ORAL ARGUMENT -- 2/15/06
05-0730

EXCESS UNDERWRITERS AT LLOYD'S, LONDON AND CERTAIN COMPANIES SUBSCRIBING SEVERALLY BUT NOT JOINTLY TO POLICY NO. 548/TA4011F01
v.
FRANK'S CASING CREW & RENTAL TOOLS, INC.

Petitioners were represented by Mr. J. Clifton Hall, III (Westmoreland Hall), from Houston, Texas.

Respondent was represented by Mr. Warren W. Harris (Bracewell & Guiliana), from Houston, Texas.

CHIEF JUSTICE: Thank you. Be seated please. Good morning. The Court has three matters on its oral submission docket. In the order of their appearance they are Docket No. 02-0730, *Excess Underwriters at Lloyd's v. Frank's Casing Crew & Rental Tools*, from Harris County and the Fourteenth Court of Appeals District. Justice Brister is not sitting in this cause. Docket No. 04-0933, *The City of Grapevine Texas v. Amy Sipes and Tana Trevino Waddell*, from Tarrant County and the Second Court of Appeals District, and Docket No. 03-0914, *Hyundai Motor Company v. Victor Manuel Vasquez and Brenda Suarez Vasquez*, from Bexar County and the Fourth Court of Appeals District. Justice Green and I are not sitting in that cause. The Court has allotted twenty minutes per side in each of these arguments and will take a brief recess between the arguments. We expect to complete all three of them before noon. These proceedings are being recorded and a link to the argument should be posted on the Court's website by the end of the day today. The Court is now ready to hear argument in 02-0730, *Excess Underwriters v. Frank's Casing.*

MARSHALL: May it please the Court. Mr. Clifton Hall will present argument for the petitioners. Petitioners have reserved five minutes for rebuttal.

MR. HALL: May it please the Court. I am Cliff Hall and there's been quite a lot written about this case and the opinion since the Court issued it last year and it has been a bit of a challenge to decide which of those issues that have been raised to come here and talk to you about, especially with **(inaudible)** to come and I am sure you have your own individual ideas as to what you want me to talk about, but if it was left to me there's four main things I want to cover today. The first is that the Court has not in the *Frank's Casing* opinion created a new right of reimbursement that does not exist in an insurance policy. I think that what happened and what the Court did in *Frank's* is recognize what it had previously recognized as a right that insurers have to litigate coverage and that under the circumstances of the *Frank's* case that that right was not lost merely

by virtue of a demand and an insurer acceding to that demand in settling or funding a settlement that is its insured agreed. The second thing I want to talk about is a conflict or the alleged conflict that *Frank's* creates for defense counsel because I think that argument is a loose rat. I don't believe that it changes the duties or responsibilities of defense counsel in any way. I think defense counsel can act as they have acted in the past in handling these cases. Third point that I want to address is that there's a whole bunch of arguments that I think fall under the heading of insurance companies are bad, insurance companies are evil, and insurance companies can't be left to their own devices or left to be dealt with like everybody else is dealt with, and therefore, we need to constrict the ruling in *Frank's Casing* and constrict the ability of insurance companies to act. I think that the response to that is that's not what happened in this case in the first instance but Justice Hecht said in his **(inaudible)** paragraph of his concurrence was we are not saying the insurance companies can act with prejudice to their insurers, we are not saying insurance companies don't have the obligation to act in good faith and if they don't there are plenty of remedies that are available to deal with those insurance companies. And then the last thing I want to address is why I believe that *Frank's* is good policy and that *Frank's Casing* will result in the right kind of things happening in the handling of these cases and will result in ultimately the party that can either -- that the determination of who pays will be made as a result of the determination of whether there is coverage under a policy.

JUSTICE O'NEILL: Will it result in lower premiums?

MR. HALL: Well, I think it results in a more free market place which I think tends to result in lower premiums.

JUSTICE O'NEILL: Isn't that a job for the insurance commissioner by contract?

MR. HALL: What is that Your Honor? That job to . . .

JUSTICE O'NEILL: Well, I mean there is an argument made that the insurance companies are going to get a windfall because reimbursement has not been the norm until *Frank's Casing*. And now if they can get, recoup these monies that there should be a decrease in premiums and isn't that highly regulated here and in *Matagorda County* we said put it in the contract and let the premium fall out accordingly.

MR. HALL: Well, there are a couple of answers to that. One, in the excess of surplus lines market which is what this case arises under, it's not a homeowners, auto, personalized insurance which is what is highly regulated by the state, it's the excess of surplus lines market which is a market where larger asssureds, more sophisticated assureds that have more difficult problems that don't fit into the ordinary sort of book business. The State of Texas, as indeed every state I believe, has recognized that they have not been regulating excess of surplus lines of market like they do with the homeowners personalized type of insurance. Is that . . .

JUSTICE O'NEILL: So all the easier then to put it into the contract?

MR. HALL: Well, let me address that in this way because I think that there is in my view a misconception about this right to reimbursement. Because I don't think that's what the Court is talking about or has done at all. What the Court recognized in **(inaudible** at 6:39**)** *Griffin* and *Gandy* and in other cases is an insurer has a right, indeed an insured has a right, to litigate whether or not their policy provides coverage under a certain circumstance. I think that that's a given. All right. And the Court says in *Gandy* and *Griffin*, you should do that early if you can and the Court recognizes you can't in all circumstances do that. Sometimes there are a lot of reasons that you might not be able to, but sometimes you can't get the coverage determination made before the underlying case is ripe for settlement. That's what happened in this case. That's what happened in *Matagorda County* case. The right to litigate coverage was there. The right to litigate coverage had not been brought to fruition before the critical moment comes up in the underlying case. Now, the question is what happens, why is it that that right to litigate coverage is somehow lost because an insured demands settlement? An insured negotiates a settlement, demands that its insurance company fund the settlement and then takes advantage of that settlement when it is made with the express condition --we are going to continue to take the non-coverage position and we are going to exercise our right - continue to exercise our right which the Court has acknowledged exists.

JUSTICE: Who determines when a case is ripe for settlement?

MR. HALL: That's determined by the factors in the underlying case.

JUSTICE: Well isn't the insured or is it the insurer who is attempting to dictate when a settlement should be made?

MR. HALL: Well in the case -- in Frank's case it was the insured. The insured controlled the defense. Underwriters are excess underwriters. They have no defense obligation. They didn't participate in the defense. They didn't control the settlement negotiations. They were told, we've got a deal by Frank's. We've got a deal, we want you to pay it. And if you don't pay it we are going to hold you liable under *Stowers*.

JUSTICE MEDINA: And you are essentially telling the insureds to settle at their own peril, right?

MR. HALL: No. All I'm saying is the insured can do one of two things. You can settle or not settle. It controls. Nothing in *Frank's* says that insurers have a right to force them to settle. Can't do that. There's nothing in the opinion that says that. All it says is if an insured decides I want this case settled and then makes a demand, or if they don't make a demand and say instead we accept, expressly accept that settlement is what we want in this case. Okay, those are two important contingencies. Absolute control in settlement, it rests with the insured. They don't have to settle. But if they decide they do want to settle and the insured, excuse me, the insurer, has reserved its rights and said look, there is a coverage dispute here and if you want me to settle, you want me to fund your settlement that you have entered into, that's what happened, you want

me to fund your settlement, I'll pay the money but I am going to continue to exercise my right to litigate whether or not I owe them. And if ultimately I prevail in the right that I have recognized by this Court to litigate coverage, if I ultimately prevail then my remedy is reimbursement. Because . . .

JUSTICE MEDINA: That removes the incentive for early settlement if there's that risk hanging over the insured's head that they can't settle the case because the insurer has a different opinion as to the value of the case. What's the purpose of trying to resolve a case and save costs down the road?

MR. HALL: Well total control with defending the case rather than the **(inaudible)**. Total control . . .

JUSTICE MEDINA: Well, in theory.

MR. HALL: No, no. In practice. This Court has said . . .

JUSTICE MEDINA: Not when you have this type of result hanging over the insured's head that they are settling this case at their peril because under this case now you can seek reimbursement against them.

MR. HALL: Well, . . .

JUSTICE MEDINA: Until the cover issue is resolved.

MR. HALL: You can get reimbursement if the case is covered. If the claim is not covered, I can then, my remedy is I get reimbursement. I get the money back. What's wrong with that?

JUSTICE MEDINA: Right. But you can also hold your reservation rights letter forever. So look, we don't think it's covered go settle the case and we'll resolve it later.

MR. HALL: Well, if you are suggesting that an insurer would do that in bad faith or in some way to leverage their insured, I don't think, one, that's what happened in *Frank's Casing* and there is no suggestion or evidence of that. And, two, if as I said at the outset if an insurer sets out in a practice that intentionally is designed to prejudice its insured or leverage its insured, there's adequate remedies. There's plenty of law.

JUSTICE O'NEILL: How would you ever prove that? I mean, it strikes me that the insurers incentivized now to settle early within policy limits. It cuts off its defense costs and I understand there was no duty to defend here, but as a practical matter in other cases it cuts off any defense costs, it eliminates any *Stowers* liability, and it puts all the onus on the insured then to put its resources into the coverage battle so the insured finds itself not wanting to disagree to the

settlement but then I've got to spend my money fighting a coverage battle down the road and doesn't that defeat the very purpose of getting insurance in the first place?

MR. HALL: Well, why would, with respect, why would an insurance company do that? I've heard that; I've read that in the briefs.

JUSTICE O'NEILL: Well, to save defense costs and protect themselves from *Stowers* liability or bad faith liability.

MR. HALL: So you've got a lawsuit that's pending, you're going to settle early before you know anything about liability, the suggestion is you are going to pay too much money, and then you are going to turn around and sue your insured.

JUSTICE MEDINA: Well, you could settle early . . .

MR. HALL: I have to say, I have represented insurance companies a long time. I don't understand the logic along that.

JUSTICE O'NEILL: But why . . .

MR. HALL: What does that get you?

JUSTICE O'NEILL: Well, it gets them no risk exposure on a bad faith claim and it gets them their money back.

MR. HALL: If there's no coverage.

JUSTICE O'NEILL: Right.

MR. HALL: Well, . . .

JUSTICE O'NEILL: But what I'm saying is . . .

MR. HALL: Why shouldn't they get their money back if there is no coverage?

JUSTICE O'NEILL: But the insurer's resources are going to go towards fighting the coverage battle down the road.

MR. HALL: The insured's resources, if there is no coverage for a claim, the underwriter has a right to litigate that issue of coverage or not.

JUSTICE JOHNSON: Mr. Hall, let me ask a question. Given this scenario where the insured is in charge of the litigation, as I read your policy under the assistance and cooperation clause

here, they are in charge of settlement, defense of the claim as you said. And then we go to when you pay on the indemnity policy. We have an indemnity policy and that is the next clause, J, when you pay either after judgment or after settlement. And then the insured as I read this makes a claim and you have 30 days to decide what is covered or not.

MR. HALL: Correct.

JUSTICE JOHNSON: Now in your scenario, the way this happened you are saying that the insurer made a demand that you pay early before coverage was determined as provided for by your policy.

MR. HALL: Correct.

JUSTICE JOHNSON: And your position is they, by making that demand had to agree to the conditions.

MR. HALL: Correct.

JUSTICE JOHNSON: Okay. Now is that -- the question seems to me like is we have a question of whether we are going to have an implied duty of law or one of fact. And it seems to me like where we are in this case is your policy covers the issue and the question is one of fact. Was there an agreement or not? Am I missing something on reading your policy and your argument?

MR. HALL: I don't think you missed anything on reading the policy and I think that that is an approach that could lead to the conclusion and an analysis, I think it was phrased by Justice Wainwright in the first opinion is there was a deal struck here. There was an agreement. There was an offer.

JUSTICE JOHNSON: Well, no. I want to know what your position is.

MR. HALL: I agree with that. I think that there was in fact a condition that was placed on the funding of the settlement. The insured was not obligated . . .

JUSTICE JOHNSON: Okay. Let me stop you. So if that funding was not made then you had the right under your policy to wait for Frank's to settle, come to you, and then litigate the coverage?

MR. HALL: Yes.

JUSTICE JOHNSON: Okay. So why then, if in fact we talk about two different aspects here. One implied in law, the right of reimbursement. One implied in fact. Now if we are covered under the policy, why would we need to go to an implied-in-law right of reimbursement?

MR. HALL: Well, again I don't think that the right is to reimbursement. The right is to contest and litigate and get an adjudication of is it covered or not. And then . . .

JUSTICE JOHNSON: You have that in your policy?

MR. HALL: Well, it's not in the policy.

JUSTICE JOHNSON: Well, but if you . . .

MR. HALL: This Court recognizes that there is a right implied at law to contest and litigate whether or not contracts . . .

JUSTICE JOHNSON: Whether you had coverage?

MR. HALL: Correct.

JUSTICE JOHNSON: And your policy, I thought we just went over that, your policy provides that if there is a settlement by Frank's, the way it is structured you don't pay until after a judgment or a settlement. Then they make a claim to you and you have thirty days to decide whether it is covered or not.

MR. HALL: Well, that's the feature of the indemnity policy. That's what . .

JUSTICE JOHNSON: Your policy in this case, that's the way it works. Is that . . .

MR. HALL: Correct.

JUSTICE JOHNSON: Okay.

MR. HALL: Correct. But the point I would like to reiterate is the right that's being exercised here is the right to litigate coverage. If you litigate coverage and you can get it concluded before the moment of settlement comes in the underlying case, then the remedy is you don't have to pay if you are correct on coverage. But if you can't get it concluded before the underlying case is ripe for settlement, then your remedy if you have been agreed to fund and it's agreed by the insured and you have agreed and you have put that condition on it that you are going to seek reimbursement, then if you win . . .

JUSTICE JOHNSON: If they accept?

MR. HALL: If they accept and they accept the benefit of the bargain and take the money, then the only way that you can have a remedy if you get a ruling that there was no coverage is to say they get their money back. It's not a right to reimbursement that's being enforced, it is in fact the litigation of the coverage D.J. and the right. The reimbursement is the remedy.

JUSTICE WAINWRIGHT: There is a difference between reimbursement and coverage though.

MR. HALL: I agree with that. I agree with that. But the right to litigate coverage is meaningless in the context of this situation where the insurer has funded with the reservation and the express notice of an intent to litigate coverage and get reimbursement if they are correct about their non-coverage condition. That's a meaningless, hollow right unless, if they prevail, they can get their money back.

CHIEF JUSTICE JEFFERSON: Any further questions?

JUSTICE WAINWRIGHT: One other question Chief. Was there a benefit to Excess by settling during trial or were there benefits, I should say.

MR. HALL: Sure. I mean I think that the Excess Underwriters by settling eliminated some potential for bad faith if that was there. I mean, you know, bad faith is a difficult thing. It's a reason -- well, this is a very subjective thing. I think all insurers like to get that out of the way if they can do that. And so there was that benefit. There was the benefit that instead of having to pay if they lost $7.5, their policy went up to $10 million, so they could have had to pay a little bit more money even without the aura of bad faith. So there was a benefit for them. There was also a benefit for the insured. And there was benefit for the third-party injured plaintiff. Everybody else in this equation benefitted and wanted that money to change hands.

JUSTICE WAINWRIGHT: So if you litigate coverage after the fact and then have a reimbursement as a remedy, does the insured get a credit for the benefit to Excess that it obtained by paying the settlement during the trial?

MR. HALL: Well, I don't see why there would be a credit. I mean, there is no coverage. The insured gets a benefit. Both parties enter that agreement getting a benefit. The insured gets the same benefit. They could have been exposed to in excess of $7.5 million. They could have been exposed in excess of $10. There could have been all kinds of problems that it had happened to **(inaudible)** them if they continued to litigate their trial. So both go into that agreement getting a benefit. At the end of the day, as this Court said in the majority opinion, the decision of who bears the responsibility to pay for a claim should depend on whether it is covered or not. And the *Frank's Casing* opinion allows that to happen. Thank you.

CHIEF JUSTICE JEFFERSON: The Court is ready to hear from the respondent.

MARSHALL: May it please the Court. Mr. Warren Harris will present argument for the respondent.

JUSTICE: Mr. Harris there's a lot of comment on ripe for settlement. Who makes that determination?

MR. HARRIS: Whenever a private -- the demand starts with the plaintiff. The plaintiff makes a demand, that's what triggers *Stowers*.

JUSTICE: But does the insured truly have that decision-making process when the insurer is dictating to them that there may not be coverage and not to settle the case for whatever reason?

MR. HARRIS: Well the insurer should be making an early resolution to coverage dispute. That's where this starts. It all starts with the insurer sending a reservation of rights.

JUSTICE: Right.

MR. HARRIS: The claims coverage can't be determined under the policy it wrote if it claims it has argument as to why there is no coverage. And it should make that decision early on. This Court has said that we want to promote early resolution in coverage disputes so that that issue can be resolved before you get to the settlement demand being made by the plaintiff. That's why it should be promoted to happen early on.

CHIEF JUSTICE JEFFERSON: The claims were covered here?

MR. HARRIS: I'm sorry, Judge?

CHIEF JUSTICE JEFFERSON: Were the claims covered here?

MR. HARRIS: The trial court in the declaratory judgment action found they were not.

CHIEF JUSTICE JEFFERSON: And then was that issue appealed?

MR. HARRIS: That was not appealed. There were several summary judgments filed on the coverage issue. The appeal was taken before I was counsel in the case but there was a lot of confusion with the orders. Reimbursement was originally allowed, then this Court's decision in *Matagorda County* came up.

CHIEF JUSTICE JEFFERSON: So just as a matter, just as a fact, and I'm not going to get into the legal argument right now, but if we were to reverse course and say there was no right to reimbursement, then the benefit you would have is the payment by Excess Underwriters in which there is no coverage. I mean, you would get that benefit. The claim is not covered. We can say that. That's conclusive now. It's not been appealed. So you would get the benefit of that?

MR. HARRIS: There was no cross appeal filed and the answer to your question is yes, Your Honor.

CHIEF JUSTICE JEFFERSON: And so how do you defend the windfall in effect that you would get?

MR. HARRIS: It's not a windfall for at least three reasons. First you look at the fact that Excess Underwriters also benefitted from the settlement. Excess Underwriters got at least three benefits which I think Mr. Hall talked about. They capped the liability under the policy. They cut off any *Stowers* liability and cut off any defense costs. There is also a detriment to the insurer if you allow reimbursement. Because insurance affects the demands made by plaintiffs. And whenever there is the specter of insurance that exists and the insurer has not gotten an early resolution, the plaintiff's demand is going to be based on the fact that there may be coverage. It's going to reflect that there's coverage. And so the settlement demand comes in at a higher number and that's the number that the insurer then settles the case for. And further, there's not a windfall because reimbursement is a right that could be placed in the policy. Insurance companies know how to write that clause and put it in the policy. This is a surplus lines policy. It wasn't regulated. They could have put that provision in as a matter of contract. They chose not to do so and are now asking the Court to imply that in the contract.

JUSTICE WAINWRIGHT: What do you mean when you say it's not regulated?

MR. HARRIS: It's a surplus lines policy.

JUSTICE WAINWRIGHT: I heard that.

MR. HARRIS: That my understanding is doesn't go through the Department of Insurance to regulate the forms.

JUSTICE WAINWRIGHT: Any of the forms? Any of the language?

MR. HARRIS: Not in this case.

JUSTICE WAINWRIGHT: Or is there limited regulation?

MR. HARRIS: I don't know of any regulation. I'm not a regulatory lawyer, Judge. But I don't know of any regulation on this policy. This policy is a Lloyd's of London umbrella, excess umbrella 1971 form. You can go to a form book and find the Lloyd's '71 policy. It's their policy.

JUSTICE JOHNSON: Mr. Harris, let me ask you about the policy. There is some question about a consent to settle provision requiring the consent of the insurer to settle, requiring before Excess can settle. Would you address that. I think their reference Clause J that talks about when and how it is to be paid.

MR. HARRIS: That's right, Judge. It's on page 330 of the record. You were exactly right in the way you described it earlier. This is an indemnity policy. Underwriters only has the obligation to pay once the insured, Frank's, makes a payment under the policy. The lost payable clause, Clause J, determines when that needs to be done. And it's when the case goes to the judgment or when the insured, the assured is the language used in the policy, but when the insured gets a settlement with the plaintiff and Underwriters also has to sign off on it.

JUSTICE JOHNSON: Would Excess have breached this policy? As I read the record, Excess went over and had a conversation, at least, during trial with the plaintiff trying to settle what they deemed may be covered. Would they have breached the policy by settling the whole case or any part of it?

MR. HARRIS: Well, they weren't trying to settle the whole case at that time.

JUSTICE JOHNSON: My question is would they have breached anything in this policy by settling all or part of the case?

MR. HARRIS: There is no provision in the policy for them doing that. I can't say that there is a breach but the policy doesn't contemplate Underwriters paying this in the first instance. And I think that there may have been some obligations breached when they went over and tried to settle two-thirds of the case and leave the insured exposed to the remainder. But under the policy I don't know that it is an express breach, but the policy just doesn't contemplate it. They went in and did something that's not allowed under the policy and now they want to get reimbursement, another right that's also not in the policy.

JUSTICE JOHNSON: So under it - do you disagree with the construction earlier that under Clause J, Excess had a right to make a coverage determination after Frank's settled the case and made a claim?

MR. HARRIS: I too would disagree with that. I don't think Clause J has anything to do with that. I think we have to turn to Texas law and who has the burden to get an early resolution.

JUSTICE JOHNSON: Okay. Well, what does Clause J -- how long does Underwriters have to pay Frank's? First of all it's an indemnity policy contemplating that Frank's would settle the claim?

MR. HARRIS: Contemplating that Frank's could settle the claim, and I believe it's thirty days. What it does, it says liability in this policy does not attach until the assured pays the underlying claim. They then have twelve months to make a claim once it is resolved either by a judgment or by an agreement from the insured, the plaintiff in the underlying case and the insurance company, and then the insurer has thirty days to make that payment under the indemnity provision.

JUSTICE JOHNSON: After the claim is made and proven in conformity with this policy. They apparently waived that when they jumped in and whether there was an agreement or not, the claim was settled.

MR. HARRIS: Absolutely.

JUSTICE JOHNSON: Question to you also. Is it a question of fact for them to come in at this point and litigate?

MR. HARRIS: Well, there is no express agreement. We don't have anything in the contract. We don't have any express agreement. When they first raised the question of reimbursement there was no response. It was silence just like in *Matagorda County*. So it can't be implied in fact. And this Court reached that exact issue in *Matagorda County*.

JUSTICE JOHNSON: Well, the question I have is this. Did they have the right under the policy to wait and litigate coverage after settlment had they chosen to do so?

MR. HARRIS: No, Judge. There is nothing in the policy that gives them that right. And in fact the burden is on the insurer under Texas law to do that in advance. There is nothing in the policy that changes the law on that issue. They have the burden to get this issue decided and they've got a couple of ways they can do it. They can file a declaratory judgment under this Court's decision in *Gandy*, and get that issue resolved. The Court has said that you want to promote early resolution . . .

JUSTICE: True.

MR. HARRIS: And that's exactly what didn't happen here.

JUSTICE HECHT: Do you think we should postpone liability determinations until the fact -- that issue can be resolved?

MR. HARRIS: This Court has not reached that issue I am aware of. I don't know that we need to actually go in and study -- you're asking Your Honor about studying the underlying case?

JUSTICE HECHT: Yes. I am saying if there is a coverage dispute, should the rule be that liability determinations just simply must await a coverage determination?

MR. HARRIS: I don't believe there is any need to do that. The insurer has . . .

JUSTICE HECHT: Well, then how else. I mean, you want it to be done early, but if it can't be done early enough, then what?

MR. HARRIS: The insurer has the ability and go in and attempt to get it done. And you are right, in every instance that won't happen. If they are not able to get it resolved, the insurer has to make the decision that it makes in every case and has made in this state since at least 1929. It has to decide if there is coverage under its policy.

JUSTICE HECHT: But should it have to do it with the bad faith liability hanging over it? That's the question and I guess my question is, do you think it should be done early?

MR. HARRIS: That's right. And this Court has said that in *Indy*.

JUSTICE HECHT: And early means ahead of the liability determination?

MR. HARRIS: Early means as soon as you can. In good faith attempt to resolve it before the underlying claim is resolved.

JUSTICE HECHT: But, why shouldn't it just await. Why shouldn't the liability claim just await that determination?

MR. HARRIS: Because that leaves the uncertainty of whether there is or isn't insurance. And insurance **(inaudible)** . . .

JUSTICE HECHT: . . . **(inaudible)** resolved. It would get resolved. Then you'd know . The going into the liability determination you'd know one way or the other.

MR. HARRIS: So you are saying why shouldn't you just defer the underlying claim?

JUSTICE HECHT: Yes.

MR. HARRIS: I think that's going to affect the rights of those parties and I think that's a public policy issue for the Court whether to stay the underlying claim but I think that may have some severe ramifications on the abilities of parties to litigate their claims in court.

JUSTICE: But, it could remove the appearance of a windfall in a case like this. Correct?

MR. HARRIS: It would give the insurer and in most instance the ability to resolve the coverage issue first, but I think it's also going to have an effect on parties in the underlying litigation that may be adverse and the Court's going to have balance that.

JUSTICE: And how's that?

MR. HARRIS: Because it would tell a plaintiff you can't prosecute your case because an insurance company has contested coverage and we're going to have to let that run its course.

JUSTICE: But then they would also let the plaintiff know that perhaps there's insurance and the case may be worthwhile pursuing.

MR. HARRIS: But the plaintiff's going to know that anyway. The plaintiff is able to get that through discovery. Plaintiffs know that in evaluating cases.

JUSTICE: They know that there's a policy. But they don't know if in fact the coverage has been determined?

MR. HARRIS: Typically I think will know of the existence of the coverage dispute and that's why we need to get it resolved so that everybody knows whether there is or isn't coverage. The plaintiff will be able to determine that, the insurer will be able to determine whether there is or isn't coverage and everybody is put back on a level playing field. Insurance companies use the uncertainty as leverage.

JUSTICE HECHT: So, but I'm just trying to be clear, in a case like this one you wouldn't mind from the position of this case if the coverage issue had been determined early on?

MR. HARRIS: And that's what should have happened.

JUSTICE HECHT: You don't have any objection?

MR. HARRIS: No, Your Honor.

JUSTICE HECHT: There had been argument. Sometimes that forces people to take awkward positions. But you think that can be resolved and that's what should happen?

MR. HARRIS: I think it may vary in some cases. There might be some instances where it can't be resolved. In this case it could have. There were two. The coverage issues that were prosecuted in the summary judgment were whether the welding was done was Frank's product and whether that constituted completed operations under **(inaudible)**of the policy. Those were legal issues that could have been resolved during the eleven month window between the reservation of rights letter and the settlement in the case.

JUSTICE HECHT: So there's some concern that the insured is having to use its resources to litigate coverage when it shouldn't have to and those concerns, but at least in this circumstance you don't see that as a problem if the coverage had been litigated early on in the case.

MR. HARRIS: That's right. And if the insurer is not able to get that resolved, the insurer still has the burden as it has under Texas law for many years, to make that coverage issue. It's in the business of assessing risk and allocating risk. It's its insurance policy and it's its arguments that it's having to address. The insurer has the burden.

JUSTICE: You don't. I mean, there's no questions that your client did not pay for the coverage that -- the amount that was paid on its behalf.

MR. HARRIS: That's what was ultimately determined in the declaratory judgment.

JUSTICE: Right. As I understand the circumstances, your client had a $1 million retainage and a $1 million underlying policy, is that right?

MR. HARRIS: I don't remember the $1 million retainage. It was a $1 million underlying this policy. There may have been some retainage but I don't think it was that high.

JUSTICE: And then Excess paid the $7.5 on top of that.

MR. HARRIS: $7.5 total which included underlying . . .

JUSTICE: The total was $7.5?

MR. HARRIS: That policy was partially exhausted through defense costs. I think about half of the underlying claim -- or underlying policy.

JUSTICE: So we are talking about relatively $5 million in coverage that your client didn't pay for. Right?

MR. HARRIS: Yes. Yes, Your Honor.

JUSTICE: And you think that's fair?

MR. HARRIS: It's fair when you look at all of the circumstances. You can't take the isolation of whether there is or isn't coverage. We are now looking at whether there is a right to reimbursement. But you have to look at all the circumstances in doing that. They could have put a reimbursement provision in the policy.

JUSTICE: Well, I know all that. But having made the demand for them to pay that, knowing that there was a coverage issue and now resisting the notion that they should have to pay any of that back.

MR. HARRIS: They knew there was a coverage issue. They knew it hadn't been resolved and they hadn't made an attempt to resolve it. They knew when settling the case they were going to get a benefit from this and by settling the case it also changed the dynamics because you have the specter of insurance sitting over the situation where the parties don't know whether there is or isn't insurance coverage, whenever they settle the case without that issue resolved. That is a harm to the insurer because it changes the demand of the plaintiff. To give you a hypothetical example, you take an insured that has a $1 million net worth and there is a claim that is worth $2

to $3 million. Let's suppose there's a $5 million umbrella policy laying on top of that claim. The claim of the plaintiff is going to vary depending on whether there is or isn't coverage. If there's only a $1 million in possible assets from the defendant, that case cannot settle for $2 or $3 million without insurance coverage. If there is insurance coverage, then it's going to be a different dynamic. If the insurer sits on its rights and doesn't get that claim resolved, the parties don't know whether there is or isn't coverage, what's the demand from the plaintiff going to look like? You look at the amicus brief filed by Shell, Temple-Inland, Burlington Resources. Insurance affects the demand. Insurance affects settlement. That's going to come in the $2 to $3 million range, maybe a little under that depending on the liability facts.

JUSTICE: Without insurance, of course, the payment would be a $1 million because that's all you had.

MR. HARRIS: Probably less than that. Because that's assuming if it's a business you basically hand the keys to the business to the plaintiff.

JUSTICE: Right. And of course nobody wants to own the business - they just want the money.

MR. HARRIS: That's right.

JUSTICE: So why wouldn't the same thing happen here? If the insurance company says okay, we'll pay the $2 million or $3 million. We'll come back and ask for the $1 million, or less than a $1 million or whatever could be agreed on, that you would have paid anyway?

MR. HARRIS: Well, it's a different dynamic. In the second scenario you are assuming you are going to pay every nickle of net worth. That's probably not going to happen in a settlement. It is going to come in at some amount under that and if the plaintiff doesn't, the plaintiff's got to litigate liability, the plaintiff's got to litigate damages, but once the case is settled, those are fixed, the amount of the possible settlement or the amount of the judgment is fixed. At that point it's only litigating the insurance coverage issue and once that happens the insurance company has a judgment and it's enforcing a $2 or $3 million judgment. They can get all of your non-exempt assets at that point.

JUSTICE: What risks are assumed by the insured under your scenario? It seems to me all the risk falls upon the insurer. Is that the way it ought to be?

MR. HARRIS: The burden that is put on the insurer is to decide coverage and to get an early resolution when it disputes coverage. It's not strictly liable for making a wrong decision. The insurer, when faced with the *Stowers* demand has to act as a reasonable insurer would. If the insurer is wrong in that circumstance, it's not going to be strictly liable and the same under a bad faith claim. It needs to act reasonably in deciding whether there is or isn't coverage.

JUSTICE O'NEILL: What do you think about . . .

JUSTICE GREEN: There is no risk to the insurer?

MR. HARRIS: There is no risk to the insurer?

JUSTICE GREEN: The insured.

MR. HARRIS: There is risk to the insured because if the insurer accepts the settlement at that amount that contemplates insurance, it's going to be asked to respond to a significantly higher judgment.

CHIEF JUSTICE JEFFERSON: But the lawyer for the insured is going to say, let's say the lawyer makes that determination and agrees there's no coverage. I've analyzed this and I don't believe there is coverage at all, but I think you should make a demand to your insurance company to settle this because that's going to put them, if we change our decision, that's going to put them to this dilemma. They pay it or they risk bad faith and there is some, I think that there is no coverage, but there is some uncertainty. There's enough uncertainty that we can, that I'm instructing or I am advising you to make a demand when I'm tell you there's no coverage. That seems just a little perverse. When it's clear to you there is no coverage, make a demand under the policy which really doesn't exist and put the pressure on them to make a decision.

MR. HARRIS: Your Honor, the first assumption there is that you have shifted the burden to make that decision to the insured which is going to require the insured who is represented by the counsel hired by the insurer to get coverage counsel to come in and make those determinations when it should be the insurer make those determinations. And it's usually far from clear whether there is or isn't coverage. This is not a case where it was crystal clear that there was no coverage. The insurance company was offering $5 million . . .

JUSTICE HECHT: It was summary judgment that you didn't appeal.

MR. HARRIS: But during the settlement . . .

JUSTICE HECHT: That's about as clear as it gets in these kinds of things, isn't it?

MR. HARRIS: Well, Judge I'm not exactly sure why it wasn't appealed but during the settlement the insurance company was offering $5 million to settle the claim and if it was clear that there was no insurance, they would not have been offering $5 million out of their own pocket if they thought truly there was no insurance. The insurance company settled this case because they thought there was a real risk that there was insurance for at least a substantial portion of the claim. If you look at the settlement correspondence, they were saying that there is one provision that might not be covered dealing with debris removal. That was what they were really asserting and that's why they offered to pay two-thirds of the claim.

JUSTICE O'NEILL: It is fair to say that before this case there were, insurance companies never sought reimbursement from their insureds and that this changes the whole dynamic of the settlement process?

MR. HARRIS: Before this case, insurers did not have the ability to do that. If the insurers as underwriters did in this case under a coverage dispute paid the settlement, the case was over.

JUSTICE O'NEILL: And that's my question, was that always the case. Was that the practice in the industry or were insureds kicking in money to avoid any sort of reimbursement claim?

MR. HARRIS: Insurers would use the coverage dispute as a leverage to attempt to get a contribution. We see that from the Shell amicus brief, we see that from the roundtable discussion we filed with the Court. That's what's going on in real life from the practicalities. Is they are attempting to get contributions but ultimately if they either get a small contribution or get no contribution, the insurer had to make that decision. It had to decide whether there was or wasn't coverage, act reasonably, and pay the claim or don't pay the claim if there's no coverage. If there's no coverage, there is absolutely no exposure.

CHIEF JUSTICE JEFFERSON: Any further questions?

JUSTICE WAINWRIGHT: Yes. One more, maybe two. Would you address the concern that had been raised by attorneys in amicus briefs that the implied at law approach raises a conflict or puts them in a conflict position.

MR. HARRIS: TABC I think does a great job of laying that out in its letter brief. And basically whenever there is a reservation of rights letter filed and there is a coverage dispute, that puts counsel for the insured, the insurance defense counsel, in a real box to deciding what to do. You get a demand in from the plaintiff, do you forward that demand? Then you are making a demand and under the Court's new rule created, that's going to create a right of reimbursement. Do you say that the settlement is reasonable? If you say it's reasonable, you have created a right of reimbursement. Do you allow your client to consent to the settlement? If you do, you have now created a right of reimbursement. Any of those things can create prejudice to your client because you are in this conflict situation and doing nothing may not be any better. You get an offer in from the plaintiff, you call the plaintiff and say send it to the insurance company. I can't get in the middle of this. The insurance company is going to say, you're the lawyer here. Is this a reasonable settlement? We need you to evaluate the case.

JUSTICE WAINWRIGHT: Separate counsel can make that determination. Right?

MR. HARRIS: Yeah. But that's the whole point. That's what we've seen in some of the amicus briefs. Well, it's not a conflict, they can just hire another lawyer. Well, you're hiring another lawyer because there is a conflict. And that's going to require the insured to now go hire a second lawyer whenever it was paying for a defense under the policy. It was paying for the

insurance company to make the decision and to handle the case - to decide settlement to decide whether there is coverage. And now anytime there is a reservation of rights letter filed, it will require the insured to go hire another lawyer to deal with this conflict.

JUSTICE: It's common to hire another lawyer in non-covered issues.

MR. HARRIS: Whenever the declaratory judgment is filed and the case is brought to issue, what often happened is insurance companies will routinely file a reservation of rights letter. Don't know if they are serious about it or not. If they don't file the litigation and don't proceed with it, often it sits there. And then what happens is the underlying case progresses, then a settlement demand is made, then the insurer is saying well, I filed a reservation of rights letter a year ago, I haven't done anything on it, I now need to decide whether there is or isn't coverage to see if this case ought to be settled. And what the insurer is trying to do now is to alleviate that burden from itself and shift that burden to the insured to say you ought to be deciding whether there's coverage. You need to make that determination when that burden has always been placed on the insurer before.

CHIEF JUSTICE JEFFERSON: Any further questions. Thank you.

MR. HALL: I would like to first address the issue that defense counsel **(inaudible)**. This Court's made it very clear in *Dallas*, in *Travelers,* if there is an insurance disputed, defense counsel's sole obligation is to the insurer. Period. End of story. That's what they have to do and this Court's been very clear about that. The *Frank's Casing* case does not say that defense counsel evaluates the case and says that a demand has been made is reasonable that that is in fact a demand on the insurer to settle or that is in fact an express agreement that the settlement ought to occur. It doesn't stand for the proposition that all of the briefs say that it does which is the proposition required to put somebody in a conflict. There is no conflict. The defense counsel represents the interest of the insured. That's clear. The Court has said that. That's what they have to do and in evaluating the case they do what the insured tells them. If the insured wants an evaluation, they evaluate. The evaluation is not going to trigger anything that happened in *Frank's Casing* and, I'll submit, it's not what happened in *Frank's*. It's a completely different case than *Frank's.*

JUSTICE O'NEILL: Although you wouldn't be opposed to removing the *Stowers* piece of *Frank's* because that wouldn't affect the decision as far as you are concerned? I mean that the plaintiff makes a demand and therefore creates a right to reimbursement, there is something sort of perverse about that reasoning that the plaintiff is the one who can make that determination. You wouldn't mind if that piece of the opinion went away?

MR. HALL: The piece of the opinion that the plaintiff makes a *Stowers* demand?

JUSTICE O'NEILL: And that making the *Stowers* demand that is determined to be reasonable that the insured wants you to settle for, triggers a reimbursement right.

MR. HALL: I don't want a *Stowers* as a guy who represents insurers a lot. We have lived with *Stowers* for a long time. It's fair. I don't have any problem . . .

JUSTICE O'NEILL: No. What I'm talking about is the piece of the opinion that says if the plaintiff sends a *Stowers* letter and the insured says the *Stowers* letter has come in, settle the case, that somehow the insured has agreed to a reimbursement right. You wouldn't mind that piece of the opinion being gone. Apparently, that has generated a lot of heartache by seeing the amicus briefs, that piece of the opinion.

MR. HALL: Well, maybe I can answer it this way. I think it's a case of be careful what you ask for. Because let's take the *Frank's Casing* case and apply *Matagorda County* to it. If *Matagorda County* had been the law of the land from day one when *Frank's* gets underway, which it wasn't, *Matagorda County* opinion came out of this Court after Judge Work had already issued a summary judgment in favor of no coverage and the right to get the money back because there was no coverage. But what would have happened in *Frank's*? Lawsuit gets filed; insurer looks at it; there's a coverage problem; obviously a coverage problem because ultimately it was held that there was no coverage; they reserve rights. Not only do they reserve rights, under *Matagorda County* they've got to file a D.J. and not only do they have to file it, they have to vigorously prosecute it because they have got to try to get it concluded or at least get it to the point where they have enough insight into the coverage issues so that at the time that the underlying case is ripe for resolution they know better what they want to do. Okay. So now, what has happened? The insured is defending the case and they are litigating coverage. They are fighting on two fronts. I've been in that situation before after this Court issued the *Matagorda County* case.

JUSTICE O'NEILL: But *Matagorda* didn't change that result. I mean, in *Gandy* we said push the coverage dispute early.

MR. HALL: *Gandy* said push it when you can and recognize you can't always do it.

JUSTICE O'NEILL: But in this case you could.

MR. HALL: Well, I'm not positive about that. In this case it was ripe for resolution of summary judgment. Remember, three days of trial. So a lot of fact issues had been already developed and the issues that were involved and were products and completed obs exclusions. That requires some development of facts in order for the court to make the legal determination of no coverage. You've got to have some underlying basis of uncontested fact to reach that resolution.

JUSTICE O'NEILL: Which is the purpose of discovery.

MR. HALL: Correct. And so that's what would have happened and the case would have been litigated, if I continue with the scenario. Alright. So you're in -- sure it's in two different

lawsuits now and then eventually the underlying lawsuit gets ripe for some type of settlement negotiation or they go to trial. And so they then come and *Frank's* takes the same position that they took in this case. We want you to settle. We're not going to agree to anything. We just want you to pay the money. We've got a deal done. You pay. End of story. Well, if *Matagorda County* is the law of the land, the insurer is going to say, I'm not doing that. You're on your own. You know what's going. Let's continue out of the coverage D.J. I've got a right to do that and that's what we're going to do and they continue the coverage D.J. In that circumstance the injured party doesn't get paid, Frank's is litigating on two different fronts, and I would submit that it really is better to have it happen the way it happened in *Frank's*.

JUSTICE JOHNSON: Mr. Hall, let me ask you. If I might Chief, ask one question. You indicated that you are, as an insurance defense lawyer I take it, not uncomfortable with *Stowers*?

MR. HALL: Correct.

JUSTICE JOHNSON: How about bad faith?

MR. HALL: I'm not uncomfortable with the law in bad faith. I mean, an insurer has to act responsibly and reasonably and deal with its insureds in good faith and a lot of the briefs that are filed say all kind of horrible things are going to happen because insurance companies aren't going to do that. Well, I think if they don't do that they are going to have trouble on their hands. And I think that, you know, insurance companies don't as a general proposition mind having to deal with their insureds in the way this Court has said they have to which is in good faith.

JUSTICE WAINWRIGHT: Do you agree that reimbursement provisions can be put in these types of policies without regulatory approval?

MR. HALL: Ah. Yes.

JUSTICE WAINWRIGHT: In Texas?

MR. HALL: Yes. Ah, it is an excess of surplus lines policy and to answer your prior question, it is regulated by not as vigorously as admitted carriers are regulated. So there are some things that have to be put in the policy but there is a lot more freedom of negotiation. The question I would ask is why do you do that and where do you draw the line? You don't have to put in the policy that I have a right to file a D.J. You don't . . .

JUSTICE O'NEILL: But you . . .

MR. HALL: have to put those kinds of things because it's obvious you can do that and so if you start putting into contracts trying to anticipate all different permeations that might arise in saying how you're going to deal with it. One, I think it's impractical and impossible. And two, the Court's already recognized the right to litigate coverage and as I said earlier, that's the right is to

litigate the rights and obligations under the policy. And then the question is if you win, what happens? And if you've already paid the money and you've paid it with the notice and the reservation, the only thing that can put the parties back to where they ought to be, i.e., that the money that was paid to settle the claim comes from the insurers that is not covered, is to say that there is a reimbursement.

JUSTICE WAINWRIGHT: There has been so much discussion about this opinion, surely you recognize the fact that there is a reimbursement right out there now that's broader than *Matagorda County*. It's caused a lot of people a lot of discussion. Some heartache. Some enthusiasm. So if that provision is brought up to be put in a policy, it's going to affect the reasonable actor sitting at a table negotiating rates. Certainly you recognize that?

MR. HALL: Ah.

JUSTICE WAINWRIGHT: It's going to at least enter . . .

MR. HALL: I'm not an underwriter. I would suspect that . . .

JUSTICE WAINWRIGHT: It's going to at least enter into the negotiation.

MR. HALL: Yes.

JUSTICE WAINWRIGHT: So it's not just following course. It is a difference, good or bad, it's a difference.

MR. HALL: It would be a difference in the policies. I don't think it's required to have that in the policies though for this is a remedy this Court has already embraced.

JUSTICE O'NEILL: But it would affect the premium paid?

MR. HALL: It may or it may not. I mean, I think generally premiums are affected more, less by those kinds of conditions and more by market conditions and whether there has been a storm in the gulf and other things like that. That is a much, much bigger impact than this kind of provision does.

CHIEF JUSTICE JEFFERSON: Thank you Mr. Hall. The cause is submitted and the Court will take a brief recess.

MARSHALL: All rise.