



Legal Beat

By MICHAEL SEAN QUINN

couple of years later, appealed to the First Court of Appeals, which sits in Houston, and eventually to the Supreme Court of Texas.

The Court of Appeals wrote two opinions and an additional order on the substance of the case. The Texas Supreme Court has written two opinions (so far), one of which was withdrawn, and there is a vigorous dissent. The story is not quite over yet. The Supreme Court's decision is not yet absolutely final, and its decision requires some changes in the underlying judgment. This case is important for several reasons.

Agent Liability and the Passage of Time—Part I

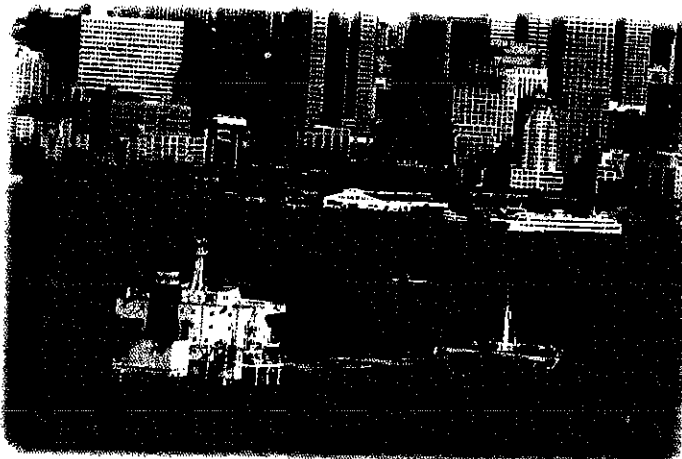
Most court decisions involving insurance law do not have immediate and direct bearing on the liability of Texas insurance agents. However, on Jan. 16, 1998, the Texas Supreme Court decided a case of signal importance to insurance agents. *Johnson & Higgins of Texas v. Kenneco Energy* involves a subtle and complicated story which began in 1982.

York City in 1987, from which there was an appeal. The agent/customer case was filed in Houston state court in 1988, tried a

Often, conflicts between insurance intermediaries and their customers are the last to be resolved. When liability insurance is involved, the underlying tort case is often resolved first. After the underlying case is resolved, there is a coverage case. When first-party insurance is involved, the coverage case comes first. After the coverage case, when liability insurance is involved, there may be a *Stowers* case. When first-party insurance is involved, there may be a bad faith case.

Finally, if the insured does not have all the relief it thinks it should

The Supreme Court was sharply divided. Some of the issues were decided 5-4, while others were decided 6-3. This case was surely one of the most heavily litigated in recent insurance history. Kenneco's case against its insurers was tried in federal district court in New



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get, there may be the case against the intermediary. This is not to say that the case against the insurance broker is always dead last. There may be one more to come. A dissatisfied insured may still sue some of its lawyers for having screwed up one or more of the previous cases.

Hence, a great deal of time may pass between the time the plaintiff-insured-customer says the insurance agent did something wrong and the time the case comes up for adjudication. This passage of time creates a number of problems. Statutes of limitations may run; the plaintiff may allege that they are tolled (i.e., stopped, suspended, stood-still) by the agent's conduct; the customer may try to talk about the agent's conduct during the disputes with the insurer; and—all the while—prejudgment interest may be accumulating.

Thus, as time passes, memories fade, new opportunities for foul-ups present themselves and the potential value of the lawsuit is rising. (Of course, it goes without saying, the meters of all the attorneys are clicking, clicking, clicking away.) Often, there is nothing the agency can do except sit around and wait.

The Kenneco series of cases illustrates these temporal themes marvelously. The case is so complicated, however, that it cannot be discussed in one article alone. In this piece, facts of the cases will be set forth. Later, we will discuss the law.

Kenneco Energy was formerly known as Armada Supply. In 1982, it bought a tanker cargo of fuel oil from Petrobras, the Brazilian national oil company, to be shipped by sea from Rio de Janeiro to New York City. The price of the purchase was to be the market price of the fuel in New York on the day of its arrival. The seller bore the cost of shipment, insurance and freight. (These are called "CIF" sales.) This shipment left Rio on Nov. 16, 1982. The CIF seller had selected Brazilian underwriters to insure the cargo; the lead underwriter was Banorte Saguradora. It insured the cargo for its purchase price plus 10 percent.

During the voyage, several things happened. First, Kenneco sold the cargo to Sun Oil Trading at the fixed price of \$30.55. Second, the market price for cargoes of fuel oil fell, so Kenneco stood to make a good deal of money. Third, Kenneco sought to buy more insurance. It wanted to insure its probable profits on the deal, and it had become concerned about whether the Banorte group were sound and reputable underwriters. Fourth, the cargo itself became problematic, as we shall see.

On Nov. 30, 1982, Kenneco sent one of its risk managers (let's call her "Risk") to see the people at its usual agency, Johnson & Higgins of Texas. Its account executive

was on vacation, so Risk could not talk to him. She talked to a second fellow, who could not answer her questions. Consequently, she talked to a third operative (let's call him "Operative"), who was really a cargo adjuster. He attempted to answer her questions and take care of her business.

The meeting between Risk and Operative is crucial. According to Kenneco, the meeting had two purposes. First, it wanted secondary coverage in case the Brazilian underwriters did not pay. The risk it was

insuring, obviously, was Banorte's non-payment.

Second, it wanted to cover its potential profits on the Sun deal if it was not consummated. (Kenneco already had a sort of secondary insurance with the London market, and it wondered if its purposes could be accomplished through its London policy.) Operative did not know the policies well. Indeed, he read the language of one crucial passage out loud to Risk during the meeting trying to familiarize himself with it. As a

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result of his discussions with Risk, Operative did two things. (1) He prepared a certificate of insurance under the contingency coverage Kenneco already had with London. Significantly, he did not offer a "guarantee of collectability," which would have simply and directly insured Kenneco against the risk of non-payment by the Banorte group. Perhaps he didn't know about it. (2) Operative changed the value of the cargo on the existing London policy from market price to \$30.55 per barrel, thereby insuring the profit, or so it was thought.

There were two problems with this

methodology. First, the contingency coverage on its face required back-to-back CIF sales. Since Kenneco's contract of sale with Sun was not a CIF sale, there was no applicable contingency clause. Second, the increase in the insured value of the cargo did not insure the increased value of the oil against the contingency of the Sun contract failing or against Banorte's non-payment.

It simply increased the valuation of the cargo in case there was an accidental physical loss. In other words, the existing London policy did not cover purely financial contingencies.

Apparently, Operative did not realize that Kenneco could not recover under both certificates. Neither did Risk. She thought that the contingency coverage kicked in if Banorte did not pay and that the lost profits would be covered by the increased valuation in the existing policy.

Risk testified that she told Operative that Kenneco's sale to Sun was not a CIF sale. She testified that she asked Operative about the proviso in the contingency clause requiring that the sales be back-to-back CIF sales and that Operative said that it wouldn't apply.

In contrast, Operative testified that he told Risk that there would be contingency coverage but that he made this statement on the basis of Risk having said that the pertinent sales were both CIF sales. Operative's notes indicated that the sale to Kenneco in Brazil was a CIF-sale, but they were silent on Kenneco's sale to Sun.

When the cargo reached New York, Sun rejected it. There were three problems. (A) The ship left Rio short on cargo. Somehow, it disappeared between the pipeline and the ship. (B) The crew had used some of the cargo as fuel for the ship. (C) The crew had replaced the oil it took with salt water, thereby contaminating some of the cargo. Not only did Sun reject the cargo, but it rescinded the contract, and so Kenneco lost a shade over \$1.6 million in profits on the sale.

Kenneco renegotiated the contract with Sun, but the ship fled New York harbor to avoid legal sanctions. (Kenneco had sued the ship in New Jersey federal court, and a maritime arrest warrant had been issued.) While at sea, the salt water the crew injected contaminated the remainder of the cargo. Eventually, Kenneco got the tanker to return to New York harbor, took control of the cargo, reconditioned the oil, and sold it in several lots below the \$30.55 price of the Sun contract. (One of these various sales generated a commercial, non-insurance lawsuit, which was eventually resolved.)

On approximately Dec. 22, 1983, Operative stated that he realized for the first time that Kenneco's sale to Sun was not a CIF-sale. He did not get the truth out quickly, by telling Kenneco about the problem with contingency coverage.

Instead, Operative calculated that premium to include that coverage and caused J&H to send a bill to Kenneco. He did this even though he knew that it was "highly improbable" that such coverage existed.

In early 1983, Kenneco filed claims with the Brazilian underwriters and with London. Both denied coverage in March 1983. London refused the contingency coverage because the two sales were not

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both CIF-sales. London denied coverage even though J&H charged the premium, and it received and (apparently) retained it. (J&H consistently advocated the existence of contingency coverage to London.) London also refused to pay under the increased valuation endorsement because there had been no physical loss.

The Brazilian underwriters denied coverage because they contended that there was no coverage until the oil got on board the tanker. They also contended that when the ship left New York harbor to avoid arrest, a new voyage began, and the insur-

ance expired. In addition, the Brazilian underwriters sought to limit coverage in various ways. They argued that the spread of the contamination loss from part of the cargo to all of the cargo should not be covered. They suggested that Kenneco paid too much to recondition the oil and sold the oil at too low a price. Finally, there was a disagreement about how many deductibles applied.

The various disputes Kenneco faced went through five judicial "moments," in addition to the two already mentioned. In April 1983, Kenneco sued both the

London and Brazilian underwriters in federal district court in New York City. It did not sue J&H at that point. The district judge decided the case without a jury in 1987, and a panel of the Second Circuit decided it again in 1988. On Dec. 15, 1986, J&H and Kenneco entered into an agreement preventing applicable statute of limitations from running any further.


Very significantly, that agreement was formed approximately two years and nine months after London and Brazil denied Kenneco's claims. The standstill agreement tolled all statutes of limitations from running from the date of the agreement's formation until 30 days after the final resolution of the federal court action.

Before the federal court action was finally determined, however, J&H filed a declaratory judgment action in a Houston state court. That case was tried by jury. Naturally, it was appealed. The court of appeals finished its work in 1996, and the case went to the Supreme Court of Texas. In 1998, it was decided there 6-to-3 on some issues and 5-to-4 on others.

For all its various twists and turns, there were a huge number of issues before the various courts.

Was there coverage? Did J&H's premium billing affect the existence of coverage? Did London's acceptance of the money affect coverage? Was J&H negligent? Was any negligence action Kenneco might have against J&H barred by the statute of limitations? Did J&H breach its contract with Kenneco? Did J&H defraud Kenneco in any way? Did J&H violate the Texas Insurance Code, and, if so, what statute of limitations applies? Did J&H's conduct after insurers denied coverage in any way block it from relying on applicable statutes of limitations? What was the impact of the New York litigation on the Texas case? How should interest be computed?

Some of these questions could interest only lawyers. Indeed, some of them could pique the curiosity of only the dullest and most technically-minded attorneys. A number of these issues, however, are of pressing concern to Texas insurance agents. To some degree, such businesses will need to shape their conduct by reference to holdings, the reasoning, and the hints to be found in these cases.

"Well," you asked, "how did all these issues get decided?" Stay tuned for the next installment. 

Look for part II in the May 4 issue. Quinn is an Austin-based attorney with the law firm of Sheinfeld, Maley & Kay, which also has offices in Houston and Dallas.



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