

claim for damage repair;

- claims submitted in writing - written notice must be provided within 3 business days of the insurance company's receipt of the notice.

**28. DEDUCTIBLE RECOVERY.** If another person is liable for damage to your auto and you filed a claim and paid a deductible on your own policy, your insurance company must make a reasonable and diligent effort to recover the deductible from that person within twelve months from the date your claim is paid. If not, your company must:

- authorize you, at least 90 days prior to the expiration of the statute of limitations, to pursue your own collection efforts, or

- refund your deductible.

**29. NOTICE OF LIABILITY CLAIM SETTLEMENT.**

Your insurance company must notify you if it intends to pay a liability claim against your policy. The company must notify you in writing of an initial offer to compromise or settle a claim against you no later than the 10th day after the date the offer is made. The company must notify you in writing of any settlement of a claim against you no later than the 30th day after the date of the settlement.

**30. INFORMATION NOT REQUIRED FOR CLAIM PROCESSING.**

You have the right to refuse to provide your insurance company with information that does not relate to your claim. In addition, you may refuse to provide your federal income tax records unless your insurer gets a court order or your claim involves lost income or a fire loss.<sup>10</sup>

**B. DUTIES SET OUT IN THE INSURANCE CONTRACT.** Many of the duties relating to the claims process are also part of the insurance contract itself. Please refer to Appendix B of this Guide for provisions on "Duties after Loss" from standard personal lines policies regarding loss and claim adjustment.

**5 COMMON LAW CONFLICT OF INTEREST.** While conflict of interest is more commonly thought of in the context of an attorney-client or a fiduciary relationship, there are situations where Texas courts have applied the concept to an insurance company in the claims handling context. First, it has been applied in the context of a carrier's duty to defend an insured against third-party claims when the carrier issues a reservation of rights. This will be more closely examined later in this publication. Second, it has been applied in the context of an uninsured motorist claim where the carrier seeks to defend the uninsured motorist in direct opposition to the claim being advanced by the carrier's insured. This conflict has been referred

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<sup>10</sup> *Id.*

to by one Texas court as the "Hunt Presumption."<sup>11</sup> Finally, conflict of interest has been applied to the situation of carrier subrogation against its insured.

A. **UNINSURED MOTORISTS CLAIMS AND THE HUNTPRESUMPTION.** The *Hunt* case refers to an uninsured motorist case decided in 1970, *Allstate Ins. Co. v. Hunt*,<sup>12</sup> in which Allstate, the plaintiff/insured's auto insurance carrier, wanted to participate in the tort action between the insured and uninsured driver, i.e. defend uninsured driver. In a case of first impression Houston's 14<sup>th</sup> Court of Appeals considered whether an insurance company should be permitted to participate in the defense of an uninsured motorist in a suit brought by its own insured.<sup>13</sup> The Court noted that:

Serious ethical problems arise when an insurance company seeks to participate in the defense of an uninsured motorist. There may be (1) a potential or actual conflict of interest between the insurance company and its own insured and (2) there may be a potential or actual conflict of interest between the insurance company and the uninsured motorist. As the representative of the uninsured motorist the company stands in a fiduciary relationship to him. As the insurer of one suing the uninsured motorist it has, contractually, not only the right but also the duty to represent its insured in defense of any claim that may be asserted against him as a result of the collision in question, and thus stands in a fiduciary relationship to him. Thus to permit the insurance company to defend the uninsured motorist is to permit it to assume a fiduciary relationship to two parties having conflicting interests in the subject matter of the trust.<sup>14</sup> ... Of immediate concern is the conflict of interest between the company and its own insured. If the insured brings suit against the uninsured motorist and the company is permitted to defend such uninsured motorist, the company would attempt to prove either the negligence of its own insured, or the uninsured motorist's freedom from negligence. Either determination would inure to the benefit of the insurance company. The company interests are therefore opposed to those of its own insured.<sup>15</sup> ... *We are of the opinion,... that the conflict of interest that is in every case potentially present compels a determination that the insurance company must refrain from representing the uninsured motorist or from intervening in an uninsured motorist case such as the one here presented. Only such determination will eliminate the possibility of the conflict of interest arising.*<sup>16</sup>

<sup>11</sup> *Nationwide Mut. Ins. Co. v. Patterson*, 962 S.W.2d 714,716 (Tex. App.--Austin 1998, writ denied).

<sup>12</sup> 450 S.W.2d 668 (Tex. Civ. App.– Houston [14th Dist.] 1970, *aff'd* 469 S.W.2d 151 (Tex.1971)).

<sup>13</sup> *Id* at 671.

<sup>14</sup> *Id* at 671-672.

<sup>15</sup> *Id* at 672.

<sup>16</sup> *Id.* at 672-673 (emphasis added).

- 1) Interestingly, since uninsured motorist coverage was still relatively new at that time, the Court also relied on the traditional auto insurance concept that the primary obligation of the company issuing automobile liability coverage is to defend the insured against suits alleging damages within the terms of the policy, and not ancillary coverage such as this.<sup>17</sup> Accordingly, the *Hunt* Court also concluded that an insurance company should not be permitted to voluntarily place itself in a position under an ancillary policy provision where it cannot ethically fulfill its basic contractual obligation to defend its insured.<sup>18</sup>
  
- 2) **The *Hunt* Presumption and the Consent Clause.** While *Hunt* seemed to cast a bright line rule, essentially followed for thirty years, that carriers cannot participate in an insured's suit against an uninsured motorist, a little noticed case in 1998, cracked the door open a bit for carriers on this particular conflict of interest issue.<sup>19</sup> In the *Patterson* case, Nationwide issued an automobile policy in North Carolina for a vehicle that was involved in an accident in Texas.<sup>20</sup> The policy did not contain a consent to sue clause and the insured brought suit in Texas against the uninsured tortfeasor and Nationwide, the plaintiff's carrier. The parties agreed that Texas law applied. The Plaintiff took a no-answer default judgment against the uninsured driver, and summary judgment was rendered against Nationwide for the full amount of the judgment rendered against the uninsured driver. On appeal, Nationwide argued it should not be bound by the default judgment because it could not defend the uninsured defendant pursuant to the rule announced in *Hunt*.<sup>21</sup> The Austin Court of Appeals disagreed and held that as a presumption, the existence of conflicting interests and fiduciary duties precludes an insurer from defending an uninsured motorist against the company's own insured.<sup>22</sup> The prohibition, however, is not absolute and the Court noted, as did the *Hunt* court, that there may be other instances where the insured motorist is clearly at fault and the insurance company has not, in fact, obtained confidential information from its insured as it did in the *Hunt* case.<sup>23</sup> The lack of substantial conflict of interest, and the right of the insurance company to protect itself, would weigh on the side of allowing it to participate in the trial on the side of the uninsured motorist.<sup>24</sup> *Hunt* creates, therefore, only a presumption that a conflict of interest precludes the insurer from acting against its insured's interest, but allows the insurer to do so on a proper showing to the

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<sup>17</sup> *Id.* at 673.

<sup>18</sup> *Id.*

<sup>19</sup> *Nationwide Mut. Ins. Co. v. Patterson*, 962 S.W.2d 714,716 (Tex. App.--Austin,1998, writ denied).

<sup>20</sup> *Id.* at 714.

<sup>21</sup> *Id.* at 716.

<sup>22</sup> *Id.* at 716

<sup>23</sup> *Id.* at 716.

<sup>24</sup> *Id.*

Court.<sup>25</sup> It is the insurer's duty to rebut the presumption when the issue is raised.<sup>26</sup>

- 3) Importantly absent from the policy in the *Patterson* case was a "Consent Clause" which is a standard provision in the Texas Automobile policy. With respect to uninsured motorist coverage it provides "Any judgment for damages arising out of a suit without our consent is not binding on us." This provision typically gives the insurer contractual protection without having the need to defend the uninsured defendant driver.

**B. SUBROGATION.** Subrogation is an area of law that continues to develop and has seen considerable activity in the Texas courts over the last several years. Subrogation is the right of one who has paid an obligation which another should have paid to be indemnified by the other.<sup>27</sup> There are three types of subrogation recognized in Texas: 1) equitable or legal subrogation; 2) contractual subrogation; and 3) statutory subrogation.<sup>28</sup> Although most often used in the insurance context, equitable subrogation applies to all situations where a party shows that it involuntarily paid a debt primarily owed by another which in equity should have been paid by the other party.<sup>29</sup> Contractual subrogation is created by an agreement that grants the right to pursue reimbursement from a third party in exchange for payment of a loss.<sup>30</sup> Under both equitable or contractual subrogation, the insurer stands in the shoes of the insured, and may assert only those rights held by the insured subject to any defenses of the third party against the insured.<sup>31</sup> While these types of subrogation rest on common principles, they are not co-equal and express contractual subrogation terms trump equitable principles.<sup>32</sup> For example, in a recently decided Texas Supreme Court case, the Court held that the equitable "made whole" doctrine, a common defense raised against health insurers trying to recover medical expenses paid on behalf of an injured plaintiff, does not prohibit those health insurers from enforcing clear and specific contractual subrogation which entitles them to recover the amount of health care benefits paid on behalf of the Plaintiff.<sup>33</sup>

- 1) **General Rule: absent a contractual right or statutory authority a carrier does not have the right to subrogate against its own**

<sup>25</sup> *Id.*

<sup>26</sup> *Perez v. Kleinart*, 211 S.W.3d 468, 475 (Tex. App.—Corpus Christi 2006, not pet.).

<sup>27</sup> *Employers Cas. Co. v. Dyess*, 957 S.W.2d 884, 886 (Tex. App.—Amarillo 1997, pet. denied).

<sup>28</sup> *State Farm Mut. Auto. Ins. Co. v. Perkins*, 216 S.W.3d 396, 400 (Tex. App. — Eastland 2006, no pet.).

<sup>29</sup> *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d 765, 774 (Tex. 2007); *Frymire Eng'g co. v. Jomar Intern., Ltd.*, 259 S.W.3d 140, 142, 144-46 (Tex. 2008).

<sup>30</sup> *Mid-Continent Ins.*, 236 S.W.3d at 774.

<sup>31</sup> *Id.*

<sup>32</sup> *Fortis Benefits v. Cantu*, 234 S.W.3d 642, 648-649 (Tex. 2007).

<sup>33</sup> *Id.* at 651.

**insured for sums paid out under an insurance policy.**<sup>34</sup> This rule, also known as the Antisubrogation Rule, provides that an insurer has no right of subrogation against its own insured for a claim arising from the very same risk for which the insured was covered.<sup>35</sup> The prohibition against an insurer subrogating itself against its insured is based on, among other things, the public policy considerations which are raised due to the fiduciary relationship between the two.<sup>36</sup> One Court indicated that "the situation where an insurer attempts to subrogate and sue his own insured, whom he is obligated to defend, gives rise to so many opportunities for conflict of interests or misrepresentation of the insured that public policy commands that the insurer be denied the right to do so."<sup>37</sup> Moreover, Texas courts have recognized a "special relationship" between an insurance company and its insured, giving rise to duties of good faith and fair dealing.<sup>38</sup> Allowing an insurer to unilaterally settle uncovered claims and then step into the shoes of the claimant and sue its own insured runs counter to this relationship and to public policy interests in fostering trust and eliminating conflicts of interests between the insurer and its insured.<sup>39</sup>

- 2) **Prohibited Subrogation.** Two recent decisions by the Texas Supreme Court further illustrate the general prohibition against subrogation, including: 1) claims against the insured for an insurer's payment of non-covered claims - *Frank's Casing*; and 2) claims by one co-insurer against another co-insurer for reimbursement of monies paid by the first insurer on behalf of the insured on the same loss - *Mid-Continent v. Liberty Mutual*.
  - a. **An insurer's payment of non-covered claims and the controversy over *Frank's Casing*.** In 2005, the Texas Supreme Court issued a controversial opinion that recognized a new right of reimbursement for insurers against their insureds for paying non-covered liability claims.<sup>40</sup> This marked a major departure from prior Texas law and the customary relationship between insurers and insureds in Texas. Because the *Frank's*

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<sup>34</sup> *Matagorda County v. Texas Ass'n of Counties Government Risk Management Pool*, 975 S.W.2d 782, 786 (Tex. App.– Corpus Christi, 1998) *aff'd*, 52 S.W.3d 128 (Tex. 2000); *AGIP Petroleum Co. v. Gulf Island Fabrication, Inc.*, 920 F.Supp. 1318, 1326 (S.D. Tex. 1996); *Stafford Metal Works, Inc. v. Cook Paint & Varnish Co.*, 418 F. Supp. 56, 58 (N.D. Tex. 1976).

<sup>35</sup> *State Farm Mut. Auto. Ins. Co. v. Perkins*, 216 S.W.3d at 401.

<sup>36</sup> *Stafford*, 418 F.Supp. at 58-59.

<sup>37</sup> *Stafford*, at 62.

<sup>38</sup> *Crim Truck & Tractor Co. v. Navistar Intern. Transp. Corp.*, 823 S.W.2d 591, 593-94 (Tex. 1992); *Aranda v. Insurance Co. of N. Am.*, 748 S.W.2d 210, 212-13 (Tex. 1988); *Arnold v. National County Mut. Fire Ins. Co.*, 725 S.W.2d 165, 167 (Tex. 1987).

<sup>39</sup> *Matagorda County v. Texas Ass'n of Counties Government Risk Management Pool*, 975 S.W.2d 782, 786 (Tex. App.– Corpus Christi, 1998) *aff'd* 52 S.W.3d 128 (Tex. 2000).

<sup>40</sup> *Excess Underwriters at Lloyd's London v. Frank's Casing Crew & Rental Tools, Inc.*, 48 Tex. Sup. Ct. J. 735, 2005 Tex. LEXIS 418 (May 27, 2005), *opinion withdrawn and superceded* 246 S.W.3d 42 (Tex. 2008).

decision of 2005 did not fit well with established Texas insurance law, it was not surprising to see the Court grant a rehearing of the case, and in 2008 withdraw its prior opinion, and ultimately deny the carrier's right to reimbursement. The final decision is more consistent with established Texas insurance law. Because of the stir caused by this initial decision, further discussion is warranted.

- i     **The Facts:** The underlying litigation giving rise to this reimbursement case began after a drilling platform fabricated by Frank's Casing for ARCO collapsed several months after being installed in the Gulf of Mexico.<sup>41</sup> ARCO sued several Defendants including Frank's Casing.<sup>42</sup> Frank's had a \$1,000,000 primary liability insurance policy and a \$10 million excess policy through certain Lloyd's underwriters.<sup>43</sup> At trial, when it became apparent Frank's was the target defendant, Frank's in-house counsel solicited and received a demand from ARCO to settle for \$7.5 million.<sup>44</sup> The counsel forwarded the demand to the excess underwriters with Frank's own demand that the settlement demand be accepted.<sup>45</sup> Communications between Frank's and the excess underwriters resulted in general consensus that the claim should be settled for \$7.5 million, but no agreement as to how the settlement should be split between them, or if coverage issues would be reserved for later determination.<sup>46</sup> Frank's again demanded that the excess underwriters settle the case within their limits.<sup>47</sup> In response, the excess underwriters advised Frank's they would settle the claim for \$7.5 million and then seek reimbursement from Frank's because they believed the claims were not covered.<sup>48</sup> Up to that point in time, the only action that the excess underwriters had taken on coverage was to issue two reservation of rights letters asserting that the claims alleged against Frank's in the ARCO suit were not covered.<sup>49</sup> The excess underwriters made no effort to resolve any coverage issue in a declaratory judgment

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<sup>41</sup> *Excess Underwriters at Lloyd's London v. Frank's Casing Crew & Rental Tools, Inc.*, 246 S.W.3d 42, 43 (Tex. 2008).

<sup>42</sup> *Id.* at 44.

<sup>43</sup> *Id.*

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> *Id.* at 45.

<sup>49</sup> *Id.*

action until after they agreed to settle ARCO's case against Frank's.<sup>50</sup> The final settlement agreement in the ARCO suit preserved any claims that existed as of that time between Frank's and its excess underwriters.<sup>51</sup> Coverage litigation then ensued between the excess underwriters and Frank's. Interestingly, the trial court determined through summary judgment that none of ARCO's claims in the underlying case were covered under the excess policy.<sup>52</sup> Nevertheless, based on the Texas Supreme Court's holding in *Matagorda County*, the excess underwriters were not entitled to reimbursement, and judgment was then rendered in favor of Frank's Casing.<sup>53</sup> The Court of Appeals affirmed but expressed reservation about the result after applying *Matagorda County* to the facts of this case.<sup>54</sup> On the first hearing of this case, the Texas Supreme Court was troubled by the fact that Frank's was able to get \$7.5 million in insurance coverage to pay claims that were ultimately determined not to be covered. That concern provided the motivation by which the Court in the 2005 decision found a reimbursement right for insurers who paid non-covered claims, despite the fact that the holding directly conflicted with prior precedents on this very point.

- ii **Prior Law on Insurer Reimbursement.** In the 2000 decision of *Matagorda County*, the Texas Supreme Court held that absent a specific policy provision or specific agreement with the insured to the contrary, an insurer who had not resolved coverage issues before funding a settlement, could not later assert a claim against the insured for reimbursement of the settlement monies paid on behalf of the insured for non-covered claims.<sup>55</sup> The *Matagorda County* decision was consistent with prior decisions of the Texas Supreme Court declaring that when an insurer is asked to defend an insured against a liability claim, the insurer must either accept coverage or make a good faith effort to resolve coverage before resolution of the Plaintiff's

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<sup>50</sup> *Id.*

<sup>51</sup> *Id.*

<sup>52</sup> *Id.* at 49.

<sup>53</sup> *Id.* at 43.

<sup>54</sup> *Id.* at 45.

<sup>55</sup> *Texas Ass'n. of Counties County Gov't Risk Mgmt. Pool v. Matagorda County*, 52 S.W.3d 128, 135 (Tex. 2000).

claim against the insured.<sup>56</sup> The rationale for these decisions was that because the insurer is in the business of analyzing and allocating risk, the insurer is in the best position to assess the viability of its coverage position, and litigate it if necessary.<sup>57</sup> Under this rule, the burden was clearly on the insurer to resolve all coverage issues promptly.<sup>58</sup> The Supreme Court's most recent decision in *Frank's Casing* reaffirms this rule.

iii **The 2008 Decision in *Franks' Casing*.** In response to significant criticism relating to its 2005 decision in *Frank's Casing*, the Texas Supreme Court reversed itself, withdrew its prior opinion, and rendered judgement in favor of *Frank's*. The 2005 decision was a poorly reasoned departure from established Texas law that unwisely shifted the burden to instigate coverage litigation on the insured, instead of the carrier. In the Court's final opinion, it reaffirmed the rule established in *Matagorda County* by holding that without a specific contract provision providing a right of reimbursement an insurer that settles a claim against its insured when coverage is disputed and is later determined not to exist, may only seek reimbursement from the insured if the insurer obtains the insured's clear and unequivocal consent to the settlement and the insurer's right to reimbursement.<sup>59</sup> The Court also reaffirmed the reasoning behind that rule that requires the insurer, rather than the insured, to determine what course of action is appropriate on the coverage issue because the insurer is in the business of analyzing and allocating risk and is in the best position to assess the viability of its coverage defense.<sup>60</sup>

iv **KEY LESSONS.** The 2008 *Frank's Casing* decision is not surprising and is better tailored to prior Texas cases in this area. The reason that the excess underwriters got into the position they did in the *Frank's Casing* case is that they did nothing to determine coverage until it was too late. Had they been more attentive and initiated coverage litigation at an earlier stage, they likely would not have been put in the position of having

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<sup>56</sup> *Farmers Texas County Mut. Ins. Co. v. Griffin*, 955 S.W.2d 81, 84 (Tex.1997); *State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696, 714 (Tex.1996).

<sup>57</sup> *Texas Ass'n of Counties County Gov't Risk Mgmt. Pool v. Matagorda County* at 135.

<sup>58</sup> *Id.*

<sup>59</sup> *Excess Underwriters at Lloyd's London v. Frank's Casing Crew & Rental Tools, Inc.*, 246 S.W.3d at 45.

<sup>60</sup> *Id.* at 47-48.

to determine whether to pay \$7.5 million to settle claims they thought were not covered. Generally, when an insurance company is asked to defend an insured against a liability claim, the insurer is required to either accept coverage or make a good faith effort to resolve coverage before adjudication of the Plaintiff's claim.<sup>61</sup> If a carrier waits until trial of the underlying case against the insured or settlement discussion begin, it is usually too late to do anything meaningful on the coverage defenses. If the insurer then pays money to settle a claim against an insured, without getting an agreement from the insured that unequivocally preserves the carrier's right of reimbursement, that money is gone without any recourse to the insurer. When faced with claims, most insureds are not inclined to agree to give an insurer the right to reimbursement, especially if the insured recognizes that it has the insurer in a quandary over the coverage issue. Accordingly, it is incumbent on, and clearly in the interest of, the insurer to carefully consider possible coverage issues after the claim is presented and make a determination whether a coverage suit is warranted. If there is any meritorious coverage defense as to the insurer's duty to indemnify, insurers should strongly consider a coverage suit. While a coverage suit may lack finality until the facts in the underlying case are fully adjudicated, insurers are in a stronger bargaining position to resolve the underlying case, if a coverage suit has already been filed. One of the main lessons of *Frank's Casing* for insurers is to be proactive in seeking resolution of coverage issues as early in the claims process as possible either through negotiation or judicial determination.

- b. **Claims by one insurer against a co-insurer for reimbursement of monies paid by the insurer in indemnification on behalf of the insured on the same loss.** In the 2007 case of *Mid-Continent Ins. Co v. Liberty Mutual Ins. Co.*, the Texas Supreme considered whether an insurance carrier had a claim against another co-insurer covering the same loss, when there was a disproportionate amount paid by the first carrier.<sup>62</sup> The case arose out of a serious highway motor vehicle accident in a construction zone. The injured plaintiffs sued the project's general contractor, Kinsel Industries, and the subcontractor responsible for signs and

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<sup>61</sup> *State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696, 714 (Tex. 1996).

<sup>62</sup> *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d 765, 768 (Tex. 2007).

barricades, Crabtree Barricades.<sup>63</sup> Kinsel was insured by its own carrier, Liberty Mutual with a \$1 million primary CGL and \$10 million excess policy.<sup>64</sup> Kinsel was also an additional insured under Crabtree's \$1 million CGL policy with Mid-Continent.<sup>65</sup> Importantly both CGL policies contained identical "other insurance" clauses that provided for equal or pro rata sharing up the co-insurers respective policy limits if the loss is covered by other primary insurance.<sup>66</sup> While the two carriers did not dispute that both owed some portion of Kinsel's defense and indemnification, the carriers disagreed over the settlement value of the case.<sup>67</sup> Mid-Continent evaluated the case value against Kinsel at \$300,000 and refused to pay anything more than 50% of this value.<sup>68</sup> Liberty Mutual believed the risk was closer to \$2-3 million.<sup>69</sup> Ultimately, Liberty Mutual agreed to settle the case for \$1.5 million, using Mid-Continent's \$150,000 and itself funding the difference.<sup>70</sup> Liberty Mutual later sued Mid-Continent for failing to act reasonably in evaluating the risk against the insured and in failing to reasonably exercise its rights under the CGL policy. The trial court found for Liberty Mutual, finding a right of subrogation against the other co-insurer and awarding it its proportionate share.<sup>71</sup> On appeal, the Fifth Circuit Court of Appeals certified the question to the Texas Supreme Court.<sup>72</sup>

- i **Holding.** Contrary to the developing law among some lower courts, the Texas Supreme Court found in favor of Mid-Continent and held that there is no direct duty of reimbursement between co-primary insurers with identical "other insurance" clauses, and that there is no contribution or subrogation rights available to Liberty Mutual.<sup>73</sup> The Court based its holding on a case it decided back in 1943, *Hicks Rubber*.<sup>74</sup> While both this Court and the Court in *Hicks Rubber* recognized the general rule that, if two or more insurers bind themselves to pay the entire loss insured against, and one insurer pays the whole loss, the one so paying has

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<sup>63</sup> *Id.* at 768-769.

<sup>64</sup> *Id.* at 769.

<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

<sup>67</sup> *Id.* at 770.

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> *Id.* at 771.

<sup>73</sup> *Id.* at 772.

<sup>74</sup> *Traders & General Ins. Co. v. Hicks Rubber Co.*, 169 S.W.2d 142 (Tex 1943).

a right of contribution against the co-insurer for the disproportionate amount paid, they found that such right was extinguished when the policies contain “other insurance” or “pro rata” clauses.<sup>75</sup> The pro rata clause operates to ensure that each insurer is not liable for any greater proportion of the loss than the coverage amount in its policy bears to the entire amount of insurance coverage available.<sup>76</sup> The effect of the pro rata clause precludes a direct claim for contribution among insurers because the clause makes the insurance contracts several and independent of each other.<sup>77</sup> **The co-insurer who pays more than its contractually agreed upon proportionate share does so voluntarily;** that is, without a legal obligation to do so and without a remedy for reimbursement.<sup>78</sup> (Although it should be noted that the effect of the “pro rata” clause is limited to the insurer and so this ruling does not prohibit an action by the insured against one or more insurers for an unpaid loss.<sup>79</sup>) The Court also determined that since in subrogation the insurer takes only those rights the insured had, and because the insured had already been fully indemnified by the settlement, it had no right to give to the subrogating insurer.<sup>80</sup> Accordingly, Liberty Mutual did not have a claim for subrogation.

- ii **COMMENTARY.** The *Mid-Continent* decision could easily have been decided differently and is an unfortunate decision for Texas insurance law. In the subrogation context, it simply makes little sense to base this holding on the fact that since the insured has already been paid or indemnified for the loss by the paying insurer, the insurer that paid for that loss has no damages because it stands in the shoes of the insured who has been fully paid. That is the whole point of subrogation in the first place. Moreover, there is no public policy served by this decision and it does nothing to promote the prompt resolution of liability cases against insureds. It certainly does not encourage or reward insurers that are proactive in resolving cases on behalf of their insureds. Rather, the effect of this decision is that it discourages a co-primary insurer from

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<sup>75</sup> *Mid-Continent* at 771 (citing *Traders & General Ins. Co. v. Hicks Rubber Co.*, 169 S.W.2d at 148.).

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

<sup>80</sup> *Id.* at 774-776.

settling a claim when there is any dispute on the value of the claim between the multiple primary insurers. This means that co-primary insurers will be limited to the pro-rata share of the lowest settlement value as determined by one of the co-primary insurers. That is usually not a recipe for resolving cases promptly. It will be interesting to see how this concept plays out if a policy limits demand is ever made on the insured and one insurer refuses to pay its share. Does that mean the recalcitrant co-primary insurer will again get the benefit of not doing anything? The other unfortunate effect of this decision is that it discourages co-primary insurers from participating in the insured's defense when at least one other primary carrier has already stepped forward to defend. As long as the defense is being provided by one carrier, under these decisions, the other carrier can simply wait until sued and a judgment is entered stating that it has a duty to defend before it will have any obligation to do anything. Under at least one court decision, a carrier that delays like this is not liable for past defense costs, and only has to start paying its share of defense costs incurred thereafter. Given these cases, in situations where a co-primary insurer refuses to defend, the other primary insurer is well advised to secure a declaratory judgment as soon as possible so that the recalcitrant insurer will be forced to participate. Insurers are also advised not to pay more than the any agreed pro rata share of any settlement since anything paid in excess of that amount is a volunteer payment for which there is no chance of reimbursement absent a specific agreement providing for such recovery from the other insurer.

- iii **KEY LESSONS.** Subrogation is an indispensable part of the insurance process and most always permitted by Texas courts. The most significant recent development for insurers is the elimination of claims that were available between co-primary insurers when faced with co-existing indemnity obligations for a single insured. In any case where there is more than one primary liability carrier for a single insured, carriers must pay special attention as to whether all primary insurers are participating in the defense of the insured. If one is not, then serious consideration should be given as to whether suit needs to be filed immediately to compel participation by the other insurer. As for indemnity payments, an insurer needs to be aware that if it pays a disproportionate share, it will not likely have any

recourse to sue any other primary insurer for reimbursement. Given the pressure that a carrier may be under to fulfill its duties to the insured, having a conflict with another co-primary insurer over the value of a claim certainly makes this area of law complex. Consultation with Texas coverage counsel for guidance regarding the appropriate action is certainly needed and recommended.

- 3) **Permissible Subrogation & Exceptions to the Anti-Subrogation Rule.** Subrogation that is authorized by contract or statute are the main exceptions to the anti-subrogation rule. Courts have also carved out certain exceptions to the general rule and they are: 1) claims for defense costs among co-insurers; 2) Legal malpractice claims against Insured's attorneys who defended the insured in a third-party liability case where the excess carrier had to pay more than it should have because of the attorney's negligence; 3) an insurer subrogation claim against the insured under separate policy; and 4) insurer subrogation against a third-party tortfeasor.

- a. **Claims for Defense Costs among co-insurers.** According to the federal Fifth Circuit Court of Appeals, the holding in *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*<sup>81</sup> discussed above does not apply to the defense obligation, and therefore, one carrier can subrogate or make a claim of contribution against another co-insurer for defense costs incurred on behalf of the same insured.<sup>82</sup> The Court reasoned that since the "other insurance" clause applies only to the duty to indemnify, not the duty to defend, it does not preclude contribution or subrogation claims relating to sharing defense costs. Each carrier that is obligated to defend the same insured has the same duty to defend, and a carrier that pays more than its fair share should be permitted to pursue a contribution or subrogation claim against a wrongfully non-participating carrier.<sup>83</sup> Interestingly, unlike the *Mid-Continent* case, where the Fifth Circuit certified the legal question to the Texas Supreme Court, the Fifth Circuit in the *Trinity Universal* case made this decision itself, and had to distinguish the *Mid-Continent* decision to do so. Perhaps it did not want to give the Texas Supreme Court another opportunity to render another poor insurance decision.

- i **Commentary:** The court's sole conclusion that supports its opinion is that the "other insurance" clause applies only to the duty to indemnify. This conclusion is

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<sup>81</sup> 236 S.W.3d 765, 768 (Tex. 2007).

<sup>82</sup> *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.*, 592 F.3d 687, 694 (5<sup>th</sup> Cir. 2010)

<sup>83</sup> *Id.*

misplaced. The Court cites no authority for the proposition, and it is inconsistent with how Texas courts have applied “other insurance” clauses in other cases. Texas courts have applied such clauses to both the duty to indemnify and the duty to defend.<sup>84</sup> In fact, the Court’s conclusion on this point appears to contradict one of its own prior holdings regarding the application of “other insurance” clauses.<sup>85</sup> Accordingly, while the end result is laudable, and understandable given the *Mid-Continent* decision, the rationale supporting the decision is not consistent with how other courts have considered and applied “other insurance” clauses. Perhaps this is a function of wanting to not have this case turn out like *Mid-Continent* case. Nevertheless, caution should be used in any sole reliance on this decision.

- b. **Legal Malpractice Claims Against Insured’s Attorneys.** In the context of the defense of a third-party claim, Texas courts permit, through the doctrine of equitable subrogation, an excess insurance carrier to assert a legal malpractice claim against the insured’s defense attorneys, and a negligence action against the primary carrier.<sup>86</sup> But the evidentiary burden is heavy. In such a case where the defense counsel or primary carrier cause the excess carrier to pay more than it should have to settle the case, the excess carrier has to show that the settlement was excessive in the abstract yet reasonable under the circumstances.<sup>87</sup> The excess carrier must also prove that the attorney or primary carrier mishandled the defense of the insured and that a judgment for the plaintiff against the insured in excess of case’s true value resulted from the mishandling.<sup>88</sup> Accordingly, the excess carrier must show that the true value of the case was less than the amount paid to settle it, but was inflated due the attorney’s malpractice.<sup>89</sup> If proven, the excess carrier can recover damages against the attorney as the difference between the true and inflated values of the case, less any amount saved by the settlement.<sup>90</sup> In such a case, evidence of the excess carrier’s post-tender conduct is admissible on the affirmative defense of comparative responsibility if raised, and even evidence of pre-tender

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<sup>84</sup> *Hardware Dealers Mut. Fire Ins. Co. v. Farmers Ins. Exchange*, 444 S.W.2d 583, 590 (Tex. 1969); *Safeco Lloyds Ins. Co. v. Allstate Ins. Co.*, No. 04-09-00322, 2009 WL 4981082, at \*8 (Tex. App. – San Antonio Dec. 23, 2009, n. pet h.).

<sup>85</sup> *Royal Ins. Co. of America v. Hartford Underwriters Ins. Co.*, 391 F3d 639, 644 (5<sup>th</sup> Cir. 2004).

<sup>86</sup> *American Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480 (Tex. 1992).

<sup>87</sup> *Keck, Mahin & Cate, Grant Cook v. Nat’l Union Fire Ins. Co.*, 20 S.W.3d 692, 703 (Tex. 2000).

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

<sup>90</sup> *Id.*

conduct might be admissible if the insured's defense was harmed by the excess carrier's interference.<sup>91</sup>

- c. **Insurer Subrogation Claim Against Insured under Separate Policy.** In the 2006 case of *State Farm Mut. Auto, Ins. Co. v. Perkins*, the Eastland Court of Appeals considered whether a UM carrier, that had paid benefits to the insured, could subrogate against the insured's recovery against a third-party, but whose insurance carrier was the same as the insureds.<sup>92</sup> In this case State Farm paid UM benefits to Perkins, because the driver of a dump truck was not insured. Perkins brought suit against the owner of the truck who was also insured by State Farm, and State Farm intervened in the action to recoup monies paid on the UM claim, as it was permitted to do under the personal automobile insurance policy. State Farm was denied any recovery in the trial court and the issue was appealed. Because State Farm's subrogation action sought benefits from a different policy, i.e. not Perkins's policy, the court permitted the subrogation action, and held that it was not against public policy to permit subrogation in this case.<sup>93</sup>
- d. **Insurer Subrogation Against a Third-Party Tortfeasor.** In the *Frymire Engineering* case, the Texas Supreme Court looked at whether an insurer who paid to settle a contractual liability claim against the insured, could subrogate against a third-party tortfeasor responsible for causing the damages that required the payment.<sup>94</sup> The tortfeasor argued that because the payment was required by contract, the insurer's settlement payment was not voluntary and equitable subrogation, therefore, was not applicable.<sup>95</sup> The Court confirmed the general rule that equitable subrogation applies in every instance in which one person, not acting voluntarily, has paid a debt for which another is primarily liable and which in equity should be paid by the latter.<sup>96</sup> The Court analogized to and relied heavily on its prior holding in the *Keck, Mahin* case discussed above where subrogation was allowed.<sup>97</sup> The Court held that the carrier, in the name of its insured, could pursue claims against the alleged third-party tortfeasor under the doctrine of equitable subrogation because it had shown that it paid a debt primarily owed by the tortfeasor, it made the payment voluntarily, and seeks subrogation in a situation with

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<sup>91</sup> *Id.* at 703-04.

<sup>92</sup> *State Farm Mut. Auto. Ins. Co. v. Perkins*, 216 S.W.3d 396, 399 (Tex. App. – Eastland 2006, no pet.).

<sup>93</sup> *Id.* at 403.

<sup>94</sup> *Frymire Engineering Co., Inc. v. Jomar Int'l, Ltd.*, 259 S.W.3d 140, 141 (Tex. 2008).

<sup>95</sup> *Id.* at 145.

<sup>96</sup> *Id.* at 142.

<sup>97</sup> *Id.* at 143-144.

the tortfeasor would be unjustly enriched if the insured was not allowed to pursue the claims.

- e. **KEY LESSONS.** The holdings in the *Keck, Mahin* case and in the *Frymire Engineering* case show how easily the Court allows the subrogation in many cases where it is clearly equitable to do so. It is a stark contrast to the Court decision in *Mid - Continent* where subrogation was withheld based on the “other insurance” clause.

#### 4) Other Subrogation Issues

- a. **Subrogation and the “Made Whole” Doctrine.** The “made whole” doctrine is an equitable defense that, until recently, was frequently raised by insureds when health insurance carriers attempted to recover paid medical expenses through a subrogation claim in the insured’s third-party tort lawsuit. This defense was initially recognized by the Texas Supreme Court in a 1980 equitable subrogation case wherein the Court held that an insurer is not entitled to subrogation against its insured’s recovery against a third-party if the insured’s loss is in excess of the amounts recovered from the insurer and the third-party causing the loss.<sup>98</sup> That is, an insurer is not entitled to subrogation of medical benefits unless the insured has already been “made whole.” Since that time, when a health insurer tried to recover its paid medical expenses caused by a third-party’s fault, the insured plaintiff would argue that the settlement monies did not cover the insured’s entire loss, and therefore, the carrier was not entitled to full reimbursement. As a result, the carrier was usually only able to recover a fraction of the paid medical expenses, if any at all. The rationale for the rule was that if one party is to go unpaid for any part of the loss, that loss is best borne by the insurer.<sup>99</sup> This was an especially powerful argument in severe personal injury cases where the medical expenses were extensive and so too were the insured’s injuries. But the days of the “made whole” doctrine being the Plaintiff’s trump card are now over in Texas.
  - i Health insurers obtained a nice victory against the “made whole” doctrine from the Texas Supreme Court in the case of *Fortis Benefits v. Cantu*.<sup>100</sup> In that case, Vanessa Cantu sued multiple parties after being

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<sup>98</sup> *Fortis Benefits v. Cantu*, 234 S.W.3d 642, 644-645 (Tex. 2007)(citing *Ortiz v. Great Southern Fire & Cas. Ins. Co.*, 597 S.W.2d 342 (Tex. 1980)).

<sup>99</sup> *Id.*

<sup>100</sup> *Id.*

severely injured in a motor vehicle accident.<sup>101</sup> Her health insurer, Fortis Benefits intervened asserting a contractual right to recover its paid medical expenses of \$378,500.<sup>102</sup> Plaintiff had evidence that her future medical care would be between \$1,700,000 and \$5,300,000 but she settled with the Defendants for \$1,445,000. When the Plaintiff and Fortis could not agree how much Fortis would take, Cantu asked the trial court to deny any relief to Fortis under the “made whole” doctrine because her damages far exceeded the settlement and benefits that Fortis had paid. The trial court denied Fortis’ claim, and that decision was affirmed by the court of appeals.

- ii At the Texas Supreme Court, Fortis argued that the “made whole” defense was an equitable doctrine that did not preclude its contractual rights of subrogation and reimbursement.<sup>103</sup> The Court agreed, distinguishing equitable subrogation from the very specific terms of the parties’ contract. The Court held that the equitable “made whole” doctrine is not applicable in cases where the parties’ agreed contract provides a clear and specific right of subrogation,<sup>104</sup> and found that Fortis was contractually entitled to recover out of the settlement amount, the amount of health care benefits it paid to the Plaintiff.<sup>105</sup>
- iii Most health insurance contracts provide a right of subrogation or reimbursement to the carrier for health care costs incurred as the result of a third-party’s conduct. After the *Fortis* decision, carriers now have an undeterred contractual right recognized by the courts to recover the full amount of their paid medical expenses out of the insured Plaintiff’s settlement. However, it also follows that insurers should expect claims to be made by plaintiff’s attorneys for a percentage of the recovery due to plaintiff’s counsel’s effort. The main lesson from the *Fortis* decision for health insurers are that they should: 1) examine their contracts to make sure the rights to subrogation and reimbursement are clearly set forth in the contract; 2) investigate medical payments to insureds due to injuries to ascertain whether a

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<sup>101</sup> *Id.* at 644.

<sup>102</sup> *Id.*

<sup>103</sup> *Id.* at 645.

<sup>104</sup> *Id.* at 651.

<sup>105</sup> *Id.*

subrogation claim can and should be filed; 3) establish a subrogation team including outside attorneys who can assert subrogation rights in appropriate cases; and 4) in appropriate cases pursue reimbursement claims even if the insured plaintiff does not file suit.

- iv The “made whole” doctrine is still applicable in equitable subrogation actions but is balanced against the “One Satisfaction” rule which bars a plaintiff from being compensated twice for one injury.<sup>106</sup> Equitable based subrogation provides that once the insured is made whole from his damages, the insurer that has paid for the insured’s covered losses is entitled to the insured’s rights and remedies for the covered losses, so that the insured is not compensated twice for one injury.<sup>107</sup>

**b. Subrogation and Worker’s Compensation Reimbursement.**

Texas law has for many decades required the first money recovered by an injured worker from a tortfeasor to go to the worker’s compensation carrier and, until it is paid in full, the employee or his representatives have no right to any funds.<sup>108</sup> Occasionally, plaintiffs attempt various schemes to prevent the worker’s compensation carrier from obtaining any recovery. The Texas Supreme Court looked at one of these cases recently in *Texas Mutual Ins. Co v. Ledbetter* and strongly affirmed the carrier’s absolute right to be reimbursed despite these questionable efforts to cut them out. The *Ledbetter* case arose when Charles Ledbetter was electrocuted in the course of his employment. Texas Mutual paid worker’s compensation benefits by way of funeral expenses and monthly death benefits to his widow and minor son.<sup>109</sup> A third-party lawsuit was brought by the widow as administrator of the estate, individually and on behalf of her minor son, and two adult daughters.<sup>110</sup> The case was settled for \$4.5 million and notice of a minor’s settlement hearing was given to all parties and Texas Mutual.<sup>111</sup> Texas Mutual intervened in the case asserting its subrogation claim. Prior to the minor’s settlement hearing, plaintiff’s counsel nonsuited all claims except for the estate’s claims, and at the hearing allocated the settlement amount between the estate and the plaintiff’s attorney. The Court granted the nonsuits, approved the settlements, and

<sup>106</sup> *Osborne v. Jauregui, Inc.*, 252 S.W.3d 70, 78 ( Tex. App. – Austin, 2008, pet. denied).

<sup>107</sup> *Id.*

<sup>108</sup> *Tex. Mut. Ins. Co. v. Ledbetter*, 251 S.W.3d 31, 33 (Tex. 2008)(citing *Argonaut Ins. Co. v. Baker*, 87 S.W.3d 526, 530 (Tex. 2002)).

<sup>109</sup> *Id.* at 34.

<sup>110</sup> *Id.*

<sup>111</sup> *Id.*

struck the carrier's intervention denying it any recovery. The carrier appealed; the court of appeals held that the trial court erred by striking the carrier's intervention and allocating 100% of the settlement to the estate based on the evidence.<sup>112</sup> Both sides appealed to the Texas Supreme Court.

- i **Ruling.** The Supreme Court reaffirmed the carrier's statutory right to first money, the insurer's right to intervene in the case, and determined that the trial court erred in dismissing the plaintiffs from the case because it prejudiced the insurer's claim.<sup>113</sup> Not only did the Supreme Court take exception to the fact the carrier was squeezed out of first money, but the fact that the minor's interests were not protected or dealt with on the settlement hearing record. The Court then concluded by implying that in this attempted work around, the plaintiffs were guilty of conversion by noting that when an injured worker settles a case without reimbursing the worker's compensation carrier, everyone involved is liable to the carrier for conversion, including the plaintiffs, plaintiff's attorney, and the Defendants.<sup>114</sup> The Court remanded the case back to the trial court for reinstatement of the plaintiffs, reimbursement to the carrier, and protection of the minor's interest.
- ii The rule of law established in this case is not unique, but reinforces that schemes to defeat a worker's compensation carrier's right to reimbursement are not acceptable. The Court reminded that all parties that participate to defeat such a right may be liable for conversion to the insurer. Accordingly, in any case involving a worker's compensation lien, defendants are well advised to make sure that the worker's compensation insurer is included in the settlement.

- 5) **KEY LESSONS.** There is a recognized special relationship between carrier and insured, for which carriers should use careful contemplation before instituting any action against or contrary to the insured. The insurance contract should be the first thing considered to determine whether a particular action against an insured is permissible or warranted. When dealing with non-standard policies, such as in the *Patterson* case, a carrier may have to assert positions against the insured or risk waiving valuable rights to challenge the

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<sup>112</sup> *Id.* at 35.

<sup>113</sup> *Id.* at 35-38.

<sup>114</sup> *Id.* at 38 (The court noted that as between those parties, the ones that actually received the funds unlawfully should disgorge them rather making the tortfeasors pay twice).

insured's claim. Accordingly, a thorough knowledge of the particular policy at issue is essential for determining if a particular subrogation action is essential or appropriate in a given case.

## 6 PRIVACY ISSUES

- A. **Non-Public Personal Financial Information.** Texas law requires the Texas Insurance Commissioner to enact regulations for insurance companies that will safeguard consumer financial information to the extent of Federal privacy laws governing financial institutions.<sup>115</sup> The Department issued detailed regulations regarding the disclosure of personal financial information to non-affiliated third parties.<sup>116</sup> These regulations primarily concern the use of information gathered in the course of financial transactions with insurance consumers and set forth procedures for providing privacy notices to consumers with respect to use of personal financial information. Carriers now provide, as a matter of course, a privacy policy statement with the issuance of the insurance policy. These issues are not routinely encountered in claims handling context. However, care should be taken when personal financial records, such as tax returns, are produced to the carrier as a part of the claims process. Such records should normally be safeguarded and not disclosed to third-parties who are not involved in the claims process.
- B. **Non-Public Personal Health Information.** The general rule is that carriers must obtain an authorization from the subject person before disclosing any non-public personal health information about the person to a third party.<sup>117</sup> However, there are a number of exceptions to this rule, including as necessary for claims administration, adjustment, and management.<sup>118</sup> But note that a carrier does have a responsibility, before the disclosure of any such information, to have the receiving third-party agree not to disclose the protected information other than as necessary to carry out the purposes for which the covered entity disclosed the information.<sup>119</sup>
- 1) The use of health information, such as medical records, is essential to the claims evaluation process in a bodily injury claim. These records contain confidential health information. Carriers routinely use evaluators to review medical records to opine on the appropriateness of treatment, charges, diagnosis, etc. Such activities are permissible under Texas law, without any further authorization from the claimant. But any use of the protected records beyond the claims context, is likely not permissible. Further information on the Texas regulations regarding insurance companies and privacy can be found on the internet at: <http://www.tdi.state.tx.us/webinfo/08qbulletins.html>.

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<sup>115</sup> TEX. INS. CODE ANN. § 601.051.

<sup>116</sup> 28 TAC Chapter 22.

<sup>117</sup> 28 TAC § 22.53.

<sup>118</sup> 28 TAC § 22.57.

<sup>119</sup> 28 TAC § 22.60.