

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE

In re:

No. 95-11611
Chapter 11

SCT YARNS, INC.

Debtor

SCT NEWCO, INC.

Plaintiff

v

Adversary Proceeding
No. 95-1216

AMERICAN CREDIT INDEMNITY COMPANY

Defendant

MEMORANDUM

Appearances: Rosemarie L. Bryan and Douglas E. Peck, Witt, Gaither & Whitaker,
Chattanooga, Tennessee, Attorneys for Plaintiff

Richard A. Schulman, Spears, Moore, Rebman & Williams,
Chattanooga, Tennessee, Attorneys for Defendant

R. THOMAS STINNETT, UNITED STATES BANKRUPTCY JUDGE

SCT Yarns filed a chapter 11 case in this court and then filed this suit against American Credit Indemnity Company. The assets of SCT Yarns, including this lawsuit, were sold to SCT Newco, which was substituted as plaintiff. For convenience, the court will refer to both SCT Yarns and SCT Newco as SCT. Of course, the transactions that led to this lawsuit were between SCT Yarns and American Credit Indemnity Company (“American Credit”). With regard to those transactions, SCT means SCT Yarns.

SCT seeks to recover under a credit insurance policy issued by American Credit. Both SCT and American Credit have filed motions for summary judgment. The motions raise one main issue. Did the credit insurance policy cover debts owed to SCT by one of its customers, Great American Knitting Mills (“Great American”).

The insurance policy provided coverage of debts owed to SCT by customers listed in the policy. Great American was not listed, but its parent company, Bidermann Industries, Inc., (“Bidermann”) was listed. SCT contends the policy covers Great American’s debts nevertheless. SCT relies on representations made by American Credit’s agent when SCT attempted to obtain coverage of Great American’s debts. SCT alleges that it asked American Credit’s agent for coverage of Great American’s debts, American Credit’s agent said that Bidermann should be listed because American Credit wanted it that way in order to provide coverage of Great American’s debts, and SCT agreed only because it understood that listing Bidermann would cover Great American’s debts.

American Credit asserts the policy provides no coverage of Great American’s debts to SCT for the following reasons. Great American was not listed in the policy as one of SCT’s customers whose debts were insured. The policy does not provide that coverage

of a parent company, such as Bidermann, includes coverage of its subsidiary, such as Great American. SCT is not attempting to recover on the ground that Bidermann is also liable for Great American's debts. Finally, American Credit is not bound by the statements of its agent since the dispute involves a written, unambiguous insurance policy.

The court can grant summary judgment only if there is no genuine issue of material fact, and the moving party is entitled to judgment as a matter of law. Fed. R. Bankr. P. 7056; Fed. R. Civ. P. 56(c).

SCT's complaint and American Credit's answer establish some undisputed facts. SCT regularly sold yarn products to Great American on a 30 day credit basis. Great American is a subsidiary of Bidermann Industries. SCT bought credit insurance from American Credit. Bidermann Industries U.S.A., Inc., Bidermann Industries Corp., Great American, and other related companies filed chapter 11 bankruptcy cases in New York in July 1995. SCT has paid all premiums required by the policy with American Credit. After the bankruptcy filings, SCT filed a claim with American Credit, and it denied coverage on the ground that only the debts of Bidermann Industries, not the debts of Great American, were covered by the policy.

SCT's Motion for Summary Judgment

SCT relies on the affidavits of David Cox, J. Martin Harris and Stephen Roberson, in which they make the following statements.

David Cox

In 1990 Mr. Cox was SCT's credit manager and treasurer. He was responsible for obtaining credit insurance on credit extended by SCT to yarn customers. SCT had been selling to Great American on credit for a number of years before 1990. SCT billed Great American, but Bidermann paid the invoices. Since SCT was concerned about Great American's ability to pay, Mr. Cox contacted J. Martin Harris at American Credit about obtaining credit insurance on Great American's debts. Mr. Cox explained to Mr. Harris that SCT sold the yarn products to Great American not to Bidermann. SCT's practice was to obtain coverage on the buyer who was billed, Great American, not on a parent or affiliate such as Bidermann. Mr. Cox specifically asked Mr. Harris for coverage of Great American's debts. He did not ask for coverage of debts owed by Bidermann. American Credit, however, directed that Bidermann should be the debtor listed in the policy, instead of Great American, because Bidermann was paying the bills. Mr. Cox thought this was odd and questioned Mr. Harris about it. Mr. Harris said that since American Credit wanted Bidermann listed in the policy, then the policy should be that way. Mr. Harris assured Mr. Cox this would cover credit sales to Great American. Based on these representations, SCT acquiesced in Bidermann being listed in the policy instead of Great American. Mr. Cox would not have agreed if he thought it would result in no coverage of Great American's debts to SCT. SCT had no reason to obtain credit insurance coverage of Bidermann's debts unless it also covered Great American's debts. Mr. Cox made this fact clear to American Credit. Based on the representations of Mr. Harris, SCT understood that American Credit would indemnify SCT for the actual value of credit extended to Great American if it failed to pay. In reliance on coverage of debts owed by

Great American, Mr. Cox authorized millions of dollars in credit to Great American over the five year period from 1990 to 1995. After the loss and SCT's claim, no one from American Credit contacted Mr. Cox to verify his conversations with Mr. Harris about adding Great American or Bidermann to the credit insurance policy. Mr. Cox left SCT in 1995.

.J. Martin Harris

Mr. Harris worked for American Credit from April 1967 until October 1993. In or around 1990 he received a telephone call from David Cox who was employed at the time by SCT. Mr. Harris remembers speaking with Mr. Cox about adding Bidermann or Great American to SCT's credit insurance policy. Mr. Harris does not recall the substance of their conversation. He does not recall whether he told Mr. Cox that coverage under the policy should be for Bidermann rather than Great American. Since he cannot recall the substance of their conversation, he can not contradict Mr. Cox's recollection. At the time of the affidavit, no one from American Credit had contacted Mr. Harris to ask about his conversations with Mr. Cox regarding adding Great American or Bidermann to the policy.

Stephen Roberson

Mr. Roberson has been employed by SCT for over 22 years and is currently its credit manager. SCT has had credit insurance policies with American Credit for over 40 years. Each year new names of parties to whom SCT extended credit would be added to the policy, and SCT and American Credit would negotiate new premiums. For a number of years before 1995, SCT extended credit to Great American for products SCT shipped to it. SCT billed Great American for the products shipped to it, but its parent corporation, Bidermann, paid the invoices. As far as Mr. Roberson knows, SCT never shipped any

products to Bidermann. SCT had no reason to obtain credit insurance on Bidermann, because it never extended credit to Bidermann, unless the coverage of Bidermann's debts included sales to Great American. Great American and Bidermann filed for bankruptcy in 1995. At the time, SCT had nearly \$300,000 in credit outstanding to Great American. SCT filed a claim with American Credit for \$297,798.62. After American Credit indicated its intention to deny the claim, Mr. Roberson sent a letter to American Credit's claim examiner explaining SCT's reliance on the representations by American Credit that adding Bidermann to the policy would cover shipments to Great American. The letter, dated October 30, 1995, is attached to Mr. Roberson's affidavit. American Credit denied the claim in December 1995.

American Credit's Motion for Summary Judgment

American Credit supported its motion for summary judgment with the affidavit of Craig Fargason. Mr. Fargason makes the following statements.

In 1995 Mr. Fargason was employed by American Credit as an insurance agent. He handled SCT's policy. He was the agent at the time SCT filed its claim and at the time the disputed policy was entered into between SCT and American Credit. American Credit's files indicate that SCT requested coverage on Bidermann in 1990. Coverage continued to be requested and approved on Bidermann in each of SCT's subsequent policies. American Credit's files contain correspondence from SCT and its agents to American Credit and correspondence generated by American Credit regarding SCT's policy. None of this correspondence mentions Great American. American Credit's records indicate it was always under the impression that Bidermann was SCT's customer

because Bidermann was named by SCT as the covered entity. No one at SCT ever told Mr. Fargason that Great American was to be covered under the policy. American Credit is not aware that any of its agents or representatives told SCT the addition of Bidermann to the policy would cover SCT's sales to Great American. The insurance policy forbids the agent from altering the terms of the policy without approval from American Credit. If such an arrangement had been made, the president of American Credit, would have had to sign the agreement in accordance with the terms of the policy. SCT had two options with regard to obtaining coverage of Great American's debts. First, SCT could have added Great American to the policy in addition to Bidermann. Assuming Great American would have been approved for coverage, SCT would have had to pay an additional premium. Second, SCT could have requested that Bidermann guarantee the debts of Great American. Bidermann would have been required to submit a written agreement absolutely guaranteeing the debts of Great American. Assuming American Credit would have approved this arrangement, Great American could have been listed as a covered debtor subject to the written guarantee by Bidermann. SCT did not exercise either of these options. The policy limited coverage of Bidermann's debts to \$100,000 until the supplemental endorsement in 1995 increased it by 20% to a total of \$120,000. American Credit denied SCT's claim on Great American's debt because Great American was not a covered party under the policy.

The Terms of the Insurance Policy

The insurance policy is made up of the beginning policy with a number of endorsements (amendments). One of the endorsements begins:

It is agreed that a debtor named below is hereby approved for coverage for a gross amount not to exceed the amount set opposite such debtor's name below. . . .

Bidermann is included in the list of debtors.

The policy defines loss as follows:

Such loss shall consist of the unpaid invoice price of bona fide sales of the Insured, shipped during the Shipment Period and actually delivered in the usual course of business to individuals, firms, copartnerships or corporations located in the United States of America or Canada, and shall have been covered, filed and proved as hereinafter provided. (lines 1.8 - 1.13)

As to coverage, the policy provides:

Coverage of any loss . . . shall be limited to that portion of the indebtedness of a debtor to the Insured which consists of the unpaid price of shipments made within the Shipment Period, in the name of the Insured . . . provided, the debtor to whom the goods were shipped and delivered shall have had, at the date of shipment, a governing rating for which coverage is specified in the Table of Ratings (lines 2.32 - 2.42)

One of the endorsements apparently does away with the use of the ratings table. It provides for coverage up to the total amount for shipments during the coverage period but not more than the limit set in the policy for that particular debtor.

The policy goes on to provide that shipments made to a debtor under a division, style or trade name and shipments made to a branch location of the debtor shall be treated as shipments to the debtor. (lines 3.6-3.19). An endorsement provides coverage for goods not shipped or delivered to the debtor if they were specially processed or purchased to fill an order made by the debtor.

The policy provides an alternative method for determining the amount of coverage if the debts are absolutely guaranteed. Coverage can be increased by determining the coverage of the guarantor's debts. (lines 3.20 - 3.32)

The policy also provides:

No notice to or knowledge of any Agent or other person shall effect a waiver of any provision thereof. No agent shall be authorized to make any alteration therein or addition thereto, either verbally or in writing, or to waive any such provision, and no addition, alteration or waiver shall be valid unless expressed in writing over the signature of the President of the Company.

DISCUSSION

American Credit does not dispute the explanation by SCT's credit manager (Mr. Cox) of how Bidermann came to be listed in the policy instead of Great American. American Credit's agent at the time (Mr. Harris) does not recall the substance of the conversation with Mr. Cox regarding coverage of Great American's debts. Another employee of American Credit, Mr. Fargason, merely stated the methods recognized by American Credit as valid methods for adding a customer to a policy. This does not contradict the statements by SCT's credit manager.

Furthermore, the affidavits submitted by American Credit do not raise any question as to the credibility of SCT's credit manager (Mr. Cox). Neither affidavit directly challenges Mr. Cox's story. The affidavits also do not reveal any inconsistency between Mr. Cox's explanation and the usual procedures followed by American Credit or its agent, Mr. Harris. *Compare United States v. Krieger*, 773 F.Supp. 580 (S.D.N.Y. 1991) and *F & J Enterprises, Inc. v. Columbia Broadcasting Systems, Inc.*, 373 F. Supp. 292 (N. D. Ohio

1974); see generally 10A Charles A. Wright, et al., *Federal Practice and Procedure* § 2726 (2d ed. 1985). Therefore, American Credit cannot avoid summary judgment on the ground that the court should hear Mr. Cox's testimony in order to judge his credibility.

Thus, there is no genuine of issue of fact as to the following facts:

Mr. Harris was American Credit's agent and handled the 1990 transaction with SCT's credit manager, Mr. Cox, that resulted in adding Bidermann to SCT's credit insurance policy with American Credit.

Mr. Cox on behalf of SCT sought coverage of debts owed by Great American.

Mr. Harris told SCT's credit manager, Mr. Cox, that American Credit wanted Bidermann listed as the customer.

Mr. Harris assured Mr. Cox that this would give coverage of Great American's debts to SCT.

Mr. Cox would not have agreed to listing Bidermann as the customer if he thought it would result in no coverage of debts owed by Great American.

Based on the assumption that the policy from American Credit covered Great American's debts, SCT continued selling to Great American on credit.

When Great American filed bankruptcy in 1995, it owed SCT almost \$300,000.

American Credit refused to pay SCT's claim based on this debt.

Under Tennessee law these facts may be sufficient to make American Credit liable for Great American's debts to SCT. American Credit can be bound by the representation of its agent, Mr. Harris, that listing Bidermann would provide coverage of Great American's debts. See *Tenn. Code Ann.* § 56-6-147; *Bill Brown Construction Co.*

v. Glens Falls Insurance Co., 818 S.W.2d 1 (Tenn. 1991); *Estate of Wilson v. Arlington Auto Sales, Inc.*, 743 S.W.2D 923 (Tenn. Ct. App. 1987); *City of Lawrenceburg v. Maryland Casualty Co.*, 16 Tenn. App. 238, 64 S.W.2d 69 (1933).

American Credit can be bound only if SCT reasonably relied on the agent's statements. SCT's reliance on the agent's representations appears to have been reasonable. SCT's credit manager made it clear to the agent that SCT wanted coverage of Great American's debts. Someone at American Credit apparently told the agent, or he had the impression from prior work, that the parent company, Bidermann, should be listed as the customer. SCT's credit manager specifically questioned whether this was the correct method to cover Great American's debts. American Credit's agent assured him it was. These facts make out a case for reasonable reliance by SCT's credit manager on the assurances from American Credit's long-time agent that Great American's debts would be covered. *Smith v. Continental Insurance Co.*, 63 Tenn. App. 48, 469 S.W.2d 138 (1971); *Estate of Wilson v. Arlington Auto Sales, Inc.*, 743 S.W.2D 923 (Tenn. Ct. App. 1987); *Spears v. Federal Crop Insurance Corp.*, 579 F.Supp. 1022 (M. D. Tenn. 1984); see also *Vulcan Life & Accident Ins. Co. v. Segars*, 216 Tenn. 154, 391 S.W.2d 393 (1965); *Henry v. Southern Fire & Casualty Co.*, 46 Tenn.App. 335, 330 S.W.2d 18 (1958).

The detriment to SCT is obvious. It continued doing business with Great American on the assumption its debts were insured under the policy with American Credit, and it needed the coverage when Great American filed bankruptcy. Furthermore, SCT could have made sure it had coverage of Great American's debts if it had known that listing Bidermann did not provide coverage under the policy with American Credit. *Bill Brown Construction Co. v. Glens Falls Insurance Co.*, 818 S.W.2d 1 (Tenn. 1991).

American Credit contends SCT could not have reasonably relied on the statements by American Credit's agent. American Credit relies on the policy provision that prevents an agent from altering the policy without the approval of American Credit's president. To support its argument, American Credit cites *Bailey v. Life & Casualty Insurance Co.*, 35 Tenn. App. 574, 250 S.W.2d 99 (Tenn. App. 1951).

Bailey dealt with the effective date of a life insurance policy. The question was whether the policy became effective before the time provided in the written application signed by the plaintiff. The court seems to have reasoned that the insurance company was not bound by the agent's statements because they were not revealed to the company before it issued the policy. This reasoning is not entirely consistent with other Tennessee cases. *Smith v. Continental Insurance Co.*, 63 Tenn. App. 48, 469 S.W.2d 138 (1971); *City of Lawrenceburg v. Maryland Casualty Co.*, 16 Tenn. App. 238, 64 S.W.2d 69 (1933); *see also Spears v. Federal Crop Insurance Corp.*, 579 F.Supp. 1022 (M. D. Tenn. 1984).

The *Bailey* case, however, does fit the pattern of several cases dealing with the effect of written applications for insurance. The application set out rules as to when the policy would become effective and put limits on the agent's authority. The plaintiff knew the rules on the effective date and knew the limits on the agent's authority. As a result, the plaintiff could not prove reasonable reliance on statements by the agent that vaguely suggested an earlier effective date. An earlier case makes the point more clearly. *Arnold v. Locomotive Engineers Mut. Life & Acc. Ins. Assoc.*, 30 Tenn.App. 166, 204 S.W.2d 191 (1946). The court reached the same result in *Seals v. Appalachian National Life Ins. Co.*, 597 S.W.2d 904 (Tenn. App. 1980); *compare Cockrum Lumber Co. v. Sterchi*, 157 Tenn.

440, 9 S.W.2d 704 (1928) and *Tennessee Farmers Mutual Fire Ins. Co. v. Thompson*, 12 Tenn.App. 501 (1931) (conditions not enforceable against customer without notice).

In this case the insurance policy was in writing and prohibited the agent from making changes without approval by American Credit's president. Of course, adding Bidermann to the policy was not the change that American Credit disputes. American Credit focuses on the agent's statement that listing Bidermann as the customer would cover the debts of Great American. American Credit contends:

- (1) The policy clearly required the customer (Great American) to be listed in order to insure its debts;
- (2) SCT must be treated as having known this;
- (3) SCT must also be treated as having known that the agent could not change the policy without the company's permission;
- (4) Thus, SCT knew the agent's proposal to cover Great American's debts by listing Bidermann as the customer was a change in the policy that was beyond the agent's authority; and
- (5) As a result, SCT could not reasonably rely on the agent's statements as making the policy cover Great American's debts.

The court concludes this case does not involve an attempt by SCT or American Credit's agent to change the terms of the policy, other than to add Great American. For the purpose of argument, however, the court assumes the case involves an attempt to change the policy.

The insurance policy essentially provides coverage of unpaid debts arising from shipments by SCT to the customer listed in the policy. SCT's credit manager and American Credit's agent obviously understood this: the customer who receives the

shipments generally should be the customer listed in the policy in order to insure its debts. This is why SCT's credit manager questioned American Credit's agent as to whether listing Bidermann would result in coverage of Great American's debts. American Credit's agent assured SCT's credit manager that listing Bidermann was the correct procedure for insuring Great American's debts. Despite more than 20 years experience as American Credit's agent did not think listing Great American was the only way to insure its debts. He obviously thought that listing Bidermann would provide coverage of Great American's debts to SCT. Indeed, American Credit's agent apparently thought that American Credit required Bidermann to be listed in order to cover Great American's debts. He told SCT's credit manager that American Credit required Bidermann to be listed. As a result, American Credit's agent convinced SCT's credit manager to list Bidermann. Now, American Credit contends SCT should be held to a higher standard of knowledge than American Credit's experienced agent. According to American Credit, SCT must be treated as if it knew the agent was wrong. The court disagrees.

The facts raised a question as to whether Great American or Bidermann should be listed in the policy. The policy did not explain how to deal with the situation. The policy did not define "debtor" in a way that answered the question. The policy included a provision for determining the dollar amount of coverage based on the existence of a guarantor, but that provision did not answer the question. SCT's credit manager and American Credit's agent were experienced businessmen, but in the court's opinion, they could have studied the insurance policy and still made the same mistake. In summary, the court will not treat SCT as if it knew the policy did not allow Great American's debts to be

covered by listing Bidermann as the customer. The meaning of the policy was not so clear that SCT should have ignored the agent's representations.

In summary, SCT should not be treated as if it knew that obtaining coverage of Great American's debts by listing Bidermann would require a change in the insurance policy. As a result, SCT's credit manager reasonably relied on the agent's representations that listing Bidermann would provide coverage of Great American's debts.

This distinguishes the case from the series of cases involving written applications for insurance. In those cases, the applicants were trying to obtain insurance coverage they knew they did not have. In this case SCT diligently attempted to obtain coverage of Great American's debts, and based on its dealings with American Credit's agent, reasonably believed it had coverage of Great American's debts.

A major question remains, however, as to whether the court should even consider the conversations between SCT's credit manager and American Credit's agent. American Credit contends the parol evidence rule prevents admission of the evidence.

When the parties to an agreement have put it in writing and the writing appears to be their complete agreement, the court may admit evidence of prior negotiations to resolve an ambiguity *but not* to vary the terms of the written contract. This rule of contract law is known as the parol evidence rule. *Maddox v. Webb Const. Co.*, 562 S.W.2d 198 (Tenn. 1978); *Book-Mart of Florida, Inc. v. National Book Warehouse, Inc.*, 917 S.W.2d 691 (Tenn. App. 1995).

American Credit contends that because the written contract lists Bidermann, then any outside (parol) evidence that the policy was supposed to cover Great American's debts must be excluded. The court disagrees.

Parol evidence is admissible to prove an alleged estoppel or waiver. The Tennessee courts have long recognized this exception to the parol evidence rule. See, e.g., *Littlejohn v. Fowler*, 45 Tenn. 284 (1868); *Woods v. Forest Hill Cemetery, Inc.*, 183 Tenn. 413, 192 S.W.2d 987 (1946); *Freeze v. Home Federal Savings & Loan Assoc.*, 623 S.W.2d 109 (Tenn. App. 1981).

This rule applies to cases involving coverage under an insurance policy. See, e.g., *Bailey v. Life & Casualty Insurance Co.*, 35 Tenn. App. 574, 250 S.W.2d 99 (Tenn. App. 1951); *Bill Brown Construction Co. v. Glens Falls Ins. Co.*, 818 S.W.2d 1 (Tenn. 1991); *Industrial Life & Health Ins. Co. v. Trinkle*, 30 Tenn.App. 243, 204 S.W.2d 827, 829 (1947); *Maryland Casualty Co. v. McTyier*, 150 Tenn. 691, 266 S.W.2d 767 (1924).

To bolster its argument, American Credit relies on a Tennessee statute. Tenn. Code Ann. § 47-50-112. Subsection (a) of the statute provides:

(a) All contracts, including, but not limited to, notes, security agreements, deeds of trust, and installment sales contracts, in writing and signed by the party to be bound, including endorsements thereon, shall be prima facie evidence that the contract contains the true intention of the parties and shall be enforced as written, provided, that nothing herein shall limit the right of any party to contest the agreement on the basis it was procured by fraud or limit the right of any party to assert any other rights or defense provided by common law or statutory law in regard to contracts.

The “provided” clause at the end of this subsection preserves rights and defenses allowed by the common law of Tennessee. As a result, the statute does not limit the right of a party to assert waiver or estoppel as allowed by the common law. The right to assert the waiver or estoppel necessarily includes the right to prove them by parol evidence as allowed by the common law.

Subsection (b) of the statute deals with the effect of an other debts or future advance clause in a security agreement. See *Willie v. First American National Bank (In re Willie)*, 157 B.R. 623 (Bankr. M. D. Tenn. 193). It does not apply to the insurance contract in question.

Subsection (c) is more troublesome. It provides:

(c) If any such security agreement, note, deed of trust, or other contract contains a provision to the effect that no waiver of any terms or provisions thereof shall be valid unless such waiver is in writing, no court shall give effect to any such waiver unless it is in writing.

Tenn. Code Ann. § 47-50-112(c).

Written contracts routinely contain two writing requirements. First, no change in the contract will be effective unless it is in writing. Second, no term of the contract can be waived except in writing. Despite these provisions, a party to the contract can still prove an oral change in the contract, as illustrated by the following arguments, counter arguments and conclusion:

(1) No oral change in the contract can be effective since the contract allows only written changes.

(2) The written change requirement was waived by oral statements or other conduct.

(3) The written change requirement could not have been waived by oral statements or other conduct because the contract allows only written waivers.

(4) The written waiver requirement was also waived by oral statements or conduct.

(5) Conclusion: Because the written waiver requirement was waived by oral statements, then the written change requirement could be waived by oral statements, and was in fact waived; as a result the oral changes to the contract were effective.

Subsection (c) of § 47-50-112 appears to overrule this reasoning by prohibiting an oral waiver of the requirement that all waivers must be written. This leaves two ways for oral changes to be effective, and both require a writing. There must be (1) a written waiver of the written change requirement, or (2) a written waiver of written waiver requirement plus an oral waiver of the written change requirement.

Subsection (c) could overrule many Tennessee cases holding that an insurance company is bound by the knowledge or statements of its agent. Whether subsection (c) has that effect depends on whether the result in those cases depended on an oral waiver.

Tennessee cases have relied on the statements or actions of an insurance agent as being a waiver of the policy's requirement that changes or waivers be in writing. See, e.g., *Maryland Casualty Co. v. McTyier*, 150 Tenn. 691, 266 S.W. 767 (1924); *Industrial Life & Health Ins. Co. v. Trinkle*, 30 Tenn. App. 243, 204 S.W.2d 827 (1947)

affirmed 185 Tenn. 434, 206 S.W.2d 414 (1947); *see also Woods v. Forest Hill Cemetery, Inc.*, 183 Tenn. 413, 192 S.W.2d 987 (1946) (involving a lease).

The cases, however, do not deal with true waivers. They deal with estoppel.

Estoppel is a barrier imposed by the court.

The doctrine of estoppel is based upon the ground of public policy, fair dealing, good faith, and justice, and its purpose is to forbid one to speak against his own act, representations, or commitments to the injury of one to whom they were directed and who reasonably relied thereon. . . . Thus, the doctrine of equitable estoppel or estoppel in pais is founded upon principles of morality and fair dealing and is intended to subserve the ends of justice. It always presupposes error on one side and fault or fraud upon the other and some defect of which it would be inequitable for the party against whom the doctrine is asserted to take advantage.

28 Am.Jur.2d, Estoppel and Waiver § 28 (1966).

The use of estoppel is revealed by the courts' focus on two questions. First, did the insurance customer reasonably rely on the agent's representations or reasonably think that coverage existed based on the facts revealed to the agent? Second, did the customer change position based on this reliance? *See, e.g., Bill Brown Construction Co. v. Glens Falls Insurance Co.*, 818 S.W.2d 1 (Tenn. 1991); *Spears v. Commercial Ins. Co.*, 866 S.W.2d 544 (Tenn. App. 1993); *Robinson v. Tennessee Farmers Mutual Ins. Co.*, 857 S.W.2d 559 (Tenn. App. 1993); *McDonough v. State Farm Mutual Auto Ins. Co.*, 755 S.W.2d 57 (Tenn. App. 1988); *Das v. State Farm Fire & Casualty Co.*, 713 S.W.2d 318 (Tenn. App. 1986). Detrimental reliance is relevant to estoppel but not to a true waiver, as explained by the following:

Waiver and estoppel are closely akin, their legal effect is much the same, and the terms . . . are often loosely used interchangeably. . . . [A] waiver may be established even though the acts, conduct, or declarations are insufficient to establish an estoppel.

Specifically . . . a waiver is a voluntary and intentional abandonment or relinquishment of a known right, whereas an equitable estoppel may arise even though there was no intention . . . to relinquish or change any existing right. On the other hand, prejudice to the other party is one of the essential elements of equitable estoppel, whereas waiver does not necessarily imply that the party asserting it has been misled to his prejudice or into an altered position. . . .

. . . It is unquestionably true that the dividing line between waivers implied from conduct and estoppels often becomes so shadowy that in the law of insurance, for instance, the two terms have come to be quite commonly used interchangeably. When the term “waiver” is so used, however, the elements of an estoppel almost invariably appear, and it is quite apparent that it is employed to designate not a pure waiver, but one which has come into . . . existence . . . through application of the principles underlying estoppels.

28 Am.Jur.2d, Estoppel & Waiver § 30 (1966).

The Tennessee courts have described the result as waiver by estoppel, estoppel by waiver, or implied waiver, but they recognize that estoppel is the true basis of the decisions. *Chattem, Inc. v. Provident Life & Accident Ins. Co.*, 676 S.W.2d 953 (Tenn. 1984) (implied waiver also known as equitable estoppel); *Maryland Casualty Co. v. McTyier*, 150 Tenn. 691, 266 S.W. 767 (1924) (doctrine of waiver involves estoppel); *Baird v. Fidelity-Phoenix Fire Ins. Co.*, 178 Tenn. 653, 162 S.W.2d 384 (1942) (describing waiver as a broad form of estoppel); *Gitter v. Tennessee Farmers Mutual Ins. Co.*, 60 Tenn. App. 698, 450 S.W.2d 780 (1969) (implied waiver same as equitable estoppel).

If the insurance customer reasonably relies to his detriment on the agent's representations regarding coverage, the representations bind the insurance company. This

is true despite contradictory provisions in the written insurance policy. *Estate of Wilson v. Arlington Auto Sales, Inc.*, 743 S.W.2d 923 (Tenn. App. 1987) (twelve month period represented to be six months); *Magnavox Co. v. Boles & Hite Construction Co.*, 585 S.W.2d 622 (Tenn. App. 1979) (full coverage); *Tennessee Storm Window & Hardware Co. v. Newark Ins. Co.*, 506 S.W.2d 792 (Tenn. App. 1974) (representation of coverage on separate warehouse); *Henry v. Southern Fire & Casualty Co.*, 46 Tenn. App. 335, 330 S.W.2d 18 (1958) (full coverage); *City of Lawrenceburg v. Maryland Casualty Co.*, 16 Tenn. App. 238, 64 S.W.2d 69 (1933) (coverage represented to be same as prior policy); see also *Bell v. Wood Insurance Agency*, 829 S.W.2d 153 (Tenn. App. 1992) (suit against agents for failure to obtain correct coverage). The court can assume the policies in most of these cases prohibited unwritten changes or waivers or both, since such provisions are standard; the insurance companies were still bound by the agent's representations.

The use of estoppel, instead of waiver, is suggested by another facet of the Tennessee cases. The courts have decided first that the insurance company should be bound by the agent's knowledge or representations. The courts have based waiver on the same representations or knowledge. In other words, waiver is a side effect of the conclusion that the insurance company is bound by what its agent knew or said. *Maryland Casualty Co. v. McTyier*, 150 Tenn. 691, 266 S.W. 767 (1924); *Co-Operative Stores Co. v. United States Fidelity & Guaranty Co.*, 137 Tenn. 609, 195 S.W. 177 (1917); *T. H. Hays & Sons v. Stuyvesant Ins. Co.*, 194 Tenn. 35, 250 S.W.2d 7 (1952); *Phillips v. North River Ins. Co.*, 14 Tenn. App. 356 (1931).

The Tennessee Supreme Court made a similar point in its most recent decision on the subject. Estoppel creates an insurance contract different from the written

policy. This insurance contract agrees with the agent's representations or knowledge. Contradictory provisions in the written policy are rendered ineffective. The policy's requirement that changes or waivers must be in writing does not prevent the unwritten changes from being effective. This is merely a side effect of the estoppel that creates the different contract terms. It is not a true waiver of the writing requirements. *Bill Brown Construction Co. v. Glens Falls Ins. Co.*, 818 S.W.2d 1 (Tenn. 1991).

Subsection (c) of § 47-50-112 prohibits a court from giving effect to an unwritten waiver when the contract requires a written waiver. The court concludes that waiver in this statute does not apply to an estoppel that has the same effect as a waiver; it is not a true waiver. This narrow reading of the statute prevents it from possibly overruling longstanding rules of Tennessee common law. *In re Deskins' Estates*, 214 Tenn. 608, 381 S.W.2d 921 (1964); *Linder v. Metropolitan Life Ins. Co.*, 148 Tenn. 236, 255 S.W. 43 (1923).

The Tennessee courts have not treated § 47-50-112(c) as relevant. The statute became effective in 1984. Since 1984 the Tennessee courts have decided numerous cases regarding the effect of an insurance agent's knowledge or statements on the coverage provided by the policy or the effect of the insured's actions after the loss. The Tennessee courts have not used § 47-50-112(c) as a basis for ruling in favor of the insurance company. See, e.g., *Bush v. Exchange Mutual Ins. Co.*, 866 S.W.2d 575 (Tenn. App. 1993); *Robinson v. Tennessee Farmers Mutual Ins. Co.*, 857 S.W.2d 559 (Tenn. App. 1993); *Allstate Ins. Co. v. First of Georgia Ins. Co.*, 753 S.W.2d 672 (Tenn. 1988); *McDonough v. State Farm Mutual Auto Ins. Co.*, 755 S.W.2d 57 (Tenn. App. 1988); *Black v. Aetna Ins. Co.*, 909 S.W.2d 1 (Tenn. App. 1995). About seven years after the statute

became effective, the Tennessee Supreme Court decided the *Bill Brown Construction* case. That case rejected a distinction that supposedly existed in the law of estoppel. It reaffirmed the established rule that an insurance agent's representations or knowledge of facts can, by means of estoppel, result in insurance coverage not expressly provided by the written policy. The court never mentioned § 47-50-112(c). *Bill Brown Construction Co. v. Glens Falls Ins. Co.*, 818 S.W.2d 1 (Tenn. 1991).

The court concludes § 47-50-112(c) does not apply. Neither it nor the parole evidence rule prevents admission of the evidence regarding the dealings between SCT's credit manager and American Credit's agent. Therefore, American Credit is estopped from denying coverage of Great American's debts — even if it involves a change in the policy.

This brings the court back to its earlier point: this case really does not involve any attempt to make a change in the terms of the policy, other than to add Great American as a covered debtor. SCT did not want a change in the policy so that naming a parent company (Bidermann) would also cover the debts of its subsidiary (Great American). SCT's credit manager and American Credit's agent both knew that SCT wanted coverage of Great American's debts. The question is not whether they attempted to change the policy so that listing Bidermann would also cover the debts of Great American. The question is whether listing Bidermann should be treated the same as listing Great American.

The difference may be easier to understand by treating this case as a reformation case. Great American's debts will be insured if SCT can prove the policy should be reformed to list Great American instead of Bidermann. This is an easy case for

reformation to change Bidermann to Great American. SCT's credit manager and American Credit made a mistake as to which corporation should be listed in the policy as the customer whose debts were insured. *Phillips v. North River Insurance Co.*, 14 Tenn. App. 356 (1931); *Vaughn v. American Heritage Life Ins. Co.*, 573 S.W.2d 165 (Tenn. App. 1978); *Dickens v. St. Paul Fire & Marine Ins. Co.*, 170 Tenn. 403, 95 S.W.2d 910 (1936).

The court, however, need not order reformation. Tennessee law allows the court to omit this step and reach the same result by means of estoppel. American Credit's agent assured SCT that listing Bidermann would provide coverage of Great American's debts. SCT reasonably relied on those statements to its detriment. As a result, the court can treat the policy as if listing Bidermann was the same as listing Great American. *Henry v. Southern Fire & Casualty Co.*, 46 Tenn. App. 335, 330 S.W.2d 18 (1958); *Phillips v. North River Insurance Co.*, 14 Tenn. App. 356 (1931).

Finally, it makes no difference that the policy at the time of the loss was a renewal or successor policy to the one that was in effect when SCT added Bidermann. *Brewer v. Vanguard Insurance Co.*, 614 S.W.2d 360 (Tenn. App. 1980).

The court concludes that SCT is entitled to summary judgment with regard to liability. The next question is whether the amount of damages can be determined without a hearing.

SCT originally sought to recover the 25% penalty for bad faith failure pay an insurance claim. Tenn. Code Ann. § 56-7-107. SCT has dropped its claim for the penalty.

SCT also sought damages in excess of the policy limit of \$120,000. SCT theorized that it could recover additional damages for breach of contract. The Tennessee courts do not allow additional damages for breach of an insurance contract by refusal to pay, except for the bad faith penalty and interest. *Haun v. Guaranty Security Ins. Co.*, 61 Tenn. App. 137, 453 S.W.2d 84 (1969); *Shamrock Homebuilders, Inc. v. Cherokee Ins. Co.*, 486 S.W.2d 548 (Tenn. App. 1972). Thus, SCT cannot recover above the policy limit.

In the pleadings and evidence submitted with regard to the summary judgment motions, American Credit does not dispute that SCT's damages were more than the policy limit of \$120,000. As a result, the court can grant summary judgment for the policy limit of \$120,000.

The court is also of the opinion that SCT should recover pre-judgment interest. American Credit has raised interesting arguments in opposition to SCT's claim, but an investigation of SCT's dealings with American Credit's agent and a review of the Tennessee case law should have left American Credit with very little doubt as to its liability. Furthermore, American Credit's refusal to pay doubtlessly added to SCT's financial troubles. In these circumstances the court will allow pre-judgment interest but only from the date SCT filed the complaint commencing this adversary proceeding. See Tenn. Code Ann. § 47-14-123; *Otis v. Cambridge Mut. Fire Ins. Co.*, 850 S.W.2d 439 (Tenn. 1993); *Engert v. Peerless Ins. Co.*, 53 Tenn.App. 310, 382 S.W.2d 541 (1964); *Oman Construction Co. v. City of Nashville*, 49 Tenn.App. 171, 353 S.W.2d 97 (1961).

This Memorandum constitutes findings of fact and conclusions of law as required by Fed. R. Bankr. P. 7052.

At Chattanooga, Tennessee.

BY THE COURT

entered 4/9/1997

R. THOMAS STINNETT
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE

In re:

No. 95-11611
Chapter 11

SCT YARNS, INC.

Debtor

SCT NEWCO, INC.

Plaintiff

v

Adversary Proceeding
No. 95-1216

AMERICAN CREDIT INDEMNITY
COMPANY

Defendant

JUDGMENT

In accordance with the court's memorandum opinion entered this date,

It is ORDERED that the plaintiff SCT Newco, Inc., recover a judgment against the defendant, American Credit Indemnity Company, in the amount of \$120,000.00 plus costs and pre-judgment interest at the statutory rate beginning on December 28, 1995.

ENTER:

BY THE COURT

entered 4/9/1997

R. THOMAS STINNETT
U.S. BANKRUPTCY JUDGE