NO. 02-0730

IN THE

SUPREME COURT OF TEXAS

AUSTIN, TEXAS

EXCESS UNDERWRITERS AT LLOYD'S LONDON AND CERTAIN COMPANIES SUBSCRIBING SEVERALLY BUT NOT JOINTLY TO POLICY NO. 548TA4011F01

Petitioners,

V.

FRANK'S CASING CREW & RENTAL TOOLS, INC.

Respondent.

On Appeal from the Fourteenth Court of Appeals

MOTION FOR REHEARING

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ISSUES PRESENTED

1. This Court's decision in *Texas Ass'n of Counties County Gov't Risk Management Pool v. Matagorda County*, 52 S.W.3d 128 (Tex. 2000), barred Excess Underwriters' claim for reimbursement. Although California insurance law is different in several material respects, this Court has now adopted California law on reimbursement. This new rule will change Texas law under *Stowers* and *Gandy*. Did the Court properly clarify (and effectively overrule) *Matagorda County*?

2. Underwriters did not preserve the choice-of-law issue in the trial court and failed to prove that Louisiana law is different than Texas law on the reimbursement issue. Nevertheless, this Court held that Excess Underwriters could obtain reimbursement under Louisiana law. Did this Court properly determine as a matter of first impression that Louisiana law would allow reimbursement?

INTRODUCTION

Less than five years ago, this Court in *Texas Ass' of Counties County Gov't Risk Mgmt. Pool v. Matagorda County*, considered all of the issues raised in this case. 52 S.W.3d 128 (Tex. 2000). The Court, in a 7-2 decision, carefully considered the policy implications of its decision and found that the better rule is to place the burden on the insurer when choosing a course of action in the face of a coverage dispute. The *Matagorda County* decision was correctly decided. This Court has nevertheless adopted the dissent and effectively overruled *Matagorda County*. The Court's sea change on this issue injects unpredictability into the law. There has been no intervening change in insurance law, contract law, or public policy to cause this change.

Although the result reached by the majority may seem fair on the surface, that perceived fairness cannot be isolated from the insurance doctrines that intersect under the scenario in this case. *Stowers* does not require an insurer to pay an uncovered claim; an insurer that decides not to pay a claim because it believes there is no coverage does not face strict liability under *Stowers* or bad faith liability because it is ultimately incorrect with regard to coverage. Prior to the Court's opinion in this cause, an insurer was required under *Gandy* to make a good faith effort to resolve the coverage dispute before resolving the underlying claim through a declaratory judgment action so the insured would know whether there was coverage before settlement decisions had to be made. These insurance rules are modified by the Court's opinion without discussion.

In *Matagorda County*, this Court recognized the delicate balance between insurers and their insured. This Court held that when the right to reimbursement is not provided

in the policy, the insurer must show that the insured consented not only to the settlement of the underlying claim, but also to the insurer's right to seek reimbursement. 52 S.W.3d at 135. As the Court recognized, an insurer has several options available to it to protect itself in this situation. *See id.* at 135-36. Further, the insurer, who is in the business of insurance, is in the best position to decide a course of action and to assess the viability of its coverage defenses. *Id.* The Court has now shifted from the insurer to the insured the difficult decision of deciding the viability of the insurer's coverage arguments when the insurer disputes coverage. The Court does not acknowledge or address the policy issues considered and decided in *Matagorda County.* The Court's opinion does not recognize how the new rule impacts insureds' rights and gives insurers great power over their insured.

This Court should reconsider and re-hear this cause. This cause impacts and modifies several areas of insurance law, but the majority opinion was joined in fully by only a bare majority of the Court. Only five Justices participating in the opinions were present at oral argument, and fewer will participate on the motion for rehearing. There are important legal issues that should be considered by the entire Court eligible to participate.

SUMMARY OF THE ARGUMENT

The Court's decision to allow reimbursement in this case follows California law, but there are significant differences between California and Texas insurance law that support a different result. Both the *Stowers* doctrine and the justiceability of the coverage

declaratory judgment action under *Gandy* are different under California law.

The Court's decision also abrogates the *Stowers* doctrine. The *Stowers* duty is triggered by a demand from the plaintiff in the underlying case. Anytime there is a coverage dispute, it will now be very difficult for an insured to comment on the reasonableness of a plaintiff's *Stowers* demand because doing so will give the insurer a right to reimbursement. This is a dramatic change from current practice and also creates potential conflicts for defense counsel hired by the insurer to represent the insured. The new rule provides even more leverage to insurers.

The Court's opinion reshapes the landscape of settlement when there is a coverage dispute. Reservations of rights letter are frequently sent by insurers. Through this means, insurers will now be able to easily obtain a right of reimbursement that is not provided for in the parties' contract.

The two grounds on which the Court predicates reimbursement do not support an implied right to reimbursement based on both legal and factual distinctions that the Court does not address. The Court should address whether it has overruled the policy decision in *Matagorda County* placing the burden of analyzing coverage on the insured. Further, reimbursement would not be allowed under Louisiana law.

ARGUMENT

I. This Court Should Not Adopt the California Reimbursement Rule Because of Fundamental Differences Between Texas and California Insurance Law.

In adopting California law on reimbursement, this Court did not address the fundamental differences between California and Texas insurance law. Texas' *Stowers*

doctrine is different than the corollary doctrine under California law. Further, Texas law under *Gandy* requires an insurer to make an early attempt to resolve a coverage dispute while California law prohibits this. These fundamental differences should require a different rule in Texas. In fact, the California Supreme Court recognized the difference between the states' laws in *Blue Ridge* when it declined to follow *Matagorda County*.

A. *The Texas* Stowers *rule is different than the corollary California rule.*

Under California law, the insurer cannot consider coverage in determining whether a settlement offer is reasonable. *Blue Ridge Ins. Co. v. Jacobsen*, 22 P.3d 313, 322-23 (Cal. 2001) (citing *Johansen v. California State Auto. Ass'n Inter-Ins. Bureau*, 538 P.2d 744 (Cal. 1975)). Because California law does not allow an insurer to consider coverage in deciding whether an offer is reasonable, an insurer has no choice but to pay a reasonable settlement demand even if coverage is disputed. An implied reimbursement right might make sense in that context.

In contrast, Texas *Stowers* law does allow an insurer to take into account whether a claim is covered in deciding whether to pay a settlement and expressly holds that an insurer has no duty to settle claims that are not covered. *Rocor Int'l, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 77 S.W.3d 253, 262 (Tex. 2002); *American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994). Under Texas law, an insurer faced with a reasonable settlement demand is not required to pay that settlement if there is no coverage. *See infra* p. 7. Thus, unlike California law, an insurer in Texas does not need an implied right to reimbursement to protect its position when coverage is disputed.

B. *The Court has implicitly overruled* Gandy*'s requirement that an insurer make a good faith attempt to resolve the coverage dispute.*

Another fundamental difference between California and Texas law is the availability of declaratory relief before the underlying case is resolved. This Court held in *State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696, 714 (Tex. 1996), that an insurer should make a good faith effort to resolve the coverage dispute before resolving the underlying claim. The Court reiterated this rule in *Matagorda County*, 52 S.W.3d at 135. In its opinion in this cause, however, the Court follows *Blue Ridge* and states: "The coverage dispute between an insured and its insurer can be resolved after the injured plaintiff is compensated." Slip op. at 7. This statement is at direct odds with *Gandy.*

In California, an insurer cannot proceed with a declaratory judgment action before the underlying lawsuit is resolved. *Blue Ridge*, 22 P.3d at 322-23. The California rule is contrary to the law in Texas. This difference between California and Texas insurance law is an express reason the California Supreme Court in *Blue Ridge* distinguished *Matagorda County. Id.* The Court should reconcile its decision in this cause with *Gandy* so that insurers and insureds know whether *Gandy* is still good law or whether the California rule is now the law in Texas, too.

The opinion in this cause discourages early resolution of coverage disputes. Early resolution of the coverage dispute avoids the problems raised for the insurer and the insured when faced with a plaintiff's *Stowers* demand at the eleventh-hour. Early resolution also allows the plaintiff and the insured to know whether there is insurance coverage in negotiating a settlement. This Court should reaffirm *Gandy.*

II. A Demand to Settle Should Not Give Rise to a Reimbursement Claim.

The Court's holding that an insured's demand to settle a claim within policy limits allows an implied reimbursement right abrogates the *Stowers* doctrine. Now, an insurer can insulate itself from any *Stowers* liability at the expense of the insured. This new rule also establishes a conflict between defense counsel and the insured.

A. *An insurer should not have a right to reimbursement because of a demand to settle.*

The Court first holds that the insurer has a right to reimbursement when an insured demands that an insurer accept a settlement offer within policy limits. Slip op. at 8. The Court goes on to state: "When there is a coverage dispute and an insured demands that its insurer accept a settlement offer within policy limits, the insured is deemed to have viewed the settlement offer as a reasonable one." Slip op. at 10. This part of the Court's opinion is largely taken from the dissent in *Matagorda County*.

A demand by the insured to settle the case should not give the insurer a reimbursement right not agreed to in the contract. The trigger of an insurer's duty under *Stowers* is a demand made by the plaintiff in the underlying case.[1] *See American Physicians Ins. Exch.*, 876 S.W.2d at 848-49. Because it is the underlying plaintiff who "Stowerizes," rather than the insured, whether an insured encourages an insurer to accept a plaintiff's *Stowers* demand should not create a new extra-contractual right.

The Court appears to be concerned with insurers' potential *Stowers* liability.

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[1] The plaintiff's settlement demand must also be for a covered claim, be within policy limits, and be such that a prudent insurer would accept it. 876 S.W.2d at 848.

Making an incorrect decision on whether to pay a *Stowers* demand, however, does not impose strict liability on an insurer. Not settling the claim in this context may be reasonable. *See American Physicians Ins. Exch.*, 876 S.W.2d at 852 (even if insurer was incorrect about whether settlement demand fell within policy limits, issue still existed as to whether insurer acted reasonably in refusing to settle). Further, an insurer does not face bad-faith liability merely because it is ultimately incorrect with regard to coverage. *See United States Fire Ins. Co. v. Williams*, 955 S.W.2d 267, 268 (Tex. 1997); *Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48, 56 (Tex. 1997) ("[A]n insurer will be liable if the insurer knew or should have known that it was reasonably clear that the claim was covered."). Current Texas law correctly allocates the burdens and duties when there is a coverage dispute.

Further, the Court creates a new rule and uses the *Stowers* demand to have the insured deem the settlement to be reasonable. In this case, it has never been disputed that the settlement was reasonable. (C.R. 462, 469). Nor was it disputed in *Matagorda County* that the settlement was reasonable. *See* 52 S.W.3d at 129. The dispute at the time of settlement was not whether it was reasonable, but whether it was covered.

The reimbursement right established in this cause is predicated not on the policy wording, but on an insured's demand for settlement, regardless of whether the policy contemplates or addresses the issue. A reimbursement clause is a bargained-for right of the insurer that will affect the premium paid. The possible payment of non-covered claims is a loss that insurers may take into account when setting premiums because past

losses is a factor insurers use in setting rates. *See Matagorda County*, 52 S.W.3d at 131 n.4, 135-36. If this possibility is removed by a right to reimbursement, then the premium should be reduced accordingly.

The insurer can put the right to reimbursement in the policy if it chooses to have that right. 52 S.W.3d at 131 n.4, 136. Insurers have chosen not to bargain for this right from policyholders, the Legislature, or the regulators. Insurers no longer need to put that right in policies, or adjust premiums accordingly, because it is now implied in law.

The Court also stated that whether an insured has insurance should not affect the settlement negotiations. Slip op. at 9. This is not realistic in practice because current litigation practice almost always involves a consideration of whether insurance coverage exists. The discovery rules even require that a defendant produce copies of relevant insurance policies to the plaintiff. TEX. R. Civ. P. 192.3(g), 194.2(g).

B. *Using a demand to settle to create a reimbursement right will establish a conflict between an insured and its counsel.*

The new rule announced in this cause creates a potential conflict and potential liability for the insured's counsel. Counsel for an insured will often, in light of a reasonable *Stowers* demand by the plaintiff, make a demand for the insurer to settle the underlying case as a covered claim. Although hired by the insurer, counsel's loyalty is to the insured, including when attempting to have the insurer settle the case. *See State Farm Mut. Auto. Ins. Co. v. Traver*, 980 S.W.2d 625, 627-28 (Tex. 1998). A demand from the insurer for an extra-contractual right to reimbursement that threatens the insured's legal rights creates a conflict requiring separate counsel. *See Northern County Mut. Ins. Co. v.*

Davalos, 140 S.W.3d 685, 689 (Tex. 2004).

Under this Court's opinion, if an insured's counsel makes a demand for an insurer to take a plaintiff's *Stowers* demand and settle a case because the insured believes the claim is covered, this will give the insurer a new extra-contractual reimbursement right. Defense counsel cannot agree that a settlement is reasonable without facing liability from the client, the insured, for allowing a reimbursement right. This is especially problematic because defense counsel is usually best positioned to advise the insurer as to the reasonableness of a settlement demand, *e.g.*, the insurer cannot satisfy its duties under *Stowers* without sufficient information to determine potential liability.

C. *Allowing an implied right to reimbursement will create additional leverage for the insurer.*

This new reimbursement right, although not bargained for by the parties under the policy, will allow insurers to put new pressure on insureds at a critical time to either contribute to settlements or face a reimbursement claim along with the additional attorneys' fees that go with defending it. An insurer can now contest coverage, put off the coverage decision, and pay a demand for settlement that is within policy limits—thereby insulating itself from any *Stowers* liability—and then sue the insured for reimbursement.

The prior rule has been working well. Under *Matagorda County*, an insurer knew that it was to decide whether it was in its best interest to pay a claim on disputed coverage or deny the claim and stand on its coverage defenses. It has been a highly unusual case where the insurer wants to settle and then continue to litigate with its insured. Many

insurers will now increasingly choose to file suit seeking reimbursement because it is in their financial interest to do so.

III. An Agreement that a Settlement Demand Should be Accepted Should Not Trigger Reimbursement.

The second basis for the Court's opinion is that reimbursement will be implied where an insured agrees that the settlement offer should be accepted, and the insurer has notified the insured that it intends to seek reimbursement. Slip op. at 8, 12. This rule adopts the first prong in *Matagorda County* and makes it the only prong of the test if the insurer notifies the insured that it intends to seek reimbursement. The Court has eliminated the second prong in *Matagorda County* that there be an express consent to the right to seek reimbursement. An extra-contractual right to reimbursement should not be implied in law because of an insured's consent to the settlement.

A. *The umbrella policy does not require Frank's consent to settle.*

The umbrella policy in this case does not require that the insured consent to settlement. The umbrella policy is an indemnity policy. (C.R. 323). Underwriters does not have to indemnify Frank's until certain conditions are met. The Court cites the provision in the policy setting forth the time frame in which Frank's must make a claim under the policy.[2] *See* slip op. at 5 n.5. The policy provision relied on by the Court as

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[2] The heading of the section of the umbrella policy is: "J. Loss Payable." Although the Lloyd's umbrella policy appears at several places in the record, (*e.g.*, C.R. 330), none of the copies contain a legible heading for this clause. A sample form of a Lloyd's Umbrella Policy containing the identical clause can be found at THE UMBRELLA BOOK, Appendix at LUP-6 (2003).

requiring Frank's consent to settlement is a "Loss Payable" clause.[3] This provision provides that Underwriters is not required to indemnify Frank's for a settlement made by Frank's unless Underwriters consented to the settlement. (*See* C.R. 330 ("The Assured shall make a definite claim for any loss for which the Underwriters may be liable under the Policy within twelve (12) months . . . after the Assured's liability shall have been fixed and rendered certain . . . by written agreement of the Assured, the claimant, and Underwriters."). The policy requires Underwriters' consent to a settlement by Frank's; there is no limitation on Underwriters paying a claim directly, with or without Frank's consent.[4]

B. ***Even where consent is required, it may not be unreasonably withheld.***

Even if consent was required under the policy, however, this rule is not workable because an insured cannot withhold consent from a reasonable settlement. When an

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[3] A loss payable clause sets forth the requirements that must be met before the insurer is obligated to respond with a loss payment. *See* THE UMBRELLA BOOK, Policy Terms at CNepa-1 (2003). In contrast, a consent to settlement clause is a "provision found in professional liability insurance policies that requires an insurer to seek an insured's approval prior to settling a claim for a specific amount." GLOSSARY OF INSURANCE & RISK MANAGEMENT TERMS at 32 (7th ed. 1999). A consent to settlement clause typically reads: "The company shall not settle any claim without the written consent of the insured. . . ." 1 ALLAN D. WINDT, INSURANCE CLAIMS AND DISPUTES § 5:3 at 504 n.1 (4th ed. 2001).

[4] The limited rule of this Loss Payable clause was discussed at oral argument in response to a question from Justice Owen as to whether the policy requires Frank's consent to settle: "The only consent, and that's the only consent provision in this policy, says if you are going to pay a claim you have to make demand to be reimbursed for that within twelve months of this agreement. There is nothing in the policy that requires Frank's to consent to the situation we've got here where the insurer is paying the claim directly."

insured has the right to consent to settlement under a policy, the insured cannot unreasonably withhold that consent except at its own risk. *See Saucedo v. Winger*, 915 P.2d 129, 134 (Kan. Ct. App. 1996) ("[W]here the policy requires the consent of the insured prior to entering into a settlement with the plaintiff, the insured should not be allowed to withhold consent except at his or her own risk."); 1 ALLAN D. WINDT, INSURANCE CLAIMS AND DISPUTES § 5:3 at 506 n.5 (4th ed. 2001).

The Court has set up a test for reimbursement that the insured cannot win. If an insured consents to a settlement, it will be implied to have agreed to reimburse the insurer if it is later determined there is no coverage. If an insured withholds its consent to a reasonable settlement, it will have waived its claims against the insurer at its own risk. An insured that is facing at the same time both a settlement demand and a challenge from its insurer over coverage now has the new decision of determining whether it can withhold consent to settlement because it does not want to grant the insurer an implied extra-contractual right to seek reimbursement. This is an untenable position for the insured.

C. *The Court should require an insurer's notice that it would seek reimbursement to be made timely.*

This Court should require that a notice of intent to seek reimbursement be timely issued to the insured. *See* slip op. at 8. An insurer must timely assert its reservation of rights, and should likewise be required to timely notify the insured of the insurer's intent to seek reimbursement.

Excess Underwriters did not timely notify Frank's that it intended to seek

reimbursement.[5] Excess Underwriters first notified Frank's that it intended to seek reimbursement only a few hours before it settled the case. (*See* C.R. 470). This notice of reimbursement did not provide sufficient time for Frank's to analyze the notice, determine whether there was coverage, and find a way to protect itself from Excess Underwriters' unilateral assertion of a right to reimbursement. *See W. Cas. & Sur. Co. v. Newell Mfg. Co.*, 566 S.W.2d 74, 77 (Tex. Civ. App.—San Antonio 1978, writ ref'd n.r.e.); *see also Rhodes v. Chicago Ins. Co.*, 719 F.2d 116, 120 (5th Cir. 1983) (applying Texas law). If the Court allows unilateral notice of reimbursement to create an extra-contractual right, the notice should be given timely.

IV. The Court Should Address Whether It has Overruled the Policy Decision in *Matagorda County* Placing the Burden of Analyzing Coverage on the Insurer.

In *Matagorda County*, the Court recognized that the insurer is in the business of analyzing and allocating risk and is, therefore, in the best position to address the viability of its coverage dispute. 52 S.W.3d at 135-36. This was—rightly so—an important policy issue underlying the Court's decision. Notably absent from the Court's opinion in this cause is any discussion of this policy reason for placing on the insured the difficult decision of whether there is coverage when settling a claim.

Placing the burden on the insurer to address its coverage dispute is appropriate because it is the insurer that in its reservation of rights letter claims why it believes there

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[5] Excess Underwriters' reservation of rights letters did not provide notice of an intent to seek reimbursement. Contesting coverage and claiming a right to seek reimbursement are two very different concepts. *See Medical Malpractice Joint Underwriting Ass'n of Mass. v. Goldberg*, 680 N.E.2d 1121, 1129 n.31 (Mass. 1997).

is no coverage. These reservation of rights letters (often form letters) usually set forth a multitude of possible bases for denial of coverage, many of which are never seriously asserted by the insurer. (*Compare* C.R. 687-94, 697-98 (reservation of rights letters asserting thirteen potential coverage defenses) *with* C.R. 211-37, 1134-51 (motions for summary judgment asserting two coverage defenses).

It is difficult for an insured to determine which of the numerous possible coverage defenses the insurer intends to press. Having the insurer decide coverage and whether to pay a settlement in light of the coverage defenses is part of what the insured is paying for with its premiums. In fact, the Illinois Supreme Court has recently recognized that the burden of deciding coverage is better placed on the insurer in denying an insurer a unilateral right to reimbursement of defense costs. *General Agents Ins. Co. of Am., Inc. v. Midwest Sporting Goods Co.*, 828 N.E.2d 1092, 1102 (Ill. 2005).

V. Reimbursement Would Not Be Allowed Under Louisiana Law.

After reversing based on Texas law, the Court also holds that Underwriters would be entitled to reimbursement under Louisiana law, citing the civil code provision for unjust enrichment and a non-insurance case. Slip op. at 16-17. The Court's reliance on these authorities is misplaced.

No court in Louisiana has applied article 2298 of the Louisiana Civil Code to a case involving an insurance company and its insured under the facts presented in this case. Moreover, the Court's analysis of unjust enrichment under article 2298 omits the element of an absence of justification or cause for the enrichment. *Carriere v. Bank of*

La., 702 So. 2d 648, 671-72 (La. 1996). Because Underwriters received benefits by paying the settlement, including a cap on its *Stowers* exposure and defense costs, it cannot satisfy the elements of unjust enrichment. *See General Agents Ins. Co.*, 828 N.E.2d at 1103 (no unjust enrichment because insurer that pays defense costs pursuant to reservation of rights is protecting itself as much as the insured). Underwriters did not even try to establish unjust enrichment under Texas law.

Further, this Court should not address these issues of first impression under Louisiana law. If the Court applies Texas law, there is no reason to opine whether Louisiana law would reach the same result. The Court should modify its opinion to delete the Louisiana law decision, or hold that Underwriters waived application of Louisiana law.

PRAYER

For these reasons, Respondent, Frank's Casing Crew & Rental Tools, Inc. respectfully requests that this Court grant this Motion for Rehearing, vacate its opinion of May 27, 2005, and affirm the court of appeals' and trial court's judgments. In the alternative, Respondent requests that the Court remand the case to the trial court. Respondent also requests any further relief to which it may be entitled.

Respectfully submitted,

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CERTIFICATE OF CONFERENCE

I certify that I conferred with J. Clifton Hall, counsel for petitioners, Excess Underwriters at Lloyd's London and Certain companies Subscribing Severally but not Jointly to Policy No. 548TA4011F01, regarding this motion, and petitioners oppose the relief sought.

Warren W. Harris/by permission
Warren W. Harris

CERTIFICATE OF SERVICE

I certify that a copy of Respondent's Motion for Rehearing was served on counsel of record by United States certified mail, return receipt requested, on the 20th day of July 2005, addressed as follows:

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