# CASE NO. 02-0730

IN THE SUPREME COURT OF TEXAS

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

VS.

FRANK'S CASING CREW AND RENTAL TOOLS, INC.

On Rehearing

**BRIEF OF AMICUS CURIAE**
**PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA**

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**TO THE HONORABLE SUPREME COURT OF TEXAS:**

Amicus curiae, Property Casualty Insurers Association of America, respectfully submits this Brief.

## INTEREST OF AMICUS CURIAE

The Property Casualty Insurers Association of America ("PCI"), which has paid the fee for preparing this brief, is an association of insurance companies and professionals which represents more than 1,000 property and casualty insurers throughout the United States. Its members write personal and commercial liability insurance policies, ranging from standard homeowners' policies to commercial general liability policies. In Texas, PCI's 70 members collectively account for over 30% of the homeowners' insurance premiums, and over 40% of the personal auto insurance premiums. In light of its substantial presence in the Lone Star State, PCI has a significant interest in seeing to it that this Court's well-reasoned original decision remains the law in Texas.

## QUESTION PRESENTED

Do the grounds urged by Frank's Casing and its amici warrant withdrawal of this Court's original opinion and judgment?

## ARGUMENT

### I. Simply because a right of reimbursement is not explicitly stated in the insurance contract does not mean it should not exist.

Perhaps the most basic argument in support of rehearing has been urged by United Policyholders, a "California-based non-profit association of insurance consumers." *See Amici Urge Rehearing and Reversal of Frank's Casing*, V. 21, TEXAS LAWYER pp. 1, 18 (Oct. 24, 2005). The contention advanced is that this Court's decision is unsound because it is based upon "extra-contractual rights" not contained in the insurance policy. PCI respectfully submits that "extra-contractual rights not contained in the insurance policy" have long been a part of Texas jurisprudence, both by statute and common law. TEX. INS. CODE ANN. § 21.21 (Vernon 2005); *G. A. Stowers Furniture Co. v. American Indemn. Co.*, 15 S.W.2d 544, 547-48 (Tex. Comm'n App. 1929, holding approved). Whether a right is denominated contractual or extra-contractual is not the question. The question is whether the right, fundamentally, should exist. In this case, unless this Court is going to turn its back on established principles of equity and restitution, the right of reimbursement clearly should exist.

As recognized by Professor Kenneth S. Abraham almost two decades ago, "Liability insurance policies often create obligations that are insufficiently detailed to govern insurer conduct completely." KENNETH S. ABRAHAM, *Distributing Risk: Insurance, Legal Theory, and Public Policy*, 203 (1986). Standardized personal and commercial liability contracts

cannot address all issues relating to the rights and obligations of the parties.[1] The insured/insurer relationship is a complex one that involves duties and rights that often must be determined by the courts. The suggestion that a right of reimbursement should not exist simply because it is not explicitly stated in the insurance contract ignores this unique relationship, and the natural progression and evolution of insurance law.

Over seventy-five years ago, this Court established an important extra-contractual right in *G. A. Stowers Furniture Co. v. American Indemn. Co.*, 15 S.W.2d 544, 547-48 (Tex. Comm'n App. 1929, holding approved). This Court held that an insurer was obligated to accept a reasonable settlement demand for a covered claim within policy limits. *Id*. This Court will search typical policy language in vain for such an obligation. The obligation arises out of court-created common law.

PCI respectfully submits that the right of reimbursement described in *Frank's Casing* is a mirror image of the *Stowers* right which has existed for over seven decades, in favor of the policyholder. *Stowers* imposes an extra-contractual duty upon insurers to settle *covered* claims under certain circumstances. *Frank's Casing* merely confers upon insurers a corresponding *right* to obtain reimbursement when it is ultimately determined the claims

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[1] For example, with respect to the insurer's obligation to defend its insured, liability policies do not discuss the extent to which the insurer enjoys a right to control the defense. They do not address who is the client of defense counsel appointed by the insurer to defend the insured, and to whom counsel owes his or her loyalties when interests diverge (or appear to have a potential for divergence). They do not address whether the duty to defend runs through appeals, or how conflicts are resolved when the insurer and insured disagree about strategies to be employed in defending the claim against the insured. Finally, they do not address to what extent the insurer must act, if at all, to protect non-covered interests of the insured (such as the insured's reputation interests). Robert H. Jerry, II, *The Insurer's Right to Reimbursement of Defense Costs*, 42 ARIZ. L. REV. 13, 19 (Spring 2000).

which were settled were *not* covered. Simply stated, this Court was right when it rendered its decision in *Stowers*, and it was right when it rendered its original decision in *Frank's Casing*.

## II. A right of reimbursement encourages the resolution of underlying disputes, while at the same time preserving the rights of the parties to have coverage determined by the courts.

This Court has urged that unresolved coverage disputes between liability insurers and insureds be expeditiously determined, where possible, in a declaratory judgment action. *State Farm Fire and Cas. Co. v. Gandy*, 925 S.W.2d 696, 714 (Tex. 1996). However, such actions ordinarily involve only the duty to defend, because that is an issue of law determined solely by reference to the pleadings in the underlying suit and the insurance contract language. The duty to indemnify, on the other hand, most often cannot be decided before the underlying suit is resolved, because it hinges on the actual facts. *See Farmers Texas County Mut. Ins. v. Griffin*, 955 S.W.2d 81, 84 (Tex. 1997) (holding that the duty to indemnify is justiciable before the underlying suit is resolved *only* "when the insurer has no duty to defend and the same reasons that negate the duty to defend likewise negate any possibility the insurer will ever have a duty to indemnify."); *see also Utica Nat'l Ins. Co. of Texas v. American Indem. Co.*, 141 S.W.3d 198, 205 (Tex. 2004) (resolving insurer's duty to defend but remanding duty-to-indemnify issue for trial).

While insurers have a means for seeking resolution of the duty to defend prior to the settlement of an underlying suit, they commonly do not have such an option with respect to the duty to indemnify. The absence of a procedural vehicle for resolving the duty to

indemnify prior to disposition of the underlying suit gives the insurer a Hobson's choice: (1) settle the underlying suit and essentially "give up" its claim that the policy affords no coverage; or (2) refuse to settle the underlying suit, and expose the insured to not only a judgment but potentially an excess judgment. The insurer must either give up potential contractual rights or risk potential extra-contractual obligations. That is a choice it should not be required to make.

The right of reimbursement described in this Court's original opinion is just because it provides a third option to insurers called upon to settle claims they maintain, in good faith, are not covered by their policies: protect the insured from a judgment without forcing the insurer to forfeit its contractual rights under the policy. In the absence of the *Frank's Casing* right to reimbursement, all an insurer can do (other than simply pay a non-covered claim) is reject that claim and subject the insured to trial. That trial may result in not only a judgment (perhaps even an excess judgment) against the insured, but also potential *Stowers* liability to the insurer. The right of reimbursement recognized by the Court in *Frank's Casing* eliminates these "Gotcha" tactics and focuses instead on the principle that the party who ultimately owes should pay.

## III. This Court's original holding is consistent with Section 35 of the Restatement (3d) of Restitution and Unjust Enrichment.

Justice Wainwright struck a resonant chord in his original concurring opinion. One need look no further than Section 35 of the Restatement (Third) of Restitution and Unjust

Enrichment to see why his comments were on target. Tentative Draft No. 3 of Section 35 provides:

> (1) If one party to a contract demands from the other a performance that is not in fact due by the terms of their agreement, the party on whom the demand is made may render such performance under protest or with reservation of rights, preserving a claim in restitution to recover the value of the benefit conferred in excess of the recipient's contractual entitlement.
>
> (2) The claim described in subsection (1) is available only to a party acting in good faith and in the reasonable protection of the claimant's own interests. It is not available where there has been an accord and satisfaction between the parties, or where a performance with a reservation of rights is inadequate to discharge the claimant's obligation to the recipient.

Section 35 of the Restatement supports both the rationale underlying this Court's original holding and Justice Wainwright's concurrence. If the policyholder calls upon the insurer to settle non-covered claims, and the insurer does so, the insured is unjustly enriched because it receives coverage it did not bargain for. To remedy this situation, the Restatement provides an insurer may settle the underlying liability suit under protest or with a reservation of rights, and at the same time preserve its claim to recover from the insured payments made on non-covered claims. The only condition placed upon the insurer's right of reimbursement is that it act in good faith and in reasonable protection of its own interest.

When one looks further, at illustration 10 under Section 35 of the Restatement, one sees a factual scenario strikingly similar to *Frank's Casing*:

> 10. A is insured against specific liabilities with B Company, to the maximum amount of $300,000.00. C brings an action against A for serious personal injuries. Coverage under the B policy is possible but

> doubtful. B initiates a suit for declaratory judgment and advises A that it will furnish a defense of the C lawsuit, while reserving the right to dispute coverage and to recover its costs in respect of non-covered claims. A accepts the defense. B initiates a suit for declaratory judgment. While this action is pending, C proposes to settle her suit against A for $300,000.00; should the case go to trial, a jury verdict might exceed $10,000,000.00. C's offer must be accepted or rejected promptly, before the coverage dispute can be adjudicated. By local law, a liability insurer that fails to accept a reasonable settlement offer within its policy limits assumes an obligation to indemnify its insured without regard to those limits. B advises A that it will fund the proposed settlement, reserving its right to seek restitution from A if C's claims are eventually determined to be outside the policy coverage. As a first alternative, B tenders to A the defense of the C lawsuit; as a second alternative, B offers to continue the defense of the suit if A will direct it to decline the proposed settlement. A repudiates any obligation to reimburse B if C's claims are not covered; objects to the proposed settlement; refuses the tendered defense; and advises B that he will pursue a claim for "bad faith" if the settlement is declined and A is subsequently held liable to C. B pays $300,000.00 to settle the underlying action, then brings suit to obtain reimbursement from A. The court finds that the settlement of C's claim was reasonable; that B has acted in good faith and in the interests of A; and that A's liability to C is outside the coverage of the B policy. *B is entitled to recover $300,000.00 from A by the rule of this Section. If B were denied the opportunity to participate in the settlement under a unilateral reservation of rights (at least where prior adjudication of the coverage dispute is unavailable), the insurance contract would in effect be reformed to provide insurance for which A has not bargained or paid*.

RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 35 cmt. c, illus. 11 (Tentative Draft No. 3 2005) (emphasis added).

The above example, taken directly from the Restatement, demonstrates why the *Frank's Casing* right of reimbursement must be recognized. If the insurer is not afforded a right of reimbursement, the contract of insurance will effectively be reformed to provide coverage which the insured has neither bargained for nor paid a premium. "Because it offers

recourse to a party who might otherwise be effectively compelled to render an extracontractual performance [i.e., pay non-covered claims], [the right of reimbursement] serves both to reinforce the parties' agreement and to prevent the unjust enrichment that would otherwise result." *Id*. As aptly stated by Justice Wainwright: "A deal is a deal, and in Texas we enforce deals." *Excess Underwriters at Lloyd's London v. Frank's Casing and Rental Tools, Inc.*, 48 Tex. Sup. Ct. J. at 750 (May 27, 2005) (Wainwright, J., concurring). The deal struck by the parties in the present case did not require Excess Lloyds to pay claims not covered by the terms of its insurance contract.

The commentary to Section 35 gives further insight as to why the principles of unjust enrichment and restitution support a carrier's right to reimbursement of monies paid to settle non-covered claims. While critics of this Court's original opinion suggest the holding is unjust and promotes inefficiency, the commentary to Section 35 demonstrates the opposite. The right of restitution "*promotes* justice and efficiency." *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 35 cmt. a (Tentative Draft No. 3 2005) (emphasis added). As the commentary correctly states: "The mechanism of contingent or provisional performance (that is, performance subject to an eventual claim in restitution) will serve in many cases to reduce the overall cost of resolving the parties' dispute." *Id*. The following passage sums it up best:

> Disputes over contractual requirements commonly arise in the midst of the undertaking, rather than at its outset or conclusion. The cost of interruption is then at its highest; the risk of consequential harms (which must ultimately be borne by one party or the other) leverages the stakes beyond the amount

> initially in dispute. *If the party on whom a questionable demand is made can protect its position only by refusing performance, the costs of resolution are magnified accordingly. Performance with reservation of rights can reduce these costs by deferring dispute resolution to a point at which the risk of consequential harm is lower.*

RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 35 cmt. a (Tentative Draft No. 3 2005).

The reimbursement right recognized by this Court in *Frank's Casing* enables an insurer to settle a liability suit at an early stage, thus protecting the insured and reducing the overall cost of resolving the parties' dispute. It also reduces the risk of "consequential harm," along with the costs associated with collateral litigation which the insurer is ultimately forced to file if it has no right of reimbursement. An insurer without a *Frank's Casing* reimbursement right must either pay what it does not owe, deny the claim entirely, or institute a declaratory judgment action, thereby increasing the costs for all concerned. "The party who owes ought to be the party who pays" approach of *Frank's Casing* simplifies rather than complicates the dispute resolution and litigation process. Instead of three suits, including the underlying tort suit, a declaratory action, and perhaps an ultimate *Stowers* action, the parties are forced to address the realities of who ultimately owes the claim at an early stage. Insureds who owe claims can do what they are supposed to do: pay them. Insurers who do not owe claims are not forced, through legal mechanics and gamesmanship, into untenable and litigation-provoking positions.

In short, the Court was right, Justice Wainwright was right, and the original opinion in *Frank's Casing* is right.

## IV. The additional arguments made by amici for Frank's Casing do not support a withdrawal of this Court's original opinion.

The amici for Frank's Casing, including United Policyholders, make several other statements in their briefs relating to the "purpose of insurance" and the "nature" of insurance contracts. Upon examination, none of them warrant withdrawal of this Court's opinion.

- "For the policyholder to derive the benefit of the insurance bargain, the insurance company must protect the policyholder's interests above its own." *United Policyholders's Brief*, p. 5.

Insurance contracts are not designed to provoke lawsuits. Insurers and insureds commonly have shared interests. Rather than an "us vs. them" mentality, "we" is a common theme in successful insurance relationships, and in life. This is particularly true in the context of third-party liability insurance. *See* Lee R. Russ, COUCH ON INSURANCE § 198:3 (December 2005) (noting that "the insurer and insured share a common interest more often and more widely in the third-party context."). When an insurer settles a claim, it not only reduces its insured's exposure, it also reduces the insurer's litigation and defense costs exposure. Settlement is good. This Court has encouraged settlement throughout the ages. The original opinion of this Court in *Frank's Casing* does just that.

Moreover, reimbursement is not at odds with "the insurance bargain." While it is true the insurer agrees *to defend* those suits that are *potentially* within the scope of coverage, it only agrees *to pay* those claims that are *actually* within the scope of coverage. That is the

"insurance bargain" that is struck. This Court's opinion in *Frank's Casing* recognizes the considerable difference between a duty to defend and a duty to pay. Amici for Frank's Casing do not.

- "It is the very nature of the insurance contract that payment is to be made automatically without the need for a lawsuit." *United Policyholders's Brief*, p. 5.

Insurance contracts are not ATM machines. They are not designed to pay cash "automatically," as suggested by amici for Frank's Casing. Rather, they are to be enforced the same as any other contract. *Forbau v. Aetna Life Ins. Co.*, 876 S.W.2d 132, 133 (Tex. 1994). A claim must be *covered* before an insurer has any obligation to pay it. Anything less would result in derogation of the duty which an insurer has to *all* of its policyholders to pay **only** *covered* claims.

The "ATM machine" argument advanced by opposing amici also flies in the face of reality. Ours is not a perfect world. Insurers and their insureds will not always agree on whether particular liability claims are covered. The best our judicial system can do is provide a system that minimizes the "consequential harm" that results where an insurer is forced to make the Hobson's choice the amici demand. In the end, a right of reimbursement is the only real choice that both minimizes consequential harm and comports with fundamental principles of equity.

- "The Court's ruling encourages insurance company delay." *United Policyholders' Brief*, p. 14.

The "us vs. them" mentality that permeates the briefing of opposing amici distorts both the insurer's obligations and its motivations. Nowhere is this clearer than in the contention that this Court has somehow encouraged insurer delay.

When an insurer defends while reserving its rights to ultimately contest coverage, *the insurer* pays for the defense. Litigation defense is costly. Insurers have no incentive to "delay" resolution. Moreover, the duty-to-defend issue can and is resolved solely by reference to the pleadings and the policy. *King v. Dallas Fire Ins. Co.*, 85 S.W.3d 185, 187 (Tex. 2002).

With regard to indemnity payments, it makes no sense for insurers to delay and drag out litigation while they continue to pay defense-related expense. What does it profit an insurer with a $20,000 minimum limits auto policy to delay and drag out for three years resolution of an auto accident case? Or a homeowner's insurance carrier that has a $50,000 liability policy?

Finally, there is no veracity to amici's assertion that "allowing an insurance company to wait to file a declaratory judgment action benefits the insurance company, but puts the policyholder in the uncertain and precarious position of *having to defend* the underlying claim without knowing whether coverage exists." *See United Policyholders' Brief*, p. 15. An insurer only has a *Frank's Casing* right of reimbursement *if* it defends the underlying suit under reservation of rights. In such a situation, it is the insurer, not the insured, who is

paying the freight in the underlying suit before the coverage issue is resolved. If an insurer knows it will have the ability to be reimbursed for monies paid to settle claims where coverage is questionable, it will be far more inclined to settle rather than incur the expense of defending an underlying suit and thereafter litigate a coverage action. Without the right of reimbursement recognized by this Court, insurers will be disinclined to settle underlying liability suits, for fear they will either be paying non-covered claims or settling lawsuits on which they will never be able to recoup what is rightly owed by another.

## V. "It's alright as long as someone else's ox is being gored" is neither the law nor the policy of this State.

There is a subliminal theme in the briefs of those who urge this Court to discard its well-reasoned original opinion. The theme, not foreign to disputes of this nature, is that it is alright to deny a fundamental, basic, and equitable right of reimbursement as long as an insurance company is on the losing end. As Justice Nathan Hecht has eloquently stated, although we state that insurance policies are to be interpreted and enforced as any other contract, too often a different rule seems to be applied when an insurance company is involved. *Utica Nat'l Ins. Co. v. American Indem. Co.*, 141 S.W.3d 198, 206 (Hecht, J., dissenting, joined by Owen, J). Respectfully, when one litigant is treated differently than another, there is no rule of law. Michael Jackson and the Reverend Billy Graham step into the courtroom on equal footing in our system of justice, or there is no real justice.

Amici, whose ranks include multi-billion dollar international companies, suggest to the Court it is acceptable for an insurance company to pay and never get reimbursed on a

claim it did not owe, but that they should not be required to pay on claims they, not insurers, ultimately do owe. History and equity have always recognized the right of one to be reimbursed for that which he was ultimately not obligated to pay, but nonetheless paid under protest or duress. This Court's original opinion does no more and no less. For that reason alone, it should stand.

There is a further reason why goring only the insurance company's ox makes no sense in this or any other case, and that reason is practical and simple. Take a look at the style of this case. This is not about a small dollar auto policy or a required homeowner/fire insurance contract. It is a dispute between excess underwriters and a business corporation. The vast majority of cases of this nature involve commercial business insurance contracts, like the one at issue. Most insurers have neither the intention nor the desire to involve those who purchase simple insurance policies in coverage dispute litigation. But insurers should have the right, as this Court held, to seek reimbursement from insureds in this and any other cases, where substantial amounts are paid that are not owed, and paid under at least the implied threat of extra-contractual damage claims.

Finally, who should pay uncovered claims? Those who pay premiums for insurance contracts, or those who owe the claims in the first place? Consider the argument of the amici and Frank's Casing. Distilled to its essence, it is that if through the ongoing cost of litigation and cajoling, as well as extra-contractual damage exposure, one can force an insurer to pay an uncovered claim in order to settle a case, this Court should not let the insurer recover what it paid from the person who was rightfully responsible in the first place. The law is not and

should not be a series of trap doors, waiting to send those who misstep into oblivion. What it should do, and what this amicus respectfully asks this Court to do, is afford the same treatment and relief to Excess Underwriters as it does to Frank's Casing. If the tables were turned, and Frank's Casing was attempting to recover money it had paid and that Excess Underwriters actually owed, would anyone seriously argue the insurer should not be obligated to pay?

## CONCLUSION

What is most splendid about this Court's original opinion is its proper disregard for who the parties are and its devotion to legal and equitable principles. And that is as it should be.

Should a person who pays a debt that he ultimately did not owe be permitted to recover that debt from the person who was actually responsible for it? In the end, the question before the Court is that simple.

This Court's original holding should be sustained, not only to end to the gamesmanship that so frequently accompanies litigation in this arena, but to reinforce one of the most fundamental legal principles that governs our system of dispute resolution: he who owes should ultimately pay.

Respectfully submitted,

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## CERTIFICATE OF SERVICE

I hereby certify that a copy of the ***Brief of Amicus Curiae Property Casualty Insurers Association of America*** was served on counsel of record by United States certified mail, return receipt requested, on the 3rd day of February, 2006, addressed as follows:

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