



# Legal Beat

By MICHAEL SEAN QUINN

## Wooge's Case: Ownership of Renewals

There are always tensions between producers and insurers. Economically, insurance carriers have incentives to control or reduce commission levels and to obtain "ownership" of the chance to renew policies with insureds (the so-called "expirations"). On the other hand, intermediaries wish to maximize commissions (or, at least avoid having them cut) to prolong them as long as possible, and to maintain control over expirations (renewals). After all, developing acustomer/client/insured is an investment on the part of an intermediary.

Moreover, one of the most important things insurance intermediaries do is mysterious. A significant function of independent insurance agents is to create new markets. This is why many independent agents actually come up with new policy ideas and even draft contracts for some carriers. This is essentially an entrepreneurial function. It requires intuitive insight, a feel for people and markets, a web of personal connections in various businesses, knowledge of business economics, finance, and procedure, and a willingness to exploit and expand those connections. Frequently, these are not the gifts of executives at insurance companies. Entrepreneurship of intangibles (e.g., insurance policies) seems wispy, and it is certainly not well understood.

These tensions are exacerbated in Texas by the fact that intermediaries are statutorily the legal agents of insurers for many purposes but have an economic incentive to assist insureds in dealing with exactly those insurers. (Uncomfortably for everybody, insurance intermediaries are sometimes simultaneously the agents of the insureds.) Relations between insurance carriers and insurance broker/agent-intermediaries are invariably ambiguous, even if they are also personally cordial and historically long-lasting.

In 1992 one of these relationships exploded. The tale is a cautionary one of stunning proportions. Eventually, it involved three separate court decisions, two in the federal district court for the Northern District of Iowa and one in the Eighth Circuit Court of Appeals. The district court decisions, *S&W Agency v. Foremost Insurance*,

were handed down by a Magistrate in 1998, although they were not published until 1999. Magistrates are high-class judges' helpers.



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Mostly they hear discovery disputes in civil cases, make recommendations to district judges on complex matters, and dispose of lots of preliminary matters in criminal cases. They can also conduct full, binding trials, if both parties consent.

### I. Found Facts

The facts in this lawsuit were vigorously contested, even today the parties disagree about what happened and how to interpret it. According to the Magistrate's opinion, however, here are the facts:

Gaylord Wooge owned an insurance agency in a small Iowa town. In the early 1980s, he conceived the idea of selling insurance coverage to owners of RVs. His product had two distinct features. First, it provided replacement cost coverage if the RV was totally destroyed. Second, it was marketed through associations of RV owners—"affinity groups"—sponsored by the manufacturers of the vehicles. Wooge sold the insurance through these associations.

The associations held periodic rallies throughout the country. Wooge traveled to the rallies, set up booths, gave seminars on

insurance, gave away ice cream, and marketed RV insurance. Such forays cost him up to \$10,000 a piece. Apparently, the manufacturer of the RV made this arrangement, principally at Wooge's behest, by agreeing to replace completely wrecked RVs at just over its cost. The manufacturer was willing to do this, because RV owners tend to be careful drivers so that neither the insurance company nor the manufacturer would be affected very often.

Principally, because of Wooge's efforts and his knowledge concerning RV owners, the replacement cost endorsement became a huge success. Many RV owners liked the deal. Everyone profited. Foremost, for example, made double its usual underwriting profit, and Wooge was one of its two largest producers.

While Wooge had written agency contracts with Foremost for over ten years, which were expressly terminable at will, according to the Magistrate there was no question but that the "Wooge Endorsement" created a special relationship between the insurance agency and the insurer. Indeed, because of the way the agency had invested time and money in developing the market for that endorsement, the insurance company itself repeatedly characterized its relationship with the

Wooge agency as more like a long-term partnership than like an arms-length contract terminable at whim.

Notwithstanding written documents to the contrary, the jury found that Foremost had agreed that Wooge would be the exclusive marketer of policies containing his RV replacement cost endorsement. It even bore his name in company slang. Apparently, Foremost started marketing the endorsement independently to another manufacturer, but conceded to Wooge that it should not have done so when he objected.

According to the jury and the district court, throughout 1990 and 1991 Foremost acted deceptively. On the one hand, it reassured Wooge repeatedly that he was and would remain its partner for the long term in developing and marketing the endorsement. At the same time, internally, Foremost was disgruntled with (1) the high commissions it paid Wooge and (2) the fact that he owned the right to renew customer business. It wanted more money and more control for itself. As a consequence, Foremost secretly developed a plan to cancel Wooge's agency agreement if he did not agree to new arrangements that dramatically lowered his commissions.

In 1992, Foremost presented this new agreement to Wooge. He rejected it. Fore-

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most terminated the existing agreement. Wooge's business and profits took a nose-dive, and he sued.

## II. Court Action

It took two weeks to try the case. The jury returned a verdict in favor of Wooge. It found that Foremost had intentionally interfered with Wooge's contracts with manufacturer association groups, had made fraudulent misrepresentations to Wooge and had fraudulently failed to disclose facts to him, and had misappropriated trade secrets that Wooge owned. In fact, the jury found that Foremost had misappropriated three different kinds of trade secrets. These were (a) expiration data, (b) information about Wooge's agreements with RV manufacturers, and (c) information about the characteristics of RV owners and the RV market place. The jury awarded Wooge \$668,000 in compensatory damages and \$8 million in punitive damages against Foremost.

The Magistrate let the actual damage award stand, set aside the award of \$8 million in punitive damages upon obscure statutory grounds of interest only to Iowans, and deferred any award of attorneys' fees. The parties then agreed to try the punitive damage issue to the Magistrate alone, sitting as a district court, without a jury. The Magistrate ultimately awarded Wooge \$4 million in punitive damages and nearly \$300,000 in attorneys' fees and costs. The Eighth Circuit quickly affirmed the lower court's judgment in a cursory, unreported opinion. The judgment has been paid.

## II. Legal Stuff

The insurance company depended on legal arguments all the way. In theory, there is nothing wrong with technical arguments. Every piece of litigation is really a debate in which a great many legal points have to be formulated, recast, asserted, spun, deconstructed, supported (with facts), rebutted, (with evidence), propped up (with authority), refuted (with counter legal arguments), and so forth. Overall, the legal process is a stilted, combative conversation, albeit with a flexible structure, though a relatively standardized vocabulary. In theory, at least, every point is up for grabs. Every legal contention must be vindicated, and every factual contention can be—again, at least in theory—controverted.

In most lawsuits, the number of contested issues reduces itself as time goes along. In most cases, everybody pretty

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much sees the same thing. In other cases, some witnesses hear one thing, while others hear a different thing, but some of the witnesses are credible, while others are not. In business relationships, which are largely creations of agreement and voluntary custom, many more things remain open to dispute than in simpler tort cases. This is particularly true when the business relationship is a specialized one of long standing. When a business relationship is both long and technical, matters can become very complicated indeed.

Such was the dispute between Wooge

and Foremost. Foremost put most of its debating "eggs" in the we-had-a-written-contract basket. That contract, as stated, was terminable at will. Wooge put his debating "eggs" in the but-you-said-we-were-long-term-partners basket. In response, Foremost said, "Ho! Ho! Ho! Written contracts trump loose talk." While Wooge said, "Not when talk modifies writing. Not when the written agreement is sketchy, incomplete, or ambiguous. And not when the writing is not really a contract."

The jury and the Magistrate embraced Wooge's picture of the case. It did not help

matters that several employees or former employees of the insurer admitted facts that supported Wooge's case. Admissions matter acutely.

Some law professors have developed the idea of the relational contract. Such contracts arise in long-term relationships where the interactive behavior of the parties is at variance with the writing. In relational contracts, so the professors say, behavior trumps writing. A written contract does not contain the real agreement between the parties who have interacted for a long time, according to the relational theory. The real agreements are to be found in how the parties treat each other, what they expect from each other, and what they would spontaneously say about their reciprocal obligations. It is perfectly clear to me that Foremost never considered the possibility that its relationship to Wooge would be explicitly or implicitly conceptualized as a relational contract. It looked only at theory. It never looked to context. It never sniffed the air.

Furthermore, it apparently did not dawn on Foremost that the rhetoric its marketing people employed would ever be seriously used against it. Foremost apparently believed that it could rhetorically refer to Wooge as "partner," and yet not be taken seriously. After all, Foremost must have said to itself, who really takes rhetoric seriously?

This was a mistake. Hype is dangerous. Sometimes, rhetoric has reality. Not all grandiose, inflated marketing remarks designed to create good feeling and enhance performance are mere puffery to be ignored. Admissions matter acutely.

By repeatedly calling Wooge its partner and by repeatedly doing things with Wooge more characteristic of partnership than of arms-length contractual dealings, something like a partner relationship (at the very least) arose. Consequently, Foremost acquired fiduciary duties to Wooge. Perhaps this is what the Magistrate meant when he said that they had a special relationship. But if Foremost owed fiduciary duties to Wooge, it could not sneak around in its own bureaucratic underbelly plotting to injure him. As his fiduciary, it had a duty to tell him what it was up to. Because Foremost was Wooge's fiduciary, any contemplated action adverse to his interests in any way must be disclosed to him at an early date. Fiduciaries must treat one another with the utmost good faith. This is an essential point Foremost never seemed to grasp.

It also apparently came as a surprise to Foremost that Wooge had trade secrets. Perhaps Foremost did not think Wooge's information was highfalutin enough to be a real trade secret. Arrogant error! Perhaps Foremost apparently believed that Wooge had destroyed the confidential, and therefore

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protected, status of economically valuable information he had by sharing that information with it. But this whole idea is cockeyed if Foremost was in (something like) a fiduciary relationship with Wooge.

#### IV. Punitive Damages

Foremost misread the situation it was in from beginning to end. In his first opinion, the Magistrate said that he had to set aside Wooge's punitive damage claim for technical reasons. At the same time, he announced that he would schedule the trial of that issue on very short notice. In so doing, he made the following remark: "The jury that heard this case found the plaintiff's claim for punitive damages to be very compelling. So did this court." Now, why would Foremost put the punitive damage section of the case to trial when the court has virtually announced that it will return a substantial judgment for punitive damages? Of what could the company have been thinking?

Quite predictably, the Magistrate hit Foremost with \$4 million in punitive damages, predicated all of those damages on Foremost's fraud. However, the court went out of its way to describe other deplorable Foremost conduct. For example, after Foremost terminated Wooge, he set up a meeting but was rebuffed. A senior executive at Foremost actually hung up the phone on Wooge. Elderly RV owners received a blizzard of non-renewal notices. Simple business could not be conducted, because Foremost dragged its feet. Foremost charged an absurdly high sum of money to effect the transfer of policies to another company, and thereby discouraged the transfer. In addition, Foremost had a policy of not directly soliciting customers from terminated agent for a period of two years. On the very day of Wooge's termination, that policy changed from two years to six months.

Juries are sometimes sloppy about finding malice. Courts seldom are. Moreover, the pervading ideology of the American judiciary is to hold punitive damages down. On the Magistrate's compressed description, Foremost's conduct does not merely flunk the "smell test," it stinks to the high heavens. It is difficult to fathom what happened here. One of the functions of a defense lawyer is to be a Cassandra when the client plays Pollyanna. Either some lawyer didn't do his job, or some committee of Foremost executives was unbelievably irrational.


#### V. Conclusion

Wooge's Partnership Gambit will not always work. Nor should it. Not long ago, a federal district court in Texas rejected a law firm's attempt to achieve partnership status with an insurance company it represented frequently based upon some similar kinds of rhetoric. The Texas court's resolution of the law firm case was just as correct as the Iowa courts resolution of Wooge's case. The insurer did not have nearly the connections with the law firm that Foremost had with Wooge, and the relationships between law firms and insurers in general are quite different

than those between producers and insurers.

Nevertheless, insurers should beware expansive business jargon centering on the idea of partnering together. Contemporary low-brow management manuals are filled with this sort of nonsense. Take care! It can create horrendous liability, as Wooge taught Foremost in spades. ■

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