A Proposal for Preserving Subrogation Rights Between Primary Co-Insurers by Properly Defining the Context in Which *Mid-Continent Insurance Company v. Liberty Mutual Insurance Company* Applies

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Introduction

In 2007, in *Mid-Continent Insurance Company v. Liberty Mutual Insurance Company* ("*Mid-Continent*"), the Texas Supreme Court held that one insurer could not use contribution and subrogation claims against another insurer to recover a portion of settlement funds paid under the duty to indemnify a mutual insured. The court, upon announcing its holding, limited it by stating, "[W]e conclude there is no right to reimbursement *in the context presented*."[1]

The use of contribution and subrogation claims to recover money from a co-insurer have long been used in the insurance world to attempt to recover some or all of the defense costs and indemnification payments made by an insurer in an underlying lawsuit.[2] Determining whether a right to reimbursement still exists, and in what context, has presented some insurers with a difficult question since *Mid-Continent* was decided.[3] Since 2007, the Fifth Circuit has determined that "the context" in which reimbursement is barred includes other suits by a primary insurer to recoup settlement payments made pursuant to the duty to indemnify from a co-insurer, and rejected the argument that "the context" is limited to circumstances where one primary co-insurer also provides excess coverage to the insured and is motivated by a desire to protect the excess coverage.[4] However, "the context" apparently is not so broad as to encompass claims where one primary co-insurer breaches its duty to defend the insured, and the paying co-insurer seeks to recover a share of the defense costs.[5]

This paper will offer a definition of "the context" of the Texas Supreme Court's holding in *Mid-Continent*. Analyzing the potential scope of *Mid-Continent* reveals some questionable

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[1] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d 765, 777 (Tex. 2007)(emphasis added).
[2] *See, e.g., Traders and General Ins. Co. v. Hicks Rubber Co.*, 169 S.W.2d 142, 148 (Tex. 1943)(determining the right of one insurer to recover money from a co-insurer). The case is almost seventy years old.
[3] As of May 20, 2010, the author located 35 cases from state appellate courts and federal appellate and district courts in the Fifth Circuit that cite *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.* In twelve of those cases, both named parties are insurers. *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.* was decided less than three years ago.
[4] *Nautilus Ins. Co v. Pac. Emplrs. Ins. Co.*, 303 Fed. Appx. 201, 2008 U.S. App. LEXIS 25523 (5th Cir. Tex. 2008).
[5] *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.*, 592 F.3d 687 (5th Cir. 2010).

policy reasons employed by the Texas Supreme Court to decide that case, although the court made what many would argue is the correct decision. Those flaws have lead to some creative means of avoiding the potentially broad scope of *Mid-Continent*; creative means that disregard other existing Texas Supreme Court precedent to arrive at logical outcomes that follows the rules of equity. By properly defining the context to which *Mid-Continent* applies, one will observe that the possible detrimental effects of applying the case to an over broad set of circumstances can be avoided, and the law applied in a manner that does not disregard equity and other existing precedent in the contribution and subrogation arena. Properly defining the context of *Mid-Continent* reduces, if not eliminates, the need for the results-oriented decisions that have occurred since *Mid-Continent* was decided.

I. The Contribution Claim

In the insurance context, as opposed to statutory contribution claims between co-defendants under Chapter 33 of the Texas Civil Practice & Remedies Code, the contribution claim has been explained as follows:

> The primary requisites of the equitable right to contribution and the obligation to contribute, and the corresponding right and obligation at law, are (1) a situation wherein the parties are in aequali jure under some common obligation or burden, and (2) compulsory payment or other discharge, by the party seeking contribution, of more than his fair share of the common obligation or burden.[6]

Where two policies apply to a loss, and one insurer pays more than its fair share of the common obligation, that insurer has a right to contribution against the co-insurer that has refused to pay. Absent common liability, no right to contribution exists.[7]

In *Employers Casualty Co. v. Transport Insurance Co.*, the Texas Supreme Court explained that a contribution claim cannot exist where the co-insurers have pro rata other

[6] *Employers Cas. Co. v. Transport Ins. Co.*, 444 S.W.2d 606, 609 (Tex. 1969).
[7] *Charter Builders v. Durham*, 683 S.W.2d 487, 489 (Tex. App.—Dallas 1984, writ ref'd n.r.e.).

insurance clauses.[8] Providing further explanation to the court's decision over thirty-five years earlier in *Traders and General Ins. Co. v. Hicks Rubber Co.*, the court explained that the other insurance clauses relieve the insurers of a common burden.[9] Where the competing polices have pro rata other insurance clauses, each insurer's compulsory requirement to indemnify the insured is limited to the proportion of insurance that insurer provided.[10] The pro rata clauses relieve the insurers of an obligation to pay the insured's entire loss, so any payments above the pro rata portion are voluntary, not compulsory.[11]

In *Employers Casualty Co. v. Transport Insurance Co.*, one insurer was seeking to recover from the other insurer a portion of both its defenses costs and the settlement payment made under its duty to indemnify the insured.[12] There, one insured had defended and settled the underlying lawsuit, but the other insured had refused denying that its policy covered the loss.[13] In that case, the court again held that in the insurance context, where competing policies have other insurance clauses, the other insurance clauses bar a contribution claim for both the duty to defend and the duty to indemnify.[14] *Employers Casualty Co. v. Transport Insurance Co.* is still good law, as it was cited with approval and followed by the court in *Mid-Continent Insurance Company v. Liberty Mutual Insurance Company*.[15]

[8] *Employers Cas. Co. v. Transport Ins. Co.*, 444 S.W.2d 606, 609 (Tex. 1969).
[9] *Id*.
[10] *Id*.
[11] *Employers Cas. Co. v. Transport Ins. Co.*, 444 S.W.2d at 609-10.
[12] *Employers Cas. Co. v. Transport Ins. Co.*, 444 S.W.2d at 607.
[13] *Id*.
[14] *Employers Cas. Co. v. Transport Ins. Co.*, 444 S.W.2d at 609.
[15] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 774. *See also, Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 778 (Willett, J., concurring).

II. The Subrogation Claim

There are two different subrogation rights that apply in the insurance context: contractual subrogation and equitable subrogation.[16] The different varieties of subrogation represent separate and distinct rights that, while related, are independent of each other.[17]

Equitable subrogation allows a party who would otherwise lack standing to step into the shoes of another and pursue claims belonging to the party that has standing.[18] Equitable subrogation applies whenever one person, not acting voluntarily, has paid a debt for which another was primarily liable and that in equity should have been paid by the latter.[19] In determining whether an equitable subrogation right exists, Texas courts interpret the doctrine liberally in favor of permitting subrogation.[20] According to the Texas Supreme Court, equitable subrogation arises most often in the insurance context.[21]

Equitable subrogation is asserted by a party that has paid a debt owed by another. In explaining what constitutes a "debt owed by another", the Texas Supreme Court held that just because the claimant may also have been obligated to pay the same debt does not excuse an equitable subrogation claim.[22] If another party may owe the same damages under a recognized legal theory, it does not matter that the subrogee does as well. The satisfaction of a debt owed by

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[16] *Employers Cas. Co. v. Transport Ins. Co.*, 444 S.W.2d at 610. While a third variety of subrogation, statutory subrogation, also exists, it is omitted from this paper's discussion because it has almost no application to a dispute between primary co-insurers providing commercial general liability coverage. Statutory subrogation often arises in the workers' compensation context, where a statutory subrogation interest exists and is defined by the Texas Labor Code §417.002. *Texas Workers' Compensation Ins. Fund v. Knight*, 61 S.W.3d 91, 93-94 (Tex. App.—Amarillo 2001, no pet.).

[17] *Fortis Benefits v. Cantu*, 234 S.W.3d 642, 648 (Tex. 2007).

[18] *Frymire Engineering Co. v. Jomar International, Ltd.*, 259 S.W.3d 140, 142 (Tex. 2008).

[19] *Id*.

[20] *Id*.

[21] *Id*.

[22] *Frymire Engineering Co. v. Jomar International, Ltd.*, 259 S.W.3d at 143.

one party, like an insurer under a policy, does not foreclose the existence and satisfaction of a debt owed by another party for the same damages.[23]

An involuntary payment includes a payment as a legal obligation, and a payment by a party to protect some interest of that party.[24] In contract, a voluntary payment is a payment "without any assignment or agreement for subrogation, without being under any legal obligation to make payment, and without being compelled to do so for the preservation of any rights or property."[25] Texas courts are "liberal in their determinations that payments were made involuntarily."[26] Since an insurance policy legally obligates the insurer to pay covered claims within the limits of the policy, payments to defend or indemnify an insured under an insurance contract are easily encompassed within the meaning of an involuntary payment.[27]

Another element to equitable subrogation is that the circumstances must favor equitable relief. Circumstances that favor equitable subrogation include where the third party would escape responsibility and thereby be unjustly enriched because it has caused the damages that were paid by another.[28] An example, which also illustrates this circumstance, is permitting an excess carrier to pursue a claim against a primary carrier under an equitable subrogation theory.[29]

Imagine if the excess insurer could not maintain a *Stowers* claim against the primary insurer through subrogation. Absent an equitable subrogation interest in that circumstance, the belief is that primary carrier would not have as great an incentive to settle claims within its policy limits. Imagine if the primary insurer faces a claim that is highly likely to exceed policy

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[23] *Id*.
[24] *Frymire Engineering Co. v. Jomar International, Ltd.*, 259 S.W.3d at 145.
[25] *Id* (citing *First Nat'l Bank of Kerrville v. O'Dell*, 856 S.W.2d 410, 415 (Tex. 1993)).
[26] *Id*.
[27] *Id*.
[28] *Frymire Engineering Co. v. Jomar International, Ltd.*, 259 S.W.3d at 146.
[29] *American Centennial Insurance Co. v. Canal Insurance Co.*, 843 S.W.2d 480 (Tex. 1992).

limits, but in which there is a small chance of a finding of no liability. If there is excess insurance in an amount that the judgment will not exceed, it may create a moral hazard. If the primary insurer is likely to pay policy limits regardless, but has a small chance of success, it may create a circumstance where the primary insurer rejects a *Stowers* demand. From the primary carrier's standpoint, it has nothing to gain from accepting the *Stowers* demand if there is excess insurance and the excess insurer cannot maintain a *Stowers* action. So, why not roll the dice? The exposure above policy limits will be borne by another. So, there is arguably incentive for the primary insurer to go ahead and try the lawsuit and see if it can reduce its exposure by a favorable verdict. The alternative is to pay a demand for policy limits, which is the maximum loss the primary insurer can sustain under its duty to indemnify.

If there is no risk of *Stowers* liability because that second, excess insurer cannot recover the exposure created by a primary insurer perceived as having nothing to lose, the result is an unfair distribution of losses among primary and excess insurers.[30] The excess insurer that is willing to comply with its duties to the insured is saddled with exposure because of the acts of a primary insurer that does not do so. So, equity recognizes a subrogation claim in that context to prevent what is perceived as an unjust result.

When considering equity in the equitable subrogation context, the Texas Supreme Court has shown a tendency to look for a greater good beyond the scope of the single case before it.[31] In the insurance context, equity sometimes aligns with a rule that will decrease litigation.[32]

In contrast to equitable subrogation, contractual subrogation rights are controlled by general contract law principles.[33] The subrogation rights under a contractual subrogation claim

[30] *American Centennial Insurance Co. v. Canal Insurance Co.*, 843 S.W.2d at 482-83.
[31] *See id.* (considering the impact of the Court's decision on the handling of future claims by insurers).
[32] *See State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696, 714 (Tex. 1996)(invalidating, on public policy grounds, a settlement and assignment of claims by an insured).

arise from and are governed by the terms of the contract transferring the interest, and those terms do not yield to the principles of equitable subrogation, so long as the contract is legal and enforceable.[34] In the context of a general liability policy, the contractual subrogation right arises by virtue of a clause similar, if not identical, to the following clause taken from an ISO form general liability policy:

> If the insured has rights to recover all or part of any payment we have made under this Coverage Part, those rights are transferred to us. The Insured must do nothing after loss to impair them. At our request, the Insured will bring "suit" or transfer those rights to us and help us enforce them.[35]

As the clause reads, the insured transfers to the insurer any rights it may have to recover from a third party the injury or damage that has been paid for by the insurer. This contract subrogation right is dependent on the ability of the insured to recover damages from another party under some legally recognized cause of action.

III. The Texas Supreme Court Decides *Mid-Continent* on a Certified Question from the Fifth Circuit.

In *Mid-Continent*, Mid-Continent and Liberty Mutual were co-insurers defending Kinsel Industries against a claim involving substantial injuries suffered to a family traveling through a construction zone on a highway.[36] Neither insurer disputed that it owed some portion of Kinsel's defense.[37] Mid-Continent complied with its duty to defend Kinsel, and acknowledged coverage of the claim.[38] However, where Liberty Mutual assessed the value of the underlying claim against Kinsel at potentially $1.5 million, Mid-Continent calculated the settlement value of the claim at $300,000.[39] Liberty Mutual reached a settlement at mediation of $1,500,000, but

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[33] *Id*. (citing *Lexington Ins. Co. v. Gray*, 775 S.W.2d 679, 683-84 (Tex. App.—Austin 1989, writ denied).
[34] *Fortis Benefits v. Cantu*, 234 S.W.3d at 648.
[35] ISO Form CG 00 01 10 01, at 10.
[36] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 769.
[37] *Id*.
[38] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 771.
[39] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 770.

Mid-Continent refused to contribute more than $150,000, half of its assessed value of $300,000, to the settlement.[40] So, Liberty Mutual, which also provided excess coverage to Kinsel, contributed the remaining $1,350,000 towards the settlement.[41] Liberty Mutual then filed suit to recover from Mid-Continent its pro rata share of the sum paid to settle the claim.[42]

One initial observation about the case, before discussing the Texas Supreme Court's opinion, is that both Liberty Mutual and Mid-Continent complied with all contractual and common law duties they owed the insured, Kinsel.[43] The only dispute between two insurance companies concerned their subjective beliefs about the value of the underlying claim.

A. The Supreme Court Holds There Is No Contribution Claim Between the Co-Insurers.

The court looked at whether Liberty Mutual possessed a contribution claim against Mid-Continent.[44] The problem with recognizing a contribution claim in that context was almost seventy years of case law from Texas and other states. Contribution requires that one pay a common obligation or burden shared by another.[45] Going back to *Traders and General Ins. Co. v. Hicks Rubber Co.*, the Texas Supreme Court has held that pro rata other insurance clauses limit each insurer's responsibility to the insured at its pro rata portion of the loss.[46] There is no common obligation.[47]

Because the policies issued by Mid-Continent and Liberty Mutual contained pro rata other insurance clauses, there was no common obligation that Liberty Mutual paid.[48] Regardless of whether Liberty Mutual paid more than the limits of its policy, or more than half the

[40] *Id.*
[41] *Id.*
[42] *Id.*
[43] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 771-72.
[44] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 772.
[45] *Id.*
[46] *Traders and General Ins. Co. v. Hicks Rubber Co.*, 169 S.W.2d 142, 148 (Tex. 1943).
[47] *Id.*
[48] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 772.

settlement value, the terms of the policy limited Liberty Mutual's contractual obligation to one-half the value of the settlement, up to policy limits. Any payments beyond that amount were voluntary, and not owed by Liberty Mutual. Any amounts up to the one-half were owed only by Liberty Mutual, and were not common to Mid-Continent and Liberty Mutual. Thus, the common obligation, an essential element to a contribution claim, was lacking.[49]

The court distinguished a claim between primary co-insureds from a claim by an insured against its insurer, where a contribution claim by the insured would be allowed under Texas law.[50] That distinction arises from the nature of the obligation. If an insured is found liable for a third party's damages, the insured has an obligation to pay all those damages as a result of the judgment against it. If the insured has a policy that covers the claim for which the insured is liable, the insurer, under the policy, also has an obligation to pay all those damages up to its policy limit.[51] Thus, where the insured must pay a judgment due to an insurer's refusal, and seeks payments from an insurer by way of contribution, presumably in addition to a breach of contract claim, a common obligation would exist.

While it is worth noting this exception mentioned by the court, it is also worth noting that this exception is not universal to any payment by the insured. If, for instance, the insured chose to settle a claim where the insured assessed liability or damages different from the insurer, as was the case between the insurers in *Mid-Continent*, the insured would be hampered by contractual obligations it owes to the insurer. For instance, a typical policy provides that the insurer will not indemnify an insured for voluntary payments: "No insured will, except at that insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense,

[49] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 773.
[50] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 772.
[51] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 772 (citing *Traders and General Ins. Co. v. Hicks Rubber Co.*, 169 S.W.2d at 147-48).

other than for first aid, without our consent."[52] Absent a judgment, there is no obligation owed by either the insurer or the insured. With a settlement payment, unless the insurer has breached the policy and relieved the insured of the subsequent obligation to comply with the insurance contract, or the insurer has consented to the settlement payment, which was not the case in *Mid-Continent*, a contribution claim by an insured for settlement payments is likely to suffer from the same fatal flaw as Liberty Mutual's claim did in the case.

B. The Court Does Not Recognize A Subrogation Claim in the Context Presented to it by *Mid Continent*.

In the *Mid-Continent* opinion, the Texas Supreme Court discusses both equitable and contractual subrogation together.[53] The court ultimately decides that Liberty Mutual does not have a contractual subrogation right or an equitable subrogation right against Mid-Continent.[54] While the ultimate outcome reached by the court may have been correct, some of the logic employed by the court in reaching its holding appears flawed, especially when compared to existing precedent.

The Texas Supreme Court recognizes that Liberty Mutual, through its policy, possesses a subrogation right by virtue of having paid Kinsel's claim.[55] The court then explains that possessing a subrogation right is only part of the equation. In order to bring a subrogation claim, the insurer must step into the shoes of the insured.[56] As a result, the insurer can only assert claims that the insured could assert against third parties, subject to whatever defenses those third parties possess.[57] The court then looks at whether Kinsel has any valid claims it can assert against Mid-Continent, the defendant, as a result of Mid-Continent's actions as a primary co-

[52] ISO Form CG 00 01 10 01, at 9. *See also, Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 769 (quoting the voluntary payment clause from both policies at issue).
[53] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 774.
[54] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 775-76.
[55] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 775.
[56] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 774.
[57] *Id.*

insurer in the underlying lawsuit, explaining, "The potential rights of Kinsel to which Liberty Mutual may be subrogated stem from the contractual and common law duties an insurer owes its insured".[58]

The Texas Supreme Court held that a subrogation claim did not exist for any breach by Mid-Continent of a common law duty to Kinsel.[59] As the court explained, the only common law duty of an insurer that has been recognized in a third party context is the *Stowers* duty, which requires: (1) a covered claim; (2) a demand within policy limits; and (3) the terms of the demand are such that an ordinary, prudent insurer would accept it.[60] There is no common law duty in responding to settlement demands beyond the *Stowers* duty.[61] Because the settlement demand to Kinsel of $1,500,000 exceeded the $1,000,000 limit of the Mid-Continent policy, there was never a demand within policy limits to trigger a *Stowers* duty. As a result, there was no common law *Stowers* claim that Kinsel possessed against Mid-Continent, and that it could transfer to Liberty Mutual.

The court also explained that equity, a necessary element to an equitable subrogation claim, did not favor creating an equitable subrogation claim in the circumstances before it.[62] As mentioned earlier, decisions to create an equitable remedy often focus on a public good beyond the specific results in any single case. Whether expressed in terms of public policy or equity, the court, like many courts, does not favor the creation of an equitable remedy when the result will be an increase in litigation.[63] While not stated in the *Mid-Continent* opinion, there is a legitimate concern over an increase in litigation if the court had permitted the equitable subrogation of

[58] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 775.
[59] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 776.
[60] *Id.*
[61] *Id.*
[62] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 776.
[63] *Mallios v. Baker*, 11 S.W.3d 157, 165 (Tex. 2000)(citing cases from California, Connecticut, Illinois, Michigan, Minnesota, New Jersey, and Tennessee)(citations omitted); *State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696, 707 (Tex. 1996) (citing RESTATEMENT (SECOND) OF CONTRACTS § 317(2)(b) (1981)).

claims between primary co-insurers so that they could subsequently challenge one another's valuation of an underlying claim.

Another factor that weighed against the creation of an equitable remedy is the difficulty of asking a jury to consider the objective and economic factors applied by licensed professionals to assign values to third party litigation.[64] As was explained in the concurring opinion in *Mid-Continent*:

> As a further reason for not recognizing the cause of action Liberty Mutual pursues, claims of this sort present an almost impossibly complex challenge for the fact finder. A jury considering such a claim would have to decide what the reluctant insurer *should* have paid in settlement, based, I suppose, on (1) considering the range of awards that a jury hearing the underlying claim against the insured *might* have awarded (given all manner of tangible and intangible factors that inform such an analysis), (2) arriving at an expected value of the judgment in the underlying case, and (3) factoring into the calculus the implications of the *Stowers* doctrine and what a reasonable insurer would do given this barrage of complicated information.[65]

Another case decided by the Fifth Circuit one year after *Mid-Continent* illustrates this difficulty. In *Mid-Continent*, when the insurers disagreed about the settlement value of a case, one insurer paid to settle the entire case and the dispute was over the settlement amounts paid. [66] There was not a trial in the underlying lawsuit to show the prudence of that insurer's decision to settle. In *Nautilus Insurance Co. v. Pacific Employers Insurance Co.*, one insurer, Nautilus, paid to settle some of the claims asserted against its insured.[67] The other insurer, Pacific, refused to settle and proceeded to trial.[68] The jury, after hearing the evidence, ruled against the plaintiffs

[64] *Nautilus Ins. Co v. Pac. Emplrs. Ins. Co.*, 303 Fed. Appx. 201, 206-7 (5th Cir. 2008).
[65] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 778 (Willett, J., concurring).
[66] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 770.
[67] *Nautilus Ins. Co v. Pac. Emplrs. Ins. Co.*, 303 Fed. Appx. at 202.
[68] *Nautilus Ins. Co v. Pac. Emplrs. Ins. Co.*, 303 Fed. Appx. at 202-3.

and in favor of the insured on some of the claims Nautilus paid to settle.[69] The trial court then rendered summary judgment in favor of the insured on the remaining claims.[70]

Even though one insurer, Nautilus, paid $1,500,000 to settle the claims, Pacific, by exercising its contractual right to not settle and proceeding to trial, avoided paying any money under its indemnity obligation on the underlying claims.[71] Having the benefit of a trial between the real parties to determine the value of the underlying claims, one can observe that Nautilus may have overpaid to settle, while Pacific, which took the risk of trying the case and paying a judgment in excess of the settlement value, was found to owe nothing to the plaintiffs in the underlying lawsuit. As the Fifth Circuit explained, in finding that Nautilus had no subrogation right, "Pacific went to trial and won, so it would seem inequitable to force Pacific to contribute to the settlement when it chose not to settle and prevailed."[72] Equity supports not interfering with the decisions of co-insurers as long as the insured is not liable, at the end of the day, for the decisions of the insurers.

This concern about asking the factfinder to consider circumstances that did not exist between the subrogee and the defendant is not unique to Texas or insurance claims. As Justice Oliver Wendell Holmes succinctly summarized in THE COMMON LAW over 100 years ago, "the history of early law everywhere shows that the difficulty of transferring a mere right was greatly felt when the situation of fact from which it sprung could not also be transferred. Analysis shows that the difficulty is real."[73] So, equitable factors do not favor creation of an equitable subrogation claim in the circumstances presented in *Mid-Continent*.

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[69] *Id.*
[70] *Id.*
[71] *Id.*
[72] *Nautilus Ins. Co v. Pac. Emplrs. Ins. Co.*, 303 Fed. Appx. at 206.
[73] Oliver W. Holmes, Jr., THE COMMON LAW 340, 409 (Boston; Little, Brown, and Company 1881).

The Court also considered whether Mid-Continent breached its contract, the insurance policy, in handling the claim.[74] If Mid-Continent breached its obligations under the policy, it would give rise to a breach of contract action that Kinsel would possess and that Liberty Mutual would succeed to as subrogee. The Court held that Liberty Mutual did not have a claim for breach of contract standing in Kinsel's shoes.[75]

While that holding dovetails with existing precedent, the reasoning employed by the court to reach its holding can be troubling if expanded beyond the context of *Mid-Continent*. If one examines the handling of the underlying lawsuit, it is apparent that Mid-Continent did not breach the insurance policy. Mid-Continent recognized its obligation to participate in the defense and indemnification of Kinsel.[76] The opinion does not indicate that Mid-Continent failed to participate in the defense and pay a pro rata share of Kinsel's defense costs. What the opinion focuses on as the alleged misconduct of Mid-Continent is its refusal to pay $750,000 to settle the underlying lawsuit when Liberty Mutual assessed that case as having a value of up to $1,500,000, but Mid-Continent disagreed.[77]

Why did Mid-Continent behave in this fashion? Well, it obviously viewed the underlying lawsuit differently as to Kinsel's exposure. However, it also had a contractual right to behave in this fashion in negotiating a settlement. A typical general liability policy reads, "We may, *at our discretion*, investigate any 'occurrence' and settle any claim or 'suit' that may result."[78] The "we" and "our" in this clause refer to the insurer, which was Mid-Continent. Contractually, Mid-Continent, if it employed this form or a similar general liability form to insure Kinsel, has the discretion to settle or not settle the suit brought against Kinsel. While Liberty Mutual disagreed

[74] *Id.*
[75] *Id.*
[76] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 769.
[77] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 770.
[78] ISO Form CG 00 01 10 01, at 1 (emphasis added).

with Mid-Continent about the exposure for the underlying claim, a disagreement between two insurers would not change Mid-Continent's contractual obligations to Kinsel. At the end of the day, regardless of any demands from Liberty Mutual or Kinsel, the general liability policy would leave Mid-Continent, and not Kinsel or Liberty Mutual, with the discretion to accept or refuse a settlement demand funded by Mid-Continent's policy. By refusing to contribute $750,000 to settle the underlying lawsuit, Mid-Continent did not breach the policy. Under the circumstances presented to the Fifth Circuit and, through certification, to the Texas Supreme Court in *Mid-Continent*, there would be no evidence of a breach of contract by Mid-Continent for which it would have to answer to Kinsel and, by extension, to Liberty Mutual for funding $1,350,000 of the settlement of the underlying lawsuit.

The Texas Supreme Court, while it reached a decision that appears to comport with logic, equity, and existing precedent, did not do so for the reason stated above. Instead, the court considered the harm, if any, to the insured.[79] The court determined that because the plaintiff's demand had been accepted and the loss paid in full, there was no right on the part of the insured to recover any money from the co-insurer.[80] The court explained:

> [A] fully indemnified insured has no right to recover an additional pro rata portion of settlement regardless of that insurer's contribution to the settlement. Having fully recovered its loss, an insured has no contractual rights that a co-insurer may assert against another co-insurer in subrogation.[81]

While it focuses on insurers, the crux of the court's holding is that a party cannot possess a subrogation claim from a subrogor like an insured if the insured has not paid any money out of its own pocket. In a circumstance where the subrogor has not paid any of its own money, the court concludes that the subrogor has no damages to sustain a breach of contract claim. This

[79] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 775.
[80] *Id*.
[81] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 775-76.

rationale is contrary to the logic employed by the court in the subrogation context in a decision shortly after the court decided *Mid-Continent*. It also does not follow prior precedent, which the court cited with approval and appeared to follow in large part in *Mid-Continent*.

In *Frymire Engineering Co. v. Jomar International, Ltd.* ("*Frymire*"), which was decided just eight months after *Mid-Continent*, the Court permitted a subrogation claim by an insurer against a third party that was not a primary co-insurer even though the insured did not paid any of its own money to settle the underlying lawsuit.[82] In that case, the insured, Frymire, installed a valve, which ruptured, causing extensive water damage to the building in which the valve was installed.[83] The insurer, Liberty Mutual, paid $458,496 to the building owner to settle an underlying negligence claim against the insured.[84] The insured did not contribute to the settlement. Liberty Mutual then brought a subrogation claim against the valve manufacturer, Jomar, alleging a product defect.[85] The court engaged in an extensive analysis of the requirements for equitable subrogation, and held that Liberty Mutual, the liability insurer that paid money on Frymire's behalf to settle the underlying lawsuit, did have an equitable subrogation claim against Jomar.[86] However, if the court had followed the logic it employed in *Mid-Continent*, Liberty Mutual would not have possessed a subrogation claim in *Frymire*. In *Frymire*, the insured had not paid money to settle the underlying lawsuit against the building owner. Liberty Mutual paid money, pursuant to its duty to indemnify the insured, to settle the underlying lawsuit and obtained a complete release on behalf of its insured.[87] Liberty Mutual then filed suit to recover its indemnification payment, not to recover any amount paid by the

[82] *Frymire Engineering Co. v. Jomar International, Ltd.*, 259 S.W.3d 140 (Tex. 2008).
[83] *Frymire Engineering Co. v. Jomar International, Ltd.*, 259 S.W.3d at 142.
[84] *Id.*
[85] *Id.*
[86] *Frymire Engineering Co. v. Jomar International, Ltd.*, 259 S.W.3d at 147.
[87] *Frymire Engineering Co. v. Jomar International, Ltd.*, 259 S.W.3d at 142.

insured.[88] Still, the Court did recognize an equitable subrogation claim in *Frymire* despite the fact that the party whose claim was being transferred was "a fully indemnified insured".[89] *Mid-Continent* and *Frymire*, which were decided within one year of each other by the Texas Supreme Court, appear to be logically inconsistent opinions.

Admittedly, *Frymire* concerned an equitable subrogation claim and not a contractual one. Frymire also concerned a subrogation claim against a third party that was not a primary co-insurer. Still, those distinctions did not exist in *Employers Casualty Co. v. Transport Insurance Co.* ("*Employers Casualty*"). In *Employers Casualty*, one insurer assumed the defense of a suit on behalf of its insured and paid $6,750 to settle the underlying lawsuit.[90] There is no indication in that case that the insured, Prior Products, paid any of its own money to defend itself or settle the underlying lawsuit.[91] In *Employers Casualty*, Transport, a primary co-insurer, refused to defend the insured and contribute to the settlement.[92] Employers, after settling the underlying lawsuit, field suit against Transport asserting a claim for contribution.[93] The court held that there was no contribution claim because the competing policies contained pro rata other insurance clauses.[94] However, even though the insured was fully indemnified in Employers Casualty, the court explained that the paying primary co-insurer, Employers, would possess a right to recover from Transport through subrogation, either under contract or equitably.[95]

In *Mid-Continent*, the Court cited, with approval, *Employers Casualty*.[96] The court then applied the law from *Employers Casualty* to the particular facts of the case in *Mid-Continent*, and

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[88] *Id.*
[89] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 775.
[90] *Employers Cas. Co. v. Transport Ins. Co.*, 444 S.W.2d 606, 607 (Tex. 1969).
[91] *Id.*
[92] *Id.*
[93] *Id.*
[94] *Employers Cas. Co. v. Transport Ins. Co.*, 444 S.W.2d at 609.
[95] *Employers Cas. Co. v. Transport Ins. Co.*, 444 S.W.2d at 610.
[96] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 774.

found there was no subrogation claim in that case.[97] The reason the court gave for finding no subrogation claim in *Mid-Continent* was a fact, the full indemnification of the insured, which existed in *Employers Casualty* as well. The rationale used by the court to distinguish *Mid-Continent* from *Employers Casualty* does not distinguish the two cases. If the basis used by the court in 2007 to deny a subrogation claim by a primary co-insurer against another primary co-insurer existed in 1969, then why did the court, in 1969, state that Employers would have a remedy in the form of a subrogation claim against a non-contributing co-insurer? Why endorse such an action in 1969, and then deny that the claim is available to primary co-insurers almost 40 years later for a reason that does not distinguish *Mid-Continent* from *Employers Casualty*?

In a subsequent case before the Fifth Circuit, the logical outcome of the Texas Supreme Court's ruling was questioned by an insurer. In *Nautilus Insurance Co. v. Pacific Employers Insurance Co.*, Nautilus tried to limit the application of *Mid-Continent* on policy grounds by arguing that the above-stated rationale employed by the court in *Mid-Continent* would lead to the elimination of subrogation claims in Texas, and that could not have been the court's intent.[98] Nautilus' point was that subrogation requires one person, not acting voluntarily, to pay a debt for which another was primarily liable,[99] so the subrogee has always paid a debt of the subrogor. If a debt has been paid by another, whether it is an insurer paying for an insured's fault or a defendant paying a plaintiff's damages, the subrogor whose rights are transferred, in many circumstances, has been fully compensated. The subrogor, in the words of the court, has been "fully indemnified".[100] Looking beyond the facts presented in *Mid-Continent*, the court's holding could be stated in the following fashion: a party that has fully recovered its loss has no

[97] *Id.*
[98] *Nautilus Ins. Co. v. Pacific Employers Ins. Co.*, 303 Fed. Appx. at 206.
[99] *Frymire Engineering Co. v. Jomar International, Ltd.*, 259 S.W.3d at 142.
[100] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 775.

right to transfer.[101] If that holding is extended outside the context of insurers and insureds, it arguably completely eliminates almost all subrogation claims.

The Fifth Circuit, confronting Nautilus' argument, pointed out that the Texas Supreme Court, in *Mid-Continent*, recognized a subrogation right in other instances so that its holding would not completely eliminate subrogation claims.[102] The *Mid-Continent* holding was also limited to contractual subrogation claims, and should have no application to equitable subrogation claims.[103] The Fifth Circuit also explained:

> The Texas Supreme Court, however, is the final arbiter of Texas law. . . . Even if the court's decision in Mid-Continent will have these policy effects, that is within the province of the Texas Supreme Court to decide.[104]

The negative impact of the basis for the court's ruling in *Mid-Continent* can already be seen in a few cases that have been decided in the past three years since the decision. In *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.*, one insurer, Employers, refused to defend a co-insured in an underlying lawsuit.[105] Several co-insurers filed suit seeking contribution and indemnity from Employers.[106] The suit ended up in federal court, and the district court handling the case found Employers had a duty to defend the insured, which Employers breached.[107] However, the district court then refused to award any damages to the co-insureds based on the

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[101] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 775-76.
[102] *Nautilus Ins. Co. v. Pacific Employers Ins. Co.*, 303 Fed. Appx. at 206.
[103] *See Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 776 (reading, "Having fully recovered its loss, an insured has no contractual rights that a co-insurer may assert against another co-insurer in subrogation."). The subrogation claims that the Fifth Circuit points out that the court preserved were equitable subrogation claims like the one asserted by an excess insurer against a primary insurer that breached its *Stowers* duty, which the court permitted in *Canal Insurance*.
[104] *Id*.
[105] *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.*, 592 F.3d 687, 690 (5th Cir. 2010).
[106] *Id*.
[107] *Id*.

holding in *Mid-Continent*, thereby eliminating any liability for the insured that had breached its duty to the insured.[108] In explaining its reasoning, the district court opinion reads:

> Addressing Liberty Mutual's equitable and contractual subrogation claims, the court reasoned that a subrogee such as Liberty Mutual steps into the shoes of its insured and can assert only those rights the insured could have asserted against Mid-Continent. . . . An insured's right to indemnity is limited to the actual amount of loss. . . . A pro rata clause "implements that principle by eliminating the potential for double recovery by the insured." . . . Therefore, when an insured has been fully indemnified, "'the liability of the remaining insurers *to the insured* ceases, even if they have done nothing to indemnify or defend the insured.'" . . . The court concluded that "[h]aving fully recovered its loss, an insured has no contractual rights that a co-insurer may assert against another co-insurer in subrogation."[109]

The decision by the district court, which was based on the Texas Supreme Court's rationale in *Mid-Continent*, created a windfall for the one primary co-insurer that breached its duty, negligently or intentionally, to the common insured. On appeal, the Fifth Circuit agreed that there was a duty to defend.[110] The Fifth Circuit then avoided *Mid-Continent*'s ruling on subrogation claims by holding that pro rata other insurance clauses do not apply to the duty to defend an insured.[111] The Fifth Circuit reasoned that the other insurance clauses only applied to a loss, and the obligation to pay an insured's defense costs is not a loss.[112] According to the Fifth Circuit, the duty to defend was a common obligation giving rise to a contribution claim, which the Fifth Circuit permitted in that case without reaching the subrogation question.[113]

While the Fifth Circuit's ruling in *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.* was a clever method of avoiding the apparent scope of the *Mid-Continent* ruling, it has its limitations. In *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.*, the underlying lawsuit was

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[108] *Id*.
[109] *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.*, 586 F. Supp. 2d 718, 730-31 (S.D. Tex. 2008), rev'd, 592 F.3d 687 (5th Cir. 2010) (citations omitted)(emphasis in original).
[110] *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.*, 592 F.3d at 693.
[111] *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.*, 592 F.3d at 695.
[112] *Id*.
[113] *Id*.

still pending and the only recovery the primary co-insurers sought was for Employers breach of the duty to defend.[114] What if Employers had also breached a duty to indemnify a common insured? In that circumstance, a contribution claim is clearly ruled out by almost seventy years of Texas Supreme Court precedent. Does Employers have to pay for the mutual defense, but benefit by breaching its duty to indemnify the same common insured? Employers, or any insurer, would arguably benefit from avoiding its indemnity obligation altogether. The co-insured will have been fully indemnified, thereby eliminating a contractual subrogation claim. There also will not have been a breach of the common law *Stowers* duty because the other insurers will have protected the insured from exposure to damages beyond its policy limits. So, does the less prudent insurer benefit from its neglect or breach as a result of *Mid-Continent*?

Another problem with the Fifth Circuit's holding in *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.* is it ignores and is contrary to the Texas Supreme Court's holdings in *Employers Casualty* and *Traders and General Ins. Co. v. Hicks Rubber Co.* ("*Hicks*")

> In *Hicks*, the two policies contained other insurance clauses. One read:
>
> > If the Assured has other insurance covering a loss *or expense* covered hereby, the Company shall be liable only for the proportion of such loss *or expense* which the sum hereby insured bears to the whole amount of valid and collectible insurance.[115]

The other policy's other insurance clause read:

> > If the Named Insured has other insurance against a loss by the policy, the Company, as respects the Named Insurer, shall not be liable under this policy for a greater proportion of such loss than the applicable limit of liability expressed in the Declarations bears to the total applicable limit of liability of all valid and collectible insurance against such loss.[116]

[114] *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.*, 586 F. Supp. 2d at 721.
[115] *Traders and General Ins. Co. v. Hicks Rubber Co.*, 169 S.W.2d 142, 144 (Tex. 1943) (emphasis added).
[116] *Id*.

One policy's clause applied to "loss or expense" while the other policy only applied to "a loss".[117] The Texas Supreme Court did not find that these clauses had different meanings. To the contrary, the court held, "The 'Other Insurance' provisions of these policies are in different words, but they mean the same thing."[118] One cannot argue that *Hicks* does not apply to or control the application of other insurance clauses to the duty to defend because it only dealt with the duty to indemnify. In *Hicks*, the insurer that paid more than its pro rata share sued the co-insurer to recover its overpayment of "costs and expenses."[119] The Fifth Circuit ignored *Hicks* when it held that the other insurance clauses in *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.* did not apply to the duty to defend because they applied only to a "loss".[120]

Further, in *Employers Casualty*, the co-insurer filed suit to recover its overpayment of both the amount it paid to settle the case and its attorney's fees.[121] There, both policies had other insurance clauses that applied to "a loss" covered under the policy.[122] The Texas Supreme Court was considering a co-insurer's right to contribution for both defense costs and payments under the duty to indemnify, and held that the co-insurer had no right of contribution.[123] So, the Fifth Circuit's holding in *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.* that a contribution claim does exist for the duty to defend cannot be reconciled with the controlling authority of Texas Supreme Court precedent in *Hicks* and *Employers Casualty.*

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[117] *Id*.
[118] *Id*.
[119] *Traders and General Ins. Co. v. Hicks Rubber Co.*, 169 S.W.2d at 148.
[120] The general liability form quoted earlier in this article, Form CG 00 01 10 01, does not indemnify an insured against a "loss". It indemnifies an insured, under Coverage A., for "those sums the Insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies." ISO Form CG 00 01 10 01, at 1. "Loss" is not defined in the policy. So, while it reached a fair decision that equity would favor, the Fifth Circuit's analysis in reaching that decision in *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.* is not without flaws.
[121] *Employers Cas. Co. v. Transport Ins. Co.*, 444 S.W.2d at 607.
[122] *Id*.
[123] *Employers Cas. Co. v. Transport Ins. Co.*, 444 S.W.2d at 609.

There is another reasoning employed by the court in *Mid-Continent* that can have unintended consequences if taken out of context. As discussed earlier, equity would not favor the creation of an equitable subrogation claim in the circumstances before the court in *Mid-Continent*.[124] Even though equity would not favor allowing an equitable subrogation claim against an insurer that complied with its contractual and common law duties to an insured, thereby increasing litigation and multiple lawsuits concerning one loss, the court, in *Mid-Continent*, based its ruling on its conclusion that because a co-insurer, by indemnifying the insured, pays a debt it is obligated to pay under the insurance policy, it is not paying a debt for which another is primarily liable.[125]

This stated basis, that the policy makes a co-insurer primarily liable as well, could effectively eliminate any equitable subrogation claim between primary co-insurers. The general liability policy obligates an insurer to pay covered damages. Even where there are multiple primary policies that share the risk pro rata, each policy obligates the insurer to indemnify the insured for covered damages. In *Mid-Continent*, both policies had pro rata other insurance clauses.[126] Whether the money paid is to defend the insured, settle the claim, or pay a covered judgment, each insurer, where more than one insurer provides primary coverage to an insured, is obligated by its policy to pay covered claims. Following the court's logic in *Mid-Continent*, whenever co-insurers share a risk pro rata, and one insurer pays more than its share, there is no equitable subrogation claim because that insurer was required to do so under its policy.

The only subrogation claims that could survive would be equitable subrogation claims by excess insurers because, under the terms of their policies, the primary insurer would be obligated to exhaust its limits first, and would be primarily liable. Yet, if, for example, a judgment is

[124] *See supra*, at 11.
[125] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 776.
[126] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 769.

entered for $100,000, there are two primary co-insurers with equal policy limits and pro rata other insurance clauses, and one insurer pays all $100,000 of that judgment while the other denies the claim, incorrectly, can it truly be said that the paying co-insurer is paying a debt for which it too is primarily liable? It possesses a contract limiting its risk to the pro rata portion of the damages. While the paying co-insurer's policy obligates it to pay covered damages, it limits that coverage to 50% of the damages in the above example by virtue of the other policy and the pro rata other insurance clause. If the paying co-insurer pays the entire judgment, it is paying a debt for which it is primarily liable. However, if the other insurer also provides coverage for the claim, and its pro rata share is one-half of the judgment, then the other insurer would be primarily liable for its 50% of the covered damages. The non-paying co-insurer would have a greater, or more primary responsibility, for the damages beyond the paying insurer's pro rata share.

The Texas Supreme Court reached the same conclusion stated in the prior paragraph just one year later in another subrogation case, albeit a subrogation case that was not between co-insurers. Faced with the argument that a subrogation plaintiff, who had indemnified a third party under a contract obligating it to do so, was primarily liable because of its obligation to pay the debt, the court explained:

> Jomar correctly argues that Frymire's contractual payment fulfilled a debt owed by Frymire to the hotel; however, the satisfaction of this contractual debt does not foreclose the existence and satisfaction of another debt owed by Jomar to the hotel. We have previously permitted subrogation-based claims to proceed under similar circumstances.[127]

[127] *Frymire Engineering Company, Inc. v. Jomar International, Ltd.*, 259 S.W.3d at 143.

Equitable subrogation does not require that the party making the subrogation claim not be liable for the obligation it has paid. It requires that the amount paid be an amount for which another is also primarily liable, and that in equity should have been paid by the other party.[128]

The issue in *Mid-Continent* was not that Liberty Mutual was primarily liable. To the extent Liberty Mutual paid more than its share to indemnify the plaintiff in the underlying lawsuit, another party, Mid-Continent, would have a greater responsibility and therefore be primarily liable. The issue in *Mid-Continent* was equity.

In addition to the equitable reasons stated earlier, allowing parties to buy subrogation claims with voluntary payments that settle a claim in which the subrogation defendant is already involved can also lead to the unsavory result of defendants, or their insurers, buying claims. In *Beech Aircraft Corp. v. Jinkins*, several defendants settled all claims brought by the plaintiff and then sought contribution from a co-defendant. The Texas Supreme Court, in disallowing a contribution claim in that case, explained:

> We see no advantage in allowing defendants responsible for the plaintiff's injuries a right to, in effect, buy the plaintiff's claims and prosecute the other jointly responsible parties. It is not apparent that such settlements will result in any significant savings of time or resources. We can, however, envision that the settling defendant's unusual posture as surrogate plaintiff, co-defendant and cross-plaintiff will confuse a jury and possibly prejudice the remaining parties. We hold that a defendant can settle only his proportionate share of a common liability and cannot preserve contribution rights under either the common law or the comparative negligence statute by attempting to settle the plaintiff's entire claim.
>
> We are mindful of the general rule that a cause of action for damages for personal injuries may be sold or assigned. *Bradshaw v. Baylor University*, 126 Tex. 99, 84 S.W.2d 703 (1935); *Monk v. Dallas Brake & Clutch Service, Inc.*, 697 S.W.2d 780, 782 (Tex. App. – Dallas 1985, writ ref'd n.r.e.); *Duke v. Brookshire Grocery Company*, 568 S.W.2d 470, 472 (Tex. Civ. App. —Texarkana 1978, no writ). Our holding in the present case is an exception to this general rule. A settling defendant who is jointly responsible for personal injuries to a common plaintiff may not preserve contribution rights either by obtaining a complete release for all

[128] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 774.

> other parties allegedly responsible or by obtaining assignment of the plaintiff's entire claim.[129]

The same rule of equity, which would prohibit such claims, is applicable to insurers and applicable to subrogation claims as well. This rule does not rest on whether the subrogee or the defendant is primarily liable. It involves balancing of all the equities in the circumstances before the court. Balancing those equities in a circumstance where one insurer has paid more money to settle a claim than a primary co-insurer, who has not breached any duty to the insured and is participating in the defense of the insured, equity favors a decision which will reduce litigation and result in a savings of time and court resources. Equity also favors a decision that will not lead to confusing circumstance in a second case, where one party stands in the shoes of another and asks a factfinder to analyze the professional decisions of insurance companies in an earlier case not before the factfinder.

Equity arguably does not weigh in favor of creating such a claim until the result of not allowing a subrogation claim would allow parties that breach a contract, or otherwise commit a wrongful act, to achieve a windfall from avoiding their obligations. Where a decision would create a moral hazard, and encourage parties to disregard the rights of the insured in favor of profits, then equity arguably does favor allowing an equitable subrogation claim. Such was the case in *Canal Insurance* and *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.*, where the defendant insurer had breached a duty to the insured and, in doing so, had forced others to pay additional sums because of that insurer's breach.

[129] *Beech Aircraft Corp. v. Jinkins*, 739 S.W.2d 19 (Tex. 1987).

IV. Recommendation- Define the Context of *Mid-Continent* so as to Permit Subrogation Claims Where There Are Co-Primary Insurers, and One Insurer has Breached a Duty to the Insured.

As illustrated in examples provided in the prior section, courts have been working, since *Mid-Continent* was decided, to determine its scope as insurers have both fought to limit and expand the scope of the opinion to assist them as cases arise.[130] As previously discussed, the Fifth Circuit has subsequently decided that *Mid-Continent* does not apply to defense costs, because those costs are subject to a contribution claim.[131] Further, courts have observed that *Mid-Continent* concerned two policies covering one insured during the same policy period for an "occurrence" that took place on a specific date- concurrent policies. One court has indicated that *Mid-Continent* does not apply to policies that provided consecutive coverage to an insured for a continuing "occurrence" because of the difference between consecutive coverage, where acts occur in discrete coverage periods under one policy, and concurrent coverage, where every act occurs during the period of coverage provided by both policies.[132] That court explained:

> The Court agrees with Maryland that *Mid-Continent* does not bar its subrogation claims. The *Mid-Continent* holding specifically applies to co-primary insurance policies rather than two separate, consecutive insurance policies which do not provide coverage for the same claim. . . . Unlike the situation in *Mid-Continent*, the "other insurance" clauses in this case do not bar a claim for contractual subrogation because the policies at issue cannot both provide coverage for the same loss-only one company's policy was in effect at the applicable time.[133]

However, that viewpoint is not universally accepted.[134]

The Fifth Circuit has also limited *Mid-Continent* specifically to disputes between primary co-insurers as parties have come before the Fifth Circuit to argue that the one satisfaction

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[130] *See supra*, at 19-20.
[131] *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.*, 592 F.3d at 695.
[132] *Maryland Cas. Co. v. Acceptance Indem. Ins. Co.*, 2009 U.S. Dist. LEXIS 105285, at 12-13 (W.D. Tex. 2009).
[133] *Id*.
[134] *See Lexington Ins. Co. v. Chicago Ins. Co.*, 2008 U.S. Dist. LEXIS 60629, at 63-64 (S.D. Tex. 2008) (finding that *Mid-Continent* does apply to consecutive primary co-insurers).

argument that the Texas Supreme Court accepted in *Mid-Continent* applies to other circumstances where the subrogee was fully indemnified by the subrogor.[135]

Still, in addition to there being a split among courts about what limitations to *Mid-Continent* are valid,[136] the limitations placed on *Mid-Continent* have not completely resolved the potential negative effects the opinion can have, if construed too broadly, when primary co-insurers come before a court arguing about a subrogation claim.

In 2009, a district court faced a subrogation claim where one primary co-insurer sought to recover defense and indemnity payments from another primary co-insurer that breached both its duty to defend and indemnify the insured.[137] The district court recognized the holdings in both *Mid-Continent* and *Hicks*, and held there was no contribution claim.[138] The court then confronted the holding in *Mid-Continent* on subrogation claims. The court distinguished the case before it by recognizing that in *Mid-Continent*, the co-insurer fulfilled its contractual obligations to defend and indemnify the insured.[139] In the case before the court, the co-insurer had "completely refused to honor the terms of its policy and satisfy its duty to defend and indemnify the insured."[140] The district court then held that *Mid-Continent* did not bar the co-insurer's subrogation claims, recognizing that the insured had a viable breach of contract claim the co-insurer could enforce.[141] The court also explained that equity would weigh against requiring insurers that honor the terms of their policies to pay more than their fair share while insurers that wrongly refuse benefits to the insured are rewarded for their breach.[142]

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[135] *Home Owners Mgmt. Enters. v. Mid-Continent Cas. Co.*, 294 Fed. Appx. 814, 819 (5th Cir. 2008).
[136] *See supra*, notes 135 and 137.
[137] *Maryland Cas. Co. v. Acceptance Indem. Ins. Co.*, 2009 U.S. Dist. LEXIS 105285, at 2-3 (W.D. Tex. 2009).
[138] *Maryland Cas. Co. v. Acceptance Indem. Ins. Co.*, 2009 U.S. Dist. LEXIS 105285, at 10.
[139] *Maryland Cas. Co. v. Acceptance Indem. Ins. Co.*, 2009 U.S. Dist. LEXIS 105285, at 13.
[140] *Id*.
[141] *Maryland Cas. Co. v. Acceptance Indem. Ins. Co.*, 2009 U.S. Dist. LEXIS 105285, at 16.
[142] *Id*.

The concurring opinion in *Mid-Continent*, while it is not the law, also explained Justice Willett's view of the continuing viability of subrogation claims between co-primary insurers. Justice Willett began by emphasizing that the court's opinion relies heavily on the underlying facts, and that the outcomes in "fiendishly difficult" insurance law questions are "often driven by unique factual circumstances."[143] A key fact, if not the key fact, which Justice Willett focused on in concurring with the answer to the certified question was Mid-Continent's not breaching any duty it owed Kinsel.[144] Mid-Continent did not deny coverage or refuse to participate in the underlying lawsuit.[145] It defended Kinsel and participated in a settlement of the underlying lawsuit within the insured's combined policy limits.[146] As Justice Willett explained, "Kinsel purchased insurance and got exactly what it paid for, a legal defense of the claim against it and a settlement within policy limits, both funded by its insurers."[147] Mid-Continent, as an insurer, was entitled to exercise its business judgment in deciding whether to settle the underlying case, and for how much, and just because multiple carriers disagree in their exercise of that judgment does not give rise to duty between them.[148]

Justice Willett then provided qualifications in his opinion that would limit the effect of the court's answer to the first certified question. Justice Willett explained that his answer to the question would be different if the Mid-Continent policy required it to pay more of the settlement than Mid-Continent had paid.[149] He also offered his opinion that the result "might" be different if: (1) the case involved a primary carrier and excess carrier, where the primary carrier refused a settlement within policy limits and exposed the excess carrier; (2) if there was a judgment and

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[143] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 777 (Willett, J., concurring).
[144] *Id*.
[145] *Id*.
[146] *Id*.
[147] *Id*.
[148] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 777-78 (Willett, J., concurring).
[149] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 778 (Willett, J., concurring).

Mid-Continent refused to pay its share; or (3) if Mid-Continent had denied coverage and refused to pay anything to defend the insured.[150] However, in the facts before the court, there was no claim for Liberty Mutual to make because it stood in the shoes of the insured, Kinsel, and Kinsel had no legal basis for a complaint against Mid-Continent.[151]

If one considers the proposed exceptions mentioned by Justice Willett in the *Mid-Continent* concurring opinion, there is one uniform event that differentiates them from the context presented to the court in *Mid-Continent*. In each of the exceptions presented by Justice Willett, an insurer had breached a duty to its insured. With the excess and primary carrier, the primary carrier in the first scenario had failed to accept a demand within policy limits, giving rise to a *Stowers* duty. Even if the insured was not exposed to the resulting liability, and did not have to pay any money from its own pocket, the duty had been breached. In the second scenario, the insurer had refused to comply with its contractual duty to indemnify the insured by failing to pay its share of the underlying judgment. In the case cited by Justice Willett for that factual scenario, *Traders and General Ins. Co. v. Hicks Rubber Co.*, the insured was exposed to and paid a portion of the judgment as a result of the insurer's breach. However, even if the other insurer stepped in and covered that extra portion of the judgment, you still have a failure to comply with a contractual duty by one insurer.[152] In the final exception presented by Justice Willett, the insurer will have breached its duty to defend the insured in an underlying lawsuit. In that third scenario, the insured is defended by another insurer. Still, there is a breach of a duty owed by the insurer to the insured under the policy.

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[150] *Id*.
[151] *Id*.
[152] The insurer would also be in breach of its policy "if the Mid-Continent policy required it to pay more of the settlement than Mid-Continent had paid." *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 778 (Willett, J., concurring).

What Justice Willett's proposed exceptions illustrate is that a subrogation claim by one insurer against another, where the insurers provide primary co-insurance for a covered claim, should be viable as long as a duty, common law or contractual, has been breached by the defendant insurer. Even though the loss may be born by the co-insurer such that the insured has been fully indemnified for its loss, the co-insurer should still be able to maintain a subrogation claim so long as there is a breach of a duty by the co-insurer.

Take an example where one primary co-insurer breaches the duty to defend an insured, the concurrent insurance policies apportion the loss pro rata, other primary co-insurers pay all of the defense costs, and the insured has not sustained any damage. However, the paying primary co-insurers have sustained damages to the extent that they paid more than their proportionate share of the defense costs. If *Mid-Continent* is applied to that context, the paying primary co-insurers have no subrogation claim.[153] Still, the paying co-insurers should be able to maintain an action to recover those overpayments. The non-paying co-insurer has breached its duty to defend, and should not profit from the breach.

The context in *Mid-Continent* was that the subrogation defendant, Mid-Continent, was a primary co-insurer that had not breached any duty to its insured. There are two potentially dangerous holdings in *Mid-Continent* if the court's decision is expanded beyond that context: (1) that an insurer cannot act as a subrogee for a fully indemnified insured, and (2) that a primary co-insurer is primarily liable to the insured. If the context in *Mid-Continent* is recognized to be where the subrogation defendant has not breached a duty to the insured, the exceptions proposed by Justice Willett in the concurrence are recognized, and it resolves the potential problems created by *Mid-Continent* that have resulted in the creative rulings like the one employed in

[153] Despite the holding in *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.* that a contribution claim does exist for the duty to defend, the Texas Supreme Court has held otherwise in *Hicks* and *Employers Casualty.*

Trinity Universal Ins. Co. v. Employers Mut. Cas. Co. In short, *Mid-Continent* needs to be limited to circumstances where neither primary co-insurer has breached any duty to the insured.

If *Mid-Continent* is limited to circumstances where no insurer has breached a duty to the insured, both law and equity will lead to results that do not favor a breaching party. In the example from the prior paragraph, the primary co-insurers that meet their duty to defend the insured will have subrogation claims against the breaching insurer. The same should be true where a primary co-insurer elects to settle a case without a trial after another co-insurer has breached its duty to defend the insured. The paying co-insurer should be able to maintain a subrogation action to recover the amount of the settlement that exceeds its proportionate share. There has been a breach of the policy, failure to defend the insured. While an insurer is free to settle or not settle a case under the terms of its policy, and one can argue that the co-insurer, standing in the shoes of an insured, made a voluntary payment to settle the underlying lawsuit, the distinction is the breach of the duty to defend. It is a fundamental principle of contract law that a material breach by one contracting party excuses performance by the other party.[154] In a circumstance when one primary co-insurer breaches its duty to defend, the other co-insurer should be free to settle the underlying lawsuit, and the amounts paid by that insurer to settle the lawsuit beyond its proportionate share should be recoverable.

Where there are primary co-insurers, one refuses to defend or indemnify the insured, and the other co-insurer defends through a trial that results in covered damages, that co-insurer should also have an equitable subrogation claim and maybe even a contractual subrogation claim, depending on the terms of the policy.[155]

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[154] *Hernandez v. Gulf Group Lloyds*, 875 S.W.2d 691, 692-93 (Tex. 1994); *Coastal Ref. & Mktg. v. United States Fid. & Guar. Co.*, 218 S.W.3d 279, 294-95 (Tex. App.—Houston [14th Dist.] 2007, pet. denied); *Lennar Corp. v. Great Am. Ins. Co.*, 200 S.W.3d 651, 691 (Tex. App.—Houston [14th Dist.] 2007, pet. denied).

[155] *Employers Cas. Co. v. Transport Ins. Co.*, 444 S.W.2d at 610.

Allowing a primary co-insurer to assert a subrogation claim against another co-insurer that breaches a common law or contractual duty also serves equitable interests. As was pointed out by Judge Sparks in *Maryland Cas. Co. v. Acceptance Indem. Ins. Co.*, equity would weigh against requiring insurers that honor the terms of their policies to pay more than their fair share while insurers that wrongly refuse benefits to the insured are rewarded for their breach.[156] Equity should not reward parties for breaching agreements, or failing to satisfy common law duties. Yet, if such insurers are permitted to escape their responsibility because a primary co-insurer pays a claim and the insured is fully indemnified and does not suffer a loss, a basis given by the court in refusing to recognize such a claim in *Mid-Continent*, [157] then co-insurers that breach their agreement will be rewarded. That cannot have been the court's intent when it decided *Mid-Continent*.

If *Mid-Continent* is expanded beyond the context of primary co-insurers that have not breached a duty to the insured, and a primary co-insurer cannot bring a subrogation claim against another primary co-insurer that has breached a duty to the insured, then the paying co-insurer has little incentive to settle. Any payments will be deemed voluntary and not recoverable beyond the paying co-insurer's proportionate share. Such a rule would create an impediment to settlement, rather than encourage it. If a co-insurer that is defending an insured receives a reasonable settlement offer, but will be unable to recover any payments it makes in excess of its proportionate share, there is less incentive to settle. Why make payments owed by another if you cannot recover those payments? The result would be that more cases are likely to go to trial, despite reasonable settlement offers.

[156] *Maryland Cas. Co. v. Acceptance Indem. Ins. Co.*, 2009 U.S. Dist. LEXIS 105285, at 16
[157] *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d at 775-76.

Even if there is a judgment, there is likely to be an increase in litigation if a primary co-insurer can never make a subrogation claim. In the event of a judgment, *Mid-Continent* limits the primary co-insurer's obligation to its proportionate share of the judgment. So, a co-insurer can pay its proportionate share and meet it obligations leaving the insurer to assert a subrogation claim after a trial on the merits in the first case. The likely result is that the insured, or the plaintiff, with an assignment of the insured's claim, will then file suit against both co-insurers to determine coverage under the two policies. That suit will include extra-contractual claims. The resulting litigation will have three parties, and claims that should be bifurcated in any resulting trial.[158]

If a subrogation claim were recognized in circumstances where one insurer breaches a duty to the insured, the second insurer has a greater incentive to settle. The co-insurer paying more than its proportionate share can assert a subrogation claim, and recover its overpayment as well as the costs incurred to recover that overpayment. That incentive is added to the incentive to accept a reasonable settle demand within policy limits and eliminate the additional costs and uncertainty of a trial. Further, in the subsequent litigation, one insurer is making a contractual or common law claim against another insurer. With a contract claim based on a breach of the policy, the dispute can often be determined by summary judgment, without the need for a bifurcated trial, and with fewer parties to the litigation. So, recognizing a subrogation interest in favor of one primary co-insurer against another insurer that has breached a policy or common law duty would encourage settlement of reasonable demands, decrease litigation, or, at a minimum, the complexity of subsequent litigation, and would not reward those that refuse to abide by the terms of their policies.

[158] *See Liberty Nat. Fire Ins. Co. v. Akin*, 927 S.W.2d 627, 630 (Tex. 1996)(explaining why insurance contract disputes against insurers should be severed from extra-contractual insurance disputes).

Limiting the context of *Mid-Continent* to circumstances where there has been no breach of a duty will also align *Mid-Continent* with earlier Texas Supreme Court decisions that have not been overturned by *Mid-Continent*. *Employers Casualty*, while it held that there is no action between concurrent co-insurers for contribution, explained that the insurer in that case would possess a subrogation claim and could have proceeded under subrogation to recover its defense costs and indemnity payments, had it elected to bring a subrogation action.[159] In *Employers Casualty*, the non-paying co-insurer had breached a duty to the insured. Recognizing a subrogation action between primary co-insurers where one insurer has breached a duty would also eliminate the need to create inventive, results-oriented judicial remedies that are contrary to existing precedent and may have unforeseen negative consequences, like *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.*

Conclusion

While the end result in *Mid-Continent* is logical, and arguably in the best interest of insurers and insureds based on the facts in that case, the methods employed by the Texas Supreme Court to reach its holding can be construed too broadly. Expanding *Mid-Continent* beyond the context where neither co-insurer has breached a duty to the insured creates an environment where there is an incentive for insurers to play chicken with a claim when one insurer has accepted coverage. This environment is created because whenever one insurer accepts a risk that has been co-insured, and behaves as a reasonably prudent insurer in handling the defense and indemnification of the claim, the other insurer is freed from the obligation of meeting its contractual duty to the insured. To remedy the potential for undesired consequences, *Mid-Continent* should be limited, as explained by Justice Willett in the concurrence, in order to

[159] *Employers Cas. Co. v. Transport Ins. Co.*, 444 S.W.2d at 610.

preserve subrogation claims between primary co-insurers when one of the insurers breaches a duty to the insured.