TEXAS LEGAL LIABILITY ADVISOR

INFORMATION TO AVOID LIABILITY JANUARY - MARCH 2006

INSURER REIMBURSEMENT IN TEXAS: INSURERS WIN ROUND ONE AT SUPREME COURT

© 2006 Mark Courtois

INTRODUCTION

Every so often a court decision comes along that significantly redefines a particular area of law. As for Texas insurance law, the Texas Supreme Court rendered that kind of decision in 2005 in the case of *Excess Underwriters at Lloyd's London v. Frank's Casing Crew & Rental Tools, Inc.*[1] While there have been many cases throughout the years that identify and define the competing rights and responsibilities between insurers and their insureds in Texas, this particular decision represents a major shift in Texas insurance law in favor of insurers. To achieve this result, the Texas Supreme Court gutted one of its prior decisions,[2] and shifted the risk of resolving coverage questions to the insured. The Frank's decision further calls into question the effect this case will have on many other rules governing the insurer/insured relationship. The apparent good news for insurers is that they no longer bear the burden of promptly determining coverage issues for fear of waiving coverage defenses. Insurers can now pay a non-covered claim, and as long as they have properly reserved their rights and obtained some acknowledgment from the insured that the claim should be settled, the insurer can settle with the third-party claimant, and then turn around and seek reimbursement from the insured for the amount paid. But what appears on its face to be a favorable decision for insurers, may in the long run actually cost insurers more money than was the case under the former rule prohibiting such reimbursement except in certain limited circumstances.

This is a major change in Texas insurance law and profoundly impacts how both insurers and insureds must now approach the handling of third-party claims. But before anyone gets too comfortable with the new direction of Texas insurance law, the Texas Supreme Court has granted a rehearing in the case with oral argument scheduled for February of 2006. Until a decision is rendered on the rehearing, caution should be used in proceeding with any reimbursement action. Because the *Frank's* decision creates a rule that does not fit with the traditional rules that govern Texas insurance law, it would not be surprising for the Court to

The Texas Legal Liability Advisor is published by FUNDERBURK & FUNDERBURK, LLP, 2777 Allen Parkway, Suite 1000, Houston, Texas 77019, as a service to the business community. Questions related to this publication, suggestions for future topics, or if you would like to be added to the regular mailing list for this publication, please contact Mark Courtois at Tel: 713-620-7226; Fax: 713-526-2708; or email: mjcourtois@ffllp.com. Further information about our firm can be found at www.ffllp.com. The information provided herein is for educational purposes only and its use does not in anyway give rise to an attorney-client relationship.

reverse itself, or at least narrow the decision significantly. In the meantime, this article explores the meaning and effect of the Frank's decision.

THE FACTS OF FRANK'S CASING

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.[3] ARCO sued Frank's Casing among others. Frank's maintained a $1,000,000 primary liability insurance policy and a $10 million excess policy through certain Lloyd's underwriters.[4] The excess policy required Frank's approval of any settlement.[5] After the second day of 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.[6] The counsel forwarded the demand to the excess underwriters with Frank's own demand that the settlement demand be accepted.[7] Discussions between the insured and its excess carrier 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 could be reserved for later determination.[8] Thereafter, Frank's again demanded that the excess underwriters settle the case within their limits.[9] 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.[10] Prior to that time, the excess underwriters had issued a reservation of rights to Frank's claiming certain claims alleged against Frank's in the ARCO suit were not covered. However, the excess underwriters made no effort to resolve any coverage issue in a declaratory judgment action until after they agreed to settle ARCO's case against Frank's.[11] The final settlement agreement in the ARCO suit preserved any claims that existed as of that time between Frank's and its excess underwriters.[12]

Coverage litigation then ensued between the excess underwriters and Frank's. Interestingly, the trial court found through summary judgment that none of ARCO's claims in the underlying case were covered under the excess policy. 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.[13] The Court of Appeals affirmed but expressed reservation about the result after applying *Matagorda County* to the facts of this case.[14]

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, cannot later assert a claim against the insured for reimbursement of the settlement monies paid on behalf of the insured for non-covered claims.[15] 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 claim against the insured.[16] The rationale was that because the insurer is in the business of analyzing and allocating risk, the insurer was in the best position to assess the viability of its coverage position.[17] As a result, the risk was clearly on the insurer to resolve all coverage issues promptly.[18] All of that has now changed with the decision in *Frank's*.

THE *FRANK'S CASING* DECISION

While the Supreme Court did not expressly overrule its prior decision in *Matagorda County*, effectively there is little of *Matagorda County* that survives. What seemingly troubled the Court was Frank's demand on the excess underwriters to settle the case within policy limits, even though the claims alleged against Frank's at that time were not covered according to the excess underwriters. When the excess underwriters failed to promptly resolve the coverage issues before the settlement demands were made, they were faced with the dilemma of deciding whether to fund the settlement and by doing so abandoning all arguments that the claims were not covered, or not fund the settlement and risk damages above the policy limits and possible statutory penalties if the claims were in fact covered. Interestingly, the fact that the excess underwriters received summary judgment on the coverage issues when coverage was finally litigated, indicates that had they not sat on their duty to get the coverage issues determined promptly, they could have avoided this dilemma entirely. In other words, the insurer's failure to abide by the duty to promptly determine coverage issues early in the underlying case caused their own dilemma when the settlement demands were finally presented. Up to this point in time, this was the risk insurers weighed and evaluated on a regular basis, and rightfully so because they are well equipped to do so. Because of this dilemma facing the excess underwriters, however, Frank's was able to benefit from what was effectively broader insurance coverage than it originally bargained for from the insurer, and got a settlement of a case where the claims were ultimately determined to not be covered at all.[19] The Court found that fact most troubling, and accordingly, held that an insurer has a right to reimbursement against the insured if: 1) the insurer has timely asserted its reservation of rights; 2) the insurer has notified the insured it intends to seek reimbursement; 3) the insurer has paid to settle claims that were not covered; and 4) the insured has demanded that the insurer accept a settlement offer within its policy limits or the insured expressly agrees that the settlement offer should be accepted.[20] The Court further held that when an insured asserts that a settlement offer has triggered a *Stowers* duty, and the insurer then accepts that settlement offer or a lower one, the insured is estopped from asserting that the settlement is too financially burdensome for the insured to bear if it turns out the claims against the insured are not covered.[21]

PUBLIC POLICY AND AFTERMATH OF THE DECISION

The stated public policy consideration underlying the Court's decision in *Frank's* is that reimbursement rights encourage insurers to

settle cases even when coverage is in doubt, which inures to the benefit of injured parties.[22] The Court believes that with reimbursement rights, when an insurer settles a claim where coverage is in dispute, the risk that the insured lacks the assets to fund a settlement is shifted from the injured plaintiff to the insurer.[23] The problem with this rationale is that it does not appreciate the realities of the insurer/insured relationship in Texas. Instead of having the insurer bear the burden of weighing the viability and risk of coverage issues, something insurers do all the time, now insureds have to weigh coverage issues and make early decisions on issues that insureds typically do not encounter or appreciate. Under the prior system, insurers weighed their coverage options, and if they came to the settlement table and offered money without any prior declaratory judgment action on the issue of coverage, that was usually the end of the litigation arising out of the incident. Now because of these new reimbursement rights, the insured is put in the position of fighting both the plaintiff and its own insurer, and then wonder whether a payment by its insurer actually represents an end to the litigation over the incident. Under this new holding, insurers are now allowed to sit on the fence, and are not required to promptly address coverage issues. The result for insureds is that they now need to seek independent counsel after receiving any reservation of rights letter. There is little doubt that many insureds will be counseled to institute coverage actions so that they are not left holding the bag when settlement discussions begin. In short, the *Frank's* decision shifts the burden and risk regarding coverage issues from the insurer to the insured, despite the reality that as between those parties, the insured is generally less equipped to evaluate and weigh such issues.

One question not answered by the decision is whether this new risk shifting duty is mandatory on the insurer or an optional right? The decision seems to imply that insurers may now have a duty to settle non-covered claims and then seek reimbursement against their insured whether or not the insured has assets for reimbursement. If it is mandatory, insurers will obviously be paying many more non-covered claims, and be put to the burden and cost of seeking reimbursement from a vast majority of insureds who are financially not in a position to reimburse the insurer. If that is the case, then insurers are well advised to file declaratory judgment actions in every such instance, to avoid payment of non-covered claims when settlement discussions begin. Most insurers are more likely to have insureds who cannot afford reimbursement than they are to have insureds which can pay a reimbursement claim. If most insureds could afford to pay the claim outright, there would be little use for insurance in the first place. Reimbursement rights are, therefore, only as good as the financial solvency of the insured. But unless this is a mandatory duty on the part of insurers, no insurer is going to fund a settlement of any sizeable amount on a non-covered claim unless there is a substantial likelihood it will be able to obtain reimbursement from the insured, i.e. the insured has sufficient assets to reimburse the insurer. Ironically, in such a case, where the insured has such assets, the injured plaintiff does not need the insurer to step forward to pay the claim anyway. Over the long term, if this decision stands, insurers are likely to fund settlements in a greater number of cases where there is no coverage, than insurers had to pay before the *Frank's* decision.

Another troubling aspect of the decision is the fact that an insurer's reimbursement claim will by its very nature cause more inherent conflict in the insured/insurer relationship. For instance, is it going to become a common practice of insurers to do an asset search on their own insured every time a reservation of rights letter is issued? The assets of the insured are now an issue that each insurer will need to evaluate on an ongoing basis. The increased adversity implicit in the reimbursement claim runs directly contrary to the trust relationship that is necessary between insured and insurer in handling third-party claims. It should also be apparent that Plaintiffs may now utilize this decision to pressure liability insurers with legitimate coverage defenses, to fund settlements of claims against their insureds, even non-covered ones, and let the insurer take the risk of getting reimbursement from the insured.

Additional problems abound, including the question of apportionment. For instance, will we see actions by insurers to recover partial settlement dollars, if there are non-covered and covered claims settled in the same settlement paid for by the insurer? In other words, it may become the case that insurers will try to apportion percentages of a settlement with a third-party to non-covered claims so as to increase their own reimbursement rights. Such scenarios will undoubtedly further intensify the adversarial relationship between insurers and insureds. Finally, there are a host of other issues which may result and reverberate from this decision. There will be ramifications in terms how settlements will need to be structured; whether the *Stowers* duty still exists; and the simple fact that insureds now need independent counsel a great deal more often. There are also problems with professional liability policies which by their own terms require consent from the insured before the carrier can settle a case. When such consent is given, it can now be used against the insured for reimbursement purposes.

In sum, *Frank's* is a poorly reasoned decision that not only shifts the coverage burden to the insured, but disrupts the historical balance in the Texas insurer/insured relationship and calls into question the current status of many other well settled Texas rules governing the insured - insurer relationship.

Recommendations

Because the Supreme Court could alter this decision on rehearing, caution should be used in any action invoking the rights created in this case. If the decision stands, **insurers should**: 1) continue to evaluate and consider coverage issues early in third-party liability cases so they are not called upon to fund entire settlements of non-covered claims; 2) continue to use declaratory judgment actions in cases where it is clear that the carrier will be asked to contribute to settle a **non-covered** claim and the insured has no means to reimburse the carrier; 3) continue to make timely and comprehensive reservations of rights letters for non-covered claims; 4) request the insured's response and position with respect to responding to a settlement demand. On the other hand, **insureds should**: 1) consult independent coverage counsel anytime a reservation of rights letter is received; 2) consider using declaratory judgment actions against the insurer when coverage issues are raised; 3) refrain from making any demand on the insurer to settle a case where non-covered claims are being asserted; 4) make sure that all settlement demands come from the liability plaintiff in the underlying case; 5) remain neutral on whether the insurer should settle a case where non-covered claims are involved and avoid giving consent to such settlements.

Finally **defense counsel** retained by insurance carriers need to be aware of these issues, ready to advise their insured clients on these issues, and suggest independent counsel review and counsel on these issues.

Notes

[1]2005 WL 1252321 (Tex. May 27, 2005).
[2]Texas Ass'n of Counties County Gov'n Risk Man
[3]*Excess Underwriters at Lloyd's London v. Frank's Casing Crew & Rental Tools, Inc.,* 2005 WL 1252321 (Tex. May 27, 2005), p*1.
[4]*Id.*
[5]*Id.* at p*2.
[6]*Id.* at p*1.
[7]*Id.*
[8]*Id.*
[9]*Id.*
[10]*Id.*
[11]*Id.* at p*1-2.
[12]*Id.* at p*2.
[13]*Id.*
[14]*Id.*
[15]*Texas Ass'n. of Counties County Gov't Risk Management Pool v. Matagorda County*, 52 S.W.3d 128, 135 (Tex. 2000)
[16]*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).
[17]*Texas Ass'n of Counties County Gov't Risk Management Pool v. Matagorda County* at 135.
[18]*Id.*
[19]*Id.* At p*4.
[20]*Excess Underwriters at Lloyd's London v. Frank's Casing Crew & Rental Tools, Inc.,* at P*3.
[21] *Id.*
[22] *Id.* at 4.
[23] *Id.*

Mark Courtois is a partner at the Houston law firm of FUNDERBURK & FUNDERBURK, LLP. He is a civil trial lawyer who counsels and represents businesses, and insurance companies in litigation matters. He can be reached at tel: 713-620-7226; fax: 713-526-2708; or MJCOURTOIS@FFLLP.COM.

TEXAS LEGAL LIABILITY ADVISOR
FUNDERBURK & FUNDERBURK, LLP
2777 Allen Parkway, Suite 1000
Houston, Texas 77019

TO:

INSIDE: **INSURER REIMBURSEMENT IN TEXAS: INSURERS WIN ROUND ONE AT SUPREME COURT**