where a party is entitled to the benefits of a contract and can save himself from the damages resulting from its breach at a trifling expense or with reasonable exertions, it is his duty to incur such expense and make such exertions.

Walker v. Salt Flat Water Co., 128 Tex. 140, 96 S.W.2d 231, 232 (1936). No party in this case presented any evidence that MUD could have mitigated its damages, and it was not error for the trial court to refuse the requested instruction.

Great American in actuality is complaining that the jury did not agree with its assessment of damages in this case. The issue of damages was contested at trial, with MUD presenting evidence that the lift station needed to be replaced at a cost of $411,400, and representatives of Smith Pump testifying that the lift station could be repaired at a much lower cost. The jury's answer to the damages question in the amount of $411,400 is supported by some evidence in the record.

VI

We initially granted writ in this case to consider Great American's points of error regarding the trial court's method of calculation of prejudgment interest and attorneys' fees in its judgment under the statutory trebling provisions of article 21.21 of the Insurance Code. Because we hold that article 21.21 is inapplicable to commercial sureties, statutory trebling of damages is no longer at issue. However, we still must determine the extent of Great American's liability resulting from the contractual liability of their principal, including attorneys' fees, if this matter can be decided as a matter of law.

A

The jury's findings support several different theories of liability against Underground. [FN8] No party disputes that Great American is liable under its performance bond as a matter of law if its principal, Underground, did in fact breach its contract with MUD. The jury found that the actual damages caused by Underground's breach were $411,400. The face value of the performance bond is $397,503.20. We first must determine the extent of Great American's liability in excess of the face value of the bond, if any.

> FN8. Specifically, the jury found that Underground failed to furnish and install a lift station with the thickness of the sides determined by the depth of burial, that Underground failed to correct defective work, and that Underground's failure to comply with its warranty was a producing cause of damages to MUD.

[8][9][10] It is well settled that a performance bond is enforceable only to the extent of the obligee's actual damages. *Alpha Oil & Gas*, 747 S.W.2d at 378. Likewise, when an obligee's actual damages exceed the penal amount of a bond, a surety's liability generally is limited to the penal sum of the bond. *New Amsterdam Cas. Co. v. Bettes*, 407 S.W.2d 307, 314-15 (Tex.Civ.App.--Dallas 1966, writ ref'd n.r.e.) (surety not liable for actual or special damages caused by default of principal in excess of face amount of bond); *Bill Curphy Co. v. Elliott*, 207 F.2d 103, 108-09 (5th Cir.1953) (surety not liable for actual damages necessary to complete construction contract in excess of face amount of bond because to hold otherwise would make it "futile to state any amount of liability in the bond" and overlook "the well-established rule in Texas and elsewhere that the sole object of stating the penalty in a bond is to fix the limit of liability of the signers"). The specific terms of the performance ***427** bond in this case limit MUD's total recovery, including "costs and other damages," to the total amount of $397,503.20. [FN9] We conclude, therefore, that Great American is not liable for MUD's actual damages caused by Underground's breach in excess of $397,503.20, the face value of the bond.

> FN9. The performance bond specifically states:
> Underground Utilities Co. as Principal,

> hereinafter called Contractor and Great American Insurance Company, ... as Surety, are held and firmly bound unto North Austin Municipal Utility District No. One as Obligee, hereinafter called Owner, in the amount of $397,503.20.
> The bond further states that whenever the Contractor is in default the Surety may complete the contract in accordance with its terms and conditions or arrange for another contractor to complete the work and pay
> sufficient funds to pay the cost of completion less the balance of the contract price; *but not exceeding, including other costs and damages for which the Surety may be liable hereunder, the amount set forth in the first paragraph hereof.*
> (emphasis added).

B

[11] We must determine if Great American is liable for attorneys' fees incurred either as a result of Underground's breach of contract or Great American's breach of its performance bond. We turn first to the issue of Underground's breach.

In accordance with the rule that a surety's liability on an underlying contract is limited to the penal sum of the bond, Great American is not liable for attorneys' fees assessed against its principal in excess of the bond amount. *T & R Painting Constr., Inc. v. St. Paul Fire & Marine Ins. Co.*, 23 Cal.App.4th 738, 29 Cal.Rptr.2d 199, 203 (1994) (holding that obligee can recover from surety attorneys' fees that are provided for in obligee's subcontract so long as the total recovery against the surety does not exceed the penal amount of the bond); *Harris v. Northwestern Nat'l Ins. Co.*, 6 Cal.App.4th 1061, 8 Cal.Rptr.2d 234, 238 (1992) (acknowledging the rule that surety cannot be required to pay attorneys' fees in excess of the penal sum of the bond); *Lawrence Tractor Co. v. Carlisle Ins. Co.*, 202 Cal.App.3d 949, 249 Cal.Rptr. 150, 153 (1988) (noting that unless contract specifically obligates surety to pay attorneys' fees in excess of penal sum of the bond, recovery for attorneys' fees from surety is limited to the amount of the bond); *Seattle-First Nat'l Bank v. Aetna Life & Cas. Co.*, 31 Wash.App. 480, 642 P.2d 1259, 1260-61 (1982) (stating the general rule that a surety's liability for attorneys' fees cannot exceed the penal sum of the bond, but acknowledging that the rule may be varied by contract or statute).

[12] While the limited terms of the surety bond itself do not provide a basis for MUD to recover attorneys' fees incurred as a result of Underground's breach in excess of the face amount, the obligation of Great American under the surety bond may provide a separate basis upon which MUD may recover attorneys' fees incurred as a result of Great American's default. Chapter 38.001 of the Texas Civil Practice and Remedies Code allows a party to recover reasonable attorneys' fees for a valid claim on an oral or written contract, and is to be liberally construed. Tex.Civ.Prac. & Rem.Code §§ 38.001, 38.005. At issue is whether MUD's claim against Great American under the surety bond is a claim on a written contract. [FN10]

> FN10. We note that under section 38.002, three prerequisites to recovery under section 38.001 exist: representation by an attorney, presentment of the claim, and lack of timely tender. Tex.Civ.Prac. & Rem.Code § 38.002. MUD's third amended petition asserted that MUD was entitled to attorneys' fees under section 38.001 and that all conditions precedent had occurred. These conditions were in fact met.

This Court has applied the common law of contracts to questions relating to a surety's liability. *Alpha Oil & Gas*, 747 S.W.2d at 379. Suretyship is a contract with three parties: the principal, the surety, and the obligee. The surety makes a direct promise to the obligee. *See Tolbert v. Standard Accident Ins. Co.*, 148 Tex. 235, 223 S.W.2d 617, 620 (1949). In this case, MUD was specifically named in the bond. The intended beneficiary of a contract can bring suit to enforce the contract. *See, e.g., Paragon Sales Co. v. New Hampshire Ins. Co.*, 774 S.W.2d 659, 660 (Tex.1989); *Dairyland County Mut. Ins. v. Childress*, 650 S.W.2d 770, 775

(Tex.1983); ***428***Quilter v. Wendland,* 403 S.W.2d 335, 337 (Tex.1966). MUD has a right to sue on the surety bond issued by Great American and is entitled under section 38.001 of the Texas Civil Practice and Remedies Code to recover attorneys' fees as a result of Great American's own default on the terms of its bond. [FN11]

> FN11. We note that the Legislature has expressly provided that a payment bond beneficiary who has provided public work labor or material under a public work contract may recover reasonable attorneys' fees in a suit against the principal or surety. Tex.Gov't Code §§ 2253.073, 2253.074. These sections are inapplicable here, as MUD's recovery against Great American is based upon the performance bond, rather than the payment bond.

C

[13] Having determined that Great American is liable for attorneys' fees incurred as a result of its breach of the performance bond as a matter of law, we next address the issue of the proper calculation of the amount of those fees. Question 17 submitted to the jury asked: "What is a reasonable fee for the necessary services of North Austin Municipal District's attorneys in this case, stated as a percentage of North Austin Municipal District's recovery?" The jury found 33 1/3 %. Great American argues that question 17 is defective because it does not require the jury to find attorneys' fees that are segregated by parties and claims. [FN12] However, MUD's recovery from each defendant can be determined from the jury's answer to the other damages issues, and attorneys' fees can be calculated as to each defendant on the claims for which it is actually found liable. Great American is liable for the breach of its performance bond occasioned by its refusal to pay or perform under the terms of that bond when Underground defaulted on its contractual obligations to MUD. The actual damages exceed the face amount of the bond and Great American is liable for the full amount of the bond, $397,503.20. The jury's response to question 17, finding a reasonable fee to be 33 1/3 % of the recovery, can be applied to that amount. We therefore overrule this point of error.

> FN12. Great American did not object to the form of this question on any basis other than its failure to segregate damages arising from the various parties and claims. We address the segregation issue but otherwise do not express an opinion as to the propriety of this question under section 38.001 of the Texas Civil Practice and Remedies Code.

[14] The question of the proper calculation of the fees to be awarded under question 17 remains. Under the facts of this case, we hold that Great American is liable to MUD for attorneys' fees of $132,501.07, which is 33 1/3 % of $397,503.20. In so holding, we reject the method of calculation used by the trial court and affirmed by the court of appeals to award attorneys' fees against Great American under article 21.21. The court of appeals reasoned that because the jury awarded MUD attorneys' fees of 33 1/3 % of its "recovery," the fee award literally must constitute 33 1/3 % of the judgment in MUD's favor. Under this approach, if a trial court found that the amount of damages to be awarded to the plaintiff after calculating prejudgment interest and statutory trebling was $66.66, and the jury found a reasonable attorneys' fee to be 33 1/3 %, the award of attorneys' fees would be $33.33 (33 1/3 % of $100.00), not $22.22 (33 1/3 % of $66.66). [FN13] The court of appeals' method essentially inflates the award of attorneys' fees, resulting in an award not contemplated by the jury.

> FN13. Expressed algebraically, the formula used by the trial court to calculate attorneys' fees under article 21.21 is: J = 3D + 1/3 J, where J equals the total amount of the plaintiff's judgment, D equals the damages found by the jury plus prejudgment interest, and 1/3 J equals the final amount of attorneys' fees to be awarded. Under this method of calculation, the trebled amount of damages (including prejudgment interest) will equal 2/3 of the plaintiff's judgment: 2/3 J = 3D.

> The plaintiff's total judgment therefore equals 4.5 times the actual damages figure (including prejudgment interest): J=9/2D.

* * * * * *

We conclude that as a surety, Great American has no common law duty of good faith and fair dealing and that article 21.21 of the Insurance Code is inapplicable to a surety. We further hold that under the facts of this case, Great American is liable for breach of its bond in the amount of $397,503.20. We affirm in part and reverse in part the judgment of the court of appeals, and remand this case to the trial court for further proceedings ***429** in conformity with this opinion, including a determination regarding prejudgment interest.

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