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Miss. Insurers Should Beware The Voluntary Payment Doctrine

By **David Kroeger and Huiyi Chen** (April 16, 2019, 4:29 PM EDT)

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The scenario is a common one. An insurer disputes coverage but, when presented with an opportunity to settle the underlying claim at a reasonable amount, tries to hedge its bets by paying the settlement amount while continuing to assert its coverage defenses.

The U.S. Court of Appeals for the Fifth Circuit and the Mississippi Supreme Court's recent decisions in Colony Insurance Co. v. First Specialty Insurance Corp.[1] illustrate a significant downside to such an insurer strategy — the insurer may be found to have made a "voluntary payment," thereby precluding it from seeking indemnity or contribution from others. Policyholders should continue to be mindful of the voluntary payment doctrine, as it may impact their insurers' willingness or ability to settle underlying claims on which they are seeking to simultaneously contest coverage.

In Colony Insurance Co. v. First Specialty Insurance Corp., a primary insurer settled a wrongful death action while simultaneously contesting that the defendant in the underlying wrongful death action was its insured, and that even if it were, an exclusion barred coverage. The primary insurer then sought indemnity and reimbursement for the settlement payment from the defendant's excess liability insurer in a federal district court in Mississippi. The district court granted summary judgment in favor of the excess liability insurer, citing Mississippi's voluntary payment doctrine.

The primary insurer appealed to the Fifth Circuit, which certified a state law question to the Mississippi Supreme Court, which in turn held that the primary insurer was a voluntary payor and therefore not entitled to indemnity.[2] The Fifth Circuit thereafter affirmed the district court's summary judgment ruling. The Colony Insurance decisions may have an effect on the willingness of third-party insurers to settle on behalf of the policyholder when there is a separate coverage dispute.

The litigation sprang from a workplace incident. Jerry Lee Taylor II was an employee of Accu-Fab & Construction. On July 28, 2014, while working on Omega Protein Corporation's facility, Taylor was killed as a result of an explosion. A wrongful death claim was anticipated.

Both Omega and Accu-Fab had purchased insurance to cover any potential lawsuit brought by Taylor's

estate, but the insurers disputed who should pay, and how much. Omega was the named policyholder of (1) the ACE American Insurance Company, which provided a $1 million primary commercial general liability policy, subject to a $250,000 deductible; and of (2) First Specialty Insurance Corporation, which provided a $10 million excess liability policy to supply limits in excess of the underlying AAIC policy.

Accu-Fab, on the other hand, was the named insured on Colony Insurance Company's primary liability policy with a $1 million liability limit. The Colony policy also contained an "Additional Insured" provision covering "[a]ll persons or organizations as required by written contract with the Named Insured [i.e., Accu-Fab]," but only for an injury "caused, in whole or in part, by" Accu-Fab's acts or omissions or the acts or omissions of "those acting on [Accu-Fab's] behalf."

This "Additional Insured" endorsement also amended the Colony policy's "Other Insurance" clause, stating that Colony's coverage for the "additional insured" was primary and that Colony would not seek contribution from other insurance available to the "additional insured." In addition, the Colony policy had a "Total Pollution Exclusion," which excluded from coverage injuries caused by "seepage," "release, or escape of 'pollutants' at any time."

On March 4, 2015, Omega informed Colony that it expected to receive a claim of personal injury/wrongful death arising from the July 2014 explosion, and asserted that it qualified as an "additional insured" under the Colony policy. Omega demanded that Accu-Fab and Colony defend and fully indemnify any such claims.

Almost 10 days later, on March 13, 2015, Colony agreed to conduct an investigation into the incident "under a full and complete reservation of rights." Colony contended that Omega did not qualify as an "additional insured" because the explosion was not caused by Accu-Fab or some party acting on its behalf. Colony also argued that the "Total Pollution Exclusion" applied because the explosion was caused by seepage or release of combustible gases, which constituted "pollutants."

On April 17, 2015, Colony filed a complaint for declaratory judgment in Mississippi state court, asking the court to declare that the Colony policy did not provide any coverage for damages or injuries resulting from the July 2014 explosion. Both Accu-Fab and Omega were named as defendants.

While the state court declaratory action was pending, on Sept. 2, 2015, Taylor's estate and survivors filed a wrongful death action against Omega in federal district court. The estate did not name Taylor's employer, Accu-Fab, as a defendant. At Omega's request, Colony agreed to fund Omega's defense in the wrongful death action, again subject to a "full and complete" reservation of rights, including to seek recovery of all defense costs from Omega and its insurers if it was ultimately determined in the declaratory action that Colony indeed did not owe a defense to Omega. Colony also clarified that its consideration of any settlement offer in the wrongful death suit would be in the light of the full reservation of rights.

Less than five months into the wrongful death lawsuit, and while the declaratory action was still pending, Taylor's estate offered to settle for $2 million. First Specialty, Accu-Fab's excess liability insurer, asked Colony to tender its $1 million limit, reasoning that this was probably the only and best opportunity to settle at or under $2 million; otherwise Omega and the insurers would be exposed to greater liabilities as the lawsuit proceeded.

Taking in First Specialty's opinion and concerned about potential additional exposure, Colony tendered its $1 million limits and, together with Omega's primary insurer tendering its $1 million limits, obtained

a “full and complete” release for Omega in the wrongful death lawsuit. Colony subsequently dismissed its declaratory action against Accu-Fab and Omega.

Colony then filed a lawsuit against First Specialty for a full reimbursement of its settlement contribution in the United States District Court for the Southern District of Mississippi. First Specialty filed a summary judgment motion, and Colony filed a cross-motion for summary judgment. The district court ruled in First Specialty’s favor, reasoning that Mississippi’s voluntary payment doctrine precluded Colony from seeking indemnity.

Colony appealed to the Fifth Circuit. Recognizing that there was no decisive Mississippi state case law on this issue, the Fifth Circuit certified two questions to the Mississippi Supreme Court, including the following: Does an insurer act under “compulsion” if it takes the legal position that an entity purporting to be its insured is not covered by its policy, but nonetheless pays a settlement demand in good faith to avoid potentially greater liability that could arise from a future coverage determination?[3] The Mississippi Supreme Court answered that question and found the answer dispositive of the case, and thus declined to answer the second question.

The Mississippi Supreme Court concluded that under Mississippi law, “a voluntary payment cannot be recovered back” if it is made without “compulsion,” “fraud,” or “mistake of fact,” and if the payor was under “no legal or moral obligation to pay.”[4] The Mississippi Supreme Court then analyzed what constituted “compulsion” under Mississippi law. Citing Black’s Law Dictionary and precedents, the court held that a payment was not compulsory merely because it was made to protect one’s own interest; instead, there must be “an immediate and urgent necessity” for the payment.[5]

Applying the legal standard to the facts of the case, the Mississippi Supreme Court found that Colony was not under “an immediate and urgent necessity” to pay the settlement.[6] First, the court pointed out that Colony had disputed coverage from beginning to end: it not only contended that the injury was excluded based on the “Total Pollution Exclusion,” but also maintained that it did not insure Omega at all (because Omega did not qualify as an “additional insured”).[7] As a result, the court concluded that Colony only made the payment out of a “fear” that Omega “might be” an additional insured, and that the exclusion might not apply; such fear of additional potential and uncertain exposure was not compulsion, at least not to the Mississippi Supreme Court.[8]

Second, the court emphasized that the settlement occurred only “approximately four months” after the filing of the wrongful death lawsuit, and while the declaratory lawsuit was still pending.[9] As such, the court concluded that Colony should have pursued the declaratory lawsuit to obtain an equitable remedy instead of settling when the wrongful death lawsuit was still at an early stage.[10] The court commented that “[i]n civil cases, the purpose of courts is to extend aid to those who have not been able by lawful means to aid themselves, and relief is not available to those who have neglected to take care of their interests.”[11]

The Fifth Circuit found the Mississippi Supreme Court’s ruling to be dispositive of the issue at hand and accordingly held that Colony was a voluntary payor and could not seek indemnity or reimbursement from First Specialty. As a result, the Fifth Circuit affirmed the district court’s grant of summary judgment in favor of First Specialty.[12]

The Fifth Circuit and Mississippi Supreme Court’s decisions illustrate the plain risks associated with an insurer’s attempt to simultaneously preserve all potential arguments that might be available to it. Colony could have elected not to vigorously pursue its coverage defenses in the first place, thereby

making it much easier to settle the underlying claim and seek indemnity from another insurer. Or Colony could have elected to pursue its coverage defenses to conclusion (if it truly believed in their merits) and risked the exposure associated with its refusal to settle the underlying claim.

Colony instead tried to do both, and the Fifth Circuit and the Mississippi Supreme Court refused to allow the inconsistency. The end result is that insurers, at least under Mississippi law, will need to think twice before trying to preserve all arguments potentially available to them, and policyholders will need to be mindful of the voluntary payment issue in determining their own strategy for pursuing their insurers.

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[1] No. 17-60094, 2019 WL 1312154 (5th Cir. Mar. 21, 2019)

[2] See Colony Ins. Co. v. First Specialty Ins. Corp., 262 So. 3d 1128 (Miss. 2019).

[3] See Colony Ins. Co. v. First Specialty Ins. Corp., 726 F. App'x 992, 995–96 (5th Cir. 2018).

[4] See Colony Ins. Co., 262 So. 3d at 1132 (citing Mississippi Supreme Court cases).

[5] See id. at 1133–34.

[6] See id.

[7] See id. at 1133.

[8] See id.

[9] See id. at 1134.

[10] See id.

[11] See id. (internal quotation marks and citation omitted).

[12] See Colony Ins. Co., No. 17-60094, 2019 WL 1312154, at *3.