



# 2018 ACCEC Annual Meeting

May 16-18, 2018 | The Westin Chicago River North | Chicago, IL

## Thank you to our sponsors!



**ESQUIRE**  
DEPOSITION SOLUTIONS



Be Certain.

**KCIC**



**FORENSIC ACCOUNTANTS**

# ACCEC

American College of Coverage and  
Extracontractual Counsel



## 2018 ACCEC Annual Meeting

May 16-18, 2018 | The Westin Chicago River North | Chicago, IL



# AGENDA

## Wednesday, May 16, 2018

1:00 pm – 4:00 pm <i>Jackson Park</i>	<b>Board Meeting</b> <ul style="list-style-type: none"> <li>Lunch will be buffet-style from 12:00pm to 2:00pm.</li> </ul>
4:30 pm – 5:30 pm <i>Jackson Park</i>	<b>Membership Committee Meeting</b>
6:30 pm – 8:00 pm <i>Promenade Ballroom C</i>	<b>Welcome Reception</b> <ul style="list-style-type: none"> <li>Professional Liability (E&amp;O and EPLI) Committee Meeting</li> </ul>

## Thursday, May 17, 2018

7:30 am – 8:30 am <i>Promenade Ballroom ABC</i>	<b>Breakfast Buffet</b> <ul style="list-style-type: none"> <li>Cyber Insurance &amp; Computer Crime Committee Meeting</li> <li>Professionalism &amp; Ethics Committee Meeting (8:00am)</li> </ul>
8:30 am – 8:40 am <i>Grand Ballroom C</i>	<b>Welcome Remarks</b> <ul style="list-style-type: none"> <li><i>Bruce Celebrezze: Clyde &amp; Co.; ACCEC President</i></li> <li><i>Stacy Broman, Meagher &amp; Geer, P.L.L.P.; 2018 Annual Meeting Co-chair</i></li> <li><i>Jason Mazer, Cimo Mazer Mark PLLC; 2018 Annual Meeting Co-chair</i></li> </ul>
8:40 am – 9:30 am <i>Grand Ballroom C</i>	<b>Coverage in a Time of Storms</b> <i>Speakers: William Berk, Berk, Merchant &amp; Sims, PLC; Sherilyn Pastor, McCarty &amp; English LLP; Neil Rambin, Drinker Biddle &amp; Reath LLP</i> <p>Following storm events, disputes can arise over the cause and amount of covered loss. Most policies allow parties to invoke appraisal by a competent and disinterested appraiser or panel to attend to valuation issues. We will discuss when an appraisal award can be set aside for a party or party appraiser's failure to disclose potential conflicts of interest. We also will discuss concurrent and efficient proximate cause issues, which are likely to arise where covered and excluded causes combine to create a loss.</p>

<p>9:30 am – 10:15 am <i>Grand Ballroom C</i></p>	<p><b>Rules of the Game</b> <i>Speakers: Kenneth Abraham, University of Virginia School of Law; Richard Bryan, Jackson &amp; Campbell, P.C.; Lorelie Masters, Hunton &amp; Williams, LLP; Jack Montgomery, Jones Day</i></p> <p>The panelists will present a dialogue, separately between policyholder and its counsel, and between insurer and its counsel, regarding the issues frequently encountered at the commencement of a Bermuda form arbitration. The issues will include: commencement and pleadings, the seat of the arbitration, curial law, selection of arbitrator (US, English, Bermudian, other) selection of chair (same possibilities) and involvement of the parties in his/her selection, the need for and selection of a QC, discovery, expert witnesses, proof of law, admissibility of extrinsic evidence, and the possible consideration of a preliminary issue (similar to summary judgment).</p>
<p>10:15 am – 10:30 am <i>Grand Ballroom C</i></p>	<p><b>Break</b></p>
<p>10:30 am – 11:40 am <i>Grand Ballroom C</i></p>	<p><b>Ethical Issues Arising Out of Sharing Information</b> <i>Speakers: Marialuisa Gallozzi, Covington &amp; Burling LLP; Neil Posner, Much Shelist, P.C.; Doug Richmond, Aon Professional Services</i></p> <p>Complex cases give rise to complicated relationships among insurers, insureds, lawyers, experts, to name just a few. In the typical situation, information has to be shared in order to allow all parties to do their jobs, and protect their respective interests. This panel will discuss the ethical, as well as evidentiary, concerns that are implicated by these situations.</p>
<p>11:30 am – 12:30 pm <i>Grand Ballroom C</i></p>	<p><b>Transactional Liability Insurance</b> <i>Speakers: Joseph Finnerty III, DLA Piper LLP; Jill Kerxton, Aon Risk Solutions; Peter Rosen, Latham &amp; Watkins LLP</i></p> <p>Panelists will briefly trace the development of transactional liability policies and how the M&amp;A markets have increasingly adopted these policies in private and public M&amp;A transactions. The panel will discuss the various types of transactional liability policies, their mechanics and their key provisions. The panel also will discuss how the policies and their provisions have affected the way private equity firms and companies have approached the purchase or sale of a private company. The panel will further discuss the claims history of these policies and give specific examples from known arbitrations and litigations.</p>
<p>12:30 pm – 1:30 pm <i>Promenade Ballroom ABC</i></p>	<p><b>Lunch</b> <b>Annual Business Meeting, featuring Recognition of New Members</b></p>

<p>1:45 pm – 2:45 pm <i>Grand Ballroom C</i></p>	<p><b>Comparative Bad Faith: Trends, Tricks, and Traps</b>  <i>Speakers: Barbara O’Donnell, Sulloway &amp; Hollis P.L.L.C. (moderator); Lewis Collins, Butler Weihmuller Katz Craig LLP; Christine Haskett, Covington &amp; Burling LLP; Doug McIntosh, McIntosh Sawran &amp; Cartaya P.A.; Doug Richmond, Aon Professional Services</i></p> <p>Is comparative bad faith a viable theory in 1st and 3rd party claim and, if so, to what extent? The Extra-Contractual Committee will present a point-counterpoint panel discussion of this concept including: Are burdensome requests/refusal to provide information evidence of comparative bad faith? Is the application of comparative fault principles inconsistent with an insurer’s obligation of good faith and fair dealing? Does the defense of comparative bad faith discourage so-called “set-ups” and does it invade claimant’s counsel’s state of mind? Is this theory already accounted for when considering the willingness of the claimant to settle/no reasonable possibility of settlement? Under the Totality of the Circumstances test, is comparative bad faith a proper consideration or does the attorney client or work product privilege prevent such an inquiry? Can the parties use “custom and practice” experts to opine on questions of policy interpretation or good faith claim handling?</p>
<p>2:45 pm – 3:00 pm</p>	<p><b>Break</b></p>
<p>3:00 pm – 3:45 pm <i>Grand Ballroom C</i></p>	<p><b>Managing Captive Claims</b>  <i>Speakers: Michael Aylward, Morrison Mahoney LLP; David Goodwin, Covington &amp; Burling LLP; Barbara Miller, Wells Fargo &amp; Company</i></p> <p>Many large companies use their captive insurance companies to pay claims and then reinsure their captives. This session, which will include the claims manager for Wells Fargo’s captive insurer, will explore how captives handle claims in the real world, and how reinsurers respond to claims from captives.</p>
<p>3:45 pm – 4:30 pm <i>Grand Ballroom C</i></p>	<p><b>Fifteen Cases in 45 Minutes</b>  <i>Speakers: Robert Chesler, Anderson Kill PC; Anthony Leuin, Shartsis Friese LLP; Suzanne Midlige, Coughlin Duffy LLP</i></p> <p>A review of the leading insurance coverage decisions of 2017-2018, including Medidata Solutions v. Federal Insurance Co., Travelers v. Activis, OneBeacon v. Celanese, and Harleysville v. Heritage Communities.</p>
<p>6:30 pm – 7:30 pm <i>Promenade Ballroom C</i></p>	<p><b>Reception</b></p> <ul style="list-style-type: none"> <li>• New Fellows &amp; First Time Attendees are invited to come early, at 6:00pm</li> </ul>
<p>7:30 pm – 9:30 pm <i>Riverfront Room</i></p>	<p><b>Dinner</b></p>

<p>7:30 am – 8:30 am <i>Promenade Ballroom ABC</i></p>	<p><b>Breakfast Buffet</b></p>
<p>8:30 am – 9:15 am <i>Grand Ballroom C</i></p>	<p><b>The Legacy of Level 3 More than 15 Years Later</b> <i>Speakers: Mitchell Dolin, Covington &amp; Burling LLP; Michael Manire, Manire &amp; Galla LLP</i></p> <p>It has been fifteen years since the Seventh Circuit issued its landmark ruling in Level 3 questioning the availability of D&amp;O coverage for damages that are “restitutionary in character. In the ensuing years, courts have come to markedly different approaches on the insurability of damages that might be characterized as restitution or disgorgement. What is Level 3’s legacy, how has the law evolved, and how have changes in policy language addressed these issues?</p>
<p>9:15 am – 10:00 am <i>Grand Ballroom C</i></p>	<p><b>The Opioid Epidemic</b> <i>Speakers: Robert Kole, Choate Hall &amp; Stewart LLP; R. Hugh Lumpkin, Ver Ploeg &amp; Lumpkin, P.A.</i></p> <p>State and local governments across the country are filing lawsuits on almost a daily basis, seeking recovery of the costs they have expended and are expending as a result of the opioid epidemic. Those suits are being brought against manufacturers, distributors, pharmacies and doctors, among others. The presentation will explore the coverage issues arising from these multi-billion dollar claims, both in terms of decisions that already have been rendered and those that may be on the horizon.</p>
<p>10:00 am – 10:15 am</p>	<p><b>Break</b></p>
<p>10:15 am – 11:15 am <i>Grand Ballroom C</i></p>	<p><b>Are Two Policies Better than One?</b> <i>Speakers: Suzan Charlton, Covington &amp; Burling LLP; Scott Hecht, Stinson Leonard Street LLP; Ronald Kammer, Hinshaw &amp; Culbertson LLP</i></p> <p>This lively panel will discuss the interplay between occurrence-based CGL policies and claims-made PL policies when both are triggered. Typically one would think that more coverage is better for the insured, but this is not always the case. Issues that may arise include control of the defense, how defense costs are treated when only the PL policy is a “wasting” policy, and how indemnity costs are allocated, particularly when each policy provides different amounts of coverage.</p>
<p>11:15 am – 12:15 pm <i>Grand Ballroom C</i></p>	<p><b>Emerging Coverage B Claims</b> <i>Speakers: James Bryan, Nexsen Pruet PLLC; Laura Foggan, Crowell &amp; Moring LLP; Seth Lamden, Neal Gerber Eisenberg LLP</i></p> <p>Civil rights claims for wrongful conviction, imprisonment and incarceration have put a spotlight on the availability of Coverage B for such claims. This panel will analyze the emerging body of law concerning these claims as well as emerging theories and defenses to coverage with respect to other Coverage B offenses, notably the scope of coverage for privacy claims.</p>
<p>12:15 – 12:20 pm <i>Grand Ballroom C</i></p>	<p><b>Closing Remarks</b></p>

**ACCEC**

American College of Coverage and  
Extracontractual Counsel



2018 ACCEC Annual Meeting

May 16-18, 2018 | The Westin Chicago River North | Chicago, IL

# REGISTRANTS

[www.americancollegecec.org](http://www.americancollegecec.org) / [info@americancollegecec.org](mailto:info@americancollegecec.org) / 703-683-5561

**Fellow/Honorary Attendee List, as of May 9, 2018**

*Complete contact info can be found in our online directory: [americancollegecec.org](http://americancollegecec.org)*

**Marion Adler**

Rachlis Duff Adler Peel & Kaplan, LLC  
Chicago, IL

**Leslie Ahari**

Clyde & Co US LLP  
Washington, DC

**Robert Allen**

The Allen Law Group  
Dallas, TX

**David Anderson**

Anderson Coverage Group LLC  
Chicago, IL

**Walter Andrews**

Hunton Andrews Kurth, LLP  
Washington, DC

**Samuel Arena**

Stradley Ronon  
Philadelphia, PA

**Lane Ashley**

Lewis Brisbois Bisgaard & Smith LLP  
Los Angeles, CA

**Michael Aylward**

Morrison Mahoney LLP  
Boston, MA

**David Baldwin**

Potter Anderson Corroon LLP  
Wilmington, DE

**Michael Barnes**

Dentons US LLP  
San Francisco, CA

**William Beck**

Lathrop & Gage  
Kansas City, MO

**William Berk**

Berk, Merchant & Sims PLC  
Coral Gables, FL

**Jill Berkeley**

Neal, Gerber & Eisenberg LLP  
Chicago, IL

**J. Stephen Berry**

Dentons US LLP  
Atlanta, GA

**Lyndon Bittle**

Carrington, Coleman, Sloman &  
Blumenthal  
Dallas, TX

**Stacy Broman**

Meagher & Geer PLLP  
Minneapolis, MN

**Thomas Brusstar**

Hinkhouse Walsh Williams LLP  
Chicago, IL

**Richard Bryan**

Jackson & Campbell, P.C.  
Washington, DC

**James Bryan**

Nexsen Pruet, PLLC  
Greensboro, NC

**John Buchanan III**

Covington & Burling LLP  
Washington, DC

**Fellow/Honorary Attendee List, as of May 9, 2018**

*Complete contact info can be found in our online directory: [americancollegecec.org](http://americancollegecec.org)*

**Timothy Burns**

Perkins Coie  
Madison, WI

**Janet Davis**

Cozen O'Connor  
Chicago, IL

**Mary Craig Calkins**

Kilpatrick Townsend & Stockton LLP  
Beverly Hills, CA

**Timothy Dingilian**

Jackson & Campbell, P.C.  
Washington, DC

**Bruce Celebrezze**

Clyde & Co US LLP  
San Francisco, CA

**Mitchell Dolin**

Covington & Burling LLP  
Washington, DC

**Suzan Charlton**

Covington & Burling LLP  
Washington, DC

**Andrew Downs**

Bullivant Houser Bailey PC  
San Francisco, CA

**Robert Chesler**

Anderson Kill, P.C.  
Newark, NJ

**Angela Elbert**

Neal, Gerber & Eisenberg LLP  
Chicago, IL

**Lewis Collins**

Butler Weihmuller Katz Craig  
Tampa, FL

**Shattuck Ely**

Fellows LaBriola LLP  
Atlanta, GA

**J. James Cooper**

Reed Smith LLP  
Houston, TX

**Joseph Finnerty III**

DLA Piper LLP  
New York, NY

**Franklin Cordell**

Gordon Tilden Thomas Cordell LLP  
Seattle, WA

**Barry Fleishman**

Shapiro Lifschitz and Schram, PC  
Washington, DC

**William Clayton Crawford**

Foland, Wickens, Roper, Hofer &  
Crawford, P.C.  
Kansas City, MO

**Laura Foggan**

Crowell & Moring LLP  
Washington, DC

**Edward Currie, Jr.**

Currie, Johnson & Myers  
Jackson, MS

**Marialuisa Gallozzi**

Covington & Burling LLP  
Washington, DC

**Fellow/Honorary Attendee List, as of May 9, 2018**

*Complete contact info can be found in our online directory: [americancollegecec.org](http://americancollegecec.org)*

**Arthur Garrett**

Keller and Heckman LLP  
Washington, DC

**Steven Gilford**

Proskauer Rose LLP  
Chicago, IL

**Stephen Goldman**

Robinson & Cole LLP  
Hartford, CT

**David Goodwin**

Covington & Burling LLP  
San Francisco, CA

**John Green**

Farella, Braun + Martel  
San Francisco, CA

**David Halbreich**

Reed Smith LLP  
Los Angeles, CA

**Laura Hanson**

Meagher & Geer PLLP  
Minneapolis, MN

**Christine Haskett**

Covington & Burling LLP  
San Francisco, CA

**Scott Hecht**

Stinson Leonard Street LLP  
Kansas City, MO

**Michael Huddleston**

Munsch Hardt Kopf & Harr, PC  
Dallas, TX

**Robert Jerry, II**

University of Missouri School of Law  
Columbia, MO

**Gary Johnson**

Richards Brandt Miller Nelson  
Salt Lake City, UT

**Ronald Kammer**

Hinshaw & Culbertson LLP  
Coral Gables, FL

**Robert Kelly**

Jackson & Campbell, P.C.  
Washington, DC

**Philip King**

Cozen O'Connor  
Chicago, IL

**Robert Kole**

Choate Hall & Stewart LLP  
Boston, MA

**Nancy Kornegay**

Trahan Kornegay Payne LLP  
Houston, TX

**Seth Lamden**

Neal, Gerber & Eisenberg LLP  
Chicago, IL

**Mark Lawless**

McGuireWoods LLP  
Austin, TX

**Michael Leahy**

Haight Brown & Bonesteel LLP  
Los Angeles, CA

**Fellow/Honorary Attendee List, as of May 9, 2018**

*Complete contact info can be found in our online directory: [americancollegecec.org](http://americancollegecec.org)*

**Anthony Leuin**

Shartsis Friese LLP  
San Francisco, CA

**Paula Litt**

Honigman Miller Schwartz and Cohn  
LLP  
Chicago, IL

**R. Hugh Lumpkin**

Ver Ploeg & Lumpkin  
Miami, FL

**Michael Manire**

Manire & Galla LLP  
New York, NY

**Lorelie Masters**

Hunton Andrews Kurth, LLP  
Washington, DC

**Kathy Maus**

Butler Weihmuller Katz Craig  
Tallahassee, FL

**Jason Mazer**

Cimo Mazer Mark PLLC  
Miami, FL

**Mary McCutcheon**

Farella, Braun + Martel  
San Francisco, CA

**Doug McIntosh**

McIntosh Sawran & Cartaya, P.A.  
Fort Lauderdale, FL

**Kevin Merriman**

Ward Greenberg Heller & Reidy, LLP  
Rochester, NY

**Helen Michael**

Kilpatrick Townsend & Stockton LLP  
Washington, DC

**Suzanne Midlige**

Coughlin Duffy LLP  
Morristown, NJ

**Joseph Montgomery, III**

Jones Day  
Pittsburgh, PA

**Vince Morgan**

Pillsbury Winthrop Shaw Pittman LLP  
Houston, TX

**John Mumford, Jr.**

Hancock, Daniel & Johnson, P.C.  
Glen Allen, VA

**Robert N. Naifeh, Jr.**

Derryberry & Naifeh, LLP  
Oklahoma City, OK

**Barbara O'Donnell**

Sulloway & Hollis, P.L.L.C.  
Providence, RI

**Lee Ogburn**

Kramon and Graham PA  
Baltimore, MD

**Lisa Pake**

Haar & Woods, LLP  
St. Louis, MO

**Sherilyn Pastor**

McCarter & English  
Newark, NJ

**Fellow/Honorary Attendee List, as of May 9, 2018**

*Complete contact info can be found in our online directory: [americancollegecec.org](http://americancollegecec.org)*

**Stephen Pate**  
Cozen O'Connor  
Houston, TX

**Heather Sanderson**  
Sanderson Law  
Calgary, AB

**Martin Pentz**  
Foley Hoag LLP  
Boston, MA

**Tracy Saxe**  
Saxe Doernberger & Vita  
Trumbull, CT

**Susan Popik**  
Susan Popik, Attorney  
Redwood City, CA

**David Schoenfeld**  
Shook Hardy & Bacon  
Chicago, IL

**Neil Posner**  
Much Shelist  
Chicago, IL

**A. Hugh Scott**  
A. Hugh Scott PC  
Boston, MA

**Alexander Potente**  
Clyde & Co US LLP  
San Francisco, CA

**Thomas Segalla**  
Goldberg Segalla LLP  
Buffalo, NY

**Neil Rambin**  
Drinker Biddle  
Dallas, TX

**Clifford Shapiro**  
Barnes & Thornburg LLP  
Chicago, IL

**Doug Richmond**  
Aon Professional Services  
Olathe, KS

**Caroline Spangenberg**  
Kilpatrick Townsend & Stockton LLP  
Atlanta, GA

**Peter Rosen**  
Latham & Watkins  
Los Angeles, CA

**Charles Spevacek**  
Meagher & Geer PLLP  
Minneapolis, MN

**Marc Rosenthal**  
Proskauer Rose LLP  
Chicago, IL

**Jeffrey Stempel**  
University of Nevada, Las Vegas  
Henderson, NV

**Robert Ross**  
Midkiff, Muncie & Ross, P.C.  
Richmond, VA

**Catalina Sugayan**  
Clyde & Co US LLP  
Chicago, IL

**Fellow/Honorary Attendee List, as of May 9, 2018**

*Complete contact info can be found in our online directory: [americancollegecec.org](http://americancollegecec.org)*

**James Sutterfield**

Sutterfield & Webb, LLC  
New Orleans, LA

**Koorosh Talieh**

Perkins Coie  
Washington, DC

**Spence Taylor**

Barze Taylor Noles Lowther LLC  
Birmingham, AL

**Wayne Taylor**

Mozley, Finlayson & Loggins, LLP  
Atlanta, GA

**Rhonda Tobin**

Robinson & Cole LLP  
Hartford, CT

**John Trimble**

Lewis Wagner, LLP  
Indianapolis, IN

**Alan Van Etten**

Deeley King Pang & Van Etten  
Honolulu, HI

**Debra Varner**

McNeer, Highland, McMunn & Varner,  
L.C.  
Clarksburg, WV

**James Varner, Sr.**

McNeer, Highland, McMunn & Varner,  
L.C.  
Clarksburg, WV

**John Vishneski III**

Reed Smith LLP  
Chicago, IL

**Jeffrey Vita**

Saxe Doernberger & Vita, PC  
Trumbull, CT

**Joyce Wang**

Carlson, Calladine & Peterson LLP  
San Francisco, CA

**Rebecca Weinreich**

Lewis Brisbois Bisgaard & Smith LLP  
Los Angeles, CA

**Barron Weinstein**

Weinstein & Numbers, LLP  
Larkspur, CA

**Robin Westerfield**

Bowles & Verna LLP  
Walnut Creek, CA

**ACCEC**

American College of Coverage and  
Extracontractual Counsel



2018 ACCEC Annual Meeting

May 16-18, 2018 | The Westin Chicago River North | Chicago, IL

# PRESENTATIONS

# COVERAGE IN A TIME OF STORMS

2018 Annual Meeting

May 16-18, 2018

Chicago, IL  
Sherilyn Pastor  
William Berk  
Neil Ramin



## Disputes Over Cause and Amount of Covered Loss Common After Storm Events



## Causation

What if losses results from covered and excluded causes?

- Concurrent Cause Doctrine
- Efficient Proximate Cause Doctrine



**ACCEC**  
American College of Coverage and  
Extracontractual Counsel

## Causation – Additional Considerations

- Burden of Proof
- Anti-Concurrent Causation Provisions
- Courts & Regulators' to ACC Provisions



**ACCEC**  
American College of Coverage and  
Extracontractual Counsel

## Disputes Over Amount of Covered Loss



**ACCEC**  
American College of Coverage and  
Extracontractual Counsel

## Appraisal

- Evolution of Appraisal as an ADR
- Appraisers as Advocates: Competent & “Independent”
- Appraisers as Competent & “Impartial”
- Case Law on Appraisal
- Finality of Appraisal: Binding on the Amount of Loss

**ACCEC**  
American College of Coverage and  
Extracontractual Counsel

# Trends and Features of Transactional Liability Insurance and Its Effects on the M&A Marketplace



ACCEC  
American College of Coverage and  
Extracurricular Counsel

2018 Annual Meeting  
May 16 - 18, 2018  
Chicago, IL

*Peter Rosen, Partner*  
*Latham & Watkins*

*Joseph G. Finnerty III*  
*Partner, DLA Piper*

*Jill Kerxton*  
*Managing Director, Aon*  
*Transaction Solutions*





## Transaction Risks

Due Diligence

↓

Risk Assessment

↓

**Traditional Solutions**

- Additional Due Diligence
- Additional Representations and Warranties
- Broader/Larger Indemnities/Escrows
- Reduction of Purchase Price, Earn-outs, Purchase Price Adjustment Mechanisms, Holdbacks
- Other Contractual Arrangement

**Insurance Solution**

TRANSACTIONAL  
INSURANCE

## Transactional Insurance Products

- Facilitate mergers, acquisitions, divestitures and other business transactions, especially in an auction process
- Provide access to the insurance industry's capital and allow the transfer of certain transaction-related risks to the insurance markets
- Transactional Insurance Products include:
  - Representations & Warranties Insurance (General)
  - Tax Indemnity Insurance
  - Successor Liability Insurance
  - Fraudulent Conveyance Insurance
  - Litigation Insurance
  - Wage and hour coverage for M&A transactions
  - Environmental Insurance for M&A transactions
  - CFIUS Insurance for M&A transactions

## Transactional Insurance Market Overview

- Continued Evolution: More flexible and innovative insurance solutions than ever before
- Insurance market now offers:
  - Broader coverage with more limited exclusions
  - A more streamlined process
  - Significantly increased limits of liability
  - Material reduction in premium rates and deductible levels
  - Ability to issue policies out of more countries than ever before
  - U.S. style policies for deals with an international component

## Transactional Insurance Market Overview

Already an established product in certain markets, and has seen significant recent growth in North America.

Total Policies Bound in 2017

- North America ~1500
- Worldwide ~3250

Specific Broker Activity in North America (past four years)

Aon:

- 2017 -- 434 closed transactions
- 2016 -- \$12.6 billion in limits / 350 closed transactions
- 2015 -- \$6.9 billion in limits / 227 closed transactions
- 2014 -- \$5.2 billion in limits / 157 closed transactions
- 2013 -- \$2.1 billion in limits / 54 closed transactions

Marsh:

- 2017 -- 320 closed transactions
- 2016 -- \$6.0 billion in limits / 212 closed transactions
- 2015 -- \$4.3 billion in limits / 159 closed transactions
- 2014 -- \$2.7 billion in limits / 130 closed transactions
- 2013 -- \$1.3 billion in limits / 66 closed transactions

Willis

- 2017 225 closed transactions
- 2016 -- \$2.6 billion in limits / 145 closed transactions
- 2015 -- \$2.0 billion in limits / 132 closed transactions
- 2014 -- \$1.2 billion in limits / 86 closed transactions
- 2013 -- \$684 million in limits / 47 closed transactions

Lockton:

- 2017 -- 225 closed transactions
- 2016 -- ~120 closed transactions
- 2015 -- ~80 closed transactions
- 2014 -- 35 closed transactions

## Transaction Liability Insurance Carriers in 2014....

beazley

ALLIED  
WORLD

ambridge

Concord Specialty Risk

THE  
HARTFORD

AIG

## ....Fast Forward to 2018



## Uses of Transactional Risk Insurance Products

Buyers	Sellers
<b>Risk Management Uses</b> <ul style="list-style-type: none"> <li>• Increase maximum indemnity/ extend survival period for breaches of reps &amp; warranties</li> <li>• Ease collection concerns</li> <li>• Manage jurisdictional issues (i.e., cross-border deals)</li> <li>• Provide recourse when no seller indemnity possible (i.e., bankruptcy)</li> <li>• Satisfy lenders' requirements for additional security on transaction</li> </ul>	<b>Risk Management Uses</b> <ul style="list-style-type: none"> <li>• Reduce contingent liabilities</li> <li>• Distribute sale proceeds</li> <li>• Protect passive sellers</li> </ul>
<b>Strategic Uses</b> <ul style="list-style-type: none"> <li>• Distinguish bid in auction</li> <li>• Protect key relationships</li> </ul>	<b>Strategic Uses</b> <ul style="list-style-type: none"> <li>• Attract best offers by maximizing indemnification</li> <li>• Include R&amp;W Insurance as the sole remedy in draft agreements in auctions</li> </ul>

## Representations and Warranties Insurance

### What is Covered under Transactional Insurance

- *There are known knowns. These are the things we know that we know.*
- *There are known unknowns. That is to say, there are things that we know we don't know.*
- *But there are also unknown unknowns. There are things we don't know we don't know.*
- -Donald Rumsfeld (former Secretary of Defense)

## Two Types of R&W Insurance Policies

1. Buyer-Side Policy
  - Insurance replaces sellers' potential indemnification liabilities under acquisition agreement
  - Covers loss resulting from alleged breaches buyers discover or third parties assert during the policy term
  - Can enhance indemnification terms set out in acquisition agreement via extended survival periods and/or an increased cap
  - Covers fraud by the sellers
2. Seller-Side Policy
  - Sellers backstop their potential indemnification liabilities agreed to in acquisition agreement
  - Liability policy structure – covers claims made against sellers alleging breaches of reps and warranties (actual losses and defense costs)
  - Mirrors indemnification terms set out in acquisition agreement
  - Typically excludes fraud by the sellers
  - Knowledge between sponsors and management sellers can be severed

## Basics of R&W Insurance

- Protects against financial losses resulting from inaccuracies in the representations and warranties relating to the target company or selling shareholders
- Capacity to insure limits from \$1 million to \$1,000,000,000+
- Policy period typically 6 years for fundamental and tax representations, and 3 years for other representations (regardless of survival period in underlying agreement)
- Retention can drop down as escrow released (usually at 12 or 18 months)
- Materiality scrape and pre-closing tax indemnity in underlying deal typically matched
- Items not covered: forward-looking statements and projections, known or scheduled matters, known breaches (may be addressed via a separate contingency policy), deferred tax assets, underfunded benefit plans, known environmental risks, known wage and hour risks, deal-specific underwriting concerns

## R&W Insurance: Key Terms

- Premiums
  - Typically 2.75% - 3.75% of limit insured (no indemnity deals slightly more expensive than indemnity deals)
  - Rates are generally lower outside of US
  - Who pays? Negotiable. (And, if seller demands that buyer pay, buyer can consider in offered purchase price.)
- Deductibles
  - Typically 0.75% - 2% of transaction value (no indemnity deals may have slightly higher retention than indemnity deals)
  - Buy-side policies often use underlying agreement deductible plus escrow account as policy deductible (which may drop down as escrow is released)
  - Seller-side policies use a negotiated amount

## R&W Insurance: Key Terms

- Policies are negotiated among deal parties and insurer and specifically tailored to fit each unique transaction
  - Coverage has become more insured-friendly
  - Insurers have expanded coverage for certain known matters and have agreed to remove certain exclusions (e.g., for punitive damages insurable under law, and consequential, special, and multiplied damages [if the purchase agreement is silent re such damages])
  - Coverage for materiality scrape and pre-closing tax indemnity generally covered if scrape and indemnity are included in the underlying agreement (even in a no indemnity deal where the reps and warranties do not survive closing)
  - Expanded coverage may entail additional premium
- “Sign to Close” coverage
  - Insurers will cover breaches discovered between signing and closing arising from matters existing prior to signing (i.e., matters the insurers can diligence)
  - Insurers will not cover breaches which both first arise and are discovered between signing and closing (termed “interim breaches” in most policies)
  - To incept at signing, a 10% non-refundable down-payment of premium is required

## Reps & Warranties Insurance—Process

Step 1: Negotiate and execute NDA (counsel/broker)

Step 2: Provide submission to prospective insurers (through broker)

- Requested information includes draft agreement, financial information, offering memo

Step 3: Obtain quote within 2 - 5 days (through broker)

- No charge to obtain quote
- Quote process will inform prospective insured of the market's appetite to insure deal (and the market's concern regarding certain risk areas, which will be excluded in the quote, or subject to heightened scrutiny in the carrier's underwriting process)

Step 4: Select carrier and pay underwriting fee (client)

- Fees range from \$30k-\$50k depending on the nature of the risk
- Insurers will typically share own report with any excess carriers for additional \$5k per carrier

## Reps & Warranties Insurance—Process

Step 5: Underwriting process for 5 - 10 days (team)

- High level review of due diligence (if buyer-side) or disclosure process (if seller-side)
- Access to legal, financial, tax, other DD reports (if buyer-side)
- Conference call(s) and follow-up email questions with deal team

Step 6: Policy wording negotiations (counsel/broker)

- Will often be concurrent with underwriting process
- Work closely with outside counsel
- Latham has extensive experience negotiating and binding R&W insurance, and has bound policies with all of the major carriers

## R&W Insurance – In Practice

### RWI Policy to Reduce Purchase Price

- PE Fund contemplated purchasing manufacturer for \$1 billion, with \$100 million escrow / cap.
- Instead, PE Fund purchased \$80 million buyer-side RWI Policy which provided broader coverage with a longer survival period.
- Because an escrow / indemnity was no longer required, PE Fund was able to negotiate a lower purchase price by \$25 million (resulting in a net gain to PE Fund of \$22 million, considering \$3 million RWI Premium)

## R&W Insurance – In Practice

### Stapled Insurance Package to Minimize Escrow and Indemnity

- PE Firm preparing to sell \$400 million manufacturing company through auction process. The company was the last of 15 divestitures from a holding company, and therefore had numerous hanging indemnities from past sales, as well as tax and environmental exposures.
- Pre-auction, Seller obtains an insurance package (including RWI, tax and environmental insurance) in favor of an eventual purchaser. Bidders were directed to work with Aon, and Seller made it clear it would provide no indemnity.
- Seller was able to attract more bids by providing bidders with clear direction towards a source of recourse, and, because the prospective insurers had already vetted the risk through their engagement with Seller, the Buyer's due diligence process was generally smooth and efficient.

## R&W Insurance – In Practice

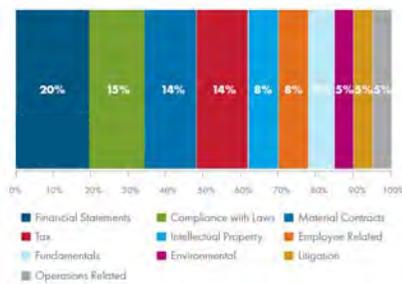
### RWI Policy to Ease Collection Concerns

- Publicly-traded company in the manufacturing industry had purchased the diesel engine business of another publicly-traded manufacturing company for \$150 million. The parties negotiated a \$3 million escrow with a \$20 million cap, but Buyer was concerned about its ability to collect from Seller, because Seller was close to insolvency at the time.
- Buyer purchased an RWI Policy, which allowed the Buyer to collect under the Policy above the \$3 million escrow.
- Seller agreed to pay for fifty percent of the Policy premium and, in return, Buyer agreed to revise the Agreement such that Seller would only be liable above the escrow for Loss that was not covered under the Policy.

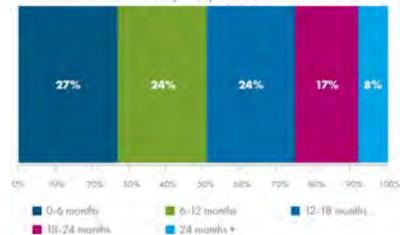
Source: AIG Global M&A Claims Study 2017

## Representations & Warranties Insurance: Global Claims

R&W Reported Incidents by Breach Type



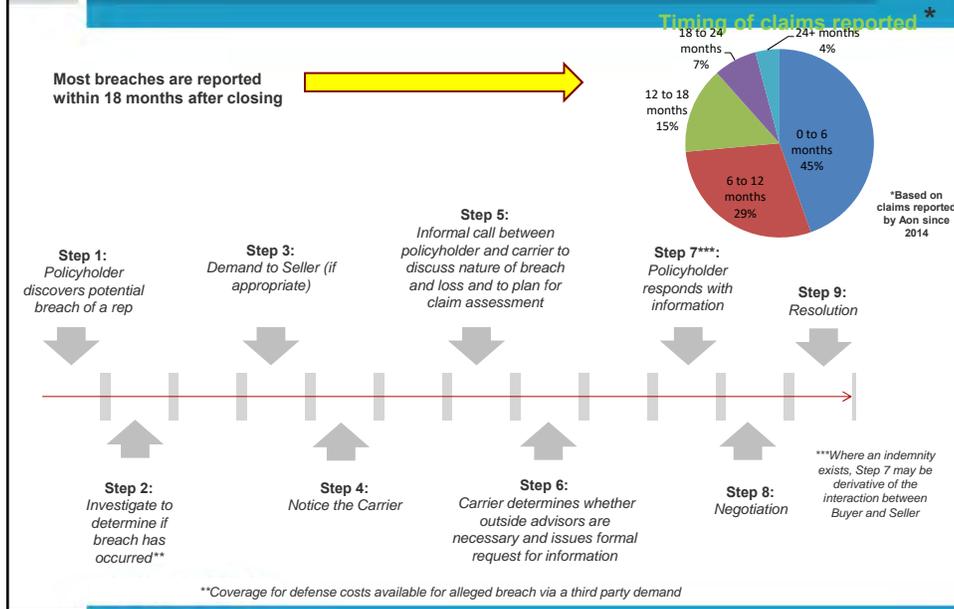
R&W Distribution of Average Claim Report Lags from Policy Inception Date



Source: AIG Global M&A Claims Study 2017

Source: AIG Global M&A Claims Study 2017

## Timeline of a Claim (Buy-side policy)



## Representations and Warranties Claims Handling / ADR Data

### From an informal survey of leading brokers and insurers

- **Arbitration Provisions:** Certain insurers / brokers reported that 50% of policies they issued / brokered (respectively) contained arbitration provisions, while other insurers / brokers reported 75%, 85%, and even 100%.
  - Of those policies that contain arbitration provisions, certain insurers / brokers reported that 50% established arbitration as mandatory, while others reported 60%, 70%, and even 100%.
- **Frequency of Arbitration:** Certain insurers / brokers reported never having engaged in arbitration with an insured w/r/t a transactional insurance policy, while others reported having engaged in arbitration up to three times.
- **Frequency of Mediation:** Certain insurers / brokers reported never having engaged in mediation with an insured w/r/t a transactional insurance policy, whereas others reported having engaged in mediation up to two times.
- **Neutrals Reported as Engaged:** Hon. Wayne R. Anderson (Ret.); Paul J. Bschorr; John Byrne; Hon. Barry Cozier (Ret.); David Geronemus; Marc Goldstein; Douglas M. Krauss; Sanford Litvack; Hon. George Marlow (Ret.); Hon. Leo Milonas (Ret.).
- **Experts Reported as Engaged:** Alix Partners, Alvarez & Marshal, BDO, BRG, EY, FTI, Stout, RSM

## Other Transactional Insurance Products (Contingent Liability)

### Contingent Liability Insurance

- What is it?
  - Covers identified potential exposures that have not yet materialized
  - Provides certainty around an unknown legal outcome that could affect deal valuation and/or effect closing of a transaction
  - Transfers risk of an adverse outcome to an insurer
- What can it cover?
  - Tax exposures
  - Successor liability
  - Fraudulent transfers
  - Litigation exposures
  - Wage and Hour exposures
  - Environmental exposures
- Coverage can be excess of existing insurance or indemnity or can serve as primary recourse

## Requirements And Process

- Requirements for Underwriting
  - Primarily questions of legal interpretation
  - Comprehensive legal opinion analyzing facts and applicable law
  - Low chance of adverse outcome
- Insurer's Diligence
  - Copies of legal analysis provided by insured's advisers
  - Other relevant documentation
  - Underwriting call
  - Privilege issues
  - Insurer's independent legal analysis
- After coverage is bound
  - Policy may grant insurer rights to take over the conduct of litigation or right to fully associate with insured's legal counsel and approve all major strategic decisions
  - Insurer's right to approve settlements in advance

## Tax Indemnity Insurance

- Tax Insurance coverage is intended to protect against the failure of a transaction or situation to qualify for its intended tax treatment. Insurers will consider submissions in respect of US Federal, State, local and/or foreign taxes. By providing assurance against the unanticipated or ill-timed occurrence of a tax loss, Tax Insurance is an effective means of protecting against an unpredictable or catastrophic drain on cash flow
- Tax Insurance is a tool that has been in use since the mid-1980s and has become a tried and true means to obtain certainty regarding a tax position where traditional sources of comfort are unavailable, impractical or simply would take too long. Transaction parties have often relied upon tax insurance to navigate tax exposures in M&A transactions and corporate taxpayers are now seeing it as a means to address ongoing business tax risk

## Tax Indemnity Insurance

- Some situations which have lent themselves to the use of Tax Insurance include:
  - Tax-Free Reorganizations
  - Tax-Free Mergers
  - Tax-Free Spin Offs
  - Net Operating Losses
  - Partnership Issues
  - Structured Real Estate Transactions
  - Retroactive Change in Law
  - Cross-Border Transactions
  - Transfer Pricing
  - Tax Credits
  - Low Income Housing (Section 42)
  - Historic Rehabilitations (Section 47)
  - Real Estate Transfer Tax
  - Consolidated Return Issues
  - Tax-Exempt Financings
  - Transferee or Successor Liability
  - S Corporations / 338(h)(10) Elections

*Tax insurance is **NOT** available for tax shelters. Tax Insurance typically specifies the particular tax treatment which is being insured. It always has an aggregate limit (selected by the insured), can include a "gross up", and generally is available for a non-cancellable term of seven years to address the statute of limitations. Any settlement with the taxing authority must be approved in advance by the insurers.*

© 2017 The American College

## Successor Liability

### Solutions

#### Successor Liability Insurance

- A successor liability insurance policy ("SLIP") can be used in any asset purchase agreement where there is concern about the asset buyer's exposure to liabilities it does not expressly assume
- A SLIP is most commonly used where there is concern about the asset seller's financial ability to meet any retained liabilities or indemnifications obligations
- The liability can either be an identified issue (claim/litigation/judgment on appeal) or unidentified/general indemnification obligation
- A SLIP has particular application for asset sales within bankruptcy matter (Section 363 sales) where there is concern that an unsecured creditor will seek to impose successor liability for a claim against the asset buyer, despite a "free and clear" order

#### Fraudulent Conveyance Insurance

- A fraudulent conveyance (or fraudulent transfer) insurance policy ("FCIP") insures buyers of assets (or business units) from a (distressed) pre-bankruptcy seller, against subsequent allegations that the sale was a fraudulent conveyance or transfer under federal (Section 548 of the Bankruptcy Code) or state laws (Section 7 of the UFTA)
- FCIP will cover defense costs, plus financial loss where a successful challenge results in a clawback of assets or the requirement that additional funds be paid by the asset buyer to satisfy the "reasonably equivalent value" standard
- FCIP can also be used to insulate the original (distressed) asset buyer in a subsequent sale of those assets

© 2017 The American College

## Litigation Insurance

- Covers adverse outcome of potential litigation
  - Transfers litigation off insured's books
  - Can back-stop inadequate insurance limits
  - Satisfies buyer's concern of an unexpected litigation result
- Broad subject matter
  - Can cover securities and other class actions, intellectual property, antitrust, products liability and construction defect litigation
  - Insurers may consider covering risk of adverse appellate rulings
- Provides coverage for defense costs, damages, awards and settlements
- Can be structured to transfer entire financial risk
- In more advanced litigation, often acts as a cap excess of a self-insured amount – *i.e.*, worst case scenario coverage.

© 2018 AIG

## Wage & Hour Insurance

Specific coverage to respond to potential/unknown wage and hour claims either:

- a) Where R&W insurer excludes Wage & Hour ("W&H") from R&W policy; or
- b) Where buyer requires run off and ongoing coverage for W&H given nature of business

Features:

- A stand alone tailored coverage for Wage and Hour claims.
- Brings technical expertise and experience to an areas typically excluded by reps insurers.
- Can be written as run off or ongoing coverage for Target, with or without RDI (subject to underwriting)
- Limits of up to USD 5m (potentially up to USD 10m) to deploy excess existing program or leading.

Six key sectors:

Hospitality	Manufacturing
Technology	Retail
Transportation	Healthcare

© 2018 AIG

## Environmental Insurance

**Wide range of insurance options – historic/legacy cover on a site specific basis, operational cover to fill gaps in existing insurance programs, contractual cover where funders of projects insist on protection, on site off-site, business interruption, transportation, and contingent liability.**

<b>Loss:</b>	Includes damages, settlements and costs arising from a claim (bodily injury, property damage, third party or regulatory requirement to clean-up, remediation compensation)
<b>Insured sites:</b>	Site specific coverage and unspecified sites
<b>Period of Insurance:</b>	Any claim made against the Insured arising 1 - 10 years (post completion), can include on-going operational coverage
<b>Common Exclusions:</b>	Change of Use and Voluntary Site Investigation
<b>Policy deductible:</b>	Typically each and every pollution event

## U.S. Style Coverage Potentially Available for Deals Involving Non-U.S. Assets

### Examples of Deals Involving non-U.S. Assets

- Example 1: U.S. style policy issued in connection with merger of a U.S. entity and European entity into a newly-formed UK entity. U.S. entity was beneficiary of coverage (which effectively insured European assets).
  - Example 2: U.S. style R&W policy and separate tax policy issued in connection with international deal largely centered in Canada.
- \*\*\*\*\*
- As the transactional risk markets continue to mature, we anticipate even greater flexibility and appetite from carriers for creative solutions (including availability of U.S. style coverage for non-U.S. assets).
  - Note that the named insured in a U.S. style policy must provide a U.S. address for inclusion in the Policy.

## Comparative Bad Faith?

Douglas Richmond - AON Risk Solutions

Lewis Collins - Butler Weihmuller Katz Craig

Christine Haskett - Covington & Burling

Doug McIntosh - McIntosh, Sawran & Cartaya



2018 Annual Meeting  
May 16-18, 2018  
Chicago, IL

*Is the application of comparative  
fault principles in a bad faith case  
incongruous with an insurance  
company's obligation of good faith  
and fair dealing?*

**Douglas Richmond**  
**AON Risk Solutions**

## Comparative Fault v. Duty of Good Faith & Fair Dealing

- The implied duty of good faith and fair dealing holds that neither party to a contract will do anything to impair the other party's right to the benefits of their agreement.
  - The very definition suggests that there is room for the application of comparative fault. After all, there has to be both a breach of the duty and resulting impairment (i.e., harm), both of which may be affected by the plaintiff's conduct.
  - Although the duty of good faith and fair dealing is a contract law concept, courts' decisions to make its breach actionable in tort invites comparative fault.
- In various jurisdictions, an insurer's bad faith is measured against a negligence standard. See, e.g., *Associated Wholesale Grocers, Inc. v. Americold Corp.*, 934 P.2d 65, 89 (Kan. 1997) (requiring a liability insurer to act "in good faith and without negligence" in settlement).



## Comparative Fault v. Duty of Good Faith & Fair Dealing

- The application of comparative fault is especially apt where the insurer's allegedly negligent conduct is in dispute.
- Even where an insurer's liability for bad faith requires willfulness, malice, or the like, comparative fault, although not as cleanly applied as with a negligence standard for bad faith liability, still has legs.
  - Compare product liability cases where a manufacturer sued on a strict liability theory is still entitled to compare the plaintiff's fault. *Patrick v. Md. Cas. Co.*, 267 Cal. Rptr. 24, 28 (Ct. App. 1990).
  - A plaintiff should not be able to avoid the consequences of its own conduct merely by pleading around it or by how it denominates its cause of action. *Id.* at 29.



*Are burdensome demands for  
information or refusal to provide  
information evidence of comparative  
bad faith?*

**Lewis F Collins, Jr  
Butler Weihmuller Katz Craig  
Tampa, FL**

**The Theory**

- “[i]f the duty of good faith and fair dealing truly is a ‘two-way street,’ then ‘mutual duties come with mutual remedies’ (Doug Richmond)
- “... corrective justice seeks to achieve justice or moral balance between those who suffer wrongful losses and those who cause them. “
- “Because corrective justice seeks to achieve moral balance between the parties, there would be something amiss about a system that, when evaluating claims for compensation by those who suffer losses, did not at least consider the victim's own potential responsibility for some or all of the loss. Corrective justice thus supports some sort of defense to the bad faith tort action.”

Ellen Smith Pryor, Comparative Fault and Insurance Bad Faith, 72 Tex. L. Rev. 1505, 1515 (1994)



## Failure to Cooperate

- “The cases reviewed by this Court involving the question of bad faith relate to alleged bad faith on the part of insurance companies, not bad faith of insureds.”
- “. . . it is *just as reprehensible* for an insured to fail to deal fairly with the insurer as it is for the insurer not to deal fairly with the insured. Plaintiff, as an insured, cannot *manipulate the law to create a sword* for bad faith damages . . .
- “Mississippi law not only requires good faith on the part of the insurance company, it *also requires* good faith and fair dealing *on the part of the insured*”

*Blue Diamond, Inc. v. Liberty Mut. Ins. Co.*, 21 F. Supp. 2d 631, 633 (S.D. Miss. 1998)



## Why Is Today Different?

- “Courts should exercise caution ‘when the gravamen of the complaint is not that the insurer has *refused* a settlement offer, but that it has *delayed* in accepting one”
- Caution “arises from the desire to avoid creating the incentive to **manufacture bad faith claims** by shortening the length of the settlement offer, while starving the insurer of the information needed to make a fair appraisal of the case.”
- Court questioned why PL demand was good one day but offer a few days later not

*Wade v. Emcaso Ins. Co.*, 483 F.3d 657 (10th Cir. 2007)



## Comparative Bad Faith?

- “the **focus** in a bad faith case is not on the actions of the claimant but rather on those of the **insurer in fulfilling its obligations to the insured.**”
- “. . .the conduct of a claimant and the claimant’s attorney are relevant to determining the **‘realistic possibility of settlement** within the policy limits.”
- “...lawyer had thwarted [UM carrier’s] efforts to conduct a meaningful independent review of her UM claim.”
- “...the insured’s lawyer’s—actions are part of the “totality of the circumstances” . . . “especially to the extent that they **impede the insurer’s good faith duty to investigate** facts and **give fair consideration** to settlement.”

*Cousins v GEICO*, US 11<sup>th</sup> Cir. Jan. 2018. 2018 WL 416462



*Does the defense of comparative bad faith discourage so-called “set-ups” or does it invade claimant’s counsel’s state of mind?*

Christine Haskett  
Covington & Burling

## Live by the Sword, Die by the Sword

- The birth of comparative bad faith.
  - *California Casualty General Ins. Co. v. Superior Court*, 173 Cal. App. 3d 274 (1985):
    - Noting that tort principles apply to bad faith claims
- The death of comparative bad faith in California.
  - *Kransco v. American Empire Surplus Lines Ins. Co.*, 23 Cal. 4th 390 (2000):
- The duties of the insurer and the insured are not reciprocal tort duties.
- The duty of good faith and fair dealing is a tort duty as applied to the insurer but a contract duty as applied to the insured.



## Does Comparative Bad Faith Discourage “Set-Ups”?

- The “Set-Up”
  - A demand on an insurer within or up to policy limits, knowing the insurer almost certainly will not accept, made with the express purpose of using the insurer’s refusal against it in a bad faith “failure to settle” claim.
  - A bad faith claim can be asserted by:
    - The insured, demanding coverage of a settlement with a third party or payment of a first party claim.
    - A third party claimant, demanding the insurer consent to a settlement with its insured (in some states).
    - An excess insurer, demanding that a primary insurer settle a claim below the excess insurer’s limits.



## Does Comparative Bad Faith Discourage “Set-Ups”?

- An attempt to solve a problem that already has a solution.
  - Insurer’s good or bad faith judged based on its conduct ***under the circumstances***.
  - See, e.g., *Lopez v. Allstate Fire & Cas. Ins. Co.*, 2015 WL 5320916 (S.D. Fla. 2015) (“[W]hether an insurer had a realistic opportunity to settle is relevant to the determination of bad faith.”).



## Does Comparative Bad Faith Discourage “Set-Ups”?

- Insured’s ***conduct*** – not state of mind – relevant to whether insurer’s conduct was reasonable and in good faith.
  - failure to cooperate
  - undue collusion
- Allowing insurer a separate defense based on the insured’s state of mind allows insurer two cumulative defenses based on the same evidence.



## Other Remedies for Insurers

- Evidence of insured's misconduct may factually disprove bad faith
- Insured's breach of covenant of good faith and fair dealing may be separately actionable as contract claim
- Some forms of misconduct by insured void coverage altogether
- Insured's fraudulent misconduct separately actionable and can give rise to tort damages (e.g., insurance fraud)



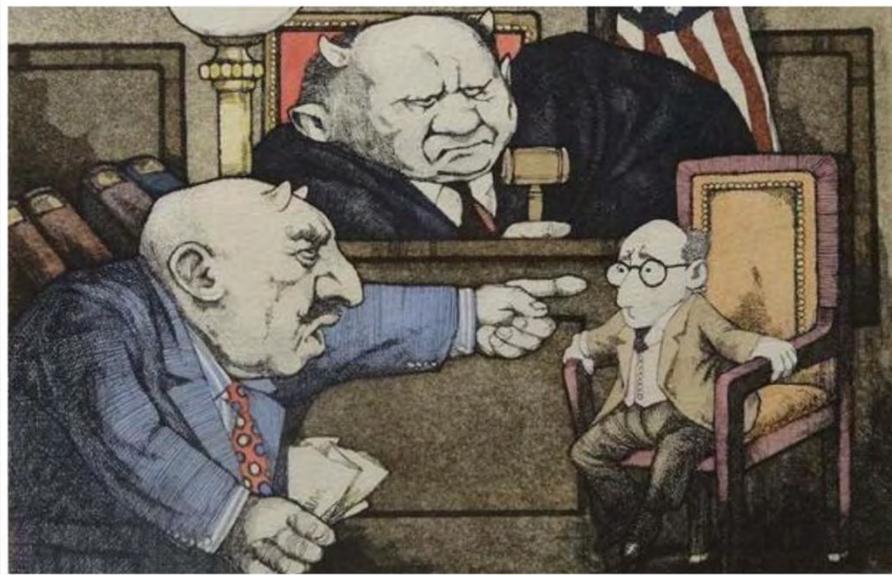
## Other Remedies for Insurers

- "These remedies adequately serve to protect an insurer from the insured's misconduct without creating the logical inconsistencies and troublesome complexities of a defense of comparative bad faith." *Kransco*, 23 Cal. 4th at 408.



*Use of “custom and practice” experts  
to opine on questions of policy  
interpretation or good faith claim  
handling*

Doug McIntosh  
McIntosh, Sawran & Cartaya  
Ft. Lauderdale, FL



**ACCEC**  
American College of Coverage and  
Extrac contractual Counsel

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF FLORIDA  
GAINESVILLE DIVISION

[REDACTED]

*Plaintiff,*

v.

CASE NO. [REDACTED]

[REDACTED]

*Defendant.*

ORDER EXCLUDING EXPERT TESTIMONY

This Court previously entered an order expressing skepticism as to whether the expert witness reports—each prepared by a lawyer with experience in insurance law—disclosed any opinions admissible under the rules of evidence. See ECF No. 177. The parties have had an opportunity to be heard on the matter. Plaintiff says that neither expert should testify and that this Court should simply instruct the jury on the law. Defendant says that its expert is qualified and that his opinions would help the jury understand the evidence and determine the facts at issue.



An expert of this kind cannot instruct the jury on the law. The expert cannot resolve factual disputes. And closing argument disguised as opinion testimony is not “helpful” to the jury under Rule 702(a). What might be helpful to the jury is testimony about the insurance industry—its customs, practices, and so on. But there is little of that in these reports.

This Court has carefully reviewed the expert witness report of Defendant’s expert, [REDACTED], and finds that his opinions in this case are not admissible under Federal Rule of Evidence 702. ECF No 179-3 ¶¶ 1–13. When the facade of improper opinion is stripped away, there is little in [REDACTED] expert report but a summary of the facts in a light favorable to Defendant and argument about the significance of those facts. For example, he repeatedly asserts that Defendant acted “promptly” and “diligently.” *Id.* And he opines that documents “clearly” indicate this or that. *Id.* ¶¶ 9, 10. This does not “concern[] matters that are beyond the understanding of the average lay person,” especially after this Court has instructed the jury on the applicable law. See *United States v. Frazier*, 387 F.3d 1244, 1259, 1262 (11th Cir. 2004) (en banc). Such testimony would not be helpful to the jury. See, e.g., *Tardiff v. Geico Indem. Co.*, 481 F. App’x 584, 587 (11th Cir. 2012).



Accordingly,

**IT IS ORDERED:**

1. Plaintiff's expert witness may not testify as to the opinions disclosed in his expert report, ECF No. 171-1.
2. Defendant's expert witness may not testify as to the opinions disclosed in his expert report, ECF No. 170-1.

**SO ORDERED on February 24, 2016.**

[Redacted Signature]



**IV. MOTION IN LIMINE TO PREVENT [Redacted] EXPERT, DOUGLAS M. MCINTOSH, FROM PROVIDING IMPERMISSIBLE "CLOSING ARGUMENT" TESTIMONY, FROM OPINING AS TO [Redacted] STATE OF MIND, AND FROM MISTATING WELL-ESTABLISHED PRINCIPLES OF FLORIDA LAW**

[Redacted] hired Douglas M. McIntosh, Esq. as its expert witness regarding "whether the conduct of [Redacted] and its claims professionals in the handling of the claim made by [Redacted] against its insured, [Redacted], complied with industry standards and Florida law, or otherwise met the good faith obligation of [Redacted] to its insureds under Florida law and based on [his] experience with such claims handling in Florida." Douglas M. McIntosh Expert Witness Report, attached as Ex. B at 1-2. But McIntosh's expert report and testimony constitutes a summary of certain self-selected documents in a light favorable to [Redacted], and provides impermissible opinions regarding the credibility and intentions of [Redacted] and his attorneys. McIntosh's opinions do not follow any reliable methodology, invade the purview of both the Court and the jury, and will not assist the finder of fact in this case. "Courts have rejected testimony as not helpful to the jury where it appears the witness is not truly applying expertise to the facts in a way that will help the jury, but instead simply reviewing the very same evidence that the jury will receive with a spin favoring the party who has hired the expert. Such testimony might be rejected as unhelpful to the jury because it simply presents the same sort of 'closing argument' as might be presented by lawyers for one side or the other." [Redacted]

[Redacted] (N.D. Fla. Feb. 9, 2016), [D.E. 177], attached as Ex. C, (citing [Redacted] *The Use and Misuse of Expert Testimony in Bad Faith Actions* 6, available at [http://www.americanbar.org/content/dam/aba/administrative/litigation/materials/2013\\_insurance\\_coverage/litigationcommittee/b\\_4\\_1.pdf](http://www.americanbar.org/content/dam/aba/administrative/litigation/materials/2013_insurance_coverage/litigationcommittee/b_4_1.pdf)).

The Honorable Judge: [Redacted] analysis in [Redacted] [Redacted] (N.D. Fla. Feb. 24, 2016), [D.E. 185], attached as Ex. D, is particularly instructive. McIntosh provided an expert report and deposition testimony regarding [Redacted] compliance with its good faith duties in [Redacted]. After considering McIntosh's proffered report, the [Redacted] court determined that his opinions were not admissible as they were simply a closing argument disguised as expert testimony. And McIntosh's report in [Redacted] bears striking similarities to the report he produced in the instant case, containing verbatim quotes regarding his ultimate opinion. See Expert Witness Report of Douglas M. McIntosh in [Redacted] attached as Ex. E (hereinafter "[Redacted] expert report"). In both reports, McIntosh opines that "[Redacted] and its claims professionals promptly and diligently handled the investigation and exposure . . . presented to its insured(s) by the accident." [Redacted] expert report (Ex. E) at p.2, ¶1 and [Redacted] expert report (Ex. B) at p. 3, ¶1. Both reports then give a recitation of the facts in a light favorable to [Redacted], crediting [Redacted] claims notes and employees' testimony while disregarding evidence to the contrary.

The reports conclude with the opinions that "Nothing [Redacted] did or failed to do served to create excess exposure to [Redacted] insureds . . . and in fact, [Redacted] did all it could do to try to settle the claims made and avoid an excess exposure to [the insured]." [Redacted] report (Ex. E) at p. 6, ¶12; [Redacted] report (Ex. B) at p. 11 ¶23. The reports both opine that "[Redacted] at all times material to this claim, acted prudently and in an expeditious manner to try to settle the claims against its insured(s) and nothing [Redacted] or its claims professionals did, or failed to do, caused an excess exposure to its insureds. Instead it is apparent from review of all the documents availed to me, that there was never an opportunity to settle the claim by virtue of the fact that [the claimant's attorneys] never intended to . . . accept the bodily injury limits of \$10,000

provided in the Bodily Injury policy at issue." [REDACTED] report (Ex. E) at p. 6, ¶13; [REDACTED] report (Ex. B) at p. 11, ¶24.

"When the façade of improper opinion is stripped away, there is little in McIntosh's expert report but a summary of the facts in a light favorable to Defendant and argument about the significance of those facts." [REDACTED] Order [D.E. 185] (Ex. D) at 2. In finding that McIntosh's testimony would not be helpful to the jury, the [REDACTED] court noted that McIntosh's opinions that "documents 'clearly indicate this or that . . . do[ ] not concern[ ] matters that are beyond the understanding of the average lay person,' especially after this Court has instructed the jury on the applicable law." *Id.* (quoting *U.S. v. Frazier*, 387 F. 3d 1244, 1259 (11th Cir. 2004)(en banc)).

In addition to constituting impermissible closing argument, McIntosh offers improper opinion testimony relating to [REDACTED] and his attorney's state of mind. During his deposition, McIntosh testified that "the [REDACTED] firm absolutely withheld information that it had that was being consistently and continually requested by [REDACTED] to be able to fairly adjust the claim." Deposition of Douglas McIntosh, attached as Ex. F, at 28:20-29:2. McIntosh credited [REDACTED] claims notes as being true and accurate, stating in his report that "the ALOG notes reflect a total lack of reply by the offices of Attorney [REDACTED] to repeated requests for information." Report (Ex. B) at p. 8. And despite the objective evidence that [REDACTED] did not tender the policy limits to [REDACTED] until over a year after his accident, McIntosh states that "[REDACTED] at all times intended to and attempted to tender its \$10,000 Policy limits to [REDACTED] through his attorneys, but [REDACTED] through counsel expressed no intent or desire to accept those limits." [REDACTED] Report (Ex. B) at p. 9 (emphasis added). McIntosh's opinions make assumptions in favor of [REDACTED] asserting that [REDACTED] called [REDACTED] attorneys between January 2010 and March 2010 in order to tender the policy limits even though the claim notes "did not specifically say

that," and the policy limits were not tendered until October 2010. McIntosh Dep. (Ex. F) at 77:23-78:18. McIntosh concedes that his opinions rely upon documentation from the ALOG, as he has "not seen objective evidence in the sense of phone logs or testimony from someone verifying that on the receiving end they heard what was written." *Id.* at 76:17-77:1.

The credibility determinations inherent in McIntosh's opinions are impermissible. "In fact, it is true that courts have held expert testimony regarding the credibility of a witness or party inadmissible, finding such testimony an invasion of the jury's province." *Gray v. State*, 2007 WL 2225815 (M.D. Fla. July 31, 2007) (citing *U.S. v. Falcon*, 245 F.Supp.2d 1239, 1245 (S.D.Fla.2003) ("[A]bsent extreme or unusual circumstances, expert scientific testimony concerning the truthfulness or the credibility of a witness is inadmissible because it invades the jury's province in determining credibility."); See also *The CIT Group-Business Credit Inc. v. Graco Fishing and Rental Tools, Inc.*, 815 F. Supp. 2d 673, 678 (S.D.N.Y. 2011) ("[E]xpert testimony is not admissible to establish a fact fundamentally grounded on a party's state of mind . . . . [The expert] cannot give his opinion as to the credibility of witnesses."); *S.E.C. v. Badian*, 822 F. Supp. 2d 352, 358 (S.D.N.Y. 2011) ("[The expert] is not qualified to testify as to what was in the defendant's mind when he used these words and phrases. For these reasons, [his] testimony will be excluded in its entirety.").

Expert evidence has a "powerful and potentially misleading effect," and "may be assigned talismanic significance in the eyes of lay jurors." *U.S. v. Frazier*, 387 F.3d 1244, 1263

(11th Cir. 2004) (finding district court did not err in excluding certain portions of expert testimony). For that reason, "district courts must take care to weight the value of such evidence against its potential to mislead or confuse." *Id.* McIntosh should be precluded from offering "closing argument" testimony, and from offering opinions as to [REDACTED] state of mind. His testimony should also be limited to accurately reflect Florida Law so as to not mislead the jury.

**CERTIFICATION OF GOOD FAITH EFFORT TO CONFER**

Pursuant to Local Rule 3.01(g), the undersigned counsel certify that they conferred telephonically with [REDACTED] and [REDACTED] counsel for [REDACTED] on October 10 and 11, 2017, but [REDACTED] does not agree to the relief sought herein.<sup>2</sup>

Respectfully submitted,

[REDACTED SIGNATURE]



Issue IV: Motion to Preclude Mr. McIntosh from Making Closing Argument Testimony.

This request is denied without prejudice. The experts shall not testify about the lawyers' state of mind.

Upon review and consideration, it is therefore

ORDERED AND ADJUDGED that:

Document 81 Filed 11/07/17 Page 4 of 4 PageID 2206

1. Defendant's Motion in Limine (Dkt. 64) is granted in part and denied in part.
2. Plaintiff's Motion in Limine (Dkt. 65) is denied.

DONE and ORDERED in Tampa, Florida, this 7th day of November, 2017.

Copies furnished to:  
Counsel/Parties of Record.

**ACC**  
American College of Coverage and  
Extrac contractual Counsel



**ACCEC**  
American College of Coverage and  
Extrac contractual Counsel

# Comparative Bad Faith?

2018 Annual Meeting

May 16-18, 2018

Chicago, IL

Douglas Richmond, AON Risk Solutions  
Lewis Collins, Butler Weihmuller Katz Craig  
Christine Haskett, Covington & Burling  
Doug McIntosh, McIntosh, Sawran & Cartaya



# MANAGING CAPTIVE CLAIMS

2018 Annual Meeting

May 16-18, 2018

Chicago, IL

Michael Aylward, Morrison Mahoney LLP

David Goodwin, Covington & Burling LLP

Barbara Miller, Wells Fargo & Company



## Forms of Risk Transfer

- Traditional Insurance
- Self-Insurance
- Going Partially Bare
- Alternative Premium Arrangements
- Fronting Policies
- Contractual Indemnities/Additional Insured Status
- Captive Insurance Policies



## Captive Insurance Companies

- A captive insurance company is an insurance company formed by a business owner to insure the risks of operating the business. The operating business pays premiums to the captive and the captive insures the risks of operating the business.
- Characteristics of Captives
  - Owned by named insured
  - Regulated by jurisdiction in which captive is incorporated
  - Typically is limited in the types of insurance it can issue
  - Run by captive manager
  - Manages own claims (or retains a TPA to manage claims)
  - Can reinsure its risks



## Reinsurance

- Reinsurance allows insurers (cedents) to transfer risk to third parties in return for a share of the premium.
- Two types of reinsurance:
  - Treaty reinsurance
  - Facultative reinsurance
- Ceding insurer/reinsurer



## Features of Reinsurance

- Notice of claim
- Claims cooperation/claims control
- Right to associate
- Follow-the-fortunes/Follow-the-settlements clauses
- Alternative dispute resolution provisions



## Presenting Captive Insurance Company Claims to Reinsurers

- Timely notice
  - Make sure that the notice provisions are satisfied
- Cooperation
- Information exchange
- Coverage opinions
- Settlement
- Be aware of non-follow-form provisions in reinsurance
- ADR and choice of law provisions in certificate of reinsurance



## Claims Handling Under A Captive Insurance Policy

- Retained limits
- Manage claims like a commercial insurer? Or make *ex gratia* payments?
- Managing defense counsel/working with in-house counsel
- Role vis-à-vis the underlying claimant
- Declining coverage to the captive's owner?
- Paying claims when reinsurance is uncertain?
- Reporting requirements to regulators?



## MANAGING CAPTIVE CLAIMS

QUESTIONS?



# ACCEC's 6th Annual Meeting

## Fifteen Cases in 45 Minutes Major Insurance Developments in 2017

The Westin Chicago River North  
May 17, 2018  
3:45 – 4:30 pm



### SPEAKER



**Robert D. Chesler, Esq.**  
Anderson Kill  
Shareholder, Newark  
(973) 642-5864  
rchesler@andersonkill.com

Robert D. Chesler is a shareholder in Anderson Kill's Newark office. Mr. Chesler represents policyholders in a broad variety of coverage claims against their insurers and advises companies with respect to their insurance programs. Mr. Chesler is also a member of Anderson Kill's Cyber Insurance Recovery group.

A leading participant in the birth of modern insurance law in the early 1980s, Mr. Chesler has earned the reputation as "The Insurance Guru" for exceptional insurance coverage knowledge, and has emerged as a leader in such new areas of insurance coverage as cyber-insurance, D&O, IP, privacy and "green" insurance.

Mr. Chesler has served as the attorney of record in more than 30 reported insurance decisions, representing clients including General Electric, Ingersoll-Rand, Westinghouse, Schering, Chrysler, and Unilever, as well as many small businesses including gas stations and dry cleaners. He has received numerous professional accolades, including a top-tier ranking for Insurance Litigation: New Jersey in Chambers USA: American's Leading Lawyers for Business, which dub him a "top-notch attorney" and "dominant force in coverage disputes." He is also listed in The Legal 500, The Best Lawyers in America, Super Lawyers and Who's Who Legal in the Insurance and Reinsurance section of the publication.



## SPEAKER



**Suzanne C. Midlige, Esq.**  
Coughlin Duffy LLP  
Managing Partner  
(973) 631-6006  
smidlige@coughlinduffy.com

Suzanne Cocco Midlige is the Managing Partner and a founding member of Coughlin Duffy and a member of the Insurance and Reinsurance Services Group.

Prior to election to Managing Partner, Suzanne served as the Practice Group Leader for the Insurance and Reinsurance Services Group from 2004 to 2012. Suzanne's practice focuses on the representation of domestic and international insurers and reinsurers in litigated and non-litigated matters



2

## SPEAKER



**Anthony B. Leuin, Esq.**  
Shartsis Friese LLP  
(415) 421-6500  
aleuin@sflaw.com

Tony Leuin is a senior partner in Shartsis Friese LLP in San Francisco, where he has practiced for over 35 Years. He represents policyholders in all manner of insurance coverage disputes.

Tony has been a Contributing Editor to The Rutter Group's California Practice Guide: Insurance Litigation, has repeatedly been named a Northern California "Super Lawyer" in Insurance Coverage, and frequently writes and speaks on insurance coverage topics. He currently serves on ACCEC's Membership Committee.



3

## BEWARE THE STATUTE OF LIMITATIONS

*R.T. Rogers Oil Co. v. Zurich American Insurance Co.*, 2017 U.S. Dist. LEXIS 105150 (D. W. Va. 2017)

- Statute generally deemed to start to run when insurance company denies coverage, but what is a denial?
- Leaky underground storage tank – October 10, 2003, policyholder demanded 100% of costs from Zurich.
- May 28, 2004, Zurich offered 42%
- Policyholder sued Zurich on December 14, 2015 – court holds statute of limitations denies coverage. Why?
- Court finds that Zurich's offer of 42% was denial of policyholder's demand for 100%, starting the running of the statute.

## WHO CONTROLS THE LITIGATION?

*OneBeacon America Insurance Co. v. Celanese Corporation*, 84 N.E. 3d 867 (Mass. 2017)

- OneBeacon agrees to defend and indemnify Celanese on asbestos claims, and appoints its own counsel instead of counsel that Celanese has used for 14 years.
- Celanese says conflict, keeps its own attorney on the case - \$2.4 million in fees
- Court finds no conflict
- Real issue – Celanese concerned about rate of exhaustion
- Court – no evidence suggesting OneBeacon has a policy of exhausting liability limits rapidly to avoid paying defense costs.

## WHO CONTROLS THE LITIGATION?

### *OneBeacon America Insurance Co. v. Celanese Corp.* 84 N.E. 3d 867

- OneBeacon offered to defend Celanese for asbestos and chemical product BI claims, **without** a reservation of rights
- Celanese refused to cede control of defense or replace its counsel of 14 years with counsel selected by OneBeacon
- OneBeacon filed DJ; Trial Court held that OneBeacon has right to control defense

## *OneBeacon – ISSUES ON APPEAL*

- Does OneBeacon have the right to control the defense if it has offered to defend with out a reservation of rights?
  - Yes
- Does Celanese have the right to refuse OneBeacon’s control of the defense if a sufficient conflict exists?
  - Yes, if:
    - The defense tendered is not complete, but should have been;
    - The attorney hired by Insurer acts unethically, and at the insurer’s direction advance the insurer’s interests at the expense of the insured;
    - The defense would not, under governing law, satisfy insurer’s duty to defend ; OR
    - The insurer attempts to obtain some type of concession from the insured before it will defend.

## ***OneBeacon – ISSUES ON APPEAL***

- Does a sufficient conflict exist here?
  - No.
  
- Is OneBeacon liable for defense costs where Celanese has refused OneBeacon's control of the defense?
  - App. Ct: Celanese had right to hire its own attorney, but not to have OneBeacon pay for it

## **OPIOID INSURANCE**

*Travelers Property Casualty Co. v. Actavis, Inc.*, 16 Cal. App. 5<sup>th</sup> 1026 (2017), *sub judice* (Cal. Supreme Ct.) (rvw granted but briefing deferred)

- Court of Appeal found no duty to defend – underlying complaints alleged only intentional wrongdoing
  
- The underlying cases “do not create a potential for liability for an accident because they are based, and can only be read as being based, on the deliberate and intentional conduct of [Actavis] that produced injuries – including a resurgence in heroin use – that were neither unexpected nor unforeseen”
  
- Compare with *Cincinnati Insurance Co. v. H.D. Smith Wholesale Drug Co.*, 829 F. 3d 771 (7th Cir. 2016) (underlying complaint contained negligence counts; insurance company had to defend)
  
- Should underlying plaintiff's drafting of the complaint control coverage?
  
- California Supreme Court to address doctrinal confusion surrounding “occurrence?”

## DOES NOTICE OF CIRCUMSTANCE PROVIDE NOTICE?

*First Horizon National Corp. v. Houston Casualty Co.*, 2017 WL 2954716 (W.D. Tenn. 2017)

- First Horizon filed notice of circumstance with its D&O insurance company
- Policy's notice of circumstance provision required "full particulars as to dates, persons, and entities involved, potential claimants and the consequences which have resulted or may result therefrom"
- Court –notice was so vague and boilerplate that it did not qualify under the policy
- Notice did not include settlement demand from government
- Court threw out notice and denied claim on late notice
- First Horizon lost \$75,000,000 in insurance coverage

## FAILURE TO ALLOCATE

*United Health Group Inc. v. Executive Risk Specialty Insurance Co.*, 870 F.3d 856 (8th Cir. 2017)

- United Health settled two separate lawsuits for a single lump sum payment of \$350,000,000
- Settlement did not allocate the sum between the two complaints
- United – no duty to allocate as long as settlement included covered claims
  - Court – argument "untimely and meritless"
- United – under Minnesota law, no duty to allocate
  - Court – United Health has burden to allocate with "enough specificity to permit a reasoned judgment about liability"
- "To survive summary judgment, an insured need not prove allocation with precision, but it must present a non-speculative basis to allocate a settlement between covered and non-covered claims"

## FEDERAL JURISDICTION: ABSTENTION OR RETENTION?

*Kelly v. Maxum Specialty Group*, 2017 U.S. App. Lexis 15824 (3d Cir. 2017)

- Tort action in state court
- Coverage action brought by policyholder in state court, removed by insurance company to federal court
- District court exercises abstention because of parallel proceedings: “the question of coverage...will necessarily arise in the state court action before it is completed”
- Reversed. “[M]ere potential or possibility that two proceedings will resolve related claims between the same parties is not sufficient to make those proceedings parallel; rather, there must be a substantial similarity in issues and parties between contemporaneously pending proceedings”
- Result – more cases will stay in federal court

## THE LAST PULL OF THE CONTINUOUS TRIGGER

*Air Master & Cooling Selective Insurance Co.*, 452 N.J. Super. 35 (App. Div. 2017)

- Continuous trigger applies to construction claims – first time applied outside of environmental and toxic tort claims?
- The trigger ends at “manifestation,” but not manifestation to the insured
- “Essential manifestation of injury,” “The revelation of the inherent nature and scope of that injury”
- Complaints by unit owners? Expert’s report two years later?
- Court found fact issue and sent it back to trial court

## MISSING POLICIES

*E.M.Sergeant Pulp & Chemical Co. v. Travelers Indemnity Co.*, 2017 WL 239339 (D.N.J. 2017)

- Attention on opioids, social engineering, crypto currency – many companies still incurring long tail environmental and toxic tort claims
- Each year, it becomes more difficult to find old policies – major problem for policyholder in *pro rata* states
- Sergeant had principally ledger entries that were more than fifty years old naming Travelers with policy numbers
- Sergeant used an expert witness – Henry Booth – to explain about standardized policies and what the policy numbers meant
- Court denied Travelers’ motion for summary judgment, and the case then settled
- Clients often do not understand that limited secondary evidence may be sufficient to procure coverage

## CYBER INSURANCE

*Medidata Solutions v. Federal Insurance Company*, 268 F.Supp. 3d 471 (S.D.N.Y. 2017), *sub judice* (2d Cir.)

- Social engineering, not hacking
- Accounts payable employee received email purporting to be from company president re acquisition – should cooperate with attorney “Meyer”
- “Meyer” calls, demands wire transfer
- Employee says she needs approval from officers and receives email from president authorizing transfer
- Wire transfer went through - \$4,770,226. All emails from president were frauds
- Fraudster used a computer code to alter email messages requesting the funds transfer so they seemed to come from Medidata’s president
- Crime policy covered “direct loss” of money resulting from computer fraud, funds transfer fraud, and forgery
- Court finds coverage under computer fraud and funds transfer fraud provisions, but not forgery

## BROKER LIABILITY: HOW SPECIAL IS THE RELATIONSHIP?

*Holborn Corporation v. Sawgrass Mutual Insurance Co.*, (No. 16-09147) (S.D.N.Y. Jan. 17, 2018)

- Holborn is insurance broker for Sawgrass
- Sawgrass allegations:
  - Holborn would “design a specific reinsurance program custom tailored to Sawgrass’ unique business needs”
  - Relationship would be one of “trust and confidence”
  - Holborn made “a series of representations concerning its expertise,” substantially the same as the representations on Holborn’s website

## BROKER LIABILITY: HOW SPECIAL IS THE RELATIONSHIP? (cont’d)

- Holborn recommended a reinsurance policy “that it represented as having been the most advantageous for its unique business needs”
- Sawgrass “relied on Holborn’s analysis and recommendations and purchased the reinsurance that Holborn recommended”
- Court dismissed Sawgrass’ claim – no special relationship – “All insurance customers are seeking the most advantageous insurance policy, and as a result, a decision generally about what policy will be the most advantageous does not suggest ‘that the Plaintiff enjoyed anything other than an ordinary consumer-agent insurance relationship’”

## A BROAD INTERPRETATION OF INVASION OF PRIVACY

*L.A. Lakers Inc. v. Fed. Ins. Co.*, 2017 U.S. App. LEXIS 16109 (9<sup>th</sup> Cir. 2017)

- Case involving a D&O Liability Coverage Section of an insurance policy and arising from a Telephone Consumer Protection Act (“TCPA”) underlying action
- Spectator followed directions on overhead monitor at a Laker’s basketball game and sent a text message to the displayed number. He received an automated response text in violation of the TCPA

## A BROAD INTERPRETATION OF INVASION OF PRIVACY

*L.A. Lakers Inc. v. Fed. Ins. Co.*, 2017 U.S. App. LEXIS 16109 (9<sup>th</sup> Cir. 2017) (*Cont’d*)

- 9<sup>th</sup> Cir. held that the spectator’s TCPA claim is by its nature an invasion of privacy claim
- “Accordingly, a liability insurance policy that unequivocally and broadly excludes coverage for invasion of privacy claims also excludes coverage for TCPA claims”

## Q: Reliance on Absolute Pollution Exclusion to Deny Coverage for Pollution Injury as Bad Faith?

*Xia v. ProBuilders Specialty Ins. Co. v. RRG* 400 P. 3d 1234 (WA 2017)

- Homebuyer injured by toxic levels of carbon monoxide in basement
- Policy had absolute pollution exclusion
- Insurer disclaimed; policyholder stipulated to damages and assigned rights to homeowner

- Carbon monoxide falls within pollution exclusion
- Exclusion does not bar coverage
  - “Efficient proximate cause” rule – initial cause of loss was nonpolluting, covered event (negligent installation of water heater)
  - negligent act took before polluting event (the release of the carbon monoxide)
  - pollution exclusion applies where pollutant is “acting as a pollutant” when causing harm and “efficient proximate cause” not a prior covered event
- ProBuilders had duty to defend
- Xia wins summary judgment on breach of contract and bad faith

## CLAIM HANDLER LIABILITY

*Konstantin v. Certain Underwriters at Lloyd's London*, N.Y. Misc. LEXIS 407 (Supreme Court of N.Y., N.Y. County, January 24, 2018)

- Asbestos verdict of \$7,195,738.57 against Tishman Speyer
- Five of Tishman's insurance companies are reinsured by National Indemnity Company, a Berkshire Hathaway Company
- Claims for those five insurance companies are administered by Resolute Management, Inc., a subsidiary of National Indemnity
- Payment by five companies is delayed
- Tishman brings tortious interference claim against Resolute for intentionally delaying payment to increase the float – Tishman relies on Warren Buffett letters re float
- Court denies Resolute's motion to dismiss
- Finds that agency doesn't protect Resolute from its own wrongdoing

## "UNAVAILABILITY RULE" IS INCOMPATIBLE WITH TIME ON THE RISK ALLOCATION

*KeySpan Gas East Corp. v. Munich ReIn. America, Inc.* 37 N.E 3d 98

- Environmental contamination case involving multiple sites
- Policyholder argued that it should not be allocated a *pro rata* share of loss for periods where insurance was unavailable, both in early years before insurers offered coverage for the risk, and for later years with pollution exclusions
- NY's highest court said no
- Held: "the unavailability rule cannot be reconciled with a *pro rata* [by time on the risk] approach"
  - focused on policy language limiting coverage to losses and occurrences happening "during the policy period," which requires *pro rata* allocation under Con Ed.

## PA SUPREME COURT SETS STANDARD FOR STATUTORY BAD FAITH

*Rancosky v. Washington National Ins. Co.*, 170 A. 3d 364 (PA 2017)

- PA Supreme court set standard for proving bad faith under PA statute [42 Pa. C.S. § 8371]
- Policyholder must prove, by clear and convincing evidence
  - 1: Insurer did not have reasonable basis for denying benefits under the policy; AND
  - 2: Insurer knew or recklessly disregarded lack of reasonable basis for denying benefits
- First prong is objective: would reasonable insurer have denied claim under facts and circumstances presented?
- Second prong: policyholder need not necessarily prove insurer motivated by self-interest or ill will
- No higher showing required for punitive damages

# The Opioid Epidemic

2018 Annual Meeting

May 16-18, 2018

Chicago, IL

Robert A. Kole, Choate, Hall & Stewart

R. Hugh Lumpkin, Ver Ploeg and Lumpkin



## Introduction

- Background Facts
- Nature of Underlying Claims
- Coverage Issues
  - CGL
  - Products Liability
  - D&O
- Predictions and Trends



## Background

- The most fatal drug crisis in U.S. history
- Taken a greater toll than AIDS at the height of that epidemic
- Some have estimated that 500,000 more people will die in the next decade



## Background Statistics

- 1 in 10 Americans know someone who has died of a drug overdose
- In 2016, more than 40,000 people in the U.S. died from opioids
- In 2015, 2 million people were addicted to opioids
- 11 million Americans have misused opioids in the last year



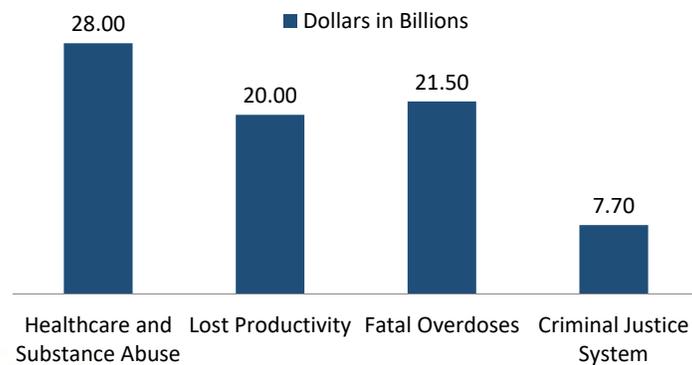
## Background Statistics

- U.S. lifespans declined for the second year in a row
- Nearly half of employers identified a negative business impact from opioids
- In 2010, 81.2 opioid prescriptions were written per 100 Americans (down to 66.5 in 2016)
- In 2016, the opioid epidemic cost **\$504 billion**



## Background: Statistics

- 2013 Data
- Aggregate Annual Cost: \$78.5 Billion



## Background: Cases

- Early Cases
  - *State of West Virginia v. AmerisourceBergen et al.*, No. 12-C-141 (W.Va. Sup. Ct. Boone County) (“W. Virginia Action”)
    - State sought \$2 billion-plus in damages from **distributors**
    - Spawned significant coverage litigation; settled
  - *City of Chicago v. Purdue Pharma L.P. et al.*, No. 1:14-cv-04361 (N.D. Ill) (“Chicago Action”)
    - Marketing/misrepresentation case against **manufacturers**
    - Pending
    - Manufacturer and distributor complaints now being combined into one action



## Parties

- Plaintiffs
  - Principally cities, towns, counties and states
  - A few claims brought by individuals
  - Indian Tribes
  - Third-Party Payers
  - Unions



## Parties

- Defendants
  - Manufacturers (*Purdue, Teva/Cephalon, Janssen, Endo, Actavis, Mallinckrodt*)
  - Distributors (*McKesson, Amerisource, Cardinal Health*)
  - Pharmacies (*CVS, Walmart, Kroger, Costco*)
  - Doctors/KOL's (*Russell Portnoy, Perry Fine, Scott Fishman, Lynn Webster, Willis Knighton*)
  - *Joint Commission on Accreditation*



## Underlying Claims: Manufacturers/KOL's

- Misrepresentation actions, patterned after the tobacco cases
- Pharmaceutical manufacturers, with help from KOL's, misrepresented the effectiveness and safety of their products to increase sales
  - Knew products were not safe or effective for long-term, chronic pain
  - Engaged in a coordinated scheme to convince doctors and the public that opioids were appropriate – indeed required – for long-term pain
  - Result: "Blockbuster profits"



## Underlying Claims: Distributors/Pharmacies

- Distributors and pharmacies over-distribute drugs for financial gain, contributing to opioid epidemic
- Knew or should have known orders were suspicious, based principally on volume
  - *E.g. Kermit, West Virginia*
- Allegations range from intentional (*“willfully turned a blind eye”*) to negligence (*failure to implement sufficient controls to monitor orders*)



## MDL

- In December 2017, transferred to N.D. Ohio (Judge Polster)
- Now over 500 cases in the MDL
  - Dozens of state cases as well
- Judge aggressively pursuing settlement
  - Committees consisting of plaintiffs, manufacturers, distributors, and AGs – insurers?
  - DOJ involved as “friend of the Court”
- Targeted litigation and bellwether trials contemplated



## CGL Coverage Issues

- Occurrence/Accident
- Damages “because of” or “for” bodily injury/care or loss of services
- Products Exclusions
- Damage during the policy period/SOL
- Allocation
- Other



## Occurrence/Accident

- **Manufacturing Case:** *Travelers v. Actavis*, 2017 Cal. App. LEXIS 976 (Cal. Ct. App. Nov. 6, 2017) (conditional cert granted by California Supreme Court)
  - Manufacturer complaints alleging a deliberate scheme to mislead.
  - “Common, sophisticated and highly deceptive marketing campaign” designed to increase sales is not an accident under California law.



## Occurrence/Accident

- *Travelers v. Actavis* (Continued)
  - Under California law, “a deliberate act is not an accident, even if the injury is unintentional, unless the injury was produced by an additional, unexpected, independent, and unforeseen happening.”
  - It is “not unexpected or unforeseen that promoting the use of opioids would lead to a resurgence in heroin use.”



## Occurrence/Accident

- **Three Distributor Cases**
  - Each based on the West Virginia Action.
  - The complaint alleges that the distributor policyholders engaged in a blend of intentional and negligent conduct, including a failure to implement controls to spot and report suspicious orders.
  - Each decision concludes that the complaint alleged an accident for duty to defend purposes.



## Occurrence/Accident

- *Cincinnati Ins. Co. v. Richie Enterprises LLC*, 2004 U.S. Dist. LEXIS 27306 (W.D. Ken. March 4, 2014)
  - Kentucky law.
  - The complaint “sets forth allegations that the alleged harm is fortuitous and properly deemed ‘accidental’ since Richie did not intend for the alleged drug addiction to occur.”



## Occurrence/Accident

- *Cincinnati Ins. Co. v. H.D. Smith Wholesale Drug Co.*, 2015 U.S. Dist. LEXIS 100823 (C.D. Ill. 2015)
  - Illinois law.
  - Court focused on the fact that “two of the eight counts specifically assert negligence” and “other counts include allegations of both negligent and intentional conduct”.



## Occurrence/Accident

- *Liberty Mut. v. J.M. Smith Corp.*, 602 F. App'x 115 (4th Cir. 2015)
  - Under South Carolina law, an accident is “an effect which the actor did not intend to produce and cannot be charged with the design of producing.”
  - “It is at least possible that the state court will find that the defendants did not take sufficient care to catch suspicious activity and therefore accidentally caused harm to prescription drug abusers and the state of West Virginia.”



## Occurrence/Accident: Takeaways

- Nature of the allegations may matter
  - Fraudulent scheme
  - Negligent oversight
- Jurisdiction may matter
  - Focus on harm
  - Focus on conduct



## Bodily Injury

- Are damages sought by municipalities for providing health care to addicted citizens amounts policyholder is “legally obligated to pay” either “because of” or “for” bodily injury
  - Cases are mixed
  - Most recent proclamation by court of appeals = yes (*at least for duty to defend purposes*)
  - Creates very complex indemnity issues



## Bodily Injury

- Duty to Defend
  - *Cinc. Ins. Co. v. H.D. Smith LLC*, 829 F.3d 771 (7th Cir. 2016)
  - Gun Cases
    - *Scottsdale Ins. v. Nat'l Shooting Sports*, 2000 U.S. App. LEXIS 40229 (5th Cir. July 11, 2000)
    - *NAACP v. Acusport*, 253 F. Supp.2d 459 (E.D.N.Y. 2003)
    - *SIG Arms, Inc. v. Emp'rs Ins. Co. of Wausau*, 122 F. Supp.2d 255 (D.N.H. 2000)



## Bodily Injury

- Duty to Defend
  - Care or loss of services language
    - “Damages claimed by any person or organization for care ... resulting ... from bodily injury”
    - Municipalities are seeking their damages resulting from providing care to injured citizens
  - “Because of” broader than “for” bodily injury



## Bodily Injury

- Duty to Defend
  - Unclear how this theory plays out in the indemnity context
  - Does policyholder have to prove when municipality provided care to individual citizens?
  - Is the relevant date the date of “injury” to the citizen or the date of payment by the municipality?
  - May have to parse damages between care to addicted citizens and costs of prisons, judges, police, etc.



## Bodily Injury

- No Duty to Defend
  - *Trav. Prop. Cas. Co. of Am. v. Anda, Inc.*, 2015 U.S. Dist. LEXIS 31450 (S.D. Fla. March 9, 2015)
  - *Cinc. Ins. Co. v. Richie Enter. LLC*, 2014 U.S. Dist. LEXIS 96510 (W.D. Ky. July 16, 2014) (*Richie II*)
  - *Steadfast Ins. Co. v. Purdue Frederick Co., No. 08-cv-020191697*, 2002 Conn. Super. LEXIS 1093 (Conn. Sup. Ct. April 10, 2006)



## Bodily Injury

- No Duty to Defend
  - Government entities are seeking their own economic losses, not damages sustained by citizens
  - Any recovery would go to state, not injured citizens
  - Citizens free to bring their own action
  - No citizen has to take stand at trial and prove nature or extent of injury or damages



## Bodily Injury

- Takeaways
  - Policy language may matter
    - “For” versus “because of” bodily injury
    - Care or loss of services provision
  - Jurisdiction may matter



## Products Exclusion

- Courts so far consistently have applied to exclude coverage
- Opioid addiction “arises out of” opioid products
  - Heroin addiction too
- Exclusions apply to statements about the safety and effectiveness of products
  - *Trav. Prop. Cas. Co. of Am. v. Anda, Inc.*, 2016 U.S. App. LEXIS 15760 (11th Cir. Aug. 26, 2016)
  - *Trav. Prop. Cas. Co. of Am. v. Actavis, Inc.*, 16 Cal. App. 5th 1026 (Cal. Ct. App. Nov. 6, 2017)



## Products Exclusion

- Gun Cases
  - “Arising out of” requires more than mere coincidence, but less than proximate cause
  - Exclusion applies to non-defective products
    - *Taurus Holdings, Inc. v. U.S. Fid. and Guar. Co.*, 913 So. 2d 528 (Fla. 2005)
    - *Brazas Sporting Arms, Inc. v. Am. Empire Surplus Lines Ins. Co.*, 220 F.3d 1 (1st Cir. 2000)
    - *Beretta U.S.A. Corp. v. Fed. Ins. Co.*, 17 Fed. App’x 250 (4th Cir. 2001)



## Products Exclusion

- Some jurisdictions apply the exclusion more narrowly
  - Doesn’t apply to insured’s conduct -- *e.g.*, failure to warn
  - Even where the exclusion expressly includes “failure to warn”, it may not apply unless the operation is complete. *Bombar v. W. American Ins. Co.*, 932 A.2d 78 (Pa. Super. 2007)
- The exclusion may still apply -- even in jurisdictions where it’s limited to defective products
  - *E.g.*, product is inherently dangerous & ineffective for what marketed for



## Products Exclusion

- Takeaways
  - Cases have been consistent -- so far
  - Focus on language
    - "Arising out of"
    - Safety and fitness of product; failure to warn
  - Jurisdictions may matter
    - Some courts read products exclusions narrowly
    - Limit to product defects



## Damage During the Policy Period

- Allegations typically vague as to time period
  - How far back can policyholder go
  - Factual issues
    - When did individuals / population suffer BI
    - When did policyholder manufacture/distribute product generally
    - When did policyholder manufacture/distribute product in that jurisdiction
  - Legal issues -- SOL



## Allocation

- Has not yet been litigated
- Hybrid between traditional long-tail claims (*asbestos, environmental*) and standard claims
- How will losses be allocated across policies
  - Manifestation v. triple trigger
  - By claimant or by expenditure



## Products Liability Policies – Coverage Issues

- “Expected or Intended” Exception to the Definition of “Occurrence”
- Exclusions for “Unfair Competition,” Criminal Violations, and Intentional Acts of Non-Compliance with FDA Rules/Regulations



## “Expected or Intended” Exception to the Definition of “Occurrence”

- Insurers have argued policyholders expected the injury and loss.
- Similar to the “no occurrence” defense asserted under CGL policies.
- Mixed results.
  - Nature of the allegations may matter
    - Fraudulent scheme
    - Negligent oversight
  - Jurisdiction may matter
    - Focus on harm
    - Focus on conduct



## Exclusions for “Unfair Competition,” Criminal Violations, and Intentional Acts of Non-Compliance with FDA Rules/Regulations

- *Travelers Prop. Cas. Co. of Am. v. Anda, Inc.*, 2015 U.S. Dist. LEXIS 31450 (S.D. Fla. Mar. 9, 2015).
  - Found an unfair competition exclusion precluded coverage for an opioid-related complaint.
  - Exclusion provided as follows: “[i]n the event a claim is made or suit is brought...alleging...any loss” “in any way related to any actual or alleged...[u]nfair competition...and...[a]ny other loss; then this exclusion shall apply to preclude coverage for the entire claim or suit...or a duty to defend...”
  - Court ruled the count titled “Violations of the West Virginia Consumer Credit and Protection Act (WVCCPA) – Unfair Methods of Competition or Unfair or Deceptive Acts or Practices” alleged unfair competition by the insured and the exclusion thus precluded coverage.



## D&O Policies – Coverage Issues

- Definition of “Loss”
- Conduct Exclusions



## Definition of “Loss”

- “Loss” commonly excludes fines, penalties or matters deemed uninsurable under applicable law.
- Insurers may deny coverage for opioid-related liability based on D&O policies’ definition of “loss.”



## Conduct Exclusions

- Exclusions for claims arising out of: (1) the gaining by any insured of any profit or advantage to which such insured was not legally entitled; or (2) the commission by any insured of any criminal or deliberately fraudulent or dishonest act.
- Carriers may also cite these exclusions to deny coverage under D&O policies.



## Predictions/Trends

- Underlying litigation will continue to grow exponentially
- Judge Polster looking to market-share type settlement
- Coverage issues almost certainly will be litigated across the country
- Many years before this settles down



# Emerging Coverage B Claims

2018 Annual Meeting

May 16-18, 2018

Chicago, IL

James W. Bryan, Nexsen Pruet PLLC

Laura A. Foggan, Crowell & Moring LLP

Seth D. Lamden, Neal Gerber & Eisenberg LLP



# Coverage for Malicious Prosecution



## Coverage B Insuring Agreement (2013)

We will pay those sums that the insured becomes legally obligated to pay as damages because of “personal and advertising injury” to which this insurance applies . . . This insurance applies to “personal and advertising injury” caused by an offense arising out of your business ***but only if the offense was committed in the “coverage territory” during the policy period.***



## “Personal and Advertising Injury” Offenses (2013)

- a. False arrest, detention or imprisonment;
- b. Malicious prosecution;
- c. The wrongful eviction from, wrongful entry into, or invasion of the right of private occupancy of a room, dwelling or premises that a person occupies, committed by or on behalf of its owner, landlord or lessor;
- d. Oral or written publication, in any manner, of material that slanders or libels a person or organization or disparages a persons’ or organization's goods, products or services;
- e. Oral or written publication, in any manner, of material that violates a person's right of privacy;
- f. The use of another's advertising idea in your "advertisement"; or
- g. Infringing upon another's copyright, trade dress or slogan in your advertisement".



## Pre-2013 Personal Injury Coverage

- Prior to 1976, personal injury coverage was available on non-ISO forms.
- 1976: ISO “Broad Form Comprehensive General Liability Endorsement” provided optional Coverage B coverage
- 1986 ISO CGL form (CG 00 01 11 85): Coverage B added
- Personal injury coverage has always included “malicious prosecution”



## Defining the Coverage B Offense of “Malicious Prosecution.”

- Courts look to substantive tort law to determine whether a suit alleges malicious prosecution. Label of cause of action is irrelevant.
- Civil and criminal malicious prosecution are similar. Core elements:
  - (1) the initiation or continuation of a lawsuit;
  - (2) lack of probable cause;
  - (3) malice; and
  - (4) favorable termination of the lawsuit.
- Difference between civil and criminal: Criminal – no need to show special injury. In some jurisdictions, civil requires a showing of additional damages. In many jurisdictions, the right not to be unjustifiably involved in litigation is a sufficient injury.



## Does the Offense of Malicious Prosecution Include Abuse of Process?

- Elements of abuse of process:
  - (1) an ulterior purpose; and
  - (2) a willful act in the use of the process not proper in the regular conduct of the proceeding.
- Many courts find that the term “malicious prosecution” is unambiguous and does not include the separate tort of abuse of process.
- Other courts find that the term “malicious prosecution” is ambiguous from the perspective of a layperson and, therefore, includes abuse of process.



## Triggering Coverage B – When Does Malicious Prosecution Occur? (Majority Rule)

- Coverage B is triggered if offense is committed during the policy period. When is malicious prosecution committed?
- Majority rule: Commencement of a malicious prosecution during the policy period triggers coverage. Rationale: Filing of the improper charges or suit is when the injury occurs.
- Majority of courts reject argument that offense of malicious prosecution occurs for purposes of coverage only after favorable termination, which is when statute of limitations commences.



## Triggering Coverage B – When Does Malicious Prosecution Occur? (Minority Rule)

- Coverage B is triggered if there is a favorable termination of the underlying proceeding during the policy period.
- Rationale: Favorable termination is a necessary element of the tort of malicious prosecution, and the offense does not occur until all elements have been satisfied.
- Other courts: the event that causes harm is not the release from prison or termination of malicious proceedings.



## Triggering Coverage B – Other Considerations

- Some courts have rejected a continuous trigger approach (*i.e.* all policies triggered from date of malicious filing through exoneration or favorable termination).
- Note: Many reported decisions interpreting malicious prosecution coverage involved non-ISO forms that focus on an “occurrence” rather than an “offense,” and even some cases involving ISO forms mistakenly discuss occurrences instead of offenses.



## Exclusion - Knowing Violation of Rights of Another

- **Knowing Violation of Rights of Another:** “This insurance does not apply to: ‘Personal and advertising injury’ caused by or at the direction of the insured with the knowledge that the act would violate the rights of another and would inflict ‘personal and advertising injury.’”
- Erie Ins. Property & Cas. Co. v. Edmond, 785 F.Supp.2d 561, 568 (N.D.W.Va. 2011) (exclusion “applies if the insured acted with the knowledge that his acts would violate another’s rights, and intended them to cause ‘personal and advertising injury.’”



## Exclusion - Knowing Violation of Rights of Another

- Five Pennsylvania cases involved a judicial kickback scheme to maintain a high rate of occupancy in juvenile detention facilities operated by the insureds. As part of the alleged conspiracy, judges would violate the civil rights of the juveniles appearing before them by denying them a right to counsel and ensuring disproportionately large sentences.
- “Even though the [insureds] make out claims for false imprisonment that would otherwise fall under the protection of Coverage B, the alleged knowing violation of the underlying plaintiffs’ rights trigger the ‘knowing violation’ exclusion and strip Colony of its duty to defend against the allegations in the underlying complaints.” Colony Ins. Co. v. Mid-Atlantic Youth Services Corp., 2010 WL 817703 (M.D.Pa. Mar. 9, 2010)



Oral or written publication of material that violates a person's right of privacy



## Oral or Written Publication That Violates a Person's Right of Privacy

- Is there coverage for claims that a policyholder failed to safeguard private and confidential information that was in their custody, control and care or failed to adequately monitor, audit and oversee the security of their electronic systems containing confidential records?



## Oral or Written Publication That Violates a Person's Right of Privacy

### Publication

- In "failure to protect" cases, is there any "publication" or unreasonable publicity or disclosure of information about a person's private life?
- In many "failure to protect" disputes, it is clear that the policyholder did not take any steps that were designed to disseminate or publish the material.
- Is the Coverage B offense of "publication" of material the same as an alleged failure to safeguard confidentiality?



## Oral or Written Publication That Violates a Person's Right of Privacy

### Publication

- Does a "publication" require that the material be communicated or disseminated to others?
- Consider: claim concerns a lost laptop or other mobile device that holds personal information which cannot easily or automatically be accessed due to passwords or encryption.
- Where an underlying complaint alleges only the risk that someone could access the materials, not that any unreasonable publicity or disclosure of information about the plaintiffs' lives actually took place, there may be no coverage under the designated offenses in Coverage B.



## Oral or Written Publication That Violates a Person's Right of Privacy

### Examples

- ***Recall Total*** – Connecticut Supreme Court

- A tape with electronic data containing personal information fell from the back of a van. There was no claim that anyone ever *accessed* the information on the tape. Because “access is a necessary prerequisite to the communication or disclosure of personal information,” the court held that the claim did not fall within the Coverage B designated offense of “electronic, oral, written or other publication of material that . . . violates a person’s right of privacy . . .”

- ***Urban Outfitters*** – Third Circuit

- The complaints alleged that the policyholder collected personal ZIP codes of customers when purchasing products via credit cards. The insured was alleged to have used those ZIP codes internally to distribute material to consumers’ homes, but took no steps to share the information with any third party. The court determined that a “publication” required “provision of information to the public.”



## Oral or Written Publication That Violates a Person's Right of Privacy

### Examples

- ***Portal Healthcare*** – Fourth Circuit

- The plaintiffs were able to access their own healthcare records via a google search. They alleged that through a security glitch, for a period of four months, patient medical records were accessible on the internet to anyone without any security restrictions. The court found a duty to defend notwithstanding arguments that there was no “publication” because the policyholder sought to keep the materials private and there was no evidence that third-parties actually accessed the records.



## Wrongful Entry – Coverage for Pollution Claims



### WRONGFUL ENTRY – COVERAGE FOR POLLUTION CLAIMS

- Wrongful Entry/Invasion of Right of Private Occupancy – Coverage B
- “Personal injury” is defined as an injury other than “bodily injury” arising out of the offense of:
- “The wrongful eviction from, wrongful entry into, or invasion of the right of private occupancy of a room, dwelling or premises that a person occupies, *committed by or on behalf of its owner, landlord or lessor.*”
- Can there be coverage for trespass and nuisance in pollution claims under Coverage B? **Yes.**



## WRONGFUL ENTRY – COVERAGE FOR POLLUTION CLAIMS

- Pollution claims often include claims for trespass and nuisance.
- Do trespass and nuisance constitute a personal injury offense that is covered under Coverage B?
- Restrictive interpretation = no coverage
- Expansive view = yes coverage



## WRONGFUL ENTRY – COVERAGE FOR POLLUTION CLAIMS

- Restrictive Interpretation = No Coverage
- Some courts do not consider trespass to be a “wrongful entry”
- Dryden Oil Co. of New England, Inc. v. Travelers Indem. Co., 91 F.3d 278 (1st Cir. 1996) (Massachusetts tort of “wrongful entry” does not extend beyond trespasses by landlords upon the leased premises)



## WRONGFUL ENTRY – COVERAGE FOR POLLUTION CLAIMS

- Restrictive Interpretation/No Coverage
- Some courts do not consider trespass to be an “invasion of the right of private occupancy”
- Kruger Commodities, Inc. v. United States Fidelity & Guar., 923 F.Supp. 1474 (M.D.Ala.1996) (Arkansas law)
- Right of private occupancy only refers to those rights associated with individual’s act of inhabiting the premises, not to rights associated with individual’s right to use and enjoy the inhabited premises
- Because claimants were not denied occupancy of their property due to the foul odors from insured’s nearby processing animal carcasses plant, insured was not entitled to personal injury coverage under Coverage



## WRONGFUL ENTRY – COVERAGE FOR POLLUTION CLAIMS

- Expansive view = yes coverage: Some courts do consider trespass to be a “wrongful entry” or “other invasion of the right of private occupancy.”
- Kitsap County v. Allstate Ins. Co., 136 Wash.2d 567, 964 P.2d 1173 (1998)
- Adjoining landowners alleged trespass as a result of odors and pollution emanating from the insured’s landfill and waste disposal facility
- Personal injury offense had a broader definition – “wrongful entry or eviction, or other invasion of the right of private occupancy.”
- Since the dictionary definition of “offense” can include violating a law without intending to do so, an **average purchaser of insurance**
  - would think that a trespass was a wrongful entry and
  - would think that a trespass was also an other invasion of the right of private occupancy because it is a trespass against a person’s right to use premises or land that are secluded from the intrusion of others



## WRONGFUL ENTRY – COVERAGE FOR POLLUTION CLAIMS

Illinois courts have found “wrongful entry” ambiguous and held it covers a trespass injury caused by migration of a hazardous substance onto the property of another.

Millers Mut. Ins. Ass’n of Illinois v. Graham Oil Co., 668 N.E.2d 223 (Ill. App. 1996):

- “Wrongful entry” could reasonably mean a dispute over “possession of real property,” but it could also reasonably mean “all trespassory invasions to real property, whether aimed at dispossession or not.”



## WRONGFUL ENTRY – COVERAGE FOR POLLUTION CLAIMS

### Reading the Pollution Exclusion Out of Policy?

Does allowing personal injury coverage for trespass and nuisance have the effect of reading the pollution exclusion for bodily injury and property damage out of the policy?

Courts are split.



## WRONGFUL ENTRY – COVERAGE FOR POLLUTION CLAIMS

Some courts hold that a personal injury provision **cannot** serve as the basis for coverage of pollution-related claims that otherwise come within the ambit of the pollution exclusion. Arrowood Indem. Co. v. Oxford Cleaners and Tailors, LLC (D. Mass. 2014)

For other courts, the pollution exclusion which, by its terms, applies only to the policy's property damage and bodily injury provisions, cannot defeat coverage for pollution-related claims that arguably fall within the scope of the policy's personal injury coverage. Pipefitters Welfare Educ. Fund v. Westchester Fire (7th Cir.1992) (Illinois law)



Oral, written or electronic publication of material that *disparages a person's or organization's goods, products or services*



Oral, written or electronic publication of material that *disparages a person's or organization's goods, products or services*

- Does the policy's disparagement clause refer to the common law tort of product disparagement, which requires pleading and proof of a false statement, or to any statement or opinion that disparages another's goods?
- *Travelers Property Casualty Company of America v. Charlotte Russe Holding, Inc.*, 207 Cal. App. 4th 969 (2012), found a potential for coverage in an allegation that the insured retailer sold the manufacturer's premium apparel at closeout prices, thereby damaging the apparel's high-end reputation.
- However, *Charlotte Russe Holding, Inc.*, was disapproved two years later by the California Supreme Court in *Hartford Casualty Insurance Company v. Swift Distribution, Inc.*, 2014 Cal. Lexis 3765 (2014).



Oral, written or electronic publication of material that *disparages a person's or organization's goods, products or services*

- After *Swift Distribution, Inc.*, the prevailing view is that to trigger the "personal injury" coverage at issue in the disparagement cases, the plaintiff must plead and prove the defendant's statement was not only disparaging but also false.
- The issue is not without controversy, however. Courts construing similar policy language under the laws of other states have reached inconsistent conclusions.



## Emerging Coverage B Claims: Questions and Final Discussion

James W. Bryan, Nexsen Pruet PLLC  
Laura A. Foggan, Crowell & Moring LLP  
Seth D. Lamden, Neal Gerber & Eisenberg LLP



**ACCEC**

American College of Coverage and  
Extracontractual Counsel



**2018 ACCEC Annual Meeting**

May 16-18, 2018 | The Westin Chicago River North | Chicago, IL



# PAPERS

# COVERAGE IN A TIME OF STORMS

## American College of Coverage and Extracontractual Counsel 6<sup>th</sup> Annual Meeting

Chicago, IL  
May 16-18, 2018

Sherilyn Pastor  
McCarter & English, LLP  
Newark, NJ  
[spastor@mccarter.com](mailto:spastor@mccarter.com)

William Berk  
Berk, Merchant & Sims, PLC  
Miami, FL  
[www.berklawfirm.com](http://www.berklawfirm.com)

Neil Rabin  
Drinker Biddle & Reath LLP  
Dallas, TX  
[neil.rabin@dbr.com](mailto:neil.rabin@dbr.com)

Following storm events, disputes can arise over the cause and amount of covered loss. It may be that a loss involved both a covered and excluded cause of loss. In *Bayrock/Sapir Org. LLC v. Affiliated FM Ins. Co.*, No. 652014/2013 (N.Y. Sup. Ct. 2013), for example, the policyholder alleged that power interruption, causing it loss, was covered because it was caused by an explosion at substation and flying debris. The insurer disagreed, urging that the policyholder's loss was caused by flooding and therefore excluded from coverage. Whether there is coverage when a claim involves covered and excluded causes of loss will depend on the facts, the terms of the involved policy, and whether the controlling jurisdiction's law follows the efficient proximate cause doctrine or the concurrent cause doctrine.

The law on causation varies from state to state, with courts fashioning competing doctrines to address circumstances where property loss results from a combination of covered and excluded causes. Under the concurrent cause doctrine, as long as there is a covered "but for" cause of the loss – no matter how insignificant in the chain of causation – the excluded cause cannot be used to defeat coverage. Other courts, seeking to better balance insurer's and insured's interests, apply some form of the efficient proximate cause doctrine, which focuses on whether the covered cause was the predominant or driving cause of the loss.

New York applies a proximate, efficient and dominant cause of loss test. Meaning, when a loss is caused by covered and excluded causes, the policyholder is entitled to coverage if the covered peril is the "dominant and efficient cause" of the loss. *See, e.g., Leonard v. Nationwide Mut. Ins. Co.*, 499 F.3d 419, 431 (5th Cir. 2007). The efficient proximate cause of the loss is the one that sets the other causes in motion that, in an unbroken sequence, produce the result for which recovery is sought. *See McDonald v. State Farm Fire & Cas. Co.*, 837 P.2d 1000, 1004 (Wash. 1992).

By way of illustration, in *Sabella v. Wisler*, 377 P.2d 889 (Cal. 1963), a homeowner purchased a home that it turns out was negligently built on an improperly compacted lot. When a sewer line under the home leaked several years later, water weakened the unstable land beneath the home's foundation, causing it to settle (but not collapse). The policyholder sought coverage for the damage. Its insurer denied the claim, citing to an exclusion for loss caused by "settling, cracking, shrinkage, or expansion of pavements, foundations, walls, floors, or ceilings; unless loss by . . . collapse of buildings ensues." The California Supreme Court held there was coverage as a matter of law because an insured peril, negligence in the installation of the sewer pipe, was the efficient cause of the loss.

Although seemingly straightforward, the efficient proximate cause doctrine's analysis and accompanying coverage determinations can be complex. In *First Special Ins. Corp. v. American Home Assur. Co.*, 558 F.3d 97, 104 (1st Cir. 2009), the First Circuit Court of Appeals held that the efficient proximate cause doctrine is applicable only where two distinct perils exist, each of which is independently capable of inducing damage. Meaning, the doctrine applies only in a fact-specific situation, namely "where the causes are independent." *Id.* at 104-05. Other courts applying the doctrine have made clear that when an insured cause sets excluded causes in motion in an unbroken sequence between the insured risk and ultimate loss, the insured risk is regarded as the proximate cause of the entire loss. This is true even if an event in the chain of causation was specifically excluded from coverage. *See, e.g., Kelly v. Farmer's Ins. Co.*, 281 F.Supp. 2d 1290, 1296 (W.D. Okla. 2003); *Bowers v. Farmers Ins. Exch.*, 991 P.2d 734, 738 (Wash. Ct. App. 2000).

Some courts instead apply the concurrent causation doctrine, or some variation of it. These jurisdictions conclude that there is coverage whenever two or more causes contribute to a loss, and

at least one of the causes is a covered peril. *E.g., American Home Assur. Co. v. Sebo*, 141 So. 3d 195141 So. 3d 195 (Fla. 2016) (“when independent perils converge and no single cause can be considered the sole or proximate cause, it is appropriate to apply the concurring cause doctrine”). *Accord Curtis v. State Farm Lloyds*, 2004 U.S. Dist. LEXIS 29887, at \*29 (S.D. Tex. 2004).

New Jersey, by contrast, considers whether the first or last step in the chain of causation resulting in the loss was a covered event. If it was, there is coverage. *See, e.g., Simonetti v. Selective Ins. Co.*, 859 A.2d 694, 700 (N.J. App. Div. 2004). Texas also applies a concurrent causation analysis. In *Farmers Group Ins., Inc. v. Poteet*, 434 S.W. 3d 316 (Tex. App. 2014), for example, a policyholder’s home sustained damage as a result of a central heating and air-conditioning system’s discharge of smoke and soot. The insurer, however, refused to pay the entirety of the claim, alleging that the soot resulted from a culmination of covered and uncovered perils. The Texas Court of Appeals held that under the doctrine of concurrent causation, when covered and non-covered perils combine to create a loss, the insured is entitled to recover that portion of the damage caused solely by the covered peril.

There is no uniformity regarding the burden of proof in causation disputes. In *Jones v. Federated National Insurance Company*, 2018 WL 443892, (Fla. Ct. App. Jan. 17, 2018), a Florida appellate court recently held that after the insured proves it sustained loss during the policy’s period, the burden is on the insurer:

1. The insured has the initial burden of proof to establish that the damage at issue occurred during a period in which the damaged property had insurance coverage. If the insured fails to meet this burden, judgment shall be entered in favor of the insurer.
2. If the insured’s initial burden is met, the burden of proof shifts to the insurer to establish that (a) there was a sole cause of the loss, or (b) in cases where there was more than one cause, there was an “efficient proximate cause” of the loss.

3. If the insurer meets the burden of proof under either 2.(a) or 2.(b), it must then establish that this sole or efficient proximate cause was excluded from coverage by the terms of the insurance policy. If the insurer does so, then judgment shall be entered in its favor. If the insurer establishes that there was a sole or efficient proximate cause, but fails to prove that this cause was excluded by the all-risk insurance policy, then judgment shall be entered in favor of the insured.

4. If the insurer fails to establish either a sole or efficient proximate cause, and there are no applicable anti-concurrent cause provisions, then the concurrent cause doctrine must be utilized. Applying the concurrent cause doctrine, the insurer has the initial burden of production to present evidence that an excluded risk was a contributing cause of the damage. If it fails to satisfy this burden of production, judgment shall be entered in favor of the insured.

5. If the insurer does produce evidence that an excluded risk was a concurrent cause of the loss, then the burden of production shifts to the insured to present evidence that an allegedly covered risk was a concurrent cause of the loss at issue. If the insured fails to satisfy this burden of production, judgment shall be entered in favor of the insurer.

6. If the insured produces evidence of a covered concurrent cause, the insurer bears the burden of proof to establish that the insured's purported concurrent cause was either (a) not a concurrent cause (i.e., it had no (or a de minimis) causal role in the loss), or (b) excluded from coverage by the insurance policy. If the insurer fails to satisfy this burden of proof, judgment shall be entered in favor of the insured.

*Id.* at \*3.

Texas courts, however, place the burden of proof on the insured. *In Certain Underwriters at Lloyd's of London v Lowen Valley View LLC*, 2017 WL 3115142 (N.D. Tex. July 21, 2017), the court explained that an insured must establish that it sustained damages covered by its insurance policy to recover under its contract. When covered and excluded perils combine to cause damage, the insured therefore must present sufficient evidence affording a jury a reasonable basis on which to segregate those damages caused by covered perils from those caused by uncovered perils. The court concluded that failure to meet such burden may be fatal to an insured's claim. *Id.* at \*8.

Some insurance policies now contain what are described as anti-concurrent causation ("ACC") provisions. These clauses purport to exclude coverage any loss caused in part by any

excluded peril. One such provision provides: “We will not pay for loss or damage caused directly or indirectly by any of the following ... such loss or damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss.” ISO Form CP 00 99 02 00 (ISO Properties, Inc. 2007).

ACC provisions have been met with mixed responses by courts and insurance regulators. A number of courts have upheld their enforcement. *E.g., Iroquois on the Beach, Inc. v. General Star Indem. Co.*, 550 F.3d 585, 588 (6th Cir. 2008); *Artic Slope Regional Corp. v. Affiliated FM Ins. Co.*, 564 F.3d 707, 711 (5th Cir. 2009). These states conclude that the parties have a right to contract what an insurance policy will and will not cover. *See JAW The Pointe, L.L.C. v. Lexington Ins. Co.*, 460 S.W.3d 597 (Tex. 2015).

Some states, however, have refused to enforce ACC provisions, or have passed or introduced legislation banning their enforcement. *E.g.*, NY Assembly Bill No. A7455A. California’s Insurance Code, in fact, codifies the efficient proximate cause doctrine, and California courts have made clear that insurers cannot “contract around” this statutory mandate. *E.g., Julian v. Hartford Underwriters Ins. Co.*, 35 Cal.4th 747 (2005); *Garvey v. State Farm Fire & Cas. Co.*, 48 Cal.3d 395 (1989).

Some courts disfavor ACC clauses, giving them limited effect -- applying them to events that happen at the same time (concurrently), and not to sequential events, or declining to enforce them as vague or contrary to policyholders’ reasonable expectations. *See, e.g., Safeco Ins. Co. of Am. v. Hirschmann*, 112 Wash. 2d 621, 773 P.2d 412 (1989) (ACC clause unenforceable, reasoning that it would defeat the policyholder’s reasonable expectation that it was entitled to recover for all losses set in motion by a covered cause of loss. *Accord Fruit & Vegetable Supreme Inc. v. The Hartford Steam Boiler Insp.*, 28 Misc.3d 1128 (N.Y. Sup. Ct. 2010) (food spoilage and

loss of income not recoverable because service interruption coverage was excluded, but pre-black out damages were unrelated and constituted covered loss). *See also Western Nat'l Mut. Ins. Co. v. University of No. Dakota*, 653 N.W.2d 4 (N.D. 2003); *Wright v. Safeco Ins. Co.*, 109 P.3d 1 (Wash. Ct. App. 2004); *Murray v. State Farm Fire and Cas. Co.*, 509 S.E.2d 1 (W. Va. 1998).

The law relating to causation and the enforceability of ACC provisions continues to develop. Following a loss, insurers and insureds should therefore carefully consider the specific facts and policy provisions implicated, and the controlling jurisdiction's statutory and case law.

# **COVERAGE IN A TIME OF STORMS**

American College of Coverage and Extracontractual Counsel  
6<sup>th</sup> Annual Meeting

Chicago, IL  
May 16-18, 2018

William Berk  
Berk, Merchant & Sims, PLC  
Miami, FL  
wberk@berklawfirm.com

Sherilyn Pastor  
McCarter & English  
Newark, NJ  
spastor@mccarter.com

W. Neil Rabin  
Drinker Biddle & Reath LLP  
Dallas, TX  
neil.rabin@dbr.com

## INTRODUCTION

Following storm events, disputes can arise over the cause and amount of covered loss. Most policies allow parties to invoke appraisal by an appraiser or panel to establish the value or amount of the loss. This paper addresses issues that can arise when the appraisers are seen not to meet proper criteria, or transparency is lacking.

### IMPARTIALITY IN APPRAISAL: LESSONS LEARNED

- I. Appraisal has changed
  - A. Recent case law and policy language have changed the ground rules for appraisal.
  - B. Where it was once considered acceptable, and, indeed, expected, for the parties to appoint appraisers to serve as their advocates in appraisal, many policies now require the parties to appoint “impartial” appraisers, using language akin to the neutrality requirement for umpires.
  - C. Several courts have disqualified appraisers who are not impartial, and at least one federal court has sanctioned a party and its counsel for appointing an appraiser lacking impartiality.
  
- II. Evolution of Appraisal as an Alternate Dispute Resolution Mechanism
  - A. Designed to be a quick, inexpensive method to resolve differences over the amount of loss.
  - B. Based on contract language in the policy.
  - C. Courts initially treated appraisal as “akin” to arbitration, and as such interpreted appraisal in accordance with arbitration case law. *Intracoastal Ventures Corp. v. Safeco Ins. Co.*, 540 So. 2d 162, 1989 Fla. App. LEXIS 1365, 14 Fla. L. Weekly 673 (Fla. Dist. Ct. App. 4th Dist. 1989)
  - D. One court found the appraisal provision void for lack of mutuality of obligation because the insurer reserved the right to deny the claim.
  - E. The Florida Supreme Court overturned this decision, noting that appraisal was limited to “amount of loss” issues, and not coverage. *State Farm Fire & Cas. Co. v. Licea*, 685 So. 2d 1285, 1996 Fla. LEXIS 2149, 21 Fla. L. Weekly S 543 (Fla. 1996)
  - F. What constitutes “coverage” (and not appraisable) vs. “amount of loss issues became in itself the subject of substantial litigation.

- G. The Florida Supreme Court attempted to resolve this issue by ruling that if any part of a loss was covered, then the cause of loss was an appraisable issue; and the converse was true, if no part of a claim was paid, then the matter was not appraisable. *Johnson v. Nationwide Mut. Ins. Co.*, 828 So. 2d 1021, 2002 Fla. LEXIS 1885, 27 Fla. L. Weekly S 779 (Fla. 2002).
- H. This concept was watered down through various decisions and the use of line item award forms. *Kendall Lakes Townhomes Developers, Inc. v. Agric. Excess & Surplus Lines Ins. Co.*, 916 So. 2d 12, 2005 Fla. App. LEXIS 15692, 30 Fla. L. Weekly D 2349 (Fla. Dist. Ct. App. 3d Dist. 2005).
- I. Procedurally, appraisal was often conducted like arbitration and challenges were subject to the Florida Arbitration Code.
- J. The Florida Supreme Court rejected this notion and held that appraisal was to be conducted in an informal manner, essentially without formal rules. *Allstate Ins. Co. v. Suarez*, 833 So. 2d 762, 2002 Fla. LEXIS 2592, 27 Fla. L. Weekly S 1028 (Fla. 2002). *Citizens Prop. Ins. Corp. v. Mango Hill #6 Condo. Ass'n*, 117 So. 3d 1226, 2013 Fla. App. LEXIS 10974, 38 Fla. L. Weekly D 1507, 2013 WL 3455604 (Fla. Dist. Ct. App. 3d Dist. 2013).

### III. Partiality of Appraisers and Umpires

- A. Because of the courts' reliance on arbitration law as a foundation for appraisal, courts held that in appraisal it was expected that the parties' appraisers would serve as advocates for the parties. *Lee v. Marcus*, 396 So. 2d 208, 1981 Fla. App. LEXIS 18889 (Fla. Dist. Ct. App. 3d Dist. 1981).
- B. Generally, the policies required appointment of "competent" and "independent" appraisers. *State Farm Fire & Casualty Co. v. Middleton*, 648 So. 2d 1200, 1995 Fla. App. LEXIS 2, 20 Fla. L. Weekly D 99 (Fla. Dist. Ct. App. 3d Dist. 1995).
- C. Public adjusters with contingent fee agreements were permitted to serve as appraisers, as were independent adjusters handling claims for insurance companies. *Rios v. Tri-State Ins. Co.*, 714 So. 2d 547, 1998 Fla. App. LEXIS 7507, 23 Fla. L. Weekly D 1523 (Fla. Dist. Ct. App. 3d Dist. 1998).
- D. The parties sought to appoint as appraisers those who would most effectively advocate on their behalf, rather than those who necessarily were most qualified to determine the amount of loss.
- E. Relationships with umpires were deemed essential.
- F. The only restrictions seemed to be appointment of the parties themselves.
- G. The courts held the line on umpires—those with financial ties to the parties were not considered to be impartial or neutral. *Weinger v. State Farm Fire & Casualty*,

620 So. 2d 1298, 1993 Fla. App. LEXIS 6656, 18 Fla. L. Weekly D 1487 (Fla. Dist. Ct. App. 4th Dist. 1993).

- H. But how impartial are umpires when an appraisal industry has arisen, dependent on repeat business.
- I. Recent Florida statutes seek to define “impartiality” of an umpire in a contrived, restricted manner, inconsistent with the English language. Fla. Stat. § 627.70151 (2016):
  - An insurer that offers residential coverage as defined in s. 627.4025, or a policyholder that uses an appraisal clause in a property insurance contract to establish a process for estimating or evaluating the amount of loss through the use of an impartial umpire, may challenge an umpire’s impartiality and disqualify the proposed umpire *only* if:
    - (1) A familial relationship within the third degree exists between the umpire and a party or a representative of a party;
    - (2) The umpire has previously represented a party in a professional capacity in the same claim or matter involving the same property;
    - (3) The umpire has represented another person in a professional capacity on the same or a substantially related matter that includes the claim, the same property or an adjacent property, and the other person’s interests are materially adverse to the interests of a party; or
    - (4) The umpire has worked as an employer or employee of a party within the preceding 5 years.
- J. Eventually, a court held the party’s attorney could not serve as its appraiser. *Fla. Ins. Guar. Ass’n v. Branco*, 148 So. 3d 488, 2014 Fla. App. LEXIS 14602, 39 Fla. L. Weekly D 2020 (Fla. Dist. Ct. App. 5th Dist. 2014).
- K. Policy language has changed: *it now often requires the parties to appoint “impartial” appraisers, where previously they were required to appoint “independent” or “competent” appraisers.*
- L. In general, case law has not kept pace, and the use of completely neutral appraisers—i.e., those with no existing business relationship to the party—is rare.
- M. There are potential perils to the above approach.

#### IV. Case Authority

- A. *Auto-Owners Ins. Co. v. Summit Park Townhome Ass’n*, 2018 U.S. App. LEXIS 7334, 2018 WL 1440627 (10<sup>th</sup> Cir. 2018) and *Auto-Owners Ins. Co. v. Summit Park Townhome Ass’n*, 2018 U.S. App. LEXIS 7335 (10<sup>th</sup> Cir. 2018).

1. \$10 million appraisal award set aside and attorneys for the insured sanctioned over \$300,000 where the court found the appraiser for the insured was not impartial.
2. Policy language in Colorado required impartial appraiser.
3. Case law in Colorado required impartial appraiser.
4. Court order required full disclosure.
5. Factual and legal basis of the *Summit Park* decision.

a. Implications of *Summit Park*

A party cannot avoid the consequences of the acts or omissions of a freely selected agent. Sanctions were based on violation of the district court's disclosure order.

To the extent it is based on policy language requiring the appointment of an *impartial* appraiser it can be considered persuasive.

B. *Church Mutual Insurance Company v. Coutu*, No. 17-cv-00209-RM-NYW, 2017 WL 4029589 (D. Col. Sept. 13, 2017):

A church submitted a claim for roof repair costs following a windstorm and associated hail. The insurer paid on the claim and continued adjusting activities. The church hired a public adjuster (Coutu) who convinced the church to initiate appraisal proceedings. The appraisal demand named Bensusan of Atlantis Claims as the "impartial" appraiser while the insurer named its own appraiser. The appraisers then selected Mr. Kezer as the umpire. A substantial appraisal award was thereafter entered in favor of the church. At a meeting between Bensusan, the church and Coutu to divide up the proceeds, the church learned for the first time that Bensusan's compensation was a percentage of the award. The church then filed a bad faith claim against the insurer, which counterclaimed seeking to vacate the appraisal award due, amongst other reasons, to Bensusan's undisclosed financial interest in the outcome. In addition, the insurer claimed that Bensusan and Coutu actively concealed their financial and business relationships. In unscrambling this, the court made several observations which bear on the matters at hand.

First, the court had to determine the status of Coutu and Bensusan—one a public adjuster and the other purportedly an appraiser. The court found that a public adjuster is hired by the insured in assisting with the claim and would thus be considered an agent of the insured. An appraiser, on the

other hand, is supposed to be “impartial,” and thus may not be, in actuality, an agent of the insured. (This would not, however, insulate either from tort liability for their own wrongs).

Second, the court had to consider the nature and scope of any duty of disclosure as this would impact the existence of tort liability arising from any alleged failure to disclose. The court found a duty to disclose and a sufficiently-alleged breach of that duty. “ Taking the (insurer’s) factual contentions as true, the appointments of Messrs. Bensusan and Kezer as ‘impartial’ under the Policy were statements that purported to tell the whole truth but did not, thereby creating a duty to disclose the necessary information regarding (their) financial interests in the transaction to prevent these statements from being misleading.” *Id.*, \*8. In part, the court’s determination is buoyed by a Colorado Division of Insurance bulletin, defining impartial to mean an appraiser has no financial interest in the outcome and does not have a pecuniary interest in the amounts determined by the appraisal process.

Regarding the public adjuster, Coutu, the court similarly found a duty of disclosure, albeit for other reasons. The court found that good faith and fair dealing required the public adjuster to also make full disclosure of his financial interest in the outcome.

C. *Owner’s Insurance Co. v. Dakota Station II Condominium Assoc.*, No. 16CA0733, 2017 WL 3184568 (Col. Ct. App. July 27, 2017):

Wind and hail damaged the Dakota condominium and a claim was made with the insurer. The parties went to appraisal, each naming an appraiser who in turn selected an umpire. The umpire ultimately adopted four damage estimates from the insurer’s appraiser (Burns) and two from Dakota’s (Haber). Burns refused to sign the final award. The insurer then paid Dakota. Dakota then filed suit claiming delay in resolving the claim. During discovery, the insurer obtained information suggesting that Haber was not impartial moving to vacate the award.

The trial court ruled in favor of Dakota and the insurer appealed. The key issue on appeal is what is meant by the phrase “impartial appraiser” as used in the insurance policy. The court first observed that “the policy does not hold an appraiser as not favoring one side more than another in the sense that a judge or arbitrator...would be required to be impartial.” *Id.* at \*4. Quoting an Iowa Supreme Court case with approval, the court found that “so long as the selected appraiser acts fairly, without bias, and in good faith, he or she meets the policy requirement of an impartial appraiser.” *Id.*

First, the court found entirely proper a pre-appointment meeting between Haber, the insured and the insured’s public adjuster.

Second, a communication between Haber and the insured's public adjuster during the appraisal process was also found to be appropriate.

Last, the court found that a 5% cap on the appraiser's fee did not show bias, but protected the insured.

On February 20, 2018, the Colorado Supreme Court agreed to hear the insurers' appeal.

- D. *North Glenn Homeowners Ass'n v. State Farm Fire and Casualty Co.*, No. 16-0912, 2017 WL 2875869 (Iowa Ct. App. July 6, 2017):

North Glenn submitted a claim for hail damage to State Farm which was paid. A second claim was then made due to a later storm, but State Farm rejected it, opining the damage was caused by the earlier storm. North Glenn requested appraisal and after certain court maneuverings, the appraisal proceeded.

A final award was rendered resulting in further court proceedings during which State Farm claimed North Glenn's appraiser was biased.

Quoting from an earlier decision, the court rejected State Farm's claim, stating "the intent of the appraisal procedure is not to provide appraisers who possess the total impartiality that is required in a court of law. The appraisers do not violate their commitment by acting as advocates for their respective selecting parties. However, appraisers should be in a position to act fairly and be free from suspicion or unknown interest." *Id.*, \*6.

- E. *Heritage Property and Cas. Ins. Co. v. Romanach*, No. 3D16-995, 2017 WL 2960729 (Fla. 3d DCA July 12, 2017):

A water leak damaged the interior of the insureds' home and a claim was made to Heritage. A dispute arose and Heritage invoked appraisal under a clause requiring the umpire be competent and impartial. The appraisers selected Guerrero to be the umpire who issued a substantial award to the insureds, and the insurer's appraiser objected.

Heritage filed a declaratory action seeking a new appraisal, contending that the insured's appraiser and the umpire "colluded." In support, Heritage claimed it had discovery evidence that there were professional and familial relationships between the insureds' appraiser, the umpire and the owner of a water mitigation company hired by the insureds. Had these matters been disclosed, Heritage claimed its appraiser would never have agreed to the selection of Guerrero.

On motion, the trial court dismissed the case with prejudice and Heritage appealed. The appellate court reversed, finding that Heritage had stated a valid claim. Of particular interest, the court declined to opine – expressly-

on what relief Heritage might obtain; a new appraisal or a tort claim against the umpire...or perhaps something else.

- F. *In re Philadelphia Indemnity Ins. Co.*, Case No. 13-17-00506 Court of Appeals, 13th District of TX:

The trial court's granting of a motion to set aside an appraisal award based upon its finding that the appraiser appoint by the insurer was not impartial was upheld as, at the time of the appraisal, he was a defendant in an unrelated lawsuit in which the insured's counsel was the Plaintiff's attorney.

- G. *General Star Indem. Co. v. Spring Creek Village Apartments Phase V, Inc.*, 2004152 S.W.3d 733, 737-738 (Tex. App.—Houston [14th] 2004)

The fact that the appraiser had a financial interest (contingency fee contract) in the outcome of appraisal created a fact issue regarding whether he was impartial.

- H. *Gardner v. State Farm Lloyds*, 76 S.W.3d 140 (Tex. App.—Houston [1st. Dist.] 2002)

The fact that the appraiser appointed by State Farm was an employee of Haag Engineering which had a significant business relationship with State Farm was no evidence that the appraiser was not "independent." He had no individual interest in the claim, was not an employee of State Farm and there was no evidence that State Farm exerted control over him.

- I. *Holt. v. State Farm Lloyds*, 1999 WL 261923 (N.D. Texas 1999)

A fact issue existed regarding whether the State Farm appointed, Tim Marshall of Haag, was "independent" as one quarter of his income came from appraisal work for State Farm.

- J. *Amtrust Ins. Co. of Kansas, Inc. v. Starship League City, L.P.*, 2013 WL 1222329 (E.D. Texas—Sherman Division, 2013)

The court denied Plaintiffs' Motion to Set Aside Appraisal Award, instead finding that a fact issue existed on whether the appraiser appointed by the insured was impartial, as he was an advocate for the insured. Prior to the appraisal he had recommended experts to the insured and gave advice to the insured on when to ask for an appraisal and how to proceed with the appraisal process.

- K. *Franco v. Slavonic Mut. Fire Ins. Assn.*, 154 S.W.3d 777, 786-787 (Tex.App.—Houston [14th] 2004).

Appraiser was not found to be biased even though he previously inspected the property because his conclusions regarding the cause of the damage were his own and there was no evidence anyone exercised control over him.

L. Practical Implications & Pointers

1. How does a party choose an appraiser?
2. What kind of disclosures must be made?
3. How does a party challenge another's appraiser?
4. What is the appraiser's obligation?
5. What is the umpire's obligation?
6. What is counsel's obligation?
7. How does a State's statute figure in the analysis?

Rights and Duties Where Insured  
Has Independent Counsel

American College of Coverage and Extracontractual Counsel  
6<sup>th</sup> Annual Meeting

Chicago, IL  
May 16-18, 2018

# Rights and Duties Where Insured Has Independent Counsel

By

**William T. Barker**  
**Dentons U.S. LLP**  
**233 S.Wacker Dr. #7800**  
**Chicago IL 60606**  
**312-876-8140**

[william.barker@dentons.com](mailto:william.barker@dentons.com)

**Reprinted from WILLIAM T. BARKER & RONALD D. KENT, NEW APPLEMAN INSURANCE LAW BAD FAITH LITIGATION, SECOND EDITION with permission. Copyright 2018 Matthew Bender & Company, Inc., a LexisNexis company.**

**All rights reserved. Further reproduction without the express written permission of Matthew Bender, or its affiliated companies, is prohibited.**

**William T. Barker** is a partner in the Chicago office of Dentons U.S. LLP, with a nationwide practice representing insurers in complex litigation, including matters relating to coverage, claims handling, sales practices, risk classification and selection, agent relationships, and regulatory matters. He sometimes serves as an expert witness on matters of insurance, professional responsibility and standard of care. He is a co-author (with Ronald D. Kent) of INSURANCE BAD FAITH LITIGATION and (with Charles Silver) of PROFESSIONAL RESPONSIBILITIES OF INSURANCE DEFENSE COUNSEL. He has been described as the leading lawyer-commentator on the connections between procedure and insurance. See Charles Silver & Kent Syverud, *The Professional Responsibilities of Insurance Defense Lawyers*, 45 DUKE L.J. 255, 257 n.4 (1995).

Mr. Barker is a member of the American Law Institute and an Adviser to its project on the Restatement (Fourth) of the Law of Liability Insurance.. He is Co-Chair of the Subcommittee on Ethics of the ABA Section of the Litigation Insurance Coverage Litigation Committee and a Vice Chair of the ABA Tort Trial & Insurance Practice Section ("TIPS") Committee on Insurance Coverage Litigation. He is the Liaison from TIPS to the ABA Standing Committee on Ethics & Professional Responsibility and to the ABA Standing Committee on Lawyers' Professional Liability.

## Chapter 14 Rights and Obligations When Policyholder Has Independent Counsel SYNOPSIS

§ 14.01 Scope

§ 14.02 Selection of Independent Counsel

[1] Who Selects?

[2] Who Qualifies for Selection as Independent Counsel?

- [3] Does a Right to Independent Counsel Entitle the Policyholder to Two Lawyers?
- § 14.03 What Rights Do Insurers Have When Dealing with Independent Counsel?
  - [1] Insurers Are Entitled to Advance Consultation About Defense Expenditures and Activities
  - [2] Insurers Are Entitled To Challenge Defense Expenditures and Activities That They Regard as Inappropriate and To Withhold Payment for Costs and Services They Have Not Approved
  - [3] The Montana Supreme Court’s Rejection of Prior Approval Requirements Is Unlikely to Be Applied in an Independent Counsel Context
  - [4] An Insurer Is Entitled to Pay No More Than Market Rates for the Type and Quality of Service Reasonably Necessary to the Defense of the Case
  - [5] An Insurer’s Cost-Minimization Rights May Be Affected if It Breaches the Duty To Defend
    - [a] *Hartford Casualty Insurance Co. v. J.R. Marketing, L.L.C.*
    - [i] The Court of Appeal Decision
    - [ii] The Supreme Court Decision
    - [iii] Analysis
  - [b] *National Union Fire Insurance Co. v. Seagate Technology, Inc.*
- § 14.04 Ethical Obligations of Independent Counsel
  - [1] Overview
  - [2] Obtaining Informed Consent to the Representation
  - [3] Handling Confidential Information and Cooperation with Insurer
    - [a] Providing and Withholding Information
    - [b] Avoiding Waiver and the Common Interest Rule
    - [c] Courts Ought Not To Confuse the Common Interest Rule with the Joint Client Rule
  - [4] Honesty and Avoidance of Fraud
    - [a] Deceptive Statements or Omissions
    - [b] Assisting Fraud
  - [5] Involvement in Policyholder Disputes with the Insurer
    - [a] Disputes Regarding the Representation
    - [b] Disputes Regarding Coverage and Claim Handling
- § 14.05 Can an Insurer Sue Independent Counsel?
  - [1] Lawyers Rarely Have Duties of Care to Non-Clients
  - [2] Some Jurisdictions Allow Insurers to Be Equitably Subrogated to Policyholders’ Malpractice Claims
  - [3] *Great American Excess & Surplus Insurance Co. v. Quintairos, Prieto, Wood & Boyer, P.A.*: Equitable Subrogation, But No More
    - [a] The Case
      - [i] Overview
      - [ii] The Personal Injury Action
      - [iii] The Malpractice Action
    - [A] The Mississippi Court of Appeals Decision
    - [B] The Mississippi Supreme Court Decision
  - [b] A Negligent Misrepresentation Claim Does Not Depend on an Attorney-Client Relationship, but Is Unlikely To Succeed in This Case
    - [c] The Equitable Subrogation Claim Was Properly Allowed
    - [d] The Direct Legal Malpractice Claim Was Properly Precluded
      - [i] Providing an Excess Insurer with Copies of Status Reports and Settlement Evaluations, Standing Alone, Should Not Suffice To Create an Attorney-Client Relationship
      - [ii] Permitting Direct Malpractice Liability Without an Attorney-Client Relationship Would Be Improper Unless Limited in a Way That Would Make It Superfluous
    - [e] Defense Counsel and Primary Insurers Can Protect Against Direct Liability to Others to Whom They Provide Status Reports and Settlement Evaluations by Disclaiming any Undertaking To Provide Legal Services to the Recipients
  - [4] Some Jurisdictions Provide Alternative Claims
  - [5] Independent Counsel Could Request That the Insurer Agree Not To Sue for Malpractice
- § 14.06 Compensation of Independent Counsel After Premature Withdrawal of Carrier’s Defense

\* \* \* \*

## § 14.03 What Rights Do Insurers Have When Dealing with Independent Counsel?

### [1] Insurers Are Entitled to Advance Consultation About Defense Expenditures and Activities

Once counsel has been selected, “[t]he *Cumis* rule requires complete independence of counsel.”<sup>1</sup> (The *Cumis* rule is discussed in §§ 6.03 & 6.05, above.) “*Cumis* counsel represents solely the insured.”<sup>2</sup> Counsel may select defense strategies disadvantageous to the carrier.<sup>3</sup> The insurance contract does not govern the relationship between the insurer and defense counsel. But counsel (especially counsel representing and answerable solely to the policyholder) could injure the policyholder’s coverage by failing to act in accordance with the policyholder’s duties under the policy (*e.g.*, by failing to communicate information the insurer is entitled to receive). At least as long as consulting with the insurer does not entail any substantial risk of harm to the policyholder, counsel’s duties to the policyholder require counsel to engage in such consultation (if requested by the insurer) to avoid any risk of injuring the policyholder’s coverage interests. Moreover, disclosure to the insurer of information relating to the representation is impliedly authorized to the extent necessary to avoid the risk of breaching the insurance policy, as long as disclosure does not endanger any policyholder interests and as long as the policyholder has not directed that such information be kept confidential. (See §§ 10.02 above, 14.04[3] below.)

Again, [California Civil Code § 2860](#) codifies some of these obligations and imposes them directly on defense counsel:

(d) When independent counsel has been selected by the insured, it shall be the duty of that counsel and the insured to disclose to the insurer all information concerning the action except privileged materials relevant to coverage disputes, and timely to inform and consult with the insurer on all matters relating to the action . . . .

In *Hartford Casualty Insurance Co. v. J.R. Marketing, L.L.C.*,<sup>3.1</sup> a concurring opinion noted that that existence of a conflict on some issues

1

CA—*State Farm Fire & Cas. Co. v. Superior Ct.*, 216 Cal. App. 3d 1222, 1226 (1989).  
See also *Mosier v. Southern Cal. Physicians Ins. Exchange*, 63 Cal. App. 4th 1022, 1042 (1998).

2

US/CA—*Emp’rs Ins. Co. of Wausau v. Albert D. Seeno Constr. Co.*, 692 F. Supp. 1150, 1157 (N.D. Cal. 1988);

CA—63 Cal. App. 4th at 1042; *Assurance Co. of America v. Haven*, 32 Cal. App. 4th 78, 87 (1995).

3

NY—*Nelson Elec. Contr. Corp. v. Transcontinental Ins. Co.*, 231 A.D.2d 207 (1997) (subcontractor policyholder did not breach duty of cooperation by having independent counsel forego claim against general contractor which would have reduced carrier’s net liability, but required subcontractor to provide uninsured indemnity to general contractor, on the basis that the best defense strategy was to present a common defense against the injured workers).

3.1

CA—*Hartford Cas. Ins. Co. v. J.R. Marketing, L.L.C.*, 61 Cal. 4th 988 (2015).

does not mean the insurer and insured are entirely at odds. Their interests remain aligned as to third party claims unaffected by the coverage dispute. And even as to the claims implicating that dispute, “[b]oth the insured and the insurer, of course, share a common interest in defeating the claims.” The conflict exists only to the extent that “if liability is found, their interests diverge in establishing the basis for that liability.”<sup>3.2</sup>

The independent counsel scheme created by § 2860, like its counterparts in other jurisdictions, contemplates that “an insurer can reasonably insist that independent counsel fully inform it of factual and legal developments related to the defense, consult with it on defense strategy and tactics, and consult with it before incurring major expenses in the course of the defense.” Indeed, “[t]he insurer’s advice, insight, or suggestions may prove valuable to the insured.”<sup>3.3</sup>

These duties to disclose relevant information and to consult with the insurer seem especially well founded in the insurance contract. While a conflict of interest denies the insurer the right to direct counsel,<sup>4</sup> to receive information prejudicial to the policyholder on the subject of the conflict, and to impede actions beneficial to the policyholder on that issue, it does not eliminate the insurer’s interest in the defense. The insurer still desires the most effective and efficient defense, as the insurer is still obliged to pay defense costs and may be required to pay any judgment or settlement. The policyholder is still bound by the contractual duty of cooperation except insofar as that duty is excused by the conflict. Moreover, the insurer retains the right to settle at its own expense and the right to deny payment of any settlement not approved by it. Exercise of these rights requires full and timely information, so the insurer can consider settlement opportunities and actions that may be necessary to fulfill any duty to the policyholder to accept reasonable settlement demands.

Moreover, the insurer should at least be entitled to make suggestions on defense options and decisions and to have the information necessary to do so. While the policyholder and defense counsel are not bound by any such suggestions, they cannot be harmed and may be helped by receiving them. As Dean Syverud observed with respect to common defense counsel guidelines, “[t]he advance consultation by defense counsel contemplated in the Guidelines is as minimal a form of cooperation as one can imagine.”<sup>5</sup> “As long as the consultations do not reveal confidential information held by the insured that might be used to defeat coverage, allowing the insurer to consult on the defense cannot harm the

<sup>3.2</sup> 61 Cal. 4th at 1012 (Liu, J., concurring).

<sup>3.3</sup> 61 Cal. 4th at 1012 (Liu, J., concurring), quoting (Richmond, *Independent Counsel in Insurance*, 48 SAN DIEGO L. REV. 857, 890 (2011) (footnotes omitted by Justice Liu).

<sup>4</sup> See:

**US/RI**—*Hartford Cas. Ins. Co. v. A & M Assocs., Ltd.*, 200 F. Supp. 2d 84, 90 (D.R.I. 2002) (explaining that the insurer cannot control the litigation);

**WI**—*Jacob v. W. Bend Mut. Ins. Co.*, 203 Wis. 2d 524, 536 (Ct. App. 1996) (explaining that unless the insurer is willing to accept coverage, it has no authority to affect independent counsel’s defense of the insured).

<sup>5</sup> Kent D. Syverud, *The Ethics of Insurer Litigation Management Guidelines and Legal Audits*, 21 No. 7 INS. LITIG. REP. 180, 188 (1999).

insured.”<sup>6</sup>

Consultation is valuable, in and of itself, in achieving an economical defense. Lawyers make money by delivering services. Their incentive is, therefore, to maximize service levels, which is antithetical to minimizing costs. “Even a lawyer who aims to provide only worthwhile defense efforts can subconsciously resolve doubts in favor of doing more, and so earning more.”<sup>7</sup>

Consultation, even without an approval requirement, tends to restrain inefficient efforts:

The lawyer’s evaluation is sharpened by responding to the adjuster’s comments and questions. Consultation also allows the claims staff to consider with counsel whether the effort proposed could safely be postponed, particularly when there is still a possibility of settlement.<sup>8</sup>

In short, consultation is valuable to the insurer and cannot be prejudicial to the policyholder (as long as any confidential information bearing on coverage is withheld from the insurer, as all agree it must be). Moreover, “[t]o the extent that such consultation avoids unnecessary discovery or motion practice, it also benefits the judicial system.”<sup>9</sup>

The Restatement of the Law of Liability Insurance provides such a right to consultation by stating that, when the insured has an independent defense, “[t]he insurer has the right to associate in the defense of the legal action,”<sup>10</sup> just as an excess insurer or other nondefending insurer would have.<sup>11</sup>

Even in a case which most severely restricted the insurer’s use of prior approval requirements, it was conceded that requirements of advance consultation are permissible. At oral argument, Justice Gray had the following exchange with one of Petitioners’ counsel, Robert James:

*Mr. James:* Rule 1.8 is fairly straight forward. A lawyer shall not accept compensation for representing a client from one other than the client unless there is no interference with the lawyers independence of professional judgment. Rule 5.4 is very similar. It essentially says the same thing. A lawyer shall not permit a person who recommends, employs or pays the lawyer to render legal services for another to direct or regulate the lawyer’s professional judgment. When the billing rules say that we need pre-approval to hire experts to conduct research to file a motion, to file pleadings, to engage in trial preparation or to decide how to staff a case we simply can’t agree to do so. Why? Our position is that the plain and ordinary meaning of these ethical rules prohibit us from allowing an insurance company from directing and regulating our judgment to do so. It’s just that simple.

<sup>6</sup>Douglas R. Richmond, *Independent Counsel in Insurance*, 48 *SAN DIEGO L. REV.* 857, 890–91 (2011).

<sup>7</sup>Opinion of Geoffrey C. Hazard, Jr., 15, *In re Ugrin, Alexander, Zadick & Higgins, P.C.*, 299 *Mont.* 321 (2000) (“Hazard Op.”).

<sup>8</sup>Hazard Op. 15; see Hazard Op. at 15–17 (expanding on the point).

<sup>9</sup>Hazard Op. at 4.

<sup>10</sup>RESTATEMENT OF THE LAW OF LIABILITY INSURANCE § 17(4) (Prop. Final Dr. No. 1 Mar. 28, 2017).

<sup>11</sup>See RESTATEMENT § 23(1)(b) (right to associate includes “[a]reasonable opportunity to be consulted regarding major decisions in the defense of the action that is consistent with the insurer’s level of engagement with the defense of the action”).

*Justice Gray:* Counsel, if the billing rules said “consult” instead of “approve,” would they still violate the rules?

*Mr. James:* No, I think that we consult with the insurance company all the time with insurance adjusters and tell them here’s what we think should be done so I think that one of the things that the insurance companies can expect defense counsel to do is to consult with them and find out what our thinking is, why we are thinking [that] and in many cases an adjuster may say let me question you about that. Maybe this isn’t a good thing at this particular time and maybe you will agree or maybe you will disagree.<sup>12</sup>

Advance consultation on substantial expenses may also lead the insurer to settle to avoid that cost or to withdraw its reservation of rights to regain control of the defense. Either of these results would be beneficial to the policyholder.

Were the insurer unaware that independent counsel was representing only the insured, the provision of legal advice to the insurer could result in creation of an attorney-client relationship not intended by the lawyer<sup>13</sup> (and creating the very conflicts that the counsel’s independence was intended to avoid). But that could occur only if the insurer had a reasonable belief that the lawyer was acting on its behalf, and the process by which independent counsel was retained ordinarily should negate any such expectation.<sup>14</sup> Any communication or consultation between independent counsel and the insurer is purely informational.<sup>15</sup> If there is any doubt about the lawyer’s relationship with the insurer, the lawyer should clarify that the insurer is not a client. And, in some jurisdictions, the fact that the lawyer is independent counsel will automatically preclude existence of any attorney-client relationship with the insurer, without regard to the insurer’s belief.<sup>16</sup>

<sup>12</sup>Transcribed from tape of argument.

<sup>13</sup>RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 14 (2000).

<sup>14</sup>*See*

**CA**—*Mosier v. S. Cal. Physicians Ins. Exch.*, 63 Cal. App. 4th 1022, 1043 (1998) (quoting *First Pac. Networks, Inc. v. Atl. Mut. Ins. Co.*, 163 F.R.D. 574, 579 (N.D. Cal. 1995)).

<sup>15</sup>

**CA**—63 Cal. App. 4th at 1043 (quoting *First Pac. Networks, Inc. v. Atl. Mut. Ins. Co.*, 163 F.R.D. 574, 579 (N.D. Cal. 1995)).

*See*

**US/WA**—*Bell Lavalin, Inc. v. Simcoe & Erie Gen. Ins. Co.*, 61 F.3d 742, 748 (9th Cir. 1995) (status reports and confidential information about defense provided by independent counsel do not create any duty of loyalty to insurer).

<sup>16</sup>

**OH**—*Swiss Reinsurance Am. Corp. v. Roetzel & Andress*, 163 Ohio App. 3d 336, at 1525 (2005) (concluding that conflict of interest precluded existence of attorney-client relationship between insurer and lawyer that it hired to defend insured).

## [2] Insurers Are Entitled To Challenge Defense Expenditures and Activities That They Regard as Inappropriate and To Withhold Payment for Costs and Services They Have Not Approved

Even where there is a conflict of interest, an insurance policy is not a blank check, requiring payment by the insurer for whatever work defense counsel chooses to do. An insurer is entitled not to pay for services that are overpriced or inappropriate to the case.<sup>17</sup> The provider of services is not the sole judge of their necessity.<sup>18</sup> Insurers must also be able to review all legal bills, including those submitted by independent counsel, to protect against fraud. For example, they must be able to determine that all services billed were actually performed, that lawyers are not turning expense items into profit centers by tacking surcharges onto them, etc.

So, sooner or later, a representative of the insurer must decide whether particular services are appropriate and should be paid for. A preapproval requirement simply requires that question to be addressed before the services are rendered instead of afterwards.

In other words, the insurer is entitled to challenge defense activities and expenditures it regards as excessive or inappropriate, and do so before they are executed, to the point of warning that it will not voluntarily pay for them. Accordingly, even where the policyholder is represented by independent counsel, insurers are still “entitled to apply billing Guidelines for purposes of obtaining the most effective, professional and efficient defense possible for their insureds.”<sup>19</sup> But, while an insurer is entitled to some time to review and evaluate independent counsel bills that it is asked to pay, unreasonable delay in doing so can constitute a breach of the duty to defend.<sup>19.1</sup>

Of course, the insurer’s refusal to pay does not end the matter. The policyholder can direct counsel to execute the disputed recommendations for expenses or activities, and counsel will be obliged to do so.

<sup>17</sup> See, e.g.,

**CA**—*Center Found. v. Chicago Ins. Co.*, 227 Cal. App. 3d 547 (1991) (challenge to fees of Cumis counsel upheld in case where conflict of interest divests insurer of right to control defense); see also *Caiafa Prof’l Law Corp. v. State Farm Fire & Cas. Co.*, 15 Cal. App. 4th 800 (1993) (same);

*cf.* **OR**—*Village at North Pointe Condo. Ass’n v. Bloedel Constr. Co.*, 278 Or. App. 354, 372 (2016) (while plaintiff was contractually obliged to pay defendant’s fees for the underlying litigation, it was not obliged to pay for insurance coverage litigation).

<sup>18</sup>

**CA**—*Sarchett v. Blue Shield*, 43 Cal. 3d 1, 8–10 (1987) (medical insurance, requiring payment for all “necessary” services; collecting cases from other jurisdictions).

<sup>19</sup> Kent D. Syverud, *The Ethics of Insurer Litigation Management Guidelines and Legal Audits*, 21 No. 7 INS. LITIG. REP. 180, 187 (1999); accord Opinion of Geoffrey C. Hazard, Jr., 3–4, *In re Ugrin, Alexander, Zadick & Higgins, P.C.*, 299 Mont. 321 (2000);

**CA**—*Pepsi-Cola Metro. Bottling Co. v. Ins Co. of N. Am.*, 2010 U.S. Dist. LEXIS 144401, at \*32–34 (C.D. Cal. Dec. 28, 2010) (reduction of payments in accordance with billing guidelines was a permissible method of disputing reasonableness of fees).

<sup>19.1</sup> **CA**—2010 U.S. Dist. LEXIS 144401, at \*21–22.

Either before or after that is done, the policyholder or counsel can seek to collect from the insurer for those expenses or services. If a court or arbitrator finds the expenses or services appropriate, the insurer will have to pay.<sup>20</sup> Otherwise, the policyholder will have to pay, unless the inappropriateness of the expenses or services prevents counsel from collecting from anyone.

In short, neither party may sit as judge in its own case. If disputes cannot be compromised, they must be submitted to an outside adjudicator. Both sides must take account of the likely rulings of such an adjudicator on the facts presented, and disputes are unlikely to be pressed unless the parties have very different predictions about such a ruling.

Outright refusal to pay has significant risks for the insurer. If held to be incorrect, it may be deemed a breach of the duty to defend, freeing the policyholder from policy restrictions on refusal to settle and, in some jurisdictions, even subjecting the insurer to an estoppel to assert coverage defenses.<sup>21</sup> However, a California court has treated payment of independent counsel fees as a form of first-party benefit, meaning that an insurer is not subject to any extracontractual liability for withholding payment of amounts subject to a bona fide dispute.<sup>22</sup> To avoid these risks, an insurer may wish to advance the disputed funds, while reserving the right to seek to recoup them.<sup>23</sup> But the ability to recoup may be problematic where the policyholder is impecunious, and counsel may have defenses to recoupment not available to the policyholder. If recoupment is to be sought, the insurer should either (1) obtain an agreement that the advances will be returned if the insurer prevails in later litigation or (2) seek prompt adjudication of the propriety of the expenses or services in question. Failure to do one or the other may prevent recoupment even if the expenses or services might be found beyond the insurer's obligations to pay.

The Restatement of the Law of Liability Insurance provides that:

In the event of a dispute during the course of the defense about the reasonableness of fees, either party should have the option of paying counsel under protest the difference between what the parties contend to be a reasonable fee, and counsel should have the option of receiving under protest what it regards as only a partial payment, and thereby defer the resolution of the reasonableness of the fees until after the duty to

20

**CA**—A California statute provides for mandatory arbitration of fee disputes with independent counsel. [CAL. CIV. CODE § 2860\(c\)](#). If the policyholder contends that the insurer has breached the policy or acted in bad faith by prolonged delay in responding to the tender of defense, that dispute should be resolved by the court before compelling arbitration of the dispute about the amount of the fees. [Janopaul Block Cos. v. Super. Ct., 200 Cal. App. 4th 1239, 1249–51 \(2011\)](#).

<sup>21</sup> See 3 Jeffrey E. Thomas & Francis J. Mootz, III, *NEW APPLEMAN ON INSURANCE LAW LIBRARY EDITION* §§ 16.03[3][g][iii], 17.02, 20.04[2][b].

<sup>22</sup>

**CA**—[Behnke v. State Farm Gen. Ins. Co., 196 Cal. App. 4th 1443, 1470 \(2011\)](#).

<sup>23</sup>

**CA**—[Buss v. Super. Ct., 16 Cal. 4th 35, 52 \(1997\)](#).

See also William T. Barker & Ronald D. Kent, *NEW APPLEMAN INSURANCE BAD FAITH LITIGATION, SECOND EDITION*, § 2.11.

defend has ended and any coverage defenses have been adjudicated or settled, so as not to invade the attorney-client privilege or work-product immunity.<sup>24</sup>

Nothing in this alternate procedure regarding payment is inconsistent with a right to advance review of proposed defensive actions and to give notice if the insurer intends to dispute fees incurred to take what it regards as unnecessary or inefficient defensive actions.

Apart from the possibility of freeing the policyholder to settle, an unreasonable refusal to pay could be the basis of a bad faith claim, as defense costs are a form of first-party benefit.<sup>25</sup>

### [3] The Montana Supreme Court's Rejection of Prior Approval Requirements Is Unlikely to Be Applied in an Independent Counsel Context

The Montana Supreme Court has held that any requirement of prior approval impermissibly interferes with a lawyer's obligation to exercise independent judgment on behalf of the policyholder.<sup>26</sup> The decision was rendered with respect to ordinary defense counsel, and the concern that motivated it does not justify an extension of the holding to representations in which independent counsel represent policyholders. This is so because independent counsel recommend options to policyholders and follow policyholders' instructions. They do not follow insurers' instructions and, therefore, are not subject to insurers' prior approval. They may learn that an insurer will not willingly pay for a defense-related service they believe should be employed, but they are nonetheless entirely free to recommend the service to the policyholder, to perform it at the policyholder's request, to bill for it, and to help the policyholder sue for reimbursement. Independent counsel thus stands in the same position as any other lawyer whose client has arguable contractual rights against another party which the latter disputes.

The propriety of this conclusion is reinforced by the similarity of the procedure to that approved by the ABA Standing Committee on Ethics for cases in which counsel is not independent.<sup>27</sup> Its Opinion 01-421 assumes that the insurer has directed the lawyer to proceed in a particular way, rather than merely declining to pay for services the lawyer has recommended. Because actual direction of the lawyer creates

<sup>24</sup> RESTATEMENT OF THE LAW OF LIABILITY INSURANCE § 17, cmt. *b* (Prop. Final Dr. No. 1 Mar. 28, 2017).

<sup>25</sup> *E.g.*,

**US/CA**—*Tibbs v. Great Am. Ins. Co.*, 755 F.2d 1370 (9th Cir. 1985);

**CA**—*Continental Casualty Co. v. Royal Ins. Co.*, 219 Cal. App. 3d 111 (1990);

**ND**—*Smith v. Am. Family Mut. Ins. Co.*, 294 N.W.2d 751 (N.D. 1980).

*See also* William T. Barker & Ronald D. Kent, NEW APPLEMAN INSURANCE BAD FAITH LITIGATION, SECOND EDITION, § 3.08[3].

<sup>26</sup>

**MT**—*In re Ugrin, Alexander, Zadick & Higgins, P.C.*, 299 Mont. 321 (2000).

*See also* discussion in § 14.03[1], above.

<sup>27</sup> The procedures approved in ABA Opinion 01-421 for handling particular conflicts in insurance defense representations appear to have been first recommended in Ellen S. Pryor & Charles Silver, *Defense Lawyers' Professional Responsibilities: Part I-Excess Exposure Cases*, 78 TEX. L. REV. 599, 644 (2000). But those procedures are logically implied by the conflicts rules applicable to all representations involving duties to multiple persons.

no insurmountable problem, a mere threat to withhold payment can hardly do so.

Much of the ABA Opinion addresses what the policyholder must be told about a representation in which the insurer expects to exercise a power to direct counsel. No such requirements apply to an independent counsel representation, so they need not be discussed here.

If counsel believes that some insurer decision poses a substantial risk to the policyholder, counsel should point that out to the insurer and request reconsideration. If the insurer will not reconsider, then counsel must inform the policyholder, fully describe the risks and benefits, and inquire whether the policyholder will consent to having counsel proceed on the basis the insurer requests. The Tennessee Bar describes such a consultation as follows:

Counsel should describe the decision and its risks and benefits from the standpoint of the insured. Of course, these will include whatever risks to the insured that counsel believes might result from the compliance. But objection to the insurer's directive would also have risks and therefore, where appropriate, counsel should point out that the insurer might take the position that any unjustified refusal to permit counsel to follow its direction would breach the insurance contract. If the insurer were correct in so contending[,] an objection would endanger the insured's coverage. On the other hand, if the insured permits counsel to follow the insurer's directive, the insured could also reserve the right to hold the insurer responsible for any resulting damage to the insured. (The insurer would be liable if the directive were found to breach its duties under the insurance policy.) The insured should be advised of the utility of obtaining independent counsel, at the insured's own expense, in considering whether to acquiesce in the insurer's directive (perhaps under protest). If the insured acquiesces, after being properly advised, counsel may comply with the insurer's directive.<sup>28</sup>

If the policyholder gives informed consent (perhaps coupled with a declaration of intent to hold the insurer responsible for any resulting injury), then counsel may comply with the insurer's direction. If the policyholder refuses to consent, then counsel cannot proceed in the way the insurer requests. If the insurer will not rescind the disputed decision, counsel must then withdraw. (A request to withdraw will necessarily involve the court, which may resolve any dispute between insurer and policyholder.)

In an independent counsel situation, there will be no possible need for withdrawal and no need to get the insurer's consent for proposed activities or expenses. The lawyer and the policyholder need only discuss whether to assume the risk of nonpayment and the burden of litigating for payment. If the policyholder is willing to advance the necessary funds or if the lawyer is willing to extend credit (possibly on a nonrecourse basis), they may proceed and pursue the insurer later. In the meantime, the insurer remains obligated to continue funding agreed expenses and activities.

While the Montana Supreme Court presumably would reject the ABA analysis, its opinion is both

distinguishable when the problem is presented in an independent counsel context and should be rejected by other courts even where it is not distinguishable. (See § 11.04, above.)

#### [4] An Insurer Is Entitled to Pay No More Than Market Rates for the Type and Quality of Service Reasonably Necessary to the Defense of the Case

In a few states, statutes regulate the fees that insurers must pay independent counsel. Thus, in California,

[t]he insurer's obligation to pay fees to the independent counsel selected by the insured is limited to the rates which are actually paid by the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions in the community where the claim arose or is being defended ... .<sup>29</sup>

Oregon has a special statute requiring independent counsel for environmental claims when an insurer defends under reservation of rights, whether or not there is a conflict of interest. <sup>1</sup> One of the provisions in the statute directs that "[t]he obligation of an insurer to pay fees to independent counsel ... is based on the regular and customary rates for the type and complexity of the environmental claim at issue arose or is being defended."<sup>2</sup>

Absent such a statute, lawyers are still limited to charging fees permissible under the applicable Rules of Professional Conduct. Most such rules are based on ABA Model Rule 1.5:

(a) A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses. The factors to be considered in determining the reasonableness of a fee include the following:

- (1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;
- (2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;
- (3) the fee customarily charged in the locality for similar legal services;
- (4) the amount involved and the results obtained;
- (5) the time limitations imposed by the client or by the circumstances;
- (6) the nature and length of the professional relationship with the client;
- (7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and
- (8) whether the fee is fixed or contingent.<sup>30</sup>

In addition to the limits imposed by the Rules of Professional Conduct, the insurer has a right to have the insured make the selection in accordance with the contractual duty of good faith and fair dealing.

29

**CA**—CAL. CIV. CODE § 2860(c).

*See also*

**AK**—ALASKA STAT. § 21.96.100(d) (similar provision).

<sup>1</sup> OR. REV. STAT. § 465.843(1).

<sup>2</sup> OR. REV. STAT. § 465.843(3)(a).

<sup>30</sup> MODEL RULES OF PROF'L COND., Rule 1.5(a) (2011).

As explained in *Center Foundation v. Chicago Insurance Co.*:<sup>31</sup>

the duty of good faith imposed upon an insured includes the obligation to act reasonably in selecting as independent counsel an attorney qualified to present a meaningful defense and willing to engage in ethical billing practices at a standard stricter than that of the marketplace. Conduct arguably acceptable in the ordinary attorney-client relationship where the latter pays the former from his own pocket is not necessarily appropriate in the tripartite context created when independent counsel undertakes to represent the insured at the expense of the insurer.

Insurers are likely to argue that a reasonable fee for defense services is established by the rates charged by lawyers from whom the insurers regularly purchase similar services. In their view, the cost of defending the insured ought not to be increased by the fortuitous existence of circumstances entitling the insured to independent counsel.

But lawyers not regularly retained by the insurer obliged to pay for independent counsel may resist accepting payment at the rates that the insurer normally pays for similar services. Insurers are able to provide their regular counsel with a volume of work warranting a significant discount in the rates charged for that work. Independent counsel do not receive a similar volume of work. If they have adequate business at rates not affected by such a discount, they have no incentive to accept the discounted rates charged by firms the insurer regularly retains.

If the insurer were obliged to pay no more than its customary discounted rates, a policyholder seeking independent counsel might find it necessary to supplement the insurer's payments to obtain comparable counsel or accept the services of less able (and therefore less expensive) counsel than would normally be retained for the particular case. Accordingly, policyholders would argue that the insurer's customary discounted rates are not adequate or reasonable for independent counsel.

One argument sometimes made in support of limiting the insurer's obligation to payment of its customary rates is that providing a defense by independent counsel is a form of substitute performance where a conflict of interest has rendered the performance contemplated by the contract partially impracticable.<sup>32</sup> One commentator summarizes this argument as follows:

because the conflict does not excuse the insurer's duty to defend, the doctrine of substitute performance should be understood to effectuate the terms of the contract, i.e., the insurance policy, without conferring an advantage on either party. "Substitute performance" should therefore be a minimal variation from the performance originally contemplated. This approach is said to track courts' general recognition that a party injured by a contract breach should receive the benefit of its bargain but never a windfall.

Continuing, substitute performance advocates theorize that courts that allow an insured to select defense counsel and control the defense because of a conflict of interest rendering the insurer's duty to defend impractical are supplying a substitute for the carrier's performance so as to preserve the carrier's remaining contractual obligations. As a

<sup>31</sup> *Center Foundation v. Chicago Insurance Co.*, 278 Cal. Rptr. 13, 21 (Cal. Ct. App. 1991).

<sup>32</sup> See RESTATEMENT (SECOND) OF CONTRACTS § 270 (1981).

substitute for the carrier's duty to defend, it follows that the alternative performance must conform to the original. The insured's defense should not be funded at a level substantially lower than the defense the carrier otherwise would have provided so that the insured receives the benefit of its bargain, but nor should the insured's defense costs substantially exceed those which the carrier would have paid were it in control lest the insured be unjustly enriched. Therefore, the carrier cannot be obligated to pay independent counsel hourly rates greater than those it would pay panel counsel.<sup>33</sup>

This argument has a number of flaws. Most fundamentally, the doctrine of impracticability applies to excuse performance only where "a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made."<sup>34</sup> Nonoccurrence of a conflict of interest can hardly have been a basic assumption by the insurer: existence of conflicts in a significant number of cases and the need to provide a defense despite them is well known to insurers. Moreover, increased expense in performance generally is not considered to render performance even partially impracticable.<sup>35</sup> An insurer drafts the policy, and it could contractually specify limits on the rates payable to independent counsel. If the insurer has failed to include such language, it can hardly claim surprise when it is called upon to pay more than its customary rates to retain independent counsel appropriate to the case. And the insurer is still protected by the limitation of the fees payable to a reasonable amount.<sup>36</sup>

Putting the matter succinctly, "while the substitute performance approach is superficially appealing, it quickly unravels when closely scrutinized."<sup>37</sup>

<sup>33</sup> Douglas R. Richmond, *A Professional Responsibility Perspective on Independent Counsel in Insurance*, 33 No. 1 INSURANCE LITIGATION REPORTER 5, 9 (2011).

<sup>34</sup> RESTATEMENT (SECOND) OF CONTRACTS § 261.

<sup>35</sup> Allan Farnsworth, CONTRACTS § 9.6, at 646 (3d ed. 1999).

*See, e.g.,*

**US**—*Carabetta Enters., Inc. v. United States*, 482 F.3d 1360, 1366 (Fed. Cir. 2007) (finding that increased cost of performance did not make government agency's performance impracticable);

**DC**—*East Capitol View Cmty. Dev. Corp. v. Denean*, 941 A.2d 1036 (D.C. 2008) (noting the rule).

*But see*

**CA**—*Habitat Trust for Wildlife, Inc. v. City of Rancho Cucamonga*, 175 Cal. App. 4th 1306, 1341 (2009) (excessive and unreasonable expense may render performance impracticable).

<sup>36</sup> *See*

**IL**—*Mobil Oil Corp. v. Md. Cas. Co.*, 288 Ill. App. 3d 743, 759 (1997) (approving rate of \$150/hour for independent counsel, even though insurer only paid its own, very experienced attorneys \$94/hour).

<sup>37</sup> Douglas R. Richmond, *A Professional Responsibility Perspective on Independent Counsel in Insurance*, 33 No. 1 INS. LITIG. REP. 5, 10 (2011).

The policy promises the policyholder an adequate and appropriate defense to any suit seeking any relief that, if established, would be covered.<sup>38</sup> This is promised at no cost to the policyholder. To fulfill this promise, the insurer must be obliged to pay independent counsel fees equal to “the prevailing market rates in the relevant community” for the type and quality of services reasonably necessary for the defense of the particular lawsuit.<sup>39</sup> The market rate will typically reflect the factors enumerated in Model Rule 1.5. However, the rate the insurer will be obliged to pay should not exceed the rate which counsel had agreed to accept from the policyholder.<sup>3</sup>

The market rate may or may not be the customary rate charged by the lawyer(s) the insured has chosen to retain, depending on whether it is appropriate to the case:

not all cases are alike. The “novelty and difficulty” of a matter may be either factual or legal. A catastrophic injury, wrongful death, or professional liability case, for instance, is much different from a slip-and-fall or automobile case involving minor injuries. Insurers obligated to engage independent counsel chosen by an insured must acknowledge that the defense of difficult matters generally requires experienced and skilled lawyers and that such lawyers can command greater rates than lawyers who handle relatively minor or simple cases. Fortunately for all concerned, liability insurers, as professional litigants, understand this quite well. Most insurers factor the nature of a case into their defense assignments and they typically have strata of law firms on their panels. Thus, and by way of example, although Firms A and B on an insurer’s

<sup>38</sup>3 JEFFREY E. THOMAS & FRANCIS J. MOOTZ, III, NEW APPLEMAN ON INSURANCE LAW LIBRARY EDITION § 17.01; WILLIAM T. BARKER & RONALD D. KENT, NEW APPLEMAN INSURANCE BAD FAITH LITIGATION, SECOND EDITION, § 3.02[1]–[4].

<sup>39</sup>

**US**—*Blum v. Stenson*, 465 U.S. 886, 900 (1984) (statutory fees under 42 U.S.C. § 1988).  
*See*

**NJ**—*Aquino v. State Farm Ins. Co.*, 349 N.J. Super. 402, 415–16 (App. Div. 2002) (trial court must determine reasonable hourly rate and consider necessity of the work done);

**NY**—*Prashker v. U.S. Guar. Co.*, 1 N.Y.2d 584, 593 (1956) (independent counsel entitled to a reasonable fee);

**OH**—*Socony-Vacuum Oil Co. v. Cont’l Cas. Co.*, 144 Ohio St. 382, 397 (1945) (same);

**WA**—*Nat’l Sur. Corp/ v. Immunex Corp.*, 297 P.3d 688, 695 (Wash. 2013) (same).

*See also* RESTATEMENT OF THE LAW OF LIABILITY INSURANCE § 17, cmt. *b* (Prop. Final Dr. No. 1 Mar. 28, 2017) (“The reasonableness of defense fees in relation to the complexity of the claim and the risks at stake is a fact question. What the insurer usually pays lawyers to defend similar claims is relevant but not dispositive. Law firms regularly retained by an insurer commonly accept reduced rates in return for a good supply of business. A lawyer providing an independent defense should not be required to accept the rates paid to the insurer’s regular defense lawyers, unless the lawyer so regularly accepts other business at those rates that they represent the reasonable value of his or her services. On the other hand, the lawyer’s regular rates or amount of time spend on a matter may be excessive in relation to the complexity of the claim or the amount at stake in the matter.”).

<sup>3</sup> *Northern Sec. Ins. Co. v. R.H. Realty Trust*, 941 N.E.2d 688, 697-98 (Mass. App. Ct. 2010).

panel may receive simple cases to defend at very low hourly rates, Firms C and D are assigned complex matters or large losses, and are compensated at higher hourly rates.<sup>40</sup>

If a policyholder chooses to use more capable attorneys than the case requires, the policyholder may have to pay the extra cost beyond what would be required for less capable, but adequate attorneys. And disputes regarding the required level of capability (and the corresponding reasonable rate) may need to be adjudicated. Pending adjudication, insurer, policyholder, and lawyers need to have some agreement on payment of fees as the litigation proceeds.

Even if the carrier has breached the duty to defend, the policyholder has the burden of proving that the rate demanded is reasonable.<sup>4</sup>

## [5] An Insurer's Cost-Minimization Rights May Be Affected if It Breaches the Duty To Defend

### [a] *Hartford Casualty Insurance Co. v. J.R. Marketing, L.L.C.*

#### [i] The Court of Appeal Decision

In *Hartford Casualty Insurance Co. v. J.R. Marketing, L.L.C.*,<sup>41</sup> a California court held that an insurer that had breached the duty to defend and had been required to pay its insured's independent counsel could not seek to recover from defense counsel the amount by which those fees were allegedly excessive. The California Supreme Court granted review and reversed,<sup>41.1</sup> depriving the court of appeal opinion of precedential weight. The description of that opinion is retained to identify and illuminate issues not addressed by the supreme court and as background for the supreme court's decision.

Hartford issued policies to J.R. Marketing, L.L.C. and Noble Locks Enterprises, Inc. Certain suits were tendered to Hartford for defense. Hartford initially refused a defense, but (after the policyholders filed suit) ultimately provided a defense under reservation; it refused to provide independent counsel. The trial court held that Hartford was obliged to provide independent counsel. It ordered Hartford to pay bills within 30 days of receipt, subject to a right to seek recovery of allegedly excessive or unnecessary amounts after resolution of the underlying action. However, it also held that, because of its prior breaches of the duty to defend, Hartford could not invoke the limits on hourly rates imposed by § 2860 of the [California Civil Code](#).<sup>42</sup> Squire Sanders was retained as independent counsel.

After the underlying matter was resolved, the policyholders submitted legal bills totalling over \$15 million, which Hartford paid and then filed a new action seeking recovery of allegedly excessive charges and charges for allegedly unnecessary services. Squire Sanders demurred to the complaint,

<sup>40</sup>Douglas R. Richmond, *Independent Counsel in Insurance*, 48 [SAN DIEGO L. REV.](#) 857, 885 (2011) (footnotes omitted).

<sup>4</sup> *Liberty Mut. Ins. Co. v. Cont'l Cas. Co.*, 771 F.2d 579, 582 (1<sup>st</sup> Cir. 1985) (MA law).

<sup>41</sup>

CA—*Hartford Cas. Ins. Co. v. J.R. Marketing, L.L.C.*, 216 Cal. App. 4th 1444 (2013), *rev'd in part*, 61 Cal. 4th 988 (2015).

<sup>41.1</sup> CA—*Hartford Cas. Ins. Co. v. J.R. Marketing, L.L.C.*, 61 Cal. 4th 988 (2015).

<sup>42</sup>

CA—216 Cal. App. 4th at 1448–51.

challenging Hartford’s claimed right to recover allegedly unjust enrichment resulting from payment of the disputed charges, and the superior court sustained the demurrer. (It denied demurrers filed by the policyholders.)<sup>43</sup> The court of appeal affirmed.

Reiterating conclusions it had reached in a prior, unpublished decision, it first stated that the billing rate limitations and arbitration right provided by § 2860

come with an important caveat. “ [T]o take advantage of the provisions of [section] 2860, an insurer must meet its duty to defend and accept tender of the insured’s defense, subject to a reservation of rights.’ ” When, to the contrary, the insurer fails to meet its duty to defend and accept tender, the insurer forfeits the protections of section 2860, including its statutory limitations on independent counsel’s fee rates and resolution of fee disputes. More generally, “[w]hen an insurer wrongfully refuses to defend, the insured is relieved of his or her obligation to allow the insurer to manage the litigation and may proceed in whatever manner is deemed appropriate.”<sup>44</sup>

Because Hartford had refused the tender of defense, the court held that it was not entitled to the protections of § 2860.<sup>45</sup>

The court also recognized that Hartford had a right, after the underlying case was concluded to seek reimbursement of any defense expenditures solely allocable to noncovered claims.<sup>46</sup> However, that right is based on the law of unjust enrichment—a right that runs only against a party who has been unjustly enriched. In the court’s view, the right to independent counsel

“envisions an attorney pursuing an insured’s defense independently of the insurer rather than intertwined with it.” Thus, under this scheme, where, as here, the insurer breaches its duty to defend the insured, the insurer loses all right to control the defense, including, necessarily, the right to control financial decisions such as the rate paid to independent counsel or the cost-effectiveness of any particular defense tactic or approach. Retroactively imposing the insurer’s choice of fee arrangement for the defense of the insured by means of a post-resolution quasi-contractual suit for reimbursement against the insured’s separate counsel, such as Hartford seeks to pursue here against Squire, runs counter to

43

CA—216 Cal. App. 4th at 1452.  
44

CA—216 Cal. App. 4th at 1454–55 (citations omitted).  
45

CA—216 Cal. App. 4th at 1455.  
46

CA—216 Cal. App. 4th at 1455, *following* *Buss v. Superior Court*, 16 Cal. 4th 35, 50 (1997).

these *Cumis*-scheme principles . . . .<sup>47</sup>

In addition to undercutting the policyholder’s right to control the defense, allowing an independent suit against defense counsel would expand the insurer’s dispute resolution rights as a result of its breach of its duty to defend. Had the breach not rendered § 2860 inapplicable, the insurer would be limited to proceeding in arbitration, and ought not to obtain the right to litigate as one fruit of its breach.<sup>48</sup> Moreover, Squire Sanders had not conferred a benefit primarily on Hartford, but rather on its (insured) clients. If they agreed to the payment of excessive or noncovered amounts, it is to them (rather than the law firm) that Hartford should look for reimbursement.<sup>49</sup>

### [ii] The Supreme Court Decision

The California Supreme Court narrowly defined the issue it had agreed to review: from whom may a CGL insurer seek reimbursement when (1) the insurer initially refused to defend its insured against a third party lawsuit; (2) compelled by a court order, the insurer subsequently provided independent counsel under a reservation of rights—so-called *Cumis* counsel—to defend its insured in the third party suit; (3) the court order required the insurer to pay all “reasonable and necessary defense costs,” but expressly preserved the insurer’s right to later challenge and recover payments for “unreasonable and unnecessary” charges by counsel; and (4) the insurer now alleges that independent counsel “padded” their bills by charging fees that were, in part, excessive, unreasonable, and unnecessary?<sup>49.1</sup>

47

CA—216 Cal. App. 4th at 1457–58 (citations and footnote omitted).

<sup>48</sup>On this point, the opinion is a little schizophrenic: it had just correctly held the right to arbitrate to be a benefit to the carrier, which benefit was forfeited by breach of the duty to defend. Now it treats the right to litigate as a benefit which ought not to be acquired by breaching the duty to defend. More realistically, litigation is the inferior option remaining if the right to arbitrate has been lost.

49

CA—216 Cal. App. 4th at 1458–60.

<sup>49.1</sup>CA—61 Cal. 4th at 992 (citations omitted). The court identified three questions that it did not decide:

the trial court’s 2006 enforcement order, requiring Hartford to promptly pay *Cumis* counsel’s bills, specified that Hartford “is . . . not permitted to take advantage of Section 2860.” Nevertheless, the order stated that counsel’s bills “still must be necessary and reasonable” and that, “[t]o the extent Hartford seeks to challenge fees and costs as unreasonable or unnecessary, *it may do so* by way of reimbursement after resolution of the [Marin County action].” (Italics added.) In light of the 2006 enforcement order’s express provision authorizing Hartford to seek reimbursement for excessive fees, we need not and do not decide here whether, absent such an order, an insurer that breaches its defense obligations has *any* right to recover excessive fees it paid *Cumis* counsel.

Next, section 2860 specifies that disputes concerning the fees charged by *Cumis* counsel are to be resolved by final and binding arbitration. In

It summarized its conclusion as follows:

We conclude that under the circumstances of this case, the insurer may seek reimbursement directly from *Cumis* counsel. If *Cumis* counsel, operating under a court order that expressly provided that the insurer would be able to recover payments of excessive fees, sought and received from the insurer payment for time and costs that were fraudulent, or were otherwise manifestly and objectively useless and wasteful when incurred, *Cumis* counsel have been unjustly enriched at the insurer's expense. *Cumis* counsel provide no convincing reason why they should be absolutely immune from liability for enriching themselves in this fashion. Alternatively, *Cumis* counsel fail to persuade that any financial responsibility for their excessive billing should fall first on their own clients—insureds who paid to receive a defense of potentially covered claims, not to face additional rounds of litigation and possible monetary exposure for the acts of their lawyers.<sup>49.2</sup>

The court reasoned that if

Squire Sanders's bills were objectively unreasonable and unnecessary to the insured's defense in the underlying litigation and that they were not incurred for the benefit of the insured, principles of restitution and unjust enrichment dictate that Squire Sanders should be directly responsible for reimbursing Hartford for counsel's excessive legal bills.<sup>49.3</sup>

Squire Sanders argued that it was only an incidental beneficiary of Hartford's performance of a preexisting contractual obligation. But Hartford did not simply perform its contractual obligation. That obligation was limited both by the 2006 enforcement order and by the rules of professional conduct to payment of reasonable costs. Nor did Hartford voluntarily pay the amounts billed, but did so under compulsion of court order. These facts negated any claim that any benefit to Squire Sanders was incidental.<sup>49.4</sup>

contrast, the 2006 enforcement order provided that any dispute over allegedly excessive fees would be addressed in a court action. Because the 2006 enforcement order is final and not subject to our review, and because Squire Sanders has raised no issue about the effect of section 2860's arbitration provision on the current litigation, we do not decide whether, in general, a dispute over allegedly excessive fees is more appropriately decided through a court action or an arbitration.

Finally, because the 2006 enforcement order expressly stated that resolution of any fee dispute would take place *after* the underlying litigation concluded, we do not decide *when* such fee disputes generally ought to be decided relative to the underlying litigation. [61 Cal. 4th at 997 n.7]

<sup>49.2</sup> CA—61 Cal. 4th at 992–93.

<sup>49.3</sup> CA—61 Cal. 4th at 999.

<sup>49.4</sup> CA—61 Cal. 4th at 1000–01.

Squire Sanders also urged that allowing a claim for restitution against defense counsel would frustrate public policy by unduly interfering with the insured’s attorney-client privilege and its absolute right to direct independent counsel’s defense. The court again disagreed: “Although *Cumis* counsel must indeed retain the necessary independence to make reasonable choices when representing their clients, such independence is not inconsistent with an obligation of counsel to justify their fees.”<sup>49.5</sup> Moreover, the governing statute specifically requires *Cumis* counsel to justify their fees, albeit in arbitration, rather than litigation.<sup>49.6</sup> Squire Sanders argued that the arbitration process was “more collaborative,” but the court noted there is an inherent degree of tension in any dispute resolution process and concluded that it “fail[ed] to see how the degree of tension in the relationship between Hartford and the insureds in this case—even if purportedly higher than in cases where section 2860 is triggered—meaningfully heightens any threat to *Cumis* counsel’s independence.”<sup>49.7</sup>

Squire Sanders also contended that section 2860 arbitration was less disruptive because it provides for contemporaneous resolution of fee disputes as they arise during the course of the underlying lawsuit against the insureds. Squire Sanders asserts that contemporaneous proceedings intrude less on counsel’s independence than after-the-fact litigation, because a contemporaneous proceeding provides “real-time guidance to counsel about which activities [they] may undertake,” without raising the concern that counsel will “hav[e] the rug pulled out from under [them] years after the fact by the insurer.”<sup>49.8</sup>

The court found this point “speculative at best.”<sup>49.9</sup> The statute does not dictate timing, and defense counsel might prefer to delay addressing billing issues, “insofar as this would allow counsel to devote their full attention to the insureds’ defense while the third party suit is in progress, rather than becoming embroiled in side arguments with the insurer over fees.”<sup>49.10</sup> But there was no need to resolve timing issues, because those were dictated here by the enforcement order, drafted by Squire Sanders and upheld on a prior appeal.<sup>49.11</sup>

Squire Sanders argued that the insured had exclusive authority to monitor and control counsel’s expenditures and that it should bear the responsibility for any failure to do so, subject to a right of indemnity from counsel. The court rejected this argument because it all but ignores the realities of cases like the one before us. Squire Sanders acknowledges that the insureds in this case were not sophisticated, frequent litigators accustomed to monitoring their counsel’s day-to-day litigation decisions. Having contracted with Hartford, and having paid premiums, to be spared the fees and expenses of their defense, there is no indication that the insureds had reasonable cause to expect that they would nonetheless face exposure if Squire Sanders submitted

<sup>49.5</sup> CA—61 Cal. 4th at 1002.

<sup>49.6</sup> CA—61 Cal. 4th at 1002–03.

<sup>49.7</sup> CA—61 Cal. 4th at 1004.

<sup>49.8</sup> CA—61 Cal. 4th at 1004.

<sup>49.9</sup> CA—61 Cal. 4th at 1004.

<sup>49.10</sup> CA—61 Cal. 4th at 1004.

<sup>49.11</sup> CA—61 Cal. 4th at 1004.

unreasonable and excessive bills to Hartford. Nor is there any indication the insureds expected that they would have to mount and finance a separate litigation against their own counsel in order to have any hope of recovering the funds they were ordered to pay to the insurer as a result of counsel's unreasonable billing. Such a circuitous, complex, and expensive procedure serves neither fairness nor any other policy interest. We see no persuasive ground to hold that any direct liability to Hartford for bill padding by Squire Sanders must fall solely on the insureds.<sup>49.12</sup>

Squire Sanders also expressed the fear that if its client refused to waive attorney-client privilege, it might be unable to defend against Hartford's claim for fees. But there was no concrete indication that this would be necessary and, in any event,

an objective assessment of the litigation as a whole to determine whether counsel's bills appear fundamentally reasonable is unlikely to involve an examination of individual attorney-client communications or the minute details of every litigation decision. If privileged information on these subjects is included in counsel's billing records, it can be redacted for purposes of assessing whether counsel's bills are reasonable. Trial courts are accustomed to dealing with claims of attorney-client privilege in a manner that balances the competing interests of the parties, and can thus presumably address any privilege issues that arise on a case-by-case basis.<sup>49.13</sup>

Justice Liu, in a concurring opinion, pointed out that there remained a significant issue as to the division of any liability to Hartford between Squire Sanders and J.R. Marketing. While the court assumed (in accordance with Hartford's allegations) that any unreasonable fees or unnecessary services conferred no benefit on J.R. Marketing, Squire Sanders was free to contest this assumption on remand. To the extent that any such fees or services were incurred for the benefit of J.R. Marketing,

such fees necessarily fall outside the scope of today's holding. For that holding is premised on the dual assumptions "that Squire Sanders's bills *were* objectively unreasonable and unnecessary to the insured's defense in the underlying litigation *and* that they were not incurred for the benefit of the insured." On remand, it will be Hartford's burden to show not only that the fees it seeks to recover from Squire Sanders were not "*objectively reasonable at the time they were incurred*, under the circumstances then known to counsel" but also that the fees were not incurred for J.R. Marketing's benefit. If Squire Sanders's fees were unreasonable but incurred primarily for J.R. Marketing's benefit, Hartford's reimbursement action should lie against J.R. Marketing, not Squire Sanders.<sup>49.14</sup>

### [iii] Analysis

Looking at the case solely in terms of the issue defined by the supreme court, the decision seems correct. If the fees were really so unreasonable that charging them would have been a violation of the California Rules of Professional Conduct, then Squire Sanders was unjustly enriched to the extent that the

<sup>49.12</sup> CA—61 Cal. 4th at 1005.

<sup>49.13</sup> CA—61 Cal. 4th at 1005–06 (citations omitted).

<sup>49.14</sup> CA—61 Cal. 4th at 1010 (concurring op.).

fees exceeded the largest permissible charge. That would be equally true if the charges were “fraudulent” or the bills “padded” with clearly unnecessary work.

But an insurer’s right to pay only reasonable charges is not merely a right not to pay amounts that counsel could not lawfully charge. It is a right to pay no more than the market rate for services reasonably necessary to the proper defense of the case. (See § 14.03[4], above.)

Insofar as the fees at stake were potentially lawful charges for services requested by or beneficial to J.R. Marketing, the court of appeal’s result seems largely correct, though some of the court’s reasoning is questionable. The policyholders presumably agreed to pay the rates charged by the law firm. By doing so, they incurred a valid debt to the law firm when it rendered service to them, even if adequate service could have been obtained from a less expensive firm, unless the rates were so exorbitant that it was unethical to charge them. Thus, at least with respect to the rates charged, the law firm was not unjustly enriched by Hartford’s payment.

The Restatement (Third) of Restitution and Unjust Enrichment provides that “[e]ven if the claimant has conferred a benefit that results in the unjust enrichment of the recipient when viewed in isolation, the recipient may defend by showing that some or all of the benefit conferred did not unjustly enrich the recipient when the challenged transaction is viewed in the context of the parties’ further obligations to each other.”<sup>50</sup> An illustration of that rule is that

A owes B \$ 5,000. Intending to pay C, another creditor, A sends \$ 5,000 to B who accepts the payment despite notice of A’s mistake. (B’s notice of A’s mistake means that B is not entitled to defend as a bona fide payee by the rule of § 67.) A has a prima facie claim to restitution of the mistaken payment (§ 6), but B is not unjustly enriched by A’s unintended payment of a valid debt. B is not liable to A in restitution.<sup>51</sup>

While the payment to the law firm in this case was compelled (by the order to pay), the law firm was still not, as to the rates charged, unjustly enriched. Even as to possibly unnecessary work, if the policyholders approved it, it also might have created a valid debt of the policyholder, precluding unjust enrichment of the law firm. While a more refined analysis would have been desirable, the result seems at least approximately correct.

Insofar as the court of appeal’s reasoning suggests that the policyholders had unfettered freedom to approve law firm rates or the cost-effectiveness of particular work, that is inconsistent with the policyholders’ own duty of good faith, as discussed in § 14.03[4] above. The duty of good faith is not dependent on the other party’s performance of its own contractual obligations.<sup>52</sup> Even if the carrier has breached the duty to defend, the policyholder is obliged to reasonably manage defense costs. The policyholder alone is liable for any excessive amounts it agreed to pay and it would be unjustly enriched if the carrier instead had been required to pay such amounts without reimbursement.

<sup>50</sup> RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 62 (2011).

<sup>51</sup> RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 62, Illus. 2.

<sup>52</sup>

CA—Gruenberg v. Aetna Ins. Co, 9 Cal. 3d 566, 578 (1973).

**[b] *National Union Fire Insurance Co. v. Seagate Technology, Inc.***

*National Union Fire Insurance Co. v. Seagate Technology, Inc.*<sup>53</sup> was a high stakes dispute over application of the principle that an insurer that wrongfully denies coverage cannot rely on the limitation of independent counsel rates provided by [Section 2860 of the California Civil Code](#). Seagate was sued in 2000 by Convolve, Inc. and the Massachusetts Institute of Technology for patent infringement. National Union and certain of its affiliates (collectively, AIG) insured Seagate. AIG initially refused the tender of defense, but began paying for independent counsel (at § 2860 rates) in 2003. In 2004, AIG sought a declaration that it had no duty to defend. In 2007, the district court ruled that a duty to defend had arisen on November 1, 2001, but terminated on July 18, 2007. Seagate appealed, but AIG withdrew the defense. In 2012, the Ninth Circuit held that the duty to defend had not terminated. As a result, the question arose whether AIG was required to pay the full rates charged by Seagate’s counsel after it withdrew the defense, or only § 2860 rates. This was said to be a \$20 million question.<sup>54</sup>

As the court saw it, everything turned on whether, after the ruling that the duty to defend had terminated, AIG had “wrongfully” withdrawn its defense.<sup>55</sup> The court relied on general principles regarding the finality of judgments:

In the ordinary case, the duty to defend terminates upon a judicial determination that the insured does not have a potentially-covered claim. The decision granting summary judgment became such a judicial determination when judgment was entered under Rule 54(b). The entry of judgment created a final order with res judicata effect. It is a “basic proposition that all orders and judgments of courts must be complied with promptly. If a [defendant] believes that order is incorrect the remedy is to appeal, but, absent a stay, he must comply promptly with the order pending appeal.”<sup>56</sup>

Seagate had appealed but had not sought a stay. “As a result, NIU was entitled to the benefit of the (erroneous) ruling that there was no longer a duty to defend.”<sup>57</sup> The court also found persuasive an unpublished Fourth Circuit opinion concluding that withdrawal of a defense in a similar situation was not unjustified under North Carolina law:

53

US/CA—[Nat’l Union Fire Ins. Co. v. Seagate Tech., Inc., 2013 U.S. Dist. LEXIS 10502 \(N.D. Cal. Jan. 25, 2013\)](#).

54

US/CA—[2013 U.S. Dist. LEXIS 10502, at \\*2–4](#); [Nat’l Union Fire Ins. Co. v. Seagate Tech., Inc., 2013 U.S. Dist. LEXIS 89242, at \\*3–5](#). Some of the issues in the case turned on the distinctions among the companies, but those can be disregarded for purposes of the point discussed here.

55

US/CA—[2013 U.S. Dist. LEXIS 10502, at \\*13–14](#).

56

US/CA—[2013 U.S. Dist. LEXIS 10502, at \\*5](#) (citations omitted).

57

US/CA—[2013 U.S. Dist. LEXIS 10502, at \\*5–6](#).

“it would tip the balance too far in favor of the insured to hold that an insurer must wait for all appeals of a declaratory judgment (relieving it of a duty to defend) to be exhausted before removing its defense of the insured. The fact that the insurer provided a defense for the insured until the time the insurer received a declaratory judgment Order demonstrates to this Court that the insurer adhered to the spirit of the public policy requiring defense of insured persons.”<sup>58</sup>

Following reversal, AIG’s contractual responsibilities were “reinstated retroactively.”<sup>59</sup> In the court’s view, “During the pendency of the appeals, Seagate should have been aware that it was retaining expensive counsel at a risk to itself. If Seagate had wanted to change this calculus, it should have made a motion for stay pending appeal.”<sup>60</sup>

Putting aside the issue of what effect should be given to the judgment, prior to its reversal, there is some equitable appeal to Seagate’s position on the particular facts in that case. Had AIG continued to fund the defense, California law would have permitted it to reserve the right to recover amounts expended on a defense it was not obligated to provide.<sup>61</sup> Seagate was the rare insured who could be relied upon to reimburse a multimillion defense bill, should it be found that no defense was due. In that situation, the issue was only who should have to advance costs during the pendency of the appeal. But one cannot base a rule of law on the exceptional ability of one insured to provide reimbursement for benefits not due.

This decision will surely be appealed, unless the parties settle. How it will fare on appeal is hard to predict.

## § 14.04 Ethical Obligations of Independent Counsel

### [1] Overview

There is a vast amount of literature on the ethical obligations and problems of lawyers defending policyholders on behalf of insurers. There is a smaller, but still substantial amount of literature dealing with whether and when a policyholder is entitled to independent counsel. There is very little published writing addressing the ethical obligations and problems of lawyers serving as independent counsel for policyholders.<sup>1</sup> Of course, those duties include all of the usual duties of a lawyer retained by the

58

US/CA—2013 U.S. Dist. LEXIS 10502, at \*7, quoting *Auto-Owners Insurance Co. v. Potter*, 242 F. App’x 94, 101 (4th Cir. 2007),  
59

US/CA—2013 U.S. Dist. LEXIS 10502, at \*7.  
60

US/CA—2013 U.S. Dist. LEXIS 10502, at \*14.  
61

US/CA—*Buss v. Super. Ct.*, 16 Cal. 4th 35, 46–53 (1997).

<sup>1</sup>The only substantial treatments known to us are James M. Fischer, *The Professional Obligations of Cumis Counsel Retained for the Policyholder but not Subject to Insurer Control*, 43 TORT TRIAL & INS. PRAC. L.J. 173 (2008), and Douglas R. Richmond, *A Professional Responsibility Perspective on Independent Counsel in Insurance*, 33 No. 1 INS. LITIG. REP. 5 (2011). Our own thinking on these issues has benefited from those articles.

policyholder to defend a suit. But independent counsel do have their own special ethical issues, which deserve our attention. Some of these issues, notably regarding fees and consultation with the insurer are addressed in § 14.03 above, with particular attention to the interaction of the lawyer's duties and the insurance law duties of the policyholder. Insurance law has a primary role in those issues, with lawyer duties a secondary consideration. This section addresses issues where lawyer duties come to the fore and insurance law plays a secondary role.

## [2] Obtaining Informed Consent to the Representation

A key feature of independent counsel is that the lawyer is paid by the insurer, even though the policyholder is the lawyer's sole client. Such third-party payment implicates Model Rule 1.8(f):

A lawyer shall not accept compensation for representing a client from one other than the client unless:

- (1) the client gives informed consent;
- (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and
- (3) information relating to representation of a client is protected as required by Rule 1.6.<sup>2</sup>

Looking first to the requirement of "informed consent," the Model Rules define that as "the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct."<sup>3</sup> (See also § 9.03, above.) It is not necessary to "inform a client ... of facts or implications already known to the client ... ; nevertheless, a lawyer who does not personally inform the client ... assumes the risk that the client ... is inadequately informed and the consent is invalid."

Thus, while the process by which independent counsel was provided and selected will often have informed the policyholder about some aspects of independent counsel's representation, it is wise for independent counsel to discuss the terms of that representation and some of the problems it can present at the outset and to have that consent and the underlying advice confirmed in writing. Of particular importance are any facts which might raise questions as to counsel's independence of the insurer, such as representations of the insurer or its affiliates in other matters. (See § 6.05[15] above.) Such facts might cause the policyholder to look elsewhere for counsel, if the policyholder makes the selection, or to object to the insurer's selection, if the insurer makes the selection.

The policyholder should understand any significant limitations on the scope of the representation and some important aspects of the way in which the representation will be conducted. The policyholder should be informed of the extent to which the insurer will be consulted in defense planning and the general nature of the problems that can arise if the insurer disagrees with the defensive activities proposed by counsel. (See § 14.03[1]–[2] above.) This information could affect the ways in which the policyholder chooses to be involved in defense planning, even where no dispute has yet arisen. The policyholder should be informed of the arrangements with the insurer regarding payment of fees or the need to negotiate such arrangements, and of any possibility that the policyholder might have to pay or advance some portion of the fees. (See § 14.03[2]&[4] above.) The policyholder should be informed of the extent to which confidential information will be shared with or withheld from the insurer and of the problems

<sup>2</sup>MODEL RULES OF PROF'L COND. Rule 1.8(f) (2011). *See also* Rule 5.4(c) ("A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.").

<sup>3</sup>Model Rule 1.0(e).

that can arise from such sharing or withholding. (See §§ 14.03[1] above and 14.04[3] below.)

In an independent counsel situation, the insurer will have no right to control the defense, so counsel's independence of judgment would seem assured. But the fee arrangement (or any collateral relationship with the insurer) may provide incentives that could affect counsel's judgment. If so, these must be explained.

### [3] Handling Confidential Information and Cooperation with Insurer

#### [a] Providing and Withholding Information

As in all representations, information relating to the representation must be kept confidential, as provided in Model Rule 1.6.<sup>4</sup> However, disclosure of such information may be impliedly authorized if useful to the representation, not injurious to the interests of the policyholder, and not forbidden by the policyholder. (See § 10.01, above (discussing confidentiality in representations by assigned counsel).)

Disclosure is useful to the representation if necessary to comply with the policyholder's duty of cooperation, thereby preserving the policyholder's coverage. (See § 14.03[1] above.) Even if disclosure may not be necessary to comply with the policyholder's duty of cooperation, it may be useful if it avoids a risk that the duty might be breached. Disclosure may also be useful if it will help persuade the insurer to take or authorize some action favored by the policyholder (such as settling the case).

Disclosure would be injurious to the policyholder's interests if it would assist the insurer in disputing coverage, so coverage sensitive information must be kept from the insurer unless the policyholder gives informed consent to disclosure.<sup>5</sup> (If defense counsel is not a coverage lawyer, it may be necessary to obtain coverage advice to determine what information is or is not coverage sensitive.) Disclosure may also be injurious to other interests of the policyholder, such as interests in reputation. And, of course, the policyholder may forbid disclosure of certain information even if not otherwise injurious to the policyholder.

If information to be withheld is not coverage sensitive, withholding it might breach the policyholder's duty of cooperation. The policyholder should be advised of this risk. If defense counsel is not able to evaluate that risk, the policyholder should be warned of it and advised to consult other counsel if evaluation is desired. (See § 9.02[5] & [7], above.)

#### [b] Avoiding Waiver and the Common Interest Rule

But counsel must also beware of the risk of waiving privilege for information communicated to the carrier. Voluntary disclosure of privileged information to a nonprivileged person can waive the privilege.<sup>6</sup> Because the carrier shares common interests with the policyholder in defeating or minimizing the claim, it might be thought that information could be shared without risk of waiver under a common

<sup>4</sup>MODEL RULES OF PROF'L COND. Rule 1.6 (ABA 2011).

<sup>5</sup>

**IL**—Illinois law is exceptional on this issue, taking the view that the insurer and policyholder are persons of common interest on all aspects of a defense representation, even where there is a coverage dispute and the policyholder is represented by independent counsel. *Waste Management, Inc. v. International Surplus Lines Ins. Co.*, 144 Ill. 2d 178, 194 (1991). Where this rule applies, the policyholder must be warned. As a practical matter, this results in an exception to what would otherwise be the applicable attorney-client privilege. Independent counsel subject to this rule should still not make disclosures of material damaging to the policyholder's interests without a court order to do so.

<sup>6</sup>RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 79 (2000).

interest arrangement.<sup>7</sup> But the exception to the waiver rule permitting sharing of information among persons of common interest has an additional requirement that is often overlooked: each party to the common-interest arrangement must be represented by a lawyer.

The rejected Federal Rule of Evidence 503 on attorney-client privilege formulated the common-interest rule as one permitting sharing between lawyers: the privilege extends to communications “by [the client] or his lawyer *to a lawyer representing another* in a matter of common interest.”<sup>8</sup> While that rule never took effect, federal courts often look to it as a succinct statement of the common law that Rule 501 of the Federal Rules of Evidence makes authoritative in cases where federal law provides the rules of decision.<sup>9</sup> The Third Circuit has explained the basis and evolution of the rule:

Recognizing that it is often preferable for co-defendants represented by different attorneys in criminal proceedings to coordinate their defense, courts developed the joint-defense privilege. In its original form, it allowed the attorneys of criminal co-defendants to share confidential information about defense strategies without waiving the privilege as against third parties. Moreover, one co-defendant could not waive the privilege that attached to the shared information without the consent of all others. Later, courts replaced the joint-defense privilege, which only applied to criminal co-defendants, with a broader one that protects all communications shared within a proper “community of interest,” whether the context be criminal or civil. Thus, the community-of-interest privilege allows attorneys representing different clients with similar legal interests to share information without having to disclose it to others. It applies in civil and criminal litigation, and even in purely transactional contexts.<sup>10</sup>

But, as implied by the statement in Rejected Rule 503, one noteworthy feature of the resulting rule is that “to be eligible for continued protection, the communication must be shared with the attorney of the member of the community of interest.”<sup>11</sup> The Restatement’s formulation of the common-interest rule also imposes this requirement: “If two or more clients with a common interest in a litigated or nonlitigated matter *are represented by separate lawyers* and they agree to exchange information concerning the matter, a communication of any such client that otherwise qualifies as privileged ... that relates to the matter is privileged as against third persons.”<sup>12</sup> As a result, “[a] person who is not represented by a lawyer and who is not himself or herself a lawyer cannot participate in a common-interest arrangement.”<sup>13</sup>

<sup>7</sup> RESTATEMENT § 76.

<sup>8</sup> Rule 503(b)(3), reprinted in 3 Joseph M. McLaughlin, WEINSTEIN’S FEDERAL EVIDENCE, SECOND EDITION § 503 (emphasis added).

<sup>9</sup> 3 Joseph M. McLaughlin, WEINSTEIN’S FEDERAL EVIDENCE, SECOND EDITION § 501.02[1][c].

<sup>10</sup>

US—Teleglobe Communs. Corp. v. BCE, Inc. (In re Teleglobe Communs. Corp.), 493 F.3d 345, 36364 (3rd Cir. 2007).

<sup>11</sup>

US—493 F.3d at 364.

<sup>12</sup> RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 79 (2000) (emphasis added).

<sup>13</sup> RESTATEMENT § 79, cmt. d.

In 2012, the Texas Supreme Court applied the requirement that each party have counsel to deny privilege in a case where counsel for a workers compensation carrier had shared reports to the carrier with the employer, who was interested because payments under the policy were subject to a deductible of \$1 million per claim.<sup>14</sup> Under Texas law, the carrier alone was liable, and the employer was not a party to the proceeding.<sup>15</sup> There is no insurer-insured privilege, though communications between the two relating to liability insurance claims may sometimes be covered by the attorney-client privilege.<sup>16</sup> Because the employer was not represented by counsel regarding the matter, the communications could not be protected from waiver by the common-interest exception (which the Texas court dubbed the “allied litigant doctrine”).<sup>17</sup> Nor was the employer a joint client.<sup>18</sup> Accordingly, disclosure to the employer had waived the privilege, making the disclosed communications available to the employee in a bad faith action against the carrier.

It would seem that the communications might still have been protected by the work product immunity. (See § 10.07[5], above.) But no argument based on that doctrine was made in the case. Unless that protection were available and adequate to prevent adverse effect on the policyholder, the resulting risk to privilege would have meant that independent counsel’s duty of confidentiality would preclude sharing of privileged information unless the carrier were represented by counsel, through whom the information was shared.

The Restatement of the Law of Liability Insurance provides that, even in an independent counsel situation, “[t]he insured’s provision of information to the liability insurer does not waive confidentiality of the information with respect to third parties.”<sup>19</sup> It reasons that:

The grounds for protecting confidentiality in the independent counsel context are identical to those in ordinary-duty-to-defend context. The conflict of interest that lies behind the independent counsel requirement does not eliminate the common interest of insurer and insured in defeating the third-party claim; it does not change the fact that the insurer serves as the insured’s agent for purposes of settling; and it does not eliminate the need for the insurer and insured to share confidential information in a manner that is protected from third

14

**TX**—*In re XL Specialty Ins. Co.*, 373 S.W.3d 46 (Tex. 2012).

15

**TX**—373 S.W.3d 46, 53–54.

16

**TX**—373 S.W.3d 46, 53–54.

17

**TX**—373 S.W.3d 46, 54.

18

**TX**—373 S.W.3d 46, 54–55.

<sup>19</sup>RESTATEMENT OF THE LAW OF LIABILITY INSURANCE § 17(5) (Prop. Final Dr. No. 1 Mar. 28, 2017).

parties.<sup>20</sup>

Notwithstanding the Restatement, the implication of the foregoing is that a carrier that wishes to receive privileged information from independent counsel may itself need to have counsel regarding the matter and conduct any sharing through counsel, lest a court take the view that sharing without such counsel waives the privilege. (See § 10.\_\_, above)

### [c] Courts Ought Not To Confuse the Common Interest Rule with the Joint Client Rule

In *Maplewood Partners, L.P. v. Indian Harbor Insurance Co.*<sup>21</sup> the court treated a nondefending insurer as a co-client of the policyholder's defense counsel, thereby granting the insurer access to the policyholder's privileged and work product materials from the underlying litigation for use in the coverage litigation. The error of constructing an attorney-client relationship for that purpose is discussed in § 4.04[6], above. This section will contrast the court's handling of the waiver issue under the joint client rule with the treatment that should have been accorded under the common interest rule.

This was a coverage suit, in which Maplewood and related entities and individuals contended that Indian Harbor had paid less than was due for defense and indemnification of underlying suits. There were three of these, the "RRGC action," the "Slashy matter," and the "Green claim." Indian Harbor sought discovery of materials the Maplewood parties claimed were privileged. Indian Harbor argued that it had been a joint client, so that no privilege or immunity barred its access to the documents.<sup>22</sup> The court essentially agreed.<sup>23</sup>

The policy was a financial services liability policy, which did not impose a duty to defend, but did require the insurer to pay for defense expenses (along with damages, judgments, settlements, etc.) in excess of the \$250,000 retention. Defense expenses could not be incurred without Indian Harbor's consent, and the policyholders agreed "to provide the Insurer with all information, assistance, and cooperation that the Insurer may reasonably request."<sup>24</sup>

Retention of defense counsel is not described, but it appears that they (two separate firms) were retained by the policyholders, as would be the norm under a duty to reimburse policy (in contrast to a duty to defend policy). In the RRGC action, defendants acted as a joint defense group. Defense counsel Miller communicated regularly with Indian Harbor, through the insurer's [monitoring] counsel. Miller provided assessments of liability, litigation updates, and settlement estimates, all pursuant to and consistent with

<sup>20</sup> RESTATEMENT § 17, cmt. *d* (citation omitted).

<sup>21</sup>

US/FL—*Maplewood Partners, L.P. v. Indian Harbor Ins. Co.*, 295 F.R.D. 550 (S.D. Fla. 2013).

<sup>22</sup>

US/FL—295 F.R.D. at 556–57.

<sup>23</sup>

US/FL—295 F.R.D. at 603–04. The opinion extensively analyzed confidentiality issues, and that discussion is addressed in § 14.04[3], below. The discussion here focuses solely on whether there was joint representation.

<sup>24</sup>

US/FL—295 F.R.D. at 557–58.

the Policy’s cooperation clause. Miller also prepared a litigation budget and a “Pre-trial Report” for Defendant, who paid for the preparation of the Report, which included an assessment of the financial and legal risks of the litigation.<sup>25</sup>

Miller told Indian Harbor’s counsel that he was ““always happy to speak with [insurer’s counsel] to answer any questions you may have [regarding potential liability and damages/value of the RRGC action].””<sup>26</sup>

Throughout the RRGC action, the Maplewood parties treated their interests as aligned, never discussing any allocation of responsibility among themselves.<sup>27</sup> Indian Harbor was included in settlement discussions.<sup>28</sup> It consented to the settlement and contributed to it. But another insurer, Travelers, and some of the Maplewood parties paid all defense expenses. They and Travelers paid the bulk of the settlement.<sup>29</sup> The Maplewood parties now sought reimbursement for some of the defense expenses and settlement costs they paid.

In the Shashy matter, all of the Maplewood parties were represented by Miller. The claims were resolved in a mediation, at which Indian Harbor was present. The Maplewood parties now sought reimbursement of defense expenses.<sup>30</sup>

The Green claim originated as a counterclaim in the Shashy matter and was resolved by arbitration. The Maplewood parties now sought reimbursement of defense costs.<sup>31</sup>

The court concluded that all of the Maplewood parties were joint clients of Miller and his legal team, and then inquired whether Indian Harbor was also a client, observing that “ “[a]s a general matter, no co-client is entitled to have a lawyer withhold material information from another. There is no reason to

25

US/FL—295 F.R.D. at 563–65 (footnotes omitted).

26

US/FL—295 F.R.D. at 565 n.54.

27

US/FL—295 F.R.D. at 565–66.

28

US/FL—295 F.R.D. at 566.

29

US/FL—295 F.R.D. at 567–68.

30

US/FL—295 F.R.D. at 569.

31

US/FL—295 F.R.D. at 569.

make insurance defense representations an exception to this rule.’ ”<sup>32</sup>

The court relied on the fact that defense counsel provided extensive confidential information to Indian Harbor’s monitoring counsel, without ever seeking a waiver from the Maplewood parties permitting such disclosure.<sup>33</sup> It also relied on cases allowing policyholders to discover communications between the insurer and the defense counsel retained to defend the policyholders.<sup>34</sup>

The court recognized that there were two distinct doctrines that would permit disclosure of privileged material without waiving the privilege:

The confidentiality element of the attorney-client privilege can be viewed as a limit on the scope of the privilege, i.e., the privilege does not extend past the boundary within which the attorney and client maintain confidentiality in common. Two doctrines protect from disclosure those items as to which a court might otherwise conclude that the privilege had been waived by a failure to maintain confidentiality: the “joint client” and the “common legal interest” doctrines. These two doctrines are distinct and do not overlap.<sup>35</sup>

The court accurately described the common interest doctrine as follows:

The “common legal interest” rule is an exception to the general rule that disclosure of otherwise privileged communications eliminates, or waives, the privileged status of those communications. This rule “enables litigants who share unified interests to exchange this privileged information to adequately prepare their cases without losing the protection afforded by the privilege.” . . . .

Pursuant to this doctrine, attorneys representing clients with similar legal interests can share information without risk of being compelled to disclose such information generally. Interests of the members of the joint defense group need not be entirely congruent. One member of a joint defense group cannot waive the privilege that attached to the information shared by another member of the group without the consent of that member, but any defendant could, of course, testify as to her own statements at any time. By agreeing to be a part of a joint defense, she only agrees not to disclose anything learned from her co-defendants

32

US/FL—295 F.R.D. at 595, quoting *Defense Lawyers’ Professional Responsibilities: Part II—Contested Coverage Cases*, 15 GEO. J. LEGAL ETHICS 29, 86 (2001) (citations and notes omitted).

33

US/FL—295 F.R.D. at 597.

34

US/FL—295 F.R.D. at 599–600.

35

US/FL—295 F.R.D. at 594 (footnote omitted).

through that joint arrangement, nor could any of those co-defendants disclose what she had told them or their attorneys in confidence. However, if the parties to that agreement are later in opposition with each other, statements which were made by one co-defendant to another defendant's attorney are not protected by privilege.<sup>36</sup>

The court expressed “a healthy skepticism as to the doctrine’s worth” and an intent to “rein in what may be considered an overly broad interpretation of the ‘common legal interest’ (formerly ‘joint defense group’) exception to traditional concepts of waiver of the attorney-client privilege.”<sup>37</sup> Nonetheless, the court concluded that the doctrine “provides an alternative basis to support my conclusion that [the Maplewood parties] must disclose the documents listed in the privilege log.”<sup>38</sup>

The court agreed that that the parties had a common legal interest in the underlying litigation: [Indian Harbor] also was engaged in [the Maplewood parties’] settlement discussions, as required by the Policy’s explicit terms which [the Maplewood parties] accepted when purchasing the Policy. It is evident that [Indian Harbor] shared a common legal interest in defending its insured in the underlying proceedings. This interest was legal, and not just financial, because of the multiple additional issues—including, e.g., the question of whether other entities might proceed against the insurer in the event of an unsatisfactory result.<sup>39</sup>

But even while analyzing application of the common interest doctrine, the court relied on its conclusion that Indian Harbor was a co-client:

The interests of [the Maplewood parties] (and their entire joint defense group) were aligned with Indian Harbor as all had an interest in minimizing liability in the Underlying Matters. [The Maplewood parties] have declared that: “No legal effort was made in connection with the prosecution of Maplewood’s counterclaims in RRG or Shashy that did not operate to minimize the potential liability of an insured on a claim made against the insured.” In other words, all of Miller’s efforts were geared toward minimizing liability, which would be the goal of Indian Harbor as well. The law provides that *all of these joint clients, including Indian Harbor*, could freely communicate (without waiving any

36

US/FL—295 F.R.D. at 605–06.  
37

US/FL—295 F.R.D. at 606–07 & n.232.  
38

US/FL—295 F.R.D. at 607 n.232.  
39

US/FL—295 F.R.D. at 610.

privilege) in order to prepare a successful defense.<sup>40</sup>

The joint client conclusion cannot be right in connection with a common-interest arrangement. The common interest doctrine applies only when the cooperating parties do *not* share an attorney (typically because they have conflicting interests on matters related to the one in which they share a common interest). As the court itself recognized, the two rules do not overlap.<sup>41</sup>

The court continued by reasoning that if it is assumed that the insurer shares a “common legal interest” with [the Maplewood parties], then Miller’s communications to Defendant on behalf of all of his clients and as to all details of the RRG settlement are construed to be two client’s “consulting in common” of an attorney. Miller communicated, presumably, at all times with the permission of Maplewood Partners, acting through Glaser. The other clients cannot now claim that certain aspects were privileged, as they apparently raised no objection at the time and, in any event, Glaser apparently granted permission for the disclosures on behalf of the corporate entity holding the privilege.

That is true enough *as to information that was voluntarily shared* pursuant to the common-interest arrangement. It is wrong, as it applies to information and documents not voluntarily shared. If two clients were indeed consulting the lawyer in common, the lawyer would have a fiduciary duty to each client to provide full information as to all matters within the scope of the relationship. Clients who permit their lawyers to share certain matters bearing on their common interests do not thereby assume any duty to share other information which, while related to their common interest, may also pertain to matters where there are conflicting interests. Thus, except in Illinois,<sup>42</sup> existence of a common legal interest does not provide a basis for one party to demand access to information about another party’s privileged communications that were not voluntarily shared with it.<sup>43</sup>

40

US/FL—295 F.R.D. at 607 (emphasis added, footnote and citation omitted).

41

US/FL—295 F.R.D. at 594.

<sup>42</sup> See

IL—Waste Mgmt., Inc. v. Int’l Surplus Lines Ins. Co., 144 Ill. 2d 178, 193–95 (1991), criticized in § 2.06[2], above. The court based the requirement of disclosure, alternatively, on the insured’s duty to cooperate and on the common-interest doctrine. The discussion in § 2.06[2] specifically addresses the cooperation clause rationale. But, the criticism expressed there applies equally to the common-interest rationale. Additional reasons to reject the cooperation-clause rationale are set forth in this sub-subsection.

<sup>43</sup> E.g.,

US/CT—Remington Arms Co. v. Liberty Mut. Ins. Co., 142 F.R.D. 408, 418 (D. Del. 1992) (“ ‘the rationale which supports the ‘common interest’ exception to the attorney-client privilege simply doesn’t apply if the attorney never represented the party seeking the allegedly privileged materials.’ ”), quoting Bituminous Casualty Corp. v. Tonka

The discovery request pursuant to which the court ordered production was not limited to information that had been voluntarily shared, but rather demanded:

3. All documents and communications between You and any of Your Agents, including but not limited to [defense counsel], pertaining to the Underlying Matters.
4. All documents and communications pertaining to estimates, evaluations and/or assessments of your potential legal liability and/or settlement values in the Underlying Matters made by You and/or Your Agents.<sup>44</sup>

Nonetheless, having concluded that the parties “consulted [defense counsel] in common, the court applied what it thought to be the applicable Florida rule: “ ‘There is no lawyer-client privilege ... [as to] a matter of common interest between two or more clients ... or their successors in interest, if the communication was made by any of them to a lawyer retained or consulted in common when offered in a civil action between the clients.’ ”<sup>45</sup> But that statute, on its face, applies to joint client relationships, not common-interest arrangements, where the parties have separate attorneys and do not “consult in common” with either of those attorneys in the way joint clients would do.

The court supported its analysis by concluding that it would be difficult, burdensome, and potentially complicated for defense counsel to distinguish and separately treat coverage sensitive information, while freely sharing information relating only to the defense:

As defense counsel, Miller is not charged with knowledge of coverage issues. To effectively defend his clients, Miller needed the trust and confidence of his clients, and his primary objective was loss minimization in the Underlying Matters, an objective shared by the clients who hired him and the “client” who was potentially responsible for any judgment, and for Miller’s fees. Miller was not being compensated to establish coverage (or lack thereof), but rather was contracted to advance his clients’ interests, as they defined them, in the Underlying Matters. Nor should Miller, or any defense counsel, need to spend much time deciding who they represent as a client. Miller could get a waiver from [the Maplewood parties] as to his ability to communicate with the insurer and, if his clients are not willing, then perhaps they need other counsel. If Miller is going to disclose information to Indian Harbor that might be adverse to the coverage question, then Miller needs to tell his clients in advance. If the clients object to the disclosure, then they face the risk that the cooperation clause of the insurance policy will have been breached and there will be no coverage. If the clients agree to the disclosure, then Miller might need

Corp., 140 F.R.D. 381, 386 (D. Minn. 1992).  
44

US/FL—*Maplewood*, 295 F.R.D. at 580.  
45

US/FL—295 F.R.D. at 594 n.189, quoting FLA. STAT. § 90.502(4)(e).

to withdraw as defense counsel rather than straddle the line between two sets of interests. There is no rational basis to burden Miller or other defense attorneys with the dual role of protecting privileged items while also trying to obtain reimbursement for defense expenses as to underlying claims defended before the insured ends up in litigation against its own insurer. Thus, the conception of a joint client relationship as to all communications relating to the Underlying Matters provides clear guidance as to boundaries of privilege.<sup>46</sup>

The Maplewood parties and defense counsel certainly could have proceeded in that way, if they were willing to accept the duties of disclosure which would flow from making Indian Harbor a joint client. But if the Maplewood parties desired to retain discretion as to what information would be shared (perhaps at the cost of facing accusations of noncooperation), they were free to accept the difficulties, burdens, and complexities of a common-interest arrangement without the duties of disclosure which would flow from making Indian Harbor a joint client. The court improperly conflated the common-interest doctrine with the joint client rules, thereby depriving the Maplewood parties of the benefits of their choice not to be joint clients with Indian Harbor. Other courts should not make that mistake.

#### [4] Honesty and Avoidance of Fraud [a] Deceptive Statements or Omissions

Representation of a policyholder by independent counsel typically takes place in a context where the policyholder and the insurer are adversaries with respect to coverage. As a result, both policyholder and counsel are entitled to withhold from the insurer information relating to the defense representation that is coverage sensitive. But even in the context of an adversarial relationship, the lawyer is not permitted to lie to the insurer. Model Rule 4.1 provides that “[i]n the course of representing a client, a lawyer shall not knowingly ... make a false statement of material fact or law to a third person”<sup>47</sup> (*i.e.*, someone other than the client). Moreover, Model Rule 8.4 provides that “[i]t is professional misconduct for a lawyer to ... (c) engage in conduct involving dishonesty, fraud, deceit, or misrepresentation.”<sup>48</sup>

Professor Fischer has noted the following implications of these rules:

An attorney may not make a misrepresentation and may not use the rule of confidentiality to justify the speaking of untruths. When the attorney speaks, the attorney must speak honestly. A statement that is a half-truth because it omits material facts needed to put the statement in its proper context may be deemed a misrepresentation subjecting the speaker to civil liability. As recently noted by the Montana Supreme Court, the privilege to withhold client confidential information does not provide a license or justification for misleading utterances. An attorney who discloses information to the insurer to enable the insurer to determine its duties and obligations under the insurance contract must take care to disclose accurately and truthfully or not disclose at all. Even a negligent

46

US/FL—295 F.R.D. at 609–10 (footnote omitted). Of course, there would be no need for Miller to straddle any line if Miller never undertook any duties to Indian Harbor, beyond the general legal duty to refrain from misrepresentation.

<sup>47</sup> MODEL RULES OF PROF’L COND. Rule 4.1 (ABA 2011).

<sup>48</sup> MODEL RULES OF PROF’L COND. Rule 8.4 (ABA 2011).

statement may be actionable if it contains a material misrepresentation on which the recipient of the information (the insurer) reasonably relies to its detriment. The scope of a lawyer's liability for negligent misrepresentation has been hotly debated and disputed. The fact that the identity of the recipient of the information is known and the specific end and aim of the communication is to induce action by the insurer are factors enhancing the likelihood that the court would find *Cumis* counsel owed a duty of candor to the insurer. *Cumis* counsel must be careful not to confuse the absence of a duty of care owed to the insurer with the existing duty to avoid making material misrepresentations to the insurer.<sup>49</sup>

The lawyer need not even be the source of the false statement. Douglas Richmond notes that “a lawyer may violate Rule 4.1(a) by knowingly affirming or ratifying another person’s false statement, or by failing to correct it.”<sup>50</sup>

These rules can be triggered by very limited culpability. The Rule 4.1 requirement that the misrepresentation be made “knowingly” requires only actual knowledge of the falsity, not any “evil intent or a bad purpose.”<sup>51</sup> Many courts require knowing falsehood to establish violation of Rule 8.4(c).<sup>52</sup> But others hold that even statements made with reckless disregard for their truth or falsity can constitute violations.<sup>53</sup> Indeed, at least one jurisdiction will find a violation based on grossly negligent misstatements.<sup>54</sup>

<sup>49</sup> James M. Fischer, *The Professional Obligations of Cumis Counsel Retained for the Policyholder but not Subject to Insurer Control*, 43 TORT TRIAL & INS. PRAC. L.J. 173, 187–88 (2008) (footnotes omitted).

<sup>50</sup> Douglas R. Richmond, *A Professional Responsibility Perspective on Independent Counsel in Insurance*, 33 No. 1 INS. LITIG. REP. 5, 18 (2011).

<sup>51</sup>

**ND**—*In re Edison*, 724 N.W.2d 579, 584 (N.D. 2006).

<sup>52</sup> *See, e.g.,*

**FL**—*Fla. Bar v. Mogil*, 763 So. 2d 303, 309–11 (Fla. 2000);

**MA**—*In re Firstenberger*, 878 N.E.2d 912, 913–14 (Mass. 2007);

**OR**—*In re Conduct of Skagen*, 149 P.3d 1171, 1184 (Or. 2006).

<sup>53</sup> *E.g.,*

**DC**—*In re Ukwu*, 926 A.2d 1106, 1113–14 (D.C. 2007);

**IA**—*Iowa Supreme Court Atty. Disciplinary Bd. v. Gottschalk*, 729 N.W.2d 812, 818 (Iowa 2007);

**PA**—*Office of Disciplinary Counsel v. Surrick*, 749 A.2d 441, 445 (Pa. 2000).

<sup>54</sup>

**AR**—*Walker v. Supreme Court Comm. on Prof'l Conduct*, 246 S.W.3d 418, 424 (Ark. 2007).

Nor does a violation of these rules require that anyone be misled or harmed by the misrepresentation.<sup>55</sup> Rule 8.4(c) contains no express requirement of materiality, though some courts will imply one.<sup>56</sup>

Thus, independent counsel must take care to avoid false or misleading statements or omissions in communicating with the insurer. Moreover, independent counsel must be careful in advocating the policyholder's position to the insurer. Thus, in trying to induce the insurer to settle, it may be useful to argue that there is a great risk of excess liability if the case is tried. And it may be possible to argue that the likelihood or likely magnitude of the judgment is greater than counsel personally believes it to be. If so, counsel must avoid stating any opinion regarding the risk that does not reflect counsel's actual beliefs.

### [b] Assisting Fraud

Model Rule 1.2(d) forbids a lawyer to "counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent."<sup>57</sup> If independent counsel learns that the policyholder is perpetrating a fraud, counsel may not assist in doing so. The first step will usually involve remonstrance with the policyholder to correct any prior misrepresentations and refrain from any in the future. If the policyholder will not do so, it may sometimes be sufficient for independent counsel to withdraw from the representation. But, as Prof. Fischer points out, in some instances

[o]ne may even argue that counsel has affirmative disclosure obligations here and may not simply remain silent if counsel is aware that the policyholder client is perpetrating a fraud on the insurer. Rule 4.1(b) provides that an attorney must disclose a material fact when necessary to prevent assisting a criminal or fraudulent act by the client, unless disclosure is prohibited by Rule 1.6. Traditionally, the Rule 1.6 confidentiality exception swallowed the rule. Recent amendments to Rule 1.6 have, however, added exceptions that "permit" the attorney to disclose client confidential information to prevent "the client from committing a crime or fraud reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services." Disclosure is no longer "prohibited," as that term is used in Rule 4.1(b) because Rule 1.6(b)(2)–(3) permits disclosure; therefore, the exception no longer significantly constrains the duties set forth in Rule 4.1(b), i.e., disclose material facts "to avoid assisting a criminal or fraudulent act by a client."<sup>58</sup>

55

**CT**—*Ansell v. Statewide Grievance Comm.*, 865 A.2d 1215, 1223 (Conn. App. Ct. 2005).  
56

**OR**—*In re Conduct of Skagen*, 149 P.3d 1171, 1184 (Or. 2006).

<sup>57</sup> MODEL RULES OF PROF'L COND. Rule 1.2(d) (ABA 2011). *Accord* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 94(2) (2000).

<sup>58</sup> James M. Fischer, *The Professional Obligations of Cumis Counsel Retained for the Policyholder but not Subject to Insurer Control*, 43 TORT TRIAL & INS. PRAC. L.J. 173, 189 (2008) (footnotes omitted). *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 67(1)–(2) (2000) (authorizing disclosure on the same basis as Model Rule 1.6(b)(2)–(3)). The Restatement explains that these exceptions to the duty of confidentiality

Of course, even if that argument is accepted, it would still be necessary to determine when disclosure is necessary to prevent assisting a fraud.

## [5] Involvement in Policyholder Disputes with the Insurer

### [a] Disputes Regarding the Representation

If there are disagreements with the insurer on conduct of the defense, the policyholder will require advice on the risks and benefits of acceding to the insurer's wishes or proceeding contrary to those wishes. Defense counsel is better positioned than any other lawyer in evaluating the impact on the lawsuit being defended of proceeding one way or another. After all, defense counsel may have considered both alternatives before making a recommendation and certainly considered both alternatives before concluding that another course was preferable to the one recommended by the insurer. Defense counsel might not be competent to advise on the risks of breaching insurance policy duties by proceeding contrary to the insurer's wishes. But the insured will require advice on this subject, and if defense counsel is competent to provide that advice, defense counsel is the most logical person to do so.

Such advice might be considered coverage advice, for which the policyholder, rather than the insurer, should pay. But it might not be separable from advice regarding the defense or any separable component might be too small to be worth trying to break out.

### [b] Disputes Regarding Coverage and Claim Handling

Because the insurer is not a client of independent counsel, there is no ethical obstacle to counsel also representing the policyholder on coverage and other disputes with the insurer.<sup>59</sup> But there is an argument that, as a matter of insurance law, "an insurer is within its rights to insist that lawyers serving as independent counsel not advise insureds on coverage."<sup>60</sup>

reflect a balance between the competing considerations of protecting interests in client confidentiality and lawyer loyalty to clients, on the one hand, and protecting the interests of society and third persons in avoiding substantial financial consequences of crimes or frauds, on the other ... . The exceptions are ... justified on the ground that the client is not entitled to the protection of confidentiality when the client knowingly causes substantial financial harm through a crime or fraud and when ... the client has in effect misused the client-lawyer relationship for that purpose. In most instances of unlawful client acts that threaten such consequences to others, it may be hoped that the client's own sober reflection and the lawyer's counseling will lead the client to refrain from the act or to prevent or mitigate its consequences. [RESTATEMENT, § 67, cmt. b.]

<sup>59</sup> See, e.g.,

**US/PA**—*Maddox v. St. Paul Fire & Mar. Ins. Co.*, 2002 U.S. Dist. LEXIS 26686, at \*10 n.6 (W.D. Pa. May 29, 2002), *appeal dismissed*, 2003 U.S. App. LEXIS 14715 (3d Cir. Jul. 22, 2003);

**US/NY**—*Emons Indus, Inc. v. Liberty Mut. Ins. Co.*, 747 F. Supp. 1079, 1083–84 (S.D.N.Y. 1990). See also Douglas R. Richmond, *Independent Counsel in Insurance*, 48 *SAN DIEGO L. REV.* 857, 894 (2011).

<sup>60</sup> 48 *SAN DIEGO L. REV.* at 895.

This argument is not very strong. It relies on two cases,<sup>61</sup> which both take the position that the insurer is entitled to approve the policyholder's selection of defense counsel, such approval not to be unreasonably withheld.<sup>62</sup> Those cases are therefore unlikely to be followed in jurisdictions holding that the policyholder is entitled to select independent counsel unilaterally. (See § 14.02 above.)

More importantly, both cases proceed on the basis that the insurer is under a duty to provide only an impartial defense—not to sacrifice its own interests. [The policyholder's] defense counsel must not be motivated to slant the defense in any manner relating to whether a claim is or is not in the scope of coverage. Allowing [the policyholder] to appoint as "independent counsel" a firm that bears its loyalty to [the policyholder] or any animus to [the insurer] would reintroduce, albeit in a converse manner, the very difficulties that necessitate in the first instance the appointment of independent counsel.<sup>63</sup>

But this ignores the fact that defense counsel often must advocate a position on coverage sensitive issues. Thus, when the policyholder is alleged to have harmed the plaintiff either negligently or intentionally, the policyholder surely does not receive a complete defense unless defense counsel argues that the injury was no more than negligent. A policyholder defended other than in this way could be subjected to both an unjustified finding of intentional injury (with the resulting increased damages) and, in consequence, a loss of coverage. Such a policyholder could wind up worse off than had there been no insurance. The insurer's protection is not some artificial "impartial" defense; it is the right not to be bound on coverage by the findings made in a case where control of the defense rested in the hands of a policyholder with coverage interests adverse to those of the insurer.<sup>64</sup>

More generally, the right to independent counsel exists only because of a conflict arising out of the manner in which the defense can be conducted. The point of giving the insured independent counsel is to ensure that judgment calls relating to the defense are made in the way that benefits the policyholder rather than the insurer. Independent counsel must therefore be able to advise the policyholder as to how different defense choices could impact coverage.

<sup>61</sup> See:

**US/NY**—*N.Y. State Urban Dev. Corp. v. VSL Corp.*, 563 F. Supp. 187 (S.D.N.Y. 1983), *aff'd in pertinent part*, 738 F.2d 61, 65–66 (2d Cir. 1984);

**US/PA**—*Maddox v. St. Paul Fire & Mar. Ins. Co.*, No. 01-1264, 2002 U.S. Dist. LEXIS 26686 (W.D. Pa. May 29, 2002), *appeal dismissed*, 2003 U.S. App. LEXIS 14715 (3d Cir. Jul. 22, 2003).

<sup>62</sup>

**US/NY**—In *VSL Corp.*, that position was based, in part, on policy language found to reserve that right. 738 F.2d at 65. That makes the case even less likely to be followed in the absence of such policy language.

<sup>63</sup>

**US/NY**—563 F. Supp. at 190 n.1, *followed by* 2002 U.S. Dist. LEXIS 26686, at \*8–9.

<sup>64</sup> RESTATEMENT (SECOND) OF JUDGMENTS § 58(2) (1982).

The insurer is entitled to have bills limited to services required to defend the policyholder, so it does not pay for the policyholder's representation in coverage disputes. But there is no reason to deny the policyholder the right to the economies of using one law firm for both defense and coverage, if the lawyers in that firm are competent to render both types of service and the policyholder wishes them to do so.<sup>65</sup>

A different view was taken in *General Insurance Co. of America v. Walter E. Campbell Co.*<sup>66</sup> Walter E. Campbell Co. ("WECCO") had, "for decades, engaged in the business of handling, installing, disturbing, removing, and selling asbestos-containing insulation materials."<sup>67</sup> This was a coverage action regarding defense and indemnification of many underlying asbestos-personal-injury cases.<sup>68</sup> The principal coverage issues were (1) when the claimant in each case was exposed to asbestos (which affected allocation of coverage) and (2) whether and when the claimant had been exposed to asbestos during WECCO's ongoing operations (to which only per-occurrence limits applied) as opposed to injury resulting from completed operations (to which aggregate limits applied).<sup>69</sup>

WECCO settled with two of its insurers, agreeing to assume their obligations and to reduce any claims against non-settling insurers by any amounts allocable to settling insurers.<sup>70</sup> By stepping into the shoes of the settling insurers, WECCO had the largest share of the defense obligation, so the court agreed that it should take the lead in managing the defense.<sup>71</sup>

WECCO had substituted its coverage counsel, Morgan Lewis & Bockius ("MLB") as defense counsel in the underlying actions and the non-settling insurers objected, arguing that it had a conflict of interest, and the court agreed: "Given the long and protracted efforts of [MLB] to pull cases into coverage under the Non-Settled Insurers' policies, [MLB] cannot also be placed into the position where it can slant the defense in a manner that could render the claims covered claims."<sup>72</sup> Accordingly, as long as MLB remained counsel, the non-settled Insurers would have "no defense or indemnity obligations with respect to those suits."<sup>73</sup>

But this would appear to be an ordinary situation in which a pivotal issue (when exposure occurred and in what circumstances) is involved in both defense of the underlying action and the coverage dispute. If so, WECCO would have a right to independent counsel, even had it not assumed the rights of the settling insurers to defend. For the reasons stated above, WECCO would have had the right to have its counsel defend in a manner that maximized its interests, including its coverage interests.

If WECCO did not have a right to independent counsel, then the claim of the non-settling insurers

65

US/NY—Emons Indus, Inc. v. Liberty Mut. Ins. Co., 747 F. Supp. 1079 (S.D.N.Y. 1990).

<sup>66</sup> Gen. Ins. Co. of Am. v. Walter E. Campbell Co., 2016 U.S. Dist. LEXIS 62842 (D. Md. May 12, 2016).

<sup>67</sup> 2016 U.S. Dist. LEXIS 62842, at \*7.

<sup>68</sup> Gen. Ins. Co. of Am. v. Walter E. Campbell Co., 107 F. Supp. 3d 466 (D. Md. 2015).

<sup>69</sup> 107 F. Supp. 3d at 473.

<sup>70</sup> 107 F. Supp. 3d at 480.

<sup>71</sup> 2016 U.S. Dist. LEXIS 62842, at \*14–15.

<sup>72</sup> 2016 U.S. Dist. LEXIS 62842, at \*15.

<sup>73</sup> 2016 U.S. Dist. LEXIS 62842, at \*15.

would have depended on some right to have the settling insurers defend impartially on behalf of all insurers. We are not aware of any authority on whether such a right would exist. But even if it did, MLB would not have been conflicted. It would defend in whatever manner its client, WECCO directed. If that defense were improperly conducted, the responsibility would have rested on WECCO, not MLB.

\* \* \* \*

# Trends and Features of Transactional Liability Insurance and its Effects on the M&A Marketplace

American College of Coverage and Extracontractual Counsel  
May 16 – 18, 2018

Chicago, IL

Peter Rosen  
Drew Levin  
Latham & Watkins LLP

Gary Blitz  
Jill Kerxton  
Aon Transaction Solutions

© 2017 American College of Coverage and Extracontractual Counsel and Latham & Watkins LLP

## I. What is Transactional Liability Insurance?

### A. Representation and Warranties Insurance Policies

Transactional liability insurance has arisen in recent years as a solution for many types of transactions in the mergers and acquisitions marketplace. Historically, after performing its due diligence and assessing relevant risks, a buyer in an M&A transaction might push for broader indemnification or a larger escrow (e.g., 10% of purchase price) as collateral against potential breaches of seller's or the target's representations and warranties. In certain circumstances, a buyer might even push for other post-closing mechanisms, such as holdbacks or earn-outs, effectively further reducing the purchase price. More recently, however, with the popularization and use of the representation and warranty insurance product, buyers can achieve a sense of comfort that, upon completion of a reasonable diligence process, recourse with respect to representations and warranties can be assured. This ultimately can result in greater certainty for the buyer and a better economic deal for the seller, which is permitted to exit the sale leaving behind less in escrow. In this way, representation and warranty insurance ("RWI") can be beneficial for both a buyer and a seller in an M&A transaction in that it can provide greater post-closing certainty for each party by providing an alternative path for risk assumption with respect to a transaction agreement's representations and warranties.

At a basic level, representation and warranty insurance protects a buyer against loss from unknown breaches of the representations and warranties of either a target company or its selling equity holders that are discovered post-closing (or even post-signing, if structured accordingly). Policies can also be obtained by sellers as a backstop against a seller's indemnification obligations post-closing (although these "seller-side" policies are far less common). Representation and warranty insurance policies can expedite the progress of a deal, create additional bid certainty in auction contexts, minimize escrow obligations or indemnification caps, extend the survival of buyer's right to indemnification, facilitate a clean exit and earlier distribution for sellers, and minimize buyer's risk with respect to seller's creditworthiness.

Insurers offering RWI will perform their own underwriting which will include a review of the data room, review of diligence reports prepared by a buyer and its representatives (shared on a non-reliance basis), and a diligence call and other discussions with buyer and its representatives. Insurers in the market today have the capacity to insure limits ranging from \$1 million to over \$1 billion. Typical policies, like contractual indemnity caps, have limits of liability set at 10% or 20% of enterprise value. In some cases, parties may insure a larger percentage of the enterprise value of the transaction or buy additional limits to protect specific representations, such as certain fundamental representations involving title, corporate formalities or intellectual property in the context of the sale of a technology company.

Policies typically extend six years from closing for breaches of fundamental and tax representations, with a three-year term for other representations. These term lengths are typical regardless of the length of survival of the representations and warranties in the underlying transaction documents. This means that a typical RWI policy can potentially provide an extension of coverage for a buyer under the seller's and target's representations. Most policies are subject to a retention (i.e. deductible) that typically ranges from 0.75% to 2% of total

transaction value, which tends to be shared equally between the buyer and seller. However, when the underlying transaction is structured as a public style or no seller indemnity transaction, the retention will be borne entirely by the buyer, and the premium may be slightly increased, usually by about five percent. Policies can be structured such that the retention (or deductible), if there is one, is reduced as an escrow fund is released (typically at 12 or 18 months), and a policy will generally match the structure of the underlying deal with respect to both the materiality scrape and pre-closing tax indemnity.

Certain items, however, that may receive coverage by the representations and warranties of an underlying deal, may not be covered by a RWI policy, including: (i) known or scheduled matters, (ii) known breaches (which may be addressed via a separate contingency policy), (iii) deferred tax assets, and (iv) certain tax issues, such as net operating loss carryforwards and transfer pricing, and (v) underfunded benefit plans. Likewise, after performing diligence, an insurer may propose additional, deal-specific exclusions based on concerns arising from its own underwriting.

## B. Tax Indemnification Policies

Separate tax indemnity policies may also be available to protect the insured against an adverse ruling by the Internal Revenue Service (“IRS”) or other relevant taxing authority with respect to certain manifest tax risks, including the anticipated tax treatment of the underlying transaction or a given diligence issue relating thereto. Such policies can cover tax, interest, penalties, contest costs and gross-up for tax on the insurance proceeds.

A tax indemnity policy can be used to improve the odds of execution by bridging the gap between a buyer’s evaluation of a particular tax issue and the seller’s evaluation of the same issue. These policies do not necessarily require that a formal tax opinion be obtained, though providing insurers with some work product to underwrite can make for a more efficient underwriting process. Such policies can cover potential issues relating to S Corp. qualification and section 338(h)(10) elections, reorganizations (either that they are tax free or not more taxable than intended by the parties), tax-free spinoffs, net operating losses, section 335(e), transfer pricing, the sale of REIT shares, real estate issues or cross-border issues.

## II. History of Transactional Liability Insurance

Transactional liability insurance has existed as a potential transaction solution since the early 1980’s, when Lloyd’s of London first provided tax insurance for leasing transactions. The RWI product emerged on the scene in the late 1990’s. Like many products, the earliest versions were too limited in coverage and the process was too costly and time-intensive to be of much use in the marketplace.<sup>1</sup> Today, however, the product has matured and the process has been dramatically streamlined, and the result has been the use of transactional liability insurance truly burgeoning, with over 1,000 policies underwritten in the U.S. in 2016 and approximately 2,250 worldwide. From total policy limits of under \$5 billion in the U.S. in 2012, current estimates show a total of over \$25 billion in limits in the U.S. for such policies in 2016 – more than a five-fold increase.

<sup>1</sup> <https://irmka.scic.com/2015/06/04/transactional-liability-insurance/>

A key catalyst for the change has been a shift in insurers' views on the diligence process. Originally, insurers would typically undertake a lengthy and independent diligence review of the target company with respect to the representations and warranties to be covered by a given policy. This process could take months in total and the engagement of multiple insurers (to see which would ultimately provide acceptable terms) and was typically intrusive to the in-process transaction. In recent years, however, insurers have become more comfortable relying upon the diligence performed by a buyer – such that the insurer's process focuses on conducting secondary diligence of the buyer's primary diligence. This approach greatly reduces both the intrusiveness of and time required by the underwriting process, making it a much more attractive solution for both buyers and sellers.<sup>2</sup> Additionally, insurers now staff their underwriting teams with former M&A attorneys who are familiar with applicable deal mechanics and timeframes, which enables greater customization of policies and streamlining of the underwriting process for a given transaction. Insurer initial indications of interest are typically available within days. New insurers are continuing to enter the field, increasing competitiveness and overall capacity. From fewer than ten insurers just four years ago, there are now nearly thirty insurers in the marketplace.

### III. Current Statistics and Trends

As discussed above, the volume of deals utilizing transactional liability insurance has been steadily on the rise in recent years. In North America, Aon Transaction Solutions alone has seen its total policy limits rise from approximately \$2.1 billion in 2013, comprising 54 total policies, to \$[ ● ] 15 billion in 2017, comprising [ ● ] 460 policies.

#### A. Analysis of Cost Considerations

Which party pays for a RWI policy is negotiable and, where a seller demands that buyer cover the cost, can be considered in connection with the total purchase price being offered. A typical RWI policy would carry a total cost of around 2.75-3.5% of the total insured limit under the policy, although this rate will be somewhat dependent upon the specific details of the transaction; for instance, deals without any seller indemnification provision would typically lead to a slightly higher premium for any applicable RWI policy. Rates are also dependent on the scope of coverage being secured, with significantly lower rates (for more limited coverage) generally available for non-U.S.-style transactions.

In terms of retentions (which are also referred to as deductibles) under the policy, 0.75-2% of total transaction value is typical. Recent competition among insurers is driving this figure down; similarly, for certain simple operations, such as a privately held REIT, insurers may only require even lower retentions. Retentions may be slightly higher (or, on the higher end of the 0.75-2% range) in a no-seller-indemnity structure. For practical purposes, the retention under a buyer-side RWI policy will often match the sum of the deductible and escrow in the underlying agreement. Relatedly, as noted above, the policy retention may drop down upon the release of the escrow funds.

<sup>2</sup> *Id.*

## B. Key Coverage Differentiators and Advantages of Utilizing RWI Policies

Key differentiators of RWI policies, as compared with standard indemnification and related provisions of a transaction agreement, include:

- *Increased policy duration* – RWI policy terms will typically exceed those for the survival of the representations and warranties of an underlying deal;
- *Coverage limits* – Insureds may purchase coverage of up to 100% of the purchase price, as opposed to a typical seller indemnity coverage of 5-10% of the purchase price;
- *Definition of Loss* – Carriers will generally only exclude categories of loss where they are excluded by an underlying agreement (i.e., “follow silence with silence”), which leaves the door open for potential recovery of consequential and multiplied damages;
- *Materiality Scrape* – Carriers will generally recognize the materiality scrape of an underlying agreement, and disregard applicable materiality qualifiers in a seller’s or target’s representations and warranties when determining the existence of a breach and/or calculating damages, as applicable.

Buyers and sellers may each have strong motivations for introducing RWI as an element of a transaction. In addition to the factors outlined above, buyers can use RWI in an auction process in order to distinguish their bid from other prospective purchasers, to protect key relationships in the context of a proposed management rollover, ease collection concerns (particularly from a distressed or otherwise uncreditworthy seller), or provide recourse where no seller indemnity would otherwise be possible. Sellers, on the other hand, can look to an RWI policy to reduce or eliminate post-closing indemnity obligations for unknown breaches (thus adding deal certainty), thereby reducing contingent liability, protecting passive sellers, aiding in the timely distribution of sale proceeds, expediting a sale process, and, during the sale process, attracting the best offers from prospective buyers by enhancing recourse options for those buyers.

## IV. How Transactional Liability Insurance Shapes M&A Transactions

In the current marketplace, the availability and use of transactional insurance can often shape the form and process of the underlying transaction. Some examples from our experience, showing the operation of this influence, follow below.

### A. Example A – RWI Policy to Reduce Purchase Price

A U.S. private equity fund was purchasing a manufacturer for approximately \$1 billion, with a \$100 million escrow/indemnity cap. The fund was approached with a proposal to replace a portion of the escrow/indemnity cap with a buyer-side RWI policy, in the hope that the fund would then be able to obtain a purchase price adjustment in the fund’s favor.

A buyer-side RWI policy for \$80 million excess of a \$20 million deductible was negotiated and placed, which provided coverage broader than the seller indemnity. Additionally, the policy period extended for the standard six years for all fundamental and tax representations and warranties, and the retention would be reduced to \$4 million after 18 months in conjunction

with the release of the escrow. In connection therewith, the fund was able to negotiate an ultimate purchase price of \$975 million – about \$22 million less than initially contemplated (after taking into account the insurance cost).

#### B. Example B – “Stapled Insurance Package” to Minimize Escrow and Indemnity

A U.S. private equity firm was preparing to sell a \$400 million manufacturing company through an auction process. The target company was the last of 15 divestitures from a holding company, and therefore had numerous hanging indemnities from past sales, plus potential tax and environmental issues. The seller hoped to effect the sale on an “as is” basis, in order to have no surviving indemnities or escrow post-closing.

Before commencing the auction, quotes were structured and obtained for a package of representations and warranties, tax and environmental insurance in favor of an eventual purchaser. Prospective purchasers were directed to work with Aon, and the private equity firm made it known that it would provide no indemnities. Ultimately, the RWI policy was able to cover the hanging liabilities from the holding company’s prior transactions in addition to the representations relating to the target transaction, and the transaction agreement had no survival period and provided a credit against the purchase price for the insurance cost (which amounted to 1% of transaction value). Through this approach, the seller was able to encourage more bids and a better ultimate sale price than it had anticipated. Additionally, because the prospective insurers had already vetted the applicable risks, buyer’s due diligence process was generally smooth and straightforward, which helped contribute to a successful auction process.

#### C. Example C – RWI Policy to Ease Collection Concerns

A publicly-traded company in the manufacturing industry had purchased the diesel engine business of another publicly-traded manufacturing company for approximately \$150 million. The parties negotiated a \$3 million escrow and a \$20 million cap on indemnification for breaches of representations and warranties, but the buyer was concerned about its ability to collect under the indemnification provisions of the agreement because the seller was in danger of becoming insolvent at the time of the sale.

To resolve these issues, an RWI policy for the buyers was structured and negotiated that provided a primary recourse to the buyer above the amount of the escrow. The policy had a \$20 million limit and a \$3 million retention (which was equal to the escrow). The parties further were able to amend the purchase agreement in order to provide that the seller would only have liability in the amount above the escrow in the event that the policy did not provide coverage, and in return the seller agreed to pay 50% of the policy’s premium.

#### D. Example D – Cross Border Tax Insurance

A non-U.S. company sought to purchase the shares of a U.S. manufacturing corporation from a private equity seller. The buyer’s due diligence revealed that a prior restructuring transaction might be taxable under complex consolidated return regulations. This was unexpected, because the private equity firm had received a legal opinion that the transaction

should be tax-free. This opinion, however, was based on several assumptions about events that did not ultimately occur. The private equity firm refused to provide the buyer with full tax indemnity. The buyer had 10 days remaining in its period of exclusivity with the target (which included the Christmas holiday), and the private equity firm was unwilling to extend the exclusivity period.

A tax insurance policy was put in place to insure the buyer against the tax liability risk as a result of the restructuring not being treated as a tax-free transaction. The tax insurance policy had a \$50 million limit and a seven-year term, and was bound within the remaining 10 days of the exclusivity period, which allowed the sale and purchase agreement to be executed within the remaining window. The deal closed several weeks later.

#### E. Example F – Tax Free Spinoff

A public company client, which was a leading foreign multinational in the manufacturing industry, spun off a U.S. business unit. Less than a year later, the client sold that unit to a private equity firm. IRS policy limited the ability of the taxpayers to obtain “comfort” rulings on whether the spin-off transaction qualified for tax-free treatment under Section 355 of the Tax Code. For example, the IRS will not rule on certain key technical aspects such as the “business purpose,” “device” and Section 355(e) “plan requirements.” The potential tax liability was approximately \$270 million.

Due to the magnitude of the risk, the client sought a tax insurance policy to protect against a successful IRS challenge of the tax-free nature of the spin-off. Aon Transaction Solutions structured and secured the largest tax insurance policy placed in the previous decade for a \$350 million limit, with a \$5 million retention and a seven year term. The tax opinion policy covered (1) the full amount (less the retention) of potential U.S. federal and state income taxes, plus interest and penalties, following a successful challenge by the IRS, and (2) a “gross-up” (up to the \$350 million limit) for the tax on any proceeds received by the client under the tax opinion policy.

### V. Claims

Because the use of RWI has become widespread, substantial data is now available regarding the types of claims most likely to arise in connection with these policies. The following are brief summaries of Aon’s and AIG’s respective experience from claims under RWI policies.

#### A. Aon’s Experience

Aon’s transactional liability insurance clients in North America seem to be experiencing claims with a frequency that matches the increased use of the insurance solution in M&A transactions. Claims under RWI policies that inceptioned since 2014 result most frequently from breaches of representations relating to financial statements (25%), followed by claims relating to employment (16%), tax matters (14%), intellectual property matters (9.5%), product liability and recall (6%), and environmental (2%). The remainder of the claims encompass other (25%)

breach types (e.g., contracts, compliance). When considered on an annual basis, approximately 18.5% of deals in 2014 with RWI policies gave rise to claims, and the figures were similar for other years, at 17% for 2015 policies and 17% for 2016 policies. Thus far, 8% of 2017 policies have given rise to claims notices.

In total, since 2014, there have been 137 claims under Aon R&W policies – 124 total claims arose in buy-side policies (15% of buy-side policies) and 13 total claims arose in sell-side policies (30% of sell-side policies). Of 137 claims since 2014, 77 remain open and are early in the claims process, 16 were resolved within the applicable retention, 30 have been inactive/dormant, 10 resulted in loss payment and just 4 were ultimately denied by the insurer.

## B. AIG's Analysis

AIG's data<sup>3</sup> was similar to Aon's in several respects, but broke claims down into different categories. AIG's analysis conformed to that of Aon with respect to breaches of reps relating to financial statements being the most likely category of rep likely to give rise to a claim (at 20% of all such claims under AIG RWI policies). This was followed by claims relating to compliance with laws (15%), breaches of representations relating to contracts (14%) and tax matters (14%), intellectual property (8%) and employment matters (8%), breaches of fundamental representations (7%), and finally environmental issues (5%), litigation (5%) and operations related matters (5%). In AIG's analysis, approximately one in five policies issued globally (21%) had claims presented thereunder. When 2015 is included in the relevant period, the ratio falls to 18%.

## VI. Conclusion

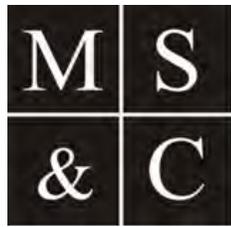
RWI is now an accepted means for buyers and sellers in M&A transactions to “bridge the gap” in negotiations relating to representations and warranties and related mechanisms for recovery. More broadly, transactional insurance has developed to address and solve for an increasingly broad slate of M&A risk-allocation issues. Given the continued robust interest from insurers and buyers and sellers alike, forecasts project continued growth in the years to come.

<sup>3</sup> AIG Mergers & Acquisitions 2017 Claims Report, available at <https://www.aig.com/business/insurance/mergers-and-acquisitions/mergers-acquisitions-claims-reports>

# USE OF EXPERTS IN COVERAGE AND BAD FAITH CASES

American College of Coverage and Extracontractual Counsel  
6<sup>th</sup> Annual Meeting

Chicago, IL  
May 16-18, 2018



McIntosh Sawran

McIntosh Sawran & Cartaya, P.A.

FORT LAUDERDALE • MIAMI • WEST PALM BEACH

## USE OF EXPERTS IN COVERAGE AND BAD FAITH CASES

---

### I. Experts: Federal Court Case Law

United States Supreme Court (Federal Evidentiary Standards)

*Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993).

- **Issue:** Whether an expert witness's scientific knowledge be generally accepted in the relevant field to be admissible?
- **Holding:** The Court held that federal judges must enforce their "gatekeeping role" by considering two central factors: reliability and relevance of the proposed expert testimony. Those two factors comport with *Fed. R. Evid.* 702 that expert testimony involve scientific knowledge to assist the trier of fact to understand evidence or determine a fact in issue. Further, the central issue is whether the expert's reasoning and methodology properly can be applied to the facts in issue.
- **Reasoning:** The Court reasoned that the inquiry under Rule 702 was a flexible one and no sole factor determines admissibility. The Court outlined four exclusive factors: (1) whether the theory or scientific technique has been tested; (2) whether it has been subject to peer review and publication; (3) the known or potential rate or error; and (4) whether the principle was generally accepted in the relevant scientific community.

United States Circuit Court of Appeal, Eleventh Circuit

*United States v. Frazier*, 287 F.3d 1244 (11<sup>th</sup> Cir. 2004)

- **Issue:** Whether the District Court, by excluding expert testimony of a forensic investigator regarding what he would have expected while recovering inculpatory hair and seminal fluid in a rape case, yet allowing the government to present expert evidence on the same issue, abused its discretion?
- **Holding:** The decision to prevent a qualified forensic investigator from testifying in support of defendant’s testimony that he did not have sexual intercourse with victim, and that recovery of inculpatory hair or seminal fluid would have been “expected” if sexual intercourse had occurred, was not abuse of discretion. Further, by introducing that investigators had failed to recover any inculpatory hairs or seminal fluids from victim in support of her claims that defendant had forced her to have sexual intercourse with him, and by arguing the significance of that failure, the defendant opened the door for government to offer reliable expert testimony in rebuttal.
- **Reasoning:** The Court reasoned that the meaning of the expert’s opinion of what “would be expected” regarding the recovery of inculpatory hair or seminal fluid in a rape case was uncertain because the specific meaning of what the expert “expected” was impossible to discern. The court could not define what the term “expect” meant in conjunction with the experts testimony because that term could imply a likelihood anywhere between 50–100%. Further, the rebuttal testimony introduced by the government to counteract the viewpoint that the absence of finding hair or seminal fluid meant no sexual assault had occurred falls within the purpose of rebuttal evidence.

*Tardiff v. Geico Indem. Co.*, 481 F. App’x 584, 587 (11<sup>th</sup> Cir. 2012)  
(Bad Faith – Claims Handling)

- **Issue:** Whether the District Court abused its discretion in excluding the expert testimony of an insurance consultant regarding standards for handling insurance claims and whether their testimony was based on their own experience and personal knowledge?
- **Holding:** The Court held that the District Court did not abuse its discretion in excluding the expert testimony of plaintiff’s insurance consultant concerning industry standards for handling insurance claims or allowing

testimony of claims adjust and insurer's lawyer.

- **Reasoning:** The Court reasoned that plaintiffs did not show the district court abused its discretion in concluding that the consultant's testimony would not have been helpful to the jury in deciding whether Geico breached its fiduciary duty of good faith because, as the plaintiff's conceded, no Florida court has held that plaintiffs must present expert testimony to prove an insurer acted in bad faith. Additionally, the plaintiff's did not show that the expert testimony concerned matters that are beyond the understanding of an average lay person and that without the testimony, the jury would be unable to decide whether GEICO acted in bad faith.

United States Court of Appeals, Tenth Circuit

*City of Hobbs v. Hartford Fire Ins. Co.*, 162 F.3d 576 (10<sup>th</sup> Cir. 1998)

- **Issue:** Whether the district court erred in excluding testimony of an insurance expert who lacked knowledge specific to third party bad faith claims?
- **Holding:** The Court held that the district judge did not abuse his discretion by refusing to admit insurance claims expert's proffered testimony.
- **Reasoning:** The Court reasoned that the jury was capable of determining the bad faith issue on its own and that expert did not demonstrate knowledge specific to New Mexico and handling of third party claims. The Court went on to note that while a proffered expert possess knowledge as to a general field, the expert who lacks specific knowledge does not necessarily assist the jury.

*N. Am. Specialty Ins. Co. v. Britt Paulk Ins. Agency, Inc.*, 579 F.3d 1106 (10<sup>th</sup> Cir. 2009)

- **Issue:** Whether the jury should have been able to heard expert testimony regarding standard insurance practice to establish that an insurance company mishandled a claim?

- **Holding:** The Court held that the exclusion of expert testimony regarding standard insurance industry practice was not abuse of discretion.
- **Reasoning:** The Court reasoned the excluded expert would have compared the insurance company's actions to the industry standard. Further, this testimony would not assist the trier of fact and the jury is perfectly capable of resolving the issues without expert testimony.

United States District Court, Middle District of Florida

*Travelers Indemnity Co. of Illinois v. Royal Oak Enterprises, Inc.*, 2004 WL3770571 (M.D. Fla. 2004). (Bad Faith; Industry Standards)

- **Issue:** Whether the legal opinion of an expert in a report can be struck or limited by a motion to strike on the grounds that the testimony exceeds the scope of the case and strays away from the purpose of expert witness testimony?
- **Holding:** The Court held that where a substance of the expert's testimony concerns ordinary practices and trade customs which are helpful to the fact-finders evaluation of the parties conduct against the standards of ordinary practice in the insurance industry, his passing reference to a legal principle or assumption in an effort to place his opinions in some sort of context will not justify the outright exclusion of the expert's report in its entirety.
- **Reasoning:** The Court reasoned that the experts report does not offer legal opinions or conclusions of law. Rather, it discloses a series of opinions as to the customs and practices of the insurance industry concerning the issues in dispute. The Court recognized that the customs and practices throughout the expert's twenty-five years in the field have undoubtedly been shaped by insurance law and it is understandable that some of the statements made in his report reflect that reality. Additionally, expert opinions on the alleged bad faith and breach of duty on behalf of the insured were not struck because a breach of contract counterclaim still existed before the Court. Because bad faith cannot be completely divorced from a breach of contract claim under Florida law, the expert opinion is still relevant.

United States District Court, Alaska

*Certain Underwriters at Lloyds, London v. Inlet Fisheries, Inc.*, 389 F.Supp. 2d (D. Alaska 2005)

- **Issue:** Whether an expert in the insurance industry is qualified to testify as an expert on underwriting marine pollution policies when the expert has minimal experience with respect to underwriting marine pollution policies?
- **Holding:** The Court held that the insured's witness was not qualified to testify as an expert on underwriting marine pollution insurance policies despite having over 45 years of experience in the insurance industry.
- **Reasoning:** The Court reasoned that the expert lacks "particularized experience with vessel pollution policies." Additionally, his opinion as to current industry standards is based on experience in underwriting at a time when pollution insurance did not stand-alone but were part of protection and indemnity policies, and even that experience is not of recent vintage. Finally, Wilton has no knowledge of the underwriting policies, practices, or procedures of either Lloyds or Water Quality Insurance Syndicate, the dominant issuers of marine pollution policies. Therefore, although qualified to testify as an expert on some aspects of the standards of the insurance industry, he is not qualified to testify as an expert on underwriting marine pollution insurance policies.

United States District Court, Southern District of Florida

*Maharaj v. GEICO Casualty Company*, 2015 WL 11279830 (S.D. Fla. 2015) (Bad Faith; Industry Standards)

- **Issue:** Whether a bad faith expert witness should be precluded from testifying when her testimony offers opinion about Florida law and she is not an attorney?
- **Holding:** The Court held that there was no reason why the expert should be precluded from testifying on issues of standards of the industry, but the expert may not opine as to whether the defendant acted in bad faith.
- **Reasoning:** The Court reasoned that the opinion testimony from a qualified

witness as to the claims handling standards within the insurance industry, and whether or not Defendant's actions met those standards, will help the jury understand the evidence and determine a fact in issue. The jury, however, does not need any assistance in applying the law to the testimony and making a factual determination as to whether or not GEICO acted in "bad faith". Further the court took into consideration the experts experience in the industry as a result their conclusion. (page 6).

United States District Court, Southern District of Georgia

*Cooper v. Pacific Life Ins. Co.*, 2007 WL 430730 (S.D. Ga. 2007)  
(Industry Practices)

- **Issue:** Whether an expert's opinion should be excluded when it is intended to reflect actual industry custom and practice despite that the industry custom and practice is shaped by legal requirements?
- **Holding:** The Court held that an expert may testify as to the practices normally followed by insurance companies regulated by securities laws, but cannot purport to instruct the jury on the legal requirements of the statutes and regulations. Additionally, an expert may give his opinion on industry practice and is entitled to state reasonable assumptions regarding the requirements of applicable legal requirements.
- **Reasoning:** The Court reasoned that an expert may opine as to industry custom and standard without presenting bare conclusions of law. Additionally, the Defendants will have the opportunity to cross-examine the expert to prevent the jury from placing too much weight on the expert's legal conclusions. Further, cross-examination, presentation of contrary evidence and careful instruction on the burden of proof are traditional and appropriate means of attacking shaky but admissible evidence.

United States District Court, Kansas

*Employers Reinsurance Corp. v. Mid-Continent Cas. Co.*, 202 F.Supp.2d 1212 (D. Kan. 2002)

- **Issue:** Whether an expert who has worked in the insurance industry for more

than forty years may give testimony on whether an insurer acted in bad faith?

- **Holding:** The Court held that the reinsured's expert was qualified to testify about industry custom regarding reinsurance agreement coverage of underlying declaratory judgment litigation expenses but the experts' testimony as to whether reinsurer breached its duty of good faith and fair dealing were legal conclusions which were not admissible.
- **Reasoning:** The Court reasoned that while the expert his background and experience qualify him to testify under *Daubert*, the portion of his opinion that the insurer breached its duty of utmost good faith and fair dealing constitutes an impermissible attempt to apply the law to the facts of the case to form a legal conclusion.

*Moses v. Halstead*, 477 F.Supp. 2d 1119 (2007) (Industry Standards)

- **Issue:** Whether expert testimony regarding insurance industry standards and practices should be excluded?
- **Holding:** The Court held that the attorney's expert witness regarding insurance industry standards and practices were admissible.
- **Reasoning:** The Court reasoned that while the facts are not so complicated as to require testimony of an expert witness, the expert's expertise in the process of handling an insurance defense case and the standard of care regarding that process would be helpful to the Court. *See Lone Star Steakhouse & Saloon, Inc. v. Liberty Mutual Ins. Group*, 343 F.Supp. 2d 989 (D. Kansas 2004) (court allowed testimony regarding insurance industry standards and practice and whether insurance company's actions conformed to those standards).

United States District Court, New Jersey

*Crowley v. Chait*, 322 F. Supp. 2d 530 (D. New Jersey 2004)

- **Issue:** Whether two expert witnesses were qualified to testify on an issue of underwriting in the surplus lines in the insurance market and whether they

used sound methodology in that testimony?

- **Holding:** The Court held that the plaintiff's insurance industry experts were qualified to testify whether or not there was enough information in files of surplus lines insurer for it to perform underwriting.
- **Reasoning:** The Court reasoned both experts have extensive experience in underwriting and the surplus lines insurance industry. The Court stated it "is not even necessary to construe the Daubert qualifications requirement liberally to admit their testimony." Further, their vast experience in the insurance industry and with the issues that form the core of this litigation readily qualifies them to opine on the underwriting practices at issue. As to the issue of methodology, the Court reasoned that the use of inconsistent approaches as between the experts may raise questions about the reliability of the findings of one or both of them, but it does not in and of itself show that the methodology they employed was so inherently flawed as to render their respective testimonies inadmissible.

United States District Court, Southern District of New York

*Mahoney v. JJ Wesier and Co., Inc.*, 2007 WL 3143710

- **Issue:** Whether an expert in the insurance industry for 50 years may give testimony on the relationship between the claim-loss ratio for a health insurance policy and on the claim-loss ratio routinely seen in the industry?
- **Holding:** The Court held that the expert could give expert testimony on the relationship between the claim-loss ratio for a health insurance policy and on the claim-loss ratio routinely seen in the industry.
- **Reasoning:** The Court reasoned that given the expert's fifty years of experience in the insurance industry, he is qualified to give testimony as an expert. Despite the contention that the expert did not have experience with the precise type of insurance policy in question, the Court stated that was an issue of reliability and not admissibility. As to the issue of the claims-loss ratio in the industry, the Court reasoned that although these opinions lack the existence of corroborating empirical evidence, the expert testified that he has seen premiums refunded on hundreds of occasions even without a

contractual provision requiring such refunds and was familiar with the duties of third-party administrators.

United States District Court, Northern District of Illinois

*Federal Ins. Co v. Arthur Andersen, LLP*, 2006 WL 6555232 (N.D. Ill. 2006) (Custom and Practices)

- **Issue:** Whether the Court should preclude two experts from testifying on the custom and practice of concluding if an insurer's conduct constituted a breach of the duty to defend?
- **Holding:** The Court held that the experts may testify regarding whether the insurer's conduct meets industry custom and practice but may not testify as to the ultimate issue of whether the insurer breached its duty to defend.
- **Reasoning:** The Court reasoned that the first expert had the knowledge, skill, experience, training or education on the issue of whether the insurer's claims adjuster used proper claims adjusting procedures because he had worked in the insurance industry in various capacities for almost 40 years. Further the Court reasoned that the second expert could testify regarding whether the insurer's conduct meets insurance industry custom and practice because evidence relating to the insurance industry's custom and practice of claims handling is squarely relevant to whether Federal breached its duty to defend, and expert testimony on this topic will help the jury in determining whether Federal breached that duty.

United States District Court, Southern Division of South Dakota

*Hanson v. Mutual of Omaha Ins. Co.*, 2003 WL 26093254

- **Issue:** Whether an expert witness with over forty years of experience practicing insurance law can give an opinion on the issue of bad faith?
- **Holding:** The Court held that the expert met the prongs of the *Daubert* test and could opine on the issue of bad faith.

- **Reasoning:** The Court reasoned that because of the expert’s experience with numerous insurance companies, he has the expertise to testify about whether he believes Mutual of Omaha sufficiently monitors denied claims and its claims analysts in comparison to other insurance companies. Additionally, this proposed testimony is relevant because it tends to make the existence of bad faith more or less probable than without his testimony. Furthermore, during his forty-year career in insurance law, he learned about the common practices of insurance companies and has specific information from which he forms his opinions. Any testimony based on facts learned from his personal experience with insurance companies or from the documents in this case does not amount to speculation or guesswork. The Court did, however, prevent the expert from testifying on what he thinks are good practices rather than on an industry standard. The Court stated that what he thinks are good practices amount to speculation and guesswork.

United States District Court, Eastern District of Oklahoma

*American Commerce Ins. Co. v. Harris*, 2009 WL 130225

- **Issue:** Whether an expert’s opinion regarding bad faith by an insurer in handling a fire loss claim should be excluded?
- **Holding:** The Court held that the expert may not testify on the issue of bad faith by the insurer but may testify as to the assistance the expert provided to the claimant in submitting his fire loss claim.
- **Reasoning:** The Court reasoned that it is fairly clear that any expertise the adjustor may have in relating in this regard is of a general nature and that any opinion testimony by the adjustor as to bad faith should be excluded because it would not assist the trier of fact to understand the evidence or to determine a fact in issue.

II. Must Attorneys Be Licensed as Adjusters, or Worked as One, to Provide Expert Testimony on Claims Practices?

(Refer to state statute.)

Alabama

- i. Ala. Code 1975 § 27-9A-3(b)

- An independent adjuster does not include any of the following:  
[a]ttorney-at-law admitted to practice in this state when acting in their professional capacity as an attorney.

### Arkansas

- i. A.C.A. § 23-64-102(4)(B)
  - A licensed attorney at law who is qualified to practice law in this state is not deemed to be an “adjuster” for purposes of this chapter.
- ii. A.C.A. § 23-64-102(5)(B)
  - The term “insurance consultant” shall not be deemed to include licensed attorneys, actuaries, certified public documents, medical bill analysts, or any other person who gives or offers to give incidental advice to the public in the normal course of business or professional activity other than insurance consulting.

### California

- i. West’s Ann. Cal. Ins. Code. § 15008(a)
  - This chapter does not apply to any of the following: [a]n attorney at law admitted to practice in this state, when performing his or her duties as an attorney at law.

### Colorado

- i. C.R.S.A. § 10-2-105(2.5)(a)
  - With respect to public adjusters, a license as a public adjuster is not required for: [a]n attorney-at-law admitted to practice in this state, when acting in his or her professional capacity as an attorney.

### Florida

- i. Fla. Stat. § 626.860
  - Attorneys at law; exemption– Attorneys at law duly licensed to practice law in the courts of this state, and in good standing with The Florida Bar, shall not be required to be licensed under the provisions of this code to authorize them to adjust or participate in the adjustment of any claim, loss, or damage

arising under policies or contracts of insurance.

### Idaho

- i. I.C. § 41-5804(1)
  - Notwithstanding section 41-5803, Idaho Code, a license as a public adjuster shall not be required of the following: [a]n attorney admitted to practice in this state, when acting in his or her professional capacity as an attorney.

### Illinois

- i. 215 ILCS 5/1515(d)(1)
  - Notwithstanding subsections (a) through (c) of this Section, a license as a public adjuster shall not be required of the following: an attorney admitted to practice in this State, when acting in his or her professional capacity as an attorney.

### Kansas

- i. K.S.A. 40-5503(c)(1)
  - Notwithstanding the provisions of this section, a license as a public adjuster shall not be required of the following: [a]n attorney at law admitted to practice in this state, when acting in such person's professional capacity as an attorney.

### Louisiana

- i. LSA-R.S. 22:1693(E)
  - Notwithstanding Subsections A through D of this Section, a license as a public adjuster shall not be required of any of the following: [a]n attorney at law admitted to practice and in good standing in this state and [a] person employed only for the purpose of obtaining facts surrounding a loss or furnishing technical assistance to a licensed public adjuster, or licensed attorney, including photographers, estimators, private investigators, engineers, and handwriting experts.

### Maine

- i. 24-A.M.R.S.A. § 1411(3)(A)
  - A person may not for a fee or commission engage in the business of offering advice, counsel, opinion or similar service

with respect to the benefits, advantages or disadvantages under any policy of insurance that is issued in this State unless that person is: [e]ngaged or employed as an attorney licensed in this State to practice law.

### Massachusetts

#### i. M.G.L.A. 175 § 162

- Whoever, for compensation, not being an attorney at law acting in the usual course of his profession, directly or indirectly solicits from an insured or the representative of an insured, or performs services pursuant to an agreement, engagement or undertaking to represent the insured in connection with the assessment of damages, negotiation, settlement, appraisal or reference of a loss under a fire insurance policy, homeowners insurance policy, commercial multi-peril insurance policy, business interruption insurance policy, fidelity bond or crime insurance policy, inland or ocean marine insurance policy, other property damage insurance coverage of any sort, shall be a public insurance adjuster.

### Minnesota

#### i. M.S.A. § 72B.03(b)(1)

- The definition of adjuster does not include, and a license as an adjuster is not required of, the following: attorneys-at-law admitted to practice in this state, when acting in the attorney's professional capacity as an attorney.

### Mississippi

#### i. Miss. Code Ann. § 83-17-401(a)(i)

- Adjuster shall not include: [a]n attorney-at-law who adjusts insurance losses from time to time and incidental to the practice of law, and who does not advertise or represent that he is an adjuster.

### Montana

#### i. MCA 33-17-102

- The term [adjuster] does not include a: licensed attorney who is qualified to practice in this state.

### New Hampshire

- i. N.H. Rev. Stat. § 402-B:5
  - The commissioner shall waive the requirement of such examination in the following cases: [a]ttorneys-at-law.
- ii. N.H. Rev. Stat. § 402-B:2(III)(a).
  - The provisions of this chapter shall not apply to the following: [a]ttorneys duly admitted to practice in this state pursuant to the provisions of RSA 311 when acting in their professional capacity as an attorney.

### New Jersey

- i. N.J.S.A. 17:22B-4(b)(1)
  - Nothing contained in this act shall apply to: any licensed attorney of this State who acts or aids in adjusting insurance claims as an incident to the practice of his profession and who does not advertise himself as a public adjuster.

### New York

- i. McKinney's Insurance Law § 2101(g)(2)(B)
  - Public adjuster means any person, firm, association or corporation . . . except that term shall not include: any licensed attorney at law of this state who acts or aids in adjusting insurance claims as an incident to the practice of his profession and who does not advertise himself as a public adjuster.

### North Carolina

- i. N.C.G.S.A. § 58-33A-10(d)(1)
  - Notwithstanding subsections (a) through (c) of this section, a license as a public adjuster shall not be required by any of the following: [a]n attorney-at-law admitted to practice in this State, when acting in his or her professional capacity as an attorney.

### Ohio

- i. R.C. § 3951.01(E)(1)
  - Nothing contained in Chapter 3951 of the Revised Code shall apply to the following: [a]n attorney at law admitted to practice

in this state who adjusts insurance losses in the course of the practice of the attorney's profession and who does not hold the attorney out by sign, advertisement, or otherwise as offering such services to the general public.

### Oklahoma

- i. 36 Okl. St. Ann. § 6203(5)
  - o The definition of an insurance adjuster shall not be deemed to include, and a license as an adjuster shall not be required of, the following: [a] licensed attorney in the State of Oklahoma who adjusts insurance losses from time to time, incidental to the practice of law, and who does not advertise or represent that he is an adjuster.

### Rhode Island

- i. Gen. Laws 1956, § 27-2.4-5(b)(9)
  - o A license as an insurance provider shall not be required of the following: [a] person engaged or employed as an attorney licensed to practice law in Rhode Island and provided that those persons do not sell, solicit or negotiate insurance.

### South Carolina

- i. Code 1976 § 38-48-10(1)
  - o "Public insurance adjuster" means any individual who, for salary, fee, commission, or other compensation, engages in public adjusting and who is licensed under § 38-48-20. A public insurance adjuster is not an attorney licensed to practice by the South Carolina Supreme Court who adjusts insurance losses in the course of the practice of law. A public insurance adjuster is not an adjuster representing an insurer and is not licensed in accordance with the provisions of Chapter 47.

### Texas

- i. V.T.C.A., Insurance Code § 4102.051(b)(1)
  - o An attorney licensed to practice law in this state who has complied with Section 4102.053(a)(6).

Virginia

- i. VA Code Ann. § 38.2-1845.3
  - o This article shall not apply to . . . any licensed attorney in the Commonwealth . . . .

Washington D.C.

- i. DC ST § 31-1631.12(3)(A)–(B)
  - o This chapter shall not apply to: [a]n attorney at law who does not regularly act as a public insurance adjuster or represent to the public by sign, advertisement, or other written or oral communication indicating that the attorney at law acts as a public insurance adjuster.

STATE BY STATE SURVEY:  
BAD FAITH LAW DEFENSES

---

Prepared for ACCEC Fellows at May, 2018  
ACCEC Annual Meeting

Courtesy of: DRI, The Voice of the Defense Bar

Reprinted with Permission, from

“Insurance Bad Faith: A Compendium of State Law,”  
DRI, © 2015

Also, “State of Affairs” Recap,

Courtesy of: Goldberg, Segalla, LLP



# State Of Affairs – State By State

- Reverse Bad Faith
  - Yes or Possible  
CA, CT, PA, TN, UT, WI
  - No or Not addressed  
AL, AK, AR, CO, CT, DE, DC, FL, GA, HI, ID, IL, IN, IA, KS, KY, LA, ME, MD, MA,  
MN, MS, ND, MI, NE, NV, NH, NJ, NM, NY, NC, ND, OH, OK, OR, PR, RI, SC, SD,  
TX, VI, VA, WA, WI, CAN.
- Insured's Conduct
  - Yes  
AK, AZ, CA, CO, CT, DL, FL, HI, ID, IL, IN, IA, KS, KY, LA, MD, MI, MS, MO, MT,  
NV, NJ, NM, NY, ND, OH, OK, OR, PA, PR, TN, TX, UT, VT, VA, WA, WV, CAN.
  - No or Not Considered  
AL, AR, DC, GA, ME, MA, MN, NB, NC, RI, SD, WV

DRI Insurance Bad Faith, A Compendium of State Law 2015-2016

# Alabama

By Walter J. Price III and R. Bruce Barze, Jr.

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

No. Although new regulations have been passed by the Alabama Department of Insurance regarding the handling of insurance claims, they are not to be used for civil or criminal purposes to presume any standard of care, and they are not the basis for a cause of action. See Ala. Admin. Code r. 482-1-125-.02. Nevertheless, in two decisions Ala. Code §27-12-24, preempted on other grounds, *Gilbert v. Alta Health & Life Ins. Co.*, 276 F.3d 1292 (11th Cir. 2001), has been described as the “codification” of Alabama’s bad faith law. *Hilley v. Allstate Ins. Co.*, 562 So. 2d 184, 185 n.1 (Ala. 1990); *Gilbert v. Alta Health & Life Ins. Co.*, 276 F.3d 1292, 1296 (11th Cir. 2001). The statute provides:

No insurer shall, without just cause, refuse to pay or settle claims arising under coverages provided by its policies in this state and with such frequency as to indicate a general business practice in this state, which general business practices evidenced by:

- (1) A substantial increase in the number of the complaints against the insurer received by the Insurance Department;
- (2) A substantial increase in the number of lawsuits against the insurer or insureds by claimants; and
- (3) Other relevant evidence.

Ala. Code §27-12-24.

### ***Can a third party bring a statutory action for bad faith?***

No, though see citations and discussion above.

### ***Is there a common law action for bad faith?***

Yes. The Alabama Supreme Court first recognized the common law cause of action for bad faith in *Chavers v. Nat’l Sec. Fire & Cas. Co.*, 405 So. 2d 1 (Ala. 1981). *White v. State Farm Fire & Cas. Co.*, 953 So. 2d 340 (Ala. 2006) contains a more recent treatment of the tort of bad faith in Alabama.

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

An excess carrier cannot bring a claim against the primary insurer either on principles of equitable subrogation or on principles of contract. *Chavers & Pearce Constr. Co., Inc. v. Traveler*, 843 So. 2d 140, 143 (Ala. 2002) (holding “in the absence of contrary contractual obligations, a primary insurer owes no duty of good faith to an insured with respect to the settlement of a claim against an insured. The reasons which justify the tort of bad faith, currently recognized against their insurers... are present in the primary-insurer/excess-carrier relationship where, as here, contractual duties to settlement of a claim are absent”).

### ***What causes of action for extracontractual liability have been recognized outside the claim handling context?***

An insured may sue an insurer for fraud if the insurer has no intent to pay a claim at the time the policy was sold. *Old Southern Life Ins. Co. v. Woodall*, 348 So. 2d 1377, 1380 (Ala. 1977).

An insured may sue an insurer for misrepresentation or suppression if an insurer’s agent persuades an insured to switch to a policy that costs more and offers less benefits. *Boswell v. Liberty Nat’l Life Ins.*

**Under what circumstances will bad faith claims be severed for trial from the underlying claim?**

A bad faith claim may be bifurcated from the trial of the underlying claim based on Alabama Rule of Civil Procedure 42(b), which governs bifurcation generally.

Alabama Rule of Civil Procedure 18, which permits the joinder of liability coverage claims with the underlying dispute, provides: "In no event shall this or any other rule be construed to permit a jury trial of a liability insurance coverage question jointly with the trial of a related damage claim against an insured." Ala. R. Civ. P. 18(c); *see also Univ. Underwriters Ins. Co. v. E. Cent. Ala. Ford-Mercury, Inc.*, 574 So. 2d 716, 723-24 (Ala. 1990). Where a coverage action is joined (irrespective of whether there are attendant bad faith claims) during the first phase, neither the jury nor the judge would consider the insurer's participation or the coverage issue. *Id.* The jury would become aware of the insurer and the coverage issue only in the event that it rendered a verdict in the plaintiff's favor in the first phase. *Id.* The judge would consider the coverage issue only if he or she rendered a judgment for the plaintiff in the first phase. *Id.* In the second phase, the same jury or judge would hear and decide the coverage issue between the defendant insured and the insurer. *Id.*

**Under what circumstances will the compensatory and punitive damages claims be bifurcated?**

No criteria have been set forth for the bifurcation of compensatory and punitive damages in a strictly bad faith context. Instead, it would be the same as for any other case involving punitive damages.

**Defenses and Counterclaims**

**Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?**

This issue has not been considered in any reported decision.

**Is "advice of counsel" a recognized defense?**

"While advice of counsel, along with all the other relevant factors, may be considered by the trial judge in his determination whether the strongest tendencies of the evidence, if believed, make out a case for the jury on the 'lawful basis for refusal' issue, it is not necessarily an absolute defense." *Chavers v. Nat'l Sec. Fire & Cas. Co.*, 405 So. 2d 1, 8 (Ala. 1981).

Where, as here, the advice of insurer's counsel is not founded on professional evaluation of the credibility of admissible evidence, but instead is confined totally to inadmissible and unproved hearsay evidence, absent any ongoing investigation relative thereto, such advice cannot serve, as a matter of law, to insulate the insurer client from bad faith liability.

*Id.*; *see also Davis v. Cotton States Mut. Ins. Co.*, 604 So. 2d 354, 359 (Ala. 1992) ("Crucial to the insurers' showing that they did not act in bad faith is their employment of a lawyer in private practice to research the coverage of the motor vehicle.").

**What other defenses are available?**

Any claim of bad faith for wrongful refusal to pay will fail if the evidence demonstrates that the coverage claim was "fairly debatable." *Gulf Atl. Life Ins. Co. v. Barnes*, 405 So. 2d 916, 924 (Ala. 1981); *Nat'l Ins. Ass'n v. Sockwell*, 829 So. 2d 111, 126-27 (Ala. 2002); *Nat'l Sec. Fire & Cas. Co. v. Bowen*, 417 So. 2d 179, 183 (Ala. 1982).

When the bad faith claim is predicated on the investigation of the claim:

The relevant question before the trier of fact would be whether a claim was properly investigated and whether the results of the investigation were subjected to a cognitive evaluation and review. Implicit in that test is the conclusion that the knowledge or reckless disregard of the lack of a legitimate or reasonable basis may be inferred and imputed to an insurance company when there is a reckless indifference to facts or to proof submitted by the insured.... [However a bad faith claim] cannot follow when an insurance company in the exercise of ordinary care makes an investigation of the facts and law and concludes

on a reasonable basis that the claim is at least debatable.

*Gulf Atl. Life Ins. Co.*, 405 So. 2d at 924 (citation and internal quotation marks omitted).

Other defenses are available in certain cases. In a fire case, an insurer can assert arson or concealment. *S & W Props., Inc. v. Am. Motorists Ins. Co.*, 668 So. 2d 529, 531 (Ala. 1995). Misrepresentation on an application by an insured also is a defense. *Am. Gen. Life & Accident Ins. Co. v. Lyles*, 540 So. 2d 696, 699 (Ala. 1988).

### ***Is there a cause of action for reverse bad faith?***

No.

### **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

Alabama does not recognize a claim for the negligent or wanton handling of first-party insurance claims. *Kervin v. S. Guar. Ins. Co.*, 667 So. 2d 704, 706 (Ala. 1995).

Through dicta, the Alabama Supreme Court has stated that it may recognize a third-party claim in contract (and thus possibly for bad faith) directly against an insurer when there is a “new and independent obligation,” such as a set of promises arising from a contract exchanged between a third party and insurer. See *Williams v. State Farm Mut. Auto. Ins. Co.*, 886 So. 2d 72, 74–75 (Ala. 2003).

It is proper for an insurer to rely upon the fact that the insured misrepresented material facts (such as bankruptcy filings, litigation history) to outright deny a claim under a casualty policy. *Nationwide Mut. Fire Ins. Co. v. Pabon*, 903 So. 2d 759, 767–68 (Ala. 2004).

#### AUTHORS

**Walter J. Price III** | Huie, Fernambucq & Stewart LLP | 205.297.8832 | wprice@huielaw.com

**R. Bruce Barze, Jr.** | Balch & Bingham LLP | 205.226.8716 | bbarze@balch.com

# Alaska

By Stuart D. Jones

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

No. There is no private cause of action for a violation of Alaska's Unfair Claims Settlement Practices Act. See AS §21.36.125(b); see also *Lockwood v. GEICO Gen. Ins. Co.*, 323 P.3d 691, 696 n.15 (Alaska 2014) (affirming summary judgment, in part, and rejecting the plaintiff's argument that an insurer's alleged pattern of delaying paying created a question of fact whether the insurer violated several provisions of the Unfair Claims Settlement Practices Act); *O.K. Lumber Co. v. Providence Washington Ins.*, 759 P.2d 523, 526–27 (Alaska 1988).

### ***Can a third party bring a statutory action for bad faith?***

No, as to a statutory action for bad faith. See *O.K. Lumber Co. v. Providence Washington Ins.*, 759 P.2d 523, 527 (Alaska 1988). Alaska's courts have "decline[d] to recognize a tort duty of good faith and fair dealing independent of the contractual relationship.... A breach of the covenant [of good faith and fair dealing] is not tortious and does not give rise to a cause of action in favor of a third party." *Id.* at 525–26; but see *CP ex rel. ML v. Allstate Ins. Co.*, 996 P.2d 1216, 1221 (Alaska 2000) (distinguishing the holding of *OK Lumber* where the plaintiff was suing as an assignee of the insured's rights; therefore, plaintiff was suing as a first party, not a third party). However, "[t]he Alaska Supreme Court 'will recognize a third-party right to enforce a contract upon a showing that the parties to the contract intended that at least one purpose of the contract was to benefit a third party.'" *Green v. Allstate Ins. Co.*, 885 F. Supp. 2d 959, 963 (D. Alaska 2012) (quoting *Ennen v. Integon Indemnity*

In *Ennen*, the Alaska Supreme Court held that the plaintiff, who was injured while riding as a passenger in an insured vehicle, was an intended third-party beneficiary under the terms of the UIM coverage required by Alaska statute. Therefore, as an unnamed, additional insured, the plaintiff was held entitled to bring a cause of action for bad faith. 268 P.3d at 283–84; but see *Charles v. Stout*, 308 P.3d 1138, 1140–41 (Alaska 2013) (affirming summary judgment rejecting a passenger's contention that he was a third-party beneficiary of a contract between the owners of the auto and a credit union where the latter had the right, but not the obligation, to provide liability insurance if the named insureds failed to do so, and there was no evidence that an insurance policy had been issued).

### ***Is there a common law cause of action for bad faith?***

Yes. *Jackson v. American Equity Ins. Co.*, 90 P.3d 136, 142 (Alaska 2004); see *O.K. Lumber Co. v. Providence Washington Ins.*, 759 P.2d 523, 525 (Alaska 1988). The common law cause of action for bad faith is predicated upon the parties' unequal bargaining positions, which creates a "special relationship" and renders the enforcement of the implied covenant of good faith and fair dealing "particularly important." However, a tort claim for breach of the implied covenant of good faith and fair dealing requires more than negligent conduct by the insurer. *Alaska Pac. Assur. Co. v. Collins*, 794 P.2d 936, 946–47 (Alaska 1990); see *State Farm Fire & Cas. Co. v. Nicholson*, 777 P.2d 1152, 1157 (Alaska 1989); *Anchorage Corp. v. Integrated Concepts & Research Corp.*, 1 F. Supp. 3d 1001, 1017–19 (D. Alaska 2014) (citing *Ennen*, and holding that despite a presumption that parties that benefit from a government contract are incidental beneficiaries under Federal law, and may not enforce

*Brannon v. Continental Cas. Co.*, 137 P.3d 280, 283, 287 (Alaska 2006) (relief sought from the bankruptcy court to assign and pursue breach of contract and breach of the covenant of good faith and fair dealing against an insurer denying coverage and a duty to defend the insured; vacating a judgment of dismissal on the ground that the stay from the bankruptcy tolled the running of the statute of limitations).

Upon insolvency of the insurer, the Alaska Insurance Guaranty Association can intervene and substitute itself as the defendant. *Estes v. Alaska Ins. Guar. Ass'n*, 774 P.2d 1315, 1316 (Alaska 1989). In 1970, the Alaska State Legislature created the Alaska Insurance Guaranty Association, which pursuant to Alaska Stat. §21.80.060(a)(2), "has all rights, duties, and obligations of the insolvent insurer as if the insurer had not become insolvent." The AIGA does not have any coverage defense greater than those of the insolvent insurer. Bankruptcy "Rule 610 gives the debtor in possession the right to intervene in a pending action, but nothing in that rule requires that proceedings be held in abeyance while the debtor reaches a decision." *Roach v. First Nat'l Bank of Anchorage*, 636 P.2d 608, 613 (Alaska 1981).

#### **How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?**

Intervention of the Alaska Insurance Guaranty Association does not abate the insured's claims, because AIGA can substitute itself as the defendant with the coverage defenses of the insolvent insurer. *Estes v. Alaska Ins. Guar. Ass'n*, 774 P.2d 1315, 1316 (Alaska 1989).

#### **Defenses and Counterclaims**

##### **Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?**

Yes. *Great Divide Ins. Co. v. Carpenter*, 79 P.3d 599, 608 (Alaska 2004) ("Ordinarily the insured is barred by the cooperation clause of the policy from settling without the insurer's consent."); *Grace v. Ins. Co. of N. Am.*, 944 P.2d 460, 464 (Alaska 1997) (unjustified

breach of the cooperation clause voids coverage); *Industrial Indem. Co. of Alaska, Inc. v. Great Am. Ins. Co.*, 686 P.2d 1216, 1219 (Alaska 1984) (impairment of insurer's subrogation rights relieves it of further liability); *Nelson v. Progressive Corp.*, 976 P.2d 859, 867 (Alaska 1999) (defense expert testified the plaintiff insured had "set up" insurer for bad faith lawsuit).

##### **Is "advice of counsel" a recognized defense?**

"Advice of counsel," while not recognized as a complete defense, is likely admissible as evidence of the reasonableness of the insurer's conduct. Conversely, evidence of advice from counsel has been admitted as relevant evidence against the insurer. *Lloyd's & Inst. of London Underwriting Cos. v. Fulton*, 2 P.3d 1199, 1206 (Alaska 2000) (evidence that insurer retained coverage counsel was relevant to impeach insurer's position that it was not aware of any coverage issues); *United Services Auto. Ass'n v. Werley*, 526 P.2d 28, 31-32 (Alaska 1974) (attorney-client privilege pierced by crime-fraud exception).

##### **What other defenses are available?**

No other defenses have been expressly recognized or precluded.

##### **Is there a cause of action for reverse bad faith?**

No. However, evidence of the insured's conduct is admissible as either a complete defense or to mitigate the insurer's potential liability. See generally *Petersen v. Mut. Life Ins. Co. of N.Y.*, 803 P.2d 406, 409 (Alaska 1990) (jury's finding that the insured knowingly made misrepresentations, omissions, and concealed facts on his application for life insurance); *Grace v. Ins. Co. of N. Am.*, 944 P.2d 460, 464 (Alaska 1997); *Industrial Indem. Co. of Alaska, Inc. v. Great Am. Ins. Co.*, 686 P.2d 1216 (Alaska 1984); *Nelson v. Progressive Corp.*, 976 P.2d 859, 867 (Alaska 1999).

#### **AUTHOR**

**Stuart D. Jones** | Bullivant Houser Bailey PC | 503.499.4616 | stuart.jones@bullivant.com

# Arizona

By Leon B. Silver and Andrew S. Jacob

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

No. *Melancon v. USAA Cas. Ins. Co.*, 174 Ariz. 344, 347, 849 P.2d 1374, 1377 (App. Div. 2 1992) (Unfair Claims Practices Act, Ariz. Rev. Stat. §20-461, does not “create[] a private right or cause of action.”).

### ***Can a third party bring a statutory action for bad faith?***

No. *Melancon v. USAA Cas. Ins. Co.*, 174 Ariz. 344, 347, 849 P.2d 1374, 1377 (App. Div. 2 1992); *Leal v. Allstate Ins. Co.*, 199 Ariz. 250, 255, ¶28, 17 P.3d 95, 100 (App. Div. 1 2000).

### ***Can an insured compel administrative enforcement of the Unfair Claims Practices act?***

No. Mandamus relief is not available to compel administrative enforcement of the Unfair Claims Practices Act, Ariz. Rev. Stat. §20-461. *Blankenbaker v. Marks*, 231 Ariz. 575, 579, ¶18, 299 P.3d 747, 751 (App. Div. 1 2013).

### ***Is there a common law cause of action for bad faith?***

Yes. Arizona recognizes both first- and third-party bad faith claims. *Clearwater v. State Farm Mut. Auto. Ins. Co.*, 164 Ariz. 256, 258, 792 P.2d 719, 721 (1990) (distinguishing first-party from third-party claims). “[B]ecause the risk to the insured and the responsibilities of the insurer are distinguishable in first- and third-party claims, the applicable standard of conduct is necessarily different.” *Id.* at 260, 792 P.2d at 723. This is discussed in more detail below. Both kinds of insurance bad faith claims arise from a

breach of “a legal duty implied in an insurance contract that the insurance company must act in good faith in dealing with its insured on a claim.” *Noble v. National Amer. Life Insur. Co.*, 128 Ariz. 188, 190, 624 P.2d 866, 868 (1981). Hence, in contrast to ordinary claims for breach of the implied duty of good faith and fair dealing, insurance bad faith claims sound in tort, not contract. *Id.*; see also *Walter v. Simmons*, 169 Ariz. 229, 238, 818 P.2d 214, 223 (App. Div. 1 1991) (“Although the duty of good faith is inherent in any insurance contract, it is not strictly a contractual obligation; rather, it is an obligation imposed by law that governs the insurer in discharging its contractual responsibilities.”).

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

Upon defending and/or paying a claim, an excess insurer may bring an equitable subrogation action against another insurer for breach of the duties to defend, indemnify, and/or good faith owed to the insured. *Hartford Accid. & Indem. Co. v. Aetna Cas. & Sur. Co.*, 164 Ariz. 286, 290-91, 792 P.2d 749, 753-54 (1990); *Twin City Fire Ins. Co. v. Burke*, 204 Ariz. 251, 257, ¶17, 63 P.3d 282, 288 (2003).

### ***What causes of action for extracontractual liability have been recognized outside the claim handling context?***

An insurer may be liable for a tortious breach of the duty of good faith when its conduct toward an insured is inconsistent with the security the insured seeks in purchasing insurance. *Rawlings v. Apodaca*, 151 Ariz. 149, 155, 726 P.2d 565, 571 (1986) (insurer that paid insureds’ first-party fire loss claim could be held liable for bad faith where it refused to provide

simultaneously bring actions for breach of contract and for first-party bad faith, and need not prevail on the contract claim in order to prevail on the bad faith claim. The court expressly rejected as dicta a footnote in *Brown v. Superior Court*, 137 Ariz. 327, 330 n.1, 670 P.2d 725, 728 (1983), which questioned whether a plaintiff should be permitted to pursue both a breach of contract and bad faith claim simultaneously. See also Ariz. R. Civ. P. 18(b) (permitting joinder of a claim that would be strictly "cognizable only after another claim has been prosecuted to a conclusion"); *First Mercury Ins. Co. v. Cedar West Capital, LLC*, 2012 WL 6217549 (D. Ariz. Dec. 13, 2012) (discussing precedents under federal rules for such joinder in detail).

#### ***Under what circumstances will trial of bad faith and coverage claims be bifurcated?***

Ariz. R. Civ. P. 42(b) permits separate trials of claims on any issue. Pursuant to this rule, a court may order separate trials for bad faith claims and other claims relating to the dispute between insurer and insured. See, e.g., *Trus Joist Corp. v. Safeco Ins. Co.*, 153 Ariz. 95, 98, 735 P.2d 125, 128 (1986) (trial court divided proceeding into three separate trials or "phases," each tried separately on merits, Phase I for coverage issues, Phase II for issues of rescission, and Phase III for jury trial on breach of contract and bad faith claims).

#### ***Under what circumstances will trial of compensatory and punitive damages claims be bifurcated?***

Ariz. R. Civ. P. 42(b) permits separate trials of any claim or issue. A claim for punitive damages can and should often be separated from the other issues in a case and tried separately after a plaintiff has prevailed on the issues for compensatory damages. See, e.g., *Hawkins v. Allstate Ins. Co.*, 152 Ariz. 490, 507, 733 P.2d 1073, 1090 (1987) (Holohan, J., dissenting). The same jury that heard the first phase of the case can hear the second phase dealing with the punitive damages issue. *Id.*; see, e.g., *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408 (2003).

## **Defenses and Counterclaims**

### ***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Yes. In both first- and third-party claims, the conduct of the insured or the claimant, or their attorneys, may be relevant to the reasonableness of the insurer's conduct. See, e.g., *Miel v. State Farm Mut. Auto. Ins. Co.*, 185 Ariz. 104, 110–11, 912 P.2d 1333, 1339–40 (App. Div. 1 1995) (trial court erred in not permitting insurer to examine claimant's attorney about short deadline for demand); *Borland v. Safeco Ins. Co. of Am.*, 147 Ariz. 195, 200–01, 709 P.2d 552, 557–58 (App. Div. 1 1985) (discussing conduct of insured's counsel as part of rationale for denying punitive damages).

### ***Is "advice of counsel" a recognized defense?***

Yes. *State Farm Mut. Auto. Ins. Co. v. Lee*, 199 Ariz. 52, 58, 13 P.3d 1169, 1175 (2000) (discussing how defense waives attorney-client privilege). A reasonable, although erroneous, coverage decision may be a defense to a bad faith claim. *Aetna Cas. & Sur. Co. v. Superior Court*, 161 Ariz. 437, 778 P.2d 1333 (App. Div. 1 1989). Because the duty of good faith is non-delegable, an insurer cannot avoid liability for bad faith by relying upon advice that its attorney knows or should know is erroneous. See generally *Walter v. Simmons*, 169 Ariz. 229, 818 P.2d 214 (App. Div. 1 1991) (duty of good faith is non-delegable.)

### ***Is compliance with industry custom a recognized defense?***

No. Compliance with industry custom is not a defense, *Sparks v. Republic Nat'l Life Ins. Co.*, 132 Ariz. 529, 539, 647 P.2d 1127, 1137 (1982), but may be relevant regarding the reasonableness of the insurer's conduct. See, e.g., *Rawlings v. Apodaca*, 151 Ariz. 149, 157–58, 726 P.2d 565, 573–74 (1986).

### ***How should an insurer handle multiple claimants?***

An insurer faced with multiple claims in excess of the insured's policy limits meets its duty to equally

consider settlement offers by: (a) promptly filing an interpleader as to all known claimants, (b) paying the policy limits into the court, and (c) defending the insured as to each of the pending claims. *McReynolds v. American Commerce Ins. Co.*, 225 Ariz. 125, 131, 235 P.3d 278, 284, ¶26 (App. Div. 1 2010).

***Does an excess carrier have duties before the primary carrier offers its policy limits?***

No. An excess insurer does not have a duty to evaluate settlement offers, or to participate in the defense “or to act at all,” until the primary insurer offers its policy limits. *Twin City Fire Ins. Co. v. Burke*, 204 Ariz. 251, 256, 63 P.3d 282, 287, ¶18 (2003); *Regal Homes, Inc. v. CNA Ins.*, 217 Ariz. 159, 167–68, 171 P.3d 610, 618–19 ¶34 (App. Div. 1 2008).

***Does an insured’s bankruptcy stay an insurer’s duty to act in good faith?***

No. A bankruptcy stay does not stay an insurer’s duty to give fair consideration to settle creditor claims against its insured debtor. *Acosta v. Phoenix Indem. Ins. Co.*, 214 Ariz. 380, 386, ¶29, 153 P.3d 401, 407 (App. Div. 2 2007) (holding that the fact that a bankruptcy court would have to approve a settlement does not obviate the insurer’s opportunity to settle claims against the debtor).

***Is there a cause of action for bad faith against an insured?***

Unlikely. Because the imbalanced relationship is an important reason for permitting insureds to sue in tort, see *Rawlings v. Apodaca*, 151 Ariz. 149, 154–55, 726 P.2d 565, 570–71 (1986) and *Dodge v. Fidelity & Deposit Co. of Maryland*, 161 Ariz. 344, 346–47, 778 P.2d 1240, 1242–43 (1989), it is unlikely that Arizona courts would impose a legal, tort duty on the insured to act in good faith towards the insurer. That said, Arizona courts certainly recognize that an insurer may offer evidence of unreasonable conduct, by the insured or a third-party claimant, in defense of the insurer’s conduct. See *Miel v. State Farm Mut. Auto. Ins. Co.*, 185 Ariz. 104, 110–11, 912 P.2d 1333, 1339–40 (App. Div. 1 1995); *Borland v. Safeco Ins. Co. of*

*America*, 147 Ariz. 195, 200–01, 709 P.2d 552, 557–58 (App. Div. 1 1985).

***Does an insurer have a claim against an attorney who advises an insured to enter into a Damron/Morris agreement?***

No. *Safeway Ins. Co. v. Guerrero*, 210 Ariz. 5, 106 P.3d 1020 (2005), held that an insurer does not have a cause of action against a tort plaintiff’s attorney for tortious interference with the insurance policy by wrongfully inducing the insured to enter into a *Damron-Morris* agreement. However, the Court observed that filing suit upon a “manufactured” bad faith claim may be sanctioned under Rule 11, may be required to pay the insurer’s attorneys’ and may be liable for wrongful institution of civil proceedings. *Id.* at 15, ¶35, 106 P.3d 130. And, there may be a viable claim against an attorney who induces an insured to breach the cooperation clause.

**Other Significant Cases Involving Bad Faith and Extracontractual Claims**

Not all contract issues between insured and insurer are subject to a legal duty of good faith. For example, breach of the implied covenant of good faith and fair dealing that relates to premiums and dividends, because it does not impact the financial security of the insured, is not subject to a tort action for bad faith. *Beaudry v. Ins. Co. of the West*, 203 Ariz. 86, 92, ¶¶24–25, 50 P.3d 836, 842 (App. Div. 1, 2002).

Where coverage is not contested but the amount of a property loss is disputed, an insurer must pay any undisputed portion of claim promptly; a failure to do so is bad faith. *Filasky v. Preferred Risk Mut. Ins. Co.*, 152 Ariz. 591, 597, 734 P.2d 76, 82 (1987); *Borland v. Safeco Ins. Co. of Am.*, 147 Ariz. 195, 200, 709 P.2d 552, 557 (App. Div. 1 1985).

In an action for breach of contract and bad faith, the portions of the insurer’s claim file leading up to and including decisions on the claim are discoverable despite “work product” objections because they are relevant and no “substantial equivalent” is available to the plaintiff. *Brown v. Superior Court*, 137 Ariz. 327, 335, 670 P.2d 725, 733 (1983).

An insurer may be liable for abuse of process for defending a personal injury action unreasonably, including a failure to participate in an ordered settlement conference in good faith. *Crackel v. Allstate Ins. Co.*, 208 Ariz. 252, 257–58, ¶14, 92 P.3d 882, 887–88 (App. Div. 2 2004).

When an insurer defends a bad faith action on the basis that its claims handling was both objectively and subjectively reasonable, it impliedly waives the attorney–client privilege regarding communications with attorneys on the coverage issue in dispute, even if it does not assert the advice of counsel defense. *State Farm Mut. Auto. Ins. Co. v. Lee*, 199 Ariz. 52, 58, ¶15, 13 P.3d 1169, 1175 (2000). On the other hand, a plaintiff who pleads its “reasonable belief” does not put its legal advice in issue unless such belief is a necessary element of its claim. *Empire West Title Agency, L.L.C. v. Talamante*, 234 Ariz. 497, 500, ¶18, 323 P.3d 1148, 1151 (2014).

A trial court erred by permitting nationwide discovery of “pattern and practice” evidence and permitted discovery related to dissimilar claims, holding that it was unreasonable and unduly burdensome. *State Farm Mut. Auto. Ins. Co. v. Superior Court*, 167 Ariz. 135, 139, 804 P.2d 1323, 1327 (App.

Div. 1 1991); *see also Tritschler v. Allstate Ins. Co.*, 213 Ariz. 505, 519, &745, 144 P.3d 519, 533 (App. Div. 2 2006) (same).

An insurer is not required to pay uninsured motorist coverage for special damages such as emotional distress while the amount of such damages is being adjudicated. *Voland v. Farmers Ins. Co. of Ariz.*, 189 Ariz. 448, 943 P.2d 808 (App. Div. 2 1997). Unlike damages for property losses, it cannot be said whether some portion of such damages is undisputed. *Id.*

Although honest negligence by itself does not support a bad faith claim, an excessive delay in correcting such negligence can support such claim. *Haney v. ACE American Ins. Co.*, CV-13-02429-PHX-DGC, 2015 WL 58670, 2015 U.S. Dist. Lexis 309 (D. Ariz. Jan. 5, 2015).

#### AUTHORS

**Leon B. Silver** | Gordon Rees Scully Mansukhani LLP | 602.794.2460 | lsilver@gordonrees.com

**Andrew S. Jacob** | Gordon Rees Scully Mansukhani LLP | 602.794.2460 | ajacob@gordonrees.com

# Arkansas

By Aaron D. French and Philip C. Graham

## Causes of Action

### *Is there a statutory basis for an insured to bring a bad faith claim?*

Yes. Ark. Code Ann. §23-79-208(a)(1) provides for a limited private cause of action where an insurer “fail[s] to pay the losses within the time specified in the policy after demand is made,” and provides the insurer shall be liable to pay the insured or assignee, “in addition to the amount of the loss, twelve percent (12%) damages upon the amount of the loss, together with all reasonable attorney’s fees for the prosecution and collection of the loss.” The insured must, however, recover an amount that is within twenty percent (20%) of the amount demanded, or is within thirty percent (30%) for cases involving a homeowner’s policy. Ark. Code Ann. §23-79-208(d)(1), (2).

The purpose of the statute is to punish unwarranted delaying tactics of insurance companies. *Nat’l Standard Ins. Co. v. Westbrook*, 962 S.W.2d 355, 357 (Ark. 1998). The insurer’s good faith is not a valid defense against liability under the statute. See, e.g., *Home Mut. Fire Ins. Co. v. Jones*, 977 S.W.2d 12, 17 (1998); *Life & Cas. Ins. Co. of Tenn. v. Wiggins*, 273 S.W.2d 405, 406 (Ark. 1954). The statutory penalties will not be assessed, however, if it was reasonably necessary for the insurer to continue its investigation beyond the time that payment was due. *Silvey Cos. v. Riley*, 888 S.W.2d 636, 638 (Ark. 1994).

While the Arkansas Trade Practices Act, codified at Ark. Code Ann. §23-66-201, *et seq.*, “regulates trade practices in the business of insurance,” it provides “no private right of action to insureds for violations of the Act or of regulations promulgated under the Act’s authority.” *Design Prof’ls Ins. Co. v. Chicago Ins. Co.*, 454 F.3d 906, 911–12 (8th Cir. 2006)

(interpreting Arkansas law).

### *Can a third party bring a statutory bad faith claim?*

No. A third-party action for bad faith to recover damages in excess of policy limits sounds in tort, not in contract, and the statutory penalty and attorney fees of Ark. Code Ann. §23-79-208(a)(1) are not recoverable. *Tri-State Ins. Co. v. Busby*, 251 Ark. 568, 473 S.W.2d 893, 896 (Ark. 1971); see also *Aetna Cas. & Sur. Co. v. Broadway Arms Corp.*, 664 S.W.2d 463, 465 (Ark. 1984) (finding Trade Practices Act does not preempt area upon which tort of bad faith is founded in third-party claims for bad faith, because Act was intended to apply only to undesirable conduct of insurers in first-party claims).

Though not bad faith, Ark. Code Ann. §23-79-210(a) provides an injured claimant with a direct right of action against an insurer, where the tortfeasor or the tortfeasor’s agent is “not subject to suit for tort” but carries liability insurance.

### *Is there a common law cause of action for bad faith?*

Yes. See, e.g., *Aetna Cas. & Sur. Co. v. Broadway Arms Corp.*, 664 S.W.2d 463, 465 (Ark. 1984) (recognizing bad faith claim for failure to pay policy benefits); *McCall v. S. Farm Bureau Cas. Ins. Co.*, 501 S.W.2d 223, 224 (Ark. 1973) (recognizing bad faith claim for failure to settle third-party claim under liability policy).

A third party may not bring a direct action for common law bad faith against an insurer, but may obtain an assignment of an insured’s right to bring such an action. See *RLI Ins. Co. v. Coe*, 813 S.W.2d 783, 789 (Ark. 1991).

***Is a bad faith claim asserted in connection with a policy that provides third-party coverage viable if the third party does not prevail in the underlying claim?***

No. In the context of bad faith claims, a third-party claimant can take only those rights that have been assigned by the policyholder. See generally *Freeman v. Colonia Ins. Co.*, 890 S.W.2d 270 (Ark. 1995); *RLI Ins. Co. v. Coe*, 813 S.W.2d 783 (Ark. 1991). Since a third-party "failure to settle" action requires the entry of an excess judgment against the insured, there can be no viable action if the plaintiff does not prevail in the underlying action with an excess judgment.

**Practice and Procedure**

***Statute of limitations***

The statute of limitations for common law bad faith claims is three years. *Carpenter v. Auto. Club Interins. Exch.*, 58 F.3d 1296, 1300 (8th Cir. 1995) (applying Arkansas law); Ark. Code Ann. §16-56-105.

The statute of limitations for actions seeking statutory penalties, such as Ark. Code Ann. §23-79-208(a)(1), is two years. Ark. Code Ann. §16-56-108 (West 2010).

***Under what circumstances will bad faith claims be dismissed or stayed pending the resolution of the underlying claims?***

No reported case has analyzed the circumstances in which a bad faith claim should be dismissed, severed or stayed pending the resolution of the underlying claim.

***Under what circumstances will bad faith claims be severed for trial from the underlying claim?***

To date, Arkansas courts have not addressed whether a bad faith claim may be severed for trial from the underlying claim.

***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

Under the Arkansas Rules of Civil Procedure, a court "may order a separate trial of any claim, cross-claim, counterclaim, or third-party claim, or of any separate issue or any number of claims, cross-claims, counterclaims, third-party claims or issues." Ark. R. Civ. P. 42(b).

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

A claimant or insured may obtain payment owed by insolvent insurers from the Arkansas Property and Casualty Insurance Guaranty Fund. Ark. Code Ann. §23-90-101, *et seq.* The fund does not provide coverage for punitive damage claims. Ark. Code Ann. §23-90-103(c)(i). In addition, no coverage is provided for attorneys' fees, court costs or interest. Ark. Code Ann. §23-90-103(d). A claimant must exhaust all other collateral sources of coverage through solvent insurers before seeking relief from the Fund. Ark. Code Ann. §23-90-117(a)(1).

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Not specifically addressed in Arkansas within the context of common-law bad faith claims, but presumably it would be admissible, given the defenses available. See, e.g., *Carpenter v. Auto. Club Interins. Exch.*, 58 F.3d 1296, 1303 (8th Cir. 1995) (applying Arkansas law).

***Is "advice of counsel" a recognized defense?***

Not specifically addressed in Arkansas.

***What other defenses are available?***

Valid defenses against an insured's claim of bad faith include an insured's contributory negligence, failure to cooperate, and lack of good faith. *Carpenter v.*

*Auto. Club Interins. Exch.*, 58 F.3d 1296, 1303 (8th Cir. 1995) (applying Arkansas law).

***Is there a cause of action for reverse bad faith?***

Not specifically addressed in Arkansas. It should be noted, however, that Ark. Code Ann. §23-79-208(a)(2) provides that “in no event” will an insured be liable for the attorneys’ fees incurred by the insurer in defending a claim in which the insurer is ultimately found not liable for the loss.

AUTHORS

**Aaron D. French** | Sandberg Phoenix & von Gontard P.C. | 314.446.4293 | afrench@sandbergphoenix.com

**Philip C. Graham** | Sandberg Phoenix & von Gontard P.C. | 314.425.4952 | pgraham@sandbergphoenix.com

# California

By Heather J. Zacharia

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

No. There is no private right of action under Cal. Ins. Code §790.03(h). *Moradi-Shalal v. Fireman's Fund Ins. Cos.*, 46 Cal. 3d 287, 313 (1988). A technical violation of the Fair Claims Settlement Practices Act does not provide a statutory basis for bad faith liability against an insurer, but it may be evidence of bad faith. *See id.*

### ***Can a third party bring a statutory action for bad faith?***

Yes, but only under Cal. Ins. Code §11580 (direct action statute); *Hand v. Farmers Ins. Exch.*, 23 Cal. App. 4th 1847, 1859 (1994). The insured can assign bad faith claims to a third party, including a claim for fees incurred in prosecuting claims for breach of contract under *Brandt v. Superior Court*, 37 Cal. 3d 813 (1985). *See Essex Ins. Co. v. Five Star Dye House, Inc.*, 38 Cal. 4th 1252, 1265 (2006).

### ***Is there a common law cause of action for bad faith?***

Yes. *Waller v. Truck Ins. Exch., Inc.*, 11 Cal. 4th 1, 35-36 (1995) (third-party claim); *Chateau Chamberay Homeowners Ass'n v. Associated Int'l Ins. Co.*, 90 Cal. App. 4th 335, 345 (2001) (first-party claim).

### ***What cause of action exists for an excess carrier to bring a claim against primary carrier?***

By way of equitable subrogation (standing in the shoes of the insured), an excess insurer can sue a primary insurer for breach of express and implied contractual obligations. *Fireman's Fund Ins. Co.*

*v. Maryland Cas. Co.*, 21 Cal. App. 4th 1586, 1601 (1994); *Fireman's Fund Ins. Co. v. Maryland Cas. Co.*, 65 Cal. App. 4th 1279, 1292 (1998). There is no direct cause of action however for bad faith by an excess carrier against a primary carrier, as there is no contractual relationship. *Id.*

### ***What causes of action for extracontractual liability have been recognized outside the claim-handling context?***

Intentional infliction of emotional distress. *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 580 (1973); *Fletcher v. Western Nat'l Life Ins. Co.*, 10 Cal. App. 3d 376, 398 (1970). This requires a showing of extreme and "outrageous conduct," "so extreme as to exceed all bounds of that usually tolerated in a civilized community." *Ricard v. Pacific Indem. Co.*, 132 Cal. App. 3d 886, 895 (1982); *Schlauch v. Hartford Accident & Indem. Co.*, 146 Cal. App. 3d 926, 936 (1983).

Fraud (*i.e.*, false advertising or representations) and negligent misrepresentation (such as agent's failure to apprise insured of change in policy coverage). *See, e.g., Butcher v. Truck Ins. Exch.*, 77 Cal. App. 4th 1442, 1461-65 (2000); *Bock v. Hansen* 225 Cal. App. 4th 215, 231 (2014); *Cal. Serv. Station Etc. Ass'n v. American Home Assur. Co.*, 62 Cal. App. 4th 1166, 1176 (1998); *McLaughlin v. National Union Fire Ins. Co.*, 23 Cal. App. 4th 1132, 1148 (1994); *Tarmann v. State Farm Mut. Auto. Ins. Co.*, 2 Cal. App. 4th 153, 157-59 (1991); *Eddy v. Sharp*, 199 Cal. App. 3d 858, 865 (1988) (coverage not as agreed).

Violation of the unfair business practices statute, codified at Business & Professions Code section 17200, *et seq.* *See, e.g., Zhang v. Superior Court*, 57 Cal. 4th 364 (2013). Equitable relief can include injunctions against continued claim practices and disgorgement of profits. However, these types of

means there are no funds available for bad faith liability under either common law tort (breach of the implied covenant of good faith and fair dealing) or violations of the unfair settlement practices statute, codified at Cal. Ins. Code §790.03.

## **Defenses and Counterclaims**

### ***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Yes. The covenant of good faith and fair dealing is a two-way street. *Chateau Chamberay Homeowners Ass'n v. Associated Int'l Ins. Co.*, 90 Cal. App. 4th 335, 345 (2001); *Kransco v. American Empire Surplus Lines Ins. Co.*, 23 Cal. 4th 390, 410–11 (2000).

### ***Is "advice of counsel" a recognized defense?***

Yes. *State Farm Mut. Auto. Ins. Co. v. Superior Court (Johnson Kinsey Inc.)*, 228 Cal. App. 3d 721, 725–26 (1991); *Mock v. Michigan Millers Mut. Ins. Co.*, 4 Cal. App. 4th 306 (1992).

### ***What other defenses are available?***

Pursuant to the "genuine dispute doctrine," where there is a genuine issue as to the insurer's liability under the policy, there can be no bad faith liability imposed on the insurer for advancing its side of that dispute. *Chateau Chamberay Homeowners Ass'n v. Associated Int'l Ins. Co.*, 90 Cal. App. 4th 335, 347–48 (2001) (first-party insurance); *CalFarm Ins. Co. v. Krusiewicz*, 131 Cal. App. 4th 273, 286 (2005) (third-party insurance). This is true even where the insurer's decision is later determined to have been legally erroneous. See *Opsal v. United Servs. Auto. Ass'n*, 2 Cal. App. 4th 1197, 1205 (1991); *Blake v. Aetna Life Ins. Co.*, 99 Cal. App. 3d 901, 922–23 (1979). The mistaken withholding of policy benefits, if reasonable or based on a legitimate dispute as to the insurer's liability under California law, does not expose the insurer to bad faith liability. *Tomaselli v. Transamerica Ins. Co.*, 25 Cal. App. 4th 1269 (1994). However, the insurer must have conducted an adequate investigation in order to assert the "genuine dispute doctrine" as a defense. *Wilson v. 21st Century Ins. Co.*, 42 Cal. 4th 713 (2007).

### ***Is there a cause of action for reverse bad faith?***

Yes, although the cause of action sounds in contract, not in tort. *Agric. Ins. Co. v. Superior Court (MKDG/Rhodes SC P'ship)*, 70 Cal. App. 4th 385, 389–90 (1999); *Kransco v. American Empire Surplus Lines Ins. Co.*, 23 Cal. 4th 390, 410–11 (2000).

## **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

An insurer may be liable for bad faith for litigation conduct, specifically making a "lowball" settlement offer of an insured's claim. *White v. Western Title Ins. Co.*, 40 Cal. 3d 870 (1985).

An insurer cannot be held vicariously liable for injury or damage caused by a third-party vendor's negligence in performing services on behalf of an insured. *Rattan v. United Servs. Auto. Ass'n*, 84 Cal. App. 4th 715 (2000). The insured's remedies lie against the vendor, as well as any insurer acting as a guarantor of workmanship. *Id.*

An insured's failure to complete an appraisal under a policy which contractually requires one may bar all claims for breach of contract, bad faith, fraud, and punitive damages as a matter of law under Cal. Ins. Code §2071. *Community Assisting Recovery, Inc. v. Aegis Sec. Ins. Co.*, 92 Cal. App. 4th 886, 892–94 (2001).

California courts appear increasingly likely to find bad faith for denial of a claim if the insurer breached the duty to investigate. See, e.g., *Wilson v. 21st Century Ins. Co.*, 42 Cal. 4th 713 (2007).

In the absence of a settlement demand or any other manifestation the injured party is interested in settlement, when the insurer has done nothing to foreclose the possibility of settlement, there is no liability for bad faith failure to settle. *Reid v. Mercury Ins. Co.*, 220 Cal. App. 4th 262 (2013).

An insurer may be liable for breach of the duty of good faith and fair dealing if it refuses an offer to settle within the total available limits of each insurance policy on the risk, even if it exceeds the individual insurer's policy limits. *Howard v. American National Fire Insurance Co.*, 187 Cal. App. 4th 498 (2010).

An insurer is assumed to have knowledge of facts which, had it conducted an investigation, supports the possibility of coverage. *Safeco Ins. of America v. Parks*, 170 Cal. App. 4th 992 (2009).

A first-party insured, alleging causes of action for insurance bad faith, may bring an action against an insurer under the Unfair Competition Law (Cal. Bus. & Prof. Code §17200 *et seq.*), rejecting the argument

that such a holding will turn any bad faith claim into a claim for unfair competition/false advertising. *Zhang v. Superior Court* 57 Cal. 4th 364 (2013).

ATTORNEY

**Heather J. Zacharia** | Bullivant Houser Bailey PC |  
415.352.2715 | heather.zacharia@bullivant.com

# Colorado

By Matthew Y. Biscan and Jennifer Kirk Morris

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

Yes. Pursuant to C.R.S. §10-3-1115(1)(a), a "person engaged in the business of insurance shall not unreasonably delay or deny payment of a claim for benefits owed to or on behalf of any first-party claimant." An "insurer's delay or denial was unreasonable if the insurer delayed or denied authorizing payment of a covered benefit without a reasonable basis for that action." C.R.S. §10-3-1115(2). If an insurer is found in bad faith, C.R.S. §10-3-1116(1) provides that a plaintiff may "recover reasonable attorney fees and court costs and two times the covered benefit."

See also:

1. C.R.S. §10-3-1113, codifying the tort of bad faith against insurers;
2. C.R.S. §10-3-1104, setting forth Unfair and Deceptive Acts or Practices; and
3. C.R.S. §6-1-101 *et seq.*, The Colorado Consumer Protection Act ("CCPA").

### ***Can a third party bring a statutory action for bad faith?***

No. An injured third-party claimant may not bring a statutory bad faith claim against the alleged tortfeasor's insurer. *Schnacker v. State Farm Mut. Auto. Ins. Co.*, 843 P.2d 102 (Colo. App. 1992); see also *Cassidy v. Millers Cas. Ins. Co. of Tex.*, 1 F. Supp. 2d 1200, 1211 (D. Colo. 1998); and *Parrish Chiropractic Centers, P.C. v. Progressive Casualty Insurance Co.*, 874 P.2d 1049 (Colo. 1994).

A third-party claimant who becomes a judgment creditor may have a contractual right to sue the insurance company directly under a standard policy condition that allows persons who secure a judg-

ment against an insurer to recover under the policy. *Colard v. American Family Mut. Ins. Co.*, 709 P.2d 11 (Colo. App. 1985).

Colorado courts have also held that, in a workers' compensation case, an employee may bring a bad faith claim against the employer's insurance carrier, to the extent that the employee has a direct right of action against that carrier. *Savio v. Travelers Ins. Co.*, 678 P.2d 549 (Colo. App. 1983), *aff'd in relevant part*, 706 P.2d 1258 (Colo. 1985).

### ***Is there a common law cause of action for bad faith?***

Yes. An insured's purpose in purchasing liability insurance is to "obtain some measure of financial security and protection against calamity, rather than to secure commercial advantage." Because an insurer's refusal to pay valid claims without justification defeats that expectation, a liability insurance company will be liable for breaching the duty of good faith and fair dealing when it unreasonably refuses to settle a claim. See *Farmers Group, Inc. v. Trimble*, 658 P.2d 1370 (Colo. App. 1982) ["Trimble I"], *aff'd*, 691 P.2d 1138 (Colo. 1984) ["Trimble II"]; see also *Travelers Ins. Co. v. Savio*, 706 P.2d 1258, 1272-73 (Colo. 1985) (adopting the rationale of *Trimble II* in the workers' compensation context).

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

There is currently *no* statutory or common-law basis for an excess carrier to bring a bad faith claim. In *Keefer v. U.S. Fire Ins. Co.*, No. 90-A-486, 1991 WL 2233, at \*3 (D. Colo. Jan. 7, 1991), the District Court of Colorado, when discussing the difference between a primary insurer and an excess carrier, stated

824 P.2d 11 (Colo. App. 1991); *Rodriguez v. Safeco Ins. Co.*, 821 P.2d 849 (Colo. App. 1991).

### **Under what circumstances will bad faith claims be severed for trial from the underlying claim?**

A court has discretion to bifurcate a case into separate trials for the breach of contract and bad faith claims. *Novell v. American Guar. & Liab. Ins. Co.*, 15 P.3d 775, 779 (Colo. App. 1999) (it was not abuse of discretion to deny a request for bifurcation where the duplication in evidence and attorneys' fees created by separate trials would have been significant). The court will evaluate convenience, avoidance of prejudice, and the promotion of expedition or economy in the adjudicatory process. C.R.C.P. 42(b); *Gaede v. Dist. Court of Eighth Judicial Dist.*, 676 P.2d 1186, 1188 (Colo. 1984).

### **Under what circumstances will the compensatory and punitive damages claims be bifurcated?**

Rule 42(b) of the Colorado Rules of Civil Procedure outlines the factors that a court will weigh in determining whether to bifurcate claims. The court will evaluate convenience, avoidance of prejudice, and the promotion of expedition or economy in the adjudicatory process.

### **How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?**

It does not appear that there are reported decisions directly ruling on this issue in Colorado. But the Colorado Court of Appeals appears to have tacitly approved of the assignment of a bankrupt insured's bad faith claim from the bankruptcy trustee to judgment creditors. In *Bankruptcy Estate of Morris v. COPIC Insurance Co., Inc.*, 192 P.3d 519 (Colo. App. 2008), the appellate court affirmed in part, reversed in part, and remanded for trial an order granting summary judgment for the insurer on the judgment creditors' bad faith claim. See also *Cassidy v. Millers Casualty Ins. Co. of Texas*, 1 F. Supp. 2d 1200 (D. Colo. 1998)

(judgment creditors could not pursue bad faith claim against insurer absent assignment from insured).

### **How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?**

The Colorado Insurance Guaranty Association Act is set forth in C.R.S. §§10-4-501 through 10-4-520.

### **Defenses and Counterclaims**

#### **Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?**

Yes. Colorado courts have held that deliberate "padding" of a first-party claim by the insured may void the entire claim. See *Frontier Exploration, Inc. v. American Nat'l Fire Ins. Co.*, 849 P.2d 887 (Colo. App. 1992); *Northwestern Nat'l Ins. Co. v. Barnhart*, 713 P.2d 1360 (Colo. App. 1985). In such cases, the insurer must demonstrate actual and substantial prejudice.

#### **Is "advice of counsel" a recognized defense?**

Yes. Colorado courts have held that the prosecution of an appeal based on the advice of counsel is not bad faith; even where the plaintiff presents testimony that the appeal had no chance of prevailing. *Brandon v. Sterling Colo. Beef Co.*, 827 P.2d 559 (Colo. App. 1991), cert. denied (1992).

#### **What other defenses are available?**

When an insurer has the right to deny benefits, a claim for bad faith may be moot or without merit as a matter of law. *Jarnagin v. Banker's Life & Cas. Co.*, 824 P.2d 11 (Colo. App. 1991); *Rodriguez v. Safeco Ins. Co.*, 821 P.2d 849 (Colo. App. 1991) (where coverage for the underlying claim was excluded, a bad faith claim must be dismissed); *Branscum v. American Cmty. Mut. Ins. Co.*, 984 P.2d 675 (Colo. App. 1999) (where health insurance policy provided no coverage for insured's hysterectomy, bad faith claim for refusal to pay was properly dismissed); *City of Westminster v. Centric-Jones Constructors*, Nos. 01CA0502, 02CA0602, 2003 WL 22098771 (Colo.

App. Sept. 11, 2003) (where obligee suffered no actual damages, obligee may not recover punitive damages from a surety as a matter of law).

When an insurance company participates in a legal proceeding to determine the scope of coverage under a policy, the insurer is not liable for bad faith unless the participation is premised upon "no rational argument based on law or evidence." *Tozer v. Scott Wetzel Servs., Inc.*, 883 P.2d 496, 499 (Colo. App. 1994). The determination of whether the legal action is reasonable for purposes of this standard is a question of law to be determined by the court. *Cf. Peterman v. State Farm Mut. Auto. Ins. Co.*, 948 P.2d 63, 68 (Colo. App. 1997), *reh'g denied* (1997), *rev'd on other grounds*, 961 P.2d 487 (Colo. 1998) (Insurer not acting in bad faith for rejecting insured's request to intervene in litigation involving uninsured motorist, even when the insured obtained a default judgment against the uninsured motorist. Moreover, because the insurance policy contains a valid and enforceable arbitration provision applicable to the insured's claim for uninsured motorist benefits, the insurer does not act in bad faith by insisting that the insured's claim to such benefits be arbitrated).

An insurer may challenge claims that are "fairly debatable" without incurring liability for bad faith even if the decision to deny coverage is mistaken. An insurer does not act with reckless disregard of a valid claim when it reasonably believes there is no coverage. *Pham v. State Farm Mut. Auto. Ins. Co.*, 70 P.3d 567 (Colo. App. 2003) (where coverage issues were complicated, debatable, undecided under state law, and reliance on statutory and case law was reasonable); *Wagner v. American Family Mut. Ins. Co.*, 569 F. App'x 574 (10th Cir. 2014) (holding that, although the policyholder disagreed with her homeowner's carrier as to the interpretation of certain exclusions in her policy, its denial of her claim was not unreasonable); citing *Zolman v. Pinnacol Assurance*, 261 P.3d 490, 497 (Colo. App. 2011) ("[A]n insurer will be found to have acted in bad faith only if it has intentionally denied, failed to process, or failed to pay a claim without a reasonable basis.").

### ***Is there a cause of action for reverse bad faith?***

It does not appear that there are reported decisions on this issue in Colorado.

### **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

A performance bond surety may be subject to a claim for bad faith for its failure to act in good faith when processing claims made by an obligee pursuant to the terms of a performance bond. A "special relationship exists between a commercial surety and an obligee that is nearly identical to that involving an insurer and an insured." *Transamerica Premier Ins. Co. v. Brighton School District 27J*, 940 P.2d 348 (Colo. 1997), *reh'g denied* (1997); see also *Brighton School District 27J v. Transamerica Premier Ins. Co.*, 923 P.2d 328 (Colo. App. 1996).

In order to pursue a bad faith claim against a surety, the obligee must prove that it suffered actual damages. When an obligee suffers no actual damages, an obligee may not recover punitive damages from a surety as a matter of law. *City of Westminster v. Centric-Jones Constructors*, 100 P.3d 472 (Colo. App. 2003).

### ***Duty to act in good faith in the context of arbitration***

The Colorado Court of Appeals has refused to extend a bad faith claim when the delay in payment occurs because the insurer has exercised a contractual option to arbitrate, provided that there was a reasonable basis for submitting the claim to arbitration. *Bucholtz v. Safeco Ins. Co. of America*, 773 P.2d 590, 593 (Colo. App. 1988), *cert. denied* (1989).

### ***The Colorado Governmental Immunity Act bars a claim for bad faith***

When a claim is brought against a governmental entity that has acted as a self-insurer, the claim is barred by the Colorado Governmental Immunity Act, which provides a public entity sovereign immunity against actions for tort injuries. *Jordan v. City of Aurora*, 876 P.2d 38 (Colo. App. 1993).

***The doctrine of collateral estoppel may be asserted by the insurer to preclude a subsequent tort claim for bad faith***

An insurer who prevails in arbitration with the insured on a contract claim for willful and wanton delay and denial of no-fault benefits may use the traditional collateral estoppel doctrine to preclude the insured from subsequently bringing a bad faith claim against the insurer based on the same conduct. *Dale v. Guar. Nat'l Ins. Co.*, 948 P.2d 545 (Colo.

1997); *Guar. Nat'l Ins. Co. v. Williams*, 982 P.2d 306 (Colo. 1999).

AUTHORS

**Matthew Y. Biscan** | Satriana & Biscan LLC | 303.468.5403 | [biscan@sbattys.com](mailto:biscan@sbattys.com)

**Jennifer Kirk Morris** | Montgomery Amatuzio Dusbabek Chase LLP | 303.592.6600 | [JMorris@madc-law.com](mailto:JMorris@madc-law.com)

# Connecticut

By Brian P. McDonough

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

Yes. There are two statutes under which an insured can bring a bad faith claim against an insurer, the Connecticut Unfair Insurance Practices Act (“CUIPA”) (Conn. Gen. Stat. §38a-815, *et seq.*), and the Connecticut Unfair Trade Practices Act (“CUTPA”) (Conn. Gen. Stat. §42-110g). Connecticut Superior Courts are split on whether a private right of action exists under CUIPA. *See, e.g., Oaks Partners v. Vigilant Ins. Co.*, No. FSTCV095012672S, 2010 WL 3038435, at \*3 (Conn. Super. Ct. July 7, 2010). Notwithstanding that split of authority, CUTPA affords insureds a private right of action to enforce CUIPA violations. *Mead v. Burns*, 199 Conn. 651, 663 (1986); *see also State v. Acordia, Inc.*, 310 Conn. 1, 27 (2013) (“[C]onduct by an... insurance company that is related to the business of providing insurance can violate CUTPA only if it violates CUIPA[.]”).

CUIPA identifies seventeen separate categories of unfair insurance practices. Subsection 6, which includes unfair claims settlement practices, is the most widely invoked.

### ***Can a third party bring a statutory action for bad faith?***

No. *See, e.g., Carford v. Empire Fire and Marine Ins. Co.*, 94 Conn. App. 41, 62 n.12 (2006) (“We agree that CUIPA does not clearly create rights in the third-party claimant against the insurer[.]”) (internal quotations omitted); *see also Asmus Electric, Inc. v. G.M.K. Contractors, LLC*, No. CV040489527, 2005 WL 758126 (Conn. Super. Ct. Feb. 25, 2005); *Chapell v. LaRosa*, No. CV990552801, 2001 WL 58057 (Conn. Super. Ct. Jan. 5, 2001); *Calnan v. Allstate Indemnity*

*Co.*, No. 980264160S, 1998 WL 881853 (Conn. Super. Ct. Dec. 3, 1998).

### ***Is there a common law cause of action for bad faith?***

Yes. *See, e.g., Carford v. Empire Fire & Marine Ins. Co.*, 94 Conn. App. 41, 58 (2006) (Connecticut “recognizes a common-law duty of good faith and fair dealing between an insurer and its insureds.”). However, no Connecticut court has recognized this cause of action for third parties who have not entered into a contractual relationship with the insurer. *See Vasilakos v. Ford*, No. CV085006202S, 2009 WL 659234 (Conn. Super. Ct. Feb. 19, 2009); *Izzo v. Kruk*, No. CV020468089, 2003 WL 21101076 (Conn. Super. Ct. Apr. 29, 2003); *Peterson v. Allstate Ins. Co.*, No. CV 90 9387142, 1992 WL 239088 (Conn. Super. Ct. Sept. 17, 1992).

### ***What cause of action exists for an excess carrier to bring a claim against primary carrier?***

Equitable contribution or equitable subrogation. *See, e.g., Infinity Ins. Co. v. Worcester Ins. Co.*, No. CV000597436, 2000 WL 1890126, at \*4 (Conn. Super. Ct. Dec. 4, 2000) (“Thus, the [excess insurer’s] remedy, if any, is not by a direct action against the [primary insurer] but rather through equitable contribution, where the plaintiff stands in the place of the insured and succeeds to whatever rights he may have in the matter.”) (internal quotations omitted). However, equitable subrogation may be utilized only after full payment of the amount owed by the insured. *Id.*; *see also Horace Mann Ins. Co. v. Nationwide Mut. Ins. Co.*, No. 3:05-cv-0664 (CFD), 2008 WL 2951865, at \*4 n.10 (D. Conn. July 31, 2008) (“[I]t is unlikely that the Connecticut Supreme Judicial

Super. Ct. Apr. 22, 1988) (granting summary judgment dismissal of “bad faith” claims for violation of CUIPA and CUTPA due to “prematurity”); see also *Novey v. Hayes*, No. CV106010741S, 2010 WL 5610838, at \*2 (Conn. Super. Ct. Dec. 16, 2010).

***Under what circumstances will bad faith claims be severed for trial from the underlying claim?***

See, e.g., *Khanthavong v. Allstate Ins. Co.*, No. 324502, 1996 WL 704366, at \*6 (Conn. Super. Ct. Dec. 3, 1996) (severing bad faith claim and stating: “[T]his court is aware that... actions against insurers... are increasingly accompanied by bad faith claims and CUTPA/CUIPA actions. Not infrequently, these additional claims are themselves brought in bad faith, to ‘up the ante’ at pretrial and trial by increasing the insurer’s exposure; to exponentially increase the scope of discovery, with the hope of obtaining the insurer’s entire file, including its work-product investigation; and for purposes of trial strategy. In such cases, the prejudice to the defendant is evident.”) (footnote omitted); but see *Hennessey v. Travelers Property Cas. Ins. Co.*, No. CV 980332786S, 1999 WL 240231, at \*5 (Conn. Super. Ct. Apr. 14, 1999) (refusing to sever bad faith claim and stating: “The interests served by bifurcated trials are convenience, negation of prejudice and judicial efficiency. In the present case, bifurcation would be more inconvenient and less efficient because both claims stem from the same transaction, with similar evidence and witnesses. This court concludes that any possible prejudice to the defendant in having both issues tried together is minimal and outweighed by the need for judicial economy.”) (internal citations and quotations omitted).

***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

There are no insurance bad faith cases addressing bifurcation of compensatory and punitive damages. However, Connecticut courts have permitted the compensatory and punitive damages aspects of other kinds of claims to be bifurcated. See, e.g., *Hi-Ho Tower, Inc. v. Com-Tronics, Inc.*, 255 Conn. 20, 26 (2000) (recognizing

that trial court, “[i]n connection with the third count of [defendant’s] counterclaim [for tortious interference]... bifurcated the question of punitive damages,” and affirming subsequent award of punitive damages).

***Defenses and Counterclaims***

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Possibly. Superior Court decisions suggest the admissibility of unreasonable settlement demands for demonstrating the absence of insurer bad faith. See, e.g., *Jones v. Standard Fire Ins. Co.*, No. TTD-CV116004270S, 2013 WL 541015, at \*1 (Conn. Super. Ct. Jan. 11, 2013) (“Disagreement between an insurer and insured as to coverage of the appropriate amount to which the insured is entitled is not equivalent to bad faith and, standing alone, does not evince dishonest purpose. *The insured’s demand may itself be excessive and unwarranted[.]*”) (emphasis added); *Derosia v. Treadwell*, No. CV076000269S, 2008 WL 1735150, at \*1 (Conn. Super. Ct. Mar. 27, 2008) (same).

***Is “advice of counsel” a recognized defense?***

Possibly. Although not in an insurance bad faith context, the Supreme Court of Connecticut has recognized advice of counsel as a complete defense against a claim of malicious conduct. *Vandersluis v. Weis*, 176 Conn. 353, 361 (1978) (“Advice of counsel is a complete defense to an action of malicious prosecution or vexatious suit when it is shown that the defendant... instituted his civil action relying in good faith on such advice, given after a full and fair statement of all facts within his knowledge, or which he was charged with knowing. The fact that the attorney’s advice was unsound or erroneous will not affect the result.”). That said, in the insurance context, there are a number of decisions alluding to advice of counsel as a viable defense to a bad faith claim. See, e.g., *Hutchinson v. Farm Family Cas. Ins. Co.*, 273 Conn. 33, 45–46 (2005) (“In the event that the defendant [insurer] claimed reliance on the advice of counsel as a defense, however, the privileged materials would be subject to disclosure under the ‘at issue’ exception.”); *Ridgeway v. Mt. Vernon*

*Fire Ins. Co.*, No. CV116009339, 2012 WL 6901203, at \*4 (Conn. Super. Ct. Dec. 24, 2012) (“[T]he defendant has not waived the attorney–client privilege by placing the advice of counsel at issue because... [none] of the special defenses reference or rely on the advice of counsel.”); *Fuentes v. New London Cnty. Mut. Ins. Co.*, No. CV065002176, 2009 WL 566215, at \*1 (Conn. Super. Ct. Feb. 5, 2009) (“[T]here is no pending defense that the defendant relied on the advice of counsel in connection with the plaintiff’s bad faith claim, and... the court hereby finds... the correspondence from coverage counsel... [is] privileged.”).

### ***What other defenses are available?***

The equitable doctrine of “unclean hands” has been recognized as a potential defense to claims of insurer bad faith. *E.g.*, *Robarge v. Patriot Gen. Ins. Co.*, No. CV-91-0393211S, 1991 WL 269109, at \*1 (Conn. Super. Ct. Dec. 4, 1991) (“The plaintiffs’ first claim is that a bad faith action is an action at law, and therefore is impervious to the equitable defense of unclean hands. However, the Connecticut Supreme Court has held, contrary to the plaintiffs’ position, that it is well-settled that equitable defense or claims may be raised in an action at law.”) (internal quotations omitted).

### ***Is there a cause of action for reverse bad faith?***

No Connecticut court has determined whether it

would recognize a cause of action for reverse bad faith brought by an insurance company.

### **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

*Mead v. Burns*, 199 Conn. 651, 663–64 (1986) (“Despite our conclusion... that a single failure to conduct a reasonable investigation of an insurance claim, in the absence of a ‘general business practice,’ does not constitute a violation of CUIPA, the plaintiff maintains that he may pursue a CUTPA violation for a single failure to investigate. We disagree.”); *but see Amato v. Sherwood Forest, Inc.*, No. CV92-0341185, 1995 WL 558984, at \*6 (Conn. Super. Ct. Sept. 13, 1995) (noting that non-insurance cases have concluded that isolated transaction can constitute CUTPA; “This court therefore concludes that the requirement of a showing of a general practice in *Mead* resulted from the fact that CUIPA, General Statutes §38-61, was the underlying standard, and that the Supreme Court does not interpret CUTPA as generally applying only to general practices rather than to individual transactions in trade or commerce.”).

AUTHOR

**Brian P. McDonough** | Zelle McDonough & Cohen LLP | 617.742.6520 | [bmcdonough@zelmcd.com](mailto:bmcdonough@zelmcd.com)

# Delaware

By Matthew M. Haar

## Causes of Action

***Is there a statutory basis for an insured to bring a bad faith claim?***

No.

***Can a third party bring a statutory bad faith claim?***

No.

***Is there a common law cause of action for bad faith?***

Yes. Delaware recognizes a common law “cause of action for the bad faith delay, or the nonpayment, of an insured’s claim in a first-party insured-insurer relationship... as a breach of contractual obligations.” *Tackett v. State Farm Fire & Cas. Ins. Co.*, 653 A.2d 254 (Del. 1995), *declined to follow on other grounds, E.I. DuPont de Nemours & Co. v. Pressman*, 679 A.2d 436 (Del. 1996). A third party can bring a cause of action for bad faith only if there is an assignment. *Rowlands v. PHICO Ins. Co.*, Nos. 00-477-GMS, 00-485-GMS, 2000 WL 1092134 (D. Del. July 27, 2000).

***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

Absent a contractual provision to the contrary, a primary insurer generally does not owe any duty to an excess carrier. *Hoechst Celanese Corp. v. Nat’l Union Fire Ins. Co. of Pittsburgh, Pa.*, No. 89C-SE-35, 1993 WL 603360 (Del. Super. Ct. Nov. 16, 1993).

***What causes of action for extracontractual liability have been recognized outside the claim handling context?***

Although Delaware courts have recognized no specific causes of action, the Delaware Supreme Court has held that an insurer can be liable for a “lack of good faith, or the presence of bad faith... where the insured can show that the insurer’s [action] was ‘clearly without any reasonable justification.’” *Tackett v. State Farm Fire & Cas. Ins. Co.*, 653 A.2d 254, 264 (Del. 1995) (quoting *Casson v. Nationwide Ins. Co.*, 455 A.2d 361, 369 (Del. Super. Ct. 1982)), *declined to follow on other grounds, E.I. DuPont de Nemours & Co. v. Pressman*, 679 A.2d 436 (Del. 1996).

## Damages

***Are punitive damages available?***

Yes. Punitive damages are recoverable for an intentional, egregious or malicious breach of an insurance contract. *Tackett v. State Farm Fire & Cas. Ins. Co.*, 653 A.2d 254 (Del. 1995), *declined to follow on other grounds, E.I. DuPont de Nemours & Co. v. Pressman*, 679 A.2d 436 (Del. 1996); *Thomas v. Hartford Mut. Ins. Co.*, No. 01C-01-046HDR, 2004 WL 1102362 (Del. Super. Ct. Apr. 7, 2004); *Int’l Fid. Ins. Co. v. Delmarva Sys. Corp.*, No. 99C-10-065 WCC, 2001 WL 541469 (Del. Super. Ct. May 9, 2001).

***Are attorneys’ fees recoverable?***

Generally no. Attorneys’ fees are only recoverable when authorized by contract or statute. *Casson v. Nationwide Ins. Co.*, 455 A.2d 361 (Del. Super. Ct. 1982). An insured can recover its attorneys’ fees if it is the prevailing party in a dispute with its property insurer. 18 Del. Code §4102.

*PHICO Ins. Co.*, Nos. 00-477-GMS, 00-485-GMS, 2000 WL 1092134 (D. Del. July 27, 2000).

## **Practice and Procedure**

### **Statute of limitations**

Three years. *Crowhorn v. Nationwide Mut. Ins. Co.*, No. 00C-06, 010WLW, 2002 WL 1767529 (Del. Super. Ct. July 10, 2002).

### **Under what circumstances will bad faith claims be dismissed or stayed pending the resolution of the underlying claims?**

“Delaware courts, in the interests of comity and judicial economy, normally will stay an after-filed suit in Delaware when a previously filed suit stating similar claims is pending in a court of another state.” *Transamerica Corp. v. Reliance Ins. Co. of Ill.*, No. 94C -10-221, 1995 WL 1312656, at \*3 (Del. Super. Ct. Aug. 30, 1995).

### **Under what circumstances will bad faith claims be severed for trial from the underlying claim?**

Trial will be severed “to avoid prejudice”, or if “conducive to expedition and economy.” *Playtex, Inc. v. Columbia Cas. Co.*, 1990 WL 9551 (Del. Super. Ct. Jan. 22, 1990).

### **Under what circumstances will the compensatory and punitive damages claims be bifurcated?**

Bifurcation is appropriate “to avoid prejudice,” or if “conducive to expedition and economy.” *Playtex, Inc. v. Columbia Cas. Co.*, 1990 WL 9551 (Del. Super. Ct. Jan. 22, 1990).

### **How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?**

Pursuant to 11 U.S.C. §362(a), a bankruptcy petition acts as an stay of the claim. The application of this

rule in a bad faith context has not been specifically addressed in Delaware.

### **How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?**

Insolvency is treated as bankruptcy in Delaware and courts will follow 11 U.S.C. §362(a).

## **Defenses and Counterclaims**

### **Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?**

Yes, but such a defense could expand discovery regarding the insurer’s claims handling practices. *Tackett v. State Farm Fire & Cas. Ins. Co.*, 653 A.2d 254 (Del. 1995), *declined to follow on other grounds*, *E.I. DuPont de Nemours & Co. v. Pressman*, 679 A.2d 436 (Del. 1996).

### **Is “advice of counsel” a recognized defense?**

Yes, but such a defense almost necessarily expands discovery regarding the insurer’s handling of the claim. *Tackett v. State Farm Fire & Cas. Ins. Co.*, 653 A.2d 254 (Del. 1995), *declined to follow on other grounds*, *E.I. DuPont de Nemours & Co. v. Pressman*, 679 A.2d 436 (Del. 1996).

### **What other defenses are available?**

None specifically addressed by Delaware courts.

### **Is there a cause of action for reverse bad faith?**

Not specifically addressed in Delaware.

#### **AUTHOR**

Matthew M. Haar | Saul Ewing LLP | 717.257.7508 | mhaar@saul.com

# District of Columbia

By Steven E. Leder

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

There is no statutory basis for a bad faith claim under District of Columbia law. *Washington v. Gov't Emps. Ins. Co.*, 769 F. Supp. 383, 386 (D.D.C. 1991); *Choharis v. State Farm Fire & Cas. Co.*, 961 A.2d 1080, 1087, 1090–91 (D.C. 2008). Although not bad faith, a statute authorizes the recovery of attorneys' fees for advising and representing a claimant for payment of overdue personal injury protection benefits under the no-fault motor vehicle insurance statute. See D.C. Code §31-2410. That statute also authorizes interest from the date the payment first became due.

### ***Can a third party bring a statutory action for bad faith?***

There is no bad faith statute under District of Columbia law. In addition, the United States Court of Appeals for the District of Columbia Circuit has held that “[w]hen there is no contractual relationship between the claimant and the insurer, . . . the implied covenant does not exist, and hence there is no doctrinal basis for holding the insurer liable in tort.” *Messina v. Nationwide Mut. Ins. Co.*, 998 F.2d 2, 5 (D.C. Cir. 1993).

### ***Is there a common law cause of action for bad faith?***

The tort of bad faith refusal to provide insurance coverage has not been recognized in the District of Columbia in either the first-party or third-party context. However, every contract contains an implied covenant to act in good faith, and damages may be recovered for its breach as part of a contract action. *Nugent v. Unum Life Ins. Co. of Am.*, 752 F. Supp.

2d 46, 56–57 (D.D.C. 2010); *Nkpado v. Standard Fire Ins. Co.*, 697 F. Supp. 2d 94, 98 (D.D.C. 2010); *Thorpe v. Banner Life Ins. Co.*, 632 F. Supp. 2d 8, 19 (D.D.C. 2009); *Choharis v. State Farm Fire & Cas. Co.*, 961 A.2d 1080, 1087–88 (D.C. 2008). *Choharis* resolved a split among federal courts concerning whether the District of Columbia would recognize a bad faith tort for the refusal to provide insurance coverage. Compare *Fireman's Fund Ins. Co. v. CTIA-The Wireless Ass'n*, 480 F. Supp. 2d 7, 9 (D.D.C. 2007); *Brand v. Gov't Emps. Ins. Co.*, No. Civ.A. 04-01133, 2005 WL 3201322, at \*5 (D.D.C. Nov. 29, 2005); *Am. Registry of Pathology v. Ohio Cas. Ins. Co.*, 401 F. Supp. 2d 75, 79 (D.D.C. 2005); *Am. Nat'l Red Cross v. Travelers Indem. Co. of R.I.*, 896 F. Supp. 8, 12 n.4 (D.D.C. 1995); *Washington v. Gov't Emps. Ins. Co.*, 769 F. Supp. 383, 386 (D.D.C. 1991) with *Washington v. Group Hospitalization, Inc.*, 585 F. Supp. 517, 520 (D.D.C. 1984).

The District of Columbia Court of Appeals has not addressed bad faith in the “wrongful failure to settle within policy limits” context. However, in *Choharis*, the court suggested that fiduciary principles may come into play in the settlement of a third-party claim and the course of defending the insured. *Choharis*, 961 A.2d at 1090 n.15; see also *Wender v. United Servs. Auto. Ass'n*, 434 A.2d 1372, 1374–75 (D.C. 1981) (addressing attorney–client privilege issue in bad faith refusal to settle case). In so noting, the *Choharis* court cited Maryland law, which has special significance, as the common law of the District of Columbia is derived from Maryland common law in 1801. *Choharis*, 961 A.2d at 1090 n.10; see also *Fireman's Fund Ins. Co. v. CTIA-The Wireless Ass'n*, 480 F. Supp. 2d 7, 11 (D.D.C. 2007). Hence, it seems likely that the District of Columbia will follow Maryland's lead and recognize a bad faith cause of action sounding in tort for an insurer's wrongful refusal to

***Is a third-party bad faith claim asserted in connection with a policy that provides third-party coverage viable if the third-party claimant does not prevail in the underlying claim?***

The District of Columbia has not recognized a bad faith cause of action.

## **Practice and Procedure**

### ***Statute of limitations***

A three-year statute of limitation applies to a tort action. *See* D.C. Code §12-301(8). Thus, to the extent that the District of Columbia recognizes the tort of wrongful refusal to settle, a three-year limitation likely applies. A three-year limitation also applies to contract claims. *See* D.C. Code §12-301(7).

### ***Under what circumstances will bad faith claims be dismissed or stayed pending the resolution of the underlying claims?***

This has not been addressed by the District of Columbia courts.

### ***Under what circumstances will the compensatory and punitive damage claims be bifurcated?***

This has not been addressed by the District of Columbia courts.

### ***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?***

A bankruptcy petition filed by either the insured or the insurer triggers an automatic stay of the proceedings. 11 U.S.C. §362(a)(3). The stay continues until the bankruptcy is either discharged or the bankruptcy court lifts the stay. The District of Columbia Court of Appeals has not addressed the effect of a bankruptcy petition on a bad faith claim.

### ***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

The Property and Liability Insurance Guaranty Association Act, D.C. Code §31-5505, *et seq.* steps in where certain insurers become insolvent to pay "covered claims" up to \$300,000. D.C. Code §31-5505(a)(1)(C). The District of Columbia Court of Appeals has not addressed the application of the Act to bad faith actions. However, the language of the Act makes its intent clear.

A covered claim is one that arises "out of and is within the coverage and not in excess of the applicable limits" of the insurance policy issued by the insolvent insurer. D.C. Code §31-5501(6). Moreover, the Act provides that "[i]n no event shall the Association be obligated to pay a claimant an amount in excess of the obligation of the insolvent insurer under the policy from which the claim arises." D.C. Code §31-5505(a). Bad faith damages are not an "obligation... under the policy." These provisions should limit the guaranty association's liability to the obligations of the insolvent insurer under the policy and exclude bad faith claims. Moreover, punitive damages are expressly excepted from the definition of "covered claims." D.C. Code §31-5501(6).

## **Defenses and Counterclaims**

### ***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

This has not been addressed by the District of Columbia courts.

### ***Is "advice of counsel" a recognized defense?***

Yes. *See, e.g., Wender v. United Servs. Auto. Ass'n*, 434 A.2d 1372, 1373-75 (D.C. 1981).

### ***What other defenses are available?***

The court may consider whether the coverage issue is rare or one of first impression. *Eureka Inv. Corp., N.V. v. Chicago Title Ins. Co.*, 743 F.2d 932, 945-46 (D.C. Cir. 1984).

***Is there a cause of action for reverse bad faith?***

This has not been addressed by the District of Columbia courts. However, at least one court has addressed whether the insured's alleged breach of the implied covenant of good faith barred coverage. See, e.g., *Eureka Inv. Corp., N. V. v. Chicago Title Ins.*

*Co.*, 530 F. Supp. 1110, 1121-22 (D.D.C. 1982), *aff'd in part, rev'd in part*, 743 F.2d 932 (D.C. Cir. 1984).

AUTHOR

**Steven E. Leder** | Leder & Hale PC | 443.279.7900 |  
leder@lederhale.com

# Florida

By Andrew Abramovich

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

Yes. Any person may bring a civil action for damages arising from, *inter alia*, an insurer's bad faith. Fla. Stat. §624.155(1) (2014).

It is a condition precedent to a statutory cause of action against an insurer authorized to transact insurance in Florida that the insurer and the Florida Department of Financial Services ("DFS") be given 60 days' written notice of the alleged violation. Fla. Stat. §624.155(3)(a); Fla. Stat. §624.05(1) (2014). The notice must be on a form provided by the DFS (known as a Civil Remedy Notice of Insurer Violations) and contain statutorily and administratively prescribed information. Fla. Stat. §624.155(3)(b). If the insurer cures the alleged violation by paying the damages or correcting the circumstances giving rise to the alleged violation within 60 days after the notice is filed, no statutory cause of action will lie. Fla. Stat. §624.155(3)(d); *see Talat Enter., Inc. v. Aetna Cas. & Sur. Co.*, 753 So. 2d 1278 (Fla. 2000) (holding that payment of contractual damages, without payment of extracontractual damages, within 60-day statutory cure period constitutes payment of "damages" [or correction of] "the circumstances giving rise to the violation" such that first-party bad faith action for extracontractual damages is precluded).

### ***Can a third party bring a statutory action for bad faith?***

Yes. *State Farm Fire & Cas. Co. v. Zebrowski*, 706 So. 2d 275, 277 (Fla. 1997) (holding that third party can bring statutory bad faith action against insurer pursuant to Fla. Stat. §624.155(1)(b)(1) after obtaining excess judgment against insured without first obtaining assignment from insured); *see also Allstate*

*Indem. Co. v. Ruiz*, 899 So. 2d 1121, 1126 (Fla. 2005) (noting that Fla. Stat. §624.155 "does not distinguish between statutory first- and third-party actions"). A third party can also bring a statutory action for violations of any of three provisions of Florida's Unfair Insurance Trade Practices Act, Fla. Stat. §626.9541(1)(i), (o), or (x) (2014). *Auto-Owners Ins. Co. v. Conquest*, 658 So. 2d 928, 929 (Fla. 1995) (holding that term "[a]ny person" in Fla. Stat. §624.155(1) unambiguously permits third party to bring a civil action for violations of Unfair Insurance Trade Practices Act). The statutory cause of action expressly does not preempt the common law cause of action for third-party bad faith, but no person is entitled to judgment under both the statutory and the common law remedies. Fla. Stat. §624.155(8).

While payment of contractual damages during the 60-day statutory cure period precludes a first-party bad faith action (*see above discussion of Talat Enters., Inc. v. Aetna Cas. & Sur. Co.*, 753 So. 2d 1278 (Fla. 2000)), a tender of policy limits during the statutory cure period will not always preclude a third-party common law cause of action for bad faith. *Macola v. Gov't Emps. Ins. Co.*, 953 So. 2d 451 (Fla. 2006) (holding that tender of liability limits within 60-day statutory cure period after insured has been sued but before entry of excess judgment does not preclude common law cause of action for bad faith when insured remains exposed to excess judgment).

### ***Is there a common law cause of action for bad faith?***

Yes, there is a common law cause of action for third-party bad faith. *Boston Old Colony Ins. Co. v. Gutierrez*, 386 So. 2d 783, 784 (Fla. 1980); *Auto Mut. Indem. Co. v. Shaw*, 184 So. 852, 856-58 (Fla. 1938). There is no common law cause of action for first-party bad

***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

Determination of the amount of punitive damages should be bifurcated from trial on liability for actual damages, amount of actual damages, and liability for punitive damages. *W.R. Grace & Co. v. Waters*, 638 So. 2d 502, 506 (Fla. 1994); *but see Dessanti v. Contreras*, 695 So. 2d 845, 845-47 (Fla. 4th Dist. Ct. App. 1997) (holding that failure to bifurcate determination of amount of punitive damages was harmless error in light of facts and noting that *W.R. Grace* does not require bifurcation of liability for punitive damages from other issues). Federal courts routinely bifurcate trial on the amount of punitive damages. *See, e.g., Horrillo v. Cook Inc.*, No. 08-60931-CIV, 2014 WL 2712341, at \*1 (S.D. Fla. Apr. 29, 2014); *Soliday v. 7-Eleven, Inc.*, No. 2:09-cv-807-FtM-29SPC, 2011 WL 2413656, at \*1 (M.D. Fla. June 13, 2011).

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Yes. *Barry v. Geico Gen. Ins. Co.*, 938 So. 2d 613, 618 (Fla. 4th Dist. Ct. App. 2006) (conduct of claimant and claimant's counsel is relevant to issue of whether insurer had realistic possibility to settle claim). Florida does not recognize comparative bad faith as an affirmative defense. *Nationwide Prop. & Cas. Ins. Co. v. King*, 568 So. 2d 990 (Fla. 4th Dist. Ct. App. 1990).

A court should examine the "totality of the circumstances" in both first-party and third-party cases. *See State Farm Mut. Auto. Ins. Co. v. Laforet*, 658 So. 2d 55, 62-63 (Fla. 1995).

***Is "advice of counsel" a recognized defense?***

"Advice of counsel" is evidence to be considered in a bad faith action, but it is not dispositive. *Cotton States Mut. Ins. Co. v. Trevethan*, 390 So. 2d 724, 728 (Fla. 5th Dist. Ct. App. 1980) (holding that reliance on advice of counsel is "evidence to be considered on the issue of bad faith" but it "does not insulate the insurer" from bad faith judgment, and citing *Thompson v. Commercial Union Ins. Co. of N.Y.*, 250 So. 2d 259, 264 (Fla. 1971) for proposition that "failure to follow counsel's advice is evidence of bad faith"); *see also Kearny v. Auto-Owners Ins. Co.*, 8:06-CV-595-T-24TGW, 2009 WL 3712343 (M.D. Fla. Nov. 5, 2009).

***Is there a cause of action for reverse bad faith?***

No. *See Nationwide Prop. & Cas. Ins. Co. v. King*, 568 So. 2d 990 (Fla. 4th Dist. Ct. App. 1990) (affirming trial court decision to strike affirmative defense of comparative bad faith).

AUTHOR

Andrew Abramovich | Boyd & Jenerette, P.A. | 904.353.6241 | aabramovich@boyd-jenerette.com

# Georgia

By Pamela N. Lee

## Causes of Action

### *Is there a statutory basis for an insured to bring a bad faith claim?*

Yes. O.C. Ga. Ann. §33-4-6 allows a fact finder to award a penalty of 50 percent of loss or \$5,000, whichever is greater, plus reasonable attorney fees. The statute is aimed, primarily, at first-party claims handling. The damages set forth in O.C. Ga. Ann. §33-4-6 are the exclusive remedy for bad faith denial of insurance benefits, such that litigation expenses under O.C. Ga. Ann. §13-6-11 are not recoverable. *See Atlanta Title Ins. Co. v. Aegis Funding Corp.*, 287 Ga. App. 392, 651 S.E.2d 507 (2007), *cert. denied*, 2008 Ga. Lexis 107 (2008). The statute is strictly construed due to the penalty involved. *See Doss & Assocs. v. First Am. Title Ins. Co.*, 325 Ga. App. 448, 754 S.E.2d 85 (2013). If a demand submitted to the insurance company does not contain sufficient information, the courts will not consider it to be a proper demand for payment under the statute and will not assess the penalty. *Id.* The insured bears the burden of proving bad faith. *Id.*

Georgia courts, however, have allowed a statutory claim for bad faith in handling third-party claims. *See, e.g., Leader Nat'l Ins. Co. v. Kemp & Son, Inc.*, 189 Ga. App. 115, 375 S.E.2d 231 (1988), *aff'd*, 259 Ga. 329, 380 S.E.2d 458 (1989).

O.C. Ga. Ann. §33-4-7 is specifically directed at the handling and settlement of motor vehicle claims. The penalties match O.C. Ga. Ann. §33-4-6, allowing an award of 50 percent of the loss or \$5,000, whichever is greater, plus reasonable attorney's fees.

### *Can a third party bring a statutory action for bad faith?*

A third-party claimant has no direct right to bring a statutory bad faith claim. *Fla. Int'l Indem. Co. v. City of Metter*, 952 F.2d 1297 (11th Cir. 1992), presenting

certified question answered by *Googe v. Fla. Int'l Indem. Co.*, 262 Ga. 546, 422 S.E.2d 552 (1992); *Payne v. Twiggs Cnty. Sch. Dist.*, 269 Ga. 361, 496 S.E.2d 690 (1998) (absent statutory obligation, injured party was not a third-party beneficiary under the insurance policy); *Googe v. Fla. Int'l Indem. Co.*, 262 Ga. 546, 422 S.E.2d 552 (1992); *Scott v. Mamari Corp.*, 242 Ga. App. 455, 530 S.E.2d 208 (2000); *Raintree Trucking Co., Inc. v. First Am. Ins. Co.*, 245 Ga. App. 305, 534 S.E.2d 459 (2000); *Owens v. Allstate Ins. Co.*, 216 Ga. App. 650, 455 S.E.2d 368, 369 (1995); *Pub. Nat'l Ins. Co. v. Wheat*, 100 Ga. App. 695, 112 S.E.2d 194, 197-98 (1959).

Though a third-party claimant aggrieved by an insurer's failure or delay in settling has no independent legal standing to seek a statutory or common law claim for extracontractual damages, after becoming a judgment creditor of an insured, such claimant may have a direct right to seek recovery against the policy as an asset of the insured. *See Metro. Prop. & Cas. Co. v. Crump*, 237 Ga. App. 96, 513 S.E.2d 33 (1999); *Commercial Union Ins. Co. v. Bradley Co.*, 186 Ga. App. 610, 367 S.E.2d 820 (1988); *Smith v. Gov't Emps. Ins. Co.*, 179 Ga. App. 654, 347 S.E.2d 245 (1986). While a statutory bad faith claim is not assignable, a tort-based claim—such as negligent failure to settle—can be assigned. *See S. Guar. Ins. Co. v. Dowse*, 278 Ga. 674, 605 S.E.2d 27 (2004); *Canal Indem. Co. v. Greene*, 265 Ga. App. 67, 593 S.E.2d 41 (2004), *cert. denied*, May 3, 2004; *S. Gen. Ins. Co. v. Ross*, 227 Ga. App. 191, 489 S.E.2d 53 (1997).

### *Is there a common law cause of action for bad faith?*

Georgia recognizes a tort-based cause of action for failure to settle a third-party claim within policy limits. *S. Guar. Ins. Co. v. Dowse*, 278 Ga. 674, 605 S.E.2d 27 (2004); *Cotton States Mut. Ins. Co. v. Brightman*, 276 Ga. 683, 580 S.E.2d 519 (2003); *S. Gen. Ins. Co.*

***On what issues is expert evidence required to establish bad faith?***

None.

***On what issues is expert evidence precluded?***

None.

**Practice and Procedure**

***Under what circumstances will bad faith claims be severed for trial from the underlying claim?***

Severance is within the trial court's discretion. However, under O.C. Ga. Ann. §33-4-7(d), which concerns a direct claim by a claimant against an auto liability insurer, "[t]he insurer shall be an unnamed party, not disclosed to the jury, until there has been a verdict resulting in recovery equal to or in excess of the claimant's demand. If that occurs, the trial shall be recommenced in order for the trier of fact to receive evidence to make a determination as to whether bad faith existed in the handling or adjustment of the attempted settlement of the claim or action in question." This statute applies only to property damage incurred by the claimant, not bodily injury claims. *Mills v. Allstate Ins. Co.*, 294 Ga. App. 671, 669 S.E.2d 658 (2008).

***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

O.C. Ga. Ann. §51-12-5.1(d) requires bifurcation of compensatory and punitive damage claims: "(1) An award of punitive damages must be specifically prayed for in a complaint. In any case in which punitive damages are claimed, the trier of fact shall first resolve from the evidence produced at trial whether an award of punitive damages shall be made. This finding shall be made specially through an appropriate form of verdict, along with the other required findings. (2) If it is found that punitive damages are to be awarded, the trial shall immediately be recommenced in order to receive such evidence as is relevant to a decision regarding what amount of damages will be sufficient to deter, penalize, or pun-

ish the defendant in light of the circumstances of the case. It shall then be the duty of the trier of fact to set the amount to be awarded according to subsection (e), (f), or (g) of this Code section, as applicable."

It should be noted, however, that punitive damages are not available remedies in failure to settle or failure to pay cases brought under O.C. Ga. Ann. §33-4-6 or O.C. Ga. Ann. §33-4-7. *Howell v. S. Heritage Ins. Co.*, 214 Ga. App. 536, 448 S.E.2d 275 (1994).

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

While the possible acceptance of "comparable bad faith" has been raised at times, its application has not been affirmatively decided. *See Alexander Underwriters Gen. Agency v. Lovett*, 182 Ga. App. 769, 357 S.E.2d 258 (1987) (wherein the court found no error in refusing to give a comparative bad faith jury charge because there was no evidence that the insured had acted in bad faith, possibly implying that the court would recognize the comparative bad faith defense in an appropriate case). However, Georgia courts have held that conduct of the insured that may breach the contract of insurance is admissible in a bad faith action. *See, e.g., Allstate Ins. Co. v. Hamler*, 247 Ga. App. 574, 545 S.E.2d 12 (2001).

***Is "advice of counsel" a recognized defense?***

The advice of counsel is not a "defense" by itself but is one factor to consider in determining whether or not the insurer acted in bad faith.

***Is there a cause of action for reverse bad faith?***

There is no cause of action for reverse bad faith in this jurisdiction.

**AUTHOR**

**Pamela N. Lee** | Swift Currie McGhee & Hiers LLP | 404.888.6162 | [pamela.lee@swiftcurrie.com](mailto:pamela.lee@swiftcurrie.com)

# Hawaii

By Wesley H.H. Ching

## Causes of Action

### *Is there a statutory basis for an insured to bring a bad faith claim?*

No, except in the motor vehicle context. HRS §431:10C-315(a)(4) (two-year statute of limitation “after the entry of a final judgment in, or dismissal with prejudice of, a tort action arising out of a motor vehicle accident, where a cause of action for insurer bad faith arises out of the tort action.”).

### *Can a third party bring a statutory action for bad faith?*

No, except in the motor vehicle context. *Honbo v. Hawaiian Ins. & Guar. Co.*, 86 Haw. 373, 949 P.2d 213 (App. 1997), *review denied*, 88 Haw. 370, 966 P.2d 1096 (1998) (extended time limitation in HRS §431:10C-315(a)(4) applies to third-party insurer bad faith claims arising out of motor vehicle tort cases); *Willis v. Swain*, 129 Haw. 478, 486, 304 P.3d 619, 627 (2013) (even where the Insurance Joint Underwriting Program (JUP), by statute, provides public assistance to those unable to afford insurance and there is no written policy, assignee insurer has a duty to act in good faith in dealings with assignee insured).

### *Is there a common law cause of action for bad faith?*

Yes. See *Best Place, Inc. v. Penn Am. Ins. Co.*, 82 Haw. 120, 920 P.2d 334 (1996) (recognizing the tort of bad faith in the first-party insurance context); *Catron v. Tokio Marine Mgmt. Inc.*, 90 Haw. 407, 411, 978 P.2d 845, 848 (1999).

### *Can an excess carrier assert a bad faith claim against a primary carrier?*

No reported cases. This question has been certified to the Hawaii Supreme Court from the United States District Court for the District of Hawaii in *St. Paul Fire & Marine Insurance Co. v. Liberty Mutual Insurance Co.*, Civ. No. 13-00361 (certified to Haw. Sup. Ct. April 1, 2014).

### *Can an insurance carrier face extracontractual liability outside the claim handling context?*

No reported cases. See *Aloha Petroleum, Ltd. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, No. 1:13-cv-00296-DKW-RLP, 2014 U.S. Dist. Lexis, at \*16 (D. Haw. July 8, 2014) (noting that Hawaii courts have not spoken on this issue).

## Damages

### *Are punitive damages available?*

Yes. See *Best Place, Inc. v. Penn Am. Ins. Co.*, 82 Haw. 120, 134, 920 P.2d 334, 348 (1996).

### *Are attorneys' fees recoverable?*

Yes. HRS §431:10-242 (“Where an insurer has contested its liability under a policy and is ordered by the courts to pay benefits under the policy, the policyholder, the beneficiary under a policy, or the person who has acquired the rights of the policyholder or beneficiary under the policy shall be awarded reasonable attorney’s fees and the costs of suit, in addition to the benefits under the policy.”).

In assumpsit actions, “which allow[] for the recovery of damages for the non-performance of a contract, either express or implied, written or verbal, as well as quasi contractual obligations,” HRS §607-

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

Bad faith claims cannot arise out of actions taken by the Hawaii Insurance Guaranty Association (HIGA) in the performance of its statutory duty to investigate, adjust, compromise, settle, and pay covered claims imposed pursuant to HRS §431:16-108(4), and are barred under the plain language of HRS §431:16-116. *Mendes v. Hawaii Ins. Guar. Ass'n*, 87 Haw. 14, 950 P.2d 1214 (1998). With respect to whether a bad faith claim can arise from the actions of the insolvent insurer, HIGA is deemed the insurer but only to the extent of its obligation on covered claims. HRS §431:16-108(2). Under HRS §431:16-105, a “covered claim” means an unpaid claim “that arises out of and is within the coverage and is subject to the applicable limits of an insurance policy” and shall not include any “amount awarded as punitive or exemplary damages.” Moreover, under HRS §431:16-108(1), in “no event shall the association be obligated to a policyholder or claimant in an amount in excess of the stated policy limit of the insolvent insurer under the policy from which the claim arises.” Based on the statutory language, it appears that HIGA would not be liable for extracontractual claims of bad faith against an insolvent insurer.

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Yes. Although an insured’s comparative bad faith is not a viable affirmative defense, it may be used

to disprove insurer’s bad faith. See *Wailua Assocs. v. Aetna Cas. & Sur. Co.*, 183 F.R.D. 550, 561–62 (D. Haw. 1998).

***Is “advice of counsel” a recognized defense?***

Yes. Although there is no reported appellate case on this issue, as a matter of practice, the “advice of counsel defense” is employed. Note that the insurer’s “advice of counsel” defense impliedly waives the confidentiality of attorney–client (insurer) communications.

***What other defenses are available?***

“[C]onduct based on an interpretation of the insurance contract that is reasonable does not constitute bad faith.” *Best Place, Inc. v. Penn Am. Ins. Co.*, 82 Haw. 120, 133, 920 P.2d 334, 347 (1996). Similar, an insurer does not act in bad faith where it denied coverage based on an open question of law. *Enoka v. AIG Hawai’i Ins. Co.*, 109 Haw. 537, 128 P.3d 850 (2006).

***Is there a cause of action for reverse bad faith?***

No reported appellate case. *But see Wailua Assocs. v. Aetna Cas. & Sur. Co.*, 183 F.R.D. 550 (D. Haw. 1998) (holding that comparative bad faith by insured is not a viable affirmative defense).

AUTHOR

Wesley H.H. Ching | Fukunaga Matayoshi Hershey & Ching LLP | 808.533.4300 | whc@fmhc-law.com

Mr. Ching thanks and acknowledges Sheree Kon-Herrera of Fukunaga Matayoshi Hershey & Ching LLP for her participation in preparing this chapter.

# Idaho

By Rob Anderson and John J. Burke

## Causes of Action

### *Is there a statutory basis for an insured to bring a bad faith claim?*

No. Idaho's Unfair Claim Settlement Practices Act, codified at Idaho Code §41-1329, prohibits insurers from engaging in unfair settlement practices, but violation of the Act does not give rise to a private cause of action. *White v. Unigard Mut. Ins. Co.*, 730 P.2d 1014, 1021 (Idaho 1986).

### *Can a third party bring a statutory action for bad faith?*

No.

### *Is there a common law cause of action for bad faith?*

Yes. A first-party insured may bring an action for common law bad faith against its insurer. *White v. Unigard Mut. Ins. Co.*, 730 P.2d 1014, 1021 (Idaho 1986). A bad faith claim is viable in two situations: (1) when the insurer intentionally and unreasonably denies or delays payment on a claim, and in the process harms the claimant in such a way not fully compensable at contract, or (2) when the insurer negligently fails to make timely settlement of a claim. *Lakeland True Value Hardware, LLC v. Hartford Fire Ins. Co.*, 291 P.3d 399, 404 (Idaho 2012); *Reynolds v. American Hardware Mut. Ins.*, 766 P.2d 1243, 1246 (Idaho 1988). However, Idaho does not recognize any third-party direct actions at common law, so an injured third party may not bring a bad faith cause of action against a tortfeasor's insurer. *Hettwer v. Farmers Ins. Co.*, 797 P.2d 81, 82 (Idaho 1990).

### *What cause of action exists for an excess carrier to bring a claim against a primary carrier?*

Unclear, but likely none. Idaho's no-direct-action rule also applies where the parties are insurers. *Stonewall Surplus Lines Ins. Co. v. Farmers Ins. Co. of Idaho*, 971 P.2d 1142, 1146 (Idaho 1998). There is one published decision in which the Idaho Supreme Court resolved a declaratory/money damages action between two insurers with a shared insured. *Empire Fire & Marine Ins. Co. v. North Pacific Ins. Co.*, 905 P.2d 1025 (Idaho 1995). However, the Idaho Supreme Court appeared to later disavow that decision by noting that the issue of direct action was not before it in that matter. *Stonewall Surplus Lines v. Farmers*, 971 P.2d at 1146 n.2.

### *What causes of action for extracontractual liability have been recognized outside the claim handling context?*

The Idaho Supreme Court has recognized that an insurer can be liable in tort if an agent makes representations about available coverage, even if there is contrary language in the policy, or by negligently failing to adequately insure the insured's property and for failing to provide complete coverage when requested to do so. *Featherstone v. Allstate Ins. Co.*, 875 P.2d 937, 940 (Idaho 1994). Moreover, "[a]n insured is entitled to rely on representations of an agent that the agent would take on additional responsibility beyond the agent's ordinary duty." *Id.*

## Damages

### *Are punitive damages available?*

Yes. *Walston v. Monumental Life Ins. Co.*, 923 P.2d 456, 465 (Idaho 1996). However, the amount of punitive damages recoverable is limited to "the greater

IIGA will provide coverage to insureds for “covered claims” existing prior to the order of liquidation or brought within 30 days of the order of liquidation. Idaho Code §41-3608. A “covered claim” is defined in relevant part as, “an unpaid claim, including one for unearned premiums submitted by a claimant, which arises out of and is within the coverage and is subject to the applicable limits of an insurance policy to which this act applies issued by an insurer, if such insurer becomes an insolvent insurer...” Idaho Code §41-3605(7). The amount of coverage provided by IIGA is the lesser of the insolvent insurer’s policy limits, or \$300,000 per claim for all covered claims. Idaho Code §41-3608(1)(a), (b). Because a covered claim is one that must “arise out of and is within coverage,” it does not provide coverage for extracontractual bad faith damages. See Idaho Code §41-3605(7) (delineating what is and is not a covered claim).

## Defenses and Counterclaims

### *Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?*

Yes. In a first-party bad faith case, the insured must prove by a preponderance of the evidence that: 1) the insurer intentionally or unreasonably denied or withheld payment; 2) the insured’s claim was not fairly debatable; 3) the insurer’s denial or delay was not the result of good faith mistake; and 4) the resulting harm was not fully compensable by contract damages. *Robinson v. State Farm Mut. Auto. Ins. Co.*, 45 P.3d 829, 832 (Idaho 2002). To the extent that the insured’s conduct is relevant to any of the foregoing issues, such evidence is admissible. See, e.g., *Pacheco v. Safeco Ins. Co.*, 780 P.2d 116 (Idaho 1989) (insurer was allowed to present evidence that insured’s fire loss was caused by the insured’s own act of arson, which would defeat coverage under the policy).

A third-party bad faith case requires the court to apply the “equality of consideration” test which requires, among other things, that the court consider any other factors which may weigh toward establishing or negating the bad faith of the insurer. *McKinley v. Guaranty Nat’l Ins. Co.*, 159 P.3d 884, 888 (Idaho 2007).

### *Is “advice of counsel” a recognized defense?*

The Idaho Supreme Court held an insurer acted reasonably in relying on advice of counsel on an issue not resolved by Idaho courts when the decision was supported by, “a tremendous amount of authority from other jurisdictions.” *Weinstein v. Prudential Prop. & Cas. Ins. Co.*, 233 P.3d 1221, 1269 (Idaho 2010). As to third-party cases, one of the specific factors to be considered in the equality of consideration test is whether the insurer followed the legal advice of its own attorney. *McKinley v. Guaranty Nat’l Ins. Co.*, 159 P.3d 884, 888 (Idaho 2007).

### *What other defenses are available?*

Generally, any relevant evidence that may disprove the four elements of bad faith set forth in *Robinson v. State Farm Mut. Auto. Ins. Co.*, 45 P.3d 829, 832 (Idaho 2002), is admissible to support the insurer’s defense.

### *Is there a cause of action for reverse bad faith?*

No.

#### AUTHORS

**Rob Anderson** | Anderson Julian & Hull LLP | 208.344.5800 | raanderson@ajhlaw.com

**John J. Burke** | Elam & Burke | 208.343.5454 | jjb@elamburke.com

# Illinois

By Thomas E. Rice

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

Yes. Under Section 155 of the Illinois Insurance Code, an insured can recover "reasonable" attorneys' fees, "costs," and a modest statutory recovery limited to no more than \$60,000 for "vexatious and unreasonable" delay or refusal to pay a first-party claim. 215 Ill. Comp. Stat. 5/155. The statute does not apply to claims of a failure to settle within policy limits. *Cal. Union Ins. Co. v. Liberty Mut. Ins. Co.*, 930 F. Supp. 317, 319-20 (N.D. Ill. 1996).

### ***Can a third party bring a statutory action for bad faith?***

No. "As a general rule, the remedy embodied in section 155 of the Insurance Code extends only to the party insured and policy assignees. Therefore, the remedy embodied in section 155 of the Insurance Code does not extend to third parties." *Yassin v. Certified Grocers of Ill., Inc.*, 133 Ill. 2d 458, 466, 551 N.E.2d 1319, 1322 (1990) (citations omitted).

### ***Is there a common law cause of action for bad faith?***

There is a common law cause of action for failure to settle when a liability insurer breaches its duty to act in good faith in responding to settlement offers. Recent cases involving such a claim include *Haddick ex rel. Griffith v. Valor Ins.*, 198 Ill. 2d 409, 763 N.E.2d 299 (2001) and *O'Neill v. Gallant Ins. Co.*, 329 Ill. App. 3d 1166, 769 N.E.2d 100 (2002).

In first-party cases, the tort of bad faith is not recognized as a separate and independent action. *Cramer v. Ins. Exch. Agency*, 174 Ill. 2d 513, 526, 675 N.E.2d 897, 904 (1996). Instead, the Section 155 stat-

utory remedy is available in such circumstances. *Id.* Otherwise, allowing a bad faith action would transform many breach of contract actions into independent tort actions. *Id.* However, in cases where a plaintiff actually alleges and proves the elements of a separate tort, a plaintiff may bring an independent tort action, such as common law fraud, for insurer misconduct. *Id.*

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

An excess carrier may bring an equitable subrogation action against a primary carrier. *U.S. Fire Ins. Co. v. Zurich Ins. Co.*, 329 Ill. App. 3d 987, 1003, 768 N.E.2d 288, 300 (2002); *Twin City Fire Ins. Co. v. Country Mut. Ins. Co.*, 23 F.3d 1175, 1180 (7th Cir. 1994). In addition, intermediate appellate court authority suggests that an excess carrier has a direct cause of action against any lower-tiered carrier having control over the litigation. *Central Ill. Public Serv. Co. v. Agricultural Ins. Co.*, 378 Ill. App. 3d 728, 737, 880 N.E.2d 1172, 1181 (2008). (claim by excess carrier allowed to proceed where "[t]he factual question raised by the counterclaim is whether [a lower-tiered excess carrier] failed to participate in settlement negotiations in a meaningful way so that [the higher-tiered excess carrier] was exposed to greater damages.")

### ***What causes of action for extracontractual liability have been recognized outside the claim handling context?***

None.

***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

There is no Illinois authority on this issue.

***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?***

Pursuant to 11 U.S.C. § 362(a), a bankruptcy petition acts as an automatic stay of the commencement or continuation of judicial proceedings brought against the bankrupt party. To date, Illinois courts have not applied this law in the context of a bad faith insurance claim, or otherwise examined how a bankruptcy petition affects the litigation of an insurance bad faith claim.

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

All insurance companies authorized to transact business in Illinois are members of the State Guaranty Fund. 215 Ill. Comp. Stat. 5/534.5. Furthermore, each member must contribute to the Fund. 215 Ill. Comp. Stat. 5/537.6. The principal obligation of the Fund is to pay the “covered claims” of insolvent insurers. *Hasemann v. White*, 177 Ill. 2d 414, 686 N.E.2d 571, 572 (Ill. 1997).

The Illinois Court of Appeals held it was not error for the trial court to grant an order compelling the defendant to assign to the plaintiff its purported “bad faith” cause of action against its insolvent insurer and against the Fund as successor to the insurer. *Nicholson v. St. Anne Lanes, Inc.*, 158 Ill. App. 3d 838, 840, 512 N.E.2d 127, 128 (1987). The court held that where the judgment exceeded the policy limits and the defendant is insolvent, a bad faith cause of action may be the defendant’s only asset of value to the plaintiff. *Id.*

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Yes, in determining whether conduct is vexatious and unreasonable, the trier of fact must examine the totality of the circumstances, including the reasonableness of such conduct. *Ragan v. Columbia Mut. Ins. Co.*, 291 Ill. App. 3d 1088, 1098–99, 684 N.E.2d 1108, 1115 (1997).

***Is “advice of counsel” a recognized defense?***

No case has recognized or rejected the “advice of counsel” defense regarding liability. On the issue of damages, “advice of counsel” is evidence that may be considered. *See O’Neill v. Gallant Ins. Co.*, 329 Ill. App. 3d 1166, 769 N.E.2d 100 (2002) (awarding punitive damages, where insurer ignored the advice of counsel that it should settle); *see also Central Ill. Public Serv. Co. v. Agricultural Ins. Co.*, 378 Ill. App. 3d 728, 880 N.E.2d 1172, 1180 (2008) (excess insurer may owe duty to a higher-tiered excess carrier to negotiate in good faith based upon “advice of defense counsel”).

**What other defenses are available?**

While not specifically “defenses” in bad faith failure to settle cases, courts will consider seven factors to determine whether the insurer acted in bad faith: (1) the advice of the insurer’s own adjusters; (2) a refusal to negotiate; (3) the advice of defense counsel; (4) communication with the insured in keeping him or her fully aware of the claimant’s willingness to settle for the amount of coverage; (5) an adequate investigation and defense; (6) a substantial prospect of an adverse verdict; and (7) the potential for damages to exceed the policy limits. *O’Neill v. Gallant Ins. Co.*, 329 Ill. App. 3d 1166, 1172–76, 769 N.E.2d 100, 106–08 (2002).

Furthermore, an insurer is generally not required to initiate settlement negotiations unless the probability of an adverse finding on liability is great and the amount of probable damages would greatly exceed policy limits. *SwedishAmerican Hosp. Ass’n*

*of Rockford v. Ill. State Med. Inter-Ins. Exch.*, 395 Ill. App. 3d 80, 103, 916 N.E.2d 80, 99–100 (2009).

When a bad faith claim is assigned to the injured plaintiff, there is a concern that the injured plaintiff and the insured may engage in collusive conduct against the insurer. *Phelan by Phelan v. State Farm Mut. Auto. Ins. Co.*, 114 Ill. App. 3d 96, 102, 448 N.E.2d 579, 583 (1983). “Such collusive conduct could be raised as a defense to an assigned bad faith claim against an insurance company.” *Id.*

***Is there a cause of action for reverse bad faith?***

Illinois courts have not yet addressed whether a claimant’s failure to cooperate in settlement, a “bad faith setup,” or an insured’s “reverse bad faith” are defenses.

AUTHOR

**Thomas E. Rice** | Baker Sterchi Cowden & Rice |  
816.448.9333 | rice@bscr-law.com

# Indiana

By Anna M. Mallon, Keith D. Mundrick,  
Christopher G. Johnson, and Liam E. Felsen

## Causes of Action

### *Is there a statutory basis for an insured to bring a bad faith claim?*

Only within a worker's compensation context. Specifically:

The worker's compensation board, upon hearing a claim for benefits, has exclusive jurisdiction to determine whether the employer, the employer's worker's compensation administrator, or the employer's Worker's Compensation insurance carrier has acted with a lack of diligence and bad faith or has committed an independent tort in adjusting or settling the claim for compensation.

Ind. Code. §22-3-4-12.1. The constitutionality of this statute was upheld in *Sims v. U.S. Fid. & Guar. Co.*, 782 N.E.2d 345 (Ind. 2003).

Although the Indiana Code enumerates unfair claim settlement practices, Ind. Code. §27-4-1-4.5, it does not provide a private cause of action. See Ind. Code §27-4-1-18; *Erie Ins. Co. v. Hickman*, 622 N.E.2d 515, 519 n.1 (Ind. 1993).

### *Can a third party bring a statutory action for bad faith?*

No.

### *Is there a common law cause of action for bad faith?*

Yes, but only for first-party claims. Indiana courts have long recognized a legal duty, implied in all insurance contracts, for the insurer to deal in good faith with its insured. *Freidline v. Shelby Ins. Co.*, 774 N.E.2d 37, 40 (Ind. 2002). Because of the "special relationship" between the insurer and its insured,

the foreseeable harm to an insured that results from the exercise of bad faith in settling claims, and society's interest that there be fair play between insurer and insured, a breach of the implied duty to deal with an insured in good faith is tortious. *Erie Ins. Co. v. Hickman*, 622 N.E.2d 515, 518 (Ind. 1993).

Generally, an insurer is obligated to refrain from: (1) making an unfounded refusal to pay policy proceeds; (2) causing an unfounded delay in making payment; (3) deceiving the insured; and (4) exercising any unfair advantage to pressure an insured into a settlement of his or her claim, although this list is not exhaustive. *Id.* at 519. A cause of action in tort does not arise every time a claim is erroneously denied—an insurer may, in good faith, dispute claims; even a lack of diligent investigation alone is not a breach. *Id.* at 520. On the other hand, an insurer that denies liability knowing that there is no rational, principled basis for doing so has breached its duty. *Id.* Generally, an element of conscious wrongdoing must be present. *Hoosier Ins. Co. v. Audiology Foundation of Am.*, 745 N.E.2d 300, 310 (Ind. Ct. App. 2001) ("A finding of bad faith requires evidence of a state of mind reflecting dishonest purpose, moral obliquity, furtive design, or ill will.") (quoting *Colley v. Ind. Farmers Mut. Ins. Group*, 691 N.E.2d 1259, 1261 (Ind. Ct. App. 1998)).

The duty to deal in good faith is owed to any insured, including corporations and foundations. See *Hoosier Ins. Co. v. Audiology Found. of America*, 745 N.E.2d 300 (Ind. Ct. App. 2001). However, the insurer's duty to deal in good faith *with the insured* does not extend to third parties, nor does it create a tort action for third-party claimants, not even for third-party beneficiaries who are entitled to sue an insurer

on bad faith). However, a showing of prejudice was required to establish that trial court erred in denying motion for separate trials in an automobile personal injury case. *State Farm Mut. Auto Ins. Co. v. Gutierrez*, 866 N.E.2d 747 (Ind. 2007).

***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

The Seventh Circuit Court of Appeals has held that there is an overlap between the evidence relating to compensatory and bad faith claims. *McLaughlin v. State Farm Mut. Auto. Ins. Co.*, 30 F.3d 861, 871 (7th Cir. 1994) (applying Indiana law; procedure is to try compensatory and punitive damages claims together with appropriate jury instructions).

***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?***

Pursuant to 11 U.S.C. §362(a), a bankruptcy petition acts as an automatic stay of the commencement or continuation of judicial proceedings brought against the bankrupt party.

To date, Indiana courts have not considered how the automatic stay provision of the Bankruptcy Code, 11 U.S.C. §362(a), affects the litigation of a bad faith insurance claim.

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

The Indiana Insurance Guaranty Association provides coverage only for "covered claims," defined as "an unpaid claim which arises out of and is within the coverage and not in excess of the applicable limits of an insurance policy," and does not include "[a]ny supplementary obligation including but not limited to adjustment fees and expenses, attorney fees and expenses, court costs, interest and bond premiums..." Ind. Code §27-6-8-4(4).

All proceedings against an insolvent insurer

shall be stayed for up to six (6) months and such additional time thereafter as may be determined by the court from the date the insolvency is determined or an ancillary proceeding is instituted in the state whichever is later to permit proper defense by the association of all pending causes of action.

Ind. Code §27-6-8-7.

***Defenses and Counterclaims***

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

While no Indiana appellate court has ruled on the admissibility of evidence regarding the reasonableness of the conduct of the insured in a bad faith claim, the Indiana Comparative Fault Act, codified at Ind. Code §34-51-2, suggests that the insured's own conduct or "fault" can be compared to the insurer's conduct. With two exceptions (which are not applicable to bad faith cases), the Comparative Fault Act applies to "any action based on fault that is brought to recover damages for injury or death to a person or harm to property." Ind. Code §34-51-2-1. "Fault," for purposes of the Comparative Fault Act, includes not only negligent conduct, but also acts or omissions that are willful, wanton, reckless or intentional toward the person or property of others. Ind. Code §34-6-2-45(b).

***Is "advice of counsel" a recognized defense?***

Yes. See, e.g., *Worth v. Tamarack Am.*, 47 F. Supp. 2d 1087 (S.D. Ind. 1999), *aff'd*, 201 F.3d 377 (7th Cir. 2000) (affirming summary judgment for insurer sued for bad faith where, among other things, insurer retained outside counsel to render opinion). *Heritage Mut. Ins. Co. v. Advanced Polymer Tech.*, 97 F. Supp. 2d 913 (S.D. Ind. 2000) (rejecting bad faith claim where (1) insurer had advice of coverage counsel that claims did not fall within scope of "advertising injury" coverage; (2) coverage counsel examined policy and the legal authority offered by insured; (3) when claim was denied, counsel requested that insured forward any additional information that would influence coverage decision; and

(4) reasons supplied by insurer's counsel for denial of coverage were rational, understandable and ultimately correct).

#### ***What other defenses are available?***

The right to disagree. An insurer has the right to reasonably disagree with its insured in good faith. *Erie Ins. Co. v. Hickman*, 622 N.E.2d 515, 520 (Ind. 1993); see *Eli Lilly & Co. v. Zurich Am. Ins. Co.*, 405 F. Supp. 2d 948, 958 (S.D. Ind. 2005) (granting summary judgment to insurer as to bad faith claim where insurer's coverage position, although rejected by court, was rational and its denial of coverage was not unreasonable).

ERISA preemption. Claims of bad faith are preempted by the Employee Retirement Income Security Act ("ERISA") because Indiana's tort of bad faith is not a regulation of insurance under the "common sense" or McCarran-Ferguson Act exception to the ERISA preemption issue. *Midwest Sec. Life Ins. Co. v. Stroup*, 730 N.E.2d 163 (Ind. 2000).

#### ***Is there a cause of action for reverse bad faith?***

Although no Indiana appellate court has yet addressed this issue, the United States Court of Appeals for the Seventh Circuit has commented that it is unlikely that reverse bad faith would be viable under Indiana law. *Willis Corroon Corp. v. Home Ins. Co.*, 203 F.3d 449, 453 (7th Cir. 2000) (it is "very doubtful assumption" that cause of action for reverse bad faith exists).

#### AUTHORS

**Anna M. Mallon** | Cantrell Strenski & Mehringer LLP | 317.352.3500 | amallon@csmlawfirm.com

**Keith D. Mundrick** | Cantrell Strenski & Mehringer LLP | 317.352.3500 | kmundrick@csmlawfirm.com

**Christopher G. Johnson** | Frost Brown Todd LLC | 502.568.0357 | cjohnson@fbtlaw.com

**Liam E. Felsen** | Frost Brown Todd LLC | 502.568.0357 | lfelsen@fbtlaw.com

# Iowa

By Timothy N. Lillwitz and Caroline K. Bettis

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

No. See generally *Kooyman v. Farm Bureau Mut. Ins. Co.*, 315 N.W.2d 30 (Iowa 1982). The Iowa Legislature, at Iowa Code Ann. §507B.4, has defined unfair methods of competition and unfair or deceptive acts or practices in the business of insurance to include unfair claims settlement practices, such as not attempting in good faith to effectuate prompt, fair, and equitable settlements of claims where liability has become reasonably clear. Iowa Code Ann. §507B.4(9)(f).

### ***Can a third party bring a statutory action for bad faith?***

No. A private cause of action for insurance bad faith (breach of the implied covenant) is a product of Iowa common law. See generally *Kooyman v. Farm Bureau Mut. Ins. Co.*, 315 N.W.2d 30 (Iowa 1982); *Seeman v. Liberty Mut. Ins. Co.*, 322 N.W.2d 35 (Iowa 1982); *Terra Indus., Inc., v. Commonwealth Ins. Co. of Am.*, 990 F. Supp. 679 (N.D. Iowa 1997).

### ***Is there a common law cause of action for bad faith?***

Yes. *Dolan v. Aid Ins. Co.*, 431 N.W.2d 790 (Iowa 1988). In Iowa, a “first-party suit... is a cause of action against an insurer for bad faith failure to pay its own insured.” *Kelly v. State Farm Mut. Auto. Ins. Co.*, 764 F. Supp. 1337, 1340 (S.D. Iowa 1991).

“To show a claim for bad faith, a plaintiff must show the absence of a reasonable basis for denying benefits of the policy and defendant’s knowledge or reckless disregard of the lack of a reasonable basis for denying the claim.” *Dolan*, 431 N.W.2d at 794,

quoting *Anderson v. Cont’l Ins. Co.*, 271 N.W.2d 368, 691 (Wis. 1978).

Where a claim is “fairly debatable,” the insurer is entitled to debate the claim. *Reuter v. State Farm Mut. Auto. Ins. Co.*, 469 N.W.2d 250, 253 (Iowa 1991); see also *Bellville v. Farm Bureau Mut. Ins. Co.*, 702 N.W.2d 468, 472–73 (Iowa 2005) (explaining claim is fairly debatable when it is “open to dispute on any logical basis.”). “Where an insurance claim is ‘fairly debatable’ the bad faith claim must fail.” *Stahl v. Preston Mut. Ins. Ass’n*, 517 N.W.2d 201, 203 (Iowa 1994). Also, the court stated that “[it] is appropriate, in applying the test, to determine whether a claim was properly investigated and whether the results of the investigation were subjected to a reasonable evaluation and review.” *Dolan v. Aid Ins. Co.*, 431 N.W.2d 790, 794 (Iowa 1988) (quoting *Anderson v. Cont’l Ins. Co.*, 271 N.W.2d 368, 691 (Wis. 1978)); see *Kiner v. Reliance Ins. Co.*, 463 N.W.2d 9 (Iowa 1990); see *McIlravy v. N. River Ins. Co.*, 653 N.W.2d 323 (Iowa 2002).

There is no direct cause of action for bad faith by a person not a party to the insurance contract for failing to settle or adjust the claim properly. *Long v. McAllister*, 319 N.W.2d 256 (Iowa 1982); *Bates v. Allied Mut. Ins. Co.*, 467 N.W.2d 255 (Iowa 1991).

However, the insurer’s failure to settle a claim under a liability policy is actionable. *Kooyman v. Farm Bureau Mut. Ins. Co.*, 315 N.W.2d 30 (Iowa 1982).

An uninsured employer is not subject to bad faith tort liability for failing to pay an award of workers’ compensation benefits to an employee. *Bremer v. Wallace*, 728 N.W.2d 803, 806 (Iowa 2007).

insurer with a deductible or self-insured retention of two hundred thousand dollars or more. However, such a claim shall be considered a covered claim, if as of the deadline set for the filing of claims against the insolvent insurer or its liquidator, the insured is a debtor under 11 U.S.C. §701 *et seq.*

- (i) That would otherwise be a covered claim, but is an obligation to or on behalf of a person who has a net worth greater than that allowed by the guarantee fund law of the state of residence of the person, and which state has denied coverage to that person on that basis.
  - (j) That is an obligation owed to or on behalf of an affiliate of, as defined in section 521A.1, an insolvent insurer.
- (2) Notwithstanding the subparagraph divisions of subparagraph (1), a person is not prevented from presenting a noncovered claim to the insolvent insurer or its liquidator, but the noncovered claim shall not be asserted against any other person, including the person to whom benefits were paid or the insured of the insolvent insurer, except to the extent that the claim is outside the coverage of the policy issued by the insolvent insurer.

Iowa Code Ann. §515B.2(4).

## Defenses and Counterclaims

### *Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?*

Evidence regarding the reasonableness of the conduct of the insured or third-party claimant is admissible, at least to the extent necessary to ascertain whether such conduct is covered by the insurance policy. *See,*

*e.g., Ottumwa Hous. Auth. v. State Farm Fire & Cas. Co.*, 495 N.W.2d 723, 726-727 (Iowa 1993).

### *Is "advice of counsel" a recognized defense?*

Not specifically. However, in *Ferris v. Employers Mutual Casualty Co.*, the court held that a mistake in judgment by the insurer's counsel, which resulted in a judgment in excess of the insured's policy limit, when the insurer could have settled within the policy limits, did not constitute bad faith. 122 N.W.2d 263, 270 (Iowa 1963). The court stated that the reasonableness of a settlement offer should not be measured by the outcome of litigation, but "must be considered in the light of the case as it fairly appeared to the insurer and its authorized agents and attorneys at the time the offer was made." *Id.* Thus, an attorney's advice is not a defense in and of itself, but an attorney's advice is considered when determining reasonableness of the insurer's conduct.

Moreover, the Iowa Supreme Court has recognized that if no Iowa appellate court has addressed the legal position taken by the insurer, that position is deemed fairly debatable as a matter of law and a bad faith claim will not lie. *Wilson v. Farm Bureau Mut. Ins. Co.*, 714 N.W.2d 250, 263 (Iowa 2006).

### *What other defenses are available?*

In general, an insurer's objectively reasonable denial of coverage will preclude liability for bad faith. *United Fire & Cas. Co. v. Shelly Funeral Home, Inc.*, 642 N.W.2d 648 (Iowa 2002). Where an objectively reasonable basis for denial of a claim actually exists, the insurer cannot be held liable for bad faith as a matter of law. *Bellville v. Farm Bureau Mut. Ins. Co.*, 702 N.W.2d 468, 473 (Iowa 2005) (citation omitted).

An insurer has a reasonable excuse against bad faith if the claim for benefits is "fairly debatable." *See, e.g., Dolan v. Aid Ins. Co.*, 431 N.W.2d 790, 794 (Iowa 1988); *Gibson v. ITT Hartford Ins. Co.*, 621 N.W.2d 388, 397 (Iowa 2001); *Covia v. Robinson*, 507 N.W.2d 411, 416 (Iowa 1993) (holding that in workers' compensation context, reasonable excuse exists if claim for benefits is "fairly debatable"); *Seastrom v. Farm Bureau Life Ins. Co.*, 601 N.W.2d 339 (Iowa 1999).

Issue preclusion may be a potential defense. *Gardner v. Hartford Ins. Accident & Indem. Co.*, 659 N.W.2d 198 (Iowa 2003).

Acquiescence may be a defense. *Kohlstedt v. Farm Bureau Mut. Ins. Co.*, 258 Iowa 337, 139 N.W.2d 184, 186 (1965).

In *Kapadia v. Preferred Risk Mutual Insurance Co.*, the court held that the insurer may establish the breach of the consent-to-settlement clause as an affirmative defense to recovery on the underinsurance endorsement if it proves that, absent such a breach, it could have collected from the tortfeasor under its rights embraced by the contractual subrogation clause. 418 N.W.2d 848 (Iowa 1988).

***Is there a cause of action for reverse bad faith?***

No. *Johnson v. State Farm Mutual Automobile*

*Insurance Co.*, 533 N.W.2d 203, 208 (Iowa 1995). The Iowa court has, however, permitted an action for sanctions under Iowa R. Civ. Pro. 1.413(1) against the insureds and their attorney for filing a frivolous first-party bad faith claim. See *Farm Bureau Mut. Ins. Co. v. Iowa Dist. Ct. for Pottawattamie Cnty.*, No. 03-1395, 2005 WL 67521 (Iowa Ct. App. Jan. 13, 2005).

AUTHORS

**Timothy N. Lillwitz** | Bradshaw, Fowler, Proctor & Fairgrave PC | 515.243.4191 | lillwitz.timothy@bradshawlaw.com

**Caroline K. Bettis** | Bradshaw, Fowler, Proctor & Fairgrave PC | 515.243.4191 | bettis.caroline@bradshawlaw.com

# Kansas

By Thomas E. Rice

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

In first-party claims, Kan. Stat. Ann. §40-256 provides for reasonable attorneys' fees where the insurer has "refused without just cause or excuse" to pay the full amount of the loss. *See also* Kan. Stat. Ann. §§40-908, 40-3111.

### ***Can a third party bring a statutory action for bad faith?***

No.

### ***Is there a common law cause of action for bad faith?***

An insurance company may become liable for an amount in excess of its policy limits if it fails to act in good faith and without negligence when defending and settling claims against its insured. When an insurer determines whether to accept or reject an offer of settlement, it must give at least the same consideration to the interests of its insured as it does to its own interests.

*Glenn v. Fleming*, 247 Kan. 296, 305, 799 P.2d 79 (1990). However, Kansas does not recognize a common law cause of action for the tort of bad faith in connection with first-party claims. *Spencer v. Aetna Life & Cas. Ins. Co.*, 227 Kan. 914, 611 P.2d 149, 158 (1980).

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

An excess insurer may assert a claim against a primary insurer under principles of equitable subrogation as subrogee of the insured. *Ins. Co. of N. Am.*

*v. Med. Protective Co.*, 768 F.2d 315, 321 (10th Cir. 1985); *Pac. Employers Ins. Co. v. P.B. Hoidale Co., Inc.*, 789 F. Supp. 1117, 1121 (D. Kan. 1992).

### ***What causes of action for extracontractual liability have been recognized outside the claim handling context?***

None have been recognized to date.

## Damages

### ***Are punitive damages available?***

No. Damages for breach of contract are limited to pecuniary losses sustained, and punitive damages are not recoverable in the absence of an independent tort. *Guarantee Abstract & Title Co., Inc. v. Interstate Fire & Cas. Co., Inc.*, 232 Kan. 76, 652 P.2d 665, 667-68 (1982). Such independent tort must indicate the presence of malice, fraud or wanton disregard for the rights of others. *Id.*

### ***Are attorneys' fees recoverable?***

Yes. Kan. Stat. Ann. §40-256 (for first-party, third-party insurance claims for failure to pay "without just cause or excuse"); Kan. Stat. Ann. §40-908 (for first-party property, covered-peril claims); Kan. Stat. Ann. §40-3111(b) (for non-payment or untimely payment of personal injury protection benefits); Kan. Stat. Ann. §60-2006 (for certain auto property damage claims).

### ***Are consequential damages recoverable?***

Yes, lost income and lost profits are recoverable as consequential damages arising from an insurer's failure to pay without just cause or excuse. *Mo. Med. Ins. Co. v. Wong*, 234 Kan. 811, 676 P.2d 113, 124 (1984) (awarding lost income); *Hochman v. Am.*

§60-511. If the insured brings a claim based on an independent tort, the two-year statute of limitations applies. Kan. Stat. Ann. §60-513.

***Under what circumstances will bad faith claims be dismissed or stayed pending the resolution of the underlying claims?***

Any claim of insurer misconduct will be resolved in the original suit or garnishment on the judgment.

***Under what circumstances will bad faith claims be severed for trial from the underlying claim?***

Any claim of insurer misconduct will be resolved in the original suit or garnishment on the judgment.

***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

Kansas case law has not addressed bifurcation of a claim for punitive damages in an action against an insurer.

## **Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Yes. See *Johnson v. Westhoff Sand Co., Inc.*, 31 Kan. App. 2d 259, 62 P.3d 685, 694-97 (2003) (considering insured's failure to provide timely notice and insured's failure to cooperate where insurer refused to provide defense).

***Is "advice of counsel" a recognized defense?***

Kansas courts have not addressed this issue to date.

***What other defenses are available?***

None have been recognized to date.

***Is there a cause of action for reverse bad faith?***

Kansas courts have not addressed this issue to date.

AUTHOR

Thomas E. Rice | Baker Sterchi Cowden & Rice |  
816.448.9333 | rice@bscr-law.com

# Kentucky

By Mindy G. Barfield, Christopher G. Johnson, and Liam E. Felsen

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

Yes. Kentucky's Supreme Court has ruled that Kentucky's Unfair Claims Settlement Practices Act ("KUCSPA"), codified in Ky. Rev. Stat. §304.12-230, supports a private cause of action by operation of Ky. Rev. Stat. §446.070. See *State Farm Mut. Auto. Ins. Co. v. Reeder*, 763 S.W.2d 116 (Ky. 1988).

The KUCSPA prohibits insurers from, inter alia, "[r]efusing to pay claims without conducting a reasonable investigation based on all available information," and requires that insurers attempt "in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear." Ky. Rev. Stat. §304.12-230(3),(6). Insureds may also bring cognizable claims under the KUCSPA for a litany of other alleged acts or omissions, including "refusing to pay claims without conducting a reasonable investigation," failing to "promptly provide a reasonable explanation... for denial of a claim," and "misrepresenting pertinent facts or insurance policy provisions relating to coverage issues." Ky. Rev. Stat. §304.12-230(4), (14), (1).

A private cause of action has also been recognized under Kentucky's Consumer Protection Act ("KCPA"), codified at Ky. Rev. Stat. §367.110, *et seq.* See also *Stevens v. Motorists Mut. Ins. Co.*, 759 S.W.2d 819 (Ky. 1988). The settlement practices of an insurer after the commencement of litigation, but not its counsel's litigation tactics, can serve as a basis for bad faith liability under the KUCSPA. *Knotts v. Zurich Ins. Co.*, 197 S.W.3d 512, 514 (Ky. 2006).

### ***Can a third party bring a statutory action for bad faith?***

Third parties have standing to pursue a private cause of action for violation of the KUCSPA, Ky. Rev. Stat. §304.12-230. See, e.g., *State Farm Mut. Auto. Ins. Co. v. Reeder*, 763 S.W.2d 116 (Ky. 1988). However, third parties lack standing to pursue a private cause of action for violation of the KCPA, Ky. Rev. Stat. §367.110. See *Motorist Mut. Ins. Co. v. Glass*, 996 S.W.2d 437, 447 (Ky. 1997).

The Kentucky Supreme Court in *Glass* also ruled that third parties cannot recover attorneys' fees under Ky. Rev. Stat. §304.12-235(3). *Glass*, 996 S.W.2d at 455.

### ***Is there a common law cause of action for bad faith?***

Yes. A first-party common law bad faith cause of action has been recognized for the failure to pay policy benefits. *Curry v. Fireman's Fund Ins. Co.*, 784 S.W.2d 176 (Ky. 1989). Kentucky courts have recognized that a first-party insured is not necessarily barred from bringing a claim for bad faith against an insurer when the insurer defends under a reservation of rights, files a declaratory judgment action, and then pays the claim only after a court determines that there is coverage. *Guaranty Nat'l Ins. Co. v. George*, 953 S.W.2d 946 (Ky. 1997); *Ind. Ins. Co. v. Demetre*, \_\_\_ S.W.3d \_\_\_, No. 2013-CA-000338-MR, 2015 Ky. App. Lexis 10 (Ky. Ct. App. Jan. 30, 2015). A third party, however, may not bring a common law bad faith claim against an insurer absent an assignment of the policyholder's rights. See, e.g., *Manchester Ins. & Indem. Co. v. Grundy Ins. Co.*, 531 S.W.2d 493 (Ky. Ct. App. 1975).

***Is a third-party bad faith claim viable if the plaintiff does not prevail in the underlying claim?***

See above. However, a favorable jury verdict for less than the amount sought by plaintiff will not automatically vitiate a bad faith claim. Even a “fairly debatable” claim in terms of value must be debated fairly by the insurer. See *Farmers Mut. Ins. Co. v. Johnson*, 36 S.W.3d 368, 375–76 (Ky. 2000) (recognizing bad faith claim could still be pursued even though value of underlying claim was fairly debatable and was jury issue if there was evidence that insurer had acted in bad faith in handling that claim).

**Practice and Procedure**

***Under what circumstances will bad faith claims be severed for trial from the underlying claim?***

Consistent with and pursuant to *Wittmer v. Jones*, 864 S.W.2d 885 (Ky. 1993), bifurcation of bad faith claims for trial purposes is mandatory in Kentucky. Recently, plaintiffs have argued that *Wittmer* is a third-party case and the rationale for bifurcation—that it precludes evidence admissible in a bad faith case from being introduced in the underlying case where that same evidence would be prejudicial and inadmissible—does not apply in the first-party context. There is no post-*Wittmer* state court precedent to support this argument. Further, the *Wittmer* rule regarding bifurcation was adopted from Justice Liebson’s dissent in the *Federal Kemper Ins. Co. v. Hornback*, 711 S.W.2d 844 (Ky. 1986), which was a first-party bad faith case. *Hornback* was overruled on other grounds in *Curry v. Fireman’s Fund Ins. Co.*, 784 S.W.2d 176 (Ky. 1989).

While there are several Kentucky federal court decisions rejecting bifurcation, those courts were not bound by *Wittmer* and instead follow Fed. R. Civ. P. 42(b), which makes a federal court’s decision to bifurcate discretionary. See, e.g., *Woody’s Rest., LLC v. Travelers Cas. Ins. Co. of Am.*, No. 5:12-CV-92-JMH-REW, 2014 WL 108317 (E.D. Ky. Jan. 9, 2014).

***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

Given the standard for bad faith in Kentucky, there are no circumstances under which compensatory and punitive damages would be bifurcated from one another at trial. In *Wittmer v. Jones*, 864 S.W.2d 885, 890 (Ky. 1993), the Kentucky Supreme Court made clear that to constitute bad faith a plaintiff must establish the insurer’s conduct was sufficiently outrageous to justify the imposition of punitive damages. If the record contains no such evidence, the trial court must direct a verdict on bad faith for the insurer. If there is evidence to support a finding of outrageous conduct, then the issue of bad faith is presented to the jury along with instructions on both compensatory and punitive damages.

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

While it is generally believed that an insurer cannot assert a direct claim against the insured or third-party claimant for their conduct (*i.e.*, reverse bad faith), the conduct of the insured or third-party claimant is almost always relevant and admissible in a bad faith case to show whether or not insurer acted reasonably in handling the claim. See, e.g., *Farmland Mut. Ins. Co. v. Johnson*, 36 S.W.3d 368, 379 (Ky. 2000).

***Is “advice of counsel” a recognized defense?***

No, Kentucky courts have never allowed insurers to assert advice of counsel as an absolute defense against bad faith claims. See *Hamilton Mut. Ins. Co. of Cincinnati v. BATTERY*, 220 S.W.3d 287, 294 (Ky. Ct. App. 2007). While insurers may seek and rely on the reasonable advice of counsel, “[an insurer] remains ultimately responsible for its own non-delegable statutory duty to properly investigate claims and adjust them in harmony with the terms and conditions of its policy.” *Id.*

***Is there a cause of action for reverse bad faith?***

While no Kentucky state court has expressly prohibited an insurer from pursuing a claim for reverse bad faith, the Sixth Circuit Court of Appeals recently predicted that the Kentucky Supreme Court would reject a claim for reverse bad faith. *State Auto Prop. & Cas. Ins. Co. v. Hargis*, 785 F.3d 189, 200 (6th Cir. 2015).

AUTHORS

**Mindy G. Barfield** | Dinsmore & Shohl LLP | 859.425.1025 | [mindy.barfield@dinsmore.com](mailto:mindy.barfield@dinsmore.com)

**Christopher G. Johnson** | Frost Brown Todd LLC | 502.568.0357 | [cjohnson@fbtlaw.com](mailto:cjohnson@fbtlaw.com)

**Liam E. Felsen** | Frost Brown Todd LLC | 502.568.0357 | [lfelsen@fbtlaw.com](mailto:lfelsen@fbtlaw.com)

# Louisiana

By James R. Nieset, Jr.

## Causes of Action

### *Is there a statutory basis for an insured to bring a bad faith claim?*

Yes, the two principal Louisiana bad faith statutes are La. Rev. Stat. Ann. §§22:1892 and 22:1973. The statutes were renumbered in 2009, and last amended substantively in 2006. The duties imposed upon insurers by these statutes are owed to both first-party and third-party claimants.

There are a number of very specific duties owed by the insurer to both first-party and third-party claimants. One such duty is to “initiate loss adjustment” of a property damage or medical expense claim within fourteen days after proof of loss, subject to a “catastrophic loss” exception when the time period is thirty days. Initiating loss adjustment means the taking of “some substantive and affirmative step” to gather information necessary to evaluate the claim. *Rogers v. Commercial Union Ins. Co.*, 2001-443 (La. App. 3 Cir. 10/3/01); 796 So. 2d 862. The mere opening of a claim file is not enough. Louisiana cases are not entirely clear on how much the insurer must do to satisfy this duty.

Another principal duty owed by the insurer to first-party claimants is to make unconditional payment of claims within 30 days of receipt of an adequate proof of loss. La. Rev. Stat. Ann. §22:1892 sets forth a 30-day time period and La. Rev. Stat. Ann. §22:1973 a 60-day time period for the insurer to make an unconditional payment to the insured after the insured makes satisfactory proof of loss. To establish a “satisfactory proof of loss,” the insured must show sufficient facts to fully apprise the insurer of the claim and must indicate the extent of the damage. *Combetta v. Ordoyne*, 2004-2347 (La. App. 1 Cir. 5/5/06); 934 So. 2d 836, 843. Proof of loss is a “flexible requirement to advise an insurer of the facts of the

claim” and it need not be in writing or in any particular format. *Louisiana Bag Co. v. Audubon Indem. Co.*, 2008-0453 (La. 12/2/08); 999 So. 2d 1104. If the insurer has actual knowledge of the facts of the loss, such knowledge constitutes notice and suffices as proof of loss. The Louisiana Supreme Court in *Louisiana Bag* case held that an insurer’s form requirement of proof of loss before payment is insufficient to create probable cause to delay payment, and that to allow an insurer to do so would frustrate the intent and purpose of the statute, as it would allow the insurer to solely determine when proof of loss is received.

If the insurer fails to timely make payment and the failure is “arbitrary and capricious,” the insurer is subject to a statutory penalty and, under La. Rev. Stat. Ann. §22:1973, perhaps other damages. This means the insurer who fails to make an unconditional tender is liable for penalties if reasonable persons could not disagree on whether payment should be made or that a certain amount should be paid.

La. Rev. Stat. Ann. §22:1893 states that a property insurer cannot make a coverage determination solely on the basis of floodwater markings on structures or displacement of a home from its foundation.

La. Rev. Stat. Ann. §22:1811 relates to an insurer’s duties under life insurance policies and La. Rev. Stat. Ann. §22:1821 addresses the insurer’s duties under health and accident policies.

### *Can a third party bring a statutory action for bad faith?*

Yes, under certain circumstances. Insurers owe the following principal duties to third-party claimants: paying third-party property damage and medical expense claims within thirty days of a written settlement agreement; instituting loss adjustment of property damage and medical expense claims

issues of compensatory damages from the issues of bad faith, penalties, and attorney's fees in order to avoid jury confusion. *Dugas v. Auto. Cas. Ins. Co.*, 98-807 (La. App. 5 Cir. 2/10/99), 729 So. 2d 25, 27.

***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

See answer to the preceding question.

***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?***

The filing of a bankruptcy petition by the insured or the insurer will stay the proceedings until the bankruptcy is either discharged or the bankruptcy court lifts the stay. In the event of bankruptcy proceedings by the insured, bankruptcy law governs the bankruptcy trustee's rights to proceed with bad faith claims.

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

The Louisiana Insurance Guaranty Association guarantees policies issued by authorized insurers in Louisiana for "covered claims" (and subject to other limitations). Under La. Rev. Stat. Ann. §22:2055, the definition of a "covered claim" excludes claims based on pre-insolvency obligations of the insolvent insurer, such as bad faith claims. *Lastie v. Warden*, 611 So. 2d 721 (La. Ct. App. 1992).

## **Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Yes. The insurer may introduce evidence to show that the insured did not produce satisfactory proof of loss to trigger the statutory requirements. *Combetta v. Ordoyne*, 2004-2347 (La. App. 1 Cir. 5/5/06); 934 So. 2d 836, 843; *Louisiana Bag Co. v. Audubon Indem. Co.*, 2008-0453 (La. 12/2/08); 999 So. 2d 1104.

***Is "advice of counsel" a recognized defense?***

Yes, as to those bad faith claims that raise the issue of whether an insurer's action was reasonable, the insurer certainly can introduce evidence that its action was based on advice of counsel. However, there exists very little Louisiana case law in the context of an "advice of counsel" defense in an insurer bad faith case.

***What other defenses are available?***

The insurer may argue that its failure to pay was not "arbitrary, capricious, or without probable cause" and was based on a good faith defense. Further, the Louisiana bad faith statutes apply to failure to pay undisputed amounts owed, not to amounts that are contested.

***Is there a cause of action for reverse bad faith?***

No.

AUTHOR

**James R. Nieset, Jr.** | Porteous, Hainkel & Johnson LLP | 504.412.6253 | jnieset@phjlaw.com

# Maine

By James M. Bowie and Hillary J. Bouchard

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

Yes, there is a limited statutory basis. An insured can bring suit against its own insurer for unfair claims settlement practices ("UCSPA"). See 24 Me. Rev. Stat. Ann. tit. 24, §2436-A. The following constitute "unfair claims settlement practices": (1) "Knowingly misrepresenting to an insured pertinent facts or policy provisions relating to coverage at issue;" (2) "Failing to acknowledge and review claims, which may include payment or denial of a claim, within a reasonable time following receipt of written notice by the insurer of a claim by an insured arising under a policy;" (3) "Threatening to appeal from an arbitration award in favor of an insured for the sole purpose of compelling the insured to accept a settlement less than the arbitration award;" (4) "Failing to affirm or deny coverage, reserving any appropriate defenses, within a reasonable time after having completed its investigation related to a claim;" or (5) "Without just cause, failing to effectuate prompt, fair and equitable settlement of claims submitted in which liability has become reasonably clear."

The UCSPA applies to all insurance contracts and annuity contracts, other than reinsurance, wet marine and transportation insurance, and policies or contracts not issued for delivery in Maine nor delivered in Maine (unless otherwise specifically indicated in the policy). See Me. Rev. Stat. Ann. tit. 24, §2401.

### ***Can a third party bring a statutory action for bad faith?***

The UCSPA is limited to actions by an insured. There is no other statutory basis otherwise allowing such an action by a third party. Further, common law provides that a third party cannot bring an action for bad

faith, given the lack of a contractual relationship with the insurance company: "A duty of good faith and fair dealing in the handling of claims runs only to an insurance company's insured." *Linscott v. State Farm Mut. Auto Ins. Co.*, 368 A.2d 1161, 1163 (Me. 1977).

### ***Is there a common law cause of action for bad faith?***

An insured's cause of action against the insurer lies only for breach of contract and/or a UCSPA violation.

Maine courts have specifically rejected the independent tort of bad faith. *Marquis v. Farm Family Mut. Ins. Co.*, 628 A.2d 644 (Me. 1993). Instead, "the traditional remedies for breach of contract are available to the insured in the event an insurer breaches its contractual duty to act in good faith." *Id.* at 652.

Insurers, however, are subject to tort claims just as any other entity. In order for such a tort action to lie, the allegations must be "based on actions that are separable from the actual breach of contract." *Stull v. First Am. Title Ins. Co.*, 2000 ME 21, ¶14, 745 A.2d 975, 980.

In the workers' compensation context, Maine courts have allowed employees to proceed with tort claims against the employer's carrier, such as intentional infliction of emotional distress and intrusion of privacy, arising out of the claims handling process. See *Hawkes v. Commercial Union Ins. Co.*, 2001 ME 8, 764 A.2d 258; *Gibson v. Nat'l Ben Franklin Ins. Co.*, 387 A.2d 220 (Me. 1978).

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

Other than cases involving general actions for contribution by one carrier against another, which may include requests for a declaratory judgment

# Maryland

By Steven E. Leder

## Causes of Action

### *Is there a statutory basis for an insured to bring a bad faith claim?*

A claim against first-party insurers for failure to act in good faith exists under Md. Code Ann., Cts. & Jud. Proc. §3-1701. The statutory cause of action for failure to act in good faith “applies only to first-party claims under property and casualty insurance policies issued, sold, or delivered in the State [of Maryland].” Md. Code Ann., Cts. & Jud. Proc. §3-1701(b). Some federal decisions and a Maryland Insurance Administration (“MIA”) decision have construed the term “first-party claims” in the statute to include claims by an insured against its own insurer for defense and indemnity costs. *Whiting-Turner Contracting Co. v. Liberty Mut. Ins. Co.*, 912 F. Supp. 2d 321, 339 (D. Md. 2012) (*dicta*); *Eyes for You, LLC v. Zurich Am. Ins. Co.*, Case No. 27-1001-12-0001 at 6–7 (Md. Ins. Admin. May 9, 2012). This broad construction of the term “first-party” claims has not been tested in the Maryland appellate courts.

Before seeking relief pursuant to Section 3-1701, the insured must first exhaust its administrative remedies before the MIA pursuant to Md. Code Ann., Ins. §27-1001. However, if a case fits within one of the following exceptions, it may be filed in court and is not subject to the jurisdiction of the MIA: (1) a small claim within the jurisdiction of a Maryland District Court, (2) where the insurer and insured agree to waive the MIA requirement; or (3) where a claim involves a commercial insurance policy with policy limits that exceed \$1,000,000. *Lanham Servs. Inc. v. Nationwide Prop. & Cas. Ins. Co.*, No. PWG-13-3294, 2014 WL 2772227, \*4 (D. Md. June 18, 2014) (permitting insured to aggregate limits for each building insured under policy in order to meet \$1,000,000 exception even though claim itself was only for \$637,100).

Whether an insurer acted in good faith involves assessing the “totality of the circumstances” including:

- (1) efforts or measures taken by the insurer to resolve the coverage dispute promptly or in such a way as to limit any potential prejudice to the insureds;
- (2) the substance of the coverage dispute or the weight of legal authority on the coverage issue; and
- (3) the insurer’s diligence and thoroughness in investigating the facts specifically pertinent to coverage.

*Cecilia Schwaber Trust Two v. Hartford Acc. & Indem. Co.*, 636 F. Supp. 2d 481, 487 (D. Md. 2009) (citation omitted).

### *Can a third party bring a statutory action for bad faith?*

A third party may not bring a bad faith claim unless specifically authorized in the policy. *See, e.g., Bean v. Allstate*, 285 Md. 572, 577, 403 A.2d 793, 796 (1979). However, an action for bad faith may be assigned. *Med. Mut. Liab. Ins. Soc’y of Md. v. Evans*, 330 Md. 1, 25, 622 A.2d 103, 114 (1993).

### *Is there a common law cause of action for bad faith?*

The sole cause of action for third-party bad faith thus far recognized by the Maryland appellate courts is one for wrongful refusal to settle within policy limits. *Kremen v. Md. Auto. Ins. Fund*, 363 Md. 663, 675, 770 A.2d 170, 177 (2001); *Mesmer v. Md. Auto. Ins. Fund*, 353 Md. 241, 259, 725 A.2d 1053, 1061 (1999).

There is no common law cause of action for first-party bad faith in Maryland. *Johnson v. Federal Kemper Ins. Co.*, 74 Md. App. 243, 246, 536 A.2d 1211, 1212–13 (1988), *cert. denied*, 313 Md. 8, 542 A.2d 844 (1988); *Harris v. Keystone Ins. Co.*, Civil No. CCB-13-

***Is a bad faith claim viable if a coverage decision has been determined to be correct?***

There is no cause of action for bad faith refusal to settle where the insurer has refused to defend. *Mesmer v. Md. Auto. Ins. Fund*, 353 Md. 241, 262-63, 725 A.2d 1053, 1063-64 (1999).

***Is a third-party bad faith claim asserted in connection with a policy that provides third-party coverage viable if the third-party claimant does not prevail in the underlying claim?***

The only recognized third-party bad faith claim is for a judgment in excess of the policy limits where the insurer wrongfully refused to settle for an amount within the policy limits. *See, e.g., Mesmer v. Md. Auto. Ins. Fund*, 353 Md. 241, 262-63, 725 A.2d 1053, 1063-64 (1999).

## **Practice and Procedure**

### ***Statute of limitations***

An insurer's wrongful refusal to settle is a tort. *See, e.g., Mesmer v. Md. Auto. Ins. Fund*, 353 Md. 241, 266, 725 A.2d 1053, 1065 (1999). The Maryland statute of limitations for tort causes of action is three years. Md. Code Ann., Cts. & Jud. Proc. §5-101. The cause of action accrues upon a final excess judgment. *Allstate Ins. Co. v. Campbell*, 334 Md. 381, 397, 639 A.2d 652, 659 (1994); *see also Luppino v. Vigilant Ins. Co.*, 110 Md. App. 372, 381, 677 A.2d 617, 621 (1996), *aff'd*, 352 Md. 481, 723 A.2d 12 (1999).

***Under what circumstances will bad faith claims be dismissed or stayed pending the resolution of the underlying claims?***

Not applicable.

***Under what circumstances will the compensatory and punitive damage claims be bifurcated?***

Although not required, courts frequently bifurcate claims for compensatory and punitive damages. *Darcars Motors of Silver Springs, Inc. v. Borzym*, 379 Md. 249, 273-74, 841 A.2d 828, 842-43 (2004). Md.

Code Ann., Cts. & Jud. Proc. §10-913(a) prohibits the admission of evidence of the defendant's financial condition in personal injury actions unless the jury first finds that "punitive damages are supportable under the facts."

## **Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Yes. The actions of the third-party claimant, such as failure to make a demand within policy limits, bear on the reasonableness of the insurer in not settling the case. Contributory negligence of the insured may also be a defense. For example, whether the insured requested that his or her insurer settle the case or agreed that a case should not be settled may be considered by the jury. *Kremen v. Md. Auto. Ins. Fund*, 363 Md. 663, 682, 770 A.2d 170, 181 (2001); *Am. Mut. Ins. Co. of Bos. v. Bittle*, 26 Md. App. 434, 439, 338 A.2d 306, 309 (1975). However, a bad faith suit is not barred by the insured's wish to litigate where it is not based upon a fully informed judgment. *Schlossberg v. Epstein*, 73 Md. App. 415, 434, 534 A.2d 1003, 1012 (1988).

***Is "advice of counsel" a recognized defense?***

There are no reported Maryland insurance cases on point. However, advice of counsel is a defense to tort actions. *VF Corp. v. Wrexham Aviation Corp.*, 112 Md. App. 703, 715, 686 A.2d 647, 654 (1996), *aff'd in part, rev'd in part on other grounds*, 350 Md. 693, 715 A.2d 188 (1998). Hence, it should be one factor the trier of fact may consider in determining the reasonableness of the insurer's conduct in not settling the case.

***What other defenses are available?***

Since bad faith is a tort action, any defense to a tort may be asserted in a bad faith action, including contributory negligence or assumption of risk.

No case has found bad faith where there was an offer of policy limits prior to trial. *See, e.g., Cook v. Nationwide Ins. Co.*, 962 F. Supp. 2d 807, 821 (D. Md. 2013); *Allstate Ins. Co. v. Campbell*, 334 Md. 381, 391-92, 639 A.2d 652, 656-58 (1994).

In first-party cases, the MIA may not find that the insurer failed to act in good faith “solely on the basis of delay in determining coverage or the extent of payment to which the insured is entitled if the insurer acted within the time period specified by statute or regulation for investigation of a claim by an insurer.” Md. Code Ann., Cts. & Jud. Proc. §3-1701(f).

***Is there a cause of action for reverse bad faith?***

No such cause of action has been recognized.

AUTHOR

**Steven E. Leder** | Leder & Hale PC | 443.279.7900 |  
leder@lederhale.com

# Massachusetts

By R.J. Maselek and Suzanne M. Whitehead

## Causes of Action

### *Is there a statutory basis for an insured to bring a bad faith claim?*

Yes, however, there are different statutory bases for an insured to bring a bad faith claim depending on whether the insured is a consumer or a business. Consumers are protected by the Massachusetts Consumer Protection Act, Mass. Gen. Laws ch. 93A §9, while businesses engaged in “trade or commerce” are protected by Mass. Gen. Laws ch. 93A §11.

Massachusetts General Laws Chapter 176D §3(9) governs Unfair and Deceptive Acts in the Business of Insurance. A Chapter 176D §3(9) violation automatically constitutes a violation of Mass. Gen. Laws ch. 93A §9, *Polaroid Corp. v. Travelers Indem. Co.*, 414 Mass. 747, 610 N.E.2d 912, 917 (1993); *Hopkins v. Liberty Mut. Ins. Co.*, 434 Mass. 556, 750 N.E.2d 943, 948–49 (2001), and it is “evidence” of a violation under §11. See also, e.g., *MacDonald & Evans, Inc. v. Utica Mut. Ins. Co.*, 578 F. Supp. 2d 222, 230 (D. Mass. 2008) (“Although... Chapter 176D violations do not allow automatic recovery under Chapter 93A §11... a Chapter 176D violation may be evidence of a Chapter 93A §11 violation.”); *Wolverine, Proctor & Schwartz, Inc. v. XYZ Tape Corp.*, No. Civ. A. 04-12189-RWZ, 2006 WL 335342 (D. Mass. Feb. 10, 2006); *Smyrna Rebar Co. v. U.S. Fid. & Guar. Co.*, 65 Mass. App. Ct. 1103, 837 N.E.2d 313 (2005) (insurer’s failure to make reasonable offer of settlement where liability is clear can be violation of 93A, even though Chapter 176D does not directly apply to this §11 claim).

To establish a violation of §11, a plaintiff must demonstrate: “(1) that the defendant engaged in an unfair method of competition or committed an unfair or deceptive act or practice, as defined by G.L. c. 93A §2...; (2) a loss of money or property suffered as a result; and (3) a causal connection between the

loss suffered and the defendant’s unfair or deceptive method, act, or practice.” *Auto Flat Car Crushers, Inc. v. Hanover Ins. Co.*, 469 Mass. 813, 17 N.E.3d 1066, 1074–75 (2014)

### *Can a third party bring a statutory action for bad faith?*

Yes. In 1979, the Massachusetts Legislature amended Mass. Gen. Laws ch. 93A to provide a private right of action to any person “who has been injured by another person’s use or employment of any method, act or practice declared to be unlawful” under the statute. See *Hershenow v. Enter. Rent-A-Car Co. of Boston, Inc.*, 445 Mass. 790, 840 N.E.2d 526 (2006); *Van Dyke v. St. Paul Fire & Marine Ins. Co.*, 388 Mass. 671, 448 N.E. 2d 357 (1983); *Mutual Ins. Co. v. Murphy*, 630 F. Supp. 2d 158, 163 (D. Mass. 2009) (“An insurer owes the duty to effectuate a prompt settlement not only to its policyholders, but also to those third parties making claims against its policyholders.”).

However, certain sections of Mass. Gen. Laws ch. 176D §3(9) apply only to policyholders and not third parties. For example, subsection (g) of Mass. Gen. Laws ch. 176D §3(9) prohibits insurance companies from “[c]ompelling *insureds* to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such *insureds*” (emphasis added). This language creates no rights in persons other than the insured. Compare this language to that of §3, subsections (9)(j) (“insured or beneficiaries”); (9)(k) (“insured or claimants”); and (9)(l) (“insured or claimant”). *Jacobs v. Town Clerk of Arlington*, 402 Mass. 824, 525 N.E.2d 658, 661 (1988); see also *Clegg v. Butler*, 424 Mass. 413, 676 N.E.2d 1134, 1139 (1997).

on point, compensatory and punitive damages in a Chapter 93A are always tried together.

***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?***

There is no case law in Massachusetts that explicitly holds that actual or potential bad faith rights held by a policyholder become an asset of the bankruptcy estate, subject to prosecution or assignment by the bankruptcy trustee. In the event of insolvency by the insurer, the Bankruptcy Code's automatic stay provisions may serve to discharge the claims.

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

The Massachusetts Insurer's Insolvency Fund can be held liable for bad faith under Chapters 93A and 176D. *Wheatley v. Mass. Insurers Insolvency Fund*, 456 Mass. 594, 925 N.E.2d 9 (2010).

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Yes. An insurer's conduct must be viewed in light of the situation as a whole and a claimant's failure to make a timely demand or refusal to negotiate realistically may be relevant in defending a bad faith claim. In evaluating the reasonableness of an insurer's offer of settlement, a factfinder must consider the situation as a whole and can take into consideration a plaintiff's demands. This holds true even where the claimant's demand is unreasonably high, and the insurer's apprehension that a jury might award a large verdict (because the claimant was a bereaved mother) does not make the insurer's lower offer unreasonable. *Forcucci v. U.S. Fid. & Guar. Co.*, 11 F.3d 1, 2 (1st Cir. 1993); see *Schulz v. Liberty Mut. Ins. Co.*, 940 F. Supp. 27, 31 (D. Mass. 1996); *Bobick v. U.S. Fid. & Guar. Ins. Co.*, 439 Mass. 652, 790 N.E.2d 653

(2003); *DiVenuti v. Reardon*, 37 Mass. App. Ct. 73, 637 N.E.2d 234, 236 (1994).

***Is "advice of counsel" a recognized defense?***

Yes. To establish the advice of counsel defense, the party raising it must show that: (1) he or she is acting in good faith in the belief that he or she has good cause for his action and is not seeking an opinion in order to shelter him or herself; (2) he or she has made a full and honest disclosure of all the material facts within his or her knowledge or belief; (3) he or she is doubtful of his or her legal rights; (4) he or she has reason to know that his or her counsel is competent; (5) he or she honestly complied with counsel's advice; and (6) his or her counsel is of such training and experience that counsel is able to exercise prudent judgment in such matters. *G.S. Enters., Inc. v. Falmouth Marine, Inc.*, 410 Mass. 262, 571 N.E.2d 1363 (1991); see also *Hejinian v. Gen. Am. Life Ins. Co.*, No. 05-3851-BLS1, 2009 WL 981732, at \*8 (Mass. Super. Ct. Jan. 13, 2009) (insurer could not rely on advice of counsel defense when counsel ignored controlling appellate precedent; advice of counsel defense "does not give an insurance company a blank check to decline coverage as long as it finds an attorney to support its position.").

***What other defenses are available?***

No statutory bad faith claim may be brought under Mass. Gen. Laws ch. 93A, §11 (applicable to claimant engaged in trade or commerce) unless the actions and transactions constituting the alleged unfair method of competition or the unfair or deceptive act or practice "occur primarily and substantially within the Commonwealth" of Massachusetts. *Kuwaiti Danish Computer Co. v. Digital Equip. Corp.*, 438 Mass. 459, 781 N.E.2d 787, 797 (2003).

Whether the alleged unfair or deceptive act or practice of which [the insured] complains occurred primarily or substantially within the Commonwealth is not a determination that can be reduced to a precise formula. Rather, this court considers its findings of facts within the context of the entire claim to determine whether the center of gravity of the circum-

stances that give rise to the claim is primarily and substantially within Massachusetts.

*Welch Foods, Inc. v. Liberty Mut. Fire Ins. Co.*, No. 001249A, 2005 WL 1131747, at \*25–26 (Mass. Super. Ct. Apr. 6, 2005). In that case, the court held that the center of gravity was not within Massachusetts, even though the insured had its headquarters in Massachusetts, when the underlying action was not brought in Massachusetts and almost all of the key players involved in the handling of the claim lived and worked outside of Massachusetts.

Individual claimants not engaged in trade or commerce must comply with the notice requirements of Mass. Gen. Laws ch. 93A, §9(3). A demand letter listing the specific deceptive practices claimed is a prerequisite to suit under §9 and as a special element must be alleged and proved. The demand letter is a procedural requirement, the absence of which is a bar to suit. *Richard Slaney v. Westwood Auto., Inc.*, 366 Mass. 688, 322 N.E.2d 768 (1975); *Entrialgo v. Twin City Dodge, Inc.*, 368 Mass. 812, 333 N.E.2d 202 (1975), *York v. Sullivan*, 369 Mass. 157, 338 N.E.2d 341, 345–46 (1975); see also *Alan Corp. v. Int'l Surplus Lines Ins. Co.*, 823 F. Supp. 33, 43 (D. Mass. 1993) (“Merely chanting the statutory mantra of the seven subsections of M.G.L. c. 176D does not suffice to satisfy the requirement, in the absence of a factual basis supporting the allegations,” of Fed. R. Civ. P. 8, which requires a plaintiff to set forth a “short and plain statement of the claim showing that the pleader is entitled to relief...”); *Evangelista v. Hingham Mut. Fire Ins. Co.*, No. 034587, 2005 WL 705840, at \*3 (Mass. Super. Ct. Feb. 14, 2005) (“An adequate demand letter will define the injury suffered and the relief demanded in a manner that provides the prospective defendant an opportunity to review the facts and law implicated to see if requested relief should be granted or denied and to enable them to make a reasonable tender of settlement in order to limit recoverable damages.”); *Mass. Port Auth. v. Employers Ins. of Wausau*, No. 953079A, 2004 WL 3250454, at \*5 (Mass. Super. Ct. Dec. 21, 2004) (“The courts measure the sufficiency of the [Chapter 93A] demand letter

with practicality. Realistic communication to the respondent should contain the identity of the claimant, the injury or loss, the essential facts of actionable behavior, and reference to pertinent law. Severable flaws within the letter do not invalidate it. In addition, the courts will read and interpret the letter in light of any prior communication between the parties and in light of any existing knowledge of the respondent.”) (internal citation omitted).

### ***Is there a cause of action for reverse bad faith?***

No. See *Schulz v. Liberty Mut. Ins. Co.*, 940 F. Supp. 27 (D. Mass. 1996). However, the conduct of the insured or third-party claimant may be the basis of an affirmative defense based on comparative bad faith. (See the cases cited above regarding the effect of the reasonableness of the conduct of the insured or third-party claimant.)

### **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

Any rights that a policyholder has with respect to an insurer’s handling of a claim are assignable. See *DiMarzo v. Am. Mut. Ins. Co.*, 389 Mass. 85, 449 N.E.2d 1189 (1983).

A self-insurer cannot be held liable for unfair settlement practices under Chapters 93A or 176D. See *Morrison v. Toys “R” Us, Inc.*, 441 Mass. 451, 806 N.E.2d 388 (2004).

An insurer which issues a fronting policy cannot be held liable for unfair settlement practices under Chapters 93A or 176D. *Tilton v. National Union Fire Ins. Co. of Pittsburgh, Pa.*, Civil Action No. 07-10163-RWZ, 2008 WL 781921 (D. Mass. 2008).

#### AUTHORS

**R.J. Maselek** | Zelle McDonough & Cohen LLP | 617.742.6520 | rmaselek@zelmcd.com

**Suzanne M. Whitehead** | Zelle McDonough & Cohen LLP | 617.742.6520 | swhitehead@zelmcd.com

# Michigan

By Charles W. Browning, Lauren B. McMillen, and Warren J. White

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

No. However, the Michigan legislature has provided in the Uniform Trade Practice Act, Mich. Comp. Laws §500.2001, *et seq.*, that an insurer is liable for penalty interest if it fails to timely pay a claim not reasonably in dispute. *Burnside v. State Farm Fire Cas. Co.*, 528 N.W.2d 749, 753 (Mich. Ct. App. 1995) (citing *McCahill v. Commercial Union Ins. Co.*, 446 N.W.2d 579 (Mich. Ct. App. 1989)). An insured may be entitled to 12 percent interest for its insurer's failure to pay a claim within sixty days of receipt of satisfactory proof of loss. Uniform Trade Practice Act, Mich. Comp. Laws §500.2006.

### ***Can a third party bring a statutory action for bad faith?***

No.

### ***Is there a common law cause of action for bad faith?***

Yes. The Michigan Supreme Court has defined bad faith as the "arbitrary, reckless, indifferent, or intentional disregard of the interests of the person owed a duty." *Commercial Union Ins. Co. v. Liberty Mut. Ins. Co.*, 393 N.W.2d 161, 164 (Mich. 1986).

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

Equitable subrogation. An excess carrier may maintain a cause of action against a primary carrier for the primary carrier's bad faith failure to defend or settle within policy limits. *Commercial Union Ins. Co. v. Medical Protective Co.*, 393 N.W.2d 479, 483

(Mich. 1986) (citing *City of Wakefield v. Globe Indem. Co.*, 225 N.W. 643 (Mich. 1929)). The excess carrier is equitably subrogated to the position of the insured and acquires no lesser or greater rights than those held by the insured. *Id.* at 483.

## Damages

### ***Are punitive damages available?***

Yes. Although the general rule is that exemplary, or punitive, damages are not recoverable for breach of contract, where an element of damages involves proof of tortious conduct on the part of the defendant that exists independent of the breach, exemplary damages may be recoverable. *Kewitt v. Mass. Mut. Life Inc. Co.*, 295 N.W.2d 50, 55 (Mich. 1980) (citing *Harbaugh v. Citizens Telephone Co.*, 157 N.W.2d 32 (Mich. 1916)).

### ***Are attorneys' fees recoverable?***

No. *Burnside v. State Farm Fire Cas. Co.*, 528 N.W.2d 749, 752-53 (Mich. Ct. App. 1995) ("The American Rule stands as a barrier to the recovery, as consequential damages, of foreseeable counsel fees incurred in enforcing remedies... breach of contract damages are not awarded to punish a wrongdoer... An insured's right to recover attorney's fees as an element of damages is not triggered by the foreseeability of loss... [i]nstead, attorney fees are recoverable only when expressly authorized by statute, court rule, or a recognized exception.") (citing *Valentine v. General American Credit, Inc.*, 326 N.W.2d 628 (Mich. 1984)).

### ***Are consequential damages recoverable?***

The damages recoverable for breach of contract are those that naturally arise from the breach or those that were in contemplation of the parties at the time the contract was made. *Kewin v. Mass. Mut. Life Inc. Co.*, 295 N.W.2d 50, 53 (Mich. 1980) (citing *Hadley v.*

- (11) refusal to settle a case within the policy limits following an excessive verdict when the chances of reversal on appeal are slight or doubtful; and
- (12) failure to take an appeal following a verdict in excess of the policy limits, where there are reasonable grounds for such an appeal, especially where trial counsel so recommended.

*Id.* at 165–66.

***Does a bad faith claim proof require evidence of a pattern or practice of unfair or deceptive conduct?***

No.

**Practice and Procedure**

***Statute of limitations***

No Michigan case has addressed this question directly. However, some argument can be made regarding the applicable statute of limitations. Because the bad faith cause of action was initially recognized as one “brought in tort,” see *City of Wakefield v. Globe Indem. Co.*, 225 N.W. 643 (Mich. 1929), bad faith claims could be found to be governed by the three-year statute of limitations applicable to tort claims generally. The limitation on tort claims is codified at Mich. Comp. Laws §600.5805(10). However, more recent Supreme Court precedent states that the bad faith cause of action “originates in the implied covenant of good faith and fair dealing which arises from the contract between the insurer and the insured.” *Commercial Union Ins. Co. v. Med. Protective Co.*, 393 N.W.2d 479, 482 (Mich. 1986). Thus, the six-year statute of limitations applicable to contract claims would most likely be found to govern. Mich. Comp. Laws §600.5807(8).

***Under what circumstances will bad faith claims be dismissed or stayed pending the resolution of the underlying claims?***

Michigan courts do not appear to have addressed this question.

***Under what circumstances will compensatory and punitive damages claims be bifurcated?***

Michigan courts do not appear to have analyzed the bifurcation of damages in a bad faith case. In general, Mich. Ct. R. 2.505(B) authorizes the court’s discretion in ordering a separate trial for one or more claims or issues where convenience, avoidance of prejudice, or expedition and economy will be served. See *Smith v. Oakwood Healthcare, Inc.*, No. 279908, 2009 WL 1067017, \*2–3 (Mich. Ct. App. Apr. 21, 2009); see also *Detloff v. Taubman Co., Inc.*, 315 N.W.2d 582, 583 (Mich. Ct. App. 1982) (the court should exercise its discretion in ordering separate trials only upon a “most persuasive showing” that convenience and the avoidance of prejudice will be served).

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Yes. In *Commercial Union Ins. Co. v. Med. Protective Co.*, 356 N.W.2d 648, 653 (Mich. Ct. App. 1984), the court held that in an equitable subrogation action by an excess insurer against a primary insurer, the insured’s failure to cooperate in the underlying litigation could act as a bar to the excess insurer’s bad faith claim. See also *Jackson v. Saint Paul-Mercury Indem. Co.*, 339 F.2d 40, 44 (6th Cir. 1964) (“if the insured actively concurs in the rejection of a compromise offer, he cannot recover against the insurer for [bad faith] failure to settle.”).

***Is advice of counsel a recognized defense?***

Michigan courts do not appear to have addressed this question.

**Defenses and Counterclaims**

***What other defenses are available?***

The Michigan Supreme Court has held that “the insurer does not act in bad faith if it refuses settlement in the honest belief that it has a fair chance of victory, or of keeping the verdict within the policy limit, or, upon reasonable grounds, that the compromise amount is excessive, or if it has legal defenses, as yet undetermined by a court of last resort, which

fairly seem applicable....” *City of Wakefield v. Globe Indem. Co.*, 225 N.W. 643, 645 (Mich. 1929). A “mistake of judgment is not bad faith.” *Id.*

### ***Is there a cause of action for reverse bad faith?***

Michigan courts do not appear to have addressed this question.

### **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

“Michigan recognizes an insured’s claim against its insurer for bad faith in refusing to settle.” *J. Farmer Leasing, Inc. v. Citizens Ins. Co. of Am.*, 696 N.W.2d 681, 683, n.3 (Mich. 2005). The seminal case of *City of Wakefield v. Globe Indem. Co.*, 225 N.W. 643, 643 (Mich. 1929), recognized the bad faith cause of action “brought in tort.” However, the Michigan Supreme Court refused “to declare the mere bad-faith breach of an insurance indemnity contract to be an independent and separately actionable tort, and thereby to open the door to recovery for mental pain and suffering....” *Kewin v. Mass. Mut. Life Ins. Co.*, 295 N.W.2d 50, 56 (Mich. 1980); *see also Young v. Mich. Mut. Ins.*, 362 N.W.2d 844, 847 (Mich. App. 1984) (refusing to recognize plaintiff’s claim “that defendant’s bad faith acts or omissions caused him hardship, anxiety, outrage and inconvenience”). More recently, the Michigan Supreme Court stated that the bad faith cause of action “originates in the

implied covenant of good faith and fair dealing which arises from the contract between the insurer and the insured.” *Commercial Union Ins. Co. v. Med. Protective Co.*, 393 N.W.2d 479, 482 (Mich. 1986).

### **Effect of an Insured’s Insolvency**

Michigan law requires liability insurance policies to include a provision “that the insolvency or bankruptcy of the person insured shall not release the insurer from the payment of damages for injury sustained or loss occasioned during the life of such policy....” Mich. Comp. Laws Serv. §500.3006 (Lexis-Nexis 2010).

Where an insurer becomes liable above its policy limit for bad faith breach, it will be liable at that level only to the extent the insured is collectible. *Frankenmuth Mut. Ins. Co. v. Keeley*, 461 N.W.2d 666, 667 (Mich. 1990) (on rehearing, adopting the dissent’s rationale in *Frankenmuth Mut. Ins. Co. v. Keeley*, 447 N.W.2d 691, 709 (Mich. 1989)).

#### AUTHORS

**Charles W. Browning** | Plunkett Cooney, P.C. | 248.901.4000 | [cbrowning@plunkettcooney.com](mailto:cbrowning@plunkettcooney.com)

**Lauren B. McMillen** | Plunkett Cooney, P.C. | 248.901.4000 | [lmcmillen@plunkettcooney.com](mailto:lmcmillen@plunkettcooney.com)

**Warren J. White** | Plunkett Cooney, P.C. | 248.901.4000 | [wwhite@plunkettcooney.com](mailto:wwhite@plunkettcooney.com)

# Minnesota

By Dale O. Thornsjo and Lance D. Meyer

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

Minnesota's statutory bad faith claims are limited to certain claims asserted against certain insurers involving certain first-party insurance policies as those terms are defined in Minn. Stat. §604.18.

Minnesota has no other statutory basis for an insured to bring a bad faith claim. Violation of the state's claim handling statute (Minn. Stat. §§72A.17-72A.325) may constitute "unfair or deceptive acts," but there is no statutory bad faith violation recognized. Minnesota has not recognized a private right of action for violation of the state's claim handling statute. See *Morris v. Am. Family Mut. Ins. Co.*, 386 N.W.2d 233, 237-38 (Minn. 1986).

### ***Can a third party bring a statutory action for bad faith?***

No. Moreover, the statutory claim for taxable costs under Minn. Stat. §604.18 may not be assigned, Minn. Stat. §604.18, subd. 4(e), and is not available to parties claiming a third-party beneficiary status under the policy, Minn. Stat. §604.18, subd. 1(b).

### ***Is there a common law cause of action for bad faith?***

There is no tort cause of action for bad faith breach of contract per se. *Morris v. Am. Family Mut. Ins. Co.*, 386 N.W.2d 233, 237 (Minn. 1986) (setting out "the traditional rule that a bad faith breach of contract does not convert the breach of contract into a tort"). A cause of action exists in a third-party failure-to-settle scenario when an insurer, after having assumed a defense and its concomitant duty to reasonably settle, fails to exercise good faith in

settlement discussions, resulting in liability to the insured in excess of the policy limits. *Short v. Dairyland Ins. Co.*, 334 N.W.2d 384, 387 (Minn. 1983); *St. Paul Fire & Marine Ins. Co. v. A.P.I., Inc.*, 738 N.W.2d 401, 407 (Minn. Ct. App. 2007), *rev. denied* (Minn. Dec. 11, 2007); see also *Christian Builders, Inc. v. Cincinnati Ins. Co.*, 501 F. Supp. 2d 1224, 1237-38 (D. Minn. 2007) (failure to inform insured of potential conflict between insurer's interests and those of its insured may create liability for bad faith) (citing *Lange v. Fid. & Cas. Co. of N.Y.*, 185 N.W.2d 881, 885-86 (Minn. 1971)).

Under Minnesota law, insurance contracts include an implied covenant of good faith and fair dealing. *Columbia Cas. Co. v. 3M Co.*, 814 N.W.2d 33, 36 (Minn. Ct. App. 2012), *rev. denied* (Minn. June 19, 2012). Minnesota has recognized a cause of action for breach of the implied covenant of good faith and fair dealing in circumstances in which one party unjustifiably hinders the other party's performance of the contract. *In re Hennepin Cnty. 1986 Recycling Bond Litig.*, 540 N.W.2d 494, 502 (Minn. 1995); *3M*, 814 N.W.2d at 40. Minnesota's appellate courts have yet to address whether the implied covenant of good faith and fair dealing is limited to unjustifiable hindrance of a party's performance under the contract. *3M*, 814 N.W.2d at 40.

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

An excess insurer is subrogated to the insured's rights against a primary insurer for breach of the primary insurer's good faith duty to settle. *Cont'l Cas. Co. v. Reserve Ins. Co.*, 238 N.W.2d 862, 864 (Minn. 1976); *Northfield Ins. Co. v. St. Paul Surplus*

As a claim for bad faith under a liability policy depends entirely upon the resolution of the underlying claims, it follows that a bad faith claim against a liability insurer failure to settle claim should be severed or stayed pending resolution of the underlying claims. However, no reported cases to that effect exist.

***Under what circumstances will bad faith claims be severed for trial from the underlying claim?***

An award of taxable costs in Section 604.18 bad faith claims under certain first-party policies is determined in a proceeding subsequent to the merits of the coverage claim. Minn. Stat. §604.18, subd. 4(b).

Minnesota does not permit direct actions against liability insurers as part of the underlying claim. *Miller v. Mkt. Men's Mut. Ins. Co.*, 115 N.W.2d 266, 268 (Minn. 1962); *Anderson v. St. Paul Fire & Marine Ins. Co.*, 414 N.W.2d 575, 577 (Minn. Ct. App. 1987) (direct action rule bars plaintiff from seeking declaratory judgment against defendant's insurer, even though defendant failed to contest insurer's denial of coverage); *but see Westfield Ins. Co. v. Wensmann, Inc.*, 840 N.W.2d 438, 448 (Minn. Ct. App. 2013) (holding that prohibition against direct actions does not preclude insurer from intervening in underlying action to protect its interests), *rev. denied* (Minn. Feb. 26, 2014). As a claim for bad faith under a liability policy depends entirely upon the resolution of the underlying claims, it follows that a bad faith claim against a liability insurer for failure to settle should be severed or stayed pending resolution of the underlying claims. However, there are no reported cases.

***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

There are no reported cases, probably due to the rule that punitive damages are not awardable absent some independent tort on which the claim of punitive damages would be based. *Morris v. Am. Family Mut. Ins. Co.*, 386 N.W.2d 233, 237 (Minn. 1986). Minn. Stat. §549.20, subd. 4 states that in a civil action in which punitive damages are sought, the trier of fact shall, if requested by any of the parties,

first determine whether compensatory damages are to be awarded; after a determination has been made, the trier of fact shall, in a separate proceeding, determine whether and in what amount punitive damages will be awarded.

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

No reported cases. However, Minnesota has recognized good faith and fair dealing are correlative obligations between the insurer and the insured such that a liability insurer is entitled to an honest statement by the insured, and the insured is entitled to the insurer's good faith, where accepting or rejecting a compromise offer is involved. *Larson v. Anchor Cas. Co.*, 82 N.W.2d 376, 387 (Minn. 1957). As well, a liability insurer may not be exposed to a failure-to-settle bad faith claim if the insured not only refrains from demanding settlement from the insurer within the liability policy limits, but also insists it is not liable in the underlying action, even after an excess verdict against it. *Peterson v. Am. Family Mut. Ins. Co.*, 160 N.W.2d 541, 544 (Minn. 1968).

***Is "advice of counsel" a recognized defense?***

Advice of appointed defense counsel on case valuation is a factor in determining whether a liability insurer's decision not to settle within the applicable policy limits is made in good faith and is based on reasonable grounds to believe that the amount demanded is excessive. *Christian Builders, Inc. v. Cincinnati Ins. Co.*, 501 F. Supp. 2d 1224, 1232 (D. Minn. 2007). Advice of coverage counsel may be a factor in determining whether the liability insurer's coverage decisions are in good faith. *Stan Koch & Sons Trucking, Inc. v. Great W. Cas. Co.*, Civ. No. 05-1225 (RHK/AJB), 2006 WL 2331181, at \*6-7 (D. Minn. 2006).

***What other defenses are available?***

That an insurer had a good faith belief its insured was not clearly liable, that the settlement demand was greater than the insured's liability exposure, or that it never received a demand which was within

the policy limits. *Boerger v. Am. Gen. Ins. Co.*, 100 N.W.2d 133, 135 (Minn. 1959); *Northfield Ins. Co. v. St. Paul Surplus Lines Ins. Co.*, 545 N.W.2d 57, 60 (Minn. Ct. App. 1996), *rev. denied* (Minn. June 19, 1996); *Iowa Nat'l Mut. Ins. Co. v. Auto-Owners Ins. Co.*, 371 N.W.2d 627, 629 (Minn. Ct. App. 1985), *rev. denied* (Minn. Oct. 18, 1985).

It is also likely the insurer's good faith belief that coverage does not apply to the claim may be a valid defense, especially if the coverage issue involves the extent to which claims are covered. *See Buysse v. Baumann-Furrie & Co.*, 448 N.W.2d 865, 874 (Minn. 1989).

### ***Is there a cause of action for reverse bad faith?***

No reported cases. Nonetheless, Minnesota has recognized that good faith and fair dealing are correlative obligations between the insurer and the insured such that a liability insurer is entitled to an honest statement by the insured, and the insured is entitled to the insurer's good faith, where accepting or rejecting a compromise offer is involved. *Larson v. Anchor Cas. Co.*, 82 N.W.2d 376, 387 (Minn. 1957).

### **Other Significant Cases Involving Bad Faith—Fiduciary Duty**

*Owatonna Clinic-May Health Sys. v. Med. Protective Co. of Fort Wayne, Ind.*, 714 F. Supp. 2d 966, 970 (D. Minn. 2010) (predicting Minnesota Supreme Court would not require separate finding of bad faith to compel insurer to pay prejudgment interest under Minn. Stat. §60A.0811 in excess of its policy limits).

*Cargill, Inc. v. Ace Am. Ins. Co.*, 784 N.W.2d 341 (Minn. 2010) recognizes a primary insurer that has a duty to defend, and whose policy is triggered for

defense purposes, has an equitable right to seek contribution for defense costs from any other insurer who also has a duty to defend the insured, and whose policy has been triggered for defense purposes. *Id.* at 354. But breach of a duty to defend (and presumably bad faith) precludes application of an equitable right to contribution. *Id.*; *see also Land O'Lakes, Inc. v. Emp'rs Mut. Liab. Ins. Co. of Wis.*, 846 F. Supp. 2d 1007, 1041 (D. Minn. 2012) (reading *Cargill* as holding that breach of duty to defend—whether in good faith or in bad faith—precludes insurer from seeking equitable contribution).

*Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. Donaldson Co.*, No. 10-4948 (JRT/JJG), 2014 WL 2865900 (D. Minn. June 24, 2014) involves the discovery of underwriting communications, reserve information, and communications with reinsurers in a coverage action in which an insured asserted counterclaims of bad faith and breach of the duty of good faith and fair dealing. The district court concluded that the sought-after documents were relevant and discoverable in cases where an insured brings claims for bad faith and/or breach of the covenant of good faith and fair dealing. *Id.*, at \*3–5. At the same time, the district court concluded the insured's communications with its own independent defense counsel and in-house counsel were not relevant to the insured's counterclaims and thus not discoverable. *Id.*, at \*6–9.

#### AUTHORS

**Dale O. Thornsjo** | O'Meara, Leer, Wagner & Kohl, P.A. | 952.806.0498 | DOThornsjo@OLWKLaw.com

**Lance D. Meyer** | O'Meara, Leer, Wagner & Kohl, P.A. | 952.806.0498 | LDMeyer@OLWKLaw.com

# Mississippi

By Brad C. Moody and Jason R. Bush

## Causes of Action

### *Is there a statutory basis for an insured to bring a bad faith claim?*

Mississippi does not provide a statutory basis for an insured to bring a tort claim for bad faith. Although a bad faith claim is not a statutorily created cause of action, it is important to note that since a bad faith claim is a claim for punitive damages, an insured/plaintiff must meet the requirements of Mississippi's punitive damages statute. This statute, Miss. Code §11-1-65, was amended in 2004 to apply to claims based on contracts, and therefore, currently applies to claims for bad faith under insurance contracts. See H.B. 13, 2004 Leg., 1st Spec. Sess. (Miss. 2004).

Mississippi also imposes a statutory duty on insurers not to engage in unfair or deceptive acts that are geared toward inducing policy holders to cancel a policy in favor of another insurer's policy. See Miss. Code Ann. §§83-5-33, 83-5-35, 83-5-37. The statutes do not create a private cause of action. *Protective Serv. Life Ins. Co. v. Carter*, 445 So. 2d 215, 219 (Miss. 1983). But, in at least one case, the Mississippi Supreme Court emphasized the fact that the regulation was violated when evaluating the plaintiff's common law claim. See *Protective Serv. Life Ins. Co.*, 445 So. 2d 215, 216, 219-20 (Miss. 1984); *Mullen v. Nationwide Mut. Ins. Co.*, No. 1:11CV351-KS-MTP, 2013 WL 228074, at \*3 (S.D. Miss. Jan. 18, 2013) ("the Mississippi Supreme Court has held that conduct prohibited by insurance regulations can also meet the elements of a common law tort.")

### *Can a third party bring a statutory action for bad faith?*

Third parties do not have a cause of action for bad faith. Rather, an insurer's duty with regard to an insurance contract only applies to insured parties,

or to the insured's beneficiaries under a life insurance policy. *Kaplan v. Harco Nat'l Ins. Co.*, 716 So. 2d 673, 677 (Miss. Ct. App. 1998). See also *Myers v. Miss. Farm Bureau Mut. Ins. Co.*, 749 So. 2d 1173, 1174 (Miss. Ct. App. 1999) ("The insurance policy was between the Bews and Farm Bureau. Myers is a third-party who is not privy to the contract [and] therefore, cannot maintain an action of bad faith against Farm Bureau.") Nevertheless, Mississippi law permits the assignment of bad faith claims to third parties. See *Kaplan*, 716 So. 2d at 677-80.

### *Is there a common law cause of action for bad faith?*

Yes. Mississippi common law permits an insured to recover extracontractual remedies from an insurer, including recovery of punitive damages based on an insurer's bad faith. A claim for bad faith is considered an independent and intentional tort in Mississippi which requires more than simple negligence. See *Universal Life Ins. Co. v. Veasley*, 610 So. 2d 290, 295 (Miss. 1992). Although the bad faith cause of action is not statutorily created, the claim for punitive damages ultimately depends on the right of an insured to recover punitive damages under Mississippi's punitive damages statute. See *McLendon v. Wal-Mart Stores, Inc.*, 521 F. Supp. 2d 561, 565-66 (S.D. Miss. 2007); *Mixon v. Golden Rule Ins. Co.*, No. 2:12CV234-KS-MTP, 2014 WL 232114, at \*5 (S.D. Miss. 2014).

### *What cause of action exists for an excess carrier to bring a claim against a primary carrier?*

In Mississippi, an insurer has a "serious" contractual duty to defend actions brought against an insured which requires a "good faith effort to protect the insured's interest in court." *State Farm Mut. Auto.*

134 (Miss. 1989) (as a matter of law, “MIGA cannot be liable for punitive damages.”).

## **Defenses and Counterclaims**

### ***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Evidence of an insured’s failure to cooperate may be admissible in a bad faith action against an insurer. *Cherry v. Anthony, Gibbs, Sage*, 501 So. 2d 416, 420 (Miss. 1987) (holding that “it is difficult to see how [the insurer] can be faulted for bad faith when it is clear that [the insured] did not cooperate with [the insurer] in [the insurer’s] investigation”); *see also Dauro v. Allstate Ins. Co.*, 114 F. App’x 130, 134–36 (5th Cir. 2004) (holding that the insurer had an arguable basis for refusing to pay policy limits since the insured failed to cooperate with the insurer’s investigation). Also, it is important to note that the Mississippi Supreme Court has acknowledged that not only the insurer’s conduct, but the insured’s conduct is also measured under the implied duty of good faith applicable in the context of insurance contracts. *Andrew Jackson Life Ins. Co.*, 566 So. 2d at 1188 (holding that the implied covenant of good faith and fair dealing applies to the insurer and the insured requiring the “abstinence by all parties from commission of wrongful conduct...”).

### ***Is “advice of counsel” a recognized defense?***

In a bad faith action, “good faith reliance upon the advice of counsel may prevent imposition of punitive damages.” *Szumigala v. Nationwide Mut. Ins. Co.*, 853 F.2d 274, 282 (5th Cir. 1988), citing *Henderson v. U.S. Fid. & Guar. Co.*, 695 F.2d 109, 113 (5th Cir. 1983); *see also Murphree v. Fed. Ins. Co.*, 707 So. 2d 523, 533 (Miss. 1997). However, an insurer’s simple reliance upon the advice of counsel is not enough. *Id.* It is “but one factor to be considered in deciding whether the [insurer’s] reason for denying a claim was arguably reasonable.” *Id.*

### ***What other defenses are available?***

In addition to affirmative defenses that are admissible in all actions and the defense of an insured’s failure to cooperate, Mississippi recognizes that false

statements by an insured on a policy application may be used as a defense in a bad faith action. *See Reserve Life Ins. Co. v. McGee*, 444 So. 2d 803, 809–10 (Miss. 1983). Accordingly, if an insurer proves that a material misrepresentation on the application by an insured, the policy may be “arbitrarily voided *ab initio*.” *Id.*; *see also Gordon v. Nat’l States Ins. Co.*, 851 So. 2d 363, 365–66 (Miss. 2003) (holding that the insurer’s initial denial of payment was arguably reasonable due to the insured’s misrepresentations); *Travelers Indem. Co. v. Wetherbee*, 368 So. 2d 829, 835 (Miss. 1979) (holding that “an insured is penalized for misrepresentations through loss of coverage, whereas the insurer is penalized for wrongful acts through punitive damages”).

### ***Is there a cause of action for reverse bad faith?***

Although the implied duty of good faith under an insurance contract applies to both insureds and insurers, Mississippi does not recognize a cause of action for reverse bad faith. *See Andrew Jackson Life Ins. Co.*, 566 So. 2d at 1188.

## **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

While it does not necessarily apply to bad faith claims, insurance carriers and attorneys should be aware of *Moeller v. American Guarantee and Liability Insurance Co.*, 707 So. 2d 1062, 1069 (Miss. 1996), particularly in the context of reservation of rights letters in the liability context. There the Mississippi Supreme Court held that where a defense is tendered under a reservation of rights, the insured must be given the opportunity to select its own counsel to defend the claim and the carrier also must pay the legal fees reasonably incurred in the defense.

### **AUTHORS**

**Brad C. Moody** | Baker, Donelson, Bearman, Caldwell & Berkowitz, PC | 601.351.2400 | bmoody@bakerdonelson.com

**Jason R. Bush** | Page, Kruger & Holland, P.A. | 601.351.2400 | jrbush@pagekruger.com

# Missouri

By Aaron D. French and Philip C. Graham

## Causes of Action

### *Is there a statutory basis for an insured to bring a bad faith claim?*

A “vexatious refusal” to pay benefits creates liability under Mo. Rev. Stat. §§375.420, 375.296 (non-Missouri insurers). An insured cannot bring a vexatious refusal claim in automobile liability cases. Mo. Rev. Stat. §375.420. The vexatious refusal to pay statute, Mo. Rev. Stat. §375.420, provides for statutorily calculated damages, “not to exceed twenty percent of the first fifteen hundred dollars of the loss, and ten percent of the amount of the loss in excess of fifteen hundred dollars and a reasonable attorney’s fee.” Certain Missouri mutual insurers, as provided for in Mo. Rev. Stat. §§380.011 and 380.221, are not subject to the vexatious refusal statutes. Mo. Rev. Stat. §380.511.

For purposes of the statute, an insurer’s failure to pay a claim is “vexatious” when it is “willful and without reasonable cause or excuse, as the facts would have appeared to a reasonable person before trial.” *Groves v. State Farm Mut. Auto. Ins. Co.*, 540 S.W.2d 39, 42 (Mo. 1976).

There is no statutory basis for an insured’s action against the insurer for bad faith refusal to settle claims against the insured. A bad faith refusal to settle a claim is a common law action, recognized in *Zumwalt v. Utilities Ins. Co.*, 228 S.W.2d 750 (Mo. 1950).

### *Can a third party bring a statutory action for bad faith?*

Missouri has recognized that third-party beneficiaries who are covered under a policy have standing to bring vexatious refusal to pay claims pursuant to Mo. Rev. Stat. §375.420. *Drury Co. v. Mo. United Sch. Ins. Counsel*, No. ED100320, 2014 Mo. App. Lexis 319 (Mo. Ct. App. Mar. 25, 2014).

Missouri courts have not directly addressed whether a third-party non-beneficiary has standing to bring a claim under Mo. Rev. Stat. §375.420. But the court in *Drury* inferred that only primary and third-party beneficiaries have standing to bring a bad faith action against the insurer. *Drury Co. v. Mo. United Sch. Ins. Counsel*, No. ED100320, 2014 Mo. App. Lexis 319, at \*3 (Mo. Ct. App. Mar. 25, 2014).

The Missouri Unfair Insurance Practices Act, codified at Mo. Rev. Stat. §375.936, does not support a private cause of action. *See, e.g., Tufts v. Modesco Inv. Corp.*, 524 F. Supp. 484 (E.D. Mo. 1981).

A judgment creditor can bring a garnishment action to recover the policy funds. *Johnston v. Sweany*, 68 S.W.3d 398 (Mo. 2002).

### *Is there a common law cause of action for bad faith?*

Not for claims based on the failure to pay policy benefits. Mo. Rev. Stat. §375.420 provides the exclusive remedy for extracontractual damages resulting from an insurer’s failure to pay an insurance claim for a loss incurred by its own insured. *See, e.g., Halford v. American Preferred Ins. Co.*, 698 S.W.2d 40 (Mo. Ct. App. 1985); *see also Overcast v. Billings Mut. Ins. Co.*, 11 S.W.3d 62 (Mo. 2000).

However, there is a common law cause of action for bad faith refusal to defend, *see Butters v. City of Independence*, 513 S.W.2d 418 (Mo. 1974), and for the failure to settle a third-party claim under a liability policy. *See, e.g., Zumwalt v. Utilities Ins. Co.*, 228 S.W.2d 750 (Mo. 1950). A third party may not bring a common law bad faith claim against an insurer absent an assignment of the insured’s right to bring such a claim. *See, e.g., Linder v. Hawkeye-Sec. Ins. Co.*, 472 S.W.2d 412 (Mo. 1971). The Missouri Supreme Court has held that bad faith failure claims

association of all pending causes of action. Mo. Rev. Stat. §375.778(6).

The Missouri Supreme Court has held that a vexatious refusal action under Mo. Rev. Stat. §375.420 cannot be pursued against the Missouri Property and Casualty Insurance Guaranty Association for its own conduct in handling a claim, although the opinion suggests that the Association may be responsible for damages under Mo. Rev. Stat. §375.420 for the insolvent insurer's conduct in handling the claim. *Mo. Prop. & Cas. Ins. Guar. Ass'n v. Pott Indus.*, 971 S.W.2d 302, 306 (Mo. 1998).

## **Defenses and Counterclaims**

### ***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Yes, in bad faith refusal to settle actions. If the claimant is unwilling to settle within the policy limits, there can be no bad faith refusal to settle. See *Landie v. Century Indem. Co.*, 390 S.W.2d 558, 563 (Mo. Ct. App. 1965). Similarly, although it is not an element of the cause of action, evidence that the insured demanded the insurer settle within its limits is highly relevant to whether the insurer's declination of coverage or defense was undertaken in bad faith. *Scottsdale Ins. Co. v. Addison Ins. Co.*, 448 S.W.3d 818, 827 n.5 (Mo. 2014); see also *Shobe v. Kelly*, 279 S.W.3d 203, 210 (Mo. Ct. App. 2009) (holding insured was not required to show insured demanded insurer settle case within policy limits where insurer refused to defend).

### ***Is "advice of counsel" a recognized defense?***

Probably. The reasonableness of the insurer's refusal to pay is a defense to a vexatious refusal action. *State ex rel. John Hancock Mut. Life Ins. Co. v. Hughes*, 152 S.W.2d 132, 134 (Mo. 1941).

The insurer's "good faith" in refusing to defend the insured is likewise a defense to a bad faith refusal to defend action. *Landie v. Century Indem. Co.*, 390 S.W.2d 558, 563 (Mo. Ct. App. 1965). In a refusal to settle case, the insurer's honest belief that there is no coverage under the policy or that the insured has a viable defense to the claim can pro-

vide the basis for insurer's good faith belief. *Id.* Such a belief may be based upon the advice of counsel, unless the advice is patently unreasonable.

### ***What other defenses are available?***

In defense of a vexatious refusal claim, reasonable cause or excuse, unambiguous policy language defeating coverage, other contractual defenses, and material misrepresentations that void policy are recognized defenses. *State ex rel. John Hancock Mut. Life Ins. Co. v. Hughes*, 152 S.W.2d 132, 134 (Mo. 1941). The statutory penalty for vexatious refusal to pay cannot be recovered where the insured sought recovery of more than that to which he or she was entitled. *Cross v. Peerless Ins. Co.*, 351 S.W.2d 826 (Mo. Ct. App. 1961). A vexatious refusal claim is preempted by the Employee Retirement Income Security Act ("ERISA"). *Kelly v. PanAmerican Life Ins. Co.*, 765 F. Supp. 1406 (W.D. Mo. 1991). The insurer's honest belief that there is no policy coverage, or that insured has a valid defense to that claim, such that settlement is not warranted, is a recognized defense. See *Landie v. Century Indem. Co.*, 390 S.W.2d 558, 563 (Mo. Ct. App. 1965).

Defenses to a bad faith refusal to settle claim include the lack of opportunity to settle within the policy limits. *Landie v. Century Indem. Co.*, 390 S.W.2d 558, 563 (Mo. Ct. App. 1965).

### ***Is there a cause of action for reverse bad faith?***

Missouri courts have not yet addressed whether a claimant's failure to cooperate in settlement, a "bad faith setup," or an insured's "reverse bad faith" are defenses.

## **Other Significant Cases**

Insurers should be aware of Mo. Rev. Stat. §537.065. If the insurer refuses to defend, chooses to defend under a reservation of rights that the insured rejects, and/or refuses to settle within policy limits, the insured is entitled to enter into an agreement with the claimant pursuant to Section 537.065. That statute provides that the claimant "can enter into a contract with such tortfeasor... whereby... the person asserting the claim agrees that in the event

of a judgment against the tortfeasor neither he nor any person... will levy execution, by garnishment or otherwise... except *against the specific assets listed in the contract...*” (emphasis added). Almost always, the specific asset identified is the policy issued by the insurer that refused to defend or settle within policy limits.

Following the execution of an agreement pursuant to Mo. Rev. Stat. §537.065 the claims against the insured are reduced to a judgment, usually in an uncontested trial. If an insurer had the opportunity to control and manage the litigation, it may be bound by the determination of liability and damages against the insured(s) as a result of an uncontested “trial” in a subsequent action by the claimants to garnish the policy proceeds to satisfy the judgment. *Schmitz v. Great Am. Assur. Co.*, 337 S.W.3d 700, 709 (Mo. 2011). An insurer’s defenses may be limited in the subsequent equitable garnishment action to the insurer’s coverage defenses, the reasonableness of the underlying settlement if a trier of fact did not hear evidence regarding liability and damages, and/

or fraud and collusion between the claimant and insurer in entering into an agreement pursuant to Mo. Rev. Stat. §537.065.

The Missouri Supreme Court held that the insurer’s failure to defend and refusal to settle within policy limits constituted a breach of the policy, and the insurer was responsible for all damages flowing from the breach irrespective of the policy’s limits of insurance. In so ruling, the Missouri Supreme Court specifically noted that the case *did not* involve any claims for bad faith or extracontractual damages. *Columbia Cas. Co. v. HIAR Holding, LLC*, 411 S.W.3d 258, 273–74 (Mo. 2013).

#### AUTHORS

**Aaron D. French** | Sandberg Phoenix & von Gontard P.C. | 314.446.4293 | afrench@sandbergphoenix.com

**Philip C. Graham** | Sandberg Phoenix & von Gontard P.C. | 314.425.4952 | pgraham@sandbergphoenix.com

# Montana

By J. Scott Miller

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

Yes. The Montana Unfair Trade Practices Act, Mont. Code Ann. §33-18-101 *et seq.* (“UTPA”), is the only basis for pursuing a bad faith claim. Mont. Code Ann. §§33-18-242(1), 33-18-242(3). However, third-party claimants have broader rights to sue insurers, and “[a]n insured may not bring an action for bad faith in connection with the handling of an insurance claim.” Mont. Code Ann. §33-18-242(3).

### ***Can a third party bring a statutory action for bad faith?***

Yes. Mont. Code Ann. §33-18-242(1).

### ***Is there a common law cause of action for bad faith?***

Yes. However, the common law causes of action available to insureds versus third parties are quite different.

An insured may bring a common law bad faith claim against an insurer for conduct that is unrelated to “the handling of an insurance claim.” *Thomas v. Northwestern Nat’l Ins. Co.*, 1998 MT 343, 292 Mont. 357, 973 P.2d 804 (1998); *Williams v. Union Fid. Life Ins. Co.*, 2005 MT 273, ¶58, 329 Mont. 158, ¶58, 123 P.3d 213, ¶58 (2005).

Third-party claimants may assert common law bad faith claims for claim handling practices (in addition to UTPA claims). *Brewington v. Employers Fire Ins. Co.*, 1999 MT 312, 297 Mont. 243, 992 P.2d 237 (1999) (plain language of §33-18-242(3) only limits the causes of action available to “insureds”).

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

In order to determine insurers’ rights under their respective policies, an excess insurance carrier may file a declaratory judgment action against the primary insurance carrier under Montana’s Uniform Declaratory Judgments Act. Mont. Code Ann. §27-8-101, *et seq.*

### ***What causes of action for extracontractual liability have been recognized outside the claim handling context?***

Insurers have been held liable for bad faith for failure to disclose changes in policy provisions upon renewal. *See, e.g., Thomas v. Northwestern Nat’l Ins. Co.*, 1998 MT 343, 292 Mont. 357, 973 P.2d 804 (1998).

## Damages

### ***Are punitive damages available?***

Yes. The UTPA provides that “Exemplary damages may also be assessed in accordance with §27-1-221.” Mont. Code Ann. §33-18-242(4). A plaintiff can recover punitive damages by proving by a preponderance of the evidence that the insurer violated one or more specified subsections of Mont. Code Ann. §33-18-201, and by proving by clear and convincing evidence that the insurer acted with actual malice or actual fraud as defined in Mont. Code Ann. §27-1-221.

Punitive damages may be awarded in common law claims if the claimant can prove that the insurer acted with actual fraud or actual malice in breaching the covenant of good faith and fair dealing. *Palmer*

any claim for extracontractual or punitive damages. Mont. Code Ann. §33-10-102(2)(a).

## **Defenses and Counterclaims**

### ***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

If an insured breached obligations under the contract of insurance, such as the duty to cooperate with the investigation of a claim, such conduct is relevant to the issue of whether the insurer had a reasonable basis in law or fact for denying the claim. *Tynes v. Bankers Life Co.*, 224 Mont. 350, 364, 730 P.2d 1115, 1124 (1986). However, the insured's conduct will not permit an apportionment of fault between the insurer and insured. *Stephens v. Safeco Ins. Co. of America*, 258 Mont. 142, 852 P.2d 565 (1993). In *Stephens*, the jury found that both the insured and insurer breached the covenant of good faith and fair dealing. However, where the insurer's breach constituted a tort, the court held that the insured's breach amounted only to a breach of contract. *Id.* at 565. The court concluded that the insured's tort damages could not be reduced in proportion to their own liability for breaching the insurance contract.

In *Spadaro v. Midland Claims Serv.*, 227 Mont. 445, 740 P.2d 1105 (1987), a third-party case, the court held that the claimant's delay in settling a claim constitutes an affirmative defense to bad faith. However, an insurer cannot refuse to settle with a third-party claimant who refuses to release claims against the insured. *Shilhanek v. D-2 Trucking, Inc.*, 2003 MT 122, 315 Mont. 519, 70 P.3d 721 (2003). *Shilhanek* expressly held that nothing in the UTPA requires a general release from the insured or insurer as a condition of settlement pursuant to MCA §33-18-201. *Id.*

### ***Is "advice of counsel" a recognized defense?***

Yes. See *Palmer by Diacon v. Farmers Ins. Exch.*, 261 Mont. 91, 861 P.2d 895, 907 (1993). If an insurer directly relies on an advice of counsel defense, attorney client privilege regarding any such communication is waived. *Id.* In a UTPA action, advice of counsel is included within the "reasonable basis" defense. Mont. Code Ann. §33-18-242(5).

### ***What other defenses are available?***

An insurer may not be held liable if it had a reasonable basis in law or fact for contesting the claim or the amount of the claim. Mont. Code Ann. §33-18-242(5); *State Farm Mut. Auto. Ins. Co. v. Freyer*, 372 Mont. 191, 312 P.3d 403 (2013) (insurer's failure to settle did not breach covenant of good faith and fair dealing where insurer had reasonable basis for contesting the insured driver's child's claim). Evidence that is relevant to either the issue of liability or damages in the underlying claim will generally be admitted in support of the insurer's defense.

### ***Is there a cause of action for reverse bad faith?***

No. When the insured breaches the covenant of good faith and fair dealing, such breach is deemed a breach of the insurance contract, and not a tort. *Stephens v. Safeco Ins. Co. of America*, 258 Mont. 142, 852 P.2d 565 (1993). Moreover, any fault apportioned to an insured for breaching an insurance contract may not offset damages awarded as a result of the insurer's bad faith. *Id.*

## **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

Montana law authorizes a declaratory judgment action in which a third-party claimant may seek advance payment of medical bills or other special damages from a tortfeasor's insurer where liability for the loss and causation of damages are reasonably clear. *Ridley v. Guaranty Nat'l Ins. Co.*, 286 Mont. 325, 951 P.2d 987 (1998) (it is an unfair trade practice per se for insurer to demand release for its insured while withholding payment of third party's medical expenses, where both insured's liability for underlying accident and causally related damages, are reasonably clear). Neither the UTPA nor any Montana Supreme Court decision specifically defines "reasonably clear." However, liability is not reasonably clear, and there is no duty to advance pay, when there are genuine issues of material fact regarding negligence or liability. *Giambra v. Travelers Indem. Co.*, 2003 MT 289, 318 Mont. 73, 76, 78 P.3d 880, 882 (2003).

The insurer's duty to "advance pay" such damages prior to obtaining a release has been extended to include payment of lost wages and other special damages. See *Dubray v. Farmers Ins. Exch.*, 2001 MT 251, 307 Mont. 134, 36 P.3d 897. Advance payments must be made up to policy limits, and without demanding a release for the insured. *Shilhanek v. D-2 Trucking, Inc.*, 2003 MT 122, 315 Mont. 519, 70 P.3d 721 (2003).

In a declaratory judgment action, only the "advance payments" may be recovered, not UTPA damages. *Safeco Ins. Co. of Ill. v. Montana Eighth Jud. Dist. Court*, 2000 MT 153, 300 Mont. 123, 2 P.3d 834 (2000). In *Safeco*, the Court explained that because claims for advance payment do not seek "bad faith damages," a declaratory judgment action seeking advance payment may be brought before any final resolution of the underlying claim. *Id.* at 34.

Under *Ridley v. Guaranty National Insurance Co.*, 286 Mont. 325, 951 P.2d 987 (1998) and its progeny,

an insurer must pay medical expenses and other special damages, such as lost wages, to a third-party claimant where both the liability of its insured and causation of damages is reasonably clear. An insurer must do so up to the limits of liability coverage, and may not demand a release from the third party in exchange for such advance payment. Thus, before the merits of an underlying claim are settled or adjudicated, an insurer may be forced to relinquish all available insurance proceeds while it is simultaneously prohibited from demanding a release for its insured. In this area, it is believed that Montana is a minority jurisdiction of one. Currently, tort defendants and insurers alike are raising constitutional defenses to this line of cases.

AUTHOR

J. Scott Miller | Klinedinst PC | 916.444.7573 |  
smiller@klinedinstlaw.com

# Nebraska

By Patrick Q. Hustead and Connor L. Cantrell

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

No. Nebraska statutes do not currently give rise to an independent bad faith claim. Federal courts have held that “the Nebraska Unfair Competition and Trade Practices Act does not contemplate private suits but instead only vests powers and duties in the state Director of Insurance, who is empowered to enjoin and penalize certain prohibited acts...” *Allied Fin. Servs., Inc., v. Foremost Ins. Co.*, 418 F. Supp. 157 (D. Neb. 1976). The courts generally follow this rule, and the most recent state court decision in *White v. Medico Life Insurance Co.*, 212 Neb. 901, 327 N.W.2d 606 (1982), did not overrule *Allied*. An argument is sometimes made at the trial level that because the decision in *Allied* preceded the 1974 enactment of the Nebraska Consumer Protection Act, that Act together with the Nebraska Unfair Competition and Trade Practices Act now creates a private cause of action.

### ***Can a third party bring a statutory action for bad faith?***

No. There are no statutory grounds for a third-party action for bad faith. As stated above, while insurance companies are regulated by the Unfair Insurance Trade Practices Act “UITPA” (Neb. Rev. Stat. §44-1522 *et seq.*), UITPA does not contemplate private suits. *See also Allied Fin. Servs., Inc., v. Foremost Ins. Co.*, 418 F. Supp. 157 (D. Neb. 1976).

### ***Is there a common law cause of action for bad faith?***

Yes. First-party bad faith is based upon allegations that the insurer, in bad faith, refused to settle its policyholder’s claim and caused the policyholder to sustain a direct loss. *Braesch v. Union Ins. Co.*, 237

Neb. 44, 464 N.W.2d 769 (1991), *overruled on different grounds by Wortman v. Unger*, 254 Neb. 544, 578 N.W.2d 413 (1998).

Third-party bad faith arises when an insurer wrongfully fails to settle a claim brought by a third party against an insured. *Hadenfeldt v. State Farm Mut. Auto. Ins. Co.*, 195 Neb. 578, 239 N.W.2d 499 (1976).

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

Appellate courts are generally silent on this issue, though Nebraska law defines primary insurance coverage as “when, under the terms of the policy, liability attaches immediately upon the happening of an occurrence that gives rise to liability, as opposed to excess or secondary coverage, which attaches only after a predetermined amount of primary coverage has been exhausted.” *Midwest Neurosurgery, P.C. v. State Farm Ins. Cos.*, 12 Neb. App. 328, 673 N.W.2d 228 (2004). The court in *Midwest Neurosurgery* tacitly recognized an excess carrier’s ability to bring a declaratory judgment action against a primary carrier, though not in the bad faith context.

### ***What causes of action for extracontractual liability have been recognized outside the claim handling context?***

None, though Nebraska courts have not precluded such claims.

## Damages

### ***Are punitive damages available?***

No. The Supreme Court of Nebraska held in *Abel v. Conover*, 170 Neb. 926, 104 N.W.2d 684 (1960), that it

## **Defenses and Counterclaims**

### ***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

The court in *Graske v. Auto-Owners Insurance Co.*, 647 F. Supp. 2d 1105 (D. Neb. 2009), held that Nebraska law does not currently recognize the defense of contributory or comparative negligence of the conduct of a third-party claimant because negligence is not the standard that applies to the affirmative claim. The court noted that Neb. Rev. Stat. §25-21,185.07 lists the actions to which contributory negligence is a defense and noted that the tort of bad faith is not included. The court also noted that the tort of bad faith is recognized in Nebraska as an intentional tort. See *Ihm v. Crawford & Co.*, 254 Neb. 818, 821, 580 N.W.2d 115, 118 (1998). Relying on these facts, the court denied an insurer's request to amend its answer to include this defense to a third-party claimant's claim.

### ***Is "advice of counsel" a recognized defense?***

The court in *Graske v. Auto-Owners Insurance Co.*, 647 F. Supp. 2d 1105 (D. Neb. 2009), held that, while

the defense of advice of counsel may be relevant and admissible, advice of counsel "by itself" is insufficient to act as an affirmative defense in the third-party context.

### ***What other defenses are available?***

The defenses generally available under Nebraska law in a civil case are also available in a bad faith case.

### ***Is there a cause of action for reverse bad faith?***

There are no appellate decisions on reverse bad faith, and it is an open question.

## **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

None at present.

### **AUTHORS**

**Patrick Q. Husted** | The Husted Law Firm | 303.721.5000 | pqh@thlf.com

**Connor L. Cantrell** | The Husted Law Firm | 303.721.5000 | clc@thlf.com

# Nevada

By Laura G. Ryan

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

Yes. NRS §686A.310(2); *Hummel v. Continental Cas. Ins. Co.*, 254 F. Supp. 2d 1183, 1191 (D. Nev. 2003). NRS §686A.310(1) lists the unfair practices.

### ***Can a third party bring a statutory action for bad faith?***

No. *Hart v. Prudential Prop. & Cas. Ins. Co.*, 848 F. Supp. 900, 903 (D. Nev. 1994); see NRS §686A.310(2) (“an insurer is liable to its *insured* for any damages sustained by the *insured* as a result of the commission of any act set forth in subsection 1 as an unfair practice.”) (emphasis added).

### ***Is there a common law cause of action for bad faith?***

Yes. An implied covenant of good faith and fair dealing is recognized in every contract under Nevada law. *Pemberton v. Farmers Ins. Exchange*, 109 Nev. 789, 792–93, 858 P.2d 380, 382 (1993); *USF Ins. Co. v. Smith's Food & Drug Ctr., Inc.*, 921 F. Supp. 2d 1082, 1090 (D. Nev. 2013).

Breach of the fiduciary nature of the insurer-insured relationship is part of the duty of good faith and fair dealing. *Ins. Co. of The West v. Gibson Tile Co.*, 122 Nev. 455, 463 (Nev. 2006); *Powers v. United Servs. Auto. Ass'n*, 114 Nev. 690, 701–02, 962 P.2d 596 (1998).

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

No direct action has been recognized in Nevada, although the theory of equitable subrogation has been recognized in other contexts. *Houston v.*

*Bank of America Fed. Sav. Bank*, 78 P.3d 71, 73–74 (Nev. 2003) (“Equitable subrogation permits a person who pays off an encumbrance to assume the same priority position as the holder of the previous encumbrance.”).

### ***What causes of action for extracontractual liability have been recognized outside the claim handling context?***

None to date.

## Damages

### ***Are punitive damages available?***

Yes. NRS §42.005(1) authorizes an award of punitive damages where “the defendant has been guilty of oppression, fraud or malice, express or implied.” Statutory limits on the multiplier do not apply to insurers who act in bad faith regarding their obligations to provide insurance coverage. NRS §42.005(2). The statutory definitions of oppression, fraud and malice do not apply to insurers; instead, the common law definitions of these terms governs. NRS §42.005(5).

“A plaintiff is never entitled to punitive damages as a matter of right; their allowance or denial rests entirely in the discretion of the trier of fact.” *Dillard Dept. Stores, Inc. v. Beckwith*, 115 Nev. 372, 380, 989 P.2d 882, 887 (1999).

Where the defendant insurer made no independent inquiry concerning its insured’s accident, corrected reports verified that the insured’s stroke resulted from accident rather than disease, and there was adequate notice of the insured’s unqualified and immediate need for benefits, an obstinate and unjustified refusal to pay constituted oppression, and punitive damages were properly awarded. *Ainsworth v. Combined Ins. Co. of America*, 104 Nev. 587, 763 P.2d 673 (1988), cert. denied, 493 U.S. 958 (1989).

subsequent proceeding must be conducted before the same trier of fact to determine the amount of such damages to be assessed.”

**How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?**

A debtor’s claim for injuries to the person, even if unliquidated at the time the petition was filed, is property of the bankruptcy estate and therefore the bad faith lawsuit against the insurer became property of the estate as of the commencement of the case. *In re Bronner*, 135 B.R. 645, 647 (9th Cir. 1992).

If the insurer claims bankruptcy, the provisions of NRS §687A become applicable. NRS §687A.160(1) sets forth the procedure for requesting a stay and for the Nevada Insurance Guaranty Association (“NIGA”) becoming involved.

**How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?**

Under NRS §687A.160(1), either NIGA or the insured may request a stay of at least three months, to permit a proper defense by NIGA. The request is made by filing an affidavit showing cause, defined as a showing that “the unavailability of the insolvent insurer’s files or records which are reasonably necessary for the Association to confirm coverage and adjust the claim.” However, NIGA has no liability for bad faith claims against an insolvent insurer, for the reason that NIGA protects the insured, not the insurer.

11 U.S.C. §362(a) governs the stay against proceeding against the insolvent insurer who has filed a bankruptcy petition.

**Defenses and Counterclaims**

**Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?**

Yes. For example, late notice bars coverage, and the insurer need not demonstrate prejudice. *Las Vegas Star*

*Taxi, Inc. v. St. Paul Fire & Marine Ins. Co.*, 102 Nev. 11, 714 P.2d 562 (1986). The court held that the district judge’s rulings were correct. The insured failed to produce any proof of the notice’s existence. The insurer was not required to show actual prejudice in order to avoid liability because the insured’s conduct in settling the action went far beyond the legitimate limits of the insurance contract as to absolve the insurer of any liability under the policy. *Id.* at 11; *Westchester Fire Ins. Co. v. Mendez*, 2:05-cv-01417-PMP-RJJ, 2010 U.S. Dist. Lexis 66273, at \*17 (D. Nev. July 1, 2010) (“Nevada never has adopted the notice-prejudice rule, but it has addressed and rejected the rule when raised by the insured against the insurer,” citing *Las Vegas Star Taxi, Inc. v. St. Paul Fire & Marine Ins. Co.*, 102 Nev. 11, 714 P.2d 562, 564 (Nev. 1986)).

**Is “advice of counsel” a recognized defense?**

Yes. *Mann v. Glens Falls Ins. Co.*, 418 F. Supp. 237, 249 (D. Nev. 1974), *rev’d on other grounds*, 541 F.2d 819 (9th Cir. Nev. 1976).

**What other defenses are available?**

A warranty in the insurance policy which defines the insurer’s duty to pay must be strictly complied with and, once a breach of warranty has occurred, the insurer may void the policy. *American Home Assur. Co. v. Harvey’s Wagon Wheel, Inc.*, 398 F. Supp. 379, 382 (D. Nev. 1975).

Policy conditions requiring the insured to cooperate and provide proof of loss are enforceable. *Engleman v. Royal Ins. Co.*, 56 Nev. 319, 323, 51 P.2d 417 (1935). However, such a clause does not preclude recovery, at least where the insured has attempted to comply substantially with it, or where the insurer waived its conditions. *Davenport v. Republic Ins. Co.*, 97 Nev. 152, 154, 625 P.2d 574 (1981).

A misrepresentation by an insured is material if the false statement concerns a subject relevant and germane to the insurer’s investigation. To be deemed a material misrepresentation, it must be shown that an insurer’s investigation would have proceeded differently had the insured told the truth. *Powers v. United Servs. Auto. Ass’n*, 114 Nev. 690, 699, 962 P.2d 596 (1998).

A misrepresentation in a policy application precludes recovery only if it was “either: 1. Fraudulent; 2. Material either to the acceptance of the risk, or to the hazard assumed by the insurer; or 3. The insurer in good faith would either not have issued the policy or contract, or would not have issued it at the same premium rate, or would not have issued a policy or contract in as large an amount, or would not have provided coverage with respect to the hazard resulting in the loss.” NRS §687B.110.

### ***Is there a cause of action for reverse bad faith?***

No. Two Nevada Federal District Court cases have recognized an insured’s bad faith (efforts to manufacture bad faith claims against insurers by sending unreasonable demand letters with purposefully short deadlines) but have yet to provide a remedy to the insurer for such a claim. See *AAA Nevada Ins. Co. v. Chau*, No. 08-cv-00827, 2010 U.S. Dist. Lexis 71690, at \*4 n.1 (D. Nev. July 15, 2010) (recognizing that insured’s law firm has a pattern of attempting to manufacture bad faith claims with demand letters that give arbitrary deadlines); *Pasina v. Cal. Cas. Indem. Exch.*, 2:08-cv-01199-RJ-RJJ, 2010 U.S. Dist. Lexis 109695, at \*45 (D. Nev. Sept. 28, 2010).

### **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

Given the deferential standard of review, the court found the evidence more than sufficient to support the jury’s bad faith verdict. Under Nevada law, “[b]ad faith is established where the insurer acts unreasonably and with knowledge that there is no reasonable basis for its conduct.” *Albert H. Wohlers & Co. v. Bartgis*, 114 Nev. 1249, 969 P.2d 949, 956 (Nev. 1998) (citation omitted).

The Nevada Supreme Court recognizes biased investigations and misrepresentation of policy terms as evidence of bad faith. See *Powers v. United Servs. Auto. Ass’n*, 114 Nev. 690, 962 P.2d 596, 604 (Nev. 1998); *Albert H. Wohlers & Co. v. Bartgis*, 114 Nev. 1249, 969 P.2d 949, 956 (Nev. 1998); *Merrick v. Paul Revere Life Ins. Co.*, 500 F.3d 1007, 1013 (9th Cir. Nev. 2007).

“To establish a prima facie case of bad-faith refusal to pay an insurance claim, the plaintiff must establish that the insurer had no reasonable basis for disputing coverage, and that the insurer knew or recklessly disregarded the fact that there was no reasonable basis for disputing coverage.” *Powers v. United Servs. Auto. Ass’n*, 114 Nev. 690, 962 P.2d 596, 604 (Nev. 1998) (emphasis added). “The vital element... is the insurance company’s wrongful conduct, not in merely denying a claim incorrectly and, therefore, without ‘proper’ cause, but in denying the claim wrongfully, without any reasonable basis or with the knowledge that it is denying a rightful claim.” *Id.* at 620.

To recover punitive damages on a bad faith claim, the plaintiff must show “oppression, fraud, or malice, express or implied.” *United Fire Ins. Co. v. McClelland*, 105 Nev. 504, 780 P.2d 193, 198 (Nev. 1989) (quoting NRS §42.010 (now NRS §42.005)).

Under Nevada law, a plaintiff may secure punitive damages upon showing “by clear and convincing evidence” that the defendant is “guilty of oppression, fraud, or malice, express or implied.” NRS §42.005. Where an insurer “under[takes] an intentional course of conduct designed to ensure the denial” of a claim such conduct may qualify as “fraud and malice” sufficient to support a punitive damages claim. *United Servs. Auto. Ass’n*, 114 Nev. 690, 962 P.2d 596, 605 (Nev. 1998); *Merrick v. Paul Revere Life Ins. Co.*, 500 F.3d 1007, 1013 (9th Cir. Nev. 2007); *Allstate Prop. & Cas. Ins. Co. v. Mirkia*, 2:12-cv-01288-RJ-PAL, 2014 U.S. Dist. Lexis 84275, at \*19–20 (D. Nev. 2014).

Whether the record contains sufficient evidence to justify an award of punitive damages is a question of law. But where the necessary factual basis for punitive damages exists, the amount of the award rests with the sound discretion of the jury. *Austin v. Ce&L Trucking, Inc.*, 610 F. Supp. 465, 472 (D. Nev. 1985).

Determination of the appropriateness of the amount of an award for punitive damages is based on 1) the financial position of the defendant; 2) the defendant’s culpability and blameworthiness; 3) the vulnerability of, and injury suffered by, the offended party; 4) the offensiveness of the punished conduct; and 5) the means necessary to deter further miscon-

duct. *Ainsworth v. Combined Ins. Co. of America*, 104 Nev. 587, 593–94, 763 P.2d 673 (1988), cert. denied, 493 U.S. 958 (1989).

In *Brandner v. UNUM Life Insurance Co. of America*, 152 F. Supp. 2d 1219 (D. Nev. 2001), the court granted summary judgment on the plaintiff's claims of unfair insurance practices, insurance bad faith, breach of fiduciary duty, and breach of contract. The court held that the doctor's causes of action were preempted by ERISA.

In evaluating whether a complaint met the \$75,000 jurisdictional minimum, the court in *McCaa v. Massachusetts Mutual Life Insurance Co.*, 330 F. Supp. 2d 1143 (D. Nev. 2004) stated that: "Nevada law provides that a jury may award punitive damages against an insurer who acts in bad faith." *Id.* at 1149 (citing NRS §42.005(3)). "However, as the Nevada Supreme Court has stated: the Court has difficulty constructing a factual situation where an insurer who violated the statute could have done so with a malicious intent yet not denied, or refused to pay, the claim. Oppression means 'a conscious disregard for the rights of others which constitutes an act of subjecting plaintiffs to cruel and unjust hardship....' Malice involves actual hatred or ill will, or the desire to successfully injure, vex, annoy or harass.... It is difficult to conceive a situation where an insurer would act with such ill-will toward an insured or subject an insured to cruel and unusual hardship and yet not deny or refuse to pay the claim." *Id.* at 1149 (citations omitted). The court went on to consider whether attorneys' fees should be con-

sidered in calculating the amount in controversy, but considered only the statutory basis (claim brought or defended in bad faith) and rejected the claim. Notably, they did not address attorneys' fees as an element of consequential or compensatory damages in spite of the bad faith allegation.

Under Nevada law, in order to recover punitive damages, a plaintiff must show the defendant acted with oppression, fraud or malice. See *Pioneer Chlor Alkali Co. v. National Union Fire Ins. Co.*, 863 F. Supp. 1237, 1250 (D. Nev. 1994). Oppression is a conscious disregard for the rights of others constituting cruel and unjust hardship. *Id.* at 1251. Malice is conduct which is intended to injure a person or despicable conduct which is engaged in with a conscious disregard of the rights and safety of others. See NRS §42.005(1); *Lee v. Bank of Haw.*, 2:14-cv-00161, 2014 U.S. Dist. Lexis 125011, at \*7 (D. Nev. 2014).

Punitive damages are not available when a defendant can be held liable only for a breach of contract. *Ins. Co. of The West v. Gibson Tile Co., Inc.*, 122 Nev. 455, 134 P.3d 698, 699 (Nev. 2006). Even a finding of bad faith will not, in and of itself, support a claim for punitive damages. *United Fire Ins. Co. v. McClelland*, 105 Nev. 504, 780 P.2d 193, 199 (Nev. 1989); *Tomkiel v. Hartford Cas. Ins. Co.*, 2:13-cv-01888, 2014 U.S. Dist. Lexis 51199, at \*8 (D. Nev. 2014).

#### AUTHOR

**Laura G. Ryan** | Gordon Rees Scully Mansukhani LLP | 619.696.6700 | lryan@gordonrees.com

# New Hampshire

By William A. Schneider

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

Yes, but only under *very* limited circumstances. The Supreme Court of New Hampshire has held that the New Hampshire Consumer Protection Act (RSA 358-A) will not support a private cause of action against insurers for alleged unfair claims handling practices, which are defined by RSA 417:4 (XV).

In *Bell v. Liberty Mutual Ins. Co.*, 776 A.2d 1260 (N.H. 2001), the Supreme Court ruled that the Act's exception for "trade or commerce otherwise permitted under laws as administered by any regulatory board or officer acting under statutory authority of this state..." applied to the insurance industry since trade practices were already closely regulated by the insurance department pursuant to various "unfair insurance trade practices" enumerated in RSA 417.

Although a violation of RSA 417 will not support a private cause of action under RSA 358-A, as the Supreme Court noted in *Bell*, policyholders may, in certain circumstances, pursue a direct right of action under RSA 417 itself. Thus, RSA 417 not only empowers the insurance commissioner to investigate and punish unfair trade practices but in certain circumstances allows consumers to bring a private cause of action against the insurer for claimed violations. Specifically, RSA 417:19 provides that any adversely affected policyholder may bring suit against an insurer if the Insurance Commissioner has found the insurer to be in violation following a hearing under RSA 417. Conversely, insureds are barred from bringing suit if the Insurance Commissioner fails to take action within 120 days of receiving a complaint from the allegedly injured person, since that shall constitute a finding that the alleged act or practice is not in violation of this chapter. If

successful, the policyholder is entitled to recover his costs of the suit, as well as reasonable attorney's fees.

### ***Can a third party bring a statutory bad faith claim?***

No. A third party has no direct cause of action against the insurance company for negligent failure to settle. See *Duncan v. Lumbermen's Mutual Cas. Co.*, 23 A.2d 345 (N.H. 1941). The *Bell* decision discussed above foreclosed a third party's reliance on RSA 358-A to impose liability on an insurer for bad faith.

### ***Is there a common law cause of action for bad faith?***

Yes. The seminal New Hampshire case construing the law of bad faith is *Lawton v. Great Southwest Fire Ins. Co.*, 392 A.2d 576 (N.H. 1978). In *Lawton*, a policyholder sued his fire insurer for its unreasonable delay and failure to pay a fire loss and for mental anguish that he claimed to have suffered as the result of this delay. In *Lawton*, the Supreme Court ruled for the first time that an insured's recovery under an insurance policy was not restricted to the policy limit. The court ruled that such a limitation to recovery would encourage insurers to delay settlement in an attempt to coerce a financially pressured claimant into accepting an unfair settlement as its only liability would be to pay its original obligation plus interest. Accordingly, the Supreme Court declared that, in addition to the specific terms of the contract, there is "implied in every contract an obligation of good faith and fair dealing." The insurer's breach of this implied covenant may give rise to extracontractual damages if the insurer unreasonably fails to pay a covered loss.

Since *Lawton*, courts interpreting New Hampshire law have maintained the view that there is an implied obligation of good faith and fair dealing

(holding statute of limitations on insured's claim against insurer for denial of underinsured motorist benefits accrued on date insurer denied claim).

***Under what circumstances will bad faith claims be dismissed or stayed pending the resolution of the underlying claims?***

There is no State constitutional guarantee to a non-bifurcated trial. A court has discretion to bifurcate issues it deems appropriate. *Panas v. Harakis*, 529 A.2d 976, 987 (N.H. 1987).

***Under what circumstances will bad faith claims be severed for trial from the underlying claim?***

Undecided, but a court has discretion to bifurcate issues it deems appropriate. *Panas v. Harakis*, 529 A.2d 976, 987 (N.H. 1987).

***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

Undecided, but a court has discretion to bifurcate issues it deems appropriate. *Panas v. Harakis*, 529 A.2d 976, 987 (N.H. 1987).

***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?***

Undecided. No New Hampshire authority on point.

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

Undecided. No New Hampshire authority on point.

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Yes. To determine whether an insurer satisfied

its duty to the policyholder a court must focus its analysis on the conduct of the parties, not just the insurer, during the settlement negotiations and trial. See *Gelinas v. Metropolitan Property & Liability Ins. Co.*, 551 A.2d 962, 967 (N.H. 1988). The amount demanded by a plaintiff to settle is relevant evidence that can be considered in determining whether an insurance company acted reasonably. *Id.* at 969-70.

***Is "advice of counsel" a recognized defense?***

Professional advice is merely one item to be considered in determining the due care of the indemnity company. *Dumas v. Hartford Acc. & Indem. Co.*, 56 A.2d 57, 61-62 (N.H. 1947), criticized on other grounds in *Dumas v. State Farm Automobile Ins. Co.*, 274 A.2d 781 (N.H. 1971).

***What other defenses are available?***

Standard "contract" based defenses apply.

***Is there a cause of action for reverse bad faith?***

Undecided. No New Hampshire authority on point.

**Other Significant Issues Involving Bad Faith and Extracontractual Claims**

Tort claims based on a breach of an insurer's duty to its insured to exercise due care in defending and settling claims against the insured are assignable. *Dumas v. State Mut. Auto Ins. Co.*, 274 A.2d 781 (N.H. 1971).

Whether an insurer acted in bad faith is a question of fact. *Lawton v. Great Southwest Fire Ins. Co.*, 392 A.2d 576, 580 (N.H. 1978).

Investigators retained by insurers owe a duty to the insured as well as the insurer to conduct a reasonable investigation of an insurance claim. *Morvay v. Hanover Ins. Co.*, 506 A.2d 333, 334 (N.H. 1986).

**AUTHOR**

**William A. Schneider** | Morrison Mahoney LLP | 617.439.7573 | wschneider@morrisonmahoney.com

# New Jersey

By Matthew M. Haar

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

No. New Jersey has an Unfair Trade Practices Act. N.J. Stat. Ann. §17:29B-1, *et seq.* It does not support private causes of action. *See, e.g., Pierzga v. Ohio Cas. Grp. of Ins. Cos.*, 208 N.J. Super. 40, 504 A.2d 1200 (App. Div.), *cert. denied*, 104 N.J. 399, 517 A.2d 402 (1986).

### ***Can a third party bring a statutory bad faith claim?***

No. New Jersey has an Unfair Trade Practices Act. N.J. Stat. Ann. §17:29B-1, *et seq.* It does not support private causes of action. *See, e.g., Pierzga v. Ohio Cas. Grp. of Ins. Cos.*, 208 N.J. Super. 40, 504 A.2d 1200 (App. Div.), *cert. denied*, 104 N.J. 399, 517 A.2d 402 (1986).

### ***Is there a common law cause of action for bad faith?***

Yes. *See, e.g., Pickett v. Lloyd's*, 131 N.J. 457, 621 A.2d 445 (1993) (recognizing common law bad faith cause of action for failure to pay policy benefits); *Rova Farms Resort, Inc. v. Investors Ins. Co. of Am.*, 65 N.J. 474, 323 A.2d 495 (1974) (recognizing common law bad faith cause of action for failure to settle claims against insured under liability policy). Third parties may bring direct actions for bad faith claims against insurers. *See, e.g., Atlantic City v. Am. Cas. Ins. Co.*, 254 F. Supp. 396 (D.N.J. 1966). The bad faith cause of action belongs to the insured, not third parties obtaining a judgment. *Biasi v. Allstate Ins. Co.*, 104 N.J. Super. 155, 249 A.2d 18 (1969); *but see Reszler v. Travelers Prop. Cas. Ins. Co.*, No. 06-586 (AET), 2007 U.S. Dist. Lexis 24683 (D.N.J. Apr. 3, 2007) (holding that allegations that insurer owed duty of care to foreseeably injured third party are sufficient to assert cause of action).

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

Equitable subrogation. *See, e.g., Fireman's Fund Ins. Co. v. Sec. Ins. Co. of Hartford*, 72 N.J. 63, 367 A.2d 864 (1976). A primary insurer owes a duty of good faith to an excess insurer to settle a claim within the limits of the primary policy. *See, e.g., CNA Ins. Co. v. Selective Ins. Co.*, 354 N.J. Super. 369, 807 A.2d 247 (App. Div. 2002).

### ***What causes of action for extracontractual liability have been recognized outside the claim handling context?***

While no specific causes of action have been recognized by New Jersey courts, the New Jersey Supreme Court has held that “[d]eliberate, overt and dishonest dealings, insult and personal abuse,” as well as “intolerable conduct that is outrageous in character,” would support causes of action for extracontractual liability against an insurer. *Pickett v. Lloyd's*, 131 N.J. 457, 475, 621 A.2d 445, 455 (1993).

## Damages

### ***Are punitive damages available?***

Yes, but only in “egregious circumstances.” *Pickett v. Lloyd's*, 131 N.J. 457, 475, 621 A.2d 445, 455 (1993). The insurer’s conduct must be wantonly reckless or malicious. *See, e.g., Miglicio v. HCM Claim Mgmt. Corp.*, 288 N.J. Super. 331, 347, 672 A.2d 266, 274 (Law Div. 1995). The recovery of damages is governed by the Punitive Damages Act, codified at N.J. Stat. Ann. §2A:15-5.9, *et seq.* This Act restricts a claimant’s right to recover punitive damages, and requires proof by clear and convincing evidence.

claims or issues,” if “the court determines that separate trials will be in furtherance of convenience or will avoid prejudice.” Other than applying a statute mandating bifurcation of compensatory and punitive damage claims in product liability actions, New Jersey courts have not analyzed whether and under what circumstances compensatory and punitive damage claims should be bifurcated.

***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?***

Pursuant to 11 U.S.C. §362(a), a bankruptcy petition acts as an automatic stay of the commencement or continuation of judicial proceedings brought against the bankrupt party. To date, New Jersey courts have not applied this law in the context of a bad faith insurance claim, or otherwise analyzed how a bankruptcy petition may affect an insurance bad faith claim.

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

A claimant or insured may obtain payment from the New Jersey Property-Liability Insurance Guaranty Association for any claim “which arises out of and is within the coverage, and not in excess of the applicable limits of an insurance policy,” provided that the claimant is a resident of New Jersey, or “the property from which the claim arises is permanently located in [New Jersey.]” N.J. Stat. Ann. §17:30A-5 (definition of “covered claim”). The Association does not provide coverage for “punitive damages unless covered by the policy,” or “counsel fees for prosecuting claims against the association.” N.J. Stat.

Ann. §17:30A-5 (“covered claim” shall not include”). Any claimant must exhaust coverage from a solvent insurer before bringing a claim with the Association. N.J. Stat. Ann. §17:30A-12(b). Upon application and notice, all proceedings in which the insolvent insurer is a party must be stayed for a minimum of 120 days, and for such additional time as is necessary to permit the Association to raise a proper defense of all causes of action. N.J. Stat. Ann. §17:30A-18. New Jersey courts have not determined whether the Association is liable for any bad faith conduct on the part of the insolvent insurer.

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Yes. *See, e.g., Miller v. N.J. Ins. Underwriting Ass’n*, 177 N.J. Super. 584, 427 A.2d 135 (Law Div. 1981).

***Is “advice of counsel” a recognized defense?***

For bad faith liability insurance claims, no. *See, e.g., Rova Farms Resort, Inc. v. Investors Ins. Co. of Am.*, 65 N.J. 474, 323 A.2d 495 (1974). New Jersey courts have not analyzed whether the advice of counsel is a recognized defense to first-party bad faith claims.

***What other defenses are available?***

None specifically recognized by New Jersey courts.

***Is there a cause of action for reverse bad faith?***

Not specifically addressed in New Jersey.

AUTHOR

Matthew M. Haar | Saul Ewing LLP | 717.257.7508 | mhaar@saul.com

# New Mexico

By Patrick Q. Hustead and Connor L. Cantrell

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

Yes. NMSA §59A-16-20 defines various acts that may constitute bad faith by an insurer. “Any person”—not only an insured—has a statutory right to bring a claim for violations of this section, under NMSA §59A-16-30.

### ***Can a third party bring a statutory action for bad faith?***

Yes. NMSA §59A-16-30; *Hovet v. Lujan*, 89 P.3d 69 (N.M. 2004) (third party has direct right of action against tortfeasor’s insurer for failure to make good faith efforts to settle liability claim). The “victim” must wait, however, to file a bad faith action until conclusion of the underlying claim against the tortfeasor, and a judicial determination of fault against the tortfeasor has been made.

It should also be noted that the court in *Jolley v. Associated Electric & Gas Insurance Services Ltd.*, 237 P.3d 738, 739 (N.M. 2010) declined to extend the third-party right of action for a non-mandatory excess liability insurer’s failure to settle an underlying lawsuit.

### ***Is there a common law cause of action for bad faith?***

Yes, a common law claim for bad faith exists in both the first-party and third-party context.

In the third-party context, the claim was first recognized in *Lujan v. Gonzales*, 501 P.2d 673 (N.M. Ct. App. 1972) (insurer “cannot be partial to its own interests, but must give its interests and the interests of the insured equal consideration.”); *see also Crawford v. Am. Employers’ Ins. Co.*, 526 P.2d 206 (N.M. Ct. App. 1974), *rev’d on other grounds by Am.*

*Employers’ Ins. Co. v. Crawford*, 533 P.2d 1203, 1204 (N.M. 1975).

In the first-party context, the claim was first recognized in *State Farm General Insurance Co. v. Clifton*, 527 P.2d 798 (N.M. 1974) (bad faith exists in the denial of an insured’s first-party claim where the denial is “frivolous or unfounded”); *see also Chavez v. Chenoweth*, 553 P.2d 703 (N.M. Ct. App. 1976); *Jackson Nat’l Life Ins. Co. v. Receconi*, 827 P.2d 118, 134 (N.M. 1992).

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

An excess carrier apparently has the same rights against a primary carrier as any insured has against its insurer. *Ambassador Ins. Co. v. St. Paul Fire & Marine Ins. Co.*, 690 P.2d 1022, 1026 (N.M. 1984) (answering questions certified by Tenth Circuit in *Ambassador Insurance Co. v. St. Paul Fire & Marine Insurance Co.*, 753 F.2d 824 (10th Cir. 1985)).

### ***What causes of action for extracontractual liability have been recognized outside the claim handling context?***

“The duty of good faith cannot be so narrowly circumscribed. As we stated above, there can be an infinite variety of situations out of which such acts may arise.” *Crawford v. Am. Employers’ Ins. Co.*, 526 P.2d 206 (N.M. Ct. App. 1974), *rev’d on other grounds, Am. Employers Ins. Co. v. Crawford*, 533 P.2d 1203 (N.M. 1975).

Additionally, NMSA §59A-16-20 defines bad faith to include a number of acts beyond refusing to defend and failing to pay claims, including “misrepresenting to insureds pertinent facts or policy provisions....”

do not favor staying an underlying action to resolve insurance coverage issues. See, e.g., *State Farm Fire & Cas. Co. v. Ruiz*, 36 F. Supp. 2d 1308, 1315 (D. N.M. 1999) (“a determination of whether an exclusion relieves an insurer from a duty to defend must be made in the primary lawsuit, and not in an action for declaratory judgment, because it is a factual question.”), quoting *Lopez v. N.M. Public Schools Ins. Auth.*, 870 P.2d 745, 748 (N.M. 1994).

***Under what circumstances will bad faith claims be severed for trial from the underlying claim?***

In *Hovet v. Allstate Insurance Co.*, 89 P.3d 69 (N.M. 2004), the New Mexico Supreme Court held that, in order to avoid confusion at trial of the underlying tort action, the victim must wait to file a bad faith claim until conclusion of the underlying action and a determination as to the tortfeasor has been made.

***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

No reported cases.

***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?***

No reported cases.

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

The statutes governing the state Property and Casualty Insurance Guaranty are set forth at NMSA §59A-43-1, *et seq.* It does not appear, however, that this issue is resolved either by these statutes or relevant case law. Nonetheless, the Act empowers the Guaranty Association to “adjust, compromise, settle and pay covered claims to the extent of the association’s obligation and deny all other claims.” NMSA §59A-43-7(A)(4). Pre-

sumably, this statute bars recovery from the Guaranty Association on bad faith claims.

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

New Mexico courts have not expressly ruled on the issue, but have hinted that such a defense would be viable if it is properly raised and developed. *O’Neel v. USAA Ins. Co.*, 131 N.M. 630, 41 P.3d 356 (N.M. App. 2002); *Jessen v. Nat’l Excess Ins. Co.*, 776 P.2d 1244 (N.M. 1989).

***Is “advice of counsel” a recognized defense?***

No reported cases.

***What other defenses are available?***

A policyholder’s dishonesty is an affirmative defense. See UJI 13-1710. The duty to deal fairly and honestly rests equally upon the insurer and the insured. *Modisette v. Found. Reserve Ins. Co.*, 427 P.2d 21 (N.M. 1967). Dishonest conduct on the part of the insured vitiates the insurance policy, and completely bars any recovery of compensatory and punitive damages. *Jessen v. Nat’l Excess Ins. Co.*, 776 P.2d 1244 (N.M. 1989).

***Is there a cause of action for reverse bad faith?***

No reported cases.

**Other Significant Cases Involving Bad Faith and Extracontractual Claims**

There are no significant cases currently pending, though New Mexico’s decisions in *Hovet v. Lujan* and *Sloan v. State Farm Mutual Automobile Insurance Co.*, both noted above, significantly altered New Mexico law in the bad faith context.

**AUTHORS**

**Patrick Q. Husted** | The Husted Law Firm | 303.721.5000 | pqh@thlf.com

**Connor L. Cantrell** | The Husted Law Firm | 303.721.5000 | clc@thlf.com

# New York

By Brian R. Biggie and Clayton D. Waterman

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

Generally, no. Insurers' conduct is regulated under New York Insurance Law §2601 (Unfair Claim Settlement Practices; Other Misconduct; Discrimination). The violations are policed by the Department of Financial Services, and violations do not support a private right of action. *Dinstber v Allstate Ins. Co.*, 110 A.D.3d 1410, 974 N.Y.S.2d 171 (N.Y. App. Div. 3d Dep't 2013); *Rocanova v. Equitable Life Assur. Soc. of the U.S.*, 83 N.Y.2d 603, 634 N.E.2d 940, 612 N.Y.S.2d 339 (1994).

While the New York statutory scheme recognizes a cause of action under New York General Business Law §349 for various deceptive business practices, courts limit the application to the "marketing schemes" of insurers that had a broad impact on consumers at large, and distinguish claims involving claims handling or settlement practices. *Kantrowitz v. Allstate Indem. Co.*, 48 A.D.3d 753, 853 N.Y.S.2d 151 (N.Y. App. Div. 2d Dep't 2008). Violations of §349 may be pursued by the attorney general or by any person who has been injured as a result of the deceptive conduct. An individual plaintiff's damages are limited and cannot exceed three times the actual damages up to \$1,000. However, individuals who successfully pursue a §349 claim can recover their attorney fees. *See Gaidon v. Guardian Life Ins. Co. of Am.*, 94 N.Y.2d 330, 725 N.E.2d 598, 704 N.Y.S.2d 177 (1999).

### ***Can a third party bring a statutory action for bad faith?***

No. *See* discussion above.

### ***Is there a common law cause of action for bad faith?***

In the first-party insurance context, New York courts

do not recognize an independent tort cause of action for an insurer's alleged failure to perform its contractual obligations under an insurance contract. When there has been merely a breach of contract, the remedy is limited to contract damages, which do not include punitive damages or other types of extracontractual damages. *N.Y. Univ. v. Cont'l Ins. Co.*, 87 N.Y.2d 308, 662 N.E.2d 763, 639 N.Y.S.2d 283 (1995); *Rocanova v. Equitable Life Assur. Soc. of the U.S.*, 83 N.Y.2d 603, 634 N.E.2d 940, 612 N.Y.S.2d 339 (1994). However, when there is an independent tort and the tortious conduct is egregious, directed to the insured, and part of a pattern and practice directed toward the public generally, punitive damages may be awarded. *See Bi-Econ. Mkt., Inc. v. Harleysville Ins. Co. of N.Y.*, 10 N.Y.3d 187, 886 N.E.2d 127, 856 N.Y.S.2d 505 (2008); *N.Y. Univ. v. Cont'l Ins. Co.*, 87 N.Y.2d 308, 662 N.E.2d 763, 639 N.Y.S.2d 283 (1995); *Rocanova v. Equitable Life Assur. Soc. of the U.S.*, 83 N.Y.2d 603, 634 N.E.2d 940, 612 N.Y.S.2d 339 (1994); *Dinstber v. Allstate Ins. Co.*, 110 A.D.3d 1410, 974 N.Y.S.2d 171 (N.Y. App. Div. 3d Dep't 2013); *Cont'l Cas. Co. v. Nationwide Indem. Co.*, 16 A.D.3d 353, 792 N.Y.S.2d 434 (N.Y. App. Div. 1st Dep't 2005).

In the liability insurance context, bad faith is established only where the liability in the underlying action is clear and the potential recovery far exceeds the insurance coverage and the insurer refuses to settle. Factors considered by courts include whether the insurer's investigatory efforts prevented it from making an informed evaluation of the risk; the likelihood of success on the liability of the underlying action; the potential magnitude of the damages; the financial burden each party may be exposed to as a result of the refusal to settle; whether the insurer properly investigated; any potential defenses; and other evidence which tends to establish or negate the insurer's bad faith in refusing to settle. *Pavia v. State*

*Corp. v. Cont'l Ins. Co.*, 174 A.D.2d 722 (N.Y. App. Div. 2d Dep't 1991); *Transamerica Ins. Co. v. Tolis Inn, Inc.*, 129 A.D.2d 512 (N.Y. App. Div. 1st Dep't 1987); *Redanz v. Kuntz*, 99 A.D.2d 654 (N.Y. App. Div. 4th Dep't 1984); *Sabre v. Rutland Plywood Corp.*, 93 A.D.2d 903 (N.Y. App. Div. 3d Dep't 1983).

That said, in the context of an insurance coverage dispute, severance of the bad faith claim is more problematic. Severance remains within the discretion of the trial court. In this context, courts will generally not sever the bad faith cause of action, as the nature of the claim is intertwined with the insured's claim for coverage. However, if the insurer can show a substantial risk of prejudice, the court may grant severance. *Tilcon N.Y., Inc. v. Transcon. Ins. Co.*, 261 A.D.2d 608, 690 N.Y.S.2d 724 (N.Y. App. Div. 2d Dep't 1999); see generally N.Y. C.P.L.R. §603 (Severance and Separate Trials).

#### ***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

As noted above, because New York courts do not recognize an independent tort of bad faith, given that the nature and extent of the actions or inactions of the insurer in denying a claim or refusing to settle are so interconnected, compensatory and punitive damages are generally not bifurcated.

#### ***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?***

Where the insured was insolvent before the rendition of the excess judgment, had not paid any part of the judgment, and was subsequently discharged from any future obligations to pay the judgment, it is not actually harmed by an insurer's bad faith refusal to settle. If the insured was solvent at the time of the excess judgment, courts have held that the only way to make the insured whole would be to allow him or her to recover the entire amount of the judgment. See *Young v. Am. Cas. Co.*, 416 F.2d 906 (2d Cir. 1969) (applying New York law, citing *Harris v. Standard Accident & Ins. Co.*, 297 F.2d 627 (2d Cir. 1961), cert

denied, 369 U.S. 843, 82 S. Ct. 875, 7 L. Ed. 2d 847 (1962)).

#### ***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

There is no pertinent case law on point as it pertains to bad faith extracontractual claims. However, New York Insurance Law §7608 (Payment From Funds; Subrogation Limit on Payment) provides, with respect to payments made by a guaranty fund: "No payment from the funds shall exceed the limit of liability provided for in the insurance policy or surety bond." Therefore, arguably, it would appear that extracontractual damages could not be paid out of the guaranty fund. See *In re N.Y. Sur. Co.*, 282 A.D.2d 463, 723 N.Y.S.2d 201 (N.Y. App. Div. 2d Dep't 2001).

#### **Defenses and Counterclaims**

##### ***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

While the New York courts have not been specifically called on to accept the doctrine of comparative bad faith, at least one federal court has indicated that it would allow an affirmative defense of comparative bad faith. See *Ins. Co. of N. Am. v. Milberg Weiss Bershad Specthrie & Lerach*, No. 95 Civ. 3722 (LLS), 1996 WL 520902 (S.D.N.Y. Sept. 12, 1996). New York courts have held that where the insured breaches the cooperation clause of the policy or fails to provide a timely notice, such actions or inactions can result in a dismissal. See *Allstate Ins. Co. v. Grant*, 185 A.D.2d 911, 587 N.Y.S.2d 382 (N.Y. App. Div. 2d Dep't 1992); *Dyno-Bite, Inc. v. Travelers Cos.*, 80 A.D.2d 471, 439 N.Y.S.2d 558 (N.Y. App. Div. 4th Dep't 1981).

##### ***Is "advice of counsel" a recognized defense?***

Yes. An insurer can rely on advice of counsel, and courts have held that to impose punitive damages where an insurer reasonably relies on the advice of counsel would be a harsh result. See *Gordon v. Nationwide Mut. Ins. Co.*, 30 N.Y.2d 427, 436, 285 N.E.2d 849 (1972); see also *Decker v. Amalgamated*

*Mut. Cas. Ins. Co.*, 35 N.Y.2d 950, 324 N.E.2d 552, 365 N.Y.S.2d 172 (1974).

***What other defenses are available?***

An affirmative defense to punitive damages based on the limits of the New York State Constitution and the United States Constitution (*i.e.*, due process, excessive fine and ex post facto clauses) may be raised. See generally *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408 (2003); *BMW of N. Am. v. Gore*, 517 U.S. 559 (1996).

***Is there a cause of action for reverse bad faith?***

No. See discussion of the defense of comparative bad faith above.

AUTHORS

**Brian R. Biggie** | Goldberg Segalla LLP |  
716.566.5400 | bbiggie@goldbergsegalla.com

**Clayton D. Waterman** | Goldberg Segalla LLP |  
716.566.5400 | cwaterman@goldbergsegalla.com

# North Carolina

By James W. Bryan, Jeffrey D. Keister, and Jessica C. Tyndall

## Causes of Action

### *Is there a statutory basis for an insured to bring a bad faith claim?*

Yes. Violations of the North Carolina Unfair Claims Settlement Practices statute, N.C. Gen. Stat. §58-6315(11), are actionable under North Carolina's Unfair and Deceptive Practices Act, N.C. Gen. Stat. §75-1.1, *et seq.* ("Chapter 75"), and in some instances establish a violation of Chapter 75 per se. *See Gray v. N.C. Ins. Underwriting Ass'n*, 352 N.C. 61, 529 S.E.2d 676, *reh'g denied*, 352 N.C. 599, 544 S.E.2d 771 (2000); *Martini v. Companion Prop. & Cas. Ins. Co.*, 679 S.E.2d 156, 2009 N.C. App. Lexis 1099 (2009); *Country Club of Johnston Cnty., Inc. v. U.S. Fid. & Guar. Co.*, 150 N.C. App. 231, 563 S.E.2d 269 (2002); *Cash v. State Farm Mut. Auto. Ins. Co.*, 137 N.C. App. 192 (2000), 528 S.E.2d 372, *aff'd*, 353 N.C. 257, 538 S.E.2d 569 (2000).

The courts have concluded that per se violations of Chapter 75, including conduct that violates N.C. Gen. Stat. §58-63-15(11)(f) (insurance violations), occur only where the regulatory statute specifically defines and proscribes conduct which is unfair or deceptive within the meaning of N.C. Gen. Stat. §75-1.1. *Noble v. Hooters of Greeneville, LLC*, 681 S.E.2d 448, 2009 N.C. App. Lexis 1387 (2009).

However, a plaintiff need not establish a violation of §58-63-15(11) to succeed on a private cause of action against an insurer under Chapter 75. *See Country Club of Johnston Cnty., Inc. v. U.S. Fid. & Guar. Co.*, 150 N.C. App. 231, 563 S.E.2d 269 (2002). Further, in order to prevail on a Chapter 75 claim, a plaintiff need not prove that an unfair claim settlement practice was committed with such frequency as to constitute a general business practice. *See Gray v. N.C. Ins. Underwriting Ass'n*, 352 N.C. 61, 529 S.E.2d 676 (2000).

N.C. Gen. Stat. §58-63-15(11), which enumerates the acts constituting unfair claims settlement prac-

tices, requires that such acts be committed with sufficient frequency as to constitute a general business practice, and does not create a cause of action in favor of anyone other than the Commissioner of Insurance. *See Cash v. State Farm Mut. Auto. Ins. Co.*, 137 N.C. App. 192, 528 S.E.2d 372 (2000), *aff'd*, 353 N.C. 257, 538 S.E.2d 569 (2000).

### *Can a third party bring a statutory action for bad faith?*

No. A third party cannot sue the insurer of an adverse party under either N.C. Gen. Stat. §58-63-15 or N.C. Gen. Stat. §75-1.1. *See Brown v. Nationwide Mut. Ins. Co.*, No. 1:11CV49, 2015 U.S. Dist. Lexis 536 (M.D.N.C. Jan. 6, 2015) (confirming tort claimant had no right to sue third-party liability carrier for bad faith even where liability carrier and claimant's UIM carrier were the same company.); *Woods v. Sentry Ins. Mut. Co.*, No. COA 08-49, 2008 N.C. App. Lexis 1773 (N.C. Ct. App. Oct. 7, 2008) (no action lies where third party is neither insured nor in privity with insurer); *Prince v. Wright*, 141 N.C. App. 262, 541 S.E.2d 191 (2000); *Lee v. Mut. Cmty. Sav. Bank*, 136 N.C. App. 808, 525 S.E.2d 854 (2000).

The courts have held that a third party (plaintiff) is unable to recover from an insurer the cost of litigating a case and the unpaid balance of the underlying judgment against the insured on the basis that the insurer refused in bad faith to settle plaintiff's original claim and failed to properly protect its insured from an excess verdict. *Taylor v. N. C. Farm Bureau Mut. Ins. Co.*, 181 N.C. App. 343, 638 S.E.2d 636 (2007).

However, if the plaintiff achieves the status of an intended third-party beneficiary arising from the contractual relationship between the adverse party and the adverse party's insurance company, the plaintiff may then bring a claim against the insurance

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

The North Carolina Insurance Guaranty Association (“Association”) was created by the Insurance Guaranty Association Act. N.C. Gen. Stat. §58-48-1, *et seq.* “The purpose of [Article 48] is to provide a mechanism for the payment of covered claims under certain insurance policies.” *Id.* at §58-48-5. Under the statute, the Association shall: “(1) Be obligated to the extent of the covered claims existing prior to the determination of insolvency.... This obligation includes only the amount of each covered claim that is in excess of fifty dollars (\$50.00) and is less than three hundred thousand dollars (\$300,000)... [and] (2) Be deemed the insurer to the extent of the Association’s obligation on the covered claims and to such extent shall have all rights, duties, and obligations of the insolvent insurer as if the insurer had not become insolvent.” *Id.* at §58-48-20(4).

Under a plain reading of the statute, the Association cannot be held liable for the torts of an insolvent insurer and punitive damages cannot be recovered from the Association. *See Bentley v. N.C. Ins. Guar. Ass’n*, 418 S.E.2d 705, 707 (N.C. App. 1992). Similarly, no action will lie against the Association for an insolvent insurer’s unfair or deceptive acts or practices in or affecting commerce. *Id.*; N.C. Gen. Stat. §75-1.1 *et seq.*

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Contributory negligence of the insured is not a defense to a claim for violation of N.C. Gen. Stat. §75-1.1 for an unfair or deceptive act or practice. *See Marshall v. Miller*, 202 N.C. 539, 276 S.E.2d 397 (1987). Similarly, since the tort of insurer bad faith is analogous to an intentional tort, as opposed to the tort of negligence, the contributory negligence of the insured is also likely not a defense.

An insurer’s legitimate request for information in investigating the insured’s fire loss claim, coupled

with the insured’s own delay in responding to the request, did not show the existence of aggravating or outrageous conduct on the insurer’s part or bad faith claim handling by the insurer. *See Schaffner v. USAA Cas. Co.*, 616 S.E.2d 692 (N.C. Ct. App. 2005) (unpublished opinion) (citing *Von Hagel v. Blue Cross & Blue Shield*, 91 N.C. App. 58, 62–63, 370 S.E.2d 695, 699 (1988); *see also Brown v. Nationwide Mut. Ins. Co.*, No. 1:11CV49, 2015 U.S. Dist. Lexis 536 (M.D.N.C. Jan. 6, 2015) (no bad faith found on underinsured motorist claim where insurer requested additional information following mediation of insured’s third-party tort claim in which UIM carrier sent a participant to “monitor” settlement negotiations); *Meadlock v. Am. Family Life Assur. Co.*, 729 S.E.2d 127, 2012 WL 2891079 (N.C. Ct. App. 2012) (unpublished) (among papers of deceased wife was insurance application which contained her material misrepresentation; thus, even though insurer failed to implement reasonable standards to capture data from electronic signatures, since wife, when alive, was aware of misrepresentations in application, availability of more data concerning wife’s signature on application would not have been relevant to plaintiff husband’s claim for unfair or deceptive acts or practices); *Rivenbark v. N.C. Farm Bureau Mut. Ins. Co., Inc.*, 155 N.C. App. 777, 574 S.E.2d 715 (2003) (unpublished opinion) (no bad faith found on underinsured motorist claim where insured contributed significantly to insurer’s delay by filing, dismissing, and re-filing his underlying suit against tortfeasor and by delaying in submitting his economic records to underinsured motorist insurer).

An insurer may not assert the “unclean hands” of the insured as a defense to a bad faith claim or an unfair or deceptive acts or practices claim because these claims do not seek an equitable remedy. *Guessford v. Pa. Nat’l Mut. Cas. Ins. Co.*, 918 F. Supp. 2d 453 (M.D.N.C. 2013).

Where intentional misrepresentation or fraudulent conduct of the insured is alleged, the conduct of the insured would be at issue in a bad faith action. *See Lanier v. State Farm Fire & Cas. Co.*, Civil No. 5:07CV129-V, 2009 WL 926914 (W.D.N.C. Mar. 31, 2009) (summary judgment for insurer on bad faith claim granted because insured played

role in intentional setting of fire that destroyed his home and then made misrepresentation to insurer during insurer's claim investigation to conceal his involvement); see also *Currie v. Phoenix Ins. Co.*, No. 3:13-CV-0366-MOC-DSC, 2014 U.S. Dist Lexis 10939 (W.D.N.C. Jan. 29, 2014) (dismissing under Rule 12(b)(6) insured's claim for breach of contract and bad faith following insured's indictment for arson in connection with fire forming basis of insured's claim under policy). The general law of material misrepresentation is as follows: "A misrepresentation of a material fact, or the suppression thereof, in an application for insurance, will avoid the policy." See *Tharrington v. Sturdivant Life Ins. Co.*, 115 N.C. App. 123, 128, 443 S.E.2d 797, 801 (1994). Pursuant to statute, "all statements or descriptions in any application for a policy of insurance, or in the policy itself, shall be deemed representations and not warranties, and a representation, unless material or fraudulent, will not prevent a recovery on the policy." N.C. Gen. Stat. §58-3-10. Intentional misrepresentation can serve to void an entire policy, whether the statement is made either before or after the loss. See *Smith v. State Farm Fire & Cas. Co.*, 109 N.C. App. 276, 426 S.E.2d 457 (1993). Regarding the statutory standard in the context of a "fraud and false swearing provision" in a fire policy, the "entire policy shall be void if, whether before or after a loss, the insured has willfully concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof, or the interest of the insured therein, or in case of any fraud or false swearing by the insured relating thereto." N.C. Gen. Stat. §58-44-15. "Simply put, to void a fire insurance policy for either misrepresentations or false swearing, the insurer must prove that the insured knowingly and willfully made statements which were false and material." *Webster Enters., Inc. v. Selective Ins. Co. of the Se.*, 125 N.C. App. 36, 43, 479 S.E.2d 243, 248 (1997) (citing *Bryant v. Nationwide Mut. Fire Ins. Co.*, 313 N.C. 362, 370, 329 S.E.2d 333, 338 (1985)).

Where mistake of insured is alleged, the intent and conduct of the insured would also be at issue in a bad faith action. The general law of mistake is as follows: "A mutual mistake is one shared by both parties to the agreement, such that each party oper-

ates under a misunderstanding as to the terms of the contract or the provisions of the writing intended to embody the agreement." See *Gaston Cnty. Dyeing Mach. Co. v. Northfield Ins. Co.*, 509 S.E.2d 778, 782 (N.C. Ct. App. 1998), *aff'd on other grounds*, 524 S.E.2d 558 (N.C. 2000). "A unilateral mistake, unaccompanied by fraud, imposition, undue influence, or like oppressive circumstances, is not sufficient to avoid a contract or conveyance." See *Fin. Servs. v. Capitol Funds*, 217 S.E.2d 551 (N.C. 1975).

An insured's reliance can be a factual issue. Proof of an unfair or deceptive act or practice "based on the unfair claim settlement practice of misrepresenting pertinent facts or insurance policy provisions relating to coverages requires demonstration that the plaintiff detrimentally relied upon the misrepresentation." See *Westchester Fire Ins. Co. v. Johnson*, 221 F. Supp. 2d 637 (M.D.N.C. 2002); *ABT Bldg. Prods. Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 472 F.3d 99, 127 (4th Cir. 2006) (evidence before jury provided ample and compelling support for finding of detrimental reliance).

However, an insurer's misrepresentation to an insured for the purpose of inducing or tending to induce such insured to lapse, forfeit, or surrender his or her insurance, pursuant to N.C. Gen. Stat. §58-63-15(1), does not require the insured to prove his or her reliance on such misrepresentation in order to prove an unfair and deceptive practice under N.C. Gen. Stat. §75-1.1. See *Cullen v. Valley Forge Ins. Co.*, 161 N.C. App. 570, 589 S.E.2d 423 (2003).

### ***Is "advice of counsel" a recognized defense?***

This issue has not specifically been addressed by North Carolina courts; however, federal courts applying North Carolina law have held that reliance on advice of counsel is a defense to bad faith claims. See *Ring v. Commercial Union Ins. Co.*, 159 F.R.D. 653 (M.D.N.C. 1995) (because insurer did not rely on "advice of counsel as a defense," plaintiffs could not obtain discovery of insurer's attorney-client communications and attorney work product), but is not a defense to unfair or deceptive acts or practices claims. *Guessford v. Pa. Nat'l Mut. Cas. Ins. Co.*, 918 F. Supp. 2d 453 (M.D.N.C. 2013).

### **What other defenses are available?**

Where the insurer's denial of coverage is based on a construction of the insurance policy which is "neither strained nor fanciful," the insurance carrier is not liable for the tort of bad faith even if the insurer did breach the contract. See *Olive v. Great Am. Ins. Co.*, 76 N.C. App. 180, 333 S.E.2d 41 (1985). The insurer has a right to disagree with the insured over how to interpret the policy as long as it is done in good faith. *Id.* at 189, 333 S.E.2d at 46. Further, an insurer does not commit bad faith unless its conduct is "not based on honest disagreement or innocent mistake." *Lovell v. Nationwide Mut. Ins. Co.*, 108 N.C. App. 416, 424 S.E.2d 181 (1993), *aff'd in part, disc. review improvidently granted in part*, 334 N.C. 682, 435 S.E.2d 71 (1993); see also *Clear Creek Landing Home Owners' Ass'n, Inc. v. Travelers Indem. Co. of Conn.*, No. 1:12cv157, 2012 WL 6641901 (W.D.N.C. Dec. 20, 2012) (disagreement between insured and insurer as to whether the roof damage was attributable to stress damage (not covered) or hail damage (covered) did not transform insured's breach of contract claim into tort for bad faith settlement); *Defeat the Beat, Inc. v. Underwriters at Lloyd's London*, 194 N.C. App. 108, 119, 669 S.E.2d 48, 59 (2008); *Bank of Am. Corp. v. SR Int'l Bus. Ins. Co.*, SE, No. 05 CVS 5564, 2007 WL 4480057 (N.C. Super. Dec. 19, 2007) (unpublished) (no bad faith where insurer never recognized valid claim and consistently denied claim).

In *Blis Day Spa, LLC v. Hartford Insurance Group*, 427 F. Supp. 2d 621 (W.D.N.C. 2006), the federal district court granted summary judgment for the insurer as to the insured's bad faith claim. The insured's day spa building was destroyed by fire, and the insured moved its business to a temporary facility. Hartford made numerous advance payments for property damage and business interruption losses and extra expenses but a dispute arose as to certain other business interruption losses and expenses. Hartford invoked the policy's appraisal provision but the insured filed suit instead. After finding genuine issues of material fact and denying the insurer's motion for summary judgment as to insured's breach of contract claims, the court nonetheless came to the insurer's side on the bad faith claim. The

of bad faith: (a) there was no evidence that Hartford ever recognized as valid the disputed portions of the insured's claims; (b) the insured failed to demonstrate that Hartford's refusal to pay the claim was not because of a legitimate honest disagreement as to the validity of the claim or an innocent mistake; (c) any alleged misrepresentations by the insurer's accountant consultant had nothing to do with the disputes over the business income losses; and (d) Hartford's failure to pay the disputed amounts when it allegedly was aware that the insured was financially bereft is insufficient to establish aggravating conduct. *Id.*

The list of affirmative defenses in the North Carolina Rules of Civil Procedure is helpful in assessing defenses to bad faith claims. "In pleading to a preceding pleading, a party shall set forth affirmatively accord and satisfaction, arbitration and award, assumption of risk, contributory negligence, discharge in bankruptcy, duress, estoppel, failure of consideration, fraud, illegality, injury by fellow servant, laches, license, payment, release, *res judicata*, statute of frauds, statute of limitations, truth in actions for defamation, usury, waiver, and any other matter constituting an avoidance or affirmative defense." N.C. Gen. Stat. §1A-1, Rule 8. Further, "In all averments of fraud, duress, or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally." N.C. Gen. Stat. §1 A-1, Rule 9.

At least one insurer invoked *res judicata* unsuccessfully, arguing that where its UIM insured secured an arbitration award and confirmed the award through judgment against the UIM insurer at the state trial court level, the insured could not thereafter bring a separate lawsuit for bad faith and unfair and deceptive trade practices against the UIM insurer. Although the insurer prevailed at the trial court level in moving to dismiss the insured's second lawsuit, the North Carolina Court of Appeals held that the prior judgment against the insurer arising out of its derivative responsibility for the underlying underinsured motorist's torts was separate from the first-party type liability that the insured contended arose during the handling of the UIM claim. *Lee v.*

*Allstate Ins. Co.*, No. COA09-1694, 2010 N.C. App. Lexis 1420 (N.C. Ct. App. Aug. 3, 2010).

Mitigation of damages is a defense to the tort claim of insurer bad faith and unfair and deceptive trade practices. *Guessford v. Pa. Nat'l Mut. Cas. Ins. Co.*, 918 F. Supp. 2d 453 (M.D.N.C. 2013). "One who is injured in his person or property by the wrongful or negligent act of another is required to protect himself from loss, if he can do so with reasonable exertion or at trifling expense; and ordinarily, he will be allowed to recover from the delinquent party only such damages as he could not, with reasonable effort, have avoided." *Troitino v. Goodman*, 225 N.C. 406, 416, 35 S.E.2d 277, 284 (1945). "The general principle is fully recognized with us that, in case of contract broken or tort committed, the injured party should do what reasonable care and business prudence requires to minimize the loss." *Monger v. Lutterloh*, 195 N.C. 274, 142 S.E. 12, 16 (1928). "Imposing such a duty assures that an award of damages will put the injured party in as good a position as if the contract had not been breached while affording the least amount of cost to the defaulting party." *Chapel Hill Cinemas, Inc. v. Robbins*, 143 N.C. App. 571, 547 S.E.2d 462 (2001).

Assignments of personal tort claims are void as against public policy. As a result, bad faith tort claims are not assignable. See *Horton v. New S. Ins. Co.*, 122 N.C. App. 265, 468 S.E.2d 856 (1996).

Defenses to allegations of a violation of N.C. Gen. Stat. §75-1.1 for an unfair or deceptive act or practice are many, but there are some significant differences compared with defenses to a tort claim.

"A mere breach of contract does not constitute an unfair or deceptive trade practice." See *Martinez v. Nat'l Union Fire Ins. Co.*, 911 F. Supp. 2d 331 (E.D.N.C. 2012); *Rogers v. Unitrim Auto & Home Ins. Co.*, 388 F. Supp. 2d 638 (W.D.N.C. 2005); *Mosley & Mosley Builders v. Landin Ltd.*, 97 N.C. App. 511, 518, 389 S.E.2d 576, 580 (1990). Even if the breach is intentional, it does not amount to a Chapter 75 claim. See *Bartolomeo v. S.B. Thomas, Inc.*, 889 F.2d 530 (4th Cir. 1989). A plaintiff must show substantial aggravating circumstances attending the breach to recover under Chapter 75. See *Branch Banking*

*& Trust Co. v. Thompson*, 107 N.C. App. 53, 62, 418 S.E.2d 694, 700 (1992).

A plaintiff must also prove proximate cause—that he or she has suffered actual injury as a proximate result of the defendant's conduct. See *Wysong & Miles Co. v. Emps. of Wassau*, 4 F. Supp. 2d 421 (M.D.N.C. 1998); *Meadlock*, 729 S.E.2d 127, 2012 WL 2891079 (N.C. App. 2012); *Walker v. Branch Banking & Trust Co.*, 133 N.C. App. 580, 515 S.E.2d 727 (1999). In *Defeat the Beat, Inc. v. Underwriters at Lloyd's London*, 194 N.C. App. 108, 117, 669 S.E.2d 48, 54 (2008), the court of appeals held that even though evidence existed of violations of Chapter 75, the plaintiff presented no evidence of any monetary injury caused by these alleged violations and summary judgment for the insurer was affirmed. In a case involving first-party coverage, mold, proximate cause defense and unfair claim settlement practices, the court of appeals in *Nelson v. Hartford Underwriters Ins. Co.*, 177 N.C. App. 595, 630 S.E.2d 221 (2006) held that none of the insurer's actions (*i.e.*, investigating and denying the insureds' mold claim and slowing the insureds' remediation) were the proximate cause of the insureds' injury from mold contamination in their home. "A response to an injury is, by its nature, not the cause of the injury itself; the injury happens first, and the response to an injury follows. The response is thus not the cause of the injury, but rather a reaction to it.... Plaintiffs suffered no new injury from Hartford's actions. Instead, plaintiffs' ongoing mold contamination simply proceeded unabated, as a continuation of the already-existing injury." *Id.* at 613, 630 S.E.2d at 234. The court concluded that plaintiffs' unfair or deceptive trade practice claim cannot be sustained and summary judgment for the insurer was appropriate. *Id.*; see also *Burrell v. Sparkkles Reconstruction Co.*, 189 N.C. App. 104, 657 S.E.2d 712 (2008) (court upheld directed verdict for the insurer on grounds that an alleged unfair claim settlement practice of the insurer (*e.g.*, slow response to mold damage from water leak) did not proximately cause the damage to the house).

If the conduct of the insurer would have no effect on the consuming public, a Chapter 75 claim should be denied. See *Marshall v. Miller*, 202 N.C. 539, 548, 276 S.E.2d 397, 403 (1987).

An insurer that fails to attempt in good faith to effectuate prompt, fair, and equitable settlement of a claim in which liability has become reasonably clear violates the unfair and deceptive trade practices statute, N.C. Gen. Stat. §75-1.1, without the necessity of an additional showing of frequency indicating a general business practice. *See Gray v. N.C. Ins. Underwriting Ass'n*, 352 N.C. 61, 529 S.E.2d 676, *reh'g denied*, 352 N.C. 599, 544 S.E.2d 771 (2000). Where the evidence is conflicting, summary judgment is likely to be denied. *See, e.g., Kielbania v. Indian Harbor Ins. Co.*, No. 1:11CV663, 2012 WL 3957926 (M.D.N.C. Sep. 10, 2012), *recommendation adopted*, 2012 WL 6554081 (M.D.N.C. Dec. 14, 2012) (court noted that, on one hand, insurer's initial offer and estimate of loss at \$903,913.75 actual cash value was unreasonable under circumstances, being roughly half umpire's ultimate appraisal of \$1,732,898.70 actual cash value, but on other hand, insurer's estimates provided adequate explanation and basis for valuation).

But an insurer is not liable for "not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear" where the insurer has not been able to obtain all the information needed to settle the first-party insurance claim and where the insurer has not circumvented the written terms of the policy. *See Westchester Fire Ins. Co. v. Johnson*, 221 F. Supp. 2d 637, 646-47 (M.D.N.C. 2002). Neither is the insurer liable if delays in claim investigation are due to "scheduling problems" between the insurer and insured and due to the insurer's concerns when receiving an unexpectedly large monetary request in a proof of loss. *Id.* Additionally, the insurer is not liable for a "delay[ed] investigation or payment of claims by requiring an insured claimant... to submit a preliminary claim report and then requiring the subsequent submission of formal proof-of-loss forms, both of which submissions contain substantially the same information" where the insurer requests subsequent information that is not substantially the same, and the insured responds by providing information that differs substantially from an earlier examination under oath. *Id.* In *Blis Day Spa, LLC v. Hartford Ins. Grp.*, 427 F. Supp. 2d 621 (W.D.N.C. 2006), the federal district court

granted summary judgment for the insurer as to the insured's Chapter 75 claim. The court ruled that the insured failed to present evidence of an unfair or deceptive trade practice as follows: (a) as to the claim denial, there was no evidence that Hartford ever recognized the validity of the insured's loss estimates or that Hartford's denial was not the product of an honest disagreement or honest mistake; (b) as to any alleged negligent misrepresentations by Hartford's adjuster and accountant consultant, there is no evidence that the misrepresentations caused Hartford to delay payments on the claim or that the insured was damaged as a result of the misrepresentations; (c) as to Hartford's failure to settle, even though Hartford allegedly knew the insured was financially bereft, there is no evidence that Hartford believed the claim to be valid but disputed it for the purpose of forcing the insured to settle for less than what was owed under the policy; and (d) as to Hartford's failure to investigate, there is no evidence of a failure to investigate or damages resulting from such a failure to investigate. *Id.* at 634-36.

A reasonable, non-negligent misunderstanding regarding a policy term may be a defense to a Chapter 75 claim. *See Topsail Reef Homeowners Ass'n v. Zurich Specialties London*, 11 F. App'x 225, 2001 WL 565317 (4th Cir. May 25, 2001) (unpublished opinion) (insurer had reasonable bases to challenge the validity of insured's submitted claim); *Cockman v. White*, 76 N.C. App. 387, 333 S.E.2d 54 (1985). Similarly, an erroneous interpretation of the law does not amount to an unfair or deceptive act or practice. *See Branch Banking & Trust Co. v. Columbia Peanut Co.*, 649 F. Supp. 1116 (E.D.N.C. 1986).

A proper investigation and denial of an insurance claim is not unethical, oppressive, or deceptive in any way and does not amount to a Chapter 75 violation. *See Marshburn v. Associated Indem. Corp.*, 84 N.C. App. 365, 353 S.E.2d 123 (1987). Neither is it a Chapter 75 violation where the insurer had a reasonable basis for denying coverage, reasonably believed it was not liable for full death benefits, paid the undisputed portion in a timely manner, and its explanation of its "no coverage" position to the insured was timely and reasonable. *See Cent. Carolina Bank & Trust Co. v. Sec. Life of Denver Ins. Co.*, 247 F. Supp. 2d 791

(M.D.N.C. 2003); see also *Carter v. W. Am. Ins. Co.*, 190 N.C. App. 532, 661 S.E.2d 264 (2008).

Occasions can arise where a problematic claim investigation is not actionable for a bad faith claim but is actionable as an unfair or deceptive act or practice claim. See, e.g., *Cleveland Constr., Inc. v. Fireman's Fund Ins. Co.*, 819 F. Supp. 2d 477 (W.D.N.C. 2011) (on one hand, despite insurer's failure to investigate claim, insurer's conduct did not rise to level of aggravated conduct to support bad faith claim, but on other hand, although insurer received notice of claim, it did never investigate claim and insured produced competent evidence of Chapter 75 violation because insurer did not commence timely investigation).

An insurer was not found to have engaged in unfair or deceptive acts or practices when there were questions as to its liability for a fire loss on a homeowners policy for quite some time after the fire and during that time the insurer pursued answers to those questions diligently. *Luther v. Seawell*, 191 N.C. App. 139, 662 S.E.2d 1 (2008). Another insurer was on the winning side of summary judgment in *Amatulli & Sons, LLC v. Great Northern Insurance Co.*, Civil No. 3:06cv286, 2008 WL 90092 (W.D.N.C. Jan. 8, 2008) (unpublished), because its claim denial letter reflected a reasonable belief that the insured had not properly documented its claim, the letter explained why the insurer disagreed with each objection made by the insured and the letter said the insurer would consider additional information if the insured presented it. *Id.* at \*17.

Allegations of a bad faith denial of a claim for insurance benefits under a credit life insurance policy did not suffice in alleging a claim for unfair or deceptive trade practices in *Mason v. Universal Underwriters Life Insurance Co.*, Civil No. 1:06CV190, 2006 WL 2847288, at \*6 (W.D.N.C. Oct. 4, 2006) (unpublished). See *Beasley v. Nat'l Sav. Life Ins. Co.*, 75 N.C. App. 104, 109, 330 S.E.2d 207 (1985).

A mistake in the claim handling process is also not necessarily a Chapter 75 violation if the evidence shows that the insurer's conduct is not immoral, unethical, oppressive, unscrupulous, or substantially injurious to consumers. In *Central Carolina Bank*

*& Trust Co. v. Security Life of Denver Insurance Co.*, 247 F. Supp. 2d 791 (M.D.N.C. 2003), the court determined that a life insurer did not engage in an unfair claim settlement practice in violation of Chapter 75, when, after the parties agreed that the insurer would pay an undisputed amount due under the insurance policy without adversely affecting the claimant's right to seek payment of the disputed amount, the insurer remitted a check inadvertently stamped with an endorsement providing that check represented full payment and satisfaction of any claim against the insurer. The court considered that the stamp was inadvertently placed on the check, that the insurer remedied the mistake by issuing a new check with additional interest and without the endorsement stamp, and that the claimant's right to contest the disputed amount was not adversely affected.

The plaintiff's status can also be a defense. An assignee of an unfair or deceptive act or practice claim does not have a valid claim because causes of action under Chapter 75 are not assignable. See *Investors Title Ins. Co. v. Herzig*, 330 N.C. 681, 413 S.E.2d 268 (1992). North Carolina generally does not recognize a cause of action for third-party claimants against the insurance company of an adverse party based on unfair and deceptive trade practices, when the plaintiff is neither an insured nor in privity with the insurer. See *Koch v. Bell, Lewis & Assocs., Inc.*, 176 N.C. App. 736, 740, 627 S.E.2d 636, 639 (2006); *Prince v. Wright*, 141 N.C. App. 262, 541 S.E.2d 191 (2000).

However, if the plaintiff achieves the status of an intended third-party beneficiary arising from the contractual relationship between the adverse party and the adverse party's insurance company, the plaintiff may then bring a claim against the insurance company for the tort of bad faith and for violation of the unfair and deceptive practices statute. *Id.*; *Murray v. Nationwide Mut. Ins. Co.*, 123 N.C. App. 1, 472 S.E.2d 358 (1996), *disc. review denied*, 345 N.C. 344, 483 S.E.2d 172 (1997) (claimant who obtained judgment against an insured could seek treble damages for violation of Chapter 75 and punitive damages for the tort of bad faith for the insurer's conduct after the judgment, although plaintiff must elect between the two remedies after jury verdict in bad faith case).

The location of the damages may also be an issue. Chapter 75 does not apply to foreign injuries with a negligible effect on North Carolina trade or commerce. See *In' Porters, S.A. v. Hanes Printables, Inc.*, 663 F. Supp. 494 (M.D.N.C. 1987).

The good faith of the insurer is not a defense to an alleged violation of Chapter 75. See *Gray v. N. Carolina Ins. Underwriting Ass'n*, 352 N.C. 61, 68, 529 S.E.2d 676, 681 (2000); *La Notte, Inc. v. New Way Gourmet, Inc.*, 83 N.C. App. 480, 485, 350 S.E.2d 889, 892 (1986). Also, the intent of the insurer is not relevant as a defense to a Chapter 75 claim. See *Marshall v. Miller*, 302 N.C. 539, 548, 276 S.E.2d 397, 403 (1981). And an insurer's ignorance of the falsity of a representation is also not a defense. See *Forbes v. Par Ten Group*, 99 N.C. App. 587, 394 S.E.2d 643, 651 (1990).

#### ***Is there a cause of action for reverse bad faith?***

There does not appear to be any law in North Carolina on this issue.

#### **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

See also *Strategic Outsourcing, Inc. v. Cont'l Cas. Co.*, 414 F. Supp. 2d 545 (W.D.N.C. 2006), *aff'd in relevant part, rev'd on other grounds*, Nos. 07-1237, 07-1279,

2008 WL 1751789 (4th Cir. Apr. 16, 2008), where the United States District Court for the Western District of North Carolina found no unfair and deceptive trade practice in an insurer's raising the insured's "guaranteed rate" for workers compensation insurance. The court reasoned that the mere breach of contract does not rise to the level of an unfair and deceptive trade practice, and that the Fourth Circuit Court of Appeals looks for proof of deliberate deception, such as where an insurer knew its position was invalid, but nevertheless used its power to force the insured to settle for less than what was owed. The court further noted that an insurer's incorrect interpretation of a policy term does not violate the statute where its decision is "neither strained nor fanciful, regardless of whether it was correct." *Id.* at 554 (quoting *Olive v. Great Am. Ins. Co.*, 76 N.C. App. 180, 333 S.E.2d 41, 46 (1985)).

#### AUTHORS

**James W. Bryan** | Nexsen Pruet LLC | 336.373.1600 | [jbryan@nexsenpruet.com](mailto:jbryan@nexsenpruet.com)

**Jeffrey D. Keister** | McAngus Goudelock & Courie | 704.643.6303 | [jkeister@mgclaw.com](mailto:jkeister@mgclaw.com)

**Jessica C. Tyndall** | McAngus Goudelock & Courie | 919.719.8235 | [Jessica.Tyndall@mgclaw.com](mailto:Jessica.Tyndall@mgclaw.com)

# North Dakota

By Bradley M. Jones and Anthony J. Alt

## Causes of Action

### *Is there a statutory basis for an insured to bring a bad faith claim?*

This is an open question. Plaintiffs have argued that Chapter 26.1-04 of the Unfair Insurance Practices Act in the North Dakota Century Code creates a private civil right of action. But the North Dakota Supreme Court has declined to conclusively determine whether Chapter 26.1-04 does, in fact, create such a right. When confronted with this question, the Supreme Court has found under the facts presented in those cases that even if a private right of action were presumed, the plaintiffs had failed to show that the insurers had engaged in statutorily prohibited conduct. *Dvorak v. Am. Family Mut. Ins. Co.*, 508 N.W.2d 329, 333 (N.D. 1993); *Volk v. Wis. Mortg. Assur. Co.*, 474 N.W.2d 40, 45 (N.D. 1991). The North Dakota Supreme Court, however, has noted that if there were a private cause of action, it could only be established through evidence of the company's engagement in prohibited conduct "with a frequency indicating a general business practice." *Dvorak*, 508 N.W.2d at 333; *Volk*, 474 N.W.2d at 45. Thus, whether there is a statutory basis for an insured to bring a bad faith claim remains an open question. See *Dvorak*, 508 N.W.2d at 333 & n.3 (stating that "[i]t is unnecessary to decide whether, under other circumstances, Chapter 26.1-04, N.D. Cent. Code might create a private civil claim for relief"). Nevertheless, a violation of Chapter 26.1-04-01 may be used as evidence of bad faith. See *Moore v. Am. Family Mut. Ins. Co.*, 576 F.3d 781, 786-77 (8th Cir. 2009); *Ingalls v. Paul Revere Life Ins. Grp.*, 561 N.W.2d 273 (N.D. 1997)).

### *Can a third party bring a statutory action for bad faith?*

No.

### *Is there a common law cause of action for bad faith?*

Yes. "An insurer has a duty to act fairly and in good faith in dealing with its insured, including a duty of fair dealing in paying claims, providing defenses to claims, negotiating settlements, and fulfilling all other contractual obligations." *Hartman v. Estate of Miller*, 656 N.W.2d 676 (N.D. 2003). For cases involving first-party insurance, see, e.g., *Hartman, supra*; *Corwin Chrysler-Plymouth, Inc. v. Westchester Fire Ins. Co.*, 279 N.W.2d 638, 645 (N.D. 1979). For cases involving third-party insurance, see, e.g., *Smith v. Am. Family Mut. Ins. Co.*, 294 N.W.2d 751, 758 (N.D. 1980).

An insurer's duty of good faith and fair dealing is owed to the insured, not to third-party claimants. *Dvorak*, 508 N.W.2d at 331-33 (N.D. 1993); but see *Szarkowski v. Reliance Ins. Co.*, 404 N.W.2d 502, 505-06 (N.D. 1987) (concluding that there was a duty of good faith and fair dealing to a third party who was an "intended claimant" and third-party beneficiary because a performance bond expressly gave the claimant the right for relief against the surety if the principal failed to pay for labor and materials). Accordingly, a tort claimant may not bring an action directly against an insurer absent an assignment or a policy provision to the contrary. See *Kesler v. Auto-Owners Ins. Co.*, No. 3:06-cv-79, 2007 WL 4233173, at \*2-4 (D.N.D. Nov. 28, 2007); *Dvorak*, 508 N.W.2d at 332.

### *What cause of action exists for an excess carrier to bring a claim against a primary carrier?*

North Dakota has not addressed this issue.

(D.N.D. Aug. 26, 2008) (noting that both parties opposed bifurcation).

***Under what circumstances will bad faith claims be severed for trial from the underlying claim?***

When an insured asserts a personal injury action against a tortfeasor and an insurer intervenes as the uninsured motorist carrier, the court may sever the insured's asserted bad faith claim against the carrier from the personal injury claim. *See Fetch v. Quam*, 623 N.W.2d 357 (N.D. 2001)

When an insured amends its claims against its insurer to add bad faith refusal to defend and bad faith refusal to indemnify claims, the claims against the insurer may be severed. *See Hart Constr.*, 514 N.W.2d at 385.

***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

At the election of either party. *See* N.D. Cent. Code §32-03.2-11(2); *see also Maristuen v. Nat'l States Ins. Co.*, 57 F.3d 673, 675 (8th Cir. 1995) (noting that trial had been split into "two stages").

***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?***

North Dakota has not addressed this issue.

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

North Dakota courts have not specifically addressed the impact of insolvency or intervention of the state guaranty fund upon bad faith claims. Insolvency of the insurer is generally discussed at N.D. Cent. Code Ch. 26.1-06.1 (particularly relevant provisions of which are provided below).

The insolvency of the insurer may result in the appointment of the insurance commissioner

as "rehabilitator" of the insurer. N.D. Cent. Code §26.1-06.1-13. In any state court action in which the insurer is a party, the court shall stay the proceeding for 90 days after the issuance of the rehabilitation order. N.D. Cent. Code §26.1-06.1-14(1). No statute of limitations or defense of laches runs with respect to any action by or against an insurer between the filing of a petition for appointment of a rehabilitator and the order granting or denying that petition. N.D. Cent. Code §26.1-06.1-14(2). Any action against the insurer that might have been commenced when the petition was filed may be commenced for at least sixty days after the order of rehabilitation is entered or denied. The rehabilitator may, within one year or such other longer time as applicable law may permit, institute an action or proceeding on behalf of the insurer upon any cause of action against which the period of limitation fixed by applicable law has not expired at the time of the filing of the petition upon which such order is entered. *Id.*

Any guaranty association covering life or health insurance or annuities shall have standing to appear in any court proceeding concerning the rehabilitation of a life or health insurer if such association is or may become liable to act as a result of the rehabilitation. N.D. Cent. Code §26.1-06.1-14(3).

Upon issuance of an order appointing a liquidator of a domestic insurer or of an alien insurer domiciled in this state, no action at law or equity or in arbitration may be brought against the insurer or liquidator, whether in this state or elsewhere, nor may any existing actions be maintained or further presented after issuance of the order. N.D. Cent. Code §26.1-06.1-23. The courts will give full faith and credit to injunctions against the liquidator or the company or the continuation of existing actions against the liquidator or the company, when the injunctions are included in an order to liquidate an insurer issued pursuant to corresponding provisions in other states. *Id.* No statute of limitation or defense of laches runs with respect to any action against an insurer between the filing of a petition for liquidation against an insurer and the denial of the petition. Any action against the insurer that might have been commenced when the petition was filed may be

commenced for at least sixty days after the petition is denied. *Id.*

Whenever any third party asserts a cause of action against an insured of an insurer in liquidation, the third party may file a claim with the liquidator. N.D. Cent. Code §26.1-06.1-37.

## **Defenses and Counterclaims**

### ***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

If a covenant-not-to-execute-plus-assignment agreement is entered into between the insured and third-party claimant, the insured or third-party assignee must establish the reasonableness of the settlement. *D.E.M. v. Allickson*, 555 N.W.2d 596, 603 (N.D. 1996). If the insured or the third-party claimant fails to provide proof of facts supporting a reasonable demand for settlement, *i.e.*, a settlement amount supported by the facts, the insurer is not liable for bad faith refusal to pay or to settle. *See Fetch v. Quam*, 623 N.W.2d 357 (N.D. 2001). The assignee may be required to establish the reasonableness of the settlement through expert testimony regarding the likely evidence and likely outcome if the matter had been tried. *See Allickson*, 555 N.W.2d at 603.

### ***Is “advice of counsel” a recognized defense?***

North Dakota courts have not expressly addressed whether “advice of counsel” is a valid defense.

### ***What other defenses are available?***

In a first-party refusal to pay a claim, the insurer is liable for bad faith if it acts unreasonably and without “proper cause.” The insurer has proper cause to

refuse compensation to an insured, and thus acts reasonably, where the insurer has a good defense to coverage. *Fetch v. Quam*, 623 N.W.2d 357 (N.D. 2001).

Further, as a matter of law, an insurance company is not guilty of bad faith for denying a claim when the claim is “fairly debatable” as to liability. *Id.* ¶28. The insurer is likewise not liable for bad faith where it has a “reasonable basis” for denying policy benefits based upon a reasonable reading of unambiguous policy language. *Martin v. Allianz Life Ins. Co. of N. Am.*, 573 N.W.2d 823 (N.D. 1998).

Moreover, the insurer is not liable for a bad faith refusal to settle an uninsured motorist claim brought by its insured, which is fairly debatable as to liability or where the amount demanded in settlement is not supported by facts regarding damages. *Fetch v. Quam*, 623 N.W.2d 357 (N.D. 2001).

### ***Is there a cause of action for reverse bad faith?***

North Dakota has not addressed this issue.

## **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

No bad faith exists, though there may be a conflict of interest, where an insurer intervenes in an action between its insured and an uninsured motorist and presses all the defenses of the uninsured motorist. *Fetch v. Quam*, 623 N.W.2d 357 (N.D. 2001).

### **AUTHORS**

**Bradley M. Jones** | Meagher & Geer, P.L.L.P. | 612.338.0661 | [bjones@meagher.com](mailto:bjones@meagher.com)

**Anthony J. Alt** | Meagher & Geer, P.L.L.P. | 612.338.0661 | [aalt@meagher.com](mailto:aalt@meagher.com)

# Ohio

By Patrick E. Winters and Warren J. White

## **Causes of Action**

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

No. *Strack v. Westfield Cos.*, 33 Ohio App. 3d 336, 338, 515 N.E.2d 1005, 1008 (1986).

### ***Can a third party bring a statutory action for bad faith?***

No. *Strack v. Westfield Cos.*, 33 Ohio App. 3d 336, 338, 515 N.E.2d 1005, 1008 (1986).

### ***Is there a common law cause of action for bad faith?***

Yes. “[A]n insurer has the duty to act in good faith in the handling and payment of the claims of its insured. A breach of this duty will give rise to a cause of action in tort against the insurer.” *Hoskins v. Aetna Life Ins. Co.*, 6 Ohio St. 3d 272, 452 N.E.2d 1315, Syl. Pt. 1 (Ohio 1983); *see also Gerken v. State Auto Ins. Co. of Ohio*, 20 N.E.3d 1031, 1044–45 (Ohio Ct. App. 2014). In *Hart v. Republic Mut. Ins. Co.*, 152 Ohio St. 185, 87 N.E.2d 347 (Ohio 1949), the Ohio Supreme Court first faced the issue: Where a liability insurer reserves “the right to settle any claim or suit and to make such investigation or negotiation as may be deemed expedient by the company,” what duty does it owe in defending the insured? *Id.* at 187, 87 N.E.2d at 349. The court held that the insurer owes a duty of good faith with respect to the settlement of such a claim, and the insurer can be held liable in tort for its failure or refusal so as to entitle the insured to recover for the excess of the judgment over the policy limit if the insurer is guilty of fraud or bad faith. *Id.* at 188, 87 N.E.2d at 349.

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

Equitable subrogation. *Centennial Ins. Co. v. Liberty Mut. Ins. Co.*, 62 Ohio St. 2d 221, 224, 404 N.E.2d 759, 762 (Ohio 1980) (“An excess insurer is subrogated to the insured’s rights against a primary insurer and may maintain an action for breach of the primary carrier’s good faith duty to settle and defend. To prevail in such a suit the excess insurer must... demonstrate the primary insurer’s failure to exercise good faith in line with our case law dealing with the subject.”); *see also Sanderson v. Ohio Edison Co.*, 69 Ohio St. 3d 582, 587, 635 N.E.2d 19, 24 (Ohio 1994) (“[A] primary insurer violates its duty to defend at its own peril... its breach of that duty will make it liable for anything the secondary insurer had to pay in a good-faith settlement of the claim as a result of the primary insurer’s breach of duty...” (citing *Aetna Cas. & Sur. Co. v. Buckeye Union Cas. Co.*, 157 Ohio St. 385, 392, 105 N.E.2d 568, 571 (Ohio 1952))).

### ***What causes of action for extracontractual liability have been recognized outside the claim handling context?***

Misrepresentation. *See Cornett v. State Farm Mut. Ins. Co.*, No. 19103, 2002 WL 1483219, \*1 (Ohio Ct. App. July 12, 2002) (reversing and remanding for further proceedings on fraud claim because insured may have relied on insurer’s agent’s alleged misrepresentations regarding stacking of uninsured/underinsured motorist coverages); *Dietz-Britton v. Smythe, Cramer Co.*, 139 Ohio App. 3d 337, 347, 743 N.E.2d 960, 968 (Ohio Ct. App. 2000) (“An insurer should not be able to avoid liability under all circumstances in which it voluntarily relinquishes a known right or induces another into changing his position

against insurers. *Id.* “[T]he fullness or the emptiness of an insured’s purse would be an irrelevant and poor measure of liability and performance of duty by the insurer under his contract.” *Id.* (quoting *Wolfberg v. Prudence Mut. Cas. Co.*, 98 Ill. App. 2d 190 (1968)). The fact that the insured is insolvent does not preclude a bad faith claim against the insurer. *Logan v. Allstate Ins. Co.*, 169 Ohio App. 3d 754, 760, 865 N.E.2d 57, 62 (2006) (citing *Carter v. Pioneer Mut. Cas. Co.*, 67 Ohio St. 2d 146, 149, 423 N.E.2d 188 (Ohio 1981)).

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

The Ohio Insurance Guaranty Association Act (“OIGA”) provides a mechanism for the payment of covered claims under certain insurance policies to claimants or policyholders because of the insolvency of an insurer. *PIE Mut. Ins. Co. v. Ohio Ins. Guar. Ass’n*, No. 91AP-184, 1991 WL 224210 (Ohio Ct. App. Oct. 3, 1991) *aff’d*, 66 Ohio St. 3d 209, 212–13, 611 N.E.2d 313, 315–16 (Ohio 1993). “Upon a determination that an insolvent insurer exists, OIGA assumes that insurer’s obligations to insureds or third-party claimants while being empowered with all of the insurer’s rights in that regard.” *Id.*, 611 N.E.2d at 315. However, OIGA is obligated to refuse payment where other applicable sources of insurance coverage exist. *Id.*, 611 N.E.2d at 317. Statutorily, OIGA steps in as a source of insurance coverage *only* when all other possible sources of insurance recovery are exhausted. *Id.* *PIE Mutual* also recognizes that “it can be argued that OIGA is statutorily immune from lawsuits,” such as the lawsuit for bad faith in that action. *Id.*, 611 N.E.2d at 318. “While the insured or third-party claimant is entitled to judicial relief necessary to force OIGA to perform its statutory duties, no action seeking damages can be maintained against the association. *Id.*

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

“Generally, an insurer in a supplemental proceeding

under R.C. 3929.06 has available to it any defense arising from the insured’s failure, in the underlying action, to satisfy conditions in the insurance policy which are a prerequisite to indemnification.” *Sanderson v. Ohio Edison Co.*, 69 Ohio St. 3d 582, 635 N.E.2d 19 (Ohio 1994).

***Is “advice of counsel” a recognized defense?***

In a discussion about exceptions to the attorney–client privilege, the dissent in *Boone v. Vanliner Ins. Co.*, 91 Ohio St. 3d 209, 219, 744 N.E.2d 154, 162 (Ohio 2001), suggested that an advice of counsel defense for insurers would exist in Ohio. See *C.B. Fleet Co. v. Colony Specialty Ins. Co.*, No. 1:11-CV-0375, 2012 WL 9514721, at \*4 (N.D. Ohio Dec. 21, 2012) (discussing party’s invocation of advice of counsel defense). The dissent in *Boone* stated: “Courts have also recognized that an insurer in a bad-faith case may impliedly waive the [attorney–client] privilege altogether by raising an advice-of-counsel defense, thereby placing its attorney–client communications directly at issue. *Boone*, 91 Ohio St. 3d at 219, 744 N.E.2d at 162 (Cook, J., dissenting) (citing *Palmer by Diacon v. Farmers Ins. Exch.*, 261 Mont. 91, 110, 861 P.2d 895, 907 (Mont. 1993) and *Transamerica Title Ins. Co. v. Superior Court*, 188 Cal. App. 3d 1047, 1053, 233 Cal. Rptr. 825, 829 (1987)).

***What other defenses are available?***

There is no bad faith where the insurer’s refusal to provide a defense was “predicated upon circumstances that furnish reasonable justification therefor.” *Schuetz v. State Farm Fire & Cas. Co.*, 147 Ohio Misc. 2d 22, 48, 890 N.E.2d 374, 395 (Ohio Ct. Com. Pl. 2007) (quoting *Zoppo v. Homestead Ins. Co.*, 71 Ohio St. 3d 552, 644 N.E.2d 397 (Ohio 1994)).

An insurer may be able to use as a defense the fact that the insured violated policy conditions. “[W]here the provisions of an insurance policy are clear and unambiguous Courts may not indulge themselves in enlarging the contract by implication in order to embrace an object distinct from that contemplated by the parties....” *Marginian v. Allstate Ins. Co.*, 18 Ohio St. 3d 345, 347, 481 N.E.2d 600, 602 (Ohio 1985).

***Is there a cause of action for reverse bad faith?***

There is no “reverse bad faith” cause of action, whereby an insurer could assert a cause of action against an insured after the insured willfully submits a fraudulent claim and then sues the insurer in tort for insurer’s bad faith in refusing to pay fraudulent claim. *Tokles & Son, Inc. v. Midwestern Indem. Co.*, 65 Ohio St. 3d 621, 605 N.E.2d 936, 937 (Ohio 1992).

**Other Significant Cases Involving Bad Faith and Extracontractual Claims**

[I]n an action alleging bad faith denial of insurance coverage, the insured is entitled to discover claims file materials containing attorney–client communications related to the issue of coverage that were created prior to the denial of coverage.” *Boone v. Vanliner Ins. Co.*, 91 Ohio St. 3d 209, 211–12, 744 N.E.2d 154, 156 (Ohio 2001).

In response to *Boone*, the Ohio General Assembly modified the statute governing privileged commu-

nications, Ohio Rev. Code Ann. §2317.02. Specifically, the Ohio legislature amended that statute to require that if the client is an insurance company, an attorney may be compelled to testify regarding allegedly privileged communication, *subject to an in camera inspection by a court*. This modification was recognized in *Galion Comm. Hosp. v. Hartford Life & Accident Ins. Co.*, No. 1:08 CV 1635, 2010 WL 359126 (N.D. Ohio Jan. 29, 2010).

Finally, the Ohio Court of Appeals has since clarified that the ruling in *Boone* does not permit the discovery of an attorney’s work product or materials outside of the claims file. *Goodrich Corp. v. Commercial Union Ins. Co.*, Nos. 23585, 23586, 2008 WL 2581579 (Ohio Ct. App. June 30, 2008).

AUTHORS

**Patrick E. Winters** | Plunkett Cooney, P.C. | 248.901.4000 | pwinters@plunkettcooney.com

**Warren J. White** | Plunkett Cooney, P.C. | 248.901.4000 | wwwhite@plunkettcooney.com

# Oklahoma

By Amy Steele Neathery

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

No.

### ***Is there a common law cause of action for bad faith?***

Yes. The basis of a bad faith claim has been established by case law. *Christian v. Am. Home Assur. Co.*, 1977 OK 141, 577 P.2d 899.

### ***Can a third party bring an action for bad faith?***

The general rule in Oklahoma is that third parties who are strangers to the insurance contract lack standing to sue for bad faith. *Allstate Ins. Co. v. Amick*, 1984 OK 15, 680 P.2d 362. However, in *Townsend v. State Farm Mutual Automobile Insurance Co.*, 1993 OK 119, 860 P.2d 236, the Oklahoma Supreme Court held that Class 2 insureds (permissive users and occupants of the insured vehicle) have both a statutory and contractual relationship with the insurer, therefore, they have standing to maintain a bad faith claim. The general rule that third parties lack standing to bring bad faith claims was re-affirmed in *Ellis v. Liberty Mutual Insurance Co.*, 2009 OK CIV APP 29, 208 P.3d 934 (finding that *Townsend* “did not extend privity to someone who was not connected to the insured either by contract or statute”).

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

A primary carrier has a duty to use utmost good faith with respect to the insured and such a duty is not lessened by the existence of excess insurance.

That duty is extended to include the excess carrier within the shelter of the obligation. However, this does not provide the excess carrier with a right to contribution for defense costs although both policies may contain a defense agreement. *U.S. Fid. & Guar. Co. v. Tri-State Ins. Co.*, 285 F.2d 579 (10th Cir. 1960).

### ***What causes of action for extracontractual liability have been recognized outside the claim handling context?***

The Unfair Claims Settlement Practices Act, Oklahoma Statute Title 36 §1250.1 has been determined not to create a private cause of action. *Walker v. Chouteau Lime Co. & Shelter Ins. Co.*, 1993 OK 35, 849 P.2d 1085. Oklahoma has not specifically recognized a cause of action premised on so-called “systemic” bad faith, but the Tenth Circuit found that evidence of an insurer’s “pervasive, consistent, pattern of abusive rescissions” was relevant to a bad faith claim. *Vining v. Enter. Fin. Grp., Inc.*, 148 F.3d 1206 (10th Cir. 1998).

## Damages

### ***Are punitive damages available?***

Yes. At least a nominal compensatory award is necessary in order for punitive damages to follow. *Willis v. Midland Risk Ins. Co.*, 42 F.3d 607 (10th Cir. 1994); *Norman’s Heritage Real Estate Co. v. Aetna Cas. & Ins. Co.*, 727 F.2d 911 (10th Cir. 1984). A showing of “oppression, fraud or malice” is necessary to establish punitive damages. Oklahoma Statutes Title 23 §9(A). “When there is no evidence to show that the actions were tainted by oppression, fraud, malice or gross negligence, there is no basis for the submission of the punitive damage issue to the jury.” *Hall v. Globe Life & Accident Ins. Co.*, 1999 OK 89, 998 P.2d 603.

**On what issues is expert evidence required to establish bad faith?**

Expert testimony is not required, but it is permissible within the discretion of the court on the ultimate issue of whether or not the insurer breached the duty of good faith. *Vining v. Enter. Fin. Grp., Inc.*, 148 F.3d 1206 (10th Cir. 1998); *Hall v. Globe Life & Accident Ins. Co.*, 1998 OK CIV APP 161, 968 P.2d 1263. However, most trial judges recognize that policy holders do not have the requisite knowledge to testify as to claim handling practices and will require expert testimony on those subjects.

**On what issues is expert evidence precluded?**

Admissibility of expert evidence is within the sound discretion of the trial court. In *Thompson v. State Farm Fire & Casualty Co.*, 34 F.3d 932 (10th Cir. 1994), the Tenth Circuit affirmed the trial judge's exclusion of expert testimony as to whether the insurer had breached its duty of good faith.

**Is a bad faith claim viable if a coverage decision has been determined to be correct?**

Yes; there can be a cause of action for bad faith, even if there is no breach of contract. *Vining v. Enter. Fin. Grp., Inc.*, 148 F.3d 1206 (10th Cir. 1998). Examples include improper settlement tactics or delays in issuing payment.

**Is a third-party bad faith claim viable if the plaintiff does not prevail in the underlying claim?**

The issue has not been specifically addressed. However, if there has been a breach by the insurance company, it will likely be held liable for all consequential damages regardless of whether the plaintiff prevailed on the underlying claim. Liability would include the insured's defense costs. See *First Bank of Turley v. Fid. & Deposit Ins. Co. of Md.*, 1996 OK 105, 928 P.2d 298.

**Practice and Procedure**

**Statute of limitations**

A cause of action for bad faith is an action in tort,

and a two year tort statute of limitations applies. *Lewis v. Farmers Ins. Co.*, 1983 OK 100, 681 P.2d 67.

**Under what circumstances will bad faith claims be dismissed or stayed pending the resolution of the underlying claims?**

The issue has not been addressed by state courts in Oklahoma.

**Under what circumstances will bad faith claims be severed for trial from the underlying claim?**

In state court, bifurcation is generally not permitted. *Newport v. USAA*, 2000 OK 59, 11 P.3d 190; *Buzzard v. McDanel*, 1987 OK 28, 736 P.2d 157. In federal court, bifurcation is permissible. *Oulds v. Principal Mut. Life Ins. Co.*, 6 F.3d 1431 (10th Cir. 1993) but rarely utilized.

**Under what circumstances will the compensatory and punitive damages claims be bifurcated?**

Under Oklahoma Statute, the punitive damage portion occurs in a second stage post liability verdict. Oklahoma Statute Title 23 §9.1.

**Defenses and Counterclaims**

**Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?**

Generally, the insured's conduct is not admissible. *First Bank of Turley v. Fid. & Deposit Ins. Co. of Md.*, 1996 OK 105, 928 P.2d 298. However, in *Steadfast v. Agricultural*, 2013 OK 63, 304 P.3d 474, the court stated that the insured has an implied duty to deal fairly and in good faith with the insurer and implied that the insured failure to do so could be admissible.

**Is "advice of counsel" a recognized defense?**

Yes, but it requires waiver of the attorney-client privilege. In *Barnes v. Oklahoma Farm Bureau Mutual Insurance Co.*, 2005 OK 55, 11 P.3d 162, the insurer relied upon advice of counsel. The court did not directly determine that advice of counsel was a

viable defense in an appropriate circumstance, but in this case concluded that the advice of counsel was patently unreasonable. The advice was contrary to the court's prior interpretation of the policy language involved and contrary to its plain, unambiguous language. Accordingly, the insurance company could not shield itself from an unreasonable interpretation of the language by relying upon advice of counsel.

#### **What other defenses are available?**

A legitimate dispute is a complete shield to a bad faith claim. *Oulds v. Principal Mut. Life Ins. Co.*, 6 F.3d 1431 (10th Cir. 1993); *Manis v Hartford Fire Ins. Co.*, 1984 OK 25, 681 P.2d 760.

#### **Is there a cause of action for reverse bad faith?**

Oklahoma has rejected a reverse bad faith claim. *First Bank of Turley v. Fid. & Deposit Ins. Co. of Md.*, 1996 OK 105, 928 P.2d 298.

#### **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

The Oklahoma Supreme Court has made it clear that when an insurer is determining whether to defend its insured, it cannot rely simply upon the allegations of the petition. "The insured's defense duty is determined on the basis of information gleaned from the petition (and other pleadings), from the insured and from other sources available to the insurer." *First Bank of Turley v. Fid. & Deposit Ins. Co. of Md.*, 1996 OK 105, 928 P.2d 298.

In a first-party claim, the duty of good faith and fair dealing precludes an insurer from offering less than its own evaluation of the claim. In *Newport v. USAA*, 2000 OK 59, 11 P.3d 190, the insurer evaluated a UM claim as being worth between \$750,000.00 and \$900,000.00. Its offers went from \$500,000.00 to \$600,000.00 and finally to \$700,000.00. These offers below the insurance company's own evaluation of the claim were held to be evidence of bad faith.

In *Buzzard v. Farmers Insurance Co.*, 1991 OK 127, 824 P.2d 1105, an accident reconstructionist testified to establish causation and justify the adjuster's actions only after a bad faith claim had been filed.

His testimony was held to be properly excluded. "The action of the company must be assessed in light of all facts known or knowable concerning the claim at the time the plaintiff requested the company to perform its contractual obligation." *Alsobrook v. Nat'l Travelers Life Ins. Co.*, 1992 OK CIV APP 168, 852 P.2d 768.

In *Wathor v. Mutual Assurance Administrators, Inc.*, 2004 OK 2, ¶12, 87 P.3d 559, 563-64, the Oklahoma Supreme Court recognized that third-party claims administrators could owe a duty of good faith to an insured if the administrator "performs many of the tasks of an insurance company, has a compensation package that is contingent on the approval or denial of claims, and bears some of the financial risk of loss for the claims."

The Oklahoma Supreme Court issued an extraordinary ruling that an insurer was liable for bad faith even though the insurer did not withhold payment of benefits and paid such benefits to the third-party plaintiff. *Badillo v. Mid Century Ins. Co.*, 2005 OK 48, 121 P.3d 1080. The court also ruled that the standard for an insurer's culpability for bad faith "is more than simple negligence but less than the reckless conduct necessary to sanction a punitive damage award against an insurer."

Oklahoma recognizes a cause of action for workers compensation bad faith when a workers' compensation insurer fails to authorize court-ordered medical treatment or pay court-ordered monetary benefits. *Sizemore v. Cont'l Cas. Co.*, 2006 OK 36, 142 P.3d 47. Prior to proceeding with a district court bad faith action, the injured worker must obtain a certification order from the Workers' Compensation Court. *Summers v. Zurich Am. Ins. Co.*, 2009 OK 33, 213 P.3d 565.

Independent adjusters cannot be liable for a bad faith; the remedy lies solely with the insurer. *Trinity Baptist Church v. Bhd. Mut. Ins. Co.*, 2014 OK 106, 341 P.3d 75.

#### **AUTHOR**

**Amy Steele Neathery** | Pierce Couch Hendrickson Baysinger & Green | 405.235.1611 | aneathery@piercecouch.com

# Oregon

By Paul Rosner and Marianne M. Ghim

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

No. *Employers' Fire Ins. Co. v. Love It Ice Cream Co.*, 64 Or. App. 784, 670 P.2d 160, 164 (1983); *Richardson v. Guardian Life Ins. Co. of America*, 161 Or. App. 615, 984 P.2d 917, 923, review denied, 329 Or. 553, 994 P.2d 129 (1999). The unfair practices statute is codified at Or. Rev. Stat. §746.230.

### ***Can a third party bring a statutory action for bad faith?***

No. *Richardson v. Guardian Life Ins. Co. of America*, 161 Or. App. 615, 984 P.2d 917, 923, review denied, 329 Or. 553, 994 P.2d 129 (1999). However, in *Portland School Dist. v. Great American Ins. Co.*, 241 Or. App. 161, 249 P.3d 148 (2011), the Oregon Court of Appeals held a pre-suit settlement that incorporated an assignment and covenant not to execute was valid. *But see Brownstone Homes Condo. Ass'n v. Brownstone Forest Heights, L.L.C.*, 255 Or. App. 390, 298 P.3d 1228 (2013) review allowed, 353 Or. 867, 306 P.3d 639 (2013) (holding an unqualified covenant not to execute on a stipulated judgment against an insured extinguished the plaintiff's claims against the insurer).

### ***Is there a common law cause of action for bad faith?***

No. In the first-party context, the Oregon Court of Appeals has taken the position that "an insurer's bad faith refusal to pay policy benefits to its insured sounds in contract and is not an actionable tort in Oregon." *Employers' Fire Ins. Co. v. Love It Ice Cream Co.*, 64 Or. App. 784, 791, 670 P.2d 160, 165 (1983) (fire insurance); see also *Zenor v. Standard Ins. Co.*, No. Civ. 01-1226-FR, 2002 WL 31466503, 2002 U.S. Dist. Lexis 6578, at \*4 (D. Or. Apr. 3, 2002) (disability insurance).

In the third-party context, the Oregon Supreme Court has declined to use the terms "good faith" or "bad faith," but instead has described the liability insurer's duty objectively, as one of "due care." *Maine Bonding v. Centennial Ins. Co.*, 298 Or. 514, 517, 693 P.2d 1296, 1298-1299 (1985) (right of insurer to control defense imposes on insurer "the duty to exercise diligence and care toward the insured").

An insured's claim for breach of that duty sounds in tort only where the insurer has undertaken the insured's defense and then failed to defend with reasonable care. Where the insurer's breach involves an improper failure to defend, the insured is limited to an action for breach of contract, whether the breach of the contract is "negligent, intentional, or otherwise." *Georgetown Realty, Inc. v. Home Ins. Co.*, 313 Or. 97, 106, 831 P.2d 7, 12 (1992); *Northwest Pump & Equip. Co. v. American States Ins. Co.*, 144 Or. App. 222, 925 P.2d 1241, 1245 (1996) (duty to exercise reasonable care with respect to settlement of claim arises from exercise of right to control defense); see also *Warren v. Farmers Ins. Co. of Or.*, 115 Or. App. 319, 838 P.2d 620, 623 (1992), review denied, 316 Or. 529, 854 P.2d 940 (1993). If the defense is not undertaken, the duty to exercise reasonable care does not arise; a complete failure to defend, and thereby a complete failure to settle, constitutes a breach of contract, whether the breach results in a judgment within or outside the policy limits.

The insurer's defense obligation includes the duty to settle the case within the policy limits if it would be reasonable to do so. *Goddard v. Farmers Ins. Co. of Or.*, 202 Or. App. 79, 120 P.3d 1260, 1264 (2005), modified on other grounds, 203 Or. App. 744, 126 P.3d 682 (2006); see also *Georgetown Realty, Inc. v. Home Ins. Co.*, 313 Or. 97, 831 P.2d 7, 8 n.1 (1992); *Northwest Pump & Equip. Co. v. American States Ins. Co.*, 144 Or. App. 222, 925 P.2d 1241, 1245 (1996)

## Practice and Procedure

### ***Statute of limitations***

Six years for bad faith actions sounding in contract. Or. Rev. Stat. §12.080(1). The six-year statute of limitations includes claims regarding the implied covenant of good faith and fair dealing. *Meunier v. Northwestern Mut. Life Ins. Co.*, 51 F. Supp. 3d 1023, 1036 (D. Or. 2014). Two years for bad faith actions sounding in tort. Or. Rev. Stat. §12.110(1).

### ***Under what circumstances will bad faith claims be dismissed or stayed pending the resolution of the underlying claims?***

An insurer that has a duty to defend based upon the allegations in the underlying complaint cannot develop facts in a separate declaratory judgment action—filed before the underlying action against its insured has been decided—to establish that it had no duty to indemnify, and consequently no duty to defend. An insurer also cannot use a declaratory judgment action to litigate, even in part, its insured's liability to the third-party claimant in the underlying action if the insured would be placed "in the conflictive position of being required to abandon [its] denial of liability" in order to obtain coverage. A court must stay a determination of, or dismiss, such claims. *North Pac. Ins. Co. v. Wilson's Distrib. Svc., Inc.*, 138 Or. App. 166, 175, 908 P.2d 827, 832 (1995), *review denied*, 323 Or. 264, 916 P.2d 312 (1996); *cf. American States Ins. Co. v. Dastar Corp.*, 318 F.3d 881, 890–91 (9th Cir. 2003) (concluding that *North Pacific* does not preclude adjudication of indemnity claims in declaratory judgment action, where claims do not relate to disputed issues in underlying action); *but see Charter Oak Fire Ins. Co. v. Interstate Mechanical, Inc.*, 958 F. Supp. 2d 1188 (D. Or. 2013) (for discussion of when court will exercise its discretion under *Brillhart v. Excess Ins. Co. of America*, 316 U.S. 491, 62 S. Ct. 1173, 86 L. Ed. 1620 (1942)).

### ***Under what circumstances will bad faith claims be severed for trial from the underlying claim?***

No reported cases. However, Or. R. Civ. P. §53B governs bifurcated trials, and is identical to Fed. R.

Civ. P. 42(b). Accordingly, federal law on this issue is probative.

### ***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

No reported cases. However, Or. R. Civ. P. §53B governs bifurcated trials, and is identical to Fed. R. Civ. P. 42(b). Accordingly, federal law on this issue is probative. *See Goddard v. Farmers Ins. Co. of Oregon*, 344 Or. 232, 179 P.3d 645 (2008) (discussion of compensatory and punitive damages awards in context of bad faith failure to settle third-party claim).

### ***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?***

As a matter of federal bankruptcy law, filing of a bankruptcy petition creates an automatic stay on any litigation involving the debtor.

### ***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

An injured claimant must first exhaust the limits of any applicable policy or policies before the claimant can assert a claim to recover damages covered by the Oregon Insurance Guaranty Association. *Carrier v. Hicks*, 316 Or. 341, 851 P.2d 581, 587 (1993).

## Defenses and Counterclaims

### ***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

An insured's comparative fault is not an available affirmative defense in a third-party bad faith case. However, an insured's breach of a liability policy's cooperation clause, which must be established by "willful" non-cooperation, is a complete bar to recovery. *Stumpf v. Continental Cas. Co.*, 102 Or. App. 302, 794 P.2d 1228, 1232–33 (1990); *Charter Oak Fire Ins. Co. v. Interstate Mechanical, Inc.*, 958 F.

Supp. 2d 1188 (D. Or. 2013) (insurer must establish three elements to demonstrate breach of policy's cooperation clause: (1) the insurer diligently sought the insured's cooperation; (2) the insured willfully failed to cooperate; and (3) the insured's failure to cooperate prejudiced the insurer).

### ***Is "advice of counsel" a recognized defense?***

The Oregon Supreme Court has recognized the "advice of counsel" defense in the context of a contract. *Rose v. Rose*, 144 Or. 683, 25 P.2d 1051 (1933). Oregon courts have not addressed the defense in the specific context of an insurance contract.

### ***What other defenses are available?***

An insurer can raise a policy exclusion as an affirmative defense to a bad faith claim. *Porter v. Utah Home Fire Ins. Co.*, 58 Or. App. 729, 659 P.2d 130, 135 (1982), *overruled on other grounds*, *Employers' Fire Ins. Co. v. Love It Ice Cream Co.*, 64 Or. App. 784, 670 P.2d 160, 164-65 (1983).

### ***Is there a cause of action for reverse bad faith?***

No reported cases.

## **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

*Santilli v. State Farm Life Ins. Co.*, 278 Or. 53, 562 P.2d 965, 969 (1977) (declining to decide whether to recognize cause of action for tortious breach of a first-party insurance policy, but commenting that considerations leading courts to recognize tortious breach of third-party liability policy "are not applicable outside the field of liability insurance"). *Braun-Salinas v. American Family Ins. Group*, No. 3:13-CV-00264-AC, 2014 WL 1333731, 2014 U.S. Dist. Lexis 45121 (D. Or. Apr. 1, 2014) (reviewing cases that discuss whether state insurance code creates duty independent of insurance policy to support a claim in tort, which concluded answer is no).

### AUTHORS

**Paul Rosner** | Soha & Lang, P.S. | 206.654.6601 | [rosner@sohalang.com](mailto:rosner@sohalang.com)

**Marianne M. Ghim** | Bullivant Houser Bailey PC | 503.499.4632 | [marianne.ghim@bullivant.com](mailto:marianne.ghim@bullivant.com)

# Pennsylvania

By Matthew M. Haar

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

Yes. Pennsylvania has a bad faith statute, which expressly authorizes a private cause of action. 42 Pa. C.S.A. §8371; *see also Amato v. Rockingham Cas. Co.*, No. 2:04CV1115, 2006 U.S. Dist. Lexis 24761 (W.D. Pa. Apr. 12, 2006); *Condio v. Erie Ins. Exch.*, 2006 Pa. Super. 92, 899 A.2d 1136.

### ***Can a third party bring a statutory bad faith claim?***

No. A third party may not bring a claim under the Pennsylvania bad faith statute absent an assignment of rights from the insured. *See, e.g., Brown v. Candelora*, 708 A.2d 104 (Pa. Super. Ct. 1998). An insured may assign a bad faith claim to a third party. *Allstate Prop. & Cas. Ins. Co. v. Wolfe*, 105 A.3d 1181 (Pa. 2014).

### ***Is there a common law cause of action for bad faith?***

For bad faith claims for the failure to pay policy benefits, no. The common law cause of action for bad faith was rejected by the Pennsylvania Supreme Court in *D'Ambrosio v. Pa. Nat'l Mut. Cas. Ins. Co.*, 494 Pa. 501, 431 A.2d 966 (1981); *Digregorio v. Keystone Health Plan East*, 2003 PA Super 509, 840 A.2d 361. There is a common law cause of action for the failure to settle liability insurance claims. *See, e.g., Cowden v. Aetna Cas & Sur. Co.*, 389 Pa. 459, 134 A.2d 223 (1957). Third parties may not bring a direct action against an insurer for bad faith under any theory. *See, e.g., Brown v. Candelora*, 708 A.2d 104 (Pa. Super. Ct. 1998).

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

Equitable subrogation. *See, e.g., U.S. Fire Ins. Co. v. Royal Ins. Co.*, 759 F.2d 306 (3d Cir. 1985) (applying Pennsylvania law). A primary carrier, however, owes no duty of good faith to the excess carrier. *Id.*

### ***What causes of action for extracontractual liability have been recognized outside the claim handling context?***

Defamation. *See, e.g., Hensley v. Nationwide Mut. Ins. Co.*, No. Civ. A. 98-660, 1999 WL 391071 (E.D. Pa. Jun. 16, 1999) (applying Pennsylvania law).

## Damages

### ***Are punitive damages available?***

Yes. The Pennsylvania bad faith statute specifically authorizes awards of punitive damages. 42 Pa. C.S.A. §8371(2).

### ***Are attorneys' fees recoverable?***

Yes. The Pennsylvania bad faith statute specifically authorizes awards of attorney's fees and costs. 42 Pa. C.S.A. §8371(3). In analyzing whether attorneys' fees should be awarded in a bad faith case, courts must consider the following factors: "(1) time and effort reasonably expended by the attorney in the litigation; (2) quality of services rendered; (3) results achieved and benefits conferred upon the class or upon the public; (4) magnitude, complexity, and uniqueness of the litigation; and (5) whether the receipt of a fee was contingent upon success." *Birth Center v. St. Paul Cos., Inc.*, 727 A.2d 1144, 1160 (Pa. Super. Ct. 1999) (quoting Pa. R. Civ. P. 1716), *aff'd*, 567 Pa. 386, 787 A.2d 376 (2001); *see also Jurinko v.*

vania courts have not applied this rule to determine whether and under what circumstances compensatory and punitive damage claims will be bifurcated.

**How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?**

Pursuant to 11 U.S.C. §362(a), a bankruptcy petition acts as an automatic stay of the commencement or continuation of judicial proceedings brought against the bankrupt party. To date, Pennsylvania courts have not applied this law in the context of a bad faith insurance claim. Although a third party may bring a direct action against an insurer for a claim under a liability insurance policy held by a bankrupt insured, see 40 P.S. §117, this does not authorize the claimant to bring a direct action under the Pennsylvania bad faith statute. See, e.g., *Federico v. Charterers Mut. Assur. Ass'n Ltd.*, 158 F. Supp. 2d 565 (E.D. Pa. 2001). A party has no right to a jury trial of a claim under the Pennsylvania bad faith statute brought in bankruptcy court. *In re Kridlow*, Nos. 97-35168DAS, 98-0833, 1999 WL 97939 (Bkrptcy. E.D. Pa. Feb. 19, 1999).

**How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?**

A claimant or insured may obtain payment from the Pennsylvania Insurance Guaranty Association for “[a]n unpaid claim... submitted by a claimant, which arises out of and is within the coverage and is subject to the applicable limits of an insurance policy,” provided that the claimant is a resident of Pennsylvania, or “the property from which the claim arises is permanently located in [Pennsylvania.]” 40 P.S. §991.1802. The Association does not provide coverage for “punitive or exemplary damages.” 40 P.S. §991.1802. A person having a claim under an insurance policy issued by a solvent insurer must exhaust his or her rights under the policy before bringing a claim with the Association. 40 P.S. §991.1817(a). All proceedings in which an insolvent insurer is a party must be stayed for 90 days from the date the

insolvency is determined. 40 P.S. §991.1819. A claim under the Pennsylvania bad faith statute cannot be asserted against the association for its handling of a claim. See, e.g., *T & N PLC v. Pennsylvania Ins. Guar. Ass'n*, 800 F. Supp. 1259 (E.D. Pa. 1992). The Pennsylvania courts have not decided the specific issue of whether a bad faith claim can be asserted against the Association for the conduct of the insolvent insurer. The Pennsylvania Supreme Court has held, however, that the Association could be required to pay statutorily imposed extracontractual damages, provided that the damages arose under a validly asserted claim. *Matusz v. Safeguard Mut. Ins. Co.*, 340 Pa. Super. 116, 489 A.2d 868 (1985).

**Defenses and Counterclaims**

**Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?**

Yes. See, e.g., *Northwestern Mut. Life Ins. Co. v. Babayan*, 430 F.3d 121 (3d Cir. 2005) (applying Pennsylvania law); *Jung v. Nationwide Mut. Fire Ins. Co.*, 949 F. Supp. 353 (E.D. Pa. 1997).

**Is “advice of counsel” a recognized defense?**

Yes. See, e.g., *Mueller v. Nationwide Mut. Ins. Co.*, 31 Pa. D. & C. 4th 23, 32–33 (Comm. Pl. Ct. 1996).

**What other defenses are available?**

None specifically recognized by Pennsylvania courts.

**Is there a cause of action for reverse bad faith?**

A cause of action for reverse bad faith was pled in *Legion Ins. Co. v. Doeff*, No. 3174, 2001 WL 1807398 (Pa. Ct. Com. Pl. June 6, 2001). The court did not analyze the cause of action in its decision. The bad faith conduct of a policyholder was successfully pled as a defense in *Jung v. Nationwide Mut. Fire Ins. Co.*, 949 F. Supp. 353 (E.D. Pa. 1997).

**Other Significant Cases Involving Bad Faith and Extracontractual Claims**

In *Mishoe v. Erie Ins. Co.*, 824 A.2d 1153 (Pa. 2003), the Pennsylvania Supreme Court held that claimants had no right to a jury trial on statutory bad faith claims brought in Pennsylvania state court.

AUTHOR

**Matthew M. Haar** | Saul Ewing LLP | 717.257.7508 | mhaar@saul.com

# Puerto Rico

By Kathy J. Maus

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

No. "Though many jurisdictions have adopted statutes providing a cause of action against insurance companies for bad faith, Puerto Rico has no such law." *Irizarry v. Ennia, N.V.*, 678 F. Supp. 957, 960 (D.P.R. 1988). "A person so aggrieved must proceed under the general provisions in the Civil Code concerning contract and tort law." *Id.*; see *Oriental Fin. Group, Inc. v. Fed. Ins. Co.*, 598 F. Supp. 2d 199 (D.P.R. 2008).

### ***Can a third party bring a statutory action for bad faith?***

No. Puerto Rico does not have a bad faith statute.

### ***Is there a common law cause of action for bad faith?***

Puerto Rico courts have not yet decided whether an explicit bad faith cause of action exists under Puerto Rico law. *U.S. v. United Sur. & Indem. Co.*, No. Civ. 04-1135(HL), 2005 WL 1308919 (D.P.R. June 1, 2005); *Event Producers, Inc. v. Tyser & Co.*, 854 F. Supp. 35, 39 (D.P.R. 1993), *aff'd*, 37 F.3d 1484 (1st Cir. 1994) (where the court dismissed plaintiff's bad faith claim, noting that "defendants' behavior was appropriate and reasonable under the circumstances, and not at all reckless"). However, federal courts sitting in diversity have determined Puerto Rico courts would recognize such an action. *Id.*; see also *Feliciano v. United Servs. Auto. Ass'n*, 646 F.2d 695 (1st Cir. 1981) (where court found in favor of defendant insurer; plaintiff tort victims in automobile accident failed to show that defendant insurer had acted unreasonably, in bad faith, and contrary to way prudent insurer would have acted under similar circumstances); *Noble v. Corporacion Insular De Seguros*,

738 F.2d 51, 53 (1st Cir. 1984) (court acknowledged availability of separate action for wrongful refusal to pay claim in first-party context).

As mentioned above, the U.S. District Court for the District of Puerto Rico noted that "given the trend in other states and the general tendency in Puerto Rico to protect consumers, there can be a bad faith action against an insurer. The standard would be either conscious wrongdoing, reckless indifference, or the lack of a reasonable basis for denying the claim." *Event Producers*, 854 F. Supp. at 39. Furthermore, the Supreme Court of Puerto Rico has stated that "(liability) may be imposed on the insurer if the latter unwarrantedly has refused a reasonable settlement offer to the prejudice of the insured, without it being necessary to establish with direct or circumstantial evidence that [it] acted in a dishonest or fraudulent manner." *Morales v. Automatic Vending Service, Inc.*, 103 D.P.R. 281 (1975). Citing to its decision in *Event Producers, Inc.*, the United States District Court for the District of Puerto Rico recently noted that an insurer's "behavior of outright withdrawing legal representation and denying coverage after more than three years—without even bothering to first secure declaratory relief in its favor—raises eyebrows." *Zurich Am. Ins. v. Lord Elec. Co. of P.R.*, 986 F. Supp. 2d 104, 108, n.3 (D.P.R. 2013). Citing to Puerto Rico law that "makes clear that an insurer 'must implement reasonable methods for the expeditious investigation of claims which may arise from the terms of a policy,'" the court warned the insurer it "would do well to keep these legal percepts in mind in going forward with this case." *Id.*

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

There does not appear to be any case law in Puerto

***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?***

No case law in Puerto Rico directly addresses the effect of a bankruptcy petition by either the insured or insurer on the prosecution or defense of bad faith and extracontractual claims.

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

Under Puerto Rican law, the Puerto Rico Miscellaneous Insurance Warranty Association is an association, made compulsory by law, composed of all insurers authorized to transact insurance in Puerto Rico, except life, disability, and health insurance. See *Silva v. Bergman*, Civ. No. 93-1370 (JAF), 1994 WL 394862 (D.P.R. July 21, 1994). Under section 40.210 of the Puerto Rico Insurance Code, 26 L.P.R.A. §4021, upon the issuance of an order naming a liquidator to an insurer, no judicial action shall be filed against the insurer or against the liquidator.” *Silva*, 1994 WL 394862, at \*4 n.2.

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Yes. See *Feliciano v. United Servs. Auto Ass'n*, 646 F.2d 695, 698 (1st Cir. 1981).

***Is “advice of counsel” a recognized defense?***

Advice of counsel does not appear to be a recognized defense in the few bad faith cases reported in Puerto Rico.

***Is there a cause of action for reverse bad faith?***

No. There does not appear to be a cause of action for reverse bad faith in Puerto Rico.

AUTHOR

**Kathy J. Maus** | Butler Weihmuller Katz Craig LLP |  
850.999.4009 | kmaus@butler.legal

# Rhode Island

By Brian P. McDonough and Peter J. Barrett, Jr.

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

Yes. R.I. Gen. Laws §9-1-33. Claims under ERISA, however, preempt the bad faith statute. *Desrosiers v. Hartford Life & Accident Ins. Co.*, 354 F. Supp. 2d 119 (D.R.I. 2005) (citing *Ky. Ass'n of Health Plans, Inc. v. Miller*, 538 U.S. 329 (2003)); *Morris v. Highmark Life Ins. Co.*, 255 F. Supp. 2d 16 (D.R.I. 2003).

### ***Can a third party bring a statutory action for bad faith?***

No. Rhode Island's bad faith statute only applies to claims by "an insured." R.I. Gen. Laws §9-1-33; *Cianci v. Nationwide Ins. Co.*, 659 A.2d 662 (R.I. 1995). The Rhode Island Supreme Court has held that Rhode Island's Unfair Claims Settlement Practices Act does not provide a right of action to third-party claimants. *Great Am. E & S Ins. Co. v. End Zone Pub & Grill of Narragansett, Inc.*, 45 A.3d 571, 574 (R.I. 2012). In addition, because there is an adversarial relationship between an insurer and third parties, there is no fiduciary duty owed by an insurer to third parties. *Canavan v. Lovett, Schefrin & Harnett*, 745 A.2d 173, 174 (R.I. 2000); *Auclair v. Nationwide Mut. Ins. Co.*, 505 A.2d 431 (R.I. 1986). Accordingly, third parties cannot sue an insurer for bad faith. *Id.*

### ***Is there a common law cause of action for bad faith?***

Yes. *Robertson Stephens, Inc. v. Chubb Corp.*, 473 F. Supp. 2d 265 (D.R.I. 2007); *Bibeault v. Hanover Ins. Co.*, 417 A.2d 313, 319 (R.I. 1980). However, because the Rhode Island General Assembly has enacted a comprehensive fire insurance statute which does not address bad faith claims, there is no *common law* claim for bad faith denial of a claim for fire insur-

ance benefits. *A. A. Pool Serv. & Supply, Inc. v. Aetna Cas. & Sur. Co.*, 395 A.2d 724, 726 (R.I. 1978). Fire insurers nevertheless still may be liable for bad faith under R.I. Gen. Laws §9-1-33.

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

Rhode Island courts have not addressed this issue. However, the Rhode Island Supreme Court has recognized the doctrine of equitable subrogation, *Lombardi v. Merchants Mutual Insurance Co.*, 429 A.2d 1290, 1291 (R.I. 1981), which some jurisdictions recognize is a basis for an excess carrier's bad faith claim against a primary carrier. *See generally Excess Carrier's Right to Maintain Action Against Primary Liability Insurer for Wrongful Failure to Settle a Claim Against Insured*, 10 A.L.R. 4th 879 (1981). This concept may be limited in Rhode Island, however, based on the Rhode Island Supreme Court's reluctance to permit assignments or transfers of bad faith claims from the insured to other individuals or entities. *See Imperial Cas. & Indem. Co. v. Bellini*, 947 A.2d 886, 893 (R.I. 2008).

### ***What causes of action for extracontractual liability have been recognized outside the claim handling context?***

Although no specific causes of action have been recognized by the Rhode Island courts, the bad faith statute applies to allegations that an insurer "otherwise wrongfully and in bad faith refused to timely perform its obligations under the contract of insurance." R.I. Gen. Laws §9-1-33.

If an insurer rejects a third party's reasonable written offer to settle a claim against an insured for an amount equal to, or less than policy limits,

***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

Although the bad faith and coverage claims will be tried separately, the Court may elect to order bifurcation over severance, “particularly if the plaintiff wishes to forego discovery.” *Weeks v. Progressive Ins. Co.*, No. W.C. 04-744, 2005 WL 1792115 at \*1 (R.I. Super. Ct. June 23, 2005).

***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?***

Pursuant to 11 U.S.C. §362(a), a bankruptcy petition acts as an automatic stay of the claim. The application of this rule in a bad faith context has not been specifically addressed in Rhode Island.

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

This issue is not specifically addressed in Rhode Island.

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

This issue is not specifically addressed in Rhode Island.

***Is “advice of counsel” a recognized defense?***

This issue has not been specifically addressed in Rhode Island, though the United States District Court for the District of Rhode Island has noted that an advice of counsel may be presented in defending a bad faith claim. See *Wolf v. Geico Ins. Co.*, 682 F. Supp. 2d 197, 201 (D.R.I. 2010) (“An advice-of-counsel defense may also justify discovery of attorney–client privileged material.”) (citing 2 Michael F. Aylward, *New Appleman Insurance Law Practice Guide* §19.18 (2009)).

***What other defenses are available?***

Rhode Island courts have not recognized any specific defenses to a bad faith action, although the courts have recognized that “all facts and circumstances available to the insurer at the time it denied coverage under the policy” can be considered. *Skaling v. Aetna Ins. Co.*, 799 A.2d 997, 1015 (R.I. 2002).

***Is there a cause of action for reverse bad faith?***

This issue is not specifically addressed in Rhode Island.

**AUTHORS**

**Brian P. McDonough** | Zelle McDonough & Cohen LLP | 617.742.6520 | bmcDonough@zelmcd.com

**Peter J. Barrett, Jr.** | Stevenson McKenna & Callanan LLP | 781.740.1115 | pbarrett@smcattorneys.com

# South Carolina

By Nicholas A. Farr

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

No. South Carolina has no statute providing an independent cause of action for bad faith. South Carolina has enacted an Insurance Trade Practices, codified at S.C. Code Ann. §§38-57-10 to 38-57-320, and a Claims Practices Act, codified at S.C. Code Ann. §§38-59-10 to 38-59-50. These statutes specifically enumerate a variety of prohibited activities, S.C. Code Ann. §§38-57-40 to 38-57-180, and set forth specific types of claims practices that are improper, S.C. Code Ann. §38-59-20. However, the South Carolina Supreme Court has expressly held that these Acts do not create a private cause of action. *Masterclean, Inc. v. Star Ins. Co.*, 347 S.C. 405, 556 S.E.2d 371 (S.C. 2001).

As discussed in the Damages section below, S.C. Code Ann. §38-59-40 provides an insured with a cause of action *ex contractu* for attorneys' fees where an unreasonable or bad faith breach of contract has occurred, but it specifically provides that nothing therein should be construed to alter or affect any common law bad faith remedies. S.C. Code Ann. §38-59-40(3). This statutory right to recover attorneys' fees is dependent upon entry of judgment in favor of the insured on a breach of contract cause of action and does not support an independent cause of action. See *Powell v. Ins. Co. of N. Am.*, 285 S.C. 588, 330 S.E.2d 550 (Ct. App. 1985); *Flynn v. Nationwide Mut. Ins. Co.*, 281 S.C. 391, 315 S.E.2d 817 (Ct. App. 1984). Section 38-59-40 is an *ex contractu* remedy only; it does not apply *ex delicto*. *Hubbs v. Gov't Employees Ins. Co.*, 287 S.C. 579, 340 S.E.2d 532 (S.C. 1986); *Nichols v. State Farm Mut. Auto. Ins. Co.*, 279 S.C. 336, 306 S.E.2d 616 (S.C. 1983), superseded by statute on other grounds as stated in *Duncan v. Prov-*

*ident Mut. Life Ins. Co. of Philadelphia*, 310 S.C. 465, 427 S.E.2d 657 (S.C. 1993).

### ***Can a third party bring a statutory action for bad faith?***

No. South Carolina has not enacted legislation enabling a third party to maintain an extracontractual claim against an insurer. Likewise, South Carolina does not permit a third party to maintain a cause of action at common law for the breach of the implied covenant of good faith and fair dealing against an insurer. *Kleckley v. Northwestern Nat'l Cas. Co.*, 338 S.C. 131, 526 S.E.2d 218 (S.C. 2000).

As with a first party, no third party may maintain a claim against an insurer under the South Carolina Insurance Trade Practices Act or the South Carolina Claims Practices Act. *Masterclean, Inc. v. Star Ins. Co.*, 347 S.C. 405, 556 S.E.2d 371 (S.C. 2001); *Gaskins v. S. Farm Bureau Cas. Ins. Co.*, 343 S.C. 666, 541 S.E.2d 269 (Ct. App. 2000).

### ***Is there a common law cause of action for bad faith?***

Yes. South Carolina recognizes a common law cause of action for both breach of the duty of good faith and fair dealing implicit in every insurance contract and breach of the implied covenant of good faith and fair dealing inherent in all insurance contracts in situations in which the insurer (1) refuses to settle, in bad faith, a third-party liability claim within the policy limits, and (2) refuses to pay, in bad faith, first-party benefits due under a first-party insurance contract. *Tiger River Pine Co. v. Md. Cas. Co.*, 163 S.C. 229, 161 S.E. 491 (S.C. 1931) (bad faith refusal to pay liability claim within policy limits); *Nichols v. State Farm Mut. Auto. Ins. Co.*, 279 S.C. 336, 306 S.E.2d 616 (S.C. 1983) (bad faith refusal to pay ben-

minations, and theories of recovery. See *Auto-Owners Ins. Co. v. Rhodes*, 385 S.C. 83, 682 S.E.2d 857 (Ct. App. 2009), *aff'd in part, rev'd in part*, 405 S.C. 584, 748 S.E.2d 781 (S.C. 2013).

***Under what circumstances will bad faith claims be severed for trial from the underlying claim?***

There is some precedent in South Carolina that a plaintiff's bad faith claims against an insurer and an alleged tortfeasor do not arise out of the same transaction or occurrence and, thus, should be severed. See *Pollock v. Goodwin*, C/A No. 3:07-3983-CMC, 2008 WL 216381, at \*5 (D.S.C. Jan. 23, 2008) (holding that negligence-type claims arising out of accident do not arise from same transaction or occurrence as claims based upon alleged breach of insurance contract); *Rodriguez v. Cruz*, Civil Action No. 3:05cv1193-MPJ, Order (D.S.C. Sept. 1, 2005) (finding that plaintiff's joinder of claims against defendants was improper attempt to combine automobile wreck case with direct claim against insurer).

***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

Compensatory and punitive damages claims may be bifurcated if the defendant can demonstrate that it will be unfairly prejudiced for the claims to be tried together. Generally, liability must be established before a plaintiff can seek punitive damages. *McGee v. Bruce Hosp. Sys.*, 344 S.C. 466, 470-71, 545 S.E.2d 286, 288 (S.C. 2001). As such, a court may order bifurcation to avoid the risk of having a jury influenced by punitive evidence to award compensatory damages when liability is in dispute.

***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?***

There is no statutory or case law in South Carolina addressing the effect of a bankruptcy petition on the prosecution or defense of a bad faith case.

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

There is no statutory or case law in South Carolina addressed the effect of the insolvency or intervention of a state guaranty fund on the prosecution or defense of a bad faith case.

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

There is no statutory or case law in South Carolina regarding the admissibility of evidence pertaining to the reasonableness of the insured's conduct.

***Is "advice of counsel" a recognized defense?***

There is no case law in South Carolina formally recognizing advice of counsel as a defense in a bad faith case. Nonetheless, it is a defense often raised. When the advice of counsel is raised as a defense, it may open the door to a potential waiver of the attorney-client privilege. See *City of Myrtle Beach v. United Nat'l Ins. Co.*, C/A No. 4:08-1183-TLW-SVH, 2010 WL 3420044 (D.S.C. Aug. 27, 2010).

***Is there a cause of action for reverse bad faith?***

South Carolina has not recognized a cause of action for reverse bad faith.

AUTHOR

Nicholas A. Farr | Gallivan, White & Boyd P.A. | 864.271.5347 | nfarr@GWBlawfirm.com

# South Dakota

By Mark J. Arndt

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

No. South Dakota's Unfair Claims practices act does not create a private cause of action. See S.D. Codified Laws §58-33-69.

### ***Can a third party bring a statutory bad faith claim?***

No.

### ***Is there a common law cause of action for bad faith?***

Yes. An insurer's violation of its duty of good faith and fair dealing is considered both a tort and a breach of contract. *Stene v. State Farm Mut. Auto. Ins. Co.*, 1998 SD 95, 583 N.W.2d 399. Bad faith lies when an insurer lacks "a reasonable basis for denial of policy benefits [or failure to comply with a duty under the insurance contract] and the knowledge or reckless disregard [of the lack] of a reasonable basis for denial..." *Dakota, Minn. & E.R.R. Corp. v. Acuity*, 2009 SD 69, ¶17, 771 N.W.2d 623, 629.

In a first-party bad faith claim, plaintiff must prove: (1) that a claim was denied or benefits withheld without a reasonable basis; and (2) the knowledge or reckless disregard of the lack of a reasonable basis for the denial. *Arp v. AON/Combined Ins. Co.*, 300 F.3d 913, 916 (8th Cir. 2002); see also *In re Cert. of a Question of Law*, 399 N.W.2d 320, 322 (S.D. 1987); *Phen v. Progressive N. Ins. Co.*, 2003 SD 133, 672 N.W.2d 52, 59.

South Dakota also recognizes a cause of action for bad faith failure to settle in the context of third-party claims. Third-party bad faith is traditionally based on principles of negligence and arises when an

insurer wrongfully refuses to settle a case brought against its insured by a third party. *Kunkel v. United Sec. Ins. Co. of N.J.*, 84 SD 116, 121, 168 N.W.2d 723, 726 (1969) (negligence and bad faith "are often used interchangeably"); *Crabb v. Nat'l Indem. Co.*, 87 SD 222, 229-30, 205 N.W.2d 633, 637 (1973). Third-party bad faith exists when an insurer breaches its duty to give equal consideration to the interests of its insured when making a decision to settle a case. *Hein v. Acuity*, 2007 SD 40, ¶9, 731 N.W.2d 231, 235.

An insurer may be liable for bad faith where it refuses to settle and recklessly disregards the fact that it has no reasonable basis for such refusal. "Reckless disregard" may be inferred when insurer has exhibited reckless indifference to facts or to proof submitted by insured. No liability attaches for bad faith failure to settle when the claim is "fairly debatable"; however, this defense does not apply where the insured's liability and the permanent and serious nature of plaintiff's injuries are unchallenged, even if the value of the claim was subject to dispute. *Am. States Ins. Co. v. State Farm Mut. Auto. Ins. Co.*, 6 F.3d 549, 553 (8th Cir. 1993); *Kirchoff v. Am. Cas. Co. of Reading, Pa.*, 997 F.2d 401, 405 (8th Cir. 1993) (bad faith where interests of insured and insurer are not given equal consideration; valuing claim at \$300,000 but offering only \$8,000 is evidence of bad faith claims handling).

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

An excess carrier can recover attorney fees from the primary carrier on equitable principles in a declaratory judgment action. See *Church Mut. Ins. Co. v. Smith*, 509 N.W.2d 274 (S.D. 1993). Even though there is no direct contractual relationship between

certain circumstances, the issue has never been squarely presented to the court. See *Dakota, Minn. & E.R.R. Corp. v. Acuity*, 2009 SD 69, 771 N.W.2d 623. The South Dakota federal district court, however, has been asked to address the issue on three separate occasions. See *Hautala v. Progressive Direct Ins. Co.*, No. CIV. 08-5003-JLV, 2010 WL 1812555 (D.S.D. 2010); *Tripp v. W. Nat. Mut. Ins. Co.*, No. CIV. 09-4023-KES, 2010 WL 547181 (D.S.D. 2010); *Bjornestad v. Progressive N. Ins. Co.*, No. CIV. 08-4105, 2009 WL 2588286 (D.S.D. 2009). On all three occasions, the court, after considering the criteria for bifurcation set forth in Fed. R. Civ. P. 42(b), refused to bifurcate, holding that to do so would neither promote judicial economy nor avoid prejudice to the parties, as much of the evidence presented in the breach of contract claim would overlap with the evidence presented in the bad faith claim.

## **Defenses and Counterclaims**

### ***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Probably not. See *Isaac v. State Farm Mut. Auto. Ins. Co.*, 522 N.W.2d 752, 759-60 (S.D. 1994) (holding that contributory negligence is not available as a defense in bad faith action because a bad faith action is predicated on more than negligence of another); *McElgunn v. Cuna Mut. Ins. Soc.*, 700 F. Supp. 2d 1141 (D.S.D. 2010) (same). Similarly, the comparative fault statute does not apply. See *McElgunn*, 700 F. Supp. 2d 1141.

### ***Is "advice of counsel" a recognized defense?***

Yes. See *Hurley v. State Farm Mut. Auto. Ins. Co.*, No. CIV. 10-4165-KES, 2013 WL 365234 (D.S.D. 2013) (recognizing the advice of counsel defense in determining whether the attorney-client privilege has been waived with regard to certain communications).

### ***What other defenses are available?***

The insurer is not guilty of a bad faith denial of a first-party claim where the question whether a policy exclusion is void is fairly debatable. The insurer will be found liable for bad faith only where it has inten-

tionally denied (or failed to process or pay) a claim without a reasonable basis. *Phen v. Progressive N. Ins. Co.*, 2003 SD 133, 672 N.W.2d 52. Moreover, in first-party claims "being dilatory or even slow... doesn't in and of itself amount to bad faith." *Arp v. AON/ Combined Ins. Co.*, 300 F.3d 913, 916 (8th Cir. 2002).

Liability will not attach where a third-party claim is fairly debatable. However, this defense does not apply where an insured's liability and the permanent and serious nature of plaintiff's injuries are unchallenged, even if the value of the claim is subject to dispute. *Am. States Ins. Co. v. State Farm Mut. Auto. Ins. Co.*, 6 F.3d 549, 553 (8th Cir. 1993).

The South Dakota Supreme Court has implied that an insurer is not liable for bad faith where the denial is based on an issue of first impression. *Mudlin v. Hills Materials Co.*, 2007 SD 118, ¶14, 742 N.W.2d 49, 53-54.

### ***Is there a cause of action for reverse bad faith?***

No reported cases.

## **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

A third-party bad faith failure to settle claim can be assigned. *Am. States Ins. Co. v. State Farm Mut. Auto. Ins. Co.*, 6 F.3d 549 (8th Cir. 1993).

The settlement between the victim and the tortfeasor, which included a covenant not to execute in exchange for assignment of cause of action against agents, was neither intrinsically collusive nor ineffective for lack of damages. See *Kobbeman v. Oleson*, 1998 SD 20, 574 N.W.2d 633.

An insurer's post-litigation conduct is generally not admissible to prove bad faith, as the relevant inquiry is made "at the time [the insurer] made the decision to deny coverage." *Dakota, Minn. & E.R.R. Corp. v. Acuity*, 2009 SD 69, ¶¶33-43, 771 N.W.2d 623, 633-636.

The South Dakota federal district court takes a very liberal approach to discovery in first-party bad faith cases, allowing discovery of everything from information relating to every bad faith claim filed against an insurance company, to the personnel files

of the insurance company employees who worked on the claim, and the claims manuals, audit procedures, and quality assurance materials supplied by the company. See *Lillibridge v. Nautilus Ins. Co.*, No. CIV. 10-4105-KES, 2013 WL 1896825 (D.S.D. 2013); *Hurley v. State Farm Mut. Auto. Ins. Co.*, Civ. No. 10-4165-KES, 2012 WL 1600796 (D.S.D. 2012); *Lyon v. Bankers Life & Cas. Co.*, No. CIV. 09-5070-JLV,

2011 WL 124629 (D.S.D. 2011); *Brown Bear v. Cuna Mut. Grp.*, 266 F.R.D. 310 (D.S.D. 2009).

AUTHOR

**Mark J. Arndt** | May & Johnson PC | 605.336.2565 |  
marndt@mayjohnson.com

# Tennessee

By Tonya J. Austin and N. Adam Dietrich II

## Causes of Action

### *Is there a statutory basis for an insured to bring a bad faith claim?*

Yes. Tenn. Code Ann. §56-7-105 provides that an insurer's bad faith refusal to pay a loss may result in liability to the insurer of, in addition to the loss, the insured's additional expense or injury resulting from the bad faith breach. The additional liability is limited to 25 percent of the loss. Note that a formal demand for payment is a prerequisite to recovery under the statute. *PacTech Inc. v. Auto-Owners Ins. Co.*, 292 S.W.3d 1, 9 (Tenn. Ct. App. 2008).

For claims accruing prior to April 29, 2011, the Tennessee Consumer Protection Act, Tenn. Code Ann. §47-18-101, *et seq.* ("TCPA"), once served as the basis for an insured's claim against an insurer. *Riad v. Erie Ins. Exch.*, 436 S.W. 3d 256, 269-70 (Tenn. Ct. App. 2013); *accord Myint v. Allstate Ins. Co.*, 970 S.W.2d 920 (Tenn. 1998). The TCPA "protects consumers and legitimate business enterprises from those who engage in unfair or deceptive acts or practice in the conduct of any trade or commerce in part or wholly within this state." Tenn. Code Ann. §47-18-102(2). Tenn. Code Ann. §47-18-104(b)(27) is a catchall provision that prohibits "engaging in any other act or practice which is deceptive to the consumer or to any other person." *See Myint*, 970 S.W.2d at 925-26. It is well established under Tennessee law that a claim under the TCPA accrues when "the unlawful act or practice is discovered." *Riad*, 436 S.W. 3d at 269 (quoting *Fortune v. Unum Life Ins. Co.*, 360 S.W.3d 390, 402 (Tenn. Ct. App. 2010)).

However, bad faith claims under the TCPA are statutorily barred for claims accruing after April 29, 2011, in light of an amendment to Title 56 of the Tennessee Code. *Montesi v. Nationwide Mut. Ins. Co.*, 970 S.W.3d 1, 9 (Tenn. Ct. App. 2013). This amend-

ment provides, in relevant part, that Title 50 and Title 56 "shall provide the sole and exclusive statutory remedies and sanctions applicable to an insurer, person or entity licensed, permitted, or authorized to do business under this title for alleged breach of, or for alleged unfair or deceptive acts or practices in connection with, a contract of insurance." Tenn. Code Ann. §56-8-113. The amendment took effect upon becoming law, on April 29, 2011. 2011 Tenn. Pub. Acts ch. 130, §2. The TCPA has a one-year statute of limitation. Tenn. Code Ann. §47-18-110.

### *Can a third party bring a statutory action for bad faith?*

Probably not. In the absence of a policy provision or statute, a third-party incidental beneficiary cannot maintain a direct action against the insurer. *Ferguson v. Nationwide Prop. & Cas. Ins. Co.*, 218 S.W.3d 42, 56 (Tenn. Ct. App. 2006); *but see Wilson v. Arlington Auto Sales Inc.*, 743 S.W.2d 923, 930 (Tenn. Ct. App. 1987) (recognizing standing for intended third-party beneficiaries). Tenn. Code Ann. §56-7-105 does not provide the grounds for a third-party action; an insurer's liability under that statute extends only to holders of a policy or fidelity bond.

However, for claims accruing prior to April 29, 2011, a third party could potentially rely on the TCPA, which, on its face, does not require privity. As noted above, the TCPA is designed to "protect consumers and legitimate business enterprises from those who engage in unfair or deceptive acts or practices in the conduct of any trade or commerce." Tenn. Code Ann. §47-18-102(2).

by offering a prompt and fair settlement for actual harm caused; and (9) any other circumstances shown by the evidence that bear on determining the proper amount of the punitive award.

*Culbreath v. First Tenn. Bank Nat'l Ass'n*, 44 S.W.3d 518, 527-28 (Tenn. 2001).

***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense and extracontractual claims?***

An automatic stay applies when either party files a bankruptcy petition. Under 11 U.S.C. §362(a)(1), the stay applies to

the commencement or continuation... of a judicial, administrative or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case.

The stay may be lifted after permission to proceed is given by the bankruptcy court.

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

The purpose of the Tennessee Insurance Guaranty Association is

to provide for a mechanism for the payment of covered claims under certain insurance policies to avoid excessive delay in payment and to avoid financial loss to claimants or policyholders because of the insolvency of an insurer, and to provide an association to assess the cost of such protection among insurers.

Tenn. Code Ann. §56-12-102. The governing statute further provides:

[A]ll proceedings in which the association is obligated to defend by reason of this part shall be stayed for six (6) months from the date the insolvency is determined or such additional time as shall be granted either by the court in which the action is pending or by the court in

which the action is pending or by the chancery court of Davidson County, upon petition by the association for good cause shown to permit proper defense of such Causes of Action.

Tenn. Code Ann. §56-12-117(a).

***Defenses and Counterclaims***

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Yes. See *Fulton Bellows, LLC v. Fed. Ins. Co.*, 662 F. Supp. 2d 976 (E.D. Tenn. 2009); *Whaley v. Underwood*, 922 S.W.2d 110 (Tenn. Ct. App. 1995); *McKimm v. Bell*, No. 57, 1988 WL 126835, at \*6 (Tenn. Ct. App. Nov. 30, 1988) *aff'd*, 790 S.W.2d 526 (Tenn. 1990) (recognizing that reasonableness or unreasonableness of insured's conduct had some bearing on whether notice was given to insurer in timely manner).

***Is "advice of counsel" a recognized defense?***

Yes. *Perry v. U.S. Fid. & Guar. Co.*, 359 S.W.2d 1, 22 (Tenn. Ct. App. 1962). However, there is very little case law on point in the insurance context. In Tennessee, the "advice of counsel" defense can be relied upon only if the advice given was honestly and reasonably believed. See *Mitchell v. George*, 474 S.W.2d 131, 138 (Tenn. Ct. App. 1971). The defendant is also required to fully and honestly disclose all facts to its counsel in order to rely upon the defense. *Spicer v. Thompson*, No. M200203110COAR3CV, 2004 WL 1531431, at \*25 (Tenn. Ct. App. July 7, 2004).

***What other defenses are available?***

Even if an insurer makes a mistake of judgment in determining whether coverage exists for a claim, so long as it made a fair investigation of the claim and dealt fairly and honestly in arriving at its best judgment, it could not be guilty of bad faith. *Perry v. U.S. Fid. & Guar. Co.*, 49 Tenn. App. 662, 675, 359 S.W.2d 1, 7 (1962). Similarly, if an insurer "unsuccessfully asserts a defense and the defense was made in good faith," a penalty cannot be imposed pursuant to the bad faith statute. *Sisk v. Valley Forge Ins. Co.*, 640 S.W.2d 844, 852 (Tenn. Ct. App. 1982); see also *Stonebridge Life Ins. Co. v. Horne*, No. W2012-00515-COA-

R3-CV, 2012 WL 5870386, at \*11 (Tenn. Ct. App. Nov. 21, 2012) (finding that insurer's decision to interplead policy proceeds was reasonable and thus did not constitute bad faith when insurer was uncertain who was proper beneficiary of proceeds).

In order to plead a cause of action under the bad faith statute, liability under Tenn. Code Ann. §56-7-105 must be specifically alleged. *See Leverette v. Tenn. Farmers Mut. Ins. Co.*, No. M2011-00264-COA-R3CV, 2013 WL 817230, at \*17 (Tenn. Ct. App. Mar. 4, 2013). While there is conflicting precedent on the issue in Tennessee, some cases have held that it is not enough for an insured to make a simple demand for payment before initiating litigation under the bad faith statute; rather, the insured must make an explicit threat of litigation along with the demand. *See Riad v. Erie Ins. Exch.*, 436 S.W. 3d 256, 271 (Tenn. Ct. App. 2013).

Finally, any defense available for breach of contract may be used as a defense to extracontractual claims.

***Is there a cause of action for reverse bad faith?***

Yes. Under Tenn. Code Ann. §56-7-106, an insurer may bring a counterclaim against an insured when the insured brings an action in bad faith against the insurer. The penalty is limited to twenty-five percent (25%) of the loss claimed under the policy by the insured.

AUTHORS

**Tonya J. Austin** | Frost Brown Todd LLC | 615.251.5550 | [taustin@fbtlaw.com](mailto:taustin@fbtlaw.com)

**N. Adam Dietrich II** | Frost Brown Todd LLC | 615.251.5550 | [adietrich@fbtlaw.com](mailto:adietrich@fbtlaw.com)

# Texas

By W. Edward Carlton

## Causes of Action

### *Is there a statutory basis for an insured to bring a bad faith claim?*

Yes. Section 541.151 of the Texas Insurance Code authorizes a private cause of action if a person suffers actual damages caused by unfair or deceptive insurance practices under Section 541.060 or misrepresentation of an insurance policy under Section 541.061. See, e.g., *Great Am. Ins. Co. v. N. Austin MUD*, 908 S.W.2d 415, 420 (Tex. 1995) (addressing prior codification), citing *Allstate Ins. Co. v. Watson*, 876 S.W.2d 145, 147 (Tex. 1994). Additionally, Section 17.50(a) (4) of the Texas Business & Commercial Code, also known as the Deceptive Trade Practices Act (DTPA), authorizes an action where a consumer, including an insured, has relied to his detriment on a false, deceptive, unfair or misleading act or practice, and such reliance was a producing cause of damages. *Brown & Brown of Tex. v. Omni Metals, Inc.*, 317 S.W.3d 361, 387 (Tex. App.—Houston [1st Dist.] 2010, *pet. denied*), citing *Am. Home Shield, Inc. v. Kortz*, 2000 WL 1262617, at \*3 (Tex. App.—Houston [1st Dist.] 2000, *pet. dismissed*) (mem. op., not designated for publication). However, workers' compensation claimants no longer have a cause of action under Section 541.060 or a DTPA claim based upon alleged unfair or deceptive claims handling practices. *Tex. Mut. Ins. Co. v. Ruttiger*, 381 S.W.3d 430, 444–46 (Tex. 2012).

### *Can a third party bring a statutory action for bad faith?*

No. *Allstate Ins. Co. v. Watson*, 876 S.W.2d 145, 147 (Tex. 1994). Bad faith claims under chapter 541 of the Insurance Code and the DTPA are not assignable. *PPG Indus., Inc. v. JMB/Houston Ctr. Partners, Ltd.*, 146 S.W.3d 79, 92 (Tex. 2004); *Great Am. Ins. Co. v. Fed. Ins. Co.*, No. 3:04-CV-2267-H, 2006 WL 2263312, at

\*9–10 (N.D. Tex. 2006); *Launius v. Allstate Ins. Co.*, No. 3:06-CV-0579-B, 2007 WL 1135347 (N.D. Tex. 2007); cf. *Mendoza v. Am. Nat'l Ins. Co.*, 932 S.W.2d 605 (Tex. App.—San Antonio 1996, *no writ*) (claims under the Insurance Code do not survive and cannot be brought by a representative of the decedent's estate).

Although the law is not clear, based on the prohibition on assigning unliquidated personal injury claims, it is likely that an insured may not assign a common law bad faith claim. See *Lexington Ins. Co. v. S.H.R.M. Catering Servs., Inc.*, 567 F.3d 182 (5th Cir. 2009); *PPG Indus.*, 146 S.W.3d at 105–06.

### *Is there a common law cause of action for bad faith?*

Yes. With the exception of workers' compensation claims, an insurance company has a duty of good faith and fair dealing in handling its insureds' first-party claims. Initially recognized in *Arnold v. Nat'l Co. Mut. Fire Ins. Co.*, 725 S.W.2d 165, 167 (Tex. 1987). The duty is imposed because of a special relationship between the insured and the insurer, including their unequal bargaining power and the nature of insurance contracts. *Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48, 52 (Tex. 1997). An insurer will be liable for breaching the duty if the insurer knew or should have known that it was reasonably clear that the claim was covered. *Id.* at 56. The duty was extended to workers' compensation claims in *Aranda v. Insurance Co. of North America*, 748 S.W.2d 210, 212–13 (Tex. 1988). However, the *Aranda* decision was recently overruled, and the duty of good faith is no longer applicable to workers' compensation claims. *Tex. Mut. Ins. Co. v. Ruttiger*, 381 S.W.3d 430, 444 (Tex. 2012). For UM/ UIM claims, please note that the Texas Supreme Court's decision in *Brainard v. Trinity Universal Insurance Co.*, 216 S.W.3d 809, 818 (Tex. 2006), holding

***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

If a defendant timely requests it, the court is required to provide a bifurcated trial of the jury's determination of the amount of punitive damages separate from the initial trial to determine potential liability for compensatory and punitive damages and the amount of compensatory damages. Tex. Civ. Prac. & Rem. Code Ann. §41.009; *Transp. Ins. Co. v. Moriel*, 879 S.W.2d 10, 29–30 (Tex. 1994).

***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?***

The automatic stay, which arises by operation of law as soon as the petition for bankruptcy is filed and does not require judicial action, "operates as a stay, applicable to all entities, of the commencement or continuation, including the issuance or employment of process, of a judicial... action or proceeding against the debtor that was or could have been commenced before the commencement to the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title..." 11 U.S.C. §362(a) (1993). It appears that the stay would encompass the prosecution of a bad faith or extracontractual claims. These causes of action are not one of the actions excepted by the statute. 11 U.S.C. §362(b) (1993).

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

The Texas Property and Casualty Insurance Guaranty Act provides for the payment by the guaranty association of covered claims up to a statutorily mandated maximum cap in the event a member insurance company becomes insolvent. Tex. Ins. Code §462.002. A covered claim is defined as an unpaid claim of an insured or third-party liability claimant that arises out of and is within the coverage and is not in excess of the applicable limits of

an insurance policy. Tex. Ins. Code §462.201. Bad faith claims are not covered claims, and, therefore, insolvency will preclude a bad faith claim against an insolvent insurer, its insured, or the guaranty association. Tex. Ins. Code §462.210.

***Defenses and Counterclaims***

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Yes. The insurer may be able to assert that the plaintiff's own acts or omissions caused or contributed to the plaintiff's injury. The insurer can argue that if there is evidence of the plaintiff's fault, the court should submit a jury question on the issue of proportionate responsibility. *See* Tex. Civ. Prac. & Rem. Code §33.002(a), (b). Proportionate responsibility is an affirmative defense. *Estate of Barrera v. Rosamond Vill.*, 983 S.W.2d 795, 799 (Tex. App.—Houston [14th Dist.] 1998).

***Is "advice of counsel" a recognized defense?***

No. The Texas Supreme Court has not endorsed an insurer's reliance upon its counsel's legal advice as an absolute defense to a cause of action based upon breach of the duty of good faith and fair dealing. In cases involving bad faith, insurers have offered opinion letters from attorneys as support for their claim of a reasonable basis for denial of coverage. *See, e.g., St. Paul Surplus Lines Ins. Co. v. Dal Worth Tank, Inc.*, 917 S.W.2d 29, 55 (Tex. Civ. App.—Amarillo, 1995), *rev'd on other grounds*, 974 S.W.2d 51 (Tex. 1998) (acting upon advice of counsel in denying coverage does not establish good faith, but can be considered as a circumstance tending to show good faith); *see also Beacon Nat'l Ins. Co. v. Reynolds*, 799 S.W.2d 390, 397 (Tex. App.—Fort Worth 1990, *writ denied*) (insurer who did not seek advice letter until months after denying claim did not rely upon advice of counsel in good faith).

***What other defenses are available?***

Reasonable Basis. The insurer can assert it had a reasonable basis for denying or delaying coverage of the claim. *State Farm Lloyd's Ins. Co. v. Maldonado*, 935

S.W.2d 805, 819–20 (Tex. App.—San Antonio 1996), *aff'd in part and rev'd in part on other grounds*, 963 S.W.2d 38 (Tex. 1998). Evidence that merely shows a bona fide dispute about the insurer's liability on the contract does not rise to the level of bad faith. *Transp. Ins. Co. v. Moriel*, 879 S.W.2d 10 (Tex. 1994).

Regarding bad faith claims arising out of worker's compensation cases, an insurer may assert that the claimant failed to exhaust administrative remedies. *Am. Motorists Ins. Co. v. Fodge*, 63 S.W.3d 801 (Tex. 2001). Additionally, if a Texas Industrial Accident Board order includes findings in a workers' compensation case of uncertainty of the carrier's liability or uncertainty of the extent of the employee's injury, those findings may collaterally estop a claim for bad faith. *Rangel v. Hartford Accident & Indem. Co.*, 821 S.W.2d 196, 199 (Tex. App.—Dallas 1991), *writ denied* (Mar. 25, 1992).

**Fraud in the Inducement.** If the plaintiff obtained the insurance policy through fraud, the defendant has a complete defense to all causes of action arising under the policy. *Koral Indus. v. Sec.-Conn. Life Ins. Co.*, 802 S.W.2d 650, 651 (Tex. 1990).

### ***Is there a cause of action for reverse bad faith?***

No. Texas courts have not recognized the doctrine of comparative bad faith, which would allow the insurer to assert a defense that the plaintiff itself acted in bad faith. *Waite Hill Servs. v. World Class Metal Works*, 935 S.W.2d 197, 202 (Tex. App.—Fort Worth 1996), *rev'd on other grounds*, 959 S.W.2d 182 (Tex. 1998), citing *Texas Farmers Ins. Co. v. Soriano*, 844 S.W.2d 808, 815 n.5 (Tex. App.—San Antonio 1992, *rev'd on other grounds*, 881 S.W.2d 312 (Tex. 1994)); *see also Southland Lloyd's Ins. Co. v. Tomberlain*, 919 S.W.2d 822, 832 n.5 (Tex. App.—Texarkana 1996, *writ denied*).

### **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

*Westchester Fire Ins. Co. v. Am. Contractors Ins. Risk Retention Grp.*, 1 S.W.3d 872 (Tex. App.—Houston [1st Dist.] 1999) (although there is a duty to accept reasonable settlement offers, when the initial demand is above insurer's policy limits,

and, therefore, not reasonable, the Stower's duty is not triggered).

*Withrow v. State Farm Lloyds*, 990 S.W.2d 432 (Tex. App.—Texarkana 1999), *rev. denied* (Apr. 1, 1999) (a simple negligence cause of action does not exist in Texas when an insurer denies an insured coverage for personal loss under a policy).

*Henson v. S. Farm Bureau Cas. Ins. Co.*, 17 S.W.3d 652 (Tex. 2000) (holding that automobile insurers owe prejudgment interest on top of the policy benefits only if they withhold those benefits in breach of their insurance contracts).

*Mid-Century Ins. Co. v. Boyte*, 80 S.W.3d 546 (Tex. 2002). The injured party, in his second suit, claimed common-law bad faith and violations of Tex. Ins. Code Ann. art. 21.21, a subject now covered in chapter 541. The question was whether an insurer's common-law and statutory duties of good faith and fair dealing extended beyond entry of judgment in favor of its insured. The court concluded that when the trial court rendered the money judgment against the insurer, the insurer was transformed, as to that claim, from insurer to judgment creditor. Therefore, the injured party had no bad faith cause of action against his insurer for its post-judgment conduct.

*Rocor Int'l, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 77 S.W.3d 253, 260 (Tex. 2002). An insured may assert a bad faith claim against its excess liability carrier for damages that it sustains as a result of unfair claim settlement practices (at least where the excess carrier's unreasonable failure to promptly settle the case causes the insured to incur otherwise unnecessary attorneys' fees and defense costs).

*Md. Ins. Co. v. Head Indus. Coatings & Servs., Inc.*, 938 S.W.2d 27 (Tex. 1996). The Texas Supreme Court further held that a liability insurer does not owe its insured a common law duty of good faith and fair dealing to investigate and defend claims by a third-party against its insured.

*Garrison Contractors, Inc. v. Liberty Mut. Ins. Co.*, 927 S.W.2d 296 (Tex. App.—El Paso 1996), *aff'd*, 966 S.W.2d 482 (Tex. 1998). Even though an individual employee of an insurance company may owe no duty of good faith and fair dealing to an insured, he may

potentially be liable under Art. 21.21 (now chapter 541) of the Texas Insurance Code.

*Excess Underwriters at Lloyd's, London v. Frank's Casing Crew & Rental Tools, Inc.*, 246 S.W.3d 42, 48 (Tex. 2008). Excess carrier insurers sued the insured for reimbursement of a disputed coverage amount. The insured had entered into a settlement agreement in a separate lawsuit. The excess carriers paid the entire settlement amount and sought reimbursement from the insured for the contribution paid by the primary carriers. The excess carriers asserted that the insured had impliedly agreed to reimbursement when it agreed to be bound by the settlement. Hold-

ing for the insured, the court stated, "In settling the [separate] suit, both [the insured] and the excess carriers expressly sought to preserve their positions in the coverage dispute; in effect, they agreed to disagree on the reimbursement question and let the trial court decide the legal effect. This is a far cry from impliedly consenting to reimbursement."

AUTHOR

**W. Edward Carlton** | Quilling, Selander, Lownds, Winslett & Moser, P.C. | 214.880.1873 | [ecarlton@qslwm.com](mailto:ecarlton@qslwm.com)

# Utah

By Gary L. Johnson and Kallie A. Smith

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

No. See *Cannon v. Travelers Indem. Co.*, 994 P.2d 824 (Utah Ct. App. 2000) (no private right of action exists under Section 31A-26-303(5) of the Utah Unfair Claims Settlement Practices Act or under Rule 590-89-3 of the Utah Administrative Code).

No. See *Machan v. UNUM Life Ins. Co. of America*, 116 P.3d 342, 348 (Utah 2005) (“[W]e conclude the 2000 version of Utah Code section 31A-26-301 did not allow a private cause of action by an insured against an insurer.”).

### ***Can a third party bring a statutory bad faith claim?***

No. See *Cannon v. Travelers Indem. Co.*, 994 P.2d 824 (Utah Ct. App. 2000) (no private right of action exists under Section 31A-26-303(5) of the Utah Unfair Claims Settlement Practices Act or under Rule 590-89-3 of the Utah Administrative Code).

### ***Is there a common law cause of action for bad faith?***

Yes. In first-party relationships, bad faith claims arise from a breach of the “duty of good faith and fair dealing implied in all contracts.” *Beck v. Farmers Ins. Exch.*, 701 P.2d 795, 798 (Utah 1985); see also *Christiansen v. Farmers Ins. Exch.*, 2005 UT 21, ¶10, 116 P.3d 259 (first-party bad faith claim based on judicially recognized duties not found within four corners of the contract); *Canyon Country Store v. Bracey*, 781 P.2d 414, 421 (Utah 1989). However, the cause of action is in contract and not in tort. *Beck*, 701 P.2d at 800.

In a third-party relationship, bad faith claims arise from a breach of the insurer’s fiduciary respon-

sibility to the insured in the disposition and settlement of claims. *Ammerman v. Farmers Ins. Exch.*, 430 P.2d 576 (Utah 1967) (holding that bad faith cause of action sounds in tort, not contract); *Black v. Allstate Ins. Co.*, 100 P.3d 1163 (Utah 2004) (holding that, although insurer’s duty was contractual during investigation phase before any legal proceedings had been filed against insured, the duty to defend, including duty to accept reasonable settlement offers, arises at the commencement of formal legal proceedings against the insured); *Campbell v. State Farm Mut. Auto. Ins. Co.*, 840 P.2d 130, 140 (Utah Ct. App. 1992).

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

Utah courts have held that an insurer which settles a claim that should have been covered by another insurance company may recover the amount paid in settlement under the equitable doctrine of subrogation. *State Farm Mutual Auto. Ins. Co. v. Northwestern National Ins. Co.*, 912 P.2d 983, 985–87 (Utah 1996); *Davis County v. Jensen*, 83 P.3d 405 (Utah Ct. App. 2000). Applying this reasoning, the United States District Court for the District of Utah recognized a claim for equitable subrogation by an excess insurer against a primary insurer in *Rupp v. Transcontinental Ins. Co.*, 627 F. Supp. 2d 1304, 1326 (D. Utah 2008). Also, an insurer that successfully defends an insured which should have been defended by another insurance company may recover the defense costs and attorneys’ fees under the doctrine of subrogation. *National Farmers Union Property & Cas. Co. v. Farmers Ins. Group*, 377 P.2d 786, 787–88 (Utah 1963); see also *Sharon Steel Corp. v. Aetna Cas. & Surety Co.*, 931 P.2d 127 (Utah 1997).

**How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?**

The insurer may be liable for consequential damages flowing from bankruptcy of insured if it is foreseeable. *Beck v. Farmers Ins. Exch.*, 701 P.2d 795, 802 (Utah 1985).

**How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?**

Unable to locate case on point in Utah.

**Defenses and Counterclaims**

**Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?**

Yes, but introduction of such evidence can open the door to other evidence being admissible in rebuttal. *Campbell v. State Farm Mutual Auto. Ins. Co.*, 65 P.3d 1134 (Utah 2001). Evidence of whether insured performed his/her parallel duties of good faith is relevant and probative under Utah law. *Borand v. USAA Cas. Ins. Co.*, 2015 U.S. Dist. Lexis 20711 (D. Utah February 19, 2015).

**Is "advice of counsel" a recognized defense?**

In *Larsen v. Allstate Ins. Co.*, 857 P.2d 263 (Utah Ct. App. 1993), the Court held that in determining whether the insurer's position was fairly debatable and thus not in bad faith, a factor in favor of invoking the defense was whether the insurer obtained legal counsel to support its position. However, in *Lieber v. ITT Hartford Ins.*, 15 P.3d 1030 (Utah 2000), the court held that the actions of legal counsel for an insurance company could constitute the basis for additional bad faith claims against the insurer.

**What other defenses are available?**

A common defense in first-party relationship claims is the existence of a "fairly debatable" issue of fact or law, which justifies the insurer's denial of the

insured's claim. *Callioux v. Progressive Ins. Co.*, 745 P.2d 838, 842 (Utah Ct. App. 1987); *Billings v. Union Bankers Ins. Co.*, 918 P.2d 461 (Utah 1996); *Prince v. Bear River Mutual Ins. Co.*, 452 Utah Adv.Rpt. 50 (2002); *Hill v. State Farm Mut. Auto. Ins. Co.*, 829 P.2d 142 (Utah Ct. App. 1992); *Larsen v. Allstate Ins. Co.*, 857 P.2d 263 (Utah Ct. App. 1993); *American Concept Ins. Co. v. Lochhead*, 751 P.2d 271 (Utah Ct. App. 1988); *Amica Mutual Ins. Co. v. Schettler*, 768 P.2d 950, 958 (Utah Ct. App. 1989); *Deseret Federal Sav. & Loan Ass'n v. U.S. Fidelity & Guar. Co.*, 714 P.2d 1143 (Utah 1986); *Saleh v. Farmers Ins. Exchange*, 2006 UT 20, 133 P.3d 428 (Utah 2006). No Utah appellate court, however, to date has addressed the issue of whether the "fairly debatable" defense is applicable in a third-party relationship.

Other defenses generally can include that the insured failed to provide a timely proof of loss (although strict compliance is not required). *Canyon Country Store v. Bracey*, 781 P.2d 414, 418 (Utah 1989); *Zions First Nat. Bank v. Nat. Am. Title Ins.*, 749 P.2d 651, 655 (Utah 1988). Other defenses include that the insured did not cooperate or comply with policy terms. *Beck v. Farmers Ins. Exch.*, 701 P.2d 795, 801 (Utah 1985), or that that the claim is pre-empted by ERISA, *Demond v. FHP*, 849 P.2d 598 (Utah Ct. App. 1992). Cooperation with law enforcement also can be a potential defense. *Amica Mutual Ins. Co. v. Schettler*, 768 P.2d 950, 958 (Utah Ct. App. 1989), as can rescission for a misrepresentation made by the insured in the application. *Perkins v. Great-West Life Assur. Co.*, 814 P.2d 1125 (Utah App. 1991). Similarly, Utah courts often apply and enforce policy exclusions. *Alf v. State Farm Fire & Cas. Co.*, 850 P.2d 1272 (Utah 1993).

**Is there a cause of action for reverse bad faith?**

Potentially. In first-party relationships, the insured and the insurer have parallel obligations of good faith. *Beck v. Farmers Ins. Exch.*, 701 P.2d 795, 801 (Utah 1985); *Canyon Country Store v. Bracey*, 781 P.2d 414 (Utah 1989). Evidence of insured's alleged breach of its duties of good faith are relevant and probative. *Borand v. USAA Cas. Ins. Co.*, 2015 U.S. Dist. Lexis 20711.

The insurer is not entitled to an award of attorneys' fees for bad faith under existing Utah case law, although it could be under Utah statute. *Valley Constr., Inc. v. Mid-Continent Cas. Ins. Co.*, 2010 U.S. Dist. Lexis 136654, 5, 2010 WL 5395083 (D. Utah Dec. 27, 2010).

### **Other Significant Cases Involving Bad Faith and Contractual Claims**

Late payment of an excess judgment by an insurer does not in-and-of-itself protect the carrier from a bad faith claim. *Campbell v. State Farm Mut. Auto. Ins. Co.*, 840 P.2d 130, 139-40 (Utah Ct. App. 1992) ("Eventual payment of the excess judgment does not compensate the insured for emotional injury, damages to the insured's reputation and credit rating, any punitive damages awarded against the insured, or any other legally cognizable injury stemming from the insurer's failure to settle. Nor does it 'cure' the insurer's earlier wrongful conduct.").

An injured worker probably has no contractual claims for bad faith against a workers compensation insurer in Utah. *Savage v. Educators Ins. Co.*, 908 P.2d 862 (Utah 1995); *Gunderson v. May Dep't Stores Co.*, 955 P.2d 346 (Utah Ct. App. 1998).

Consequential damages are potentially available in a first-party context for breach of contract, even without evidence of bad faith, provided such consequential damages are foreseeable. *Machan v. Unum Life Ins. Co. of America*, 116 P.3d 342, 345-47 (Utah 2005).

#### AUTHORS

**Gary L. Johnson** | Richards Brandt Miller Nelson | 801.531.2000 | gary-johnson@rbmn.com

**Kallie A. Smith** | Richards Brandt Miller Nelson | 801.531.2000 | kallie-smith@rbmn.com

# Vermont

By Brian P. McDonough and Donna E. Hess

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

No. The Vermont Insurance Trade Practices statute does not create a private right of action. *Wilder v. Aetna Life & Cas. Ins. Co.*, 433 A.2d 309 (Vt. 1981).

However, the Vermont Consumer Fraud Act, Vt. Stat. Ann. tit. 9, §§2451–2480g, makes unlawful unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce. In *Greene v. Stevens Gas Serv.*, 858 A.2d 238 (Vt. 2004), the Vermont Attorney General filed an amicus curiae brief in support of the insured's argument that the 1985 amendments to the Consumer Fraud Act had broadened the act's scope such that it now applies to insurance, and *Wilder v. Aetna Life & Casualty Insurance Co.*, 433 A.2d 309 (Vt. 1981) is no longer controlling law. The Vermont Supreme Court resolved the case without deciding whether the consumer fraud law now extends to insurance. The court did note that in those states that recognize the Consumer Fraud Act's applicability to insurance transactions, a mere coverage dispute is insufficient to show consumer fraud.

### ***Can a third party bring a statutory action for bad faith?***

No. An insurer/insured relationship must exist. *Peerless Ins. Co. v. Frederick*, 869 A.2d 112 (Vt. 2004).

### ***Is there a common law cause of action for bad faith?***

Yes. *Bushey v. Allstate Ins. Co.*, 670 A.2d 807 (Vt. 1995).

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

The issue has not been decided under Vermont law.

### ***What causes of action for extracontractual liability have been recognized outside the claim handling context?***

One case imposed bad faith liability upon an insurer for the acts of retained defense counsel as its agent: "the insurer acted in bad faith when it failed to inform the insured of the existence of settlement demands, the status of negotiations and the raising of the *ad damnum* just prior to trial, and neglected to provide the insured an opportunity to participate in the decision concerning his presence at trial." *Myers v. Ambassador Ins. Co.*, 508 A.2d 689, 692 (Vt. 1986).

In *Murphy v. Patriot Insurance Co.*, 106 A.3d 911 (Vt. 2014), the Vermont Supreme Court held that an insurer does not have an independent tort duty to handle its insured's claim in a reasonable manner and, therefore, there was no basis to bring an extracontractual negligence claim against the insurer.

## Damages

### ***Are punitive damages available?***

Yes. *Phillips v. Aetna Life Ins. Co.*, 473 F. Supp. 984 (D. Vt. 1979); *Martell v. Universal Underwriters Life Ins. Co.*, 564 A.2d 584 (Vt. 1989).

### ***Are attorneys' fees recoverable?***

Yes, according to federal cases purporting to apply Vermont law. *Village of Morrisville Water & Light Dept. v. U.S. Fid. & Guar. Co.*, 775 F. Supp. 718 (D. Vt. 1991); *Burlington Drug Co. v. Royal Globe Ins. Co.*, 616 F. Supp. 481 (D. Vt. 1985). The *Burlington*

age. *Serecky v. Nat'l Grange Mut. Ins.*, 857 A.2d 775 (Vt. 2004).

***Is a third-party bad faith claim viable if the plaintiff does not prevail in the underlying claim?***

No Vermont decision directly addresses this issue.

## **Practice and Procedure**

### ***Statute of limitations***

The statute of limitations depends on the nature of claimed injuries: three years for the emotional distress part of a claim, six years for economic damages. However, a cause of action does not accrue until each element of the cause of action exists. A cause of action for breach of contract accrues when the breach occurs, and a cause of action against an insurance company for a bad faith coverage decision accrues when the company errs, unreasonably, in denying coverage. *Benson v. MVP Health Plan, Inc.*, 978 A.2d 33 (Vt. 2009).

***Under what circumstances will bad faith claims be dismissed or stayed pending the resolution of the underlying claims?***

No Vermont decision directly addresses this issue.

***Under what circumstances will bad faith claims be severed for trial from the underlying claim?***

No Vermont decision directly addresses this issue.

***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

No Vermont decision directly addresses this issue.

***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?***

No Vermont decision directly addresses this issue.

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

No Vermont decision directly addresses this issue.

## **Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

No Vermont decision directly addresses this issue.

***Is "advice of counsel" a recognized defense?***

This defense is generally recognized in Vermont, but no Vermont decision addresses this defense in the bad faith context. See *Wash. Elec. Coop., Inc. v. Mass. Mun. Wholesale Elec. Co.*, 894 F. Supp. 777 (D. Vt. 1995).

***What other defenses are available?***

All of the usual tort defenses are available.

***Is there a cause of action for reverse bad faith?***

No Vermont decision directly addresses this issue. However, the insured/insurer relationship has been held to be mutually fiduciary. *Phillips v. Aetna Life Ins. Co.*, 473 F. Supp. 984, 989 (D. Vt. 1979) ("the parties to an insurance contract owe each other mutual duties of good faith and stand in the position of fiduciaries in relation to each other"); *Carmichael v. Adirondack Bottled Gas Corp.*, 161 Vt. 200, 635 A.2d 1211, 1216 (1993) ("An underlying principle implied in every contract is that each party promises not to do anything to undermine or destroy the other's rights to receive the benefits to the agreement."). Accordingly, Vermont law could support a reverse bad faith claim.

## **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

Vermont does not recognize a separate duty on the part of independent adjusters that would subject

them to common law tort actions by insureds who have suffered economic loss as the result of allegedly mishandled claims or otherwise were negligent during the claim investigations. However, because the conduct of an adjuster acting within the scope of his or her authority as agent for the *insurer* is imputed to the insurer, the insurer is subject to liability for the adjuster's mishandling of claims in actions alleging breach of contract or bad faith. *Hamill v. Pawtucket Mut. Ins. Co.*, 892 A.2d 226 (Vt. 2005).

*City of Burlington v. Hartford Steam Boiler Inspection & Ins. Co.*, 190 F. Supp. 2d 663 (D. Vt. 2002) ("A duty to disclose also exists whenever an insurer's failure to seasonably deny coverage may deprive an insured of her ability to take action and protect

her rights.... Particularly, in the context of duty to defend policies, where insureds often lack the authority to control their defense, courts regularly find that an insurer must reply seasonably to an insured's notice of claim letter so that the insured does not lose an opportunity to conduct her own investigation, settle the claim, file her own lawsuit, or otherwise protect her interests.").

#### AUTHORS

**Brian P. McDonough** | Zelle McDonough & Cohen LLP | 617.742.6520 | bmcdonough@zelmcd.com

**Donna E. Hess** | Zelle McDonough & Cohen LLP | 617.742.6520 | dhess@zelmcd.com

# Virgin Islands

By Julius F. Parker III

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

No.

### ***Can a third party bring a statutory action for bad faith?***

No. Since there is no statutory action for bad faith, no party may bring such an action.

### ***Is there a common law cause of action for bad faith?***

Yes. See *Justin v. Guardian Ins. Co.*, 670 F. Supp. 614, 617 (D.V.I. 1987). In order to prove a prima facie case of first-party bad faith, the plaintiff must show: "(1) the existence of an insurance contract between the parties and a breach by the insurer; (2) intentional refusal to pay the claim; (3) the non-existence of any reasonably legitimate or arguable reason for the refusal (debatable reason) either in law or fact; (4) the insurer's knowledge of the absence of such a debatable reason; or (5) when the plaintiff argues that the intentional failure results from the failure of the insurer to determine the existence of an arguable basis, the plaintiff must prove the insurer's intentional failure to determine the existence of such a debatable reason." *Justin*, 670 F. Supp. at 617 (citing *Dempsey v. Auto Ins. Co.*, 717 F.2d 556, 561 (11th Cir. 1983)); see also *In re Tutu Water Wells Contamination Litig.*, 78 F. Supp. 2d 436 (D.V.I. 1999) (question of whether insurer's denial was reasonable is one of fact).

In a third-party bad faith action, where the insurer totally disregards the insured's interests in rejecting a reasonable settlement offer, the insurer has breached its good faith settlement obligations and is liable for the amount of the judgment in

excess of the policy limits. See *Buntin v. Cont'l Ins. Co.*, 525 F. Supp. 1077 (D.V.I. 1981).

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

No court in the Virgin Islands has expressly held that a primary carrier owes any duty to an excess carrier sufficient to support a cause of action for the breach thereof. However, the district court has suggested in dicta that such a cause of action does indeed exist. See *Prime Hosp. Corp. v. Gen. Star Indem. Co.*, No. CIV.1997-91, 1999 WL 293865, at \*4, n.10 (D.V.I. Apr. 29, 1999) ("If the insured purchases excess coverage, he in effect substitutes an excess insurer for himself. It follows that the excess insurer should assume the rights as well as the obligations of the insured in that position.") (quoting *Cont'l Cas. Co. v. Reserve Ins. Co.*, 238 N.W.2d 862 (Minn. 1976)).

### ***What causes of action for extracontractual liability have been recognized outside the claim handling context?***

Virgin Islands law prohibits various "Unfair Practices and Frauds" by insurers. Such prohibited practices include:

- Misrepresenting policy conditions (22 V.I. Code §1209);
- Rebating (22 V.I. Code §1214);
- Illegal inducements (22 V.I. Code §1215);
- Twisting (22 V.I. Code §1219); and
- Illegal dealing in premiums (22 V.I. Code §1220).

*Justin v. Guardian Ins. Co.*, 670 F. Supp. 614, 617 n.8 (D.V.I. 1987).

***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?***

There is no decisional authority under Virgin Islands law which explicitly holds that actual or potential bad faith rights held by a policyholder become an asset of the bankruptcy estate, subject to prosecution or assignment by the bankruptcy trustee. In the event of insolvency by the insurer, the Virgin Islands Insurance Guaranty Fund has jurisdiction to oversee the reorganization or liquidation of the insurer. See 22 V.I. Code §237.

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

Once the Virgin Islands Insurance Guaranty Association accedes to the obligations of an insolvent insurer, any possible bad faith claim abates. The Virgin Islands Guaranty Association has absolute immunity for any authorized action and no bad faith claim may be maintained against the Association for any action authorized by 22 V.I. Code 237. See *Jarvis v. Horsford*, No. CIV. 168-1997, 2001 WL 883545 (D.V.I. May 24, 2001).

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Yes. Courts may consider acts of the insured as bearing on his or her post-loss obligations or conduct in

settlement negotiations. However, Virgin Islands courts do not recognize the affirmative defenses of “reverse bad faith” or “comparative bad faith.” See *In re Tutu Water Wells Contamination Litig.*, 78 F. Supp. 2d 436 (D.V.I. 1999). Therefore, to the extent the insured’s conduct is intended to establish the insured’s bad faith, such evidence would not be admissible.

***Is “advice of counsel” a recognized defense?***

Yes. See *Martin v. Am. Bankers Life Assurance Co. of Fla.*, 184 F.R.D. 263 (D.V.I. 1998) (holding that assertion of advice of counsel in defense of a bad faith claim would waive the attorney-client privilege).

***What other defenses are available?***

The defense that the insurer’s denial of coverage was fairly debatable appears to be the only other defense available to an insurer in a bad faith action. See *Justin v. Guardian Ins. Co.*, 670 F. Supp. 614 (D.V.I. 1987). Whether that assertion constitutes an affirmative defense is itself debatable since one of the elements the plaintiff must prove in order to succeed on a bad faith claim is that the insurer’s denial was not fairly debatable. Therefore, it is really more in the nature of a proof of a negative from the plaintiff’s perspective rather than a positive defense to be asserted by the insurer.

***Is there a cause of action for reverse bad faith?***

No. Virgin Islands courts do not recognize a cause of action for reverse bad faith.

**AUTHOR**

**Julius F. “Rick” Parker III** | Butler Weihmuller Katz Craig LLP | 850.894.4111 | jparker@butler.legal

# Virginia

By Thomas S. Garrett and Robert F. Friedman

## Causes of Action

### *Is there a statutory basis for an insured to bring a bad faith claim?*

#### The Unfair Trade Practices Act

Virginia's Unfair Trade Practices Act, Va. Code Ann. §38.2-500, *et seq.*, does not create a private cause of action against insurers. *Salomon v. Transamerica Occidental Life Ins. Co.*, 801 F.2d 659, 660-61 (4th Cir. 1986); *A & E Supply Co., Inc. v. Nationwide Mut. Fire Ins. Co.*, 798 F.2d 669, 674 (4th Cir. 1986). However, one court has suggested that an insured may seek the imposition of penalties against the insurer based on, among other things, the insurer's failure to "attempt[ ] in good faith to make prompt, fair and equitable settlements of claims in which liability has become reasonably clear." *See, e.g., Ryder Truck Rental, Inc. v. UTF Carriers, Inc.*, 790 F. Supp. 637, 640 n.3 (W.D. Va. 1992); *see also* Va. Code §38.2-515 (State Corporation Commission may assess penalties against insurers for violations of Act). The Supreme Court of Virginia has also rejected the argument that an insurer's reliance on policy conditions violated Virginia public policy based on the terms of the Unfair Settlement Practices Act. *See Allstate Ins. Co. v. United Servs. Auto. Ass'n*, 249 Va. 9, 14, 452 S.E.2d 859, 862 (1995).

#### Fee Shifting Statutes

Three statutes permit the recovery of attorneys' fees based upon a showing of bad faith: Va. Code Ann. §§38.2-209, 38.2-807, 8.01-66.1.

Va. Code Ann. §38.2-209 provides that an insured may recover costs and reasonable attorney fees if the insurer's failure or refusal to provide coverage was not in good faith. Notably, §38.2-209 does not create a separate and independent cause of action for bad faith. Instead, it is only a source of additional recovery on a breach of contract claim against the insurer.

*See, e.g., Massachusetts Bay Ins. Co. v. Decker*, No. 7:11-CV-00342, 2012 WL 43614, at \*1 (W.D. Va. Jan. 9, 2012); *Tiger Fibers, LLC v. Aspen Spec. Ins. Co.*, 594 F. Supp. 2d 630 (E. D. Va. 2009); *Salomon v. Transamerica Occidental Life Ins. Co.*, 801 F.2d 659, 661 (4th Cir.); *A & E Supply Co., Inc. v. Nationwide Mut. Fire Ins. Co.*, 798 F.2d 669, 674 (4th Cir. 1986).

Section 38.2-209 applies to both first-party and third-party insurance policies. *See, e.g., Carolina Cas. Ins. Co. v. Draper & Goldberg, PLLC*, 369 F. Supp. 2d 667 (E.D. Va. 2004); *Structural Concrete Products, LLC v. Clarendon America Ins. Co.*, Civil No. 3:07CV253, 2007 WL 2437661 (E.D. Va. 2007); *CUNA Mut. Ins. Co. v. Norman*, 237 Va. 33, 38, 375 S.E.2d 724, 726-27 (1989).

Va. Code Ann. §8.01-66.1 applies to claims under motor vehicle insurance, including medical payments coverage. Section 8.01-66.1(A) applies to claims of \$3,500 or less in excess of the deductible and permits double the amount due under the policy and counsel fees and expenses if the denial was not made in good faith. *See, e.g., Nationwide Mut. Ins. Co. v. St. John*, 259 Va. 71, 524 S.E.2d 649 (2000). Section 8.01-66.1(D) applies to claims in excess of \$3,500 and permits double the statutory rate of interest from the date the claim was submitted and attorneys' fees and expenses if the claim denial was not in good faith.

The burden of proof under Section 8.01-66.1 is a preponderance of the evidence. *Nationwide Mut. Ins. Co. v. St. John*, 259 Va. 71, 75-76, 524 S.E.2d 649, 651 (2000). The same standard likely applies to Section 38.2-209 because both attorneys' fees statutes are remedial in purpose.

Va. Code Ann. §38.2-807 applies to unlicensed insurers only and permits the recovery of attorneys' fees of up to 12.5 percent of the verdict where the insurer fails to make payment for thirty days after

within five years from the date of accrual. However, Va. Code Ann. §38.2-2105 requires all first-party property policies to contain a provision that requires the insured to bring suit under the policy within two years of the inception of the loss. *See also Hitt Contracting, Inc. v. Indus. Risk Insurers*, 258 Va. 40, 516 S.E.2d 216 (1999) (applying two year contractual limitations period to bar coverage for suit initiated after expiration of the time period). Thus, a bad faith claim under a property policy must be brought within two years of the inception of the loss.

***Under what circumstances will bad faith claims be dismissed or stayed pending the resolution of the underlying claims?***

Some courts have held that a bad faith claim for attorneys' fees cannot be asserted until after the insured has obtained a judgment against the insurer. *St. John's African Methodist Episcopal Church v. GuideOne Spec. Mut. Ins. Co.*, 902 F. Supp. 2d 783, 786-87 (E.D. Va. 2012) (motion granted to bifurcate bad faith claim until after judgment is entered against insurer on substantive cause of action); *U.S. Airways Inc. v. Commonwealth Ins. Co.*, 64 Va. Cir. 408, 2004 WL 1094684, at \*9 (2004) (insured could not present evidence of bad faith until judgment establishing coverage); *Cradle v. Monumental Life Ins. Co.*, 354 F. Supp. 2d 632, 636 (E.D. Va. 2005); *see also Seneca Ins. Co. v. Shipping Boxes I, LLC*, 30 F. Supp. 3d 506, 513 (E.D. Va. June 6, 2014) (granting motion to bifurcate but stating that separate trial would not occur with respect to attorneys' fees; instead court would determine that issue following resolution of substantive claims); *Great Am. Ins. Co. v. GRM Mgmt., LLC*, No. 3:14CV295, 2014 WL 6673902, at \*7 (E.D. Va. Nov. 24, 2014). However, other courts have criticized this reasoning as unworkable because a bad faith claim for attorneys' fees is not a separate cause of action. *See, e.g., Structural Concrete Products, LLC v. Clarendon America Ins. Co.*, Case No. 3:07cv253, 2007 WL 2437661, at \*4-5 (E.D. Va. Aug. 22, 2007); *Styles v. Liberty Mut. Ins. Co.*, Case No. 7:06cv00311, 2006 WL 1890104, at \*2-3 (W.D. Va. July 7, 2006); *Standard Fire Ins. Co. v. Proctor*, No. 3:10CV655, 2011 WL 3269633, at \*3 (E.D. Va. July 29, 2011); *Botkin v. Donegal Mut. Ins. Co.*,

No. 5:10CV00077, 2011 WL 1225999, at \*4 (W.D. Va. Mar. 29, 2011).

By definition, a bad faith claim for the amount of an excess judgment will not arise until after the underlying claim has been resolved.

***Under what circumstances will bad faith claims be severed for trial from the underlying claim?***

*See above.*

***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

Virginia courts have not addressed this issue. As noted, punitive damages are recoverable only to the extent that an insured establishes an "independent tort." *Douros v. State Farm Fire & Cas. Co.*, 508 F. Supp. 2d 479, 483 (E.D. Va. 2007).

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

The insured's conduct may be considered in evaluating the reasonableness of the insurer's conduct. *Florists' Mut. Ins. Co. v. Tatterson*, 802 F. Supp. 1426, 1437 (E.D. Va. 1992).

***Is "advice of counsel" a recognized defense?***

The advice of counsel is almost certainly a factor in assessing the reasonableness of an insurer's conduct. *See, e.g., CUNA Mut. Ins. Co. v. Norman*, 237 Va. 33, 375 S.E.2d 724 (1989). In other contexts, Virginia courts have recognized the advice of counsel defense. *See, e.g., Chippouras v. AJ.&L Corp.*, 223 Va. 511, 290 S.E.2d 859 (1982) (malicious prosecution); *Closgard Wardrobe Co. v. Normandy*, 158 Va. 50, 163 S.E. 355 (1932) (malicious prosecution). In *Aetna v. Price*, 206 Va. 749, 764 146 S.E.2d 220, 230 (1966), the court held that failure of an insurer to accept the settlement recommendation of its attorney, standing alone, is insufficient to sustain a charge of bad faith.

### **What other defenses are available?**

Since coverage is a prerequisite to bad faith, any defense to coverage is a defense to bad faith. *Reisen v. Aetna Life & Cas. Co.*, 225 Va. 327, 335, 302 S.E.2d 529, 533 (1983). For example:

- The statute of limitations. *See, e.g., Bilicki v. Windsor-Mount Joy Mut. Ins. Co.*, 954 F. Supp. 129 (E.D. Va. 1996), criticized on other grounds, *Zaeno Int'l v. State Farm Fire & Cas.*, 152 F. Supp. 2d 882, 885 (E.D. Va. 2001).
- A material misrepresentation in the application. *See, e.g., Mountain Sec. Sav. Bank v. United Guar. Residential Ins. Co.*, 678 F. Supp. 610 (W.D. Va. 1987).
- A material misrepresentations or fraud in the claim. *See, e.g., U.S. Fid. & Guar. Co. v. Haywood*, 211 Va. 394, 397, 177 S.E.2d 530, 533 (1970).
- Arson. *See, e.g., Stonewall Ins. Co. v Hamilton*, 727 F. Supp. 271 (W.D. Va. 1989).
- Breach of a condition precedent. *See, e.g., Salomon v. Transamerica Occidental Life Ins. Co.*, 801 F.2d 659, 660-61 (4th Cir. 1986).
- The action is preempted by ERISA. *Id.*

The insurer's conduct is measured against a reasonableness standard set out in *CUNA Mut. Ins. Society v. Norman*, 237 Va. 33, 38, 375 S. E. 2d 724, 726-27 (1989), *Capitol Ennt'l Servs., Inc. v. N. River Ins. Co.*, 536 F. Supp. 2d 633 (E.D. Va. 2008) and *HHC Assocs. v. Assurance Co. of America*, 256 F. Supp. 2d 505

(E.D. Va. 2003). There can be no breach of the insurer's duty if there is no covered loss. *Reisen v. Aetna Life & Cas. Co.*, 225 Va. 327, 335, 302 S.E.2d 529, 533 (1983); *Brenner v. Lawyers Title Ins. Co.*, 397 S.E.2d 100, 104, 140 Va. 185, 193 (1990); *A & E Supply Co. v. Nationwide Mut. Fire Ins. Co.*, 798 F.2d 669, 676 (4th Cir. 1986). Moreover, if the insurer can prove by clear and convincing evidence that underlying judgment was procured by fraud or collusion, the insurer may avoid liability for bad faith. *Spence-Parker v. Maryland Ins. Group*, 937 F. Supp. 551, 560 (E.D. Va. 1996).

### **Is there a cause of action for reverse bad faith?**

Virginia courts have not addressed this issue.

### **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

An insurer does not owe the insured a fiduciary duty. *State Farm Mut. Auto. Ins. Co. v. Floyd*, 235 Va. 136, 143, 366 S.E.2d 93, 97 (1988).

#### AUTHORS

**Thomas S. Garrett** | Harman Claytor  
Corrigan Wellman | 804.762.8005 |  
tgarrett@hccw.com

**Robert F. Friedman** | Harman Claytor  
Corrigan Wellman | 804.762.8005 |  
rfriedman@hccw.com

# Washington

By Paul Rosner and Joanne T. Blackburn

## Causes of Action

### **Is there a statutory basis for an insured to bring a bad faith claim?**

Yes. Rev. Code Wash. §48.01.030 imposes a duty on insurers to act in good faith which “may” give rise to a tort action for bad faith. *Smith v. Safeco Ins. Co.*, 78 P.3d 1274, 1276 (Wash. 2003); *American States Ins. Co. v. Symes of Silverdale, Inc.*, 78 P.3d 1266, 1269 (Wash. 2003).

A breach of Rev. Code Wash. §48.01.030 is also a per se violation of the Washington Consumer Protection Act (“WCPA”), codified at Rev. Code Wash. Ch. 19.86, which supports a private right of action. *Levy v. North Am. Co. for Life & Health Ins.*, 586 P.2d 845, 847 (Wash. 1978) (citing Rev. Code Wash. §19.86.020); *Leingang v. Pierce County Med. Bureau, Inc.*, 930 P.2d 288, 296 (Wash. 1997). Bad faith constitutes a per se violation of the WCPA. *Gingrich v. Unigard Sec. Ins. Co.*, 788 P.2d 1096 (Wash. 1990).

The Insurance Fair Conduct Act (“WIFCA”), codified at Rev. Code Wash. §§48.30.010(7) and 48.30.015(1), creates a private right of action in the first-party context.

### **Can a third party bring a statutory action for bad faith?**

No. *Tank v. State Farm Fire & Cas. Co.*, 715 P.2d 1133, 1139, 1141 (Wash. 1986) (applying rule to WCPA bad faith claim); see also *Smith v. Safeco Ins. Co.*, 78 P.3d 1274, 1276 (Wash. 2003) (applying rule to non-WCPA bad faith claim). The insured, however, may assign a bad faith claim to a third party. *Safeco Ins. Co. of America v. Butler*, 823 P.2d 499, 508–509 (Wash. 1992).

### **Is there a common law cause of action for bad faith?**

Yes. It is “fairly broad and may be breached by conduct short of intentional bad faith or fraud.” *Griffin v. Allstate Ins. Co.*, 29 P.3d 777, 783 (Wash. Ct. App. 2001) (quoting *Industrial Indem. Co. of the N.W. v. Kallevig*, 792 P.2d 520 (Wash. 1990), opinion modified on denial of reconsideration, 36 P.3d 552 (Wash. Ct. App. 2001)).

This tort action is available in both first-party cases, *Coventry Assocs. v. American States Ins. Co.*, 961 P.2d 933, 937 (Wash. 1998), and third-party cases, see, e.g., *First State Ins. Co. v. Kemper Nat’l Ins. Co.*, 971 P.2d 953 (Wash. Ct. App. 1999) (also recognizing cause of action against insurer for negligence, which is independent of cause of action for bad faith).

In *St. Paul Fire & Marine Ins. Co. v. Onvia, Inc.*, 196 P.3d 664 (Wash. 2008), the Washington Supreme Court held that an insurer’s violation of one or more claims handling regulations can support an action for bad faith and/or an action for violation of the WCPA even where there is no coverage at all for the claim; however, no presumption of harm or coverage by estoppel applies to violations of insurance claims handling regulations.

### **What cause of action exists for an excess carrier to bring a claim against a primary carrier?**

Equitable subrogation. A primary insurer owes an excess insurer the same duty that it owes to its insured. *First State Ins. Co. v. Kemper Nat’l Ins. Co.*, 971 P.2d 953, 958 (Wash. Ct. App. 1999); *Truck Ins. Exch. of Farmers Ins. Group v. Century Indem. Co.*, 887 P.2d 455, 458 (Wash. Ct. App. 1995).

***Under what circumstances will bad faith claims be dismissed or stayed pending the resolution of the underlying claims?***

Actions prior to the time damages can be determined are premature. See *Kahin v. Lewis*, 259 P.2d 420, 424 (Wash. 1953). If the underlying action requires a determination of coverage which may affect the insured's liability, the coverage action may be dismissed or stayed. *Western Nat'l. Assur. Co. v. Hecker*, 719 P.2d 954, 958 n.1 (Wash. Ct. App. 1986) (dictum); *Mutual of Enumclaw v. Dan Paulson Construction, Inc.*, 169 P.3d 1, 11-12 (2007); *Mutual of Enumclaw Ins. Co. v. T & G Const., Inc.*, 199 P.3d 376 (2008).

***Under what circumstances will bad faith claims be severed for trial from the underlying claim?***

Bad faith claims will not be tried in the same trial as the underlying claim, with rare statutory exceptions. Wash. R. Evid. 411; Wash. R. Civ. P. 14(c).

***Under what circumstances will the compensatory and punitive damages claims be bifurcated?***

Punitive damages are generally not available in bad faith actions. *Barr v. Interbay Citizens Bank of Tampa, Fla.*, 635 P.2d 441, 444 (Wash. 1981). However, under WIFCA, Rev. Code Wash. §48.30.015(2), treble damages up to three times the actual damages may be awarded by the superior court after the trial. Note that in federal cases, the jury may be tasked with making the determination to award damages of up to three times actual damages. *Northwestern Mut. Life Ins. Co. v. Koch*, 771 F. Supp. 2d 1253 (W.D. Wash. 2009). Under the WCPA, treble damages of up to \$25,000 per claim are determined by the judge after trial. See Rev. Code Wash. §19.86.090.

***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?***

Bankruptcy law places the trustee, or debtor-in-possession, in the shoes of a debtor corporation. The

subject policy becomes part of a bankruptcy estate, but state law, not bankruptcy law, will determine the contractual terms between the parties. However, a state has no power to make or enforce any law that conflicts with federal bankruptcy laws. *American States Ins. Co. v. Symes of Silverdale, Inc.*, 78 P.3d 1266, 1269 (Wash. 2003). Because an insurance policy is a contract, both parties can rely upon the policy's terms and conditions when presenting claims and defenses to the insurance contract. See *id.* (trustee asserted breach of contract and bad faith claim against property insurer). When the insured is bankrupt through no fault of the insurer, and the insurer provided a defense in the underlying action, the insured is precluded from agreeing to an excess consent judgment with the claimant and attempting to collect the excess as damages for bad faith. *Werlinger v. Warner*, 109 P.3d 22 (Wash. Ct. App. 2005).

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

The Washington Insurance Guaranty Association ("WIGA") steps into the shoes of an insolvent insurer. Rev. Code Wash. §48.32.060(1)(b); see also *Washington Ins. Guar. Ass'n. v. McKinstry Co.*, 784 P.2d 190, 192 (Wash. Ct. App. 1990). A claim for bad faith is not a "covered claim" within the meaning of the Act and is therefore not recoverable from WIGA. *Vaughn v. Vaughn*, 597 P.2d 932, 934 (Wash. Ct. App. 1979).

***Defenses and Counterclaims***

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Yes, on the question of the insured's comparative fault under general tort law. Rev. Code Wash. §4.28.070.

***Is "advice of counsel" a recognized defense?***

Not clear. In *Woo v. Fireman's Fund Ins. Co.*, 164 P.3d 454, 463 (Wash. 2007), the insurer disclaimed coverage, relying on a coverage opinion which stated that the case law relied upon might be distinguishable.

The court stated that the insurer's determination that it had no duty to defend "contradict[ed] one of the most basic tenets of the duty to defend," namely that the insurer must defend if an insurer is relieved of its duty to defend only if the claim alleged in the complaint is "clearly not covered by the policy." Presumably, reliance "on an equivocal interpretation of case law" to give the insurer—rather than the insured—the benefit of the doubt, is not a defense to bad faith.

### **What other defenses are available?**

An insured who intentionally misrepresents or conceals material facts during the claims process may not assert a bad faith or WCPA claim. *Mutual of Enumclaw Ins. Co. v. Cox*, 757 P.2d 499, 504 (Wash. 1988); *Wickswat v. Safeco Ins. Co.*, 904 P.2d 767, 773–776 (Wash. Ct. App. 1995). However, an insurer that fails or refuses to defend in bad faith is estopped from denying coverage. *Truck Ins. Exch. v. VanPort Homes, Inc.*, 58 P.3d 276, 281 (Wash. 2002).

### **Is there a cause of action for reverse bad faith?**

No reported cases. However, Rev. Code Wash. §48.01.03 places the obligation of good faith on the insured as well as the insurer. *Public Employees Mut. Ins. Co. v. Kelly*, 805 P.2d 822, 827 (Wash. Ct. App. 1991).

### **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

*Truck Ins. Exch. v. VanPort Homes, Inc.*, 58 P.3d 276 (Wash. 2002) applies "coverage by estoppel" because the liability insurer acted in bad faith. The court held that a settlement (with a stipulated judgment and covenant not to execute) between the plaintiff and the insured will be deemed reasonable, and therefore binding upon the insurer without regard to policy limits, unless there is evidence of "collusion or fraud." In addition, "coverage by estoppel" is available in third-party cases where the insurer defends in bad faith or, in bad faith, fails to defend. *Kirk v. Mount Airy Ins. Co.*, 951 P.2d 1124, 1128 (Wash. 1998); *Safeco Ins. Co. of America v. Butler*, 823 P.2d 499, 505 (Wash. 1992) ("where an insurer acts in bad faith in handling a claim under a reservation of

rights, the insurer is estopped from denying coverage"). Coverage by estoppel is not available in first-party bad faith cases. *Coventry Assocs. v. American States Ins. Co.*, 961 P.2d 933, 939–940 (Wash. 1998).

*Smith v. Safeco Ins. Co.*, 78 P.3d 1274, 1277 (Wash. 2003) holds that if an insured could present evidence that the insurer's alleged reasonable basis for denying coverage was not the actual basis for its action or that other factors outweighed the alleged reasonable basis, summary judgment in the insurer's favor on the bad faith claims was improper.

*St. Paul Fire and Marine Insurance Co. v. Onvia, Inc.*, 196 P.3d 664 (Wash. 2008) holds that a third-party insured has a cause of action based upon bad faith claims in handling that is *not* dependent on the duty to defend, indemnify or settle; however, the insured is not entitled to a presumption of harm but required to prove the insurer's conduct caused the actual harm. A WCPA claim exists for an insured for violation of claims handling regulations that does not depend upon a finding of bad faith or existence of a duty to defend, indemnity or settle.

*Woo v. Fireman's Fund Insurance Co.*, 164 P.3d 454, 459 (2009) holds that a carrier has a duty to defend "when a complaint against the insured, construed liberally, alleges facts which could, if proven, impose liability upon the insured within the policy's coverage"; but there are two exceptions to when a duty to defend is determined based only on the complaint, and both favor the insured. If it is not clear on the face of the complaint that the policy provides coverage, but coverage could exist, the insurer must investigate and give the insured benefit of any doubt that a duty to defend is owed, and if the allegations of the complaint conflict with the facts known to or readily ascertainable by the carrier, or the allegations are ambiguous or inadequate, facts outside the complaint may be considered. However, the insurer cannot rely on facts outside the complaint to deny a duty to defend, but may do so only to trigger the duty.

*Mutual of Enumclaw v. Dan Paulson Construction, Inc.*, 169 P.3d 1, 11–12 (2007) holds that an insurer's bad faith in subpoenaing an arbitrator "created uncertainty concerning potential prejudicing of the arbitrator and the effect of the insurer's interference on

the confirmability of the arbitration award” constituted prejudice to the insured, and the insurer could not rebut the presumption of harm to the insured.

*Water’s Edge Homeowners Ass’n v. Water’s Edge Assocs.*, 216 P.3d 1110 (Wash. Ct. App. 2009) involves a trial court’s finding that a stipulated judgment of \$8.75 million was unreasonable based upon actions taken by the parties. An insurer does not bear the burden of proving fraud or collusion. Rather, “after the parties establish reasonableness, the *Chaussee* factor is merely whether there is any evidence of bad faith, collusion, or fraud.... Nor does any evidence of bad faith, collusion, or fraud appear to invoke the typical standard for proof of fraud, which must be proved by evidence that is clear, cogent, and convincing. The burden here was not on [the insurer] but, rather, on the HOA to prove its settlement was reasonable.”

*Ledcor Industries (USA), Inc. v. Mutual of Enumclaw Ins. Co.*, 206 P.3d 1255 (2009) holds that the fact that other insurers were actively defending a general contractor, which qualified as an additional insured under a subcontractor’s policy, did not relieve the subcontractor’s insurer of its duties to investigate and defend the contractor. After holding that the carrier acted in bad faith by failing to defend promptly the general contractor, the court held that the general contractor was not entitled to indemnification under the subcontractor’s policy for liability caused by other subcontractors based on the policy language at issue. The court held that coverage by estoppel did not apply because “estoppel does not operate to create coverage.” The court also held the contractor suffered no harm from the insurer’s failure to defend and indemnify it because the insurer funded the subcontractor’s settlement with the contractor.

*American Best Food, Inc. v. Alea London, Ltd.*, 229 P.3d 693 (Wash. 2010) holds that where there is a lack of any Washington case directly on point, and case law from other states supported the insured’s interpretation, the legal uncertainty required the insurer to provide a defense. The insurer’s failure to defend based upon a questionable interpretation of law was unreasonable and in bad faith as a matter of law.

*Cedell v. Farmers Ins. Co. of Washington*, 176 Wash. 2d 686, 295 P.3d 239 (Wash. 2013) holds that

“[w]hen an insured asserts bad faith against his insurer in the way the insurer has handled the insured’s claim, unique considerations arise.” *Id.* at 696. To protect the insured from bad faith the Court starts from the presumption that “there is no attorney–client privilege relevant between the insured and the insurer in the claims adjusting process, and that the attorney–client and work product privileges are generally not relevant.” *Id.* at 689–99. An insurer can only overcome this presumption by showing that its attorney was not engaged in investigation, evaluation, or processing the claim, but instead in providing the insurer with legal advice and opinion as to its own potential liability. Once shown, the insurer is entitled to an in camera review of the claims file wherein the court may redact communications and evaluate whether the attorney–client privilege may be pierced based on the insured’s claims. *Id.* at 699. The *Cedell* presumption is not limited to first-party bad faith claims. See *Carolina Cas. Co. v. Omeros Corp.*, 2013 WL 1561963 (W.D. Wash. 2013); see also *Grange Ins. Ass’n v. Lund*, 2014 WL 584011 (W.D. Wash. 2014).

*Beasley v. State Farm Mut. Auto. Ins. Co.*, No. C13-1106RSL, 2014 WL 1494030 (W.D. Wash. Apr. 16, 2014) holds that a violation of those Washington Administrative Code (“WAC”) provisions incorporated into WIFCA, Rev. Code Wash. §48.30.015(5), may justify the imposition of treble damages under Rev. Code Wash. §48.30.015(3) and/or an award of fees and costs under Rev. Code Wash. §48.30.015(3), but such violations do not constitute a per se violation of WIFCA without finding an underlying unreasonable denial of coverage or payment. There are no reported state court decisions at this time on whether a WAC violation alone may support a WIFCA claim; nonetheless, two trial courts have given instructions to the jury to allow a single WAC violation to trigger WIFCA. See *Madden v. Medico Ins. Co.* (Wash. Superior Court Spokane County 2011); *Nguyen v. Allstate Ins. Co.* (Wash. Superior Court King County 2009).

#### AUTHORS

**Paul Rosner** | Soha & Lang, P.S. | 206.654.6601 | rosner@sohalang.com

**Joanne T. Blackburn** | Gordon Thomas Honeywell LLP | 206.676.7540 | jblackburn@gth-law.com

# West Virginia

By Aaron C. Boone, Ashley Hardesty Odell, and Evan R. Kime

## Causes of Action

### Can a first party bring a statutory bad faith claim in West Virginia?

Yes. The West Virginia Unfair Trade Practices Act ("WVUTPA"), W. Va. Code §33-11-4, provides a statutory basis for an insured to bring a bad faith claim.

### Can a third party bring an action for bad faith in state court?

No. Third parties have no cause of action for violation of the WVUTPA in West Virginia. See W. Va. Code §33-11-4a (complaints by third-party claimants; elimination of private cause of action). Also, third parties do not have standing to sue an insurer for violation of the duty of good faith or fair dealing. See *Elmore v. State Farm Mut. Auto. Ins. Co.*, 202 W. Va. 430, 504 S.E.2d 893 (1998).

### What are the common causes of action raised in extracontractual cases in West Virginia?

- "Hayseeds Claim," for breach of duty of good faith and fair dealing. *Hayseeds, Inc. v. State Farm Fire & Cas.*, 177 W. Va. 323, Syl. Pt. 1, 352 S.E.2d 73 (1986).
- "Jenkins Claim," for violations of the WVUTPA. *Jenkins v. J.C. Penney Cas. Ins. Co.*, 167 W. Va. 597, Syl. Pt. 3, 280 S.E.2d 252 (1981), overruled on other grounds, *State ex rel. State Farm Fire & Cas. Co. v. Madden*, 192 W. Va. 155, 451 S.E.2d 721 (1994).
- "Shamblin Claim," excess judgment against an insured on a liability claim. *Shamblin v. Nationwide Mut. Ins. Co.*, 183 W. Va. 585, 396 S.E.2d 766 (1990).

### Who qualifies as a "first party claimant" able to pursue a bad faith claim?

The term "third-party" claimant has been interpreted to mean a third party to a liability policy. Where a "third party" to the insurance contract (not the named insured) makes a claim for direct benefits under a policy, they are a "first-party claimant" and may still bring a case under the WVUTPA. See *Loudin v. Nat'l Liab. & Fire Ins. Co.*, 228 W. Va. 34, 41, 716 S.E.2d 696, 703 (2011); see also *Dorsey v. Progressive Classic Ins. Co.*, 232 W. Va. 595, 595, 753 S.E.2d 93, 94 (2013) (finding that guest passenger is first-party insured under medical payments section of auto policy); *Goff v. Penn Mut. Life Ins. Co.*, 229 W. Va. 568, 572, 729 S.E.2d 890, 894 (2012) (finding that named beneficiary to life insurance policy is first-party insured).

### Can a third party bring an administrative action for bad faith to the West Virginia Office of the Insurance Commissioner?

Yes. A third-party claimant's sole remedy against a person for an unfair claims settlement practice, or the bad faith settlement of a claim, is filing an administrative complaint with the West Virginia Offices of the Insurance Commissioner. W. Va. Code §33-11-4a.

### What remedies can the Insurance Commissioner award to a third party who successfully brings a third-party action before the Commissioner?

In third-party claims, the Unfair Claims Settlement Practice Trust Fund statute, codified at W. Va. Code, §33-11-4b, allows the Insurance Commissioner to award restitution up to \$10,000 pursuant to W. Va. Code §§33-11-6 and 33-11-4a. "Restitution provided herein may include: (A) Actual economic damages, and (B) noneconomic damages not to exceed ten

**What are the damages in a Jenkins Claim (Violation of the WVUTPA)?**

Increased costs and expenses resulting from the failure to offer a prompt fair settlement. *Jenkins v. J.C. Penney Cas. Ins. Co.*, 167 W. Va. 597, 609, 280 S.E.2d 252, 259 (1981), *overruled on other grounds, State ex rel. State Farm Fire & Cas. Co. v. Madden*, 192 W. Va. 155, 451 S.E.2d 721 (1994).

Attorney's fees for litigating a case under the WVUTPA are not recoverable. *Lemasters v. Nationwide Mut. Ins. Co.*, 232 W. Va. 215, 223, 751 S.E.2d 735, 743 (2013). Attorney fees are recoverable only for "fees incurred in the 'underlying action.'" *Id. Hayseeds* attorney's fees do not continue to accrue while a bad faith case is litigated. *Id.*

**Are punitive damages available?**

Yes. Punitive damages are available in bad faith claims, but only if the policyholder can establish a high threshold of "actual malice." *McCormick v. Allstate Ins. Co.*, 202 W. Va. 535, 505 S.E.2d 454 (1998).

**Practice and Procedure**

**Statute of limitations**

The statute of limitations for statutory violations is one year as set forth in W. Va. Code §55-2-12(c). *Wilt v. State Auto. Mut. Ins. Co.*, 203 W. Va. 165, 506 S.E.2d 608 (1998).

W. Va. Code §33-11-4a provides:

A third-party claimant may file an administrative complaint against a person for an alleged unfair claims settlement practice with the Commissioner. The administrative complaint shall be filed as soon as practicable but in no event later than one year following the actual or implied discovery of the alleged unfair claims settlement practice."

The statute of limitations on a *Hayseeds* Claim has not been addressed.

**Under what circumstances will bad faith claims be stayed pending the resolution of the underlying claims?**

In a first-party bad faith action against an insurer,

bifurcation and stay of the bad faith claim from the underlying action are not mandatory. Under Rule 42(c) of the West Virginia Rules of Civil Procedure, a trial court, in furtherance of convenience, economy, or to avoid prejudice, may bifurcate and stay a first-party bad faith cause of action against an insurer. *Light v. Allstate Ins. Co.*, 203 W. Va. 27, Syl. Pt. 2, 506 S.E.2d 64 (1998).

**Under what circumstances will the compensatory and punitive damages claims be bifurcated?**

West Virginia Rules of Civil Procedure, Rule 42(c) provides that "[t]he court, in furtherance of or to avoid prejudice... may order a separate trial of any... separate issue[.]" A showing must be made that a separation of the litigation is warranted to promote the recognized goals of judicial economy, convenience of the parties, and the avoidance of prejudice, the overriding concern being the provision of a fair and impartial trial to all litigants. *Bennett v. Warner*, 179 W. Va. 742, 748, 372 S.E.2d 920, 926 (1988).

**Defenses and Counterclaims**

**Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?**

The specific issue has not been addressed. However, the common law defenses of estoppel, waiver, and laches are well established in West Virginia.

**Is "advice of counsel" a recognized defense?**

Yes. *U.S. Fid. & Guar. Co. v. Canady*, 194 W. Va. 431, 460 S.E.2d 677 (1995). However, once a lawsuit has been filed pertaining to the claim, the actions of the attorney handling the suit are governed by the standard of "litigation misconduct" controlled by reference to the Rules of Civil Procedure, and not the WVUTPA. *Barefield v. DPIC Cos., Inc.*, 215 W. Va. 544, 559, 600 S.E.2d 256, 271 (2004); *Rose v. St. Paul Fire & Marine Ins. Co.*, 215 W. Va. 250, 257, 599 S.E.2d 673, 680 (2004).

### ***What other defenses are available?***

Set-off. A UM or UIM insurer who acts in bad faith is a joint tortfeasor and is entitled to set off other payments. As a result, its liability for a verdict in excess of policy limits is reduced by the amount of other uninsured benefits paid on behalf of the tortfeasor. *Morrison v. Haynes*, 192 W. Va. 303, 452 S.E.2d 394 (1994).

### ***Is there a cause of action for reverse bad faith?***

This specific issue has not been addressed.

### **Other Significant Issues and Cases**

Coverage opinion letters and seminar and training materials are privileged, but retention agreements and billing statements are not protected by the work product doctrine in a first-party bad faith case. *State ex rel. Montpelier U.S. Ins. Co. v. Bloom*, 233 W. Va. 258, 757 S.E.2d 788 (2014).

In *Medical Assurance of West Virginia, Inc. v. Recht*, 213 W. Va. 457, 583 S.E.2d 80 (2003), the court held that the privilege exists as to communications between defense counsel and the insured which were also shared with the insurer.

Under *State ex rel. Allstate Insurance Co. v. Gaughan*, 203 W. Va. 358, 508 S.E.2d 75 (1998), in bad faith actions, the insurer has a “quasi attorney-client privilege,” and a work product privilege, applicable to certain communications and work product found in the liability insured’s litigation file. However, these privileges may not apply where the bad faith action is brought by the named insured.

#### AUTHORS

**Aaron C. Boone** | Bowles Rice LLP | 304.485.8500 | [aboone@bowlesrice.com](mailto:aboone@bowlesrice.com)

**Ashley Hardesty Odell** | Bowles Rice LLP | 304.285.2522 | [ahardestyodell@bowlesrice.com](mailto:ahardestyodell@bowlesrice.com)

**Evan R. Kime** | Bowles Rice LLP | 304.347.2124 | [ekime@bowlesrice.com](mailto:ekime@bowlesrice.com)

# Wisconsin

By Pamela J. Tillman, Dale O. Thornsjo, and Lance D. Meyer

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

No. However, there is one exception, for bad faith in the handling and adjustment of workers' compensation claims. Wis. Stat. §102.18(1)(bp); see *Bosco v. Labor & Indus. Rev. Comm'n*, 2004 WI 77, 272 Wis. 2d, 681 N.W.2d 157. Wis. Stat. §102 does not apply to a third-party fund administrator (who served as the administrator and agent of the Department of Workforce Development for the uninsured employers fund program), and thus does not bar a plaintiff from pursuing a separate bad faith tort claim against the third-party administrator for how it handled and processed the claim. See *Aslakson v. Gallagher Bassett Svcs., Inc.*, 2007 WI 39, ¶79, 300 Wis. 2d 92, 729 N.W.2d 712; Wis. Admin. Code §DWD 80.70.

The unfair claims settlement practices are promulgated at Wis. Admin. Code §INS 6.11. The Commissioner of Insurance has authority to penalize insurers for violations, but insureds have no private right of action against insurers. *Kranzush v. Badger State Mut. Cas. Co.*, 103 Wis. 2d 56, 307 N.W.2d 256 (1981). However, violation of those rules may be evidence of bad faith. *Heyden v. Safeco Title Ins. Co.*, 175 Wis. 2d 508, 498 N.W.2d 905 (Wis. Ct. App. 1993), *overruled on other grounds*, *Weiss v. United Fire & Cas. Co.*, 197 Wis. 2d 365, 541 N.W.2d 753 (1995).

### ***Can a third party bring a statutory action for bad faith?***

In most instances, no. *Kranzush v. Badger State Mut. Cas. Co.*, 103 Wis. 2d 56, 307 N.W.2d 256 (1981). However, a beneficiary may sue an insurer for benefits due under a life insurance policy when the insured owner of the policy has passed away. See

*Plautz v. Time Ins. Co.*, 189 Wis. 2d 136, 525 N.W.2d 342 (Wis. Ct. App. 1994).

### ***Is there a common law cause of action for bad faith?***

Yes, first recognized in *Anderson v. Continental Insurance Co.*, 85 Wis. 2d 675, 271 N.W.2d 368 (1978) and developed in progeny. A discussion of the elements of the tort in different contexts is included below.

Notably, Wisconsin courts have repeatedly explained that “[t]he insurer’s duty of good faith and fair dealing arises from the insurance contract and runs to the insured.” *Neri v. Barber*, 846 N.W.2d 34 (Wis. Ct. App. 2014) (emphasis added) (affirming dismissal of bad faith claim because third-party claimant cannot bring claim for bad faith against insurer).

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

In *Loy v. Bunderson*, 107 Wis. 2d 400, 320 N.W.2d 175 (1982), the Wisconsin Supreme Court held that the tort of bad faith cannot arise between a primary insurer and an excess insurer absent a contract between them describing their respective duties and obligations relating to their mutual insured. See also *Teigen v. Jelco of Wis., Inc.*, 124 Wis. 2d 1, 367 N.W.2d 806 (1985). Absent such a contractual arrangement, disputes between insurers typically have involved claims for declaratory relief seeking a judicial determination of which policies are primary and which are excess, along with accompanying claims for money damages representing funds improperly paid by one insurer. See, e.g., *Riccobono v. Seven Star, Inc.*, 2000 WI App 74, 234 Wis. 2d 374, 610 N.W.2d 501.

The Wisconsin Insurance Security Fund will not pay claims for bad faith against an insolvent insurer. See Wis. Stat. §646.31.

## Defenses and Counterclaims

### *Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?*

While no Wisconsin case directly addresses the conduct of the insured or the third-party claimant under evidentiary admissibility standards, that conduct seems relevant to the reasonableness and adequacy of the investigation undertaken by the insurer. If the insurer's investigation is legitimately hampered by such conduct, it seems to follow that bad faith should not be found. In *Aul v. Golden Rule Insurance Co.*, 2007 WI App 165, 304 Wis. 2d 227, 737 N.W.2d 24, although not dispositive with respect to its finding of no bad faith, the court considered the fact that the insured did not submit favorable follow up test results in order for the carrier to reevaluate its denial of coverage. The court also stated that it was an "unreasonable" expectation for the insured to assume its insurer would follow up or pursue subsequent test results.

### *Is "advice of counsel" a recognized defense?*

Yes. In *Berk v. Milwaukee Automobile Insurance Co.*, 245 Wis. 597, 15 N.W.2d 834 (1944), the Wisconsin Supreme Court reversed a trial court finding that an insurer acted in bad faith by failing to settle a claim against an insured. *Berk* specifically cited the insurer's reliance on its counsel's advice as evidence that no bad faith occurred, stating that "[i]t was reasonable and natural that [the insurer] should rely... on the judgment and advice of its attorney," who had recommended against settlement. See also *Winter v. Seneca*, 2012 WI App 1, ¶19, 338 Wis. 2d 212, 808 N.W.2d 175 (holding that in determining whether insured has presented "fairly debatable" claim, insurer may be guided by third-party advice, including advice of attorneys and experts).

### *What other defenses are available?*

Wisconsin insurers should be prepared to prove that their conduct was based on an honest and intelligent

consideration of all of the facts and circumstances learned upon a diligent and good faith investigation into all aspects of a claim. See *Trinity Evangelical Lutheran Church v. Tower Ins. Co.*, 2003 WI 46, 261 Wis. 2d 333, 661 N.W.2d 789.

### *Is there a cause of action for reverse bad faith?*

Not expressly recognized. However, the Wisconsin Supreme Court recognized in *Anderson v. Continental Insurance Co.*, 271 N.W.2d 368 (Wis. 1978), that every contract in Wisconsin places an obligation of good faith upon "each party" as a matter of contract law. Wisconsin courts also recognize an insured's contractual duty to cooperate with the insurer in the resolution or defense of claims.

## Other Significant Cases Involving Bad Faith and Extracontractual Claims

In *McEvoy v. Group Health Cooperative*, 213 Wis. 2d 507, 570 N.W.2d 397 (Wis. 1997), the Wisconsin Supreme Court held that the tort of bad faith applies to health maintenance organizations (HMOs) making out of network benefits decisions for their subscribers under certain circumstances. The case involved a plan and participant not governed by ERISA.

The Wisconsin Court of Appeals case *Majorowicz v. Allied Mutual Insurance Co.*, 212 Wis. 2d 513, 569 N.W.2d 472 (Wis. Ct. App. 1997) is noteworthy for several reasons. First, the court appears to have applied the bad faith standard applicable for first-party claims to a third-party claim in affirming a trial court finding that the insurer acted in bad faith when it failed to settle a claim against its insured. Second, the court found that the duty of good faith is a non-delegable duty under Wisconsin law, and an insurer cannot escape liability by delegating the investigation, evaluation, and defense of claims against the insured to defense counsel.

In *Jones v. Secura Insurance Co.*, 2002 WI 11, 249 Wis. 2d 623, 638 N.W.2d 575, the Wisconsin Supreme Court held that the breach of the insurance contract and the tort of bad faith are separate causes of action, and that an insured was not barred from pursuing a claim for bad faith despite the fact the

breach of contract claim was barred by the statute of limitations.

In *Lockwood International v. Volm Bag Co., Inc.*, 273 F.3d 741 (7th Cir. 2001), the Seventh Circuit Court of Appeals, purportedly applying Wisconsin law, held that an insurer acted in bad faith when it settled all covered claims against its insured while permitting the underlying plaintiff to file an amended complaint alleging only uncovered claims. The court stated that it had “difficulty imagining a more conspicuous betrayal of the insurer’s fiduciary duty to its insured than for its lawyers to plot with the insured’s adversary a repleading that will enable the adversary to maximize his recovery of uninsured damages from the insured while stripping the insured of its right to a defense by the insurance company.” *Id.* at 744; see also *Soc’y Ins. v. Bodart*, 2012 WI App 75, ¶¶13, 22, 343 Wis. 2d 418, 425, 429, 819 N.W.2d 298, 301, 303 (adopting general rule that “[a]n insurer’s duty to defend ends after all at least arguably covered claims are settled and dismissed” but recognizing an exception where “the insurer has purported to ‘settle’ claims out of a case but has done so in bad faith”).

In *Liebovich v. Minnesota Insurance Co.*, 2007 WI App 28, ¶18, 299 Wis. 2d 331, 728 N.W.2d 357, *aff’d on other grounds*, 2008 WI 75, 310 Wis. 2d 751, 751 N.W.2d 764, the Wisconsin Court of Appeals refused to reinstate the insured’s bad faith denial of coverage claim against the insurer, even though it held that the insurer wrongfully refused to defend him in a neighbor’s suit alleging construction of his house in violation of setback requirements. Acknowledg-

ing that the “fairly debatable” analysis is the same with respect to the duty to defend analysis and the bad faith claim analysis, the court’s finding that it was fairly debatable whether the policy covered the insured for the acts alleged in the complaint in effect defeated the bad faith claim that coverage was self-evident.

In *Roehl Transport, Inc. v. Liberty Mutual Insurance Co.*, 2010 WI 49, 784 N.W.2d 542, the Wisconsin Supreme Court ruled an insured (which had negotiated a high \$500,000 deductible policy) could maintain a bad faith failure to settle claim against its insurer when the insurer exercises control over the settlement of a third-party claim, even though the judgment does not exceed the policy limits. In other words, because there was evidence that the insurer could have settled the case for well below the \$500,000 deductible and did not, which led to a \$800,000 verdict, the insurer was held to be in bad faith. This was in spite of the fact that the verdict did not exceed the \$2 million general policy limits of the insured’s policy.

#### AUTHORS

**Pamela J. Tillman** | Meissner Tierney Fisher & Nichols S.C. | 414.273.1300 | [pjt@mtfn.com](mailto:pjt@mtfn.com)

**Dale O. Thornsjo** | O’Meara, Leer, Wagner & Kohl, P.A. | 952.806.0498 | [DOThornsjo@OLWKLaw.com](mailto:DOThornsjo@OLWKLaw.com)

**Lance D. Meyer** | O’Meara, Leer, Wagner & Kohl, P.A. | 952.806.0498 | [LDMeyer@OLWKLaw.com](mailto:LDMeyer@OLWKLaw.com)

# Wyoming

By Stuart R. Day, Keith J. Dodson, and Erica R. Day

## Causes of Action

### ***Is there a statutory basis for an insured to bring a bad faith claim?***

The Wyoming Unfair Trade Practices Act does not explicitly permit a private cause of action. See *Wyo. Stat. Ann.* §26-13-101, *et seq.*; see also *Wilson v. State Farm Mut. Auto. Ins. Co.*, 795 F. Supp. 1077, 1082 (D. Wyo. 1992) (stating “the Wyoming Unfair Trade Practices Act does not provide for a private right of action”).

### ***Can a third party bring a statutory action for bad faith?***

No. *Herrig v. Herrig*, 844 P.2d 487, 492 (Wyo. 1992) (no cause of action for bad faith); *Julian v. New Hampshire Ins. Co.*, 694 F. Supp. 1530 (D. Wyo. 1988). However, third-party claimants can recover attorneys’ fees and costs under the Wyoming Unfair Trade Practices Act if they can establish: (1) that they have reduced the claim to judgment or reached a settlement agreement with the insured, (2) that the insurer subsequently refused to pay the judgment or settlement amount to the extent it was covered by the policy; and (3) the refusal to pay was unreasonable or without cause. *Herrig*, 844 P.2d at 495.

### ***Is there a common law cause of action for bad faith?***

Yes. *State Farm Mut. Auto. Ins. Co. v. Shrader*, 882 P.2d 813, 825 (Wyo. 1994); *Scherer Constr., LLC v. Hedquist Constr., Inc.*, 18 P.3d 645, 652 (Wyo. 2001). The Wyoming Supreme Court has recognized the concept of a breach of the covenant of good faith in contract and tort situations; the tort-based cause of action is more limited. *Grommet v. Newman*, 220 P.3d 795, 804 (Wyo. 2009). In the insurance context, the implied duty of good faith and fair dealing is premised upon the special relationship created by the

unequal bargaining power that an insurer has over an insured,” and a breach of the implied covenant of good faith and fair dealing may rise to such a level as to be actionable as an independent tort. *State Farm Mut. Auto. Ins. Co. v. Shrader*, 882 P.2d 813, 825 (Wyo. 1994); see also *McCullough v. Golden Rule Ins. Co.*, 789 P.2d 855, 858 (Wyo. 1990).

In a liability claim between two insureds who have the same insurer, an insurer has a good faith duty to inform its insured of first-party policy benefits and it is apparent to the insurer that (1) there is a strong likelihood that its insured only can be compensated fully under her own policy and (2) the insured has no basis to believe that [she] must rely upon [her] policy for coverage. See *Darlow v. Farmers Ins. Exch.*, 822 P.2d 820, 828 (Wyo. 1991). The duty of good faith runs only from the insurer to the insured, so in “double insured” cases, the insurer’s duty of good faith does not run to an insured who is a third-party claimant against another insurer. *Herrig*, 844 P.2d at 492.

“A cause of action for ‘third party’ bad faith will lie when a liability insurer fails in bad faith to settle a third-party claim *within policy limits against its insured.*” *Herrig*, 844 P.2d at 490 (emphasis added); see also *Gainsco Ins. Co. v. Amoco Production Co.*, 53 P.3d 1051, 1058 (Wyo. 2002). *Jarvis v. Farmers Ins. Exch.*, 948 P.2d 898, 900 (Wyo. 1997); *Western Cas. & Sur. Co. v. Fowler*, 390 P.2d 602 (Wyo. 1964).

### ***What cause of action exists for an excess carrier to bring a claim against a primary carrier?***

No reported cases.

a second phase of trial—of the defendant's financial status and returns a separate verdict setting the award of punitive damages. *Id.* Furthermore, a cause of action for breach of a contract of insurance and a cause of action for breach of the implied covenant of good faith and fair dealing sounding in tort are sufficiently distinct and independent to permit bifurcation, when the admission of evidence of settlement negotiations would be prejudicial. *State Farm Mut. Auto. Ins. Co. v. Shrader*, 882 P.2d 813, 831 (Wyo. 1994).

***How does a bankruptcy petition (by either the insured or the insurer) affect the prosecution and defense of bad faith and extracontractual claims?***

No specific Wyoming law on point. However, the Tenth Circuit has recognized the importance of a debtor's claims (whether filed or unfiled lawsuits) being listed as an asset of the bankruptcy estate, and the failure to list a claim may bar a debtor from pursuing such claim under the doctrine of judicial estoppel. *See, e.g., Eastman v. Union Pacific Railroad Co.*, 493 F.3d 1151 (10th Cir. 2007).

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extracontractual claims?***

The statutes governing the Wyoming Insurance Guaranty Association Act are set forth at Wyo. Stat. Ann. §26-31-101 *et seq.* The Act empowers the Wyoming Insurance Guaranty Association ("WIGA") to "adjust, compromise, settle and pay covered claims to the extent of the association's obligation *and deny all other claims.*" Wyo. Stat. Ann. §26-31-106(a)(iv) (emphasis added); *see also Wyoming Medical Center, Inc. v. Wyoming Ins. Guar. Ass'n*, 225 P.3d 1061, 1066 (Wyo. 2010) (citing *Wyoming Ins. Guar. Ass'n v. Woods*, 888 P.2d 192, 195 (Wyo. 1994).) (citations omitted).

A prior default judgment, determining the insured was not obligated to pay deductible amounts to insolvent insurer, did not, under doctrine of *res judicata*, bar a claim against the insured by WIGA, seeking payment of deductible amounts for claims WIGA had paid on liability claims after insurer's

insolvency because the prior default judgment had no effect on WIGA's statutory rights and duties, which were limited expressly to those insurer would have had if it had not become insolvent. *Wyoming Medical Center, Inc. v. Wyoming Ins. Guar. Ass'n*, 225 P.3d 1061, 1066 (Wyo. 2010); *see also* Wyo. Stat. Ann. §§26-31-106, 26-31-108, 26-31-110.

The guaranty fund is limited to only those rights and duties the insurer would have had if the insurer would not have become insolvent. *Wyoming Medical Center, Inc. v. Wyoming Ins. Guar. Ass'n*, 225 P.3d 1061, 1069 (Wyo. 2010); *see also* Wyo. Stat. Ann. §26-31-103(a)(ii)(D). Since an extracontractual claim is not a covered claim, this statute would likely be construed to bar recovery from WIGA on bad faith claims.

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third-party claimant admissible?***

Yes. In the third-party context, the reasonableness of an insured's settlement with the claimant is admissible. *Gainsco Ins. Co. v. Amoco Prod. Co.*, 53 P.3d 1051, 1079-80 (Wyo. 2002) (where settlement between the insured and the claimant was "objectively unreasonable because the settlement amount greatly exceeded the amount of [the insured's] risk" and the insured did not disclose a key term of the settlement, the insurer was not liable for any part of the settlement.).

In first-party context, no reported cases.

***Is "advice of counsel" a recognized defense?***

While not expressly addressed in the insurance context, punitive damages will not lie "against a defendant who acts in good faith and under the advice of counsel." *Sheridan Commercial Park, Inc. v. Briggs*, 848 P.2d 811 (Wyo. 1993).

***What other defenses are available?***

Preemption by ERISA. *See Moffett v. Halliburton Energy Servs., Inc.*, 291 F.3d 1227 (10th Cir. 2002) (attorneys' fees under Wyo. Stat. Ann. §26-15-124 not recoverable).

In the third-party context, “[a]n insurer who is providing a defense to its insured, but who has declined an offer to settle within policy limits, is not bound by a settlement between the insured and the claimant where the insurer was not given prior notice of the terms of the settlement and was not given an opportunity to participate.” *Gainsco Ins. Co. v. Amoco Prod. Co.*, 53 P.3d 1051, 1079 (Wyo. 2002).

Invoking the right to a declaratory judgment action does not, in and of itself, support an action for bad faith. *Int’l Surplus Lines Ins. Co. v. Univ. of Wyo. Research Corp.*, 850 F. Supp. 1509, 1527 (D. Wyo. 1994) (“Absent a showing by the defendants that the plaintiff filed this suit for an improper or illegitimate purpose,... it is clear that the mere fact of filing suit, standing alone, is not evidence of bad faith”).

***Is there a cause of action for reverse bad faith?***

No reported cases.

**Other Significant Cases Involving Bad Faith and Extracontractual Claims**

*Darlow v. Farmers Ins. Exch.*, 822 P.2d 820 (Wyo. 1991) holds that, in situations where both parties

to an incident are insured by the same insurer, the insurer’s duty of good faith included informing the injured insured as to coverage and policy requirements when it was apparent to the insurer that the injured insured could only be compensated fully under her own policy.

*Ohio Casualty Ins. Co. v. W.N. McMurry Constr. Co.*, 230 P.3d 312, 327 (Wyo. 2010) holds that “insurer will be bound by the acts of its agent undertaken within the scope of that agency.” Additionally, the knowledge of insurer agent will be imputed to the insurer even if that knowledge is not communicated to the insurer.

AUTHORS

**Stuart R. Day** | Williams Porter Day & Neville PC | 307.265.0700 | sday@wpdn.net

**Keith J. Dodson** | Williams Porter Day & Neville PC | 307.265.0700 | kdodson@wpdn.net

**Erica R. Day** | Williams Porter Day & Neville PC | 307.265.0700 | eday@wpdn.net

# Canada

By Jason P. Mangano

## Causes of Action

### *Is there a statutory basis for an insured to bring a bad faith claim?*

Section 439 of the Ontario Insurance Act, 1990 R.S.O. c. I.8 (amended to 2003) states that: "No person shall engage in any unfair or deceptive act or practice." "Person" is deemed by section 438 to include an individual, a corporation, a Lloyd's name, a mutual benefit society or fraternal society.

Similar language is found in the respective insurance acts of some other Canadian common law Provinces and Territories. *See, for example*, s. 509 of Alberta's Insurance Act, R.S.A. 2000, c. I-3, which has similar wording.

The federal Competition Act, R.S. 1985, c. C-34 also provides a statutory cause of action against business entities, including insurance companies, for transgressions such as unfair competition, unfair advertising and price fixing or collusion.

The legislative provisions permitting bad faith actions are seldom, if ever, used. Instead, plaintiffs rely on common law cases to mount an action based on the insurer's common law duty to act with good faith and fair dealings with its insured.

### *Can a third party bring a statutory action for bad faith?*

A third party will not usually have an interest in a statutory bad faith claim against an insurer since the statutory cause of action is arguably personal to the policyholder.

### *Is there a common law cause of action for bad faith?*

Yes, in Canadian common law, the contract of insurance carries with it an implied obligation on

both parties to act in utmost good faith. An insurer is, therefore, required "to act promptly and fairly at every step of the claims process." *See Wadhvani v. State Farm Mut. Auto. Ins. Co.*, 2010 ONSC 2479, 2010 CarswellOnt 3340 (Ont. S.C.J. 2010) (citing *702535 Ontario Inc. v. Lloyd's London, Non-Marine Underwriters* (2000), 184 D.L.R. (4th) 687 (Ont. C.A.)) at paras. 28-30.

Canadian insurance law has recognized and followed old English authority that the relationship between insurer and policyholder is one of *uberrimae fides* or utmost good faith. *See Carter v. Bohem* (1766), 97 E.R. 1162, [1558-1774] All E.R. 183 (Eng. K.B.). For a comparative analysis of the utmost good faith principle in Canada, the U.S. and England, *see Saskatchewan Crop Insurance Corp. v. Deck*, 2008 CarswellSask 84 (C.A.). *See also* Roderick S.W. Winsor, *Good Faith In Canadian Insurance Law* (Toronto: Canada Law Book, 2007+ looseleaf service) and Gordon H. Hilliker, *Insurance Bad Faith*, 3d Ed. (Markham: LexisNexis Canada, 2015).

### *What cause of action exists for an excess carrier to bring a claim against a primary carrier?*

There is no statutory or contractual connection between the excess carrier and the primary carrier, so the excess carrier's claim cannot be pleaded directly as bad faith: *Willis v. Hope* (1990), 48 CCLI 126 (Ont. Dist. Ct.). *See also Overload Tractor Servs. Ltd. v. ICBC* (1989), 39 CCLI 18 (B.C.C.A.).

However, two Canadian decisions at the appellate level have recognized that the duties between primary and excess insurers may extend beyond contract. *See Hollinger Int'l Inc. v. Am. Home Assur. Co.*, 2006 CarswellOnt 188 (Ont. S.C.J.) (citing *Brondeur & Ball v. Am. Home Assur. Co.* (1990), 1 O.R. (3d)

claims made by a bankrupt insured, the cause of action will vest to the estate as an asset to be pursued at the discretion of the court and trustee. In *Future Health Inc. (Trustee of) v. State Farm Mutual Insurance Co. of Canada*, 2013 ONSC 6691, leave to appeal refused 2014 ONSC 356, the court refused to dismiss the bad faith action, as it was not plain and obvious that the bad faith claim could not be brought by the trustee in bankruptcy. The insurer unsuccessfully argued that the bad faith claim was an action *in personam*, and as such, could not vest in the trustee.

An insurer's bankruptcy or insolvency will result in an automatic stay of all claims against it. The party pursuing a stayed action may seek leave to lift the stay if it can demonstrate the claim will not reduce the target party's assets (*i.e.*, if there is E&O insurance or some other non-estate reserve to cover the claim against the insurer). Otherwise, such claims must be proven along with other unsecured creditors and, in the absence of a judgment, may have little or no value. Claims of this nature will not be answered by an industry fund set up to deal with insurer insolvency or bankruptcy.

In Ontario it appears a court will admit, for consideration purposes, a concession on the part of a bankrupt primary carrier of its previous bad faith conduct. *Plaza Fiberglass Mfg. Ltd. v. Cardinal Ins. Co.*, 1990 CarswellOnt 634 (O.S.C., H.C.J. 1990) (Proposition cited for upheld: a Court will admit a concession of bad faith on behalf of a bankrupt primary insurance carrier). The priority of such a claim as compared with other claims on policies issued by the company is doubtful until judgment is secured.

***How does insolvency or the intervention of a state guaranty fund affect the prosecution and defense of bad faith and extra-contractual claims?***

This issue has not been addressed by Canadian courts, *but see* above.

**Defenses and Counterclaims**

***Is evidence regarding the reasonableness of the conduct of the insured or third party claimant admissible?***

In *Wachal v. Crown Life Insurance Co.* (1999), 14 CCLI (3d) 284 (Man. Q.B.), the court refused to allow an award of punitive damages at least in part because the plaintiff exaggerated her medical condition. This was corroborated with video surveillance evidence. (*See also* "Reverse Bad Faith" below).

***Is "advice of counsel" a recognized defense?***

This has yet to be fully litigated. However, in *Wonderful Ventures Ltd. v. Maylam*, [2001] BCJ No. 1144 (B.C.S.C.), the court, in ordering bifurcation, confirmed that privileged information in the insurer's file was "relevant to the defense" of bad faith allegations, but privileged in the context of the contractual claim. *See also Lawrence v ICBC*, [2001] BCJ No 2516 (B.C.S.C.); *Sovereign Gen. Ins. Co. v. Tanar Indus. Ltd.*, [2002] AJ No 107 (Alta. Q.B.); and *Brennand v. Sun Life Assurance Co. of Canada*, 2011 BCSC 759.

Some courts have held that where a party attempts to justify its position "on the grounds of detrimental reliance upon the legal advice received," it waives the privilege associated with that legal advice. *Guelph (City) v. Super Blue Box Recycling Corp.* (2004), 2 CPC (6th) 276 (Ont. S.C.J.) (citing *Davies v. Am. Home Assurance Co.* (2002), 60 OR (3d) 512 (Ont. Div. Ct.) and *Sovereign Gen. Ins. Co. v Tanar Indus. Ltd.*, [2002] AJ No 107 (Alta. Q.B.)). However, a recent Ontario decision affirms that litigation privilege always trumps claims of bad faith. One court has held there is no "bad faith exception" to the litigation privilege rule. *See Kavanagh v. Peel Mutual Insurance Co.*, 2009 CarswellOnt 6377 (Ont. S.C.J. 2009) (citing *Davies v. Am. Home Assurance Co.* (2002), 60 OR (3d) 512 (Ont. Div. Ct.)). In contrast, in *Keane v. Dominion of Canada General Insurance Co.*, 2008 CarswellOnt 8233 (Ont. S.C.J. 2008), the insurer had to produce its claims file in a sealed envelope for the court so a determination could be made as to which portions had to be produced to the insured. It was held that material covered by litigation privilege had to be disclosed if relevant to claim of bad faith conduct. Cases

involving the production of otherwise privileged documents raise the issue of bifurcation.

A B.C. Court has held that a request by an insurer for legal advice, without more, cannot found a claim based on either bad faith or negligence. *Pearlman v. Am. Commerce Ins. Co.*, 2009 CarswellBC 387 (C.A.).

### **What other defenses are available?**

The Ontario Court of Appeal has suggested in *Khaz-zaka v. CGU Insurance Co. of Canada*, [2002] OJ No 3110, [2003] I.L.R. I-4138, 115 A.C.W.S. (3d) 984, 162 O.A.C. 293, 28 C.P.C. (5th) 15, 43 C.C.L.I. (3d) 90, 66 O.R. (3d) 390, that because the insurer's duty of good faith extends right up to the date of trial, evidence of a review process at regular intervals would be admissible and relevant in the bad faith claim. The suggestion is that if the insurer demonstrates a claims review process that is fair in all respects, even if it proves to be mistaken, an insurer will have discharged its good faith duty.

Cases that hold there must be a valid and favorably decided action on the policy before an ongoing bad faith claim will crystallize suggest that a bad faith action may be defended on the basis that the insured does not have a valid and favorably decided action on the policy. *Forestex Mgmt. Corp. v. Underwriters at Lloyd's*, 2004 FC 1303 (F.C.C.).

### **Is there a cause of action for reverse bad faith?**

Alberta courts recognize claims for "reverse" bad faith and will award punitive damages against policyholders. See *Andrusiw v. Aetna Life Ins. Co. of Can.* (2001), 33 CCLI (3d) 238 (Alta. Q.B.) and *Haiduc v. Alberta Motor Ass'n Ins. Co.*, [2003] AJ No 392 (Alta. Q.B.). In addition to obtaining punitive damages the insurer may also receive an increased costs award at the end of the trial. See *Al-Asadi v. Alberta Motor Ass'n Ins. Co.*, [2003] 7 WWR 92 (Alta. Q.B.).

According to the B.C. Court of Appeal, an insured's breach of the duty of good faith is an actionable wrong that is independent of a breach of contract claim and can form the basis of a claim for punitive damages. *Asselstine v. Mfrs. Life*, 2005 BCCA 292, 22 CCLI (4th) 169 (C.A.), *additional reasons in* 2005

BCCA 465, 26 CCLI (4th) 68 (CA) (citing *Fidler v. Sun Life Assur. Co. of Canada*, 2004 BCCA 273 (B.C.C.A.)).

Similarly, it is "trite law" in Ontario that conduct amounting to a breach of good faith by an insured will disentitle the insured relief against forfeiture. *Can. Newspapers Co. v. Kansa Gen. Ins. Co.*, [1996] ILR I-3369 (Ont. C.A.).

In the absence of other higher level authority, reverse bad faith remains an open question in many Canadian jurisdictions.

### **Other Significant Cases Involving Bad Faith and Extracontractual Claims**

The financial vulnerability of the insured and the insurer's exploitation of this will be a significant factor in assessing availability and quantum of extra-contractual damages. See *Whiten v. Pilot Insurance Co.*, [2002] 1 SCR 595 (S.C.C.); *Clarfield v. Crown Life Ins.*, [2000] OJ No 4074 (Ont. S.C.J.).

The setting of artificially low reserves for a loss may represent an act of bad faith on the part of the insurer. Discovery was permitted on this issue. *Osborne v. Non-Marine Underwriters, Lloyd's of London* (2003), 5 CCLI (4th) 124 (Ont. S.C.J.). However, the information relating to the setting of reserves per se does not have a semblance of relevance in an insurance bad faith action. *Lin (Litig. Guardian of) v. Belair Ins. Co.*, 2009 CarswellOnt 8215 (Ont. Mas. 2009).

There is conflicting authority in Canada as to whether or not an insured can assert a separate bad faith action against the adjuster or other employees of the insurer arising out of the manner in which the insured's claim was handled. In *Spiers v. Zurich Insurance Co.* (1999), 45 OR (3d) 726 (S.C.J.) (Upheld: Appellant court refused leave to appeal), a concurrent bad faith claim against the insurance adjuster was allowed to continue alongside the claim against the insurers. In *Burke v. Buss*, [2002] OJ No 2938 (Ont. S.C.J.), the court refused to follow *Spiers*. In Alberta, the court ordered a bad faith claim against an adjuster to trial owing to the conflicting case law on point. *Abassi v. Portage La Prairie Mut. Ins. Co.*, 2003 ABQB 760, [2003] I.L.R. I-4235, [2003] A.W.L.D. 501, [2003] A.J. No. 1118, [2004] 3 W.W.R. 665, 125 A.C.W.S. (3d) 245, 23 Alta. L.R. (4th) 293,

347 A.R. 275, 5 C.C.L.I. (4th) 34. One appellate decision suggests the possibility of extending the tort of bad faith to adjusters in cases where there is a malicious intent, on the part of the adjuster, to harm the insured. *Walsh v. Nicholls*, 2004 NBCA 59 (N.B.C.A.).

The insurer's duty of good faith and fair dealing puts the onus on the insurer to make available for inspection by an insured, at any time until a claim is resolved, those documents in the insurer's possession or control which will allow an insured to satisfy himself that his claim has been handled by the insurer in good faith and that he has been dealt with fairly. *Alexander v. Great-West Life Assurance Co.*, 2004 NBQB 285 (N.B. Q.B., 2004).

The proposition that an insurer may never settle claims against their policies unless the settlement involves all insureds has been rejected in Ontario. However, an insurer must only accept reasonable settlement offers or else the insurer risks breaching its duty of good faith. *Hollinger Int'l Inc. v Am. Home Assur. Co.*, 2006 CarswellOnt 188 (Ont. S.C.J.).

AUTHOR

**Jason P. Mangano** | Blaney McMurtry LLP |  
416.596.2896 | jmangano@blaney.com

# **MANAGING CAPTIVE CLAIMS**

Michael Aylward, Morrison Mahoney LLP  
David Goodwin, Covington & Burling LLP  
Barbara Miller, Wells Fargo & Company

May 16, 2018

**American College of Coverage and  
Extracontractual Counsel  
Annual Meeting**

**The discussion below is a general summary of the issues and does not necessarily reflect the views of the authors or their clients.**

## **MANAGING CAPTIVE CLAIMS**

### **I. Forms of Risk Transfer**

Insurance is, of course, a form of risk transfer. But as anyone familiar with enterprise risk management will advise, a policyholder may not be able to transfer the key risks it faces to an insurance carrier, at least not at commercially reasonable rates. What are the options available to large commercial enterprises for transferring risk?

#### **A. Traditional Insurance**

Traditional insurance policies transfer risk transfer from the insured to the insurance carrier in consideration of the payment of a premium.

#### **B. Self-Insurance**

Whereas commercial liability insurance typically applied on a “dollar one” basis, most large commercial enterprises will now layer their coverage beginning with a working primary layer that is self-insured and for which the insured itself controls the defense and adjustment of claims until the SIR is exhausted.

#### **C. Going Partially Bare**

Larger insureds who have the financial assets to absorb some risk may choose not to purchase primary coverage or will purchase no coverage at all except when required by contracts or regulations. In addition, insurance is, of course, not available to cover all risks that a business may face – whether because commercial insurers are not willing to write insurance policies that cover those risks (e.g., asbestos), or because they are contrary to law (e.g., insuring willful criminal behavior), or because of expense (e.g., a large pharmaceutical company that might try to purchase “dollar one” products liability insurance).

#### **D. Alternative Premium Arrangements**

Many larger insureds that are likely to experience frequent claims will want the expertise of an insurance carrier or third party administrator in managing

claims but will not want to pay the premiums associated with “dollar one” risk transfer. Responding to that demand, some insurance policies are subject to “retrospective premium” arrangements under which the insured will pay a minimum advance premium, with possible additional premiums at the end of the policy period depending on claims experience. In addition, some insurance policies – such as contractor- or owner-controlled insurance programs for large construction projects – include “large risk rating plans,” that use retrospective premium adjustments to turn what looks at first glance to be risk transfer insurance into an insurance program largely funded by the named insured.

### **E. Fronting Policies**

To satisfy regulatory or contractual requirements to have insurance policies in place, some larger insureds will purchase commercial insurance policies but the policies either will have retained limits equal to the policy limits or will be fully reinsured by the named insured’s captive insurer. As a result, there will be little or no net risk transfer.

### **F. Obtaining Protection from Business Partners: Contractual Indemnity and “Additional Insured” Coverage**

A business may also obtain protection through its contractual arrangements with business partners. For instance, most construction projects include indemnity terms requiring subcontractors to hold the general contractor and owner harmless against any claims arising out of the subcontractor’s work. Such indemnity undertakings are typically backed up by contractual terms giving the indemnitee additional insured status under the indemnitor’s policies.

## **II. Captive Insurance Companies**

All of the foregoing alternatives are variants on the traditional risk transfer model of insurance. One non-traditional model is the creation of a captive insurance program, wherein the insured insures itself.

Captive insurance programs can be attractive risk transfer alternative for numerous reasons, including the ability to manage the insured’s own risk, control cash flow, deduct insurance premiums and develop a coverage program that is better aligned with a corporation’s risk profile than conventional insurance allows. Whether for these reasons or others, captive programs have become a popular risk

transfer option for large commercial enterprises. In the 55 years since the first captive program was created in Bermuda in 1962, 7000 captives have been created.

### **A. What is Captive Insurance?**

“A captive insurance company is an insurance company formed by a business owner to insure the risks of the operating business. The operating business pays premiums to the captive, and the capture insures the risks of the operating business.” Jay Adkisson, *Captive Insurance Companies* viii (2006). Some of the typical characteristics of captive insurers are that the captive:

1. Is owned by the named insured (or, in some instances, by a group of insureds or consists of a risk retention group or joint powers authority);
2. Is incorporated in a jurisdiction with a regulatory structure that supports captive insurers (such as Bermuda, the Channel Islands, or Vermont);
3. Can be limited to the types of insurance policies authorized by its license (*e.g.* general liability insurance may be authorized but not workers’ compensation may not be);
4. Is run by a “captive manager” (usually by contract with a major brokerage or consulting firm);
5. Manages claims through an in-house group or a third party administrator; and
6. Limits its risk by purchasing reinsurance for the self-insured losses as well as conventional excess insurance for losses exceeding the limits of the captive program.

### **B. Why would a business set up a captive?**

1. Obtain better control over costs of insurance.
2. Lower overhead than conventional insurance.
3. Can use the existence of the captive to obtain leverage in negotiations with commercial insurers over premiums and scope of coverage.
4. Because the named insured knows its own business better than any commercial insurer, it may be able to be more precise about premiums and limits than a commercial insurer.

5. Can spread premiums over a longer period so that the named insured does not have to pay up front.
6. Can have broader policy terms and scope of coverage, or more customized coverage than commercial insurers are willing to sell.
7. More control over the claims handling process.
8. More flexibility to use higher (or lower) deductibles.
9. Direct access to reinsurance.
10. Can cover risks that commercial insurers are unwilling to accept or that, in the jurisdictions whose laws would govern a commercial insurance policy, are uninsurable (*e.g.*, a Bermuda insurer can cover a punitive damages risk for a New York business whereas a New York insurer may not be able to cover that risk).
11. Gives the insured a greater incentive to prevent losses.
12. Control own defense and retain counsel of own choice.
13. May become a profit center for the named insured.

### **C. Deciding to Set Up a Captive**

While these are significant advantages, a corporation should carefully assess its insurance needs before electing to set up a captive. Before making such a decision, a business should undertake a comprehensive and objective analysis of needs and exposures. Questions to be considered include (1) what lines of coverage should be included; (2) does the business have sufficient expertise to handle some or all of these risks in-house or should it hire a Third Party Administrator; (3) what jurisdiction has the most favorable regulatory environment for such a program and (4) how much risk is the insured willing to absorb and to what extent can this risk be mitigated by purchasing excess insurance layers and/or reinsurance to protect against adverse loss experience.

## **III. Reinsurance**

### **A. What Is Reinsurance?**

Reinsurance is not a new development in the insurance world. As one treatise explained nearly 250 years ago: “Re-assurance . . . may be said to be a

contract, which the first insurer enters into, in order to relieve himself from those risks which he has incautiously undertaken, by throwing them upon other underwriters, who are called re-assurers.” (J. Park, *A System of the Law of Marine Insurance* 315 (1789) (quoted in G. Staring & D. Hansell, *Law of Reinsurance* 1 (2017 ed.).)

## **B. Types of Reinsurance**

Generally speaking, reinsurance is either written on a “treaty” or a “facultative” basis. Treaty reinsurance covers more than one insurance policy; facultative reinsurance is reinsurance written specially to cover a single insurance policy. Reinsurance of captive insurance is almost always facultative.

## **C. Formation of a contract of reinsurance**

1. The party that purchases reinsurance is called the “cedent”: It cedes part (or, sometimes, all) of the risk to the reinsurer.

2. Traditionally, the cedent has to comply with a duty of “utmost good faith” (*uberrima fides*) in purchasing a contract of reinsurance. Some states even require the communication to the reinsurer of privileged information relevant to the decision to bind coverage. More recently, the ceding insurer’s duties to the reinsurer tend to mirror those of the policyholder’s duties to the insurer, at least outside of the marine market.

3. Facultative reinsurance policies (often called “certificates”) typically incorporate the terms and conditions of the insurance policy they are reinsuring, but also have standard form provisions and endorsements modifying either the cedent’s insurance policy (when the reinsurer is not willing to back all of the risks the ceding insurer is insuring) or the terms of the reinsurer’s standard form certificate of reinsurance.

4. Often, reinsurance of an insurance policy with large limits of liability will be written in layers, just as is the case with large insurance programs.

5. While a reinsurer’s duty to pay generally does not arise until the cedent actually pays a judgment or settlement, reinsurance agreements uniformly require the ceding insurer to give notice of claims that are “likely” to implicate the reinsurance or otherwise meet certain specified objective criteria. Timely notice of serious claims affords the reinsurer the opportunity to exercise its rights under the agreement to associate or otherwise involve itself in the investigation, adjustment, defense or settlement of the underlying claim.

Reinsurance agreements contain various different clauses affording insurers these rights, including “right to associate,” “claims cooperation” and “claims control” clauses.

A “right to associate” clause typically gives the reinsurer the right to participate “in the defense and control of any claim, suit or proceeding which may involve [the] reinsurance with the full cooperation of [the cedent].” Association clauses permit the reinsurer to consult with and advise the reinsured in its handling of the claim without imposing any affirmative obligation on the reinsurer to investigate or pay for the defense of the underlying claim. While the level of association varies from relationship to relationship, the right generally includes more than the contractual right of inspection and claims review, and allows reinsurers the right to have and timely express an opinion about the on-going handling of the underlying claim.

Some reinsurance agreements, particularly those emanating from the London Market, contain “claims cooperation” which give reinsurers greater input and control over the defense than a conventional “right to associate” clause and which may explicitly require the reinsurer’s consent before the insurer can settle.

Finally, some agreements contain “claims control” clauses that permit the reinsurer to participate directly in negotiations, adjustment and settlement of underlying claims. In general, these clauses are more common when the ceding company retains little or no risk and may therefore have little financial incentive to aggressively contest the insured’s claim against it. These clauses cede the most control to a reinsurer and may impose an affirmative obligation on the reinsurer to exercise actual control over all or a portion of the claims handling, including the obligation to investigate, adjust and resolve claims.

6. Most reinsurance certificates also contain “follow the fortunes” and “follow the settlements” provisions that limit the reinsurer’s ability to challenge its obligation to reinsure losses paid by the cedent.

a. A follow-the-fortunes clause “binds a reinsurer to accept the cedent’s good faith decisions on all things concerning the underlying insurance terms and claims against the underlying insured: coverage, tactics, lawsuits, compromise, resistance or capitulation.” *N. River Ins. Co v. ACE Am. Reins. Co.*, 361 F.3d 134, 139-40 (2d Cir. 2004) (citation omitted). The clause further “obligates the reinsurer to indemnify the ceding insurer . . . for any payments the cedent makes for claims covered by the underlying insurance.” *Nat’l Union Fire Ins. Co. of Pittsburgh, Pa. v. Am. Re-Ins. Co.*, 441 F. Supp. 2d 646, 650 (S.D.N.Y.

2006); *Christiania Gen. Ins. Corp. of N.Y. v. Great Am. Ins. Co.*, 979 F.2d 268, 280 (2d Cir. 1992) (“Under the ‘follow the fortunes’ doctrine, a reinsurer is required to indemnify for payments reasonably within the terms of the original policy, even if technically not covered by it.”). A typical “follow the fortunes” clause is: “Except as otherwise agreed, the liability of the Reinsurer specified in the Declarations will follow that of the Company and will be subject in all respects to all terms and conditions of the [ceding insurer’s] Policy . . . .”

b. “The purpose of the . . . ‘follow the settlements’ doctrine in reinsurance law is to prevent the reinsurer from ‘second-guessing’ the settlement decisions of the ceding company.” *Granite State Ins. Co. v. ACE Am. Reinsurance Co.*, 849 N.Y.S.2d 201, 203 (App. Div. 2007). “[T]he follow the settlements doctrine imposes upon the reinsurer a contractual obligation to indemnify the ceding company for payments it makes pursuant to a loss settlement under its own policy, provided that such settlement is not fraudulent, collusive or otherwise made in bad faith, and provided further that the settlement is not an ex gratia payment.” *Aetna Cas. & Sur. Co. v. Home Ins. Co.*, 882 F. Supp. 1328, 1346 (S.D.N.Y. 1995). Thus, when reinsurance certificates have follow-the-settlements clauses, “the reinsurers will be bound by the settlement or compromise agreed to by the cedent . . . .” *Excess Ins. Co. v. Factory Mut. Ins. Co.*, 822 N.E.2d 768, 771 n.3 (N.Y. 2004). A typical follow-the-settlements clause provides, in relevant part, that: “All loss settlements made by the Company, provided they are within the terms, conditions and limits of the [ceding insurer’s] Policy, and within the terms, conditions and limits of this Certificate, will be binding on the Reinsurer.”

c. Ceding insurers often argue that follow-the-fortunes and follow-the-settlements clauses are necessary parts of the reinsurance relationship because, otherwise, the process of adjusting and paying claims would be delayed and the ceding insurers could run afoul of both regulatory requirements to pay covered claims promptly and duties of good faith and faith dealing.

d. Often, reinsurers of captive insurance policies will omit or delete the follow-the-fortunes and follow-the-settlements provisions in their standard form certificates of reinsurance when they are reinsuring captive insurance policies, out of concern that the ceding captive insurer may decide to pay claims that a commercial insurer might decline. However, some authority exists for the proposition that a follow-the-fortunes clause applies when it is in a certificate of reinsurance that covers an insurance policy issued by a captive insurance company. *See Mentor Insurance Co. (U.K.) Ltd. v. Norges Brannkasse*, 996 F.2d 506 (2d Cir. 1993) (requiring reinsurer to follow the fortunes, albeit under the specific and somewhat unusual facts of the case).

6. Certificates of reinsurance often contain other standard provisions that apply to the ceding insurer, such as:

a. Most, but not all, reinsurance treaties have alternative dispute resolution clauses requiring arbitration in the event of a dispute, often with a New York, Delaware, or English choice-of-law and choice-of-forum clause.

b. The cedent typically must provide prompt notice of claim to the reinsurer. Courts are split as to whether a “notice prejudice” requirement applies if the reinsurer wishes to raise an “untimely notice” defense. *Compare Unigard Sec. Ins. Co. v. N. River Ins. Co.*, 79 N.Y.2d 576, 584 (1992) (“prejudice” required), *with Liberty Mut. Ins. Co. v. Gibbs*, 773 F.2d 15 (1st Cir. 1985) (no prejudice required; Massachusetts law).

c. The cedent must cooperate with the reinsurer’s reasonable requests for information.

d. The cedent sometimes must obtain the reinsurer’s consent before settling a claim that would trigger the reinsurer’s payment obligation before settling a lawsuit or claim that exceeds the captive policy’s deductible.

#### **D. Presenting Captive Insurance Company Claims to Reinsurers:**

1. Timely notice
2. Cooperation
3. Frequent exchanges of information and input when consistent with the defense of the underlying litigation
4. Share coverage opinions with reinsurer
5. Keep reinsurer informed in real time of settlement discussions
6. Many certificates of reinsurance are subject to unusual alternative dispute resolution requirements, such as binding arbitration before a panel comprised of current or former insurance company executives. Because of the prevalence of ADR requirements in reinsurance certificates, reinsurance litigation is rare.

#### **IV. Claims Handling Under A Captive Insurance Program**

## **A. Attachment Points**

Captive insurance policies often apply in excess of a large deductible or retained limit. As a result, it often is the case that claims against the named insured are too small to reach the attachment point of a captive insurance policy.

## **B. Arm's Length Claim Handling**

Although administered by the policyholder, a captive insurance program retains many of the hallmarks of traditional insurance including the possibility that some claims will not be covered. There is a certain tension, of course, in requiring the administrator of a captive insurance program to deny coverage to its business client. Such safeguards are essential to the actuarial viability of such programs, however, and are preconditioned to approval by state insurance regulators and the availability of reinsurance for such programs.

To the extent that claims reach the attachment point, it often is the practice of claims managers for captive insurers to handle claims at arm's length. That is, the captive insurer will pay claims only if the captive insurance policy covers them, and not as an accommodation to the named insured.

1. As a result, a claims manager or third party administrator should feel free to deny coverage or reserve rights if the claim is not, or may not be, covered. Sometimes, the claims manager or TPA will seek the advice of coverage counsel for problematic claims.

2. This is especially important when the captive insurer has purchased reinsurance, as reinsurance may not cover an *ex gratia* payment or a payment that is not made in good faith. Arm's length claims handling is also important because a captive insurer must maintain its capital and must pay out in claims roughly what it charges in premiums in order to remain in good standing with regulatory and tax authorities.

3. To the extent that the captive must obtain the reinsurer's consent to settle, a reinsurer is much more likely to consent to an arm's length acknowledgement of coverage.

4. In cases where claims are plainly not covered, the risk manager may choose to apply to the captive manager for retroactive coverage, which may or may not be granted subject to the approval of state regulators or reinsurers who may have concerns with respect to the impact of the claim on the viability of the program.

5. Some captive insurance policies provide that the captive will only indemnify the named insured to the extent that reinsurance provides coverage.

### **C. Maintaining Communication**

A captive insurer typically does not have a duty to defend, so it does not need to manage the underlying claim. However, the captive is likely to insist that the in-house counsel and defense counsel keep the captive informed of developments in the litigation and seek the captive's consent. If there is a duty to defend, the captive files should be well documented regarding coverage determinations and ongoing communications.

This Chapter has been reproduced from The Reinsurance Professional's Deskbook, 2018-2019 Edition, with permission of the publisher, Thomson Reuters. Further reproduction of this Chapter without the express permission of Thomson Reuters is prohibited.

## Chapter 8

### Reinsurer's Obligations to Cedent

*Michael F. Aylward\**

- § 8:1 Overview
- § 8:2 Introduction
- § 8:3 The reinsurer's right to associate or defend
- § 8:4 Scope of reinsurer's duty of good faith, generally
- § 8:5 —The "follow the settlements" doctrine
- § 8:6 —The "follow the fortunes" doctrine
- § 8:7 Limitations to the "follow the fortunes" doctrine, generally
- § 8:8 —Bad faith on the part of the cedent
- § 8:9 —Bad faith on the part of the reinsurer
- § 8:10 —Settlements inconsistent with terms of reinsurance agreement
- § 8:11 Application of the "follow the fortunes" doctrine, generally

---

*\*Michael F. Aylward* is a partner in the Boston office of Morrison Mahoney LLP where he chairs the firm's Complex Claims Resolution group. For the past 30 years, he has represented domestic insurers and reinsurers in adjusting and litigating claims arising out of asbestos, bad faith, clergy abuse, construction defects, intellectual property disputes, pollution, privacy, and sundry other sources of liability. He is a leading author and lecturer on insurance coverage and reinsurance issues, having contributed chapters to *New Appleman on Insurance Law* treatise (2007 and 2010), *The Law and Practice of Insurance Litigation* (West 2005), *Emerging Issues in the CGL Policy* (National Underwriter 2008), and the ABA's *Environmental Liability and Insurance Recovery* treatise (2012). Mr. Aylward has also been a leader in the defense bar, having just completed service as chair of the DRI Law Institute and having in the past served as a member of the DRI Board of Directors and chair of the respective insurance and reinsurance law committee of DRI, FDCC, and IADC. More recently, he has been among the founding members of the Massachusetts Reinsurance Bar Association and the American College of Coverage and Extra-Contractual Counsel. For the past several years, he has been included in the International Who's Who of Insurance and Reinsurance Lawyers. Mr. Aylward is an AAA-certified neutral and has served as an arbitrator in several large insurance disputes. He is a graduate of Dartmouth College (B.A. *cum laude with honors in History* 1976) and the Boston College Law School (J.D. *cum laude* 1981).

- § 8:12 —Disputes involving allocation decisions
- § 8:13 —Disputes involving numbers of “occurrences”
- § 8:14 —Miscellaneous sources of controversy
- § 8:15 —Is there an emerging consensus?
- § 8:16 Do reinsurers have a duty to approve settlements in advance?
- § 8:17 Reimbursement for the costs of coverage litigation?

**KeyCite®:** Cases and other legal materials listed in KeyCite Scope can be researched through the KeyCite service on Westlaw®. Use KeyCite to check citations for form, parallel references, prior and later history, and comprehensive citator information, including citations to other decisions and secondary materials.

### § 8:1 Overview

Reinsurance is a vehicle for ceding companies to transfer underwriting risk to reinsurers. In exchange for premium payments to the reinsurer, the reinsurer is obligated to pay ceded losses pursuant to the reinsurance contract.

Reinsurance contracts often contain language requiring that disputes be resolved by arbitrators in accordance with the custom and practice of the insurance and reinsurance industry. Certain historical reinsurance contracts, particularly facultative certificates, may lack arbitration clauses and have therefore resolved their disputes through the courts.

While the outcome of reinsurance arbitrations are confidential, the decisions resulting from disputes that have been litigated do provide insight into how the obligations of reinsurers may be adjudged. This Chapter provides an overview and analysis of judicial precedent addressing certain obligations the reinsurer and the ceding company owe to each other, as well as implied rights and duties that insurers and reinsurers must navigate in the handling and scrutiny of claims prior to their formally being ceded for payment. In addition, emerging issues and newer reinsurance contract wording are discussed, as well as a summary of Practical Points gleaned from the case law presented.

### § 8:2 Introduction

What historically has been considered a “gentleman’s agreement” has been the subject of a great deal of disagreement between ceding insurers and their reinsurers in recent years. Much of this controversy arose as a result of a significant number of asbestos, pollution and latent injury cessions, and has focused on

the whether the duty of reinsurers to “follow the fortunes” or “follow the settlements” of ceding insurers binds them to pay cessions that arguably maximize the cedent’s reinsurance recovery or that otherwise do not necessarily reflect the basis upon which the underlying coverage dispute was settled.

In this section we will consider certain rights and duties of reinsurers, both as regards the right to involve itself in the ceding insurer’s handling of underlying claim and the scope of a reinsurer’s duty to pay ceded losses. The section concludes with a discussion of whether reinsurer’s duties extend to the reimbursement of declaratory judgment expenses.

### § 8:3 The reinsurer’s right to associate or defend

While a reinsurer’s duty to pay generally does not arise until the cedent actually pays a judgment or settlement, reinsurance agreements uniformly require the ceding insurer to give notice of claims that are “likely” to implicate the reinsurance or otherwise meet certain specified objective criteria.<sup>1</sup> Timely notice of serious claims affords the reinsurer the opportunity to exercise its rights under the agreement to associate or otherwise involve itself in the investigation, adjustment, defense or settlement of the underlying claim.

Reinsurance agreements contain various different clauses affording insurers these rights, including “right to associate,” “claims cooperation” and “claims control” clauses.

A “right to associate” clause typically gives the reinsurer the right to participate “in the defense and control of any claim, suit or proceeding which may involve [the] reinsurance with the full cooperation of [the cedent]”<sup>2</sup> Association clauses permit the reinsurer to consult with and advise the reinsured in its handling of the claim without imposing any affirmative obligation on the reinsurer to investigate or pay for the defense of the underlying claim. While the level of association varies from relationship to relationship, the right generally includes more than the contractual right of inspection and claims review, and allows reinsurers the right to have and timely express an opinion about the ongoing handling of the underlying claim.

Some reinsurance agreements, particularly those emanating

---

#### [Section 8:3]

<sup>1</sup>See *British National Ins. Co. of Cayman v. Safety National Ins. Co.*, 335 F.3d 205 (3d Cir. 2003).

<sup>2</sup>*Unigard Security Ins. Co., Inc. v. North River Ins. Co.*, 4 F.3d 1049, 1055 (2d Cir. 1993).

from the London Market, contain “claims cooperation” which give reinsurers greater input and control over the defense than a conventional “right to associate” clause and which may explicitly require the reinsurer’s consent before the insurer can settle.

Finally, some agreements contain “claims control” clauses that permit the reinsurer to participate directly in negotiations, adjustment and settlement of underlying claims. In general, these clauses are more common when the ceding company retains little or no risk and may therefore have little financial incentive to aggressively contest the insured’s claim against it. These clauses cede the most control to a reinsurer and may impose an affirmative obligation on the reinsurer to exercise actual control over all or a portion of the claims handling, including the obligation to investigate, adjust and resolve claims.

The failure of the ceding insurer to give timely notice to its reinsurer may forfeit its rights to payment, although U.S. court differ with respect to whether the reinsurer must show prejudice in order to avoid coverage.<sup>3</sup>

In practice, reinsurers rarely avail themselves of the right to associate in the underlying defense, whether due to the added expense of association or concern that they may somehow expose themselves to extracontractual liability to the cedent or direct liability to the underlying claimant.<sup>4</sup>

#### § 8:4 Scope of reinsurer’s duty of good faith, generally

Just as the doctrine of *uberrima fides* requires the ceding insurer to be utterly candid in its disclosures to the reinsurer and in affording timely notice of a loss, so to is the reinsurer bound in good faith to pay losses that are ceded to it without second guessing the cedent’s decision to settle. This duty—whether expressed as the reinsurer’s duty to “follow the fortunes” or “follow the settlement” of the cedent—is not unbounded, however. In particular, a reinsurer may challenge a cession that was not made in good faith. Additionally, a reinsurer has no duty to pay losses that exceed the bounds of its contractual undertaking to the ceding insurer.

---

<sup>3</sup>*North River Ins. Co. v. CIGNA Reinsurance Co.*, 52 F.3d 1194, 1216 (3d Cir. 1995) and *Unigard Security Ins. Co. v. North River Ins. Co.*, 4 F.3d 1049, 1068–70 (2d Cir. 1993).

<sup>4</sup>*Slotkin v. Citizens Cas. Co. of New York*, 614 F.2d 301, 316–17 (2d Cir. 1979), adhered to on rehearing, 614 F.2d 301, 323 (holding reinsurers directly liable to tort claimant in case where reinsurers controlled the defense and had full control over settlement).

As a federal judge in Massachusetts has found,<sup>1</sup> “[u]tmost good faith . . . requires a reinsurer to indemnify its cedent for losses that are even arguably within the scope of the coverage reinsured, and not to refuse to pay merely because there may be another reasonable interpretation of the parties’ obligations under which the reinsurer could avoid payment.”

The reinsurer’s good faith duty to pay is a corollary of the ceding insurer’s obligation to be utterly candid in the presentation of the claim. As the Second Circuit<sup>2</sup> has observed in examining the symbiotic relationship of these duties:

Reinsurance involves contracts of indemnity, not liability. Reinsurers do not examine risks, receive notice of loss from the original insured, or investigate claims. In practice, the reinsurer has no contact with the insured . . . . The reinsurance relationship is often characterized as one of “utmost good faith.” This utmost good faith may be viewed as a legal rule but also as a tradition honored by ceding insurers and reinsurers in their ongoing commercial relationships. Historically, the reinsurance market has relied on a practice of the exercise of utmost good faith to decrease monitoring costs and ex ante contracting costs . . . . [R]einsurers cannot duplicate the costly but necessary efforts of the primary insurer in evaluating risks and handling claims. Reinsurers may thus not have actuarial expertise . . . in defending ordinary claims. They are protected, however, by a large area of common interest with ceding insurers and by the tradition of utmost good faith.

**§ 8:5 Scope of reinsurer’s duty of good faith, generally—  
The “follow the settlements” doctrine**

Many reinsurance agreements require the reinsurer to follow the ceding insurer’s settlements. Such terms vary from contract to contract. Examples include:

All loss settlements made by the Reinsured, including compromise settlements, shall be binding upon the reinsurer, providing that the loss underlying the settlement is within the terms of the original policy and is within the terms of the Reinsurance.

or:

All claims involving this reinsurance when settled by the Company, shall be binding on the Reinsurer, which shall be bound to pay its proportion of such settlements . . . .

**[Section 8:4]**

<sup>1</sup>*Commercial Union Ins. Co. v. Seven Provinces Ins. Co.*, 9 F. Supp. 2d 49, 69–70 (D. Mass. 1998), aff’d, 217 F.3d 33 (1st Cir. 2000). See also *United Fire & Cas. Co. v. Arkwright Mut. Ins. Co.*, 53 F. Supp. 2d 632, 642 (S.D.N.Y. 1999).

<sup>2</sup>*Unigard Sec. Ins. Co. v. North River Ins. Co.*, 4 F.3d 1049, 1054 (2d Cir. 1993).

or:

The liability of Reinsurer . . . shall follow that of Insurer, and except as otherwise specifically provided herein, shall be subject in all respects to the terms and conditions of Insurer's policy.

By contrast, London Standard Wording 343 provides:

All loss settlements by the Reinsured including compromise settlements and the establishment of Funds for the settlement of losses shall be binding upon the Reinsurers, providing such settlements are within the terms and conditions of the original policies and/or contracts. . .and within the terms and conditions of this Contract.

U.S. courts have declared that “the ‘follow the settlements’ doctrine imposes on the reinsurer a contractual obligation to indemnify the reinsured or ceding company for payments the reinsured makes pursuant to a loss settlement under its own policy, provided that such settlement is not fraudulent, collusive or otherwise made in bad faith, or an *ex gratia* payment, such as one made to avoid the costs of litigation even though there is no legal obligation to pay.”<sup>1</sup>

As a federal court in Illinois<sup>2</sup> explained:

The purpose of follow-the-settlements clauses in reinsurance agreements is to bind a reinsurer to accept the cedent's good faith decisions on all things concerning the underlying insurance terms and claims against the underlying insured: coverage, tactics, lawsuits, compromise, resistance or capitulation. To allow the reinsurer to question the underlying settlement would be to relitigate the underlying claim all over again; there would be little incentive for the reinsured to settle its claims with policyholders. Therefore, once the reinsured enters into a settlement agreement with a policyholder, a follow-the-settlements provision requires the reinsurer to cover settlements made by the reinsured, as long as they are not fraudulent, collusive or made in bad faith.

Likewise, the British Court of Appeals ruled in *The Ins. Co. of Africa v. Scor (U.K.) R. Co. Ltd.*<sup>3</sup> that a reinsurer is bound to follow the settlement of and indemnify the ceding company so long as (1) the settled claim falls within the risks covered by the policy of reinsurance as a matter of law and (2) the ceding company

---

**[Section 8:5]**

<sup>1</sup>*Aetna Cas. & Sur. Co. v. Home Ins. Co.*, 882 F.Supp. 1328, 1346 (S.D.N.Y. 1995), quoted in *North River Ins. Co. v. Employers Reinsurance Corp.*, 197 F.Supp. 2d 972, 986 (S.D. Ohio 2002).

<sup>2</sup>*Arrowood Indem. Co. v. Assurecare Corp.*, 2012 WL 4340699, \*3 (N.D. Ill. 2012).

<sup>3</sup>*The Ins. Co. of Africa v. Scor (U.K.) R. Co. Ltd.*, 1 Lloyd's Rep. 312 (1985).

acted honestly and in a businesslike manner in making the settlement. As the *Scor* court explained:

The original insurer of today might be the reinsurer of tomorrow; and trusting each other to act in the utmost good faith and saving the expense to reinsurers of disputing claims which the original insurers did not dispute, they agreed to insert in policies of reinsurance a clause applying their reinsurance to the original insurer's policies subject to the same terms and conditions and to pay as might be paid upon.

The *Scor* court further ruled that reinsurers could not avoid their duty to pay by showing, after the fact, that the underlying claim was not covered by the reinsured contracts of insurance. As Lord Justice Goff explained:

If insurers have settled a claim, acting honestly and in a proper and businesslike manner, then the fact that reinsurers may thereafter be able to prove that the claim of the assured was fraudulent does not of itself entitle reinsurers not to follow the settlement of the insurers. In my judgment they must follow the settlement, as they have contracted to do.<sup>4</sup>

In the absence of a "follow the settlements" clause, the ceding insurer has a much greater burden of proof. At a minimum, it must establish that its settlement was covered by its policy and not an *ex gratia* payment.

Courts have generally declined to imply the existence of a "follow the settlements" requirement where one is not specifically set forth in the reinsurance contract notwithstanding cedents' arguments that the doctrine is implicit in industry practices.<sup>5</sup> As a federal court in Florida<sup>6</sup> declared, courts should not "go outside the laws of contract construction and outside the four corners of an unambiguous contract to add a clause that was not bargained for," even though there are "benefits and numerous public policy considerations supporting enforcement of the 'follow the fortunes' doctrine in the world of reinsurance."

◆ **Practice Point:** *Confirm that you have "follow the settle-*

<sup>4</sup>*The Ins. Co. of Africa v. Scor (U.K.) R. Co. Ltd.*, 1 Lloyd's Rep. 312, 321–22 (1985).

<sup>5</sup>See *Employers Reinsurance Corp.*, 197 F. Supp. 2d 972, 986 (S.D. Ohio 2002) (applying New Jersey law) and *Affiliated FM Ins. Co. v. Employers Reinsurance Corp.*, 369 F. Supp. 2d 217, 227 (D.R.I. 2005). But see *Aetna Cas. & Sur. Co. v. Home Ins. Co.*, 882 F. Supp. 1328, 1349 (S.D.N.Y. 1995) and *International Surplus Lines Ins. Co. v. Certain Underwriters at Lloyd's, London*, 868 F. Supp. 917, 920 (S.D. Ohio 1994).

<sup>6</sup>*Employers Reinsurance Corp. v. Laurier Indemnity Co.*, No. 03-1650 (M.D. Fla. 2006).

*ments*” or “*follow the fortunes*” language in your agreements.  
*Are you in a jurisdiction where courts will imply a difference?*

U.S. courts have tended to use the terms “follow the settlements” and “follow the fortunes” interchangeably to the point where any distinction between these doctrines has been blurred to the point of near extinction. Some courts have valiantly sought to maintain a distinction, however, explaining that “[t]he ‘follow the fortunes’ doctrine requires reinsurers to accept a reinsured’s good faith decision that a particular loss is covered by the terms of the underlying policy, while the ‘follow the settlements’ doctrine requires reinsurers to abide by a reinsured’s good faith decision to settle, rather than litigate, claims on that policy.”<sup>7</sup> Likewise, a federal court in Ohio declared in *North River Ins. Co. v. Employers Re*,<sup>8</sup> that “the term ‘follow the fortunes’ more accurately describes the reinsurer’s obligation to follow the reinsured’s underwriting fortunes, whereas ‘follow the settlements’ refers to the duty to follow the actions of the reinsured in adjusting and settling claims.”

Despite this semantic confusion, it is not apparent that the comingling of these doctrines has any practical impact on the outcome of reinsurance disputes, as U.S. courts treat the insurer’s duty to “follow the fortunes” as implying a broader duty that certainly encompasses the duty to “follow the settlements.” The same may not be true of courts in other countries, however.

### § 8:6 Scope of reinsurer’s duty of good faith, generally— The “follow the fortunes” doctrine

“Under the “follow the fortunes” doctrine, a reinsurer is required to indemnify the reinsured for payments reasonably within the terms of the original policy, even if technically not covered by it. A reinsurer cannot second guess the good faith liability determinations made by its reinsured . . .”<sup>1</sup> As a result, the doctrine “requires payment where the cedent’s good-faith payments to its insured is at least arguably within the scope of the insurance coverage that was reinsured.”<sup>2</sup>

The “follow the fortunes” doctrine “binds a reinsurer to accept

<sup>7</sup>*Commercial Union Ins. Co. v. Seven Provinces Ins. Co., Ltd.*, 9 F. Supp. 2d 49, 66 (D. Mass. 1998).

<sup>8</sup>*North River Ins. Co. v. Employers Re*, 197 F.Supp. 2d 972, 978 (S.D. Ohio).

#### [Section 8:6]

<sup>1</sup>*Christiana General Ins. Corp. v. Great American Ins. Co.*, 979 F.2d 268, 280 (2d Cir. 1992).

<sup>2</sup>*Mentor Ins. Co. (UK) v. Brannkasse*, 996 F.2d 506, 517 (2d Cir. 1993).

the cedent's good faith decisions on all things concerning the underlying insurance terms and claims against the underlying insured: coverage, tactics, lawsuits, compromise, resistance or capitulation."<sup>3</sup> It insulates the cedent from a reinsurer's challenge unless the cession is fraudulent, in bad faith, or the payments are "clearly beyond the scope of the original policy" or "in excess of [the reinsurer's] agreed-to exposure."<sup>4</sup> "Basically, the doctrine burdens the reinsurer with those risks which the direct insurer bears under the direct insurer's policy covering the original insured."<sup>5</sup> It is well-established that a follow-the-fortunes doctrine applies to all outcomes, including settlements and judgments.<sup>6</sup>

As the New York Court of Appeals declared in *Travelers Cas. & Sur. Co. v. Certain Underwriters at Lloyd's of London*,<sup>7</sup> the doctrine "streamlines the reimbursement process and reduces litigation by preventing a reinsurer from continually challenging the propriety of a reinsured's settlement decisions."

#### § 8:7 Limitations to the "follow the fortunes" doctrine, generally

Reinsurers are not obliged to accept or pay settlements that are presented in bad faith or that are contrary to the terms of their contracts of reinsurance with the ceding insurer.

#### § 8:8 Limitations to the "follow the fortunes" doctrine, generally—Bad faith on the part of the cedent

A reinsurer seeking to avoid payment on the basis of a ceding insurer's claimed bad faith must show that the cedent acted with "deliberate deception, gross negligence, recklessness."<sup>1</sup> If there is a good faith dispute with respect to the ceding insurer's duties to

<sup>3</sup>*British International Ins. Co. v. Seguros La Republica, S.A.*, 342 F.3d 78, 85 (2d Cir. 2003).

<sup>4</sup>*Christiana General Ins. Co. v. Great American Ins. Co.*, 979 F.2d 268, 280 (2d Cir. 1992).

<sup>5</sup>*Bellefonte Reins. Co. v. Aetna Cas. & Sur. Co.*, 903 F.2d 910, 912 (2d Cir. 1990).

<sup>6</sup>See *North. River Ins. Co. v. CIGNA Reinsurance Co.*, 52 F.3d 1194, 1205 (3d Cir. 1995) ("Thus, we find the clause applies both to settlements and to judgments").

<sup>7</sup>*Travelers Cas. & Sur. Co. v. Certain Underwriters at Lloyd's of London*, 96 N.Y.2d 583, 596 (2001).

#### [Section 8:8]

<sup>1</sup>*American Bankers Ins. Co. of Fla. v. Northwestern National Ins. Co.*, 198

its policyholder, its decision to settle is unlikely to be found to meet this standard.<sup>2</sup>

In one recent case, a reinsurer argued that it was bad faith for the ceding insurer to include claims within its cession that it had never investigated. At issue in *American Employers Ins. Co. v. Swiss Reins. America Corp.*,<sup>3</sup> was the insurer's settlement of an underlying coverage action involving 92 different hazardous waste sites. Of the 92 sites, 37 were deemed to be significant and ten were the real focus of the insurer's concern in its settlement discussions. At the time of its settlement with the insured for \$44 million, American Employers had only obtained site specific cost estimates for the ten most important sites. Nevertheless, in ceding \$20.1 million of the loss to Swiss Re pursuant to various facultative certificates, it included \$1.2 million for the other twenty-seven sites. Swiss Re argued (and a Massachusetts District Court agreed) that as American Employers had no information about these sites and therefore could not assign any value to them in good faith.

On appeal, however, the First Circuit reversed the lower court's finding that American Employers' allocation of any amount of the settlement to sites that it had not investigated was bad faith. The court found the ceding insurer's use of an 80% discount for these 27 subsidiary sites was an extrapolation from earlier demands that the insured had made. Although somewhat arbitrary, the court took note of the cost and burden that would otherwise have been imposed on American Employers to develop more detailed site specific cost information for sites that were, in the final analysis, "small potatoes." The court therefore refused to apply a fixed rule for the amount of inquiry necessary to justify a settlement as "reasonable," declaring that "[h]ow far one looks, with what tools, and with what costs in money and delay, obviously depend on circumstances."

Whereas, a few courts have ruled, however, that a reinsurer is

---

F.3d 1332, 1335-36 (11th Cir. 1999), quoting *Unigard Security Ins. Co., Inc. v. North River Ins. Co.*, 4 F.3d 1049, 1069 (2d Cir. 1993). See also *North. River Ins. Co. v. CIGNA Reinsurance Co.*, 52 F.3d 1194, 1216 (3d Cir. 1995) ("As we have noted, bad faith requires an extraordinary showing of a disingenuous or dishonest failure to carry out a contract. The standard is not mere negligence, but gross negligence or recklessness.").

<sup>2</sup>American Bankers, 198 F.3d at 1136-37 ("Under the state of the law at the time of the submission of Hartford's claim for payment, we cannot say that American Bankers acted in a grossly negligent or reckless manner in accepting or paying those claims.").

<sup>3</sup>*American Employers Ins. Co. v. Swiss Reins. America Corp.*, 413 F.3d 129 (1st Cir. 2005).

not bound to follow the insurer's settlement if the settlement was not even "arguably" covered by the underlying insurance policies,<sup>4</sup> the First Circuit's analysis in *American Employers* reflects a relatively pragmatic view of the reinsurance relationship and does not permit a reinsurer to impose unreasonably strict burdens of inquiry on aspects of the underlying claim that are relatively unimportant.

◆ **Practice Point for Reinsurers:** *Courts are unlikely to look kindly on after the fact arguments by reinsurers that cedent should have defended a claim differently. Such arguments may have greater force and effect if the reinsurer has exercised its right to associate and made these recommendations to the cedent at the time. Alternatively, a reinsurer should be prepared to be very specific in its argument to the court, demonstrating exactly what the cost of the additional work would have been, why it was commercially reasonable to assume that most insurers would have done this and what impact it had on the outcome of the claim.*

### § 8:9 Limitations to the "follow the fortunes" doctrine, generally—Bad faith on the part of the reinsurer

In a handful of cases, cedents have succeeded in obtaining bad faith awards against reinsurers for egregious claims investigation and baseless delays in making payment. Of these, the best known is *Commercial Union Ins. Co. v. Seven Provinces Ins. Co.*<sup>1</sup>

Commercial Union sought reinsurance from Seven Provinces for sums it had paid to settle various underlying environmental liability claims presented by Teledyne. Seven Provinces disputed the cession, arguing that Commercial Union had improperly allocated the loss to its facultative certificate. Further, Seven Provinces argued that Commercial Union never should have paid the loss since the claim in question involved an owned facility and was subject to the "owned property" exclusion in the underlying insurance policy reinsured by Seven Provinces.

Judge Gertner rejected these challenges, finding that the Com-

<sup>4</sup>See *Suter v. General Accident Ins. Co. of America*, 2006 U.S. Dist. LEXIS 48209 (D.N.J. 2006) (no duty where cedent failed to conduct a reasonable, businesslike investigation before settling). See also *American Marine Ins. Group v. Neptunia Ins. Co.*, 775 F. Supp. 703, 709 (S.D.N.Y. 1991), *aff'd*, 961 F.2d 372 (2d Cir. 1992) (requiring cedent to be "honest and businesslike" in adjusting the underlying claim).

#### [Section 8:9]

<sup>1</sup>*Commercial Union Ins. Co. v. Seven Provinces Ins. Co.*, 9 F. Supp. 2d 49 (D. Mass. 1998), *aff'd* 217 F.3d 33 (1st Cir. 2000).

mercial Union settlement was reasonable and that its cession was consistent with the manner in which it had settled the underlying environmental claims. Further, the court went on to award bad faith damages against the reinsurer, finding that Seven Provinces engaged in a “moving target” strategy of evasion and delay by making “numerous and constantly shifting requests for information and raising new defenses to payment.” The court found that “Seven Provinces’ intent in its dealings with Commercial Union was to delay and object to payment so that CU would compromise the Teledyne bill and agree to a global commutation of all of the business between the parties.”

These findings were affirmed on appeal to the U.S. Court of Appeals for the First Circuit. As with Judge Gertner, the Court of Appeals declared that “Seven Provinces’ conduct—raising multiple, shifting defenses, (many of them insubstantial) in a lengthy patter of foot dragging and stringing Commercial Union along, with the intent (as its own witness admitted) of pressuring Commercial Union to compromise it’s claim had the extortionate quality that marks a 93A violation.” Moreover, in light of the exacting standard of good faith required by the doctrine of *uberima fides*, the First Circuit found that Seven Provinces’ “bad faith tactics were wholly alien to the usual course of dealings between an insurer and a reinsurer, and thus were even more clearly removed from an ordinary breach of contract.”

◆ **Practice Point:** *All of these disputes ultimately turn on the contents of the insurer or reinsurer’s claim file and often concern privileged communications from in-house or outside coverage counsel. Although discovery rules differ from state to state, courts are generally relatively liberal in allowing discovery of privileged communications in bad faith cases, especially if the party seeking discovery has made a prima facie showing that the communications were in aid of the bad faith.*

#### § 8:10 Limitations to the “follow the fortunes” doctrine, generally—Settlements inconsistent with terms of reinsurance agreement

A reinsurer is not bound to follow an insurer’s fortunes insofar as the terms of the settlement are in conflict with the terms of the reinsurance contract.

Thus, the New York Court of Appeals ruled in *Travelers Cas. and Sur. Co. v. Certain Underwriters at Lloyd's of London*<sup>1</sup> that Travelers could not compel Lloyd's to reimburse it on a "single occurrence" basis where the treaties in question covered a "disaster and/or casualty," which was defined as "resulting from a series of accidents, occurrences and/or causative incidents." The court found that the "follow the fortunes" doctrine did not trump explicit contrary language in the contract of reinsurance.

The First Circuit ruled in *Commercial Union Ins. Co. v. Swiss Reinsurance America Corp.*<sup>2</sup> that a District Court erred in declaring that a reinsurer was not bound to follow the limits of coverage set forth in the ceded policy. The court ruled that Swiss Re was bound to follow the "annualized" limits approach upon which CU had settled the underlying pollution claims with its policyholder (W.R. Grace). Whether or not CU's coverage counsel was correct in predicting that New York would require that the policy limit apply once for each year and not once per policy, the court found that this view was binding upon Swiss Re under its follow the fortunes clause so long as the resulting settlement was reasonable and made in good faith. Since the reinsurance certificates did not expressly preclude annualization, the court declared that, "concurrency between the policy of reinsurance and the reinsured policy is presumed."

In *Arrowood Surplus Lines Ins. Co. v. Westport Ins. Co.*,<sup>3</sup> the Second Circuit affirmed a Connecticut court's ruling that a reinsurer had no obligation to reimburse the ceding insurer for losses paid on account of damages suffered after the reinsurance agreement ceased to be in effect. Despite Arrowood's argument that it settled due to the risk that a lower court might rule that it had issued a three-year policy rather than the one-year policy that it claimed to have issued, the court declared that the "follow the fortunes" doctrine had no application since losses occurring after 2000 were by definition beyond the time period of the policies that the reinsurance protected.

◆ **Practice Point:** *Insofar as a loss is ceded on a basis that is alien to the scope of the reinsurance agreement, it is important*

---

**[Section 8:10]**

<sup>1</sup>*Travelers Cas. and Sur. Co. v. Certain Underwriters at Lloyd's of London*, 760 N.E.2d 319, 327–29 (N.Y. 2001).

<sup>2</sup>*Commercial Union Ins. Co. v. Swiss Reinsurance America Corp.*, 413 F.3d 121 (1st Cir. 2005).

<sup>3</sup>*Arrowood Surplus Lines Ins. Co. v. Westport Ins. Co.*, No. 08-1393 (D. Conn. Jan. 5, 2010), *aff'd*, 2010 WL 3933561 (2d Cir. Oct. 8, 2010).

*that the reinsurer immediately bring this inconsistency to the attention of the ceding insurer.*

**§ 8:11 Application of the “follow the fortunes” doctrine, generally**

The wave of large asbestos and environmental liability claims that inundated the U.S. casualty insurers in the 1990s has generated an unprecedented number of law suits between insurers seeking reimbursement for the settlement of those claims and reinsurers disputing their obligation to do so. Most of these cases turn on the issue of whether the settlements were unreasonably manipulated, before or after the fact, to reach the reinsurance.

In the next two subsections, we will discuss the following cases in which courts considered arguments by reinsurers that they had no duty to reimburse cedents for settlements that were demonstrably unreasonable or that reflected an allocation to reinsured years or layers based on legal theories that were at odds with positions that cedents took in the underlying disputes with their policyholders.

<b>Case</b>	<b>Claim Type</b>	<b>Issue</b>	<b>Prevailing Party</b>	<b>Holding</b>
<i>Travelers Cas. v. Gerling Global Re</i> , 419 F.3d 181 (2d Cir. 2005)	Asbestos	Post-settlement allocation	Cedent	Cedent’s proposed allocation deserves deference even if not a part of underlying settlement; cedent not required to allocate so to minimize its reinsurance recovery.
<i>Allstate v. American Home Assur. Co.</i> , 837 N.Y.2d 138 (App Div. 2007)	Pollution	Post-settlement allocation	Reinsurer	Post-settlement analysis prepared by outside counsel could not justify position on number of “occurrences” that was the opposite of what insurer had successfully disputed against insured in original DJ.

<b>Case</b>	<b>Claim Type</b>	<b>Issue</b>	<b>Prevailing Party</b>	<b>Holding</b>
<i>American Employers Ins. Co. v. Swiss Re</i> , 413 F. 3d 129 (1st Cir. 2005)	Pollution	Post-settlement allocation	Cedent	Cedent allowed to adopt allocation position on “annualization” of multi-year limits, even though insured never pursued it, because insured might <i>potentially</i> have sought recovery on this basis.
<i>American Home Assur. Co. v. Everest Re</i> , 653 A.2d 305 (Del. Super. 1994).	Pollution	Reasonableness	Reinsurer	Settlement that ignored Delaware law upholding pollution exclusion was legally unsupportable.
<i>Hartford Acc. &amp; Ind. Co. v. ACE American</i> , 936 A.2d 224 (Conn. 2007)	Asbestos	Reasonableness	Cedent	Summary judgment should not have been granted to reinsurers where “common cause” language was ambiguous as to ability to aggregate underlying claims.
<i>Hartford Acc. v. Columbia Cas. Co.</i> , 98 F. Supp. 2d 251 (D. Conn. 2000)	Pollution	Post-settlement allocation	Reinsurer	Summary judgment defeated based on evidence that cedent engaged in “self-serving” and unreasonable allocation.
<i>North River v. ACE American</i> , 361 F.3d 134 (2d Cir. 2004)	Breast implants	Post-settlement allocation	Cedent	Cedent held free to choose allocation theory that increases its reinsurance recovery so long as theory can be justified independent of reinsurance considerations.

Case	Claim Type	Issue	Prevailing Party	Holding
<i>USF&amp;G v. American Reins.</i> , 20 N.Y.3d 407 (2013)	Asbestos	Post-settlement allocation	Reinsurer	Summary judgment reversed based on finding that cedent should have included some component for release of serious bad faith claims and had inflated value of non-meso claims to enlarge recovery.
<i>Utica Mutual Insurance Company v. Clearwater Insurance Company</i> , 2016 WL 254770 (N.D. N.Y. 2016).	Asbestos	Post-settlement allocation	Reinsurer	No evidence that the cedent’s settlement decision was unduly influenced by reinsurance considerations.

**§ 8:12 Application of the “follow the fortunes” doctrine, generally—Disputes involving allocation decisions**

Just as a growing number of recent reinsurance disputes have arisen out of the large losses that liability insurers have been obliged to pay to resolve asbestos and environmental liability claims, so too have these reinsurance cases often turned on issues involving allocation concerns with respect to how the ceding insurer settled the underlying cases. The issue in these cases typically turns on whether the ceding insurer is ceding its reinsurance claim on the same basis as it settled the underlying claim or whether, as is sometimes the case, the ceding insurer adopts a different theory of allocation post-settlement in order to maximize its reinsurance recovery.

In *Travelers Cas. & Sur. Co. v. Gerling Global Reinsurance Corp. of America*,<sup>1</sup> the Second Circuit declared that “a cedent’s post-settlement allocation must be deferred to under a follow-the fortunes clause, regardless of any pre-settlement position taken

**[Section 8:12]**

<sup>1</sup>*Travelers Cas. & Sur. Co. v. Gerling Global Reinsurance Corp. of America*, 419 F.3d 181, 188 (2d Cir. 2005).

by the cedent, whether that position is articulated in a pre-settlement risk analysis or is implicit in the settlement with the underlying insured.” The court explained that a reinsurer seeking to avoid application of follow the fortunes must make an “extraordinary showing of a disingenuous or dishonest failure” and that “a cedent choosing among several reasonable allocation possibilities is surely not required to choose the allocation that minimizes its reinsurance recovery to avoid a finding of bad faith.”

A similarly deferential view to the cedent was adopted by the First Circuit in *American Employers Ins. Co. v. Swiss Reins. American Corp.*<sup>2</sup> Having settled with the insured for \$44 million, American Employers ceded \$20.1 million of the loss to Swiss Re, which had issued facultative certificates reinsuring three 3-year umbrella policies that had been in effect from 1962 to 1971. A key concern of American Employers in the pollution coverage litigation had been whether the “per occurrence” limits of those policies would be triggered on a “per policy” or “per year” (annualized) basis. Although American Employers had argued against annualization in its discussions with the insured and no mention was made of its in the final settlement agreement, American Employers adopted an “annualization” approach in its cession to Swiss Re.

Swiss Re resisted American Employers’ billing on the ground that a non-annualized approach should be used that would have reduced the cession by \$3.5 million. Swiss Re also contended that it should not have pay the \$1.2 million allocated to the 27 secondary sites because American Employers had no information about these sites and therefore could not assign any value to them in good faith. A federal district court in Massachusetts agreed and granted summary judgment to Swiss Re on both claims.<sup>3</sup> On appeal, however, the First Circuit took a more nuanced view of the settlement. Even though the underlying insured had never really pursued the issue of “annualization” in the coverage litigation or its settlement negotiations with American Employers, the court pointed out that the insured *could* have raised such a claim at trial and, more importantly, American Employers had premised its own settlement analysis based on the likelihood that the insured would do so. The court found, therefore, that although the issue was “close,” the ceding insurer’s position was

---

<sup>2</sup>*American Employers Ins. Co. v. Swiss Reins. American Corp.*, 413 F.3d 129 (1st Cir. 2005).

<sup>3</sup>*American Employers Ins. Co. v. Swiss Reins. American Corp.*, 275 F. Supp. 2d 29 (D. Mass. 2003).

“supportable.” The First Circuit emphasized that American Employers’ “annualization” position was “not a post-hoc characterization or a unilateral post-settlement allocation without grounding in the settlement process itself” and observed that “t]here is considerable advantage in taking the insurer’s own contemporaneous calculus as a starting point and then letting the objections be tested primarily under the rubric of reasonableness and good faith.”

In addressing these issues, courts have declined to distinguish between pre- and post-settlement allocation decisions. As a Connecticut court<sup>4</sup> declared: “Applying the follow-the-settlements doctrine to post-settlement allocation decisions does not leave a reinsurer without protection. Cedents must make good-faith allocations, and reinsurers also cannot be held accountable for any loss not covered by the reinsurance policy.”

Thus, in *North River Ins. Co. v. ACE American Reinsurance Co.*,<sup>5</sup> the Second Circuit held that “the follow-the-settlements doctrine extends to a cedent’s post-settlement allocation decisions, regardless of whether an inquiry would reveal an inconsistency between that allocation and the cedent’s pre-settlement assessments of risk, as long as the allocation meets the typical follow-the-settlements requirements, *i.e.*, is in good faith, reasonable, and within the applicable policies.” The court found that:

Though pre-settlement analysis informs an insurer, such as North River, about the risks it faces, the range of risk, and the likelihood of a particular risk, that risk of loss is not “loss” under either the initial policy of insurance or the reinsurance contract. This risk of loss upstream is the very rationale for insurance; it is presumably why the direct insured first obtained insurance, and why the reinsured sought to cede coverage to the reinsurer. Risk of loss pervades insurance calculations and decisions, but insurers and reinsurers like ACE obligate themselves to pay only for loss incurred.

As a result, the Second Circuit declared that a ceding insurer “may engage in all manner of analyses to inform its decision as to whether, and at what amount, to settle, but those analyses are irrelevant to the contractual obligation of the reinsurer to indemnify the reinsured for loss under the reinsurance policy.”

---

<sup>4</sup>See *Hartford Accident & Indem. Co. v. Columbia Cas. Co.*, 98 F.Supp.2d 251, 259 (D. Conn. 2000) (finding material facts in dispute as to whether the reinsurer was bound by the “follow-the-settlements” provision of the reinsurance contract where the cedent’s allocation may have reflected an effort to maximize the amount of reinsurance collected).

<sup>5</sup>*North River Ins. Co. v. ACE American Reinsurance Co.*, 361 F.3d 134 (2d Cir. 2004).

In *Travelers Cas. & Sur. Co. v. INA*,<sup>6</sup> the Third Circuit ruled in 2010 that the “follow the fortunes” applies to post-settlement allocation decisions and that insurers are not acting in bad faith as long as they cede such losses to reinsurers in a reasonable manner that can be justified independently of reinsurance considerations. Accordingly, an insurer is free to consider the reinsurance implications of its settlement so long as its cession reflects reasonable, businesslike decisions made in good faith.

Dow Corning sought coverage from Travelers for diverse liabilities, including breast implant claims and various chemical exposures. Ultimately, Travelers agreed to settle for a lump sum payment of \$137 million. Of this amount, \$80 million was stated in the agreement to be for the breast implant claims, \$20 million for chemical product exposures and a remaining \$37 million for unrelated claims. The insured also agreed to Travelers’ request that the breast implant claims be treated as a single “occurrence.” Further, the breast implant claims were agreed to involve “non-products” losses, whereas the chemical exposure claims were characterized as “products” claims. Of the \$80 million allocated to breast implants, Travelers characterized the entire loss payment as indemnity, not defense.

Travelers lost little time in ceding the claim to its reinsurers. INA disputed the cession, questioning whether Travelers had (1) acted in bad faith by manipulating its rationale for the settlement to maximize reinsurance recoveries; (2) artificially compressed the amount allocated to the reinsurance period by eliminating any allocation to any AL policy issued after 1982; and (3) had similarly inflated its reinsurance recovery by improperly claiming that the limits of coverage in two three-year policies should be calculated on a “per year” basis. INA also criticized Travelers’ refusal to treat any of the breast implant settlement as involving defense costs.

In the ensuing litigation in Philadelphia, the federal district court ruled in Travelers’ favor, finding that although INA had reason to be suspicious, Travelers “did not act in bad faith and that its various decisions were reasonable, businesslike decisions made in good faith.” Having ruled for Travelers in Phase One, the court found for INA in Phase Two, ruling that the three-year policies were subject to a single limit and should not have been annualized.

On appeal, the Third Circuit found that INA had failed to show that Travelers acted in bad faith by manipulating its post-

---

<sup>6</sup>*Travelers Cas. & Sur. Co. v. INA*, 609 F.3d 143 (3d Cir. 2010).

settlement allocation to maximize recovery under the reinsured layer of coverage. Recognizing that there is a dispute among the circuits with respect to whether the “follow the fortunes” doctrine should apply to post-settlement allocations—especially where, as here, the allocation decisions being challenged were not the product of active bargaining between the policyholder and the insurance company—the Third Circuit aligned itself with the majority view that the doctrine does apply to post-settlement allocations. Explaining, the Third Circuit declared that a contrary holding “would risk doing precisely what the follow the fortunes doctrine aims to prevent, interfering in settlement negotiations between insurers and their insureds by discouraging a particular type of settlement (here an all cash deal).”

While acknowledging that post-settlement allocation decisions must be made in good faith, the Third Circuit emphasized “that the insurers’ negative duty not to make allocation decisions primarily in order to increase reinsurance recovery does not translate into a positive duty on the part of the insurer to minimize its reinsurance recovery.” Accordingly, in order to prevail on a bad faith defense, the reinsurer must show more than that a particular allocation decision increased its obligations. Rather, the reinsurer must provide direct evidence that the insurer was motivated primarily by reinsurance considerations or else show that the after-the-fact rationales offered by the insurer are not credible.

In this case, the Third Court found that Travelers’ decisions were reasonable and were not designed solely to maximize its reinsurance recovery. The Third Circuit disagreed with the District Court’s conclusion that Travelers acted properly in excluding the post-1982 AL policies from its allocation. But even though it sided with INA on the substance of this argument, the Third Circuit found no bad faith. As it explained, “[b]ecause Travelers was under no duty to minimize its reinsurance recovery, the mere fact that it could have, consistent with its agreement with the insured, allocated it to all of the [reinsured] policies does not mean that it was required to do so.”

In one of the most significant reinsurance allocation cases decided to date, the New York Court of Appeals ruled in 2013 that a cedent’s allocation decisions must be objectively reasonable and are not immune to challenge merely because the reinsurance cession mirrors the allocation assumptions that the insurer utilized in settling with its policyholder. In *USF&G v.*

*American Re-Ins. Co.*,<sup>7</sup> the Court of Appeals found that lower courts should not have ruled that the reinsurer must reimburse a cedent for a multi-million asbestos settlement where disputed issues of fact remained as to what portion of the settlement should be attributed to bad faith claims and whether USF&G inflated the value of non-meso claims to cover for the fact that it had not assigned any value for the insured's release of bad faith claims against USF&G.

The Court of Appeals' decision declared the courts should give significant deference to the ceding insurer's allocation, if only because the court could not think of a good alternative that would not open the door to "long litigation over complex issues that courts may not be well equipped to resolve." Rather, the court opined that "deference to a cedent's decisions makes for a more orderly and predictable resolution of claims."

The Court of Appeals emphasized, however, that there were limits to this deference. In particular, a reinsurer is only bound by allocation decisions that are made in good faith and are objectively reasonable. While an allocation is not unreasonable merely because it furthers the self-interest of the cedent (by increasing the reinsured recovery), "the reinsured's allocation must be one that the parties to the settlement of the underlying insurance claims might reasonably have arrived at in arm's length negotiations if the reinsurance did not exist."

Importantly, the Court of Appeals also ruled that reasonableness does not exist just because the cedent's reinsurance allocation methodology mirrors the assumptions used in settling with the policyholder. The court archly noted that "in many cases claimants and insureds[,] far from being indifferent, will enthusiastically support insurers' efforts to fund a settlement at reinsurers' expense."

Summing up the first phase of its opinion, the court declared:

In sum, under a follow the settlements clause like the one we have here, a cedent's allocation of a settlement for reinsurance purposes will be binding on a reinsurer if, but only if, it is a reasonable allocation, and consistency with the allocation used in settling the underlying claim does not by itself establish reasonableness.

In the second phase of its opinion, the Court of Appeals proceeded to consider whether USF&G's allocation decisions in this case were reasonable as a matter of law in ceding this loss to its reinsurers based on the assumptions: (1) that all of the settlement amount was attributable to claims within the limits of

---

<sup>7</sup>*USF&G v. American Re-Ins. Co.*, 20 N.Y.3d 407, 985 N.E.2d 876 (2013).

USF&G's policies, and none of it to the claims that USF&G acted in bad faith when it refused to defend MacArthur in asbestos litigation; (2) that claims by claimants suffering from lung cancer had a value of \$200,000 each, while certain other claims had values of \$50,000 or less; and (3) that USF&G's entire payment should be attributed to the policy in force in 1959—the last full year in which USF&G was Western Asbestos's liability insurer. Could these assumptions “reasonably have been the basis for an arm's length settlement among the asbestos claimants, MacArthur and USF&G if reinsurance were not in the picture?”

In this case, it was clearly to USF&G's advantage not to attribute any portion of its settlement to the bad faith claims, as bad faith damages were not a reinsured “loss in connection with each policy.” However, the court found that there was significant evidence that USF&G might have faced a bad faith verdict had it not settled. In particular, the court observed that a jury could have found that USF&G “knew, well before it admitted, that it did indeed provide such coverage, and that its litigation position was an irresponsible attempt to exploit the fact that, with the passage of time, the policies it issued had disappeared.” The court suggested that even though USF&G's alternative argument that it did not owe coverage by “operation of law” to the corporate successor of its named insured might have been plausible, one reasonable basis for avoiding coverage did not nullify the bad faith denial on the basis of missing policies. The court took note of the fact that the California Superior Court had found questions of fact concerning USF&G's possible bad faith and had not only denied its motion for summary judgment on these grounds before trial, but had also denied, at the outset of the coverage trial, a motion in limine to exclude some evidence thought to be relevant to those claims.

In light of these facts, the Court of Appeals concluded that “it was therefore arguably not reasonable, at the time the coverage litigation was settled, to say that the bad faith claims had no value.” Further, it found that USF&G might have assigned inflated values to non-meso claims to offset the lack of any valuation for bad faith. The court also took note of the fact that MacArthur had included a bad faith dollar demand in earlier negotiations with USF&G and that bad faith claims had been discussed with the Bankruptcy Court in approving a plan of reorganization for MacArthur. The court concluded, therefore, that:

In short, we find it impossible to conclude, as a matter of law, that parties bargaining at arm's length, in a situation where reinsurance was absent, could reasonably have given no value to the bad faith claims. This issue must be decided at trial.

**§ 8:13 Application of the “follow the fortunes” doctrine, generally—Disputes involving numbers of “occurrences”**

In *Allstate Ins. Co. v. American Home Assurance Co.*,<sup>1</sup> a facultative reinsurer was held not obliged to accept American Home's cession of its payments to United Technologies to resolve environmental liability claims around the country on a “one site/one occurrence” basis where such arguments were inconsistent with the multiple “occurrences” position that the insurer had used against UTC in the original coverage litigation, a case in which AIG had also obtained a ruling for one of the sites that separate operations and contamination at the site involve multiple “occurrences.” Unlike the trial court, the First Department was not swayed by a single occurrence analysis that had been prepared after the fact by coverage counsel. Rather, the court declared that, “A reinsurer is not bound by the follow the fortunes doctrine where the reinsured's settlement allocation, at odds with its allocation of the loss with its insured, designed to minimize its loss, reflects an effort to maximize unreasonably the amount of collectible reinsurance. The Appellate Division also ruled that American Home's argument that there was an “industry practice of ceding pollution claims to reinsurers on a single occurrence per site basis” was not only unsubstantiated but inconsistent with its own evidence.

In *Hartford Acc. & Ind. Co. v. Columbia Cas. Co.*,<sup>2</sup> a federal district court in Connecticut denied a cedent's motion for summary judgment that was premised on a “follow the settlements” provision in facultative certificates where there were facts that could support the inference that the cedent's conduct in allocating environmental liability to only one site was grossly negligent or reckless. The court found that the cedent's classification of the settlement as a single occurrence, where there were claims from over 50 different sites, may have been motivated by its desire to maximize reinsurance recovery and was done without following the customary practice of consulting an environmental expert.

---

**[Section 8:13]**

<sup>1</sup>*Allstate Ins. Co. v. American Home Assurance Co.*, 43 A.D. 3d 113, 837 N.Y.2d 138 (App. Div. 2007).

<sup>2</sup>*Hartford Acc. & Ind. Co. v. Columbia Cas. Co.*, 98 F. Supp. 2d 251, 258–60 (D. Conn. 2000).

Similarly, the Supreme Court of Connecticut ruled in *Hartford Acc. & Ind. Co. v. ACE American Reins. Co.*,<sup>3</sup> that a trial court erred in granting summary judgment to Hartford's reinsurers with respect to whether the 17,000 individual asbestos claims against Western MacCarthur could be aggregated to reach the reinsurers' layer. Whereas the Superior Court had ruled that the underlying claims could not be aggregated as involving "any one accident," the Supreme Court took the view that the common cause language was ambiguous and that further fact finding was needed to consider whether the underlying claims were "meaningfully related" and "arose out of the same pattern of events" so as to permit aggregation.

Under the terms of the relevant reinsurance contract, coverage only became available once a multimillion dollar threshold for "any one accident," which was defined as:

Any one, or more than one accident, happening or occurrence arising or resulting from any one event, casualty or catastrophe upon which liability is predicted, under one, or more than one, of the policies covered by this Agreement, and, as respects liability arising out of products manufactured, made, handled, distributed or sold by an assured, liability arising out of property damage or out of malpractice, said term shall also be deemed and construed to mean any one, or more than one accident, happening, or occurrence which the available evidence shows to be the probable common cause or causes of more than one claim under a policy, or policies or renewals thereof irrespective of the time of the presentation of such claims to the assured or the Hartford.

At trial, the Superior Court found that the underlying claims were each a separate "occurrence" and that the workers' exposures did not have "sufficient commonality" to come within the meaning of the common clause language. However, the Supreme Court found that the "arising out of products" language in the common cause provision was as to whether it allows aggregation of claims that were "meaningfully related" and "arose out of the same pattern of events" as argued by Hartford or, as the reinsurers claimed, "incorporates spatial and temporal limitations" that preclude aggregation of claims that were incurred at hundreds of different locations and over decades. The case therefore remanded for further proceedings.

Most recently, a federal district court in New York ruled<sup>4</sup> that a cedent did not act unreasonably or in bad faith in allocating

---

<sup>3</sup>*Hartford Acc. & Ind. Co. v. ACE American Reins. Co.*, 284 Conn. 744, 936 A.2d 224 (2007).

<sup>4</sup>*Utica Mut. Ins. Co. v. Clearwater Ins. Co.*, 2016 U.S. Dist. LEXIS 6219

asbestos losses to the reinsured umbrella policies. In grant summary judgment to the cedent, the court declined to find any evidence that the loss allocation was motivated by reinsurance considerations and ruled, in any event that a cedent was not required to pick an allocation methodology that minimized its reinsurance recovery. In light of uncertainty with respect to whether its primary policies would be found to contain an applicable aggregate limit or not, the District Court ruled that the cedent acted reasonably in negotiating a settlement agreement that minimized its overall liability.

◆ **Practice Points for Cedents:**

*Contemporaneous documentation of the legal and factual basis for settlement is a far more compelling basis for justifying a later reinsurance allocation than after the fact opinion letters received from outside counsel.*

*Regular reporting to reinsurers during the claims and settlement process may also alleviate or avoid later disputes.*

*The chronology of a settlement negotiation can be important evidence. Don't throw away notes and drafts!*

*Self-serving clauses in settlement agreements wherein the policyholder agrees to the reinsurer's position may be counter-productive unless there was real consideration for these concessions and evidence of a bona fide dispute on this issue before the settlement documents were executed.*

◆ **Practice Points for Reinsurers:**

*Is the insurer's position objectively reasonable in light of the law governing that particular dispute?*

*Has the insurer been consistent in its treatment of similar disputes in the past?*

*Has the insurer provided you with contemporaneous reports or legal opinions explaining its strategy in seeking to settle and the evolution of the eventual settlement agreement?*

**§ 8:14 Application of the “follow the fortunes” doctrine, generally—Miscellaneous sources of controversy**

*North River Ins. Co. v. CIGNA Reinsurance Corp.*<sup>1</sup> involved a dispute between North River and its facultative reinsurance dispute over sums paid to Owens Corning under the Wellington Agreement. On September 20, 1993, Judge Bassler issued a

(N.D.N.Y. Jan. 20, 2016).

**[Section 8:14]**

<sup>1</sup>*North River Ins. Co. v. CIGNA Reinsurance Corp.*, No. 91-1323 (D.N.J. September 20, 1993), reversed, 52 F.3d 1194 (3d Cir. 1995).

comprehensive opinion, ruling that the “follow the fortunes” clause in the facultative certificates did not obligate the reinsurers to reimburse North River for defense costs that were not provided for under the ceded policies, notwithstanding the fact that North River was had been ordered to pay such costs as the result of an adverse ADR ruling in the course of its Wellington participation. The Court further ruled that the reinsurers were freed of any obligations that they might otherwise have had due to North River’s violation of its duty of utmost good faith in failing to notify reinsurers of its Wellington participation and its grossly negligent handling of the ADR proceeding that resulted in the imposition of defense costs as a penalty.

These findings were reversed on appeal by the Third Circuit. The Court ruled that CIGNA Re must follow its cedent’s “fortunes” because the arbitrator’s decision was not based solely on the Wellington Agreement but rather found support in the language of North River’s excess insurance policies. Further, the Court ruled that the District Court erred in finding a breach of good faith and that CIGNA Re had in any event failed to show that it was prejudiced by North River’s conduct.

The Appellate Division of the New York Supreme Court refused to hold that reinsurers were bound to follow the fortunes of National Union in paying \$150 million to Monsanto to resolve numerous underlying toxic tort and environmental claims. In *American Home Assurance Co. v. Everest Re*,<sup>2</sup> the First Department ruled that although there was no evidence at all that National Union had acted other than in good faith in negotiating the Monsanto settlement, a disputed issue of fact did arise in light of the fact that only a few months after the settlement was reached, the Delaware Superior Court ruled in *Monsanto v. Aetna*<sup>3</sup> that such claims were subject to the “sudden and accidental”-type pollution exclusion.

**§ 8:15 Application of the “follow the fortunes” doctrine, generally—Is there an emerging consensus?**

It is apparent from the foregoing cases that courts are continuing to give deference to the ceding insurer’s rationale and are reluctant to give reinsurers too much latitude in contesting the cedent’s decision to settle. At the same time, courts are express-

---

<sup>2</sup>*American Home Assurance Co. v. Everest Re*, 90 A.D.3d 580, 936 N.Y.S.2d 20 (1st Dept. 2011).

<sup>3</sup>*Monsanto v. Aetna*, 1993 WL 563253 (1993), aff’d 653 A.2d 305 (Del. Super. 1994).

ing some skepticism about the rationale underlying some cessions.

At the same time, mere consistency between the underlying settlement and the cession is clearly not enough, in and of itself, to require payment. In many cases, the insured has no interest in a term that may be crucial to the reinsurance claim and will gladly agree to self-serving wordings that do not affect it but materially advance the cedent's potential recovery from its reinsurers.

At the same time, the mere fact that the insurer is acting to advance its own interests to the potential financial detriment of its reinsurers does not automatically invalidate its claim. As the Third Circuit observed in *Travelers v. INA*, Third Circuit emphasized “that the insurers’ negative duty not to make allocation decisions primarily in order to increase reinsurance recovery does not translate into a positive duty on the part of the insurer to minimize its reinsurance recovery.”<sup>1</sup>

To the extent that the foregoing authority can be synthesized, it appears that judicial analysis of reinsurers’ duty to follow their cedents’ fortunes is coalescing around several broad principles:

- (1) A cedent’s allocation methodology is entitled to considerable deference, even if it is contrary to positions that it articulated in the original coverage litigation or negotiations with its policyholder.
- (2) “Follow the fortunes” applies both to pre- and post-settlement allocation decisions.
- (3) The ceding insurer’s allocation must be objectively reasonable, such that it might have resulted from arms length bargaining between the ceding insurer and the underlying policyholder without any consideration of the existence and terms of the reinsurance.
- (4) The allocation must fairly reflect the claims that have been released.
- (5) The cession must reflect a plausible interpretation of the law—mere reliance on some claimed industry custom and practice will not suffice.
- (6) An reinsurer’s duty to follow its cedent’s fortunes does not require it to pay losses or amounts that are beyond what it contracted to reinsure.

---

[Section 8:15]

<sup>1</sup>609 F.3d 143 (3d Cir. 2010).

**§ 8:16 Do reinsurers have a duty to approve settlements in advance?**

Owing to the importance of reinsurance to an insurer's business, insurers may sometimes consult with their reinsurers about the proposed terms of a settlement before agreeing to it. There is no specific requirement that the insurer do so, nor is there any requirement that reinsurers give their consent in advance. Nevertheless, such consultations may do much to alleviate some of the problems that are evident in the case examples in the preceding sections by affording reinsurers the opportunity to raise questions or concerns about how or why the claim is being settled and to give them insight into the cedent's own analysis of its potential liabilities.

**§ 8:17 Reimbursement for the costs of coverage litigation?**

Disputes with respect to whether reinsurers must reimburse ceding insurers for their costs of contesting the policyholder's claim rarely arise now as most reinsurance contracts explicitly include such costs within the reinsured loss. Disputes may still arise under agreements that were entered into prior to 2000 and that may lack such wordings, however.

In one of the earliest cases to consider this issue, the Supreme Judicial Court of Massachusetts ruled in *Affiliated FM Insurance Company v. Constitution Reinsurance Corporation*,<sup>1</sup> that where a facultative certificate promised that the reinsurer "shall pay its proportion of expenses [other than office expenses and payments to any salaried employee] incurred by the Reinsured in the investigation and settlement of claims or suits," the term "expenses" was ambiguous and must therefore be interpreted in accordance with the custom and usage of the insurance industry. (On remand, a Massachusetts jury ruled four years later that evidence of reinsurance custom and practice did require Constitution Re to pay Affiliated FM's coverage litigation costs.)

U.S. courts have sometimes required reinsurers to reimburse costs of coverage litigation on the basis that contractual language is ambiguous.<sup>2</sup> Others have found that the inclusion of a promise to pay the insurer's "expenses" clearly contemplates reimburse-

**[Section 8:17]**

<sup>1</sup>*Affiliated FM Insurance Company v. Constitution Reinsurance Corporation*, 415 Mass. 839, 845 626 N.E.2d 878 (1994).

<sup>2</sup>See, e.g., *Fireman's Fund Ins. Co. v. General Reins. Corp.*, 2005 US Dist.

ment for the expense of coverage litigation. Thus, a federal district court ruled in *Employers Ins. Co. of Wausau v. American Re*,<sup>3</sup> that legal fees incurred in connection with a declaratory judgment action were encompassed by the reinsurer's promise to pay "all expenses incurred in the investigation and settlement of claims or suits." Similarly, in *Employers Re v. Mid-Continent Cas. Co.*,<sup>4</sup> the Tenth Circuit affirmed a Kansas court's ruling that the cost of coverage litigation was owed by a reinsurer who had promised to reimburse "all payments under the supplementary payments provision of the [cedent's] policy, including court costs, interest upon judgment, and allocated investigation, adjustment and legal expenses."

In the absence of similarly ambiguous wordings, the Second Circuit refused to imply a duty to reimburse such costs. At issue in *British International Ins. Co., Ltd. v. Seguros La Republica, S.A.*<sup>5</sup> were 26 facultative certificates that stated that the reinsurer "is subject to the same risks, valuations, conditions, endorsements (except changes to the location), assignments and adjustments as are or may be assumed, made or adopted by the reinsured, and loss, if any, hereunder is payable pro rata with the reinsured and at the same time and place . . ." The reinsurer argued that it should not owe declaratory judgment expenses because BIIC was not subject to any "risk" of having to reimburse its own declaratory judgment expenses. This argument was accepted by the U.S. District Court in Manhattan and, on appeal, by the Second Circuit. Despite BIIC's argument that the language should be interpreted in accordance with industry custom and usage in light of *Constitution Re*, the Second Circuit found that *Constitution Re* was clearly distinguishable, since the certificates in this case did not contain the "expenses" language that the Massachusetts Supreme Judicial Court had found to be ambiguous but that, furthermore, BIIC had failed to articulate any ambiguity in the language in question. Nor was the court willing to admit evidence of industry custom and usage in the absence of ambiguity. The Second Circuit also rejected BIIC's argument that the reinsurer was obligated to reimburse a pro rata share of its

---

LEXIS 43650 (N.D. Cal. 2005) (costs of "investigation and settlement of claims or suits" held to potentially encompass costs of coverage litigation).

<sup>3</sup>*Employers Ins. Co. of Wausau v. American Re*, 256 F. Supp. 2d 923, 925 (W.D. Wis. 2003).

<sup>4</sup>*Employers Re v. Mid-Continent Cas. Co.*, 202 F. Supp. 2d 1221, 1235 (D. Kan. 2002) aff'd 358 F.3d 757, 768 (10th Cir. 2004).

<sup>5</sup>*British International Ins. Co., Ltd. v. Seguros La Republica, S.A.*, 324 F.3d 78 (2d Cir. 2003).

declaratory judgment expenses by operation of the “follow the fortunes” doctrine. The court found there was no basis for contending that BIIC’s duty to pay its own costs of coverage litigation would “potentially within the coverage of the underlying policies.” Such fees were purely for the benefit of the insurer and were not part of the coverage afforded to the policyholder.

# Key Insurance Coverage Decisions of 2017

American College of Coverage and Extracontractual Counsel  
6<sup>th</sup> Annual Meeting

Chicago, IL  
May 16-18, 2018

# Key insurance coverage decisions of 2017

By Robert D. Chesler, Esq., and Christina Yousef, Esq., *Anderson Kill PC*

MARCH 30, 2018

2017 was another robust year for consequential insurance coverage decisions. While many influential rulings were issued, the eight cases discussed in this expert analysis in particular addressed new liabilities, such as opioids and social engineering, as well as traditional ones, such as environmental contamination. Between the old and new, insurance coverage litigation can be expected to be active for the foreseeable future.

## BEWARE OF THE STATUTE OF LIMITATIONS

As a general rule, a cause of action against an insurance company for breach of contract begins to run when the insurance company denies coverage. When the meter starts is important, as insurance policies generally stipulate that any litigation must be commenced within a fixed period.

The court in *R.T. Rogers Oil Co. Inc. v. Zurich American Insurance Co.*, 262 F. Supp. 3d 381 (S.D. W. Va. 2017), addressed the sometimes-tricky issue of what constitutes a denial.

In *Rogers* the policyholder owned and operated various gas stations throughout West Virginia and procured coverage with respect to its ownership and operation of underground storage tanks. After the policyholder removed a tank from its site, the West Virginia Department of Environmental Protection determined that the tank had released fuel into the ground.

On June 24, 2003 — six days after the tank had been removed — the policyholder gave notice to its insurance company, Zurich American Insurance Co. Zurich replied July 18, 2003.

On Oct. 10, 2003, the policyholder made a demand on Zurich for 100 percent of its costs. On May 28, 2004, Zurich offered 42 percent of the plaintiff's necessary and reasonable cleanup costs.

This is apparently where matters stood until the policyholder filed suit Dec. 14, 2015.

The U.S. District Court for the Southern District of West Virginia dismissed the complaint on the basis of the statute of limitations. It found that Zurich's offer to pay 42 percent of the cleanup costs constituted a denial of the policyholder's demand that payment be made in full.

Applying New York's six-year statute of limitations for breach of contract, the court held that the statute of limitations expired May 28, 2010, six years after Zurich made its offer. As such, the court ruled that what most would consider Zurich's counteroffer was instead a denial.

Policyholders should be aware of potential statute-of-limitations problems and calculate a cause of action's accrual date at the earliest possible time in order to avoid coverage issues.

## WHO IS LITIGATING YOUR CASE?

Even when an insurance company agrees to defend its policyholder, conflicts can arise, particularly as to whether the attorney retained by the insurance company to defend its policyholder has a conflict. *OneBeacon America Insurance Co. v. Celanese Corp.*, 84 N.E.3d 867 (Mass. App. Ct. 2017), involved an extreme example of this situation.

Celanese Corp., the policyholder, contended that OneBeacon American Insurance Co. had a conflict even though OneBeacon agreed to defend without reserving its rights, thereby obligating itself for defense and indemnity costs.

---

Policyholders should be aware of potential statute-of-limitations problems and calculate a cause of action's accrual date at the earliest possible time in order to avoid coverage issues.

---

When OneBeacon appointed counsel, Celanese refused to cede its control of the defense or replace the counsel it had employed for the past 14 years with the representation selected by OneBeacon, arguing that OneBeacon had a conflict of interest.

The court disagreed, and Celanese lost \$2.4 million in attorney fees in the interim between its rejection of OneBeacon's counsel and the court's ruling.

While Celanese pointed to several possible conflicts, the fundamental issue was created by the fact that the policy limited indemnity payments but did not limit attorney fees. This arrangement created an incentive for Celanese to fully litigate each case in an effort to minimize indemnity payments.

Celanese accused OneBeacon of using a litigation strategy that did the opposite — reducing defense costs and exhausting the policy limits as soon as possible.

The court disagreed. The judge reasoned that the record contained no evidence suggesting that OneBeacon had a policy of exhausting liability limits rapidly to avoid paying defense costs.

Policyholders often obtain defenses from their insurance companies and then stop paying attention. It would behoove policyholders to pay careful attention to how their insurance companies are litigating and settling claims on their behalf.

### INSURANCE COVERAGE FOR OPIOID LITIGATION

Every new type of liability that corporations face gives rise to new insurance coverage litigation. The latest potential source of liability, opioids, is no exception.

At least five courts have addressed opioid insurance issues. Although those courts have reached varying results, the different outcomes were dictated at least in part by differences in the complaints they considered.

In particular, some complaints allege only intentional wrongdoing, while others contain mixed allegations of intentional, reckless and negligent conduct. Courts have not found coverage for the former, while some have found a duty to defend for the latter.

The most recent opioid insurance case is *Traveler's Property Casualty Co. v. Actavis Inc.*, 16 Cal. App. 5th 1026 (Cal. Ct. App., 4th Dist. 2017). The city of Chicago, along with the California counties of Santa Clara and Orange, sued Actavis. The trial court denied coverage, finding that the underlying complaints alleged intentional wrongdoing but not accidents.

The California Court of Appeal said, "The California action and the Chicago action do not create a potential for liability for an accident because they are based, and can only be read as being based, on the deliberate and intentional conduct of [the insured] that produced injuries — including a resurgence in heroin use — that were neither unexpected nor unforeseen."

In contrast, in *Cincinnati Insurance Co. v. H.D. Smith Wholesale Drug Co.*, 829 F.3d 771 (2016), the 7th U.S. Circuit Court of Appeals addressed the duty to defend against a complaint brought by the West Virginia attorney general that contained a mix of statutory and common law claims alleging negligent and intentional conduct.

The appeals court found that the insurance company had to defend the entire suit because of the negligence counts. The court held that if a single count is potentially covered, the insurance company must defend the entire case.

Uncomfortable as this result is for policyholders, the manner in which the plaintiff drafts its complaint may very well be dispositive on the coverage issue — and the policyholder can do little, if anything, about it.

### THE LAST PULL OF THE CONTINUOUS TRIGGER

*Air Master & Cooling v. Selective Insurance Co. of America*, 452 N.J. Super. 35 (N.J. Super. Ct. App. Div. 2017), is an important case for two reasons.

First, although most courts have accepted the continuous trigger theory, under which multiple consecutive insurance

policies and insurers must respond to a claim, the theory has been limited to environmental and toxic tort cases.

In *Air Master*, however, the New Jersey Superior Court Appellate Division applied it in a construction case involving progressive damage caused by construction defects over a period of several years.

Second, the court addressed the question of when that continuous trigger ended. Policyholders have looked to policy language stating that the policy provides coverage for bodily injury and property damage as long as it is unexpected and unintended from the standpoint of the insured. As a result, policyholders have argued that the trigger period continues until they gain knowledge of the claim.

The court in *Air Masters* disagreed. It held that the trigger period ends with the "essential" manifestation of the injury, which it defined as "the revelation of the inherent nature and scope of that injury."

Exactly what that means in a given context is anyone's guess and is sure to create additional litigation.

### GEESE, GANDERS, RESERVATIONS OF RIGHTS AND NOTICE

Policyholders and insurance companies alike often prefer vague or boilerplate language when communicating with each other. For both, such a practice contains the most severe risk, as demonstrated by two decisions that came down in 2017.

At least one commentator has selected *Harleysville Group Insurance v. Heritage Communities*, 803 S.E. 2d 288 (S.C. 2017), as the most important insurance coverage decision of the year.

That decision addressed the all-too-frequent reservation-of-rights letter from an insurance company that contains a brief recitation of the underlying facts, about 10 pages of excerpts from the policy and no explanation of why the insurance company might deny coverage.

The court struck the reservation-of-rights letter and stated: "It is axiomatic that an insured must be provided sufficient information to understand the reasons the insurer believes the policy may not provide coverage. ... Generic denials of coverage coupled with a copy of all or most of the policy provisions (through a cut-and-paste method) is not sufficient."

*Harleysville* should serve as a wakeup call for insurance companies, while providing an important weapon to policyholders faced with inadequate reservation-of-rights letters.

However, as demonstrated by *First Horizon National Corp. v. Houston Casualty Co.*, No. 15-cv-2235, 2017 WL 2954716 (W.D. Tenn. June 23, 2017), what is good for the goose is good for the gander.

In *First Horizon* the policyholder filed a notice of circumstance with its directors-and-officers insurance company. The notice-of-circumstance provision required “full particulars as to dates, persons, and entities involved, potential claimants, and the consequences which have resulted or may result therefrom.”

The court found First Horizon’s notice was so vague and boilerplate that it failed to advise Houston Casualty Co. of the nature of the potential liability.

Indeed, as the court noted, the notice did not mention the Justice Department’s \$610 million settlement demand. The court, therefore, threw out the notice and denied coverage on the basis of late notice, and First Horizon lost \$75 million in insurance coverage.

Policyholders frequently want to convey as little information as possible to their insurance companies. *First Horizon* indicates the perils of such an approach.

#### **Medidata Solutions v. Federal Insurance Co.**

In *Medidata Solutions Inc. v. Federal Insurance Co.*, 268 F. Supp. 3d 471 (S.D.N.Y. 2017), the policyholder, a company that provided scientists with cloud-based services, was defrauded of more than \$4 million.

*Harleysville* should serve as a wakeup call for insurance companies, while providing an important weapon to policyholders faced with inadequate reservation-of-rights letters.

In summer 2014 Medidata Solutions Inc. notified its finance department of the company’s short-term business plans, which included a possible acquisition. Medidata’s finance personnel were instructed to “to be prepared to assist with significant transactions on an urgent basis.”

In September 2014 an accounts payable employee responsible for processing all Medidata’s travel and entertainment expenses received an email purportedly sent from Medidata’s president. The email message contained the president’s name, email address and picture in the “From” field, as was consistent with internal email messages Medidata’s employees received.

The message said Medidata was close to finalizing an acquisition and that an attorney named Michael Meyer would contact that employee. The email advised the employee that the acquisition was strictly confidential and instructed her to devote her full attention to Meyer’s demands. The employee replied, “I will certainly assist in any way I can and will make this a priority.”

On that same day, the employee received a phone call from a man who claimed to be Meyer and demanded that the

employee process a wire transfer for him. The employee explained to Meyer that she needed an email from Medidata’s president requesting the wire transfer and further explained she needed approval from Medidata’s vice president and director of revenue.

Shortly thereafter, the accounts payable employee, vice president and director of revenue received a group email purportedly sent from Medidata’s president stating: “I’m currently undergoing a financial operation in which I need you to process and approve a payment on my behalf. I already spoke with [the accounts payable employee], she will file the wire and I would need you two to sign off.”

The email contained the president of Medidata’s email address in the “From” field and a picture next to his name. In response, the accounts payable employee logged on to Medidata’s online banking system and submitted the wire transfer for approval.

The vice president and director of revenue logged on to the online banking system and approved a wire transfer of nearly \$4.8 million to a bank account provided by Meyer.

Unfortunately, all the emails in the chain were fraudulent, and the account to which the money was wired was set up by fraudsters.

The policyholder sought coverage under its \$5 million insurance policy, which contained a “crime coverage section” that included coverage for computer fraud, funds transfer fraud and forgery.

The insurance company denied coverage under the computer fraud clause because there had been no “fraudulent entry of data into Medidata’s computer system.”

It further maintained there was no coverage under the policy’s funds transfer fraud clause because the wire transfer was made with the company’s knowledge and consent.

Finally, the insurer rejected Medidata’s claim for forgery coverage because the emails did not contain an actual signature and did not meet the policy’s definition of a financial instrument.

The U.S. District Court for the Southern District of New York considered cross-motions for summary judgment and found that coverage was appropriate under the policy’s computer fraud coverage clause as well as its funds transfer fraud coverage clause.

Ultimately, the court held that the policyholder demonstrated its losses were a direct result of a computer violation and occurred without its knowledge or consent.

In an age of ever-evolving technology, where new threats arise with great frequency, policyholders should be aware of technological vulnerabilities and ensure that coverage for any such potential risk is procured.

### ***E.M. Sergeant v. Travelers Indemnity***

While the insurance buzz for 2017 concentrated on new liabilities such as opioids and social engineering, many policyholders still find themselves entangled with the traditional long-tail liabilities — chiefly environmental, asbestos and other toxic torts.

These continuous trigger liabilities can date back to the 1950s and beyond. Locating applicable insurance policies for such claims is a major hurdle. In New Jersey, a policyholder can prove insurance policies by a preponderance of the evidence. *E.M. Sergeant Pulp & Chemical Co. v. Travelers Indemnity Co.*, No. 12-cv-1741, 2017 WL 239339 (D.N.J. Jan. 19, 2017), demonstrates how little evidence the policyholder may need.

*E.M. Sergeant Pulp & Chemical Co.*'s records consisted chiefly of several ledger entries that were more than 50 years old and identified Travelers Indemnity Co. and policy numbers. Sergeant supplemented these documents with expert testimony on such issues as the interpretation of the policy numbers and standardized policies.

The court relied heavily on the expert testimony in denying Travelers' motion for summary judgment based on the fact the physical policies were missing. The case subsequently settled.

Policyholders often believe that they need copies of policies to prove coverage, while insurance companies deny claims because of the lack of the actual policies. *E.M. Sergeant* shows the benefit of insurance archaeology and the potential value of even a limited amount of secondary evidence.

2017 was an eventful year for insurance coverage litigation. As new and old issues alike continue to be litigated, some issues will likely be clarified, whereas others will be litigated in perpetuity.

*This article appeared in the March 30, 2018, edition of Westlaw Journal Insurance Coverage.*

### **ABOUT THE AUTHORS**



**Robert D. Chesler** (L), a shareholder in **Anderson Kill PC's** Newark, New Jersey, office, represents policyholders in a broad variety of coverage claims and advises companies

with respect to their insurance programs. He can be reached at [rchesler@andersonkill.com](mailto:rchesler@andersonkill.com). **Christina Yousef** (R), an attorney in the firm's Newark office, concentrates in insurance recovery, exclusively on behalf of policyholders, and in corporate and commercial litigation. She can be reached at [cyousef@andersonkill.com](mailto:cyousef@andersonkill.com).

**Thomson Reuters** develops and delivers intelligent information and solutions for professionals, connecting and empowering global markets. We enable professionals to make the decisions that matter most, all powered by the world's most trusted news organization.

# Coverage for Ill-Gotten Gain under D&O Policies: The Legacy of *Level 3*

American College of Coverage and Extracontractual Counsel  
6<sup>th</sup> Annual Meeting

Chicago, IL  
May 16-18, 2018

Michael L. Manire  
Manire & Galla LLP  
New York, New York 10017  
[mmanire@maniregallalaw.com](mailto:mmanire@maniregallalaw.com)

© 2018 American College of Coverage and Extracontractual Counsel and Michael L. Manire/Manire & Galla LLP.

## I. Introduction

One of the most common points of dispute between Directors' and Officers' Liability insurers<sup>1</sup> and their insureds is the question of coverage for an insured's payment to resolve a claim for wrongful acquisition of a financial asset or wrongful failure to pay a financial obligation. Judge Richard Posner's November 26, 2001 opinion in *Level 3 Communications, Inc. v. Federal Insurance Co.*, 272 F.3d 908 (7<sup>th</sup> Cir. 2001) ("*Level 3*") continues to have extraordinary influence on that issue. This paper takes a fresh look at *Level 3* and cases that have applied or distinguished *Level 3* in the 16 years since, including recent decisions that have addressed *Level 3* in the context of changes to D&O policy wording. The paper's broad conclusion is that the principles of *Level 3* are alive and well in spite of wording changes that have been argued by some to limit its effect.

This paper organizes its analysis around three principle questions:

- 1. Is a *Level 3* analysis based on policy interpretation or public policy?**
- 2. What are the characteristics of settlements or judgments to which the *Level 3* coverage principle<sup>2</sup> applies?**
- 3. Have changes to D&O policy forms reduced the impact of *Level 3*?**

<sup>1</sup> The issue is not unique to D&O insurance, and indeed some of the cases discussed in this paper involve GL, professional liability or E&O, and other coverages.

<sup>2</sup> A precise statement of the "*Level 3* coverage principle" is elusive. It has been expressed in many different and often contradictory ways by insurers, insureds and courts, and its boundaries are the subject of debate. For purposes of this paper, Judge Posner's expression is at least the starting point: "a 'loss' within the meaning of an insurance contract does not include the restoration of an ill-gotten gain." *Id.* at 910.

## II. The *Level 3* Opinion

*Level 3* arose out of a 1994 securities fraud lawsuit filed against Kiewit Diversified Group Inc. (subsequently known as Level 3 Communications, Inc. (“Level 3 Inc.”)), its subsidiary MFS Communications, Inc. (“MFSCC”), and James Crowe (the CEO of MFSCC), by former minority stockholders of an MFSCC subsidiary, Metropolitan Fiber Systems, Inc. (“MFS Telecom”). MFSCC had purchased the stockholders’ MFS Telecom shares in 1992, just a year before taking MFS Telecom public in an IPO. The former stockholders asserted claims for securities fraud under the Securities and Exchange Act of 1934 and for related torts, alleging that the defendants failed to disclose material information about the value of their MFS Telecom shares, including plans for the IPO.

Level 3 Inc. reported the securities claim to its D&O carrier, Federal Insurance Company. Since the policy covered only the loss of the individual insured Crowe, Federal originally reserved rights and stated that it would pay an 80% allocation of Defense Costs excess of the \$2.5 million retention. See *Kiewit Diversified Group v. Federal Ins. Co.*, 999 F. Supp. 1169 (N.D. Ill. 1998). Level 3 Inc. eventually settled the case for \$11.8 million, at least part of which was as indemnification of Crowe. Federal denied coverage, based in part<sup>3</sup> on the argument that the settlement was not a covered loss. Level 3 Inc. sued Federal in the Northern District of Illinois, and the issue of coverage for the settlement reached the 7th Circuit in 2001.

In a brief decision under Nebraska law,<sup>4</sup> the 7th Circuit ruled in favor of Federal and found that the settlement was not covered under the Federal policy.

<sup>3</sup> Federal also denied on the basis of an “insured v. insured” exclusion, but that issue was resolved in another decisions in the same coverage litigation. See *Level 3 Communs. v. Fed. Ins. Co.*, 168 F.3d 956 (7<sup>th</sup> Cir. 1999).

<sup>4</sup> Although Judge Posner does not cite any Nebraska law in *Level 3*, it is clearly stated in the other Posner decision in the case, *Level 3 Communs. v. Fed. Ins. Co.*, 168 F.3d 956, 957, that the coverage litigation was governed by Nebraska law.

Judge Posner initially noted that Federal raised two alternative coverage arguments. The first was that the settlement had not resulted in a “loss” within the meaning of the policy, because the relief sought was restitutionary in nature. The second was that even if the parties intended that such a settlement would be insured under the policy, coverage would be unenforceable as against public policy. *See Level 3*, 272 F.3d at 909-910.

The court rested its decision solely on the first argument<sup>5</sup>, which Judge Posner called the “interpretive principle” and summarized as follows.

The interpretive principle for which Federal contends—that a "loss" within the meaning of an insurance contract does not include the restoration of an ill-gotten gain—is clearly right.

*Id.* at 910 (citations omitted.)

Judge Posner noted that the securities plaintiffs in the underlying class action had been seeking “the difference between the value of the stock at the time of the trial and the price they had received for the stock from Level 3,” which is “standard damages relief in a securities-fraud case.” Such relief is “restitutionary in character,” he explained, when

[it] seeks to divest the defendant of the present value of the property obtained by fraud, minus the cost to the defendant of obtaining the property. In other words, it seeks to deprive the defendant of the net benefit of the unlawful act, the value of the unlawfully obtained stock minus the cost to the defendant of obtaining the stock. ....An insured incurs no loss within the meaning of the insurance contract by being compelled to return property that it had stolen, even if a more polite word than “stolen” is used to characterize the claim for the property’s return.

*Id.* at 911.

The court acknowledged that the Federal policy defined “loss” as “the total amount which an Insured Person becomes legally obligated to pay ... including, but not limited to...

<sup>5</sup> The New York Court of Appeals acknowledged that Judge Posner’s decision was based on “contract interpretive principles,” as opposed to public policy, in *J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*, 21 N.Y.3d 324, 335-336 (2013).

settlements,” *id.* at 909, but rejected Level 3 Inc.’s argument that the insured is covered by any settlement regardless of the nature of the claim against it or the remedy sought.

That can’t be right. *Reliance Group Holdings, Inc. v. National Union Fire Ins. Co.*, 594 N.Y.S.2d 20, 25 (App. Div. 1993) (“determination of this appeal should not hinge on the circumstance that Reliance made restitution by way of settlement instead of in satisfaction of a judgment after trial”). It would mean, as Level 3’s lawyer confirmed at argument, that if Level 3, seeing the handwriting on the wall, had agreed to pay the plaintiffs in the fraud suit all they were asking for..., Federal would still be obligated to reimburse Level 3 to retain the profit it had made from a fraud.

*Id.* at 911.

Judge Posner made it even clearer that his ruling was based on an interpretation of policy language rather than on public policy, when he stated:

As the interpretive principle controls this case, we need not consider the issue of enforceability, though the two issues are intertwined, since obviously an insurance policy wouldn’t be presumed to have been drafted in such a way as to make it unenforceable.

*Id.* at 910 (citing *Central Dauphin School District v. American Casualty Co.*, 493 Pa. 254, 426 A.2d 94, 1996 Pa. LEXIS 732 (1981)).<sup>6</sup>

### **III. Subsequent Treatment of *Level 3* Generally**

The *Level 3* decision remains “good law,” and is as influential now as it was in the first years after its publication. A recent Shephard’s<sup>®</sup> report for *Level 3*, as published by LexisNexis<sup>®</sup>, shows citations in 52 cases between 2002 and 2009, and 54 between 2010 and

<sup>6</sup> In practice, certain details of *Level 3* are often overlooked. For example, the coverage question was in the context of the policy’s “company reimbursement coverage” for Level 3 Inc.’s indemnification of the individual insured defendant, Mr. Crowe. *Id.* at 909. But the fact that the actual insured liability was that of Mr. Crowe, who obviously was not an actual party to the underlying transaction, did not affect Judge Posner’s determination that Level 3 Inc. was the insured whose alleged “loss” had to be evaluated. Level 3 Inc. had underpaid for the MFS Telecom stock, and through its payment of the settlement as indemnification of Crowe, Level 3 Inc. had made restitution of its ill-gotten gain.

2017. Shepard's® categorizes 20 of the citing decisions as "Positive," while only 18 are denoted with "Caution." There is no apparent trend favoring one category over the other. None of the citing decisions is denoted with "Warning" or "Questioned."

Although *Level 3* applied state law (Nebraska), federal courts – especially in the 7th Circuit (22 times) and the 9th Circuit (18 times) – have cited the decision more often than state courts. New York (7) and Texas (5) are the states whose courts have cited *Level 3* the most often.

This author's review of the decisions denoted with "Caution" finds no decisions that expressly reject *Level 3*, but reveals a number of themes that some courts have relied on, correctly or otherwise, to distinguish the decision. Many of the decisions are subject to criticism because the courts have failed to observe Judge Posner's clear distinction between policy interpretation and public policy, a distinction that can be outcome-determinative.

#### **IV. Policy Interpretation or Public Policy?**

As noted above, Judge Posner's expressly based his *Level 3* opinion on policy interpretation and did not decide the issue of whether coverage was prohibited as a matter of Nebraska public policy. Other courts, including the 11th Circuit, have cited with approval *Level 3*'s interpretation of the policy term "loss" in accordance with its ordinary meaning, even if the term itself is further defined in the policy to include settlements. See, e.g., *CNL Hotels & Resorts, Inc. v. Twin City Fire Ins. Co.*, 291 F. App'x 220, 223 (11th Cir. 2008) (definition of "loss" was sums insured was "legally obligated to pay..., including... settlement amounts"); *Republic Western Ins. Co. v. Spierer, Woodward, Willens, Denis & Furstman*, 68 F.3d 347 (9th Cir. 1995) (return of legal fee retainer because of conflict of interest was not covered); *Local 705*

*Int'l Bhd. of Teamsters Health & Welfare Fund v. Five Star Managers*, 316 Ill. App. 3d 391, 396; 735 N.E.2d 679, 684; 249 Ill. Dec. 75, 80 (Ill. Ct. App.2000) (“The plain and ordinary meaning of “loss” cannot be ignored. [The insured] ‘simply cannot lose that to which it was not legally entitled.’”); *Conseco Inc. v. National Union Fire Ins. Co. of Pittsburgh, Pa.*, 2002 WL 31961447, \*12 (Ind. Cir.) (“The definition of “Loss” cannot be read to ignore the word ‘Loss’ itself, since doing so would completely eviscerate the meaning of the word.”); *Pratter v. Reliance Ins. Co.*, 2010 Pa. Commw. LEXIS 733, \*14 (“Loss” was defined to include “settlements,” but settlement establishing Redress Fund to refund wrongfully charged loan origination fees was not a “Loss” ).

The distinction between the policy interpretation and public policy approaches is demonstrated in an earlier decision that Judge Posner cited in his opinion.<sup>7</sup> *Central Dauphin Sch. Dist. v. American Casualty Co.*, 493 Pa. 254\*, 426 A.2d 94, 1996 Pa. LEXIS 732 (1981) arose out of a taxpayer’s successful court challenge of a tax imposed by a school district. A court ordered the school district to refund the taxes, and the school district sought coverage for the refund payments under its School Board Liability Policy. The school board argued that its improper assessment of taxes was the result of negligent conduct, which the policy covered, and that the settlement fell within the policy definition of “loss” because the school board was “legally obligated to pay” it as a result of the taxpayer’s lawsuit. The insurer countered that the refunds were not covered “loss” under the policy because the school board had not been entitled to the tax revenues in the first place. The Pennsylvania Supreme Court found there was no coverage for the settlement. Though the court’s analysis began with the policy definition of “loss,” the court focused on the phrase in the definition that excluded matters “which shall be

<sup>7</sup> As Judge Posner’s reliance on earlier case law demonstrates, the principles of *Level 3* had been recognized by other courts well before the issuance of his opinion.

deemed uninsurable under the law pursuant to which this policy shall be construed.”<sup>8</sup> *Id.* at \*258. With that, the issue became one of public policy. The court’s source of public policy was the Pennsylvania Public School Code, which the court read to require any tax refunds to be paid “out of the budget appropriation of public funds.” *Id.* at 259. The court stated that government taxation is controlled by constitutional and statutory provisions that must be strictly complied with.

Because this Commonwealth's public policy does not permit a school district to make unlawful taxation just as revenue-productive as lawful taxation, it must be concluded that a political subdivision's return of tax monies to its taxpayers collected by an unlawful tax is uninsurable. Hence there has been no "loss" within the meaning of the insurance Policy.

*Id.* The court stated its ruling would be the same even if the school board’s conduct were only negligent. *Id.*

The *Central Dauphin* court’s rationale is arguably a combination of public policy and policy interpretation, not because of the “uninsurable” wording in the definition of “loss,” but because of the court’s reliance on the fact that insurance coverage would have allowed the district to effectively keep the tax revenues. In other words, coverage would have given the district a windfall because it really had no loss within the ordinary meaning of the word. In fact, a concurring justice’s opinion asserted that the “ordinary meaning of loss” analysis was a specific alternative rationale for the decision: “The school district simply cannot ‘lose’ that to which it was not legally entitled.”<sup>9</sup> *Id.* at 262.

<sup>8</sup> This clause has been included in D&O policies since well before 1981, and is an indication of the market’s long-standing awareness of public policy limitations to insurance coverage.

<sup>9</sup> The concurring Justice Larsen included a convincing counter to a dissenting judge’s position that the inclusion of examples such as “damages and settlements” in the policy’s definition of “loss” effectively broadened the term beyond its ordinary meaning:

Despite the broad terms, there is absolutely no indication that a peculiar meaning be given to the word "loss". In fact, the examples which follow the definition are garden-variety "losses": "damages, judgments, settlements and costs, cost of investigation and defense of legal actions . . ." etc. The language of the policy

The majority decision in *Central Dauphin* provides an example of a tendency that many courts interpreting *Level 3* have shown: that of conflating the policy interpretation approach with the public policy approach. That can be a decisive error. As discussed further below, public policy analyses often focus on the nature of the insured's conduct or the particular moral hazard created, while policy interpretations typically stick to analyzing whether the insured has suffered an actual loss. A failure to clearly distinguish the two approaches can cause a presiding court to focus only on broader coverage wording (such as coverage for "Damages" with no specific requirement of actual loss) and find coverage while ignoring a strong public policy defense. Conversely, a court might find coverage for a clear case of returning a mistakenly acquired asset because the conduct was not intentional or egregious enough to trigger public policy concerns.

Judge Posner's awareness of the distinction was made even clearer in a decision issued at nearly the same time as *Level 3*. In *Mortenson v. National Union Fire Ins. Co.*, 249 F.3d 667 (7<sup>th</sup> Cir. 2001), Judge Posner gave examples of types of insurance coverage that might be forbidden as a matter of Illinois public policy: "taking out a life insurance policy on another person's life without his consent," "insurance against criminal fines [or] punitive damages," and insurance against certain "civil penalties." These are examples of coverage that would raise acute moral hazards or promote willful misconduct. They have nothing to do with whether an insured may have suffered a real "loss."

does not require that an eccentric meaning be given to the word "loss", and permitting the school district to recover the amount of the refunded taxes from the insurance company would disregard the plain and ordinary meaning rule set forth in *Pennsylvania Manufacturers' Association Insurance Co. v. Aetna Casualty and Surety Insurance Co.*, [426 Pa. 453, 233 A.2d 548 (1967)].

*Id.*

## V. What Constitutes the Return of ill-Gotten Gain?

The question of what actually constitutes “return of ill-gotten gain” has been a controversial issue, both in the policy interpretation and public policy contexts. Judge Posner acknowledged that the *Level 3* principle was limited in scope, in part to counter any argument that it rendered coverage “illusory.” He noted that a securities claim could assert that an officer’s fraudulent statement “inflated the price of the company’s stock without conferring any measurable benefit on the corporation,” so that a settlement would be a loss to the corporation that is not offset by any benefit. *Level 3* at 911.

*J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*, 21 N.Y.3d 324 (2013), is a decision that demonstrates the limitations of the ill-gotten gains concept from *Level 3* and is consistent with Judge Posner’s decision. The insured in *J.P. Morgan* sought insurance coverage for a \$160 million “disgorgement” settlement with the SEC. While the court agreed with the insurer that the portion of the \$160 million that constituted a return of the insured’s profits from its misconduct was not covered, the court held that the insurer had to reimburse the insured for the portion that represented profits earned by the insureds’ clients. That seems uncontroversial and consistent with *Level 3*, in which “[a]ll that the plaintiffs in the underlying suit obtained was the amount they received in settlement of their claim against Level 3, and that amount was part of Level 3’s gain from its officers’ misbehavior.” *Level 3* at 911.

But the contours of what constitutes ill-gotten gain are frequently disputed. There seems to be general agreement that “How the claim or judgment order or settlement is worded is irrelevant.” *Id.* But some courts have focused on other factual distinctions in *Level 3* to limit its impact more than Judge Posner may have intended.

**a. *The Distinction Between Wrongful “Acquisition” and Wrongful  
“Retention”***

In *William Beaumont Hosp. v. Fed. Ins. Co.*, 552 Fed. Appx. 494 (6<sup>th</sup> Cir. 2014), the 6<sup>th</sup> Circuit, applying Michigan law, found that an insured hospital’s payment of increased compensation to its nurses in settlement of their claim for violations of the anti-trust laws was a covered loss. It distinguished *Level 3* and some of its progeny<sup>10</sup> by noting that in those cases the insureds were repaying money they had wrongfully “obtained” or “acquired,” rather than paying something it had wrongfully “retained.” *Id.* at 499. The 6th Circuit found that an insured who settled a claim that it had improperly “retained” something it owed had indeed incurred an insurable “loss” under the terms of the insured’s liability policy.

Similar decisions include *Fed. Ins. Co. v. Arthur Andersen LLP*, 2005 U.S. Dist. LEXIS 15706\* (N. D. Ill.) (payment of retirement benefits was deemed covered loss because the insured had not improperly acquired the cash used to pay the benefits); *Chubb Custom Ins. Co. v. Grange Mut. Cas. Co.*, 2011 U.S. Dist. LEXIS 111583 (S.D. Ohio 2011) (settlement paid by insured health insurer to customers for underpayments of their claims is covered loss); *Unified W. Grocers, Inc. v. Twin City Fire Ins. Co.*, 457 F.3d 1106, 1115 (9<sup>th</sup> Cir. 2006) (finding portion of a settlement based on the insured’s receipt of “some benefit” might be covered, while the portion based on a claim to “recover... the money or property that the insured wrongfully acquired” would not be covered); *Genzyme Corp. v. Fed. Ins. Co.*, 622 F.3d 62, 70 (1<sup>st</sup> Cir. 2010) (finding that an insured’s settlement was covered loss because by buying back its own shares, the

<sup>10</sup> Namely, *In re TransTexas Gas Corp.*, 597 F.3d 298, 310 (5<sup>th</sup> Cir. 2010) (return of funds due to a fraudulent transfer was not insurable); *CNL Hotels & Resorts, Inc. v. Twin City Fire Ins. Co.*, 291 F. App’x 220, 223 (11<sup>th</sup> Cir. 2008) (per curiam) (insured acquired money in violation of law so the return of the money was not a covered loss).

insured had not “obtained an identifiable asset” that it was being forced to restore to plaintiffs); and *BLaST Intermediate Unit 17 v. CNA Ins. Cos.*, 544 Pa. 66\*, 674 A.2d 687 (Pa. 1996) (the payment of back wages was covered because the court concluded it would not result in a “windfall” to the insured).

Whether viewed as a matter of policy interpretation or public policy, the distinction for coverage purposes between the return of something obtained and the payment of something already owed seems arbitrary. As a matter of policy interpretation, it is unlikely that an insurer would choose to cover an insured for its refusal to pay or perform some obligation, but cover an insured for its decision to take something away from a third party. In either case, the insured has incurred no net loss. The insured is not just “made whole,” it is in a better position than it was before the act that gave rise to the dispute. And the public policy issues of fairness and moral hazard seem essentially the same; an insured can choose not to pay wages in order to have them funded by its insurer.

Other courts, even before *Level 3*, have effectively rejected the distinction. In *Safeway Stores v. National Union Fire. Ins. Co. of Pittsburgh, Pa.*, 64 F.3d 1282 (9<sup>th</sup> Cir. 1995) – more noted as a pro-insured decision for other reasons – an insured acquired in a leveraged buyout settled shareholder class claims by, in part, agreeing to accelerate a dividend payment so that it went to the plaintiff shareholder class rather than the acquiring company, KKR. The insured, Safeway, sought coverage for that part of the settlement as a “loss ... which the Insured Person has become legally obligated to pay on account of a claim.” The court denied the insured’s claim, reasoning that the dividend was an existing obligation and that the payment, “if a ‘loss’ to anyone, was KKR’s, not Safeway’s.” *Id.* at 1286.

Similarly, in *Town of Brookhaven v. CNA Ins. Cos.*, No. CV-86-3569, 1988 WL 23555\* (E.D.N.Y. Feb. 24, 1988), an insured town sought insurance coverage for payments it made to resolve claims that it was obligated to distribute certain tax revenues to school districts. The court found that such payments were not recoverable as loss under the policy because they constituted “the benefit enjoyed by the town by virtue of its improper withholding of money.” *Id.* at \*3.

Insurers might also argue that a settlement of a claim to enforce an existing obligation does not fall within a policy’s insuring agreement. For example, the coverage grant in the *Chubb Custom Ins. Co. v. Grange Mut. Cas. Co.* case was to pay “Loss which the Insures shall become legally obligated to pay as a result of any claim ... arising out of any Wrongful Act.” 2011 U.S. Dist. LEXIS 111583, \*5 (S.D. Ohio 2011.) If an insured is contractually or legally obligated to pay some amount and the payee sues to enforce that obligation, the “Wrongful Act” giving rise to the claim may be the insured’s failure to pay, but the insured’s legal obligation to pay the payee was the result of the applicable contract or law, not the lawsuit.

In *August Entertainment, Inc. v. Philadelphia Indemnity Ins. Co.*, 146 Cal. App. 4th 565, 52 Cal. Rptr. 3d 908 (2007), the court found that a settlement of a breach of contract claim arising out of a film licensing dispute was “not a loss resulting from a wrongful act within the meaning of” a D&O policy.

To hold otherwise would make [the insurer] a de facto party to a corporate contract and require it to pay the *full* contract price (plus interest), letting the corporation completely off the hook. Performance of a contractual obligation ... is a debt the corporation voluntarily accepted. It is not a loss resulting from a wrongful act within the meaning of the policy.

*Id.*, 146 Cal. App. 4<sup>th</sup> at 581, 52 Cal. Rptr. 3d at 581. Another example is *American Cas. Co. v. Hotel & Restaurant Empls. & Bartenders Int'l Union Welfare Fund*, 113 Nev. 764, 942 P.2d 172

(finding a claim against trustees for failure to comply with obligations did not result in a “loss” arising out of a “wrongful act”).

The Northern District of Illinois took a curious approach on the “Wrongful Act” issue in the *Fed. Ins. Co. v. Arthur Andersen LLP* case discussed above, 2005 U.S. Dist. LEXIS 15706\* (N. D. Ill.). As Arthur Andersen was facing financial pressures as a result of the Enron scandal, many of the firm’s retired partners sought accelerated distributions of their pension benefits, alleging a contractual right to do so. Some partners submitted letters to Arthur Andersen, and some sued. Arthur Andersen agreed to make the requested distributions pursuant to a settlement agreement and sought coverage under the Fiduciary Liability Coverage portion of its Executive Protection policy.

Among other things, Arthur Andersen’s insurer argued that the payment of accelerated retirement plan distributions was not covered under its policy because the distributions did not arise out of alleged Wrongful Acts. The court agreed with Federal’s argument only with respect to distributions made to partners who had not sued Andersen but had only submitted letters electing to accelerate, which the court concluded did not actually assert any Wrongful Acts. *Id.* at \*48. Benefits paid to partners who sued and alleged Wrongful Acts were deemed covered loss. *Id.*

The Northern District’s approach misses the point. Requiring an alleged Wrongful Act – which presumably could include breach of contract – is a low bar and fairly meaningless as a matter of substance. The more appropriate question is whether the payments made by the insured are made *as a result of* a Wrongful Act rather than as a result of an existing commitment.

Claims to enforce contractual obligations may also raise issues under contract or professional liability exclusions, public policy issues in some jurisdictions, and issues regarding

coverage for intentional acts. Whether or not *Level 3* itself stands for the notion that an insurance policy does not cover an insured's settlement of a claim to enforce an existing obligation, the issue remains a significant one.

***b. The Egregious Conduct Factor in the Public Policy Context***

When a court relies on public policy rather than interpretation of the insurance policy, it typically focuses on the nature of the insureds' alleged conduct. This is not surprising, since public policy decisions in other insurance contexts often relate to intentional or willful misconduct (*see, e.g.,* California Insurance Code §533) or punitive damages. *Fed. Ins. Co. v. Arthur Andersen LLP*, discussed above, 2005 U.S. Dist. LEXIS 15706\* (N. D. Ill.), is an example. Federal argued for no coverage under both policy interpretation and public policy rationales. After citing *Mortensen*, the court rejected the public policy rationale, apparently influenced by Andersen's argument that its delay in benefit distributions was a result of its efforts to manage the financial stress caused by sudden demands for accelerated benefits. The court distinguished between a hypothetical repayment of "wrongfully" taken property, on one hand, as opposed to Arthur Andersen's payment of retirement benefits that it had "rightfully" maintained in its possession on behalf of the partners, stating that coverage for the former might violate public policy but coverage for the latter would not. *Id.* at \*43, n. 19. While this reasoning also touches on the "return of something acquired" versus "payment of something retained" distinction other courts have made, the Northern District of Illinois' distinction between "rightfully" and "wrongfully" demonstrates its reluctance to assert public policy when the insured's conduct was not egregious.

The association of public policy with egregious conduct is also demonstrated in *Nutmeg Ins. Co. v. East Lake Mgmt. & Dev. Corp.*, 2006 U.S. Dist. LEXIS 85665\*, 2006 WL 3408156 (N.D. Ill.). The Nutmeg insured was sued for unlawfully withholding security deposits from tenants, who sought statutory damages equal to twice the amount of the withheld deposits. After settlement, the insurer argued that the statutory damages were not uninsurable under public policy and that the portion equal to the amount of withheld deposits was not a loss to the insured. The court found coverage for the entire amount, rejecting the public policy argument because the damages payable under the statute were not analogous to punitive damages in that they were awardable regardless of whether the landlord's conduct was inadvertent or intentional. *Id.* at \*19. (The court rejected the "no loss" argument with respect to the portion attributable to the withheld security deposits because the policy covered "Damages," the definition of which required no actual "loss." *Id.* at \*24-25.)

*BLaST Intermediate Unit 17 v. CNA Ins. Cos.*, 544 Pa. 66\*, 674 A.2d 687 (Pa. 1996), is an instructive decision that starts out as an analysis of public policy and conduct, but ultimately demonstrates the earlier-discussed tendency of courts to conflate public policy with policy interpretation. The *BLaST* insured sought coverage for its court-ordered payment of back wages under the Equal Pay Act. The insurer apparently only raised, or at least the Pennsylvania Supreme Court only identified, the public policy basis for the argument against coverage. The court found that coverage would not violate public policy, and in doing so attempted to distinguish its earlier ruling in *Central Dauphin Sch. Dist. v. American Casualty Co.*, discussed above, which found no coverage for a school district's refund of improperly imposed taxes. The *BLaST* court seemed to accept the insured's argument that its failure to pay wages in violation of

the Equal Pay Act was a “good faith” mistake, and contrasted that conduct with the “unlawful” imposition of taxes by the *Central Dauphin* school board. *Id.* at \*71-72.

However, apparently straining to justify its conclusion, the court then resorted to an analysis that smacks more of policy interpretation than public policy. The *BLaST* court reasoned that the *Central Dauphin* school board had not suffered a “loss” because the board “would have realized a windfall if allowed to collect from its insurance carrier after refunding the taxes.” *Id.* at \*73. The *BLaST* insured, on the other hand, would not receive a windfall if its payment of back wages was covered, because the insured would not be placed in a better position than it was in prior to the judgment against it in the Equal Pay Act litigation. *Id.* The decision thus turns out to be more about the “acquisition” and “retention” distinction than about conduct that raises public policy concerns.

Other courts have noted that at least in connection with a policy interpretation analysis, the nature of the insured’s conduct is irrelevant. The *Central Dauphin Dauphin Sch. Dist. v. American Casualty Co.* court, for example, noted that whether the school board had or had not been negligent was irrelevant to the issue of whether it had incurred a “loss.” 493 Pa. 254\*, 259. The 11<sup>th</sup> Circuit made the same point in *CNL Hotels & Resorts, Inc. v. Twin City Fire Ins. Co.*, 291 F. App’x 220 (11th Cir. 2008), in which it ruled that an insured’s settlement of a Section 11 Claim under the Securities Act of 1933 was not a “loss” because the insured had received an inflated purchase price in its public offering of shares.

The return of money received through a violation of law, even if the actions of the recipient were innocent, constitutes a restitutionary payment, not a "loss." It is immaterial whether CNL committed fraud.

*Id.* at 223.

## VI. Changes to D&O Policy Forms

The most significant recent developments in the treatment of the *Level 3* principle are a result of changes in D&O policy wording over the past 16 years. Some of the changes appear to be an attempt in the market – generally a “soft” market – to clarify the impact of *Level 3* and its progeny on coverage. The changes that seem most significant from the standpoint of the courts are the narrowing of the ill-gotten gain or conduct exclusions.<sup>11</sup>

This section addresses two recent cases that have relied on the wording of conduct exclusions to limit the impact of the *Level 3* principles.

In *Unites States Bank N. A. v. Indian Harbor Ins. Co.*, 68 F. Supp. 3d 1044 (D. Minn. 2014), the coverage claim was asserted by an insured bank in connection with class actions asserting that the bank had collected inflated overdraft fees from its customers. The class actions asserted claims for breach of contract, unconscionability, conversion, and unjust enrichment; and sought return of the excess overdraft fees and damages. The bank settled the claims for \$55 million and sought coverage from its professional liability insurers. Putting aside whether some portion of the settlement might have been allocable to covered damages in addition to the repayment of overcharges,<sup>12</sup> this settlement was at least in part a classic case of restitution. But the court found coverage based on policy wording that, according to the court, would override any public policy concern.

<sup>11</sup> The so-called “bump-up” provision is another example of policy wording that has evolved and often affects a *Level 3* analysis in the policy interpretation context. Sometimes written as an exclusion, sometimes as a carve-out of the definition of “loss,” the provisions typically address whether, for example, a corporation that acquires another is covered for an increase in purchase price it must pay as a part of the settlement of shareholder litigation arising from an acquisition. There are many different versions, some of which have a broader scope than others. Typically, however, they do not apply to the insurer’s obligation to advance Defense Costs.

<sup>12</sup> The court did not reach a decision on that issue.

The policy definition of “loss” excluded matters uninsurable as a matter of law. The federal judge applied Delaware law but did not rule on whether Delaware public policy permitted coverage for the settlement<sup>13</sup>. The judge actually assumed that it would, but found that the policy’s “Ill-Gotten Gains” exclusion rendered the public policy issue moot because the exclusion barred coverage for restitution of profits only if a final adjudication found the insured had obtained the profits illegally.

The opinion does not contain a full quotation of the exclusion, but it appears to have been a fairly standard version:

The provision excludes from coverage a payment for loss connected to a claim resulting from money to which U.S. Bank "is not legally entitled . . . as determined by a final adjudication in the underlying action."

*Id.* at 1049. The exclusion is often referred to as the “profit” exclusion, and is typically worded to bar coverage for loss in connection with a claim arising from profit or advantage to which an insured was not legally entitled. There are variations, but current D&O policy forms typically limit application of the exclusion to claims which have been found to arise out of illegal profit or advantage in a final adjudication adverse to the insured. The exclusion is often paired with a similar exclusion for claims arising out of fraudulent conduct.<sup>14</sup>

The court distinguished *Level 3* and *CNL Hotels & Resorts, Inc. v. Twin City Fire Ins. Co.* by asserting that the policies in those cases did not contain “ill-gotten gain” exclusions

<sup>13</sup> The court found no evidence of a Delaware public policy that restitution is uninsurable.

<sup>14</sup> For example, at least one version of the AIG Executive Edge® Broad Form Management Liability Insurance Policy contains a “*Conduct*” exclusion that bars coverage for:

Loss, other than Crisis Loss, in connection with any Claim made against an Insured... arising out of, based upon or attributable to any:

(a) remuneration, profit or other advantage to which the Insured was not legally entitled; or

(b) deliberate criminal or deliberate fraudulent act by the Insured; if established by any final, non-appealable adjudication in any action or proceeding other than an action or proceeding initiated by the Insurer to determine coverage under the policy; [proviso with exceptions omitted].

requiring a final adjudication. *Id.* at 1052. It distinguished other decisions that found restitution uninsurable despite similar final adjudication exclusions<sup>15</sup> by criticizing them for failure “to otherwise analyze the impact of the final-adjudication requirement. *Id.*

*Gallup, Inc. v. Greenwich Ins. Co.*, 2015 Del. Super. LEXIS 129, 2015 WL 1201518, is a more recent decision that takes the same approach and largely relies on *U.S. Bank*. The *Gallup* insured sought coverage for settlement of a False Claims Act claim that included the return of overpayments the insured had received as a result of its billing violations. The court found that the settlement constituted “Loss” because the policy definition of “Loss” included settlements, and that since the policy’s “Fraud/Ill-gotten Gains Exclusion” required final adjudication, the court did not have to reach the public policy question.

There are at least four significant reasons other courts should be reluctant to follow the *U.S. Bank* and *Gallup* decisions. First, while both courts purport to rely on policy interpretation, it ignores the basic finding of *Level 3*: an insured incurs no “loss” in the ordinary meaning of that word if it is merely returning something it wrongfully obtained. *Level 3* at 911. The *U.S. Bank* court relies on the principle that the policy must be interpreted as a whole, but ignores the ordinary meaning of “loss” and instead refers to the policy’s ill-gotten gain exclusion to find a contractual basis for covering the settlement (despite its presumption that coverage would violate public policy).

Second, the *U.S. Bank* court dismisses Judge Posner’s concerns about allowing insureds to settle and obtain coverage<sup>16</sup> with a rationale that ignores practical reality and overestimates

<sup>15</sup> Those other cases were *Dobson v. Twin City Fire Ins. Co.*, No. 11-cv-0192 (DOC/MLG), 2012 U.S. Dist. LEXIS 93823, 2012 WL2708392 (C.D. Cal. July 5, 2012), which has since been reversed in *Dobson v. Twin City Fire Ins. Co.*, 590 Fed. Appx. 687, 2015 U.S. App. LEXIS 647, 2015 WL 191526; and *Aon Corp. v. Certain Underwriters at Lloyd's of London*, No. 06-16852 (Ill. Cir. Ct. Ch. Div. Dec. 3, 2010)

<sup>16</sup> As noted above, the *Level 3* Court rejected the insured’s argument that the bar against coverage for ill-gotten gains does not apply if the case is settled, reasoning:

courts' willingness to allow an insurer simply to say no to a settlement for coverage reasons.

The *U.S. Bank* court argues:

Yet insurance companies can counter that incentive by not consenting to the settlement.... If the Insurers were concerned that the settlement constituted restitution, they could have refused consent or conditioned consent on an admission of liability for wrongdoing or a stipulation that the payment was restitution. The Insurers would have been wiser to refuse or condition consent at the outset rather than consent and later contest coverage in avoidable litigation.

*U.S. Bank* at 1052. Insurers reading that explanation would immediately hear the ringing of “bad faith” failure-to-settle accusations in their ears. Or at best, and depending on the jurisdiction, an insurer would anticipate the insureds’ argument that they were excused from obtaining the insurers’ consent because of the insurer’s position on coverage for restitution, *see, e.g., TIAA-CREF v. Ill. Nat’l Ins. Co.*, 2017 Del. Super. LEXIS 359, or that the insured’s failure to obtain consent was excused because the insurer is unable to prove that it was prejudiced by the settlement. *See, e.g., Hernandez v. Gulf Group Lloyds*, 875 S.W.2d 691 (Tex. 1994).

A third flaw in the *U.S. Bank* decision is its premise that finding that a restitutionary settlement is not covered loss would nullify the Ill-Gotten Gains exclusion as a matter of contract interpretation. *See id.* at 1050. The U.S. District Court for the Southern District of Florida recently rejected that argument in *Phila. Indem. Ins. Co. v. Sabal Ins. Group, Inc.*, 2017 U.S. Dist. LEXIS 159508\* (S.D. Fla.). The final adjudication limitation in conduct exclusions still serves an important purpose even if indemnification for a settlement is not allowed. It ensures

That can’t be right.... It would mean, as Level 3’s lawyer confirmed at argument, that if Level 3, seeing the handwriting on the wall, had agreed to pay the plaintiffs in the fraud suit all they were asking for..., Federal would still be obligated to reimburse Level 3 to retain the profit it had made from a fraud.

*Level 3* at 911 (citing *Reliance Group Holdings, Inc. v. National Union Fire Ins. Co.*, 594 N.Y.S.2d 20, 25 (App. Div. 1993)).

that even if a claim is a clear-cut effort to obtain restitution or disgorgement, an insurer will advance the insured's defense costs so long as the matter is still being defended. *Id.* at \*14-15.

In fact, the very facts of the instant case bear out this conclusion. "Loss" includes "Defense Costs" as well as "Damages." "Defense Costs" are clearly covered as a "Loss" and do not fall within the exclusionary provisions on "Claims" arising out of the Defendants gaining profit to which they are not legally entitled or "Claims" arising out of a dishonest, fraudulent, or criminal act, unless and until there is a final, nonappealable judgment establishing the Defendants committed such act.

*Id.* at \*15.

Furthermore, as the *Phila. Indem.* court notes, "an exclusionary provision does not apply unless there is coverage in the first instance." *Id.* at \*13 (citing *Siegle v. Progressive Consumers Ins. Co.*, 819 So.2d 732 (Fla. 2002), and *Amerisure Mut. Ins. Co. v. Auchter Co.*, 673 F.3d 1294 (11<sup>th</sup> Cir. 2012)). Thus, pursuant to the *Level 3* interpretation, the insured does not even have a "loss" to which an exclusion could be applied.

Finally, though the *U.S. Bank* court strains to try to counter this conclusion, both *U.S. Bank* and *Gallup*, if correct, would allow insurers and insureds to ignore the well-established prohibition against "contracting around public policy." See, e.g., *J.C. Penny Casualty Ins. Co. v. M.K.*, 52 Cal. 3d 1009, 1019 n.8:

[California Insurance Code] Section 533 reflects a fundamental public policy of denying coverage for willful wrongs. (*Tomerlin v. Canadian Indemnity Co.* (1964) 61 Cal.2d 638, 648 [39 Cal.Rptr. 731, 394 P.2d 571].) The parties to an insurance policy therefore cannot contract for such coverage. (Civ. Code, § 1667.) We therefore need not and do not decide whether coverage would be excluded by the explicit policy exclusion in the absence of section 533.; and *CSX Transp., Inc. v. Mass. Bay Transp. Auth.*, 697 F. Supp. 2d 213, 229 (D. Mass. 2010) ("Even sophisticated parties cannot contract around public policy.").

The *U.S. Bank* court's attempt to work around that problem fails as a matter of logic. The court assumed that insuring restitution was against Delaware public policy.

But the Court does not conclude that parties may contract to insure a payment, like restitution, that is uninsurable under public policy. All the Court concludes is

that parties may agree to ensure that a payment truly fits within a category of matters that are legally uninsurable.

*Id.* at 1052. That is to say, the state and its courts may establish public policy, but parties to a contract can determine when that policy is violated. It is difficult to imagine a more apt description of parties “contracting around public policy.”

*Gallup* contains a unique error by the court that renders it even more questionable. The court found that the policy was governed by Nebraska law, but then oddly asserts that Judge Posner’s decision in *Level 3* did not apply Nebraska law. It did.<sup>17</sup> The *Gallup* court, then, applying the same governing law as Judge Posner, took a completely different approach to interpreting essentially the same policy wording regarding what constitutes “loss.”

The *Phila. Indem. Ins. Co. v. Sabal Ins. Group, Inc.* case discussed provides additional reasons to reject *U.S. Bank* and *Gallup*. The coverage claim in *Phila. Indem.* was for a settlement to repay the State of Florida workers’ compensation and other payments received based on false claims submitted by the insured. The policy contained a final adjudication profit exclusion, but the court found there was no loss within the meaning of the policy and expressly criticized *U.S. Bank* and *Gallup*. For example:

I do not find *CNL Hotels* or *Level 3* distinguishable on the basis that the policies at issue did not include exclusionary language requiring a final judgment. While neither case delves deeply into the language of the insurance policies at issue, *Level 3* specifically mentions a final judgment. ‘Level 3 acknowledges that if a judgment had been entered in the suit against it on the basis of a judicial determination that it had engaged in fraud, Federal would win; the policy so provides.’ *Level 3*, 272 F.3d at 911 (emphasis added).

*Phila. Indem. Ins. Co.*, 2017 U.S. Dist. LEXIS 159508, \*14. The court summarized its own conclusion as follows.

<sup>17</sup> See fn. 4, *supra*.

All in all, there is no ambiguity in the Policy and the payments Defendants agreed to pay as part of the Stipulated Settlement Agreement are restitutionary in nature regardless of whether there is an admission of guilt or a final adjudication.

*Id.* at \*16.

###

## The *Level 3* Legacy

### American College of Coverage and Extracontractual Counsel 6<sup>th</sup> Annual Meeting

Chicago, IL  
May 16-18, 2018

Mitchell F. Dolin  
Cléa P.M. Liquidard  
Covington & Burling LLP  
© 2018 Mitchell F. Dolin, all rights reserved.

## **THE *LEVEL 3* LEGACY**

**by Mitchell F. Dolin and Cléa P.M. Liquard<sup>1</sup>**

More than fifteen years have passed since the Seventh Circuit issued its landmark ruling in *Level 3* questioning the availability of D&O coverage for damages that are “restitutionary in character.” *Level 3 Communications, Inc. v. Fed. Ins. Co.*, 272 F.3d 908, 910 (7th Cir. 2001). While not the first decision to conclude that coverage is barred for disgorgement or restitutionary-type payments, *Level 3* has arguably become the most well-known. In the ensuing years, courts have come to markedly different approaches on the insurability of damages that might be characterized as restitution or disgorgement. This paper posits that weaknesses in the *Level 3* court’s reasoning contributed to what has become an unsettled area of law, and explains that recent decisions have begun to apply more rigorous textual analyses and thus are more likely to allow coverage for certain claims arguably involving disgorgement or restitution, at least absent specific contractual exclusions.

This paper proceeds in three sections. The first offers an analysis of the *Level 3* decision, identifying key aspects of the court’s reasoning that led to a rule with unstable foundations. The second section discusses the varying approaches courts have taken following *Level 3* and illustrates how more recent decisions have narrowed *Level 3*’s application. The final section discusses four motivating factors driving courts to adopt a *Level 3*-type rule and identifies

<sup>1</sup> © Mitchell F. Dolin, all rights reserved. The views and opinions expressed herein are those of the authors and not of their law firm or its clients. This paper is a pre-publication discussion draft and should not be quoted without permission.

specific D&O insurance policy language that is available on the market that addresses those motivations in a more precise and predictable manner than a *Level 3*-type analysis.

**I. THE UNINSURABILITY OF RESTITUTIONARY PAYMENTS: THE *LEVEL 3* DECISION**

*Level 3* addressed insurance coverage for the settlement of an underlying securities fraud action. The corporate insured, Kiewit Diversified Group Inc. (later acquired by Level 3), through a subsidiary company, held a majority stake in a company and was alleged to have obtained the remaining shares from minority stockholders as a result of fraudulent representations by the subsidiary company and one of its directors. *Kiewit Diversified Grp. Inc. v. Fed. Ins. Co.*, 999 F. Supp. 1169, 1172 (N.D. Ill. 1998). The parent company, subsidiary, and director were named as defendants. *Id.* The stockholder-plaintiffs claimed that their stock “was far more valuable than the price reflected, and that they would not have sold their shares had” the defendants disclosed certain material information. Fed. Br., *Level 3*, 2001 WL 34106466, at \* 4-5. The plaintiffs asserted causes of action for violation of federal securities laws, fraud, breach of fiduciary duty, and breach of contract. *Id.* at \*4. The plaintiffs estimated their damages at \$70 million; the parties settled after the first day of trial for \$11.8 million. Level 3 Br., *Level 3*, 2001 WL 34106467, at \*9-10; Fed. Ins. Co. Br. at \*12.

Level 3’s D&O insurer, Federal Insurance, refused to pay the settlement on various grounds, but the ground relevant here was based on the contention that the settlement was “not [a] covered ‘Loss,’ and was not insurable.” Fed. Ins. Co. Br. at \*14.

In a decision authored by Judge Richard Posner, the Seventh Circuit agreed with the insurer’s position that allowing coverage for the securities fraud settlement would be akin to allowing coverage for theft and that the settlement could not be fairly characterized as a bona

fide “loss.” As the court put it: “It’s as if . . . Level 3 had stolen cash [from the shareholders] and had been forced to return it and were now asking the insurance company to pick up the tab.” *Level 3*, 272 F.3d at 910.

The court’s conclusion may have intuitive appeal to some, but close examination reveals that the ruling rests on a shaky foundation in at least three principal ways, each of which is discussed below.

#### **A. The “Interpretive Principle” And Public Policy**

The Seventh Circuit’s opinion, in keeping with Judge Posner’s pragmatic approach and colorful literary style, purports to cut to the heart of the matter without pausing to quote all of the potentially relevant policy language, to describe in detail the underlying lawsuit, or to mention anything about the governing state law. In this regard, the court’s well-known 2001 ruling is similar to an earlier appeal heard by the same panel reversing a trial court ruling for the insurer on a different case-dispositive issue. *Level 3 Communications, Inc. v. Federal Ins. Co.*, 168 F.3d 956 (7th Cir. 1999). In that 1999 decision, the panel, per Judge Posner, mentioned but did not cite Nebraska law and ignored the “literal accuracy” of the insurer’s position because it would be “too nutty to be tolerable as a contractual interpretation. . . .” *Id.* at 957, 959.

In addressing the insurability of restitutionary damages, the court grounded its ruling on the definition of “Loss,” which it quoted as “the total amount which any Insured Person becomes legally obligated to pay . . . including, but not limited to . . . settlements.” *Level 3*, 272 F.3d at 909. In fact, the definition in the policy, as quoted by the district court, referred to “the total amount which any insured person becomes legally obligated to pay *on account of each claim and for all claims in each policy period. . . made against them for wrongful acts for which coverage*

*applies, including, but not limited to damages, judgments, settlements, costs, and defense costs,*” but not including “*matters uninsurable under the law.*” *Level 3*, 1999 WL 675295 at \*3 (italics highlighting words not quoted in the panel opinion). Rather than focus on the content of the entire definition, much less the portions partially quoted in the panel’s opinion, the court homed in on the term “Loss” itself, applying what it called an “interpretive principle” by which it concluded that “a ‘loss’ within the meaning of an insurance contract does not include the restoration of an ill-gotten gain.” *Level 3*, 272 F.3d at 910.

Interpreting the word “Loss” as the court did might be a valid approach where the word is used as a standalone term, but in *Level 3* the meaning of “Loss” was expressly prescribed by the definition provided in the policy rather than the defined term itself. That definition specifically encompassed “settlements” among “the total amount” the insurer was obligated to indemnify and thus on its face would capture a settlement of a securities lawsuit such as that in *Level 3*. The court did not attempt to reconcile its interpretation with the words in the definition.

A similar indifference to policy wording appears in the court’s attempts to distinguish decisions going the other way. For example, the Seventh Circuit considered *Limelight Productions*, an Eleventh Circuit decision that found “no merit to the argument that ill-gotten profits are not damages covered by the insurance policies.” *Limelight Productions, Inc. v. Limelite Studios, Inc.*, 60 F.3d 767, 769 (11th Cir. 1995). The *Level 3* court brushed this and similar decisions aside, concluding that, although the “facts were similar to those in the present case, [] the operative term in the insurance policy [in those cases] was ‘damages’ rather than ‘loss’ and so was broader.” *Level 3*, 272 F.3d at 910. Actually, it was narrower. “Loss” as defined in *Level 3*’s policy included, but was not limited to, “damages”: “Loss” was defined as

“the total amount which any Insured Person becomes legally obligated to pay,” and specifically included “damages, judgments, [and] settlements.” *Level 3 Br.* at \*12 (emphasis added). The court’s opinion in *Level 3* replaced the word “damages” with ellipses when it quoted the policy’s definition of “loss” as “the total amount which any Insured Person becomes legally obligated to pay . . . including but not limited to . . . settlements.” *Level 3*, 272 F.3d at 908. Accordingly, its effort to distinguish the wording of the *Limelight* policy from *Level 3*’s policy was unsupported.

A handful of decisions preceding *Level 3* adopted similar interpretive approaches, focusing on terms such as “loss” without regard to their prescribed policy definitions. In *Town of Brookhaven*, for instance, the policy defined “Loss” as “any amount which the Assureds . . . are legally obligated to pay a claimant on account of injuries or damages suffered by such claimant . . . and shall include damages, judgments, [and] settlements,” while carving out matters “deemed uninsurable under the law.” *Town of Brookhaven v. CNA Ins. Cos.*, No. CV-86-3569, 1988 WL 23555, \*3 (E.D.N.Y. Feb. 24, 1988). The *Town of Brookhaven* was found to have distributed tax revenues to school districts “more slowly than required under” the county tax act; school districts sued to recover “the interest earned by the town during the period the town unlawfully withheld” the tax revenues from the school districts. *Id.* at \*1, \*3. The *Brookhaven* court dismissed the insurer’s argument that public policy barred coverage, but nevertheless concluded that the definition of “Loss” in the policy was not broad enough to encompass what it characterized as “repayment” of funds the town was “never entitled to.” *Id.* at \*5-6, \*3. The court reasoned that “[t]he broad language of the policy does not alter [the court’s] conclusion” that the town did not suffer a “loss” because the “plain and ordinary meaning of loss . . . cannot be ignored, and the town simply cannot lose that to which it was not legally entitled.” *Id.* at \*5

(internal citations omitted). *See also Local 705 Int’l Broth. of Teamsters Health & Welfare Fund v. Five Star Managers, LLC*, 316 Ill. App. 3d 391, 396 (2000) (policy covered “ultimate net loss” defined as “the total sum which the insured shall become legally obligated to pay . . . including, but not limited to, damages, judgments, settlements, costs and claims expenses”; but holding that “[t]he plain and ordinary meaning of ‘loss’ cannot be ignored. [The insured] simply cannot lose that to which it was not legally entitled”) (internal quotations omitted).

The *Level 3* court’s interpretive approach aside, the panel appears to have been influenced by—without predicating its holding upon—the notion that, as a matter of public policy, amounts constituting “ill-gotten gains” or restitution are not insurable.<sup>2</sup> Indeed, the *Level 3* court cited a string of cases many of which, including the California Supreme Court’s *Bank of the West* opinion, invoke a public policy rationale to preclude coverage for disgorgement and restitutionary-type payments:

When the law requires a wrongdoer to disgorge money or property acquired through a violation of the law, to permit the wrongdoer to transfer the cost of disgorgement to an insurer would eliminate the incentive for obeying the law. Otherwise, the wrongdoer would retain the proceeds of his illegal acts, merely shifting his loss to an insurer.

*Bank of the West v. Superior Court*, 2 Cal. 4th 1254, 1269 (1992).

<sup>2</sup> The court makes clear that it is relying on contract text rather than public policy or unenforceability. *See Level 3*, 272 F.3d at 910 (“As the interpretive principle controls this case, we need not consider the issue of unenforceability, though the two issues are intertwined, since obviously an insurance policy wouldn’t be presumed to have been drafted in such a way as to make it unenforceable.”); *id.* at 911 (“An insured incurs no loss within the meaning of the insurance contract. . . .”). Although the *Level 3* policy’s definition of “Loss” excludes “matters uninsurable under the law,” the panel neither quoted nor purported to rely on that aspect of the definition.

Thus, while courts adopting a *Level 3* analysis may pay homage to the idea of interpreting insurance policy language, more often than not the decisions are motivated by an unwillingness to allow insurance coverage where doing so would appear to insure fraud, reduce incentives to obey the law, or somehow allow a defendant to keep an apparent windfall.

**B. Ignoring Exclusions And Equating Settlements With Determination Of Facts**

The second questionable feature of *Level 3*'s analysis is the Seventh Circuit's refusal to apply the clear mandate of exclusionary provisions and a willingness to accept a settlement as essentially tantamount to a determination of liability.

In this regard, it is important to highlight two exclusions in the *Level 3* policy that might have been implicated by the facts in that case under certain circumstances. While the panel opinion alludes to the insured's concession that there would be no coverage if there had been a fraud judgment, the court did not cite or describe the policy's conduct exclusions. The first exclusion, to which the court was presumably alluding, barred coverage for loss:

Arising from . . . any deliberately fraudulent act or omission or any willful violation of any statute or regulation by such Insured Person, if a judgment or other final adjudication . . . establishes such a deliberately fraudulent act or omission or willful violation.

*Level 3 Br.* at \*24.

The second provision excluded losses from claims made against an Insured Person:

based upon . . . such an Insured Person having gained in fact any personal profit, remuneration or advantage to which such an Insured Person was not legally entitled.

*Id.* at \*18. The *Level 3* policy apparently had additional language making clear that this "profit" exclusion applied only to non-indemnifiable losses of directors and officers. *Id.* at \*19.

Presumably referring to the fraud exclusion, the insured in *Level 3* acknowledged that coverage would be unavailable “if a judgment had been entered in the [securities] suit . . . on the basis of a judicial determination that [Level 3] had engaged in fraud,” but contended that coverage existed for *settlements* resolving allegations of fraud. *Id.* at 911.<sup>3</sup> The Seventh Circuit disagreed, declaring that it “can’t be right” that, “[a]s long as the case is settled before entry of judgment, the insured is covered regardless of the nature of the claim against it.” *Id.* The court hypothesized that such a rule would incentivize an insured to simply agree to a settlement—even at the full amount demanded by plaintiffs—to avoid application of the exclusion, allowing the insured to “retain the profit it had made from a fraud.” *Id.*

As sole support for this conclusion, the Seventh Circuit cited *Reliance Group Holdings, Inc. v. Nat’l Union Fire Ins. Co.*, a case involving coverage for a settlement of consolidated class action securities and derivative lawsuits under a policy that appears to have covered claims against only the directors and officers (and indemnified by the company), and not claims against the company itself. 188 A.D.2d 47, 52-35 (N.Y. App. Div. 1993) (quoting coverage grant for claims made against director and officers for wrongful acts of directors and officers). In that case, Reliance Group (and its subsidiaries, referred to collectively as Reliance Group) was alleged to have obtained so-called greenmail payments—profits gained by purchasing shares of a

<sup>3</sup> While the Seventh Circuit’s opinion suggests that the fraud exclusion would apply to Level 3 if there were “a judicial determination that *it* had engaged in fraud,” *Level 3*, 272 F.3d at 911 (emphasis added), in fact, the policy at issue—which antedated the era of widespread entity coverage—does not appear to have covered claims against the company in the first instance. *See e.g., Level 3*, 1999 WL 675295 at \*4 (referring to “the uninsured corporation” and applying the larger settlement rule to allow full coverage because there was an insured person named in the underlying action).

company, threatening a hostile takeover, and then selling the shares back to the target company at a premium in exchange for backing off the take-over. *Id.* at 50. Shareholders of the target company sued Reliance Group and a director for breach of fiduciary duty for allegedly abandoning a derivative action Reliance Group had initiated against the target company. *Id.* A preliminary injunction was granted (and upheld on appeal), imposing a constructive trust on Reliance Group's greenmail profits, the purposes of which the underlying courts described as "to prevent unjust enrichment," and allow the plaintiffs to "recover[ ] wrongfully acquired assets." *Id.* at 51. A settlement was eventually reached between Reliance Group, its director, and the shareholder-plaintiffs; Reliance Group then sought coverage for the entire settlement amount as an indemnified loss on behalf of the director. *Id.* at 51-52. The court refused to recognize coverage.

Much of the court's analysis was focused on the fact that the company itself was ordered to disgorge its "wrongfully acquired assets," which was not a loss to or on behalf of the insured director. *Id.* at 51; *see also id.* at 56 ("The D&O policy covers corporate indemnification of directors and officers for *their* incurred liability, not the corporation's own liability.") (emphasis in original). The *Reliance Group* court also referred to the restitutionary nature of the company's settlement payment. Specifically, the *Reliance Group* court held that the company did not suffer a loss as defined in the policy, in part because:

It is well established that one may not insure against the risk of being ordered to return money or property that has been wrongfully acquired. Such orders do not award 'damages' as that term is used in insurance policies. *Bank of the West*, 2 Cal. 4th 1254 [(1992)]. . .

The settlement of [the underlying] action . . . was essentially equivalent to a determination reached through agreement of the parties, that [the company] had been unjustly enriched in the amount of \$21.1 million through its actions in connection with the [ ] takeover attempt. In other words, the determination of this appeal should not hinge on the circumstance that [the company] made restitution by way of settlement instead of in satisfaction of a judgment after trial.

*Id.* at 55.

In passing, the court noted that the policy contained an exclusion barring coverage for claims against insured persons “based upon or attributable to their gaining in fact of any personal profit or advantage to which they were not legally entitled.” *Id.* at 57 n.2. The court observed that, had coverage been sought for non-indemnifiable loss, rather than under the “Company Reimbursement” portion of the policy, and had the director been made to disgorge profits he gained, the claim “would almost certainly be excluded.” *Id.* That exclusion, however, did not apply to losses the company incurred by indemnifying its directors. *Id.* Rather than consider the asymmetrical structure of the exclusion as an indication of the intent of the parties to the policy, the *Reliance Group* court concluded that the existence of the profit exclusion under one coverage section “provide[d] a gloss in construing the intent of the policy with respect to the essential nature of the claims upon which coverage is contemplated.” *Id.*

For present purposes, there are two fundamental problems in the *Level 3* and *Reliance Group* reasoning.

*First*, both courts ignore the limitations of the exclusions in the policies at issue, effectively rewriting the exclusions in the course of denying coverage. In *Level 3* the court believed that if “a judgment” established that the insured had engaged in fraud (or “stealing,” as

the court would put it), the fraud exclusion would bar coverage. *Level 3*, 272 F.3d at 911. But when the Seventh Circuit refused to recognize coverage for the insured's *settlement* of the securities fraud suit, it ignored the "judgment or other final adjudication" requirement in the exclusion, effectively holding that a *settlement* resolving *allegations* of fraud was sufficient to trigger the exclusion. Similarly, both the *Level 3* and *Reliance Group* policies had provisions excluding losses attributable to an insured person "gaining in fact [ ] any personal profit or advantage to which they were not legally entitled." *Reliance Grp.*, 188 A.D.2d at 57 n.2. In both cases, however, the profit exclusion applied by its terms only to non-indemnified losses incurred by directors and officers and required a finding that the insured persons "in fact" obtained improper personal profits or advantages. Traditional contract interpretation principles would dictate that, where the parties used a provision in one section of the contract, but not in another, the parties are deemed to have intended the asymmetry. The *Reliance Group* court, however, took the presence of the exclusion in one section of the policy as indication that the parties intended the exclusion to apply to all coverage sections; again, effectively imposing its own terms in the policy. *See id.*<sup>4</sup>

*Second*, both courts seemed to equate a settlement with a tacit determination that the insured in fact engaged in the alleged wrongful conduct. As the *Reliance Group* court articulated: "The *settlement* of [the underlying] action . . . was essentially equivalent to a determination . . . that [the insured] had been unjustly enriched." *Id.* at 55 (emphasis added).

<sup>4</sup> As we shall see at pages 18-21 below, the First Circuit more recently reversed a district court's refusal to enforce a not dissimilar asymmetry and rejected a carrier's plea to deny coverage on *Level 3* type grounds. *See Genzyme Corp. v. Fed. Ins. Co.*, 622 F.3d 62 (1st Cir. 2010).

Arguably, the fact that a preliminary injunction was ordered and a temporary constructive trust imposed takes *Reliance Group* out of the realm of the typical settlement made prior to any findings of fact. The same cannot be said for *Level 3* where the parties settled after the first day of trial without any factual findings, judgment or other final adjudication. *Level 3*, 272 F.3d at 911. The *Level 3* court nevertheless reasoned that the insured's settlement was proof enough of wrongful conduct because the insureds "settled with the plaintiffs in the fraud suit for [a] not inconsiderable amount . . . after the trial had begun and much of the expense of defending the suit had therefore already been incurred." *Id.* The court also faulted the insured for making "no attempt to show that the fraud suit was groundless and the settlement merely an effort to avoid the expense of defending a nuisance suit." *Id.* at 911-12. In the court's view, a "rational defendant" would settle a law suit for a substantial sum only if there were truth to the allegations. *Id.* at 911.

Even aside from the fact that the settlement of the underlying securities action addressed in *Level 3* was for only seventeen percent of the plaintiffs' claimed damages, this analysis flips on its head the fundamental tenet that a settlement is not evidence of liability; parties enter into settlements (even for amounts exceeding nuisance value) for numerous reasons, many of which have nothing to do with the merits of the allegations. Indeed, virtually every securities action settles, for one reason or another. The *Level 3* decision comes close to accepting the insurer's position that, despite having a "final adjudication" requirement in the fraud exclusion, insurability does not depend on a finding of fraud, but instead is based the "nature of the claim" being settled. *Id.*; see also Fed. Reply Br. at \*11 (whether underlying plaintiffs "were, in fact, defrauded makes no difference. . . . The determination of insurability . . . is based on whether the

*claim* that was settled was for the return of wrongfully-acquired property”) (emphasis in original). Stated another way, under the reasoning of *Level 3*, a settlement resolving fraud allegations could be said to amount to a finding that the insured engaged in fraud.

Evidently recognizing the inherent incongruity of its reasoning, the *Level 3* court considered how it would deal with circumstances where an insured has “shown that the fraud suit was groundless, that there was no ill-gotten gain that insurance would enable it to keep.” *Level 3*, 272 F.3d at 912. The court is at a loss to explain how its rule would apply: “We need not decide; and prudence is definitely the better part of valor here, since we can find no guidance on the point from cases or other materials.” *Id.*

### **C. Focus On The General “Nature” Of The Claims And Remedy**

The final aspect of note in *Level 3* is the focus the court places on determining the “nature” of the claims and remedies. For example, the court acknowledged that the underlying plaintiffs in *Level 3* did not request restitution or rescissory damages, but rather sought “standard damages relief” in a securities suit—“the difference between the value of the stock at the time of the trial and the price they had received for the stock from Level 3.” *Level 3*, 272 F.3d at 910. Nevertheless, in the court’s view, the damages were “restitutionary in character” because they sought “to divest the defendant of the present value of the property obtained by fraud, minus the cost to the defendant of obtaining the property.” *Id.* at 910-11. Emphasizing the point, the court declared:

How the claim or judgment order or settlement is worded is irrelevant. An insured incurs no loss within the meaning of the insurance contract by being compelled to return property that it had stolen, even if a more polite word than “stolen” is used to characterize the claim for the property’s return.

*Id.* at 911.

Consequently, an insured may find itself out of luck where a court decides the underlying claims or remedies can be characterized as “restitutionary in character,” even where the underlying plaintiff does not pray for restitution or assert claims for unjust enrichment, much less establish that wrongdoing occurred. This broad-brush approach dovetails with the *Level 3* court’s belief that it is the “nature of the claim” that matters—not whether the claim is settled or adjudicated. In so ruling, the court failed entirely to address the fact that the individual insured director—who was indemnified by the company, therefore giving rise to the insurance claim—was not being asked to return an ill-gotten gain and was not even the defendant the court suggested had reaped the ill-gotten gain at issue. The loss complained of by the underlying plaintiffs was (ostensibly) a gain incurred by the corporate defendant, not by the individual defendant. Had the court focused on this basic fact, the court would have concluded that characterizing the settlement as restitution as to the individual defendant was inapt. And as we shall see, a rule that bars coverage for damages that are “restitutionary in character” is necessarily vague in application and invites litigants to test the outer boundaries of the concept.

## **II. THE LEGACY OF *LEVEL 3*: LACK OF UNIFORMITY AND RETRENCHMENT**

As Section I demonstrates, the foundations of *Level 3* are questionable in many respects. The reasoning is inconsistent with accepted canons of contract interpretation, principles of freedom of contract, and the ability of parties to compromise disputes without admitting fault. It can hardly be surprising, then, that in the years following the *Level 3* decision, courts have come to markedly different positions on the insurability of disgorgement claims and restitutionary-type damages. Indeed, early insurer-successes following *Level 3* led insurers to advance *Level 3*

arguments in many types of cases in an attempt to expand its reach. Some of the more aggressive expansion efforts caused courts to adopt more rigorous analyses, focusing more on policy language and away from the stance against insurability of restitutionary-type damages seen in *Level 3*. The following sections offer an illustration of the varying approaches courts have adopted.

**A. Adherence To *Level 3***

A number of courts have adopted the *Level 3* approach to coverage for restitutionary-type payments. For example, in *CNL Hotels & Resorts, Inc. v. Twin City Fire Ins. Co.*, 291 Fed. Appx. 220, 222 (11th Cir. 2008), the insured company, CNL, was alleged to have overvalued its stock by \$8 a share in an offering. CNL also obtained shareholder approval for a merger through an allegedly misleading proxy statement and allegedly proposed to pay an excessive price for the target entity. *Id.* Class action shareholder suits ensued; one class of plaintiffs “sought a refund of \$8 to compensate them for the difference between the price that they paid for the stock and the price at which” the stock was valued by an independent advisor. *Id.* CNL eventually settled this litigation for \$35 million. A second class of shareholders alleged that CNL proposed to pay an excessive price for the target company; this litigation was resolved by restructuring the merger deal and paying plaintiffs’ attorneys fees. *Id.*

Certain of CNL’s excess insurers denied coverage and the Eleventh Circuit agreed, holding that the \$35 million settlement “was restitutionary in nature.” *Id.* at 223 (citing *Level 3*, 272 F.3d at 910). In so holding, the Eleventh Circuit was not persuaded that, because the underlying plaintiffs did not attempt to show fraud, the case fell outside *Level 3*’s ambit:

The return of money received through a violation of law, even if the actions of the recipient were innocent, constitutes a restitution payment, not a “loss.” It is immaterial whether CNL committed fraud. CNL received money directly from the Purchaser Class through the sale of shares, and CNL returned some of the money after the Purchaser Class alleged that the sale of shares by CNL violated the law.

*Id.* The Eleventh Circuit was equally unmoved by the fact that Section 11 (the statute under which the underlying lawsuit was brought) provides for an award of damages as measured by the loss to the plaintiff shareholder, because “in this appeal the loss to the plaintiff is equal to the gain of the defendant.” *Id.* at 224.

As for CNL’s payment of attorney’s fees in connection with the excessive price proposed to be paid under the merger, the court held that the policy’s so-called “bump up” exclusion “removes the payment from the definition of ‘loss.’” *Id.* at 225. The bump-up carve-out to the definition of loss in that policy provided:

In the event of a Claim alleging that the price or consideration paid or proposed to be paid in any transaction involving all or substantially all the ownership interest in or assets of an entity is inadequate or excessive, Loss with respect to such Claim shall not include any amount of damages, settlements or judgment representing the amount by which such price or consideration is effectively increased or decreased, or to any plaintiff’s counsel fees and costs arising out of such Claim; provided, however, that this paragraph shall not apply to Claims Expenses incurred in the defense or appeal of such Claim.

*CNL Hotels & Resorts, Inc. v. Houston Cas. Co.*, 2007 WL 1363757, at \*2 (M.D. Fla. May 8, 2007).<sup>5</sup>

The Fifth Circuit also followed suit to *Level 3* in *TransTexas Gas Corp. v. U.S. Bank Nat'l Assoc.*, 597 F.3d 298 (5th Cir. 2010), a case addressing coverage for what was determined to be a fraudulent transfer under the Bankruptcy Code. In the underlying action, the trial court found (and the Fifth Circuit affirmed) that payments made to a company's CEO, who controlled the company and threatened litigation against it if his demands for severance payments were not met, were fraudulent transfers under the Bankruptcy Code. See *Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. U.S. Bank*, 2008 WL 2405975, at \*2 (S.D. Tex. June 11, 2008); *In re TransTexas*, 597 F.3d at 305-308. Consequently, the CEO was ordered to repay the amounts determined to be fraudulent transfers. *In re TransTexas*, 597 F.3d at 303. The company's insurer refused to indemnify the payment, arguing that it was not a "loss" within the meaning of the policy's definition of that term, which was defined to include "damages, settlements, [and] judgments," but excluded "matters which may be deemed uninsurable under the law." *Id.* at 309.

Taking its cue from *Level 3*, the Fifth Circuit sidestepped the issue of whether the policy's "profit or advantage" exclusion would bar coverage, and instead concluded that the insurer did not owe an indemnity obligation because "the return of funds due to a fraudulent transfer is in the nature of restitution." *Id.* at 311 n.5, 310. In so holding, the Fifth Circuit relied on *Level 3*, noting that it agreed with the *Level 3* court's "interpretation" that "a 'loss' within the

<sup>5</sup> The court ended up remanding the case for a determination as to whether the insurers had properly filed the endorsement adding the bump-up exclusion with the state's insurance regulator. *Id.*

meaning of an insurance contract does not include the restoration of ill-gotten gain.” *Id.* (internal quotations omitted).<sup>6</sup>

### **B. Expansion of *Level 3* Precipitates Closer Scrutiny By Courts**

Successes in *Level 3* and other courts may have emboldened insurers to press disgorgement and public policy uninsurability arguments to new extremes, leading courts to begin staking out the limitations of the doctrine that *Level 3* had left unattended.

*Genzyme Corp. v. Fed. Ins. Co.*, 622 F.3d 62 (1st Cir. 2010), is one of the key decisions signaling a turning point in courts’ willingness to go along with *Level 3*-type arguments. In that case, Genzyme exercised its option to exchange shares of a “tracking stock” for shares of general common stock in the company. *Id.* at 65. The price paid for the exchanged shares was determined by a formula set out in Genzyme’s articles of organization and was based on the market value of the exchanged shares. *Id.* at 64-65. Following the share exchange, holders of the exchanged shares sued Genzyme and its officers and directors alleging the defendants artificially depressed the market value of the shares “so that Genzyme could fold the [division] into the General Division at an exchange rate that would be favorable to General Division shareholders,” effectively favoring one class of noteholders over another. *Id.* at 66.

The lawsuit was settled, and Federal Insurance denied coverage arguing in the first instance that the settlement was not an insurable “loss” because it did not fall within the common meaning of the term, coverage was against public policy, and in the alternative, a bump-up

<sup>6</sup> The Fifth Circuit has an opportunity to revisit its holding in *TransTexas* when it decides *John M. O’Quinn, P.C. v. Lexington Ins. Co.*, No. 16-20224, a case that raises the issue of insurability of restitution in light of more recent Texas state case law.

exclusion in the policy applied. *Genzyme Corp. v. Fed. Ins. Co.*, 657 F. Supp. 2d 282, 287, 288 (D. Mass. 2009). The district court held that there was no coverage. Reversing in part and affirming in part, the First Circuit held that public policy did not bar coverage, but concluded that the bump-up provision applied to exclude that portion of the settlement attributable to claims made against the corporate entity defendant. A comparison of the district court and First Circuit's analyses is instructive.

On the question of whether the settlement constituted a "loss," the district court announced that it would "not attempt to make hairsplitting distinctions between the commonly understood meaning of the word 'loss' and the requirements of public policy," but would instead "use considerations of public policy to guide its inquiry into whether the Settlement Payment constitutes an insurance 'loss'"—an approach that mirrors that taken in *Level 3* but with a transparent acknowledgment of its methods. *Genzyme*, 657 F. Supp. 2d at 288. The district court then admitted that it was "hard to see how Genzyme received any material benefit from the Share Exchange that could be disgorged by a restitutionary remedy," and that, consequently, the case did "not fit comfortably within the existing case law holding that the mere return of an ill-gotten gain is uninsurable." *Id.* at 289-90. Undeterred, the court nevertheless viewed the company's conduct as of the type that cannot be insured: "Genzyme should not be able to divide the benefits of equity ownership among its shareholders one way, redistribute those benefits, and then demand indemnification from its insurer for the redivision." *Id.* at 291.

Reversing the district court, the First Circuit reviewed the requirements for implying a public policy bar to coverage and found "no basis in Massachusetts legislation or precedent for concluding that the settlement payment is uninsurable as a matter of public policy." *Genzyme*,

622 F.3d at 69. The appellate court also noted that an exception of the type proposed by the insurer “would have the effect of making it impossible to secure coverage for damages awards in routine securities litigation” where one class of shareholders alleges it was treated unfairly; “[i]f the parties wish to exclude such coverage, it is common to include limiting provisions” like the bump-up provision. *Id.* at 70. The First Circuit separately considered the argument that a *Level 3* rule—that “a restitutionary payment is not insurable”—applied. *Id.* The court held (without deciding that Massachusetts recognized the doctrine) that *Level 3* did not apply because “Genzyme obtained no identifiable asset in the share exchange and therefore the settlement payment cannot represent the restoration to the plaintiffs of some amount Genzyme had improperly taken and withheld.” *Id.*

The First Circuit did affirm, in part, the district court’s alternative finding, that the policy’s bump-up provision applied. That provision read:

[Federal] shall not be liable under Insuring Clause 3 [entity coverage] for that part of Loss, other than Defense Costs . . . which is based upon, arising from, or in consequence of the actual or proposed payment by any Insured Organization of allegedly inadequate or excessive consideration in connection with its purchase of securities issued by [any Insured Organization].

*Id.* at 72. Despite acknowledging that, on its face, the provision applied only to claims made against the company and not claims against directors or officers, the district court found its way to applying the exclusion to claims against the company *and* claims against the individual insureds. Channeling *Level 3* and *Reliance Group*, the district court appeared persuaded that “it makes little sense to allow a corporation to sidestep coverage limitation in its insurance policy through the simple expedient of claiming that a settlement payment was made to indemnify its

directors and officers.” *Genzyme*, 657 F. Supp. 2d at 294; *see also id.* at 294-95 (reasoning that such an approach would encourage fraud by insured corporations, quoting *Reliance Group*).

The First Circuit disagreed, holding that “[o]n the face of the policy, the Bump-Up clause only applies to [entity coverage]” and thus “cannot bar Genzyme from seeking recovery” for amounts “it paid to indemnify its officers and directors.” *Genzyme*, 622 F.3d at 73. The appellate court observed that the policy’s allocation provision “specifically contemplate[d] a situation in which the Bump-Up clause” would bar coverage as to claims against the company, but not the insured individuals. *Id.* The First Circuit acknowledged that securities claims are often made against both the company and its directors and officers, but that “giving effect to the plain language of the policy does nothing to allow a corporation to sidestep” coverage limitations, but rather enforces the “express benefit of the insurance policy” for which the insured paid. *Id.* at 74 (internal quotations omitted).

As the sections below evidence, in many ways *Genzyme* set the stage for other courts to engage in more rigorous analyses and police the boundaries of any disgorgement-based arguments for denying coverage.

### **C. Trimming Level 3: Coverage Where The Insured Did Not Receive A Benefit**

One of the rules coming out of *Genzyme* is that a case does not “fit within the framework of *Level 3*” where the insured “obtained no identifiable asset” and therefore, a settlement “cannot represent the restoration” of ill-gotten gains. *Genzyme*, 622 F.3d at 70. In *J.P. Morgan Securities Inc. v. Vigilant Ins. Co.*, 21 N.Y.3d 324, 336 (2013), the New York Court of Appeals

applied this principle where an insured's payment, "although labeled disgorgement . . . [does] not actually represent the disgorgement of [the insured's] own profits."

In that case, Bear Stearns entered into a settlement with the SEC under which it agreed to pay \$160 million as "disgorgement." *Id.* at 330. The SEC issued an order detailing its findings that Bear Stearns had "willfully" violated federal securities laws by "facilitat[ing] a substantial amount of late trading and deceptive market timing" on behalf of its customers. *Id.* at 331 (internal quotations omitted). The insured acknowledged that it may be reasonable to preclude coverage for "disgorgement of its own ill-gotten gains," but argued that such a rule did not apply as to Bear Stearns because "the bulk of the disgorgement payment—approximately \$140 million—represented the improper profits acquired by third-party hedge fund customers, not revenue that Bear Stearns itself pocketed." *Id.* at 333, 336. The New York Court of Appeals agreed. Distinguishing other cases where the "SEC's findings conclusively linked the disgorgement payment to improperly acquired funds in the hands of the insured," the court stated:

In this case, in contrast, Bear Stearns alleges that it is not pursuing recoupment for the turnover of its own improperly acquired profits and, therefore, it would not be unjustly enriched by securing indemnity. The Insurers have not identified a single precedent, from New York or otherwise, in which coverage was prohibited where, as Bear Stearns claims, the disgorgement payment was (at least in large part) linked to gains that went to others.

*Id.* at 337 (internal quotations omitted).

**D. Trimming Level 3: Coverage Where Neither The Claim Nor The Remedy Are Restitutionary In Nature**

In other instances, courts have adopted *Genzyme*'s attitude of skepticism toward expansive views of what counts as "restitutionary in character." For example, in *William Beaumont Hosp. v. Fed. Ins. Co.*, 2013 WL 992552 (E.D. Mich. Mar. 13, 2013), Federal Insurance refused to cover a settlement resolving an antitrust suit against the insured hospital (coverage arose under an endorsement specially extending coverage to "Claims for Antitrust Activities"). The underlying suit was brought by registered nurses employed by hospitals in the Detroit area who accused the hospitals of conspiring to depress the nurses' compensation. *Id.* at \*3. The nurses sued to "recover for the compensation properly earned by RNs . . . but unlawfully retained by [the] hospitals as a result of the conspiracy . . . ." *Id.* Federal argued that the insured's settlement payment was not within the policy's definition of "loss" and also was not in accord with the principle of *Level 3* that "coverage for restitution or disgorgement is uninsurable as a matter of public policy." *Id.* at \*9.

The definition of "loss" under the policy in *Beaumont* in fact carved out the type of restitutionary claims that animated *Level 3*; that provision exempted from "loss":

Solely with respect to any Claim based upon, arising from or in consequence of profit, remuneration or advantage to which an Insured was not legally entitled, the term Loss . . . shall not include disgorgement by any insured or any amount reimbursed by any Insured Person.

*Id.* at \*5. But neither this specific carve-out nor the allegations claiming that the insured "unlawfully retained" benefits persuaded the district court that coverage was unavailable.

Instead, the court concluded that the carve-out quoted above did not apply because the antitrust

suit arose under the Sherman Act, violation of which requires proof of concerted action among defendants that produces adverse anti-competitive effects that harms the plaintiff—the plaintiffs’ claims did not depend on proving that the defendants obtained a “profit, remuneration or advantage to which [they were] not legally entitled.” *Id.* at \*6 (alterations omitted). The carve-out provision did not apply for the additional reason that the underlying plaintiffs did not seek disgorgement as a remedy. *Id.* at \*7. The court noted that the plaintiffs did not include restitution in their prayer for relief and their damages expert computed damages based on “the difference between the actual earnings of the[] class members . . . and the ‘but-for’ earnings these RNs would have been paid in the absence of the alleged conspiracy”—a remedy that the court noted was intended to compensate the plaintiffs, not disgorge profits earned by the insured. *Id.* at \*8.

Finally, the court rejected entirely the insurer’s reliance on *Level 3* and the idea that a public policy rule barred coverage explaining that, the insurer “need not identify any sort of public policy basis for reading the Policy as excluding the remedy of disgorgement from its definition of ‘loss’” because “the *Policy itself* makes this exclusion . . . .” *Id.* at \*9 (emphasis in original). The court then reiterated its finding that the underlying suit did not involve claims or remedies that were “restitutionary in nature”:

While the [underlying] complaint makes passing reference to RN compensation “unlawfully retained” by the defendant hospitals, and while it is undoubtedly possible, as a matter of abstract, zero-sum economic theory, to assert that every additional dollar in wages the plaintiff RNs allegedly would have received but for the antitrust conspiracy alleged in this complaint is money unlawfully “withheld” or “retained” by the defendant hospitals, the Court concludes that it would stretch the notion of “disgorgement” beyond all accepted meaning in the law to say that this remedy is

being pursued against the defendant hospitals in the [underlying] litigation.

*Id.* at \*11.

**E. Trimming *Level 3*: Coverage For Settlements Resolving Allegations Of Ill-Gotten Gains**

Another way in which courts policed the boundaries is to allow coverage for *settlements* resolving allegations of fraud, unjust enrichment, or claims seeking restitutionary-type damages. Three recent cases have taken this approach.

In the first, *U.S. Bank National Assoc. v. Indian Harbor Ins. Co.*, a consumer class action was filed against U.S. Bank asserting breach of contract, unconscionability, conversion, and unjust enrichment. 68 F. Supp. 3d 1044, 1046 (D. Minn. 2014). The bank was alleged to have posted its customers’ debit-card transactions in a manner so as to maximize the amount of overdraft fees assessed; the plaintiffs sought, *inter alia*, “return of the excess over draft fees, and damages.” *Id.* When the bank sought coverage for a settlement it reached with the plaintiffs, its insurers denied coverage on grounds that “the settlement require[d] U.S. Bank to return unlawfully assessed overdraft fees . . . , returning something that one wrongfully took . . . constitutes restitution, and restitution is uninsurable.” *Id.* at 1049.

The district court assumed without deciding that the governing law (Delaware) precluded “insurance coverage for restitution as a matter of public policy,” the court nevertheless found coverage was available for the settlement. *Id.* at 1049. Critical to the court’s analysis was recognition that the policy contained a profit exclusion barring coverage for:

Loss in connection with any Claim . . . brought about or contributed in fact by any . . . profit or remuneration gained by [the

insured] to which it is not legally entitled . . . as determined by a final adjudication in the underlying action.

*Id.* at 1047 (internal quotations omitted). The court reasoned that, if it “interpreted [the definition of Loss] to preclude coverage for a payment based on a settlement resolving claims for restitution, [the court] would nullify the [profit exclusion] that precludes coverage for a payment based only on a final adjudication determination that the claims warrant restitution.” *Id.* at 1050. In an implicit rebuke of the *Level 3* approach, the *U.S. Bank* court “emphasize[d] that it will not automatically presume—as the Insurers do—that the settlement constitutes restitution because it resolved claims alleging ill-gotten gains and seeking disgorgement for those gains.” *Id.* The court went on to explain:

Not only does the clear policy language, and especially the [profit exclusion], prevent the Court from doing so. But the common-sense effect of a settlement does as well. If a settlement resolves claims alleging unlawful activity but excludes an admission of liability for the activity, it does not establish that the underlying allegations are true or false.

*Id.*

The court went on to distinguish other decisions in the *Level 3* line of cases and, in a final signal of its departure from the *Level 3* approach, rebuffed the suggestion that its ruling would incentivize insureds to settle rather than litigate the underlying lawsuits, concluding that the insurers “could have refused consent” to the settlement “or conditioned consent on an admission of liability for wrongdoing or a stipulation that the payment was restitution.” *Id.* at 1053.

The Texas Court of Appeals came to a similar conclusion in *Burks v. XL Specialty Ins. Co.*, 534 S.W.3d 458 (Tex. Ct. App. 2015).<sup>7</sup> In the underlying proceeding, a bankruptcy plan agent sought to recover allegedly fraudulent transfers of money and stock to an insured CFO and sought to avoid obligations under a separation agreement to compensate the CFO. *Id.* at 460. The company’s D&O insurer refused to fund the settlement, arguing that the settlement “represent[ed] uninsurable disgorgement or restitution.” *Id.* at 467.

Echoing *U.S. Bank* and drawing a contrast with *TransTexas*, the Texas Court of Appeals refused to grant summary judgment to the insurer, reasoning that, while “[a] **judgment** ordering the repayment of a fraudulent transfer under the Bankruptcy Code may indicate that an insured has paid restitution or disgorgement,” “the mere fact of settlement does not indicate admission of the allegations in a complaint” and the court would “not automatically presume . . . that the settlement constitutes restitution because it resolved claims alleging ill-gotten gains and seeking disgorgement of those gains.” *Id.* at 167-68 (internal citations and quotations omitted). Notably, the court “assume[d] without deciding that disgorgement is ‘uninsurable’ in Texas,” but cautioned that “[g]iven the strong policy in Texas favoring the right of parties to contract and the lack of any Texas authority holding that insuring against disgorgement is against public policy,” it rendered “no opinion on the matter.” *Id.* at 465 n.5.

Relying on *Level 3*, the insurer in *Burks* argued that it “can’t be right” that a “judgment for disgorgement is uninsurable while a settlement is not.” *Id.* at 469. As in *U.S. Bank*, the

<sup>7</sup> Following the Texas Court of Appeals’s decision in *Burks*, the parties settled, leading the court to vacate its judgment. The court specifically ruled, however, that its opinion would not be withdrawn. *See Burks v. XL Specialty Ins. Co.*, 534 S.W.3d 470 (Mem.) (Tex. Ct. App. 2016).

*Burks* court did not agree with the logic of *Level 3*, asserting instead that “the sweeping *Level 3* decision has never been cited as authority by a Texas court, [and] even the Seventh Circuit acknowledged that not all settlements in satisfaction of claims alleging ill-gotten gains necessarily would be excluded from coverage.” *Id.*

Finally, in *TIAA-CREF v. Illinois National Ins. Co.*, 2016 WL 6534271, at \*3 (Super. Ct. Del. Oct. 20, 2016), the court determined that the insured was entitled to coverage for settlements resolving class action lawsuits alleging that the insured delayed processing its customers’ withdrawal requests and failed to pay its customers gains earned on their accounts between the date the customer made the withdrawal order and the date when the transaction actually took place. Focusing on New York law, the Delaware court distinguished prior New York cases as involving SEC Orders that “conclusive[ly] link[ed]” “the insured’s misconduct and the payment of monies.” *Id.* at \*12. By contrast, TIAA-CREF “settled, expressly denying any liability,” consequently, the court found “no conclusive link between the settlements in the Underlying Actions and wrongdoing by TIAA-CREF that would render the settlement agreements uninsurable disgorgement.” *Id.*

#### **F. Rejecting The *Level 3* Public Policy Rationale**

Several courts have rejected the idea that public policy bars coverage for payments that are restitutionary in nature.

For example, in *Cohen v. Lovitt & Touché, Inc.*, 308 P.3d 1196, 1198 (Ariz. Ct. App. 2013), underlying plaintiffs sued the owners of a ranch, alleging that the company violated state law requiring that all moneys collected as a “service” charge (*i.e.*, tips) be paid directly to the company’s employees. The underlying lawsuit was settled for \$16 million. In the coverage

action, the trial court determined that the underlying settlement payment was “restitutionary” and “uninsurable as a matter of public policy.” *Id.* The Arizona Court of Appeals reversed, reasoning that such a “rule is categorical and would render losses from restitutionary payments uninsurable, regardless of the specific language of the agreement or the specific circumstances of the claim.” *Id.* at 1199. The court noted that, “[s]uch an approach forecloses consideration of variation in contractual language which could substantially mitigate or even eliminate any public policy concerns” and has the potential to strip “well-intentioned directors and officers from the type of unforeseen losses” that are intended to be covered by insurance. *Id.* at 1200.

Similarly, in an earlier case, the court in *Virginia Mason Medical Center* dismissed arguments that a settlement was uninsurable where the insured agreed to “pay each class member a sum equal to the amount which that class member had paid” for an allegedly improper hospital charge. *Virginia Mason Medical Center v. Executive Risk Indem. Inc.*, 2007 WL 3473683 at \*4 (W.D. Wash. Nov. 14, 2007) *aff’d*, 331 Fed. Appx. 473 (9th Cir. 2009). The court rejected the insurer’s argument that “loss” had an “ordinary meaning” separate from the policy definition, and that the ordinary meaning did not include a “refund of funds that were not properly obtained.” *Id.* at \*3. The court explained that “[t]he Policy’s definition of ‘loss’ clearly includes settlements resulting from claims alleging wrongful conduct” and “[d]isallowing coverage for the [] settlement on the grounds that the funds were wrongfully gained would render nonsensical the Policy’s explicit coverage for settlements resulting from a wrongful act.” *Id.* at \*2-3. *See also Virginia Mason*, 331 Fed Appx. at 474 (“Executive Risk’s reliance on the ordinary meaning of the term ‘loss’ is misplaced because the insurance policy specifically defines ‘loss’ to include payments made for damages caused by omissions and misleading statements.”).

Similarly, the court was not persuaded by the insurer's arguments (which relied on *Level 3*) that the settlement was not covered because it was "restitutionary in nature." *Id.* The court explained that it "reject[ed] the Seventh Circuit's attempt to characterize the nature of a settlement," reasoning that "restitution . . . is awarded at the conclusion of litigation once culpability is allocated, while a settlement is a negotiated bargain between two parties who have foregone the right to a finding of culpability." *Virginia Mason*, 2007 WL 3473683 at \*3. *See also Virginia Mason*, 331 Fed. Appx. at 474 ("The settlement reflected a compromise of asserted damages arising from the plaintiffs' non-disclosure claim in the underlying action, rather than disgorgement of unlawful gains.").

The *Virginia Mason* court also declined to apply a public policy bar to coverage, stating that the policy "insure[d] Virginia Mason for damages or settlements resulting from claims alleging wrongful acts," and that "vague public policy arguments should not limit express language in a policy." *Virginia Mason*, 2007 WL 3473683 at \*4. *See also Virginia Mason*, 331 Fed. Appx. at 474 (noting "the lack of any Washington public policy militating against coverage under the policy").

Separately, the insurer contended that the settlement fell within the scope of the policy's fraud and profit exclusion, which the court quoted as applying to:

Claims brought about or contributed to in fact (1) by any dishonest or fraudulent act or omission . . . or (2) by an Insured gaining any profit, remuneration or advantage to which such Insured was not legally entitled.

*Virginia Mason*, 2007 WL 3473683 at \*4. The exclusion did not apply because, as the district court put it, "the phrase 'in fact' requires an entry of some pertinent factual finding" to trigger

the exclusion—a finding that the underlying court did not make and the insurer failed to present evidence that the insured’s conduct triggered the exclusion. *Id.* at \*5. *See also Virginia Mason*, 331 Fed. Appx. at 474 (affirming on the separate ground that the exclusion did not apply because the insured “did not return something to which it was not entitled”).

Finally, in *Houston Casualty Co. v. Sprint Nextel Corp.*, 2010 WL 4852649 (E.D. Va. Nov. 22, 2010), an insurer, relying on the *Genzyme* district court decision, denied coverage for a securities class action settlement resolving allegations that the insured company and its directors and officers breached their fiduciary duties when they combined two different tracking stocks, allegedly undervaluing one of the stocks. The insurer argued, among other things, that the settlement did not constitute a loss because the company “incurr[ed] no loss of assets due to the recalibration, [and therefore] there is nothing for an insurer to indemnify” and because it was uninsurable as a matter of Kansas public policy. *Id.* at \*4, 5.

As to the first argument, the district court dismissed the position, stating that “[t]he mere fact that a securities settlement results in a transfer from a corporation to a subset of its shareholders does not mean that the settlement fails to qualify as a ‘loss’ to the corporation.” *Id.*

Nor did the court accept the insurers invitation to apply a public policy exception to coverage, observing that a court can recognize such an exception only if the rule is “so thoroughly established as a state of public mind so united and so definite and fixed that its existence is not subject to any substantial doubt.” *Id.* But as the court pointed out, “[n]o Kansas statute prohibits insurance coverage for claims alleging that D&Os breached their fiduciary duties either generally or specifically in connection with the settling of an appropriate conversion ratio for the recombination of two tracking stocks.” *Id.* Indeed, as the court astutely noted,

Kansas statutory law—like Delaware law—provides that a “corporation shall have power to purchase and maintain insurance on behalf of D&Os whether or not the corporation would have the power to indemnify such person against such liability. In other words, Kansas law expressly provides that even wrongdoing so severe as to be unindemnifiable by the corporation is nonetheless insurable under a D&O policy.” *Id.* at \*6 (internal quotations omitted).

### **III. A MORE SENSIBLE APPROACH: APPLYING THE POLICY AS WRITTEN**

Thus far, the discussion in this paper has highlighted several problematic aspects of the *Level 3* court’s analysis and has shown how the foundations of the *Level 3* doctrine have resulted in a lack of uniformity among courts concerning insurability of disgorgement and restitutionary-type claims.

This section identifies four rationales that appear to motivate courts to adopt *Level 3*-like rules. This section then describes different policy provisions currently available on the market that allow parties to address the *Level 3* rationales more precisely and with more certainty, relieving courts from having to engage in unmoored inquiries into the “nature” of a claim, settlement, or judgment.

#### **A. Rationales Motivating The *Level 3* Doctrine**

As the case survey above illustrates, there appear to be four principal rationales motivating courts to adopt *Level 3*-like rules.

***Moral hazard.*** A frequently cited justification for adopting the *Level 3* doctrine is the potential for moral hazard if insurance coverage is recognized—that is, by indemnifying an insured for certain wrongful conduct, one risks removing the insured’s incentive to follow the law. As the California Supreme Court explained: “[T]o permit the wrongdoer to transfer the

cost of disgorgement to an insurer would eliminate the incentive for obeying the law.” *Bank of the West*, 2 Cal.4th at 1269.

***Fraud and intentional violations of the law.*** A related rationale is the desire not to allow insurance for fraud or other intentionally illegal conduct. This rationale is prominent in *Level 3* itself. The relatively short *Level 3* opinion uses the word “stolen” no less than six times and “fraud” 16 times. The sentiment is clear enough: Insurance should not be used to indemnify a thief. *See Level 3*, 272 F.3d at 911 (allowing insured to collect insurance for settlement “would enable Level 3 to retain the profit it had made from a fraud”).

***You can't lose something that wasn't yours to begin with.*** Courts are also motivated by the common sense thinking that one simply does not suffer a “loss” by having to return something to which one never had ownership or entitlement, regardless of one’s intent. *See Local 705 Int’l Broth. of Teamsters*, 316 Ill. App. 3d at 396 (“[The insured] simply cannot lose that to which it was not legally entitled.”) (internal quotations omitted).

***Insurance is not intended to fund the cost of doing business.*** In some of the cases where insurers have pressed “restitutionary in character” arguments to the extreme, sympathetic courts have justified a coverage denial on grounds that the insured is attempting to shift the cost of doing business on to its insurers. *See Genzyme*, 657 F. Supp. 2d at 291 (“Genzyme should not be able to divide the benefits of equity ownership among its shareholders one way, redistribute those benefits, and then demand indemnification from its insurer for the redivision.”).

## **B. Available Policy Language To Address The *Level 3* Rationales**

Whatever the merit of the underlying rationales for *Level 3* and its kin, modern professional and management liability policies have more precise tools at their disposal to

address those concerns. It is important not to lose sight of the fact that insurance coverage is almost always a matter of contract—if insurers are concerned with insuring certain types of conduct, or suspect their insureds may attempt to bypass an exclusion through a settlement, those “problems” can be solved by drafting, pricing, or declining to take on a risk. As the Arizona Court of Appeal recognized, “parties to an insurance contract are fully capable of drafting language that prohibits coverage when an insured has intentionally or recklessly acquired property in a wrongful fashion.” *Cohen*, 233 Ariz. at 1200.

As an example, the following four policy provisions, when applied according to their terms, would substantially, if not entirely, address the four rationales outlined above and allow insurers to calibrate their coverage obligations to align with their risk tolerance for specific insureds.

***Fraud and intentional violation of the law exclusions.*** Contemporary management and professional liability policies almost invariably contain exclusions that bar coverage for fraudulent or intentionally illegal conduct. One such exclusion that is widely available on the market precludes coverage for “deliberate criminal or deliberate fraudulent acts” of the insured, “if established by any final, non-appealable adjudication” in the underlying proceedings. Variations in language allow an insurer to broaden the scope of the exclusion, for instance, by including “deliberate violation of any statute, rule, or law”; by triggering the exclusion upon findings made in “any” underlying proceeding rather than “the” underlying proceeding; or by replacing the requirement of a determination in the underlying proceeding with an allowance for the insurer itself to prove deliberate fraud or criminal conduct. At the most extreme end, an insurer could entirely eliminate the need for a determination of fact as to whether the insured

engaged fraud, thereby potentially excluding even settlements that resolve allegations of fraud. The fact that most insurers are unable for commercial reasons to insist on such a broad exclusion should not eclipse the fact that such language is available.

***Profit/financial advantage exclusions.*** Whereas fraud exclusions typically focus on the intentionally illegal conduct of the insured, insurers also have at their disposal profit exclusions that focus on financial benefits gained by the insured. A typical profit exclusion bars coverage for claims “arising out of, based upon or attributable to any remuneration, profit or other financial advantage to which the Insured was not legally entitled if established by any final, non-appealable adjudication in any underlying.” Again, variations in the exclusionary language allow the parties to properly price the risk and gain certainty on the scope of coverage. For example, the exclusion can be written so to apply only where “the insured” against whom the claim is made is also “the insured” who allegedly gained a profit or advantage; by contrast, the exclusion might be written to apply to claims arising out of a profit gained by “any insured.” Similarly, the exclusion can include the same variations in the final adjudication requirement discussed above. Finally, an insurer may choose to broaden or narrow the types of benefits—remuneration, profit, advantage—that trigger the exclusion.

***“Bump-up” exclusions.*** Different versions of the bump-up exclusion available on the market address the stated concern that an insured is purportedly shifting the costs of a business transaction to its insurer, for example, where shareholders of a target company allege the insured entity paid too little to acquire the target. One example of a bump-up provision, taken from *Genzyme*, exempts from coverage (for claims against the company), “Loss, other than Defense Costs . . . which is based upon, arising from, or in consequence of the actual or proposed

payment by any Insured Organization of allegedly inadequate or excessive consideration in connection with its purchase of securities issued by [any Insured Organization].” *Genzyme*, 622 F.3d at 72. The bump-up provision can be modified so that it applies to claims of inadequate consideration in connection with the insured entity’s purchase of securities issued by *any* company—not just the insured company. Other versions, expressly include plaintiffs’ counsel fees within the scope of the carve-out.

***Specificity in the definition of “loss.”*** In addition to the finely-tuned exclusions discussed above, a more blunt tool is available to address the *Level 3* rationales: Insurers can negotiate express carve outs for disgorgement or restitution in the definition of “loss” or “damages” in their policies.

\* \* \*

Beyond the four provisions highlighted above, there are several other policy terms—*e.g.*, retentions, consent rights, allocation provisions—that allow parties to an insurance contract to address and eliminate, to the extent they can through negotiations, the potential moral hazard and other public policy worries motivating *Level 3*-type rules.

#### **IV. CONCLUSION.**

Accepting that the underlying rationales motivating the *Level 3* doctrine may be understandable, the discussion above should make clear that the *Level 3* approach to addressing those concerns results in unpredictable application, often ignores clear policy language, and runs up against foundational principles of freedom of contract and settlement without admitting fault. Fortunately, policy terms are available to the parties that substantially address the concerns motivating the *Level 3* doctrine and which more clearly define the scope of the risk transfer.

Courts that find the *Level 3* doctrine compelling are better served by enforcing the terms of the insurance contract as bargained for by the parties—a rule that will result in more uniform decisions and will also promote the rationales on which *Level 3* is grounded.

# The Opioid Epidemic

## American College of Coverage and Extracontractual Counsel 6<sup>th</sup> Annual Meeting

Chicago, IL  
May 16-18, 2018

Robert A. Kole, Esq.  
Choate Hall & Stewart, LLP  
Boston, MA  
rkole@choate.com

and

R. Hugh Lumpkin, Esq.  
Ver Ploeg & Lumpkin, P.A.  
Miami, FL  
rlumpkin@vpl-law.com

© 2018 American College of Coverage and Extracontractual Counsel and Robert A. Kole, Esq. Choate Hall & Stewart, LLP and R. Hugh Lumpkin, Esq. Ver Ploeg & Lumpkin, P.A.

## I. History and Background

### A. Opioids

Opioids are a powerful class of painkillers derived from opium, which comes from the poppy plant. They act on opioid receptors in the body and brain to provide pain relief. Opioids include: (a) prescription drugs such as oxycodone (OxyContin), hydrocodone (Vicodin), codeine and morphine, which are controlled substances regulated by the FDA; (b) synthetic drugs such as fentanyl; and (c) illegal drugs like heroin.

The pain relieving properties of opioids have been known for centuries. Properly prescribed, opioids are recognized as an effective treatment for short term, acute pain, such as post-surgical relief or end of life care. The long-term use of opioids for chronic pain is far more controversial, and it is what principally drives the current flood of litigation against opioid manufacturers, distributors and retail pharmacies.

In general terms, plaintiffs allege that opioid manufacturers could mass produce opioids cheaply, but lacked a sufficient market for their drugs, because: (a) there were no studies indicating that opioids were effective for long-term use; and (b) opioids were considered highly addictive if used over a long period of time. Nonetheless, in order to achieve “blockbuster” profits, the manufacturers are alleged to have engaged in a coordinated scheme to convince doctors and the public that opioids not only were safe and effective for long-term use, but that effective treatment of chronic pain *required* opioids. As a result of their efforts, the market for opioids exploded, and so did the attendant costs. The distributors and retail pharmacies are alleged to have contributed to the expanded use and abuse of opioids, described more fully below.

### B. Statistics

Opioid abuse is a health epidemic of enormous scope. According to recent statistics, every day over 100 people die from opioid overdoses in the U.S. In 2016, according to the CDC, more than 42,000 people died from opioids (including prescription opioids, heroin and fentanyl).<sup>1</sup> Unfortunately, the number of opioid deaths in 2016 is not anomalous, but rather is part of a longer-term trend. From 2000 to 2016, the prescription opioid epidemic killed almost 200,000 people.<sup>2</sup> Some estimate that over the next decade, the epidemic could kill another 500,000 people.<sup>3</sup>

Many individuals who do not overdose still may suffer greatly from opioid addiction. In 2015, it is estimated that about two million Americans were addicted to opioids -- a

<sup>1</sup> <https://www.cdc.gov/drugoverdose/index.html> (last visited Jan. 17, 2018).

<sup>2</sup> ‘DEA agents say a huge opioid case ended in a whimper’, Washington Post, Dec. 17, 2017.

<sup>3</sup> Rebecca L. Haffajee, Michelle M. Mello, *Drug Companies’ Liability for the Opioid Epidemic*, New England Journal of Medicine (Dec. 20, 2017).

significant increase compared to the number of opioid addicts just five years earlier.<sup>4</sup> The estimated economic cost of opioid abuse is staggering. According to the U.S. Department of Health and Human Services, in 2016, the opioid epidemic cost \$504 billion.<sup>5</sup> This estimate of economic costs is drastically higher than earlier estimates, which themselves were strikingly high. For example, a study in the October 2016 issue of *Medical Care*, which relied on data from 2013, estimated aggregate costs for prescription opioid overdose, abuse and dependence at \$78.5 billion.<sup>6</sup> That study broke down those costs by category, estimating that:

- Spending for health care and substance abuse exceeded \$28 billion;
- Costs for lost productivity were over \$20 billion;
- Fatal overdoses, including health care and lost productivity, cost \$21.5 billion; and
- Criminal justice-related costs were \$7.7 billion.

### **C. Statutes & Regulations**

States have enacted policies that aim to address this epidemic while also ensuring access to pain management. The first of these statutes was enacted by the Massachusetts legislature in early 2016. The act, among other provisions, sets a seven-day supply limit for initial (first-time) opioid prescriptions. Prior to Massachusetts' act, some states had passed bills targeting the prescribing of opioids. For example, Washington's legislature directed five professional boards and commissions to adopt rules related to chronic, non-cancer pain management.

By the end of 2016, seven states had passed legislation limiting opioid prescriptions. More than thirty states considered at least 130 bills related to opioid prescribing in 2016 and 2017. By December 2017, twenty-four states had enacted legislation with some type of limit, guidance, or requirement related to opioid prescribing.

Most legislation limits first-time opioid prescriptions to a certain number of days' supply. A few states also set dosage limits. Nearly half the states with limits specify that they apply to treating acute pain, and many states have exceptions for chronic pain treatment, cancer and palliative care, treatment of substance use disorder, medication-assisted treatment, or for the professional judgment of the provider prescribing the opioid.

<sup>4</sup> See CNN, *Opioid addiction rates continue to skyrocket*, June 29, 2017 ("An analysis from Blue Cross Blue Shield of its members found that from 2010 to 2016, the number of people diagnosed with an addiction to opioids ... climbed 493%).

<sup>5</sup> <https://www.hhs.gov/opioids/about-the-epidemic/index.html> (citing *Mortality in the United States*, 2016 NCHS Data Brief No. 293, Dec. 2017).

<sup>6</sup> *Florence, et al.*, *Economic Burden of Prescription Opioid Overdose*, *supra*.

A few states, including Alaska, Connecticut, Indiana, Louisiana, Massachusetts and Pennsylvania, set limits specifically for minors.

Other states direct/authorize other entities (i.e., department of health/state health official, or provider regulatory boards) to set limits (i.e., New Hampshire, Ohio, Oregon, Vermont, Virginia, Washington, Wisconsin, and Arizona's executive order).

Some states like Maryland and Utah provide guidance on opioid prescribing.

States have also enacted laws related to prescription drug monitoring programs, access to naloxone, pain clinic regulation, and provider education and training.

#### **D. Public Policy**

Insurers and policyholders have and will continue to offer competing public policy arguments with respect to coverage for opioid-related liability. Insurers claim holding them responsible to pay for public services costs will transform private party liability insurance into "social insurance" covering public health epidemics. This will, according to carriers, increase the cost of liability insurance, burden insurers because they have not accounted for this risk when setting premiums, and shift costs away from those best suited to address the issue (opioid suppliers).

Policyholders maintain that: (a) insurance law allows parties to freely contract to cover risks; and (b) carriers must pay for any risks they agree to cover -- including risks not foreseen at the time of policy drafting -- and may not engage in post-claim underwriting. Courts interpret insurance policies according to their plain language and construe any ambiguous language against carriers. Some jurisdictions construe policy language in favor of insureds' reasonable expectations of coverage. In addition, policyholders claim liability insurance is a form of risk management, and deterrence and compensation functions of insurance are important to the social functioning and ordering of society.<sup>7</sup>

## **II. Underlying Claims**

In light of the public health risks and significant economic costs, entities have pursued lawsuits against opioid manufacturers and distributors. In 2012, the State of West Virginia filed a lawsuit against opioid distributors alleging that the defendants overstated the benefits of opioids and understated the risks of addiction (the "West Virginia Action"). West Virginia alleged that the defendants were responsible for creating "pill mills" which led to an addiction epidemic. The State sought to recoup the cost of public services (including medical and law enforcement costs) associated with opioid abuse.

<sup>7</sup> See, e.g., J.W. Stempel, *The Insurance Policy as Social Instrument and Social Institution*, 51 William & Mary L. Rev. 1489 (2010).

In 2017, the press reported a total of approximately \$47 million in settlements in the West Virginia Action. Given the amount sought by the State, these settlements did not necessarily signal admissions by makers and distributors or an easy path for following plaintiffs. The result of that suit appears to have nonetheless spawned an acceleration of opioid lawsuits, which continue to grow by the day.

**Plaintiffs.** Most opioid lawsuits have been brought by government entities -- states, counties, and municipalities -- that seek to recoup economic damages incurred in addressing the opioid epidemic in their jurisdictions. Like West Virginia, these plaintiffs seek damages including costs for providing public services (*e.g.*, law enforcement, health care, social services) and costs incurred in the governments' role as an employer (*e.g.*, health insurance for employees, lost productivity). Over the last year, other types of entities -- including hospitals, pension funds, third-party administrators of health care benefits, and unions -- have begun to file similar suits. To date, relatively few suits have been brought by or on behalf of individual opioid users. Recently, the Department of Justice indicated an intention to pursue damages incurred by the federal government in addressing opioid addiction.

**Defendants.** The opioid lawsuits have principally targeted two categories of defendants. The first category is prescription opioid manufacturers, including doctors and clinics that are alleged to have worked with and aided the manufacturers. The complaints against the manufacturer defendants typically allege that the manufacturers, along with doctors funded by the pharmaceutical industry (referred to as "key opinion leaders") intentionally misrepresented the benefits and risks of long-term opioid use, in order to expand the market for opioids and achieve blockbuster profits.

The second category of defendants is prescription opioid distributors. The complaints against the distributor defendants typically allege that those defendants intentionally or negligently failed to detect, investigate, or report excessive and suspicious orders of prescription opioids. Some of the complaints also allege that the distributor defendants -- like the manufacturer defendants -- misrepresented the addictiveness of opioids. A meaningful portion of the suits against the distributor defendants allege violations of the Controlled Substances Act, similar state laws, and state laws prohibiting unfair trade practices and racketeering. The group of distributor defendants has expanded over time. Initially, complaints generally targeted wholesale distributors (*e.g.*, ABC, McKesson, Cardinal Health). Increasingly, claims are also being made against consumer-facing distributors (*i.e.*, retail pharmacies, such as CVS, Wal-Mart and Costco).

**MDL.** In December 2017, the United States Judicial Panel on Multidistrict Litigation ordered at least 64 opioid lawsuits to be transferred to the Northern District of Ohio (Eastern Division), for pre-trial proceedings.<sup>8</sup> The number of lawsuits involved in this multi-district litigation ("Opioid MDL") has grown rapidly. As of March 1, 2018, over 300 lawsuits were pending or had been conditionally transferred to the Opioid MDL. More federal lawsuits will be added, as more existing cases are formally transferred to the Opioid MDL and as new

<sup>8</sup> Transfer Order, *In Re: National Prescription Opiate Litigation*, MDL No. 2804 (Dec. 5, 2017).

cases are filed. Although the Opioid MDL is dominating opioid litigation in federal courts, a significant number of opioid cases are also pending in state courts.

Judge Polster aggressively pursued a global settlement in the early stages of the Opioid MDL, creating settlement committees comprised of selected plaintiffs and defendants. He also invited the state attorney generals to the process, and indicated that he intended to coordinate with the judges presiding over the state court actions, if possible. Although those efforts are ongoing, Judge Polster recognized, at a hearing on March 6, 2018, that settlement discussions had reached an impasse. He therefore ordered the parties to engage in targeted litigation, including limited discovery, motion practice and bellwether trials.

**Government Investigations.** In addition to civil litigation, opioid manufacturers and distributors have been the targets of government investigations, which could lead to civil enforcement actions and/or criminal prosecutions. For example:

- In January 2017, McKesson agreed to pay \$150 million and suspend sales from four distribution centers, in order to resolve a federal investigation.
- In December 2016, Cardinal Health agreed to pay \$44 million to resolve investigations in four states involving allegations that it had violated the Controlled Substances Act.
- In 2016 and 2017, CVS entered into a series of settlements, totaling over \$15 million, to resolve federal investigations in three states.
- As of last fall, Purdue Pharma was under investigation by federal prosecutors in Connecticut, in connection with its representations about OxyContin.
- At least 40 state attorneys general are conducting an investigation into opioid distribution practices, including the practices of ABC, Cardinal Health, and McKesson.

These government investigations create additional pressures and potential liability for the opioid manufacturers and distributors. Further, if information from the investigations is made public, that information will be used by plaintiffs in the opioid lawsuits.

### **III. Coverage**

#### **A. Policies**

Insureds have sought coverage for opioid-related defense costs and settlements, judgments, and/or verdicts under several types of insurance policies.

## B. Coverage Issues – CGL Policies

The opioid lawsuits have created a growing body of insurance coverage litigation. These cases -- which principally have involved the duty to defend -- have focused primarily on three coverage issues with respect to commercial general liability (“CGL”) policies: (a) whether the allegations in the underlying lawsuits constitute an “occurrence”; (b) whether the lawsuits seek amounts that the insured is legally obligated to pay as damages “because of” or “for” “bodily injury”; and (c) whether a products exclusion excludes coverage.

### (1) Occurrence

In certain cases, primary insurers have denied a duty to defend on the ground that the underlying opioid complaint did not contain allegations sufficient to qualify as an “occurrence”. The insurers argued that the complaint contained allegations that the defendants engaged in *intentional* conduct for profit, which did not qualify as accidental conduct sufficient to constitute an “occurrence” under a CGL insurance policy.

This argument has faced mixed results. One set of declaratory judgment cases arose from the West Virginia Action, which involved only distributor defendants. Three federal courts -- applying South Carolina, Kentucky and Illinois law, respectively -- concluded that certain allegations in the underlying complaint sounded in negligence, including allegations that the defendants failed to implement sufficient controls to identify suspicious prescription drug orders. These courts ruled that the complaints’ allegations were sufficient to qualify as an “occurrence” for duty to defend purposes.<sup>9</sup>

By contrast, the Court of Appeals of California rejected a pharmaceutical manufacturer’s claim for coverage in connection with underlying cases brought by several California counties and the City of Chicago alleging deceptive marketing and sales practices.<sup>10</sup> The Court held that the allegations in the underlying complaint did not constitute an “accident” or “occurrence” under California law, because the policyholder was accused of a deliberate course of conduct designed to increase sales of its opioids by intentionally misleading doctors and the public. The Court emphasized that under California law, the fact that a policyholder engaged in allegedly intentional misconduct that resulted in unintended consequences -- such as opioid or heroin abuse -- does not transform the alleged misconduct into an “accident” giving rise to a duty to defend. The California Supreme Court recently accepted certiorari in connection with the *Actavis* case.

In short, in assessing the “occurrence” issue in the context of opioid litigation, courts have principally focused on: (a) the nature of the allegations (negligent oversight vs. intentional scheme); and (b) the governing law (focus on conduct v. focus on harm).

<sup>9</sup> See *Liberty Mut. Ins. Co. v. J M Smith Corp.*, 602 F. App’x 115 (4th Cir. 2015); *Cincinnati Ins. Co. v. Richie Enterprises LLC*, 2014 U.S. Dist. LEXIS 27306 (W.D. Ken. March 4, 2014) (Richie I); *Cincinnati Ins. Co. v. H.D. Smith Wholesale Drug Co.*, 2015 U.S. Dist. LEXIS 100823 (C.D. Ill. Aug. 3, 2015).

<sup>10</sup> See *Trav. Prop. Cas. Co. of Am. v. Actavis, Inc.*, 2017 Cal. App. LEXIS 976, G053749 (Cal. Ct. App. Nov. 6, 2017).

## (2) Bodily Injury

Some insurers have denied coverage for underlying opioid lawsuits on the ground that the underlying complaints did not allege covered damages “because of” or “for” “bodily injury”, as required under a CGL policy. When litigated, this coverage defense again has led to mixed results.

In 2016, the Seventh Circuit Court of Appeals -- applying Illinois law -- concluded that a duty to defend was triggered, because the underlying complaint in the West Virginia Action alleged damages “because of” bodily injury.<sup>11</sup> The Court reasoned that the “because of bodily injury” language in the operative insurance policies created wider coverage than the “for bodily injury” wording sometimes used in CGL policies. The Court also concluded that language in the policies that provided coverage for “damages claimed by any person or organization for care ... resulting ... from bodily injury” supported a duty to defend, because West Virginia had alleged, at least in part, that it incurred excessive costs relating to the care of its citizens suffering opioid addiction.

By contrast, two federal district courts concluded that there was no duty to defend government entity complaints, because those complaints did not allege covered bodily injury.<sup>12</sup> Instead, the courts concluded that the State of West Virginia sought damages only for its own economic loss, and the State did not assert claims on behalf of its individual citizens for the physical harm they personally sustained.

## (3) Products Exclusion

In some cases, insurers have denied coverage related to underlying opioid lawsuits on the ground that a products exclusion contained in the policy barred coverage for “bodily injury” either “arising out of” or “resulting from” products manufactured, sold, handled, or distributed by the policyholder. The U.S. Court of Appeals for the 11th Circuit and the Court of Appeals of California have both relied on a products exclusion to conclude that insurers have no duty to defend opioid lawsuits against pharmaceutical policyholders.<sup>13</sup> The courts concluded, in sum, that because “bodily injury” (if any) related to opioid addiction “arising out of” opioid products, the products exclusions were triggered. To date, no case has reached a contrary conclusion in the context of opioid litigation. The impact of this exclusion may be dependent on its wording – “arising out of,” “because of” and “resulting from” could auger differing results.

<sup>11</sup> *Cincinnati Ins. Co. v. H.D. Smith, LLC*, 2016 U.S. App. LEXIS 13175 (7th Cir. July 19, 2016).

<sup>12</sup> *Travelers Prop. Cas. Co. of Am. v. Anda, Inc.*, 2015 U.S. Dist. LEXIS 31450 (S.D. Fla. Mar. 9, 2015) (applying California law) *affirmed on other grounds* 2016 U.S. App. LEXIS 15760 (11th Cir. Aug. 26, 2016); *Cincinnati Ins. Co. v. Richie Enterprises LLC*, 2014 U.S. Dist. LEXIS 96510, at \*15 (W.D. Ken. July 16, 2014) (applying Kentucky law).

<sup>13</sup> *Travelers Prop. Cas. Co. of Am. v. Anda, Inc.*, 2016 U.S. App. LEXIS 15760 (11th Cir. Aug. 26, 2016); *Trav. Prop. Cas. Co. of Am. v. Actavis, Inc.*, 2017 Cal. App. LEXIS 976, G053749 (Cal. Ct. App. Nov. 6, 2017). Choate Hall was counsel for Travelers in both cases.

### **C. Coverage Issues – Products Liability Policies**

Insureds, such as those operating in the pharmaceutical industry, have also sought coverage under products liability policies. These policies typically cover sums the insured becomes legally obligated to pay as damages because of bodily injury included within the products-completed operations hazard. They cover all bodily injury occurring away from premises owned or rented by the policyholder and arising out of the insured's "product."

#### **(1) The "Expected or Intended" Exception to the Definition of "Occurrence"**

Insurers have denied coverage under products liability policies on the basis that policyholders expected the injury and loss. This is a variant on the "no occurrence" defense asserted under CGL policies. As noted above, this argument has spawned mixed results.

#### **(2) Exclusions for "Unfair Competition," Criminal Violations, and Intentional Acts of Non-Compliance with FDA Rules/Regulations**

Insurers also cite exclusions for "unfair competition," criminal violations, and/or intentional acts of non-compliance with FDA rules or regulations. These exclusions are typically found in policies issued to companies involved in the opioid distribution chain.

One federal district court found an unfair competition exclusion precluded coverage for an opioid-related complaint.<sup>14</sup> The exclusion provided as follows: "[i]n the event a claim is made or suit is brought...alleging...any loss" "in any way related to any actual or alleged...[u]nfair competition...and...[a]ny other loss; then this exclusion shall apply to preclude coverage for the entire claim or suit...or a duty to defend...." The court ruled that the count titled "Violations of the West Virginia Consumer Credit and Protection Act (WVCCPA) – Unfair Methods of Competition or Unfair or Deceptive Acts or Practices" alleged unfair competition by the insured and the exclusion thus precluded coverage for the complaint.

### **D. Coverage Issues – D&O Policies**

In recent months, shareholders have filed lawsuits against opioid manufacturers and distributors, as well as their directors and officers. Some allege that directors and officers of opioid distributors failed to monitor the size and frequency of shipments and report aberrations to the Drug Enforcement Administration, resulting in civil fines or other liabilities. Other suits allege the defendant companies, and certain directors and officers, made materially false public statements regarding the companies' opioid practices, resulting in drops in share price when misstatements were corrected or drugs were withdrawn from the

<sup>14</sup> *Travelers Prop. Cas. Co. of Am. v. Anda, Inc.*, 2015 U.S. Dist. LEXIS 31450 (S.D. Fla. Mar. 9, 2015).

market in response to FDA pressure. These suits potentially implicate another kind of insurance policy: directors' and officers' ("D&O") policies.

D&O policies typically afford coverage for loss arising from claims first made during the policy period against insured persons for "wrongful acts," commonly defined to include any "actual or alleged act, error, misstatement, misleading statement, neglect, omission or breach of duty." Private company D&O insurance policies cover wrongful acts of the company and individuals; public company D&O insurance policies usually cover loss to the company arising from securities claims brought against the company on behalf of shareholders, and derivative actions brought to enforce a right of the company, for wrongful acts.

To date, there are no published cases addressing coverage for opioid-related liability under D&O policies.

(1) Definition of "Loss"

Insurers may deny coverage for opioid-related liability based on D&O policies' definition of "Loss", which commonly excludes fines, penalties or matters deemed uninsurable under applicable law.

(2) Conduct Exclusions

Carriers may also cite exclusions for claims arising out of: (1) the gaining by any insured of any profit or advantage to which such insured was not legally entitled; or (2) the commission by any insured of any criminal or deliberately fraudulent or dishonest act.

#### IV. Predictions and Trends

The development of the Opioid MDL may go a long way toward setting the stage for the nature and resolution of coverage issues between policyholders and insurers. If Judge Polster is successful in fashioning a global settlement, a number of important questions could affect the availability of insurance coverage (if any), including: (a) how is the settlement amount calculated; (b) what remedies are included as part of the settlement; (c) how are the settlement dollars allocated among the defendants; (d) what "damages" are encompassed by the settlement, and in what time period(s) were those amounts incurred; and (e) what role, if any, will insurers play in the settlement discussions. Certainly, coverage counsel for policyholders and insurers will be keeping a close eye on the Opioid MDL.

Also, because the case law to date has focused principally on the duty to defend, indemnity issues -- which are likely to be exceedingly more complicated -- have yet to play out. For example, courts have yet to address questions such as: (a) whether there is coverage for indemnity; and (b) if so, (i) what trigger of coverage will apply, (ii) how will that trigger apply to the facts underlying opioid addiction claims, (iii) which categories of damages sought by plaintiffs are covered and not covered (*i.e.* addiction treatment; lost productivity;

additional police and court personal; etc.), (iv) when did any covered damages occur, and (iv) how will doctrines such as known loss and late notice apply, if at all. In short, the parties have just scratched the surface of the coverage issues.

More generally, any attorney who has tilled the coverage fields of environmental coverage litigation and the welter of product-liability and mass-tort litigation knows well what is afoot: who is to bear the social cost of a growing population with an equally burgeoning taste for laying blame – typically on someone who can pay the bill. Addiction is not new – AA itself was founded more than 80 years ago – and the number of substances which claim bodies and lives has increased exponentially as natural addictions now vie with laboratory inventions far more addictive than natural counterparts.

We can safely predict that it will get worse, and the social cost in real dollars will only increase. As a result, litigation over who should pay will surely increase, including the ancillary coverage litigation. And, since insurance coverage is a state-specific issue, as we have already seen, schisms in decisional authority will develop fueling careful study of conflict of laws, venue choices and insurance product types. Blame will certainly travel upstream to the executive suite, triggering D&O policy issues – the dollars are simply too large not to attract the attention of venture capital and other investors (and lawyers who ply that trade). Accordingly, we are likely at the front end of a long, challenging and expensive process.

Mo' Coverage Mo' Problems:  
Allocation and Related Complications When  
Multiple Types of Liability Insurance Apply to a Single Lawsuit

American College of Coverage and Extracontractual Counsel  
6th Annual Meeting

Chicago, IL  
May 16-18, 2018

Scott C. Hecht\*  
Katherine A. Bechina\*  
Stinson Leonard Street LLP  
Kansas City, MO

Suzan F. Charlton\*  
Covington & Burling LLP  
Washington, DC

\* All opinions expressed herein are those of the individual authors and not of their respective law firms or clients.

## Mo' Coverage Mo' Problems: Allocation and Related Complications when Multiple Types of Liability Insurance Apply to a Single Lawsuit

### I. Introduction

Oftentimes a single lawsuit may implicate coverage under two or more liability insurance policies, each policy providing a separate type of coverage that is ostensibly mutually exclusive of the coverage under the other. A common example is a lawsuit against a general contractor based on property damage associated with a design/build project. Such a lawsuit may implicate the general contractor's coverage under both a general Commercial General Liability ("CGL") insurance policy and a Professional Liability ("PL") insurance policy.<sup>1</sup> The CGL policy would generally cover damages attributable to property damage but exclude damages arising from professional services, while the PL policy's insuring agreement would only encompass losses arising from professional services. Another example is a class action lawsuit against an employer alleging an illegal modification or termination of retiree benefits. This lawsuit may involve allegations of violation of the Employee Retirement Income Security Act ("ERISA") and of age discrimination prohibited by the Age Discrimination in Employment Act ("ADEA").<sup>2</sup> The employer's Fiduciary Liability insurance policy would address allegations of ERISA violations, but exclude coverage for claims of age discrimination, while the employer's Employment Practices Liability insurance ("EPL") policy would do the opposite.

An insurer is only obligated to provide coverage with respect to those parts of loss caused by a lawsuit that are insured under the insurance contract.<sup>3</sup> Courts apply different methodologies (discussed below) to determine an appropriate allocation of insured versus non-insured parts of loss. When a lawsuit implicates more than one type of coverage, the task is the same, only doubled: the allocation of insured versus non-insured parts of loss must occur separately under each type of coverage. Ideally, the result of the combined exercise of allocating parts of loss under each coverage type will yield an aggregate result that is internally consistent. That is, each insurer will agree with the policyholder and the other insurer to accept responsibility for a distinct part of the insured loss under its own policy. The sum of the distinct parts of loss accepted as insured (when added to any agreed uninsured amounts, if applicable) will total the entire amount of the loss. In the hypothetical retiree benefits class action described above, the application of an appropriate allocation methodology may yield a determination that 10% of loss is attributable to covered exposures under an EPL policy (e.g., age discrimination) and 90% of loss is attributable to covered exposures under a Fiduciary policy (e.g., ERISA breach of fiduciary duty). So the EPL carrier would be responsible for \$0.10 of every dollar of loss and the Fiduciary carrier would be responsible for the other \$0.90 of every dollar of loss.

Allocation between the policyholder and insurers is a good thing, at least in the abstract; losses are spread among multiple parties in a manner that preserves the benefit of the bargains struck between the

<sup>1</sup> See, e.g., *Prisco v. Serena Sturm Architects, Ltd. v. Liberty Mut. Ins. Co.*, 126 F.3d 886 (7th Cir. 1997); *1325 N. Van Buren, LLC v. T-3 Grp., Ltd.*, 716 N.W.2d 822 (Wis. 2006); *N.Y. State Thruway Authority v. KTA-Tator Eng'g Servs., P.C.*, 78 A.D.3d 1566 (N.Y. App. Div. 2010).

<sup>2</sup> See, e.g., *Fulghum v. Embarq Corp.*, 785 F. 3d. 395 (10th Cir. 2015) (involving claims of breach of fiduciary duty under ERISA and age discrimination under ADEA all based on the employer's reduction of retiree welfare benefits).

<sup>3</sup> Of course, the insurer's "duty to defend," when applicable, is broad enough to strain the limits of this proposition. But even in that context, an insurer's obligation depends on the potential of covered loss. See discussion *infra*, including note 5.

policyholder and its insurers. It is easy to explain the necessity for allocation and to express the results of allocation after the fact. But the work involved in achieving an appropriate allocation is complicated. Allocation depends on the application of the language of the insurance contract and legal doctrines, influenced by the allegations, facts and circumstances of the lawsuit, the nature and viability of the particular claims asserted, the nature and magnitude of the types of relief sought, and other factors. Allocation may be required early on in a lawsuit before the facts and legal theories are well-developed, for example when required for the advancement of defense costs or in early mediation. Allocation can be subjective, and, in the event of a settlement, may depend on counter-factual assumptions about what might have happened had a trial actually occurred. In light of all of these variables, in many or most cases, allocation may not generate a result that can be characterized as objectively correct, but, at best, only "fair" in some sense.<sup>4</sup>

In any event, allocation issues provide fertile ground from which disputes may spring and thrive, even in the best of circumstances. In the case of a lawsuit requiring allocation with respect to multiple types of coverage, the potential for disputes may be even greater. The maintenance of multiple coverages is beneficial and a given, and the categorical elimination of allocation disputes arising from multiple coverages would seem to be impossible. But it may be possible to decrease or mitigate those disputes by understanding allocation methodologies and the contexts in which they apply. In the following, we attempt to provide to provide a summary that might help with that understanding.

## **II. DISCUSSION**

### **A. Given the relevance of multiple types of differing coverages, allocation may be required in a few different contexts.**

There are various contexts in which different allocation rules may apply, given the application of two or more mutually exclusive coverages to loss arising from a single lawsuit:

- when multiple insurers are obligated to defend a lawsuit under "duty to defend" policies;
- when multiple insurers are responsible for components of loss (both defense costs and settlements/judgments) on an indemnity basis;
- when multiple insurers provide coverage subject to retentions of differing levels.

Allocation in the last context borrows from principles applied in the former two contexts. Within each of the three contexts, different allocation rules may apply depending on the jurisdiction and other circumstances.

#### **1. Allocation of defense costs among multiple insurers in the "duty to defend" context.**

Allocating responsibility for defense costs between covered and non-covered matters is not a complicated matter from the policyholder's perspective under a "duty to defend" policy. An insurer with that obligation

<sup>4</sup> Perhaps as a reaction, many D&O liability policies contain language addressing various aspects of allocation, including providing that defense costs shall not be allocated (*i.e.*, all are insured), dictating the type allocation methodology, and/or imposing various ADR methods as a means for resolving allocation disputes.

must defend the entirety of a lawsuit if there is merely the possibility that any potential liability under the lawsuit would be insured.<sup>5</sup> If multiple insurers owe a duty to defend, they must allocate defense costs between themselves. Such allocation may occur voluntarily or in the context of a contribution action brought by the defending insurer against a non-defending insurer. Allocation of defense costs under these circumstances would typically be resolved based on the "other insurance" clauses of the respective insurers' policies, which apply when two or more insurance policies cover the same risk for the benefit of the same insured.<sup>6</sup> These clauses are sometimes reconcilable, and in that case, the clauses typically would dictate clearly that all primary insurers will be obligated to share in providing coverage pro rata based on limits (a "pro rata clause"), provide that one of the insurers will only provide excess coverage (an "excess clause") or provide that one of the insurers will be relieved from the responsibility altogether ("an escape clause").<sup>7</sup> On other occasions, those clauses will be mutually repugnant, in which case, state law would provide the rule for allocation, which also may be pro rata based on limits.<sup>8</sup> Whether "other insurance" clauses are reconcilable or mutually repugnant is a common source of disputes.

## 2. Allocation of defense costs in the indemnity (non-duty to defend) context.

When multiple insurers are obligated to provide coverage for defense costs, but none has a "duty to defend," it is typically the case that all defense costs "reasonably related to the defense of a covered claim" are insured.<sup>9</sup> Importantly, the fact that defense costs may be reasonably related to non-covered as well as covered matters does not eliminate coverage.<sup>10</sup> Of course, at least at the margins, "reasonably related" is in the eye of the beholder and, accordingly, can give rise to disputes.

<sup>5</sup> See, e.g., *Va. Elec. & Power Co. v. Northbrook Prop. & Cas. Ins. Co.*, 475 S.E.2d 264, 265 (Va. 1996); *McCormack Baron Mgmt. Servs., Inc. v. Am. Guar. & Liab. Ins. Co.*, 989 S.W.2d 168, 170 (Mo. 1999); *Montrose Chem. Corp. v. Sup. Ct. of L.A. Cnty.*, 6 Cal. 4th 287, 300 (Cal. 1993); *Hartford Fire Ins. Co. v. Thermos LLC*, 146 F. Supp. 3d 1005, 1012 (N.D. Ill. 2015); *Navigators Ins. Co. v. Hamlin*, 96 F. Supp. 3d 1181, 1190 (D. Or. 2015); *Upper Deck Co., LLC v. Fed. Ins. Co.*, 298 F. Supp. 2d 994, 998 (S.D. Cal. 2002).

<sup>6</sup> See Barry R. Ostrager & Thomas R. Newman, *Handbook on Insurance Coverage Disputes* § 11.01 (18th ed. 2017).

<sup>7</sup> See *id.* § 11.02. See also, e.g., *Med. Protective Co. v. Nat'l Union Fire Ins. Co.*, 25 Fed. Appx. 145, 147-48, 2002 WL 13037, at \*\*2-3 (4th Cir. Jan. 4, 2002) (holding that "other insurance" clauses were reconcilable: plaintiff insurer's policy provided primary coverage, and defendant insurer's coverage provided excess coverage; because primary policy was not exhausted, defendant insurer's policy was not implicated by the loss); *Nat'l Liab. Ins. Co. v. State Farm Fire and Cas. Ins. Co.*, 276 F. Supp. 3d 517, 526-27 (E. D. Va. 2017).

<sup>8</sup> See, e.g., *Am. Cas. Co. v. Health Care Indem., Inc.*, 520 F.3d 1131, 1136-37 (10th Cir. 2008); *Equity Mut. Ins. Co. v. Spring Valley Wholesale Nursery*, 747 P.2d 947, 954 (Okla. 1987).

<sup>9</sup> See, e.g., *Cont'l Cas. Co. v. Bd. of Educ. of Charles Cnty.*, 489 A.2d 536, 544 (Md. 1985); *Safeway Stores, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 64 F.3d 1282, 1289 (9th Cir. 1995); *Piper Jaffray Cos., Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 38 F. Supp. 2d 771, 780 (D. Minn. 1999); *Raychem Corp. v. Fed. Ins. Co.*, 853 F. Supp. 1170, 1182 (N.D. Cal. 1994); *Fed. Realty Inv. Trust v. Pac. Ins. Co.*, 760 F. Supp. 533, 537 (D. Md. 1991).

<sup>10</sup> See *Potomac Elec. Power Co. v. Cal. Union Ins. Co.*, 777 F. Supp. 980, 984 (D.D.C. 1991) (holding that "if fees and expenses were incurred in connection with a covered claim, but were also involved in an uncovered claim, then if the fees and expenses of the uncovered claim are reasonably related to the defense of a covered claim they may ordinarily be allocated wholly to the covered claim" (internal quotations and citations omitted)); *Nodaway Valley Bank v. Cont'l Cas. Co.*, 715 F. Supp. 1458, 1465 (W.D. Mo. 1989), *aff'd*, 916 F.2d 1362 (8th Cir. 1990); *Health-Chem. Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 559 N.Y.S.2d 435, 438 (N.Y. Sup. Ct. 1990) (allowing apportionment of fees devoted to the non-covered parties or claims "alone").

### 3. Allocation of indemnity coverage

When multiple insurers are responsible for components of loss arising from settlements/judgments, the components of loss are typically allocated according to two competing allocation frameworks, the "relative legal exposure" analysis and the "greater settlement rule."<sup>11</sup> Sometimes courts also apply these allocation frameworks in allocating defense costs as well as settlements/judgments.<sup>12</sup> As the following discussion suggests, these frameworks can be based on a substantial number of variables that may be subject to reasonable dispute, and often result in controversy.

Under a "relative legal exposure" analysis, loss is allocated according to the relative exposure created by covered and non-covered matters.<sup>13</sup> Relative legal exposure is "neither comparative fault nor relative liability, but is potential liability of the parties at the time of settlement."<sup>14</sup> The allocation inquiry examines how a reasonable party in the insured's position would have valued the covered and non-covered claims at the time of the settlement, considering the circumstances and events leading up to the settlement, including a review of the settlement negotiations and internal memoranda to determine whether the settlement included non-covered damages.<sup>15</sup>

In contrast, under the "greater settlement rule," the insurer is obligated to pay for the entire amount of any settlement or judgment (or when applicable, defense costs), except for the higher increment, if any, attributable to non-covered matters.<sup>16</sup> The focus of the analysis is the liability for the insured claims or

<sup>11</sup> These rules are variously known by other, similar names, including "relative exposure" or "measure of proportional fault," and the "larger settlement rule," respectively.

<sup>12</sup> See, e.g., *Safeway Stores, Inc.*, 64 F.3d at 1287 ("Allocation is appropriate only if, and to the extent that, the defense or settlement costs of the litigation were, by virtue of the wrongful acts of the *uninsured* parties, higher than they would have been had only the insured parties been defended or settled." (internal quotations and citations omitted)); *Perini Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, CIV. A. No. 86-3522-S, 1988 WL 192453, \*\*2-3 (D. Mass. June 2, 1988) (applying relative legal exposure rule to allocate defense costs).

<sup>13</sup> See *Stauth v. Nat'l Union Fire Ins. Co. of Pittsburgh*, Nos. 97-6437, 97-6438, 185 F.3d 875 (Table), 1999 WL 420401, at \*11 (10th Cir. June 24, 1999); *Owens Corning v. Nat'l Fire Ins. Co. of Pittsburgh, Pa.*, 257 F.3d 484, 492 (6th Cir. 2001); *Piper Jaffray*, 38 F. Supp. 2d at 774. "Determining relative exposure and weighing the relative benefits of the settlement and costs incurred requires a fact based analysis." *Clifford Chance Ltd. Liab. P'ship v. Indian*, 836 N.Y.S. 2d 484 (N.Y. Sup. 2006); see also *Caterpillar, Inc. v. Great Am. Ins. Co.*, 62 F.3d 955, 961 (7th Cir. 1995) (explaining relative legal exposure rule).

<sup>14</sup> *Safeway Stores, Inc. v. Nat'l Union Fire Ins. Co.*, No. C-88-3440-DLJ, 1993 WL 739643, \*5 (N.D. Cal. Feb. 4, 1993). Courts may consider a multitude of factors to determine "relative legal exposure," including the following: (1) the legal merits of the claims; (2) the ability to pay a judgment; (3) the burdens of the litigation, including the defense; (4) the effect of any "deep pocket factor"; (5) the motivations and intentions of those who negotiated the settlement, as shown by the settlement documents and any other relevant evidence; (6) the benefits sought to be, and actually, accomplished by the settlement, as shown by the settlement documents and any other relevant evidence; and (7) such other and similar matters peculiar to the particular litigation and settlement. *Id.* at \*5-6.

<sup>15</sup> *UnitedHealth Grp. Inc. v. Exec. Risk Specialty Ins. Co.*, 870 F.3d 856, 863-64 (8th Cir. 2017). See also *Nodaway Valley Bank*, 715 F. Supp. at 1461 (holding that a realistic and fair appraisal at time of settlement would allocate most of the legal exposure to insured individual directors and not to uninsured corporate holding company); *aff'd*, 916 F.2d at 1365 (noting that an allocation analysis "concerns the evaluation of the comparative responsibilities of the particular parties and of their exposure to an award of damages in the underlying suit.").

<sup>16</sup> *Harbor Ins. Co. v. Cont'l Bank Corp.*, 922 F.2d 357, 368 (7th Cir. 1990). See also *Owens Corning*, 257 F.3d at 491-92; *Caterpillar, Inc. v. Great Am. Ins. Co.*, 62 F.3d 955, 962 (7th Cir. 1995); *Safeway Stores, Inc.*, 64 F.3d at 1287;

parties in the lawsuit, and to the extent that the loss exceeds the liability for the insured claims or parties, the excess amount is not insured.<sup>17</sup>

#### **4. Allocation of defense costs (non-duty to defend) and indemnity within a retention.**

Many liability insurance policies provide coverage in excess of a retention. The amount of such retention may vary, depending on the insurance contract. In cases in which a lawsuit implicates multiple types of coverage, the amounts of the retentions under those different types of coverage often vary. The question then arises whether payments by the policyholder to satisfy a retention under one type of coverage, and/or payments by an insurer under that type of coverage, will apply to exhaust the retention under another type of coverage. For example, in the retiree benefits class action lawsuit example used above, the Fiduciary Liability policy may have a \$500,000 retention, and the EPL policy may have a \$2,000,000 retention. If the policyholder has incurred \$2,000,000 of defense costs, of which the first \$500,000 satisfied the retention under the Fiduciary Liability policy, and the next \$1,500,000 was reimbursed by the Fiduciary liability carrier, is the retention under the EPL policy exhausted? Of course, the answer depends on the retention exhaustion-related language of the EPL policy.

The exhaustion language might be no more restrictive than to apply to payments made in respect of loss associated with the lawsuit.<sup>18</sup> Or the language might be more restrictive, only permitting exhaustion by payments in respect of lawsuit-related loss that otherwise would be insured.<sup>19</sup> While a different conceptual issue, some policies also provide that a retention may not be exhausted by third-party (*e.g.*, other insurer) payments, but only by an insured's payments.<sup>20</sup>

It would seem that allocation should be required when policy language dictates that the retention may only be exhausted by loss that otherwise would be insured, otherwise an insurer might be compelled to provide coverage for uninsured matters. And there is authority for the proposition that allocation is

*Nordstrom, Inc. v. Chubb & Son, Inc.*, 54 F.3d 1424, 1432 (9th Cir. 1995); *Piper Jaffray Cos. Inc.*, 38 F. Supp. 2d at 774; *See also Raychem Corp.*, 853 F Supp. at 1180.

<sup>17</sup> *See Caterpillar, Inc.*, 62 F.3d at 962 ("The question at issue is whether the insurance policy covered certain claims, not the metaphysical underpinnings of why a corporation or its directors and officers might have acted as they did."); *Nordstrom, Inc.*, 54 F.3d at 1433 n.2 ("We reject Federal's contention that allocation in this case should also depend on an analysis of factors other than liability, such as negative publicity, that might have had a practical effect on the amount of the settlement.").

<sup>18</sup> *See, e.g., State Nat'l Ins. Co. v. White*, No. 8:10-cv-894-T-27TBM, 2011 WL 5826569, at \*4 (M.D. Fla. 2011) ("At best, the SIR Endorsement is ambiguous as to whether the SIR Retention can be satisfied only by the payment of costs and expenses incurred in connection with the covered claims and, therefore, must be liberally construed in favor of the insured."); *see also Taco Bell Corp. v. Cont'l Cas. Co.*, No. 01 C 0428, 2003 WL 1475035, at \*14 (N.D. Ill. Mar. 17, 2003) (holding that the SIR could be exhausted by any commercially reasonable "defense costs" regardless of whether those costs were attributable to covered claims).

<sup>19</sup> *In re Feature Realty Litig.*, 634 F. Supp. 2d 1163, 1170 (E. D. Wash. 2007) (addressing exhaustion under policy language providing that "self-insured retention is not exhausted or diminished by payment of any loss, claim or 'suit' that is not covered by this policy.").

<sup>20</sup> *See, e.g., Cont'l Cas. Co. v. N. Am. Capacity Ins. Co.*, 683 F.3d 79, 90 (5th Cir. 2012) (explaining that, had the subject insurance policy "explicitly require[d]" that the insured itself pay the SIR amount itself, the defense costs expended by other insurers would not have satisfied the insured's SIR).

required within a retention.<sup>21</sup> Presumably, allocation of amounts applied to exhaust a retention would be accomplished pursuant to some recognized allocation methodology, such as the relative legal exposure or the greater settlement rules discussed above. To the extent that allocation is not possible or results in no allocation toward non-covered matters, however, then the entire amount of payments by the insured or another insurer would apply toward exhausting the retention.<sup>22</sup>

The three different types of exhaustion-related language described generate different results in the retiree benefits class action example. First, if the policy language permits exhaustion by any lawsuit-related loss, then the \$2,000,000 retention of the EPL policy is exhausted by virtue of the \$2,000,000 in defense costs, paid by both the policyholder and the insured, in respect of all losses whether or not otherwise covered under the Fiduciary policy or the EPL policy. Second, if the policy language only permits exhaustion by otherwise covered losses, only such portion of the \$2,000,000 in defense costs attributable to defense of the EPL-covered claims would exhaust the retention. So, if we assumed that 10% of loss is attributable to covered exposures under an EPL policy (*e.g.*, age discrimination) and 90% of loss is attributable to covered exposures under a Fiduciary policy (*e.g.*, ERISA breach of fiduciary duty), then only \$200,000 (or 10% of the \$2,000,000 in defense costs) would apply to exhaust the EPL policy retention. Third, if the policy language only permits exhaustion by policyholder payments, the maximum amount of exhaustion would be the \$500,000 paid by the policyholder (to exhaust the retention under the Fiduciary policy), and that \$500,000 might further be reduced to \$50,000 if only 10% of the \$500,000 were attributable to the defense of claims covered under the EPL policy.

Obviously, the variance in language and alternatives for exhaustion of the retention can be advantageous or disadvantageous to the policyholder or to one or another of the insurers, depending on the circumstances. Thus, even on the rare occasion that the parties agree (or it has been established) that coverage exists under each of the different policies, the method for apportionment of the different coverages to the same lawsuit or claim is bound to give rise to disputes.

# # #

<sup>21</sup> See *In re Feature Realty Litig.*, 634 F. Supp. 2d at 1171 (holding that addressing allocation would be appropriate in the context of determining whether a retention was exhausted by payments made by another insured and the policyholder, given that policy only insured one claim among many, but sums paid were not susceptible to allocation between insured/uninsured amounts).

<sup>22</sup> *Id.* at 1173 ("As it has not been demonstrated that any element of damage is solely attributable to the non-covered cause of action, there is no reasonable basis for allocation.").

# Are Two Policies Always Better Than One?

American College of Coverage and Extracontractual Counsel  
6<sup>th</sup> Annual Meeting

Chicago, IL  
May 16-18, 2018

## ARE TWO POLICIES ALWAYS BETTER THAN ONE?

By: Ronald L. Kammer  
Hinshaw LLP<sup>1</sup>

Occasionally contractors perform professional tasks potentially implicating two types of coverage, commercial general liability ("CGL") and professional liability policies. However the policies are very different. Professional liability policies are typically claims made policies, with lower limits than CGL policies and claims expenses included in and thus reducing the available policy limits. On the other hand professional liability policies may provide greater coverage since they cover more than "property damage" and do not contain certain business risk exclusions. For example, professional liability policies cover economic losses such as cost overruns and loss of revenue from the failure to complete a project on time, whereas a CGL policy may not. Whether both the CGL and professional liability policies are in play will, of course, depend on the facts of the case.

### Threshold Question: What Work Did The Insured Perform?

The line between a professional liability and a commercial liability claim can often be blurred. Whether one or both policies apply will depend on the work the insured agreed to perform. For example, if the insured's work includes architecture and design, surveying, or civil, structural or mechanical engineering then the insured's professional liability policy may be triggered if a claim arises out of that work. In addition, construction management services may also be professional services. On the other hand, a CGL policy is intended to address liability for damage arising out of the work to build the construction project. Moreover CGL policies often contain professional liability and/or construction management exclusions. *See, e.g., Carpenter, Weir & Myers v. St. Paul Fire and Marine*, 1998 WL 976309 at \*13 (D. Kan. 1998) (Commercial general liability (CGL) coverage and professional liability coverage 'serve significantly different functions within the insurance industry.' CGL offers comprehensive coverage to the insured and may even cover the provision of services in general. A professional liability policy is designed to insure members of a particular professional group from the practice of liability arising out of a special risk inherent in the practice of the profession.).

For example, in *In re Reinforced Earth, Co.*, 925 F.Supp. 913 (D. P.R. 1996), the issue of which policy covered the loss was in play. In *Reinforced Earth*, after a period of heavy rainfall, the homeowners contracted with Reinforced Earth Company ("RECO") to construct and install an earth retention wall ("REW") in order to retain loose earth. The REW ultimately collapsed, causing the earth that the REW was supposed to retain to subside, fall, and or settle. The homeowners filed suit against RECO, alleging that the REW was defective, inadequately designed and/or installed, and not fit for its intended use, and that RECO was negligent in (i) "failing to ascertain that the soil testing reports were inadequate and that the construction of the REW was not in accordance with engineering standards"; (ii) "failing to analyze earth and soil conditions and side slope earth retention criteria"; and (iii) "failing to warn plaintiffs of the 'dangers to be encountered.'" RECO tendered the suit to both its CGL and professional liability

<sup>1</sup> The views expressed in this paper are those of the author are not of the firm or any of the clients it represents.

insurers. Transportation, the CGL insurer, moved for summary judgment that it owed no coverage, relying principally upon its policy's completed operations and professional services exclusions. The court granted Transportation's motion, ruling that "to the extent that plaintiffs challenge the design, manufacture or installation of the REW, along with any express or implied warranties pertaining to that wall, or claim that RECO improperly designed, supervised, or inspected the wall, said insurance claims against [the insurer] are unequivocally barred by the insurance policy." *Id.* at 918.

### **The Role of Other Insurance Clauses**

"Other insurance" clauses are applicable if there is concurrent coverage, *i.e.*, or where two or more insurance policies insure the same policyholder against the same risk. *Federal Ins. Co. v. Empire Mut. Ins. Co.*, 181 A.2d. 568, 569 (N.Y. App. Div. 1992); *DiCola v. American Steamship Owners Mut. Protection & Indem. Ass'n* 59 F.3d 327 (2<sup>nd</sup> Cir. 1995); *Keenan Hopkins Schmidt and Stowell Contractors, Inc. v. Continental Cas. Co.*, 653 F. Supp. 2d 1255, 1263-67 (finding "other insurance" clause applies when the other insurer(s) insure the same risk for the benefit of the same entity); *S.C. Ins. Co. v. Fid. & Guar Ins. Underwriting, Inc.* 327 S.C. 207, 489 S.E. 2d 200 (1997) (in order for other insurance clauses to apply, the policies must cover the same risk and same interest for the benefit of the same insured over the same period of time.); *Progressive Michigan Ins. Co. v. American Community Mut. Ins. Co.*, 2003 W.L. 21398326 (Ct. App. Mich. 2003) (holding that since a policy exclusion applied, the other insurance clause was inapplicable).

Where two policies cover different risks, however, their "other insurance" clauses do not apply. In *Federal Insurance Co. v. Firemen's Insurance Co.*, 2011 WL 2710458 (D. Md. July 11, 2011), the court recognized that there is a conflict as to whether "other insurance" clauses need to be compared when the policies containing them cover different risks. The Court held that the different policies had to cover the same risk in order to apply the policies' "other insurance" clauses. *See also, Polsky v. National Union Fire Ins. Co.*, Case No. 12-21275 (S.D. Fla. 2013) ("National Union contends that its "Other Insurance" clause, which provides that coverage "shall be excess of any other policy pursuant to which any other insurer has a duty to defend a Claim for which this policy may be obligated to pay Loss," renders it an excess insurance carrier to PIIC. However, because National Union and PIIC did not cover the same loss, *i.e.* National Union does not cover losses arising out of professional negligence whereas PIIC policy covers such losses, it is not an excess carrier to PIIC".)

Thus where both professional liability and CGL policies are implicated by a loss, other insurance clauses should not come into play. Rather, both the professional and CGL insurers are primary and should have a duty to defend and indemnify their mutual insured subject to the terms and conditions of their respective policies.

### **Let the Battle Begin**

One would think that having coverage under two policies is better than one. That may not be the case, as the court in *Marwell Constr., Inc. v. Underwriters at Lloyd's, London*, 465 P.2d 298 (Alaska 1970) observed:

On facts, strikingly simple, neither complex nor conflicting, we have again the problem of an Insurer who has written the policy and taken the Assured's premium urging him to go elsewhere, tentatively if not finally, because another insurer is, or ought to, or may be, liable for the whole, half, or part a loaf. In the process the moving Insurer generally garbs itself in the appealing robes of some assured so that, casting itself in a strange role, it asserts what it so often denied that the policy should be liberally construed and, by a bare toe hold manages to make itself enough of a party to force a construction of another contract made by another insurer with another assured and which, under no circumstance, was made for its benefit.

So it is here. Coming as it does the accident and the assureds seem all but forgotten as the two Insurers match clause against clause, coverage against exclusion, claim against denial, in this battle between fortuitous adversaries.

These remarks reflect the potentially harsh reality facing insureds when they are insured under two policies. Might the defense and settlement of the claim or suit on behalf of the insured be "all but forgotten" when insurers quarrel over which policy should pay—and in what order? Put another way, having insurance in more than one place can indeed be problematic for insureds.

First, is who will defend the insured and controls the defense. In a perfect world the professional liability and CGL insurer would agree to defend the case with the same counsel. The obvious advantage for the insurers is sharing in the cost of the defense – a defense which is often costly. Plus, with one firm defending the insured, it will preserve the policy limit of the professional liability policy if claims expenses are within limits.

However, in most cases this does not happen since the two insurers have divergent interests and different panel counsel firms. The professional liability insurer will defend the case by arguing the design was not the legal cause of the damages. In contrast, the CGL carrier will focus on the construction methods and means and argue that defective construction was not the legal cause of the alleged damages. Although the law requiring independent counsel and who controls the defense may differ from state to state, this divergence of issues over whether the cause of the loss is predicated upon the insured's professional or construction activities should not create a conflict since both the professional liability and CGL carriers, as well as the counsel they retain, have a common interest to defeat the claim and whether one or two lawyers are retained by the insurers, that lawyer(s) should and typically do follow their ethical obligations.

### **Some Practical Considerations for Defense**

If only it was that easy. In large exposure cases, defense counsel may need to be careful in several respects. First, defense should consider the insured's available insurance. For example, if the available CGL coverage is \$25 million and the available professional liability coverage is \$5 million, and the potential damages are \$15 million, shaping the defense strategy to minimize the potential professional liability exposure may be appropriate. Second, if defense expenses are within the policy limit of the professional liability policy, then defense counsel may have an

obligation to try and settle the claim, in whole or in part, before the limit of the professional liability policy is significantly eroded. Third, defense counsel should consider if either the CGL or professional liability policy has a large deductible or SIR, which also might affect strategy.

This example also poses interesting issues for insurers' counsel. Counsel for either (or both) the CGL or professional liability carrier may consider asking for an itemized verdict or intervening to ask for an itemized verdict. In certain circumstances this may be required, although not preferable since a lawyer for the insurer will not be present to advocate for the insurer's position (e.g. that the loss was caused by professional as opposed construction methods and means) during the trial, unless the court allows the intervenor to participate in the trial.

At the very least some jurisdictions may require the insurer to ask for an itemized verdict. For example in *Duke v. Hoch*, 468 F.2d 973 (5th Cir. 1973), the court held that were there is a conflict of interest between the insured and insurer based upon whether certain damages are covered, the insurer must request an itemized verdict. The *Duke* court held that the failure to request an itemized verdict shifts the burden of proof to the insurer to prove that an unallocated jury verdict is not covered. ("Once Home established that part of the liability represented by the judgment was for noncovered acts, the burden became Duke's to prove the precise portion of the unallocated verdict representative of acts for which Home is responsible.") *Id.* at 977.

Who has the burden of proof can be case dispositive. If the insurer cannot meet this burden, then the entire judgment may be covered.

However, insureds may be relieved of this "impossible burden of proof" where "the insurer failed to fully advise its insureds of the divergence of interest between it and them with respect to the [use of an allocated] verdict." *Duke*, 468 F.2d at 979–80. The insurer plainly has an interest in using a general verdict form when an action involves elements of both covered and non-covered damages. *Id.* at 979. To the insured, the inevitable consequence of a general verdict is a "catastrophic total loss of coverage." *Id.* But "the insurance company loses no benefit to which it is validly entitled from having the jury earmark the losses." *Id.* Accordingly, the insurance company is "required to make known to the insured the availability of a special verdict and the divergence of interest" between the insurer and insured "springing from whether damages [a]re or [a]re not allocated." *Id.*

*Arnett v. Mid-Continent Cas. Co.*, 2010 WL 2821981, at \*6 (M.D. Fla. 2010).

In the absence of an itemized award, there will be a general verdict that does not apportion damages between those caused by the insured's professional as opposed to construction activities. Although in a different context, that is what happened in *Arnett* since the carrier did not ask for an itemized verdict resulting in post-judgment coverage litigation to apportion the damage award.

The policyholder's coverage counsel also plays an important role in helping to settle the claim. Determining the cause(s) of the loss and then making demands upon the carriers is a key role. For example, if the dewatering design is deficient in one area of a project and the failure to

properly install the dewatering system in another area of the project caused the project to flood and resulted in property damage and construction delays, convincing one or both insurers to settle may require the hiring of a forensic engineer to apportion the loss. The need for a forensic engineer may equally apply to the carrier's coverage counsel. Without this evidence in hand, the insured may have difficulty convincing either (or both) the CGL and professional liability carrier to pay as the insurers may argue that the primary cause of the loss was not covered by their respective policy.

The root cause analysis will also have to focus on the type of damage since certain damages may be covered by one policy and not the other. Although the law varies from jurisdiction to jurisdiction what constitutes "property damage," whether business risk exclusions apply, and what constitutes professional services may all become relevant. *See Reinforced Earth*, 925 F. Supp. at 918.

Finally, coverage counsel for the policyholder and insurer(s) may be able to work together to resolve these issues in order to obtain an early resolution or to convince a recalcitrant insurer that it has coverage and an obligation to defend and potentially indemnify their mutual insured.

Emerging Coverage B Claims

American College of Coverage and Extracontractual Counsel  
6<sup>th</sup> Annual Meeting  
Chicago, IL

May 16-18, 2018

James W. Bryan  
Nexsen Pruet, PLLC  
701 Green Valley Road  
Suite 100  
Greensboro, North Carolina, 27408  
[JBryan@nexsenpruet.com](mailto:JBryan@nexsenpruet.com)  
336.373.1600

Laura A. Foggan  
Crowell & Moring LLP  
1001 Pennsylvania Avenue NW  
Washington, DC 20004  
[lfoggan@crowell.com](mailto:lfoggan@crowell.com)  
1.202.624.2774

Seth D. Lamden  
Neal, Gerber & Eisenberg LLP  
Two North LaSalle Street, Suite 1700  
Chicago, IL 60602  
[slamden@nge.com](mailto:slamden@nge.com)  
312.269.8052

© 2018 American College of Coverage and Extracontractual Counsel,  
Nexsen Pruet, PLLC, Crowell & Moring LLP and Neal, Gerber & Eisenberg LLP\*  
\*This paper is informational and does not represent legal advice. All statements do not  
necessarily reflect the views of the individual authors or their clients.

## I. Introduction

Coverage issues surrounding wrongful conviction, imprisonment and incarceration have put a spotlight on Coverage B litigation. The litigation is complex and multi-faceted. What follows is an overview of Coverage B policy provisions and applicable exclusions. The focus will be not only on wrongful arrest, malicious prosecution, abuse of process, and wrongful convictions, but also on the emerging Coverage B claims of right of privacy, wrongful entry coverage for pollution claims, and disparagement.

## II. Coverage B of a CGL Policy Covers Liability Arising Out of Enumerated “Offenses.”

Coverage B of the standard Insurance Services Office, Inc. (ISO) CGL policy (CG 00 01) provide coverage for damages because of enumerated “personal and advertising injury” offenses committed during the policy period. Unlike the CGL policy’s coverage for damages because of bodily injury or property damage, which must be caused by an “occurrence” and result from bodily injury or property damage that occurs during the policy period, the personal and advertising injury coverage applies to injury arising out of one or more “personal injury” offenses committed during the policy period.

The Coverage B insuring agreement in the 2013 ISO GGL form provides, in relevant part, as follows:

### 1. Insuring Agreement

- a. We will pay those sums that the insured becomes legally obligated to pay as damages because of “personal and advertising injury” to which this insurance applies . . . This insurance applies to “personal and advertising injury” caused by an offense arising out of your business but only if the offense was committed in the “coverage territory” during the policy period.<sup>1</sup>

The 2013 ISO CGL form defines “personal and advertising injury” as follows:

- a. False arrest, detention or imprisonment;
- b. Malicious prosecution;
- c. The wrongful eviction from, wrongful entry into, or invasion of the right of private occupancy of a room, dwelling or premises that a person occupies, committed by or on behalf of its owner, landlord or lessor;
- d. Oral or written publication, in any manner, of material that slanders or libels a person or organization or disparages a persons’ or organization's goods, products or services;

<sup>1</sup> CG 00 01 04 13, p. 6 of 16.

- e. Oral or written publication, in any manner, of material that violates a person's right of privacy;
- f. The use of another's advertising idea in your "advertisement"; or
- g. Infringing upon another's copyright, trade dress or slogan in your advertisement".<sup>2</sup>

ISO's 2007 version of the ISO CGL form contained the same definition of "personal and advertising injury" as the 2013 version.<sup>3</sup> From 1986 through 2007, standard CGL policies also provided personal and advertising coverage, although they defined "personal injury" and "advertising injury" separately.

Although ISO's 1973 Comprehensive General Liability Form did not provide personal injury coverage, personal injury coverage was available pursuant to an optional 1976 ISO endorsement called the "Broad Form Comprehensive General Liability Endorsement" ("BF Endorsement"), and was available on non-ISO forms prior to 1976.<sup>4</sup> Similar in scope to post-1986 CGL personal injury coverage, the personal injury coverage available in the BF Endorsement covered "all sums which the insured shall become legally obligated to pay as damages because of personal injury . . . to which this insurance applies." The BF Endorsement defined "personal injury" as:

injury arising out of one or more of the following offenses committed during the policy period:

- (1) false arrest, detention, imprisonment, or malicious prosecution;
- (2) wrongful entry or eviction or other invasion of the right of private occupancy;
- (3) a publication or utterance
  - (a) of a libel or slander or other defamatory or disparaging material, or
  - (b) in violation of an individual's right of privacy; except publications or utterances in the course of or related to advertising, broadcasting, publishing or telecasting activities conducted by or on behalf of the named insured shall not be deemed personal injury.<sup>5</sup>

In 1986, ISO moved personal injury coverage from the BF Endorsement to Coverage B of its CG 00 01 Commercial General Liability form. As with the personal injury provision in the BF Endorsement, Coverage B covered "those sums that the insured becomes legally obligated to

<sup>2</sup> CG 00 01 04 13, Definitions (14).

<sup>3</sup> CG 00 01 12 07, Definitions (14).

<sup>4</sup> See, e.g., *Roess v. St. Paul Fire & Marine Ins. Co.*, 383 F. Supp. 1231, 1233 (M.D. Fla. 1974) (discussing "Top Brass Personal Catastrophe Policy" issued in 1968 that covered damages due to "personal injuries" including "malicious prosecution.")

<sup>5</sup> CG 04 04 (Ed. 7-76), I(D).

pay as damages because of ‘personal injury’ . . . . that is committed during the policy period.<sup>6</sup> The 1986 CGL policy slightly revised the definition of “personal injury” as follows:

“Personal injury” means injury, other than “bodily injury,” arising out of one or more of the following offenses:

- a. False arrest, detention or imprisonment;
- b. Malicious prosecution;
- c. Wrongful entry into, or eviction of a person from, a room, dwelling or premises that the person occupies;
- d. Oral or written publication of material that slanders or libels a person or organization or disparages a person’s or organization’s goods, products or services; or
- e. Oral or written publication of material that violates a person’s right of privacy.<sup>7</sup>

The definition of “personal and advertising injury” contained in the 2007 version of CG 00 01 remained in the most recent version of CG 00 01, which is CG 00 01 04 13.<sup>8</sup>

### III. Coverage B Covers “Malicious Prosecution” Suits.

#### A. Courts Look to Substantive Tort Law In Determining Whether an Underlying Suit Alleges “Malicious Prosecution.”

In evaluating whether an underlying suit alleges “malicious prosecution” for purposes of triggering Coverage B, many courts hold that “‘malicious prosecution’ in an insurance policy means the technical legal definition of ‘malicious prosecution’ under the applicable jurisdiction’s tort law.”<sup>9</sup> Recognizing that CGL policies provide a “national scope” of coverage, however, other courts ignore whether the underlying claim bears the “label” of malicious prosecution, instead finding that an underlying claim alleging “essentially the elements required to prove common-law malicious prosecution” falls within the scope of Coverage B.<sup>10</sup>

Although “[t]he Restatement (First) of Torts [and] the Restatement (Second) of Torts provide separate sections to explain malicious prosecution claims arising out of civil litigation and those arising from criminal prosecutions . . . the essential elements of the two are virtually

<sup>6</sup> CG 00 01 11 85, Coverage B, 1.a.

<sup>7</sup> CG 00 01 11 85, Definitions (10).

<sup>8</sup> CG 00 01 04 14, Definitions (14).

<sup>9</sup> *Pa. Pulp & Paper Co. v. Nationwide Mut. Ins. Co.*, 100 S.W.3d 566, 574 (Tex. App. 2003) (citing cases).

<sup>10</sup> *Carolina Cas. Ins. Co. v. Nanodetex Corp.*, 733 F.3d 1018, 1025 (10th Cir. 2013) (“If labels rather than substance were the governing interpretative principle, then the term malicious prosecution would have no application in those states that use a different term to describe essentially the same tort”).

the same.”<sup>11</sup> Despite minor differences in wording from jurisdiction to jurisdiction, the following formulation of the core elements of the tort of malicious prosecution is typical: “(1) the initiation or continuation of a lawsuit; (2) lack of probable cause; (3) malice; and (4) favorable termination of the lawsuit.”<sup>12</sup> Other courts include a fifth element: damage or injury to the plaintiff.<sup>13</sup> However, a majority of courts hold that “the right not to be unjustifiably involved in litigation” constitutes sufficient damages to sustain a malicious prosecution claim and do not require the plaintiff to prove additional damages.<sup>14</sup> Moreover, “a plaintiff alleging malicious prosecution based on a criminal proceeding need not show special injury.”<sup>15</sup>

Not all jurisdictions recognize the tort of malicious prosecution.<sup>16</sup> For example, New Mexico law recognizes the tort of “malicious abuse of process” but not “malicious prosecution.”<sup>17</sup> Other jurisdictions recognize torts that are similar to malicious prosecution, but are not called malicious prosecution.<sup>18</sup>

## **B. Courts Are Split on Whether “Malicious Prosecution” Includes the Tort of Abuse of Process.**

### **1. Some Courts Hold that “Malicious Prosecution” Does Not Include “Abuse of Process.”**

“The elements of the tort of abuse of process are (1) an ulterior purpose; and (2) a willful act in the use of the process not proper in the regular conduct of the proceeding.”<sup>19</sup> “The torts of malicious prosecution and abuse of process were both created to remedy abusive litigation. Malicious prosecution blazed the trail, while abuse of process followed behind to fill in the gaps. By virtue of their histories, they are distinct torts, at least in a strictly legal sense, . . . In reality, however, the line between these torts is blurred . . .”<sup>20</sup>

Notwithstanding the similarities between abuse of process and malicious prosecution, a many courts to consider the issue have held that the term “malicious prosecution” is

<sup>11</sup> *Martin v. O'Daniel*, 507 S.W.3d 1, 10 (Ky. 2016)

<sup>12</sup> *Nanodetex Corp.*, 733 F.3d at 1025 (citing Black's Law Dictionary 977 (8th ed. 2004)).

<sup>13</sup> *St. Paul Fire & Marine Ins. Co. v. The City of Zion, et al.*, 2014 IL App (2d) 131312, at ¶15. *See also Toll Bros. v. Gen. Accident Ins. Co.*, No. 98C-08-203, 1999 Del. Super. LEXIS 313, at \*11-13 (Super. Ct. Aug. 4, 1999) (citing Prosser, *The Law of Torts* § 98, at 652 (2d. ed. 1955)); *Thompson v. Maryland Cas. Co.*, 84 P.3d 496, 503 (Colo. 2004).

<sup>14</sup> *See DeVaney v. Thriftway Mktg. Corp.*, 124 N.M. 512, 524 (1998) (“a majority of the courts that have considered the issue . . . place no such limitations on the types of damage necessary”).

<sup>15</sup> *City of Zion*, 2014 IL App (2d) 131312, at ¶15

<sup>16</sup> *See, e.g., DeVaney*, 124 N.M. at 514.

<sup>17</sup> *See id.*

<sup>18</sup> *See Nanodetex Corp.*, 733 F.3d at 1025 (citing cases).

<sup>19</sup> *Lunsford v. Am. Guar. & Liab. Ins. Co.*, 18 F.3d 653, 655 (9th Cir. 1994); *Toll Bros. v. Gen. Accident Ins. Co.*, No. 98C-08-203 WTQ, 1999 Del. Super. LEXIS 313, at \*15 (Super. Ct. Aug. 4, 1999).

<sup>20</sup> *Toll Bros.*, 1999 Del. Super. LEXIS 313 at \*28.

unambiguous and does not include abuse of process claims.<sup>21</sup> Inherent in the decisions finding that “malicious prosecution” does not include abuse of process is that abuse of process and malicious prosecution are separate torts with distinct elements. As one court explained, “[i]nsurance against malicious prosecution does not cover abuse of process,” because there is “a clear distinction in Washington law between abuse of process and malicious prosecution. [The insured] could have insured against abuse of process, but it did not. Presumably, the words of the policy have some meaning, purpose and limit.”<sup>22</sup>

## 2. **Some Courts Hold that “Malicious Prosecution” Includes “Abuse of Process.”**

Some courts have held that the personal injury offense of “malicious prosecution” “extends to the related but not enumerated offenses of abuse of process and wrongful use of civil proceedings.”<sup>23</sup> Courts’ rationale for finding that the term “malicious prosecution” includes abuse of process typically is that “malicious prosecution” “is ambiguous because it is not defined in the policy and because a laypersons’ understanding would differ from the legal definition of the term.”<sup>24</sup> Put differently, “[a] layperson could believe reasonably that the words ‘malicious prosecution’ only required a lawsuit or other legal proceeding to be brought maliciously or spitefully for an improper purpose . . . [and] that a counterclaim for abuse of process satisfied that requirement.”<sup>25</sup>

### C. **Most Courts Find that the Offense of “Malicious Prosecution” Occurs When the Malicious Prosecution Is Commenced.**

#### 1. **Majority Rule – Commencement of Litigation During Policy Period Triggers Coverage B.**

As noted above, Coverage B requires that the offense occur during the policy period. Most courts that have addressed the issue have held that the commencement of a malicious prosecution during the policy period is the event that triggers insurance coverage.<sup>26</sup> In so ruling,

<sup>21</sup> See *Hinkle v. State Farm Fire & Cas. Co.*, 308 P.3d 1009, 1015 (Ct. App. N.M. 2013) (citing cases).

<sup>22</sup> *A. Hanson Co., Inc. v. Aetna Ins. Co.*, 26 Wash. App. 290, 295 n. 3 (1980).

<sup>23</sup> 3 New Appleman on Insurance Law Library Edition § 19.04 (2017)

<sup>24</sup> *Lunsford*, 18 F.3d at 654. See also *Martin's Herend Imps., Inc. v. Twin City Fire Ins. Co.*, No. H-99-064, 2000 U.S. Dist. LEXIS 8690, at \*20 (S.D. Tex. Mar. 31, 2000); *Northwestern Nat'l Cas. Co. v. Century III Chevrolet*, 863 F. Supp. 247, 250-251 (W.D. Pa. 1994) (“the distinction between malicious prosecution and abuse of process is at best unclear.”).

<sup>25</sup> *Lunsford*, 18 F.3d at 655; *Travelers Prop. Cas. Co. of Am. v. KFx Med. Corp.*, 637 F. App'x 989, 991 n.3 (9th Cir. 2016) (“We note that the Policy purports to cover only ‘malicious prosecution’ claims—not claims for abuse of process. Nevertheless, we have previously held that, as a matter of California law, the use of either term in an insurance policy should be construed as incorporating the other”).

<sup>26</sup> *Zook v. Arch Spec. Ins. Co.*, 336 Ga. App. 669, 675 (2016) (“we adopt the majority rule that when the contract does not specify, insurance coverage is triggered on a potential claim for malicious prosecution when the insured sets in motion the legal machinery of the state.”); *Northfield Ins. Co. v. City of Waukegan*, 701 F.3d 1124, 1132 (7th Cir. 2012) (“the overwhelming majority of jurisdictions to address this issue consider the trigger date to be the date of the underlying criminal charges or conviction”); *Genesis Ins. Co. v. City of Council Bluffs*, 677 F.3d 806, 812-813 (8th Cir. 2012) (collecting cases); *City of Erie v. Guar. Nat'l Ins. Co.*, 109 F.3d 156, 160 (3d Cir. 1997) (“[T]he

courts have focused on when the injury occurs (*i.e.* the filing of the improper charges or lawsuit), not when the cause of action accrues for statute of limitation purposes (*i.e.* the termination of the charges or suit in favor of the defendant). As one court explained:

Reliance on the commencement of the statute of limitation is not dispositive in determining when a tort occurs for insurance purposes. Statutes of limitation and triggering dates for insurance purposes serve distinct functions and reflect different policy concerns. Statutes of limitation function to expedite litigation and discourage stale claims. But when determining when a tort occurs for insurance purposes, courts have generally sought to protect the reasonable expectations of the parties to the insurance contract.<sup>27</sup>

And as another court noted, “it is improbable that the term ‘personal injury’ is used in a technical sense to speak of time when a cause of action has fully matured. It is more likely intended to describe the time when harm begins to ensue, when injury occurs to the person, that is, in this case, when the relevant law suit is filed.”<sup>28</sup>

As noted above, Coverage B under an ISO policy is triggered when the offense of malicious prosecution occurs, and the requirement of an “occurrence” is inapplicable to Coverage B claims. Due to differences between ISO and non-ISO policy language, some courts evaluating trigger of coverage for malicious prosecution sometimes discuss when the “occurrence” took place instead of when the offense took place.<sup>29</sup> However, the result in such cases typically is the same as cases involving ISO personal injury coverage. In one such case, the court explained, “[a] plaintiff suffers actual damages from a malicious prosecution on the filing of the underlying complaint, which at a minimum triggers the need to invest the time, money, and effort to prepare a defense. While the termination of the underlying action is a required element and a necessary condition precedent before the malicious prosecution claim accrues for purposes of the statute of limitations, it is not an event that causes harm to the plaintiff and therefore not an ‘occurrence’ within the meaning of the policy.”<sup>30</sup>

Accordingly, although most courts to consider what event must occur during the policy period to trigger coverage for a malicious prosecution claim have held that it is the filing of the charges or commencement of the litigation, it is possible that courts in those jurisdictions or others would be receptive to the argument that the triggering event is the termination of underlying proceedings in favor of the defendant.

## **2. Minority Rule – Favorable Termination of Underlying Proceedings During Policy Period Triggers Coverage B.**

clear majority of courts have held the tort [of malicious prosecution] occurs [for insurance purposes] when the underlying criminal charges are filed.”).

<sup>27</sup> *City of Erie*, 109 F.3d at 161.

<sup>28</sup> *Genesis Ins. Co.*, 677 F.3d at 813-14.

<sup>29</sup> *See, e.g., Roess v. St. Paul Fire & Marine Ins. Co.*, 383 F. Supp. 1231, 1235 (M.D. Fla. 1974) (“Thus, in the context of this case, the date of favorable termination (rather than commencement) of the malicious action against Koubek was the operative occurrence upon which the effectiveness of the policy stands or falls”).

<sup>30</sup> *Billings v. Commerce Ins. Co.*, 458 Mass. 194, 198 (2010).

A “small minority” of courts have held that the event that triggers is coverage is the “favorable termination of the underlying proceeding” rather than the commencement of the proceeding.<sup>31</sup> The rationale behind those decisions is that termination of the underlying proceedings in favor of the plaintiff is a necessary element of the tort of malicious prosecution and, therefore, the offense of malicious prosecution does not occur until favorable termination of the malicious claim against the defendant.<sup>32</sup> However, courts rejecting this argument have observed that the event that causes the harm to the underlying plaintiff is the commencement of malicious prosecution, not the release from prison or termination of malicious proceedings.<sup>33</sup>

### 3. Rejection of Continuous Trigger

Some courts have considered – and rejected – the argument that there are multiple events that trigger malicious prosecution coverage, such as the date the underlying criminal charges were filed and the date of exoneration.<sup>34</sup> In one case, for example, the Supreme Judicial Court of Massachusetts rejected the position that malicious prosecution should be treated as a continuing tort that triggers all policies in effect while the underlying litigation was ongoing because “[u]nlike the asbestos-caused latent injuries . . . the injury to the person maliciously prosecuted is apparent the day he is served with process . . . It is clearer, simpler, and fairer to define the time of the ‘occurrence’ as the time the injurious effects ‘first became apparent,’ *i.e.*, the date of filing.”<sup>35</sup> It should be noted, however, that the leading cases to reject multiple trigger or continuous trigger theories involved non-ISO policies that covered “personal injury” caused by an “occurrence.”

#### D. Potentially Applicable Exclusions

Few exclusions come into play when addressing coverage under Coverage B for offenses such as malicious prosecution and false imprisonment. Courts seem to focus on one exclusion in particular entitled “Knowing Violation of Rights of Another.” It states as follows: “This insurance does not apply to: ‘Personal and advertising injury’ caused by or at the direction of the insured with the knowledge that the act would violate the rights of another and would inflict “personal and advertising injury.” A West Virginia federal court noted this exclusion “applies if the insured acted with the knowledge that his acts would violate another’s rights, and intended them to cause ‘personal and advertising injury.’”<sup>36</sup> In that case, the allegations of

<sup>31</sup> Zook, 336 Ga. App. at 674 (citing cases); *Am. Safety Cas. Ins. Co. v. City of Waukegan*, 678 F.3d 475 (7th Cir. 2012); *Nat’l Cas. Co. v. McFatrige*, 604 F.3d 335 (7th Cir. 2010); Roess, 383 F. Supp. at 1235 (applying Florida law).

<sup>32</sup> See *Am. Safety Cas. Ins.*, 678 F.3d at 479-80

<sup>33</sup> *Gulf Underwriters Ins. Co. v. City of Council Bluffs*, 755 F. Supp. 2d 988, 1008 (S.D. Iowa 2010) (“it is difficult to see how [a criminal defendant’s] release from prison can be described as an ‘injury’ in any sense of the word.”); *Billings*, 458 Mass. at 198 (favorable termination of a prosecution “is not an event that causes harm”).

<sup>34</sup> See *Billings*, 458 Mass. at 199 (“A malicious prosecution is not a tort where it is difficult to ascertain when the injurious effects of the tortious conduct first become manifest; any reasonable person recognizes that the injury occurs on the filing”); *City of Erie*, 109 F.3d at 165 (“no federal or state court has adopted the multiple trigger theory in malicious prosecution cases”).

<sup>35</sup> *Billings*, 458 Mass. at 199 (Punctuation and citations omitted).

<sup>36</sup> *Erie Ins. Property & Cas. Co. v. Edmond*, 785 F.Supp.2d 561, 568 (N.D.W.Va. 2011).

false imprisonment and invasion of privacy were “unambiguously root[ed] ... in Mr. Edmond’s alleged sexual misconduct and harassment. ... [I]t alleges that Mr. Edmond engaged in ‘inappropriate touching, and other inappropriate conduct,’ made ‘unwelcome sexual advances,’ ‘request[ed] sexual favors,’ and exhibited ‘other conduct of a sexual nature.’”<sup>37</sup> The court held that the allegations sufficiently “impl[ie]d the fact that he acted intentionally and with knowledge that his actions ‘would violate the rights of another’” such that under the exclusion the insurer had no duty to defend.<sup>38</sup>

Several cases stem from one incident in Pennsylvania involving a judicial kickback scheme to maintain a high rate of occupancy in juvenile detention facilities operated by the insureds.<sup>39</sup> As part of the alleged conspiracy, judges would violate the civil rights of the juveniles appearing before them by denying them a right to counsel and ensuring disproportionately large sentences.<sup>40</sup> The Middle District federal court held that the underlying complaints clearly allege that the insureds were part of a conspiracy in which they committed false imprisonment of the underlying plaintiff with the knowledge that their detention had been procured by violating the constitutional rights of the plaintiffs, that the insureds knew of these deprivations because it was part of the scheme, funded by their kickbacks, to facilitate detention of the juveniles in the facilities owned by and managed by the insureds.<sup>41</sup> “Even though the MIC and MCAC make out claims for false imprisonment that would otherwise fall under the protection of Coverage B, the alleged knowing violation of the underlying plaintiffs’ rights trigger the ‘knowing violation’ exclusion and strip Colony of its duty to defend against the allegations in the underlying complaints.”<sup>42</sup> The Third Circuit ruled in an appeal by an insured in another similar case: “We agree with the District Court that coverage is excluded because the complaint alleges that the defendants, including Mericle, ‘knowingly and willfully’ entered into an agreement to ensure future contracts for the construction of new detention facilities would be awarded to Mericle Construction in exchange for compensation.”<sup>43</sup>

#### IV. Right of Privacy

Another important issue being tested in the courts is the meaning of a commercial general liability policy’s Coverage B offense of “publication” of material that gives unreasonable publicity to a person’s private life. This issue concerns the important question whether the limited, offense-based coverage of Coverage B in widely-issued commercial general liability

<sup>37</sup> *Id.*

<sup>38</sup> *Id.* at 569.

<sup>39</sup> *Colony Ins. Co. v. Mid-Atlantic Youth Services Corp.*, 2010 WL 817703 (M.D.Pa. Mar. 9, 2010) (insureds’ motion to dismiss denied); *Markel International Ins. Co. v. Western PA Child Care, LLC*, 805 F.Supp.2d 88 (M.D.Pa. 2011) (same -- insureds’ motion to dismiss denied); *Markel International Ins. Co. v. Western PA Child Care, LLC*, 2012 WL 750842 (M.D.Pa. Mar. 8, 2012) (insurer’s motion for summary judgment granted); *Travelers Property Cas. Co. v. Mericle*, 2010 WL 3505117 (M.D.Pa. Aug. 31, 2010) (judgment entered for insurer); *Travelers Property Cas. Co. v. Mericle*, 486 Fed.Appx. 233 (3d Cir. 2012) (judgment for insurer affirmed).

<sup>40</sup> *Colony*, 2010 WL 817703 at \*6.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> *Travelers*, 486 Fed.Appx. 233 at \*5.

policies will be held to cover what are essentially cyber-liability claims—that is, claims alleging a failure to adequately protect private information. These might include, for instance, claims that a third-party hacker criminally accessed private information or claims where a mistake by the policyholder left open a means for access to certain personal information, although the policyholder intended *not* to publish that information. Such claims also might involve theft or loss of a mobile device containing personal information such as a laptop or cell phone.

Coverage B typically affords coverage for “those sums that the insured becomes legally obligated to pay as damages because of ‘personal injury’ . . . to which this insurance applies.” Personal injury coverage is limited to injury arising out of a list of designated offenses. An example of typical wording defines “personal injury” as:

“Personal injury” means injury, other than “bodily injury”, arising out of one or more of the following offenses:

- a. False arrest, detention or imprisonment;
- b. Malicious prosecution;
- c. The wrongful eviction from, wrongful entry into, or invasion of the right of private occupancy of a room, dwelling or premises that a person occupies by or on behalf of its owner, landlord or lessor, provided that the wrongful eviction, wrongful entry or invasion of the right of private occupancy is performed by or on behalf of the owner, landlord or lessor of that room, dwelling or premises;
- d. Oral, written or electronic publication of material that slanders or libels a person or organization or disparages a person’s or organization’s goods, products or services, provided that claim is made or “suit” is brought by a person or organization that claims to have been slandered or libeled, or whose goods, products or services have allegedly been disparaged; or
- e. Oral, written or electronic publication of material that appropriates a person’s likeness, unreasonably places a person in a false light or gives unreasonable publicity to a person’s private life.

Under provisions such as these, it is hotly contested whether there is coverage for claims that a policyholder failed to safeguard private and confidential information that was in their custody, control and care or failed to adequately monitor, audit and oversee the security of their electronic systems containing confidential records. Coverage B personal injury coverage is limited to injury arising out of a list of designated offenses. Under the plain language of Coverage B, this coverage depends on whether the insured has committed an enumerated offense. *See, e.g., Whiteville Oil Co. v. Federated Mut. Ins. Co.*, 87 F.3d 1310 (4th Cir. 1996) (“Unlike Coverage A which provides for coverage based on the harm suffered, Coverage B’s applicability depends upon whether the injuries arose from one of the enumerated offenses listed in the policy.”). Policyholders have sought to fit allegations concerning failure safeguard private and confidential information that was in their custody, control and care into the Coverage B “offense” of “electronic *publication* of material that . . . gives unreasonable publicity to a person’s private life” or the “offense” of “*publication* by electronic means of material that . . . discloses information about a person’s private life.”

A key issue in these types of “failure to protect” cases is whether there was any “publication” or unreasonable publicity or disclosure of information about a person’s private life. In some cases, while information may have been exposed, it will be unclear whether the plaintiff’s material was viewed by third-parties at all, and in most of these disputes it is clear that the policyholder did not take any steps that were designed to disseminate or publish the material.

Insurers urge, and many courts have held, that the Coverage B offense of “publication” of material is not the same as an alleged failure to safeguard confidentiality. Many courts have concluded that the plain meaning of the term “publication” is the “act of declaring or announcing to the public,” “to disseminate to the public,” or materially similar definitions. *See, e.g., Whole Enchilada, Inc. v. Travelers Prop. Cas. Co. of Am.*, 581 F. Supp. 2d 677, 685 (W.D. Pa. 2008) (holding that insurer had no duty to defend where underlying complaint did “not allege that [the policyholder] is liable for ‘publication’”; plaintiffs only received their own personal information on credit card receipts); *Creative Hospitality Ventures, Inc. v. U.S. Liab. Ins. Co.*, 444 Fed. App’x 370, 375-76 (11th Cir. 2011) (the phrase “publication, in any manner” was unambiguous and did not apply when there was no dissemination of information to the public); *Ticknor v. Rouse’s Enters., LLC*, 2 F. Supp. 3d 882, 896 (E.D. La. 2014) (in order for “publication” to occur, the material must be “made generally known, announced publicly, disseminated to the public, or released for distribution”); *OneBeacon Am. Ins. Co. v. Urban Outfitters, Inc.*, No. 14-2976, 2015 WL 5333845, at \*2 (3d Cir. Sept. 15, 2015) (“publication requires dissemination to the public”); *Terra Nova Ins. Co. v. Fray-Witzer*, 449 Mass. 406, 415, 869 N.E.2d 565, 572 (2007) (communication required a “public announcement”).

In each of these cases “publication” —to announce, to disseminate, to communicate, to distribute—required an intention to distribute material to others. Typically, in cyber claims, the policyholder did not take any steps to communicate anything to the public: it in fact sought to keep plaintiffs’ information private. Indeed, far from seeking to “publish” anything, the policyholder in a failure-to-protect case in fact sought to do the opposite. Even so, at least one prominent court has found coverage under Coverage B for such “right to privacy” claims. *Travelers Indemnity Company of America v. Portal Healthcare Solutions, LLC*, 2016 U.S. App. Lexis 6554 (4<sup>th</sup> Cir. 2016).

Another issue in the forefront of the dispute over whether Coverage B responds to “right of privacy” claims is that a “publication” requires that the material be communicated or disseminated to others. *See, e.g., Recall Total Info. Mgmt. v. Fed. Ins. Co.*, 83 A.3d 664, 672(Conn. Ct. App. 2013) (no “publication” where record was entirely devoid of facts suggesting that the personal information actually was accessed”), *aff’d* 115 A.3d 458 (Conn. 2015). In many cyber cases, the claim alleges something short of communication or dissemination of the plaintiff’s personal information to others, e.g., in the instance of a lost laptop or other mobile device that holds personal information which cannot easily or automatically be accessed due to passwords or encryption. Insurers urge that the plain meaning of “unreasonable publicity” and “disclosure of information about private lives” requires actual communication of information to the public. Hence, where an underlying complaint alleges only the risk that someone could access the materials, not that any unreasonable publicity or

disclosure of information about the plaintiffs' lives actually took place, there may be no coverage for the claims under the designated offenses in Coverage B.

The Connecticut Supreme Court's recent decision in *Recall Total* is illustrative. In the underlying litigation, a tape with electronic data containing personal information fell from the back of a van. *Recall Total*, 83 A.2d at 667-68. The underlying complaint did not allege, however, that anyone ever *accessed* the information on the tape. Because "access is a necessary prerequisite to the communication or disclosure of personal information," the court held that the claim did not fall within the Coverage B designated offense of "electronic, oral, written or other publication of material that . . . violates a person's right of privacy . . ." *Id.* The Third Circuit reached the same conclusion in *Urban Outfitters*. The underlying complaints at issue in *Urban Outfitters* alleged that the policyholder collected personal ZIP codes of customers when purchasing products via credit cards. *See Urban Outfitters*, 2015 WL 5333845, at \*3. In evaluating whether the claims alleged a Coverage B offense, the court determined that a "publication" required "provision of information to the public." *Id.* In *Urban Outfitters*, the insured was alleged to have used those ZIP codes internally to distribute material to consumers' homes, but there was no allegation that the insured took any steps to share the information with any third party. The Third Circuit found that no "publication" had occurred. This is an independent area of dispute in "right of privacy" cyber cases under Coverage B.

## V. Wrongful Entry - Coverage for Pollution Claims

As stated above, liability policies typically contain "personal injury" coverage for intentional-type torts. The term "personal injury" is defined as an injury other than "bodily injury" arising out of the offense of "[t]he wrongful eviction from, wrongful entry into, or invasion of the right of private occupancy of a room, dwelling or premises that a person occupies, committed by or on behalf of its owner, landlord or lessor."<sup>44</sup> The main coverage issue for pollution claims under Coverage B is this definition of "personal injury" -- wrongful entry/invasion of right of private occupancy. Courts have wrestled with whether "wrongful entry" is a personal injury offense that is covered.

### A. Restrictive Interpretation/No Coverage

Some courts have given a restrictive interpretation to "wrongful entry" and determined that personal injury coverage does not apply to trespass claims for environmental contamination. In *Whiteville Oil Co. v. Federated Mut. Ins. Co.*, a restaurant owner sued the insured gas station owner for trespass because fumes from insured's petroleum had caused the closing of the restaurant and other damages.<sup>45</sup> The "wrongful entry" offense language was the same as in the above *Meyers Lake* case. The court in *Whiteville Oil* noted that under North Carolina law the elements of trespass include an unauthorized, and therefore unlawful, entry on the land of

<sup>44</sup> *See, e.g., Meyers Lake Sportsman's Club, Inc. v. Auto-Owners (Mut.) Ins. Co.*, 2013 WL 3787437, at \*5 (Ohio App. 5 Dist. July 15, 2013).

<sup>45</sup> *Whiteville Oil Co. v. Federated Mut. Ins. Co.*, 889 F.Supp. 241 (E.D.N.C.1995), *aff'd*, 87 F.3d 1310 (4th Cir.1996).

another and may result from petroleum seeping onto another's land.<sup>46</sup> "Wrongful entry," however, is generally used to refer to claims involving the wrongful taking of property or real estate and requires actual entry on another's land. *Id.* The ordinary meaning of entry involves the actual taking of lands or tenements by entering or setting foot on them.<sup>47</sup> While every person who wrongfully enters the property of another becomes a trespasser, the converse is not true. *Id.* Every trespass is not necessarily a "wrongful entry" because to be such, there must be a threat to the owner's possessory rights in the property, which goes beyond the less involved elements of trespass which simply involve an unauthorized presence.<sup>48</sup> In the underlying complaint in *Whiteville Oil*, the claimant restaurant owner did not allege that there was entry by a person onto the land or any attempt by an individual to exercise possession of the land.<sup>49</sup> In other words, the complaint does not state a claim for "wrongful entry," but does state a claim for trespass, which is a separate offense.<sup>50</sup> Under that distinction, it was clear to the court that the trespass claim in the underlying suit is a *property offense* and not a *personal injury offense*.<sup>51</sup> As a property offense, the pollution exclusion applies to the trespass claims and the insurer did not have the obligation to defend those claims.<sup>52</sup>

Another argument for no personal injury coverage is that the liability policy section defining "personal injury" lists wrongful entry "alongside a host of other torts which all require intent: malicious prosecution, false imprisonment, libel, slander, and invasion of privacy, [and] under the contract interpretation canon of *noscitur a sociis*, the meaning of a word is or may be known by the words accompanying or surrounding it."<sup>53</sup> For this reason, the court in *Arrowood* "interprete[d] the term 'wrongful entry' in light of the words around it, which indicate that only

<sup>46</sup> *Id.* at 247.

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

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

<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

<sup>51</sup> *Id.*

<sup>52</sup> *Id.* See also *Kruger Commodities, Inc. v. United States Fidelity & Guar.*, 923 F.Supp. 1474, 1480-81 (M.D.Ala.1996) (right of private occupancy only refers to those rights associated with individual's act of inhabiting the premises, not to rights associated with individual's right to use and enjoy the inhabited premises; because claimants were not denied occupancy of their property due to the foul odors from insured's nearby processing animal carcasses plant, insured was not entitled to indemnity for personal injury coverage) (Arkansas law); *Dryden Oil Co. of New England, Inc. v. Travelers Indem. Co.*, 91 F.3d 278, 286-87 (1st Cir. 1996) ("wrongful entry" did not embrace the trespass claim for release of hazardous material during manufacturing process because (1) the wrongful conduct comprehended by the personal injury coverage afforded under policies like the present one amounts to an intentional tort under Massachusetts law, and (2) the Massachusetts tort of wrongful entry had yet to be extended beyond trespasses by landlords upon the leased premises).

<sup>53</sup> *Arrowood Indem. Co. v. Oxford Cleaners and Tailors, LLC*, 2014 WL 4104169, at \*8 (D. Mass. August 15, 2014).

intentional torts are covered by the personal injury provision. A claim of negligent trespass is insufficient to trigger coverage under the personal injury provision.”<sup>54</sup>

## B. Expansive View/Coverage

Other courts take a more expansive view of “wrongful entry” and apply personal injury coverage for trespass and nuisance claims for pollution. In *Kitsap County v. Allstate Ins. Co.*, where adjoining landowners alleged trespass as a result of odors and pollution emanating from the insured’s landfill and waste disposal facility, the personal injury offense had a broader definition – “wrongful entry or eviction, or other invasion of the right of private occupancy.”<sup>55</sup> The court noted that one must look to the type of offense that the insured is alleged to have committed and not the nature of the damages sought in the action.<sup>56</sup> Personal injury coverage does not just involve intentionally inflicted injury since the dictionary defines “offense” as an act of breaking the law, sin, crime, transgression, misdeed, and there are many laws that one may violate without intending to do so.<sup>57</sup> The court determined that an average purchaser of insurance would think that a trespass was a wrongful entry.<sup>58</sup> As to the meaning of “other invasion of the right of private occupancy,” the phrase is intended to encompass torts that are not encompassed by the terms “wrongful entry” and “wrongful eviction” and thus to the court the average purchaser of insurance would include a trespass on or against a person’s right to use premises or land that are secluded from the intrusion of others.<sup>59</sup> The court in *Kitsap* reached the same conclusion about nuisance claims because a nuisance is an unreasonable interference with another’s use and enjoyment of property, whereas a trespass is an invasion of the interest in exclusive possession of property, and each is an invasion of the possession of land normally involving some degree of interference with its use and enjoyment.<sup>60</sup>

**Illinois.** In Illinois, courts have found “wrongful entry” ambiguous and held it covers a trespass injury caused by migration of a hazardous substance onto the property of another.<sup>61</sup> The *Millers* court noted that “wrongful entry” could reasonably mean a dispute over “possession of real property,” but it could also reasonably mean “all trespassory invasions to real property, whether aimed at dispossession or not.”<sup>62</sup> Illinois cases referring to “wrongful entry” do not

<sup>54</sup> *Id.*

<sup>55</sup> *Kitsap County v. Allstate Ins. Co.*, 136 Wash.2d 567, 964 P.2d 1173, 1176 (1998).

<sup>56</sup> *Id.* at 1179.

<sup>57</sup> *Id.* at 1181.

<sup>58</sup> *Id.* at 1184.

<sup>59</sup> *Id.* at 1185; *see also Titan Holdings Syndicate, Inc. v. City of Keene, N.H.*, 898 F.2d 265 (1st Cir.1990) (“other invasion of the right of private occupancy” encompasses negligent unintentional trespass).

<sup>60</sup> *Id.*; *see also Homesite Ins. Co. of the Midwest v. Ascolese*, 2018 WL 1156075 (W.D.Wash. Mar. 5, 2018) (applies *Kitsap*: nuisance and trespass constitute personal injury offense arising out of wrongful entry and invasion of right of private occupancy).

<sup>61</sup> *See, e.g., Millers Mut. Ins. Ass’n of Illinois v. Graham Oil Co.*, 668 N.E.2d 223, 231 (Ill. App. 1996).

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

define it as a cause of action, but merely use it to characterize the unlawful nature of the trespasses therein considered.<sup>63</sup> As such, the court held “wrongful entry” ambiguous and construed it to include “unauthorized seepage and migration of gasoline onto the property of an adjoining neighbor.”<sup>64</sup>

One Illinois case articulated a test for determining whether the personal injury coverage for wrongful entry applies – there must be a “‘nexus’ between an allegation of conduct that constitutes trespass or nuisance and the legal basis for the underlying plaintiffs’ entitlement to relief.”<sup>65</sup> “The wrongful entry coverage applies only when the entry is into property that the injured person *occupies*.”<sup>66</sup> Where the underlying complaint does not allege a claim arising out of the invasion of any private occupancy rights but instead arises out of contamination of public property, the duty to defend is not triggered.<sup>67</sup> Similarly, even if the contamination invades a private occupancy right, there is no wrongful entry coverage if the nexus test is not met. In *John Sexton*, the insured sought coverage for payments made in three underlying actions for CERCLA response costs but the insured failed to prove that the one action involving a private occupancy right was actually seeking contribution from the insured for CERCLA response costs.<sup>68</sup> In other words, the nexus test was not met and there was no wrongful entry coverage.

### C. Reading the Pollution Exclusion Out of Policy?

A frequent debate in cases is whether allowing personal injury coverage for trespass and nuisance has the effect of reading the pollution exclusion for bodily injury and property damage out of the policy. If this is permitted, so the insurer’s argument goes, an insured could avoid limitations to coverage through the simple artifice of recharacterizing pollution liability claims as actions for personal injury, thereby trumping other limitations to coverage.<sup>69</sup> Courts have held that a personal injury provision cannot serve as the basis for coverage of pollution-related claims that otherwise come within the ambit of the pollution exclusion.<sup>70</sup> While there is a “theoretical possibility that the [personal injury provision], if read standing alone, might provide coverage, ... when read in the context of the entire insurance policy, coverage would contradict the clear

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

<sup>64</sup> *Id.*; see also *National Fire and Indem. Exchange v. Ali & Sons Co.*, 346 Ill.App.3d 107, 803 N.E.2d 636, 639 (2004) (because lessor sued lessee for contaminating only the leased premises, there was no “wrongful entry” coverage since a lessee could not trespass upon premises it leased).

<sup>65</sup> *John Sexton Sand & Gravel Corp. v. Nat’l Union Fire Ins. Co. of Pittsburgh, P.A.*, 2015 WL 8536736, at \*3 (N.D. Ill. December 11, 2015).

<sup>66</sup> *Id.* (emphasis in original).

<sup>67</sup> *Id.*

<sup>68</sup> *Id.*

<sup>69</sup> *Kitsap County*, 964 P.2d at 1182.

<sup>70</sup> *Arrowood*, 2014 WL 4104169, at \*9.

pollution exclusion for damage to real property.”<sup>71</sup> In dealing with unintentional migration of contaminants such as perchloroethylene, *Arrowood* court followed this reasoning:

While the pollution exclusion in the *Arrowood* policy is appended only to the property damage section, the Court does not read the provisions of an insurance policy in a vacuum, but rather considers them in the context of the entire contract. Because D & D’s claim alleges contamination of its property by substances clearly established as pollutants, an insured would have to do a pretzel-twist logically to believe on the one hand that Oxford was not entitled to coverage under the ‘bodily injury’ and ‘property damage’ sections of the policy because coverage is barred by the pollution exclusion, yet on the other hand believe he should receive coverage for the same risk under the personal injury liability coverage afforded by the policy. To do so would “render ... the pollution exclusion a dead appendage to the policy. *Lakeside*, 172 F.3d at 705.”<sup>72</sup>

On the other hand, the insured’s argument is that the pollution exclusion applicable to the property damage and bodily injury provisions would not be read out of the policy.<sup>73</sup> Not every claim for release of pollutants is a trespass, nuisance or interference with use and enjoyment of property, and the exclusion would have viability in cases where the pollution claim against the insured could not be characterized as trespass, nuisance, or other claims for personal injury.<sup>74</sup> In essence, a pollution exclusion clause which, by its terms, applies only to the policy’s property damage and bodily injury provisions, cannot defeat coverage for pollution-related claims that “arguably fall[ ] within the scope of [the policy’s] personal injury coverage.”<sup>75</sup>

<sup>71</sup> *Id.*, citing *Harrow Prods., Inc. v. Liberty Mut. Ins. Co.*, 64 F.3d 1015, 1023 (6th Cir.1995) (applying Michigan law, holding that a policy’s personal injury provision did not cover suit for TCE release because of the pollution exclusion); *Lakeside Non-Ferrous Metals, Inc. v. Hanover Ins. Co.*, 172 F.3d 702, 705–06 (9th Cir.1999) (applying California law, declining to find a duty to defend under an insurance policy’s “personal injury” provision where the underlying suit alleged land and water contamination); *Gregory v. Tennessee Gas Pipeline Co., et al.*, 948 F.2d 203, 207 (5th Cir.1991) (applying Louisiana law, holding that pollution exclusion precluded duty to defend under personal injury provision for suit alleging chemical contamination of lake).

<sup>72</sup> 2014 WL 4104169, at \*9.

<sup>73</sup> *Kitsap*, 964 P.2d at 1182.

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

<sup>75</sup> *Arrowood*, 2014 WL 4104169, at \*8, citing *Pipefitters Welfare Educ. Fund v. Westchester Fire Ins. Co.*, 976 F.2d 1037, 1042 (7th Cir.1992) (applying Illinois law, holding that insurer had a duty to defend plaintiff in underlying suit alleging negligence in connection with a chemical spill under the “other invasion of the right to private occupancy clause”); see also *Scottish Guar. Ins. Co. v. Dwyer*, 19 F.3d 307, 311–12 (7th Cir.1994) (similarly applying Wisconsin law, holding that insurer was obligated to defend insured in suit claiming damages for property damage and ingestion of contaminated water as a result of chemical releases); *City of Delray Beach, Fla. v. Agric. Ins. Co.*, 85 F.3d 1527, 1533–35 (11th Cir.1996) (applying Florida law, holding that, generally, a pollution exclusion that does not expressly apply to a personal injury provision will not bar coverage of environmental contamination, but declining to find a duty to defend because the underlying pollution claim did not fit the definition of any of the provision’s enumerated risks, including “wrongful entry”); *Admiral Indem. Co. v. 899 Plymouth Court Condominium Association*, 2017 WL 345559 (N.D.Ill. Jan. 24, 2017) (“wrongful entry” offense requires the wrongful entry to be committed by the owner, landlord or lessor of the property at issue; thus no coverage here because the insured condominium association was not the owner, landlord or lessor).

## VI. Disparagement

A final key area of dispute in Coverage B matters concerns the interpretation of the following offense: "Oral, written or electronic publication of material that slanders or libels a person or organization or *disparages a person's or organization's goods, products or services.*" The application of this offense presents questions such as whether the policy's disparagement clause refers to the common law tort of product disparagement, which requires pleading and proof of a false statement, or to any statement or opinion that disparages another's goods. Probably the most notorious case, *Travelers Property Casualty Company of America v. Charlotte Russe Holding, Inc.*, 207 Cal. App. 4th 969 (2012), found a potential for coverage in an allegation that the insured retailer sold the manufacturer's premium apparel at closeout prices, thereby damaging the apparel's high-end reputation. However, *Charlotte Russe Holding, Inc.*, was disapproved two years later by the California Supreme Court in *Hartford Casualty Insurance Company v. Swift Distribution, Inc.*, 2014 Cal. Lexis 3765 (2014).

The question presented was whether the phrase "disparages a person's or organization's goods, products or services," construed in the context of the policy, referred to the common law tort of product disparagement, also known as trade libel, or whether it referred generally to any statement or opinion that denigrates another's goods. The distinction is significant because to recover for the tort of product disparagement, the plaintiff typically must plead and prove the defendant made a false statement. Ultimately, the California Supreme Court held in *Swift Distribution, Inc.* that, in order to trigger a duty to defend a disparagement claim under the "personal and advertising injury" coverage of a general liability policy, the plaintiff must show, by express mention or clear implication, that the insured made a false or misleading statement that specifically refers to, and clearly derogates, the plaintiff's products or business.

After *Swift Distribution, Inc.*, the prevailing view is that to trigger the "personal injury" coverage at issue in the disparagement cases, the plaintiff must plead and prove the defendant's statement was not only disparaging but also false. The issue is not without controversy, however. Courts construing similar policy language under the laws of other states have reached inconsistent conclusions. E.g., *Mulberry Square Prod. v. State Farm Fire and Cas.*, 101 F.3d 414, 421 (5th Cir. 1996) (insurer had no duty to defend under business liability policy's coverage for personal injury where counterclaims against insured did not allege that insured "authored some oral or written publication that amounted to trade libel or product disparagement"); *Winklevoss Consultants, Inc. v. Federal Ins. Co.*, 11 F. Supp. 2d 995, 1000 (N.D.Ill. 1998) ("the policy offense of 'disparagement' is not synonymous with common law commercial disparagement"); *PCB Piezotronics, Inc. v. Kistler Instrument Corp.* 1997 WL 800874, at p. \*3 (W.D.N.Y. Dec. 31, 1997)) ("disparage" as used in policy's "advertising injury" coverage did not "refer[ ] exclusively to the common law tort of product disparagement"); *Acme United Corp. v. St. Paul Fire & Marine Ins. Co.*, 214 Fed.Appx. 596, 599 (7th Cir. 2007) (adopting dictionary definitions of "disparage").

**ACCEC**

American College of Coverage and  
Extracontractual Counsel



**2018 ACCEC Annual Meeting**

May 16-18, 2018 | The Westin Chicago River North | Chicago, IL



# SPEAKERS

**Kenneth S. Abraham**  
**University of Virginia School of Law**  
Charlottesville, VA  
*Rules of the Game*



Ken Abraham is one of the nation's leading scholars and teachers in the fields of insurance law and torts. He is a member of the Council of the American Law Institute, he is an Advisor to the ALI's Restatement of the Law of Liability Insurance, and he was an Advisor to the Restatement of Torts (Third). He has been a consulting counsel and an expert witness in dozens of major insurance coverage cases, involving directors and officers liability, environmental cleanup liability, toxic tort, products liability, and property insurance claims. He has also served as an arbitrator in major insurance coverage cases. He is the author of over 60 law review articles and five books. His casebook, *Insurance Law & Regulation* (6th ed. 2015, now co-authored with Daniel Schwarcz), has been used as the principal text in over 100 U.S. law schools.

**Michael F. Aylward**  
**Morrison Mahoney LLP**  
Boston, MA  
*Managing Captive Claims*



Michael F. Aylward is a senior partner in the Boston office of Morrison Mahoney LLP where he chairs the firm's complex insurance claims resolution group. For nearly thirty years, Mr. Aylward has represented insurers and reinsurers in coverage disputes around the country concerning the application of liability insurance policies to commercial claims involving intellectual property disputes, environmental and mass tort claims and construction defect litigation. He also consults frequently on bad faith and ethics disputes and has served as an arbitrator and testified as an expert in various matters involving coverage and reinsurance issues arising out of such claims.

In addition to his trial and appellate practice, Mr. Aylward often testifies as an expert on insurance related-issues. He is also a AAA-certified neutral and has served as a party-appointed arbitrator in a number of large insurance disputes. In addition to his legal practice, Mr. Aylward is a prolific author and speaker on insurance coverage issues. He is a contributing author to several leading insurance treatises, including two chapters in the New Appleman Insurance Law Practice Guide (2008) and a chapter in the 2012 ABA treatise on environmental liability and insurance coverage disputes. He also published an e-newsletter that is circulated each Tuesday to over a thousand claims professional and in-house counsel and is a co-editor of co-editor of the Insurance Law Forum blog that has been ranked among the Top 50 insurance blogs annually since it was founded in 2008.

**William Berk**  
**Berk, Merchant & Sims, PLC**  
Coral Gables, FL  
*Coverage in a Time of Storms*



William Berk is a founding member of Berk, Merchant & Sims, PLC. For nearly thirty (30) years Mr. Berk has represented insurers in coverage, liability and bad faith disputes, and has served as an expert witness.

Over his career, Mr. Berk has tried well over one hundred (100) jury trials and has handled appeals in the state and federal courts.

Mr. Berk has lectured frequently over the past twenty (20) years on such topics as bad faith litigation; insurance coverage law; appraisal; mold damages and coverage; ethics; and Chinese Drywall.

**James W. Bryan**  
**Nexsen Pruet, PLLC**  
Greensboro, NC  
*Emerging Coverage B Claims*



James W. Bryan has been practicing law for 29 years and is a member in the Greensboro, North Carolina office of the Nexsen Pruet law firm. He practices in the area of civil litigation with a concentration in insurance coverage, bad faith litigation, tort litigation, trucking industry defense, commercial litigation, and environmental law. He is a graduate of UNC-Chapel Hill and Wake Forest University School of Law. He has held several leadership positions in the Defense Research Institute, and currently he is a member of DRI's Insurance Law Committee and chair of its First Party Property Subcommittee. Mr. Bryan also is the chair of the Council of the Insurance Law Section of the North Carolina Bar Association and was past president of the Greensboro Bar Association. He is also vice-chair and master of the Guilford Inn of Court.

**Richard Bryan**  
**Jackson & Campbell, PC**  
Washington, DC  
*Rules of the Game*



Rick is the Chair of Jackson & Campbell's Liability Insurance Coverage Practice Group and serves on the Executive Committee of the firm. He began work at Jackson & Campbell in 1980 and has been a Director since 1987.

Rick has represented insurers in insurance coverage disputes for more than 30 years. His practice is concentrated primarily in the area of casualty insurance coverage, focusing on environmental, mass tort, construction defects, and occupational disease coverage disputes.

An alumnus of the National Institute for Trial Advocacy, he has conducted seminars on insurance coverage and trial practice. He authored the following chapter in Thomson West's Law and Practice of Insurance Coverage Litigation: Settlement, Releases, Covenants Not to Sue, Hold Harmless Agreements: The Insurer's Perspective.

Rick is Chair of the Kibwezi Partnership Committee, which provides support for an Education Center in the village of Kibwezi, Kenya and also provides food, clothing, financial and educational support for 37 children in the Kibwezi, Kenya area orphaned by the effect of AIDS.

**Suzan Charlton**  
**Covington & Burling LLP**

Washington, DC

*Are Two Policies Better than One?*



Suzan Charlton, special counsel with Covington & Burling LLP in Washington, DC, represents policyholders in insurance disputes. Her litigation and settlement experience encompass a broad range of losses and liabilities, including food contamination, product recalls, product liabilities (including asbestos), catastrophic property damage, pollution, and more. She has also represented indigent clients and non-profit organizations in their insurance recovery efforts.

Ms. Charlton has been recognized as a “SuperLawyer” in Washington, DC, is a past co-chair of the ABA Litigation Section ICLC’s annual CLE conference, is a managing editor of the ICLC’s website and social media platforms and has held numerous subcommittee leadership positions within the ICLC. She is a frequent author and speaker on myriad insurance topics. She is also the creator of the comic strip Lawtoons.

For more information: <http://www.cov.com/scharlton>

**Robert D. Chesler**  
**Anderson Kill**

Newark, NJ

*15 Cases in 45 Minutes*



Robert D. Chesler is a shareholder in Anderson Kill's Newark office. Mr. Chesler represents policyholders in a broad variety of coverage claims against their insurers and advises companies with respect to their insurance programs. Mr. Chesler is also a member of Anderson Kill's Cyber Insurance Recovery group.

A leading participant in the birth of modern insurance law in the early 1980s, Mr. Chesler has earned the reputation as "The Insurance Guru" for exceptional insurance coverage knowledge, and has emerged as a leader in such new areas of insurance coverage as cyber-Insurance, D&O, IP, privacy and "green" insurance.

Mr. Chesler has served as the attorney of record in more than 30 reported insurance decisions, representing clients including General Electric, Ingersoll-Rand, Westinghouse, Schering, Chrysler, and Unilever, as well as many small businesses including gas stations and dry cleaners. He has received numerous professional accolades, including a top-tier ranking for Insurance Litigation: New Jersey in Chambers USA: American's Leading Lawyers for Business, which dubs him a "top-notch attorney" and "dominant force in coverage disputes." He is also listed in The Legal 500, The Best Lawyers in America, Super Lawyers and Who's Who Legal in the Insurance and Reinsurance section of the publication.

Mr. Chesler is a relentless advocate for his clients in their efforts to obtain coverage from their insurance companies. He has strength in creatively analyzing complex insurance coverage disputes and rapidly driving towards resolution. He has spent his entire career obtaining settlements from insurance companies. He can speak "insurancese" as well as the insurers, and knows how to approach insurance companies, when to talk to them and when to litigate. His depth of experience enables him to distinguish a bad insurance claim from a good one, and understand and implement best strategies for obtaining money for his clients quickly and cost-effectively.

Mr. Chesler taught history at the State University of New York at Purchase and Legal Methods at Harvard University. He currently teaches insurance law at Rutgers Law School. He holds a Ph.D. in history from Princeton University and maintains a scholarly interest in insurance. He is co-author of the seminal article Patterns of Judicial Interpretation of Insurance Coverage for Hazardous Waste Site Liability, 18 Rutgers L.J. 9 (1986), which has been cited by numerous courts, including seven state supreme courts and the Second Circuit, along with dozens of other articles on insurance issues. He is co-author of Insurance Coverage for Intellectual Property and Cyber Insurance Claims, published by Thomas West, and is former co-editor in chief of the Environmental Claims Journal. Mr. Chesler is also co-editor of Coverage, the ABA Insurance Journal. He has chaired seminars on the new cyber-policies and food insurance issues for the ABA and NJSBA, and is currently Chair of the Insurance Sub-Committee of the American Intellectual Property Law Association.

**Lewis F. Collins**  
**Butler Weihmuller Katz Craig, LLP**  
Tampa, FL  
*Comparative Bad Faith: Trends, Tricks, and Traps*



Lewis F. Collins, Jr., is a Partner in the Tampa, Florida office of Butler Weihmuller Katz Craig, LLP. He is Board Certified in Civil Trial Law by both the Florida Bar and the National Board of Trial Advocacy, and is also a Board Certified Civil Pretrial Practice Advocate by the National Board of Civil Pretrial Practice Advocacy. He is a Fellow of the American College of Coverage and Extracontractual Counsel and has also served on the Board of Regents of that organization. He practices primarily in the areas of commercial litigation, bad faith, products liability, drug and medical device litigation, wrongful death, employment law, and professional liability defense. He was named “Lawyer of the Year for Product Liability Litigation, 2015 – Defendants in Tampa, FL.” by Best Lawyers in America.

Mr. Collins has served as the President of: Lawyers for Civil Justice (2009-10), the Federation of Defense & Corporate Counsel (2006-07) and the Florida Defense Lawyers Association (1995-96) and the Federation of Defense & Corporate Counsel Foundation (2015-16). He was a member of the Board of Directors of the Defense Research Institute and was the Dean of the Litigation Management College at the Kellogg School of Management, Northwestern University (2001 - 2002).

Mr. Collins is an “AV” rated Preeminent Lawyer, a member of ABOTA and is a Master of the American Inns of Court. In 1997, he received the Florida Defense Lawyers Presidential Achievement Award and the 1996 DRI Exceptional Performance Award. Mr. Collins was recognized as a “Leading Florida Attorney” in the field of Products Liability Defense by Leading American Attorneys, a “Florida Super Lawyer”, selected as one of the The Best Lawyers in America, Product Liability Litigation - Defendants and was also chosen one of “Tampa Bay’s Top Lawyers” by his peers.

Mr. Collins received his Bachelor of Science Degree from Florida State University in 1975 and his Juris Doctor from Loyola University, New Orleans, in 1978.

**Mitchell F. Dolin**  
**Covington & Burling LLP**

Washington, DC

*The Legacy of Level 3 More than 15 Years Later*



Mitchell Dolin co-chairs Covington’s insurance recovery practice and has practiced in this field for more than thirty years. Ranked by Chambers USA as one of the nation’s top dozen or so policyholder lawyers for each of the past several years, his advocacy work has taken place in trial and appellate courts across the country, domestic and international arbitral proceedings, and numerous high-stakes mediations. In the insurance field, he has been lead counsel to corporate policyholders pursuing general liability, D&O, E&O, and other lines of coverage for a wide array of underlying liabilities, including antitrust, employment, environmental, intellectual property, mass tort, professional services, and shareholder claims, as well as for first-party property, business interruption, cargo, and event cancellation losses. Mr. Dolin, who for several years chaired the firm’s arbitration practice group, has served as an advocate and arbitrator in numerous domestic and international arbitrations and has litigated arbitration-related questions in the courts. He has published and lectured on many arbitration, insurance, and litigation topics and is a member of the American Law Institute and a fellow of the American Bar Foundation.

**Joseph G. Finnerty III**  
**DLA Piper LLP**  
New York, NY  
*Transactional Liability Insurance*



Joseph G. Finnerty III is a litigation partner at DLA Piper US LLP who served as Chairman of the firm's New York Litigation Practice Group for eight years, and Vice Chairman of the firm's US Litigation Practice Group for seven.

Joe concentrates his commercial litigation practice in business litigation and counselling and dispute resolution for leading insurance companies worldwide. Joe has been focused most recently upon representing M&A transaction liability insurers in disputes arising under representations and warranties insurance and litigation risk insurance, including managing, quantifying and resolving pre-dispute insurance claims for alleged losses arising out of M&A transactions. Joe also regularly litigates non-insurance M&A, fiduciary duty, fraud and securities law claims for public and private companies and their management.

Joe has also successfully represented an array of liability insurers in claims seeking insurance to cover disgorgement and restitution remedies, including obtaining a final judgment for the largest insurer of investment banks in litigation claims seeking coverage for more than US\$300 million in SEC disgorgement and penalty orders. Joe has now represented leading transaction liability insurers in more than 20 different M&A transaction insurance claims.

Joe also led the successful defense of one of the world's largest insurance brokers in a consolidated class action MDL proceeding alleging the unlawful sale of cell phone replacement insurance and seeking the disgorgement of insurance premiums in excess of US\$500 million. He also led the successful defense and dismissal of two separate Alien Tort Claims Act class actions against Sheikh Mohammed bin Rashid Al Maktoum, the Ruler of Dubai.

More broadly, Joe's insurance practice includes litigation, investigations and counselling in connection with private equity management liability insurance, directors and officers liability insurance, alternative risk transfer products, captive insurance programs, professional liability, business interruption insurance, manuscript new product coverages, and, of course, transaction liability insurance (including representations and warranties, litigation risk and tax opinion insurance). Joe has represented the industry's leading liability insurance businesses, including Berkshire Hathaway, AIG, Munich Re, Chubb, Ironshore, Euclid, Zurich, St. Paul Travelers, CNA, AXIS, The Hartford, and Beazley, as well as an array of Lloyd's syndicates and London underwriters, among many others.

**Laura A. Foggan**  
**Crowell & Moring LLP**  
Washington, DC  
*Emerging Coverage B Claims*



Laura A. Foggan is a partner in Crowell & Moring's Washington, D.C. office, where she is a member of the firm's Insurance/Reinsurance Group. She is described by LawDragon 500 Magazine as "one of the most successful advocates for the insurance industry to ever practice" and recently was named Washington DC Insurance "Lawyer of the Year" by Best Lawyers (2017). Ms. Foggan's practice includes counseling insurers and reinsurers on strategic opportunities, litigation trends and emerging risks such as drones and autonomous vehicles, privacy and cyber-liability, global warming (climate change), additive ("3D") printing, IoT and utilization of blockchain. She regularly represents insurers in state and federal courts in a wide range of complex insurance litigation, such as coverage disputes involving environmental and toxic tort claims, construction, products liability, and privacy and cyber claims, among others. She has participated in more than 200 appellate cases including key national precedents on insurance issues. Ms. Foggan also possesses significant experience representing insurer trade groups on a wide variety of issues affecting the business of insurance. Currently, she is serving as the insurance industry liaison to the American Law Institute's Restatement of the Law, Liability Insurance, giving voice to insurer concerns with the project's drafts.

**Marialuisa S. Gallozzi**  
**Covington & Burling LLP**

Washington, DC

*Ethical Issues Arising out of Sharing Information*



Marialuisa Gallozzi represents policyholders in resolving complex and high value insurance coverage matters. She also provides strategic advice to policyholders about their insurance assets. She is also one of the leads for Covington's Strategic Risk and Crisis Management initiative, which helps companies manage product recall and other crises, plan for crisis events and conduct simulations.

Over the past 25 years, Ms. Gallozzi has negotiated well over 100 insurance settlements with domestic, foreign and insolvent insurers involving coverage for asbestos, implantable medical device, food contamination, environmental, D&O and other liabilities. She also has represented policyholders, in numerous first-party claims including those involving earthquake, September 11, flood, collapse, hurricane and crime/employee dishonesty losses. Ms. Gallozzi advises nonprofit organizations on a wide range of coverage matters, has extensive experience with claims against state guaranty funds and in insurer insolvencies, and advises companies on insurance rights and assets in corporate transactions.

Ms. Gallozzi chairs Covington's Evaluation Committee. She has maintained an active pro bono practice throughout her legal career and currently represents D.C. Appleseed.

Ms. Gallozzi has lectured extensively on insurance in CLE programs and at law schools, including American University, Washington College of Law, the University of Virginia School of Law and the University of Connecticut School of Law.

**David B. Goodwin**  
**Covington & Burling LLP**  
San Francisco, CA  
*Managing Captive Claims*



David Goodwin is partner in the San Francisco office of Covington & Burling LLP and a member of Covington's Insurance Coverage, Arbitration, and Appellate practice groups.

Mr. Goodwin has more than 30 years of experience representing corporate policyholders in insurance coverage disputes and litigation, his practice runs the gamut of insurance issues, including major property damage and business interruption losses, errors and omissions, fidelity, crime, financial guarantee, and director and officer claims, offshore, and onshore construction insurance disputes, and marine, products liability and environmental insurance matters. Mr. Goodwin has served as a party arbitrator in numerous insurance arbitrations. He also is a highly experienced appellate advocate who has argued more than 50 appeals.

Mr. Goodwin has a J.D. from Stanford Law School and a B.A. and M.A. from Oxford University. He has served as an adjunct professor at The University of California at Berkeley Law School, where he taught courses on insurance law.

**Christine Haskett**  
**Covington & Burling LLP**  
San Francisco, CA  
*Comparative Bad Faith: Trends, Tricks, and Traps*



Christine Haskett represents global companies in complex coverage disputes with their insurers. Ms. Haskett's practice encompasses disputes involving property and business interruption insurance, asbestos liabilities, product liability claims, construction claims, and D&O insurance.

Ms. Haskett represents companies in a wide range of industries, and she has particular expertise within the chemical, oil, and manufacturing industries and with cases involving technologies that leverage her Chemical Engineering background.

**Scott C. Hecht**  
**Stinson Leonard Street LLP**  
Kansas City, MO  
*Are Two Policies Better Than One?*



Scott Hecht is the leader of the firm's Insurance litigation practice group. He advises clients about insurance issues and litigates insurance and employee benefits disputes. Executive liability insurance policies (Directors & Officers, Errors & Omissions, Employment Practices, and Fiduciary) and Property/Business Interruption policies are Scott's primary focus, but he also has substantial experience handling matters involving general liability insurance, pollution liability insurance, title insurance, cyber insurance, and fidelity bonds.

Scott's insurance practice has given him the opportunity to assist clients in managing catastrophes, both man-made and natural. Scott also has substantial experience defending ERISA claims involving both pension and welfare benefit plans. Those claims include claims for benefits, breach of fiduciary duty and retaliation/interference, as well as all manner of litigation concerning the structure, administration and funding of employee benefit plans. Scott has ample class action experience having served as lead counsel in the defense of both ERISA and insurance-related class actions. He has litigated cases in federal judicial districts throughout the Midwest and defended appeals in the United States Courts of Appeals for the Seventh, Eighth and Tenth Circuits. Scott is a Fellow in the American College of Coverage and Extracontractual Counsel (ACCEC).

**Ronald L. Kammer**  
**Hinshaw & Culbertson LLP**  
Coral Gables, FL  
*Are Two Policies Better Than One?*



Ronald Kammer focuses on the representation of insurers nationally. He has been involved in many significant third party coverage disputes including cases that interpreted an insurance company's duty to defend and indemnify, breach of policy conditions, claims involving bad faith and unfair and deceptive trade practices, as well as coverage obligations for construction defect, pollution, trademark and patent infringement claims.

Mr. Kammer also handles first party coverage disputes, including claims involving breach of policy warrants, business interruption, misrepresentation and fraud. He regularly provides advice to insurance carriers and policyholders on issues involving policy interpretation, claims handling practice and procedures, and the drafting of insurance policy provisions. Mr. Kammer also practices in general civil litigation including commercial litigation and legal malpractice.

He has tried cases and handled appeals involving bad faith as well as first and third party insurance coverage disputes including property, commercial general liability, excess and umbrella, professional lines, commercial and personal automobile, homeowners, fidelity bond and life insurance. In addition, Mr. Kammer has served as an expert in legal malpractice, insurance coverage, bad faith and attorney fee disputes.

Mr. Kammer is the Partner-in-Charge of Hinshaw & Culbertson LLP's Miami office. He is the National Business Unit Leader of the firm's Insurance Practice and a past Business Development Partner and Regional Director for the firm.

**Jill Kerxton**  
**Aon Transaction Solutions**  
Washington, DC  
*Transactional Liability Insurance*



Jill is a Managing Director of Aon Transaction Solutions. Jill has worked in the tax and transactional insurance business throughout her career. Prior to joining Aon in 2013, Jill enjoyed a twenty-year legal career where she was a partner at firms, including Mintz Levin and predecessors of DLA Piper and Katten Muchin Rosenman. As co-leader of the Financial Risks Practice, Jill became a nationally recognized expert in the insurance of financial and transactional risks, such as M&A insurance, insurance programs covering tax and regulatory risks, litigation buyouts, environmental insurance and credit enhancements and played an instrumental role in the development of Tax insurance, R&W Insurance and other transactional insurance products. Jill began her career as a tax lawyer and acted as legal counsel to U.S., London and international insurers, many of which regularly underwrite financial risks. Today, she advises clients purchasing such insurance programs.

**Robert A. Kole**  
**Choate Hall & Stewart LLP**  
Boston, MA  
*The Opioid Epidemic*



Rob Kole is a partner in the firm's Insurance & Reinsurance Group. He has argued before the U.S. Court of Appeals for the First, Second, Fifth, Ninth and Eleventh Circuits in connection with insurance and reinsurance disputes. He is recognized in The Legal 500 as a leading lawyer for Insurance and has been elected to the World's Leading Insurance and Reinsurance Lawyers by Who's Who's Legal. In April 2010, he was named one of 10 "Insurance Law Rising Legal Stars Under 40" by Law360, and he has been named a Massachusetts Super Lawyer in each of the past 8 years.

**Seth D. Lamden**  
**Neal, Gerber & Eisenberg LLP**  
Chicago, IL  
*Emerging Coverage B Claims*



Seth D. Lamden is a partner in Neal, Gerber & Eisenberg LLP's Insurance Policyholder Practice Group. He concentrates his legal practice on assisting policyholders understand and enforce their rights to insurance coverage and has helped policyholders recover hundreds of millions of dollars in insurance proceeds from a broad array of industries, including construction, utilities, manufacturing, professional services, financial services, and managed care. Seth is a Fellow of the American College of Coverage and Extracontractual Counsel and serves as the Chair of the Self-Insurance and Risk Management Committee, Tort Trial & Insurance Practice Section (TIPS) of the ABA and as a Vice Chair of TIPS' Insurance Coverage Litigation Committee. He also serves as the chair of the Illinois Association of Defense Trial Counsel's Insurance Law Committee and is a member of the IDC's Board of Directors. Seth is the Executive Editor of the International Risk Management Institute, Inc.'s CGL Reporter and has written nine book chapters and more than 50 articles on topics relating to insurance coverage. He maintains a Martindale-Hubbell AV Preeminent™ rating and is listed in the area of insurance coverage in The Best Lawyers in America, Illinois Super Lawyers, and Leading Lawyers Network.

**Anthony B. Leuin**  
**Shartsis Friese LLP**  
San Francisco, CA  
*15 Cases in 45 Minutes*



Tony Leuin is a senior litigation partner at Shartsis Friese LLP in San Francisco. With over 35 years of experience, he has a broad background in civil disputes of all types, with particular concentration in insurance coverage. He represents policyholders in complex disputes involving commercial insurance policies, such as CGL, Directors and Officers, Errors and Omissions, Employment Practices, property, fidelity and crime policies, surety bonds, and newer products such as cyber coverages and “reps and warranties” insurance to facilitate mergers and acquisitions. Tony’s clients include public and private companies who reflect the diversity of American business, from retailing to real estate, medicine to manufacturing, financial services to food and wine.

Tony is a Contributing Editor to California’s leading treatise on insurance coverage, The Rutter Group’s California Practice Guide: Insurance Litigation. He is a long-time member of the Insurance Coverage Litigation Committee of the ABA’s Litigation Section, where he has been a frequent speaker at its annual conference, co-chaired the Construction Litigation sub-committee, and served as Website Managing Editor. He is also a member of the Insurance Coverage Section of the ABA’s Forum on the Construction Industry.

Tony sits on the Board of Directors and Executive Committee, and Chairs the Claims Committee, of Pilot/Legis, a Risk Purchasing Group composed of approximately 40 law firms (comprising approximately 1800 lawyers) who purchase Professional Liability cover in the London Market. As a consequence of this work, he has a unique window into Professional Liability insurance, including not only coverage disputes, but also policy drafting and claims handling practices.

**R. Hugh Lumpkin**  
**Ver Ploeg & Lumpkin**  
Miami, FL  
*The Opioid Epidemic*



Hugh Lumpkin was born in San Tomé, Venezuela, eventually making his home in Miami, Florida. He received his undergraduate degree from Duke University in 1977 and his law degree from the University of Miami in 1980. Since 1983, a substantial portion of his practice included representing both insurers and insureds in coverage and collateral litigation; a focus which became exclusive to policy holder representation beginning in 1999.

In 1999, Hugh made the decision to limit his practice to insurance consulting, litigation, trials and appeals and joined Brenton Ver Ploeg in forming the current firm. Ver Ploeg & Lumpkin, P.A. now employs over fifty people, including 27 attorneys in two Florida offices (Miami and Orlando), limiting its practice to policyholder insurance work, including extracontractual recoveries – a practice which is now national in both scope and reputation.

Mr. Lumpkin earned his AV rating from Martindale in 1994, has been honored as a SuperLawyer since 2006, a Best Lawyer since 2010, was recognized as the top insurance lawyer in Miami in 2013 and 2016, and has been repeatedly recognized by the South Florida Legal Guide and Florida Trend as one of the best lawyers in Florida for insurance coverage and bad faith litigation on the policyholder side of the versus. He was appointed to the American Academy of Contractual and Extra-contractual Counsel in 2014, where he now serves as co-chair of the first party insurance section. He has written and lectured extensively on a variety of topics; not limited to insurance, though the majority of his published and teaching work for the past twenty years has concerned insurance coverage and litigation

**Michael L. Manire**  
**Manire & Galla LLP**

New York, NY

*The Legacy of Level 3 More Than 15 Years Later*



Mike Manire's practice has focused on insurance since 1993, when he joined D'Amato & Lynch. He founded his new firm, Manire & Galla LLP, with a colleague in 2015. Mr. Manire has represented global D&O, E&O and professional liability insurers in connection with complex claims on policies issued both in the U.S. and abroad. He has represented insurers in coverage and bad faith litigation, but his 20 years of experience in dispute resolution and mediation has led him to a particular interest and expertise in exploring and reaching resolution. Mr. Manire has participated in settlements of both coverage and underlying liability issues in hundreds of matters, including securities fraud class actions, shareholder derivative actions, creditors' committee and bankruptcy trustee claims, breach of fiduciary duty claims, consumer class actions, employment liability actions, bankers' and investor advisors' liability claims, media and intellectual property claims, and a variety of other professional and management negligence claims.

**Lorelie S. Masters**  
**Hunton Andrews Kurth LLP**  
Washington, DC  
*Rules of the Game*



Lorie is a nationally recognized insurance coverage lawyer who has tried major insurance coverage cases and recovered over the years more than \$1,000,000,000 for clients. She has written two legal treatises in her practice area and one, on international arbitration of insurance disputes won the 2012 Book Prize by the British Insurance Law Association. In 2012, she co-founded the American College of Coverage and Extra-Contractual Counsel, and served as its second President in 2014-2015. Lorie was a co-founder of the American College of Coverage and Extracontractual Counsel and served as its second President in 2014-2015. She currently serves on the Board of Governors of the American Bar Association.

Lorie has been very active in a variety of other bar associations. In the ABA, she served on the Commission on Women in the Profession from 2009-2012, and was key to production of the Commission's 2012 report, *Visible Invisibility: Women of Color in Fortune 500 Legal Departments*. In 2007 and 2008, she helped raised funding for the Commission's Women of Color Research Initiative. She served on the ABA's Gender Equity Task Force from 2012-2015. She has been active in the Section of Litigation's Leadership since 2000, serving as its Publications and Content Officer (2013-2015), on the Council (2010-2013), and chairing various other committees, including its very successful Insurance Coverage Litigation Committee (2000-2003). As President of DC's Women' Bar Association from 2007-2008, Lorie organized the WBA's Diversity Summit, and used its findings to write the WBA report, *Creating Pathways to Success for All*. She helped found the WBA's Centennial Committee to celebrate its first 100 years (in May 2017) and secure its next 100.

She also does extensive pro bono work on both DC and other voting rights issues and representing individuals, including victims of human trafficking. She serves on the Board of the DC Bar Foundation, the largest funder of legal services providers in the DC area. She has helped found two NGOs, the Human Trafficking Pro Bono Legal Center and Saving America's Veterans (formerly the National Capital Area Veterans Service Foundation). She has worked for years on efforts to gain greater political autonomy and voting rights in Congress for those who call DC home. With that background, she decided to run as a candidate in 2014 in the first election ever for DC's Attorney General, finishing third in a crowded field.

**Doug McIntosh**  
**McIntosh Sawran & Cartaya, P.A.**

Fort Lauderdale, FL

*Comparative Bad Faith: Trends, Tricks, and Traps*



Douglas M. McIntosh founded the firm in 1989. He has handled a broad range of personal injury, product liability, commercial and professional negligence litigation, including legal, dental and medical malpractice defense, product liability and insurance coverage litigation. He has had the opportunity to counsel insurance companies on bad faith, professional errors and omissions, general liability and all-risk policies of insurance and focuses his practice predominantly on catastrophic damages and insurance coverage matters. He developed the Healthcare Law Practice Division and the Insurance Coverage Division in the firm. He has served as a testifying expert in state and federal courts in bad faith, primary, excess and reinsurance law cases. He has served on the Board of Directors and is a past president of the Florida Defense Lawyers Association (FDLA), a one-thousand member organization of the civil defense bar of this state. He has been awarded this organization's highest achievement award for his efforts for the defense bar statewide and nationally. Mr. McIntosh is an elected member of the International Association of Defense Counsel (IADC) and serves on its professional liability, medical malpractice and admiralty law committees.

He is an elected member of the Association of Defense Trial Attorneys (ADTA). Mr. McIntosh is also an active member of DRI, The Voice of the Defense Bar, and served for five years as the appointed Florida statewide representative to this national organization. He was elected as a National Director on its Board of Directors and served a three year term. Mr. McIntosh has served on numerous DRI committees, and chaired its insurance roundtable in 2009. He has served as chairperson of the Broward County Bar Association Professionalism Committee for many years and has chaired the Peer Review Council. He was awarded the BCBA Lynn Futch Professionalism in Practice Award in 2004, and the St. Thomas More Society Archbishop McCarthy Award in 2006. He has lectured to state leaders around the country on substantive and defense trial practice issues. Mr. McIntosh is a member of the Board of Governors of the Shepard Broad Law Center of Nova University. He is also an invited member of the Council on Litigation Management, a nonpartisan alliance of insurance companies, corporations, corporate counsel, litigation and risk managers, claims professionals and outside counsel.

He is admitted to practice in the state and federal courts in Florida and is admitted to practice before the United States Supreme Court. Mr. McIntosh helped found Hope Outreach Center, Inc., a community outreach program in Broward County (Florida) and served as its president for many years. He has also served as a member to Florida Supreme Court-appointed committees, and received an award from the Florida Supreme Court as a guardian ad litem for children in Broward County. Mr. McIntosh has been awarded a Peer Review Rating of "AV" by the LexisNexis Martindale-Hubbell Law Directory. He has also been voted by his peers for inclusion in Best Lawyers in America, the oldest and one of the most respected publications in the legal profession. He has been named a South Florida "Top Lawyer" and a "Super Lawyer" by peer publication reviews. Mr. McIntosh has authored numerous articles, published chapters on defense techniques for major publishers and has lectured frequently on a variety of topics,

including trial techniques, bad faith and insurance coverage in Florida and law firm economics and business practices. Mr. McIntosh is a state qualified arbitrator and has served as selected mediator, panel and sole arbitrator, in a number of matters.

**Suzanne C. Midlige**  
**Coughlin Duffy LLP**  
Morristown, NJ  
*15 Cases in 45 Minutes*



Suzanne Cocco Midlige is the Managing Partner and a founding member of Coughlin Duffy and a member of the Insurance and Reinsurance Services Group. Prior to election to Managing Partner, Suzanne served as the Practice Group Leader for the Insurance and Reinsurance Services Group. Suzanne's practice focuses on the representation of domestic and international insurers in litigated and non-litigated matters. She regularly represents multi-national insurers in asbestos coverage disputes, including the area of asbestos bankruptcy litigation. In addition, she is lead counsel for insurers in multiple insurance coverage disputes relating to contamination of Lower Passaic River and disputes involving non-traditional form of environmental contamination. Suzanne also represents insurers in disputes relating to professional liability, financial institutions and director & officer dispute

**Barbara J. Miller**  
**Wells Fargo & Company**  
Minneapolis, MN  
*Managing Captive Claims*



Barbara Miller is the Claims Manager for Wells Fargo & Company and its captive insurer, Superior Guaranty Insurance Company. She is accountable for the management of property, general liability, management liability, cyber and fidelity claims and losses incurred by Wells Fargo and its businesses. Barbara began her insurance career with Travelers Insurance. She joined Wells Fargo, formerly known as Norwest Corporation, in 1997. She obtained a law degree from William Mitchell College of Law in St. Paul, Minnesota, graduating Cum Laude. Previously, she obtained a Bachelor of Business Administration degree from Iowa State University in Ames, Iowa.

**J. W. Montgomery, III**  
**Jones Day**  
Pittsburgh, PA  
*Rules of the Game*



Jack Montgomery's practice focuses exclusively on insurance coverage advice, litigation, and arbitration. He handles insurance coverage litigation in various jurisdictions and national and international insurance arbitrations.

Notable cases include *Koppers Co., Inc. v. Aetna* (1996) (affirming a \$70 million jury verdict against Lloyd's and London companies, subject to a deduction for "share" of settling insurers); *Occidental Chemical Corp. v. Hartford* (the "Love Canal" insurance coverage dispute); *Motorola v. Associated Indem. Corp.* (2004) (requiring third-party liability insurers to defend class actions seeking the costs of headsets for cell phone users); *PepsiCo, Inc. v. Winterthur Int'l America Ins. Co.* (2004) (limiting the scope of a seepage/pollution/contamination exclusion in first-party insurance to environmental damage and not to product contamination); and *PepsiCo, Inc. v. Winterthur Int'l America Ins. Co.* (2005) (holding that lack of merchantability of a product constitutes "physical damage to tangible property"). Prior to joining Jones Day, Jack was lead counsel in *Joy Technologies, Inc. v. Liberty Mut. Ins. Co.* (1992) (applying "regulatory estoppel" to bar application of the so-called "pollution exclusion").

As lead counsel, Jack recently tried to conclusion three insurance arbitrations, two in London and one in the United States. He is also representing Transocean in connection with the Deepwater Horizon/Macondo well incident insurance issues. Other representative clients include Occidental Petroleum, Occidental Chemical, GE, GM, Motorola Solutions, PepsiCo, Macy's, and Air Products and Chemicals among others.

Jack regularly serves as an arbitrator in London-based, Bermuda-based, and domestic insurance arbitrations. For 24 years, he has been an adjunct professor at the University of Pittsburgh School of Law, teaching substantive courses on insurance law.

**Barbara A. O'Donnell**  
**Sulloway & Hollis, P.L.L.C.**

Providence, RI

*Comparative Bad Faith: Trends, Tricks, and Traps*



Barbara O'Donnell has more than 20 years of experience in matters of insurance coverage, extra contractual liability, insurance agent/broker liability, employment, and professional liability law.

Ms. O'Donnell's practice is regional, and she has handled matters in several state and federal courts and before administrative and arbitration tribunals.

Ms. O'Donnell's insurance coverage practice includes the resolution and litigation of a broad range of liability coverage issues under commercial, specialty lines, professional, directors and officers, employment practices, and other standard form and manuscript policies. She regularly advises and represents insurers in complex coverage disputes involving allocation issues, primary/excess obligations, advertising injury coverage, additional and other insured questions, application misrepresentation defenses, and the application of exclusions under claims made and occurrence based policies. Ms. O'Donnell also counsels insurers concerning claims handling obligations and effective ways to minimize exposure to extra contractual liability claims.

Drawing on the breadth of her insurance coverage and industry experience, Ms. O'Donnell also drafts policy forms and endorsements for insurers. Ms. O'Donnell also prepares and presents custom tailored training programs for insurance professional on claims handling best practices and insurance coverage obligations and defenses to assist clients in avoiding costly coverage disputes.

Ms. O'Donnell's professional liability practice includes the representation of insurance agent/brokers against claims alleging the failure to procure requested or appropriate coverages. In defending agent/brokers against these claims, Ms. O'Donnell often draws upon her insurance coverage experience to establish that the agent/broker's conduct did not cause the alleged loss in any event.

In her employment law practice, Ms. O'Donnell counsels employers about effective ways to minimize liability exposure under the expanding array of state and federal laws governing employee/employer relations. Ms. O'Donnell regularly negotiates and prepares agreements to resolve disputes, including separation, nondisclosure, and settlement agreements.

Ms. O'Donnell holds leadership positions in national bar organizations and industry organizations. She is a past chair of the ABA/TIPS Insurance Coverage Litigation Committee and the Extra Contractual Liability Section of the Federation of Defense and Corporate Counsel ("FDCC"). She currently serves as a Vice Chair of the FDCC's Reinsurance, Excess and Surplus Insurance Section. Ms. O'Donnell is a member of the ABA/TIPS Book Publishing Board and the ABA Standing Committee on Publishing Oversight. She is a past editor of TortSource, an ABA/TIPS publication, and also served for several years on the editorial board of the ABA/TIPS Tort Trial and Insurance Practice Law Journal. For over ten years, Ms. O'Donnell

served as the articles editor for The CGL Reporter, a biannual International Risk Management Institute publication.

Drawing upon her expertise in complex insurance coverage and bad faith disputes, Ms. O'Donnell serves on the faculty of the Federation of Defense and Corporate Counsel's Graduate Litigation Management Program attended by senior level corporate and insurance industry litigation management professionals. She has also been appointed to the American Arbitration Association's Complex Coverage Neutral Evaluation panel. Ms. O'Donnell has also been recognized as one of the leading insurance coverage attorneys in the Massachusetts and Corporate Counsel Super Lawyers in each of the past nine years.

Ms. O'Donnell frequently writes and speaks on insurance coverage topics. In March 2012, she spoke at DRI's Insurance Coverage Claims Institute on the topic "Defenses To Bad Faith Actions: Do They Exist And Do They Work" and moderated a panel discussion on "Multiple Claimants and Insufficient Limits- Can Insurers Lessen their Exposure to Bad Faith Claims" at the Federation of Defense and Corporate Counsel Winter Meeting. She authored the opening chapter on "Insurance Policy Interpretation and Construction" in the West Group/American Bar Association (ABA) treatise entitled The Law and Practice of Insurance Coverage Litigation. Ms. O'Donnell's article entitled "The First Wave of Decisions Interpreting Employment Practices Liability Policies" appeared in the Fall 2005 issue of The Brief, an ABA Tort and Insurance Practice Section (TIPS) publication.

**Sherilyn Pastor**  
**McCarter & English**

Newark, NJ

*Coverage in a Time of Storms*



Recognized as a leader in her field by Chambers USA and as one of New Jersey's "Best 50 Women in Business" by NJBIZ, Sherilyn Pastor is Practice Group Leader of McCarter and English's Insurance Coverage Group and a member of the firm's Executive Committee. She provides legal assistance to corporate policyholders and has secured hundreds of millions of dollars in insurance assets for a broad range of policyholder clients. She litigates complex coverage matters throughout the country and provides advice to clients assessing their potential risks, analyzing new insurance products and considering the adequacy of their programs. Ms. Pastor holds the AV Preeminent Rating from Martindale-Hubbell, its highest rating for ethics and legal ability. She has been recognized in The International Who's Who of Insurance & Reinsurance, and she has been honored as a New Jersey Super Lawyer since 2006.

Ms. Pastor is, for example, Transamerica Corporation's lead trial counsel in a dispute with a former subsidiary regarding insurance Transamerica purchased as part of a consolidated risk management structure for itself and its subsidiaries. After a several month trial for this large, multi-national corporate policyholder, Ms. Pastor secured a favorable ruling that Transamerica had no implied contract with the former subsidiary by virtue of its consolidated risk management approach. In addition to soundly rejecting the former subsidiary's claims, the trial court granted Transamerica's request for declaratory relief against the subsidiary.

Ms. Pastor also obtained summary judgment awarding Wakefern Food Corporation insurance for all its 2003 Northeast blackout losses. She assisted Lucent Technologies Inc. (now Alcatel Lucent) to recover its fiduciary liability coverage following various class action settlements with ERISA plaintiffs.

Ms. Pastor is Chair (policyholder side) of the ABA Section of Litigation, Insurance Coverage Litigation Committee. She was the Vice-Chair of the ICLC from 2009 to 2012, and has been co-chair of various ICLC subcommittees since 2002. Ms. Pastor serves on the Editorial Boards of the Insurance Coverage Law Bulletin, and is a consultant on the New Appleman Insurance Law Practice Guide. She is a member of the International Center for Conflict Prevention & Resolution's Director & Officer Liability Insurance Committee and its Insurance Neutrals Review Committee. Ms. Pastor also is a member of the New Jersey Supreme Court's Professional Responsibility Rules Committee. Ms. Pastor publishes and lectures frequently on insurance, trial skills and ethics matters.

**Neil Posner**  
**Much Shelist**

Chicago, IL

*Ethical Issues Arising Out of Sharing Information*



Neil Posner successfully counsels his clients on the complexities of buying and maintaining insurance, and using insurance as part of an overall risk-management program. Chair of the firm's Policyholders' Insurance Coverage group, Neil focuses on insurance recovery and dispute resolution, risk management, loss prevention and cost containment. His clients include public and private companies, organizations, boards of directors, individual officers and other policyholders. Neil assists clients in analyzing, negotiating and enhancing a wide range of insurance policies and plans, including Directors' and Officers' Liability, Errors and Omissions/Professional Liability, Employment Practices Liability, Fiduciary Liability, Bankers Professional Liability and Financial Institution Bonds, Cyber Liability, E-Commerce, and Privacy Risks, Commercial Property, Intellectual Property Insurance, Construction Insurance, and Transportation, Transportation Broker, and Contingent Cargo Liability.

In addition to counseling clients with regard to ongoing and future insurance requirements, Neil helps policyholders resolve all types of insurance coverage disputes, through negotiation, litigation and other forms of dispute resolution, including mediation, arbitration and settlement. He has successfully obtained insurance coverage for defendants involved in a variety of class actions and other complex lawsuits. For example, when the former CEO of a bankrupt Chicago-area public company was named in a shareholder class action brought by the bankruptcy estate — alleging securities fraud and breach of fiduciary duty, and seeking to recover damage claims totaling nearly \$400 million — Neil helped his client obtain effective insurance coverage.

Neil also practices extensively in the area of lawyer's professional liability, which includes counseling lawyers and law firms on professional responsibility and ethics matters. He has served as an expert witness in this area, and speaks and writes extensively on the subject. Neil is admitted to practice in Illinois and Wisconsin, the United States District Courts for the Northern District of Illinois and the Eastern District of Wisconsin, and the United States Tax Court.

**Neil Rabin**  
**Drinker Biddle**

Dallas, TX

*Coverage in a Time of Storms*



W. Neil Rabin represents clients in complex commercial insurance litigation, insurance coverage disputes, extra-contractual claims and disputes between insurance and reinsurance companies. With more than 35 years of experience, he has litigated a wide variety of claims and disputes that have arisen from general liability, professional liability, property, marine, aviation, workers' compensation, fidelity, automobile, excess liability, umbrella and surplus policies. Since January 1, 2016, he and/or his team have tried eleven first party property cases to a jury verdict, obtaining a complete defense verdict of no-liability in ten of those cases. In addition to Texas, he has litigated matters in California, Oregon, New Mexico, Ohio, Kentucky, West Virginia and Massachusetts.

Neil also counsels insurers and reinsurers on their coverage obligations and the avoidance of bad faith claims, as well as reinsured and reinsurers in matters arising out of reinsurance agreements.

**Doug Richmond**  
**Aon Professional Services**

Olathe, KS

*Ethical Issues Arising out of Sharing Information;*  
*Comparative Bad Faith: Trends, Tricks, and Traps*



Doug Richmond is Managing Director of Aon's Professional Services Group. Aon's Professional Services Group is the world's leading broker of insurance for law firms. Doug consults with Aon's 295 law firm clients on professional responsibility and liability issues, and additionally leads Aon's loss prevention efforts for all professions.

Before joining Aon, Doug was a partner with Armstrong Teasdale LLP in Kansas City, Missouri (1989–2004), where he had a national trial and appellate practice. In his time at Armstrong Teasdale, he tried over 40 major cases as “first chair” and was often engaged to handle appeals of cases tried by other lawyers. In 1998, he was named the nation's top defense lawyer in an insurance industry poll as reported in the publications *Inside Litigation* and *Of Counsel*. He is a member of the ABA's Standing Committee on Ethics & Professional Responsibility (2016–19). He is also a member of the American Bar Foundation, American Law Institute (ALI), American Board of Trial Advocates (ABOTA), International Association of Defense Counsel (IADC), and Federation of Defense and Corporate Counsel (FDCC). In the ALI, he is an Adviser for the Restatement of the Law of Liability Insurance and the Principles of the Law, Compliance, Enforcement, and Risk Management for Corporations, Nonprofits, and Other Organizations. Doug has also been selected to The Best Lawyers in America in the areas of legal malpractice, personal injury litigation, and railroad law. In 2003, the Euromoney Legal Media Group named him as one of the nation's top insurance and reinsurance lawyers.

Doug is the lead author of the book *Professional Responsibility in Litigation* (2d ed. 2016), and the co-author of an insurance law treatise, *Understanding Insurance Law* (6th ed. 2018) and an insurance law casebook, *Cases and Materials on Insurance Law* (8th ed. 2018). He is also a named editor of the *New Appleman Insurance Law Practice Guide*. He has published more than 60 articles in university law reviews, and many more articles in other scholarly and professional journals. Doug teaches Legal Ethics at the Northwestern University School of Law, and Insurance Law and a seminar on Liability Insurance Law at the University of Florida College of Law. He previously taught Trial Advocacy and Insurance Law at the University of Kansas School of Law, and Insurance Law and a seminar on Damages at the University of Missouri School of Law. Doug is also a regular NITA faculty member, teaching both deposition and trial skills.

Doug earned his J.D. at the University of Kansas, an M. Ed. from the University of Nebraska, and his B.S. from Fort Hays State University.

**Peter K. Rosen**  
**Latham & Watkins**  
Los Angeles, CA  
*Transactional Liability Insurance*



Peter K. Rosen received his Juris Doctorate from the University of Southern California Gould School of Law. He is a partner in the Los Angeles office of Latham & Watkins and is a member of the litigation department. From March, 2013 until February, 2018, he was the Global Chair of the Insurance Coverage Litigation practice. He represents insurance policyholders in matters involving commercial general liability policies, directors' and officers' liability insurance policies, transactional liability insurance policies, environmental insurance, fidelity insurance, professional liability policies, property disputes, and surety bonds. Mr. Rosen was the lead lawyer for the retail leaseholder at the World Trade Center in the massive insurance coverage litigation arising out of the 9/11 attacks. His role in the World Trade Center insurance coverage litigation gained him worldwide recognition. Mr. Rosen's practice also includes counseling boards of directors and senior management on directors' and officers' litigation, corporate governance issues, insurance strategies, indemnification agreements and bylaws. Mr. Rosen is recognized by Chambers USA as a leading insurance policyholder lawyer. Since 2007, Mr. Rosen has taught Insurance Law as well as Corporate Governance at the USC Gould School of Law and is teaching Insurance Law at Pepperdine Law School during the Spring, 2018 semester. Mr. Rosen is as a Fellow of the Chartered Institute of Arbitrators (CIArb), a Fellow of the America College of Coverage and Extracontractual Counsel, a Master Member of the Pepperdine Straus American Inn of Court for Dispute Resolution and a CEDR Accredited Mediator. He also is a Panel Mediator for the United States District Court for the Central District of California, a Panel Mediator for the California Court of Appeal, Second Appellate District, and a mediator and arbitrator for the Los Angeles County Attorney-Client Mediation and Arbitration Service.