Sorting Out the Rules & Responsibilities Of Primary and Excess Carriers in the Defense of "Bet the Company" Litigation

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I. Defense

A. Primary Has The Duty to Defend

The primary carrier has the duty to defend. Thus, unless the excess carrier agrees to accept tender of the primary limits or decides to associate in the defense, all costs of the defense are carrier by the primary carriers. Many of the solutions to problems with the quality of the defense provided by the primary carrier are solved with practical and sometimes unorthodox solutions.

1. Independent counsel?

In situations where the insured is allowed or required to select independent counsel, the excess carrier may have the same concerns regarding the quality of the defense. But again, so long as the defense is being provided under the primary policy, there is little the excess carrier can do that will not result in it spending money on the costs of defense and counsel.

2. Multiple primaries

a. Who picks the lawyer?

In cases where there are multiple primary policies sharing the costs of defense, there may be a conflict over who picks the lawyer to defend the case. Sometimes, both carriers will try to select co-counsel, which is simply a train-wreck.

b. *Keene* approach to tagging the line by the carrier

In jurisdictions allowing the insured to select the line or tower of coverage where multiple policies are available, the insured can pick a carrier who has a more preferable approach to who is defending. It is then left to the carriers to work out who will pay for what and how costs are allocated.

3. Fee sharing and defense agreements among carriers

In toxic tort cases, the carriers will often enter into sharing or allocation agreements. This does not change the right of the excess carrier to have the costs of defense covered by the primary carriers. Often, the excess carriers are at least consulted on questions such as whether a national coordinating counsel should be selected.

4. Problems

a. Inadequate defense

The inadequacy of the defense can take many forms. First and foremost is whether the defense counsel has experience in cases of similar complexity and exposure. Is this someone who has been involved with a "bet the company" case before? Also, importantly, does defense counsel have adequate appellate support? These types of cases typically involve several key legal issues that will be the subject of an appeal. Involvement of appellate counsel in briefing and litigation support pre-trial and at trial can make all of the difference. In Texas, for example, much of the mining for appellate error comes in the jury charge phase. Appellate counsel should be involved throughout the trial phase to assure preservation and also continuity in terms of the presentation of motions for directed verdict and post-verdict motions.

(1) Quality of defense counsel

Experience and reputation of defense counsel are critical. Also, is the defense counsel someone who has the time to devote to the project or is it going to be delegated to other partners and associates? Is there a fall-off from the lead lawyer in terms of approach, experience and ability.

(2) Captive counsel

As incomprehensible as it sounds, there are cases where the primary carrier seeks to defend with a captive counsel from its own staff. This should create a conflict of interest in that, at least in Texas, captive counsel cannot be used where there is a conflict of interest. Coverage issues obviously can raise a conflict, especially if the coverage issue overlaps with liability issues or facts. Moreover, bet the company cases always involve risk of a verdict in excess of policy limits. Often, internal company policy will be to have outside counsel involved if there are potential duty to settle within limits issues likely to arise.

In *Unauthorized Practice Of Law Committee v. American Home Assurance Company, Inc.*, 261 S.W.3d 24, 42-43 (Tex. 2008), the court held that the use of captive counsel in the face of a conflict of interest would amount to the unauthorized corporate practice of law by the insurer. The court explained:

If an insurer's interest conflicts with an insured's, or the insurer acquires confidential information that it cannot be permitted to use against the insured, or an insurer attempts to compromise a staff attorney's independent, professional judgment, or in some other way the insurer's and insured's interests do not have the congruence they have in the many cases in which they are united in simple opposition to the claim, then the insurer cannot use a staff attorney to defend the claim without engaging in the practice of law.

Id. The court refused to adopt a rule presuming a disqualifying conflict in every instance where a demand within limits was made, noting that whether captive counsel was sufficiently loyal to the insured would have to depend on more than just the offer itself. The court explained:

> An insurer has a so-called *Stowers* duty to accept a claimant's reasonable offer to settle within policy limits or stand to an excess judgment. The Committee argues that sometimes staff attorneys are restricted by their employer in whether they may apprise an insured of the insurer's *Stowers* obligation and are sometimes required to obtain management approval before making or responding to settlement offers that implicate that duty. The Committee argues that a staff attorney cannot be expected to dis-regard the insurer's policies on such matters, even when it would be in the insured's best interest to do so, because of fear of reprisal in employment . . . As we have noted, defense counsel, whether private or on staff, owes the insured unqualified loyalty. It is possible that counsel will fail to render that loyalty, but we cannot presume that a staff attorney is more likely to do so, especially absent any evidence of a complaint ever having been made.

Id. at 41. Simply put, for the policyholder concerned about captive defense counsel, loyalty needs to be judged and documented early. Also, it would be helpful to ask and know about any internal insurance company policies governing captive counsel in *Stowers* situations. All of this can be used to negotiate a change in counsel, either in cooperation with the excess carrier or not.

B. Does the Primary Have A Duty To Give Notice To The Excess Carrier?

1. Varied Answers

This is a question that greatly depends on the jurisdiction. The primary carrier is not a party to and is not itself bound by the excess policy, but it is the agent of the insured in handling the defense and litigation. The duties regarding notice are clearly placed on the insured. But, the nature of the defense obligation could alter that answer, depending on the jurisdiction. Inter-company practices and guidelines have sometimes been referenced as a source of an obligation to give notice. Finally, the recognition of a duty of good faith on the part of the primary carrier could be used as a basis for imposing such a duty.

In *G.A. Stowers Furniture Co. v. American Indemnity Co.*, 15 S.W.2d 544, 547 (Tex. Comm'n App. 1929, holding approved), the court noted:

> As shown by the above-quoted provisions of the policy, the indemnity company had the right to take complete and exclusive control of the suit against the assured, and the assured was absolutely prohibited from making any settlement, except at his own expense, or to interfere in any negotiations for settlement or legal proceeding without the consent of the company; the company reserved the right to settle any such claim or suit brought against the assured. Certainly, where an insurance company makes such a contract; it, by the very terms of the contract, assumed the responsibility to act as the exclusive and absolute agent of the assured in all matters pertaining to the questions in litigation, and, as such agent, it ought to be held to that degree of care and diligence which an ordinarily prudent person would exercise in the management of his own business . . . .

Id. The court added that the primary carrier acts as "the sole and exclusive agent of the assured, in full and complete control. Such exclusive authority to act . . . does not necessarily carry with it the right to act arbitrarily." *Id.*

Most excess policies trigger notice on the point when the underlying claim is determined to potentially involve the excess layer of coverage. Some have automatic triggers, especially professional liability policies, regarding specific types of claims triggering a duty to notify. Who knows best if the underlying case may involve the excess layer? Clearly, the primary carrier who is controlling the defense of the case knows best as to whether the excess carrier may need to be involved. Unfortunately, any such duty rubs against the primary carrier's desire in some cases to hold a hard line on settlement below its limits. If it involves the excess carrier itself, then such action would seem to admit the case could go in a bad direction and result in a judgment in excess of the primary limits.

In 1974, the Claim Executive Council of the American Insurance Association, the American Mutual Insurance Alliance and some unaffiliated insurers recommended to their member companies some guiding principles concerning the settlement and trial decisions in which both a primary and an excess insurer are potentially involved. One of the recommendations was as follows:

> 5. If at any time, it should reasonably appear that the insured may be exposed beyond the primary limit, the primary insurer *shall give*

prompt written notice to the excess insurer, when known, stating the results of investigation and negotiation, and giving any other information deemed relevant to a determination of the exposure, and inviting the excess insurer to participate in a common effort to dispose of the claim.

6. Where the assessment of damages, considered alone, would reasonably support payment of a demand within the primary policy limit but the primary insurer is unwilling to pay the demand because of its opinion that liability either does not exist or is questionable and the primary insurer recognizes the possibility of a verdict in excess of its policy limit, it shall *give notice of its position to the excess insurer* when known. It shall make available its file to the excess insurer for examination, if requested.

Guiding Principles at para. 5-6 (emphasis added).

The Guiding Principles were utilized by the court in *American Centennial Ins. Co. v. Warner-Lambert Co.,* 293 N.J. Super. 567, 576, 681 A.2d 1241, 1246 (Ch. Div. 1995). Both the primary and excess carrier had been signatories to the "The Guiding Principles for Primary and Excess Insurance Companies." The court noted that these Guidelines specifically states that the primary must inform the excess of a claim in certain circumstances. The *Warner-Lambert* court used these principles in developing an *industry standard* of sorts for when a primary insurer must notify the excess carrier of a claim. In short, the court found that if the excess may also be responsible for coverage, then the primary carrier has a duty to notify the excess carrier. *But see Lemuel v. Admiral Ins. Co.*, 414 F. Supp. 2d 1037, 1057 (M.D. Ala. 2006), *aff'd sub nom. Lemuel v. Lifestar Response of Alabama, Inc.*, No. 06-11155, 2007 WL 57097 (11th Cir. Jan. 9, 2007)(refusing to extend the burden of notice to the primary carrier as a matter of equity and fairness).

In *Monarch Cortland v. Columbia Casualty Company*, 626 N.Y.S.2d 426 (1995), the court held that an insurer who did not sign on to the Guiding Principles was not bound by them. But, the court recognized the principles were an indication of industry practice and that they might in effect apply even if the two carriers involved were not signatories. *See also American Centennial Ins. Co. v. Warner-Lambert Co.*, 681 A.2d 1241 (N.J. Ch. 1995)(using the Guiding Principles to create a direct duty to settle on the part of the primary carrier).

One commentator notes:

> Stemming from the implied duty of good faith, numerous jurisdictions have accepted the fact that the primary insurer has the duty to notify the excess insurer of potential excess exposure. However, it may be the case that the failure to provide notice must be found to be in "bad faith" to be actionable. Monarch. In other jurisdictions, the excess insurer may be required to show prejudice to bring suit for failure to notify.

Minkoff, D. & Tulli, L., "Duties Owed to the Excess Insurer by the Insured and the Primary Insurer, and Theories of Recovery Upon Breach of Those Duties," https://webcache.googleusercontent.com/search?q=cache:IPSMNvy6WsUJ:https://www.cozen.com/news-resources/publications/2007/duties-owed-to-the-excess-insurer-by-the-insured-and-the-primary-insurer,-and-theories-of-recovery-upon-breach-of-those-duties-aba-insurance-coverage-litigation-committee-seminar+&cd=3&hl=en&ct=clnk&gl=us.

C. Excess carrier protections from the primary or lower tiered excess defending and controlling the defense?

1. Introduction:

The excess carrier is empowered by most policies to either associate in the defense or take over the defense of the case. The costs of such action must, however, be carrier by the excess carrier. That does not mean that compromises cannot be made with the primary or lowered tiered carrier defending the case. The excess carrier is also protected in most jurisdictions with either a direct duty regarding settlement owed by the primary carrier to the excess carrier or an equitable subrogation claim against the primary or lowered tiered defending carrier/s.

2. Issues and considerations related to monitoring counsel

- What is the difference between monitoring counsel and counsel retained to participate/associate in the defense?
- Is there a difference in monitoring counsel and coverage counsel? Do some monitoring counsel avoid coverage issues?
- Who does the monitoring counsel represent—is it always the excess carrier?
- If the monitoring counsel represents the excess carrier, and coverage issues have been reserved, does the insured and/or its

defense counsel waive the privilege to any information provided to the monitoring counsel?

- Does that answer change if the monitoring counsel does not become involved in coverage issues?

- If the privilege is not waived by the insured providing the reports/communications to the monitoring counsel because the monitoring counsel and the defense have a common interest, is the privilege waived if the monitoring counsel provides the reports/communications to the carrier if that carrier has reserved rights?

3. Considerations Regarding Counsel Retained by the Excess Carrier to Associate/Participate in the Defense

- Does this necessarily involve appearing as counsel of record for the insured?

- Does the excess carrier waive coverage defense if it does not issue an reservation of rights when it retains counsel to participate in the defense in some fashion?

- If the defense counsel retained by the excess carrier appears as counsel of record, who has the right to control the defense--primary carrier or excess?

- What happens if the counsel participating in the defense and counsel retained by the primary carrier disagree on trial strategy?

- What happens if the participating defense counsel and the excess carrier recommend certain experts be retained or other costs be incurred, but the primary carrier and the counsel it retained say that expense is not necessary?

- What can the primary carrier share with the defense counsel retained by the excess carrier without waiving the privilege?

- What can the defense counsel retained by the excess carrier share with the excess carrier without waiving the privilege?

- What are the implications of disagreements in settlement value and settlement strategy?

- Does an excess carrier ever have a duty to retain high-powered defense counsel to participate in the defense?

D. The flow of information to the excess carrier

1. Assuming notice has been given, who has a duty to keep the excess insurer informed of developments in the defense of the case?

The policyholder practically must take the lead in making sure the excess carrier has the information it needs to handle the case. The policyholder must work with the primary carrier and defense counsel to get critical pleadings, motions, depositions, written and documentary discovery and case evaluations into the hands of the excess carrier. Reminders to defense counsel of the need to serve the true client, the policyholder, usually provides sufficient information to get cooperation.

E. Issue of privilege in communications with the excess carrier

1. Not defending per se.

The extent of the privilege varies by jurisdiction. It is not certain in many jurisdictions. If an excess carrier is not defending, then in some states this can lead to arguments that the attorney-client privilege does not apply. Work product should certainly apply regardless.

2. Special considerations in additional insured conflicts

Additional conflict of interest and thus privilege issues can arise where there is additional insured coverage involved. This stems primarily from the fact many companies collapse responsibility for the named insured and the additional insured into the same adjuster.

3. Solutions?

Consideration should be given to joint defense agreements with all concerned with a multi-carrier claim. In order to assure protection, we often urge carriers to accept a "defense" role in order to improve potential protection from controlling caselaw.

F. Appeals with multiple insurance layers

Bonding in multi-insurer cases can become difficult and contentious. In many jurisdictions, the amount required to be bonded is capped. In Texas, the cap is $25 million. If there is a tower of insurance at least exceeding this amount even if slightly, then the carriers will likely try to allocate among themselves the costs of the bond and any collateralization considerations.

Where there are coverage disputes, commitment to pay the full judgment where some or all of that judgment may not be covered is going to likely be contested. It is tantamount to a waiver of the coverage defense. If the appeal is unsuccessful and the insured insolvent, the carrier could be left paying a partially uncovered claim

II. Claims Handling and Coverage Issues For The Excess Carrier

A. Does the excess carrier have to reserve its rights?

Many jurisdictions impose no common law duty unless an insurer is defending. Statutory requirements of fair claims acts regarding the reservation of rights are not limited to defense and thus may impose an earlier obligation to reserve rights.

For example, in Texas an attempt was made to require a reservation of rights on the part of an excess carrier in *Arkwright-Boston Manufacturers Mutual Ins. Co. v. Aries Marine Corp.*, 932 F.2d 442, 447 (5th Cir. 1991). The duty to reserve at common law was based on the carrier defending, having a conflict and thus an incentive to steer the case. In *Arkwright,* the policyholder sought to impose the "defense exception" for imposing estoppel in the absence of a reservation to an excess carrier. The district court agreed, noting that the excess carrier orchestrated settlement and was in effect defending, without technically providing the legal defense. *Id*. at 1450. The court emphasized that in the case before it the insurer made no attempt to inform the insured of the coverage issues or the insured's intent to settle the underlying claim and then seek reimbursement from the insured.

The Fifth Circuit Court of Appeals reversed the decision of the district court, holding that there was no authority for the proposition that "an insurer's participation in settlement negotiations, where the insured has retained independent counsel, is tantamount to assuming the assured's defense." *Id*. at 445-46. The court held that there was not an assumption of the "defense" sufficient to bring the defense exception into play where the insurer was not actually defending the suit and the insured was fully aware of the settlement negotiations and failed to object in any way to the participation of the excess carrier in question. *Id*. (citing 16C J. Appleman, *Insurance Law & Practice*, § 9365 p.

559 (1981).

B. Does the use or hiring of monitoring or partially participating counsel alter the obligation?

Certainly, the more an attorney is involved in the defense, monitoring or otherwise, the more like a reservation is required.

C. If the case if actually going to be tried, can the insured, as a predicate, force or convince the excess carrier to reserve?

The insured needs to know what the excess coverage position is in planning for what will happen if the case is tried and a judgment entered. Coverage positions can change whether a policyholder wants to settle or go forward with trial. If the insured is led to believe there is no coverage defense being asserted, then the raising of such a coverage defense at or after trial can prejudice the insured. This then brings the case within statutory requirements to reserve within a reasonable time. If the insured is damaged by the failure to reserve, the damages are recoverable in Texas under the Insurance Code.

D. Should the excess carrier be added to any declaratory actions involving the primary carrier?

Because many forms of excess policy are following form, the excess carrier certainly has an interest in the litigation sufficient that it can be added. It is, however, another group of lawyers for the policyholder to fight. Since the primary has an interest in defending shared coverage defenses, then one would reasonably conclude the excess carrier would be bound by the decision in a case brought by or against the primary carrier.

III. Settlement

A. Duty of the Excess Carrier

In *G.A. Stowers Furniture Co. v. American Indemnity Co.*, 15 S.W.2d 544, 547 (Tex. Comm'n App. 1929, holding approved), the court predicated the duty to settle on the "control" given to and exercised by the carrier under the policy terms:

> The provisions of the policy giving the indemnity company ***absolute and complete control of the litigation***, as a matter of law, carried with it a corresponding duty and obligation, on the part of the indemnity company, to exercise that degree of care that a person of ordinary care and prudence

> would exercise under the same or similar circumstances, and a failure to exercise such care and prudence would be negligence on the part of the indemnity company.

Id.; *see also Rocor Int'l v. Nat'l Union Fire Ins. Co. of Pittburgh, PA,* 77 S.W.3d 253, 263 (Tex. 2002) (noting the *Stowers* decision is based in part "upon the insurer's control over settlement"). Stated another way, an insurer whose policy does not permit its insured to settle claims without its consent owes to its insured a common law "tort duty." *Ford v. Cimarron Ins. Co., Inc.,* 230 F.3d 828, 831 (5th Cir. 2000)(citing *G.A. Stowers Furniture Co. v. Am. Indem. Co.,* 15 S.W.2d 544 (Tex. Comm'n App. 1929, holding approved)).

Apparently, according to some authorities, the excess carrier must also have taken over the defense of the case in order to have a duty to settle. *See Keck, Mahin & Cate v. Nat'l Union Fire Ins. Co.,* 20 S.W.3d 692, 701-02 (Tex. 2000). Thus, the failure of the excess carrier in *Keck* to respond to the initial settlement demand of $3.6 million could not be used as contributory negligence in the excess carriers direct action against the primary carrier where the offer came prior to tender of the primary limits and prior to takeover of the defense. *Id.*

The *Keck* court held that even if the excess carrier was negligent in failing to "explore coverage issues more diligently, reserved its rights . . . investigated the merits of the third-party claim more thoroughly, hired independent counsel to monitor the third-party claim, supervised its claim adjuster more closely, and demanded to settle the claim months before trial," it was not actionable because it was based on conduct prior to the tender of the primary limits and because in this pre-tender situation the *excess carrier has no duty to defend or indemnify*. *Id.* The court added that pre-tender, the excess carrier had no duty to monitor the defense or to anticipate that the defense was being mishandled by the primary carrier and the defense counsel selected by the insured, noting the general tort rule that a party has no duty to anticipate the negligence of another. *Id.*

In some other jurisdictions, the courts have recognized that an excess carrier has a duty to settle once the primary limits or any self-insured retention have been tendered, regardless of whether the excess carrier is defending or not. ALLAN D. WINDT, INSURANCE CLAIMS & DISPUTES: REPRESENTATION OF INSURANCE COMPANIES & INSUREDS, sec. 5:26 (Database updated March 2011). In Texas, however, at least some courts have recognized that the tort duty to settle under *Stowers* does not apply unless the excess carrier is defending. *Emscor Mfg., Inc. v. Alliance Ins. Group,* 879 S.W.2d 894, 909 (Tex. App.—Houston [14th Dist.] 1994, writ denied)(holding that excess insurer can never have a duty to settle). The court in *Emscor* observed: "[W]e note that ***the Stowers doctrine . . . has never***

been applied to an excess carrier . . . ." *Id.* at 901(emphasis added). The *Emscor* court added: "There is simply no authority in this State establishing a cause of action by an insured against its **excess** insurer for negligence, bad faith, or for unfair and deceptive practices in the handling of a claim brought by a third-party." *Id.* at 909; *accord West Oaks Hosp., Inc. v. Jones,* No. 01-98-00879-CV, 2001 WL 83528, at *10. The court reasoned:

> The *Stowers* doctrine has been applied in Texas in only two circumstances—to the insured's right to sue a primary carrier for wrongful refusal to settle a claim within policy limits, *see G.A. Stowers Furniture Co. v. American Indem., Co.,* 15 S.W.2d 544, 547–48 (Tex.Comm'n App.1929, holding approved), and to an excess carrier's right to sue a primary carrier, under the theory of equitable subrogation, to protect the excess carrier from damages for a primary carrier's wrongful handling of a claim, *see American Centennial Ins. Co. v. Canal Ins. Co.,* 843 S.W.2d 480, 483 (Tex.1992). Neither of those circumstances are present in the instant case.
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> . . . .
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> Under *Stowers,* the insurer's duty to the insured, extends to the full range of the agency relationship as expressed in the policy**.** *See Ranger County Mut. Ins. Co. v. Guin,* 723 S.W.2d 656, 659 (Tex.1987). [emphasis added]. That duty may include investigation, preparation for defense of the lawsuit, trial of the case, and reasonable attempts to settle. *See American Physicians Ins. Exchange v. Garcia,* 876 S.W.2d 842, 849 (Tex.1994) (opinion on motion for rehearing). Here, ***Alliance had no duty to investigate, negotiate or defend Emscor*** under the terms of the excess policy or at law, and ***never undertook those responsibilities on its own.*** *See Emscor,* 804 S.W.2d at 197–99. Therefore, Alliance had no duty under *Stowers* and Emscor has failed to state a *Stowers* cause of action.

879 S.W.2d at 909 (emphasis added).

One commentator has noted:

> Commentators agree that the Texas courts have not yet found an excess carrier subject to the duty outlined in *Stowers.* Nevertheless, most agree that it is likely the court will eventually adopt some version of that duty where the primary carrier has tendered the underlying limits. Note that the above cases indicate that the excess carrier may also need to be *defending the*

case in order for a *Stowers* duty to apply, but the Supreme Court decision in *Keck* appears to treat the defense as a separate duty or concept:

> An insurer's duty to settle is independent of its duty to defend. 14 COUCH ON INSURANCE 3 rd §§ 203:12-203:13; 1 WINDT, *supra* § 5.26, at 350. An excess insurer owes its insured a duty to accept reasonable settlements, but that duty is also not typically invoked until the primary insurer has tendered its policy limits. 1 WINDT, *supra* § 5.26; *Cf. Employers Nat'l Ins. Co. v. General Accident Ins. Co.,* 857 F.Supp. 549, 554-55 (S.D.Tex.1994)(when excess liability is likely, an excess insurer may interject itself into settlement negotiations before tender by the primary insurer).

Keck, 20 S.W.3d at 701. Nevertheless, the Court also observed that the excess carrier in that case "did not assume control of the defense before INA tendered its limits and had no duty to evaluate the $3.6 million settlement demand until after that tender." *Id.* at 701. The Court additionally observed: "National had no duty to act until INA tendered its limits and surrendered the defense to National. *See* 1 WINDT, *supra* § 2.01, at 31." *Id.* at 702.

As one commentator notes: "Still, it seems counter-intuitive that an insured has no recourse against an excess carrier that refused to respond to a demand that exceeded the primary limits but could have been settled within the excess carriers limits, but was not and verdict is eventually entered that exceeds the combined limits of both the primary and excess policies. There should be some balance in the process." R. Brent Cooper, "*Triggering Stowers Under Multiple Policies,*" 5th Annual Insurance Law Symposium, p. 6 (2010). Justice Hecht noted the uncertainty of Texas law in this area in a concurring opinion in *Keck:*

> I am not persuaded that an excess insurer never has a duty to defend or settle a claim against its insured before primary coverage is exhausted. An excess carrier that has the right to intervene in the defense may be obligated to do so to protect itself and its insured when it is clear that the liability claim will exceed primary coverage.

> *Keck, supra,* at 705. Thus, the outline of exactly how the *Stowers* duty would apply is uncertain. Most believe that it will eventually be found to apply to excess carriers in some form. Undoubtedly a tender by the primary would be required, and possibly the additional fact that the excess carrier has a duty to defend and/or is defending.

O'Quinn, M., *Stowers,* MEALY'S INSURANCE LITIGATION REPORTER, at 1-2.

B. Phased or Bifurcated Offers to Multiple Carriers

With a primary ($1m) and two excess carriers ($5m each), you have a problem making an effective unconditional demand within policy limits. A bulk offer to settle for $1.1 is in excess of the primary limits. As to the first level primary, it is conditional as to tender of the primary limits and still exceeds the first level excess' limits. The second level excess can say the same, the demand is for more than their individuals limits and is conditional. But, a phased offer, required phased tendering of limits of the primary and then the first level excess has some chance of being effective. If the primary or first excess refuses, they can be clearly identified and targeted because they halted the opportunity to settle. As the second level excess, the target is clearly placed on them once the other two have tendered. The offer is then no longer conditional and requires only payment of the limits of the second level excess carrier. Working through the *Maldonado* decision, which involved bulk offer exceeding limits to the primary and the insured is instructive.

A conditional offer can become valid under *Stowers* if the condition is satisfied in time for the carrier to respond to the offer. Thus, a so-called bifurcated offer can become valid. Offers requiring a contribution by the insured and the carrier are problematic if simply combined. In other words, if you offer to settle for $1.2 million, with $200,000 from the insured and the limits from the carrier, the insured would have to tender before the offer would be unconditional as to the carrier. The offer to the carrier is conditioned on the insured tendering their portion. Timing it so that the carrier gets time to respond once the condition is satisfied is critical. Bifurcating the offer so that the condition comes first and then the carrier portion follows once the condition is satisfied, with a separate time for responding, avoids the difficulties experienced in published cases.

Again, one cannot make a bifurcated offer without making a conditional offer. For example, if the offer to the carrier is contingent on the insured kicking in some of its own money, then the offer is conditional. Can it never be a valid *Stowers* demand? Yes.

The Supreme Court certainly suggested in *Maldonado* that proof that the carrier was informed of the insured's willingness to satisfy the terms of the "condition" would

likely be sufficient to trigger the carrier's duty to settle. In that case, of course, the carrier did not receive sufficient notice.

One approach to this problem is to make the bifurcated offer in such a fashion that the insured is given a certain amount of time to consider whether it wishes to contribute as requested, and if the insured agrees, it then must notify the carrier, whose own duty will run a specified number of days from the date of the insured's notice to the carrier of its acceptance of the terms.

The goal is to make clear that there is in fact a conditional requirement, provide the mechanism for its satisfaction and then allow a reasonable time after the condition is satisfied for the carrier to accept. This is intended not fit the rule that even when an offer is conditional, it will be binding when the specified conditions have occurred. *Webster*, 906 S.W.2d at 77.

A similar approach can be taken with excess carriers. In other words, the offer needs to clearly state what is expected from the primary carrier and what is expected from the excess carrier. The mechanism for the satisfaction of the condition that the primary carrier tender limits should be part of the demand. Without a tender, the excess carrier has no duty to settle, generally. For example, the following offer could be made:

Plaintiff A and B agree to provide a complete release, including the release of any liens or other encumbrances, for the following consideration:

1. $1 million paid by Slippery Rock Ins. Co. (primary);

2. $5 million paid by Mondo Excess Ins. Co. (excess).

This offer will remain open to Slippery Rock for thirty days. If Slippery Rock agrees to the tender of the designated amount as part of a total settlement of $6 million, it will then provide notice to the insured and/or Mondo Ins. Co. The offer will then remain open to Mondo to accept this offer for the additional amount of $5 million for a term of 15 days.

The thought obviously is that while the offer is initially conditional, the satisfaction of the condition sets the stage for an unconditional offer. The communication and time enlargement provisions seek to solve problems such as those in *Maldonado*.

A similar difficulty exists where there is a self-insured retention or sizeable deductible. A bifurcated offer may be required in such settings, particularly where the coverage above is not invoked until there is a tender or exhaustion of the deductible/SIR.

C. Special problems with self-insurance and fronting policies

1. The Self-Insured Retention

a. What is it?

At its core, a self-insured retention ("SIR") is a mechanism that allows the insured to reduce the total premiums it pays in exchange for less overall coverage. In essence, the insured becomes a partner with its insurers, and retains a portion of its own risk instead of shifting the entirety to its carriers.

With large and sophisticated business, liability claims are not so much of a risk as they are a cost of doing business. *See* DOUGLAS R. RICHMOND, *Self-Insurance and the Decision to Settle*, 30 TORT & INS. L. J. 987 (1995). The larger the enterprise is, the more likely it will be to have accidents that result in costly claims. Thus, the insured can effectively gamble that the money it saves in premiums will be more than the losses it expects to absorb.

The self-insured retention can either be the functional equivalent of a primary layer of coverage, or it can be excess. Where, for example, the insured retains the first $1 million of losses, its insurers providing coverage above $1 million are excess to the SIR. Alternatively, it may be that the insured retains some intermediate portion of the coverage, say for example, a first-layer excess in between the primary and second-level excess layer.

Regardless of what form the SIR takes, knowing when it applies and what the terms of the SIR agreement require is a complex issue for courts, litigants and their attorneys today. Thus, this section of the paper will attempt to provide the reader with a guide to resolving some of these problems.

To facilitate the discussion, the following scenario will be utilized:

> The Insured has a liability policy with limits of $10 million. However, the first $2 million in losses are covered by the SIR. Therefore, the carrier actually provides coverage for losses ranging from $2,000,000.01 up to and including $10 million.
>
> Further still, the policy provides that the Insured has a duty to settle claims within the SIR when liability is reasonably

clear. Otherwise, it has a duty to tender the SIR when a given claim exceeds the $2 million SIR limit.

With this background, the issues surrounding the application of these coverage tools will be examined.

b. Dresser

In *International Ins. Co. v. Dresser Indus., Inc*., 841 S.W.2d 437 (Tex. App.--Dallas 1992, writ denied), the insured had a "fronting policy" as the primary layer of coverage, and it also retained the duty to defend. The court refused to engraft a contractual duty to protect the excess carrier by requiring reasonable attempts to settle within the SIR if possible. *Id.* at 442. Also, the court rejected arguments that there was any such common-law duty, and refused to allow such an action. *Id.* at 444-45.

Importantly, however, the clause only requires the insured to settle within the SIR where "liability is reasonably clear." This, of course, is a higher threshold than *Stowers* which only requires settlement when it is reasonable to do so, and it does not require liability to be reasonably clear.

c. What happens when . . .

Returning the above scenario, what happens when a given claim exceeds the SIR limit, but the policy requires the insured to settle a claim within the SIR where possible? Nothing. The "duty to settle" clause is not triggered because the claim cannot be settled within the SIR. Thus, the insured must still contribute the SIR to a settlement effected by the excess carrier so long as the settlement was reasonable under the circumstances.

Absent contrary policy language, the insurer usually controls the SIR in settlement. See W. T. BARKER, *Combining Insurance and Self- Insurance: Issues for Handling Claims*, 61 DEF. Counsel J. 352, 357 (July 1994). When a loss exceeds the SIR, the insured must contribute its SIR to the payment of settlement or judgments. This result is dictated by the terms of the coverage it purchased. *See, e.g. H.E. Butt Grocery Co. v. National Union Fire Ins. Co.*, 150 F.3d 526, 528, 535 (5th Cir. 1998); *see also Vesta Ins. Co. v. Amoco Prod. Co.*, 986 F.2d 981, 988 (5th Cir. 1993); *Arkwright-Boston Mfrs. Mut. Ins. Co. v. Aries Marine Corp*., 932 F.2d 443, 447 (5th Cir. 1991). This result obtains, even over the insured's objections, and most cases hold that the insurer's decision will be given considerable deference by the courts. *Id.* at 358.

There are several reasons that support giving the insurer control over the SIR and compelling payment so long as the settlement is a reasonable one. First, it is usually contractually required that the insured contribute its SIR when necessary. Policies contain language such as:

> We'll pay damages and defense costs of all covered claims or suits in excess of your self insured retentions up to the limits of coverage . . .; or
>
> The self insured retentions . . . fix the amount you'll be responsible for before the limits of coverage of this agreement will apply.

These clauses make clear that the SIR must be paid prior to the triggering of the excess layers.

Second, such a rule ceding control to the insurer promotes the public policy favoring settlement. *See, e.g. Dear v. Scottsdale Ins. Co.*, 947 S.W.2d 908 (Tex. App.--Dallas 1997, writ denied); *Brightwell v. Rabeck*, 430 S.W.2d 252 (Tex. Civ. App.--Fort Worth 1968, writ ref'd n.r.e.).

At least one California court has addressed a factually similar situation. In *Harbor Ins. Co. v. City of Ontario*, 231 Cal. App.3d 927, 282 Cal. Rptr. 701 (1991), the insured told the carrier that it had permission to settle the case, but also that it did not agree to the settlement for purposes of committing the SIR amount. *Id.* at 930-31. The court held that the insured's allowing the settlement to go forward *in any respect* amounted to *agreement as a matter of law*. *Id.* at 934-35. The court found that to allow the insured to reap the benefit of settlement going forward and then try to avoid paying the retention "would afford the insured the power unilaterally and arbitrarily to negate the SIR feature of the policy in those instances where the insurer wished to settle because the projected damages exposure penetrated the floor of the excess coverage." *Id.* at 935. This would be inconsistent with the reduced nature of the coverage purchased, including the related premiums for this reduced coverage. *Id.*

Thus, where a policy requires the insured to attempt settlement for claims falling within its SIR, it usually only does so where liability is "reasonably clear." But, when an insured purchases a policy with an SIR, it takes the risk that the entirety will be paid towards settlement. If a given claim reaches above the SIR limits, then the insured must contribute those limits toward the settlement. So long as the settlement is a reasonable one, the insured cannot otherwise complain about the excess carrier's decision to settle.

Therefore, for claims that exceed the SIR, the test is whether the settlement itself was reasonable, not whether liability was reasonably clear.

D. Responsibilities of Primary to Excess—finding and exploiting downward pressure on the primary

1. Various Theories

The courts in the various jurisdictions have adopted a number of approaches in dealing with the obligations regarding settlement owed by a primary carrier to an excess carrier. The theories can be summarized as follows:

(A) Direct duty. *Excess Liability: Rights and Duties of Commercial Risk Insureds and Insurers* § 6:5 (citing cases in California, Colorado, Illinois, Arizona, Louisiana, New York, North Carolina, and Wisconsin). Often based on a duty of good faith. *Camelot by the Bay Condominium Owners' Association, Inc. v. Scottsdale Ins. Co.,* 27 Cal.App.4th 33, 32 Cal. Rptr.2d 354 (1994); *Baen v. Framers Mutual Fire Ins. Co. of Salem County*, 723 A.2d 636, 639 (N.J. Super. Ct. App. Div. 1999). The primary is said to owe the excess carrier the same duty owed to the insured. *New England Ins. Co. v. Healthcare Underwriters Mut. Ins. Co.,* 352 F.3d 599 (2nd Cir. 2003); *accord American Centennial Ins. Co. v. Warner-Lambert Co.*, 681 A.2d 1241 (N.J. Ch. 1995)(involving primary allowing the insured to control the defense and negotiation of settlement)[1]; *Estate of Penn v. Amalgamated General Agencies,* 372 A.2d 1124, 1127 (N.J. Super. Ct. App. Div. 1977); *Hartford Accident & Indemnity Co. v. Michigan Mutual Ins. Co.*, 93 A.D.2d 337 (N.Y. App. Div. 1983), *aff'd*, 463 N.E.2d 608 (N.Y. 1984).

(B) Triangular reciprocity based on the duties shared among the primary, the insured and the excess carrier. *Transit Casualty v. Spink Corp.,* 156 Cal. Rptr. 360 (Ct. App. 1979).

(C) Equitable subrogation, allowing several different theories available directly to the insured to be used by the excess carrier.

(D) Assignment from the insured.

[1] This case is of particular interest to those excess carriers with a fronting policy below. Often with fronting policies. The insured is allowed to completely control the defense and settlement of the case at least within the fronting policy limits.

2. Equitable subrogation—

a. The Texas Experience—American Centennial v. Canal

In *American Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480, 483 (Tex.1992), the insured had a typical coverage scheme -- a primary layer with two levels of excess on top. In this case, Canal provided primary coverage up to $100,000; First State provided first-level excess coverage from $100,000 to $1 million; and American Centennial provided second-level excess coverage from $1 million to $4 million. *American Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480, 481 (Tex. 1992).

The insured, General Rent-a-Car, was sued in a wrongful-death action resulting from a blowout of an allegedly defective tire on one of its rental cars. *Id.* Canal investigated and defended the underlying lawsuit, retaining outside counsel to represent the insured. However, the defense was allegedly botched by insurance defense counsel, thus forcing the insurers to settle the case for $3.7 million. *Id.* In response, the two excess carriers sued the primary carrier and the defense lawyers, on a variety of theories.

The court framed the issue as "whether an excess insurance carrier has a cause of action against a primary carrier and trial counsel for mishandling a claim." *Id.* Initially, the court noted that *Stowers* allows an insured to sue a primary carrier for negligently failing to settle a claim within policy limits. Further, the court also noted that equitable subrogation was a vehicle by which the excess carrier could sue the primary on a *Stowers* claim. Also, the court recognized that equitable subrogation was valid under Texas law, but that it had never been raised in this context. *Id.* at 482.

The *American Centennial* court noted that many states allow an excess carrier to pursue a primary carrier for botching the defense of the underlying lawsuit and that a majority of these states do so through the vehicle of equitable subrogation. *Id.* at 482-83, nn. 2-3. The court noted that allowing such an action encourages fair and reasonable settlements of lawsuits. *Id.* at 482. Also, absent such a right, the primary would have less incentive to settle within the policy limits, and thereby cause an increase in the premiums of excess coverage. *Id.* at 483. Although the court did not expressly state as much, the concept of protecting the insured is furthered by the court's holding. By failing to treat the excess carrier as the insured, then the insured would be less able to purchase excess coverage at a discounted rate. Thus, the insured is an indirect beneficiary of the court's protection of excess carriers. Finally, the court noted that this would help to ensure a fair and equitable distribution of losses among primary and excess carriers.

In one of the more important points supporting equitable subrogation rights, the court noted that it did not want to relieve the primary carrier of its *Stowers* obligations simply because the insured contracted for excess coverage. *Id.*

Finally, the excess carriers urged the court to allow a direct action against the primary carrier, rather than through the derivative nature of a subrogation claim. The court noted that the advantage sought by such a rule would allow the excess carrier to ignore any policy defenses against the insured. Because the insurer must "stand in the insured's shoes," then any defense valid against the insured is also valid against the insurer seeking to recover on the insured's claim. The court noted that only a few jurisdictions allow such an action and that the case could be resolved without reaching the issue. Thus, the court refused to recognize a direct right at that time, but did leave the door open to reconsider the issue in a proper case. *Id.*

Damages in the equitable subrogation action by the excess carrier against the defense counsel and the primary carrier appear to clearly be based on a legal fiction. If there is excess coverage, and it pays, the insured is protected and suffers no harm. *American Centennial* clearly holds that public policy favoring protection of excess carriers and their low cost/high limits coverage and the need to make sure that offending primary carriers and defense lawyers do not escape punishment justifies this approach to damages. That being said, the assumption of damages is still based on a fiction. The Supreme Court has since indicated in other contexts that damages should be real and not fictional. *State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696 (Tex. 1996).

One ponders whether a direct action or duty rule would be more realistic and logically accurate. If the excess carrier could sue directly based on duties owed by the primary carrier to it, then the amount it pays is in fact a damage to it and not some fictional harm. The reality is that *American Centennial* reflects a blending of direct duty and equitable subrogation concepts. One need look no further than the rule that the excess carrier is subject to defenses applicable to both it and the insured in whose shoes it stands.

The opinion in *American Centennial* was a plurality opinion. In a concurring opinion joined by a majority of the court, Justice Hecht wrote that recovery in an equitable subrogation case did not include a right to recover by the excess carrier "in its own right or for statutory or punitive damages." *Id.* at 485. The concurring opinion states that the *Stowers* action would be the only one allowed and that the excess carrier would not be permitted to bring statutory or punitive damages claims. The opinion goes on to state that the majority opinion refers only to negligence/*Stowers* claims and thus must hold that these claims were the only ones available.

The Supreme Court next discussed whether the excess carrier could pursue a malpractice claim against the defense lawyers hired by the primary carrier. After initially noting that Texas recognizes the defense of privity to a legal malpractice claim, the court observed that none of these cases involved a subrogation action, rather than a direct assignment. *Id.* at 484.

The court noted that it did not want to needlessly interfere with the lawyer-client relationship, but that allowing a subrogation action in this instance would only allow the excess carrier to assert the insured's existing rights, rather than creating new ones. *Id.* at 485. As with primary carriers, the court did not want to relieve the defense lawyers of their duties to the insured simply because the insured has chosen to purchase excess coverage. Thus, it allowed a subrogation action against the defense lawyers.[2] *Id.*

b. Birmingham

Birmingham represents a classic inter-carrier dispute. After settling the underlying judgment, the excess insurer filed suit against the primary carrier, among others. *Birmingham Fire Ins. Co. v. American Nat'l Fire Ins. Co.*, 947 S.W.2d 592 (Tex. App.–Texarkana 1997, no writ).

Birmingham involved a claim by an excess carrier against a primary carrier. Initially, the court discussed whether the primary carrier had a duty to negotiate with the claimant(s), and held that under *Garcia*, a carrier has no duty to "negotiate in good faith the settlement of a case." *Id.* at 596-97. "'Negotiation' is the 'process of submission and consideration of offers until [an] acceptable offer is made and accepted.'" *Id.* at 597. The carrier likewise has no duty to even "solicit settlement offers from a third-party plaintiff." *Id.* (citing *Insurance Corp. of Am. v. Webster*, 906 S.W.2d 77, 79 (Tex. App.–Houston [1st Dist.] 1995, writ denied)).

The court also noted the fact that the "ultimate issue" according to *Garcia* is whether a reasonable demand to settle within limits was presented to the insurer. *Id.* at 598. Thus, the carrier has no duty whatsoever to negotiate or initiate settlement discussions. *Id.* at 598-99.

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[2] Importantly, the court noted that it was not deciding whether assignment of a legal malpractice claim was permissible, but rather that it was simply allowing the excess carrier to enforce the insured's action through equitable subrogation. *Id.* at 484 n.6.

Most important for the purposes of this paper is that the *Birmingham* court also held that a comparative negligence defense may be raised against an excess carrier who negligently provided damaging information to the claimant's counsel. *Id.* at 596. This seems to be a case that invokes *Canal's* warning that an insurer could be held liable for its own negligence under certain circumstances prior to the triggering of its duty to defend.

c. *Keck*—The Next Step

In *Keck, Mahin & Cate, Grant Cook v. National Union Fire Ins. Co. of Pittsburgh, P.A.*, 20 S.W.3d 692 (Tex. 2000), the court's holding sets forth a number of rulings critical to suits between carriers. The court also appears to have halted to some extent the contraction of other available tort theories, albeit without discussion of *Garcia, Guin, Traver, or Head.*

In *Keck,* the insured was sued for damages allegedly caused by improper processing and marketing of shrimp. *Id.* at 695. The insured retained the law firm of Keck, Mahin & Cate ("KMC") to defend it in the lawsuit. Subsequently, KMC tendered the defense to the insured's carriers, National Union and Insurance Company of North America ("INA"). INA was the primary insurer, with policy limits of $1 million. National Union provided excess coverage from $1 million to $10 million. *Id.*

During the underlying suit, the plaintiff's made a demand for $3.6 million, which was rejected by both carriers and the insured. *Id*. KMC advised that it believed the case could probably be settled for less than half this amount. During trial, however, the case settled for $7 million, with INA contributing its $1 million and National Union paying the remaining $6 million. *Id.*

Subsequently, National Union filed suit against INA and KMC for allegedly mishandling the defense of the suit, and it sought reimbursement of the $6 million it paid to settle the case. *Id.* National Union's claims were based on the equitable subrogation theory announced in *Canal*, *supra*. *Id.*

The appellate history of this case is worth brief mention. The 14th Court of Appeals decided the case in October, 1997. The Supreme Court initially denied review in June, 1998. However, on rehearing, the court granted review in July, 1999.

(1) An Evolving Doctrine

Keck is a significant case for a number of reasons. It represents the evolving nature of a newly created right of action. In *Keck*, the Supreme Court was faced with delineating

the contours of the rule from *Canal*. The court was faced with deciding what defenses are available, how they should be applied, and other issues to define the scope of the equitable subrogation doctrine in this context.

First and foremost, *Keck* presented an opportunity for the Supreme Court to reexamine its holdings in *Canal*. The court affirmed the validity of the subrogation rights it announced in *Canal* with little discussion. After reiterating *Canal's* basic holding, the court noted that Justice Hecht's concurring opinion, joined by a majority of the court, also stated that a defendant to an equitable subrogation claim was entitled to "any defense available against either the insured or the excess carrier, including the excess carrier's unreasonable refusal to cooperate in the defense and settlement of the action." *Id.* at 700 (quoting *Canal*, *supra*, at 486). Thus, like any subrogation claim, any defenses good against the subrogor are also good against the subrogee.

Secondly, after reaffirming *Canal,* the court went on to more fully elaborate on the true nature of the equitable subrogation action. The defendants raised a number of defenses against the excess carrier, including comparative fault and voluntary payment. Below is a detailed discussion of the court's treatment of each issue.

(2) Comparative Fault

KMC argued a number of points asserting that the excess carrier could not recover due to its own negligence. KMC argued that National Union was negligent respecting its duty to defend. Initially, the court noted that an excess carrier's duty to defend generally is not triggered until the primary carrier tenders its policy limits. *Id.* at 700-01. Thus, the court held that any alleged negligence of National Union for failing to participate in the defense prior to the tender of the primary policy limits was irrelevant to KMC's claims of comparative fault. *Id.* However, the court also noted that ***the excess carrier could not affirmatively disrupt or harm the insured's defense.*** KMC alleged that National Union failed to appear at a deposition in the underlying case. The court held that if KMC could prove that this harmed the insured's defense, then such evidence would be relevant to a comparative fault defense. *Id.* Thus, a mere failure to aid the insured's defense is not a viable defense to a subrogation claim, but ***affirmative*** conduct which actually hurts the insured's defense can be a valid defense to a subrogation claim.

Next, KMC argued that the $7 million settlement was excessive and that National Union should be held responsible for failing to settle the case for less when it had the opportunity to do so prior to trial. However, the court rejected this theory, noting that the excess carrier's duty to settle is also not typically invoked until the primary policy limits are tendered. *Id.* at 701. Since the $3.6 million offer had occurred prior to that

point, then the failure of National Union to respond to that offer was irrelevant because the offer had been revoked by the time the primary policy limits were tendered. *Id.*

The primary carrier also argued comparative fault principles. It asserted that National Union should have protected itself better by doing such things as exploring the coverage issues more thoroughly, reserving rights, investigating the underlying claim more diligently, and other similar acts. *Id.* at 702. For the reasons above, the court also rejected this argument, noting once again, that National Union's pre-tender conduct was irrelevant. *Id.* Specifically, the court stated:

> [W]e agree with the court of appeals that National's pre-tender conduct is irrelevant to the issue of comparative responsibility unless there is evidence that National interfered with the insured's defense or assumed control of the defense at some earlier point in time.

Id. at 702. Thus, in the typical case, an excess carrier will not be liable for pre-tender conduct. But, if it chooses to interfere with the claim or assume control, it should be prepared to accept responsibility for its conduct.

(3) Volunteer Doctrine/Defense

KMC also argued that the payment by National Union amounted to a voluntary choice—one that National Union was not legally obligated to perform. The court of appeals elaborated on this issue. In the court of appeals, the primary carrier argued that "National [Union] paid the $6 million as a 'volunteer', and therefore, it could not recover under an equitable subrogation theory." *National Union Fire Ins. Co. of Pittsburgh, P.A. v. Insurance Co. of N. Am.*, 955 S.W.2d 120, 124-25 (Tex. App.--Houston [14th Dist.] 1997). Unfortunately, the court did not further address the issue. However, in the discussion of whether *Canal's* holding entitles an excess carrier to recover punitive damages, the court held that it could not, stating that "[a]s a general rule, subrogation gives indemnity and no more." *Id.* at 133. Importantly, the court elaborated as follows:

> In other words, a party who successfully brings suit based on the doctrine of equitable subrogation can only recover ***the amount he was required to pay*** because of the actions of the defendant.

Id. (emphasis added).

At the Supreme Court, KMC argued that "had National thoroughly investigated the underlying claim it would have discovered that its excess policy did not provide coverage for the [underlying claim]." *Keck*, 20 S.W.3d at 702. The court noted initially that an insurer who pays a liability claim is not a volunteer if the payment is made ***in good faith and under a reasonable belief that the payment is necessary for its protection.*** *Id.* (citing *Arkwright-Boston Mfrs. Mut. Ins. Co. v. Aries Marine Corp*., 932 F.2d 442, 447 (5th Cir. 1991)). Further, the court noted that Texas courts have taken a liberal stance towards payments made by insurers to settle liability claims against their insureds. *Id.* Thus, an excess carrier's payment "has been said to be *presumptively involuntary for subrogation purposes*." *Id.* (emphasis added).[3]

The Supreme Court rejected the approach urged by KMC, observing that it would increase conflict between insurers and insureds and that it would discourage insurers from paying or settling disputed claims. Thus, the court held that this was bad public policy and they declined to adopt the volunteer doctrine as framed by KMC. *Id.*

(4) Causation

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[3] As a very general rule, a voluntary payment by a carrier bars later claims for reimbursement. The carrier should make clear in writing to other carriers and to the insured that amounts paid for defense or settlement are subject to the right to seek reimbursement pursuant to subrogation. *See, e.g., Commercial Union, supra, at* *5 (holding that where carrier had equal duty to defend but failed to raise "other insurance" issue, equitable subrogation was not permitted). Providing a defense subject to a reservation of rights, if the carrier in fact had a duty to defend, does not make a carrier a volunteer. *Texas Prop. & Cas. Ins. Guar. Ass'n v. Southwest Aggregates, Inc.*, 982 S.W.2d 600, 608-09 (Tex. App.-- Austin 1998, no writ).

An insurer is not a volunteer merely by paying a contingent claim, or by paying more than its proportionate share of a given loss. *Foremost County*, *supra*. The court noted that so long as the monies were paid on behalf of the insured, then the carrier was deemed not to be a volunteer. *Id.* However, it does have limits. Merely protecting the insured's interest is insufficient to avoid the volunteer defense. *Id.* at 762. As the Texas Supreme Court later noted, it has to be an effort to protect the payor's own interest. *See Keck Mahin & Cate, infra*, 20 S.W.3d at 702. There, the court noted that an insurer who pays a liability claim is not a volunteer if the payment is made in good faith and under a reasonable belief that the payment is necessary for its protection. *Id.* (citing *Arkwright-Boston Mfrs. Mut. Ins. Co. v. Aries Marine Corp*., 932 F.2d 442, 447 (5th Cir. 1991)). Further, the court noted that Texas courts have taken a liberal stance towards payments made by insurers to settle liability claims against their insureds. *Id.* Thus, an excess carrier's payment "has been said to be *presumptively involuntary for subrogation purposes*." *Id.* (emphasis added).

Further, the volunteer issue is unaffected regardless of whether the insurer seeking recovery does so through either conventional or equitable subrogation. *Foremost County*, *supra*. However, the presence of an "other insurance" clause may impact this analysis. *See Traders & General Ins. Co. v. Hicks Rubber Co.*, 140 Tex. 586, 597, 169 S.W.2d 142 (1943)(where both policies limited the liability to a proportionate share of the loss, recovery cannot be had for amounts paid in excess of that insurer's proportionate share).

Finally, the court dealt with the issue of causation. All the parties agreed that the settlement was excessive, but the dispute arose concerning who was at fault for the bad settlement results. The court noted that National Union had a heavy task -- it had to prove that the settlement was excessive in the abstract, but also reasonable under the circumstances. Thus, in order to recover, it had to have damages (i.e. a settlement figure higher than the case was actually worth), but at the same time, its actions had to be reasonable (i.e. the amount paid was reasonable in light of the circumstances). The court concluded:

> National's entitlement to damages will thus depend on proof that the true value of [the underlying claim] was less than $7 million but that KMC's malpractice inflated its value. Assuming such proof, National may then recover as damages the difference between the true and inflated value less any amount saved by the settlement.

Id. at 703.

(5) Implications of *Keck*, *Mahin & Cate*

The *Keck* decision may have broad implications for the rights afforded by *Canal.* Under *Canal*, an excess carrier was allowed to sue the primary carrier for mishandling the defense. *Canal*, *supra*. But, *Canal* was decided in 1992. Eight years later, *Keck* maintained this right of action.

In *Keck,* the Supreme Court left of a number of stray comments and holdings in the context of a claim by an excess carrier against the primary carrier and the defense attorneys (selected by the insured) that seem at odds with *Traver, Head* and a number of other decisions regarding theories of liability regarding settlement-related conduct. In that case, the claimant offered to settle for amounts in excess of the primary policy, but within the limits of the excess policy. The case was prematurely pushed to trial and the lawyers were unable to obtain a continuance. The primary carrier immediately tendered its policy limits. The excess carrier eventually settled the suit for almost twice the original demand from the claimants.

After *Traver*, one would have thought that an excess carrier, in an equitable subrogation action, could not bring a suit against a primary carrier for "mishandling" the insured's defense. Apparently not, according to *Keck. This is precisely the nature of the suit brought in that case.* The court held that the excess carrier could recover if it proved that the primary insurer or the defense attorneys "mishandled the defense," and that a

judgment in excess of the cases' true value would have resulted. *Id.* at 703. *But see Westchester Fire Ins. Co. v. American Contractors Ins. Co.,* 1 S.W.3d 872 (Tex. App.–Houston [1st Dist.] 1999, no pet.)(refusing to recognize a claim that the primary carrier negligently handled the settlement where the basic *Stowers* requirements were not satisfied).

Justice Hecht stated in a concurring/dissenting opinion that he was not sure that an excess carrier has ***no duty to defend or settle a claim against the insured until the primary policy is exhausted.*** Justice Hecht urges careful examination of the duties of excess carriers.

Moreover, the *Keck* court held that an excess carrier bringing an equitable subrogation suit is subject to a comparative responsibility defense based on any conduct by it that is shown to have interfered with or controlled before the tender of the limits by the primary carrier. *Keck*, 20 S.W.3d at 702. The court in *Keck,* noted that in the *American Centennial* concurring opinion, to which a majority of the court agreed, the court noted that a primary carrier should have as a defense any defense "available against either the insured or the excess carrier, including the excess carrier's unreasonable refusal to cooperate in the defense and settlement of the action." The *Keck* court also cited the opinion in *Birmingham Fire Ins. Co. v. American Nat'l Fire Ins. Co.,* 947 S.W.2d 592, 596 (Tex. App.–Texarkana 1997, writ denied), which held that a comparative negligence claim may be brought against an excess carrier who negligently provided damaging information to the claimant's counsel.

One must ask what the excess carrier's negligence has to do with a subrogation claim brought in the name of the insured? Of course, a contribution claim could be brought against the excess carrier itself for its actions in causing the harm for which its is bringing the subrogation case. Thus, this distinction may be of little apparent, practical difference. However, a claim for contribution may not be brought if the true plaintiff, the insured in a subrogation action, could not bring the claim. As the court later holds, an excess carrier that is not in the process of defending the insured has no duty to defend.

The court held that an excess carrier has no duty to settle until the primary carrier has tendered the primary limits. *Id.* ***Apparently, the excess carrier must also have taken over the defense of the case.*** *Id.* Thus, the failure of the excess carrier in *Keck* to respond to the initial settlement demand of $3.6 million could not be used as contributory negligence where the offer came prior to tender of the primary limits and prior to takeover of the defense. *Id.*

The court thus held that even if the excess carrier was negligent in failing to "explore coverage issues more diligently, reserved its rights . . . investigated the merits

of the third-party claim more thoroughly, hired independent counsel to monitor the third-party claim, supervised its claim adjuster more closely, and demanded to settle the claim months before trial," it was not actionable because it was based on conduct prior to the tender of the primary limits and because in this pre-tender situation the *excess carrier has no duty to defend or indemnify*. *Id.* The court added that pre-tender, the excess carrier had no duty to monitor the defense or to anticipate that the defense was being mishandled by the primary carrier and the defense counsel selected by the insured, noting the general tort rule that a party has no duty to anticipate the negligence of another. *Id.*

As a very general rule, a voluntary payment by a carrier bars later claims for reimbursement. The carrier should make clear in writing to other carriers and to the insured that amounts paid for defense or settlement are subject to the right to seek reimbursement pursuant to subrogation. *See, e.g., Commercial Union, supra, at* *5 (holding that where carrier had equal duty to defend but failed to raise "other insurance" issue, equitable subrogation was not permitted). Providing a defense subject to a reservation of rights, if the carrier in fact had a duty to defend, does not make a carrier a volunteer. *Texas Prop. & Cas. Ins. Guar. Ass'n v. Southwest Aggregates, Inc.*, 982 S.W.2d 600, 608-09 (Tex. App.-- Austin 1998, no writ).

An insurer is not a volunteer merely by paying a contingent claim, or by paying more than its proportionate share of a given loss. *Foremost County*, *supra*. The court noted that so long as the monies were paid on behalf of the insured, then the carrier is deemed not to be a volunteer. *Id.* However, the rule does have limits. Merely protecting the insured's interest is insufficient to avoid the volunteer defense. *Id.* at 762. As the Texas Supreme Court later noted, the excess carrier must act as well to protect the payor's own interest. *See Keck Mahin & Cate, infra*, 20 S.W.3d at 702. There, the court noted that an insurer who pays a liability claim is not a volunteer if the payment is made in good faith and under a reasonable belief that the payment is necessary for its protection. *Id.* (citing *Arkwright-Boston Mfrs. Mut. Ins. Co. v. Aries Marine Corp*., 932 F.2d 442, 447 (5th Cir. 1991)). Further, the court noted that Texas courts have taken a liberal stance towards payments made by insurers to settle liability claims against their insureds. *Id.* Thus, an excess carrier's payment "has been said to be *presumptively involuntary for subrogation purposes*." *Id.* (emphasis added).

d. Westchester

Westchester Fire Ins. Co. v. Admiral Ins. Co., 152 S.W.3d 172, 180 (Tex. App. – Fort Worth 2004, pet. denied), assumed without detailed discussion that the excess insurer can sue the primary insurer as the insured's equitable subrogee to recover its settlement

payment over and above the primary insurer's policy limits. Indeed, the case involved a legal malpractice claim by the excess insurer that settled before the trial of the *Stowers* action against the primary insurer. As the insured's equitable subrogee, *Westchester's ability to recover damages on [the insured]'s* Stowers *claim was limited to [the insured]'s ability to recover damages. See Am. Centennial, 843 S.W.2d at at 483*; *Nat'l Union Fire Ins. Co. v. Ins. Co. of N. Am*., 955 S.W.2d 120, 134 (Tex. App.--Houston [14th Dist.] 1997), *aff'd sub nom*., *Keck*, 20 S.W.3d at 704.

One of the central issues in *Westchester* was whether the excess insurer voluntarily made the settlement payment. Claims for equitable subrogation can be defeated if the subrogee voluntarily paid. Under the analysis in *Keck v. Nat'l Union Fire Ins. Co.*, 20 S.W.3d 692, 702 (Tex. 2000), a payment is not "voluntary" if made in good faith under the reasonable belief that the payment is necessary for its protection. *See also Peachtree Constr*., 647 F.3d at 256. Texas courts presume that a payment is involuntary. *Id.* Westchester's payment was involuntary because it in good faith reasonably believed at the time its payment was necessary for its protection. Accordingly, it was equitably entitled to maintain a cause of action against the primary insurer as if it were the insured. *See id*. at 702-03; *Argonaut Ins. Co. v. Allstate Ins. Co*., 869 S.W.2d at 542.

In discussing the concept of equitable subrogation, the court observed generally that the excess insurer, as equitable subrogee of the insured, "may bring *any cause of action* against [the primary insurer] that [the insured] could have brought." Although caution is required before putting too much stock in such a general observation, it nevertheless reveals that the court did not generally perceive any limitation on the *type* of cause of action that could be asserted, provided it was one the insured itself could have advanced. The Fifth Circuit has accepted the settlement-based claim of an excess carrier against a primary carrier in a *Stowers*-like situation arising from Louisiana law that is materially indistinguishable from *Stowers*. *RSUI Indem. Co. v. Am. States Ins. Co.*, 768 F.3d 374, 381-82 (5th Cir. 2014). A district court has looked to this decision as confirming *Westchester* and its predecessors in permitting an excess carrier to sue for *Stowers* violations as the insured's equitable subrogee. *Am. Empire Surplus Lines Ins. Co. v. Occidental Fire & Cas. of N.C*., No. 2:14-CV-456, 2015 U.S. Dist. LEXIS 95095, *5 (S.D. Tex. July 22, 2015). The ability of the excess insurer to prosecute a *Stowers* claim against a primary insurer has been upheld again as recently as last year in *Westport Ins. Corp. v. Pa. Nat'l Mut. Cas. Ins. Co*., 2018 U.S. Dist. LEXIS 170179, *71-73 (S.D. Tex. Aug. 18, 2018).

e. Waiver of Subrogation

Under Texas law, subrogation rights of the carrier under the contract may be waived or altered by contract. *Lancer v. Murillo,* 909 S.W.2d 122, 127 (Tex. App.–San

Antonio 1995, no writ). In an amazing, and in the authors' opinion erroneous, decision, the Dallas Court of Appeals held that a following form clause in an umbrella policy that stated that the umbrella policy's coverage was subject to the "same coverage limitations" as the insured's underlying policy effectively incorporated a waiver of subrogation provision from the primary policy. *St. Paul Fire & Marine Ins. Co. v. Reliance Nat'l Ins.*, No. 05-98-00031-CV, 2000 WL 1036320 (Tex. App.–Dallas, July 28, 2000, pet. pending). Obviously, a waiver of subrogation clause is a provision that destroys the affirmative rights of the carrier and does not amount to a "coverage limitation." Moreover, it is indeed curious how a subrogation clause from one primary carrier could be used to bar subrogation against another, unscheduled/unlisted primary carrier with respect to whom the named insured on the umbrella policy was an additional insured. Interestingly, this opinion was issued without oral argument, despite a request for the same, over two years after the appeal was filed and the opinion was based on an argument that was not previously raised at the trial court or in the appellate briefs.

3. Limitations of scope of suit—ie, extra-contractual

It is worth noting that *Am. Centennial* also reserved any decision whether the excess insurer could assert through equitable subrogation or otherwise claims for violations of the DTPA and Insurance Code because those actions were barred by limitations before the excess insurer instituted its suit against the primary insurer. *Am. Centennial*, 843 S.W.2d at 483. Even Justice Hecht in his concurring opinion recognized that the excess insurer as equitable subrogee could bring *any* action that the insured could have asserted against the primary insurer. *Id.*, at 486 (Hecht, J., concurring).

Justice Hecht recognized that the type of action that could be asserted by the excess insurer as the insured's subrogee has been extended beyond negligence claims. This recognition has been frequently repeated without challenge. It seems to be part of the broader conventional wisdom that the scope of actions to which an excess insurer may be subrogated for purposes of asserting against the primary insurer includes any action the insured could have asserted against the primary insurer, whether the action was based in equity, statute or contract. *Cantu*, 234 S.W.3d at 774; *see also Peachtree Constr.*, 647 F.3d at 256. This declaration is consistent with the reasoning provided in *Hicks*, *Transportation Ins.*, and *Mid-Continent.*

The reasoning of these recent decisions reinforces the viability of more than just common-law actions in the hands of excess insurer suing on behalf of the insured. When cases such as *Am. Centennial* and *Mid-Continent* were decided, the accepted view was that the only way the insured could recover damages for failure to accept a reasonable settlement offer was through a *Stowers* action. Since then, the Texas Supreme Court

decided *USAA Texas Lloyds Co. v. Menchaca*, 545 S.W.3d 479, 498 (Tex. 2018)(op. on reh'g). There it held that an insured could recover policy benefits under the Insurance Code when "the insurer's statutory violation causes the loss of [policy] benefits" to which the insured was or would have been entitled but for the statutory violation. The insured can also recover damages for losses independent of the loss of policy benefits resulting from the insurer's statutory violation.

As a result, the underpinning of the rule restricting equitable subrogation to the insured's common-law negligence claims against the insurer are no longer, if they ever were, justified. To the extent that an insured could have obtained relief under the Insurance Code under *Menchaca*, then it stands to reason that the concept of equitable subrogation means that the excess insurer should likewise be able to assert a claim under the Insurance Code to recover the losses it incurred on the insured's behalf.

This conclusion necessarily follows from the nature of equitable subrogation itself as "the *substitution* of one party for another such that the new party may assert the rights of the substituted party." *Associated Int'l Ins. Co. v. Scottsdale Ins. Co.*, 862 F.3d 508, 510 (5th Cir. 2017)(applying Texas law). If so, then "standing" is automatically satisfied so long as the party whose rights are being asserted by the subrogee had standing. As the court explained in *Frymire Eng'g Co. ex rel. Liberty Mut. Ins. Co. v. Jomar Int'l, Ltd.*:

> The doctrine of equitable subrogation allows a party who would *otherwise lack standing* to step into the shoes of and pursue the claims belonging to a party with standing.

259 S.W.3d 140, 142 (Tex. 2008); *followed, e.g., by Tex. Lone Star Petroleum Corp. v. Chesapeake Operating Inc.*, No. 2:14-CV-331, 2016 U.S. Dist. LEXIS 156866, 2016 WL 6677939, at *9-10 (S.D. Tex. Nov. 14, 2016). The concept of derivative standing was the basis of the ruling in *Am. Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480, 483 (Tex. 1992), that equitable subrogation allowed the excess insurer to assert the insured's rights under the primary policy against the primary insurer.