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Cover Notes
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Two Recent Insurance Coverage Decisions From The Supreme Court And Their Impact

By R. Brent Cooper

Mid-Continent Ins. Co. v.. Liberty Mutual Ins. Co., 236 S.W. 3d 765 (Tex. 2007)

A. Facts

In November 1996, an automobile accident occurred in a construction zone. Kinsel Industries was the general contractor on the highway project and Crabtree Barricades was Kinsel's subcontractor responsible for signs and dividers. Kinsel was insured by Liberty Mutual for $1 million under a CGL policy and a $10 million excess liability policy. Crabtree was insured by Mid-Continent under a CGL policy providing $1 million in coverage. Kinsel was named as an additional insured under the Mid-Continent policy. The exposure of Kinsel was the subject of some dispute. At mediation, Liberty Mutual agreed to settle for $1.5 million. Mid-Continent believed the settlement value of the case against Kinsel to be only $300,000 and agreed to only pay $150,000. Liberty funded the remaining $1.35 million of the settlement and tried to seek recovery from Mid-Continent. Liberty initially sued Mid-Continent in state court in Dallas County, Texas. This case was then removed to federal court by Mid-Continent. At the district court level, the trial judge determined that each insurer owed a duty to act reasonably in exercising its rights under the CGL policy and found that Mid-Continent was objectively unreasonable in assessing Kinsel's share of liability and ordered Mid-Continent to pay the remaining limits ($550,000) under its general liability policy. Mid-Continent had previously paid $300,000 to settle the claim against Crabtree.

Three questions were certified by the Fifth

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PAJ, Inc. d/b/a Prime Art & Jewel v. The Hanover Insurance Company, 51 Tex.Sup.J. 302 (Jan. 2008)

A. Facts

PAJ, Inc. is a jewelry manufacturer and distributor. In 1998, it was sued by Yurman Designs, Inc. for alleged infringement on a particular jewelry line. For six months after the suit was filed, PAJ did not notify Hanover of the lawsuit, but rather defended itself. Finally, it realized that coverage was available under its CGL policy and forwarded notice to Hanover. PAJ brought this suit against Hanover seeking a declaration that Hanover was contractually obligated to defend and indemnify PAJ in the copyright suit. The parties stipulated that PAJ failed to notify Hanover of the claim "as soon as practicable," but that Hanover was not prejudiced by the untimely notice. The trial court granted Hanover's motion and denied PAJ's. The Dallas Court of Appeals affirmed. 170 S.W.3d 258.

B. Holdings

The issue before the court was whether prejudice was a requirement for a late-notice defense by Hanover. The supreme court noted that in *Members Mutual Insurance Co. v. Cutaia*, 476 S.W.2d 278 (Tex. 1972), the supreme court had held that in a policy providing that proper notice was a "condition precedent" to the duty to pay, that prejudice was a requirement. Shortly thereafter, the State Board of Insurance responded with Board Order 23080 requiring a mandatory endorsement for all Texas CGL policies.

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Circuit to the Texas Supreme Court. They were as follows:

1. Two insurers, providing the same insured applicable primary insurance liability coverage under policies with $1 million limits and standard provisions (one insurer also providing the insured coverage under a $10 million excess policy), cooperatively assume defense of the suit against their common insured, admitting coverage. The insurer also issuing the excess policy procures an offer to settle for the reasonable amount of $1.5 million and demands that the other insurer contribute its proportionate part of that settlement, but the other insurer, unreasonably valuing the case at no more than $300,000 contributes only $150,000 although it could contribute as much as $700,000 without exceeding its remaining available policy limits. As a result, the case settlements (without an actual trial) for $1.5 million funded $1.35 million by the insurer which also issued the excess policy and $150,000 by the other insurer.

   In that situation is any actionable duty owed (directly or by subrogation to the insured's rights) to the insurer paying the $1.35 million by the underpaying insurer to reimburse the former respecting its payment of more than its proportionate part of the settlement.

2. If there is potentially such a duty, does it depend on the underpaying insurer having been negligent in its ultimate evaluation of the case as worth no more than $300,000, or does the duty depend on the underpaying insured's evaluation having been sufficiently wrongful to justify an action for breach of the duty of good faith and fair dealing for denial of a first party claim, or is the existence of the duty measured by some other standard?

3. If there is potentially such a duty, is it limited to a duty owed the overpaying insurer respecting the $350,000 it paid on the settlement under its excess policy.

The Texas Supreme Court answered the first certified question in the negative and therefore did not reach the next two questions.

B. Holdings

1. Contribution

On the issue of contribution, the supreme court noted that in its earlier decision of *Traders & Gen. Ins. Co. v. Hicks Rubber Co.*, 140 Tex. 586, 169 S.W.2d 142 (Tex. 1943), that the right of contribution does exist where one insurer pays amounts concurrently due by other insurers. However, the court in *Hicks Rubber* pointed out that the direct claim for contribution between co-insurers disappears when the insurance policies contain "other insurance" or "pro rata" clauses. The court in this case noted that the policies in question did contain "other insurance" clauses limiting their liability under the terms of the policy. As a result, under *Hicks Rubber*, there was no right of contribution. The court did note that a San Antonio Court of Appeals in *General Agents Insurance Co. of America v. Home Insurance Co. of Illinois*, 21 S.W.3d 419 (Tex.App.-San Antonio 2000, *pet. dism'd by agr.*), such a right had been recognized. The court specially disproved of the *General Agent's* decision to the extent it created a common law duty between co-primary insurers to reasonably exercise rights under an insurance policy.

2. Subrogation

The second cause of action addressed was the right of subrogation. The supreme court noted that both *Hicks Rubber and Employers Cas. Co. v. Transportation Ins. Co.*, 444 S.W.2d 606 (Tex. 1969), contain language that such an avenue of reimbursement could exist. The majority pointed out that two types of subrogation exists. The first is conventional, which is created by an agreement or contract. The second is equitable (or "legal") subrogation which is not dependent upon a contract, but arises in every instance in which one person, not acting voluntarily, has paid a debt for which another was primarily liable and which equity should have been paid by the later. Both Liberty Mutual and Mid-Continent policies contain subrogation clauses. However, the majority pointed out that whether the asserted right was at equity or conventional, Liberty Mutual must step into the shoes of Kinsel. As such, Liberty Mutual would be subject to any defenses that Mid-Continent possessed against Kinsel. The majority noted that the insured in this case was fully indemnified and had no right to recover additional insured amounts from any other insurer.

Liberty Mutual also argued that it was subrogated to the common law right of Kinsel to enforce Mid-Continent's duty to act reasonably when handling an insured's defense. The court noted that only one common law duty exists in the third-party context and that is limited to the *Stowers* duty. The court held that Mid-Continent did not breach any *Stowers* duty to Kinsel because the plaintiffs did not make a settlement offer within Mid-Continent's policy limits, and the court declined to extend *Stowers* any further.

3. Concurring Opinion

Justice Willett concurred in the result. However, the basis for the concurring opinion was that Mid-Continent had defended and fulfilled all the terms of its obligations under the policy. Willett indicated that a different result would attach if Mid-Continent

Mid-Continent Ins. Co. v.. Liberty Mutual Ins. Co. continued from page 2

had denied coverage and refused to pay anything or to defend its insured. Specifically, Justice Willett stated that:

> The result might also be different in a case involving a primary insurer and an excess carrier, where the primary alone provided the defense and failed to settle within its policy limits, if a judgment had been entered against and paid in part by Kinsel and Mid-Continent refused to cover its proportionate share of the judgment, or if Mid-Continent had denied coverage and had refused to pay anything or defend the insured. . . .

The later language presents several new issues. Obviously, if Mid-Continent had refused to defend its insured, it would not be in a position to rely upon any of the conditions in the policy. However, according to Willett, if Mid-Continent had not breached any of the policy provisions, but merely had determined that the case was not worthy of any settlement dollars, a different result might attach. This is a slippery slope which undoubtedly will create much fodder for litigation in the future.

PAJ, Inc. d/b/a Prime Art & Jewel v. The Hanover Insurance Company continued from page 1

The endorsement required by Board Order 23080 provides that:

> As respects bodily liability coverage and property damage liability coverage, unless the company is prejudiced by the insured's failure to comply with the requirement, any provision of this policy requiring the insured to give notice of action, occurrence or loss, or requiring the insured to forward demands, notices, summons or other legal process, shall not bar liability under this policy.

The majority held that prejudice was not a requirement in this situation. Several reasons were given. First, the court noted that at the time the State Board of Insurance created the endorsement, there was no standard coverage for advertising injury. Second, the court noted that subsequent to the Board Order 23080, the court had decided *Hernandez v. Gulf Group Lloyds*, 875 S.W.2d 691 (Tex. 1994) holding that a consent-to-settle clause under a insured motorist policy could not be enforced unless prejudice was shown. This, of course, is not the issue in a late-notice case. However, the court applied its holding by analogy. The third basis for the court's opinion was that major treatises have acknowledged Texas as a notice-prejudice rule. Again, the cases in Texas have been mixed at best and the fact that some commentators may have misinterpreted Texas law seems hardly a basis for the court's decision.

Finally, the majority noted that the majority trend among all jurisdictions is to require prejudice where there is late notice. As a result, the court held that prejudice would be required and that the six months delay by PAJ in giving notice to Hanover would not bar coverage.

C. Dissent

Four members of the court joined the dissent written by Justice Willett. The dissent first points out that the *Hernandez* case did not involve a condition precedent, but rather an exclusion. Therefore, the majority's reliance upon that was misplaced. Second, the court pointed out that with respect to the State Board's Amendatory Endorsement, that advertising injury and personal injury has been part of the standard coverage provided in the general liability policy now for over thirty years and there has been no response by the State Board for over thirty years in reaction to this change. Finally, the dissent points out that in October 2000, ISO promulgated an endorsement that requires prejudice not only for bodily injury and property damage, but also for advertising injury and personal injury which if the TDI should desire, could require to be mandatory.

UPCOMING EVENTS...

15th Annual Insurance Symposium - March 28, 2008 Dallas, Texas

Transportation Seminar - June 20, 2008 Dallas, Texas

Appellate Seminar - July 20, 2008 Dallas, Texas

C & S Highlights

Associate Komal Chaddha (San Francisco Office) received The Young Lawyer of the Year Award from the South Asian Bar Association of Northern California at their 15th Anniversary Gala.

Shareholder R. Brent Cooper (Dallas Office) was named in "Top 100 Dallas/Fort Worth Region" by *2007 Texas Super Lawyers* in *Texas Monthly's* October issue.