Relationship Between Attorneys, Primary and Excess Carriers since American Centennial and Stonewall Insurance

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I. INTRODUCTION

This paper will discuss the implications of two recent decisions by the Texas Supreme Court and the Corpus Christi Court of Appeals which have changed the legal relationships between primary insurers, excess insurers and defense counsel hired by a primary insurer.

The cases discussed in this paper constitute a significant change in Texas law, because they recognize a new cause of action for an excess insurer against a primary insurer and defense counsel hired by a primary insurer.

These cases hold that excess carriers can sue defense attorneys employed by a primary insurer for legal malpractice, notwithstanding that there typically is no privity of contract (and no direct attorney-client relationship) between excess carriers and defense counsel.

Excess carriers also have a cause of action against primary carriers for recoupment of amounts paid by an excess carrier in settlement of underlying claims, pursuant to equitable subrogation.

As a result, both primary carriers and defense counsel must consider the interests of an excess carrier when handling an underlying lawsuit. These decisions impose new duties and obligations on defense counsel and increase the probability that they may be sued for legal malpractice.

These decisions also affect the practice of plaintiff's attorneys, because there is now more pressure upon primary insurers and defense counsel to settle claims within primary policy limits. The stated policy goal of these decisions is to encourage settlement of claims within primary policy limits. Additionally, these decisions provide plaintiff's attorneys with a new practice area, through the representation of excess insurers against primary carriers and their defense counsel.

This paper will discuss and comment upon the holdings of these new decisions, explore the ramifications upon the handling of claims by defense counsel, consider some of the ambiguities and potential problems created by the cases, and discuss subsequent cases applying these decisions.

II. DISCUSSION

A. The *American Centennial* and *Stonewall Insurance* decisions.

1. *American Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480 (Tex. 1992)

In *American Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480 (Tex. 1992), the Texas Supreme Court allowed an action by an excess carrier against a primary insurer and defense counsel for the insured, for alleged mishandling of a claim against the insured. The Court stated that the primary basis for the new cause of action was "equitable subrogation", by which an excess carrier becomes "subrogated" to the rights (and cause of action) of the insured against its primary insurer and its defense counsel.

a. Facts

In the underlying wrongful death suit, General Rent-a-Car was sued for injuries and death resulting from a blow-out of a defective tire on one of its rental cars. General's primary carrier, Canal Insurance, provided coverage of $100,000.00. First State Insurance Company (first level excess) insured from $100,000.00 to $1,000,000.00, and American Centennial (second level excess) insured from $1,000,000 to $4,000,000.00. Canal Insurance retained defense counsel and defended the suit.

The Court of Appeals' opinion found at 810 S.W.2d 246 (Tex. App. -- Houston [1st Dist.] 1991) outlines the following facts.

In 1982 Russell rented a car from General Rent-a-Car International, Inc. ("General"). Five days later, Russell and her sister and her son were riding in the car when they were involved in an accident. Russell and her sister died as a result of the injuries they received in the accident.

As a result of the accident, suit was filed against General seeking damages for personal injury, wrongful death, and survivorship. Canal (the primary carrier) investigated and defended the suit hiring the Houston law firm of Giessel, Stone, Barker and Lyman to represent the insured General. They assigned Richard S. Joseph as lead counsel.

A September, 1984 Request for Admissions asked Defendant General to admit that a tire on the car had blown out because it was defective and that the blow out caused the accident. In October, 1994, Joseph, on behalf of General, admitted the fact. Furthermore, Joseph admitted that the defective tire was unreasonably dangerous and created an unreasonable risk of harm to its user. At that time, no depositions had been taken.

Fifteen depositions were taken from October, 1984 to January, 1986, and defense counsel Joseph spoke to new experts on behalf of General. As a result, Joseph's opinion of the cause of the accident changed; he no longer believed it was caused by a blow out; instead, he believed that it was caused by a rear-end collision.

In July, 1985 defense counsel Joseph filed a Motion to Withdraw General's Answers to Request for Admissions, but the trial court denied the Motion.

The Plaintiffs then non-suited all defendants except General and filed a Motion for Summary Judgment based on Defendant General's Answers to the Request for Admissions.

Trial of the case was set for February, 1986. In December, 1985, second level excess carrier American Centennial hired Beaumont attorney Kyle Wheelus, Jr. to investigate the handling of the case. In January, 1986 first level excess carrier First State retained Houston attorney Clifford Lawrence to investigate the handling of the case. Lawrence and Wheelus jointly prepared a memorandum in January, 1986 critical of defense counsel's handling of the case. Lawrence testified during his deposition that he had determined that the case could not be successfully defended at trial. Wheelus testified during his deposition that he had formed the opinion that the defense firm hired by primary carrier Canal had negligently handled the case.

In January, 1986 a meeting was held at the offices of the corporate counsel for the insured General. Representatives of Canal, First State and American Centennial appeared with their counsel. The insured General demanded that all three carriers tender their policy limits to settle the case. First level excess carrier First State and second level excess carrier American Centennial then made demand upon the primary carrier Canal to settle the case with its own funds, but Canal refused.

First level excess carrier First State and second level excess carrier American Centennial then reached a tentative agreement with the Plaintiffs and the suit was to be settled for $3.7 Million.

The excess carriers, First State and American Centennial, sued the primary carrier, the law firm handling the defense, and two of the firm's attorneys for negligence, gross negligence, breach of the duty of good faith and fair dealing, and violations of the Texas Deceptive Trade Practices Act and Article 21.21 of the Texas Insurance Code.

The trial court granted summary judgment in favor of the defendants, ruling that all

claims were barred by the statutes of limitations, and held that the primary insurer and its counsel owed no duties to the excess carriers. On re-hearing and by a two to one majority, the court of appeals reversed in part and affirmed in part.

b. The holding of the Texas Supreme Court

The Texas Supreme Court also reversed in part and affirmed in part, holding that an excess carrier may bring an "equitable subrogation" action against both a primary insurer and defense counsel, and that fact issues existed as to whether the underlying claim was properly handled.

The court stated that its ruling was based on the *Stowers* doctrine. In *G.A. Stowers Furniture Co. v. American Indemnity Co.*, 15 S.W.2d 544 (Tex. Comm'n App. 1929, holding approved), the court held that an insured can sue a primary carrier for a wrongful refusal to settle a claim within primary policy limits. The *Stowers* decision is based upon, in part, the duty of an insurer to act as an ordinarily prudent person would act in the management of his own business affairs.

In a subsequent case, the Texas Supreme Court has held that an insurer's duty to act as an ordinarily prudent person in business management extends to claim investigation, defense of the claim at trial, and settlement negotiations. *See Ranger County Mut. Ins. Co. v. Guin*, 723 S.W.2d 656, 659 (Tex. 1987).

Prior to the *American Centennial* decision, the Texas Supreme Court had not previously considered whether a primary carrier had a similar duty to protect the interests of an excess carrier from losses due to wrongful handling of a claim. As discussed *infra*, the court now holds that the *Stowers* duty extends to protection of excess carriers.

c. Equitable subrogation

The *American Centennial* court noted that courts from other jurisdictions have utilized the doctrine of "equitable subrogation" to allow an excess carrier to maintain a cause of action against a primary carrier. The rationale is that "the [excess] insurer paying a loss under a policy becomes equitably subrogated to any cause of action the insured may have against the third party responsible for the loss." *American Centennial*, 843 S.W.2d at 482. As such, the excess insurer is "able to maintain any action that the insured may have against the primary carrier for mishandling of the claim." *Id.* In recognizing a cause of action based upon equitable subrogation, the court opined that it was pursuing the policy of encouraging "fair and reasonable settlement of lawsuits." *Id.* The court reasoned that if an excess carrier had no remedy, the primary insurer would have less incentive to settle within policy limits. *Id.* at 483. The court, therefore, held as follows:

> [W]e hold that an excess carrier may bring an equitable subrogation action against the primary carrier. This does not, however, impose new or additional burdens upon the primary carrier, since our prior decisions in *Stowers* and *Ranger County* imposed clear duties on the primary carrier to protect the interests of the insured. The primary carrier should not be relieved of these obligations simply because the insured has separately contracted for excess coverage. *Id.* at 483.

d. No direct duty

The *American Centennial* court, however, declined to recognize a "direct duty" running from the primary to the excess insurer. The court noted that only a few jurisdictions have permitted a direct action (as opposed to limiting the excess carrier to equitable subrogation). Excess insurers prefer a direct

action, "because, under the theory of equitable subrogation, they are subject to any defenses assertable against an insured, including the refusal to settle and the failure to cooperate." *Id.*

The court found that allowing an equitable subrogation claim provided "an adequate remedy" to the excess insurer. Because the excess carrier had a sufficient remedy, the court declined to recognize a direct duty. The court held: "[T]he excess insurers appear to have an adequate remedy using equitable subrogation, we decline at this time to permit a direct action." *Id.*

e. Legal malpractice claim

The court also considered whether an excess carrier could bring a malpractice action against the defense attorneys.[1] Under Texas law, attorneys are not ordinary liable for damages to a non-client, because there is no privity of contract between the attorney and the non-client. *Id.* at 484. The court noted that "Texas courts have been understandably reluctant to permit a malpractice action by a non-client because of the potential interference with the duties an attorney owes to the client." *Id.* The *American Centennial* court, however, allowed the action against the law firm, reasoning that the excess insurers were only enforcing existing duties of the defense counsel to the insured, pursuant to equitable subrogation. The court held:

> Recognizing an equitable subrogation action by the excess carrier against defense counsel would not, however, interfere with the relationship between the attorney and the client nor result in additional conflicts of interest. Subrogation permits the insurer only to enforce existing duties of defense counsel to the insured. *Id.*

The court further noted that "[n]o new or additional burdens are imposed on the attorney, who already has the duty to represent the insured previously described in *Employers Casualty Co.*" *Id.* at 484-85.

f. The measure of damages

The majority opinion by Justice Doggett in *American Centennial* is silent as to the measure of damages in an equitable subrogation claim. The majority also does not discuss what causes of action the excess insurer can assert through equitable subrogation. The excess insurers in the case had asserted claims for negligence, gross negligence, breach of the duty of good faith and fair dealing, violations of the DTPA, and violations of Article 21.21 of the Texas Insurance Code. The majority, however, simply does not discuss which of these causes of action could be brought through equitable subrogation.

Justice Hecht, joined by Justices Phillips, Gonzales, Cook, and Cornyn, however, concurred in the holding and addressed these issues. Since these matters were discussed in a concurring opinion, it is questionable whether the concurrence's discussion provides clear precedent, but it does give an indication of the Court's pre-disposition on these issues.

In discussing the measure of damages for the excess insurers, the concurring opinion held as follows: "Thus, an excess carrier may recover only the difference between what it was required to pay and what it would have paid but for the primary carrier's negligent handling of the action, plus interest. It is not entitled to damages in its own right, or statutory or punitive damages." *Id.* at 485.

The concurrence further opined that the cause of action of an excess insurer should be limited solely to negligence. Justice Hecht wrote: "Although the Court does not expressly consider which [cause of action] is available to the excess carriers by subrogation, I assume from its reliance on the *Stowers* and *Ranger County* cases, and would so hold, that

the excess carriers' only cause of action is for negligence." *Id.* at 486.

2. ***Stonewall Surplus Lines Ins. Co. v. Drabek*, 835 S.W.2d 708 (Tex. App. – Corpus Christi 1992, writ denied)**

In *Stonewall Surplus Lines Ins. Co. v. Drabek*, 835 S.W.2d 708 (Tex. App. -- Corpus Christi 1992, writ denied), the Corpus Christi Court of Appeals in an *en banc* decision ruled four to two that an excess insurance carrier can sue a law firm for negligence arising out of the law firm's defense of insureds in an underlying wrongful death lawsuit. The court held that the excess insurer was equitably subrogated to the insured's claim for legal malpractice.

a. Facts

In the underlying wrongful death suit, Stonewall Surplus Lines Co. ("Stonewall") was the excess insurer for several insureds. The primary insurance carrier hired the law firm of Hirsch, Glover, Robinson & Sheiness (hereafter the "Hirsch law firm"). It assigned Jaime Drabek as lead counsel.

During the course of the underlying wrongful death lawsuit, the trial court entered a sanctions order against the insureds. It found that they abused the discovery process when they refused to submit to depositions and to comply with a request for production. The trial court struck their pleadings and rendered a partial default judgment against them regarding their joint and several liability to the survivors for actual damages. It also ordered that the only issues for trial would be:

(1) The amount of actual damages;

(2) Whether the insureds were grossly negligent; and

(3) The amount of exemplary damages which would be assessed against them upon a finding of gross negligence.

After the sanctions were imposed, the case was settled for $1.8 Million. Of that amount, the excess carrier Stonewall paid $1.3 Million and the primary carrier paid $500,000.00, which was its policy limits.

After the wrongful death suit was settled, the excess carrier Stonewall, as appellant, brought this suit for damages against the Hirsch law firm and Jaime Drabek and the primary carrier alleging that the negligence by these defendants proximately caused Stonewall, as an excess carrier, to pay substantially more to settle the wrongful death case than it should have had to pay.

The Hirsch law firm and Jaime Drabek, appellees, filed Motions for Summary Judgment which the trial court granted. This case was then severed from the suit against the primary carrier and this appeal perfected.

In reply to the summary judgment filed by the Hirsch law firm and Jaime Drabek, appellees herein, the excess carrier Stonewall, appellant herein, submitted affidavits from E.A. Anderson and Wilton Chalker, claims manager and attorney, respectively, for Stonewall, the excess carrier. These affidavits stated facts which demonstrated that prior to the sanctions order, the Hirsch law firm and Jaime Drabek, as defense counsel, determined that the case should settle for the amount of the primary carrier's limit of liability, $500,000.00, and an additional amount of $497,673.00 to paid by the excess carrier. This evaluation was made by attorney Drabek.

Both Chalker and Anderson confirmed that the settlement offer of $1.8 Million made after the sanctions order was entered, was made upon the recommendation of defense counsel Drabek, and constituted appellant's and appellee's opinion of the value of the case after the sanctions order. The Court stated "it seems clear that a fact question exists of whether the value of the case was affected by the sanction order." *Id.* at 712. The Court further held that that being true, it was error

to grant the summary judgment on the theory that there was no proximate cause as a matter of law.

b. The holding

The first issue considered by the court was whether the attorneys hired by the primary carrier to defend the insured owed a duty to the excess insurer. The court found that the attorneys had a duty to the excess insurer, pursuant to equitable subrogation.

In ruling, the court noted that traditionally persons "outside the attorney-client relationship do not have a cause of action for injuries they might sustain due to the attorney's failure to perform or his negligent performance of a duty owed to his client" (*id.* at 710), and that "[i]n the absence of privity of contract, an attorney owed no duty to third-party non-clients." *Id.* Notwithstanding these principles, the court allowed a malpractice claim in this instance, reasoning that the excess insurer should be subrogated to the rights of the insured to assert a malpractice action. *Id.* at 711.[2]

The court concluded as follows: "We hold in this case that appellants are subrogated to the insureds' claim for legal malpractice and negligence against appellees and that the trial court's finding of no duty [on the part of the attorneys to the excess carrier] is erroneous." *Id.*

c. The dissent

Chief Justice Nye, joined by Justice Bissett, dissented. The dissent argued that, under Texas law, an attorney does not have a duty to a third-party non-client. The dissent reasoned: "Texas follows the majority view that persons outside the attorney-client relationship do not have a cause of action for injuries they might sustain due to the attorney's failure to perform or his negligent performance of a duty owed to his client." *Id.* at 713. The dissent also argued against allowing an equitable subrogation claim, relying upon a Michigan Court of Appeals decision, which ruled that the doctrine of equitable subrogation should not provide a basis for an excess carrier to sue defense counsel for the insureds. The Michigan court held:

> Although the plaintiff excess insurer may be characterized as an equitable subrogee of the insured physician, it may not sue the insured's defense attorney for legal malpractice. To hold otherwise would in our judgment acknowledge a direct duty owed by the insured's attorney to the excess insurer and would be tantamount to saying that insurance defense attorneys do not owe their duty of loyalty and zealous representation to the insured client alone. Such a holding would contradict the personal nature of the attorney-client relationship, which permits a legal malpractice action to accrue only to the attorney's client. [citations omitted] Such a holding would also encourage excess insurers to sue defense attorneys for malpractice whenever they are disgruntled by having to pay within limits of policies to which they contracted and for which they received premiums. Were this to occur, we believe that defense attorneys would come to fear such attacks, and the attorney-client relationship would be put in jeopardy. *American Employers Ins. Co. v. Medical Protective Co.*, 165 Mich. App. 657, 419 N.W.2d 447 (1988), *appeal denied*, 431 Mich. 856 (1988).

Stonewall Insurance, 835 S.W.2d at 714.

Chief Justice Nye's dissent also expressed concern that the equitable subrogation cause of

action would jeopardize defense counsel's relationship to an insured. The dissent opined:

> A definite public policy interest exists to ensure that an attorney owes his or her uncompromised allegiance to a client. If an attorney, hired by the primary carrier to defend the insured, is placed in the position of owing a duty to a third-party excess carrier, absent privity of contract, then the potential threat of excess carriers bringing suits against an attorney in this posture would undermine the duty of loyalty which the attorney owed to the insured. I would hold that Stonewall does not have a cause of action against Hirsch, Glover for their alleged failure to perform a duty which they owed to the common insureds.

Stonewall Insurance, 835 S.W.2d at 715.

B. Analysis of *American Centennial* and *Stonewall Insurance*

The *American Centennial* and *Stonewall Insurance* decisions are designed to protect the interest of excess insurers from negligent handling of underlying claims. The *American Centennial* court stated that the policy behind its rationale is "to encourage fair and reasonable settlement of lawsuits." 843 S.W.2d at 482. The courts implicitly reason that excess insurers would be defenseless if they were not allowed to assert a cause of action against primary carriers and defense counsel. The courts imply that without the equitable subrogation cause of action, the primary carrier and defense counsel would have less of an incentive to ensure that claims are settled within primary policy limits.

1. Extension of the *Stowers* doctrine

The *American Centennial* and *Stonewall Insurance* courts base their decisions (in part) upon the rationale of the *Stowers* doctrine, and the courts extend the doctrine to excess insurers. In *G. A. Stowers Furniture Co. v. American Indemnity Co.*, 15 S.W.2d 544 (Tex. Comm'n App. 1929, holding approved), Texas law recognized the right of an insured to sue a primary carrier for a wrongful refusal to settle a claim within the limits of a primary policy.

In *Ranger County Mutual Ins. Co. v. Guin*, 723 S.W.2d 656, 659 (Tex. 1987), the Texas Supreme Court extended the *Stowers* duty to claims investigation, trial defense, and settlement negotiations. *See also American Physicians Ins. Exchange v. Garcia*, 876 S.W. 2d 842 (Tex. 1994).

While the Texas Supreme Court in *Guin* held that the *Stowers* duty exists between the primary carrier and its insured, the *American Centennial* decision on its face extended the *Stowers* duty to the excess carrier for its "equitable subrogation" claims.

These decisions are an extension of the *Stowers* doctrine. Under *Stowers*, the insured has a cause of action against the primary carrier and defense counsel if negligent handling of a claim results in personal exposure beyond primary policy limits. Now, the excess carrier has a cause of action if negligent handling of a claim results in unnecessary exposure of the excess policy.

The goals of both *Stowers* and *American Centennial* causes of action are similar, namely, to ensure that cases are settled within primary policy limits (if possible). In order to arrive at this policy goal, however, the *American Centennial* and *Stonewall Insurance* courts essentially created a new cause of action, under the guise of "equitable subrogation."[3]

2. Have the *Tilley* standards been constructively overruled?

The seminal decision regarding the duty of defense counsel to an insured is *Employers Casualty Co. v. Tilley*, 496 S.W.2d 552 (Tex. 1973). In *Tilley*, the insurer, Employers

Casualty Company, filed a declaratory judgment action against Joe Tilley and his company, seeking a determination that the insured's violation of late notice provisions in a policy relieved the insurer of any obligation to defend the insured in a personal injury lawsuit against the insured.

The insurance company in *Tilley* had hired an attorney who simultaneously represented it (the insurer) and Tilley (the insured). He gathered evidence in favor of the insurance company's position that the insured had violated the late notice provisions of the policy. The court directly confronted the conflict of interest issue due to the dual role of defense counsel, ruling that defense counsel owed the insured an undivided duty of loyalty.

In ruling, the court noted that the defense attorney "becomes the attorney of record and the legal representation of the insured, and as such he owes the insured the same type of unqualified loyalty as if he had been originally employed by the insured. If a conflict arises between the interests of the insurer and the insured, the attorney owes a duty to the insured to immediately advise him of the conflict." *Id.* at 558. The court's reasoning was based upon Canon Five of the Code of Professional Responsibility, which specifically discusses potential conflicts of interest facing an attorney hired by an insurer to represent the insured. Ethical Consideration 5-16 under Canon Five provides as follows:

> In those instances in which a lawyer is justified in representing two or more clients having different interests, it is nevertheless essential that each client be given the opportunity to evaluate its need for representation free of any potential conflict and to obtain other counsel if he so desires. Thus before a lawyer may represent multiple clients, he should explain fully to each client the implications of the common representation and should accept or continue employment only if the clients consent. If there are present other circumstances that might cause any of the multiple clients to question the undivided loyalty of the lawyer, he should also advise all of the clients of these circumstances.

Id. The *Tilley* court concluded, therefore, that the conduct of the insurance company through its attorney in simultaneously representing the insured and in gathering evidence to further the insured's policy defenses "clearly [was] in violation of the public policy . . . ." *Id.* at 560.

The *Tilley* decision and its standards have remained controlling on the issue of defense counsel's duty towards an insured.

The *American Centennial* and *Stonewall Insurance* decisions raise potential conflict of interest issues, and both courts seem aware that their decisions may create concerns in this area. The *American Centennial* court, for example, considered the State Bar Rules in its discussion of why Texas courts have been reluctant to permit a malpractice action by a non-client, due to the potential interference with the duties an attorney owes to the client. 843 S.W.2d at 484 (citing Supreme Court of Texas, State Bar Rules, Art. X, § 9 (Texas Disciplinary Rules of Professional Conduct), Rule 2.01 (1990)) (requiring the exercise of independent professional judgment on behalf of a client). The court reasoned that by allowing the "equitable subrogation" claim, however, it is imposing "[n]o new or additional burdens. . . on the attorney, who already has the duty to represent the insured previously described in [*Tilley*]." *American Centennial*, 843 S.W.2d at 485.

The *Stonewall Insurance* court applied similar reasoning, basing its holding on policy reasons for allowing an "equitable subrogation" claim. As pointed out by Chief Justice Nye's dissent in *Stonewall Insurance*, however, the real import of the decision is to

impose a duty on the part of defense counsel to a third-party non-client (the excess insurer). *Id.* at 713. The dissent further argues that the equitable subrogation action may be against public policy, because it would make it difficult for a defense attorney to continue to maintain "uncompromised allegiance to a client." 835 S.W.2d at 715.

By providing a new cause of action to the excess carrier, *American Centennial* and *Stonewall Insurance* leave open the question of whether the *Tilley* decision has been constructively overruled in part. Under *American Centennial* and *Stonewall Insurance*, defense counsel **must** be mindful of the interests of excess insurers throughout defense counsel's representation of an insured. Namely, defense counsel must try to ensure that a case is settled within primary policy limits, or face the threat of a malpractice action by an excess carrier. Even if defense counsel has no direct contact with an excess insurer throughout the pendency of an underlying cause of action, defense counsel must operate under the assumption that it could be liable in an "assigned" malpractice cause of action through equitable subrogation (*Stonewall Insurance*, 835 S.W.2d at 711) if ever excess levels are implicated.

As such, defense counsel and the primary carrier must guard the interests of **both** the insured and the excess carrier. While the interests of the insured and the excess carrier are often aligned (*i.e.*, settlement of a case within primary policy limits benefits both the insured and the excess carrier), the *American Centennial* and *Stonewall Insurance* courts provide no guidance for the primary carrier or defense counsel if these interests are not compatible. That is, if the interests of the insured and the excess carrier differ, do defense counsel still have their primary duty to the insured, even though the attorneys may be sued in a subsequent action by the excess insurers?

Imposing duties on the part of primary insurers and defense counsel to excess insurers is even more curious when considered under traditional agency principles. Under agency principles, neither defense counsel nor a primary insurer are agents for an excess carrier, because (1) the excess carrier does not control the means or method by which the primary carrier or defense counsel do their work, and (2) the excess carrier has no right of control over defense counsel or the primary insurer. *Matter of Carolin Paxson Advertising, Inc.*, 938 F.2d 595 (5th Cir. 1991) (applying Texas law); *Grace Community Church v. Gonzales*, 853 S.W.2d 678 (Tex. App. -- Houston [14th Dist.] 1993, no writ).

Since defense counsel and the primary carrier are not typically agents for an excess carrier, the *American Centennial* and *Stonewall Insurance* decisions leave open the question of whether the new "equitable subrogation" cause of action has created a new type of *de jure* agency relationship between excess carriers, primary carriers, and defense counsel.

3. Potential defenses against an "equitable subrogation" claim

The *American Centennial* court points out that the primary carrier and defense counsel can raise any defense they might have against the insured in an equitable subrogation claim brought by an excess insurer. These defenses would include an insured's violations of policy provisions, lack of coverage and many others. The defenses should also include matters based upon the nature of subrogation actions.

The excess carriers' unreasonable refusal to cooperate in the defense and settlement of the action should be a defense also.

Typically, equitable subrogation can occur if (1) a party on whose behalf the claimant discharged a debt was primarily liable, and (2) the claimant paid the debt involuntarily. *See Argonaut Ins. Co. v. Allstate Ins. Co.*, 869

S.W.2d 537, 542 (Tex. App. -- Corpus Christi 1993, writ denied).[4] In an "equitable subrogation" claim, the excess insurer is only "maintain[ing] an action that the insured may have against the primary carrier for mishandling of the claim." *American Centennial*, 843 S.W.2d at 482.

Under these standards, a possible defense should include that the insured has no damages. It is axiomatic that an insurer's duty to an insured is comprised of a duty to defend and a duty to indemnify. If a primary carrier hires counsel for the insured and pays for the defense, then the primary insurer satisfied its duty to defend. Likewise, if a claim against an insured settles within policy limits (either primary or excess limits), the insurers have satisfied their duty to indemnify. If a claim is settled within excess policy limits, therefore, then the insured has sustained no out-of-pocket losses and thus has no damages. As such, the insured would have no claim against either the primary carrier or defense counsel. Under typical subrogation standards, how can the excess insurer maintain a cause of action if the insured could not?

Following similar logic, defendants in an *American Centennial* cause of action should try to determine what injury (if any) the insured has sustained. If a deposition of an insured reveals that the insured has no complaints against the primary carrier and/or defense counsel pertaining to the handling of the underlying lawsuit, then should the excess carrier's cause of action be dismissed? Once again, why should the excess insurer be entitled to assert a claim of an insured, if the insured does not articulate a claim?

Further, the measure of damages for an excess insurer (as set forth in Justice Hecht's concurrence in *American Centennial*) seems somewhat inconsistent with settled subrogation law. The *American Centennial* concurrence opined that an excess carrier may recover the difference between what it was required to pay and what it would have paid but for the primary carrier's negligent handling of the action, plus interest. There is no reason for the insured to be able to recover these damages if it sued on its own behalf. As such, the excess insurer should not be entitled to these damages under subrogation principles.

Clearly, the courts are not strictly applying subrogation principles. Instead, the courts have fashioned a remedy for an excess carrier which is, at best, nominally based upon subrogation. The *American Centennial* and *Stonewall Insurance* courts are impliedly recognizing a duty on behalf of the primary carrier to the excess carrier, and also a duty on the part of defense counsel (through the insured) to the excess carrier.

The *American Centennial* and *Stonewall Insurance* decisions have, in actuality, created a new cause of action. As the discussion *supra* indicates, the parameters of this cause of action are unclear in many respects. In particular, the courts have not given clear guidance on the issues of recoverable damages and defenses against the excess insurers.

C. Subsequent decisions applying *American Centennial* and *Stonewall Insurance*

1. *Stonewall Insurance*

Three other reported decisions have considered applying the *Stonewall Insurance* case. The first case is the *American Centennial* decision, which cited the *Stonewall Insurance* case as authority for the viability of an excess carrier's maintaining a malpractice action against defense counsel through equitable subrogation. 843 S.W.2d at 844.

The recent decision of *Yaklin v. Glusing, Sharpe & Krueger*, 875 S.W.2d 380, 385 (Tex. App. -- Corpus Christi 1994, no writ), cites *Stonewall Insurance* as providing the elements for a claim of legal malpractice.

In *Zuniga v. Groce, Locke & Hebdon*, 878 S.W.2d 313 (Tex. App. -- San Antonio

1994, writ requested), the court opines that it disagrees with the *Stonewall Insurance* court's opinion that a claim for legal malpractice may be assigned. The *Zuniga* court noted that the *American Centennial* court expressly left open the question of whether a legal malpractice cause of action is assignable. *See American Centennial*, 843 S.W.2d at 484.

2. ***American Centennial***

There are several recent cases citing the *American Centennial* decision. This paper will briefly discuss them. In *Martinez v. Humble Sand & Gravel, Inc.*, 860 S.W.2d 467, 470 (Tex. App. -- El Paso 1993), *rev'd on other grounds*, 875 S.W.2d 311 (Tex. 1994), the court cited the *American Centennial* decision as providing the relevant two-year statute of limitations for a negligence cause of action. *See also Knowlton v. U.S. Brass Corp.*, 864 S.W.2d 585, 605 (Tex. App. -- Houston [1st Dist.] 1993, writ of error granted) (citing *American Centennial* as providing the relevant two-year statute of limitations for a negligence cause of action); *Barrett v. U. S. Brass Corp.*, 864 S.W.2d 606, 628, 640 (Tex. App. -- Houston [1st Dist.] 1993, writ of error granted) (citing *American Centennial* as authority for when a cause of action accrues).

In *Thompson v. Vinson & Elkins*, 859 S.W.2d 617 (Tex. App. -- Houston [1st Dist.] 1993, writ denied), residual beneficiaries under a decedent's will sued various defendants involved in the distribution of the decedent's estate. The trial court entered summary judgment in favor of the law firm, and the Houston Court of Appeals affirmed. On appeal, the plaintiffs/appellees argued that *American Centennial* abrogated the privity requirement in a legal malpractice action brought by non-clients. The *Thompson* court rejected this interpretation of the *American Centennial* opinion, ruling that "[i]t does not address the issue presented here or otherwise aid in our determination of it. In our view, it clearly did not nullify the privity requirement in cases such as the one at bar." 859 S.W.2d at 622 n.3.

In *Argonaut Ins. Co. v. Allstate Ins. Co.*, 869 S.W.2d 537 (Tex. App. -- Corpus Christi 1993, writ denied), an excess carrier sued a primary carrier under theories of breach of contract and subrogation, seeking to recover policy limits of the primary coverage for amounts the excess carrier had to pay to settle a lawsuit arising from an automobile accident.

The dispute arose out of an agreed judgment entered into by Argonaut (the excess insurer) and Allstate (the primary insurer) in an underlying lawsuit. Argonaut retained an attorney who negotiated and finalized a settlement between the parties. Allstate, however, had retained its own attorney, who was responsible for handling the defense of the insured. Allstate's attorney was not involved in the settlement negotiations. Allstate's attorney, however, signed the agreed judgment, claiming that he did so after he became aware that Argonaut had satisfied the judgment. After the court signed the final judgment, Argonaut demanded that Allstate reimburse it for the policy limits of its primary coverage, in the amount of $100,000.00. Allstate refused.

The *Argonaut* court first considered whether Allstate's refusal to pay constituted a breach of contract. The court held that the judgment provided no evidence to demonstrate that Allstate intended to, or was required to, reimburse Argonaut. The final judgment "constituted a binding contract and obligation between the parties in the underlying suit, and not between the insurance carriers." *Id.* at 541. Similarly, Argonaut was not entitled to reimbursement based upon a theory of unjust enrichment, because there was no showing that Allstate obtained any benefits by fraud, by duress, or by taking undue advantage of Argonaut.

The court then considered Argonaut's subrogation claim, citing *American Centennial*

for the proposition that "an excess carrier may bring an equitable subrogation action against a primary carrier to enforce the *Stowers* duties already imposed on the primary carrier. . . ." 869 S.W.2d at 542. The court held that Argonaut sufficiently stated a cause of action for subrogation, and that fact issues precluded granting summary judgment in favor of Allstate on Argonaut's equitable subrogation claim.

In *Certain Underwriters v. Fidelity & Casualty Ins. Co.*, 4 F.3d 541 (7th Cir. 1993), the Seventh Circuit considered a cause of action brought by an excess insurer against a primary insurer, alleging wrongful refusal to settle a products liability suit against an insured. The underlying lawsuit stemmed from an accident in which an asphalt roller built by Dresser Industries rolled over the plaintiff. The plaintiff received a $3,000,000.00 verdict, of which Dresser's primary insurer paid $1,000,000.00 of the judgment. The excess carrier paid the remainder, and sued to recover the amounts it had paid. The district court granted summary judgment in favor of the primary carrier, and the excess insurer appealed. The Seventh Circuit reversed and remanded, holding, *inter alia*, that the primary carrier had a duty to the excess insurer.

The dissent cited the *American Centennial* opinion. The dissent discussed whether the primary carrier had a duty to the excess insurer, pointing out that such a duty could be imposed based upon (1) equitable subrogation, or (2) direct duty. The dissent cited *American Centennial* as an example of a jurisdiction rejecting a direct duty between a primary and excess insurer. 4 F.3d at 547. The dissent further cites *American Centennial* as authority that an equitable subrogation action does not impose "additional burdens" on a primary carrier, since the excess carrier is only able to maintain a suit based upon the existing duties owed by the primary insurer to the insured. *Id.* at 547.

In *Texas Employers Ins. Ass'n v. Underwriting Members of Lloyds*, 836 F. Supp. 398 (S.D. Tex. 1993), the court cited the *American Centennial* decision for the dubious proposition that Texas law "imposes a duty of good faith and fair dealing on primary carriers as to excess carriers, so that a primary carrier may not refuse to settle the case within its policy limits when a reasonable primary carrier would do so. . . ." *Id.* at 410. As discussed *supra*, the *American Centennial* decision did not hold that an excess carrier may assert such a cause of action through subrogation. Instead, the concurrence in *American Centennial* argued that the cause of action of the excess carrier should be limited to only negligence. The court in *Texas Employers*, therefore, seems to have made an unwarranted extension in its interpretation of the *American Centennial* decision.

D. Conclusion

Practitioners, especially insurance defense counsel, should be constantly aware that in any case involving one or more excess insurance carriers, those insurance carriers are potential plaintiffs concerning claims handled by the primary carrier and the handling of the defense by counsel selected by the primary carrier. It is impossible to appreciate the full gravity of inter-coverage causes of action without having a working understanding of the way in which multi-layer insurance coverage operates in the context of defending an insured's lawsuit.

These cases pose additional problems for insurance defense counsel notwithstanding the language in these cases. The more masters the insurance defense counsel has to serve, the greater the potential for conflicts of interest and inability of insurance defense counsel to satisfy all of the masters' conflicting requirements.

E. Acknowledgement

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F. Disclaimer

The purpose of this paper and the oral presentation is to discuss generally the relationship of excess insurance carriers to primary carriers, insurance defense counsel selected by primary carriers and other participants in the defense of a lawsuit. This area of the law is changing rapidly, and everyone should remain alert for information that would change or modify any of the thoughts contained in this paper or the presentation. The cases, statutes and articles cited and relied upon in this article were reviewed by the author, and it is believed that those opinions have been correctly interpreted. However, since different interpretations can be drawn from the various authorities herein, each should be carefully reviewed by the reader and he/she should form his/her own opinion as to what these authorities actually hold or stand for.

Any discussion of cases herein is based exclusively on opinions of appellate courts designated for publication. Such discussion is not based upon, nor is an assertion of, personal knowledge of the facts and proceedings underlying each case.

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John H. Boswell
September 15, 1994

1. The court of appeals had held that the cause of action against the attorneys was barred by limitations, but the Texas Supreme Court reversed this aspect of the appellate court's decision. 843 S.W.2d at 483-84.

2. The court further noted that a cause of action for legal malpractice can be assigned, reasoning that it is "just as any other negligence claim." *Stonewall Insurance*, 835 S.W.2d at 711. Notably, the concurrence in the *American Centennial* implied that a cause of action for legal malpractice should not be assignable. The concurrence wrote: "By allowing the excess carrier an action against its insured's attorney through equitable subrogation, the Court's holding does not suggest that a client's rights against his attorney may be assigned." 843 S.W.2d at 486.

3. It is questionable whether the policy behind the *Stowers* doctrine is really implicated in the concerns of excess insurers. The *Stowers* doctrine is designed to protect insureds. If a claim against an insured settles within excess policy limits, however, then the insured has been fully indemnified (and thus protected), because the insured has not sustained any personal exposure.

4. Although Texas law is somewhat unclear on this issue, the *Argonaut* court indicates that there is usually a presumption that payments on behalf of excess insurers are not voluntary, because they are secondarily liable on insurance policies. *Id.* at 542.