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*Kohler v. Keller Transport, Inc.; Westchester Surplus Lines Insurance Company v. Keller Transport, Inc.: After a Confessed Judgment, is an Insurer Entitled to a Reasonableness Hearing in the Underlying Tort Action?*

Kristen Zadick  
*Alexander Blewett III School of Law*

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***PRECAP: Kohler v. Keller Transport, Inc.; Westchester Surplus Lines Insurance Company v. Keller Transport, Inc.: After a Confessed Judgment, is an Insurer Entitled to a Reasonableness Hearing in the Underlying Tort Action?***

**Kristen Zadick**

Nos. DA 12-0600 and DA 14-0278  
Montana Supreme Court

Oral Argument: Friday, September 11, 2015 at 10:00 AM in the Holiday Inn Missoula Downtown, Missoula, Montana.

I. QUESTIONS PRESENTED

Does an insurer assume a duty to defend its insureds by voluntarily defending its insureds? If so, does an insurer breach its assumed duty to defend by withdrawing its defense prior to exhausting the policy limits?

Following a confessed judgment against its insureds, is an insurer entitled to a hearing in the underlying action to review the reasonableness the judgment? If so, may the insurer intervene in the underlying action to contest the judgment?

II. FACTUAL AND PROCEDURAL BACKGROUND

In April 2008, a 6,000-gallon gasoline spill contaminated a number of homes near Flathead Lake and forced the residents of the effected homes (“Homeowners”) to evacuate.<sup>1</sup> The two cases consolidated for oral argument both arise from the spill.<sup>2</sup> Prior to the spill, Keller and Wagner entered into an agreement under which Wagner hauled gasoline owned by Erickson Petroleum (“Erickson”) to Kalispell, Montana. While hauling the gasoline on Montana Highway 35, the tanker went off the road, spilling the gasoline.<sup>3</sup> Soon after, Homeowners filed suit against Keller, Wagner, and Erickson in Lake County district court, alleging negligence for causing the accident.<sup>4</sup> At the time of the spill, Carolina Casualty Insurance Company (“Carolina”) provided primary insurance, and Westchester Lines Insurance Company (“Westchester”) provided excess insurance, to Keller and Wagner.<sup>5</sup> The

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<sup>1</sup> Br. of Appellant 3–4, Feb. 4, 2013, No. DA 12-0600.

<sup>2</sup> Order 2, July 22, 2015, Nos. DA 12-0600 and DA 14-0278.

<sup>3</sup> Br. of Appellant 3–4, No. DA 12-0600.

<sup>4</sup> Appellee’s Resp. Br. 5, Apr. 5, 2013, No. DA 12-0600.

<sup>5</sup> *Id.*

policies provided commercial automobile coverage and commercial general liability coverage (“CGL”).<sup>6</sup> Following the accident, Carolina advanced payment for certain costs, but after exhausting its \$1 million commercial automobile limit, Carolina withdrew and tendered the defense to Westchester.<sup>7</sup> Westchester initially defended Keller and Wagner but withdrew after exhausting its \$4 million commercial automobile limit.<sup>8</sup>

In August 2010, Carolina filed a declaratory judgment action in the Missoula County district court seeking rulings that (1) Carolina did not have a duty to defend Keller and Wagner in the tort action, (2) Carolina was entitled to reimbursement of its defense from Westchester, and (3) Carolina owed no coverage under the CGL policy.<sup>9</sup> In late August 2010, Homeowners made a settlement offer based on the availability of CGL coverage, demanding \$4 million from Westchester and \$1 million from Carolina. However, the insurers rejected the offer, prompting Wagner and Keller to enter settlement negotiations with Homeowners.<sup>10</sup>

Following Homeowners’ settlement with Erickson, Carolina and Westchester moved to intervene in the tort action to review the reasonableness of any judgments entered against its insureds.<sup>11</sup> Before the Lake County district court ruled on the motions to intervene, Homeowners and Keller and Wagner settled their disputes through confessed judgments.<sup>12</sup> The judgments provided that Keller and Wagner were jointly and severally liable for a \$13 million judgment in Homeowners’ favor, offset by the \$3 million settlement between Homeowners and Erickson.<sup>13</sup> Homeowners agreed to seek recovery only from the insurers, and Keller and Wagner assigned their claims to Homeowners, allowing Homeowners to pursue any proceeds from Keller and Wagner’s insurance policies.<sup>14</sup>

In February 2011, the Lake County district court stayed the insurers’ motions to intervene pending the outcome of the insurance coverage action in the Missoula County district court.<sup>15</sup> In August 2012, the Missoula County district court granted partial summary judgment against the insurers, holding Westchester and Carolina breached their duties to defend Keller and Wagner by withdrawing from the defense prior to exhausting the CGL coverage.<sup>16</sup> Following the Missoula County

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<sup>6</sup> Br. of Appellant 4, No. DA 12-0600.

<sup>7</sup> Appellee’s Resp. Br. 5–6, No. DA 12-0600.

<sup>8</sup> *Id.* at 6.

<sup>9</sup> Order 2, Aug. 30, 2012, No. DV 09-1.

<sup>10</sup> Appellee’s Resp. Br. 9, Apr. 7, 2015, No. DA 14-0278.

<sup>11</sup> Order 2, Aug. 30, 2012, No. DV 09-1.

<sup>12</sup> Appellee’s Resp. Br. 8, No. DA 12-0600.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.* at 8–9.

<sup>15</sup> *Id.* at 9.

<sup>16</sup> *Id.* at 70, 74.

district court's ruling that Westchester breached its duty to defend Keller and Wagner, the Lake County district court held Westchester' motion to intervene was rendered moot.<sup>17</sup>

Shortly thereafter, Carolina settled with Homeowners, leaving claims against Westchester.<sup>18</sup> The Missoula County district court reviewed the confessed judgment and found it reasonable.<sup>19</sup> Westchester appealed the rulings of both the Lake County and Missoula County district courts.

### III. ARGUMENTS

#### *A. Duty to defend and breach*

In granting partial summary judgment to Homeowners, the Missoula County district court determined Carolina and Westchester's policies provided additional CGL coverage in the tort action,<sup>20</sup> and that both Carolina and Westchester breached their duties to defend Keller and Wagner by withdrawing from the defense prior to exhausting the CGL limits.<sup>21</sup> The court determined the policy language regarding a general aggregate limit was ambiguous and interpreted the ambiguity in favor of extending CGL coverage to the insureds.<sup>22</sup> Further, the court held Westchester's assumption of Keller and Wagner's defense imposed a duty to continue the defense,<sup>23</sup> and Westchester breached its duty by withdrawing its defense prior to exhausting the CGL limits.<sup>24</sup> Reasoning that an insurer's breach of its duty to defend makes the insurer liable for "any settlement and judgment,"<sup>25</sup> the court concluded Westchester's breach made it liable for the confessed judgment, despite the judgment being in excess of the policy limits.<sup>26</sup>

#### *1. Arguments*

Appellant Westchester asserts it did not have a contractual duty to defend Keller and Wagner because the insurance contract "expressly provides that [Westchester has] no duty to defend."<sup>27</sup> Westchester further argues the court erred in its conclusion that Westchester assumed a duty to defend Keller and Wagner because the ruling ignores the terms of the

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<sup>17</sup> Br. of Appellant 8, Feb. 4, 2013, No. DA 12-0600.

<sup>18</sup> Appellee's Resp. Br. 3, Apr. 7, 2015, No. DA 14-0278.

<sup>19</sup> *Id.* at 4.

<sup>20</sup> Order 79, Aug. 9, 2012, No. DV 10-1133.

<sup>21</sup> *Id.* at 70, 74.

<sup>22</sup> *Id.* at 60–61 (citing *Mitchell v. State Farm Ins. Co.*, 68 P.3d 703, 709 (Mont. 2003)).

<sup>23</sup> *Id.* at 74.

<sup>24</sup> *Id.* at 79.

<sup>25</sup> *Id.* at 61 (citing *Indep. Milk & Cream Co. v Aetna Life Ins. Co.*, 216 P. 1109, 1111 (Mont. 1923)).

<sup>26</sup> *Id.* at 79.

<sup>27</sup> Br. of Appellant 16, Jan. 5, 2015, No. DA 14-0278.

policy providing for an “option” to associate with the defense and the right to withdraw from the defense after exhausting the policy limits.<sup>28</sup> Westchester argues a \$4 million “general aggregate” provision unambiguously refers to the total limits under the policy, making its withdrawal after exhausting the \$4 million limit proper.<sup>29</sup> Westchester contends its withdrawal did not amount to a breach because Keller and Wagner’s defense was not prejudiced. Rather, Westchester and Carolina paid every invoice submitted by the insureds.<sup>30</sup>

The Appellees respond that Westchester failed to exhaust the excess policy limits before withdrawing from Keller and Wagner’s defense<sup>31</sup> and breached its duty to defend the insureds,<sup>32</sup> making it liable for the judgment.<sup>33</sup> The Appellees assert that because the voluntary assumption of a contractual duty creates a duty,<sup>34</sup> once Westchester chose to defend the insureds, it assumed a duty to continue the defense.<sup>35</sup> To rebut Westchester’s argument that “general aggregate” refers to the total limit available under the policy, the Appellees argue the term is ambiguous because a policy endorsement contradicts Westchester’s interpretation of the term.<sup>36</sup> The endorsement provides that both the \$4 million commercial automobile coverage and the \$4 million CGL coverage separately apply to each accident and payment for one accident does not reduce the insurer’s liability for another accident.<sup>37</sup> Arguing that ambiguities in the insurance policy should be construed in favor of extending coverage,<sup>38</sup> the Appellees argue the provision should be interpreted to extend CGL coverage to the insureds.<sup>39</sup> Finally, while the Appellees argue an insurer’s breach of its duty to defend does not require a showing that the insured suffered prejudice, the Appellees contend Wagner suffered prejudice because its attorney fees went unpaid for five months after Westchester withdrew, preventing Wagner from retaining qualified experts.<sup>40</sup>

## 2. Analysis

Whether Westchester had and breached a duty to defend Keller and Wagner is a threshold issue. If Westchester did not have a duty to

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<sup>28</sup> *Id.* at 19–20.

<sup>29</sup> *Id.* at 23–24.

<sup>30</sup> *Id.* at 31.

<sup>31</sup> Appellee’s Resp. Br. 29, Apr. 7, 2015, No. DA 14-0278.

<sup>32</sup> *Id.* at 34.

<sup>33</sup> *Id.* at 39.

<sup>34</sup> See *Stewart v. Stand. Publ’g Co.*, 55 P.2d 694, 696 (Mont. 1936); *Sult v. Scandrett*, 178 P.2d 405, 406–07 (Mont. 1947).

<sup>35</sup> Appellee’s Resp. Br. 29, No. DA 14-0278.

<sup>36</sup> *Id.* at 15.

<sup>37</sup> *Id.* at 14–15.

<sup>38</sup> *Id.* at 13 (citing *Mitchell*, 68 P.3d at 709).

<sup>39</sup> *Id.* at 16.

<sup>40</sup> *Id.* at 45–46.

defend, or it did not breach the duty, Westchester is not liable for the confessed judgment. While the parties agree the policy provides for an option to associate with the defense, the parties dispute whether Westchester assumed a duty to defend the insureds. Although the voluntary assumption of a contractual duty imposes such a duty,<sup>41</sup> the Court has not applied this rule to an insurer's assumption of a defense. However, to reach the remaining issues of the reasonableness of the confessed judgment and Westchester's intervention motion, the Court may extend the rule and hold Westchester assumed a duty to continue the defense. Even if the Court determines Westchester had a duty to defend, the issues of Westchester's breach and potential liability for the judgment remain. The Court could find that Westchester's policy language unambiguously provides for a total \$4 million limit under the policy, which would make Westchester's withdrawal after expending that amount proper. However, to reach the issues of reasonableness and Westchester's intervention, the Court may find the "general aggregate" provision is ambiguous, which would extend CGL coverage to Keller and Wagner and make Westchester liable for a reasonable judgment entered against its insureds.

#### *B. Reasonableness Review*

Although Westchester sought a review of the reasonableness of the stipulated judgment in the Lake County court, the court did not reach the reasonableness issue because it determined Westchester's motion to intervene was moot.<sup>42</sup> However, the Missoula County district court considered the reasonableness of the confessed judgment in the coverage action.<sup>43</sup> Although the Missoula County court notes Montana law "does not impose a duty upon courts to review" a judgment where an insurer breaches its duty to defend its insured,<sup>44</sup> the court conducted a reasonableness review because Westchester raised the reasonableness issue in that action.<sup>45</sup> Accordingly, the court reviewed Homeowners' and Keller and Wagner's expert reports from the tort action, reasoning that the proper measure of reasonableness is the record of the underlying action.<sup>46</sup> The court found the judgment to be reasonable, reasoning that a jury could have awarded the amount based on the evidence presented in the tort action.<sup>47</sup>

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<sup>41</sup> *Stewart v. Stand. Publ'n Co.*, 55 P.2d 694, 696 (Mont. 1936); *Sult v. Scandrett*, 178 P.2d 405, 406–07 (Mont. 1947).

<sup>42</sup> Order 6, Aug. 30, 2012, No. DV 09-1.

<sup>43</sup> Order 40, Mar. 25, 2014, No. DV 10-1133.

<sup>44</sup> *Id.* at 39 (quoting *Nielsen v. TIG Ins. Co.*, 442 F.Supp.2d 972, 981 (D. Mont. 2006)).

<sup>45</sup> *Id.* at 43.

<sup>46</sup> *Id.* at 47–48.

<sup>47</sup> *Id.* at 48.

### *I. Arguments*

Appellant Westchester argues the \$13 million judgment merits a reasonableness hearing in the tort action because parties to a confessed judgment have little reason to set a reasonable amount of damages when only the insurer's money is at stake.<sup>48</sup> Recognizing that the insurer bears the duty to demonstrate a genuine issue of material fact as to the reasonableness of the judgment,<sup>49</sup> Westchester asserts the judgment is unreasonable because it is "more than 43 times" the lost value of Homeowners' property, the restoration plan presents a risk of harm to the environment and neighbors, and there is no evidence the plan would be successful.<sup>50</sup> Westchester further argues the Lake County district court should conduct the reasonableness hearing in the tort action because that court is familiar with the facts underlying the judgment and only that court can modify the judgment.<sup>51</sup>

The Appellees respond that not only is Homeowners' settlement with Keller and Wagner reasonable, but the Missoula County district court already conducted a reasonableness hearing.<sup>52</sup> The Appellees argue that while a breaching does not have a *procedural* due process right to a reasonableness hearing, an insurer has a *substantive* due process right to a hearing only when the insurer presents evidence that creates a genuine issue of fact regarding the reasonableness of the judgment.<sup>53</sup> Even where an insurer meets that burden, however, the district court conducting the hearing determines the nature and extent of the hearing.<sup>54</sup> The Appellees argue Westchester conducted discovery, submitted expert reports, and argued at a reasonableness hearing in the insurance coverage action, and is not entitled to an additional hearing in the tort action.<sup>55</sup> Although a subsequent Montana Supreme Court decision required a reasonableness hearing to be held in the underlying case,<sup>56</sup> the Appellees argue that case is inapplicable because it involved collusion between the entities entering into the confessed judgment. Here, there are no allegations of collusion between Keller, Wagner, and Homeowners; rather, the confessed judgment is based on expert evidence. Westchester raised the reasonableness issue in the insurance coverage action and participated in "extensive proceedings" on that issue.<sup>57</sup>

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<sup>48</sup> Br. of Appellant 36-37, Jan. 5, 2015, No. DA 14-0278 (citing *Tidyman's Mgmt. Servs. Inc. v. Davis*, 330 P.3d 1139, 1153 (Mont. 2014)).

<sup>49</sup> *Tidyman's*, 330 P.3d at 1154.

<sup>50</sup> Br. of Appellant 37-39, No. DA 14-0278.

<sup>51</sup> *Id.* at 35-36.

<sup>52</sup> Appellee's Resp. Br. 24, 39, Apr. 7, 2015, No. DA 14-0278.

<sup>53</sup> *Id.* at 40 (citing *Tidyman's*, 330 P.3d at 1154).

<sup>54</sup> *Id.* (citing *Abbey/Land, LLC v. Interstate Mech., Inc.*, 345 P.3d 1032, 1035 (Mont. 2015)).

<sup>55</sup> *Id.* at 45-46.

<sup>56</sup> *Abbey/Land*, 345 P.3d at 1035.

<sup>57</sup> *Id.*

## 2. *Analysis*

The reasonableness of the confessed judgment, and whether the failure to hold a reasonableness hearing in the underlying tort action resulted in error, will likely constitute the majority of the oral argument. The parties dispute whether the hearing should be held in the underlying tort action or the declaratory judgment action. Although both parties rely on *Tidyman's* to argue for and against a reasonableness hearing, *Tidyman's* does not address the proper court in which to conduct a hearing. Further, although the court in *Abbey/Land* required a reasonableness hearing in the underlying action, the Court may find *Abbey/Land* is distinguishable because it involved collusion between the parties entering the confessed judgment, and because Westchester already litigated the reasonableness issue in the coverage action. Because the *Abbey/Land* rule did not exist at the time of Westchester's reasonableness hearing, the Court may determine the failure to hold the reasonableness review in the underlying tort action is harmless. Since the court conducting the hearing determines the nature of the review,<sup>58</sup> the Court may hold the reasonableness hearing in the coverage proceeding was adequate.

### C. *Intervention*

Following the settlement between Homeowners and Keller and Wagner, the Lake County district court stayed Westchester's intervention motion pending the Missoula County district court's ruling on whether Westchester had and breached a duty to defend Keller and Wagner.<sup>59</sup> Reasoning that an insurer's breach of its duty to defend makes the insurer liable for any judgments against its insured,<sup>60</sup> the Lake County district court explained that if Westchester breached its duty to defend, the motion to intervene to contest the judgment would become moot because Westchester would be liable for the judgment.<sup>61</sup> Conversely, if the Missoula County district court determined Westchester did not breach its duty to defend, but owed additional CGL coverage, the motion to intervene to contest damages would become ripe.<sup>62</sup> After the Missoula County district court determined Westchester breached its duty to defend by withdrawing from the defense of Keller and Wagner, the Lake County district court accordingly held the motion to intervene was moot.<sup>63</sup>

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<sup>58</sup> *Id.* at 1155.

<sup>59</sup> Order 2, Aug. 30, 2012, No. DV 09-1.

<sup>60</sup> See *Farmers Union Mutual Ins. Co. v. Staples*, 90 P.3d 381, 386 (Mont. 2004); *Lee v. USAA Casualty Ins. Co.*, 86 P.3d 562, 565 (Mont. 2004).

<sup>61</sup> Order 5, No. DV 09-1.

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*



### *1. Arguments*

Appellant Westchester contends an issue becomes moot only when it ceases to exist and no longer presents an actual controversy.<sup>64</sup> Westchester argues the Lake County district court erred in finding that Westchester's motion to intervene was moot because (1) the breach ruling, as a partial summary judgment ruling, is not final and does not prevent the Lake County district court from granting the motion; and (2) even if the breach ruling were final, it would not render a reasonableness hearing on damages moot.<sup>65</sup> Accordingly, Westchester asserts it has a valid interest in the tort action, and should be allowed to intervene, because it is the only party that may be liable for the judgment.<sup>66</sup> Further, the Lake County district court is better situated to decide the reasonableness of the damages award, as opposed to the Missoula County district court, because the Lake County district court entered the judgment and has the power to modify the judgment.<sup>67</sup>

Responding to Westchester, the Appellees argue Westchester fails to satisfy the requirements for intervention as a matter of right under Montana Rule of Civil Procedure 24(a).<sup>68</sup> First, Westchester's motion to intervene is untimely because Westchester seeks intervention nearly two years after the case was commenced and after Westchester knew of its alleged interest in the case.<sup>69</sup> Second, Westchester has no interest in the tort action because its rights and responsibilities will be resolved in the insurance coverage action.<sup>70</sup> Third, Westchester's interest is not impaired by not being a party to the tort action because Westchester cannot be required to pay the judgment absent a court order from the insurance coverage proceeding.<sup>71</sup> Additionally, Westchester is not entitled to permissive intervention because it fails to satisfy the timeliness requirement.<sup>72</sup> The Appellees argue public policy considerations support the denial of Westchester's motion because intervention would allow Westchester to interfere with the defense, unfairly restricting the insureds and their independent counsel.<sup>73</sup>

### *2. Analysis*

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<sup>64</sup> Br. of Appellant 17, Feb. 4, 2013, No. DA 12-0600 (quoting *Med. Marijuana Growers Ass'n v. Corrigan*, 281 P.3d 210, 214 (Mont. 2012)).

<sup>65</sup> *Id.* at 19.

<sup>66</sup> *Id.* at 28–29.

<sup>67</sup> *Id.* at 12–13.

<sup>68</sup> Appellee's Resp. Br. 14, Apr. 5, 2013, No. DA 12-0600.

<sup>69</sup> *Id.* at 17–18.

<sup>70</sup> *Id.* at 24–25.

<sup>71</sup> *Id.* at 28.

<sup>72</sup> *Id.* at 31.

<sup>73</sup> *Id.* at 33.

Because Westchester seeks to intervene in the tort action to contest the reasonableness of the confessed judgment, the intervention issue is contingent on Westchester's right to a reasonableness hearing. If the Court holds Westchester is not entitled to an additional hearing, the Court will likely not decide this issue. Likewise, if the Court finds Westchester did not have a duty to defend Keller and Wagner, or did not breach a duty to defend, Westchester cannot be liable for the judgment, and its motion to intervene in the tort action would be irrelevant. Although the Appellees raise a valid question about the timeliness of Westchester's motion to intervene, the dispute likely comes down to whether Westchester has an interest in the tort action. While Westchester claims its interest relates to its potential liability for the judgment, Westchester voluntarily withdrew from the defense of its insureds and forfeited its right to control the insureds' defense. Further, Westchester participated in a separate coverage action to determine its liability for the judgment and litigated the reasonableness of the judgment. Because Westchester initiated and participated in the coverage action, the Court may find Westchester already litigated the issues it now seeks to raise in the tort action.