



Legal Beat

By MICHAEL SEAN QUINN

Successor Liability for Renewal Commissions

Employees and operatives often have tensions and conflicts with their employers and principals. This general and highly abstract truth applies no less to insurance agents than to anyone else. Agents want a larger share of the commissions. "After all," they say, "we do the work." Agencies, on the other hand, want to keep as much as possible for themselves. "After all," they say, "We work too and provide capital besides." Agents want to maintain continuing business relationships with their clientele. Agencies see insureds as their customers.

Agencies frequently subject agents to covenants not to compete. Agents want to avoid them. (I lost my first covenant-not-to-compete lawsuit trying to enforce a poorly drafted noncompete agreement for an agency against a departing agent. The agency was neither understanding nor forgiving. At least I had not drafted the covenant.)

One relatively frequent area of controversy is the right to commissions on routine policy renewals. Both agents and agencies want to maximize their participations, and that—as they say—is a zero-sum game. Agents want to take these rights with them. Agencies wish to terminate those rights after agents depart.

Who owns renewal rights?

This problem comes up over and over and over again. Many jurisdictions have cases about it. On April 27, 1999, the Supreme Court of South Dakota decided *Parker v. Western Dakota Insurers Inc.*, which was about this issue and nothing else. From 1982 to 1992, Renee Parker (Parker) worked as a salaried agent and manager for First American Systems (First). In 1998, the principal owner of First indicated he wished to retire. First wanted to maximize the resale value of the business. Consequently, it want-

ed to prevent Parker from leaving the company and taking her business with her.

Parker and First agreed to a covenant not to compete. A component of the exchange was that First would pay Parker part of the renewal commissions it received after the end of Parker's employment. Obviously, Parker was planning for her own retirement. The First-Parker contract contained two other significant provisions. The two agreed that



all insurance business Parker generated would be the property of First. Indeed, the contract specified that all renewals were the "absolute and sole" property of First. In addition, the contract was said to be binding on any successors or assigns of First.

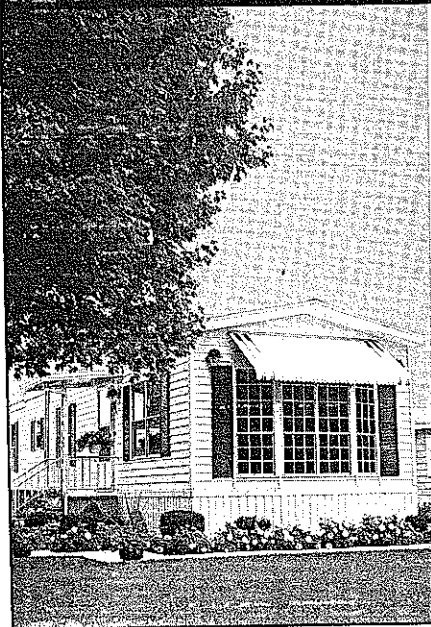
In 1988, First was sold to First American Holdings Company (Holdings). After awhile, the new outfit wanted to decrease agent commissions. It insisted on new employment agreements, and it required all agents, including Parker, to reduce their percentage participation and renewal commissions. Parker quit in 1992. In 1993, Holdings paid Parker in accordance with their agreement with First.

In 1994, however, Holdings decided to sell out to Western Dakota Insurers (Dakota). Parker learned of this transaction beforehand, and notified Dakota of her contract. Dakota said it was not interested in any obligations of First or Holdings, but only in the assets of Holdings.

Later in 1994, Dakota obtained substantially all of the assets of Holdings. Dakota did not buy Holdings' stock, and no director of Holdings became a director of Dakota. The contracts between Dakota and Holdings specifically excluded any of Holdings' debts, accounts payable, or other liabilities. Dakota's payment to Holdings was to be over time, as commissions flowed. Dakota paid a deposit of \$100,000, however, against which periodic payments were to be charged. Holdings never shared any of this

We give you more.

The specialty insurance experts.



Need specialty insurance? Texas agents think first of Foremost. We give you more choices, more service and more value so you can make the sale quickly – with little or no paperwork.

Depend on Foremost for mobile home, motor home and travel trailer insurance. It's easy! To quote or book a policy right over the phone, call toll-free:

1-800-527-3905



The Foremost Insurance Group consists of Foremost Insurance Company, Foremost Signature Insurance Company, Foremost Property and Casualty Insurance Company, American Federation Insurance Company, and Foremost Lloyd's of Texas and Foremost County Mutual Insurance Company, which conduct business in Texas only under a management agreement. "Foremost" and the "F" logo are trademarks of Foremost Corporation of America, a member of the Farmers Insurance Group of Companies. Reg. U.S. Pat. & Tm. Off. Foremost Insurance Company, 5600 Beach Tree Lane, California, MI 48316. Form 987999 05/00

6-11

sum with Parker. In the fullness of time, Holdings went bankrupt. (From the looks of things, this move was planned all along.)

The case against Dakota

Parker sued Dakota for breach of her original contract with First and for unjust enrichment. Sometimes, lawyers called suits for unjust enrichment, suits in quasi-contract. At other times, it called such suits actions for restitution.

The Supreme Court of South Dakota decided

four-person majority went out of its way to express sympathy for Parker and her unfortunate situation. They said that they had "natural sympathy" for her rather difficult straits, but, they said, it was "precisely because this pulls at our sympathies we must not allow sentiment to color our view of the facts or to lure us into misapplying the law."

Interestingly, one member of the majority had regarded himself as disqualified from serving, presumably because of some conflict of interest. Both Parker and Dakota, however, waived the conflict. Perhaps the judge had a child working in one of the law firms.

As one would expect, given the court's contrast between reason and emotion, the majority's decision is a model of technical, legal reasoning. Correctly, the court points out that normally only parties to a contract are bound by the contract. Consequently, in general, the purchaser of the assets of a business is not bound by the contractual liabilities of that business. That is almost always true when the assets of the business are purchased in bits and pieces. An interesting problem arises when the assets of a business are purchased in bulk.

Successor liability

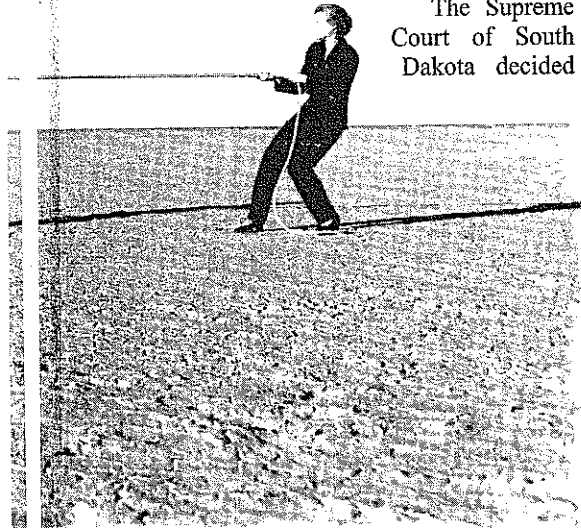
There are five exceptions to the rule that an asset purchase does not necessitate a purchase of liabilities. First, if the purchase is

really a merger, there is successor liability. Second, the same is true if the purchaser simply continues the business of the seller with a different name.

Third, there is successor liability if the purchase is somehow fraudulent. Fourth, there is successor liability when the seller's legal liability results from defects in the products it manufactured and sold. (In this exception, products are tangible goods.) Fifth, and finally, there is successor liability when a purchaser expressly or impliedly agrees to be responsible for the liabilities.

The South Dakota court's majority rules out all exceptions except the fifth one, and it observes that there was certainly no express agreement by Dakota to be responsible for the liabilities of Holdings (and hence First) when Dakota made its purchase. One wonders why the court did not contemplate conceptualizing the Holdings to Dakota sale as a merger. It certainly looks like one.

Was there an implied agreement? Courts determine whether an explicit contract includes an implied agreement by interpreting the language of the contract. If the contract is clear, courts do not look at context. If a contract is unambiguous, courts will not permit testimony as to what people intended. Facts outside the written contract are received as evidence only if the contract is for some reason ambiguous.



the case against Parker and hence for Dakota, over a lone dissent. Interestingly, the

"A world of markets within your reach."

U.S. Risk Brokers, Inc.
 Brokerage Facilities

We have access to over 120 surplus lines and specialty markets to better serve our retailers.

Specialists in:

<p>Austin 9433 Bee Cave Rd. Suite 200, Bldg. 1 Austin, TX 78733 512.263.0634 800.976.9135 512.263.264 (fax)</p> <p>Dallas 10210 N. Central Expwy. Suite 500 Dallas, TX 75231 214.265.7090 800.292.5830 214.239.1421 (fax)</p>	<p>General Liability</p> <p>Commercial Auto</p> <p>Umbrella and Excess Liability</p> <p>Employment Practices Liability</p> <p>Directors and Officers Liability</p>	<p>Property</p> <p>Energy/Oil & Gas</p> <p>Inland Marine</p> <p>Lawyers/Professional</p> <p>Miscellaneous E&O</p>	<p>Houston 2925 Briarpark Suite 550 Houston, TX 77042 800.456.5774 800.833.8803 713.266.9715 (fax)</p> <p>San Antonio 85 NE Loop 410 Suite 216 San Antonio, TX 78216 210.615.0160 800.503.2243 210.375.0207 (fax)</p>
---	--	---	---

(formerly Jurett Insurance Brokers)

The majority thought that Dakota's contract with Holdings was unambiguous. Further, it thought that Dakota's actual knowledge as to Holding's liability to Parker reinforced the idea that Dakota never intended to assume Holdings' liability to Parker.

The majority held that Parker had no specific right to any interest in commissions upon any particular renewals. The contract expressly stated that renewals were the "absolute and sole" property of First. Furthermore, Parker had no lien upon them. She had no security interest in any specific account. She had nothing in the nature of a mortgage.

According to the court, Parker was nothing but a general creditor of First and Holdings. She had no vested right in any asset belonging to First or Holdings. She owned nothing in common with them. She had no property rights, only a contract right. Holdings may have breached its contract with Parker, but that breach did not

render Dakota liable.

A dissenting view

The dissenting judge thought that the majority had a pinched view of the contract. He thought the contract was far from clear and that it was necessary to look at the purposes of the contracting parties, their intentions, and the context in which the contract was made.

Once this was done, said the dissenting judge, it was clear that the contract intended to create some sort of property interest in the renewal commission account. Granted, the renewals themselves belonged to First. The money received, however, could very well have belonged in part to First and Parker. It was clear that some property interest in the commissions belonged to Parker, so that—in effect—Parker and First and then Parker and Holdings owned something in common.

Of course, the seller of an asset can sell only what it owns. If Holdings did not own the entirety of a pool of renewal commissions, it could not sell them. If Dakota ended up with monies as the result of its deal with Holdings, and Holdings had no right to assign those monies, then Dakota would be unjustly enriched.

Furthermore, since Dakota had grabbed Parker's property and refused to pay for it, Dakota was guilty, not of breach of contract, but of the tort of conversion. (Put in non-technical terms, conversion is to tort law as stealing is to criminal law.)

Strangely, the dissenting judge says that Parker is entitled to *restitution* of the amounts she was owed. To be sure, if a dissenting judge is right, Dakota was unjustly

enriched. However, since Parker notified Dakota that part of the commission account was hers, and Dakota was guilty of conversion, most states would say that Parker was entitled to *damages* only.

Maybe the way to put the point is that Parker's right of restitution pertains to the account which should contain commission money rightfully hers. Insofar as she had been wrongfully deprived of some of this money in the past, she would be entitled to damages. The distinction between restitution and damages, obviously, is a split hair that only a lawyer could love. Part of the account is restored to her; and she gets compensatory damages for past misconduct. Significantly, the receipt of actual damages for conversion creates the opportunity also to recover punitive damages, whereas a mere award of restitution does not.

There is an extremely interesting question standing behind the issues in this case that the court does not discuss at all. If First and Parker intended that Parker should have a property interest in a group of renewal commissions, then Parker's lawyer made a terrible mistake either when he or she drafted the original agreement for Parker or when the agreement was reviewed. First's lawyer drafted. Question: Does Parker now have a malpractice action against her lawyer? If so, is it worth pursuing, since "only" \$34,102 (plus interest) was at stake? ■

Quinn is an Austin shareholder in the law firm of Sheinfeld, Maley & Kay. He is mostly involved in litigation problems involving insurance coverage.

We want to grow with You.

■ The LMN Alliance Group, a Texas company, is a fast growing alliance of insurance agencies. We are interested in expanding our operation into your area and are looking for successful companies like yours.

■ Our group is comprised of insurance professionals with combined experience of 48 years. We purchase successful agencies large or small, rural or metropolitan, personal or commercial lines and will pay "Top Dollar".

■ The key to our collective success is to retain local leadership to ensure continued future growth. So if you believe in your agency and it is for sale or have considered selling at one time or another, give us a call. It could be the solution you were looking for.



ALLIANCE GROUP, INC.

2425 W. Loop South
Suite 200
Houston, Texas 77027
713.335.5549
Fax: 713.297.8864

Quinn to Lead Insurance Section of the State Bar of Texas

Michael Sean Quinn has been appointed as the new chair of the Insurance Law Section of the State Bar of Texas, succeeding Ernest Martin.

Quinn, whose columns are seen in each issue of the *Insurance Journal* of Texas, has served as the section's chair-elect since 1999 and as a member of the section's board of directors since 1998.

A recognized authority in the field of insurance law, Quinn has been an attorney of counsel and shareholder at Houston-based Sheinfeld, Maley & Kay since 1997, authoring numerous articles and speeches on all aspects of liability and insurance issues.

"Mr. Quinn's appointment is indicative of his leadership in this area," said Robert Shults, senior partner and head of the Insurance, Environmental and Specialty Litigation Section at Sheinfeld's Houston headquarters. "His work in the practice of insurance law is widely known in Texas and throughout the national legal and insurance communities."

Quinn's formidable expertise in issues surrounding the practice of insurance law comes as a result of extensive trial and appellate work, and his role as an expert witness for insurance matters and cases involving legal ethics.

Until 1999, he served as adjunct and visiting professor of insurance law at the University of Texas-Austin School of Law. Prior to joining Sheinfeld, Maley & Kay, Quinn was a partner at Dallas-based Zelle & Larson from 1988 through 1995. After Zelle & Larson, Quinn became a full-time visiting professor at UT where he taught insurance law, pre-trial procedure, legal ethics and professional responsibility and malpractice law.

He holds a J.D. from the University of Missouri at Kansas City School of Law and a Ph.D. in philosophy with a concentration in jurisprudence and political theory from the University of Pittsburgh.