TORT REFORM WORKS
Does it work too well?

STATE BUILDING CODES BILL
Federal funds tied to enforcement

COLLIDING CO-INSURERS
Texas court shakes things up

DECEMBER 3, 2007
SOUTH CENTRAL REGION

Vol. 13, No. 23

INSURANCE JOURNAL®

THE NATIONAL PROPERTY CASUALTY MAGAZINE

WWW.INSURANCEJOURNAL.COM

16th Annual Program Directory Vol. II

25 98 45 15 04

Texas Supreme Court shakes up outlook for co-insurers at odds

Overpaying insurer may not always have cause of action against underpaying company

By David F. Johnson

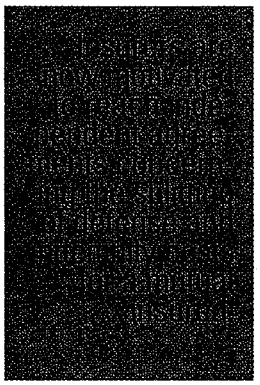
It is common for an insured to have two insurers cover the same risk. When the insured is sued regarding that risk, both insurers have a duty to defend and indemnify the insured. Often the insurers agree to a split of the costs of defense and indemnity without much of a dispute. However, what happens when the co-insurers cannot agree on a fair split of the costs and one insurer pays more than it perceives that it should?

Historically in Texas, the overpaying insurer could raise a subrogation claim against the underpaying insurer and make the underpaying insurer reimburse the overpaying insurer.

A recent Texas Supreme Court ruling in *Mid-Continent Ins. Co. v. Liberty Mutual Ins. Co.* may change all that.

A little history

In 1969, the Texas Supreme Court issued its opinion in *Employers Casualty Co. v. Transport Ins. Co.* and held that an overpaying insurer may have a subrogation claim against an underpaying insurer. [444 S.W.2d 606, 610 (Tex. 1969)] In *Employers*, one primary insurer defended and settled a case and then sued a second primary insurer that had refused to participate. The plaintiff sued on a contribution theory and argued that the breaching insurer was responsible for one-half of the defense and settlement costs.



The Court held that co-insurers were allowed an equitable contribution claim in Texas; however, the Court relied upon a concept from first-party property coverage to find that the two insurers did not actually cover concurrent obligations. [*Traders & Gen. Ins. Co. v. Hicks Rubber Co.*, 169 S.W.2d 142, 148 (1943)]. The Court found that because each policy contained an "other insurance" clause that limited the respective insurers' liability to their proportional share that their obligations were separate and independent, and therefore, a contribution claim did not exist.

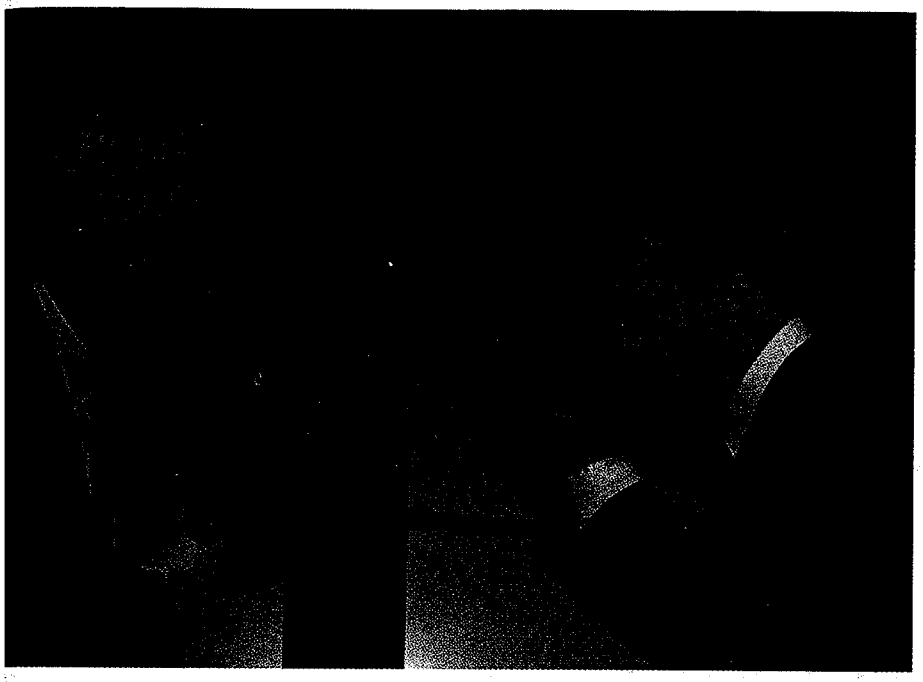
However, the Court then held in a conclusory fashion that the plaintiff may have a claim for subrogation:

"Employers Casualty was not, and is not, without a remedy. Its remedy for recovery from Transport of a pro rata part of the payment to the Siegels, as clearly indicated by the many cases listed above from other jurisdictions, lies in a suit asserting its right to payment through contractual or conventional subrogation to the

right of the insured."

After *Employers Casualty*, Texas courts of appeals routinely found that an overpaying co-insurer could raise a subrogation claim against the underpaying co-insurer. (1)

However, recently, the Texas Supreme Court issued an opinion that limits this application of the subrogation theory.



Then comes Mid-Continent

In *Mid-Continent Ins. Co. v. Liberty Mutual Ins. Co.*, the Texas Supreme Court rejected the argument that where two insurers cover the same risk, an under-paying insurer owes an independent duty to pay the over-paying insurer. [No. 05-0261, 2007 Tex. LEXIS 918 (Tex. Oct. 12, 2007).] Moreover, the Court found that the over-paying insurer had no subrogation or contribution claim.

Mid-Continent and Liberty Mutual had a mutual insured that was sued out of an automobile accident. Both policies contained "other insurance" clauses providing for equal or pro rata sharing up to the co-insurers' respective policy limits if the loss was covered by other primary insurance. The insurers agreed that a total verdict would likely be around two to three million dollars, but disagreed as to the settlement value of the mutual insured's portion of liability. The case was settled, and Liberty Mutual paid $1.35 million and Mid-Continent paid $150,000.

Liberty Mutual sued Mid-Continent for reimbursement claiming that, notwithstanding Mid-Continent's contractual right to consent to a settlement, Mid-Continent was obligated under the other insurance clauses to pay for half of the set-

continued on page 152

continued from pg. 151

tlement. A federal district court awarded Liberty Mutual $550,000 stating that:

"Mid-Continent's recalcitrance to consider any change, despite the changing circumstances, was unreasonable, causing it to unreasonably assess its insured's exposure," and compared that to Liberty Mutual who "by agreeing to settle for [1.5 million] ... resolved the case within policy limits, based on a reasonable estimation of [the insured's] liability, and avoided the real potential of joint and several liability."

Mid-Continent appealed to the Fifth Circuit. The Fifth Circuit certified three questions to the Texas Supreme Court. The first two questions are paraphrased as:

(1) When one insurer settles for an amount greater than the other, does the insurer that paid less owe a duty to reimburse the other insurer?

(2) If such a duty exists, how is that duty determined?

The Texas Supreme Court accepted the certified questions. It answered the first question and found that the other two questions were moot.

No right to reimbursement

The Court found that there was no right to reimbursement. The Court found that there was no direct cause of action between the co-insurers because there was no contribution claim under the facts of the case. In affirming its *Employers Casualty* opinion, it held that there was no contribution claim because each policy contained a pro rata "other insurance" clause, which made the policies several and independent of each other. This is an important point as most, if not all, insurance policies contain an "other insurance" clause. Therefore, co-insurers will almost never have a contribution claim against one another in Texas.

Regarding subrogation, in *Mid-Continent*, the Court found that the insured had no contractual rights or common law cause of action against Mid-Continent after being fully indemnified. First, the Court reviewed precedent that may indicate that a co-insurer may have a subrogation claim in the context of an overpaying co-insurer raising a reimbursement claim against an underpaying co-insurer. In distinguishing the subrogation language in *Employers Casualty*, the Court stated that having a right to subrogation is different from the ability to recover under that right.

In the *Mid-Continent* case, the Court then determined whether Liberty Mutual had a subrogation claim against Mid-Continent. Under either a common law or contractual subrogation claim, Liberty Mutual merely stood in its insured's shoes, and obtained only those rights held by the insured and subject to any defenses that Mid-Continent had to the insured's claims. Regarding a contractual subrogation claim, the Court stated:

"[The insured] had no right, after being fully indemnified, to enforce Mid-Continent's duty to pay its pro rata share of a loss. ... We hold, therefore, that a fully indemnified insured has no right to recover an additional pro rata portion of settlement from an insurer regardless of that insurer's contribution to the settlement. Having fully recovered its loss, an insured has no contractual rights that a co-insurer may assert against another co-insurer in subrogation."

Further, because the insured had no

continued on page 156

rights to which Liberty Mutual could be subrogated, Liberty Mutual had no right to reimbursement through subrogation.

Regarding a tort claim, the Court in *Mid-Continent* held that the only tort duty that an insurer owes to its insured to settle is under *Stowers* doctrine. Because the elements of the *Stowers* doctrine were not met, the insured had no tort claim against Mid-Continent. Further, subrogation is intended to help one paying a debt that another party is primarily liable to pay. Because a primary insurer has a duty to pay, it cannot assert a subrogation claim against another insurer who has an equal duty to pay. (2)

How will it affect disputes?

What impact will the *Mid-Continent* opinion have on insurance disputes in Texas? Some may argue that insurers will be less inclined to pitch in and pay for their "fair" share of a mutual insured's defense and settlement hoping that the other insurer will step up to the plate. That situation would certainly be disadvantageous to the insured. However, if the co-insurers end up not settling cases that should be settled, *Stowers'* claims and bad faith claims will be a remedy.

It is not anticipated that insurers will avoid their responsibilities under their policies due to *Mid-Continent*. However, insurers are now motivated to reach independent agreements concerning the splitting of defense and indemnity costs for a mutual insured.

Moreover, if an independent agreement cannot be reached, the *Mid-Continent* opinion does not foreclose an overpaying insurer to file a declaratory judgment action against the underpaying insurer before the case is settled.

Notes:

(1) See, e.g., *Employers Cas. Co.*, 444 S.W.2d at 610 (two primary co-insurers); *General Agents Ins. Co. of America, Inc. v. Home Ins. Co. of Illinois*, 21 S.W.3d 419 (Tex. App.—San Antonio 2000, pet. dism. by agr.) (both insurers were concurrent primary insurers); *Texas Prop. & Cas. Ins. Guar. Assoc. v. Southwest Aggregates, Inc.*, 982 S.W.2d 600, 610 (Tex. App.—Austin 1998, no writ) (both insurers were co-insurers); *CNA Lloyds of Texas v. St. Paul Ins. Co.*, 902 S.W.2d 657, 661 (Tex. App.—Austin 1995, writ dism. by agr.) (due to continuing injury allegation, both insurers were co-insurers)

(2) The outcome in *Mid-Continent* — the over-paying insurer has no claim against an under-paying insurer — is even more applicable where the insurers are not co-insurers. If an over-paying insurer that covers the same risk as an under-paying insurer has no claim in contribution or subrogation, then there are certainly no claims when the insurers cover completely different risks. When the insurers cover the same risks, they have equivalent responsibilities to the insured. However, insurers that do not cover the same risks have completely different responsibilities because different facts and different allegations trigger coverage.

David Fowler Johnson is board certified in civil appellate law and personal injury trial law by the Texas Board of Legal Specialization. Johnson is a shareholder in Winstead PC's Fort Worth office, is a founding member of Winstead's appellate practice group and is a member of the insurance industry practice group.