# 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 WAINWRIGHT, dissenting.

In the heat of trial, an insured and its excess insurer reached an agreement to address a situation not covered by the insurance policy. The insured accepted a $7.5 million payment from the insurers (including $500,000 from the primary insurance carrier) to settle the case against it, but later objected to enforcement of an express condition in the agreement to settle the case on its behalf. A deal is a deal, whether the insurer or the insured likes it after the fact. Because the Court's holding contradicts this principle, I respectfully dissent.

At trial it quickly became clear that defendant Frank's Casing was the focus of plaintiff ARCO's attention. Frank's Casing and its insurers feared a large verdict that might eclipse the limits

of its excess coverage. On two prior occasions Frank's Casing refused offers by the excess underwriters to fund a settlement of the claims brought against it by ARCO, subject to the condition that the excess underwriters could seek a reimbursement if the settled claims were not covered. The third offer to settle the dispute with ARCO for $7.5 million in insurance funds was also expressly conditioned on the right of the excess underwriters to seek reimbursement of the settlement payment if a later declaratory judgment action determined that ARCO's claims were not covered by the excess policy. Frank's Casing did not respond verbally or in writing to the third offer, but Frank's Casing accepted the $7.5 million check and announced on the record in the trial court that it accepted the insurance payment to fund the settlement of the dispute and that the settlement with plaintiffs was consummated "by letter dated February 23, 1998." The February 23rd letter contained the reimbursement term. The trial court rendered judgment on the settlement. In the subsequent declaratory action brought by the excess underwriters, Frank's Casing lost its argument that ARCO's claims were covered by the excess policy on summary judgment and did not appeal the final judgment. Having secured millions of dollars from the excess underwriters by virtue of their offer to settle the dispute, Frank's Casing now claims that it is not bound by the express condition in the offer to reimburse the payment by the excess underwriters. By its actions and its statements in the trial court confirming the settlement, Frank's Casing accepted the February 23rd offer. And Frank's Casing lost on the issue the parties reserved to finally determine whether a right of reimbursement arose—the trial court determined there was no insurance coverage for ARCO's claims.

Frank's Casing admits that the excess underwriters paid $7 million to settle the claims on its behalf. Frank's Casing does not dispute that the third settlement offer conditioned the right to

reimbursement on whether coverage was found to exist and did not reject the offer or object to the reimbursement condition. Frank's Casing lost on the coverage issue. Notwithstanding these facts, the Court surprisingly bifurcates the settlement offer to allow Frank's Casing to accept the benefits of a contract and reject its obligations. The Court holds that Frank's Casing consented to the settlement payment but not to the express condition. Frank's Casing, the Court holds, can keep the $7.5 million benefit from the agreement but is not bound by the obligation to reimburse the excess underwriters when it lost its claim that there was coverage of the settled claims. The Court essentially decides that the insurer is bound by the deal but that the insured can rewrite the deal if it does not like the result.

The Court relies on *Texas Association of Counties County Government Risk Management Pool v. Matagorda County*. 52 S.W.3d 128 (Tex. 2000). In *Matagorda County*, the Court restricted an insurer's right to reimbursement of settlement payments later found not to be covered by an insurance policy to circumstances where the insurer "obtains the insured's clear and unequivocal consent to the settlement and the insurer's right to seek reimbursement." *Id.* at 135. *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.

**I.**

Once upon a time, the relationship between insurer and insured was fully 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 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), the relationship between insurer and insured is still fundamentally based on the agreement of the parties. *See Provident Life & Accident Ins. Co. v. Knott*, 128 S.W.3d 211, 216 (Tex. 2003) (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* ERIC MILLS HOLMES, ET AL., HOLMES' APPLEMAN ON INSURANCE, § 1.4, at 22–23 (2d ed. 1996). A contract of insurance obligates the insurer to cover only the risks prescribed in the policy. *Id.* at 29.

The standard of proof for an agreement is straightforward. 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. Contractors, Inc. v. Gorbett Bros. 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's common law of contracts, *Matagorda County* made the existence of a contractual agreement in this context subject to "clear and unequivocal" proof of acceptance.[1] *Matagorda County*, 52 S.W.3d at 135. *Matagorda County* provides no reasoning to support its creation of that particular standard, but that remains the law in Texas. Because the parties reached an agreement on reimbursement, we should decide this case by simply enforcing their agreement.

**II.**

Frank's Casing agreed to pay premiums for the provision of excess insurance coverage by the excess underwriters in the amount of $10 million. ARCO sued Frank's Casing and others after an offshore drilling platform partially fabricated by Frank's Casing for ARCO collapsed in the Gulf of Mexico. The 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 ARCO and procured a settlement demand of $7.5 million, which Frank's Casing presented to the excess underwriters. The excess underwriters agreed to pay $7 million (plus $500,000 from the primary insurer) to settle

[1] The Court has not defined the *Matagorda County* "clear and unequivocal" standard for entering an agreement for reimbursement. It seems to require more than a simple preponderance of the evidence; beyond that, we do not know what this standard requires. Even evidence supporting a clear and convincing standard may be equivocal, but *Matagorda County* requires more than that.

the case, conditioned on their right to seek reimbursement if they were ultimately not required to extend coverage for the claims at issue.

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, the excess underwriters had to decide whether to fund a settlement for an amount less than their policy limits, which included claims potentially not covered by their policy, to avoid the risk of a larger judgment. By agreeing to pay a settlement amount that was less than the excess underwriters' policy limits, the excess underwriters would avoid a verdict that could exhaust their policy limits and potential extra-contractual claims. Thus, the 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. By settling within the excess underwriters' policy limits, Frank's Casing avoided a verdict beyond policy limits, a portion of which Frank's Casing would be personally liable to pay. 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. In other words, the settlement would also benefit Frank's Casing.

The excess underwriters decided to pay their portion of the settlement but conditioned their payment on their right to seek reimbursement if the claims were proven not to be a risk the parties

had agreed to cover under the excess policy. The excess underwriters sent a letter on February 23, 1998, making this offer to Frank's Casing. The letter further stated that the excess underwriters "w[ould] contact Arco/Vastar's attorney th[at] morning" to settle the claims against Frank's Casing. Frank's Casing concurred that the settlement was reasonable and not only approved but demanded that the excess underwriters consummate the $7.5 million settlement. The excess underwriters sent a second letter on February 23rd to confirm the settlement with ARCO, copied Frank's Casing on the letter, 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, Frank's Casing did not object to any portion of the settlement, but asserted that by agreeing to the settlement the excess underwriters waived their right to contest "coverage," making no mention of reimbursement.

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 the excess underwriters voluntarily pay a settlement to obtain the benefits of saving potentially millions of dollars from the expected verdict? 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. But for the reimbursement condition included in the 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 support allowing a right to recoup the settlement payment.

If Frank's Casing's only conduct toward the excess underwriters upon obtaining the $7.5 million settlement offer from ARCO was to acquiesce to a settlement that did not include the reimbursement condition, the excess underwriters would have no right to reimbursement. However, I conclude that Frank's Casing, by its acceptance of the $7.5 million payment and acquiescence in the settlement, bound itself under principles of contract law to the condition that the 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 dated February 19, 1998, that the excess underwriters act in a "reasonably prudent" manner, 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 beginning of court Tuesday of next week." Including the weekend, the following Tuesday, February 24, 1998, was five days away. The excess underwriters agreed to pay the settlement conditionally. The second February 23rd letter, *which Frank's Casing told the trial court was the basis of settlement*, provided:

> [The excess underwriters] continue to reserve all rights against Frank's [Casing] as to coverage under the Umbrella Policy, and *will hold Frank's [Casing] 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). The excess underwriters then settled the case against Frank's Casing 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

acknowledges that it accepted the settlement offer from the excess underwriters but argues that the excess underwriters did not obtain "Frank's [Casing's] agreement nor its clear and unequivocal consent to seek reimbursement."[2]

The second letter sent on February 23rd to the plaintiffs confirmed the verbal settlement but stated that the excess underwriters would continue to reserve all rights "against Frank's [Casing] as to coverage" and, for a second time that day, affirmed that they would "hold Frank's [Casing] 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, the excess underwriters filed a 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 letter dated February 23, 1998" (which conditioned settlement on reimbursement) from the excess underwriters to the plaintiffs, it had agreed to pay $7.5 million to settle the case with the plaintiffs. Frank's Casing then asserted that the excess "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." Counsel for the excess underwriters reconfirmed on the trial court record:

> This settlement is being funded by Frank's [Casing's] umbrella underwriters subject to a full reservation of all rights against Frank's [Casing] under the umbrella

[2] Frank's Casing also complains that it had only a few hours to study the proposed settlement from the excess underwriters. This complaint rings hollow as it was Frank's Casing's February 19th letter that imposed the February 23rd deadline on the excess underwriters to settle the case, and Frank's Casing threatened to pursue extra-contractual claims if the deadline was not met.

> policy. . . . And these [excess] underwriters will hold Frank's [Casing] responsible for and will seek reimbursements of all sums paid [for] the settlement of claims for which no coverage exists under the umbrella policy.

The trial court rendered judgment on the agreement dictated into the record. The Settlement Agreement and Release, signed later by Frank's Casing and the excess underwriters, confirmed that the excess underwriters' right to seek reimbursement was not released. The covenants not to sue and the releases between the parties did not apply "to any claims that exist presently . . . between Defendant Frank's [Casing] and Frank's [Casing's] Insurers arising from the claims asserted by Plaintiffs."

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

**III.**

A contracting party cannot accept the benefits of a contract and disclaim its obligations. *W. H. Putegnat Co. v. Fid. & 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."); *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); Robert H. Jerry, II, *The Insurer's Right to Reimbursement of Defense Costs*, 42 ARIZ. L. REV. 13, 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, 934–35 (Tex. 1983) (determining that an additional term in a loan commitment was a counteroffer); *Komet v. Graves*, 40 S.W.3d 596, 601 (Tex. App.—San Antonio 2001, no pet.) (holding an attempt to change an offer before acceptance operates as a rejection and counteroffer). Neither occurred here before the settlement was consummated.

Frank's Casing accepted the settlement proposed by the excess underwriters, thereby acquiescing in the terms of the offer, and bound itself to the settlement under the law of contracts. *See Blue Ridge Ins. Co. v. Jacobsen*, 22 P.3d 313, 317 (Cal. 2001) (holding an insurer may seek reimbursement for settlement of uncovered claims where the insured is aware of the reservation but acquiesces). 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 that 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 also 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.'") (quoting *Hathaway v. Gen. Mills, Inc.*, 711 S.W.2d 227, 229 (Tex. 1986)).

Although the excess policy does not address reimbursement, 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 settled claims were found to be covered by the excess policy, the excess underwriters' payment of the settlement would end the matter. The contractual relationship would function as intended as the excess underwriters were paid premiums to protect Frank's Casing from covered risks within policy limits. If the settled claims were found not to be covered under the excess policy, the excess underwriters would have a contractual right to seek reimbursement of the settlement payment. The Court agrees that the parties reserved the coverage question but steadfastly ignores both the fact that Frank's Casing lost on the issue reserved (on which the parties hinged the excess underwriters' right to seek reimbursement) and the implications of that determination. By the terms of the parties' arrangement during trial, there arose a right to reimbursement.

The Court concludes that no such agreement was reached or can be implied in fact but nevertheless decides that Frank's Casing may keep the benefit of the offer to pay $7.5 million to settle the case but reject the reimbursement condition on the offer. As cited, *infra*, contract law does not allow the Court's approach of "having my cake and eating it, too." A deal is a deal, and in Texas we enforce deals. If Frank's Casing wanted to reject the condition on reimbursement, it should have rejected the $7.5 million payment on its behalf and proceeded with trial, made a counteroffer that excluded the condition on reimbursement, or objected to the condition on reimbursement before the settlement was entered. The Court posits that "the excess underwriters' agreement to accept the

settlement in light of Frank's Casing's reimbursement contest implied the insurers' consent to Frank's Casing's reservation of the reimbursement question." __ S.W.3d __, __. The Court misstates some facts and ignores others. First, the excess underwriters did not accept the offer, Frank's Casing did; the excess underwriters made the offer. Second, as explained, it is true the parties hinged reimbursement on the answer to the coverage question. However, again, ignoring the facts, the Court refuses to acknowledge that Frank's Casing lost its claim of coverage, which gave rise to the excess underwriters' contractual right to reimbursement.

The Court asserts "it makes no more sense to say that Frank's Casing impliedly agreed to reimburse the carriers than it would to say that the carriers impliedly agreed to waive their coverage position." *Id.* at __. The Court's logic falters as it again ignores material facts. The excess underwriters' reservation of the right to reimbursement is an express condition in the second February 23rd letter (pursuant to which the parties consummated the settlement) and acknowledged in the language of the subsequent settlement releases. It defies logic in this context to argue that the carriers impliedly waived positions they explicitly reserved in writing when the settlement was consummated, explicitly reserved during the hearing in the trial court, and then provided for in the settlement documents. The facts of Frank's Casing's agreement to the settlement are, however, very different. Frank's affirmed on the trial court record that it settled under the terms of the second February 23rd letter, affirmatively accepted the $7.5 million check, and raised no objection when counsel for the excess underwriters stated, in the same trial court hearing on the record, that under the terms of the settlement they retained the right to seek reimbursement if the settled claims were later held not to be covered.

Frank's Casing also argues that recognizing the excess underwriters' contractual right to reimbursement is unfair. I do not agree. A trial court decided that the claims against Frank's Casing, which the excess underwriters agreed to pay to settle, were not covered claims under the excess 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 the excess underwriters are not obligated to pay for risks they did not agree to cover and for which they 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 coverage to include the claims at issue and agreeing on premiums to be paid for such coverage. But they did not.

And neither would I create an equitable right to reimbursement in this case. *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. 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 traditional principles of contract law, are changed by the Legislature, or involve fraud, extortion, mutual mistake of fact, or another basis for altering a contract. Deciding this case based on a balancing of equitable rights to reimbursement would significantly widen this window but would invite insurers and insureds to unnecessarily introduce the uncertainty and unpredictability of restitutionary theories into these situations when the relationship is one based on contract.

**IV.**

In conclusion, I would hold that absent an agreement that the insured 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. Such an agreement may be included in the insurance policy or by subsequent explicit consent or by conduct.

The parties' contractual relationship should govern an insurer's right to reimbursement. If our analysis of this reimbursement issue were based on the common law of contract, determined by the agreements between the parties, rather than undefined standards that are foreign to contract law, the law in this area would be less perplexing and more certain. Insureds and insurers alike benefit from predictability and certainty in the law.

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J. Dale Wainwright
Justice

**OPINION DELIVERED: February 1, 2008**