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THE BASSETT BULLETIN™

THE ONGOING BATTLE OF DEFENSE AND INDEMNITY UNDER AN INSURANCE CONTRACT

In 2007, the Texas Supreme Court handed down their opinion in *Mid-Continent Insurance Co. v. Liberty Mutual Insurance Co.*¹ At issue in *Mid-Continent* was whether an underpaying co-insurer owed a duty of contribution to an overpaying co-insurer after settlement of the claim. The general rule is that if two or more insurers bind themselves to pay the entire loss insured against, and one insurer pays the whole loss, the one paying has a right of action against its co-insurer, or co-insurers, for a ratable proportion of the amount paid by it, because it has paid a debt which is equally and concurrently due by the other insurers.

However, in *Mid-Continent*, the Texas Supreme Court determined that the direct claim for contribution between co-insurers disappears when the insurance policies contain “other insurance” or “pro rata” clauses.

Again, on January 4, 2010, this issue was taken up, this time in the United States Court of Appeals for the Fifth Circuit. In *Trinity Universal Insurance Co. v. Utica National Insurance*², the Fifth Circuit determined that the *Mid-Continent* decision only extended to the duty to defend, not the duty to indemnify.

DUTY TO INDEMNIFY VS. DUTY TO DEFEND

The duty to indemnify protects insureds "from payment of damages they may be found legally obligated to pay," while the duty to defend "protects the same parties against the expense of any suit seeking damages" covered by the policy.

The Texas Supreme Court has routinely held that the duty to defend and the duty to indemnify are two separate and distinct duties. In past newsletter articles to you, we have expounded on the differences between the duty to indemnify and the duty to defend. We have explained that one duty can independently exist without the other.

An insurer's duty to defend is determined under the “eight-corners rule,” in which an insurer's duty is determined by the third-party plaintiff's pleadings, considered in light of the policy provisions, without regard to the truth or falsity of those allegations. The court must resolve all doubts regarding coverage in favor of the insured, but it cannot “look outside the pleadings, or imagine factual scenarios which might trigger coverage.”

¹ 236 S.W.3d 765 (Tex. 2007).

² 592 F.3d 687 (5th Cir. Tex. 2010).

An insurer is required to defend an insured only against claims that are potentially within the coverage of the policy.³ Most policies, however, provide that the insurer will defend the insured even if the allegations against the insured are groundless, false, or fraudulent.

If a potentially covered claim falls partially within and partially outside the policy period, the insurer must, nevertheless, provide a complete defense; the duty to defend is not reduced pro rata by the insurer's "time on the risk" or any other formula.⁴ Moreover, if coverage exists for any portion of the suit, the insurer must defend the entire suit.

On the other hand, indemnity agreements are construed under normal rules of contract construction.⁵ The primary goal is to ascertain, and give effect to, the parties' intent as expressed in the instrument.

MID-CONTINENT DECISION

The lawsuit in *Mid-Continent* involved an automobile accident which occurred in the construction zone of a State of Texas highway project. A westbound car driven by Cooper crossed into oncoming traffic and collided with an eastbound car driven by the Boutin family. All members of the Boutin family were seriously injured.

The general contractor on the highway project was Kinsel Industries. Crabtree Barricades was Kinsel's subcontractor responsible for signs and dividers. The Boutin family sued Cooper, the State of Texas, Kinsel, and Crabtree. Kinsel was insured by Liberty Mutual under a \$1 million comprehensive general liability (CGL) policy. Liberty Mutual also provided Kinsel with \$10 million in excess liability insurance. Crabtree was insured by Mid-Continent Insurance under a \$1 million CGL policy. Kinsel was listed as an additional insured under Crabtree's Mid-Continent policy. Kinsel was therefore protected under two CGL policies.

The two CGL policies contained identical "other insurance" clauses which provided for equal or pro rata sharing up to the co-insurers' respective policy limits if the loss is covered by other primary insurance.

Liberty Mutual and Mid-Continent agreed that Kinsel was partially at fault. Liberty Mutual believed that Kinsel was 60% at fault for the accident, but Mid-Continent disagreed. Mid-Continent calculated Kinsel to be only 10-15% at fault for the accident. The lawsuit was eventually settled at mediation when Liberty Mutual agreed to settle on behalf of Kinsel for \$1.5 million (which was 60% of the estimated \$2.5 million anticipated verdict).

Liberty Mutual demanded that Mid-Continent contribute half, but Mid-Continent refused. Mid-Continent agreed to pay only \$150,000.00 toward the settlement. Liberty Mutual funded the remaining \$1.35 million to the Plaintiffs. In order to recover the contribution amount that Liberty Mutual believed Mid-Continent owed, Liberty Mutual filed a lawsuit. The trial court initially ordered that Mid-Continent contribute an additional \$550,000.00 to Liberty Mutual, to equal 50% of the total settlement.

³ *Houston Petroleum v. Highlands Ins.*, 830 S.W.2d 153, 155 (Tex. App.—Houston [1st Dist.] 1990, den.).

⁴ *Texas Pro. & Casualty Ins. Guar. Ass'n v. Southwest Aggregates, Inc.*, 982 S.W.2d 600, 607 (Tex. App.—Austin 1998, no pet.).

⁵ *Gulf Ins. Co. v. Burns Motors, Inc.*, 22 S.W.3d 417, 423 (Tex. 2000).

On appeal, the Texas Supreme Court determined that no direct cause of action existed between Liberty Mutual and Mid-Continent. The Court held that there is no cause of action between co-insurers in Texas when the insurance policies contain “other insurance” clauses. Thus, Liberty Mutual had no cause of action against Mid-Continent for reimbursement. Therefore, there is no right of reimbursement of indemnity paid by one co-insurer against another co-insurer when the insurance policies contain an “other insurance” clause.

TRINITY UNIVERSAL DECISION

After the 2007, *Mid-Continent* decision, another court interpreted a similar issue. The *Trinity Universal* trial case involved four commercial general liability insurance policies which all insured Lacy Masonry while on a construction site for the renovation of a hospital in New Braunfels, Texas.

The hospital sued Lacy Masonry and several other companies, alleging each was responsible for property damage caused during the design, construction, and improvement of the hospital building. Lacy Masonry tendered the defense of the suit to its insurers. Three insurers agreed to defend Lacy Masonry and shared the defense costs. However, the fourth insurer (EMC) denied that it had a duty to defend the suit under its policy and refused to participate in, or contribute to, the defense. The suit was eventually settled, and the three insurers subsequently sued EMC in Federal court alleging that EMC owed contribution for its share of the defense cost.

The Federal court determined that while EMC had violated its duty to defend, the court dismissed the claims finding that, under *Mid-Continent*, co-insurers have no direct cause of action against each other. The case was appealed to the Fifth Circuit Court of Appeals.

The appellate court determined that the Texas Supreme Court decision in *Mid-Continent* applied only to whether a co-insurer has a right of contribution or subrogation against a non-paying, co-insurer to recover money paid to indemnify a common insured for a loss. However, the Texas Supreme Court left open the issue of whether a co-insurer that pays more than its share of defense costs may recover such costs from a co-insurer who violates its duty to defend a common insured.

The EMC policy provided that EMC “will have the right and duty to defend the insured against any ‘suit’ seeking damages covered by the EMC policy.” An “other insurance” clause does not modify this obligation so as to render it several and independent. The duty to defend creates a debt which is equally and concurrently due by all of its insurers. The court held that EMC had a duty to provide a complete defense. This is because the contract obligated the insurer to defend its insured, not to provide a pro rata defense. Thus, the Fifth Circuit Court found that the insurers were entitled to recover the proportionate share of defense costs from EMC, the non-paying insurer.

WHAT DOES THIS MEAN FOR YOU?

In many cases, an insured has several different insurance policies. When faced with the competing insurance companies which may value a case in different amounts, the following factors/issues need to be considered:

- (1) Because one co-insurer has no right to demand reimbursement from another co-insurer to recover money paid to indemnify a common insured for a loss, the co-insurers should consider drafting a contract between them to create an obligation to pay each other for their proportionate share of the loss.
- (2) It is also important to consider the ramifications for actions between co-insurers on the insured. If one co-insurer's actions jeopardize the insured, the co-insurer has opened itself up to a first-party lawsuit by the insured under the Texas Insurance Code.
- (3) Finally, although a co-insurer may unilaterally decide that it is not obligated to pay for the defense of an insured, the non-paying, co-insurer opens itself up to a breach of contract suit after the underlying action is resolved. Then, instead of paying for a proportionate share of the attorneys' fees for the underlying case, the damages will grow exponentially as there will be multiple attorneys' fees that will be incurred.



The Bassett Firm

**Two Turtle Creek Village
3838 Oak Lawn Avenue
Suite 1300
Dallas, Texas 75219
(214) 219-9900 Telephone
(214) 219-9456 Facsimile
Toll Free: 1-800-310-9769
www.thebassettfirm.com**

ATTORNEYS

- **MIKE H. BASSETT**
- **JENNIFER R. ASHMORE**
- **ROBERT L. MCGEE, JR.**
- **JAMIE J. MCKEY**
- **MICHAEL J. NOORDSY**
- **JOHN J. ROBERTS**
- **MATHEW SAMUEL**

Information regarding *The Bassett Bulletin*TM is available from **Angie Stevenson** (astevenson@thebassettfirm.com) at (214) 219-9900. ©2004 The Bassett Firm. All rights reserved.

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