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/TA4011FO1, 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 September 24, 2003

JUSTICE WAINWRIGHT, concurring.

When an insurer seeks reimbursement from its insured after paying to settle claims later determined not to be covered under the insurance policy, may contract and quasi-contract principles be considered in determining whether a right to seek reimbursement of the settlement payment arises?[1] In Texas, prior to today, the answer was "no" under almost all circumstances, even though the insurer had timely reserved its right to contest coverage.

This rule was established in *Texas Ass'n of Counties County Government Risk Management Pool v. Matagorda County*. 52 S.W.3d 128 (Tex. 2000). *Matagorda County* precluded

[1] The insurance policy in this case is silent as to the insurer's right to reimbursement.

reimbursement to an insurer of settlement payments made to resolve claims that are later found not to be covered, and allowed reimbursement to be sought by the insurer "*only if* it obtains the insured's *clear and unequivocal* consent to the settlement and the insurer's right to seek reimbursement." *Id*. at 135 (emphasis added). *Matagorda County* erected this uncommon standard for contract formation even though the standard eschewed traditional common law contract principles on the tenets necessary to establish a right to recover. The Court further concluded that quasi-contract theories of quantum meruit and unjust enrichment would not support the insurer's claim of a right to reimbursement. *Id*. at 134-36. Quasi-contracts may be established under the common law, but *Matagorda County* precluded the normal application of these common law tenets. *Id*. at 135.

A contract is established when proven by a preponderance of the evidence that an offer is accepted, accompanied by consideration. *See Fed. Sign v. Tex. S. Univ.*, 951 S.W.2d 401, 408 (Tex. 1997) ("A contract must be based upon a valid consideration, in other words, mutuality of obligation."); *Haws & Garrett Gen'l Contractors, Inc. v. Gorbett Brothers Welding Co.*, 480 S.W.2d 607, 609 (Tex. 1972) ("[T]here must be shown the element of mutual agreement which, in the case of an implied contract, is inferred from the circumstances."). Unusual to Texas' common law of contracts, *Matagorda County* made a contractual agreement in this context subject to "clear and unequivocal" proof of acceptance. *Matagorda County* provides no reasoning to support its creation of that standard.

Matagorda County left open a very small window for insurers to seek reimbursement of settlement payments for claims later determined to be outside policy coverage. Although *Matagorda County* is not expressly overruled by the Court today, the small window *Matagorda County* left open

to consider reimbursement is widened by the Court's decision in this case such that the law on reimbursement comports with principles of the common law. Hence, consideration by Texas courts of common law contract theories and quasi-contract theories (e.g., quantum meruit and unjust enrichment) is appropriate once again in determining the rights and obligations of the parties. I concur in the Court's result but join only one of the bases for its outcome, and write to further explain that basis. The parties reached an agreement on reimbursement and we should decide this case by enforcing their agreement. Therefore, I join section II.C. of the Court's opinion. Although not inconsistent with precedent, the remainder of the opinion is based on equitable and policy considerations and concludes that the parties are bound by a contract implied in law.

Once upon a time, the relationship between insurer and insured was one of contract and was governed by the terms and conditions of the policy. *See Progressive County Mut. Ins. Co. v. Sink*, 107 S.W.3d 547, 551 (Tex. 2003) (insurance policy is a contract to be interpreted according to contract principles); *Barnett v. Aetna Life Ins. Co.*, 723 S.W.2d 663, 665 (Tex. 1987) ("It is a fundamental rule of law that insurance policies are contracts and as such are controlled by rules of construction which are applicable to contracts generally."). Even after common law modifications of this common law relationship and legislative regulation of the parties' consensual relationship, *see*, *e.g.*, TEX. BUS. & COM. CODE § 17.41–.63; TEX. INS. CODE § 541.001–.454; *Arnold v. Nat'l County Mut. Fire Ins. Co.*, 725 S.W.2d 165, 167 (Tex. 1987) (holding that insurers owe a duty of good faith and fair dealing toward insureds); *G.A. Stowers Furniture Co. v. Am. Indemn. Co.*, 15 S.W.2d 544, 547 (Tex. Comm'n App. 1929, holding approved) (creating a duty to accept reasonable settlement demands within policy limits), it still is fundamentally based on the agreement of the

parties. *See Provident Life & Accident Ins. Co. v. Knott*, 128 S.W.3d 211, 216 (Tex. 2003) (as a type of contract, insurance policies are interpreted under rules of contract construction); *Barnett*, 723 S.W.2d at 665. In an insurance arrangement like the one at issue, the insured and insurer enter an agreement for the insurer to cover prescribed risks. Generally, the insured pays premiums to protect it against certain unrealized fortuitous costs or damages, up to an agreed limit, that it may suffer or be obligated to pay. *See* 1 HOLMES & RHODES, HOLMES'S APPLEMAN ON INSURANCE, 2D (1996).

In this case, Frank's Casing agreed to pay premiums for the provision by Excess Underwriters of excess insurance coverage in the amount of $10 million. ARCO/Vastar sued Frank's Casing and others after an offshore drilling platform partially fabricated by Frank's Casing for ARCO/Vastar collapsed in the Gulf of Mexico. Excess Underwriters issued a reservation of rights letter contesting coverage under its excess insurance policy with Frank's Casing. When settlement discussions were unfruitful, the case was tried to a jury. During the heat of trial, with a large verdict appearing increasingly likely, Frank's Casing entered another round of settlement discussions directly with the plaintiff ARCO and procured a settlement demand of $7.5 million. Frank's Casing then "*Stowerized*" Excess Underwriters asserting that the settlement offered was reasonable and within policy limits and demanding that Excess Underwriters settle the case. Excess Underwriters agreed to pay $7 million (plus $500,000 from the primary insurer) to settle the case, conditioned on its intent to seek reimbursement if it were not required to extend coverage to Frank's Casing for claims at issue at trial and which it was about to resolve by settlement.

At the time the parties were considering the settlement, both believed they were in difficult positions. The record indicates that both parties believed a substantial verdict, possibly beyond the

excess layer of insurance coverage, was likely. Both also knew that their original contract of insurance did not address the issue of the insurer's ability to obtain reimbursement of a settlement payment for uninsured claims. Under these circumstances, the following decision trees grew.

During the trial, Excess Underwriters had to decide whether to pay for settlement of claims which it asserted were not covered. It also knew that after being *Stowerized*, if it did not pay the settlement and did not prevail in a declaratory judgment action contesting coverage, it likely would face claims for bad faith insurance practices. These claims in Texas have on many occasions resulted in large verdicts against insurers which, with common law and statutory penalties, have far exceeded actual damages proven. On the other hand, if it paid to settle on behalf of its insured, Excess Underwriters' payment would be less than its policy limits, it would avoid a verdict that could exhaust its excess limits and it would halt the accrual of attorneys' fees. Effecting a settlement would also avoid a bad faith insurance lawsuit and the potential for a punitive damage award against it. Excess Underwriters would benefit from the proposed settlement.

Frank's Casing likewise believed that it was faced with the specter of a large jury verdict against it. It solicited a settlement offer within policy limits from ARCO. Armed with a potential way out, Frank's Casing demanded that Excess Underwriters pay the settlement. The settlement would end the trial and vanquish the risk of a large verdict and Frank's Casing's potential exposure for amounts above the excess limits or for the entire verdict if there were no coverage. Plus, by sending a *Stowers* letter, Frank's Casing upped the ante against Excess Underwriters for if it did not pay the settlement, and a large verdict were rendered for which coverage was found to exist, Excess

Underwriters may have been liable for enhanced damages and substantial statutory penalties. In other words, the settlement would also benefit Frank's Casing.

Excess Underwriters decided to pay its portion of the settlement but conditioned its payment on its right to seek reimbursement if the claim were proven not to be a risk the parties had agreed to cover under their insurance policy. The insurer sent a letter on February 23, 1998, making this offer to Frank's Casing. The letter further stated that the insurer "will contact Arco/Vasta's attorney this morning" to settle the claims against Frank's in this case. Frank's Casing concurred that the settlement was reasonable and not only approved but demanded that Excess Underwriters consummate the $7.5 million settlement. Excess Underwriters sent a second letter on February 23 to confirm the settlement with ARCO and then filed a declaratory judgment action contesting coverage that same day. The next day at the hearing before the trial court, which had recessed trial to give the parties the opportunity to resolve the dispute, the parties dictated their settlement into the record. At the hearing after the parties had entered the settlement the prior day, Frank's Casing objected for the first time that Excess Underwriters did not preserve its ability to contest "coverage."

Hence, we come to the dispute before this Court. Did Frank's Casing obtain a windfall—i.e., payment by its insurer of millions of dollars to settle claims against it for which there was no coverage? Or did Excess Underwriters voluntarily pay a settlement to obtain the benefits of saving itself potentially millions of dollars from the expected verdict and millions more from a possible bad faith verdict in a subsequent lawsuit? Two sophisticated entities carefully exercised their rights and obligations in light of their potential exposure. Both made reasoned decisions they believed to be in their best interests under the circumstances. And but for the condition on reimbursement included

in Excess Underwriters' offer accepted by Frank's Casing, I would conclude that there is no right to reimbursement. Absent the parties entering into a legally enforceable agreement, I do not believe that the equities of the parties' respective circumstances alone supports allowing a right to recoup the settlement payment.

I agree with the Court that by *Stowerizing* Excess Underwriters, Frank's Casing acknowledged the reasonableness of the settlement. *See* ___ S.W.3d at ___. But I disagree with the Court that the effect of that action supports allowing the insurer to seek reimbursement. If Frank's Casing's only conduct upon obtaining the $7.5 million settlement offer from ARCO was to make a *Stowers* demand on Excess Underwriters and acquiesce to a settlement that did not include the term on reimbursement, Excess Underwriters should have no right to reimbursement. Threatening to sue does not change the contract between the parties. And such a threat should not serve as a sufficient basis to entitle Excess Underwriters to obtain reimbursement of its payment. Under these circumstances, it is difficult to conceive that Excess Underwriters was under any legally cognizable duress that undermined its will and forced it to pay the settlement. Neither the threat to exercise a legal right nor legally exercising that right can constitute duress. *In re FirstMerit Bank, N.A.*, 525 S.W.3d 749, 758 (Tex. 2001); *Ulmer v. Ulmer*, 162 S.W.2d 944, 947 (Tex. 1947). There were no allegations of fraud, collusion, or extortion to tilt the scale here.

However, I conclude that Frank's Casing, by its acquiescence in the settlement, bound itself under principles of contract law to the condition that Excess Underwriters would be able to seek reimbursement. Frank's Casing was not simply a beneficiary of its insurer's settlement, but demanded in a prior letter of February 19, 1998, that Excess Underwriters act in a "reasonably

prudent" manner and accept the settlement offer from ARCO and do so "BEFORE a ruling by the court on the contract issues . . . [which] could occur at any time, but will occur, at the latest, by the beginning of court Tuesday of next week." Including the weekend, the following Tuesday (February 24) was five days away. Excess Underwriters agreed to pay the settlement but as a condition to doing so reserved the right to seek repayment from Frank's Casing if the declaratory judgment action determined there was no insurance coverage for the claims at issue in the prior trial. The February 23 letter to Frank's Casing in which Excess Underwriters agreed to settle the case on its behalf provided:

> In order to ensure that the favorable settlement will not be lost to both Frank's and [Excess Underwriters], [Excess Underwriters] will fund the settlement up to $7,500,000 (less any contribution from the primary policy) and will continue to reserve all coverage issues under the Umbrella Policy. [Excess Underwriters] *will hold Frank's responsible for and will seek reimbursement of all sums paid in settlement of claims for which no coverage exists under the Umbrella Policy*."

(emphasis added). Excess Underwriters then settled the case against its insured the same day and faxed written confirmation to ARCO with a copy to Frank's Casing. Frank's Casing never asserts that it rejected the settlement offer or made a counteroffer. Instead, Frank's Casing acknowledged that it accepted the settlement offer from Excess Underwriters but argues that Excess Underwriters did not obtain "Frank's agreement nor its clear and unequivocal consent to seek reimbursement."[2]

The February 23 letter to ARCO confirming the verbal settlement also stated that Excess Underwriters continued to reserve all rights "against Frank's as to coverage" and, for a second time

[2] Frank's Casing's also complains that it had only a few hours to study the proposed settlement from Excess Underwriters. This complaint carries little weight as it was Frank's Casing that imposed the February 23 deadline on the settlement negotiations in its February 19 letter.

that day, affirmed that it would "hold Frank's responsible for and will seek reimbursement of all sums paid in settlement of claims for which no coverage exists under the Umbrella policy." Frank's Casing again did not reject but accepted the settlement. After entering the settlement, Excess Underwriters filed its declaratory judgment action contesting coverage that afternoon.

The next morning the trial court recessed the trial to enable the parties to dictate their settlement into the record. Frank's Casing stated that by the February 23 letter from Excess Underwriters to ARCO it had agreed to pay $7,500,000 to settle the case with the plaintiffs. Frank's Casing then asserted that "underwriters have either waived their right to reserve cover [sic] issues or alternatively [are estopped] from asserting any coverage issues since underwriters have agreed to the settlement." The court rendered judgment on the agreement dictated into the record. The Settlement Agreement and Release, signed later by the parties, including Frank's Casing and Excess Underwriters, confirmed that the covenants not to sue and the releases between the parties do not apply "to 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."

Frank's Casing has never disputed that Excess Underwriters' settlement offer was conditioned on a right to seek reimbursement. Frank's Casing argues that by its silence it accepted the part of the settlement offer providing for Excess Underwriters to make a $7 million settlement payment but did not accept the condition on that promise. The law and the facts do not support Frank's Casing's position.

A contracting party cannot accept the benefits of a contract and disclaim its obligations. *W.H. Putegnat Co. v. Fidelity & Deposit Co. of Md.*, 29 S.W.2d 1004, 1006 (Tex. 1930) ("Where

one accepts the benefits of a contract, he must assume its burdens."). Nor can a party accepting an offer validly purport to accept the offer's benefits, acquiesce in the benefits from the offeror's performance of the contract, but later reject the detriments. *United Concrete Pipe Corp. v. Spin-Line Co.*, 430 S.W.2d 360, 364 (Tex. 1968) (noting that a party may have the right to withdraw his consent before a contract's performance but not after the promise is accepted or performed); *see Daniel v. Goesl*, 341 S.W.2d 892, 895 (Tex. 1960) (one who "receives and accepts benefits under the contract . . . is bound by the terms of the contract"); Jerry, *The Insurer's Right to Reimbursement of Defense Costs*, 42 ARIZ. L. REV. 13, 71–72 (2000) ("[A]cquiescence in and acceptance of the benefits of [the party's] performance constitute a manifestation of acceptance of the terms on which [the party's] performance was tendered."). To effectively decline an offer, some terms of which an offeree disapproves, the offeree must reject the offer or make a counteroffer. *See Ashford Dev., Inc. v. USLife Real Estate Servs. Corp.*, 661 S.W.2d 933, 935 (Tex. 1983) (determining that supplemental provision of loan commitment was a counter-offer); *Komet v. Graves*, 40 S.W.3d 596, 601 (Tex. App.—San Antonio 2001, no pet.) (attempt to change offer before acceptance operates as a rejection and counter-offer). Neither occurred here before the settlement was consummated.

Frank's Casing accepted the settlement proposed by Excess Underwriters and thereby acquiesced in the terms of the offer, and bound itself to the settlement under the law of contracts. In practice in an insurance context, insureds often communicate acceptance of an offer by conduct, as in the case of an insured accepting a defense from an insurer which reserves its right to deny coverage. In such cases, the insured's acceptance of the defense is an implied consent to the insurer's reservation of the coverage issues, "even in the absence of an express consent or acceptance

of the offer." *W. Cas. & Sur. Co. v. Newell Mfg. Co.*, 566 S.W.2d 74, 76 (Tex. Civ. App.—San Antonio 1978, writ ref'd n.r.e.); *see In re Halliburton Co.*, 80 S.W.3d 566, 568 (Tex. 2002) ("[W]hen an employer notifies an employee of changes to the at-will employment contract and the employee 'continues working with knowledge of the changes, he has accepted the changes as a matter of law.'") (citing *Hathaway v. General Mills, Inc.*, 711 S.W.2d 227, 229 (Tex. 1986)); *Blue Ridge Ins. Co. v. Jacobsen*, 22 P.3d 313, 317 (Cal. 2001).

Hence, during the trial the parties extended their contractual arrangement to address the risk of a large verdict by settlement and also agreed on a method to allocate the cost. The settlement vanquished the risk of a jury verdict against them. The allocation of the cost of settlement would be based on the outcome of the coverage suit. If the claims settled were found to be covered by the excess policy, Excess Underwriters' payment of the settlement would end the matter. The contractual relationship would function as intended as Excess Underwriters was paid premiums to protect Frank's Casing from covered risks within policy limits. If the claims settled were found not to be covered under the insurance policy, Excess Underwriters would have its contractual right to seek reimbursement of the settlement payment. The relationship of the parties is still one governed by contract.

In her concurring opinion, JUSTICE O'NEILL contends that no such agreement was in fact reached, and under this contractual implied-in-fact analysis Frank's Casing may keep the benefit of the offer to pay $7,500,000 to settle the case but reject the reimbursement condition on the offer. As cited, *infra*, contract law does not allow her approach of "having my cake and eating it, too." A deal is a deal, and in Texas we enforce deals. If, as JUSTICE O'NEILL asserts, Frank's Casing really

wanted to reject the offer's condition on reimbursement, it could have done so by refusing the $7,500,000 payment on its behalf and proceeding with trial, or making a counteroffer that excluded the reimbursement condition, or objecting to the reimbursement term before the settlement was entered with ARCO. (Frank's Casing likely did not want to do the latter because objecting to the condition would also have rejected the entire offer of settlement.) She further asserts that "Frank's Casing's reimbursement contest implied the insurers' consent to Frank's Casing's reservation of the reimbursement question." Again, neither the law nor the facts support her assertion. Only *after* the settlement with ARCO was entered verbally and confirmed in writing by Excess Underwriters did Frank's Casing assert that Excess Underwriters waived or was estopped from raising any coverage issues. Assuming the objection to raising coverage issues is an objection to the reimbursement condition, a party cannot make a deal and then later selectively reject parts of it. *See W.H. Putegnat Co.*, 29 S.W.2d at 1006.[3]

Frank's Casing argues that such a result is unfair. I do not agree. A trial court decided that the claims against Frank's Casing which Excess Underwriters agreed to pay to settle were not covered claims under Frank's Casing's insurance policy. Frank's Casing did not appeal that determination, and it is therefore settled. Frank's Casing is not entitled to insurance coverage for risks for which it paid no premiums. And Excess Underwriters is not obligated to pay for risks it did

[3] Even accepting, *arguendo*, JUSTICE O'NEILL's position that Frank's Casing can reject a term of an accepted agreement, the facts still undercut her conclusion. Frank's Casing never asserted that it objected to the reimbursement term in Excess Underwriter's settlement offer. Even at the trial court hearing to enter the settlement on the record, Frank's Casing asserted only that Excess Underwriters waived or was estopped from contesting the insurance coverage issues. Its briefing is careful to only make the factual claim that it objected to a contest to coverage. Thus, contrary to JUSTICE O'NEILL's suggestion, Frank's Casing did not object to or reserve for court determination the reimbursement issue in the settlement. This issue is not a central part of my writing because it was not raised by the parties.

not agree to cover and for which it received no consideration. Should the parties have desired to cover such risks, they could have consented to such an arrangement by defining the scope of the coverage to include the claims at issue, and agreed on premiums to be paid for such insurance. But they did not.

The parties should sink or swim on the agreements they enter, unless the facts are such that they effect a change in the parties' agreement under principles of contract law, are validly affected by the Legislature, or involve fraud, extortion or other basis for altering a contract. Accordingly, the factors the Court cites as the basis for concluding that the right to reimbursement exists are not central to the reimbursement analysis. I disagree with the Court's reasoning that the weight and potential severity of a *Stowers* or bad faith insurance verdict can serve as a basis to alter the agreement of the parties. Insurance is a consensual arrangement not subject to change by the threat of a lawsuit. If *Stowers* or bad faith actions are skewing litigation and parties' legitimate incentives, then *Stowers* actions may need to be addressed by the appropriate branch rather than allow threat of such actions to serve as a basis for reimbursement.

In summary, I would hold that absent a provision in the insurance policy providing for the insured to reimburse the insurer for paying to settle a claim that is later held not to be covered, there is no right to reimbursement of the settlement payment. However, an insurer should be allowed the opportunity to prove a right to recoupment of a reasonable settlement under contract law, including under the theories of implied-in-fact contracts and quasi-contracts, if the insurer gives notice of its intention to recoup the payment in a timely reservation of rights letter or makes reimbursement a term or condition of a subsequent agreement.

This approach is straightforward and predictable. The current jurisprudence on this issue involves a convoluted set of tangled yet important interests and policy considerations that, with slight changes in the facts, can lead to widely varying results in cases that seem quite similar. *Compare Frank's Casing*, 93 S.W.3d 178 *with Matagorda County*, 52 S.W.2d 128. Under this Court's opinions, the adjudication of each case is based on the equities of the parties which will lead to a series of case-by-case adjudications or, at best, adjudications by category. Each case will involve the same plethora of questions with a different set of answers. Was a *Stowers* demand made? Did the insurer have the unilateral right to settle and was consent of the insured obtained to the settlement? Who controlled the defense? Who initiated and controlled the settlement discussions? Did the insurer give the insured the option to assume its own defense? Then the courts' balancing will begin. Instead, I believe the parties' contractual relationship should govern an insurer's right to reimbursement. These other factors may be central to other issues that arise between insurers and insureds, but should not be central to a right of reimbursement.

This case raises a tangled mound of considerations. The Court deftly traverses the multitude of policies, incentives, and equities to reach a decision. *See*, *e.g.*, *Am. Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842 (Tex. 1994); *Arnold*, 725 S.W.2d 165; *Stowers*, 15 S.W.2d 544; *see also Blue Ridge Ins.*, 22 P.3d 313. Frank's Casing acknowledges that decisions in reimbursement cases are "based on a balancing of policy considerations applicable to the relationship between an insurer

and its insured." If our analysis of this reimbursement issue were based on the agreements between the parties, the law in this area would be less perplexing and more predictable.

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J. Dale Wainwright
Justice

OPINION DELIVERED: May 27, 2005