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IN THIS ISSUE:

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Mid-Continent v. Liberty Mutual: A Ghastly Decision

A. The Background Facts

Liberty Mutual Insurance Company ("Liberty Mutual") insured Kinsel Industries ("Kinsel"), the general contractor on a highway project being completed for the State of Texas (the "State"). Crabtree Barricades ("Crabtree") was one of Kinsel's subcontractors and was responsible for the signs and dividers on the highway project. Liberty Mutual's policy had a $1 million limit and the company also provided a $10 million excess policy. Mid-Continent Insurance Company ("Mid-Continent") insured Crabtree under a nearly identical $1 million policy under which Kinsel was an additional insured. As such, Kinsel was a concurrent insured under two $1 million policies, each having identical "other insurance" clauses providing equal or pro rata sharing. In addition, each policy contained a "voluntary payment" clause, a subrogation clause, and a version of the standard "no action" clause.

During construction of the highway, a driver crossed over the center barrier into oncoming traffic and hit another car head-on. In the second car was the Boutin family, which suffered substantial injuries. The Boutins filed a lawsuit against several parties, including Kinsel. Liberty Mutual and Mid-Continent both assumed the defense of Kinsel and did not dispute that they owed the defense, as well as indemnification. At the outset of the underlying lawsuit, the insurers agreed that the total verdict against all defendants would be between $2 and $3 million. At first, they agreed that Kinsel's liability was for ten to fifteen percent of that amount. As the case progressed, however, Liberty Mutual increased its estimate to sixty percent while Mid-Continent refused to increase its estimate.

When Mid-Continent would not increase its contribution to settlement, Liberty Mutual agreed at mediation with the Boutins to settle on behalf of Kinsel for $1.5 million (sixty percent of a $2.5 million anticipated verdict). Liberty Mutual demanded that Mid-Continent contribute half, but Mid-Continent refused to pay more than $150,000. Thus, Liberty Mutual contributed the other $1.35 million, paying $350,000 more than its primary policy limits, but it retained the right to seek recovery against Mid-Continent for its portion of the settlement. Liberty Mutual sought $600,000 from Mid-Continent, but, in light of Mid-Continent's settlement

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CASES TO WATCH:

Excess Underwriters at Lloyd's, London v. Frank's Casing Crew & Rental Tools, Inc., 2005 WL 1252321 (Tex. May 27, 2005) (pending on rehearing) (whether Texas recognizes a right of recoupment by an insurer against its insured)

Fairfield Ins. Co. v. Stephens Martin Paving, 381 F.3d 435 (5th Cir. 2004) (certified to the Supreme Court of Texas and argued on November 9, 2004) (whether an award of punitive damages is insurable under an employers liability policy)

Ulico Cas. Co. v. Allied Pilots Ass'n, 187 S.W.3d 91 (Tex. App.—Ft. Worth 2005, pet. granted) (argued on April 11, 2007) (whether Texas recognizes coverage by waiver and/or estoppel when an insurer undertakes the defense without adequately reserving rights)

American Home Assur. Co., Inc. v. Unauthorized Practice of Law Comm., 121 S.W.3d 831 (Tex. App.—Eastland 2003, pet granted) (argued on September 28, 2005) (scope of the tripartite relationship between insurer, insured, and defense counsel retained by insurer)

with the Boutins for $300,000 on behalf of Crabtree, the District Court awarded only $550,000 (the remaining portion of Mid-Continent's $1 million policy limit).

B. The Certified Questions

The Fifth Circuit certified the following issues to the Supreme Court of Texas:

1. Two insurers, providing the same insured applicable primary insurance liability coverage under policies with $1 million limits and standard provisions (one insurer also providing the insured coverage under a $10 million excess policy), cooperatively assume defense of the suit against their common insured, admitting coverage. The insurer also issuing the excess policy procures an offer to settle for the reasonable amount of $1.5 million and demands that the other insurer contribute its proportionate part of that settlement, but the other insurer, unreasonably valuing the case at no more than $300,000, contributes only $150,000, although it could contribute as much as $700,000 without exceeding its remaining available policy limits. As a result, the case settles (without an actual trial) for $1.5 million funded $1.35 million by the insurer which also issued the excess policy and $150,000 by the other insurer.

   In that situation is any actionable duty owed (directly or by subrogation to the insured's rights) to the insurer paying the $1.35 million by the underpaying insurer to reimburse the former respecting its payment of more than its proportionate part of the settlement?

2. If there is potentially such a duty, does it depend on the underpaying insurer having been negligent in its ultimate evaluation of the case as worth no more than $300,000, or does the duty depend on the underpaying insured's evaluation having been sufficiently wrongful to justify an action for breach of the duty of good faith and fair dealing for denial of a first party claim, or is the existence of the duty measured by some other standard?

3. If there is potentially such a duty, is it limited to a duty owed the overpaying insurer respecting the $350,000 it paid on the settlement under its excess policy?

C. The Supreme Court Sides with Mid-Continent

On October 12, 2007, the Supreme Court of Texas delivered its opinion, which was nearly unanimous with only Justice Willett issuing a concurring opinion. *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 2007 WL 2965401 (Tex. Oct. 12, 2007) ("[W]e conclude there is no right of

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CASES TO WATCH:
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OneBeacon Ins. Co. v. Don's Building Supply, Inc., 2007 WL 2258192 (5th Cir. Aug. 8, 2007) (certifying trigger issue to the Supreme Court of Texas)

Pine Oak Builders, Inc. v. Great Am. Lloyds Ins. Co., 2006 WL 1892669 (Tex. App.—Houston [14th Dist.] July 6, 2006, pet. granted) (scope of the eight-corners rule and proper trigger theory to apply to "property damage" cases)

Johnson v. State Farm Lloyds, 204 S.W.2d 897 (Tex. App.—Dallas 2006, pet. granted) (scope of the standard appraisal clause)

reimbursement in the context presented."). Because the Court answered the first question in the negative, it did not reach the other questions.

With regard to the first certified question, Liberty Mutual contended that it was entitled to reimbursement through contractual subrogation in its CGL policy, equitable subrogation as applied in *General Agents Insurance Company of America v. Home Insurance Co. of Illinois*, 21 S.W.3d 419 (Tex. App.—San Antonio 2000, pet. dism'd by agr.), or subrogation to Kinsel's common law right to have Mid-Continent act reasonably when handling an insured's defense. The latter argument suggested a modification or expansion of Mid-Continent's *Stowers* duty in the circumstances of the case. On the other hand, Mid-Continent argued that Kinsel did not have an enforceable contract right to which Liberty Mutual could be subrogated. Mid-Continent further argued that its only common law duty was its *Stowers* duty to accept a reasonable settlement offer within policy limits, but contended that no such settlement offer was ever made. Finally, Mid-Continent urged that no direct action exists in Texas between co-insurers for a right of reimbursement.

Turning to Liberty Mutual's reliance on *General Agents*, the Court found that Liberty Mutual was actually seeking a right of contribution from Mid-Continent. Under *Traders & General Insurance v. Hicks Rubber*, 169 S.W.2d 142 (Tex. 1943), a right of contribution exists when two or more insurers bind themselves to pay an entire loss, but one pays the whole loss. The latter is entitled to a right of contribution in the amount of the ratable proportion of the amount paid. The right of contribution requires that several insurers share a common obligation or burden and that the insurer seeking contribution has made a *compulsory* payment of more than its fair share of that common burden. When "other insurance" and "pro rata" clauses exist, however, then the direct claim for contribution between co-insurers disappears because the "pro rata" clause makes the contracts several and independent from each other. That is, there is no common obligation because each co-insurer contractually agrees with the *insured* to pay its pro rata share of the loss, but does not contractually agree to pay another co-insurer's pro rata share.

As the Liberty Mutual and Mid-Continent CGL policies contained pro rata other insurance clauses, the two insurers agreed with their common insured, Kinsel, to pay a proportionate share of the insured's loss up to $1 million. But the co-insurers did not create a similar contract between themselves. The Court said:

> There is no contractual right of contribution between them, and the presence of the pro rata clauses in the CGL policies precludes an equitable contribution claim. In this situation, no contractual obligations exist between co-insurers to apportion between themselves the payment on behalf of the insured, and we are not persuaded to create such an obligation under the common law.

Mid-Continent, 2007 WL 2965401, at *5. As such, the Court disapproved of *General Agents* to the extent it recognized any duty between co-

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insurers to reasonably exercise their rights under an insurance policy. The *General Agents* opinion suggested that a breach of that duty would provide an overpaying co-insurer a right of reimbursement through subrogation, but did not identify the rights of the common insured to which the overpaying insurer could be subrogated. Thus, it seemingly created a direct duty between co-insurers, which the Court refused to accept.

As for subrogation, prior case law seemed to indicate that Liberty Mutual had either a contractual or common law right to reimbursement. The Court, however, noted the important distinction between having a right to subrogation and the ability to recover under that right. With regard to the former, Liberty Mutual asserted that it had such a right under the subrogation clause in its own policy. Any such right, however, would stem from the contractual and common law duties Mid-Continent owed Kinsel. The Court found that because Kinsel had been fully indemnified for its $1.5 million loss, it had no right to enforce Mid-Continent's duty to pay its pro rata share of the loss. A pro rata clause "implements [the] principle [of indemnification] by eliminating the potential for double recovery by the insured." *Id.* at *7. Thus, the Court held "that a fully indemnified insured has no right to recover an additional pro rata portion of settlement from an insurer regardless of that insurer's contribution to the settlement." *Id.* at *8. Because the insured has no right to enforce, the co-insurer has nothing to assert against another co-insurer in subrogation.

Looking at Kinsel's potential common law rights, the Court recognized that in the third-party insurance context an insurer's common law duty is limited to that espoused in *Stowers*, which is to protect the insured by accepting a reasonable settlement offer within policy limits. Mid-Continent, however, did not breach that duty because the Boutins did not make a settlement offer within Mid-Continent's policy limits. The Court "decline[d] to create rights for Kinsel and therefore, Liberty Mutual, via subrogation." *Id.* Further, the Court noted that Liberty Mutual had paid a debt for which it also was primarily liable and so it did not satisfy the traditional subrogation requirement that the subrogee pay a debt for which another is primarily liable. Finally, the Court distinguished its opinion in *American Centennial Insurance Co. v. Canal Insurance Co.*, 843 S.W.2d 480 (Tex. 1992), as that case recognized equitable subrogation as a basis for an excess insurer's recovery against a primary insurer. Here, though, Liberty Mutual was both a primary and an excess insurer and was in position to negotiate a good faith settlement on its insured's behalf. Thus, the Court concluded:

> Equity demanded a remedy for the excess insurer in *Canal*, but here equity does not favor such a remedy. A reasonable primary insurer, which did not improperly handle the claim, would not pay more than its primary policy limits. In paying $350,000 more than its $1 million policy limits, Liberty Mutual seems to have been motivated by concern for its excess insurance policy. Mid-

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> Continent cannot be required to agree to a settlement that requires payment in excess of its remaining coverage to protect Liberty Mutual's excess insurance interests.

Id. Finding that Kinsel had no common law cause of action against Mid-Continent and no contractual rights remaining after full indemnification, the Court held that Liberty Mutual had no right of reimbursement through subrogation. The Court's holding was more succinctly explained by Justice Willet in his concurring opinion. Justice Willett, who began by stating that "[t]his Court frequently finds itself deciding high-stakes insurance law questions, which, for me at least, can be fiendishly difficult," said that because Liberty Mutual had an excess insurance policy, it had its own selfish reasons for wanting Mid-Continent to split the $1.5 million settlement, but he explained that "[i]nsurance companies are not eleemosynary institutions." When the insured's interests are no longer at stake, there is "no reason for courts in these circumstances to prohibit insurance companies from engaging in sharp negotiations with each other." *Id.* at *10.

Commentary:

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In sum, the Court held that no right of contribution and no right of subrogation existed between co-insurers. Contribution was inapplicable because it requires a compulsory payment, which Liberty Mutual did not make—its payment was voluntary. Subrogation, on the other hand, also was inapplicable because that cause of action only grants the insurer the same rights held by the insured. Because the insured had been fully defended and indemnified, no enforceable right existed upon which subrogation could be based.

Although a seemingly innocuous opinion as to insureds, the Supreme Court of Texas' opinion in *Mid-Continent v. Liberty Mutual* actually may have long-lasting adverse effects. Most importantly, the Court's opinion detracts from its traditional precedent wherein settlement always is the preferred outcome. This, on the other hand, is the anti-settlement case.

For instance, now when two insurers are in the position faced by Liberty Mutual and Mid-Continent, no incentive exists for one insurer to step up to the plate and settle the case on behalf of its insured. No insurer will take the road taken by Liberty Mutual, which cut defense costs and eliminated the need for further litigation. Instead, the Liberty Mutuals of the world are forced to play their hand at the mercy of the Mid-Continents. That is, regardless of its own reasonable assessment of the case at hand, a reasonable co-insurer must operate based on the analysis of another, seemingly less reasonable, co-insurer. If the latter won't budge on its assessment of the case, then the former must go forth with litigation and defense costs, and the insured has to come along for the ride. Because the Court will not require that the co-insurers be reasonable, there exists no incentive to do so.

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Thus, at least for now, insureds seem to be stuck with co-insurers that likely will no longer be as willing to settle cases. Without an incentive to reasonably assess the likelihood of a judgment against a co-insured, a co-insurer can low-ball the case and stand firm, knowing that the Supreme Court of Texas will not force them to cough up more than its "reasonable" assessment. As such, despite Texas' general tradition in favor of settlements, the *Mid-Continent* opinion will encourage more litigation rather than less.

Update on *Lamar Homes*:

On September 19, 2007, Mid-Continent Casualty Company filed a motion for rehearing in *Lamar Homes v. Mid-Continent Casualty Co.*, 2007 WL 2459193 (Tex. Aug. 31, 2007). The Supreme Court of Texas requested a response from Lamar Homes, which was filed on October 5, 2007, and four amicus curiae briefs have since been filed, all of which focused entirely on the Article 21.55 issue. Currently, the parties are awaiting word from the Court as to whether it will grant or deny the rehearing.

For an extensive analysis of the Supreme Court's decision in *Lamar Homes*, see Volume I, Issue 5 of the Insurance Law Newsletter, which can be found under the Publications Tab at www.vsfirm.com. In addition, other articles by Lee H. Shidlofsky, including a new article on declaratory judgment actions and the scope of the duty to defend, also are available on the website.

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Lee H. Shidlofsky is a founding partner of Visser Shidlofsky LLP. His practice is devoted to representing and counseling corporate policyholders in the area of insurance law, risk management, contractual risk transfer, and extra-contractual issues. He is Treasurer of the Insurance Law Section and holds a council position in the Construction Law Section of the State Bar of Texas. He is the author of numerous articles and seminar papers and is a frequent speaker at continuing legal education seminars in Texas and across the country. Mr. Shidlofsky has been named a "Super Lawyer" by Texas Monthly Magazine each year since 2004, including a ranking as a Top 50 attorney in the Central and West Texas Region for 2007, and is ranked as a top insurance coverage lawyer by Chambers USA and Who's Who Legal.

Douglas P. Skelley is an associate at Visser Shidlofsky LLP. He represents and counsels corporate policyholders in numerous insurance law matters. He is a member of both the Insurance Law Section and the Construction Law Section of the State Bar of Texas.

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