CASE NO. 05-20139

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

MOTIVA ENTERPRISES, LLC

Plaintiff – Appellant,

v.

ST. PAUL FIRE AND MARINE INSURANCE COMPANY and NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PENNSYLVANIA

Defendants – Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF TEXAS (LYNN N. HUGHES, DISTRICT JUDGE)

BRIEF OF AMICUS CURIAE UNITED POLICYHOLDERS IN SUPPORT OF PLAINTIFF-APPELLANT MOTIVA ENTERPRISES, LLC'S BRIEF

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CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record certifies that the following listed persons have an interest in the outcome of this case. These representations are made in order that the judges of the Court may evaluate possible disqualification or recusal.

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Motiva Enterprises, LLC is a Delaware limited liability company, the members of which are affiliates of Shell Oil Company and Saudi Refining, Inc.

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Zurich American Insurance Company

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INTEREST OF *AMICUS CURIAE*

Amicus Curiae, United Policyholders was founded in 1991 as a non-profit organization dedicated to educating the public on insurance issues and consumer rights. The organization is tax exempt under Internal Revenue Code § 501(c)(3). United Policyholders is funded by donations and grants from individuals, businesses and foundations.

In addition to serving as a resource on insurance claims for disaster victims and commercial policyholders, United Policyholders actively monitors legal and marketplace developments affecting the interests of all policyholders. United Policyholders receives frequent invitations to testify at legislative and other public hearings, and to participate in regulatory proceedings on rate and policy issues.

A diverse range of policyholders throughout the United States communicate on a regular basis with United Policyholders, which allows us to provide important and topical information to courts throughout the country via the submission of *amicus curiae* briefs in cases involving insurance principles that are likely to impact large segments of the public.

A United Policyholders' *amicus* brief was cited in the United States Supreme Court's opinion in *Humana v. Forsyth*, 525 U.S. 299 (1999), and our arguments were adopted by the California Supreme Court in *Vandenberg v. Sup. Ct.*, 21 Cal.4th 815 (1999), and the New York Court of Appeals in *U.S. Underwriters Ins.*

Co. v. City Club Hotel, *LLC*, 3 N.Y.3d 592 (N.Y. 2004). United Policyholders has filed *amicus* briefs on behalf of policyholders in over ninety cases throughout the United States, a testament to its position as a vanguard leader in interpreting the modern dilemmas faced by policyholders in today's insurance markets.

QUESTION PRESENTED

Whether a policyholder forfeits coverage by settling a claim without the insurance company's authority, after the insurance company intentionally placed its interests adverse to those of the policyholder by issuing a reservation of rights and without any showing that the insurance company was prejudiced by the settlement.

STATEMENT OF THE CASE, JURISDICTION, AND FACTUAL AND PROCEDURAL BACKGROUND

United Policyholders adopts the statements of the case, jurisdiction and factual and procedural background as presented within the Brief of Appellant, Motiva Enterprises, LLC.

SUMMARY OF ARGUMENT

Reservations of rights, while not an outright denial, are legal notice of an insurance company's intention to contest an aspect of coverage. The insurance industry abusively exploits the unfair advantage gained by reserving its rights by reflexively issuing reservation of rights letters. In light of the inequity this causes coupled with the substantial harm it inflicts upon policyholders, the law should not create more incentives for insurance companies to reserve their rights. Instead, the law should only reward those insurance companies which provide unqualified defenses by applying the rule that *when policyholders are being defended under a*

reservation of rights they may reasonably settle claims without breaching a consent to settle clause.

This rule is win-win for both parties. First, the insurance company, whose interest is contingent upon the determination of its coverage defenses, is afforded a full opportunity to assert its arguments in the coverage litigation, a natural consequence of its reservation of rights. Concomitantly, the policyholder can settle without first obtaining permission from the very party which improperly placed its interests in controversy. What this rule really eliminates is the insurance company's ability to have a "double bite at escaping liability." United Services Automobile Association v. Morris, 741 P.2d 246, 251 (Ariz. 1986)

Furthermore, this rule is consistent with Texas law and established national trends and provides the maximum, equitably cognizable protection over the both parties' legitimate interests.

INTRODUCTION

This Court should apply the rule that when an insurance company reserves its rights, one consequence is that it loses the ability to raise a consent to settle clause as a coverage defense. This rule strikes the proper balance between protection of all parties' interests and encourages positive business practices. The rule provides legal recognition for what any policyholder that has received a reservation of rights already knows: anything less than an unqualified defense does

not equal the benefit of the insurance bargain. Further, this rule acknowledges that a policyholder should not forfeit coverage when it settles a claim for which its insurance company only proffers a qualified defense.

ARGUMENT

I. INSURANCE COMPANIES SHOULD NOT BE REWARDED FOR ISSUING UNNECESSARY RESERVATIONS OF RIGHTS BECAUSE SUCH RESERVATIONS HARM POLICYHOLDERS

A. Insurance Companies Make Money By Taking a "Wait and See" Approach Towards Coverage Determinations and Issuing Reservations of Rights

Once a claim is filed, a policyholder is in a vulnerable position. Insurance companies have three options when given notice of a claim: the insurance company can provide an unqualified defense, deny an obligation to defend or defend the policyholder subject to a reservation of rights. When an insurance company provides an unqualified defense, the insurance company has the power to control settlement of the claim it is defending. Simon v. Maryland Cas. Co., 353 F.2d 608, 612 (5th Cir. 1965). Alternatively, when an insurance company denies coverage, the policyholder is free to settle the claim unilaterally. Simon v. Maryland Cas. Co., 353 F.2d 608 (5th Cir. 1965); Gulf Ins. Co. v. Parker Prods. Inc., 498 S.W.2d 676 (Tex. 1973). Policyholders purchase insurance as protection against potential liability associated with a contingent risk that may or may not occur. Of the options available to an insurance company, only an

unqualified defense affords the policyholder the full benefit of its aleatory[1] contract.

Since insurance companies lose profits when they defend and indemnify policyholders, their intrinsic motivation is to maximize delay and denial of their contractual obligations. "Once an insured files a claim, the insurer has a strong incentive to conserve its financial resources …." E.I. Du Pont de Nemours & Co. v. Pressman, 679 A.2d 436, 447 (Del. 1996). Mercifully, the serious legal implications accompanying a denial protect policyholders from insurance companies who possess vast legal resources, from using outright denials as a common practice. See, e.g., Ranger Ins. Co. v. Robertson, 707 S.W.2d 135 (Tex. App. Austin 1986) (insurer denial forfeits right to conduct policyholder's defense); Wilcox v. American Home Assur. Co., 900 F. Supp. 850 (S.D. Tex. 1995) (denial forfeits right to select counsel for policyholder); Enserch Corp. v. Shand Morahan & Co., Inc., 952 F.2d 1485 (5th Cir. 1992) (forfeits right to assert conditions precedent in the policy).

[1] Meaning that the policyholder performs first by paying its premium and the insurance company performs second by providing coverage. Aleatory contracts are different from ordinary contracts, where both parties perform simultaneously. It is this difference which grants the insurance company a great deal of leverage. Generally, where one contracts for a new Cadillac but is tendered a 12 year-old Yugo, one can cancel one's check and go to another car dealership. Conversely, a policyholder who is promised Grade A insurance at the point of sale and receives Grade D- insurance at the point of claim cannot "cover" by going back in time and purchase alternative insurance. Additionally, the policyholder whose claim is improperly denied will typically have fewer resources to contest that denial, as it will simultaneously be under financial pressure from the very catastrophe which led to the claim.

Since the legal consequences mitigating against an outright denial of coverage do not eliminate the insurance company's desire to shield their "profits," in lieu of an acceptance or denial of coverage, they unfairly rely on the ability to reserve their rights as a common practice. See, e.g., State Farm Lloyd's Ins. Co. v. Ashby AAA Automotive Supply Co., 1995 WL 513363 (Tex. App. Dallas 1995) (homeowner's insurance company sent a reservation of rights to policyholders even though unnecessary to preserve its defense); Aetna Cas. and Sur. Co. v. Garza, 906 S.W.2d 543 (Tex. App. San Antonio 1995) (same).

B. After a Reservation of Rights Courts Nationwide Ease Compliance With Restrictive Policy Provisions

A reservation of rights, while not an outright denial of coverage, negatively impacts a policyholder facing a claim in a manner similar to that of a denial.[2] Inherently, a reservation of rights places the policyholder in a defensive posture with the very party whom the policyholder paid for liability protection. Courts have analogized a defense subject to a reservation of rights to a denial:

> A carrier's unilateral defense under a reservation of rights is similar to a refusal to provide any defense at all in its effect on the insured.

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[2] Notably, there is persuasive case law in some jurisdictions for the proposition that a reservation of rights letter is the equivalent of a denial of coverage. See Butters v. Independence, 513 S.W.2d 418, 4225 (Mo. 1974) (court found "the insured is released from the policy prohibition against incurring expenses and negotiating and settling claims" where the insurance company agreed to defend under a reservation of rights) (quoting Landie v. Century Indem. Co., 390 S.W.2d 558, 561-62 (Mo. Ct. App. 1965)); see also Central Armature Works, Inc. v. American Motorists Ins. Co., 520 F. Supp. 283, 288 (D.D.C. 1980) (holding that insurance company is estopped from raising the "consent to settlement" clause as a defense because of its conduct in denying coverage, and then reserving its rights regarding coverage).

> In either case, the carrier has violated its duties under the policy unconditionally to defend and indemnify its insured within specified limits. The consequence of that violation is that the carrier has transferred to its insured the power to conduct the defense of the claim against its insured.

Nationwide Mutual Fire Ins. Co. v. Beville, 825 So.2d 999, (Fla. App. 4th Dist. 2002) (citing Taylor v. Safeco, 361 So.2d 743, 746 (Fla 1st Dist. 1978). A reservation of rights places the policyholder's interests in jeopardy. Arizona Property and Cas. Ins. Fund v. Helme, 153 Ariz. 129, 137 (1987) (insurance company's reservation of rights to assert a policy defense may still leave the policyholder in the precarious position of having to satisfy an uninsured judgment).

In recognition of the inequitable benefit a reservation of rights confers upon an insurance company and the deleterious impact it imposes on a policyholder, courts in every jurisdiction have created judicial exceptions to the contractual obligations written into insurance policies. See Rhodes v. Chicago Ins. Co., 719 F.2d 116, 120 (5th Cir. 1983) (policyholder can reject a defense tendered under a reservation of rights and insurance company liable for the costs of the policyholder's independent representation); Union Ins. Co. v. The Knife Company, Inc., 902 F.Supp 877, 880-81 (W.D. Ark. 1995) (holding that "Union's reservation of rights puts Union and the Knife Company in a conflict of interest … [and therefore] [t]he insurer must give up control of the litigation"); United States Fidelity & Guar. Co. v. Louis A. Roser Co., 585 F.2d 932 (8th Cir. 1978) (same);

San Diego Navy Fed. Credit Union v. Cumis Ins. Soc'y, Inc., 208 Cal. Rptr. 494 (Ct. App. 1984) (same); CHI of Alaska, Inc. v. Employers Reinsurance Corp., 844 P.2d 1113 (Alaska 1993) (same); see also Kansas Bankers Sur. Co. v. Lynass, 920 F.2d 546, 548 (8th Cir. 1990) (applying South Dakota law, court held that insurance company cannot control the defense and reserve the right to contest liability without the agreement of the policyholder); State Farm Mut. Auto. Ins. Co. v. Ballmer, 899 S.W.2d 523, 527 (Mo. 1995) (recognizing the policyholder's right to reject a defense tendered with a reservation of rights).

Similarly, there is a national recognition that insurance companies should not be granted equal rights in determining settlement, despite the terms of the policy, when its obligation to be bound by any judgment is contingent as opposed to vested. See United Services Automobile Association v. Morris, 741 P.2d 246, 251 ("the insured risks financial catastrophe if they are held liable, while the insurer may save itself by litigating both issues – the insured's liability and the coverage defense – and winning either.") The obvious problem the Court in Travelers Indemnity Company v. Dingwell, 884 F.2d 629 (1st Cir. 1989) identified and addressed is that "[w]hen the insurer offers to defend the insured but reserves the right to deny coverage, however, the insurer's interest in the liability phase of the proceeding is contingent on the resolution of the coverage issue." Id. at 638-39 (emphasis added) ("[a]llowing the insurer to intervene to protect its contingent

interest would allow it to interfere with and in effect control the defense [and] [s]uch intervention would unfairly restrict the insured, who faces the very real risk of an uninsured liability ….").

The Court in Morris recognized that the "practical effect" of the insurance companies' failure to accept "full responsibility for liability exposure" is to place the policyholder in a "precarious position." Id. at 250-51 (a direct consequence of the insurance company's qualified coverage is to expose the policyholder to "a jury verdict greater than their $100,000 policy limit or, even if within the limit, one that might not be covered"). Thus, the Court held, "[t]he insurer's insertion of a policy defense by way of reservation or nonwaiver agreement narrows the reach of the cooperation clause and permits the insured to take reasonable measures to protect himself against the danger of personal liability." Id. at 251.

The rationale underlying these rules is clear: the law must protect a policyholder, served with a reservation of rights, from losing control of their defense when facing the prospect of being left with an insurance liability that could have been avoided if he had controlled the defense. As explained in Three Sons, Inc. v. Phoenix Insurance Co., 357 Mass. 271 (Mass. 1970):

> Control of the case by the insurer, when it may later disclaim liability under the policy, means that the insured's rights may be adversely affected. He has no opportunity to control aspects of the case essential to determination of liability or settlement. If liability

> is established, or a settlement reached, and the insurer has a valid ground for disclaimer, the insured is left with a liability which, had he been able to defend or settle on other terms, might never have existed.

Id. at 276-77 (quoting Salonen v. Paanenen, 320 Mass. 568, 574 (Mass. 1947) ("[W]e are not to be understood as holding that an insurer may reserve its rights to disclaim liability in a case and at the same time insist on retaining control of its defence.").

In sum, when an insurance company issues a reservation of rights, the policyholder is left to the mercy of a party whose motives to perform completely are diminished by its own pecuniary interests. Accordingly, the law reflects this tension by encouraging insurance companies to provide unqualified as opposed to qualified coverage.

II. THIS COURT SHOULD NOT ENCOURAGE INSURANCE COMPANIES TO CONTINUE REFLEXIVELY ISSUING RESERVATION OF RIGHTS LETTERS

A reservation of rights is judicial creation, crafted to protect insurance companies from having to render a coverage decision without full information. Unfortunately, insurance companies unfairly exploit this practice, using it as a barrel over which they leverage vulnerable policyholders.

If an insurance company can obtain the benefit of requiring compliance with all policy conditions despite its qualified promise to perform, there is hardly a reason for an insurance company to perform fully. Considering

the insurance industry's reflexive practice to reserve its rights, an ability to rely upon the consent to settle clause as a defense to coverage despite proffering less than full performance encourages insurance companies to reserve their rights.

In the interests of ensuring that an aggrieved claimant will be paid, promoting conservation of judicial resources as well as protecting the benefit of a policyholder's aleatory contract, society benefits when insurance companies are encouraged to provide an unqualified defense. Yet the rule sponsored by National Union and applied by the Lower Court directly contravenes these policies. The net effect of permitting an insurance company to rely on the consent to settle clause after it has reserved its rights is to encourage insurance companies to reflexively reserve their rights, even when coverage is clear.

Instead, the law should encourage vacillating insurance companies to expeditiously endorse a coverage position instead of leaving policyholders in the lurch. Recognition that policyholders offered a qualified defense may settle without prior authorization will cause insurance companies to give firm coverage positions greater consideration. Correspondingly, if the insurance company wants retain advantages it is granted under the policy, including the right to control settlement, it must perform according to its obligations.

Allowing policyholders to settle without breaching a policy's cooperation clause is the judicious rule. First, this rule advances the universal

policy of every state to encourage settlement. Furthermore, a gross injustice occurs when an insurance company is permitted to walk away from a properly covered claim by simple virtue of a policyholder's unilateral settlement. The law must continue to reflect the fact that a reservation of rights, among other things, destroys the policyholder's peace of mind it thought it purchased with its insurance policy.

Correspondingly the consequence an insurance company endures by virtue of its reservation of rights under this rule is merely the loss of an "inconsistent right to assert the exclusionary consent clause as grounds for forfeiture of plaintiff's entire coverage." Ford v. State Farm Mutual Auto. Ins. Co., 550 S.W.2d 663, 666 (Tex. 1977); Texas United Ins. Co. v. Burt Ford Enter., Inc., 703 S.W.2d 828 (Tex.App. 1986) (an insurance company's denial of coverage operates only to deprive the insurance company of the right to insist on compliance with policy conditions and does not estop the insurance company from asserting the defense of noncoverage under the policy's coverage provisions or exclusions).[3]

In short, whether or not a policyholder being defended under a reservation of rights can settle without the insurance companies' consent is integrally connected to the conduct promoted by the law. The corresponding

[3] There is no waste of judicial resources or additional burden imposed by this rule because the likelihood of coverage litigation was already caused by the insurance company's reservation of rights. See 14 Couch on Ins. § 199:48 (3d ed. Nov. 2004).

impact that an insurance company's reservation of rights has on its interests can be expected to guide insurance company's conduct and coverage decisions. The rule this *amicus* endorses strikes the appropriate balance because it allows a policyholder to protect its interests by settling claims when he is exposed to personal liability and encourages insurance companies to fairly and expeditiously assess claims.

III. PERMITTING SETTLEMENT BY A POLICYHOLDER WITHOUT BREACH OF RESTRICTIVE POLICY PROVISIONS IS CONSISTENT WITH TEXAS LAW AND THE LAW NATIONWIDE

A. There Is a National Trend Towards Permitting a Policyholder To Settle Without Breaching a Cooperation Clause When Defended Under a Reservation of Rights

Nationally, courts have adopted rules similar to the one advocated today. In Miller v. Shugart, 316 N.W.2d 729 (Minn. 1982), the Minnesota Supreme Court found that while an insurance company does not "abandon its insureds" by issuing a reservation of rights, "neither [does] it accept responsibility for the insureds' liability exposure." and "[w]hile the defendant insureds have a duty to cooperate with the insurer, they also have a right to protect themselves against plaintiff's claim." Id. at 733. Accordingly, the Court held that when "the insureds are offered a settlement that effectively relieves them of any personal liability, at a time when their insurance coverage is in doubt, surely it cannot be said that it is not in their best interest to accept the offer." Id. at 733-34; United

Services Automobile Association v. Morris, 741 P.2d 246, 252-54 (accord with holding in Miller).

In fact, the United States Court of Appeals for the First Circuit recognizes that this view merely reflects "the well-established policy that an insurer who reserves the right to deny coverage cannot control the defense of a lawsuit brought against insured by an injured party." Travelers Indemnity Company v. Dingwell, 884 F.2d 629, 639 (1st Cir. 1989); see also Eureka Investment Corp. v. Chicago Title Ins. Co., 530 F. Supp. 1110 (D.D.C. 1982), aff'd in part, rev'd in part on other grounds, 743 F.2d 932 (D.C. Cir. 1984) ("[i]t is well established that if an insurer wrongfully denies liability when its insured submits a claim, the insurer may be held liable for the costs of a reasonable settlement reached by its insured …").

As the Court in Gates Formed Fibre Products, Inc., v. Imperial Cas. and Indemnity Co., 702 F. Supp. 343 (D. Maine 1988) recognized, "[t]he cooperation clause does not prohibit the insured from seeking a settlement agreement, but makes only the reasonable requirement that the insured give the insurer notice before entering the agreement." Id. at 348. Notably here, Motiva's more than adequate notice to National Union of the settlement negotiations is uncontroverted.

Applying Oklahoma law, the United States Court of Appeals for the Tenth Circuit reasoned that if an insurance company only conditionally accepts its obligations under the policy and reserves its rights, the insurance company gives up its right to control the litigation, including the right to settle. Traders & Gen. Ins. Co. v. Rudco Oil & Gas Co., 129 F.2d 621, 628 (10th Cir. 1942). In Traders, the insurance company agreed to defend under a reservation of rights and the policyholder settled the underlying action. In its analysis, the court held that the policyholder properly controlled and settled the litigation because the insurance company had reserved its rights:

> [The insurance company] had the right to demand not a settlement on its terms and conditions, but a good faith co-operation on the part of [policyholder], wherein both parties would face the facts realistically and with a mutual respect for the interest of each … The facts fully support the realistic view of the controversy taken by [policyholder]; they deny the arbitrary position taken by [the insurance company]. At the time of the settlement by [the policyholder], the matters had reached a critical point. It had obtained an offer of compromise and settlement … negotiated by [policyholder] with the full knowledge of [the insurance company], but without its assistance or acquiescence…. If [the policyholder] waited until the coverage under the policy was determined by the suit for declaratory judgment there was a possibility that the suit for declaratory judgment would develop not only the noncoverage under the policy, but the sole liability of [the policyholder] for the injuries as well. If the proposed settlement was just, reasonable, and mutually advantageous, [the insurance company] had only to hazard the risk of coverage. The right to assert noncoverage was as much available to it after the settlement as before.

Id. at 628.

In Insurance Co. of North America v. Spangler, 881 F. Supp. 539 (D. Wyo. 1995), the Court, facing a dearth of controlling precedent, correctly determined that "the Wyoming Supreme Court would adopt the rationale of those cases holding that an insurer who reserves the right to deny coverage loses the right to control the litigation." Id. at 544 (citing Ideal Mutual Ins. Co. v. Myers, 789 F.2d 1196, 1205 (5th Cir. 1986)) ("insured's settlement of case being defended under reservation of rights 'does not operate to discharge the insurer's obligations unless insurer actually prejudiced or deprived of a valid defense.'").

CONCLUSION

For the foregoing reasons, *amicus curiae* United Policyholders respectfully submits that the Court, in its answers to the questions certified on appeal, should accept the arguments of Plaintiff-Appellant.

Dated: May 25, 2005

Respectfully submitted

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CERTIFICATE OF SERVICE

I hereby certify that paper and electronic copies of the BRIEF OF AMICUS CURIAE UNITED POLICYHOLDERS IN SUPPORT OF MOTIVA ENTERPRISES, LLC'S BRIEF, along with an electronic copy in pdf format on a 3.5 inch diskette, were forwarded by certified mail, return receipt requested, this 25th day of May, 2005, by U.S. first class mail, postage prepaid, to counsel of record as follows:

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REVISED CERTIFICATE OF COMPLIANCE

Pursuant to 5th Cir. R. 32.2 and .3, the undersigned certifies that this brief complies with the type-volume limitations of Fed. R. App. 32(a)(7)(B).

1. EXCLUSIVE OF THE EXEMPTED PORTIONS IN 5TH Cir. R. 32.2, THE BRIEF CONTAINS 3,371 words.

2. THE BRIEF HAS BEEN PREPARED in proportionally spaced typeface using Microsoft Word XP, in the following typeface name and font size: Times New Roman, 14 pt.

3. THE UNDERSIGNED UNDERSTANDS THAT A MATERIAL MISREPRESENTATION IN COMPLETING THIS CERTIFICATE, OR A CIRCUMVENTION OF THE TYPE-VOLUME LIMITS IN FED. R. APP. R. 32 (a)(7), MAY RESULT IN THE COURT'S STRIKING THE BRIEF AND IMPOSING SANCTIONS AGAINST THE PERSON SIGNING THE BRIEF.

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Charles L. Stern, Jr.