

Practical Implications of
Frank's Casing
In Construction
Defect Dispute Resolution
(Litigation and/or Arbitration)

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AUSTIN BAR ASSOCIATION
CONSTRUCTION LAW SECTION

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Caveat: *Frank's Casing* is presently on **Rehearing** before the Texas Supreme Court. The case had generated considerable comment and controversy. It is possible that a new opinion of the Court could differ from the May 2005 opinion of the Court. In the event that the Court changes course, this Paper and the opinions expressed herein may need to be substantially updated and possibly materially changed in light of the any new opinion.

The Implications of *Frank's Casing, etc.* for the Construction Practitioner

The Insured - - Frank's

Frank's Casing Crew & Rental Tools, Inc. ("**Frank's**") is a large oil field supply and construction company. Founded in 1938, Frank's provides oil and gas equipment rentals and sales to exploration and production customers operating in Louisiana, Mississippi, and Texas and offers casing, cementing, well completion or abandonment, fabrication, and maintenance services. Frank's sells casing equipment, connectors, drill pipe tools, hammers, and pipe and fabrication equipment with over 900 employees and 54 million in sales. This is the *insured*.

The Insurance Company

In this case, the insurance company was a Lloyd's consortium of companies with the name: Excess Underwriters at Lloyd's, London and Certain Companies Subscribing Severally but Not Jointly to Policy No. 548/TA4011FO1, referred to in the Supreme Court's opinion as "**EU**".

Citation

The cite for the case is *Excess Underwriters at Lloyd's, London and Certain Companies Subscribing Severally but Not Jointly to Policy No. 548/TA4011FO1 v. Frank's Casing Crew & Rental Tools, Inc.*, No. 02-0730 (**Tex. May 27, 2005**), *reversing* 93 S.W.3d 178, 2002 Lexis 4694 (Tex. App. - - Houston [14th Dist.] **June 27, 2002**)(Justice Scott Brister), *affirming* Harris Case Number: 98-08295, 189th District Court, Harris County, Judge Jeff K. Work.

Amicus Curiae

Complex Insurance Claims Litig; United Policyholders; Brad Fish, Inc.; Pilco, Inc.; Shell Oil Company (For the Insured); Motiva Enterprises L.L.C.; Burlington Resources Inc.; Texas Civil Justice League (For the Insured); Texas Association of Defense Counsel (For the Insured); Property Casualty Insurers Association of America; Complex Insurance Claims Litigation Association; Valero Energy Corporation (For the Insured).

Facts

Frank's fabricated a drilling platform in Louisiana for ARCO. The platform was installed in the Gulf of Mexico and collapsed several months later. ARCO sued Frank's and others. Frank's had a primary liability policy with limits of \$1 million, and excess coverage of up to \$10 million from EU. EU issued reservation of rights letters in which EU asserted that certain of ARCO's claims against Frank's Casing were not covered. The primary carrier retained defense counsel for Frank's.

Pre-Trial Settlement Negotiations

ARCO made a pre-trial settlement demand of \$9.9 million, which Frank's rejected. Two weeks before trial, EU contacted ARCO directly, without Frank's knowledge, and attempted to settle only the claims EU were willing to concede were covered. No agreement was reached. ARCO subsequently offered to settle all claims against all defendants for \$8.8 million, which would have required Frank's to contribute about 85% or \$7.55 million. A further proposal was that EU pay two-thirds of \$8.8 million, that Frank's pay one-third, and that all coverage issues would be waived by the underwriters. Finally, EU proposed that EU pay \$5 million and that all coverage issues be resolved in arbitration. Frank's rejected all of these proposals.

Settlement Negotiations At Trial

As trial approached, EU retained counsel to associate with Frank's and its primary carrier. ARCO's suit against Frank's Casing proceeded to trial. Frank's was the target defendant. By the close of the second day of trial, Frank's *in-house* counsel contacted ARCO and requested that ARCO (i.e. Plaintiff) make a settlement demand within the excess policy's limits. Frank's counsel suggested \$7 million. ARCO promptly responded with a demand of \$7.5 million, which Frank's communicated to EU accompanied by a demand that the underwriters accept this offer, thus "Stoverizing" the excess underwriters. EU agreed that the case should be settled for this amount and stated that EU would fund the settlement up to \$7.5 million, less any contribution from the primary carrier, if Frank's would expressly agree that all coverage issues would be resolved *at a later date*. Frank's refused and sent a second letter demanding that EU accept Plaintiff's settlement demand. EU then advised Frank's Casing that they would pay \$7.5 million, less any contribution from the primary carrier, and seek reimbursement from Frank's. That same day, EU contacted Plaintiff and orally accepted the settlement offer. The primary carrier simultaneously tendered its remaining policy limits, approximately \$500,000, to settle the lawsuit.

The Excess Policy

The excess insurance policy required Frank's approval of any settlement. The policy provided: "The Assured shall make a definite claim for any loss for which the Underwriters may be liable under this policy within twelve (12) months . . . after the Assured's liability *shall have been fixed* and rendered certain either by final judgment against the Assured after actual trial *or by written agreement of the Assured*, the claimant, and Underwriters." Frank's gave approval to its liability having been "fixed" by settlement.

A written settlement agreement among ARCO, Frank's and the excess underwriters preserved "any claims that exist presently" between Frank's Casing and the underwriters. After the verbal agreement and prior to that execution of the formal settlement agreement, EU filed suit against Frank's for reimbursement.

The Coverage Litigation

EU and Frank's filed cross motions for summary judgment. The trial court **initially** granted EU's motions for partial summary judgment finding (a) **none** of ARCO's claims against Frank's Casing were covered; (b) requiring Frank's to reimburse EU \$7,013,612.00 plus fees.

Texas Supreme Court Decides Matagorda County The Trial Court Reverses Its Decision.

Shortly after the trial court ruled in favor of EU, the Texas Supreme Court issued *Texas Association of Counties County Government Risk Management Pool v. Matagorda County*, 52 S.W.3d 128 (Tex. December 21, 2000) ("Matagorda County"). The trial court directed Frank's to file a motion for new trial only on the issue of reimbursement. Based on *Matagorda County*, the trial court withdrew its order granting partial summary judgment for EU on the reimbursement issue and signed a take-nothing judgment against EU.

Frank's At The Court of Appeals.

EU appealed to the 14th Court of Appeals. Relying on *Matagorda County*, the Court of Appeals, per Justice Brister, affirmed on June 27, 2002, and noted: "We recognize this case carries *Matagorda County* to a logical conclusion that is somewhat disquieting - Frank's was able to resolve the parties' coverage dispute in its own favor simply by sending a *Stowers* demand to the Underwriters. . . . But this is a matter that the Underwriters must take up with the superior court." EU then appealed to the Supreme Court. The case was first filed in the Supreme Court on August 12, 2002 and first argued on September 24, 2003.

Matagorda County (Tex. 12/2000)

Inmates sued Matagorda County after inmates armed with razor blades physically and sexually assaulted other inmates in the jail. The County's policy with its liability insurance company specifically excluded any claim arising out of the operation of the jail. The carrier defended with a reservation of rights and, at the same time, sought a declaratory judgment that the inmates' claims were not covered. Before the declaratory judgment action was resolved, the Plaintiffs made a settlement demand to settle their suit against the County for \$300,000, which was within policy limits. The County told the carrier that \$300,000 was a reasonable settlement offer. The County did not ask the carrier to accept the offer, but refused to fund the settlement itself. The carrier then wrote the County, reasserted its position that there was no coverage, but advised that it would fund the settlement and then seek reimbursement from the County in the declaratory judgment action. The County did not respond. The carrier settled the claims of Plaintiffs. The County stipulated in the declaratory judgment action that the settlement amount was reasonable. The trial court found that the claims were not covered.

The majority opinion said that the insurance company was NOT entitled to reimbursement

unless the insured "consented to the settlement and the insurer's right to seek reimbursement." (Emphasis Added) In December of 2002, The Supreme Court [7 - 2 decision with majority opinion by O'Neill and dissent by Owen joined by Hecht] and held in *Matagorda County* that:

- (a) an implied-in-fact agreement that carrier could seek reimbursement could not be found from the County's silence in response to the risk pool's letter stating it would seek reimbursement after it funded the settlement;
- (b) the doctrine of equitable subrogation did not apply;
- (c) the quasi-contractual theories of quantum meruit and unjust enrichment should not be applied.

New Justices On the Court

By the time that the *Frank's* was decided by the Supreme Court in May of 2005, only 3 Justices were left from *Matagorda County* - - Hecht, O'Neill, and Owen. There were six new Justices: Jefferson, Medina, Green, Wainwright, Brister, and Johnson. After Owen went to the 5th Circuit, Justice Willett was appointed in August 2005. Justice Brister was the author of the Court of Appeals opinion and has not participated in any aspect of *Frank's Casing*. One reason that the case was reargued in February of 2006 was to permit Willett and Johnson to participate in the deliberations and decision.

Bear in mind this fact: there was a 5 Justice majority. Owen was a part of this 5 Justice coalition. Owen is now gone. Brister can not participate. Therefore, where Johnson or Willett come down as to their views can be material in the breath (or narrowness) of the ultimate holding in *Frank's Casing*.

What the Supreme Court Did In Frank's

The Supreme Court reversed and held that EU was entitled to reimbursement from *Frank's* on these facts. But all members of the Court other than Hecht concluded that *Matagorda County* should not be overruled.

The Four Frank's Opinions

There were four opinions in the May 2005 decision: The majority and main opinion was by Justice Owen.

Owen's opinion represented a five Justice majority.

Her opinion has three major Parts I, II, & III. Part I is an Introduction. Part III deals with Louisiana law and appears almost as an after thought. Parts I & III play no real part in the decision.

Part II is the critical Section of the decision.

Part II includes subparts A, B, C, & D.

Part II of the Owen opinion is the key subsection of the decision.

Subsections of Part II of the Owen Opinion

- II - A** 5 Justices. This section is an introduction to Part II and has a characterization of *Matagorda County* which is not agreed to by Wainwright or O'Neill. II - A is not a critical part of the decision.
- II - B** 5 Justices. Broad Rule stated and policy discussion. **BROAD "EQUITABLE" THEORY OF RECOVERY**. This is an important statement of policy of 5 Justices.
- II - C** 7 Justices. (5 + O'Neill + Wainwright). **EXPRESS CONTRACT THEORY**. Part C discusses *Matagorda County* and announces a right of reimbursement " . . . when there is a coverage dispute, the insured has **EXPRESSLY AGREED** the third party's settlement offer should be accepted, and the insurer has notified the insured that it intends to seek reimbursement." Presumably this is the "express agreement" holding based on the fact that "*Frank's Casing* made an informed decision between continuing to defend ARCO's suit and consenting to settle that litigation, knowing that the excess underwriters intended to pursue coverage issues and to seek reimbursement of the amount paid in settlement."
- II - D** 6 Justices (5 + O'Neill & not Wainwright). Reimbursement Agreement Implied at Law -- **QUASI-CONTRACTUAL**.

Part II A (Five Justices)

Part II A attempts to distinguish *Matagorda County* and sets out the broad holding of the case. Owen describes *Matagorda County* as a situation where the carrier had an unilateral right to settle without the consent of the insured. The concern of the Court in *Matagorda County* was that a carrier could accept a claim out of the insured's "financial reach" and that the insured would be required to reimburse the carrier.

The insured would have to choose between rejecting Plaintiff's claim within policy limits or accepting a "possible obligation" that would be beyond its means. Owen stated the "concern" of the Court in *Matagorda County* is "ameliorated" in "at least" two situations. In these two situations, the insurance company has a right to be reimbursed **if** (a) it has timely asserted its reservation of rights, (b) notified the insured it intends to seek reimbursement, and (c) paid to settle claims that

were **not** covered.

The two fact patterns supporting reimbursement are:

1. when an insured has **demanded** that its insurer accept a settlement offer that is within policy limits, or
2. when an insured **expressly agrees** that the settlement offer should be accepted.

Part II B. (Five Justices)

II - B is a broad discussion of policy issues. In addition, there is a favorable discussion of *Blue Ridge Insurance. Co. v. Jacobsen*, 22 P.3d 313 (California, 2001). When *Frank's* "Stowerized" EU, *Frank's* could not " . . . thereafter take the **inconsistent** position that the settlement offer was reasonable if the insurer bore the cost of settling but unreasonable if the insured ultimately bore the cost." **If** a settlement is deemed "reasonable" for the carrier to pay, then the insured cannot complain that it is not reasonable for the insured to pay if the insured "ultimately bore the cost".

Therefore, **if** "an insured" triggers a " . . . *Stowers* duty" and settlement takes place at that level or lower, then the insured can not claim - - i.e. is estopped from asserting - - that the settlement is too "financially burdensome" for the insured if it turns out the claims against the insured are not covered. Where the insured **demands** that the carrier accept the settlement offer, the insured is "deemed" to view the settlement as reasonable. It follows, therefore, according to II-B, that the offer is one that a "reasonable insured should accept if there is no coverage". The insured "knows" that if the case is not settled, there is a risk that a judgment "larger than the settlement offer" will be entered.

It follows, according to II-B, that " . . . requiring an insured to reimburse its insurer for settlement payments if it is later determined there was no coverage **does not prejudice the insured.**" (emphasis added) This is supposedly true because the insured's substantial exposure to a judgment against it greater than the settlement amount has been eliminated at its insistence and for an amount which it agrees was reasonable.

The insured's financial ability (or lack thereof) is beside the point. Coverage should not be created just because the insured can not afford to pay a judgment.

"The insurer should be entitled to settle with the injured party for an amount the insured has agreed is reasonable and to seek recoupment from the insured **if** the claims against it were not covered."

This **REIMBURSEMENT OUTCOME** - - according to II - B is " precisely the same position it would have been in absent any insurance policy,

except that the insurer is now the insured's creditor rather than the injured third party." ((Emphasis Added)

Reimbursement encourages settlement " . . . even when coverage is in doubt.", citing without discussion *Blue Ridge Insurance. Co. v. Jacobsen*, 22 P.3d 313, 321 (California. 2001). Third parties benefit from these settlements since the "risk" of no coverage is now shifted from the "injured Plaintiff" to the insured.

As to timing, the coverage dispute between an insured and its insurer can be resolved after the injured plaintiff is compensated. The risk to the "injured plaintiff" is "lessened." Whether the carrier or the insured bears the cost of a "reasonable settlement" should depend on whether there "is coverage".

**THE KEY REALITY: DENIAL OF A RIGHT OF REIMBURSEMENT
"TILTS THE PLAYING FIELD"**

Without reimbursement, the carrier can: (a) refuse to settle and "face a bad faith claim"; (b) settle and have right of recourse even if it is determined that there is no coverage. If it is determined, as here, that there was no coverage in the first place, if reimbursement is denied, then the outcome is the creation of coverage "where there was none."

Part II - C Total of 7 Justices. (5 + O'Neill + Wainwright)

Part II - C is the EXPRESS CONTRACT THEORY. Part C discusses *Matagorda County* and announces a right of reimbursement " . . . when there is a coverage dispute, the insured has **EXPRESSLY AGREED** the third party's settlement offer should be accepted, and the insurer has notified the insured that it intends to seek reimbursement." Presumably this is the "express agreement" holding based on the fact that "*Frank's Casing* made an informed decision between continuing to defend ARCO's suit and consenting to settle that litigation, knowing that the excess underwriters intended to pursue coverage issues and to seek reimbursement of the amount paid in settlement."

Part II - D 6 Justices (5 + O'Neill and NOT Wainwright)

Part II - D QUASI-CONTRACT. "In cases such as the one presently before us, an agreement to reimburse an insurer is implied in law." The right of reimbursement is implied in law as *quasi-contractual*, whether or not it has one that is implied in fact in the policy as contractual. This holding was ostensibly in direct conflict with *Matagorda County*. Therefore, Part II - D concludes: "To the extent *Matagorda County* indicated that the *only* circumstance under which an insurer may obtain reimbursement from an insured for settlement payments when there is no coverage is when there is an express agreement that there is a right to seek reimbursement, we clarify that there are additional circumstances that will give rise to a right of reimbursement. Those include the circumstances in the case presently before us." (Emphasis Added)

Hecht Concurrence

Hecht wants *Matagorda County* to be overruled. Hecht dissented in *Matagorda County* and states here that *Matagorda County* was "wrongly decided". Whatever "distinctions" exist between *Matagorda County* and *Frank's Casing* are "immaterial". Hecht notes that here the insured had a right to consent to settlement and that *Frank's Casing* "demanded" that EU settle the case. The right to consent was not present in *Matagorda County*, but, according to Justice Hecht, ". . . neither distinction matters to the decision in this case."

The case for Hecht is not about forcing a settlement on the insured. The insureds in both cases wanted to "***have their cake and eat it, too.***"

For Hecht, consent to settlement is not an essential condition or reimbursement, and it does not matter that the insured made a "demand". The *Stowers* duty, Hecht notes, comes from a "demand" for a reasonable offer, and it is not necessary for a *Stowers* duty for the insured to **join** in the demand. Hecht believes that *Frank's* "effectively overrules" *Matagorda County*, ". . . as it should."

Hecht concludes by saying that "perhaps it is necessary to stress, again" that "no one" suggests that a carrier can "*unilaterally*" settle for a "unreasonable amount" or "in circumstances that actually (rather than hypothetically) prejudice the insured, and then force reimbursement from the insured."

Neither *Matagorda County* or *Frank's Casing*, according to Hecht, "involved such a situation, and the Court has never been ". . . cited to a case involving such a situation." If such a case exists, Hecht concluded, "statutory prohibitions against unfair practices" by insurance companies such as Article 21.21 and Article 21.55 "**offer full relief**".

Bottom line: *An insured, Hecht ended, ". . . should not be allowed to unreasonably withhold consent to settlement" to force the insurers to pay a claim and abandon coverage issues at the risk of incurring "statutory liabilities"*. The right to reimbursement, for Hecht, depends on two things: (a) reasonableness of settlement; (b) coverage. That, according to Justice Hecht, ". . . is the essence of today's decision."

O'Neill Concurrence

O'Neill joined only in Parts II-C ("express agreement") and II-D (quasi-contract). O'Neill thought that the remainder (especially Part II - B) of the Owen opinion was "**unduly broad and based at least in part upon faulty assumptions.**"

O'Neill argues that even though the insured "demands" settlement from the carrier, it does not follow that the settlement is "reasonable" from the point of view of the insured. *Stowers*, according to Justice O'Neill, was designed for the insurance company.

Stowers presumes coverage and ". . . has no application in determining an insurer's reimbursement right when coverage is disputed," citing Garcia. The insured's ability to pay is relevant. O'Neill dissents from any holding that would allow reimbursement merely by the insured asking the carrier to accept a settlement demand within the policy limits.

O'Neill goes to great lengths to distinguish her views from Justice Wainwright in his concurrence. O'Neill does not agree that there was any "implied consent" to reimbursement in this case. *Frank's Casing* no more waived its position on reimbursement than a carrier waives its coverage positions when it issues an ROR.

Finally, Justice O'Neill faults Justice Wainwright for his comments on *Matagorda County's* deviation from "common-law contract principles".

The bottom line for Justice O'Neill is that on the facts of this case, *Frank's Casing* had an "implied-in-law" reimbursement (i.e. quasi-contractual) obligation because it consented to the settlement and the carrier could not have settled without that consent.

Justice O'Neill does not mention Justice Hecht, but she concludes that the recognition in Part II C & D of an "implied reimbursement right" is "entirely consistent" with *Matagorda County*.

Wainwright Concurrence

The concurring opinion of Justice Wainwright is lengthy, and wide-ranging. Wainwright wants a result rule based on common law contract principles, and nothing else!

Matagorda County, according to Justice Wainwright, erected an "uncommon standard" for contract formation and "precluded" "normal" application of common law principles. Justice Wainwright concluded that "normal" common law principles were adequate to assess whether *Frank's Casing* has "agreed", and Wainwright would agree to Roerig only if those principles were met.

Wainwright therefore joins only Part II - C. The remainder of Owen's opinion, according to Wainwright is "not inconsistent with precedent", but "based on equitable and policy considerations" and concludes that the parties are "bound by a contract implied by law".

Wainwright concludes that there was a real "contract" formed between Frank's and EU. And what was the basis for that "contract"? There was, in fact, a literal "contract" or "agreement" when Frank's Casing permitted reimbursement since Frank's Casing did not reject the offer of EU or did not make a counteroffer.

Thus - - it was the inaction or silence of Frank's which created the "contract" - - a notion never even discussed by the majority in Part II - C. For Wainwright, by inaction or silence, a "contract" was formed by which Frank's Casing "agreed" that EU would settle and then the issue of

coverage would be litigated.

Wainwright reaches this conclusion from the fact that the carrier stated that its offer to fund was contingent on a right of reimbursement. Wainwright would not allow reimbursement unless there was a "legally enforceable agreement" at the time of settlement to permit reimbursement. For Wainwright, mere "equities" of the parties do not support allowing a right of reimbursement. For an insured to merely acknowledge the reasonableness of the settlement does not support allowing the carrier to seek reimbursement.

Frank's Casing did, however, "bind itself" by acquiescing in the settlement. For Wainwright, the parties "sink or swim" based on the "agreements they enter", unless the facts are such that they effect a change of the agreement under contract law or involve fraud, extortion or some other basis for "altering a contract".

The "factors" that the Court cites are not "central" to a reimbursement analysis. Wainwright also does not agree with the Majority on *Stowers* either. "I disagree with the Court's reasoning that the weight and potential severity of a *Stowers* or bad faith insurance verdict can serve as a basis to alter the agreement of the parties. Insurance is a consensual arrangement not subject to change by the threat of a lawsuit.

If Stowers or bad faith actions are skewing litigation and parties' legitimate incentives, then Stowers actions may need to be addressed by the appropriate branch rather than allow threat of such actions to serve as a basis for reimbursement."

Wainwright does not like judging each case based on the "equities of the parties" in that this will lead to case by case "adjudication". The "contractual relationship" should govern. Wainwright concludes by stating: "This case raises a tangled mound of considerations."

**Implications of Frank's Casing for Litigation / Arbitration of
Construction Defects and Construction Professional Liability**

- **Caveat:**
 - **Holdings and implications may change on rehearing.** This is not likely given the recent opinions of Justice Willett. Even if Willett or Johnson do not join the other 4 remaining majority Justices, it seems apparently that Justice Brister wants some change from *Matagorda County* and will not vote in *Frank's Casing*. Most likely: some substantial change will remain.
 - **Frank's Casing does not address defense costs.** Defense costs presents different issues in that there is an ROR in which the carrier undertakes to defend "subject to" the reservations.
 - **Frank's Casing does not address the issue of "partial reimbursement".** This issue arises where a carrier could take the position that "part" of the settlement was covered and part was not covered. How this Court would address this issue is beyond the scope of this paper. But it is an issue which is out there and which will arise soon if the main holdings of the May 2005 decision are upheld on rehearing.
- **When Will Reimbursement Become a Factor?** Despite *Frank's Casing*, most carriers will **not** exercise any theoretical "right" of reimbursement except when all the stars line up precisely and most likely all of the following conditions being present:
 - **Reasonably solid coverage positions.** This means that the coverage position are staked out clearly and are perhaps updated as the underlying litigation or declaratory judgment actions proceed.
 - **Well-written and timely reservations of rights letters,** including specific *Frank's Casing* language setting out the assertion of the right of reimbursement. Often this is a fatal flaw in the carrier's position in that no one took the ROR issue seriously to insure that they are timely and worded properly.
 - **A solvent insured.**
 - **Generally good "equities" viz a viz the insured.** This means that perhaps the insured has been arbitrary, has not been willing to methods to adjudicate or resolve the coverage issues or where coverage is highly questionable or where there is obvious or suspicious collusion between the insured and Plaintiff.
- Construction Litigation is a highly fertile minefield for *Frank's Casing* issues in that these four conditions often are present in construction litigation.

- ***For All in CD Litigation*** - - carriers, Plaintiffs, Defense counsel, personal counsel - - **Coverage** is no longer a “non-issue”. It is now critical. Reflection and analysis of “Coverage” cannot “wait” until the last minute. There can be no knee-jerk letters to the carrier or from the carrier.
- ***For personal counsel. Beware*** of “demanding” settlement by a carrier. On receipt of a *Stowers* demand, suggested letter to Carrier: “Dear Carrier: Here is a demand from the Plaintiff. We leave it to you to protect our interests. We want you to pay everything you are contractually obligated to pay. Please do not pay any more.”
- ***For defense counsel.*** Every aspect of comment to the carrier must be thought through.
 - Handling the “policy”?
 - Addressing and finding “manifestation” policies? How far does defense counsel have to go in finding “other coverage” when the present status of coverage is questionable?
 - ***Attention to ROR?***
 - Comments on settlement. Can defense lawyer call the settlement “Reasonable”?
 - ***Mediation.*** Waiver of *Frank’s* issues? Great deal of preparation? Personal counsel? Mediators are going to have fully understand the nuances of *Frank’s Casing*. There are several instances in Central Texas where all of the defense counsel and all of the carrier’s have expressly agreed to mediation solely on the condition that all *Frank’s Casing* rights to reimbursement are waived in writing in advance of the mediation. This type of agreement reflects how profound *Frank’s Casing* changes Texas law. Reimbursement was never in the back of any defense lawyer or personal lawyer until the opinion of *Frank’s Casing*.
 - ***Flash point:*** Dealing with a solvent insured / client who is under the gun in cases where coverage issues are prominent and where the relationship with the carrier is somewhat conflicted.
 - Don’t wait until the last minute to consider *Frank’s Casing* issues.
 - ***Documentation.*** Attention to settlement documents and reimbursement issue. How to address *Frank’s Casing* in settlement discussions? When the carrier has never thought of *Frank’s Casing*, does the Defense counsel raise the issue?
 - ***Ethical*** and Bad Faith issues for Defense counsel and carriers: ***Right to Independent Counsel*** - - *Davalos v. Northen County Mutual*, 140 S.W. 3d 685 (Tex. 2004). Will

this be the flash point and new demand? The contention by personal counsel will be: *Frank's Casing + Davalos* creates the right for an independent counsel not controlled by the carrier.

- Cases Which are Implicated by *Frank's Casing* but never mentioned by the Supreme Court. The briefs discuss these cases in great detail.
 - *State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696 (Tex. 1996)
 - *Farmers Texas County Mut. Insurance. Co. v. Griffin*, 955 S.W.2d 81, 84 (Tex. 1997).
 - *Universe Life Insurance. Co. v. Giles*, 950 S.W.2d 48 (Tex. 1997).
- How *Frank's Casing* Impacts *Stowers* Claims?
 - *Frank's Casing* is directly related to what constitutes a "Stowers Claim".
 - *Frank's Casing* quotes *American Physicians Insurance. Exch. v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994) at footnote 26 as follows: " The *Stowers* duty is **not** activated by a settlement demand unless three prerequisites are met: (1) ***the claim against the insured is within the scope of coverage***; (2) the demand is within the policy limits; and (3) the terms of the demand are such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to an excess judgment."
 - This language has been in *Garcia* since 1994. However, with this new Supreme Court, ***any carrier*** responding to a *Stowers* claim can and should consider stating that there is no "Stowers duty" in that ***the "claim" (or part of the "claim") is not covered*** with a citation to *Garcia*. It is one main contention of counsel for *Frank's Casing* and all the supporting case of parties and lawyers that there is no NEED for a right of reimbursement since the carrier can simply refuse to "pay" a *Stowers* demand based on a lack of coverage. That is, the lack of coverage is qualitatively different from the fact that the underlying liability in the litigation in question may or may not be in "question". Liability may be certain, but due to a lack of coverage, a *Stowers* "duty" is not "***activated.***" The problem which Hecht and the majority are concerned about is the fact that the carrier has to allegedly "guess" on coverage in connection with the *Stowers* demand - - in the face of a risk of an excess verdict for the insured. ***Hecht would say:*** if you force a carrier to pay a potentially uncovered loss to reduce risk for the insured, then you need to give that carrier a right of reimbursement for those portion of the settlement which is not covered.
 - **Personal counsel** for the insured **SHOULD USE EXTREME CARE** in

“demanding” that a carrier pay a *Stowers* demand in a construction case in that almost certainly some of the claims will be not be covered under a CGL policy.

- ***Defense counsel*** should use Extreme Care in commenting on any *Stowers* Demand in that such comments may inadvertently establish the “reasonableness” of the demand. In the past, the “client” always wanted the case settled and for the carrier to pay. With a right of reimbursement looming out there, defense counsel must be wary of inadvertently comments on what the carrier is supposed to do or the reasonableness of the settlement or any aspect of the ROR or coverage issues which might implicate reimbursement considerations.
- ***Coverage Counsel***. There are many opportunities for coverage counsel (or carriers) to know crate leverages *viz a viz* a *Stowers* demand in a CD case which did not exist before May of 2005. Understanding the nuances of *Frank's Casing* can provide a carrier with push back positions which will offset the time pressures and time demands of Plaintiffs and foolish personal counsel. **Caveat**: the push back and leverage will not be effective unless the ROR positions on coverage have been fully developed, timely, and properly set out in good ROR letters - - ROR's which are timely supplemented so as to make them relevant and meaningful at the time of settlement. That is, a pre-textual ROR which cites to every provision in the policy will not be useful in creating leverage against *Stowers* demands.
- **Plaintiffs**. Plaintiff may find that broad and vague *Stowers* demands do no good. It may very well be that the COVERED position of the damages exceed the relevant policy limits. Therefore, a carefully drafted *Stowers* demand in a CD context might refer to only the covered portions and yet agree to settle the entire case. There is no hard and fast rule on this point at this time. What seems clear is that in the drafting of a *Stowers* demand in a highly conflicted CD case, Plaintiffs must consider the *Garcia* admonition that the *Stowers* duty is **not** activated by a settlement demand unless “the claim against the insured is **within** the scope of coverage . . .”
- ***Insured's Personal Counsel***. This role will be much more demanding in the future in light of *Frank's Casing*. In the past, this role was writing a big pompous demand letter to the carrier with a short time demand. Personal counsel writing such letters now in light of *Frank's Casing* do so at their peril and at the peril of their unsuspecting clients.
 - Personal counsel must be crystal clear what the "coverage issues" are. They insured's defense counsel and perhaps personal counsel should have long since been aware of exactly where all the coverage bones are buried. This is a huge change in and of itself in Texas law.
 - Unless the *Frank's Casing* holdings are drastically changed on rehearing, personal counsel or defense counsel should never “demand” that the carrier settle the case or

write the carrier and state that the settlement is "reasonable" unless and until all coverage issues are resolved or where there has been some kind of agreement with the carrier on coverage. There is just too much risk that the carrier would jump on the settlement and then turn on the insured. Even if the insured is judgment-proof, the fact and reality of the expense of defending **ANOTHER** lawsuit just after this one has settled is a fate which the insured will most likely want to just about anything to avoid.

- ***Pressure on the Insured.*** It has been stated as a concern that the balance of power has been tilted from a bias against the carrier, to a bias against the insured. While this may be overstated to some extent, clearly the insured who is solvent and who can respond truly to a large settlement and has the means to spend and lose at the trial of a coverage dispute - - that insured is *under the gun in light of Frank's Casing* in construction defect cases.
- ***Plaintiff and personal counsel must know the characteristics of the insurance company.*** Some carriers would never seek reimbursement. Some might seek it in many cases. It is going to be important in the future to know ahead of time the **tendencies** of the carrier as to settlement and reimbursement issues long before discovery is closed. So often - - everyone "assumes" that the cases will settle. In the past, they often have settled. It is likely in the future that more cases will be driven to trial by *Frank's Casing* types of concerns. The lawyer most at risk in this new scenario is the Defense lawyer - - he or she thinks that the case "will settle" when in fact there are coverage issues. The defense lawyer has lagged in the defense and is not really ready for trial.
- ***Coverage Issues Are No Longer on the Back Burner.*** For decades, "coverage issues" got buried in settlement. This is, in essence, is what the Supreme Court is putting an end to in this case. Any lawyer who has any significant tort experience in Texas over a 20 year period knows this to be accurate. Also, it has often been said countless times by "defense counsel" hired by carriers' to represent the insured - - "I cannot worry about coverage issues".
- ***The risks of last minute settlement are no longer on the carrier.*** Smart counsel on both sides will now have to take the Request for Disclosure requires for "the policy" or "all policies" very seriously. For those who have not done "defense work", it would come as a complete shock as to how difficult it often is to "get the policy". It is also going to be a critical task to get the policy and to get the policy "right". In some cases in which I was involved, I required the agent to verify that the policy given to me was correct, and I would not produce an instrument as "the policy" unless I got the insured AND the carrier to both agree in writing or by email what "the policy I was producing was correct". Such issues are going to be far more dramatic in their implications after *Frank's Casing*.
- ***Ethical Issues: Defense Counsel.***
 - Nearly every commentator or observer who has read *Frank's Casing* has noted that the defense lawyer hired by the same carrier who is seeking reimbursement is going to face numerous and repetitive ethical quandaries.

- The leading case which raises these issues is *Davalos v. Northen County Mutual*, 140 S.W. 3d 685 (Tex. 2004) (“**Davalos**”). It has been suggested that a reservation of right to seek reimbursement is an irreconcilable conflict under *Davalos* for which the insureds is entitled to separate and independent counsel. See Perschback, *Be Careful What you Wish For: The Potential Pitfalls Facing Insurers after Frank’s Casing*, JOURNAL OF TEXAS INSURANCE LAW.
- **For the insured**, on receipt of a draconian reservation of rights letter, the insured should consult personal counsel to consider whether, under *Davalos*, there is an independent right to counsel. Negotiations with the carriers may then proceed so that the carrier waives the right of reimbursement while the insured waives the right of independent counsel. It is my belief that this will likely be the "typical" mode of negotiations early in the suit between the carriers and insureds in light of *Frank's Casing*. This is one potential aspect of how the insured can regain some leverage *viz a viz* the carrier.
- **Close Attention must be paid to all reservation of rights letters.** Did the carrier reserve a right to seek reimbursement in the ROR? This may or may not be determinative, pending the final opinion in *Frank's Casing*.
- **A must:** obtain exact copies of the policies. Not an approximation. The insured must pay close attention to this. Defense counsel hired by the carrier can no longer shift that risk to the carrier. This “policy” may have significant reimbursement implications.
- **Manifestations policies?** Whose duty to obtain them?
- **Another key consideration is the "reasonableness" of the settlement.** Defense counsel and personal counsel should use care on commenting on the reasonableness of a settlement demand or a settlement posture. While the counsel for EU stated in oral argument that there was no change of the ethical obligations of the defense lawyer in light of the holding in *Frank's Casing*, many other commentators and counsel in the Amicus briefs have taken a different position and have concluded that *Frank's Casing* will necessarily mean significant new ethical considerations and dilemmas for the defense lawyer.

OTHER AUTHORITIES

1. Collins and Frizzell, **Annual Survey of Texas Law: Article: Insurance Law**, 59 SMUL REV. 1379 (Summer 2006). “The ultimate decision in *Frank's Casing* will likely influence litigation on a related issue - whether an insurer is entitled to reimbursement from the insured of costs paid to defend the insured if it is determined that the insurer had no duty to defend the underlying action. While this issue was hinted at by Justice Owen and Justice Hecht in their dissent in *Matagorda County*, it was not addressed by the Texas Supreme Court in either *Matagorda County* or *Frank's Casing* and has not been squarely decided by any Texas court. However, a federal district court in another jurisdiction has relied on *Frank's Casing*

and "suggestions" in the court of appeals' decision in *Matagorda County* to conclude that the Texas Supreme Court would apply the doctrine of quantum meruit **and would permit reimbursement of defense costs** if the insurer reserves its rights and notifies the insured of its intent to seek reimbursement in the event that it is later determined that there was no duty to defend. *St. Paul Fire & Marine Insurance. Co. v. Compaq Computer Corp.*, 377 F. Supp. 2d 719, 722-25 (D. Minn. 2005)." (Emphasis Added) ¹

2. Lee H. Shidlofsky, *A Primer on the Right to Independent Counsel*, Texas State Bar Insurance Law Section (June 15, 2006). This is an excellent source on *Davalos v. Northern County Mutual*, 140 S.W. 3d 685 (Tex. 2004).
3. Glen Wilkerson, *Frank's Casing*, CLE State Bar of Texas, Advanced Personal Injury Seminar (Summer 2006). It is my understanding that this will be posted on the Section website. This paper has the **full text** of the May 2005 *Frank's Casing* opinions.
4. Shortly after the argument in **February of 2006**, there was an on-line email discussion of the arguments by the respective counsel for Frank's and EU. This dialogue is interesting and worth reviewing. The full text of the discussion can be found at this site. The following language is quoted without editing except for the noted emphasis. The lawyers are: Warren W. Harris (Bracewell & Giuliani) and Karen Milhollin (Westmoreland Hall, Houston), ***Frank's Casing: An Online Discussion, Texas Lawyer, February 16, 2006.*** <http://www.law.com/jsp/tx/PubArticleTX.jsp?id=1139997911270>. Harris represents Frank's Casing Crew & Rental Tools Inc. Karen Milhollin represents Excess Underwriters at Lloyd's.

1. ***Why do you believe the Supreme Court agreed to rehear this case?***

1. Karen Milhollin: "I don't think the Supreme Court agreed to rehear the case to change the ultimate result (in favor of Excess Underwriters). In the original opinion all of the justices agreed that Underwriters was entitled to reimbursement. There has been a rather significant change in the membership of the court since the original opinion, and there appears to be some disagreement as to which theory of law applies (implied-in-fact or implied-in-law), to obtain reimbursement for Underwriters, and, probably more significantly, how that theory will be applied in future cases -- particularly those involving primary insurers with a duty to defend."

2. ***Describe the impact of Frank's Casing on the practice of law.***

1. Harris: "The rule announced in *Frank's Casing* creates a new conflict with

¹ This Minnesota case is indicative of the issue of "defense costs" being on the near horizon.

defense counsel.² Counsel is now going to be hesitant to comment on any *Stowers* [*G.A. Stowers Furniture Co. v. American Indemnity Co.* (1929)] demands from the underlying plaintiff for fear of giving rise to an implied reimbursement right.³ It changes the way parties negotiate settlements.” (emphasis in original)

3. ***Has the decision injected any uncertainty into the law?***

1. Harris: The court's decision injected uncertainty regarding *Stowers* and *Gandy* [*State Farm Fire and Casualty Co. v. Gandy* (1996)] and many other areas of insurance law. Lawyers representing insureds are now uncertain as to what they can do or say to insurers regarding settlement offers under *Stowers* and whether such comments will trigger a right to reimbursement. In *Gandy*, the court required insurers to attempt in good faith to resolve the coverage dispute before the underlying plaintiff's claim was adjudicated so that the insured would know, before a settlement decision had to be made, whether there was coverage. Under the decision in *Frank's Casing*, early resolution of coverage disputes is no longer encouraged.⁴

4. ***Are settlement hearings now more difficult because of the decision?***

1. Milhollin: No, in fact settlement hearings may be easier as a result of the *Frank's Casing* opinion. Prior to *Matagorda*, it was our experience that coverage issues remaining to be decided at the time of a reasonable settlement offer were often disposed of by compromise between the insurer and insured, with each desiring to avoid future litigation. Some of the time that involved contribution by the insured toward settlement, if the coverage

² I agree with this comment. I think that the real world ethical implications and complications or counsel retained by insurance counsel in CD cases are significant, if not substantial. Carriers in CD litigation are reducing coverage. More and more of the “claims” are not covered. To the extent that the market withdraws coverage, the issues raised by *Frank's Casing* will become ever more prominent. In some cases today, there is a “defense” in name only - - none of the major claims are “covered”. The Justices are out of touch with this reality even though *Lamar Homes* is pending at the same time as *Frank's Casing*.

³ How to “convey” *Stowers* demands will be a critical issue in CD litigation. The Defense lawyer must have thought about “coverage” long before getting the *Stowers* demand.

⁴ The inconsistency of *Frank's Casing* May 2006 opinion and *Gandy* was an issue in several of the briefs in support of *Frank's*.

defenses were particularly strong. Other times it involved capitulation by the insurer on the coverage issues, if the settlement was favorable, and the coverage defenses not conclusive either factually or legally. *Matagorda* unsettled the art of compromise, because the insurer was forced to refuse to fund a settlement, if it believed it had a fair chance of victory on the coverage issues: If it settled, and the insured refused to consent to coverage litigation, the insurer waived its right to litigate coverage. *Frank's Casing* restores the balance by allowing each side to objectively assess the coverage case, the underlying case and the best interests of the parties. It does not encourage insurers to settle immediately for a higher-than-normal demand: That would simply require more of the insurer's immediate out-of-pocket funds, an indeterminate time period that the insurer will lose the use of that money, the possible loss of reinsurance coverage, and the additional cost of coverage litigation that may take years with no ultimate guarantee of a favorable outcome.⁵

2. Harris: Settlement is now much more complicated. *Frank's Casing* gives a new leverage⁶ to insurers to use the coverage dispute to pressure insureds into contributing to settlements. It also puts counsel for the insured in a more difficult position because of new conflicts that will now arise during settlement discussions.

5. ***Does Frank's Casing stand for the proposition that an insured should only get coverage that they've paid for?***

1. Harris: Prior to *Frank's Casing*, the burden had always been on the insurer to decide the validity of its coverage defenses. The insurer now asks the court to imply in law a right of reimbursement, when the insurer chose not to put a reimbursement provision in the insurance contract.

2. Milhollin: Yes, it reinforces the most basic of contract notions: You only get what you pay for. It is ironic that it is the large corporate insureds raising the biggest hue and cry over the *Frank's Casing* opinion. Those insureds have their own risk managers, their own in-house counsel and their own professional brokers who negotiate their insurance contracts. These commercial entities make complicated business decisions nearly every day

⁵ This position is not realistic. This may have been true partially in mega-insureds – Shell Oil - - but not in the typical litigation where a “new” lawsuit for reimbursement would be catastrophic for most insureds.

⁶ “Leverage” is the operative word. *Frank's Casing* significantly changes leverage. The Court was tired of last minute “demands” which gave the carrier no options.

as to the amount and type of risk they will pay to have covered by insurance. The particular contract involved in this case was a heavily negotiated manuscript contract presented by *Frank's Casing's* broker. ⁷ *Frank's Casing* chose what coverage it wanted and how much premium it wanted to pay. Just because an insurance policy is involved does not mean that regular contract principles fly out the window. The insurers received no premium for uncovered risks, and they should not be forced to pay uncovered risks simply because it is an insurance policy. ⁸ Ultimately, the risk of paying uncovered claims of an insured is passed back to other insureds who never contemplated or agreed to pay the costs of someone else's loss.

6. ***What was the most surprising moment at oral argument yesterday?***

1. Milhollin: Probably the most surprising moment was the questioning by the court which seemed to indicate that there continues to be a difference of opinion as to whether the right to reimbursement is implied-in-law or implied-in-fact. Each justice seems to have a slightly different opinion.
2. Harris: I did not even get one sentence out before the first question. At the first argument, I at least got a sentence out before the questioning began.

7. ***Do you consider the Stowers references in the original majority opinion to be gratuitous dicta? Was Owen correct in saying that the ordinarily prudent person standard in Stowers is the same as the ordinarily prudent insurer in Garcia? What difference does it make in Frank's Casing? (Email question From Bob Allen, Baker & McKenzie)***

1. Milhollin: No, I don't think its dicta. The reason that it was unfair for Excess Underwriters to have to pay the settlement was the Catch-22 it was put in because of *Stowers*. If it did not pay the settlement, and there was coverage, it potentially faced bad faith liability under *Stowers*. I think that Owen's analysis was correct. If you're the insurer looking at a *Stowers* demand, you have to consider whether an ordinarily prudent insurer would accept the settlement. I think that the ordinarily prudent person standard is just word

⁷ This fact does not come out in the opinions. This is a critical fact which no doubt probably influenced the court.

⁸ The bottom line agenda of *Frank's Casing* is: there has to be some mechanism whereby a carrier can protect itself from having to be **FORCED - - via a *Stowers* demand - -** to pay claims which are not covered. The need is apparent to modify the *Stowers* doctrine or "bad faith" and perhaps **not** create a new right of reimbursement. This is what Wainwright suggested.

choice: it is the same in substance.

2. Harris: 1. No, because it was part of the court's holding. 2. The Better-reasoned approach appears to be the prudent insurer standard in *Garcia*. 3. It shouldn't.

8. ***If you are personal counsel for an insured in a serious case in which coverage is disputed, how can you protect your client from a reimbursement claim, when a reasonable demand has been made within or for policy limits? What is the protocol for dealing with coverage counsel and defense counsel who is keeping the personal counsel out of the loop on settlement discussions?***
 1. Milhollin: I don't think that anything you say or do as the insured's counsel is necessarily going to protect them, or for that matter expose them, to a coverage action. The insurer is going to be interested in getting the underlying case settled for a reasonable sum, just as the insured is. The question, which is fact-dependent, is how much of a coverage dispute is there and how strong or weak are the coverage defenses. Under *Traver*, the defense counsel owes all duties to the insured. If there is a reasonable settlement demand, and the insured wants to settle, it does not hurt the insured to agree to the settlement. If the insurer is insisting that there be a coverage action to determine reimbursement, the insured can try to negotiate with the insurer, can agree to arbitration of those issues, or can take over the defense if it chooses. The insured should remember that most insurers are going to want the case to settle at a reasonable amount also in case they lose on the coverage dispute. ***Since the defense counsel owes all duties and loyalties to the insured, the insured needs to insist that its personal counsel be kept in the loop, and if defense counsel fails to do so, the insured has a right to demand new counsel. (Emphasis Added)***⁹
 2. Harris: As pointed out by the TADC in its amicus letter, counsel for the insured is in a tough position. Under *Frank's*, counsel for the insured may well create a right of reimbursement by forwarding this demand. Personal counsel should be very careful in giving advice or in communicating with the carrier.

9. ***After oral argument yesterday, do you have any impression as to whether the court is inclined to narrow the right of reimbursement in their revised opinion? Also, did***

⁹ This discussion of the high duty of "defense counsel" that is inconsistent with how much carriers want to "pay" for this additional work. Carriers typically want to control these costs. The ethical conflict in *Frank's Casing* is apparent to anyone who does CD defense work for insurance companies.

you get a feel as to how soon the revised opinion might be expected?

1. Milhollin: It was hard to tell. One of the most surprising questions came from Justice O'Neill, who asked whether it would be ok to just remove the part of the opinion referencing *Stowers*. Justice Johnson seemed aligned with Justice Wainwright on the issue of the reimbursement remedy being implied in fact and not implied in law. I got the feeling that the opinion may be tweaked a little, but the result will not change. I would expect an opinion in the next 60 days.
2. Harris: We are hopeful the court will withdraw the opinion and apply existing Texas law of *Matagorda County*. We expect the court will change the new rule created in *Frank's*. We have no idea when the revised opinion will be issued.

10. ***Did any of the court's questions reflect any consideration of the potential issues for insurance-defense counsel if the 2005 opinion remains the law?***

1. Milhollin: I didn't get the impression from the justices that they thought this was a big issue -- but, of course I could be wrong. They seemed to think that defense counsel's duties to the insured are rather clearly outlined by their previous opinions.
2. Harris: Justice Wainwright asked several questions on this issue. *Underwriters takes the position there is no conflict. (Emphasis Added)*

3. Milhollin: *Underwriters do take the position that there is no conflict.*¹⁰ The Supreme Court has been very clear in its prior opinions, particularly *Traver*, that if there is any question in retained defense counsel's mind as to whom his/her duties are owed, that they are to err on the side of the insured and tell the insurer to retain its own separate coverage counsel.

11. ***When the insured demands that an insurer settle a case, and there are significant coverage issues remaining, from a public policy perspective, why should the carrier have to give up its coverage defenses when funding the settlement? Can this be effectively handled through a further reservation of rights, if the insured simply refuses but still demands funding of the settlement?***

¹⁰ I (Glen M. Wilkerson) believe that this position is *incorrect*. There may be very large and sometimes fatal conflicts which arise due to *Frank's Casing*. **Not** in every case. But a great potential is there. The burden is on ethical insurance defense counsel to be sensitive to these issues. Again - - in a major case with a solvent insured and the right carrier - - these "conflicts" could be explosive.

1. Milhollin: Yes, and this was common practice (at least for our office) before the *Matagorda* opinion. If we had a strong coverage case, we pushed contribution from the insured or at least a right to litigate coverage after the settlement and would put these agreements in writing. The problem is that *Matagorda* prevented the insurer from doing this, and only gave it the option to refuse settlement, which benefitted no one. The other obvious problem is that if insurers are forced to pay uncovered claims, the costs of those settlements will be pushed back to other insureds in the form of higher premiums, and those other insureds never contemplated having to pay for another company's liabilities.
 2. Harris: Carriers are required to make coverage decisions every day. They are not required to always be correct about coverage, but they are required to act reasonably. Carriers can also make policies more clear. A further reservation of rights would not work, because the insurer is not reserving a right in the policy.¹¹ It is seeking an extra-contractual right from the insured and should be required to show that the insured expressly agreed to the extra-contractual right.
12. ***If there is a genuine issue of no coverage, why shouldn't the insurer always be required to seek declaratory relief, so that the insured knows what settlement funds, if any, are available?***
1. Milhollin: I would say the biggest problem is in those cases where the coverage issue is somehow dependent upon the underlying case. If coverage depends upon discovery or adjudication of liability issues, there is no way that the insurer can seek a timely declaratory judgment (one which adjudicates coverage before the underlying case is ripe for settlement). The other problem is that most insurers do not want to litigate coverage at the same time their insured is litigating the underlying case because it opens them up to bad faith claims. The third problem is that most of these issues tend to get resolved by compromise during settlement negotiations of the underlying case. The third option is probably the best, and if the insurer is required to file suit, it dampens the likelihood of compromise.
 2. Harris: We agree. The insurer properly has the burden to decide whether the coverage defenses it raises are valid. That has long been the law in Texas.

¹¹ This comment gets to the heart of the case. In theory, you can not "reserve" a right which does not exist in the first place in the policy. This is what makes the Supreme Court's task difficult. The result – EU paying 7 million and having no coverage - - is absurd. But what is the remedy?

13. *I know this is rather simplistic, but under regular contract principles, can't the right of reimbursement simply be bargained away as a term of settlement at mediation?*

1. Milhollin: I think that is where Justices Johnson and Wainwright are at: Here, the underwriters made it a condition of settlement that coverage be litigated, and *Frank's* accepted the settlement.¹²
2. Harris: The insured can agree to reimbursement, but if it is not an express right in the policy, there must be an express agreement by the insured before the insurer gets this extra-contractual right.¹³

14. *In Frank's Casing the insurer is asking the court to insert a right to reimbursement not found in the policy. In the punitive damages case pending before the court, the insurer is effectively asking the court to insert a punitive damages exclusion not found in the policy. In the Fielder Road case pending before the court, the insurer is effectively asking the court to preclude defense obligations for false claims, even though the policy expressly provides for a defense against false claims. What is behind this apparent trend of insurers asking the Texas Supreme Court to re-write policies after occurrences to include favorable provisions that the parties did not bargain for or agree to?*

1. Milhollin: Wow, I didn't think it was a trend. I don't know about the other cases, but the right to reimbursement is an inherent part of the contract. The insurer agrees to pay only covered claims. The insured agrees to retain the risk of uncovered claims. The *Frank's* opinion simply enforces those basic contract rights. Nowadays nearly 99 percent of our insureds are submitting their own contract wording via their broker. If they want an express reimbursement right, i.e., the assured agrees that in the event the underwriters pay money for an uncovered claim they will reimburse them, they could certainly insert one into the wording. I suspect that they would have to pay higher premium for it -- but, I think it's kind of silly. What comes next? Are we going to have to put into the contract all of the risks that aren't covered, all of the people who aren't insured, all of the inherent rights and obligations

¹² This is the EU position on the "express contract". It is not clear from the opinion itself how definitive EU was that Frank's "acceptance" (by silence or otherwise) meant that Frank's was "agreeing" that coverage would be litigated in the future.

¹³ This is the Frank's position on "express contract". Was there an "express contract" in this case? Where was the "acceptance"? Wainwright gets there by "silence".

of the parties? The contract would be 9,000 pages long -- and then we would really have some contract disputes. (Emphasis Added) ¹⁴

2. Harris: This is especially troubling when the court in *Matagorda County* told insurers how they could fix the reimbursement problem.
15. *Assuming the opinion stays the same and insurers may go ahead and settle and then seek reimbursement from the insured, do you have any suggestions as to how the settlement papers should be drafted to allocate the payment between covered and non-covered claims? Obviously every case will be fact specific, but any general suggestions?*

1. Milhollin: It depends on which side you're on and who is drafting the papers. Obviously, insureds try to allocate the payments in the settlement papers to make it appear that all of the money was paid for covered claims. If the insurer is funding the settlement, the issue of whether the money is for covered claims is typically not addressed. If retained defense counsel is drafting the papers, I would think they would owe a duty to their client to try and allocate as much of the settlement as possible toward covered claims. If the parties cannot agree, they may have to simply note that rights are reserved to dispute what amount of settlement was allocated for which claim.
2. Harris: I believe there is very little law on allocating claims. This will fact intensive and case specific, sorry. ¹⁵

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¹⁴ This suggests that Frank's Casing is not a "typical case" at all. This may be the end result. A case with little practical application after all. Clearly, most policies are not "brokered".

¹⁵ This dialogue illustrates how much about the "future" is uncertain **IF** the Court permits a "**broad**" -- i.e. quasi-contractual / estoppel like -- right of reimbursement.