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INFORMATION TO AVOID LIABILITY

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INSURER REIMBURSEMENT IN TEXAS: IMPORTANT NEW DEVELOPMENTS

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INTRODUCTION

Within the last year, the Texas Supreme Court issued three major decisions that impact insurer reimbursement rights in Texas. The most important of these is the opinion rendered in the rehearing of *Excess Underwriters at Lloyd's London v. Frank's Casing Crew & Rental Tools, Inc.*¹ As we reported in a previous edition of the *ADVISOR*², the Court's initial 2005 opinion recognized a new right of reimbursement for insurers against their insureds for paying non-covered liability claims. This marked a major shift in the relationship between insurers and insureds in Texas.³ However, because the *Frank's Casing* 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, withdraw its prior opinion, and ultimately deny the carrier's right to reimbursement. This article explores the new *Frank's Casing* decision; the Texas Supreme Court decision in *Fortis Benefits v. Cantu*⁴ which concerns the "made whole doctrine" and a health insurers' contractual right of subrogation to recover medical expenses paid to a plaintiff in a personal injury action; and *Texas Mutual Ins. Co. v. Ledbetter*⁵ which reaffirms a worker's compensation carrier's right to reimbursement in third-party actions.



FRANK'S CASING - 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.⁶ ARCO sued several Defendants including Frank's Casing.⁷ Frank's Casing had a \$1,000,000 primary liability insurance policy and a \$10 million excess policy through certain Lloyd's underwriters.⁸ At trial, when it became apparent Frank's Casing was the target defendant, Frank's Casing's in-house counsel solicited and received a demand from ARCO to settle for \$7.5 million.⁹ The counsel forwarded the demand to the excess underwriters with Frank's Casing's own demand that the settlement demand be accepted.¹⁰ Communications between Frank's Casing 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.¹¹ Frank's Casing again demanded that the excess underwriters settle the case within their limits.¹² In response, the excess underwriters advised Frank's Casing they would settle the claim for \$7.5 million and then seek reimbursement from Frank's Casing because they believed the claims

were not covered.¹³ 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 Casing in the ARCO suit were not covered.¹⁴ This excess insurer 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 Casing.¹⁵ The final settlement agreement in the ARCO suit preserved any claims that existed as of that time between Frank's Casing and its excess underwriters.¹⁶



Coverage litigation then ensued between the excess underwriters and Frank's Casing. Interestingly, in the coverage litigation the trial court determined through summary judgment that none of ARCO's claims in the underlying case were covered under the excess policy.¹⁷ 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.¹⁸ The Court of Appeals affirmed, but expressed reservation about the result after applying *Matagorda County* to the facts of this case.¹⁹ On the first hearing of this case, the Texas Supreme Court was troubled by the fact that Frank's Casing was able to get \$7.5 million in insurance coverage to pay claims that were ultimately determined not to be covered. That concern was apparently enough to motivate a majority of the Court in the 2005 decision to find a reimbursement right for insurers who, in this situation, had paid non-covered claims, despite the fact that such a result directly conflicted with the Court's own prior precedents on this very issue.

PRIOR LAW ON INSURER REIMBURSEMENT: REVISITING *MATAGORDA COUNTY*

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.²⁰ The *Matagorda County* decision was consistent with prior decisions by 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.²¹ 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.²² Under this rule, the burden was clearly on the insurer to resolve all coverage issues promptly.²³ The Supreme Court's most recent decision in *Frank's Casing* reaffirms this rule.

THE 2008 DECISION IN *FRANK'S 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 Casing. In our 2006 edition of the ADVISOR, we opined that the 2005 decision was a poorly reasoned departure from established Texas law that unwisely shifted the burden to instigate coverage litigation to the insured, instead of the carrier. In this most recent opinion, the Court reaffirmed the rule established in *Matagorda County*. The Court held 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: 1) the settlement, and 2) the insurer's right to reimbursement.²⁴ 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.²⁵

ANALYSIS

The 2008 *Frank's Casing* decision is not surprising and is more consistent with prior decisions 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 to determine whether to pay \$7.5 million to settle claims they thought were not covered. Generally, when an insurer 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.²⁶ If a carrier waits until trial of the underlying case against the insured or settlement discussions 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 upon, and clearly in the interest of, the insurer to carefully consider possible coverage issues after the claim is presented and to 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.

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 responsible for causing the loss.²⁷ 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 insurer 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.²⁸ 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.

Health insurers obtained a significant victory against the "made whole" doctrine from the Texas Supreme Court in the case of *Fortis Benefits v. Cantu*.²⁹ In that case, Vanessa Cantu sued multiple parties after being severely injured in a motor vehicle accident.³⁰ Her health insurer, Fortis

Benefits, intervened asserting a contractual right to recover its paid medical expenses of \$378,500.³¹ 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.

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.³² 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,³³ 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.³⁴

ANALYSIS

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 of subrogation and reimbursement are clearly set forth in the contract; 2) investigate medical payments to insureds due to injuries to ascertain whether a 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.

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.³⁵

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.³⁶ 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.³⁷ The case was settled for \$4.5 million and notice of a minor’s settlement hearing was given to all parties and Texas Mutual. 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 struck the carrier’s intervention denying it any recovery. The insurer 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.³⁸ Both sides appealed to the Texas Supreme Court.



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. 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 concluded by implying that in their attempt to work around this statutory lien, plaintiffs were guilty of conversion. 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.³⁹ Though 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. The Court remanded the *Ledbetter* case back to the trial court for reinstatement of the plaintiffs, reimbursement to the carrier, and protection of the minor's interest.

ANALYSIS

The rule of law established in the *Ledbetter* case is not unique, but reiterates that schemes to defeat a worker's compensation carrier's right to reimbursement are not acceptable. The Court cautioned that all parties who participate in a scheme to defeat a worker's compensation carrier's right may be liable for conversion to the carrier. Accordingly, in any case involving a worker's compensation lien, defendants are well advised to make sure that the worker's compensation carrier is included in the settlement.

RECOMMENDATIONS



Despite the end result of the *Frank's Casing* case, these decisions reflect the Texas Supreme Court's continued conservative approach to cases involving insurance matters, in particular the protection of insurer's contractual and statutory rights. Nevertheless, liability insurers must continue to

investigate and identify coverage issues early in the third-party litigation against their insureds, and make early decisions as to whether to litigate coverage issues with their insureds. Further, insurers have greater reimbursement rights in the context of health insurance claims, and they should design and implement systems for identifying and pursuing reimbursement claims in the third-party liability cases involving their insureds. The decisions in *Fortis* and *Ledbetter* improve the prospect of greater recoveries in reimbursement actions in the health insurance and subrogation areas.

NOTES

¹51 TEX. SUP. CT. J., 2008 Tex. LEXIS 92 (Tex. Feb. 1, 2008).

²See TEXAS LEGAL LIABILITY ADVISOR, January - February 2006 for a discussion of the 2005 decision and the problems created by the decision.

³*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).

⁴234 S.W.3d 642 (Tex. 2007).

⁵*Texas Mut. Ins. Co. v. Ledbetter*, 51 TEX. SUP. CT. J. 711, 2008 Tex. Lexis 305.

⁶*Excess Underwriters at Lloyd's London v. Frank's Casing Crew & Rental Tools, Inc.*, 51 TEX. SUP. CT. J., 2008 Tex. LEXIS 92, *2 (Tex. Feb. 1, 2008).

⁷*Id.*

⁸*Id.*

⁹*Id.* at *4.

¹⁰*Id.*

¹¹*Id.* at *5.

¹²*Id.*

¹³*Id.*

¹⁴*Id.* at *3.

¹⁵*Id.* at *5.

¹⁶*Id.*

¹⁷*Id.* at *6.

¹⁸*Id.*

¹⁹*Id.* at *5.

²⁰*Texas Ass'n. of Counties County Gov't Risk Mgmt. Pool v. Matagorda County*, 52 S.W.3d 128, 135 (Tex. 2000).

²¹*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).

²²*Texas Ass'n of Counties County Gov't Risk Mgmt. Pool v. Matagorda County* at 135.

²³*Id.*

²⁴*Excess Underwriters at Lloyd's London v. Frank's Casing Crew & Rental Tools, Inc.*, at *13.

- ²⁵ *Id.*
- ²⁶ *State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696, 714 (Tex. 1996).
- ²⁷ *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)).
- ²⁸ *Id.*
- ²⁹ *Id.*
- ³⁰ *Id.* at 644.
- ³¹ *Id.*
- ³² *Id.* at 645.
- ³³ *Id.* at 651.
- ³⁴ *Id.*
- ³⁵ *Tex. Mut. Ins. Co. v. Ledbetter*, 51 TEX SUP. CT. J. 711, 2008 Tex. Lexis 30 (April 4, 2008) (citing *Argonaut Ins. Co. v. Baker*, 87 S.W.3d 526, 530 (Tex. 2002)).
- ³⁶ *Id.* at *2.
- ³⁷ *Id.*
- ³⁸ *Id.* at *6.
- ³⁹ *Id.*



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