ORIGINAL

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

HEALTHSOUTH CORPORATION and HORIZON/CMS HEALTHCARE CORPORATION	§	
VS.	§	ACTION NO. 4:01-CV-793-Y
	§	(Consolidated w/ 4:01-CV-814-Y)
GULF UNDERWRITERS INSURANCE COMPANY and GULF INSURANCE CO.	§	
VS.	§	
AMERICAN CONTINENTAL INSURANCE COMPANY, ET AL.	§	

ORDER GRANTING MOTION FOR SUMMARY JUDGMENT

Pending before the Court is the Motion for Summary Judgment filed by third-party defendants American Continental Insurance Company, The St. Paul Companies, Inc., St. Paul Fire and Marine Insurance Company, and St. Paul Mercury Insurance Company (collectively referred to as "ACIC"). After careful review and consideration of all of the briefs related to the motion and the applicable law, the Court concludes that the motion should be granted.

I. Facts

Plaintiffs HealthSouth Corporation and its subsidiary, Horizon/CMS Healthcare Corporation ("Horizon"), (collectively, "HealthSouth") filed this action against Gulf Underwriters Insurance Company and Gulf Insurance Company (collectively, "Gulf"), seeking damages and a declaratory judgment regarding their rights to insurance coverage under certain excess-liability

insurance policies issued by Gulf. HealthSouth seeks coverage for damages, including punitive damages, assessed against them in underlying actions brought by third parties for injuries suffered in nursing homes formerly or presently owned by HealthSouth.

One such underlying action was brought and tried in this Court: *Cecil Fuqua, et al. v. Horizon/CMS Healthcare Corporation, et al.*, cause number 4:98-CV-1087-Y. In *Fuqua*, this Court found that Horizon's conduct during discovery warranted the striking of its pleadings, effectively establishing that Horizon was liable to the plaintiffs. At the conclusion of the trial regarding damages, the jury awarded the plaintiffs $2.7 million in compensatory damages and $310 million in punitive damages. The parties ultimately settled the case.

Gulf has denied coverage under the excess policies for several reasons, including that Horizon breached its duty under the policies to cooperate in the defense of the *Fuqua* suit, as evidenced by the fact that it engaged in the discovery abuse that led to the sanctions. HealthSouth has indicated that it intends to shift the blame for the discovery sanctions in the *Fuqua* litigation to either Horizon's defense counsel in that suit or its primary insurer, ACIC.

As a result, Gulf filed separate third-party complaints against both the *Fuqua* defense counsel and ACIC. Gulf's third-party complaint against ACIC alleges various direct negligence claims, including that ACIC negligently mishandled the *Fuqua* defense, that ACIC is vicariously liable for any mishandling of the

defense committed by the *Fuqua* defense counsel, that ACIC negligently failed to settle *Fuqua* for an amount below Gulf's excess-liability policy, and that ACIC breached a duty to Gulf not to waste ACIC's underlying limits on an uncovered claim. Gulf seeks a declaratory judgment holding ACIC liable to Gulf for any amounts Gulf must pay to HealthSouth in the event that ACIC, rather than Horizon, is determined to have caused the discovery sanctions in *Fuqua*. Alternatively, Gulf seeks recovery on the failure-to-settle claim via equitable subrogation. Gulf also asserts against ACIC a statutory claim under article 21.21 of the Texas Insurance Code. ACIC seeks summary judgment as to all of these claims. After review of all of the briefs submitted by the parties, the Court concludes that ACIC's motion should be granted.

II. Summary-Judgment Standard

Summary judgment is appropriate when the record establishes "that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." FED. R. CIV. P. 56(c). The party moving for summary judgment has the initial burden of demonstrating that it is entitled to a summary judgment. *See Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). The moving party need not produce evidence showing the absence of an issue of fact with respect to an issue on which the nonmovant bears the burden of proof, however. Rather, the moving party need only point out that the evidentiary documents in the record contain insufficient proof concerning an essential element of the nonmovant's claim. *See id.* at 323-25.

When the moving party has carried its summary-judgment burden, the nonmovant must go beyond the pleadings and, by its own affidavits or by the depositions, answers to interrogatories, or admissions on file, set forth specific facts showing that there is a genuine issue for trial. FED. R. CIV. P. 56(e). This burden is not satisfied with some metaphysical doubt as to the material facts, by conclusory allegations, by unsubstantiated assertions or by only a scintilla of evidence. *Little v. Liquid Air Corp.*, 37 F.3d 1069, 1075 (5th Cir. 1994). If the evidence is merely colorable or is not significantly probative, summary judgment may be granted. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249-50 (1986).

III. Analysis

1. Direct-Negligence Claims

ACIC contends that summary judgment is appropriate on all of Gulf's direct-negligence claims because Texas does not recognize such claims between an excess and primary insurer. The Court agrees. In Texas, the only claim an excess insurer can bring against a primary insurer is one under a theory of equitable subrogation for breach of the duty owed to the insured under *G.A. Stowers Furniture Company v. American Indemnity Company*, 15 S.W. 2d 544 (Tex. Comm'n App. 1929).[1] *See Gen. Star Indem. Co. v. Vesta Fire Ins.* Corp., 173 F.3d 946, 949-50 (5th Cir. 1999); *Nat'l Union*

[1]In *Stowers*, the court concluded that a primary insurer who assumed complete control over litigation brought against its insured owed the insured a duty to accept a reasonable settlement offer. 15 S.W. 2d at 547.

Fire Ins. Co. v. CNA Ins. Cos., 28 F.3d 29, 33 n.5 (5th Cir. 1994); *Am. Centennial Ins. Co. v. Canal*, 843 S.W.2d 480, 483 (Tex. 1992).

Gulf requests the Court to make an "*Erie* guess" that the Texas Supreme Court, if presented with the facts involved in this case, would join the "many" jurisdictions that recognize direct duties between a primary and excess insurer. When a forum state's supreme court has not ruled on an issue, a federal court exercising diversity jurisdiction has a duty to make "an *Erie* guess" as to what the state's supreme court would likely decide. *Herrmann Holdings, Ltd. v. Lucent Techs. Inc.*, 302 F.3d 552, 558 (5th Cir. 2002). In making the estimate, a federal court "defer[s] to intermediate state appellate court decisions 'unless convinced by other persuasive data that the highest court of the state would decide otherwise.'" *Id.* (quoting *First Nat'l Bank of Durant v. Trans Terra Corp.*, 142 F.3d 802, 809 (5th Cir. 1998)). The federal court "may also refer to rules in other states that [the state's] courts might look to." *Id.; see also Continental Cas. Co. v. Pullman, Comley, Bradley, & Reeves*, 709 F. Supp. 44, 46 (D. Conn. 1989) ("the federal court may discern the forum state's law by examining relevant decisions from the forum state's inferior courts, decisions from sister states, federal decisions, and the general weight and trend of authority"), *aff'd*, 929 F.2d 103 (2d Cir. 1991). The federal court's task, however, "is to 'attempt to predict state law, not to create or modify it.'" *Id.* (quoting *UPS, Inc. v. Weben Indus., Inc.*, 794 F.2d 1005, 1008 (5th Cir. 1986)). The federal court's "*Erie*-role is to apply existing [state] law,

not to adopt innovative theories for the state." *UPS*, 794 F.2d at 1008.

Gulf concedes that the Texas Supreme Court has "decline[d] at this time to permit a direct action" between an excess and primary insurer. *Canal*, 843 S.W.2d at 483; Gulf's Resp. to ACIC's Mot. for Summ. J. at 15. Indeed, in so declining, the Supreme Court noted that "[o]nly a few jurisdictions have permitted a direct action, rather than limiting the excess carrier to an equitable subrogation claim." *Canal*, 843 S.W.2d at 483. In support of its request for an *Erie* guess, Gulf cites cases from six different states in which the courts found that a primary insurer owed some type of direct duty to an excess insurer--hardly an overwhelming trend of authority. *See* Gulf's Resp. to ACIC's Mot. for Summ. J. at 17-18, nn. 54, 55, & 58. Furthermore, Gulf does not cite any decisions from intermediate Texas courts recognizing such an action, nor does it analogize to any other Texas cases in similar contexts that might indicate that the Texas Supreme Court would recognize such duties in the context of primary and excess insurers. As a result, Gulf has not persuaded this Court that the Texas Supreme Court would likely recognize additional duties between excess and primary insurers, and the Court thus declines to do so.

2. Texas Insurance Code Article 21.21

Gulf also brings a claim against ACIC for violation of article 21.21 of the Texas Insurance Code. Although Gulf's third-party complaint does not specify which portion of article 21.21 it believes ACIC violated, it appears that Gulf brings suit for a

violation of section 4(10)(a)(ii). That section states that "failing to attempt in good faith to effectuate a prompt, fair, and equitable settlement of a claim with respect to which the insurer's liability has become reasonably clear" is an unfair or deceptive act or practice in the business of insurance. TEX. INS. CODE art. 21.21 § 4(10)(a)(ii) (West Supp. 2004).

As pointed out by ACIC, however, article 21.21 also specifies that section 4(10)(a)(ii) "does not provide a cause of action to a third party asserting one or more claims against an insured covered under a liability insurance policy." *Id.* § 4(10)(b). In other words, a third party asserting a claim against an insured has no right to sue the insured's insurer under article 21.21 for the insurer's failure to attempt in good faith to settle the claim between the third party and the insured. Although ACIC pointed to this provision in its brief, Gulf failed to respond to ACIC's arguments regarding this provision.

Section 4(10)(b), which was enacted in 1995, appears to be a codification of Texas case law interpreting a prior version of article 21.21. *See Allstate Ins. Co. v. Watson*, 876 S.W.2d 145, 146 (Tex. 1994); *see also* 1995 Tex. Sess. Law Serv. Ch. 415 (Vernon) (enacting section 4(10)(b)). In *Watson*, the Texas Supreme Court held that a third-party claimant does not have "a direct cause of action against an insurer for unfair claim settlement practices under section 16 of art[icle] 21.21 of the Texas Insurance Code." *Id.* at 146. The Court refused "to extend to a party adverse to the insured the same duties and obligations

insurers owe to their insureds" under article 21.21. *Id.* at 147.

For similar reasons, this Court concludes that Gulf may not sue ACIC under article 21.21 for its allegedly unreasonable failure to settle the claims asserted against HealthSouth in *Fuqua* and the other underlying actions. Gulf has failed to cite, nor has the Court found, any case interpreting article 21.21 to permit an excess insurer to sue a primary insurer directly for alleged violations of that statute. Indeed, as indicated by ACIC, the Texas Supreme Court declined to interpret article 21.21 as imposing duties between an excess and primary insurer when asked to do so, concluding instead that the only duties between an excess and primary insurer are *Stowers* duties under a theory of equitable subrogation. *See Canal*, 843 S.W.2d at 481, 483 (Tex. 1992).

3. Equitable Subrogation

Thus, the only recognized claim Gulf may have against ACIC is one via equitable subrogation. ACIC contends that any subrogation claim Gulf has is barred, however, as a result of the release agreement executed by HealthSouth and ACIC. The Court agrees.

"Generally, rights conferred by subrogation are entirely derivative of the subrogor's interest, to which the subrogee merely succeeds." *See Guillot v. Hix*, 838 S.W. 2d 230, 232 (Tex. 1992). Thus, under the doctrine of equitable subrogation, Gulf steps into HealthSouth's shoes and may pursue whatever claims HealthSouth has against ACIC; but ACIC may assert against Gulf whatever defenses it would have had against HealthSouth:

'Subrogation is the substitution of one person in the

> place of another, whether as creditor or as possessor of some lawful claim, so that he who is substituted succeeds to the rights of the other in relation to the debt or claim . . . By subrogation, a court of equity, for the purpose of doing exact justice between parties in a given transaction, places one of them, to whom a legal right does not belong, in the position of a party to whom the right does belong.' *Argonaut Ins. Co. v. Allstate Ins. Co.*, 869 S.W.2d 537, 541 (Tex. App.--Corpus Christi 1993, writ denied) (quoting *McBroome-Bennet Plumbing, Inc. v. Villa France, Inc.*, 515 S.W.2d 32, 36 (Tex. Civ. App.-Dallas 1974, writ ref'd n.r.e.)). The right of subrogation may be established by contract--conventional or contractual subrogation--or based upon principles of equity--equitable subrogation. *See Liberty Mut. Ins. Co. v. General Ins. Corp.*, 517 S.W.2d 791, 797 (Tex. Civ. App.-Tyler 1974, writ ref'd n.r.e.). "If the subrogor has no rights, then the subrogee can have none." *Fishel's Fine Furniture v. Rice Food Mkt.*, 474 S.W.2d 539, 541 (Tex. Civ. App.-Houston [14th Dist.] 1971, writ dism'd) (citations omitted). Thus, because an insurer's right of subrogation is derived from the rights of the insured and is limited to those rights, there can be no subrogation where the insured has no cause of action against the defendant. *See id.*

A.S.W. Allstate Painting & Constr. v. Lexington, 94 F. Supp. 2d 782, 786 (S.D. Tex. 2000); *see also Gen. Star Indem.*, 173 F.3d 946, 949 (5th Cir. 1999) ("[A]n excess insurer, paying a loss under a policy, 'stands in the shoes' of its insured with regard to any cause of action its insured may have against a primary insurer responsible for the loss"); *Phennel v. Roach*, 789 S.W.2d 612, 615 (Tex. App.--Dallas 1990, writ denied) (in workers' compensation context, concluding that "[t]here is but one cause of action against the third party tortfeasor--that of the employee, who owns it burdened by the right of the insurance carrier to recoup itself for compensation paid.").

On August 23, 2001, ACIC and HealthSouth entered into a compromise settlement agreement that settled "all claims or

potential claims" HealthSouth may have had against ACIC for any type of "Extra Contractual Liability" relating to ACIC's participation in the underlying lawsuits, including the *Fuqua* action. (ACIC's App. at 205, ¶ 28.) "Extra Contractual Liability" was defined as "any kind of financial responsibility imposed or potentially imposed upon ACIC . . . at common law, by statute or regulation, or otherwise, that exceeds, or is in addition to, ACIC's . . . financial responsibility under the [i]nsurance [p]olicies." (ACIC's App. at 198, ¶ 2.3.) "Extra Contractual Liability" was also specifically defined to include any "*Stowers* liability." (ACIC's App. at 198, ¶ 2.3; 199, ¶ 2.11.) Given that any subrogation claim Gulf has is derivative, HealthSouth's release of any claims it had against ACIC bars Gulf's subrogation claim.[2] *See Int'l Ins. Co. v. Medical-Professional Bldg.*, 405 S.W. 2d 867, 869 (Tex. Civ. App.--Corpus Christi 1966, writ ref'd n.r.e.) ("there can be no subrogation where the insured has no cause of action against the [tortfeasor]"); *see also Keck, Mahin & Cate v. Nat'l Union Fire Ins.*, 20 S.W.3d 692, 698 (Tex. 2000) (concluding that excess insurer's subrogation claim against primary insurer and defense counsel in underlying lawsuit against insured was largely barred due to insured's settlement and release agreement with

[2]At the time HealthSouth and ACIC entered into their settlement agreement, Gulf had not made any payments to HealthSouth under the excess liability policy. As a result, at the time of the release, Gulf's subrogation right had not yet matured. *See Hartford Cas. Ins. Co. v. Albertsons Grocery Store*, 931 S.W. 2d 729, 734 (Tex. App.--Fort Worth 1996, no writ); *G. B. Warneke v. Argonaut Ins. Co.*, 407 S.W.2d 834, 838 (Tex. Civ. App.--El Paso 1966, writ ref'd n.r.e.); *see also Sec. State Bank v. Commercial Standard Title Ins. Co.*, 605 S.W.2d 673, 674 (Tex. Civ. App.--Dallas 1980, writ dism'd w.o.j.) ("The general rule is that a person who is subrogated to the rights of another may not enforce those rights until the claim of the latter against the debtor has been paid in full.").

defense counsel).

Gulf argues that paragraph fifteen of the settlement agreement between HealthSouth and ACIC specifically preserves its subrogation claim. That paragraph, which is entitled "Third-Parties," provides as follows: "Non-parties to this Agreement will not have any rights, including third-party beneficiary rights, under this Agreement, *nor shall this Agreement waive or impair the rights of any non-parties to the Agreement.*" (ACIC's App. at 202, ¶ 15) (emphasis added.) Gulf contends that the italicized portion of this sentence preserves its right of subrogation.

Gulf's argument is foreclosed, however, by the derivative nature of its right to subrogation. As previously mentioned, in pursuing a claim under the doctrine of equitable subrogation, Gulf is really pursuing HealthSouth's claim, not its own. Thus, it may pursue only what HealthSouth has, and if HealthSouth no longer has a claim to pursue, neither does Gulf, regardless of any alleged agreement to the contrary between HealthSouth and ACIC.[3] "[I]t is a well-settled rule of law that where an insured settles with or releases a wrongdoer from liability for a loss *before* payment of the loss has been made by the insurance company, the latter's right of subrogation is thereby destroyed." *Int'l Ins.*, 405 S.W. 2d at 869; *accord Hollen v. State Farm Mut. Auto Ins. Co.*, 551 S.W. 2d 46, 49 (Tex. 1977).

But Gulf also contends that "an insured cannot prejudice its

[3]Thus, it appears to the Court that the latter portion of paragraph fifteen preserves only whatever direct claims non-parties to the settlement agreement might have.

insurer's subrogation rights by settling with an offending party who has knowledge of that subrogation right." (Gulf's Br. at 8.) In Texas, this "pre-release knowledge doctrine" applies, however, only after the insurer has made payment to its insured:

> If the insured, having a claim against a tortfeasor at the time when payment of insurance is made to him by his insurer, enters into a settlement with and gives a release to the wrongdoer *after* such payment, the latter having knowledge of the insurer's rights of subrogation, and to which settlement the insurer is not a party, this does not bar an action to enforce the insurer's right of subrogation.

Int'l Ins., 405 S.W.2d at 869; *see also Westchester Fire Ins. v. Heddington Ins. Ltd.*, 883 F. Supp. 158, 162 (S.D. Tex. 1995) ("When an insured acts to cut off the insurer's claim, such as by releasing a joint tortfeasor, the insurer's right of subrogation is destroyed. However, the insured cannot, after the loss has occurred *and after payment to the insured by the insurer*, prejudice the right to subrogation by settling with or releasing the offending party who had knowledge of the insurer's right of subrogation.) (emphasis added; citation and footnote omitted). This is consistent with the derivative nature of subrogation claims, inasmuch as after payment is made by the insurer, the right to subrogation has matured; thus, the insurer has the right to pursue the insured's claim to the extent of his payment, and the insured cannot burden that right by settling with a tortfeasor who has knowledge of the subrogation right. Prior to payment by the insurer, however, the right to subrogation has not matured, and if the insured settles with the tortfeasor, that settlement destroys

the insurer's inchoate right to subrogation.[4] Because Gulf had not made any payments to HealthSouth under the excess policy at the time HealthSouth settled with ACIC, its subrogation claim is not saved by ACIC's alleged prerelease knowledge of that claim.

III. Conclusion

For the foregoing reasons, the Court concludes that ACIC's Motion for Summary Judgment [document number 122] is hereby GRANTED. ACIC is entitled to summary judgment on all of Gulf's claims against it, and those claims are hereby DISMISSED WITH PREJUDICE to their refiling.

SIGNED July 8, 2004.

Terry R. Means
TERRY R. MEANS
UNITED STATES DISTRICT JUDGE

[4]And, the destruction of the insurer's subrogation right presumably provides a defense to any claim for coverage under the policy by the insured. *See Gulf Ins. Co. v. Texas Cas. Ins. Co.*, 580 S.W.2d 645, 648 (Tex. Civ. App.--Fort Worth 1979, writ ref'd n.r.e.); *Foundation Reserve Ins. Co. v. Cody*, 458 S.W. 2d 214, 216 (Tex. Civ. App.--Dallas 1970, no writ).