

BAD FAITH BLOG

Texas Law Firm's Coverage and EC Awards Properly Reduced from \$33M to \$28M

AUTHOR: ANTHONY MARTIN

OneBeacon Insurance Company (OneBeacon) provided professional liability insurance to T. Wade Welch & Associates (Welch Firm) and firm attorneys, including Ross Wooten (Wooten). After a legal malpractice award against the Welch Firm which OneBeacon refused to settle, the Welch Firm filed common law and statutory bad faith claims against OneBeacon on which it prevailed. The District Court reduced the award to prevent a double recovery. The Fifth Circuit affirmed.

OneBeacon Insurance Company v. T. Wade Welch & Associate

The Welch Firm defended DISH Network Corporation (DISH) in hundreds of matters across the country. Russian Media Group (RMG) filed suit against DISH, which hired Wooten and the Welch Firm to defend it in that litigation. Before OneBeacon issued its original policy, RMG served DISH with discovery which Wooten had not properly handled. After the initial policy was issued, RMG filed a motion for sanctions, but Wooten did not tell the Welch Firm or DISH about the motion for sanctions. In fact, the Welch Firm first learned of the discovery problem during the second policy year.

RMG sought a sanctions "death penalty" order as a result of the discovery violations. To the surprise of all counsel, the magistrate judge granted the motion imposing the "death penalty" sanctions. The district court judge affirmed the ruling shortly before Welch learned of the discovery issue.

As soon as the Welch Firm's name partner learned of the sanctions motion and subsequent sanctions order from another associate at the firm, he informed DISH's general counsel which caused DISH to replace the Welch Firm. Shortly thereafter, the Welch Firm notified OneBeacon of the potential DISH malpractice claim. By then Wooten had resigned.

Thereafter, RMG demanded more than \$105M to settle the case, counsel for the Welch Firm reported to OneBeacon that this was a potentially high exposure claim, and that "Wooten clearly committed malpractice." One estimate of RMG's damages exceeded \$25M.

DISH offered to settle and release the Welch Firm in exchange for OneBeacon's policy limits. OneBeacon declined the settlement offer roughly 45 days later and then rescinded the Welch Firm's insurance policy. OneBeacon also filed a declaratory judgment action against the Welch Firm in the Southern District of Texas. The Welch Firm counterclaimed asserting a *Stowers* claim contending OneBeacon negligently failed to settle the claim within the policy limits. The Welch Firm also sought extra-contractual damages for violations of the Texas Insurance Code. DISH filed a formal arbitration demand which resulted in a malpractice arbitration award for roughly \$12.5M.

The District Court granted the Welch Firm's motion for partial summary judgment finding OneBeacon's had a duty to defend the DISH malpractice claim, but allowed the remaining coverage issues and the extra-contractual counterclaims to proceed to trial. At trial, the jury ruled against OneBeacon on its rescission claim, that OneBeacon knowingly violated the Texas Insurance Code, and found that OneBeacon was grossly negligent in violating its *Stowers* duties. The jury assessed damages for approximately \$12.5M on the malpractice judgment, \$8M in past and future lost profits, \$5M in punitive damages, and \$7.5M in additional damages for OneBeacon's knowing violation of the Texas Insurance Code. The District Court required the Welch Firm to elect between the \$5M award of gross negligence and the \$7.5M award for the knowing violation of the Texas Insurance Code, but otherwise left the jury verdicts intact. Both sides appealed to the Fifth Circuit, which affirmed.

The OneBeacon policy had a prior knowledge exclusion. The Fifth Circuit agreed with the district court that OneBeacon had failed to meet its burden of proving that the prior knowledge exclusion barred coverage for the Welch Firm. For that reason, the Court affirmed the district court's denial of OneBeacon's multiple motions to the effect that it was entitled to judgment as a matter of law, based on the prior knowledge exclusion.

A Texas *Stowers* duty arises when a settlement demand is made which meets "three prerequisites: (1) the claim against the insured is within the scope of coverage, (2) the demand is within the policy limits, and (3) the terms under the demand are such that an ordinary prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to an excess judgment." The Court further noted that the demand must "offer to release fully the insured in exchange for a sum equal to or less than the policy limits."

OneBeacon claimed that this was not truly a *Stowers* demand because there was no offer to release all insureds. Because the Texas Supreme Court had not directly addressed the issues, the Fifth Circuit predicted how the Texas Supreme Court would rule. The Fifth Circuit followed its earlier ruling in *Travelers Indemnity Co. v. Citco Petroleum Corp.*, 166 F.3d 761, 764 (5th Cir. 1999). There they had ruled that when a policy covers multiple insureds and is faced with a settlement demand, the insurer fulfills its duty under *Stowers* by settling the suit "against one of its insureds without being hindered by potential liability to co-insured parties who have not yet been sued." The Fifth Circuit held that DISH had made a valid *Stowers* demand which OneBeacon had rejected.

The Court also ruled that the jury had before it sufficient conflicting evidence to conclude that OneBeacon had “fail[ed] to attempt in good faith to effectuate a prompt, fair, and equitable settlement of [the DISH] claim with respect to which the insurer’s liability has become reasonably clear.” Tex. Ins. Code § 541.060(a)(2)(A). In order to have knowingly failed to settle the claim in good faith in Texas, OneBeacon had to act “with actual awareness in the falsity, unfairness, or deceptiveness of the act that made it liable.” OneBeacon contended that it simply made a mistake. However, the Welch Firm and DISH pointed to other evidence, including the fact that OneBeacon’s explanation for rejecting DISH’s demand, did not mention any valid coverage defenses. In addition, DISH’s expert testified that OneBeacon’s conduct was “an instance of prohibited ‘post-claim’ underwriting,” described as an “insurance company realiz[ing] that they have a problem, and they desperately look for a way to avoid paying the claim,” such as searching “for a morsel of evidence that they can conceivably turn into a material misrepresentation, such as we have here.”

The Welch Firm cross-appealed contending it was entitled to the jury’s assessment of the \$7.5M for the knowing violation of Chapter 541, plus the separate \$5M award for the common law exemplary damages for the grossly negligent *Stowers* violation. In light of the Texas “one satisfaction rule” plaintiff was required to elect its preferred recovery when the jury’s verdict assessed more than one set of damages for essentially the same violation. The Fifth Circuit rejected the Welch Firm’s distinction between the two claims noting that the Texas Supreme Court requires parties bringing separate Chapter 541 claims to meet the requirements of the *Stowers* claim. Because both claims are closely related and were based upon essentially “identical acts,” the district court properly required the Welch Firm to elect between the two awards.

Because the Texas jury found there was coverage and that OneBeacon had knowingly violated its duties to the Welch Firm when it denied the *Stowers* demand, the district court’s rulings on the compensatory damages and EC claims were affirmed.