

**ALLOCATING DEFENSE AND INDEMNITY AMONG
MULTIPLE CARRIERS**

**TIMOTHY MICAH DORTCH
COOPER & SCULLY, P.C.
900 Jackson Street, Suite 100
Dallas, Texas 75202**

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I. INTRODUCTION

Recently, both Federal and State Courts in Texas muddied the water regarding what insurance companies may do to allocate defense and indemnity among multiple carriers. The Federal Court for the Southern District of Texas is home to the majority of the recent decisions that address this situation and create the current state of the law. However, even with several recent opinions, insurance carriers are left perplexed in determining if they should settle underlying cases, whether they can get some or all of their defense and indemnity expenses reimbursed, and if they can seek reimbursement, what formula may they utilize. The article below discusses the current state of the law and the possible arguments that an insured/insurance company can make to maintain a recovery against a co-insurer.

A. RECENT DECISIONS

1. *Liberty v. Mid-Continent*

In *Mid-Continent Ins. Co. v. Liberty Mutual Ins. Co.*, _____ S.W.3d ____, 2007 Tex. LEXIS 918 (2007), Kinsel, a contractor, was sued pursuant to its involvement in a car accident on a highway on which it was the general contractor. 2007 LEXIS 918, *3-4. Liberty Mutual was Kinsel's primary CGL carrier, with a \$1M policy. Kinsel also was listed as additional insured on the Mid-Continent primary CGL \$1M policy issued to Crabtree Barricades, Kinsel's subcontractor. *Id.* at *4. The policies both contained identical "other insurance" clauses, requiring pro rata apportionment up to each policy's respective limits. *Id.* Both Liberty Mutual and Mid-Continent agreed that Kinsel was liable and that both insurers owed some portion of defense and indemnity. *Id.* at *6. Liberty Mutual eventually agreed at a mediation with the claimants to settle on behalf of Kinsel for \$1.5 M, but since Mid-Continent claimed they valued the case at \$300,000, they paid only \$150,000, with Liberty Mutual funding the remaining \$1.35M. *Id.* Liberty Mutual then sued Mid-Continent to recover its pro-rata share of the sum paid to settle the suit, and after removal to the Northern District of Texas, the court found that Liberty Mutual was entitled, through subrogation, to \$550,000 from Mid-

Continent, concluding that each insurer owed a duty to act reasonably in exercising rights under the CGL policy, that Mid-Continent was objectively unreasonable in its assessment of \$300,000, and that whether apportioned in pro-rata or equal shares, Mid-Continent was liable for one-half of the \$1.5M settlement, and based on amounts already paid by Mid-Continent, it was liable for \$550,000. *Id.* at *7-8. On appeal, the following certified question from the Fifth Circuit was sent to the Texas Supreme Court (while there were three questions certified by the Fifth Circuit, the only certified question the Texas Supreme Court addressed was the following):

1. Two insurers, providing the same insured applicable primary insurance liability coverage under policies with \$1 million limits and standard provisions (one insurer also providing the insured coverage under a \$10 million excess policy), cooperatively assume defense of the suit against their common insured, admitting coverage. The insurer also issuing the excess policy procures an offer to settle for the reasonable amount of \$1.5 million and demands that the other insurer contribute its proportionate part of that settlement, but the other insurer, unreasonably valuing the case at no more than \$300,000, contributes only \$150,000, although it could contribute as much as \$700,000 without exceeding its remaining available policy limits. As a result, the case settles (without an actual trial) for \$1.5 million funded \$ 1.35 million by the insurer which also issued the excess policy and \$150,000 by the other insurer.

In that situation, is any actionable duty owed (directly

or by subrogation to the insured's rights) to the insurer paying the \$1.35 million by the underpaying insurer to reimburse the former respecting its payment of more than its proportionate part of the settlement?

At the Texas Supreme Court, Liberty Mutual argued that upon payment of the settlement amount, it was subrogated to its insured's contractual right to enforce language in the Mid-Continent policy, under which it was an additional insured, to pay an equal or pro-rata share of settlement. Mid-Continent argued that it owed no direct duty to Liberty Mutual as a co-primary insurer upon which reimbursement may be based, as well as that its insured has no enforceable contractual right to which Liberty Mutual may be subrogated, as Mid-Continent fulfilled any duties to Kinsel as insured by assuming defense and acknowledging policy coverage. The Court examined two possible scenarios argued by Liberty Mutual: one involving any ability of a co-primary insurer to compel another co-primary insurer to proportionately participate in the settlement of a third-party claim, and a second involving an insured's ability to compel an insurer's proportionate participation in settlement of a third-party claim. *Id.* at *12.

The Court held that in the first scenario, Liberty Mutual essentially raised a claim for contribution, which the Court had previously held does exist between co-insurers, but that such a direct claim does not exist when the policies contain the other insurance clauses, which would operate to make the insurers liable only for a pro-rata share of a covered loss. *Id.* at *14. The court noted that each co-insurer is contractually bound to the insured to pay a pro-rata share of covered loss, and did not contractually agree to pay any other insurer's pro rata share. *Id.* The effect of the pro rata clause precludes a direct claim for contribution among insurers because the clause makes the contract several and independent of each other. With independent contractual obligations, the co-insurers do not meet the common obligation

requirement of a contribution claim—each co-insurer contractually agreed with the insured to pay only its pro rata share of a covered loss; the co-insurers did not contractually agree to pay each other's pro rata share. *Employers Cas. Co. v. Trans. Ins. Co.*, 444 S.W.2d 606, 609 (Tex. 1969).

In addition, the Mid-Continent Court stated that if a co-insurer under these circumstances pays more than its pro-rata share, it does so voluntarily, without legal obligation to do so. "Thus, a co-insurer paying more than its proportionate share cannot recover the excess from the other co-insurers." *Mid-Continent* at 14. With regard to the insured's right of recovery, the Court observed that insureds may enforce the contractual obligations of the insurers to cover the insurers' pro-rata shares of the covered loss, up to policy limits, but only when the insured has not been fully indemnified. *Id.* at *14-15. In the situation at bar, the Court held, Liberty Mutual and Mid-Continent did not enjoy any contractual relationship or obligations to pay each other's proportionate share of the insured's loss, and that the presence of pro rata clauses in both policies precluded the possibility of equitable subrogation between the insurers. See *American Centennial Insurance Co. v. Canal Insurance Co.*, 843 S.W.2d 480 at 483 (Tex. 1992). Therefore, the Court held, no contractual obligations existed between the insurers to apportion between themselves the payments on the insured's behalf, and the Court would not create a common law obligation to that effect. *Mid-Continent* at 15.

Acknowledging that a right of contribution did not exist, Liberty Mutual sought reimbursement through contractual or equitable subrogation to the rights of Kinsel. In either case, Liberty Mutual must step into Kinsel's shoes to assert only those rights held by Kinsel against Mid-Continent. Liberty argued that it was subrogated to the contractual right of Kinsel to enforce Mid-Continent's policy language which imposed a duty on Mid-Continent to defend and indemnify Kinsel and to pay a pro rata share of settlement. *Id.* at 22. The Court held that the duty of both insurers to pay a pro rata share of covered losses up to their policy

limits could not be viewed apart from the actual purpose of the pro rata clause or of the rule that once the insured has been fully indemnified, an insurer's duty to pay pro-rata shares of a loss is unenforceable. *Id.* The Court pointed out that the insured's right of indemnity under a policy is limited to actual amount of loss, and that when two policies provide coverage for losses, "the pro rata clause does not create an exception to the principle of indemnity, but rather implements that principle by eliminating the potential for double recovery by the insured." *Id.* at 23. The Court went on to hold that equity does not demand a different result here. The Court held, therefore, that a fully indemnified insured has no right to recover an additional pro rata portion of settlement from an insurer regardless of that insurer's contribution to the settlement. Having fully recovered its loss, Kinsel had no contractual rights that a co-insurer could have asserted against another co-insurer in subrogation. *Id.* at 24.

Liberty also argued that it was subrogated to the common law right of Kinsel to enforce Mid-Continent's duty to act reasonably when handling an insured's defense-including reasonable negotiation and participation in settlement. An insurer's common law duty in this third party context is limited to the *Stowers* duty to protect the insured by accepting a reasonable settlement offer within policy limits. The court stated that Mid-Continent did not breach a *Stowers* duty to Kinsel because a settlement demand was never made within Mid-Continent's policy limits. *Id.* Finally, the Court held that Liberty's dual status in the case as a primary and excess carrier negated the fundamental requirement of subrogation that a subrogee must have paid a debt for which another is primarily liable. *Id.*; see also 16 *Couch on Insurance* §223:1; 44 Am. Jur. 2d *Insurance* §1787, at 256 (2003) ("The doctrine of subrogation is inapplicable if the liability insurer seeking subrogation is the one primarily liable; and the doctrine is inapplicable if the effect of the respective policies is to establish equal liability.")

2. *Trinity v. Employers*

The Federal Court for the Southern District of Texas also issued an opinion in *Trinity Universal Ins. Co. v. Employers Mutual Cas. Co.*, 2008 U.S. Dist. LEXIS 39581 (S.D. Tex. May 15, 2008). In *Trinity* the Court held:

Plaintiffs also assert a subrogation claim for breach of contract to recover from EMC is pro-rata share of the costs of defense. However, Mid-Continent also forecloses contractual and equitable subrogation claims between co-insurers when the insured has been fully compensated. Mid-Continent's rejection of subrogation in this context derives from the principle that an insured cannot obtain more than a single recovery for any loss, and that an insurer asserting rights in subrogation stands in the shoes of its insured. Allowing an insured to recover a portion of those costs that have been paid in full by another insurer would result in an impermissible double recovery. Here, if EMC did breach its duty to defend Lacy Masonry in the underlying suit by refusing to contribute any portion of the costs of defense, Lacy Masonry had nonetheless incurred no loss because Plaintiffs had borne all costs associated with its defense.

Trinity Universal v. Employers Mut., 2008 U.S. Dist. LEXIS **34, 35. The *Trinity* case has been appealed to the Fifth Circuit in Texas and we are waiting on their ruling.

Ironically, days later, the Supreme Court of Texas issued its decision in *Frymire Eng'g Co. v. Jomar Int'l, Ltd.*, 259 S.W.3d 140, 142 (Tex. 2008). Notably, the Supreme Court held:

Jomar's argument that Frymire cannot assert equitable subrogation because its indemnity payment was under a voluntary contract would, if accepted and applied to other contracts, be a radical departure from long-settled Texas subrogation law. For instance, insurance policies are contracts, too, and if the hotel's property insurer had paid the hotel for the cost of repairs pursuant to a policy agreement, it would certainly be able to assert an equitable subrogation claim against Jomar.

3. Lexington v. Chicago

The Supreme Court explored its *Mid-Continent* holding further in *Lexington Ins. Co. v. Chicago Ins. Co.*, 2008 U.S. Dist. LEXIS 60629 (S.D. Tex. August 8, 2008) where coverage was contested by one of two insurers that issued consecutive professional liability policies to a health care agency and each contributed half to settle claims against the insured. The Court distinguished *Mid-Continent* because it did not address whether an insurer that contributes to a settlement fund but denies coverage for the underlying lawsuit, and that reserves the right to dispute coverage and seek reimbursement for the entire amount paid, may recover that amount from the other insurer, particularly when the other insurer also denies coverage. In this case, although the settlement fully indemnified the insured, both insurers denied coverage of the underlying lawsuit. Chicago and Lexington each paid fifty percent of the amount needed to settle the underlying lawsuit under a nonwaiver agreement that allowed them to fund the settlement while continuing to deny coverage and reserving any available right to seek reimbursement from the other. Both insurers dispute coverage. In this case, an insurer that disputes coverage but settles an underlying suit with another insurer that also disputes coverage is seeking reimbursement from that other insurer.

The Court held that the rulings in *Mid-Continent* only apply where both policies provide coverage for the underlying lawsuit, contrary to the Court's analysis in *Trinity Universal, supra*. *Id.* at *36-37. So the Court addressed the coverage issues: late notice by Chicago and reformation by Lexington. Having found coverage under both policies, the Court then held that because Lexington and Chicago had no contractual right to contribution between them because the Supreme Court in *Mid-Continent* found that no right to contribution exists between insurers who jointly settle an underlying lawsuit based on their independent policies with a common insured. *Id.* at *63. Also, in *Mid-Continent*, the court noted that the insurers had "no contractual right of contribution between them" and declined "to create such an obligation under the common law." *Mid-Continent*, 236 S.W.3d at 773. Because Chicago and Lexington had no contractual right to contribution between them, and because the *Mid-Continent* court found that no right to contribution exists between insurers who jointly settle an underlying lawsuit based on their independent policies with a common insured, the Court held that Lexington could not recover on a contribution claim against Chicago.

Furthermore, Lexington had no right of subrogation against Chicago because the insured was fully indemnified in the underlying lawsuit, otherwise, such a cause of action would allow the insured an opportunity for double recovery. *Id.* at *64. *See also Nautilus Ins. Co. v. Pacific Employers Ins. Co.*, 2008 U.S. App. LEXIS 25523 (5th Cir. December 16, 2008) (holding in *Mid-Continent* applied to case where one insurer paid \$1.5 million in settlement and the other paid nothing, precluding action in contribution or subrogation against nonpaying insurer); *XL Ins. America, Inc. v. TIG Specialty Ins. Co.*, 2008 U.S. Dist. LEXIS 62128 (N.D. Tex. August 13, 2008) (holding in *Mid-Continent* applied to case where primary insurer mistakenly paid funds in excess of available policy limits and was precluded from seeking contribution and/or subrogation against excess insurer).

4. *Nautilus v. Pacific Employers'*

The most recent case is *Nautilus Ins. Co v. Pac. Emplrs. Ins. Co*, 2008 U.S. App. LEXIS 25523 (5th Cir. Tex. Dec. 16, 2008). In *Nautilus*, The Fifth Circuit ran with *Mid-Continent, supra*, in a case between two primary insurers. EOG was an additional insured under a liability policy issued by Nautilus Insurance Company and a policy issued by Pacific Employers Insurance Company. Both policies contained identical pro rata ("other insurance") provisions that required the insurers to pay a pro rata portion of any judgment or settlement if the coverages overlapped with other primary insurance. Several homeowners sued EOG alleging that EOG's seismic activity caused foundation defects to their homes. EOG sought protection under its own insurance, as well as the coverage afforded by Nautilus and Pacific. Nautilus and the other insurers settled some of the lawsuits for \$3.5 million with Nautilus paying \$1.5 million of the settlement. Pacific refused to contribute to the settlement and allowed the remaining cases to proceed to trial. The jury ruled against most of the homeowners' claims and the court granted summary judgment on the remaining claims. Thus, Pacific paid nothing towards settlement and nothing in the underlying state court cases on behalf of EOG.

Nautilus and EOG sued Pacific under theories of contractual and equitable subrogation. Both the district court and Fifth Circuit followed *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d 765 (Tex. 2007) and ruled in favor of Pacific. Nautilus argued that *Mid-Continent* is distinguishable on the fact that the decision applies narrowly and only when an insurer settles a case to "protect its own coffers," which Nautilus asserts is missing. Nautilus pointed out that Liberty Mutual covered the insured for \$1 million primary and \$10 million excess and under those circumstances, Liberty Mutual had a self-serving motive to settle the entire case because it did not want to risk liability for a large judgment under its excess policy. Thus, Nautilus argued that the import of *Mid-Continent* is that an insurer cannot recover from an co-insurer based upon a right of subrogation when the insurer pays a claim to protect its own financial interest.

Nautilus claims it paid the claims against EOG solely based upon the duty to indemnify EOG as additional insured.

The Fifth Circuit held that under *Mid-Continent*, EOG had no rights to enforce against Pacific because the settlement of the cases fully indemnified EOG for those claims. The Fifth Circuit noted language in the *Mid-Continent* opinion where the Supreme Court noted that Liberty Mutual's excess coverage had no impact on its decision. Nautilus pointed out language in the *Mid-Continent* case where the court suggested Liberty Mutual's motive in paying the entire settlement was to prevent additional liability under its excess policy. *See Mid-Continent*, 236 S.W.3d at 776. The Fifth Circuit noted, however, that Nautilus may have also been concerned about additional liability under its coverage where its policy limit was \$2 million and it contributed \$1.5 million towards settlement, potentially saving \$500,000. Furthermore, the Fifth Circuit noted that the language about Liberty Mutual's excess insurance merely served to distinguish *American Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480, 483 (Tex. 1992) where the Texas Supreme Court recognized equitable subrogation for an excess insurer against the primary insurer. Nautilus, however, was not an excess insurer and thus, such analysis has no bearing upon the decision.

Nautilus made the policy argument that an insurer will be less likely to settle a suit if it cannot recover the money its pays to settle. Also, Nautilus argued that a broad reading of *Mid-Continent* will lead to the elimination of the right of subrogation, which in turn will lead to an unfair distribution of losses among insurers.

The Fifth Circuit held that even if the Supreme Court's *Mid-Continent* decision will have these policy effects, the Texas Supreme Court is the final arbiter of Texas law. However, according to the Fifth Circuit, *Mid-Continent* is unlikely to have such drastic effects because subrogation remains viable for an excess insurer against a primary insurer. Furthermore, it would be inequitable to force Pacific to contribute to settlement when it chose

not to settle, bore the risk of trial that it could be liable for more than it would pay in a settlement and prevailed at trial. The Fifth Circuit concluded that the Texas Supreme Court made the policy decision against an insurer that voluntarily pays more than its pro rata share of settlement.

B. SOLUTIONS

Given the current state of rulings from the federal courts, there seems to be little if any options for co-insurers to recover from one another. In fact, it appears that the first insurer who comes to the table to defend and indemnify may be hung out to dry in getting their fees and costs reimbursed. Here are some situations where I believe the current state of the law may still permit a recovery:

1. The Insurer's Should Demand a Contribution/Joint Defense Agreement

Because the law is still a bit muddled and because many parties and courts have not considered the ramifications of these decisions, it may be prudent to approach your co-insurer with a joint defense/indemnity agreement. In this scenario, the insurer's would agree in a binding contract to the terms and proration of fees and expenses. As such, any deviation from the agreement would sound in a breach of contract action outside the limitations of the decisions discussed above. Further, the agreement would permit an insured the ability to retain a portion of its primary limits as discussed below.

2. The Insured Can Show it is Actually Harmed

At the crux of the Court's recent decisions seems to be the idea that because the insured is not out any money, then there is no damage by which the insured may seek recovery from co-insurers. I believe that in all the cases above, the potential harm to the insured has not been brought to the Court's attention. Most notably, in any case where the insurance company pays settlement monies, the insured's available policy limits are diminished. Take for example an insured that has a One Million (\$1,000,000) policy providing coverage for a one year period. Arguably as soon as the insurance company pays

out the policy limits in any one or multiple claims, the insured's limits are gone. However, if the insurance company can subrogate its damages against other parties/insurers and obtains a recovery, that portion of the insured's policy limits should be reinstated. Absent such ability, the insured faces diminished limits and individual exposure.

Some critics argue that unless the insured can show that actual potential harm, i.e. the payment of claims over and above policy limits, then there is still no harm to the insured. However, such a burden is difficult under Texas law. Take for example an occurrence based policy. If a minor were to get injured at age 10, the policy could potentially be triggered for the next decade should the minor choose to refrain from suing until the age of 18. So does this mean that the insurance companies should have to also wait 10 years to determine if they may seek recovery from co-insurers. The insured may argue that it is damaged as soon as its policy limits are diminished. Put plainly, the insured may be exposed to more liability as the result of its policy being diminished. The insured may be able to show that such actions hurt the insured's business reputation, credit rating, and could potentially result in exposure that could have otherwise been avoided had the insurer recovered all or a portion of the monies paid out, allowing reinstatement of benefits.

3. When a Defense is Denied, an Insurer can Argue that the Co-Insurer is Estopped

In some instances, insurance companies seeking relief from co-insurers may have to rely on the *Gulf Ins. v. Parker Products*, 498 S.W.2d 676 (Tex. 1973) case. This case provides that once an insurer breaches the policy by denying a defense, they are estopped from relying on any of the conditions contained in the policy. The no settlement or no voluntary assumption of liability is a condition and we should have the argument that they are estopped. The Texas Supreme Court in *Gulf* held that:

The insurance company may ordinarily insist upon compliance with this condition for its own protection, but it

may not do so after it is given the opportunity to defend the suit or to agree to the settlement and refuses to do either on the erroneous ground that it has no responsibility under the policy. See *Womack v. Allstate Insurance Company*, 156 Tex. 467, 296 S.W.2d 233 (1956); *Travelers Indemnity Co. v. Equipment Rental Co.*, 345 S.W.2d 831 (Tex.Civ.App. 1961, writ ref'd n.r.e.); *St. Louis Dressed Beef & Provision Co. v. Maryland Casualty Co.*, 201 U.S. 173, 26 Sup.Ct. 400, 50 L. Ed. 712 (1906); 67 A.L.R.2d 1086; 142 A.L.R. 809.

The condition that Parker asserted that Gulf waived was the following:

No action shall lie against the company unless, as a condition precedent thereto, there shall have been full compliance with all of the terms of this policy, nor until the amount of the insured's obligation to pay shall have been finally determined either by judgment against the insured after actual trial or by written agreement of the insured, the claimant and the company.

The conditions in the *Mid-Continent* case were as follows:

1. The "voluntary payment" clauses provided, insureds will, except at their own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than for first aid, without our consent."
2. The subrogation clauses provided, "If the insured has rights to recover all or part of

any payment we have made under this Coverage Part ('Bodily Injury or Property Damage Liability'), those rights are transferred to us."

3. A person or organization may sue us to recover on an agreed settlement or on a final judgment against an insured obtained after an actual trial; but we will not be liable for damages that are not payable under the terms of this Coverage Part ("Bodily Injury or Property Damage Liability") or that are in excess of the applicable limit of insurance. An agreed settlement means a settlement and release of liability signed by us, the insured and the claimant or the claimant's legal representative.

The *Mid-Continent v. Liberty* case did not mention or discuss the *Gulf Ins.* case at all. The insurance company's argument could be that *Gulf* was not overruled by *Mid-Continent* and is still good law and that the *Mid-Continent* decision is not controlling in such a case:

The concurring opinion of Justice Willett seems to recognize the distinction in *Gulf* when he states that:

Here, the body of precedent presenting similar but not identical issues deserves our respect and most careful analysis, but with an appreciation of the factual differences between those cases and the one before us now. We should start with the principle that *Mid-Continent's* primary, if not exclusive, contractual and common-law duty is to its insured, *Kinsel Industries*. *Mid-Continent* did not deny coverage or sit idly on the sidelines; it participated in the defense but

disputed Liberty Mutual's subjective assessment of what the case was worth. I see no basis for concluding that Mid-Continent, by taking a hard line in negotiations, breached a duty to Kinsel--to defend, to exercise good faith, to settle within policy limits, or any other contractual or common-law duty an insurer might owe its insured. Kinsel purchased insurance and got what it paid for, a legal defense of the claim against it and a settlement within policy limits, both funded by its insurers. Not surprisingly, Liberty Mutual, with Kinsel as its named (as opposed to additional) insured and vastly greater exposure because of its excess policy, paid most of the settlement.

the century old right to subrogate. However, some supporters argue that the allocation of risk is the duty of the insurance companies and because the insureds are not harmed, no recovery from co-insurers is proper. What is certain is that this area of the law is not finished being developed and we are likely to see more and more appellate cases dealing with caveats to this body of law.

The argument versus estoppel is further supported by the recent supreme court decision in *Evanston Ins. Co. v. ATOFINA Petrochemical, Inc.*, 51 Tex.Sup.J. 460 (2008). In that case, the supreme court said a wrongful denial of coverage or a wrongful denial of defense by an insurer would bar the insurer from contesting the reasonableness of the settlement as well as challenging any other conditions.

Thus, without relevant factual differences or *Gandy* concerns to dissuade us from following *Block*, we hold that Evanston's denial of coverage barred it from challenging the reasonableness of ATOFINA's settlement. Evanston is, therefore, bound to pay the \$5.75 million that remains of the settlement.

All in all the law regarding indemnity and allocation among co-insurers changed significantly over the past few years. Many opponents argue that it discourages settlement of the underlying case and in some way abolishes