

# IN THE SUPREME COURT OF TEXAS

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No. 98-0034  
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KECK, MAHIN & CATE, GRANT COOK,  
AND ROBERT A. PLESSALA, PETITIONERS

v.

NATIONAL UNION FIRE INSURANCE COMPANY  
OF PITTSBURGH, PA, RESPONDENT

v.

INSURANCE COMPANY OF NORTH AMERICA, RESPONDENT

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ON PETITION FOR REVIEW FROM THE  
COURT OF APPEALS FOR THE FOURTEENTH DISTRICT OF TEXAS  
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**Argued January 5, 2000**

JUSTICE HECHT, concurring in part and concurring in the judgment.

I agree with the Court's statement of the case and its resolution of the issues relating to the release; hence, I join in Parts I and II of the Court's opinion. I also conclude on the record before us that Insurance Company of North America, the primary insurer against a third-party liability claim, and Keck, Mahin & Cate, the attorneys hired to defend the claim, have not shown that they should be entitled, in defense of this equitable subrogation action brought by the excess carrier, National Union Fire Insurance Company of Pittsburgh, PA, to offer evidence of National's conduct

that occurred before INA tendered its policy limits to settle the liability claim against its insured. But I do not agree with the broad basis on which the Court finds this conclusion in Part III of its opinion.

INA provided \$1 million in primary liability coverage, and National provided \$9 million in excess coverage. As the Court states, “[t]he excess policy did not require National to investigate or defend claims against [the insured] as long as another underlying insurance carrier was providing a defense.”<sup>1</sup> But as the Court also notes, “National did have the right [under its policy] to associate in the defense and trial of any claim it deemed a threat to its liability”.<sup>2</sup>

National alleges in this equitable subrogation action that it had to pay an excessive amount to settle a liability claim because of INA’s and KMC’s mishandling of the defense of the claim. INA and KMC argue that National’s own conduct contributed to the payment of an excessive settlement. The Court holds that National’s conduct prior to INA’s tender of policy limits to the third-party liability claimant is irrelevant unless National interfered with or took control of the defense. The Court bases this holding on a general rule that an excess insurer has no duty to defend or settle a liability claim before the primary insurer has tendered the limits of its policy.

The Court purports to follow the “majority rule” that an “excess liability insurer is not obligated to participate in the defense [of a third-party claim] until the primary policy limits are

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<sup>1</sup> *Ante* at \_\_\_\_.

<sup>2</sup> *Ante* at \_\_\_\_.

exhausted.”<sup>3</sup> The authority cited for this proposition is the 1982 *Couch on Insurance* treatise, which adds, two sentences later: “But certain courts have held that the excess carrier must participate in the defense and share in the cost of defense when it is clear that the potential judgment against the insured may be substantially greater than the amount of the primary policy limits.”<sup>4</sup> It is not at all clear from the 1999 supplement to the treatise whether the rule stated in 1982 still holds true.<sup>5</sup> Later treatises, including the third edition of *Couch on Insurance*, which the Court cites as additional source material, reflect some erosion from the so-called “general rule”. One of these treatises explains:

Where the insured maintains both primary and excess policies, the general rule is that an excess liability insurer is not obligated to participate in the defense until the primary policy limits are exhausted.

Accordingly, it has been held that an excess insurer has no duty to defend where there was no evidence that the underlying policy limits would be exceeded, where an exclusion in primary insurer’s policy relieved the primary insurer of the duty to indemnify the insured, or where there was no allegation that the primary insurer might become insolvent.

An excess insurer may have a duty to defend an insured where the claim against the insured is in excess of the limits of the underlying coverage. Some courts have held that an excess carrier must participate in the defense and share in the cost of defense when it is clear that the potential judgment against the insured may be substantially greater than the amount of the primary policy limits.<sup>6</sup>

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<sup>3</sup> *Ante* at \_\_\_ (quoting *Texas Employers Ins. Ass’n v. Underwriting Members of Lloyds*, 836 F. Supp. 398, 404 (S.D. Tex. 1993) (quoting 14 GEORGE J. COUCH, COUCH ON INSURANCE 2D § 51.36 (1982))).

<sup>4</sup> 14 COUCH ON INSURANCE 2D § 51.36, at 446 (1982).

<sup>5</sup> *See* COUCH ON INSURANCE 2D § 51.36 (Supp. 1999) (citing numerous cases).

<sup>6</sup> LEE R. RUSS & THOMAS F. SEGALLA, COUCH ON INSURANCE 3D §§ 200.44-.45 (1999) (footnotes omitted).

The other treatise refers to the Court’s rule as “the traditional view” but cites numerous cases for the proposition that “in appropriate circumstances, excess carriers may owe a duty to participate in the insured’s defense.”<sup>7</sup>

The Court offers one policy justification for the “general rule” — that excess insurance is less expensive because excess insurers’ “duty to defend is not typically invoked”.<sup>8</sup> In this case, however, National’s refusal to involve itself in the defense of the claim resulted in its ultimately paying \$7 million to settle a claim that plaintiffs had been willing earlier to settle for \$3.6 million. This is some indication, at least, that an excess insurer’s complete abstention from the litigation until the primary limits are tendered makes excess insurance more expensive, not less expensive. INA and KMC never believed that the claim could be settled within primary policy limits, and thus INA had little to gain by tendering its limits. Had National intervened to attempt to settle the case, the result would almost certainly have been far less than the \$7 million it paid after trial began. These circumstances are hardly unique. Even if National succeeds in its claims against INA and KMC and recoups a part of what it paid, insurance rates will still be affected. The point is, it is not intuitively obvious, as the Court seems to think — and it is certainly not obvious from this case — that the Court’s “general rule” keeps down insurance costs.

I am not persuaded that an excess insurer never has a duty to defend or settle a claim against its insured before primary coverage is exhausted. An excess carrier that has the right to intervene

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<sup>7</sup>BARRY R. OSTRAGER & THOMAS R. NEWMAN, HANDBOOK ON INSURANCE COVERAGE DISPUTES § 6.03 (9th ed., 1998) (footnotes omitted).

<sup>8</sup> *Ante* at \_\_\_\_.

in the defense may be obligated to do so to protect itself and its insured when it is clear that the liability claim will exceed primary coverage. Take the following example. *P* sues *D*, whose primary insurer, *PI*, assumes the defense. *P*'s claim is probably worth \$5 million, which exceeds *PI*'s \$100,000 policy limits and *EI*'s excess policy limits of \$1 million. *P* offers to settle for \$1.1 million, but *PI* refuses, believing *D* has an absolute defense to *P*'s claim. *EI* does nothing. When *P* obtains a judgment for \$5 million, *PI* must pay \$100,000, *EI* must pay \$1 million, and *D* must pay \$3.9 million. *D* has no *Stowers* claim against *PI* because it never received a settlement demand within its policy limits, and, under the Court's absolute rule, *D* has no claim at all against *EI*.<sup>9</sup> This result obtains even though *D* paid premiums for insurance that would have settled his liability. Also, *EI* has no subrogation claim against *PI* because *D* has no claim to which *EI* could be subrogated. Thus, the principal cause of the excess judgment, *PI*, is wholly insulated from responsibility. This is but one instance in which I think an excess insurer's duty to be involved in the defense of a claim must be carefully examined.

A rule absolutely insulating an excess insurer from responsibility for any defense of a claim prior to tender of the primary coverage is even less defensible, it seems to me, in an equitable subrogation action like this one. Suppose in my example that *A*, the attorneys hired to defend the claim, urge *PI* to accept *P*'s offer, but *PI* refuses. So *A* writes *EI* as follows:

We know that you have no duty to assist in the defense of this case, but you do have the right under your policy to protect your own interests, and you should exercise that right now. *P* has made a settlement offer within primary and excess coverage although liability could be much greater. We are worried that not only could your

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<sup>9</sup> See *Westchester Fire Ins. Co. v. American Contractors Ins. Co. Risk Retention Group*, 1 S.W.3d 872 (Tex. App.—Houston [1st Dist.], no pet.).

limits be exhausted but that *D* himself could even be exposed personally. We have handled this case superbly to have obtained as low an offer as *P* has made. Attached is a complete summary of what we have done and what we have decided not to do. If *P* ultimately obtains by judgment or settlement much more than the present offer, as we almost certainly think he will, then it will not surprise us if you try to shift some of the responsibility for your inaction to us, claiming that we did not properly handle the case. If that happens, we want to be able to defend ourselves by showing that you were fully warned, and that any complaints you make against us are pretextual to cover your own ineptness. So if you sue us later, we intend to introduce this letter into evidence so that the jury can see what really happened.

Assuming *EI* has refused to involve itself in *D*'s defense, the Court's rule would bar *A* from offering this evidence that *EI*'s subsequent malpractice claim was a disingenuous effort to look for someone else to share in the burden of what was paid to *P*. A strong argument can be made, I think, that the excess insurer's hands are not clean for purposes of its equitable claim of subrogation.

But I do not have to decide that issue here. I am not prepared to decide exactly when an excess insurer may be liable for refusing to involve itself in the defense of a claim. The weight of the learned commentary and the differences in the multitude of cases in the area convinces me that the Court should proceed more carefully than it does today. The record before us does not present circumstances that justify admission of the type of evidence *KMC* and *INA* wish to offer against *National*. I do not say that no such evidence exists, only that it is not reflected in our record. On that narrow basis, I agree that the court of appeals reached the correct result.

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Nathan L. Hecht  
Justice

Opinion delivered: May 25, 2000