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ATTORNEYS

CO-INSURER SUBROGATION - IS IT ALLOWED IN TEXAS?

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INTRODUCTION

In complex claims it is not uncommon to have co-insurers for one particular defendant. Conflict can develop among co-insurers over such issues as which policy is primary and how much should be paid to settle the claim. Without mutual resolution, the next question that inevtably arises is whether one of the insurers can settle the claim and seek reimbursement from the other co-insurer who refuses to participate fully in the settlement or defense of the claim. In 2007, the Texas Supreme Court decided *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*[1] and held that a co-insurer cannot subrogate against a co-insurer for reimbursement of a disproportionate amount paid to settle a third-party liability claim against their mutual insured. While at first glance this seems to answer the question, in reality the answer is far less clear. Since *Mid-Continent* was decided most courts looking at the issue have limited or marginalized the case to its essential facts suggesting that *Mid-Continent* may have been imprudently decided. As it stands now, the answer to the question of whether co-insurer subrogation is available in Texas depends primarily on whether the case is in state or federal court and the wording of the "other insurance" clauses[2] in the applicable insurance policies. This article explores the issue of co-insurer subrogation in Texas.

THE *MID-CONTINENT* DECISION

The *Mid-Continent* 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 barricades, Crabtree Barricades.[3] Kinsel was insured by its own carrier, Liberty Mutual with a $1 million primary CGL and $10 million excess policy.[4] Kinsel was also an additional insured under Crabtree's $1 million CGL policy with Mid-Continent.[5] Importantly both CGL polices contained identical "other insurance" clauses that provided equal or pro rata sharing up to the co-insurers respective policy limits if the loss was covered by other

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primary insurance.[6] 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.[7] Mid-Continent evaluated the case value against Kinsel at $300,000 and refused to pay anything more than 50% of that amount.[8] Liberty Mutual believed the case value exceeded $2 million.[9] Ultimately, Liberty Mutual agreed to settle the case for $1.5 million, using Mid-Continent's $150,000 while Liberty Mutual funded the balance.[10] Liberty Mutual later sued Mid-Continent in federal court for failing to act reasonably in evaluating the risk against the insured and failing to perform its obligations to its insured under the CGL policy, and for subrogation. The trial court decided in favor of Liberty Mutual, finding a right of subrogation against the other co-insurer and awarding Liberty Mutual reimbursement for Mid- Continent's proportionate share.[11]

On appeal, the Fifth Circuit Court of Appeals certified the issue of co-insurer subrogation to the Texas Supreme Court for decision.[12] 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" pro rata clauses, and that there are no contribution or subrogation rights available to Liberty Mutual.[13] The Court based its holding on a case it decided back in 1943, *Hicks Rubber*.[14] While both this Court and the *Hicks Rubber* Court 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 a right of contribution against the co-insurer for the disproportionate amount paid, the *Mid-Continent* Court nevertheless held that such right was extinguished when the policies contain "pro rata" other insurance clauses.[15] The pro rata clause operates, the Court held, 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.[16] 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.[17] So, the Court reasoned, 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.[18]

The Court also went on to prohibit the equitable and contractual subrogation claims asserted by Liberty Mutual. In both contractual and equitable subrogation, the insurer stands in the shoes of the insured, obtaining only those rights held by the insured against a third party, subject to any defenses held by the third party against the insured.[19] The Court reasoned that the insurer takes only those rights held by the insured, and because the insured had already been fully indemnified by the settlement, the insured had no rights to give to the subrogating insurer.[20] Accordingly, Liberty Mutual was precluded from its equitable subrogation claim for reimbursement. Further, the Court held that Liberty Mutual did not have a contractual right

of subrogation because the insured's right of indemnification is limited to the actual amount of its loss, which was extinguished after being indemnified.[21]

THE PROBLEM WITH THE *MID-CONTINENT* DECISION

Over a century ago the Texas Supreme Court declared that Texas recognizes the doctrine of subrogation to the fullest extent possible.[22] With the *Mid-Continent* decision, the Court abruptly turned in the opposite direction denying equitable and contractual subrogation claims that had arguably been available since the 1940s.[23] Whether this is just an unfortunate anomaly in the history of equitable subrogation principles in Texas, or a foreshadow of how the Court intends to interpret insurance subrogation cases in the future, is yet to be determined. Without question, the current Court has made clear in other insurance cases that contractual terms and statutory law precede and outweigh any equitable principles.[24] Yet it is difficult to harmonize *Mid-Continent* with other cases where the Court has freely permitted subrogation.[25] What is clear is *Mid-Continent* is a significant regression in the Court's application of Texas subrogation principles. But perhaps this decision is better understood within the time context of when it was decided.

The *Mid-Continent* case came to the Texas Supreme Court on certified question from the United States Fifth Circuit Court of Appeals in March of 2005. At that very same time, the Court was already struggling with how to decide the subrogation case of *Frank's Casing* which had been pending at the Court since 2003.[26] In May of 2005, the Court issued its first opinion in *Frank's Casing* and held, contrary to established law, that an insurer can subrogate against its own insured for reimbursement of monies paid by the insurer to settle non-covered claims.[27] The Court was justifiably criticized for the decision, and in response granted a rehearing in the matter in January of 2006.[28] So at the very same time the Court was considering two major insurance subrogation cases. In the first, *Frank's Casing*, the Court permitted the subrogation claim and the decision was soundly criticized resulting in the Court having to grant a rehearing. Perhaps, the Court did not want to make the same mistake twice and simply denied subrogation in *Mid-Continent* to avoid the problem it ran into with *Frank's Casing*.[29] The opinion in *Mid-Continent* denying insurer subrogation was issued in October of 2007. Four months later, in February of 2008, the Court issued the second and final opinion in *Frank's Casing* also denying, correctly this time, insurer subrogation against its own insured.[30] The history and opinions in these cases suggest the current Court struggles with insurance subrogation cases.

However the *Mid-Continent* decision came about, it is apparent the Court failed to appreciate one fundamental principle of subrogation and its importance in the proper handling of claims. The Court in *Mid-Continent* determined that an insurer is not entitled to reimbursement once an insured has been paid or indemnified because the insured no longer has any rights to give to the insurer to pursue. The Court's rationale is misguided as

the central focus of subrogation has always been to promote the prompt settlement of claims by allowing the insurer to pay the insured's claim and then seek reimbursement from the culpable tort feasor or responsible party. Just because the insurer pays to settle the insured's claim does not extinguish the insurer's claim of subrogation or the right to pursue it. Further, no public policy is served by the *Mid-Continent* decision. Insurers have a duty to effectuate the prompt and fair resolution of claims,[31] but the *Mid-Continent* decision hinders that process. As it stands now, in cases involving multiple policies, carriers are clearly better off playing the game of chicken with co-insurers, being the recalcitrant carrier, and letting some other carrier take the lead. Those carriers understand that if *Mid-Continent* is applicable to all "other insurance" clauses, the carrier that refuses to participate and lets another carrier pay to settle, has nothing to fear because the other insurers cannot be sued later by the settling insurer. This is not equitable or just.

As a result of the *Mid-Continent* decision, a co-primary insurer is actually discouraged from coming forward early to participate when there is any dispute between the insurers concerning coverage or the value of the claim. Co-insurers understandably fight against each other in an attempt to position themselves last in line with respect to any payment on the claim. This typically causes delay in resolving the claim and is not a recipe for resolving cases promptly or equitably.

THE AFTERMATH

Since *Mid-Continent* was decided, at least twelve subsequent cases have considered whether a co-insurer has a right of subrogation against another co-insurer.[32] Most of the cases limit *Mid-Continent* to its essential facts and permit some form of subrogation. The federal courts that routinely apply Texas law have readily recognized the problems with the *Mid-Continent* decision, and in a series of cases have limited its application.[33] The United States Fifth Circuit Court of Appeals has determined that any broad reading of *Mid-Continent* is at odds with the foundational principles of Texas insurance law and has limited its application to those situations where the insurers: 1) are co-primary insurers; 2) who do not dispute that both insurers cover the loss; and 3) are subject to the same pro rata clauses.[34] Accordingly, in situations where all three of those factors are not present, the federal courts have generally permitted subrogation by one co-insurer against another co-insurer for reimbursement claims.[35]

In another interesting Fifth Circuit decision, *Travelers Lloyds*, which mysteriously did not even mention the *Mid-Continent* case decided three years prior, the Fifth Circuit Court of Appeals held that Texas still follows the rule established in the 1969 Texas Supreme Court decision of *Hardware Dealers*[36] that when confronted with "other insurance clauses" Texas courts are to determine if the competing clauses can be harmonized or whether they conflict.[37] In *Travelers Lloyds*, the Court determined that, when from the

viewpoint of the insured, it has coverage from either one of two policies but for the other, and each policy contains a provision which is reasonably subject to a construction that is in conflict with a provision in the other policy, there is a conflict in the provisions.[38]

This Court went on to allow the subrogation claim, and concluded when "other insurance" provisions conflict, each insurer must share in the coverage "pro-rated between the two insurers proportion to the coverage each policy provided."[39] Interestingly, the *Mid-Continent* opinion did not discuss *Hardware Dealers*.

One Texas appeals court that subsequently considered both *Mid-Continent* and the *Traveler's Lloyds* cases concluded that the other insurance clauses in *Mid-Continent* were the same and thus compatible, and therefore *Hardware Dealers* did not apply to that situation.[40] That Court reasoned that in situations where the "other insurance" clauses conflict, the *Hardware Dealers* decision applies and pro rata contribution is required between the carriers.[41] While that is one interpretation that can be reasoned from these cases, the Texas Supreme Court's decision in *Mid-Continent* does not contain any such discussion; therefore, such conclusions by subsequent courts are simply a welcome means to limit the application of the *Mid-Continent* decision itself.

Despite significant criticism, no case since *Mid-Continent* has gone directly against the essential holding that denies co-insurer subrogation in cases where there are identical "pro rata" clauses in concurrent insurance policies. However, there is authority supporting subrogation claims against a co-insurer depending on the type of other insurance clauses contained in the applicable policies and whether they conflict or not. Clearly the federal courts are more receptive to co-insurer subrogation claims and the Fifth Circuit Court of Appeals has established case law for the federal district courts to follow in limiting *Mid-Continent* only to its essential facts.

SUMMARY

The Texas Supreme Court's denial of a co-insurer's subrogation claim in *Mid-Continent* does not mean that every co-insurer subrogation claim is prohibited. Sufficient case law exists to take the position that *Mid-Continent* only prohibits co-insurer subrogation claims in limited situations involving identical "pro -rata" other insurance clauses. If insurers need to assert a subrogation claim, it is preferable to assert the claim in federal court. Whether the Texas Supreme Court extends the subrogation bar to all "other insurance" clauses the next time it considers an insurance subrogation case, or whether it will follow the lead of the federal courts in permitting subrogation is something that will only be determined by future cases.

RECOMMENDATIONS

In situations where co-insurers for the same defendant cannot agree upon defense or indemnity obligations among themselves, it may be necessary for a carrier to consider its legal rights and options if it needs to act alone in the defense or settlement of the claim. Part of this consideration requires analysis of whether subrogation rights are available to the insurer. To make this determination, all applicable policies need to be obtained and analyzed by coverage counsel for an evaluation of the "other insurance" clauses. Coverage counsel should also evaluate whether a potential subrogation action can be brought in federal court. Once those issues have been evaluated, the carrier can assess fully whether there is a legitimate chance of recovering a unilateral payment of the claim from a co-insurer. This is especially important if the facts of the case indicate that it is likely the insurer will receive an early, time limited, policy limits demand, forcing the insurer to act quickly. Ultimately, a declaratory judgment action may be necessary to force a recalcitrant co-insurer to participate in the defense or settlement of the case.

NOTES

[1] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d 765 (Tex. 2007).

[2] There are three basic types of "other insurance" clauses: escape clauses, pro rata clauses, and excess clauses. *Hardware Dealers Mut. Fire Ins. v. Farmers Ins. Exch.*, 444 S.W.2d 583, 586 (Tex. 1969). An escape clause is used to avoid all liability coverage under a policy if other insurance exists. *Id.* A pro rata clause may be used to restrict liability upon concurring insurers to an apportionment basis. *Id.* An excess clause is used to restrict liability upon an insurer to excess coverage after another insurer has paid up to its policy limits. *Id.*

[3] *Mid-Continent* at 768-769.

[4] *Id.* at 769.

[5] *Id.*

[6] *Id.*

[7] *Id.* at 770.

[8] *Id.*

[9] *Id.*

[10] *Id.*

[11] *Id.*

[12] *Id.* at 771.

[13] *Id.* at 772.

[14] *Traders & Gen. Ins. Co. v. Hicks Rubber Co.*, 169 S.W.2d 142 (Tex 1943).

[15] *Mid-Continent* at 771 (citing *Traders & Gen. Ins. Co. v. Hicks Rubber Co.*, 169 S.W.2d at 148).

[16] *Id.*

[17] *Id.*

[18] *Id.* (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).

[19] *Id.* (citing to *Interstate Fire Ins. Co. v. First Tape, Inc.*, 817 S.W.2d 142, 145 (Tex. App. – Houston [1st Dist.] 1991, writ denied)).

[20] *Id.* at 774-776.

[21] *Id.* (citing to *Members Mut. Ins. Co. v. Herrman Hosp.*, 664 S.W.2d 325, 327 (Tex. 1984)).

[22] *Faires v. Cockrill*, 88 Tex. 428, 31 S.W. 190, 194 (1895).

[23] *Mid-Continent* at 774 (overruling T*raders & General Ins. Co. v. Hicks Rubber Co.*, 169 S.W.2d 142 (Tex. 1943) and *Employers Cas. Co. v. Trans. Ins. Co.*, 444 S.W.2d 606, 609 (Tex. 1969) to the extent any other subrogation claim is available against a co-insurer).

[24] *Gotham Ins. Co. v. Warren E&P, Inc.,* 57 Tex. Sup. J. 336, 2014 Tex. LEXIS 209, p*11-12(March 21, 2014); *Fortis Benefits v. Cantu,* 234 S.W.3d 642, 648-649 (Tex. 2007).

[25] *See Frymire Eng'g Co. v. Jomar Int'l, Ltd.*, 259 S.W.3d 140, 145 (Tex. 2008); *Am. Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480, 482 (Tex.1992).

[26] *Excess Underwriters at Lloyd's London v. Frank's*

Casing Crew & Rental Tools, Inc., *petition for review granted*, 2003 Tex. LEXIS 43 (Tex. April 3, 2003); initial opinion, 48 Tex. Sup. Ct. J. 735, 2005 Tex. LEXIS 418 (May 27, 2005), *opinion withdrawn and superceded*, 246 S.W.3d 42 (Tex. 2008).

[27] The initial decision in Frank's Casing was contrary to established Texas Supreme Court precedent. *Tex. Ass'n Gov't Risk Mgmt. Pool v. Matagorda County,* 52 S.W.3d 128, 133-134 (Tex. 2000).

[28] *Excess Underwriters at Lloyd's London v. Frank's Casing Crew & Rental Tools, Inc.*, rehearing granted, 2006 Tex. LEXIS 1 (Tex. January 6, 2006).

[29] The basic rule that should have guided the Court for both matters is that subrogation should be freely given except in cases where the insurer tries to subrogate against its own insured. *Tex. Ass'n Gov't Risk Mgmt. Pool v. Matagorda County*, 52 S.W.3d 128, 133-134 (Tex. 2000).

[30] *Id.*

[31] TEX. INS CODE ANN. §541.060(a)(2)(A); TEX. INS CODE ANN. §542.003(b)(4); 28 TAC §21.203(4).

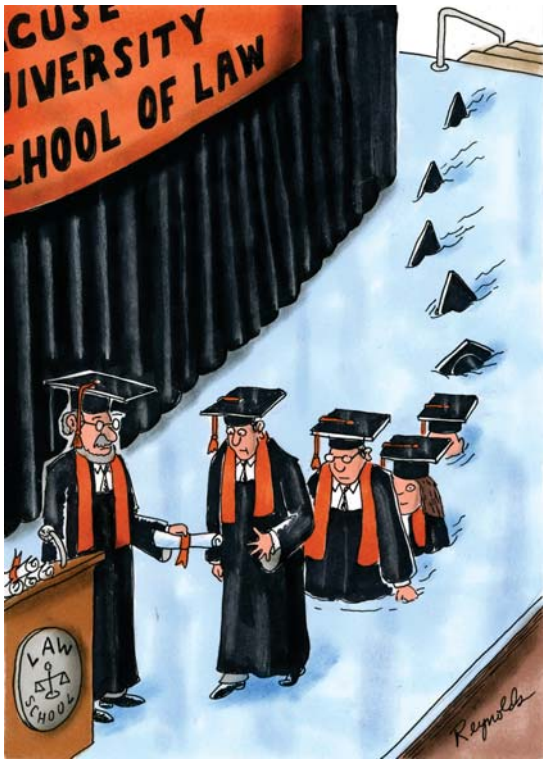
[32] *Cont'l Cas. Co. v. N. Am. Capacity Ins. Co.*, 683 F.3d 79 (5th Cir. Tex. 2012) (*Mid-Continent* does not bar an excess carrier's recovery of defense costs from primary carriers); *Colony Ins. Co. v. Peachtree Const. Ltd.,* 647 F.3d 248 (5th Cir. Tex. 2011)(*Mid-Continent* does not preclude subrogation between excess carriers and should be limited to disputes between co-primary insurers); *Md. Cas. Co. v. Acceptance Indem. Ins. Co.*, 639 F.3d 701 (5th Cir. Tex. 2011)(*Mid-Continent* does not bar recovery of defense costs from a co-insurer who violated its duty to defend nor does *Mid-Continent* preclude subrogation simply because the insured has been fully indemnified); *Amerisure Ins. Co. v. Navigators Ins. Co.,* 611 F.3d 299, 305-307 (5th Cir. Tex. 2010)(*Mid-Continent* does not preclude subrogation when an insurer has denied coverage and violated its duty to defend); *Travelers Lloyds Ins. Co. v. Pac. Emp'rs Ins. Co.,* 602 F.3d 677 (5th Cir. Tex. 2010)(Coverage should be pro-rated between the two insurers proportionate to the coverage that each policy provided); *Trinity Universal Ins. Co. v. Em'prs Mut. Cas. Co.,* 592 F.3d 687 (5th Cir. Tex. 2010)(*Mid-Continent* and its discussion of the other insurance provisions only apply to the duty to indemnify and not the duty to defend, thus a co-insurer could pursue a claim for contribution for defense costs from the other carriers in proportionate shares); *Emp'rs Ins. Co. of Wausau v. Penn-America Ins. Co.,* 705 F.Supp. 2d 686 (S.D. Tex. 2010)(*Mid-Continent* should be narrowly applied to situations involving: a) co-primary insurers; b) no dispute as to coverage; and c) pro rata clauses); *Arrowood Indem. Co. v. Gulf Underwriters Ins. Co.*, 2008 U.S. Dist. LEXIS 107779 (W.D. Tex. December 19, 2008)(*Mid-Continent* should be narrowly applied to the specific facts of the case and not be used to preclude recovery in this matter as it is unclear if any of the contracts at issue contained pro rata clauses); *Great Am. Lloyd. Ins. Co. v. Audubon Ins. Co.,* 377 S.W.3d 802 (Tex. App.– Dallas 2012, opinion withdrawn due to settlement, 2013 Tex. App. LEXIS 131, January 8, 2013)(*Mid-Continen*t should be limited to the specific facts of that case: a) co-primary insurers; b) no dispute as to coverage; and c) pro rata clauses); *U.S. Fid. & Guar. Co. v. Coastal Ref. & Mktg., Inc.,* 369 S.W.3d 559 (Tex. App. – Houston [14th Dist.] 2012, no pet.)(*Mid-Continent* does not bar contribution when excess clauses are at issue, therefore the insurers were obligated to the settlement on a pro rata basis); *Truck Ins. Exch. v. Mid-Continent Cas. Co.,* 320 S.W.3d 613 (Tex. App.– Austin 2010, no pet.)(*Mid-Continent* precludes an insurer's claim for contribution from another carrier for defense costs and bars contribution even if an insured denies coverage and breaches the duty to defend).

[33] *Cont'l Cas. Co.*, 683 F.3d at 86; *Colony Ins. Co*., 647 F.3d at 257-258; *Amerisure Ins. Co.*, 611 F.3d at 305-07; *Em'prs Ins. Co. of Wausau*, 705 F. Supp. 2d at 696; *Arrowood Indem. Co*., 2008 U.S. Dist. LEXIS at 107779; *American Home Assur. Co. v. Liberty Mut. Ins. Co.*, No. 02-3842, 2008 U.S. Dist. LEXIS 10281, 2008 WL 440303, at *2 n.4 (E.D. La. Feb. 12, 2008).

[34] *Cont'l Cas. Co.,* 683 F.3d at 86; *Colony Ins. Co.*, 647 F.3d at 258; *Amerisure Ins. Co. v. Navigators Ins. Co*., 611 F.3d at 306.

[35] There are situations where subrogation claims have not been allowed such as insurer claims against the insured (violates anti-subrogation rule),

On the lighter side of the law



and claims between insurers with policies covering different policy periods. *Royal Ins. Co. of Am. v. Caliber One Indemnity Co.*, 465 F.3d 614 , 625 (5th Cir. 2006).

[36] *Hardware Dealers,* 444 S.W.2d at 586.
[37] *Travelers Lloyds Ins. Co.*, 602 F.3d at 681.
[38] *Id.* (citing *Hardware Dealers,* 444 S.W.2d at 589).
[39] *Id.* (citing *Hardware Dealers*, 444 S.W.2d at 590).
[40] *U.S. Fid. & Guar. Co.,* 369 S.W.3d at 566.
[41] *Id.* at 567.

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