ORAL ARGUMENT – 09/24/03
02-0730
EXCESS UNDERWRITERS V. FRANKS

HALL: There are three issues I want to address. First, is the Matagorda County case, and whether or not this court is going to determine to expand, restrict or otherwise apply that case to the facts before it in the Frank's case.

We have set forth our position that the facts of this case are dramatically different than the facts were in Matagorda County. And that therefore because of the facts in this case that Matagorda should not control.

The second issue I want to address is equity. If the lower court's ruling is ____, the result will be that Frank's casing will realize a windfall in excess of $7 million in insurance proceeds that he did not bargain for, he did not pay for, and he should not be entitled to. We think that is an unjust ruling and we would urge the court not to allow that result to obtain.

The third issue is the question of which state's law governs this issue, which is in dispute before this court today? The choice of law issue is a preliminary one that has to be reached in order for the court to decide that substantive law is going to apply the case, and the merits of the issues. We have urged the court in our brief that Louisiana law is applicable but if Texas law applies we still believe we should prevail on the facts.

Matagorda was a different case than this case. And our facts are different in a material way. In Matagorda county the insurer, TAC, was a primary carrier that had a defense obligation, that in fact undertook the defense of the case, undertook unilateral settlement negotiations in which the insured did not participate and ultimately settled the case without consent of the insured.

They did so and were able to do so because the policy did not have a provision requiring the consent of the insured to settle. So in that case, TAC was able to effectively ram a settlement down its insured's throat. It was able to control the whole course of the litigation, the whole course of the settlement, and then settle the case without any participation from the insured whatsoever.

Our case is the exact opposite. We were excess carriers. We did not have a duty to defend, we did not defend the case...

JEFFERSON: You say you didn't have an obligation to defend Frank's, but isn't it true that your policy gave you the right to associate with the insured's defense and to compel Frank's to cooperate in defense of the claim?

HALL: Yes.

JEFFERSON: Isn't that something like an entitlement to defend or to participate in the defense?

HALL: It is I believe an entitlement to participate in the defense. That entitlement was not exercised except in the sense that additional counsel to defend the Frank's was higher and paid for by the excess carrier. But the excess carrier in no way controlled the defense, and importantly, in no way controlled or even participated in the settlement negotiations.

The settlement negotiations in this case that led to the conclusion of the case and settlement that we ultimately redefined were conducted unilaterally by Frank's. Frank's obtained a demand within the policy limits and then made the Stowers demand, not once, but twice on the insurer saying you need to settle the case.

PHILLIPS: Was there some time limit on that settlement demand?

HALL: I'm not positive.

PHILLIPS: Had there been settlement negotiations prior to that that you were aware of, or was the case just nowhere and then it settled?

HALL: There had been settlement negotiations during the year or whatever it was that the underlying case was pending.

PHILLIPS: And were those within an amount that would have called upon the excess carrier to participate?

HALL: There was one demand that was made for $9.9 million that potentially was within a Stowers demand. The issue was how much of the underlying had been eroded? So whether or not there was a full $10 million available, the $9.9 came in. But that demand for $9.9 was rejected by Frank's. Frank's was handling the case and said we're not interested in $9.9. They went to trial and things got worse. And they realized at trial, after 2 days, they got a lot more concerned about the case and what was going to happen to them. And so at that point they solicited the settlement demand to settle the case.

O'NEILL: Did I see in the record that the excess carrier had made an offer that was more than this one was at some point prior?

HALL: Settlement negotiations were undertaken by the attorney for the excess carrier prior to trial. He tried to settle the case in a number of different ways. He talked about settling with contributions from Frank's. He talked about settling only what he believed to be the covered claims. My view is those negotiations never really reached fruition. And so I'm not sure that they really

have any impact on the court's decision.

O'NEILL: But again was there an offer from the excess carrier to settle for more than what they ultimately settled for?

HALL: The only offer I'm aware of that was a comprehensive offer to settle the entire case was the $9.9 million and that was rejected by Frank's.

PHILLIPS: What opportunity did you have to seek some type of declaration as to your exposure?

HALL: There was time for them to seek relief to file a DJ. The DJ was not filed until the settlement had been agreed.

PHILLIPS: And how much time did it take from the time of the filing of the suit till trial started?

HALL: I don't know. I presume it was a couple of years.

O'NEILL: Can you tell me what the coverage dispute was?

HALL: Frank's was sued for - Frank's fabricated a structure that was going to be a support base for an off-shore platform. They went out and installed it and then they returned later to build the structure on top of that to find that the structure that Frank's had fabricated collapsed. It was gone. There was no bodily injury, no personal injury, no property damage other than the collapse of Frank's structure.

The CGL policy at issue had a products and complete operations exclusion because they're going to insure for property damage, physical injury, personal injury, those kinds of things. But it's not a bond to guarantee the performance of Frank's own work. And so those kinds of policies typically don't cover. And Judge Work had no trouble finding on a motion that there was no coverage.

O'NEILL: This isn't the type of case where you have to try the suit first to litigate your deck(?) action? It's pretty clear cut.

HALL: It depends at what stage you're looking at. As standing representing an insured, and a lawsuit gets filed, you have a claim and you have allegations in the petition, but until a record is developed and you get to see - sort of fill in the flesh on the bones of what's alleged, maybe you can make a case that can be easily and quickly disposed of. Maybe you can't. In this case we have the benefit of all of the underlying discovery that went on throughout the course of the trial. And the testimony and evidence was put on the first 2-3 days of trial. And so it's easy to sit here in hindsight and say, that could have been resolved very early. An insurer, I think, rightfully

generally...

O'NEILL: I guess maybe that depends on the particular case. In Gandy we did put forth that that was a preferred method to do it if it can be done. And we emphasized that in Matagorda that the insurer has an option to be able to go in there and do that. It sounds to me that the exclusion that you're relying on is fairly clear cut and so I don't know why it doesn't fit within those two cases. I understand when you say there can be a compelling case where you don't know till the underlying case is fully tried where the exclusions may lie. I think the duty to defend gets a little more complicated. I don't understand why, if it's a pretty clear cut exclusion, the better course is not to go in and get the insured to go in there and get that determined right off the bat and then it's done.

HALL: I think it's pretty clear cut that that's the right way to approach it today in light of Matagorda county. Of course the case had not been cited at the time that all this activity occurred. And what I think was going on is - I mean if you look at the Gandy decision, you say we've got a right, an insurer has a right to litigate coverage. If it believes that there is a dispute about coverage it has a right to litigate coverage. Something happened to that right apparently in this case. Because you go from having a right to litigate coverage without consent of the insured nor without any provision in the policy saying you have a right. You have a right because there's a contract between the parties and there's a right to determine what the contract means to the parties.

Now somehow along the line that right that my client would have had and had to litigate coverages was lost. Now it wasn't lost because of the waiver.

O'NEILL: This is kind of the ground we crossed a lot in Matagorda county that both sides are in an untenable position. It's in the insurers best interest to- if you've got a deep pocket which presumably there is one here, and you can recover reimbursement, you have an incentive to get it resolved within policy limits to protect yourself from a Stowers claim. And however much you end up paying doesn't really matter if you can get reimbursement. So there's no incentive really on the insurers part to effectuate the lowest settlement possible because you're protected under Stowers and you can get fully reimbursed if there's no coverage. The insured has problems and you've got problems, both sides have problems however you come out on it. In Matagorda we acknowledge that and said we think the better course is to put the risk - because if we put it where you want it, you've got to acknowledge that there are situations where it puts the insured in a completely untenable position.

HALL: I'm not sure I would acknowledge that. Matagorda as it currently stands really doesn't serve the objective this court has articulated trying to achieve - swift resolution to litigation. I'm involved with some litigation right now where there is a significant underlying dispute about alleged securities fraud and it involves damages alleged to be in excess of $100 million. There's a coverage dispute. We have to now file a DJ. And under Matagorda as it stands, we have to litigate the DJ. The insured doesn't want to litigate on two fronts. They don't want to have to fight for two years this serious securities litigation and at the same time fight their insurer. We can't be put in the position of getting to the end of the day and then having the dilemma that Matagorda presents.

Matagorda in conjunction with Stowers, the dilemma that is presented for an insurer. We are going to try to beat their litigation.

O'NEILL: And the premise of my question is, you're in a dilemma there. The insureds are in a dilemmas. We've struggled with how do you allocate this risk? If we do it all one way, there's going to be problems. If we do it all the other way there's going to be problems. And so how do we thread this needle? There's been an amicus brief field that proposes a solution. Can you address that?

HALL: I agree with the problem that the amicus brief notes. I don't really agree with the solution. Their solution is to challenge Stowers. We've lived with Stowers for a long time now and I think all sides are generally comfortable with what it means and how you deal with, and can deal with it. My proposal would be more along the lines of what J. Owen said in her dissent in Matagorda county where she noted that the language is broader than it needs to be. And went on to articulate almost our case. In it's a situation where an insured controlled settlement, demands settlement, accepts the benefit of settlement why should that then enable then to get out of...

O'NEILL: So you are going over the same grounds we covered in Matagorda?

HALL: In the sense of the issues certainly. But our facts are different.

WAINWRIGHT: In your opinion what were the driving fundamental tenants of Matagorda? Not a holding but what drove it? Obviously the court was concerned about conflict of interest in that case. It seems to me there were some concerns about there being no contractual right to reimbursement in that case. And there was some mention about the fact that this perhaps common law reimbursement claim was not established in the record of that case. Were there other things that were driving Matagorda's determination in your opinion?

HALL: When I read the appellate court opinion, _____ and this court's opinion it seems to me that the driving concern was - and I can understand it. The court didn't like how TAC was in the driver's seat and able to manipulate the entire course of that case. They handled the defense. They handled the settlement. They took a settlement that they didn't get approved for their insured. They did everything. And then they turn around and said we want our money back now. That concern is not present in our facts. Our facts are completely different facts.

WAINWRIGHT: So then you're arguing that Matagorda County doesn't apply. And looking that I'm very concerned about the underpinnings, the reasoning for why Matagorda County was decided the way it was.

Now that being the case, let's consider the factual distinctions in light of whether they changed the underpinnings for this case compared to Matagorda county. The factual distinctions as I understand them here are, that there was no duty to defend or control the defense. Different from Matagorda county. There was no Stowers demand in Matagorda County. There was

one here. You argue the insured organized the settlement. I think you used the term orchestrated. And I understand there was an exception taken to that terminology. And the other material difference was that in Matagorda County the insurer had the right to settle without the insured's consent, which wasn't present here. Those are four significant, perhaps material, perhaps not distinctions. Analyze those in light of the underpinnings of Matagorda county, not it's holding, but the reason it came out the way it did. Which of those are important and why?

HALL: I think all of those are significant issues which the court was troubled utterly by how the insured was basically left helpless. I have to say that honestly if I look at this court's opinion in Matagorda county, I'm troubled by the notion of consent to a lawsuit. I'm troubled by the notion that the court starts to talk about the issue of whether or not the insured consents to this reimbursement claim. I don't know why it is that consent is an issue to litigation when the court has already articulated in Gandy that there is a right to litigate coverage. But I'm also concerned about the _____ subrogation. Because I clearly agree with the court that there is no subrogation right that an underwriter has against its insured in these circumstances.

I don't know what the lawyers argued in that case, but I suspect that was it. The reason I say that is, those discussions to me suggest that the court was so troubled by what had happened to this insured in the way in which the course of litigation went on, that they were looking at the issue and concerned about not wanting to allow that type of conduct to occur in the future.

WAINWRIGHT: You talked about the specter of litigation hanging out over the insured and that kind of touches on the conflict of interest concern in Matagorda County Express. Well in this case with the Stowers demand, the parties know there is some adversarial relationship here. Maybe it will rise to the level of loss. Maybe it won't. So there's nothing unfair about the parties knowing that they are in the same boat together in terms of trying to resolve the case or perhaps having to pay parts or all of a judgment, but they know there's also going to be some dispute because of the Stowers demand. So that at least is a much lessened consideration in this case than Matagorda county. Do you agree?

HALL: Sure.

WAINWRIGHT: What about the fact that there was no contractual right to reimbursement. Is that the same consideration here as in Matagorda county?

HALL: Well I think that's the heart of the issue is whether there's a contractual right to reimburse. But there was no policy statement that there was a right to reimbursement if an underwriter funded a claim. That was not in the policy. I've never seen an insurance policy that says that.

O'NEILL: Isn't that the fundamental holding? It was that you can't reserve something that's not in the policy. There is no policy right to reimbursement. You can't create it by purporting to reserve it. And therefore we were left with, are we going to imply such a right under these

equitable sort of circumstances? And we determined if we do it this way it's going to be an inequitable. If we do it that we it's going to be inequitable. There are problems whichever way we put it. So we've got to come down somewhere and let's put it on the party that's better able to assume the risk.

HALL: Two things. One, I don't think that what you're trying to preserve with the reservation of rights letter is a right to reimbursement that's not in the policy. I think what you're reserving is what this court has recognized is a right to litigate coverage in a DJ. And you're saying, listen, I'm getting ready to fund this settlement. That could be considered an act that is not consistent with the position of noncoverage that we take. And I don't want any mistakes.

O'NEILL: The insurer has a choice. They can either go get the DEC action done in which event if there's fairly no coverage they can do. Or, they can decide to go forward without pushing the DEC action, and if they settle it they settle the whole thing. If there's going to be a coverage dispute, they are getting rid of the whole thing.

HALL: They do have that choice made. You're assuming that you can file a DJ and get it heard and get it heard before the underlying dispute is resolved. Maybe you can. Maybe you can't. If it's good for lawyers, it fosters litigation and we're filing DJ's that we would not have otherwise filed compelled by not wanting to wait and be dealt with the dilemma that Matagorda County presents. And so if that's what the court's ruling is is that - if the court wants to say, Look it's up the insurers. You're professionals. Y'all deal with this however you want. Then it will be more...

O'NEILL: But one of the premises was too that when you are in that position, you are settling with what you consider to be insured's money and you shouldn't be able to settle with the insured's money without the insured's consent to the amount.

HALL: That was Matagorda. That's not our case.

O'NEILL: Well it is if you say we're going to settle it and seek reimbursement, you're saying this is ultimately your money.

HALL: Well we got a demand to settle. We got several demands to settle. We got Stowerized asking us to settle. I don't see how that can be us saying we settle with your money. Insureds settle this case and if you don't you are going to be liable for extra contractual damages. They said it twice. And we argued with them about it. We talked about how we might do it in a lot of different ways, but they were insistent: settle the case. And they accepted the benefit of the money. And there's now been a ruling by J. Work: they weren't entitled to the money.

I don't see how what the court's trying to accomplish is served in Frank's case. I understand and it's consistent with the court's opinion in Rocor(?) and earlier opinions in Garcia. The court is concerned with insurers getting in and running rough shot over the case. And

if you jump in - even if you don't have a defense obligation, if you jump in and start participating in defense or settlement you better do it right or else you could be liable. I have no problem with that. It makes sense to me. And a person who represents insurers they can live with that. The problem is in this case they didn't do any of those things. None of that happened and they got hoisted on the horns of a dilemma by the combination of what this court says in Matagorda and Stowers. So they had to either settle, and if they settled they lose their right to litigate coverage, or not settle and if they don't settle they expose themselves to damages in excess of policy limits.

WAINWRIGHT: So on the issue of the concern in Matagorda county about the insurer being able to manipulate the case and the outcome, that falls away here because Frank's issued a Stower demand, and Frank's you say orchestrated the settlement?

HALL: The record, I think, is pretty clear on that point. The settlement was obtained by Frank's in-house counsel. He requested a settlement demand within policy limits. He got one. And then he turned around and said, settle this case. He wrote a Stowers letter the same day. There was some discussion about it. There were some offers made about funding it, and maybe let's find a way to go forward in arbitration or other things. Frank's refused. Wrote a second demand saying settle this case.

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RESPONDENT

HARRIS: The issue in this case is whether or the insured or the insurer should face the difficult choice when settling a claim for which coverage is disputed. This court set forth the right test in Matagorda County and you should apply that test in this case.

WAINWRIGHT: Do you agree that there are some important factual distinctions in this case from Matagorda county? Whether they are outcome determinative or material to the legal outcome, I'm not sure yet. But there are some important factual differences.

HARRIS: There are some distinctions. And yes just as the CA found, we don't think they are material.

WAINWRIGHT: What about the underlying driving underpinnings of Matagorda County. Mr. Hal brought up the risk of the insurer manipulating the case.

HARRIS: I think that is one of the concerns. One of the concerns in Matagorda County, in Goldberg, one of the Massachusetts SC cases relied on, you were looking at a situation where the insurer was acting unilaterally. In this case it is slightly different because there was a Stowers demand made. But the Stowers demand was: Settle this case because it's a covered claim. That was a demand that everyone concedes is reasonable. So there was no manipulation by the insured trying to get some sort of a sweetheart deal and set up the insurer.

There was a Stowers demand to settle the case because it was a reasonable settlement and it was a covered claim that should have been settled with the insurer's money.

HECHT: You say it's about assigning the risk. But isn't it true that if the insured is wrong and the insurer turns it down, and there's a coverage litigation and it's decided after adversely to the insured, the insureds out the money?

HARRIS: If there is no settlement and there is no coverage ultimately and that issue is litigated it will be the insured that is _____.

HECHT: But if the insurers is wrong there will be additional bad faith damages?

HARRIS: I believe the damages are more likely to be Stower in the event there's an excess judgment. I guess possibly there could be some 21.21 or other liability.

HECHT: Isn't every insured going to sue for extra contractual damages?

HARRIS: I think it's likely that you will see that, but in the context of what we're talking about - you know unless they've done other things wrong in settling it, you're looking at the indemnity claim, you're looking at the Stower for an excess judgment, and then if they didn't act reasonably there may be potential exposure under 21.21.

Let's walk through the process in Matagorda county to show what happens. Whenever there's a dispute over coverage, the first thing the insurer should do, as this court has said in prior cases, is to file a declaratory judgment action.

CJ Phillips you asked about the time span of the case pending. They sent a reservations of rights letter March 1997. They didn't file the DEC judgment action until after they settled the case, which was Feb. 1998. So there was an 11 month window that they did nothing to try to get it resolved by declaratory judgment.

HECHT: Do you agree that Frank's could have filed a declaratory judgment action as well?

HARRIS: I think Frank's could of, but I think this court has said in Brooklyn and Gandy and in Matagorda county that that's something the insurer should try to do is to get that resolved.

HECHT: Do you agree with counsel that there may be instances - may be confident - that the insured wouldn't want to be in a declaratory judgment action over coverage at the same time that he's in a suit against somebody that is after him?

HARRIS: It might be possible. I'm not sure that's really the case, because often the parties of the underlying case do want to get it resolved because they think there's coverage. If they

think there's no coverage that might be a slightly different situation.

HECHT: I'm just saying if the defendant wins today against the plaintiff, then he doesn't have to pay his expenses of a declaratory judgment action.

HARRIS: And the problem you're talking about is sometimes the insured might not want that to go forward, and rule 11 would take care of that. All you need is a rule 11 agreement saying it is agreed by the parties that we are not going to go forward in a declaratory judgment proceeding, and the insured shall not use that in any way against the insurer as the waiver of any rights in this proceeding or any other proceeding. And it's done. I think the insured and insurer can agree to that.

OWEN: Then what happens? We get to here and you send a Stower demand and say settle and the insurance company says no coverage.

HARRIS: Well it does get us here and I don't think that's what parties should do. But if it's going to prejudice the insured, and they are basically saying well sometimes we don't want to do that because it's going to prejudice the insured, that can be accommodated. I don't think that ought to be encouraged. I think they ought to be encouraged to file.

OWEN: There would be no incentive to the insurance company to ever do a rule 11 agreement because it doesn't resolve the problem they are trying to get resolved.

HARRIS: It doesn't. And they might assert their rights to go forward and do it. I'm not saying they would have to do it, but they would be able to accommodate. Your right. They should go forward and try to get that resolved so when they get in this situation they've got coverage determined.

OWEN: So what happens if the DJ action doesn't get resolved? They file it 2 weeks after the underlying lawsuit is filed, and the underlying lawsuit - you're in the middle of trial, you get a settlement offer and the DEC action is not resolved, then what?

HARRIS: If it doesn't get resolved, you go to the next step in the decisional process. The insurer should try to get the insured to consent to a right of reimbursement. If they do that no problem.

The insurer faxed us a letter at 9:00 a.m. on Feb. 23. For the first time ever in this case in any manner said, we're going to settle this case but we are coming after you for reimbursement.

OWEN: That bothers me about your brief. A reservation of rights. We all know what that means. That means you owe the money, we don't. And there have been structured settlements. One proposal before trial was we'll fund it but you'll fund part of it. I don't think you can really sit here and say you were shocked the insurance company would propose settling it and seek

reimbursement.

HARRIS: I think a reservation of rights letter saying there's no coverage is different than reimbursement. Because what the reservation of rights letters means is if this case goes to judgment don't come looking to me. You're going to be on the hook for it if it goes to judgment. Settling the case brings in new ramifications, and reimbursement is a new right that's different than simply saying when you come to me for indemnity I'm not going to pay it.

PHILLIPS: But you demanded they make the settlement and you approved the specific amount.

HARRIS: We demanded that they make the settlement under Stower as we were entitled to do. Everybody agrees it was a reasonable settlement. It was an offer lower than they had tried to settle the case for, so there's no dispute. We did approve the amount. But again the Stower demand was that they settled the case as a covered claim.

PHILLIPS: Then you're in a lot better shape than you would be with a reservation of rights case to trial and a $20 million judgment.

HARRIS: We may or may not be. Whenever the case is settled you're fixing liability if you will and you're certainly fixing the amount of damages that are owed. And the question is, well aren't you in a better position by having a $7.5 million settlement where you litigate the coverage issue as opposed to going to trial and possibly being hit for $10 - $20 million. Well in that situation you have to look at what the insured's options are. One option is to say yes, I'll consent, we'll settle the case. If there's no coverage I'll reimburse you. But in doing that, the insured has to sit there and say, wait a minute that settlement might be three times my net worth and I don't want to do that.

PHILLIPS: Are you saying if you thought there was any right to reimbursement you would not have encouraged, demanded and approved this settlement? You would have rolled the dice?

HARRIS: The record is silent on that in this case because we never had the chance to respond. They said, we're going to seek reimbursement and literally within no more than 3 hours they had the case settled. We never had a chance to respond to that, to make the decision whether we were or we were not going to.

O'NEILL: So much of this problem underlying all of these cases is settlement negotiations look entirely different based on whether there's coverage or whether there is not coverage. If there's a DEC action and it's been declared there is no coverage here, a plaintiff is going to presumably put a much lesser demand on a defendant that's not covered. And so they just take on two entirely different dynamics.

HARRIS: That's exactly right. When they think there's a $10 million policy that's going

to be one demand. Whenever they've got a defendant with a net worth of a few hundred thousand or a few million dollars possibly, that's going to be another demand. Because if the net worth of the defendant is $2-3 million in that situation the defendants got a different analysis...

OWEN: Is your client's net worth in there?

HARRIS: No. It's not in the record. But I think in fashioning the rules, the court needs to look at the context the various insureds are going to be in. Sometimes the settlement is in an amount that the insured could pay and would be willing to pay to make the case go away. I think there are a lot of other situations where insurance exceed a company's net worth. That's why you have the insurance for the catastrophic claim, that you may have a $10 million policy, and you may have $1, $2 or $5 million net worth. And so even if you wanted to, it might be a very reasonable settlement, you can't get out your checkbook and write a check and pay it because it exceeds your net worth.

WAINWRIGHT: In terms of the equities here, the petitioner frames the case as one where respondent received a $7.5 million windfall with no right or entitlement to it since there's no coverage or if there's no coverage. But it's entirely a windfall. Sounds like this equity shouldn't be considered just in terms of whether there was coverage for the settlement, but it should be considered in light of the possible payment that the insured and the insurer were both potentially looking at it if there was a huge judgment there. So it could have been a net savings of $7 million if the judgment was $14.5 verses just an out of pocket $7.5 million payment.

HARRIS: That's right. And I think there are three considerations to take into account here by some of the equities. First is, that Excess Underwriters received a benefit. Excess Underwriters cutoff any potential Stower liability. They cutoff any defense cost. They took all of that out of the picture when they made the decision that we don't know if there is coverage here or not. We are disputing that with the insured, but we're going to pay this judgment. It did it to protect its own interest. That's why the judgment was paid. Then you look at the rights taken away from the insured. Whenever they unilaterally said, we're going to settle this case but we're coming after you for reimbursement...

HECHT: Yeah. But you demanded that they settle the case.

HARRIS: We demanded that they settle the case as a covered claim, which is again different...whenever I'm sitting there as the insured and I've got to look at a demand on me, whether I choose to accept it or not, assuming it's an objectively reasonable demand, but it might otherwise be a claim that the insured still is not going to take. Just because it's a reasonable demand doesn't mean the defendant's going to accept it. The obvious reason we talked about is it exceeds their net worth and they can't pay it. But there may be other reasons they choose not to pay it out of their assets. So making the demand on the insured is a right under Stower.

JEFFERSON: But it's not a right if there's no coverage. Right?

HARRIS: There is not a determination and no one at that point knows if they are covered...

JEFFERSON: Did the policy provide coverage or not?

HARRIS: According to J. Work, no.

JEFFERSON: Did you contest that conclusion? Did you appeal it in anyway?

HARRIS: We did not appeal it. We did look litigate it in the TC, but it was not appealed.

JEFFERSON: Why didn't you take it up on appeal?

HARRIS: Notice of appeal was filed before I was retained in the case.

JEFFERSON: Assuming that there is no coverage, do you agree that Underwriters then paid on a claim for which there was no coverage at all? So it's a windfall.

HARRIS: I don't know that I would characterize it as a windfall. I think in terms of unjust enrichment and all the doctors...

JEFFERSON: Well there's no coverage, so they had no obligation to pay under the contract, but they paid $7.5 million. Isn't there something a little bit unfair about that?

HARRIS: That's why we have to look at the whole picture. And we start with, they received benefits. And this was not a gratuitous payment. The insurance company paid it because they didn't know whether there was coverage or not.

JEFFERSON: Let's assume Frank's made a complete analysis of the coverage issue and knew there was no coverage. And other things being equal it was responsible for all the damages above the primary amounts. Under your theory, what would stop Frank's from refusing and unreasonably so to recognize Underwriter's claim for reimbursement if they were to pay money toward that settlement?

HARRIS: If they knew they had no coverage, I agree. I don't think there is an incentive for them to go in and seek reimbursement. But you've got to remember the insured is making the choice. And if Frank's knows that there is no coverage, you bet the insurance company is going to know it. And if there's no coverage as you just said, there's no Stower liability. There's no indemnity liability. If the insurance company knows that there is no coverage, they have the option to do nothing.

OWEN: Y'all went in to open court after the settlement had been reached. And at that point you knew there was a reservation - that they were making a demand for reimbursement. But

Frank's chose to go forth with settlement anyway. Isn't that correct?

HARRIS: Frank's basically read the rule 11 agreement that was entered into between Underwriters and the plaintiffs in the underlying case. That was read into the record. Frank's put on the record it's objection to any claim that Underwriters had.

OWEN: But it didn't say stop the settlement. It didn't say, wait a minute. If there's even a possibility that I'm going to be put on the hook for this settlement, I want _____settled it. So Frank's agreed to go for it knowing that there was this claim out there.

HARRIS: Frank's did nothing to stop the settlement and I don't think Frank's could have stopped the settlement.

OWEN: The policy requires Frank's consent to settlement does it not?

HARRIS: Let's look at what the consent is. It's on page 330 of the record. That provision deals with getting paid back when you pay a claim. The first sentence says, the only way you're entitled to benefits under this policy is if you have paid them first. You are entitled to be indemnified if you pay them first. The second sentence says, a claim for indemnity must be made within 12 months of 1) the case being resolved by judgment; or 2) the case being resolved by an agreement between Underwriters, the insured (Frank's in this case), and the _____ in the underlying case. The only consent (and that's the only consent provision in this policy) says, if you are going to pay a claim, you have to make the demand to be reimbursed for that within 12 months of this agreement. There is nothing in the policy that requires Frank's to consent in the situation we've got here where the insured is paying the claim directly. So there is a consent provision, but it's very limited.

Underwriters went out and settled this claim on its own. They picked up the phone. They called the plaintiff and they settled the case...

OWEN: You're saying if Frank's had objected to the judgment and said, no, judge, we want to go forward with the trial. You're saying the insurance company had the right to settle it over Frank's objection?

HARRIS: I think as a practical matter. I'm not sure there's a contractual right. But I think they had it because they had an agreement with the plaintiff. And the plaintiff says, Judge. I want their money. I've got an agreement with them to pay me. I want their money, and I'm nonsuiting this case. I don't know how Frank's can stop that. They could have settled this case.

HECHT: Ordinarily if the issue is a defense, we have the _____ rule, and that's pretty much going to be a legal question every time? You're going to look at the policy. You're going to look at the pleadings. You're not going to look at the evidence unless there's some sham or fraud or something going on, and you're going to make a decision about a defense based on that. The

coverage you would have to get into the details of the claim, I guess. Is that true?

HARRIS: It's possible that you would. They had several different defenses. They alleged about a dozen different defenses and many of them, like the own product exclusion...

HECHT: Frank's did?

HARRIS: Underwriters had asserted several exclusions as a defense to coverage in this case. I don't think it's crystal clear whether it could or could not have been litigated. I think it probably could have been litigated as a DEC judgment. But they didn't even try to do that.

HECHT: At least if they are going to be problems with litigating coverage, I take it, in a lot of cases in essence you are going to have to put the plaintiff on the stand and find out exactly what the plaintiff's case is. And there may be some conflict that develops between the insurer and the insured over what they want the plaintiff to say, I take it.

HARRIS: In some situations it may be a conflict where you can't. This case I think they could have litigated it. And again it goes back to they didn't try. Had they gotten down into the court and the judge says, I've got to stay this because it's too complicated. I have to abate it. Then they would be here saying, at least we tried.

HECHT: So it's not just purely a question of legal justiciability in the sense that something has to go first. There's more of a practical problem of how it's going to be done.

HARRIS: I think that's right and whether it can. And in many instances it can. There may be some where it can't.

JEFFERSON: It was justiciable here you say?

HARRIS: I believe it was.

JEFFERSON: Why? Under what case? I mean the primary coverage hadn't been exhausted so what gives Excess the right to bring a DEC action?

HARRIS: Well you look at all the demands that were being met. All the settlement demands that were going back and forth they were all up in the $7, $8, $9 million range. Everybody was operating and the demand is going back and forth. A condition was the primary is going to be tendered. Everybody was operating as if primary would go into it. And in fact it did. A big portion of the primary had already been exhausted through defense costs. So they were even trying to get the case settled too. Everybody realized this was going to - unless it was taken up in judgment, this was going to go into excess _____.

OWEN: Was the coverage issue a legal question or were there fact issues to be

resolved?

HARRIS: I believe many of them were legal questions.

OWEN: Were there any fact issues?

HARRIS: It wasn't litigated so I can't say that for sure.

SCHNEIDER: What law applies - Texas or Louisiana and does it make any difference?

HARRIS: Texas law applies because they didn't raise Louisiana law in the TC. They didn't ask the TC to apply Louisiana law. There's been no showing there's a conflict because Louisiana has not decided it's decision. California, Massachusetts, a few other jurisdictions have reached this issue, but Louisiana has not decided the question. And they want the court to make a _____ guess under Louisiana law.

WAINWRIGHT: Do you see any way to insure that the coverage issue is decided prior to the point in time where there's tension over the settlement?

HARRIS: I think the only thing the court can do is what it did in Griffin and Gandy and Matagorda and tell the insurer that you've got to go out and try to get it resolved. You can't insure that's going to happen in every situation. That's the best you can do is to try to get it resolved. And in many cases you could. Here we had an 11-month window. It's very likely they could have filed a agreement. All they had to do was to file the DEC judgment, get summary judgments on file and get a ruling.

PHILLIPS: If you had appealed that and so it had not been a final judgment who bears the costs of that delay?

HARRIS: I don't know that anyone's bearing the cost. It just doesn't get the issue resolved.

PHILLIPS: So if its' not resolved, but they did everything they could. They sent you a letter and 5 min. later filed a declaratory judgment action, you stall it, you lose and you appeal it. Then do they still pay the judgment with no recourse or have they done everything they can and will abide the result of that declaratory judgment action even if it comes after the settlement?

HARRIS: They do have a recourse because they have to go through the right steps and ensure the insured is protected.

PHILLIPS: My question is very simple. They took our advise in Gandy and they filed a declaratory judgment. But it's not resolved prior to the time they have to make a Stower decision. Do they get to continue and get the declaratory judgment resolved and that determines whether or

not you reimburse, or are they out of luck under your reading of Matagorda?

HARRIS: They are not out of luck under my reading of Matagorda just because they didn't do that. Because they didn't follow the other steps in Matagorda or any other rule. Even the California rule in Jacobson. They didn't follow those steps. **SIDE A ENDS**

SIDE B

... They waited 11 months before doing it. And in fact they already agreed to the Stower demand.

PHILLIPS: I'm going to try my question one more time. If an insurer in the position that Excess was in had filed a declaratory judgment action would it have to be finally resolved, or final judgment in appeals exhausted before the case gets to a point that it settles in order for them to have any -if it's not finally resolved and they make the payment because they are in a Stower situation, can they have any right to reimbursement against you if they end up winning the declaratory judgment that is resolved later, or are they out of luck?

HARRIS: They can have the right to reimbursement if they have met the other requirements that have been imposed either through Matagorda or whatever rule in that jurisdiction. They have to do other things.

JEFFERSON: But that brings up the whole question then. Matagorda requires that the insured agree that they can seek reimbursement. So we would be back to the same point. I think your answer to the Chief is no.

HECHT: What other things would they have to do that they could do?

HARRIS: File their declaratory judgment action.

HECHT: And they did.

HARRIS: Well they didn't do it timely.

HECHT: But his question said they didn't.

HARRIS: They did it, but the court has said you need to do it in a timely manner. Under Matagorda county you have to get the consent of the insured. If you don't do that, you then need to make the choice whether it's covered or not or whether your want to risk Stower exposure. You may make the choice that you didn't.

If it is a loser case for liability why go through the hassle? why put your company through the exposure of the judgment? why put all your witnesses through the length of

the trial and the disruption of your business? But if it's a good settlement for - pick a number. In this case it was $7.5 million, and if that's is a number that you're willing to pay if there's no coverage, and I think I've got a horrible liability case, and I think I've got a pretty good coverage case, I think there's coverage here, of course I would consent. Because I'm using the insurance company's money to satisfy this case while I get to go litigate a coverage claim that I think I'm going to win. So I think there certainly are situations where the insured would reasonably consent to it.

HECHT: It looks to me like if you don't consent, not only are you going to win the coverage case - that's what you think - but you're going to win extra contractual damages and the insurer is going to be on the hook for the Stower.

HARRIS: If you go forward with the litigation. And in this situation they settled it out because they didn't have the option to go forward. And that's one of the other evils under Matagorda county that the court was addressing just as the California SC did in Jacobson: are you balancing the rights. By allowing a unilateral settlement and the universal reservation of the right to reimbursement you are depriving the insured of the ability to go forward. And that's not in the contract.

O'NEILL: Well that strikes me that it's skewed whatever you do. In practicality if it's not the insurance company's money, then the settlement - let's say the company has a net worth of $1 million, plaintiffs are going to settle that case with the company probably $800,000. If there's the aura of there being insurance money out there, there is going to be $9 million that the insured can't pay, so it's dilemmas all the way around.

HARRIS: That's right. It is skewed a bit, but we have to remember where Stower fits into this picture. And so first of all you've got the insured with the ability to make a Stower demand. And crafting another rule, a rule other than Matagorda county is going to erode Stower.

JEFFERSON: But Stower presupposes that the insurer has control of the defense and the exclusive right to settle neither which is applicable here.

HARRIS: They didn't have exclusive control of the defense, but they were participating in the defense, and they were participating in the settlement.

JEFFERSON: They didn't have exclusive control of the defense nor the exclusive right to settle, so why would Stower apply?

HARRIS: Stower applies whenever there is a demand made within coverage. First, Stower isn't going to apply because there's no coverage. And if there's no coverage the insurance company can do nothing. The insurance company can say, there's no coverage. We really think there's not coverage here, and we're not going to pay it.

JEFFERSON: Does Stower apply if the insured has the exclusive right to settle, and the

exclusive control of the defense if there were such a contract?

HARRIS: I'm not aware of an exception to Stower. I think this was a good Stower ____. Everyone in the underlying case, and in fact in this case, has conceded the demand that was made was a Stower demand. So I think it did apply. The question is, ultimately whether there was coverage? In Matagorda county this court put that decision back on the insurer because the insurer is in the business of making that decision.

WAINWRIGHT: There's a lot of discussion in lots of these cases about the eventual outcome - was there coverage or not? And that's going to be important in a lot of things. But the way many of these cases arise is both sides are making a judgment, educated guess about risk at a time when they are unclear about coverage. So to paint this case in the prism of the eventual outcome, determinational coverage seems to me to be completely irrelevant at least to the issue of what the parties did at the time that they took their action given the facts at that time. I assume you agree.

HARRIS: I absolutely agree. You have to look at the rights of the parties at the time the actions are being taken. We know there's a coverage dispute. We know what the rights are under the contract. We know there's no right to reimbursement under the contract. So it's either going to have to be an express agreement or in some jurisdictions they may allow an implied agreement. You have to get an agreement of some fashion on the reimbursement, then you have the Stower duty. We know that there's the ability to make a Stower demand and we know what the rights and obligations are there. And the insurance company in that position then makes the decision: Is this case covered? If it's covered, I've got an indemnity obligation and I need to do what a reasonable insurer would do, or I may be exposed to excess liability. Or, is the case not covered in which case I can do nothing and I would have no indemnity obligation and I will have no Stower obligation for an excess liability, or fall somewhere in the middle.

I don't really know if this case is covered or not. But I've got to make the decision, and I need to make the decision whether I think it's going to be covered or it's not going to be covered. I need to make the decision how fearful I am of excess liability under Stower. Because under Stower that decision is put back on me as the insurance company. And if I don't make the right decision under Stower I have to suffer those consequences.

O'NEILL: I believe you made the statement in your brief that the California cases that have gone the other way, for example Blue Ridge, are distinguishable because underlying insurance considerations are different in California than they are in Texas. How is that?

HARRIS: In Blue Ridge the court there distinguished Matagorda County. Because in Blue Ridge they do not allow a declaratory judgment action - or in California they do not allow a declaratory judgment action before the underlying matter is resolved.

O'NEILL: Is it that they don't allow it, or they don't allow the insurer to take into account coverage in assessing the reasonableness of the offer?

HARRIS: I think those are two different things. I think they don't allow it to go forward. I guess you can file it but it's to be stayed. And I don't think the declaratory judgment action can go forward. On not allowing coverage to be considered in the settlement demand in Blue Ridge v. Jacobson, they used the word "bad faith" and they refer to the Joe Hanson decision. That's really the California equivalent of Stower. Stower duties are very similar.

O'NEILL: So when you say the policy differences between California and Texas you're talking about the inability in California to push forward a DEC action as you can in Texas?

HARRIS: That was how Blue Ridge distinguished Matagorda county. But the court in Blue Ridge also looked at some different factors. One of the factors that this court did not take into account in Matagorda county was the ability of the insured to go forward in the underlying litigation. And in Blue Ridge in crafting a rule allowing implied consent they set up a three part test that you have to meet before reimbursement will be allowed. There has to be a clear express reservation of rights; there has to be a notice to the insureds that you're going to settle the case unless they object; and if they don't agree that the case ought to be settled, you then, as the insurer, have to tender the defense back to the insured. In other words, okay. You don't want to take my settlement and let me have reimbursement, then you go litigate the case. That is a valuable right that under the rule Underwriters were proposing in this case would be lost. Because they say, If we're going to settle the case. We are entitled to reimbursement. They settle the case. The insured does not have the right to go forward in the underlying litigation.

HECHT: Why is that?

HARRIS: Because they settled the case. There is no underlying case any longer.

O'NEILL: I'm not sure I read Blue Ridge the same way you do. They just say that in California they've been solicitous of the fact that they might have to stay any DEC action, and I think that statements probably true of Texas as well. You can stay a DEC action for the same reasons.

HARRIS: My reading of Blue Ridge, and I've done a little reading on CA law, is that you do not allow the DEC action to go forward while the underlying claim is pending. If you look in the discussion of Matagorda county, in Texas the SC said that the insurer has the ability to file a declaratory judgment action. But in CA what I thought it said was is basically we don't allow that.

O'NEILL: Unlike the case in Texas, Blue Ridge did not have the opportunity.

HARRIS: I think that's one of the distinctions. And the other big distinction in Blue Ridge is, that they look out for the right of the insured to be able to litigate the underlying case. Before they will imply, because that it is an implied right to reimbursement, they make sure that the insurer tenders the defense back to the insured so that the insured can litigate the case.

HECHT: It didn't seem like Underwriters ever had the defense. And it didn't seem like

Frank's wanted to take the defense back. So I don't see how that third prong is at issue here. They want the defense, which they have. They share it with their primary, I guess. But Excess doesn't have it.

HARRIS: I agree, but the same principal allows the insured to litigate the underlying case. And if you look a page or so over from where they setup that 3-part test they even say, If the insured thought there was no liability they could have litigated the underlying case. Because the insured gave them that opportunity. And that's the reason I think it's important to have the second element in Matagorda county to require consent, or if you're not going to do that, do something like the SC of CA did in Blue Ridge. I think that's a much more nebulous test and you're going to be litigating those factors; whereas here we have a very clear rule. But that's one of the big problems is taking away from the insured that right to litigate the liability in the underlying case. Because instead of fixing the amount of damages at $7.5 million, if there's a 50/50 shot on liability they may have no choice but to go forward on that.

HECHT: But what I don't understand is in this case Frank's never said, Look. We want to go forward. We're going to beat this case. They were saying the opposite. We're going to get smushed. We've got to settle it.

HARRIS: But the issue that I'm talking about got taken away, because whenever Underwriters said, We're going to get reimbursed - when they sent that letter over on Feb. 23, we're going to settle the case, we're going to get reimbursement, they then did settle the case and resolved it. But backing up a step. Prior to that, the demands made by Frank's were for the insurance company to settle the case under Stower as a covered claim, which is different. And if you had turned the question back to Frank's, Okay Frank's here's the situation. If we do settle this case for $7.5 million, if we come back after you for it are you going to be able to pay that, do you want to pay that, or do you want to go forward in the underlying case? See that's what the second prong in CA does. It makes the insurer put the insured on notice that we're going to settle the case.

HECHT: The insured said in this case, We want reimbursement. They put that on record.

HARRIS: They did and settled the case within 3 hours.

HECHT: And you said, We're not going to give it to you.

HARRIS: Well we said that the next day after the case was settled. They said, We're going to come after you for reimbursement and then they picked up the phone and settled the case.

OWEN: But you went into court before it was settled and said, We want this settled, knowing that that claim for reimbursement was out there. I don't see how if we apply the CA test you prevail. The test of CA you would lose, because your client wanted to settle the case, had the opportunity to go forward with the litigation had they so chosen with their own defense. So why

wouldn't you lose under the Blue Ridge test?

HARRIS: I don't know that we could have stopped the settlement. They went into court on the morning of Feb. 24 and read (if you look at the record) we're reading into the record the rule 11 agreement. The case was settled.

O'NEILL: But your point is why would you stop the settlement. As far as you know you've got a covered claim, because they filed a DEC action. Why would you want to stop it if you feel like you're covered?

HARRIS: That's right. You've got a situation -and that's the hard choice for the court is I think it's the ultimate decision that the court struggled with in Matagorda county. You've got the insurance company saying, We want reimbursement; and you've got the insured saying, We're not going to give you reimbursement or remaining silent, whichever is the applicable situation. And then you have to come down to is there an agreement? is it implied in fact? No, because there's no meeting of the minds. Is it implied in law? And that's where all these equities come in, and that's where I think the SC and Matagorda County got it right in saying you need to consent to that because that takes care of the situation where you're taking basically the case away from the insured and depriving them of the right to litigate it. You're dealing with the different demands that are made when there's coverage, when there's not coverage. That's the right place to put the equities and it also prevents eroding Stower. Because if you have another rule and allow the insurer to unilaterally settle the case, cap its Stower liability, and then still go back after the insureds for the money, it's a free Stower ride for them, and it takes Stower out of the picture. And Stower is in the picture there as it is in every settlement decision.

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REBUTTAL

HALL: I think J. Hecht hit it on the head when he noted the fact that what Griffin and Gandy do is recognize that the DJ is justiciable. But that there are practical ramifications here that really have to be taken into consideration. And I would simply submit to the court that the remedy currently proposed by the court with Matagorda county doesn't work if what you're trying to do is - it works if you try to foster more litigation. Because there's nothing else that an insurer can do.

And I don't understand what is wrong with a different system. Matagorda can stand on its facts. But in this situation where an excess carrier is not participating in the defense, I would still submit to the court - the record is clear it did not participate in settlement despite ____ to the contrary. We reacted to a settlement demand that was unilaterally negotiated and obtained, and if reaction to that perpetuating in doing what your insured demands that you do under threat of Stower is participating in settlement negotiations, I think that's been redefined beyond any meaningful...

O'NEILL: Well let's say for purposes of argument that Frank's had a net worth of $1

million. Then if we rule your way they are out of business. When they were at a point negotiating when there was some argument there was coverage - I mean you understand that they are in a difficult situation, because the reason these high demands are coming in is this perception that there is coverage. I mean the reason that the plaintiffs are demanding these amounts - if they knew there was no insurance, if this was a self insured and the company is worth $1 million, the settlement demand is going to be $800,000 or $900,000.

HALL: You're absolutely correct. And that goes on all the time. And it goes on in situations - saying you can file a DJ and resolve it it just doesn't happen. I mean you can do it and you can start the process...

O'NEILL: But in this situation if Excess attempted to collect this amount from Frank's and if (hypothetically) their net worth was $1 million Frank's is out of business. Whereas, if there had not been coverage they would be in business under that scenario.

HALL: So you're saying that their burden was the aura of potential insurance company?

O'NEILL: Sure. Absolutely. You would acknowledge that. The plaintiff's lawyer wants to know, Is there insurance money here or is there not? And that completely drives the settlement is whether there is insurance money.

HALL: Absolutely. I acknowledge that that happens. I don't understand how that relates to what my client did in this situation, and how it is that by capitulating to demands that they lost a right recognized by this court under Griffin.

O'NEILL: But you recognize the dilemma we're in as well. And I still haven't heard anything that if we were to decide your way, which I think would require us to tinker some with Matagorda, I could posit many scenarios where the inequities would go the other way. I think we're struggling to come up with something that would be equitable both ways.

HALL: What I would suggest the court terms of equities both ways is, I don't have issue with Matagorda in the sense that the insurer injected itself into the process and controlled everything, and then dealt with it. And that's consistent with the court's cases that culminated in Rocor(?), where the court gradually sort of just looked at that issue and said, If you're going jump and settle, even as an excess carrier, if you are going to do that, you do it right and you need to make sure you do it with a view towards protecting your insured.

Now in our case, Mr. Harris correctly notes, it was an indemnity policy. We didn't even have to fund the settlement. The excess insurers in this case timely reserved rights. They did it on a couple of occasions. Suddenly a right that they had that they had not waived was gone. And under the circumstances of this case, I don't think that that's a necessary conclusion from looking at what happened in Matagorda county or what the court was I think was concerned with in

Matagorda County.

OWEN: Were there fact disputes on the coverage issue, and if so, are they in the record what they were?

HALL: I believe that there are some things in the record on that point. In terms of the fact disputes, the issue with respect to some of the coverage issues, I think had to be developed, but I honestly can't tell the court with any precision in answer to that.

PHILLIPS: When J. Work made his determination was it based on factual revolution or purely as a matter of law?

HALL: I think there were some factual resolutions. It's always incorporated somehow. But I think that the facts aren't in great dispute. What I can't recall is whether the facts were the basis of J. Work's decision, facts that were apparent from the underlying pleadings, or had been developed in the underlying litigation, which of course went all the way up to trial. So it was quite a bit of discovery that was conducted.