



Legal Beat

By MICHAEL SEAN QUINN

Agent Liability and the Passage of Time—Part II

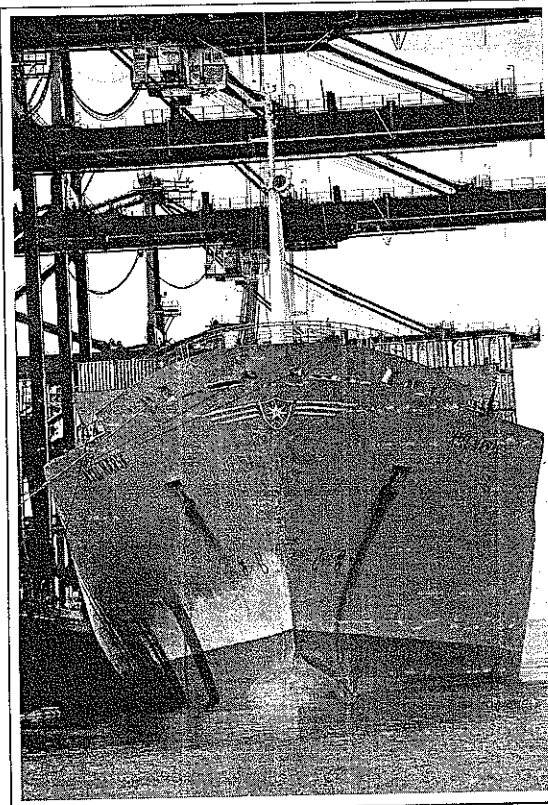
The Kenneco series of cases has been the never-ending litigation, or so some have thought. Kenneco's controversies, first with its insurers and then with Johnson and Higgins, have dragged on in the courts for 15 years—and there was pre-litigation maneuvering before that. The J&H segments alone have lasted 10 years. Perhaps, it is now nearly over. Maybe.

Background. In Part I of this essay, published in the April 13 issue, I set the stage. Kenneco's predecessor, Armada, was a speculative oil trader. It bought oil in Brazil to sell in New York. It would have made a 7-figure profit had not a miscreant ship crew spoiled things. As a prudent oil trader, Armada (1) had insurance on the cargo, (2) bought contingent insurance, in case the first cover did not pay, and (3) obtained lost profits insurance, in case something else went wrong. It did all this on the advice of J&H, which apparently screwed up royally, because neither of the new insurance contracts fit the situation, and so Lloyd's of London denied coverage under both of them. All this happened in late 1982 and early 1983.

Kenneco sued Lloyd's in New York federal court in 1983. That case was not decided until 1987, and the district court decision was not affirmed until 1988. While Kenneco's case against Lloyd's languished, it threatened to sue J&H. Consequently, the two companies entered into an agreement to prevent statutes of limitations from running any further. They entered into that agreement in December 1986.

Texas Suit. In 1988, J&H sued Kenneco for a declaratory judgment in a Houston state court. Thereupon, Kenneco countersued for damages. Eventually, the jury found that J&H had defrauded Kenneco and awarded \$1.5 million. It also found that J&H had violated the Texas Insurance Code and awarded another \$1.5 million. Next, it found that J&H was negligent and awarded \$1.7 million. Finally, the jury found that J&H had contracted with Kenneco to procure coverage and that it had breached. The jury awarded \$1.56 million for J&H's failure to obtain appropriate lost profits insurance and \$412,000 for its failure to obtain proper contingent, back-up insurance for the original

insurer. At the same time, the jury found that the limitations periods began to run in March 1983, when Lloyd's originally denied coverage under its two policies.



This last finding destroyed any possibility of an award for negligence. It is controlled by a 2-year statute of limitations. That left contract and fraud, which are each controlled by a 4-year statute. The limitations period for the Insurance Code was then uncertain. J&H moved for judgment on the verdict, while Kenneco moved for a judgment notwithstanding the verdict. The trial court awarded J&H the take-nothing judgment it requested. It gave no reasons.

The court of appeals reversed and rendered a judgment in favor of Kenneco. It found that, in all fairness, J&H could not assert the affirmative defense of limitations. Consequently, the court of appeals rendered a judgment for Kenneco for nearly \$5 million. It awarded \$2 million for breach of contract, \$2.75 million in pre-judgment interest (Wow!), and \$275,000 in attorney's fees. In computing pre-judgment interest,

the court of appeals compounded the interest daily, in accordance with then applicable Texas Supreme Court precedent.

J&H sought review in the state Supreme Court. It presented three broad issues. First, to what extent did applicable statutes of limitation require a judgment in its favor? Second, although J&H was not a party to the coverage litigation in New York, the courts there found facts favorable to J&H. Could J&H take advantage of those findings in the Texas litigation? Did they bind Kenneco? Third, how should pre-judgment interest be calculated?

Limitations. The limitation period for negligence is two years. Kenneco and J&H didn't enter an agreement standing the limitation period still until December 1986. That means that any claim for negligence committed by J&H which accrued before December 1984 was immune from suit. Remember, J&H procured the two policies of insurance in 1982. So, when did the limitations period begin to run? Kenneco wanted it to run from the time the federal court declared that there was no coverage (i.e., 1987). J&H wanted it to run from the point in time the insurer denied coverage (i.e., 1983).

Limitations periods always begin to run when the victim-plaintiff first sustains injury, unless a reasonable person couldn't know he was hurt. Then it runs from when the injury should have been discovered. There is a big exception. For lawyers who are negligent in the context of litigation, the limitation period does not begin to run until the highest court which hears the underlying case affirms the result caused by the lawyer's mistake. Should insurance agents be treated like that? Or should they enjoy

a much shorter limitations period? The Supreme Court held that Kenneco sustained injury when coverage was denied. At that point in time, all the facts required for a cause of action existed and were known. Neither the discovery rule nor the rule for lawyers applies.

Consequently, the 2-year limitations period for negligence began to run in March 1983. Kenneco could not, therefore, recover on those causes of action. It, or its lawyers, blew limitations period. (Perhaps this case has another phase after all. Maybe this really is the never ending case.)

The Supreme Court also applied the 2-year limitations period to Insurance Code violations. It said that, in general, such claims accrued when coverage is denied. It analogized Insurance Code violations to DTPA violations, which are unquestionably subject to a 2-year period.

A.O

(This is big, important news.)

Kenneco claimed that considerations of fairness prevented J&H from relying upon these limitations periods. For example, J&H charged Kenneco a premium for policies it knew were bogus. The Supreme Court thought this gambit was wrong. What lawyers call the doctrine of equitable estoppel applies to limitations defenses only if one party intentionally induces another to refrain from filing a lawsuit. No evidence suggests J&H did this.

Defensive Collateral Estoppel. There is a sensible legal rule forbidding A from relitigating an issue it has already lost in a lawsuit against B, in a subsequent lawsuit between A and C. This rule applies even when C was not a party to the lawsuit in which A lost the issue, if the issue was fully and fairly litigated. This salutary rule is called the principle of defensive collateral estoppel.

The federal courts in New York made a number of findings favorable to J&H when it came to the lost profits insurance. As a result, the Supreme Court of Texas held that Kenneco was prevented from pressing claims based on the lost profits coverage. This holding eliminated Kenneco's claims vis-a-vis lost profits coverage based on breach of contract and on common law fraud. It was not, however, prevented from pressing claims based upon the back-up coverage.

Contingency Coverage. The only claims Kenneco had left against J&H involved the contingency (back-up) coverage. The jury found that J&H had made fraudulent misrepresentations about the coverage (which it valued at \$1.5 million) and had breached an agreement to procure that coverage (which it valued at \$412,000). The Supreme Court eliminated the jury's fraud finding. It said that no evidence supported the proposition that J&H had knowingly or even recklessly made misrepresentations to Kenneco. At most, J&H had been negligent. Therefore, a judgment for fraud could not stand. At the end of the day, therefore, Kenneco received a judgment for \$412,000, plus stipulated attorney's fees, plus interest. The remaining question was how to compute that interest.

Prejudgment Interest. Prejudgment interest constitutes a form of compensatory damages for the loss of the use of money between the accrual of the plaintiff's cause of action and the date of the judgment. Some awards of prejudgment interest are governed by statute; others are governed by the common law only.

In Kenneco, the Supreme Court conformed the common law method of computing prejudgment interest to the rules embodied in Texas statutory law. Up to now,



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the key feature of prejudgment interest regulated only by common law was that it compounded daily. In the late 1980s, "court reform" eliminated this feature for most awards of prejudgment interest. In *Kenneco*, the court eliminated the compounding of common law-regulated prejudgment interest. Henceforth, all prejudgment interest shall be computed as simple interest only.

The Supreme Court portrayed itself as deferring to the public policy enunciated by the legislature and bringing uniformity and symmetry to the law of prejudgment interest. Now, under both the statute and under the common law, "prejudgment interest begins to accrue on the earlier of (1) 180 days after the date a defendant received a written notice of a claim or (2) the date suit is filed."

When did J&H get written notice of *Kenneco's* claim? The majority held that the standstill agreement constituted written

notice of the claim, so the entitlement to prejudgment interest began 180 days after the formation of that agreement. At the same time, precisely because standstill agreements are designed to make things stand still, such agreements will presumably suspend the running of prejudgment interest. The parties to them, however, may agree that interest shall keep running. That agreement must be very clear.

The Dissent. Three justices thought that the findings of the federal courts in New York precluded *Kenneco* from any recovery at all, including a breach of the contract to obtain contingency coverage. These dissenters would have awarded a take-nothing judgment to J&H.

Four dissenting judges would automatically suspend prejudgment interest during any standstill agreement. According to Justice Hecht, two of the purposes of

prejudgment interest are to encourage prompt settlements and to discourage delay by defendants. Neither of those purposes can be served by allowing prejudgment interest during an interval of time when the plaintiff delayed the litigation. (This is a very odd position. After all, in any standstill agreement the defendant is agreeing to the delay for reasons of his own. Surely, two freely contracting parties should be able to provide for the accumulation of interest during any agreed delay. Perhaps a defendant is willing to risk that sum in order to avoid the filing of the lawsuit. Isn't a standstill agreement a kind of contingent loan by the plaintiff to the defendant?)

Applications. Obviously, *Kenneco* is very favorable to insurance agents. A huge verdict against a well-known brokerage house was reduced in size many-fold. So, what does all this mean? For one thing, it signals that the Texas Supreme Court will not let policyholders inflate negligent misrepresentation claims into fraud. For another, it means that the Supreme Court is taking limitations period very seriously. Finally, the court made clear it will not let litigants use interest computation rules to balloon judgments by several orders of magnitude. So far so good.

This decision has down sides, however. First, a policyholder may not defer suing his insurance agent until after the coverage litigation is over. In the absence of a standstill agreement, the policyholder must sue the agent within two years of the date the insurance company denies coverage, if he intends to utilize negligence or 21.21.

This rule will complicate coverage suits and increase litigation against agents. Second, although the rush to court can be avoided through standstill agreements, the Supreme Court has signaled that they must be done adroitly. Policyholders may become leery of such agreements. Many E&O carriers already are. In the absence of such agreements, policyholders will sue agents sooner. Third, findings by courts in coverage litigation about agent conduct can bind policyholders. For this reason, policyholders will be inclined to sue agents in the coverage litigation.

Thus, *Kenneco*, while favorable to insurance agents, is a mixed blessing. It will probably increase litigation against insurance agencies, other things being equal. Then again, there is another bright side. More litigation against agents means more money for some lawyers. Is God in Her Heaven, or what? □

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