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

REPLY TO PETITIONERS' RESPONSE TO MOTION FOR REHEARING

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INTRODUCTION

Once an insurer agrees to defend and issues a reservation of rights, the dynamics of the relationship between the underlying plaintiff, the defendant-insured, and the insurer are changed, and coverage becomes an issue to be addressed. Prior to the decision in this cause, the insurer was the party that had to decide coverage when determining whether to pay a settlement demand. Now that burden is on the insured. The Court's opinion in this cause, and the position advocated by Underwriters, allows the insurer to step into the case, skew the dynamics of the relationship, and act with impunity in avoiding the coverage decision by simply paying a claim and seeking reimbursement. As several amici curiae have pointed out, the new rule announced by the Court in this cause is bad for Texas insureds and needlessly injects unpredictability into the law.

Underwriters' response demonstrates a misunderstanding of the realities of the insurer-insured relationship and the settlement of complex commercial claims. It also ignores the leverage that is given to insurers by the rule announced in the majority opinion. Insurers now have a tool to use against their insureds in settlement negotiations—the very real threat of a lawsuit by their insurer against them for reimbursement. Insureds will not exercise certain rights and will not speak or comment on settlement demands by underlying plaintiffs for fear of giving rise to an implied-in-law right to reimbursement. Amici curiae ranging from small to large businesses, from the defense bar to an association of thousands of businesses and individuals, have filed briefing pointing out the problems caused by, and the inequities of, the majority opinion. Yet, Underwriters does not address the majority of the practical effects and problems that

have been raised by the amici curiae.

Since this Court issued the majority and three concurring opinions, numerous articles and continuing legal education programs have focused on the difficulties raised by the new implied extra-contractual right to reimbursement granted to insurers in this case. *See* Appendix A. Defense counsel and the insurance bar need guidance from this Court. Rather than allow these issues to simply percolate among the courts of appeals as urged by Underwriters, this Court should rehear the case, vacate the prior opinion, find that Underwriters is not entitled to reimbursement from Frank's, and affirm the judgments of the courts below.

ARGUMENT

Underwriters' claim that the Court's opinion merely "restores balance" and does not give leverage to the insurer demonstrates a misunderstanding of what really happens when insurers become involved in defending and indemnifying claims against their insureds. Further, by misstating various rules and principles outlined in case law, Underwriters misstates Texas insurance law. The rule announced by this Court and advocated by Underwriters unnecessarily erodes protections for the insured while allowing insurers to avoid having to make the coverage determination.

I. Underwriters' ignores the realities of the insurer-insured relationship.

The existence of insurance inevitably affects the dynamics of the settlement process. *See, e.g.*, Brief of Amici Curiae Shell Oil Company, Motiva Enterprises LLC, Burlington Resources Inc., Temple-Inland Inc., and Brad Fish, Inc. at 11. ("At some point in the negotiations, insurance coverage invariably must be considered despite the

Court's vision of a pristine determination of reasonableness divorced from the realities of insurance coverage."). Because the availability of insurance affects the dynamics of the process, a rule that allows implied consent to reimbursement puts the insured at a distinct disadvantage. *See id.* at 3, 11.

A. *The claim that the opinion merely restores balance is wrong.*

The Court's opinion does not restore balance between the insurer and the insured. Rather, the opinion now tips the scales in favor of the insurer. *See* Letter Brief of Amicus Curiae Texas Association of Defense Counsel at 3. An insurer now has the threat of a reimbursement right to pressure its insured to contribute to a settlement after the insurer has disputed coverage. *See id.* at 2. Reservation of rights letters are commonplace, particularly in commercial litigation, and are regularly used to leverage contributions to settlement from insureds. *See* Brief of Amici Curiae Shell Oil Company *et al.* at 3, 11-12. Insurers will now as a matter of course include a notice of an intent to seek reimbursement.

Further, the insured is now the party that must try to decide whether coverage really exists in determining its course of action. This is directly contrary to this Court's opinion only five years ago in *Matagorda County.* *See* Brief of Amicus Curiae Texas Civil Justice League at 3; Brief of Amici Curiae Shell Oil Company *et al.* at 8. Frank's is not the only party to believe that there are no compelling reasons to shift this burden to the insured; amici curiae have made the same point.

Underwriters implies that "large corporate insureds like Frank's" should bear the

burden because they allegedly have their own resources for determining whether insurance coverage exists. (Response at 13). Of course, the vast majority of Texas insureds, large or small, poor or wealthy, have no expertise or significant experience with regard to analyzing the myriad exclusions to coverage contained in insurance policies. The insurer triggers the coverage dispute, and the Court's new rule of reimbursement shifts the responsibility of resolving the coverage issue to the insured.

The insured also now has a Hobson's choice in deciding its course of action. Under the Court's opinion that a right to reimbursement will be implied from an acknowledgment that a settlement is reasonable or a demand that it should be accepted, an insured must stand silent in response to a plaintiff's settlement demand for fear of being deemed to have consented to reimbursement. But, as Underwriters concedes, if an insured refuses consent to a reasonable settlement, it will waive its *Stowers* rights. (Response at 12). This situation will usually create conflicts between an insurer and its insured during settlement negotiations, "a time when the insured can least afford the risk that retained counsel may be forced to either remain silent or to withdraw altogether." Letter Brief of Amicus Curiae Texas Association of Defense Counsel at 2.

Underwriters argues that the requirement of an express agreement to the right to reimbursement somehow takes away the insurer's right to litigate coverage. (Response at 10). But no one has taken away the insurer's right under *Gandy* to file a declaratory judgment action and at least attempt to have the coverage question determined before resolution of the underlying claim. *See Texas Ass'n of Counties Cty. Gov't Risk Mgmt*

Pool v. Matagorda County, 52 S.W.3d 128, 135 (Tex. 2000). Underwriters failed to litigate the coverage issue as required by *Gandy*. The whole dispute may have been avoided and the parties would have known, at the time of the settlement, whether coverage existed if Underwriters had availed itself of this remedy. (Respondent's Brief on the Merits at 18). The Court has now provided a disincentive for the insurer to attempt an early, good faith resolution of the coverage issue as required by *Gandy*.

In arguing that the Court's opinion encourages settlements in favor of third-parties, (Response at 10-11), Underwriters ignores that insurers now have even more incentive to file lawsuits for reimbursement against their insureds based on the new implied right granted in this case. The *Matagorda County* rule worked well, and did not lead to increased litigation nor the controversy over the impact of the decision, as has this case.

Given all of the other protections available under existing Texas law and given the role insurance plays in the resolution of third-party claims, insurers do not need the new rule in this cause to avoid paying uncovered claims. Insurers should be required to use these existing remedies and procedures.

B. *The implied right to reimbursement puts the insured in a worse position.*

Underwriters is also incorrect when it states that an insured is in no worse position. (Response at 13). In fact, the insured is in a worse position under the facts of this case than if it had obtained no insurance to begin with. Once an insurer pays a settlement, the amount of the claim against the insured is fixed. Even if the amount of the settlement is objectively reasonable, it may be an amount that the insured cannot pay.

See Brief of Amici Curiae Shell Oil Company *et al.* at 13. Under this Court's opinion, the insured becomes bound to pay an amount that may well be outside of its means.

II. Underwriters cannot square the Court's opinion with *Gandy*.

In an ill-defined attempt to square *State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696 (Tex. 1996), with the opinion in this cause, Underwriters ignores the requirement in *Gandy* that an insurer must make a good faith effort to resolve the coverage dispute before the underlying claim is resolved. (*See* Response at 6). The Court's opinion in this cause relieves the insurer of any burden to have the coverage dispute resolved before the underlying plaintiff is compensated. This creates leverage for the insurer to force the insured to contribute to settlement. The insured has to not only negotiate with the plaintiff, but at the same time negotiate with its insurer. The Court's opinion and Underwriters' argument undermine *Gandy*.

III. An express reimbursement provision would not be an unnecessary duplication of contract obligations.

In a baffling argument, Underwriters also contends that express reimbursement provisions are simply unnecessary duplications of the rights and obligations stated in the insurance contract. (Response at 8). Underwriters' argument is contrary to this Court's recognition in *Matagorda County* that such express provisions have been used by insurance companies and upheld. *See Matagorda County*, 52 S.W.3d at 132 n.4. Of course, it is undisputed that the insurance policy between Frank's and Underwriters did not contain a right to reimbursement. Frank's never bargained for a situation in which

Underwriters would contest coverage and then delay resolution of that coverage question until Frank's was in the heat of trial facing a multi-million dollar judgment.

IV. Underwriters' misstates various aspects of Texas insurance law.

Underwriters argues, without explanation, that the Court's opinion makes no change to Texas law. (Response at 2, 3, 6). Underwriters does not discuss existing law because it provides insurers a remedy when they dispute coverage. The legal and policy issues raised by Frank's are well grounded in the law as it existed before the decision in this cause. This Court should decline Underwriters' invitation to ignore these important legal issues until future cases.

The claim that Texas insurance law has long recognized the reimbursement right at issue in this case is simply wrong. (*See* Response at 3-4, 10). As this Court stated in *Matagorda County*, this was an issue of first impression for the Court. 52 S.W.3d at 131. It was not until the instant cause that this Court decided the insurer may settle third-party claims and then obtain an implied right of reimbursement from the insured.

Underwriters cites cases that stand for the unremarkable, and inapplicable, proposition that an insurer may obtain repayment from its insured when the insurer makes a payment by mistake. (*See* Response at 4 n.7 and 10 n.20). Because Underwriters did not make the payment in this case by mistake, those cases are inapposite.

Underwriters also claims that Frank's is incorrect in its statement that California law is different than Texas law with regard to whether an insurer may consider coverage

when paying a third-party demand. (Response at 4). *Scottsdale Ins. Co. v. MV Transp.*, 115 P.3d 460, 470 n.5 (Cal. 2005), reinforces that California law is different. *See id.* (reiterating that in California an insurer faces "unlimited exposure" to bad faith liability if it declines a settlement or a defense based on a belief of no coverage). In contrast, Texas insurers do not face strict liability for denial of a claim on the basis of a reasonable belief that there was no coverage. *See Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48, 56 (Tex. 1997).[1]

Underwriters also states that an insured's *Stowers* demand estops the insured from contesting the reasonableness of the settlement and thus gives rise to the extra-contractual right to reimbursement. (Response at 7). Of course, it is not the insured that *Stowerizes* the insurer; it is the demand from the underlying plaintiff. *American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 848-49 (Tex. 1994). More importantly, in this case (and in most cases) the reasonableness of the settlement is not in dispute. The dispute is over whether the claim is covered. When Frank's forwarded the underlying plaintiff's demand and stated that it was an amount that a reasonable and prudent insurer would pay, Frank's made clear that it believed coverage existed and that the settlement should be

[1] Nor does a Texas insurer face the same "dilemma" as a California insurer would if the insured refuses to agree to reimbursement. (*See* Response at 5). Because Texas law employs a "reasonable belief" test, whether the claim was covered and whether an insured unreasonably refused to agree to reimbursement would presumably be factors to consider in the bad faith analysis. *See* Marc S. Mayerson, *Mess in Texas: Insurer Recoupment of Settlement Payments*, INS. COVERAGE L. BULL., Vol. 4, No. 9 at 1 (Oct. 2005).

paid as a covered claim. (C.R. 462, 685). Frank's did not agree—expressly or impliedly—to also reimburse Underwriters.

Only five years ago it was clear under Texas law that an insurer was not entitled to reimbursement of funds paid to settle claims if it was later determined there was no coverage, unless the insured expressly agreed to the settlement and to the right to seek reimbursement. The certainty from that bright line rule has been lost, with no compelling reason for ignoring stare decisis. Further, only a bare majority of the Court participating in the opinion were present at oral argument. The Court should grant rehearing and the cause should be reconsidered by the entire Court eligible to participate.

PRAYER

For these reasons, the Court should grant the relief requested in the Motion for Rehearing.

Respectfully submitted,

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