IN THE SUPREME COURT OF TEXAS

NO. 02-0730

EXCESS UNDERWRITERS AT LLOYD'S, LONDON AND CERTAIN COMPANIES SUBSCRIBING SEVERALLY BUT NOT JOINTLY TO POLICY NO. 548/TA4011F01, PETITIONERS,

v.

FRANK'S CASING CREW & RENTAL TOOLS, INC., RESPONDENT

ON PETITION FOR REVIEW FROM THE
COURT OF APPEALS FOR THE FOURTEENTH DISTRICT OF TEXAS

Argued February 15, 2006

JUSTICE HECHT, joined by JUSTICE GREEN, dissenting.

By refusing to apply to insurers the same law of unjust enrichment that applies to everyone else, the Court hands Frank's Casing Crew & Rental Tools, Inc. $7 million for which it paid nothing and to which it has no contractual right. The court does not deny the injustice of this result but argues that such windfalls are necessary to avoid situations in which an insured might be prejudiced by having to pay its own liabilities. Never mind that Frank's Casing claims no such prejudice in this case, or that no case can be found in which any insured ever claimed such prejudice, or that if any imagined prejudice ever actually did occur, it could easily be remedied. The Court's holding is contrary to the only other cases it can find on the subject,[1] and it has been expressly rejected in the *Restatement (Third) of Restitution and Unjust Enrichment*.[2] Worst of all, the burden of the windfalls

[1] *Blue Ridge Ins. Co. v. Jacobsen*, 22 P.3d 313, 318-319 (Cal. 2001); *Colony Ins. Co. v. G & E Tires & Serv., Inc.*, 777 So.2d 1034, 1038-1039 (Fla. Dist. Ct. App. 2000).

[2] RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 35 & reporter's note to cmt. c, illus. 10 (Tentative Draft No. 3, 2004) ("it is the dissenting opinion in *Texas Ass'n of Counties* [*County Gov't Risk Mgmt. Pool v. Matagorda County*, 52 S.W.3d 128, 136 (Tex. 2000) (Owen, J., joined by Hecht, J., dissenting)] that reflects the position of this Restatement").

in this and many other cases will most likely fall on other policyholders who have never tried to get away with demanding more coverage than they bought, so that insureds who stick to their policies will have the privilege of paying extra to satisfy the claims of those who do not.

A blanket rule providing an insurer reimbursement for payment of non-covered claims might work unfairness. An insurer could try to take unfair advantage of its insured's inexperience in assessing coverage issues and use a weak coverage dispute, coupled with the threat of a reimbursement claim if coverage is found lacking, to force the insured to contribute more toward the settlement of a liability claim than it should, thereby denying the insured the full protection of insurance to which it was entitled. But the Court's rule denying reimbursement in every situation is more than *potentially* unfair. As this case demonstrates, it actually allows an insured to take unfair advantage of the extra-contractual liability an insurer faces for failing to resolve claims against the insured and leverage the threat of that liability to force its insurer to settle a claim and abandon a serious coverage issue, thereby effectively obtaining coverage it did not pay for and increasing the risk for which other policyholders must pay. The general law of restitution avoids the problems of both extremes by allowing reimbursement to prevent unjust enrichment but not otherwise.[3] This is reflected in section 35 of the *Restatement (Third) of Restitution and Unjust Enrichment*, recently adopted by the American Law Institute.[4] Section 35 provides a balanced, practical, and principled rule for resolving the issue presented by this case.

The Court encourages insurers, as it has in the past, to obtain prompt resolution of coverage disputes, but today's decision leaves them no alternative. Now an insurer *must* litigate coverage before a liability claim is resolved, even if that means putting an insured in the undesirable position

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[3] Mark P. Gergen, *Restitution as a Bridge over Troubled Contractual Waters*, 71 FORDHAM L. REV. 709, 725-728 (2002).

[4] RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 35 & reporter's note to cmt. a (Tentative Draft No. 3, 2004). Tentative Draft No. 3 was approved by the membership of the American Law Institute during its annual meeting on May 18, 2004. AMERICAN LAW INSTITUTE, PROCEEDINGS AT 81ST ANNUAL MEETING 259-260 (2004).

of having to fight liability and coverage at the same time, even if it means litigating the liability claim in a declaratory judgment action to determine coverage, and even if it means delaying resolution of the liability claim until coverage has been determined. Otherwise, an insurer will be denied the right to litigate coverage altogether, which the Court surely cannot intend. I suspect that this consequence of the today's decision, forcing more coverage litigation, will cause far more problems than the hypothetical concerns expressed in the Court's opinion.

For these reasons, which I now explain more fully, I respectfully dissent.

I

Respondent Frank's Casing Crew & Rental Tools, Inc. has provided oil well and completion services and products throughout the United States since 1938. Headquartered in Louisiana, it has offices in Texas and transacts business here.

In 1995, an offshore drilling platform that Frank's Casing had fabricated in Louisiana for ARCO Oil and Gas Co. and its successor, Vastar Resources, Inc., collapsed and sank in the Gulf of Mexico. In May 1996, ARCO filed suit in Texas against two defendants, and after they in turn sued Frank's Casing as a third-party defendant, ARCO and Vastar (who had joined the suit as plaintiff, collectively "ARCO") named Frank's Casing as a defendant in January 1997. Alleging that Frank's Casing had failed to weld the platform components properly, ARCO sued for breach of contract, negligence, strict products liability, and contractual indemnity, seeking damages for lost profits and production and for costs of investigation, salvage, and repair, as well as exemplary damages and attorney fees.

In addition to a $1 million surplus lines comprehensive general liability insurance policy, Frank's Casing had a $10 million umbrella policy provided by petitioners, Certain Companies Subscribing Severally But Not Jointly To Policy No. 548/TA4011F01 and Excess Underwriters at Lloyd's, London ("the Excess Underwriters"). Frank's Casing notified both insurers of ARCO's

suit. The primary insurer assumed the defense of the lawsuit, as was its right and duty under its policy, and hired counsel to represent Frank's Casing.

In March 1997, counsel for the Excess Underwriters wrote Frank's Casing a reservation-of-rights letter, stating in part:

> Underwriters have commenced an investigation into the claims being made against Frank's in the [ARCO] Litigation. We are writing to advise you of our representation of Underwriters, to advise that we will be evaluating the coverage provided by the Umbrella Policy, to request your assistance and cooperation in our investigation into the claims being made against Frank's and the facts relevant to the Litigation, to advise that Underwriters have not yet come to any conclusions as to coverage, to invite Frank's to provide Underwriters any information that you believe might assist Underwriters in their evaluation of the coverage questions, to solicit your input into our evaluation, and to advise Frank's as to Underwriters' preliminary reservation of certain rights under the Umbrella Policy.

Specifically, the letter explained that coverage of ARCO's claims "may be limited or negated" under the umbrella policy because:

- claims alleging breach of contract and warranties "may not constitute an 'occurrence' as that term is defined by the policy" – "an accident or a happening. . . which unexpectedly and unintentionally results in personal injury or property damage or advertising liability" ;
- the policy excluded property damage claims for the failure of Frank's Casing's product or work due to deficiencies in its designs, plans, or written instructions;
- the policy also excluded the costs of removal, recovery, repair, or replacement of product or work that failed to perform its function, and the costs of raising, removal, or destruction of any of wreckage or debris or obstruction, however caused;
- the policy expressly excluded coverage for punitive damages and would not cover any damages occurring after September 30, 1995, the end of the policy period; and
- notice of the claim may not have been timely.

The letter also stated that the scope of the umbrella policy's coverage was to follow the form of the primary policy (other than the monetary limits, of course), which counsel had not had an opportunity to review, and that the primary policy might therefore further restrict coverage of ARCO's claims. In January 1998, the Excess Underwriters sent Frank's Casing a second reservation-of-rights letter giving an additional reason for lack of coverage: that ARCO's claims for lost profits and loss of use

of the platform were not "property damage" covered by the policy. The record does not reflect whether Frank's Casing responded to the letters but does indicate that Frank's Casing took the position that all claims were covered.

Nearing the February 16, 1998 trial setting, the parties discussed settlement. ARCO's claims totaled $16 million (Frank's Casing stipulated that property damage was $5,630,360.28), far more than the policy limits of Frank's Casing's insurance, but after an unsuccessful mediation, ARCO's counsel offered to settle for $9.9 million. Although Frank's Casing had no express right under its primary policy to control settlement,[5] and may or may not have had one under the umbrella policy,[6] its corporate counsel unilaterally rejected the offer as too high, even though it was within policy limits, and did not even forward it to the Excess Underwriters. On January 30, counsel for the Excess Underwriters contacted ARCO directly, without Frank's Casing's knowledge, and attempted to settle only the claims they believed were covered, but no agreement was reached. When Frank's Casing's counsel learned of this, he objected to any settlement negotiations being conducted without his involvement. ARCO then offered to settle all of its claims against all of the defendants for $8.8 million. In a February 2 letter to corporate counsel for Frank's Casing, counsel for the Excess Underwriters estimated that, after contributions offered by other defendants, Frank's Casing would be required to contribute about $7.55 million. Assuming that $750,000 of primary coverage remained, the letter made two proposals: the Excess Underwriters would pay two-thirds of the amount required to meet ARCO's demand and waive all coverage issues if Frank's Casing would pay one-third; alternatively, they would contribute $5 million to any reasonable settlement Frank's

[5] The policy provided that the insurer "shall have the right and duty to defend any suit against the Assured . . . and may make such investigation and settlement of any claim or suit as it deems expedient".

[6] The policy provided: "The Assured shall make a definite claim for any loss for which the Underwriters may be liable under this policy within twelve (12) months after the Assured shall have paid an amount of ultimate net loss in excess of the amount borne by the Assured or after the Assured's liability shall have been fixed and rendered certain either by final judgment against the Assured after actual trial or *by written agreement of the Assured, the claimant, and Underwriters*." (Emphasis added.) The Excess Underwriters argue that the last phrase gives Frank's Casing the right to consent to any settlement, but Frank's Casing argues that this stretches the phrase's meaning.

Casing reached with ARCO and arbitrate coverage issues later. Frank's Casing refused both proposals.

Under their policy, the Excess Underwriters had no duty to provide Frank's Casing a defense but did have the right to associate in the defense with Frank's Casing's cooperation when it appeared likely they would be involved,[7] and on February 2, they retained separate trial counsel. Trial commenced February 17, and it immediately became clear for the first time that Frank's Casing was ARCO's target defendant. The next day, Frank's Casing's corporate counsel requested ARCO's trial counsel to make a settlement offer within the umbrella policy's limits, suggesting $7 million. ARCO promptly responded with a $7.5 million offer, which Frank's Casing's counsel immediately passed along to the Excess Underwriters in a letter hand-delivered and faxed to their counsel, insisting that since trial was not going well, "Frank's does now look to Underwriters to settle this claim." The letter added that the Excess Underwriters' coverage reservations had "little credence" and that it was "probable" Frank's Casing would suffer a jury verdict in excess of policy limits. ARCO's last offer, the letter continued, was "one that an insurer, acting as a reasonably prudent insured, would accept." Counsel concluded:

> Should Underwriters in this instance refuse to move forward and resolve this dispute based upon [ARCO's] current demand, [Frank's Casing] specifically reserves its rights pursuant to the *Stowers* doctrine[8] to proceed against the Underwriters for any liability Frank's may incur over and above the limits of its insurance.

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[7] The policy provided:

> The Underwriters shall not be called upon to assume charge of the settlement or defense of any claim made or suit brought or proceeding instituted against the Assured but Underwriters shall have the right and shall be given the opportunity to associate with the Assured or the Assured's underlying insurers or both in the defense and control of any claim, suit or proceeding relative to an occurrence where the claim or suit involves, or appears reasonably likely to involve Underwriters, in which event the Assured and Underwriters shall co-operate in all things in the defense of such claim, suit or proceeding.

[8] *See American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 843 n.2 (Tex. 1994) ("The duty of an insurer to exercise ordinary care in the settlement of claims to protect its insureds against judgments in excess of policy limits is generically referred to in Texas as the *Stowers* duty."); *Stowers Furniture Co. v. Am. Indem. Co.*, 15 S.W.2d 544 (Tex. Comm'n App. 1929, holding approved).

On February 20, counsel for the Excess Underwriters responded by faxed letter that ARCO's offer should be accepted but stated that they continued to believe "a substantial portion" of the claims were not covered and that it would be "unreasonable for Umbrella Underwriters to assume total responsibility for [ARCO's] current demand." The Excess Underwriters again proposed to resolve both ARCO's claims and the coverage issues by paying two-thirds of ARCO's settlement demand with Frank's Casing paying one-third (after contribution of the remainder of the primary policy's limits, which turned out to be about $500,000). Alternatively, the Excess Underwriters proposed to pay ARCO's demand, less the contribution from the primary insurer, with Frank's Casing's agreement to resolve coverage issues later. When counsel for Frank's Casing faxed a reply again refusing to contribute to the settlement and reiterating its demand that the Excess Underwriters accept ARCO's offer, the Excess Underwriters acceded. ARCO had indicated that its offer would remain open only until the trial court's ruling on a particular issue, which was expected imminently. By letter faxed to Frank's Casing's counsel on the morning of February 23, counsel for the Excess Underwriters stated that they were acting "to ensure that the favorable settlement will not be lost to both Frank's and Umbrella Underwriters." But, he added, the Excess Underwriters would "continue to reserve all coverage issues" and would "hold Frank's responsible for and . . . seek reimbursement of all sums paid in settlement of claims for which no coverage exists".

A few hours later, counsel for the Excess Underwriters' faxed ARCO's trial counsel a letter agreeing to pay $7.5 million in settlement. Frank's Casing contends that it had no opportunity to respond to the Excess Underwriters' reimbursement claim before the case settled. But when the settlement was announced to the court the next day, counsel for Frank's Casing and the Excess Underwriters both referred to the latter's reimbursement claim:

> [Counsel for Frank's Casing]: Underwriters have attempted to reserve all rights against Frank's as to coverage under the umbrella policy. It is Frank's position that no proper preservation of reservations has been made and Frank's denies that the Underwriters may preserve coverages. More specifically, Underwriters' offer to resolve the issue with [ARCO], which [was] made pursuant to Frank's demand by

> a *Stowers* letter dated February 19, 1998 and February 20th, 1998, forwarded by Michael Andrepont to Jay James Cooper, counsel for Underwriters.
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> Underwriters have accepted this offer in order to avoid the possibility of having to pay out funds in excess of policy limits. As a result, it is Frank's position that Underwriters have either waived their right to reserve cover issues or alternatively or stop [sic] from asserting any coverage issues since Underwriters have agreed to the settlement.
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> [Counsel for the Excess Underwriters]: This settlement is being funded by Frank's Umbrella Underwriters subject to a full reservation of all rights against Frank's under the umbrella policy No. 548TA4011FO1. And these Underwriters will hold Frank's responsible for and will seek reimbursement of all sums paid the settlement of claims for which no coverage exists under the umbrella policy.

The parties later signed and filed a settlement agreement that made no reference to the Excess Underwriters' reimbursement claim specifically but preserved "any claims that exist presently or may arise in the future between Defendant Frank's and Frank's Insurers arising from the claims asserted by Plaintiffs."

Also on February 23, the Excess Underwriters filed this action against Frank's Casing to resolve the coverage dispute and to obtain reimbursement for the settlement of any non-covered claims. They asserted seven provisions of the umbrella policy that limited or denied coverage of ARCO's claims. The policy neither provided for nor prohibited a right of reimbursement; it was entirely silent on the subject. The Excess Underwriters asserted that the right was implied in law and in fact. In its answer, Frank's Casing asserted in part that the Excess Underwriters had not stated a claim in contract or tort and had acted with unclean hands. Frank's Casing also counterclaimed for negligence, bad faith, violations of the Texas Insurance Code, breach of contract, business disparagement, and a declaratory judgment that all of ARCO's claims were covered by the umbrella policy.

The case was presented to the trial court in seven motions for partial summary judgment, five by the Excess Underwriters and two by Frank's Casing, addressing separately the reimbursement

issue, the various coverage issues, and damages. In September 1999, the trial court issued a series of orders granting the Excess Underwriters reimbursement for any non-covered claims and denying most of Frank's Casing's counterclaims. Then in March and April 2000, the trial court granted the Excess Underwriters' motions on the coverage issues and denied Frank's Casing's remaining motion. Finally, on December 14, 2000, more than two years and nine months after the case was filed, the trial court granted the Excess Underwriters' motion on damages, ordering that they were entitled to reimbursement of $7,013,612. But a week later, this Court issued its decision in *Texas Association of Counties County Government Risk Management Pool v. Matagorda County*, holding that an insurer that pays a claim later determined not to be covered by the policy is entitled to reimbursement "only if it obtains the insured's clear and unequivocal consent to the settlement and the insurer's right to seek reimbursement."[9] The trial court directed Frank's Casing to move for reconsideration on the issue of the right to reimbursement, and Frank's Casing complied. After further hearing, the trial court granted the motion, withdrew its orders on that issue, granted summary judgment for Frank's Casing on that issue, and signed a judgment that the Excess Underwriters take nothing. The trial court did not withdraw its orders resolving the coverage issue in favor of the Excess Underwriters.

Only the Excess Underwriters appealed. The court of appeals affirmed, although it noted:

> We recognize this case carries *Matagorda County* to a logical conclusion that is somewhat disquieting — Frank's was able to resolve the parties' coverage dispute in its own favor simply by sending a *Stowers* demand to the Underwriters. Thereafter, the Underwriters had to pay if Arco's claims were *within* the policy, but also had to pay *if they [were] not* within the policy because there was no right to reimbursement. But this is a matter that the Underwriters must take up with the superior court.[10]

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[9] 52 S.W.3d 128, 135 (Tex. 2000) ("[W]e hold that, when coverage is disputed and the insurer is presented with a reasonable settlement demand within policy limits, the insurer may fund the settlement and seek reimbursement only if it obtains the insured's clear and unequivocal consent to the settlement and the insurer's right to seek reimbursement.").

[10] 93 S.W.3d 178, 180 (Tex. App.–Houston [14th Dist.] 2002).

The Court granted the Excess Underwriters petition for review[11] and issued an opinion reversing and remanding the case to the trial court for rendition of judgment in their favor.[12] Though two JUSTICES did not join fully in the Court's opinion,[13] none dissented from the judgment.[14] When respondent's motion for rehearing was filed, only four of the JUSTICES present at oral argument remained on the Court. To fully consider respondent's motion, petitioner's response, and a number of amicus briefs,[15] the Court granted the motion and ordered the case reargued.[16]

II

Frank's Casing has not challenged, either in the court of appeals or in this Court, the trial court's rulings on the coverage issues. Therefore, I assume that none of ARCO's claims were covered by the umbrella policy. The only issue, then, is whether the Excess Underwriters are entitled to be reimbursed for the amount they paid in settlement.

The parties agree that the coverage issues were governed by Louisiana law, but they disagree whether the reimbursement issue is governed by Louisiana law or Texas law, and whether the two are different. Frank's Casing contends that the Excess Underwriters never requested the application of Louisiana law in the trial court and that in any event, on the issue before us it is no different than

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[11] 46 Tex. Sup. Ct. J. 546 (Apr. 3, 2003).

[12] 48 Tex. Sup. Ct. J. 735 (May 27, 2005).

[13] *Id*. at 744 (O'Neill, J., concurring); *id*. at 746 (Wainwright, J., concurring).

[14] JUSTICE BRISTER did not participate in the decision, having authored the opinion for the court of appeals while serving as Chief Justice of that court. JUSTICE JOHNSON also did not participate, having recently been appointed to the Court.

[15] Amicus briefs in support of respondent's motion for rehearing have been submitted by United Policyholders; Brad Fish, Inc.; Pilco, Inc.; Shell Oil Co.; Motiva Enterprises LLC; Burlington Resources Inc.; Temple-Inland Inc.; Texas Civil Justice League; Texas Ass'n of Defense Counsel, Inc.; and Valero Energy Corp. Amicus briefs opposing the motion have been filed by Property Casualty Insurers Ass'n of America; American Insurance Ass'n; and Complex Insurance Claims Litigation Ass'n, on behalf of its members: AIG; Chubb & Son; Farmers Insurance Group; The Hartford Insurance Group; Liberty Mutual Group Inc.; St. Paul Fire and Marine Insurance Co.; Selective Insurance Co. of America; The Travelers Indemnity Co. and Travelers Indemnity and Surety Co.; and Zurich American Insurance Co.

[16] 49 Tex. Sup. Ct. J. 240 (Jan. 6, 2006).

Texas law. The Excess Underwriters alluded to Louisiana law twice in the trial court. A six-sentence footnote in their motion for summary judgment began, "[t]o the extent Louisiana law might apply to this case", and then cited two Louisiana statutes[17] and two cases[18] generally allowing recovery for unjust enrichment. None of the authorities cited specifically addressed the issue in this case. In response to Frank's Casing's motion for reconsideration, after this Court's decision in *Matagorda County* issued, the Excess Underwriters again briefly cited general Louisiana authority "[t]o the extent this Court finds Louisiana law controlling". Neither instance amounted to an actual assertion that the reimbursement issue is controlled by Louisiana law. If Louisiana law were controlling, it is not clear from the authorities cited how it would resolve the issue before us. Without proof that Louisiana and Texas law are different, they should be presumed to be the same,[19] and which of the two states' law controls need not be resolved.

Accordingly, I turn to the question whether Texas law affords an insurer the right to reimbursement from its insured for settling a non-covered liability claim.

III

When the parties to a contract disagree over what performance is required and that disagreement cannot be resolved before performance is due, the party who must perform is put to the choice of doing more than he thinks is called for or facing the other party's claim of breach. The potential adverse consequences of the latter course may be severe enough that the party is all but forced to render the performance demanded and forego resolution of the dispute. The other party thus obtains more than he bargained for.

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[17] LA. CIV. CODE ANN. arts. 2055, 2298.

[18] *Edmonston v. A-Second Mortgage Co. of Slidell*, 289 So.2d 116 (La. 1974); *E.F. Minyard v. Curtis Prods., Inc.*, 205 So.2d 422 (La. 1968).

[19] *Coca-Cola Co. v. Harmar Bottling Co.*, 218 S.W.3d 671, 685 (Tex. 2006); *Gevinson v. Manhattan Constr. Co. of Okla.*, 449 S.W.2d 458, 465 n. 2 (Tex. 1969); *Milner v. Schaefer*, 211 S.W.2d 600, 603 (Tex. Civ. App.—San Antonio 1948, writ ref'd); *Tempel v. Dodge*, 33 S.W. 222, 222 (Tex. 1895).

According to the *Restatement (Third) of Restitution and Unjust Enrichment*:

> The commonsense solution to this dilemma — allowing performance with reservation of rights — promotes justice and efficiency. Because it offers recourse to a party who might otherwise be effectively compelled to render an extracontractual performance, it serves both to reinforce the parties' agreement and to prevent the unjust enrichment that would otherwise result. Equally important, the mechanism of contingent or provisional performance (that is, performance subject to an eventual claim in restitution) will serve in many cases to reduce the overall cost of resolving the parties' dispute. Disputes over contractual requirements commonly arise in the midst of the undertaking, rather than at its outset or conclusion. The cost of interruption is then at its highest; the risk of consequential harms (which must ultimately be borne by one party or the other) leverages the stakes beyond the amount initially in dispute. If the party on whom a questionable demand is made can protect its position only by refusing performance, the costs of resolution are magnified accordingly. Performance with reservation of rights can reduce these costs by deferring dispute resolution to a point at which the risk of consequential harm is lower.[20]

Provisional performance is the rule for transactions governed by the Uniform Commercial Code, which provides that "[a] party that with explicit reservation of rights performs or promises performance or assents to performance in a manner demanded or offered by the other party does not thereby prejudice the rights reserved."[21] The UCC imposes no requirement that the other party consent to the reservation for it to be effective.

The point of reserving rights is, of course, is to see them vindicated, which cannot be accomplished without a remedy.[22] The remedy, according to the *Restatement (Third)of Restitution and Unjust Enrichment*, is restitution. The UCC provision, the Restatement explains, "presume[s] . . . that the 'rights reserved' by a performing party — 'where one party is claiming as of right

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[20] RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 35 cmt. a (Tentative Draft No. 3, 2004).

[21] TEX. BUS. & COM. CODE §§ 1.102 ("Scope of Chapter" in Uniform Commercial Code); 1.308(a) ("Performance or Acceptance Under Reservation of Rights").

[22] *See Miers v. Brouse*, 271 S.W.2d 419, 421 (Tex. 1954) ("The first maxim of equity is that it will not suffer a right to be without a remedy. As Lord Holt early said: 'If the plaintiff has a right, he must of necessity have a means to vindicate and maintain it . . . . It is a vain thing to imagine a right without a remedy.'" (citation omitted)); *Ashby v. White*, 92 Eng. Rep. 126, 136 (K. B. 1703) (Lord Holt, C.J., dissenting), *reprinted in* 1 SMITH'S LEADING CASES 464, 483 (9th ed. 1889). On writ of error from the King's Bench, the House of Lords reversed the judgment and ruled in favor of the plaintiff for the reasoning stated in Lord Chief Justice Holt's dissent. 1 Eng. Rep. 417 (H.L. 1703); *see* 90 Eng. Rep. 1188 (H.L. 1703); JOHN WILLIAM SMITH ET AL., A SELECTION OF LEADING CASES ON VARIOUS BRANCHES OF THE LAW: WITH NOTES 509 (9th ed., Charles H. Edson & Co. 1888).

something which the other believes to be unwarranted' — take the form of a claim in restitution for the value of any benefit conferred to which the recipient was not entitled."[23] Texas law recognizes restitution as a remedy for unjust enrichment "[w]hen a person has obtained a benefit by taking undue advantage of another".[24] The *Restatement* sets out the following rule, originally suggested by Professor Mark Gergen:[25]

> § 35. Performance of Disputed Obligation
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> (1) If one party to a contract demands from the other a performance that is not in fact due by the terms of their agreement, the party on whom the demand is made may render such performance under protest or with reservation of rights, preserving a claim in restitution to recover the value of the benefit conferred in excess of the recipient's contractual entitlement.
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> (2) The claim described in subsection (1) is available only to a party acting in good faith and in the reasonable protection of the claimant's own interests. It is not available where there has been an accord and satisfaction between the parties, or where a performance with reservation of rights is inadequate to discharge the claimant's obligation to the recipient.[26]

The rule restricts restitution to claimants who act in good faith and in the reasonable protection of their own interests. The provisional performance must also go far enough to discharge a claimant's obligation. In such circumstances, restitution is not precluded by the voluntary-payment rule because, as comment b to section 35 explains, the claimant acts under a kind of coercion — the pressure to take action to avoid consequential harms before uncertainty as to contractual obligations can be resolved.[27]

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[23] RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 35 cmt. a (Tentative Draft No. 3, 2004).

[24] *Heldenfels Bros., Inc. v. City of Corpus Christi*, 832 S.W.2d 39, 41 (Tex. 1992) ("A party may recover under the unjust enrichment theory when one person has obtained a benefit from another by fraud, duress, or the taking of an undue advantage.").

[25] *See* Gergen, *supra* note 3, at 728.

[26] RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 35 (Tentative Draft No. 3, 2004); *id*. cmt. a ("The rule of this Section is implicit in the negative statement of U.C.C. § 1-308(a) . . . .").

[27] RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 35 cmt. b (Tentative Draft No. 3, 2004) ("When the cost of resistance includes a risk of further loss or liability, beyond the amount already in controversy, the party on whom the demand is made may have no practical alternative but to submit. Performance in such cases is not

Section 35 restates the principle of restitution inherent in the UCC provision and applicable to contracts generally. But insurance policies are not governed by the UCC, and as comment c to section 35 recognizes, "disputes between insurers and policyholders over the insurer's duty to pay a claim, or to settle or defend a claim brought against the policyholder, present special difficulties for the law of restitution, because the insurer's duty to indemnify and defend is subject to extensive regulation under local insurance law."[28] Regulation is necessary because an insured is typically at a distinct disadvantage in dealing with an insurer, having little or nothing to say about the policy language, little or no experience in evaluating coverage issues, and neither the wherewithal nor the inclination to litigate disputes. The prospect that a third-party liability claim may not be covered by insurance poses a significant threat to most insureds. As the *Restatement* observes, "[p]ublic policy strongly favors the prompt discharge of an insurer's obligations to its policyholder."[29]

Nevertheless, Texas law permits a liability insurer to defend or settle a claim against its insured while reserving its rights to contest coverage,[30] as long as it acts timely and in good faith.[31] An insured may reject the reservation, demand an unconditional defense, and sue for contractual and extracontractual damages.[32] But if the insured does not reject the reservation, the insurer must be

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'voluntary,' and restitution is uniformly available to rectify the overperformance that the claimant has effectively been compelled to render."); *see Dallas County Cmty. Coll. Dist. v. Bolton*, 185 S.W.3d 868, 886 (Tex. 2005); *BMG Direct Mktg. v. Peake*, 178 S.W.3d 763, 776-778 (Tex. 2005).

[28] *Id*. cmt. c.

[29] *Id.*

[30] *See American Physicians Ins. Exch.*, 876 S.W.2d at 861 (Hightower, J., dissenting).

[31] *See American Eagle Ins. Co. v. Nettleton*, 932 S.W.2d 169, 174 (Tex. App.—El Paso 1996, writ denied) ("[A]n insurer may undertake the insured's defense and later deny coverage if it 'reserves its rights' by advising the insured that it may interpose a policy defense following adjudication of the claimant's suit against the insured. This is a proper course of action only when the insurer has a good faith belief that the complaint alleges conduct which may not be covered by the policy. In such a situation, the reservation of rights will not breach the duty to defend if timely notice of intent to reserve rights is sufficient to inform the insured of the insurer's position." (citations omitted)).

[32] *Texas Ass'n of Counties County Gov't Risk Mgmt. Pool v. Matagorda County*, 52 S.W.3d 128, 141 (Tex. 2000) (Owen, J., joined by Hecht, J., dissenting) ("Under Texas law, if an insurance company tenders a defense with a reservation of rights, the insured may either accept that defense with the reservation of rights, or it may refuse the tendered defense and defend the suit itself. If the insured decides to defend itself, it must bear the cost of that defense

given a meaningful opportunity to resolve the coverage dispute if the reservation is to be anything but an empty formality. Without that opportunity, the *Restatement* explains:

> the risk of enhanced liability in coverage disputes may compel a performance by the insurer that is outside the scope of the insurance contract. If the insurer, by denying coverage, risks a potential liability greater than the amount initially in controversy — and if the insurer is obliged to take action before the coverage issue can be adjudicated — the effect of the applicable legal rules may be to subject the insurer to an extracontractual liability. Such a result distorts the parties' allocation of risks and creates the sort of unjust enrichment with which the present Section is concerned.[33]

The present case is a prime example of such distortion of risk and unjust enrichment when an insurer is denied restitution from its insured for settling non-covered claims. The Excess Underwriters' *Stowers* obligation was to accept a reasonable settlement offer within policy limits or stand to the full recovery against Frank's Casing, even beyond policy limits. Once ARCO made such an offer, Frank's Casing had almost no incentive to confront the coverage issues. If ARCO's claims were covered by the Excess Underwriters' policy, Frank's Casing had no exposure, and if the claims were not covered, so what? If the Excess Underwriters settled and won the coverage dispute, Frank's Casing had nothing to lose without an obligation to reimburse the settlement of the non-covered claims. And if the Excess Underwriters did not settle and lost the coverage dispute, Frank's Casing would have no obligation. Only if the Excess Underwriters refused to settle and later won the coverage dispute would Frank's Casing risk any liability. But while Frank's Casing's risk of refusing to contribute to the settlement was slight, the Excess Underwriters' risk of refusing to settle was enormous. Even if they won the coverage dispute, they could not recover without a right of reimbursement, and if they lost the coverage dispute, their *Stowers* liability would extend to ARCO's full recovery, perhaps $16 million. Having estimated their ultimate exposure to be $5 million, as reflected in their settlement offer to Frank's Casing, the Excess Underwriters barely hesitated in

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if the claims against it are not covered by insurance." (citation omitted)).

[33] RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 35 cmt. c (Tentative Draft No. 3, 2004).

paying $2 million more to settle $16 million in claims, especially after trial had begun and Frank's Casing itself viewed ARCO's case claims as strong.

If the Excess Underwriters' assessment of the coverage issues had been correct, they would have paid $2 million more than they owed. As it turned out, the Excess Underwriters were finally determined to have no obligation at all. None of ARCO's claims were covered. *Stowers* liability combined with no right of reimbursement effectively forced the Excess Underwriters to extend Frank's Casing $7 million in coverage for which it had not contracted and had paid nothing. Such disincentive for insurers to resolve coverage issues carries a cost that must be paid in higher premiums.

The purpose of the law of restitution is to prevent such unjust enrichment without permitting abuse. In *Matagorda County*, the Court noted that an insurer's right of reimbursement could operate unfairly against an insured . Though the Court did not elaborate, such a situation can occur when the plaintiff's claims exceed the defendant's assets, but not its policy limits, coverage is uncertain, and the insurer can settle over the defendant's objection.[34] But *Matagorda County* incorrectly asserted that a right of reimbursement might result in a defendant having to pay more than it is worth.[35] It is impossible for an insurer to exact more from an insured than he is worth; you can't squeeze blood from a turnip. And an insurer has no more incentive or ability to sue for reimbursement that cannot

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[34] Suppose the following: at trial, P has a 50% probability of recovering 10 and a 50% probability of recovering 0; coverage is 50/50; policy limits are 10; and D has 2 in assets.

P expects, on average, to recover 3. Half the time P loses at trial and takes nothing. A fourth of the time he wins at trial and there is coverage, so he recovers 10 from I. But another fourth of the time he wins at trial but there is no coverage, so he is limited to D's assets, 2. With one chance at 10, one at 2, and two at 0, he should expect 3.

With no right of reimbursement, I expects at trial to pay only 2.5 on average, since there is only one chance in 4 that it will owe 10, and D expects to pay only 0.5 on average, since there is only one chance in 4 that it will owe 2. If there is a right of reimbursement, I can pay P 3 to settle and still lower its expected cost to 2 on average, since half the time it will recover nothing from D in the coverage suit and the other half it will recover D's 2. But D's expected cost then increases, on average, to 1, since it will lose the coverage fight half the time. In this situation, if I can insist on settling for 3, it benefits itself and harms D.

[35] 52 S.W.3d at 135 (stating that a right of reimbursement might force an insured to "choose between rejecting a settlement within policy limits or accepting a possible financial obligation to pay an amount that may be beyond its means, at a time when the insured is most vulnerable.").

be collected than a plaintiff has to demand a settlement that cannot be paid. Indeed, it almost always has less incentive. Not only will the insurer want to leverage the coverage dispute to extract a lower settlement demand from the plaintiff, but an insurer who pursues its insured into bankruptcy does so at a business cost paid in bad customer relations and lower premiums.

In any event, Frank's Casing does not argue that an obligation to reimburse the Excess Underwriters would have put it in the predicament hypothesized in *Matagorda County*. Frank's Casing is a substantial business, and there is nothing to indicate that it lacked the means to meet its liability to ARCO. When both the defendant's assets and the plaintiff's demand exceed the insurer's policy limits, granting the defendant the unilateral power to accept or reject a settlement offer may unfairly prejudice the insurer.[36]

The *possibility* of prejudice to an insured, not *actually* present in either this case or in *Matagorda County*, is avoided under section 35, which would not allow reimbursement because the insurer's settlement of the claim under a reservation of rights would result in a higher payment by the insured and therefore be "inadequate to discharge [the insurer's] obligation to the [insured]". The remedy for unjust enrichment does not come at a price of unfairness to the other party. Further, if the restrictions on restitution contained in section 35 were inadequate to prevent an unjust application of the rule, equity could intervene because restitution is an equitable remedy.[37] If an

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[36] Now suppose: at trial, P has a 50% probability of recovering 20 and a 50% probability of recovering 0; coverage is 50/50; policy limits are 10; and D has 50 in assets.

At trial, P expects, on average, to recover 10. D expects, on average, to pay 7.5. I expects, on average, to pay 2.5. If D has the unilateral power to accept or reject settlements, even assuming I has a right of reimbursement, I's average expected cost is increased to 5, and D's falls to 5. But if D can use the threat of *Stowers* liability to force I to pay 10, and I has no right of reimbursement, I's average expected cost is increased to 10, and D's falls to 0.

[37] *BMG Direct Mktg. v. Peake*, 178 S.W.3d 763, 771, 775(Tex. 2005) (noting, however, that "an adequate legal remedy may render equitable claims of unjust enrichment and equitable defenses of voluntary-payment unavailable" and citing *Matagorda County*, 52 S.W.3d 128, 133-135 (Tex.2000)); *Dallas County Cmty. Coll. Dist. v. Bolton*, 185 S.W.3d 868, 886 (Tex. 2005) (Brister, J., joined by Jefferson, C.J, and O'Neill, J., dissenting to opinion holding that allegedly illegal student activity fees were voluntarily paid as a matter of law). *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 1, cmt b ("This equitable conception of the law of restitution is crystallized by Lord Mansfield's famous statement in *Moses v. Macferlan* (1761): 'In one word, the gist of this kind of action is, that the defendant, upon the circumstances of the case, is obliged by the ties of natural justice and equity to refund the money.' Explaining restitution as the embodiment of natural justice and equity gives the subject an undoubted versatility, an adaptability to new situations, and — in the eyes of many observers — a particular moral attractiveness. Restitution in this view is the one aspect of our legal system that makes a direct appeal to standards of equitable and conscientious behavior as a source of obligations that society will enforce with a legal sanction.").

insured were unfairly prejudiced by affording an insurer a right of reimbursement, the answer is to limit the right in that situation to prevent the prejudice, not to deny it altogether in the many other cases in which it is necessary to prevent unjust enrichment.

The Court rejects section 35, not because it is in any way unfair to insureds, but because it "undermine[s] . . . the predictability that our decision in *Matagorda County* provided".[38] Of course, it does. *Never* is extremely predictable. But section 35 would certainly create no serious unpredictability in this case or any one like it. It is not very hard to see that Frank's Casing should not be given the benefit of coverage it did not buy.

Frank's Casing and amici curiae have raised several other arguments against an insured's right to be reimbursed by its insured for settling non-covered claims.

1. *Such a right disincentivizes insurers to obtain a resolution of coverage issues before a liability claim must be settled.* We have encouraged prompt resolution of coverage issues through declaratory judgment actions.[39] The argument that an insurer entitled to reimbursement might delay such resolution is easily answered; an insurer who intentionally delays resolution of coverage issues to prejudice the insured may, in a particular case, forfeit the right of reimbursement by failing to act in the good faith required by section 35.

Denying reimbursement altogether raises a different set of problems. Early resolution of coverage issues is often impossible or imprudent.[40] In many cases, there is simply not time. Here, for example, while Frank's Casing faults the Excess Underwriters for doing nothing to resolve coverage issues in the eleven months that the liability case was pending against it, the fact that the coverage case took nearly three years and seven motions for summary judgment strongly suggests that it could not have been completed before the trial of ARCO's claims. In other cases, litigating

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[38] *Ante* at ___.

[39] *See, e.g.*, *Farmers Tex. County Mut. Ins. Co. v. Griffin*, 955 S.W.2d 81, 84 (Tex. 1997) (per curiam); *State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696, 714 (Tex. 1996).

[40] *Griffin*, 955 S.W.2d at 84.

coverage while the liability claim is pending is prejudicial to the insured. The insured may be forced to take positions in support of coverage that undermine the defense of the liability claim. Pitting the insurer and insured against one another may create intolerable conflict at a time when their interests in defending against liability should be aligned. It may simply be distracting and difficult for the insured to fight the liability claimant on one front and his insurer on another. These problems may now be unavoidable, since the Court's refusal to allow an insurer to recover payment of a non-covered claim means that unless an insured agrees to defer coverage issues, they must be determined before the liability claim is resolved or be forever lost. It may even be necessary to delay resolution of the liability claim. The Court certainly does not suggest that an insurer should be denied a fair opportunity to litigate coverage issues.

2. *If there is to be such a right, it should be expressed in the policy.* It is well settled that the law may imply contractual terms to prevent unjust enrichment. In *Ferrous Products Co. v. Gulf States Trading Co.*, we said, quoting hornbook law:

> A quasi contractual obligation is one that is created by the law for reasons of justice, without any expression of assent and sometimes even against a clear expression of dissent.
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> * * *
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> Contracts implied in law, or more properly quasi or constructive contracts, are a class of obligations which are imposed or created by law without regard to the assent of the party bound, on the ground that they are dictated by reason and justice, and which are allowed to be enforced by an action ex contractu. . . . Such contracts rest on the equitable principle that a person shall not be allowed to enrich himself unjustly at the expense of another, and on the principle that whatsoever it is certain that a man ought to do, that the law supposes him to have promised to do.[41]

This settled law is a part of every contract and governs the transaction.[42] The argument here is that the general law of restitution should not apply. But restitution is necessary if an insurer's reservation of rights, long allowed by Texas law, is to have any viability in cases in which coverage issues

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[41] 332 S.W.2d 310, 312 (Tex. 1960) (citations omitted).

[42] *See, e.g.*, *Wessely Energy Corp. v. Jennings*, 736 S.W.2d 624, 626 (Tex. 1987) ("The laws existing at the time a contract is made becomes a part of the contract and governs the transaction. *Langever v. Miller*, 124 Tex. 80, 76 S.W.2d 1025, 1026-27 (1934).").

cannot be resolved before the liability claim. To deny restitution in such cases, given an insurer's *Stowers* duty to accept a reasonable settlement of a liability claim within policy limits, is effectively to create coverage where none exists. That is what happened in this case.

3. *An express agreement — the policy — precludes an agreement implied in law.* This both misstates the law and misapplies it to this case. It is true, as we said in *Fortune Production Co. v. Conoco, Inc.*, that

> [g]enerally speaking, when a valid, express contract covers the subject matter of the parties' dispute, there can be no recovery under a quasi-contract theory. . . . That is because parties should be bound by their express agreements. When a valid agreement already addresses the matter, recovery under an equitable theory is generally inconsistent with the express agreement.[43]

But we also specifically noted that there were certain exceptions which would allow recovery of "overpayments under a contract . . . under a theory of restitution or unjust enrichment."[44] Moreover, the Excess Underwriters' policy does not cover the subject of restitution. It required that Frank's Casing make a claim within a year after its liability became fixed[45] and then allowed the Excess Underwriters thirty days to decide whether to pay it. But this provision neither required nor entitled the Excess Underwriters to defer a decision on a claim until after Frank's Casing had settled it and thus force a *Stowers* violation. The policy merely provided an outside time frame for making and paying claims. On the subject of reimbursement in the circumstances before us the policy was entirely silent, and that silence does not preclude restitution.

4. *The risk of any uncertainty about coverage should be borne entirely by the insurer because of its control of the liability litigation and its superior knowledge and experience with coverage issues.* There is no question that most insurers are better able to assess coverage issues than most insureds, since insurers are likely to have encountered the issues many times. But as this

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[43] 52 S.W.3d 671, 684 (Tex. 2000) (citations omitted).

[44] *Id*. (citing *Southwestern Elec. Power Co. v. Burlington N. R.R. Co.*, 966 S.W.2d 467, 469 (Tex. 1998) ("[I]n some circumstances, overpayments under a valid contract may give rise to a claim for restitution or unjust enrichment.")).

[45] See *supra* note 6.

case illustrates, an insurer must be virtually certain that coverage does not exist before it can justify the risk of refusing to settle a claim within policy limits. Few cases are so clear. As the *Restatement* recognizes, restitution is an equitable accommodation of the insurer's and insured's interests in reserving and later resolving coverage issues. Also, while it may be possible for an insurer to exercise its right to control the defense and settlement of a liability claim in a way that unfairly prejudices an insured sued for restitution, the prejudice can be addressed in any case in which it occurs without denying restitution in all cases. Frank's Casing makes no claim of such prejudice in this case.

5. *Insurers will use meritless coverage issues and the threat of a suit for reimbursement to force insureds to contribute to settling claims when they should not have to.* This is not what happened in the present case. Instead, Frank's Casing repeatedly refused to contribute anything to the settlement of ARCO's claims, either settling the coverage issues at the same time or reserving resolution for later, when the umbrella policy provided no coverage at all. The law does not punish insureds for such obduracy as it would insurers, as for example with *Stowers* liability. But an insured should not be rewarded for forcing coverage when none exists. An insurer who raises bogus coverage issues to extract a settlement contribution from an insured is subject to other sanctions as for any unfair practice.[46]

6. *Defense counsel cannot advise an insured that a settlement offer is reasonable if in so doing he subjects the insured to a reimbursement obligation.* The premise is incorrect. Counsel's advice regarding the reasonableness of an offer does not trigger the insurer's claim for restitution. That claim depends entirely on the effectiveness of the reservation of rights, the resolution of coverage issues, the reasonableness in fact of the acceptance of the settlement offer, and the insurer's good faith and absence of inequitable conduct. Of course, if counsel's advice is communicated beyond persons protected by the attorney-client privilege, it may be evidence of the reasonableness of the offer when the issue arises, but if kept confidential the advice would be privileged from

[46] *See* TEX. INS. CODE § 541.060 (prohibiting certain unfair settlement practices).

disclosure. A right of restitution does not pose a conflict for defense counsel in advising the insured. In this case, there is no hint of such a conflict. We have no indication what Frank's Casing's defense counsel thought of ARCO's settlement offer, and corporate counsel did not hesitate in pronouncing the offer reasonable and twice insisting that the Excess Underwriters accept it.

7. *If an insurer's settlement of a non-covered claim can be recovered from the insured, the insurer will settle early, even if unfavorably, to minimize defense expenses and avoid* Stowers *liability.* It is difficult to imagine why an insurer would accept a settlement offer that is unreasonable and to which its insured objects, and then try to seek reimbursement from the insured. If for some reason it occurred, it would exhibit the the lack of good faith that section 35 requires.

These arguments do not support making an exception to the general law of restitution for the defense and settlement of liability insurance claims. The Court cites only one other court of last resort that has considered the issue: *Blue Ridge Insurance Co. v. Jacobsen*. There, the Supreme Court of California allowed a right of reimbursement in circumstances similar to this case.[47] I agree with the reasoning of that case, as does the *Restatement*.[48]

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I would reverse the court of appeals' judgment and remand the case to the trial court for rendition of judgment in favor of the Excess Underwriters. Accordingly, I respectfully dissent.

Nathan L. Hecht
Justice

Opinion delivered: February 1, 2008

[47] 22 P.3d 313, 318-319 (Cal. 2001).

[48] RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 35, illus. 10 & reporter's note (Tentative Draft No. 3, 2004).