ORAL ARGUMENT – 1/5/00
98-0034
KECK ET AL V. NATIONAL UNION FIRE INS. CO

RENFROE: In this case, Keck, Mahin & Cate seeks reversal of the judgment of the CA on two issues. The judgment of the CA with all due respect should be reversed and a take nothing judgment rendered in favor of Keck, Mahin & Cate, because the CA erred in its construction of the release first by nullifying language in paragraphs 2 and 5 of the release. The CA violated every cardinal rule of contract construction from this court. The release was found by the TC, Judge Link, to be unambiguous. The CA therefore could not read language or write language out of the instrument, and it did so when it ignored the any and all claims language in paragraphs 2 and 5.

O'NEILL: Even if that were the case, how would you differentiate conduct that occurred after the April 1, 1992 date?

RENFROE: The parties used the April 1, 1992 date as a mechanism to draw a line between their past conduct, which they were seeking to release, and their future relationship which was not part of the release. The language in para. 2 that says, We're not Granada releases Keck, Mahin & Cate for any and all claims causes of action associated directly or indirectly attributable to legal services rendered before April 1. That's the language the parties chose to achieve a release of any legal malpractice claim that might accrue later but arose directly or indirectly out of legal services rendered before April 1. Because the parties knew at the time that the discovery rule in Texas governing accrual of legal malpractice claims it was possible that although conduct occurred before April 1, the cause of action might not accrue until later.

The language actually used by the parties in paragraph 2 that says, Claims now existing or that might arise hereafter indicates the party's intention to release claims that might accrue in the future.

O'NEILL: Weren't there about 3 weeks between April 1 and the start of trial?

RENFROE: That's correct.

O'NEILL: And that the allegation is, a failure to properly prepare for trial, then how can you divorce it from those 3 weeks before trial which typically intense preparation? I don't know how to divide that line.

RENFROE: The line is divided this way. The very specific allegations of malpractice made by National Union against Keck, Mahin & Cate both in its pleadings and in the deposition testimony of its expert, Martin Mahoe, each and everyone of those acts specifically alleged all fall before April 1, 1992. And so in the first instance the fact that there is actually deposition testimony of National Union's own expert witness to the effect that all of those alleged acts of malpractice occurred before

April 1, extinguishes the claim.

HANKINSON: What is the harm that occurs at that point in time? I thought the alleged harm was here was that the law firm was not prepared to try the lawsuit and the trial incurred after the ending date that's stated in the release. Didn't the harm occur to the insured at the point in time the lawyers went to trial unprepared allegedly?

RENFROE: Certain rules of accrual with respect to legal malpractice claims say that the injury occurs when the advice is taken. Under the discovery rule, the cause of action may not accrue until much later, until the harm is actually discovered. But in this case because of the broad language actually used by the parties in paragraph 2 of the release, it indicates the parties were intending to release claims whether they were known or unknown, or whether they had not accrued yet. And while it may be true that the cause of action may have accrued later and the harm may have been suffered later, the fact is that by the use of the language claims that now exist or that may hereafter accrue that indicates the party's intention as of April 1, 1992 to extinguish those claims though they may not accrue until later and though the harm may not accrue until later.

The final error committed by the CA with respect to the construction of the release, the court improperly found that unless a claim is expressly enumerated in a release instrument, the claim cannot be extinguished. That is inconsistent with this court's recent opinion in *Memorial Medical Center v. Kessler*. And in that regard, the CA simply erred. It is indeed possible as this court well knows to extinguish liability for claims though they are not expressly enumerated in the release instrument. Release instruments are drawn every day that don't contain a catalog of each and every cause of action the parties seek to extinguish.

As the court will see from petitioner's ex. 1, a comparison of the language actually used by the parties in their release instrument, their rush to adviso(?) to the way the CA and National Union read the release instrument shows the manner in which certain language has been nullified in violation of this court's opinion in *Kessler* and other words have actually been added to paragraphs 2 and 5 to limit the scope of the release, and that's where the court erred.

PHILLIPS: Even if everything you say is true, since this release is between the attorneys presently representing and the client, doesn't it have to be put through a rather higher filter under our concept of fiduciary duties to show that the client was clearly apprized of the full nature of what they were waiving in exchange for the attorney's fees being forgiven?

RENFROE: In this case, Keck, Mahin & Cate and its client Granada did fulfill that test. The recital, the 4th recital in the release where both parties recite that the law firm Keck, Mahin and Cate had advised its client Granada separately in writing that it may be appropriate to seek independent representation in connection with the release. That fulfills the obligation to make sure that this is a proper instrument.

PHILLIPS: Is that separate writing anywhere in the record or is that a ______ document?

RENFROE: It is not in the record and I would add one more point on that. The issue the court raised in its question was not raised in the TC. There are no pleadings whatsoever by National Union in that regard.

To the issue of comparative responsibility, Keck, Mahin and Cate also seeks a reversal and a remand by this court of the judgment of the CA. When this court in *American Centennial* created for the very first time the limited right of a non-client insurance company to sue a lawyer for legal malpractice, the court was striving to correct a perceived injustice and to achieve fairness. Most importantly, it was striving to equitably redistribute the losses to the party whose conduct caused the loss. But in doing that this court said, By doing so we will not expand the liability of lawyers beyond the duties they owe to their clients. Those two fundamental tenants of *American Centennial* both have been violated by the CA's opinion.

First and foremost, Keck, Mahin and Cate seeks to introduce into evidence the entire spectrum of National Union's conduct. It wants the jury to hear the fact...

HANKINSON: And what is your legal theory that underpins your argument?

RENFROE: The first justification for the introduction of the full spectrum of National Union's conduct is the fact that a majority of this court in *American Centennial* in the concurrence signaled that the lawyer...

HANKINSON: Tell me what your legal theory is that underpins that in an equitable subordination action like this one, that the full range of conduct of the excess carrier should be admissible and considered by the fact finder?

RENFROE: Equity requires that it be considered for the proximate cause consideration. Equity requires it and authority from this court suggests that it is appropriate.

HANKINSON: The court in *American Centennial* rejected giving the excess carrier a direct action against the lawyer, correct?

RENFROE: That is correct.

HANKINSON: What is the nature in Texas law then of an equitable subordination action as the court recognized in American Centennial?

RENFROE: The theory is that the subrogee is allowed to step into the shoes of the subrogor to recover for loss that it paid on behalf of the subrogor.

HANKINSON: And so what rights and defenses are then available to the parties in an equitable subordination action?

RENFROE: In a typical equitable subordination suit the defendant in the subrogee action inherits the defenses that could have been asserted against the subrogor.

HANKINSON: So you're asking us then to expand beyond equitable subordination law in Texas when you ask us to allow the defendant to pursue any defenses that may arise out of the conduct of the subrogee? That's an expansion of the law of equitable subordination in Texas and doesn't it make it more like a direct action than it does an equitable subordination action?

RENFROE: To the extent that the court does not consider the view of the majority of this court in *American Centennial...*

HANKINSON: I just want to talk to you about equitable subordination law. I understand that there is a debate between the parties of what that concurring opinion means. So putting aside what that separate opinion meant, aren't you in fact then making this more like a direct action by an excess carrier than you are an equitable subordination action?

RENFROE: It does represent an expansion from the traditional doctrine of equitable subrogation.

HANKINSON: And then doesn't it fall in the category of making it a direct action?

RENFROE: I don't believe so.

HANKINSON: Why not?

RENFROE: Because the conduct that Keck, Mahin & Cate seeks to introduce about National Union is National Union's own action. In a direct action against the law firm, I guess the court's point is, that the same evidence would come in; and so therefore, it's analogous to a direct action.

HANKINSON: But the only reason why National Union can sue is because it has a right to equitable subordination, which means its rights arise vis-a-vis the insured and the insured's relationship with the attorney.

RENFROE: That is the theory.

HANKINSON: Otherwise National Union can't come to court?

RENFROE: That is the theory articulated in American Centennial.

HANKINSON: That's what I'm trying to do is understand. If this court has rejected the viability of a direct action, or at least in the American Centennial refused to go that far, then how do you get around the equitable subordination construct that is in place under Texas law to ask us to make additional defenses available to the law firm that arise from National Union's conduct when in fact National Union is only suing as a subrogee?

RENFROE: Because it goes to the point of proximate cause. National Union comes to this court and says, the conduct of Keck, Mahin & Cate caused this loss that I had to pay out of my pocket. When National Union goes to court and seeks to recover that loss attacking the conduct of another party saying the conduct of Keck, Mahin and Cate caused that loss...

HANKINSON: So you're asking us then to, looking at the first opinion in American Centennial, go back and rework that opinion to really in fact acknowledge some sort of modified direct action? At least a modified version of a direct action. It's not truly an equitable subordination claim anymore is it?

RENFROE: It is not. And I believe that this court in at least a majority of the members of this court in the concurrence in American Centennial signaled and recognized that there could be times when the conduct of the excess carrier contributes to the loss that it is then seeking to recover.

O'NEILL: Once you get beyond the bright line test where do you then draw the line?

RENFROE: The distinction made by the CA based on the *Mscore(?)* case, I believe goes too far, because the duty in *Mscore(?)* was the duty to defend. Mscore said only that the excess carrier has no duty to defend or no duty to actually pay its policy limits until the primary has exhausted. Here, we are not asking, we are not criticizing National Union for failing in its duty to defend or its duty to settle. We're criticizing National Union for duties far more basic and fundamental, for violating their own internal operating procedures that require the company to read its policy and reserve its rights and monitor the claim.

PHILLIPS: So you say these duties can arise before there is ever any demand from a plaintiff in the underlying lawsuit?

RENFROE: We do.

HANKINSON: Then aren't you asking us to again make a change in fundamental Texas law regarding the duties that excess carriers owe?

RENFROE: To the extent that the court considers Mscore to represent the law in Texas, yes, in a very narrow way. It goes to the problem of proximate cause, because National Union having violated its own internal operating procedures arrived at trial frankly claiming to be surprised and caught off guard.

HANKINSON: I believe you're asking us to impose additional duties then beyond what exists in Texas law now, correct?

RENFROE: To the extent that the court considers Mscore to represent the law which this court has never cited it for that purpose.

HANKINSON: Are you saying that excess carriers owe the same duties that primary carriers do?

RENFROE: No.

HANKINSON: What is the difference in your construct then between what a primary carrier owes with respect to duties to its insured as opposed to an excess carrier?

RENFROE: The primary carrier owes the duty to defend, which is the paramount duty and the paramount obligation. The primary carrier owes the duty to settle and to manage the claim properly. Distinct from those responsibilities, however, are the duties that we submit the excess carrier has to pay attention, to observe the claim and when liability under its policy becomes apparent it has some responsibility even thought the primary carrier has not tendered, it has some responsibility to exercise due care in managing the liability to its insured and its own exposure.

PHILLIPS: Isn't your whole concept intentioned with our notion that the underlying attorney owed the primary - essential sole duty of care to their client and they make certain decisions and the insurance company stays out, which is an outgrowth of the *Tilley* doctrine that we discussed in ______? And how could that work if not only the primary carrier is supervising to the extent they have to but we have various levels of excess calling the shots in the case at the risk of being denied any right to recover if there is malpractice?

RENFROE: If I understand the court's question, I suggest this. The excess carrier can take the basic fundamental steps necessary to be prepared on the day the primary carrier tenders, even if that is after judgment. But it doesn't necessarily have to be so involved in the defense of the case, and we're not urging that it do it. We're not suggesting that National Union should have actually been monitoring and second guessing the decisions of defense counsel in trial. We are simply saying that National Union should have been aware enough of the claim, it's own policy whether any of the claims were covered. It should have responded to settlement demands to proceed within its policy limits. It should have reserved its rights so that on the day it arrived at trial, when the primary tendered for the very first time National Union was not caught unaware. And that's exactly what happened here. Its executives had no idea about this claim. And so in answering your question, we are not suggesting that the excess carrier take on the day-to-day responsibilities of the defense. Not at all.

ENOCH: Who was responsible for this? Was Keck responsible for representing the

client or was National Union responsible for representing the client?

RENFROE: Keck, Mahin and Cate owed a duty solely to Granada to represent it in the trial.

ENOCH: And if they did it reasonably, then that's the end of the issue, isn't it? What is it that National Union should have done? What duty do they owe to Keck to make sure Keck was being reasonable?

RENFROE: They didn't owe a duty to Keck. They owed a duty to their insured to make sure that they understood the claim properly so that on the day that National Union took over the settlement it was informed enough to be able to make a reasonable settlement. The theory of the case that we want the jury to be able to hear...

ENOCH: So this is a Stower's case against National Union?

RENFROE: To some degree, yes.

HANKINSON: And you did suggest in your brief the possibility of imposing the Stower's obligation upon an excess carrier under Texas law?

RENFROE: We have suggested that, although we don't think it's necessary to do that, to justify the admission of this evidence. The problem was National Union arrived at the trial completely uninformed about the merits of the case. It woke up to the fact that it had not reserved ______ and it had not responded to two settlement demands. That motivated it to pay $7 million to limit its own liability for an excess judgment. In the time frame in which this case was taking place, 1991 and 1992, pre-Garcia, National Union understood at that moment that it faced liability for an excess judgment. It was unprepared to respond when the primary carrier tendered. We want to show the jury as part of the proximate cause analysis that that position that National Union found itself in having nothing to do with the actions of defense counsel...

ENOCH: That's Stowers?

RENFROE: It is Stowers.

ENOCH: Is there any other duty in Texas that an insured has against the insurance company in this context other than Stowers?

RENFROE: No, not any other common law duty. But it was that motivation that we think caused National Union to pay the amount that it did. And we believe that by depriving the jury of the opportunity to hear that evidence it will result in a completely distorted proximate cause analysis of whose conduct caused the loss. And that's exactly what this court was striving to do in American

Centennial, was distribute the loss to the party whose conduct caused it.

* * * * * * * * * *

RESPONDENT

JEWELL: We submit that in fact to agreeing with Keck's position on the comparative fault issue of the court will have to fundamentally alter not only existing Texas law about the nature of equitable subrogation, but also the fundamental relationship that exists between primary and excess carriers.

PHILLIPS: Are your damages liquidated in the underlying suit, or is it only your fault after April 1, or after the date you - what do you envision based on the CA's remand that the proof would look like at trial on damages?

JEWELL: Well the damages issue, as I understand it, National Union would have to establish the difference between what it paid to settle the case verses what it would have paid had there been but for the negligence of the firm and the primary carrier.

PHILLIPS: How about your conduct, does that come in there at all?

JEWELL: It does not come in until after the date that the primary limits were tendered. And that's consistent with Texas authority, and that's exactly what the CA held.

BAKER: What effect is the fact that the record indicates a $3.6 million demand was made and transmitted to your client, but nothing happened? Didn't that put them on notice that there is something going on that's going to implicate them in this case and they need to be involved?

JEWELL: It does not in this case because that demand, or the most recent demand came in Feb. 1992. And after that demand was communicated by ______at INA to National Union, there was another communication to National Union that in fact the primary carrier intended to resolve the case within the underlying limits.

OWEN: Doesn't at least some of the evidence of your conduct prior to trial bear on whether or not you made a reasonable settlement? For example, if National Union didn't know anything about the lawsuit, how could it properly evaluate what was a reasonable settlement? Isn't that fair game on just causation of damages?

JEWELL: I think not, because of course, the causation inquiry is going to be irrelevant if there is no duty.

OWEN: I'm talking about causation of damages. The amount of the settlement. Just as you said going in, you think the inquiry will be is there any difference between what you would

have paid but for the negligence and what you actually paid. And isn't there some argument that even if Keck, Mahin was negligent, you overpaid because you didn't properly evaluate or know enough to evaluate the law suit?

JEWELL: As I understand the record, once the primary limits were tendered National Union did retain another lawyer, Norm Snyder, to negotiate the settlement.

OWEN: Over a period of how long?

JEWELL: I think it was probably a couple of days.

OWEN: My point is, shouldn't the evidence of your lack of knowledge prior to those two days come in on whether you really did reasonably evaluate the settlement, or have a reasonable basis for settlement?

JEWELL: Of course the evaluation of National Union has to be judged from the time it duty arises and from the time the primary limits were tendered. I think based upon what happened and the primary limits being tendered right there after trial had begun and after the Wolf Point plaintiffs had made a $13 million demand, National Union basically goes from that moment on in terms of evaluating what the reasonable settlement would be, and until that time I don't think that anything that National Union did prior to trial would have any bearing.

OWEN: But if the argument is - let's say you actually did pay $4 million more than the case was worth, and that's undisputed, isn't the fact that the reason you paid $4 million more is because you weren't up to speed prior to trial? Isn't that relevant to why you overpaid?

JEWELL: If it were true that the case was overpaid, and I don't believe there is any summary judgment evidence of that to this point that the settlement was overpaid, in part it would be because of the defense of the case by the law firm and by INA's conduct. And to think that National Union is justified in not being necessarily informed about the details of the case based on the representations that were made to it by the primary carrier, that the case would be resolved within the underlying limits.

O'NEILL: Let's say that there should have been a reservation of rights. Let's just take that as true. _________ or have some impact on the value of settlement, and if you had not reasonably or evaluated the case enough to send that reservation of rights wouldn't that be relevant?

JEWELL: I don't think that it is relevant.

O'NEILL: As I understand your argument is that because there is no duty to defend before tendering the primary limits, you had no duty to do anything. But if we did recognize some sort of duty to manage or monitor, and that was the duty ________, then it would all come in, and

now shouldn't we recognize such a duty?

JEWELL: I can see where if the court were to establish a new duty in Texas previously unrecognized to an excess carrier would essentially take on qualities of a primary carrier in terms of investigation and monitoring. I can see where...

PHILLIPS: We aren't dealing with a large body of Texas law here. We're on a pretty clean slate with varying approaches in different jurisdictions that we have looked to for guidance. So we're really asking a public policy question. What is fairest to all parties concerned in the way you operate your business day-to-day? What makes the most sense so that when things go bad lawsuits are fairly allocated in a way that does not harm the normal operation of business the majority of times when they go right?

HECHT: Let me put the issue just as hard as I think it can be put, which is everybody sits down before the disaster and the lawyers say and the primary carrier says, You need to know this, you need to know this, and you need to respond. And the excess carrier says, Well we don't have to pay any attention to any of that. We're not going to do any of those things, and we're going to sue you for malpractice as soon as this is all over with because we think you caused it. Can that story not be told after the deal is done?

JEWELL: No, I can see if that's the facts of the case. If a primary carrier did make a demand while on excess carrier to participate, to advise them of X, Y, and Z, this is what's going on, these are our problems, we think that there is a high potential here that the excess layer is going to be pierced. There is a settlement demand from the plaintiffs of X amount, which is over the underlying limits, and do something.

HECHT: But your position is, you don't have a duty.

JEWELL: If the court were to hold as you're suggesting if that were the rule, that doesn't justify reversal of the case here, because those things didn't happen here. In fact, when the $3.6 million settlement demand was communicated to National Union in February, it's our recollection that even INA did not make a response to it, or did not make an offer.

ENOCH: The implication in that scenario, the implication in the hypothet is that the primary carrier is tendering the limits of their policy, and you would say, Yeah, then we would move into play.

JEWELL: Yeah. That would definitely be an interpretation of what would happen by those events. That would essentially qualify as a tendering(?) of the limits.

ENOCH: Let's assume the primary carrier says, Well you need to be aware that they made a demand in excess of the primary limits but we're not prepared to tender the limits of our

policy but we want you to participate now in this case and take on an obligation to be not negligent in failing to settle. What happens?

JEWELL: I think maybe in that instance there may be some contractual issues that arise out of the nature of the excess insurance policy itself. Whether that is something that was bargained for, whether that was something that is permitted or under the insurance policy itself.
ENOCH: It doesn't assume a duty. It doesn't participate. It is just simply presented with a demand by the primary carrier to participate without the primary carrier's commitment to tender its own policy limits. What happens in the relationship?

JEWELL: Then I think that an excess carrier would not have a duty absent a formal tender of the limits in that instance.

PHILLIPS: Do you concede that an excess carrier can take actions or fail to take action prior to the time of that formal tender that will affect the amount that it ultimately paid in the settlement?

JEWELL: I think in certain situations it's possible that can happen.

PHILLIPS: And if that happens why should we have a rule that prohibits any of that information from coming in to evidence in a subsequent malpractice suit?

JEWELL: I think the primary response to that is that it alters the nature of the _____ subrogation doctrine. It alters the nature of the excess primary relationship and we have an excess insurer that starts to become essentially another primary carrier.

HANKINSON: Describe for us what you think Texas law is, and just briefly summarize the nature of that relationship between the excess and the primary carrier and what's contemplated by the whole structure in terms of the costs of premiums and what's provided and how that works?

JEWELL: Of course, an insured like Granada would contract for primary insurance to cover third party liability claims, such as this, which would contract for defense and indemnity and so forth. But also contract for excess insurance over and above the certain underlying layer. Now of course, the excess policy only provides that the excess insurer will pay or assume the defense once the underlying limits have been tendered or exhausted. And the premiums paid for excess insurance justify that sort of expectation on the part of the insured who expects the primary carrier to control and monitor the litigation in accordance with its defense duty. And also the expectations of the insured who has not paid premiums that would justify justified an excess carrier's basically dual involvement with the primary carrier in the monitoring of the case and investigation of the case.

If we were in fact to impose new independent duties on the part of an excess carrier, then I believe that we are moving towards excess carriers becoming some sort of surrogate

primary carrier that will inevitably result in increased costs of obtaining excess coverage and you will have on many occasions multiple levels of excess insurers that will all be involved and will have everyone's fingers in the pie.

PHILLIPS: It seemed to me in your brief there was a good bit of tension between the concept that this release should not be given much weight because it was an attorney who also partially owned the company and sat on its board of directors and self dealing into the scheme to get out of just liability on this suit. And then or two pages later if you don't buy that, this release never even contemplated this law suit. And it ought to be read as such because it's often talked about cases where the fees weren't fully paid up as of the time, and so on. Which is it?

JEWELL: Our primary position is that the Wolf Point suit is not a matter that was clearly within the subject matter of the release, which is what the CA held. The language of the release I think as being strain - Keck is just straining to read this language to include the release, which would include the Wolf Point suit when Mr. Cook himself testified that the release did not cover the Wolfe Point suit, and he said that in his deposition. Of course the representative of Granada, Mr. Eller, also testified that in his view the Wolf Point suit would not have been covered by this release.

We do argue that perhaps this was not necessarily arms length transaction because of the link between Granada and the Keck firm. We have made that argument in the brief, but our first position is that the language itself just does not contemplate this suit and that this matter, even if - additionally because as Justice O'Neill was discussing there was conduct - malpractice - that occurred after April 1, 1992, which would also not be contemplated by the release as well.

* * *

LAWYER: I don't think that we have to radically change the law or change duties in Texas in order to assess an issue against an excess carrier for its own conduct. I think that Texas law is very clear that one owes a duty to oneself. The *Shiver's* case and the confirmation of that in *Highland Park*, I think clearly shows that an individual has an obligation and duty to look over one's own house. It's separate and apart from any duty it owes to anyone else. I don't think we have to change the duty that an excess carrier owes to its insured in order to impose a duty on the excess carrier to simply manage its own affairs, and manage its own affairs in a reasonable, prudent manner.

ENOCH: Well it might be liable to itself for the amount of money it paid, but that's not the issue here. The issue here is, whether or not they somehow are responsible to the primary carrier and the insured for conduct that occurred before the primary carrier tendered its balance. Does INA do any excess carrier - is it providing excess carrier...

LAWYER: It's changed and bought and sold so many different companies that I'm sure it does.

ENOCH: It seems to me your position is, that a primary carrier need not to exhaust its amount, need not do that to put upon the excess carrier the duty to participate in the defense of the lawsuit.

LAWYER: No, that's not what I'm saying. I'm saying that this would not impose any additional duties on the access carrier to either the primary carrier or its insured that do not already exist in Texas, which is simply for purposes of comparative or contributory negligence that you look to the duty that one owes to oneself. Just as the *Shivers* case clearly established in that it - now if there was a suit between Granada and the excess carrier, then all the defenses of Mscore would be available to National Union as the excess carrier, because those duties are clearly defined. But here in this case we have an excess carrier suing with impunity basically without any consideration of its own conduct and whether it managed its affairs properly against both the primary carrier and the defense counsel that the insured hired to represent them in the underlying case. And in that instance, none of these duties that would go to the excess carrier would be expanded in any way. It would be simply following the tenants of law that one should look after one's own house and in fact if you're going to sue under an equitable subrogation cause of action, such as this, that your conduct - you shouldn't be able to do it with impunity. As National Union fights so hard to do to protect against the laundry list of potential evidence that would come in as to their own comparative fault for the reason that they paid $6 million towards the $7 million settlement. That's the point that I'm simply trying to make and I think chapter 33 supports that from the standpoint that they are clearly a claimant. The 1992 version of the act applies in this particular case and as a party either suing potentially as the real party damaged for its own damages, or suing on behalf of an injured party, then they are a claimant under 33.011...

HANKINSON: We don't have a direct action by the excess carrier. The excess carrier is asserting an equitable subordination claim.

LAWYER: Correct.

HANKINSON: So how does that fit with what you just told us?

LAWYER: In chapter 33, there is no exception for subrogation at...

HANKINSON: But equitable subordination is a fiction. National Union is standing in the shoes of its insured?

LAWYER: Correct. And the distinction I see is that...

HANKINSON: So why aren't we looking to putting it in that position and treating it as the insured for purposes of deciding what defenses and obligations may exist?

LAWYER: Because I think it goes beyond mere ministerial subrogation, as I raised in my

brief.

HANKINSON: So you're asking us then to move away from the American Centennial holding that this is an equitable subordination action and look at the question of whether we should extend it to being a direct action?

LAWYER: I don't think *American Centennial* fully analyzed all of the ends and outs of an equitable subrogation cause of action between an excess carrier and a primary carrier. I think it was alluded to in a majority concurrence of the court that all parties should have all defenses available to it.

HANKINSON: It said any available defenses.

LAWYER: Any available defenses which I don't see...

HANKINSON: I'm having a really hard time with the idea of getting around the equitable subordination construct so that the conduct of National Union plays into this at all.

LAWYER: Because I'll agree with you certainly that this is a little different animal than - typically in a subrogation case you have an auto accident or something, you pay property damage and then you go after the responsible third-party with no discretionary process.

HANKINSON: And at that point in time when that occurs can the defendant look to the conduct of the insurance company and the way it managed the claim and what it paid? They can't can they?

LAWYER: No.

HANKINSON: What if the insurance carrier paid too much, didn't investigate properly and paid too much, do we look at that conduct so the defendant can say, Well you may have paid your insured this amount of money, but it was too much because you weren't doing your job back there. We're going to look at your conduct. Do we ever look behind an action like that of the conduct of the insurance carrier, or do we look at the insurance conduct?

LAWYER: In this instance, I think you have to because the...

HANKINSON: No, but in the ordinary equitable subordination action, do we?

LAWYER: Well you don't have a case that proceeded the judgment where there was really damage to the insured. This is a discretionary decision on the part of the excess carrier through its own evaluation or lack of it to pay $6 million as opposed to a judgment that's been rendered against its insured potentially exposing insured to a situation where the insured itself suffers

damages. And that's the distinction that I see between what has typically been subrogation law and is typically not a discretionary decision based upon an insurance carrier be it primary or excess.

HANKINSON: But if I'm an insurance carrier and my insured is injured in some way, and so I pay for the damages to my insured, and then I stand in the shoes of that insured to pursue the defendant who caused the harm in an effort to recover what I paid what the damages were, do we ever get into the conduct of the insurance carrier in that context?

LAWYER: I don't think we do in almost all the instances because usually that's not in dispute. It's not disputed as to what the primary carrier paid, be it medical or property. Here we have a discretionary decision. Here we have to look at to what went into that discretionary decision as opposed to simply waiting, seeing where the chips fell during a judgment, and then taking action accordingly.

* * * * * * * * * *

REBUTTAL

RENFROE: Let me go back to the questions from the court about whether to permit the introduction of the full spectrum of National Union's conduct would increase any duties, create any new duties, or add to those that currently exist as to an excess carrier?

Article 21 of the Insurance Code and 21.21-2 as well as the provisions in the Texas Administrative Code impose on all insurance companies making no distinction between excess and primary, the obligation to analyze coverage and notify the insured of coverage defenses if they exist. Those same provisions impose on all insurance companies the duty to investigate and to communicate with insureds about settlement decisions.

HANKINSON: Looking at the public policy reasons we've been talking about, do you agree with Mr. Jewell's characterization of the relationship between excess and primary insurance in Texas?

RENFROE: To some degree.

HANKINSON: How would you characterize it since that's part of the underpinning of the public policy considerations here?

RENFROE: I think the important thing is to consider the fact that the excess carrier is playing with the insured's rights and the insured's money.

HANKINSON: I asked him specifically if he would characterize what the nature of excess coverage is vis-a-vis, the primary and how it works. Do you agree with him or do you think there is a different characterization that should be put on how it works?

RENFROE: I think for purposes of the policy which is protecting the insurance benefits available to the insured, the situation from a primary - the primary insurance is that first layer of protection, the excess insurance obviously is the next layer of protection.

HANKINSON: You're buying something different when you buy primary coverage verses when you buy excess. What are you buying when you buy primary as compared to what you're buying when you buy excess?

RENFROE: When you buy primary insurance you're buying the services from the primary insurance carrier to provide a defense where the policy provides for that, as well as often the opportunity by the primary carrier to take responsibility for negotiation of settlement. Now when you buy excess insurance you are buying additional layers of protection. But in this situation as any many, the excess policies are so often triggered and the excess...

HANKINSON: What else do you get besides the excess coverage that kicks in once the primary layer is exhausted? What else do you get at the point in time a claim arises underneath these policies?

RENFROE: Once the primary is exhausted, the excess carrier owes a duty to defend, and the duty to settle.

HANKINSON: But at the time the claim arises under the respective policies at each layer, what is the insured getting from the excess carrier at that point in time?

RENFROE: If the court's question is in terms of a duty owed, the duty is first owed by the primary carrier. But with respect to the fact that the excess carrier is managing a benefit that the insured has purchased.

HANKINSON: Are the premiums structures for primary excess comparable?

RENFROE: No, they are not.

HANKINSON: And why is that?

RENFROE: They are different because the primary carrier pays the cost of defense. That is the most important distinction. I disagree with Mr. Jewell's suggestion that to admit this evidence will drive up the cost of premiums. That simply is not true. But the other big difference between the pricing and the premiums between primary and excess is frankly because the excess carriers have a more remote expectation that their policy proceeds will be tapped. That's the biggest component of the difference in cost.

OWEN: ________ now require excess carriers to monitor discovery, monitor trial.

Isn't that going to drive up the cost of excess insurance?

RENFROE: I respectfully say that it will not for these reasons. Already under the insurance code, art. 21, excess carriers as well as primary carriers have some duty to pay attention. They cannot completely ignore correspondence coming from defense counsel. Moreover, the duty that we are suggesting that the excess carrier have and take responsibility for is to simply be aware of its own policy and whether these claims were covered under its own policy and to respond to settlement demands within its layer.

OWEN: What difference does it make as between the excess carrier and the law firm whether they are covered or not if the excess carrier stands in the shoes of the insured, the insured is surely liable without regard to coverage?

RENFROE: It makes this difference, because the excess carrier is seeking to recover that money from the back of the law firm. And if indeed the excess carrier...

OWEN: Which the insured would have to pay if there was no coverage?

RENFROE: That's true. But in this case, the theory of Keck, Mahin & Cate is that the excess carrier - to the extent that it contends it paid more than it should have, the argument is it paid more than it should have because it was concerned of its own excess liability...

OWEN: Your argument is it should have denied coverage and left the insured hanging out for the judgment?

RENFROE: Whether it should have denied coverage is something for the jury to determine. But if indeed National Union's policy did not cover these claims as we think it did not, then that's correct and the issue would be between Granada and its lawyer to the extent the lawyer committed any malpractice. But it's incorrect to permit the excess carrier to say it was all the fault of the law firm when the excess carrier was motivated to pay more than it thinks it should have to protect itself from the liability for the excess judgment.

ENOCH: It strikes me that what you're saying is, there was negligence in the settlement process. We've said very clearly any number of times the only duty that's out there is a Stower's. Well maybe the excess carrier ought to have a Stower's. But that duty we've clearly said isn't implicated until there is a demand within policy limits. And the analogy to an excess carrier would be when the excess carrier knows that it is now on the hook meaning the primary has offered theirs and the case has not settled and now here is a demand that's being made within the excess carrier's limits. It seems to me there is a duty to settle. If we don't hinge the excess carrier's duty on that kind of clear rule, like we have on the primary, it seems to me we've created a different obligation of an insurance company to its insured. Now explain to me how we can impose a duty on the excess carrier similar to Stowers, which is what you are asking without the same bright line rule that we

have for the primary carrier?

RENFROE: In this case, National Union was on notice from Nov. 1991 as the court can see from the chronology in petitioner's ex. 2, that the first settlement demand was well within its layer. The settlement demands never went down.

ENOCH: But the primary carrier had not tendered its amount which the agreement between the excess and the primary is that you either have to exhaust or tender.

RENFROE: That's true. It had not tendered. And there is culpability there that we think a jury should hear about. But the result is if the court does not permit the introduction of the evidence of National Union from the time frame that it had notice that this claim was going to fall within its limits and if the court does not allow the jury to know that National Union's own examiner had indicated in his file that the excess policy was going to be implicated, those are facts that occurred even before tender, they cannot arrive at the proper loss causation analysis. And the result, I think, statewide would be to condone a tactic by an insurance company of sleek(?), settle, and sue with no consequences whatsoever for the conduct that occurred pretender. The fact that the date of tender such an arbitrary act by the primary carrier over which the excess may have no control, the law firm has no control, and the client, the insured, has no control, that fact cannot be used to draw the line in the sand as to when a party's conduct may be considered by the jury in loss causation and when it cannot.