Montana Law Review Online

Volume 76 Article 17

9-18-2015

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Recommended Citation
Kristen Zadick, Oral Argument Review, 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?*, 76 Mont. L. Rev. Online 143,
https://scholarship.law.umt.edu/mlr_online/vol76/iss1/17.

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Recap; *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. JONATHAN HACKER FOR APPELLANT WESTCHESTER SURPLUS LINES INSURANCE COMPANY ("WESTCHESTER")

Mr. Hacker opened his argument by asserting Westchester performed everything required of it under the insurance policy and more. As required by the policy, Westchester advanced payment for clean-up following the gasoline spill. Additionally, Westchester paid the insureds' defense costs up to the $4 million commercial automobile limit, even though the terms of the policy did not create a duty to provide a defense.

Questions from the justices largely centered on three topics: (1) the construction of Westchester's excess insurance policy in light of both the primary insurance policy issued by Carolina and a federally-prescribed endorsement to the excess insurance policy; (2) the implication of commercial general liability ("CGL") coverage; and (3) the reasonableness hearing held in the Missoula County district court.

The justices challenged the interpretation of the excess insurance policy on several levels. Justice Shea inquired whether the excess policy applied in the same manner as the primary policy issued by Carolina since the excess policy followed the form of the primary policy. Justice Shea noted that if the excess policy followed the form of the primary policy, the excess policy should provide separate limits for both commercial automobile coverage and CGL coverage, as the primary policy did. Mr. Hacker responded that the excess and primary policies differed because the primary policy did not contain an aggregate limit, while the excess policy issued by Westchester included such a limit. According to Mr. Hacker, although the excess policy followed the form of the primary policy, it did so only in that it provided coverage for the same types of occurrences as the primary policy.

Questions regarding the MCS-90 endorsement, which is an endorsement to the excess insurance policy required by federal law, focused on the effect of the endorsement on the interpretation of the policy, namely the "general aggregate." Justice Baker asked Mr. Hacker to address the Missoula County District Court's determination that the

MCS-90 supported an ambiguity in the excess insurance policy. Mr. Hacker responded that the endorsement was irrelevant to the interpretation of the policy language and did not change the limits under the excess policy. Rather, the endorsement is meant to assure the public that certain motor carriers satisfy minimum insurance requirements. Justice Shea questioned the express language of the MCS-90 endorsement that indicated the endorsement changed the excess policy. In response, Mr. Hacker again emphasized the endorsement did not expand coverage and Westchester should not be held responsible for ambiguities that arise from the endorsement because Westchester did not author the federally-prescribed endorsement. Additionally, Mr. Hacker noted no federal cases have interpreted the endorsement to expand or alter coverage limits.

Mr. Hacker argued Westchester did not breach a duty to defend its insureds because the excess policy expressly allowed for an option, but not a duty, to participate in the insureds' defense. Under an option to defend, Mr. Hacker noted an insurer may withdraw from the defense so long as the withdrawal does not prejudice the insured. Mr. Hacker argued Westchester properly withdrew from the defense upon exhausting the limits. Because trial was more than a year away at the time of Westchester's withdrawal, the insureds did not suffer prejudice.

In response to Chief Justice McGrath's prompting, Mr. Hacker addressed the adequacy of the reasonableness hearing held in the Missoula County declaratory judgment action. Mr. Hacker argued the reasonableness hearing was inadequate because the wrong decision-maker conducted the hearing and the district court used the incorrect standard to review the reasonableness of the confessed judgment. Mr. Hacker argued Judge Langton should have conducted the hearing in the tort action because that court had a better understanding of the facts underlying the judgment because it entered the confessed judgment. Further, Mr. Hacker argued the Missoula County District Court erred by considering only the Homeowners' evidence. Justice Shea noted the Missoula County District Court applied the same standard used to set aside a jury verdict, finding the amount fell within the range a jury could have awarded. In response, Mr. Hacker advocated for the standard set in *Tidyman's v. Management Services, Incorporated v. Davis*, [1] which requires the insurer to present sufficient evidence to create a genuine issue of fact as to the reasonableness of the amount of the judgment. Mr. Hacker argued that because the insurer bears the burden to demonstrate a genuine issue of fact, the district court should have permitted Westchester to conduct discovery and cross examine the opposing party's expert witnesses.

[1] 330 P.3d 1139, 1154 (Mont. 2014).

II. ROGER SULLIVAN FOR APPELLEES HOMEOWNERS

Mr. Sullivan opened his argument by noting Westchester's appeal hinged on a special definition of a $4 million "general aggregate" limit, but the insurer failed to define the term.

Questions from the justices focused on several topics: (1) the effect of the MCS-90 endorsement on the interpretation of the policy; (2) the number of occurrences that triggered coverage under the excess policy; and (3) the adequacy of the reasonableness hearing.

Mr. Sullivan noted that because the Westchester policy followed the form of the Carolina policy, the excess policy provided by Westchester should have applied in a manner similar to Carolina's policy. Because the Carolina policy provided separate limits for automobile and CGL coverage, Westchester's policy should have provided separate limits. The form following nature of the excess insurance policy contradicted Westchester's argument that "general aggregate" referred to the total limits under the excess insurance policy. Mr. Sullivan argued this contradiction created an ambiguity in the policy, and ambiguities are construed against the author of the policy. As the author of the policy, Westchester had the ability to define "general aggregate" but failed to do so.

Mr. Sullivan argued that the language of the MCS-90 endorsement emphasized the ambiguity because the endorsement changed the policy by providing that the policy limits applied separately. Justice Baker inquired whether any other cases, particularly federal cases, used the MCS-90 federal endorsement to determine the limits of the insurance policy. Mr. Sullivan did not directly address Justice Baker's inquiry, but clarified that the Missoula County District Court did not use the endorsement to determine the limits of the policy. Rather, in light of Westchester's reliance on an undefined term, the district court reviewed the entire policy, including the MCS-90 endorsement, to define "general aggregate." The district court did not interpret the endorsement, but rather considered the endorsement in its interpretation of "general aggregate."

Justices Shea and McKinnon expressed concern as to the number of occurrences that triggered insurance coverage. In response to Justice Shea, Mr. Sullivan noted that two separate events triggered both the commercial automobile coverage and the CGL coverage. The first occurrence, the roll-over accident, triggered the commercial automobile coverage. The damages caused through the clean-up efforts triggered the CGL coverage. Justice McKinnon next asked whether both insurers acknowledged the two triggering events. Mr. Sullivan noted that although both insurers initially denied the implication of CGL coverage, Carolina later recognized the implication of the CGL coverage.

Turning to the breach argument, Mr. Sullivan argued that once Westchester started to defend the trucking companies, it assumed a duty to continue that defense and the insureds had reasonable expectations that Westchester would continue the defense. Mr. Sullivan noted Westchester's unilateral withdrawal caused the insureds prejudice because the insureds' attorney fees went unpaid for a number of months. Mr. Sullivan argued Westchester should have followed the procedure recommended by the Montana Supreme Court. The Court recommends that the insurer continue its defense under a reservation of rights and file a declaratory judgment action to determine whether coverage exists under the policy.[2]

Finally, Mr. Sullivan analyzed the adequacy of the reasonableness hearing held in the declaratory judgment action. Mr. Sullivan framed his argument by explaining the course of action an insured may take after the insurer breaches its duty to defend by prematurely withdrawing from the defense. Mr. Sullivan noted that insureds acted within their rights by entering a confessed judgment with the injured party. Although judgment amounts must be reasonable, Mr. Sullivan noted the Missoula County district court found the amount to be reasonable. Mr. Sullivan argued Judge McLean properly reviewed the Homeowners' expert reports, which contained all the relevant damage information, and determined that the amount fell within the range of what a jury could reasonably award. Justice Shea questioned why the review took place in the Missoula court, and Mr. Sullivan responded a reasonableness review can be conducted wherever judicial efficiency so requires.

Finally, Justice Baker asked Mr. Sullivan to respond to Westchester's argument that the court reviewing the reasonableness of a judgment cannot make a determination without allowing the party opposing the judgment to cross-examine the proponent's expert witnesses. Mr. Sullivan responded that Westchester failed to carry the burden imposed on the insurer by *Tidyman's* to produce evidence creating a genuine issue of fact as to the reasonableness of the judgment. Concluding his argument, Mr. Sullivan argued Judge McLean was better suited to review the judgment amount because he was acquainted with the record. Mr. Sullivan added that to give the reasonableness hearing to Judge Langton, who was not as acquainted with the record, would violate Rule 1 of the Montana Rules of Civil Procedure, which calls for the "just, speedy, and inexpensive" determination of proceedings.[3]

III. MR. HACKER'S REBUTTAL

[2] Farmers Union Mut. Ins. Co. v. Staples, 90 P.3d 381, 386 (Mont. 2004).
[3] MONT. R. CIV. P. 1.

Mr. Hacker's rebuttal began with a question from Justice McKinnon seeking clarification as to whether the circumstances implicated CGL coverage and whether Westchester left the coverage untapped. In his response, Mr. Hacker emphasized the insureds themselves did not believe the facts implicated CGL coverage. Seeking a clear answer to Justice McKinnon's inquiry, Justice Shea asked whether Westchester's policy provided both automobile and CGL coverage. Mr. Hacker conceded that although the excess policy followed the form of the Carolina policy, which provided both automobile and CGL coverage, Westchester's excess policy did not provide for separate automobile and CGL coverage. Rather, the excess policy followed form only in that it covered the same types of occurrences that Carolina's primary policy covered. Mr. Hacker clarified the Westchester policy did not follow the form of the Carolina policy as to the limits.

In his rebuttal, Mr. Hacker emphasized two points. First, the MCS-90 endorsement did not alter the coverage limits between Westchester and its insureds, and as such the district court incorrectly relied on the endorsement to find an addition $4 million in CGL coverage. Second, the "general aggregate" limit applied to the total limits available under the excess policy. Citing the relationship and course of dealing between Westchester and its insureds, Mr. Hacker noted the insureds themselves never thought the CGL coverage applied to the claim.

As a final matter, Justice Shea asked Mr. Hacker to elaborate on the reasonableness hearing. Mr. Hacker argued the court that entered the confessed judgment should have conducted the hearing to review the reasonableness of the judgment. Further, Mr. Hacker argued the court that held the hearing should have permitted Westchester to conduct discovery and cross-examine the Homeowners' expert witnesses.

IV. PREDICTIONS

The Court's principal concerns focused on the construction of Westchester's excess insurance policy and the adequacy of the reasonableness hearing, and both Mr. Hacker and Mr. Sullivan stressed the two issues. The effect of both the Carolina policy and the federal endorsement on the excess policy may be dispositive of the coverage and breach issues. The adequacy of the reasonableness hearing in the Missoula County district court likely depends upon whether the Missoula County district court employed the proper standard in its review of the confessed judgment.

The Court may find Westchester's excess policy provided additional CGL coverage because the Westchester policy followed the form of the Carolina policy, which provided separate limits for both automobile and CGL coverage. Because Westchester conceded the

excess policy followed the form of Carolina's policy, the excess policy should apply in a like manner, providing separate limits for automobile and CGL coverage. Although Westchester noted the policy disclaimed a duty to defend and contained a "general aggregate" limit, the language conflicts with the form following nature of the policy. Because the conflict creates an ambiguity, and Westchester failed to define a term it relied upon to deny coverage, the Court may find Westchester improperly withdrew from the defense, and in doing so, breached its duty to defend. As Mr. Sullivan argued, an insurer's breach of its duty to defend makes the insurer liable for judgments against its insured, even those in excess of policy limits.[4]

Although the justices' questions focused heavily on the role of the federal MCS-90 endorsement, the Court may find the endorsement does not change the ambiguity created between the policy language and the form following nature of the excess policy. While Westchester argued the endorsement itself does not alter the limits of its policy, the Court may find the Missoula County District Court's use of the endorsement to support its finding does not merit reversal because the ambiguity exists apart from the endorsement.

The Court may find the Missoula County District Court held an inadequate reasonableness hearing because Westchester did not have the opportunity to cross-examine the Homeowners' expert witnesses or conduct discovery. Each party advocated for a different standard to determine the reasonableness of the confessed judgment. While Mr. Hacker argued for the standard set forth in *Tidyman's*, Mr. Hacker's representation of the standard is not complete. Under *Tidyman's*, as a threshold matter, the insurer must set forth specific facts that demonstrate the confessed judgment amount is unreasonable.[5] At the hearing, however, the district court maintains the discretion to determine the parameters of the hearing and to decide whether further discovery is necessary.[6] Because the burden of establishing the unreasonableness of the confessed judgment rested with Westchester, and Westchester was not permitted to conduct discovery to satisfy that burden, the Court may find the reasonableness hearing was inadequate. To remedy this issue, the Court may remand the case to the Missoula County District Court and direct the court to allow Westchester to cross-examine the Homeowners' expert witnesses and conduct discovery as to damages.

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[4] Indep. Milk & Cream Co. v. Aetna Life Ins. Co., 216 P. 1109, 1111 (Mont. 1923).
[5] *Tidyman's*, 330 P.3d at 1154.
[6] *Id.* at 1155.