

*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, 1984, 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 ordinarily 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