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DETERMINING AN INSURER'S DUTY TO INDEMNIFY BEFORE SETTLEMENT OR JUDGMENT

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I. INTRODUCTION

In 1996, the Texas Supreme Court began to overtly encourage insurers to seek an early resolution of their duty to indemnify in situations where coverage was unclear. *See State Farm Fire Ins. & Cas. Co. v. Gandy*, 925 S.W.2d 696, 714 (Tex. 1996). In *Gandy*, the Supreme Court hoped to stop the practice of collusive lawsuit settlements intended to set up insurers. These typically involved an agreement by the insured not to defend against the claim and the assignment of the insured's causes of action against its insurer in exchange for the plaintiff's promise not to enforce the judgment against the insured. In *Gandy*, the Supreme Court held that such assignments would be invalid unless made after an adversarial trial, if an insurer had accepted coverage *or* had made a good faith effort to determine coverage. The Supreme Court went on to suggest that the tort plaintiff might want to assist in the coverage litigation. *See id.*

Subsequently, the Texas Supreme Court reiterated its support for early resolution of coverage questions in two cases holding that when coverage is unclear, an insurer cannot unilaterally settle the claim and then ask a court to order the insured to pay back the settlement sum if the court determines that coverage did not exist. *See Tex. Ass'n of Counties Cnty. Government Risk Mgmt. Pool v. Matagorda Cnty.*, 52 S.W.3d 128, 134 (Tex. 2000); *Excess Underwriters at Lloyd's London v. Frank's Casing Crew & Rental Tools, Inc.*, 246 S.W.3d 42 (Tex. 2008). The Supreme Court pointed to *Gandy* as one of the reasons it was disallowing reimbursement observing:

> In *Gandy*, we required insurers either to accept coverage or make a good faith effort to resolve coverage before resolving the underlying claim. … [The insurer's] position undermines *Gandy* by reducing insurers' incentive to seek early resolution of coverage disputes.

Matagorda Cty, 52 S.W.3d at 135.

Ironically, when the Texas Supreme Court issued its *Gandy* decision, a Texas state court did not have the authority to decide if a future settlement or judgment would be covered by insurance. It was well settled that the duty to indemnify was not justiciable in a Texas court prior to settlement or judgment. *See Central Surety & Ins. Corp. v. Anderson*, 445 S.W.2d 514 (Tex. 1969) (fundamental error for trial court to determine that an insurer had a duty to indemnify an insured for a potential judgment); *Firemen's Ins. Co. of Newark N.J. v. Burch*, 442 S.W.2d 331 (Tex. 1968) (district court had no power to render advisory opinion on insurer's coverage for a possible future judgment).

Therefore, despite the Supreme Court's holding in *Gandy*, it was impossible for an insurer who had no duty to defend to protect itself from a collusive settlement or judgment. Recognizing the Hopson's choice created by *Gandy,* the Supreme Court overturned *Burch. See Farmers Tex. Cty. Mut. Ins. Co. v. Griffin*, 856 S.W. 2d 81 (Tex. 1997). Specifically, it held that the duty to indemnify is justiciable if an insurer has no duty to defend and the same reasons that negate the duty to defend also negate the duty to indemnify. *See id*.

Although the Supreme Court overturned *Burch* almost twenty years ago, courts and practitioners have not reached any consensus on the issues arising out of the *Griffin* decision. These issues include: 1) how early in the claim process does the duty to indemnify become justiciable; 2) what is the effect of an appeal on the justiciability of the duty to indemnify; 3) who has standing to bring an action under *Griffin*; 4) what evidence should a court rely on when making a decision on the duty to indemnify prior to the conclusion of the lawsuit; 5) who has the burden of proof under *Griffin*.

II. THE TRADITIONAL RULE

Although Texas adopted the Uniform Declaratory Judgment Act in 1943, it was 1968 before the Texas Supreme Court considered a court's authority to determine an insurer's duty to indemnify prior to settlement or judgment. *See Burch*, 442 S.W.2d at 331. *Burch* arose out of a car accident involving the ex-wife of Larry Butler, Firemen's Insurance Company's ("FIC") insured. The underlying plaintiffs sued both the ex-wife and Butler alleging that he was legally liable for the injuries allegedly caused by his wife, as his liability was necessary to trigger coverage.

When the parties began settlement discussions, the issue of whether FIC would have any liability for the judgment hindered the progress of the negotiations. This resulted in the underlying plaintiffs seeking a declaration that FIC would have a duty to pay any underlying judgment, which prompted a counter-claim by FIC seeking a declaration of non-coverage.

When the coverage case reached the Texas Supreme Court, it refused to rule on the duty to indemnify saying that it did not have the authority to do so. The court explained that the Texas Constitution did not empower courts to issue advisory opinions and that the Texas Declaratory Judgment Act could not override the state's constitution. *See id.* at 333.

The court said that because "the giving of advice as to proposed or possible settlements is not a judicial function," the parties' lawyers would have to make an educated guess on coverage based on the cases that the court had previously decided and other authoritative materials. *See id.* The court also observed that giving advice on coverage for a future judgment would be a waste of judicial resources, if the jury entered a take nothing verdict for the plaintiffs. *See id.*

For some 30 years, there was no way to obtain a definitive answer on coverage for a future settlement or judgment from a Texas state court. There was, however, one widely held belief that in some cases reduced the uncertainty for the parties. Under Texas law, the duty to defend is broader than the duty to indemnify. *See E&L Chipping Co., Inc. v. Hanover Ins. Co.,* 962 S.W.2d 272, 274-75 (Tex. App.—Beaumont 1998, no pet). An insurer must defend if there is any possibility that a claim might be covered. *See Heyden Newport Chem. Corp. v. Southern Gen'l Ins. Co*., 387 S.W.2d 22, 24-25 (Tex. 1965). Therefore, if there was no possibility of a covered claim based on the factual allegations in the petition then proof of those same facts could not result in a covered judgment or settlement. *See e.g. Western Heritage Ins. Co. v. River Entertainment*, 998 F.2d 311, 314 (5th Cir. 1993) (logic and common sense dictate that if there is no duty to defend there can be no indemnify after judgment); *Lay v. Aetna Ins. Co*., 599 S.W.2d 684 (Tex. Civ. App.—Austin, 1980, writ ref'd n.r.e.) (as petition did not allege destruction or

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