CONFERENCE MATERIALS

TABLE OF CONTENTS


American College of Coverage Counsel
2019 Annual Meeting
May 8-10, 2019 | Chicago Athletic Association | Chicago, IL

AGENDA

2019 Annual Meeting Agenda
May 8-10, 2019
Chicago Athletic Association - Chicago, IL

Wednesday, May 8, 2019	
1:00 pm – 4:00 pm *Evers*	**Board Meeting** • Lunch will be buffet-style from 1:00pm to 1:30pm.
6:30 pm – 8:00 pm *Tank*	**Welcome Reception, sponsored by KCIC**

Thursday, May 9, 2019	
7:30 am – 8:30 am *White City Ballroom*	**Breakfast Buffet**
7:30 am – 8:30 am *Evers*	**Committee Chairs Meeting with Executive Committee**
8:30 am –8:45 am *Madison Ballroom*	**Welcome Remarks** • Mary McCutcheon: Farella Braun + Martel LLP; ACCC President • Jim Cooper, Reed Smith LLP; 2019 Annual Meeting Co-chair • Linda Bondi Morrison, Tressler LLP; 2019 Annual Meeting Co-chair *Brief Historical Overview of the Hotel and Announcement Concerning Organized Tours After Lunch*
8:45 am – 9:30 am *Madison Ballroom*	**Emerging Liability & Coverage Issues Arising from the #MeToo Movement** • Nancy Adams, Mintz Levin Cohn Ferris Glovsky & Popeo PC • Jim Murray, Blank Rome LLP • Rebecca Weinreich, Lewis Brisbois *The statutes of limitations for sexual abuse claims are being extended, allowing decades old claims under policies, many of which have been lost or destroyed. These "new" claims against the entities - not the perpetrators - are raising novel coverage issues. In addition, the #MeToo movement continues to spotlight public accusations of public figures. What do these public accusations mean for coverage of claims brought by accusers and the accused?*

9:30 am – 10:15 am *Madison Ballroom*	**Which Came First, the Chicken or the Egg: Ensuing Loss Theory, Debate and Answers or What the Cluck is Covered After All** • *Rick Hammond, HeplerBroom, LLC* • *Tracy Alan Saxe, Saxe Doernberger & Vita* • *Hugh Lumpkin, Ver Ploeg & Lumpkin (moderator)* *This presentation addresses an issue with broad coverage implications for insurer and policyholder alike – what is a covered ensuing loss, when the peril setting other events in motion and ultimately causing harm is itself excluded from coverage. The panel and papers presented will analyze and discuss the tests articulated by courts to ascertain coverage for ensuing loss under commercial property, builder's risk and homeowner's policies, bearing in mind the sharp disagreement reflected by court decisions interpreting insuring text. At bottom, if the chicken is itself excluded as a cause of loss, but the resulting egg breaks, under what circumstances should the insurer bear the cost of restoring the egg to its pre-loss condition?*
10:15 am – 10:30 am	BREAK
10:30 am – 11:20 am *Madison Ballroom*	**You Gotta Have Faith! – Good Faith** • Fred Cunningham, Domnick Cunningham & Whalen • Heather Sanderson, Sanderson Law • John Vishneski, Reed Smith LLP *The elusive good/bad faith line: (1) Liability clear and damages above limits: is tendering policy limits enough? (2) Can insurer refuse to hire experts to defend uninsured exposure? (3) Can insurer refuse to settle weak reputation-harming claims? (4) Defending two insureds: can insurer pay a limits settlement for one?*
11:20 am – 12:05 pm *Madison Ballroom*	**The Meaning of Plain Meaning** • Lorelie Masters, Hunton Andrews Kurth LLP • Jeff Stempel, University of Nevada, Las Vegas • Jeffrey Thomas, University of Missouri - Kansas City *What is "plain meaning"? It appears, like pornography, that many simply "know it when they see it." This panel will consider the meaning of plain meaning using current insurance law doctrine; the Restatement of Law, Liability Insurance; and linguistics, including Corpus Linguistics.*
12:05 pm – 1:05 pm *White City Ballroom*	**Lunch, including Annual Business Meeting**

1:05 pm – 1:30 pm	**Extended Work Break**
1:15 pm – 1:30 pm	**Special Feature** *Small group tours of the Chicago Athletic Association*
1:30 pm – 2:30 pm *Madison Ballroom*	**The Art of Negotiation & Mediation: Are There Ethics in Poker?** • John Bonnie, Weinberg Wheeler Hudgins Gunn & Dial • Neil Posner, Much Shelist, P.C. • Clifford Shapiro, Barnes & Thornburg LLP *At one time, a lawyer's role was to "zealously" advocate, which was often interpreted to allow action at any cost. The notion of the "zealous advocate" was incorporated into the ABA's 1969 Model Code of Professional Responsibility. That all changed in 1983 with the ABA's adoption of the Model Rules of Professional Conduct, which removed the term "zealous advocate" and gave us a system of rules that tell lawyers what we "shall" do, what we "shall not" do, and what we "may" do. This program will explore how far lawyers can and cannot go under the Model Rules in mediations, negotiations, and settlement conferences.*
2:30 pm – 3:15 pm *Madison Ballroom*	**Duty to Defend: The Eight-Corners Rule and Extrinsic Evidence (Does the Wording of the Policy Change the Rules?)** • Mike Huddleston, Munsch Hardt Kopf & Harr, PC • Jodi McDougal, Cozen O'Connor *This panel will examine the well-established rules governing the duty to defend and whether an insurer can contract around them, looking to recent changes to policy language regarding defense in CGL policies. The discussion will include consideration of whether the duty to defend is a creature of contract interpretation or controlled by extrinsic common law principles. For example, does the absence of "even if groundless, false or fraudulent" matter? Is the admissibility of extrinsic evidence to determine the duty to defend affected by policy language? Does it open the door to insurers submitting extrinsic evidence in jurisdictions that allow only the policyholder to trigger a duty with extrinsic evidence?*
3:15 pm – 3:30 pm	Break
3:30 pm – 4:30 pm *Madison Ballroom*	**Allocation—Is That a Thing?—Navigating Disputes Over Allocation Between Covered and Uncovered Claims** • Jim Bryan, Nexsen Pruet, PLLC • Suzan Charlton, Covington & Burling LLP • Frank Cordell, Gordon Tilden Thomas Cordell LLP • Michael Hamilton, Goldberg Segalla *Underlying lawsuits that include both covered and uncovered claims are a recurring source of conflict between insurers and policyholders. This panel*

	will examine various policy forms addressing allocation, the trends in the case law, strategies for insurer and policyholder counsel, and litigation and non-litigation approaches to resolving allocation disputes.
6:00 pm – 6:30 pm *White City Ballroom Foyer*	**New Fellows & First Time Attendees Reception**
6:30 pm – 7:30 pm *White City Ballroom Foyer*	**General Reception**
7:30 pm – 9:00 pm *White City Ballroom*	**Dinner** *Presentation of the Thomas F. Segalla Service Award* *Recognition of New Fellows* *Recognition of winners of the Law School Practical Skills Writing Competition*

Friday, May 10, 2019	
7:30 am – 8:30 am *White City Ballroom*	Breakfast Buffet
8:30 am –9:15 am *Madison Ballroom*	**10 Cases in 45 Minutes** • Robert Chesler, Anderson Kill, P.C. • Tony Leuin, Shartsis Friese LLP • Suzanne Midlige**,** Coughlin Duffy LLP *From asbestos, pollution and bitcoin to cyberbullying, cyber-insurance and computer fraud, courts around the country ruled on a wide variety of insurance topics in 2018. This panel will examine ten key decisions, including Continental v. Honeywell, KeySpan Gas East Corp. v. Munich Re, Astellas v. Starr, Liberty v. Ledesma, Talley v. Mustafa, and State Farm v. Motta. These cases resolved many novel issues that courts had not previously addressed.*
9:15 am – 10:00 am *Madison Ballroom*	**When Disaster Strikes: Coverage for Natural Disasters** • Andrew Downs, Bullivant Houser Bailey PC • David Halbreich, Reed Smith LLP • Susan Harwood, Kaplan Zeena LLP *Natural catastrophes can happen anywhere in the country. From drought and wildfires, to tornadoes and hurricanes, to flooding and winter storms, the cost of natural disasters is rising. This panel will explore the lessons learned from the natural disasters of 2018, and the most effective arguments policyholders and insurers can make in connection with the claims that continue to arise from those events.*
10:00 am – 10:15 am	Break

10:15 am – 11:15 am *Madison Ballroom*	**How Great Minds Can Differ: Policyholder, Primary and Excess Insurer Interests in Multi-State Litigation** • Marion B. Adler, Adler Law Practice, LLC • Dominica Anderson, Duane Morris LLP • Doug McIntosh, McIntosh Sawran & Cartaya, P.A. • Marcus Snowden, Snowden Law P.C. (moderator) *The panel will discuss common conflicts and issues that arise between policyholder, primary and excess insurers, in a typical multi-state liability case. Topics to be addressed will include selection of primary defense counsel, use of coordinating counsel, decision making as to settlement and strategy, and disagreements among primary and excess insurers as to exhaustion of "occurrence" limits of the primary policy.*
11:15 am – 12:00 pm *Madison Ballroom*	**Alexa, Do I Have Coverage?** • Mary Borja, Wiley Rein LLP • John Buchanan, Covington & Burling LLP • Leo Martinez, University of California Hastings College of Law *Technology has exploded the boundaries of risk for both policyholders and insurers. Hackers these days not only steal data and funds; they also attack networked devices and critical infrastructure. This panel addresses emerging cyber-related risks, how common policy forms respond to them (or not), and potential coverage gaps and traps.*
12:00 – 12:05 pm	**Closing Remarks**

Thank you to our sponsors!

Be Certain.
KCIC

JAMS®

BDO®


American College of Coverage Counsel
2019 Annual Meeting
May 8-10, 2019 | Chicago Athletic Association | Chicago, IL

PAPERS

THE DEBATE OVER THE ANNUALIZATION OF "PER OCCURRENCE" LIMITS IN SEXUAL ABUSE COVERAGE INSURANCE DISPUTES: WHO IS RIGHT?

American College of Coverage Counsel
2019 Annual Meeting

Chicago, IL
May 8-10, 2019

James R. Murray
Jared Zola
James S. Carter
BLANK ROME LLP
Washington, DC
JMurray@blankrome.com
JZola@blankrome.com
JSCarter@blankrome.com

I. Introduction

In a growing number of jurisdictions, legislatures are passing statutes that reopen the statute of limitations for previously time-barred claims by survivors of childhood sexual abuse that happened years ago. States that have passed reviver statutes, sometimes called "window" statutes, include California, Minnesota, Montana, and, recently, New York, and many others are currently considering such legislation. The passage of these statutes inevitably leads to an avalanche of claims and lawsuits against schools, religious entities, medical institutions and other organizations, which may be ill-prepared financially to absorb the enormous potential liability and costs to defend them.

Insurance coverage can play a crucial role in addressing sexual abuse claims in a manner that benefits both the survivors and the organizations. To realize the full benefit of insurance, however, organizations seeking coverage for sexual abuse claims must confront a host of insurance coverage issues. A reoccurring coverage issue in the sexual abuse context concerns multi-year insurance policies and whether the "per occurrence" limit of liability applies once for the entire term of the policy, or separately in each annual period of the policy.

II. How the Issue Arises

Entities and organizations facing potential liability from historic sexual abuse claims frequently face allegations that they negligently hired, supervised or trained the perpetrator(s). In addition to certain present-day claims-made coverage (such as D&O insurance, for example) available in the year that the survivor makes a claim, perhaps the most valuable coverage available to entities and organizations facing sexual abuse claims is the comprehensive general

liability ("CGL") coverage purchased during the time when the sexual abuse is alleged to have occurred—sometimes many decades in the past.

Because the alleged abuse may have occurred decades ago, a preliminary task for an organization is attempting to locate evidence of its old insurance policies and reconstructing its historic liability insurance program. The process may involve combing through old files, contacting former insurance brokers and insurers, and, sometimes employing an insurance archeologist. Recognizing that documents may be misplaced over time, every state's law permits a policyholder to prove the existence of their historical insurance coverage through secondary evidence such as letters describing the coverage, certificates of insurance, the terms and conditions of insurance policies issued before or after the "missing" coverage, specimen insurance policy forms used during the relevant time, and many other forms of evidence. If these old policies can be found, or proved through secondary evidence, they can help an organization to remain solvent and to continue serving its community, while providing meaningful relief to abuse survivors.

It is not uncommon for liability insurance programs from the 1960s and 1970s to feature primary and excess CGL policies whose policy periods span more than one annual period, frequently three years. Apart from the length of the policy period, multi-year CGL policies are like single-year CGL policies. But multi-year CGL policies give rise to a unique coverage question owing to their extended policy periods: whether the "per occurrence," or "per accident," limit applies to each annual period separately or to the entire period as a whole? In other words, is the "per occurrence" limit annualized?

III. Why Annualization Matters

The annualization issue in the sexual abuse context can have a major impact on the amount of available insurance coverage to compensate the alleged victims. The reason relates to the way occurrences are calculated in sexual abuse coverage matters involving old CGL polices. The number of occurrences determines the number of "per occurrence" limits that are available to pay sexual abuse victims' claims. Although the face of a CGL insurance policy may state an "aggregate" limit, it applies only to occurrences within the "products hazard" or the "completed operations hazard." Because these hazards do not apply to sexual abuse, insurers cannot rely on the "aggregate" limit to cap the number of "per occurrence" limits that they may have to pay.

To secure the full benefit of coverage, policyholders often contend that each instance of abuse constitutes a separate occurrence that triggers a "per occurrence" limit. Some courts follow this approach. *See, e.g.*, *In re Diocese of Duluth*, 565 B.R. 914, 925 (Bankr. D. Minn. 2017) ("There are separate occurrences for each separate sexual abuse for each victim and each priest."); *see also Order and Decision, Sorg v. Safeco Ins. Co.*, No. DV 12-342 (Mont. Dist. Ct. July 5, 2012) (finding that each of seven sexual assaults by two assailants of the same victim on the same day constituted seven separate injuries). Other courts calculate the number of occurrences per victim, per perpetrator, per policy period. *See, e.g.*, *H.E. Butt Grocery Co. v. Nat'l Union Fire Ins. Co.*, 150 F.3d 526, 535 (5th Cir. 1998) ("two independent acts of sexual abuse injuring two children [perpetrated by one of the policyholder's employees] are two occurrences").

To limit the number of occurrences, insurers (primary insurers, especially) contend that the overall supervision of, or the decision to hire, or the method of training of all perpetrators

constitutes the relevant occurrence. This approach tends to generate only a handful of occurrences and thus limit the number of "per occurrence" limits that insurers may have to pay.

In a jurisdiction holding that the number of occurrences for sexual abuse claims is calculated by the number of occurrences per victim, per perpetrator, per policy period, annualization becomes important. Policyholders frequently assert that each annual period within a multi-year policy operates as separate insurance policy, each with its own "per occurrence" limit. If, for example, a victim is abused by the same perpetrator one time in each annual period of a three-year policy, the result would be that the victim's claim implicates three separate "per occurrence" limits. It is no different than if the policyholder purchased three consecutive, but separate, CGL policies.

Insurers, on the other hand, often contend that multi-year policies have a single, undifferentiated policy period and provide a single "per occurrence" limit of liability for the entire span of the multi-year policy. Under this view, considering the same example posed in the immediately prior paragraph, the abuse of a victim one time in each of the three annual policy periods yields only one occurrence. In other words, coverage available for the same abuse is reduced to one-third of what it would otherwise have been under three separate annual policies. Annualization of "per occurrence" limits of liability is irrelevant, of course, in jurisdictions adopting the court's holding in the *Diocese of Duluth* that each instance of abuse is a separate occurrence.

IV. The "Per-Occurrence" Limits of Multi-Year CGL Policies Annualize

Although insurers frequently reject annualization, policyholders are right to contend that multi-year policies were intended to operate as three separate policies. Indeed, insurers' hostility to the annualization of "per occurrence" limits would have baffled the underwriters who

underwrote multi-year policies in the 1960s and 1970s. A declaration submitted recently in a coverage litigation involving sexual abuse alleged against former priests explains why. John T. Bogart was an underwriter who worked in the insurance industry from the 1960s to the mid-1990s and regularly underwrote multi-year CGL insurance policies. Mr. Bogart began working in the insurance industry in 1962 when employed by the Insurance Company of North America ("INA"), which is now part of ACE. During his ten years working at INA from 1962 to 1972, he attended a four-month, full-time casualty underwriting school. At the underwriting school he learned techniques that insurers used to retain accounts, including selling insurance policies that spanned multiple years. Later in his career he was promoted and taught at the underwriting school. *See* Declaration of John T. Bogart ("Bogart Decl."), Ex. A., Expert Report (Doc. No. 194-2), at ¶¶ 1-4, *Diocese of Duluth v. Liberty Mutual Ins. Co.*, Civil Action No.: 0:17-cv-03254-DWF-LIB (D. Minn.)

Bogart stated to the court that multi-year insurance policies were not unusual, but rather were commonplace and, in his expert opinion as an insurance company underwriter, *more preferable to insurance companies* than single-year policies. *See* Bogart Decl., Ex. A ¶¶ 1-4. According to Mr. Bogart, multi-year, as opposed to single-year, CGL insurance policies were *strictly a marketing tool used to secure an insured's business for a longer period of time*, in exchange for a discounted premium. *See id.*, Ex A ¶ 5.

Mr. Bogart explained that multi-year CGL policies benefited the insurer in two ways: (1) securing the insured's business for a longer period of time; and (2) reducing the amount of clerical work for the insurer by extending the time between renewals. *See id.*, Ex. A ¶ 6. He elaborated that it was the intent of the insurance industry that multi-year CGL policies would be *identical to annual CGL insurance policies*, other than the premiums charged to the insured. *See*

id., Ex. A ¶ 7; *id.*, Ex. B, Deposition of John T. Bogart (Doc. No. 194-2), 159:25-160:14 ("would be treated like three regular insurance policies, three primary policies").

Mr. Bogart further explained that insurers could not have sold multi-year CGL policies if the "per occurrence" limit of liability did not renew on an annual basis because the insured would have purchased single-year policies instead. *See id.*, Ex. A ¶ 9. Mr. Bogart said that the insurance industry devised three-year policies to hold the risk easier, and it never meant to eliminate two-thirds of the coverage in the way that insurers now suggests. *Id.*, Ex. B at 25:21-26:3.

In addition to the historical perspective of underwriters, multi-year policies often contain policy wording that further confirms that the "per occurrence" limit was intended to apply on an annual basis. For example, the policy may indicate that the "aggregate" limit is annualized. Although insurers may contend that the annualization of the "aggregate" limit evidences an intent to treat the "per occurrence" limit differently, the annualization of the "aggregate" limit supports the annualization of the "per occurrence" limit. The "aggregate" limit is the total amount of coverage that the policy will pay for occurrences within the products and completed operations hazards per annual period. The "aggregate" limit thus implies that the "per occurrence" limit is annualized. Treating the "per occurrence" limit as non-annualized and the "aggregate" limit as annualized would effectively create two different policy periods within the same policy – one with three separate annual periods and one with an undifferentiated policy period. If this incongruity were the intent of the policy, it was surely incumbent upon insurers to include wording in the multi-year policies explaining this unusual arrangement. Yet nothing on the face of multi-year policies indicates that was the intent.

Why then might a multi-year policy state that the "aggregate" limit applies on an annual basis, without saying the same thing about "per occurrence" limit? The most likely and reasonable explanation was to assure policyholders that a single "aggregate" limit would not be stretched over three years. In contrast, Mr. Bogart explained, insurers at the time did not need to state that the "per occurrence" limit applied separately to each annual period because the insurer agreed to pay that limit with respect to each and every occurrence, without further limitation, irrespective of the length of the policy term—subject only to the "aggregate" limit, if applicable to the specific type of loss at issue. *See* Bogart Decl., Ex. A. ¶¶ 14.

Policies may have other features indicating that the "per occurrence" limit is annualized. For example, the policy conditions may contain an audit provision, which permits the insurer to review the insured's business records for evaluating the insured's exposure and adjusting the premium. *See* Bogart Decl., Ex. A ¶ 12. The right to review the insured's books at any time and to adjust the premium over the course of the policy period suggests by itself that multi-year policies were not intended to have a single policy period. Some policies may even state that the audit basis is annual. *Id*. Such provisions show that insurers did not want to lock themselves into a multi-year insurance relationship over the course of which the insured could become a more serious risk any more than insureds wanted to buy a multi-year policies whose limits did not renew annually yet permitted insurers to increase the premium annually.

Multi-year policies may also contain provisions concerning the payment of premiums in annual installments or that other CGL coverage parts are rated annually. Such provisions again highlight that multi-year policies were intended to provide separate annual periods. *See* Bogart Decl., Ex. A ¶ 13.

V. Conclusion

Despite what insurers may contend today, the insurance industry historically intended for multi-year policies to be the equivalent of three annual policies, each with its own "per occurrence" limit. Insurers' efforts to dispute the annualization of the "per occurrence" limit in multi-year policies is nothing short of an attempt to disavow the bargain they originally struck with their policyholders. Given the significant impact that the annualization of "per occurrence" limits can have on the coverage available in sexual abuse matters, the issue deserves careful consideration from policyholders, insurers, and the courts.

Defamation: The Second Offense

American College of Coverage Counsel
2019 Annual Meeting

Chicago, IL
May 8-10, 2019

Rebecca R. Weinreich
Lewis Brisbois
Los Angeles, CA
Weinreich@lbbslaw.com

Introduction

While anyone publically accused of sexual assault and anyone whose allegation of sexual assault has been publically denied could raise a defamation claim, the higher the profile of the people involved, the more charged the atmosphere and, sometimes, the more complicated the legal issues become. Both liability and coverage assessments recalibrate when the involved parties are public figures. In the following few pages, we explore actions and cross actions for defamation, advanced both by the alleged victims and by the alleged assailants as well as settlement dynamics where the victims/plaintiffs may prefer it if insurance coverage is denied.

Focusing primarily on sexual assault in the entertainment industry, the #MeToo / Time's Up movement's power comes from its public nature. The movement's primary tool is publicity, seen through two lenses. First, women coming forward and alleging experiences with sexual assault encourages others to do the same. Second, since the essence of the entertainment industry is its public nature, the accuseds' reputations are in fact their stock-in-trade. If their reputations are tarnished, powerful men in the entertainment industry lose perhaps their most bankable attribute. Rightly or wrongly, that raises the stakes on both sides of the allegations as compared with allegations of sexual assault in other, less public workplaces. With apologies to Phineas T. Barnum, it seems there is such a thing as bad publicity.

While sexual assault may not present complicated coverage questions, a coverage analysis for defamation would generally include exploring at least choice of law, exclusions and, especially in the entertainment industry, republication. Competing cross claims for defamation (one by the accused and, if he denies the allegations, another by the accuser) can also complicate settlement efforts and call into question the scope of defense.

Defamation

While the wording varies state to state, on the whole, defamation is publication of an unprivileged, false statement of fact which damages a person's reputation and causes injury to the subject of the statement. See generally, *Ringler Associates v. Maryland Casualty Co*. 80 Cal.App.4th 1165, 1179 (2000); *Blatty v. N.Y. Times Co.* 728 P.2d 1177, 1182-83, 1186 (Cal. 1986); *Taus v.* Loftus (Cal. 2007) 151 P.3d 1185, 1209; 42 Pa.C.S.A. §8343; *Jews for Jesus, Inc.* 997 So.2d 1098, 1106 (Fla. 2008); *Peters v. Baldwin Union Free Sch. Dist.* 320 F.3d 164, 169 (2d Cir. 2003) (quoting *Dillon v. City of New York* 704 N.Y.S.2d 1, 5(App. Div. 1999)); *Solaia Tech., LLC v. Specialty Publ. Co.* 221 Ill. 2d 558, 579 (2006); *Dolenz v. Texas State Bd. of Med. Examiners* 981 S.W.2d 487, 489, fn. 4 (Tex. Ct. of App. 1998).

The Supreme Court has declined to create a blanket privilege for any statement which could be labelled "opinion". *Milkovich v. Lorain Journal Co.*, 497 U.S. 1, 18 (1990). Prefacing an otherwise defamatory statement with the phrase "In my opinion …" or something similar does not protect the speaker because it fails to state the basis for the opinion. The test is whether an assertion "is sufficiently factual to be susceptible of

being proved true or false" rather than just evaluating whether it expresses an opinion. *Id.* at 21.

For the past 55 years, public figures have had to meet a higher standard to establish defamation. Under long standing Supreme Court precedent, a public figure must show that the statements were made knowing they were false or with reckless disregard for their truth. *New York Times v. Sullivan* 376 U.S. 254, 279-281(1964). A private figure need only show that false connotations were made with some level of fault. *Gertz v. Robert Welch, Inc.* 418 U.S. 323, 347-348 (1974). However Justice Clarence Thomas challenged that distinction in his February 2019 concurrence in *Katherine McKee v. William H. Cosby, Jr.,* 586 U.S. ___ (2019), observing that there was no constitutional support for requiring public figures to satisfy an actual malice standard.

Each statement (or re-statement) is generally an actionable event. *Shanahan v. State Farm General Insurance Co.* 193 Cal.App.4th 780, 789 (2011); *Flynn v. Associated Press* 519 N.E.2d 1304, 1306, fn. 5 (Mass. 1988); *Graham v. Today's Spirit* 503 Pa. 52, 58 (Penn. 1983).) In addition, an "offense" for purposes of insurance coverage includes each act by an insured which results in "personal injury" (*e.g.,* defamation). *Martin Marietta Corp. v. Insurance Co. of North America* 40 Cal.App.4th 1113, 1125 (1995); *Dilbert v. Hanover Insurance Co.* 825 N.E.2d 1071, 1075 (Mass. 2005); *Roman Mosaic & Tile Co. v. Aetna Casualty & Surety Co.* 704 A.2d 665, 669 (Pa. 1997); *St. Paul Fire & Marine Ins. Co. v. Green Tree Fin. Corp.-Texas* 249 F.3d 389, 393-394 (5th Cir. 2001); *Am. Safety Cas. Ins. Co. v. City of Waukegan* 776 F. Supp. 2d 670, 696 (N.D. Ill. 2011); *Merchs. & Bus. Men's Mut. Ins. Co. v. A.P.O. Health Co.*, 2002 N.Y. Misc. LEXIS 2014; *Diamond v. J.T. Tai & Co*. 1998 U.S. Dist. LEXIS 1335, 1998 WL 55350 (S.D. N.Y. 1998).

Choice of Law

In today's media climate where virtually any statement can be instantly cyber-published nationally, courts typically look to the law of the state where the defamed person was domiciled at the time that the matter complained of was published. *Davidson v. Yihai Cao*, 211 F. Supp. 2d 264, 274 (D. Mass. 2002) ("[T]he law of the state where the defamed person was domiciled at the time of publication applies 'if the matter complained of was published in that state.'") (quoting Restatement (Second) of Conflict of Laws, § 150(2) & comment b (1971)); *Gifford v. Nat'l Enquirer, Inc.*, Case No. CV 93-3655 LGB (Tx), 1993 U.S. Dist. LEXIS 21329, at *10 (C.D. Cal. Dec. 7, 1993) (applying law of state "in which the plaintiffs reside and work") (citing *Brown v. Baden* (*In re Yagman*), 796 F.2d 1165, 1171 (9th Cir. 1986)); *Condit v. Dunne* 317 F. Supp. 2d 344, 352-353 (S.D. N.Y. 2004); *Chi v. Loyola Univ. Med. Ctr.* 787 F. Supp. 2d 797, 801-802 (N.D. Ill. 2011); *Ritzman v. Weekly World News, Inc*. 614 F. Supp. 1336, 1338 (N.D. Tex. 1985).

Exclusions

Defamation claims in the #MeToo and Time's Up arena take at least two forms. If the insured is the accuser, the accused can advance a defamation claim against her on the theory that being accused of sexual assault is defamatory. If the insured is the accused, and if the accused denies the allegations of sexual assault, the accuser can advance a defamation claim on the theory that he is calling her a liar, an opportunist or the like.

When an accused tenders a defamation claim tethered to a sexual assault allegation, several exclusions bear consideration. Assuming the tender is under a homeowners or personal liability policy, common exclusions include

- expected or intended;
- sexual assault, abuse or misconduct;
- intent to cause personal injury;
- knowledge of falsity;
- criminal act; and
- business pursuits

While business pursuits may seem an unlikely exclusion to raise, within the entertainment industry, accusers often allege that the sexual abuse was part of a *quid pro quo* wherein the accused offered the accuser career advancement, a plum role, access to powerbrokers and so forth in return for sex.

Republication

When evaluating the number of occurrences and the statute of limitations, bear in mind that different states have different standards for republication.

In Arizona, republication takes place when the defendant edits and retransmits or distributes the defamatory material for a second time with the goal of reaching a new audience. The Uniform Single Publication Act (A.R.S. § 12-651(A)), protects defendants from being sued separately for each copy of a book or newspaper containing the allegedly defamatory statement. *Larue v. Brown*, 235 Ariz. 440, 444 (Ct. App. 2014). However, republishing material in a new edition, editing and republishing it, or placing it in a new form is a separate publication giving rise to a separate cause of action. *Id*. at 445 (citing Restatement (Second) of Torts § 577(A) cmt. d (1977)). Republication "occurs when a defamatory article is placed in a new form (paperback as opposed to hardcover) or edited in a new form." *Id*. (quoting *Mitan v. Davis*, 243 F. Supp. 2d 719, 722 (W.D. Ky. 2003)). "A plaintiff has a new cause of action when 'the defendant edits and retransmits the defamatory material, or distributes the defamatory material for a

second time with the goal of reaching a new audience.'" *Id.* (quoting *In re Davis*, 347 B.R. 607, 611 (W.D. Ky. 2006)).

In California, "each time the defamatory statement is communicated to a third person who understands its defamatory meaning as applied to the plaintiff, the statement is said to have been 'published'". *Shively v. Bozanich*, 31 Cal. 4th 1230, 1242 (2003). "Each publication ordinarily gives rise to a new cause of action for defamation." *Id*. (citations omitted). "The rule . . . applies when the original defamer repeats or recirculates his or her original remarks to a new audience." *Id*. at 1243. "[T]he repetition by a new party of another person's earlier defamatory remark also gives rise to a separate cause of action for defamation against the *original defamer*, when the repetition was reasonably foreseeable." *Id*. (emphasis in original; citations omitted). *See also Mitchell v. Superior Ct*., 37 Cal. 3d 268, 281(1984).

In Michigan, a third party's expected republication of a defamatory statement will not extend the one year statute of limitations for such a claim. *Mitan v. Campbell*, 474 Mich. 21, 25, 706 N.W.2d 420, 422 (2005). The court reasoned that a defamation claim accrues when "the wrong upon which the claim is based was done regardless of the time when damage results." *Id*. (citing MCL 600.5827) (plaintiff's defamation action accrued when the defendant made the disparaging statement to a reporter, not when the statement was subsequently rebroadcast on television). *Id*. at 22. *See also Lynk v. Chase Home Fin., LLC*, 644 F. Supp. 2d 868, 882 (E.D. Mich. 2009).

In New York, the original publisher of a defamatory statement will not be liable for subsequent publications by a third person "absent a showing that [defendant] approved or participated in some other manner in the activities of the third-party republisher". *Geraci v. Probst*, 15 N.Y.3d 336, 343 (2010) (quoting *Karaduman v Newsday, Inc*., 51 NY2d 531, 540 (1980)). *See also Levy v. Smith*, 132 A.D.3d 961, 962-63 (2015) ("Generally, '[o]ne who makes a defamatory statement is not responsible for its recommunication without his authority or request by another over whom he has no control'") (quoting *Hoffman v Landers*, 146 A.D.2d 744, 747 (1989)); *Egiazaryan v. Zalmayev*, 880 F. Supp. 2d 494, 501 (S.D.N.Y. 2012) ("The original publisher is not liable for republication where he had 'nothing to do with the decision to [republish] and [he] had no control over it.'") (quoting *Rinaldi v. Viking Penguin. Inc*., 73 A.D.2d 43, 425 N.Y.S.2d 101, 104 (1st Dep't 1980).

Under Texas law, "Although a party is generally not liable for a republication of a defamatory statement by another, … '[i]f a reasonable person would recognize that an act creates an unreasonable risk that the defamatory matter will be communicated to a third party, the conduct becomes a negligent communication, which amounts to a publication just as effectively as an intentional communication.'" *Collins v. Sunrise Senior Living Mgmt., Inc*., 2012 Tex. App. LEXIS 2457, *57, 2012 WL 1067953, citing *Wheeler v. Methodist Hosp*, 95 S.W.3d 628, 639-40 (Tex. App.—Houston [1st Dist.] 2002, no pet.).

In Pennsylvania, republication of defamatory matter by a third party is actionable "only if...the repetition was reasonably to be expected." *Yarus v. Walgreen Co*., 2015

U.S. Dist. LEXIS 28212, *10 fn. 1, 2015 WL 1021282, citing Restatement (Second) of Torts § 576.

Settlement Considerations

When the alleged abuser is high profile, wealthy or deeply involved and connected in the entertainment industry, settlement dynamics can be complicated. Accusers may have an interest in insurance coverage being denied, on the theory that an accused who has to fund his own defense (not to mention pay a settlement of judgment) will be weaker in the litigation and beyond. A savvy attorney may take that into consideration in drafting a complaint in such a way as to avoid covered allegations.

Another dynamic can arise when the accuser files a counterclaim for defamation. A global settlement may be harder to achieve if he is unwilling to waive his counterclaim.

While confidentiality provisions are generally included in defamation settlement agreements, one or the other or both litigants may demand a press release in an effort to bring closure to the case. Publicity can be generated by formal media outlets as well as through individual social media postings and drafting a mutually agreeable press release can consume considerable time and effort. Those issues can become especially complicated where multiple people have levelled allegations against the same accused. Even the most generic statement to the effect that the case resolved to the parties' satisfaction can trigger round after round of online, cyberspace chatter, attorneys' best efforts notwithstanding.

Conclusion

In a world where the private is increasingly public, and the personal is increasingly political, the #MeToo and Time's Up movement are changing the way our culture thinks about and talks about workplace sexual assault. Predictably, litigation and coverage disputes follow. With social media dominating every conversation, we expect some old law may fall away (*e.g.,* anything on the internet is instantly everywhere, so the place of publication no longer has much meaning) and new nuances will arise. This, in turn, may trigger new policy language which, in time, will be disputed and adjudicated. And, as with so much in the human condition, coverage attorneys will lead the way.

WHICH CAME FIRST, THE CHICKEN OR THE EGG; ENSUING LOSS THEORY, DEBATE AND ANSWERS, OR, WHAT THE CLUCK IS COVERED AFTER ALL[1]

American College of Coverage Counsel
2019 Annual Meeting

Chicago, IL
May 8-10, 2019

R. Hugh Lumpkin
Ver Ploeg & Lumpkin
Miami, FL
RLumpkin@vpl-law.com

Tracy Alan Saxe
Saxe Doernberger & Vita, P.C.
Trumbull, CT
tas@sdvlaw.com

Rick Hammond
Hepler Broom, LLC
Rick.Hammond@heplerbroom.com

[1] Paper authored by Tracy Alan Saxe, Tiffany Casanova, Rick Hammond, R. Hugh Lumpkin.

The concept of determining whether there is insurance coverage for a loss under a property insurance policy is straightforward generally: assess the damage, identify the cause of the loss, and compare the cause of loss against the policy provisions and exclusionary terms. When there is one cause of loss, this is relatively simple. However, realistically, most losses are not attributable to one singular cause of loss but instead the result of multiple contributing causes of loss. In these cases, the loss is the result of sequential (i.e., chain-of-event) or concurrent (i.e. simultaneous) causes. If all the causes of loss are covered, assessment and receipt of coverage remains simple. However, when some causes are covered while others are excluded, ascertaining coverage becomes much more complicated.

Further complicating the coverage assessment, many property policies, including commercial property, builder's risk, and homeowner policies now include "ensuing loss" clauses and "anti-concurrent/anti-sequential loss" clauses, which function as policy language modifications to the jurisdictional tests applied to scenarios with multiple contributing causes.

As will become evident, there is increasing debate on the application of jurisdictional standards and policy interpretation in assessing coverage under property policies with multiple contributing causes. These written materials and the associated presentation address the standards applied to analyze coverage in these scenarios, the impact of ensuing loss and anti-concurrent clauses, and the disagreement on all of these issues between jurisdictions nationwide.

I. SEQUENTIAL AND CONCURRENT CAUSES OF LOSS GENERALLY

Most losses are attributable to multiple causes of loss. These causes of loss can be categorized as sequential and concurrent causes of loss. Often, these concepts are used interchangeably or conflated by courts or literature, but they have distinct meanings and applications and the impact on coverage varies depending on the type.

A. **Sequential Cause of Loss**: A loss caused by dependent and related acts or events, similar to a chain reaction.[2] An example would be where an electrical short causes a kitchen fire that triggers a sprinkler system, causing water damage, resulting in mold, requiring removal and replacement of sheetrock in the kitchen. The damaged sheetrock is attributable to multiple causes of loss, or one event, followed by another, leading to damage.

B. **Concurrent Cause of Loss**: A loss caused by two or more independent or unrelated events. There are two types of concurrent cause of loss scenarios.

1. *Category 1*: A combination of acts or events that independently are insufficient to create damage on its own. For example, at a construction project, a contractor fails to cover its work with a protective covering. This exposes the unfinished work to weather related conditions, such as rain, causing damage to the property. Neither

[2] See IRMI's Glossary of Insurance & Risk Management Terms (11th ed.).

of these causes would have resulted in damage alone. In other words, if the contractor put the covering on, and it rained, there would be no damage. If the contractor forgot to put the covering on, but it did not rain, there would be no damage. Together, however, damage results.

2. *Category 2*: A combination of acts or events, each separately responsible for damage on its own but isolating the damage attributable to each cause is impossible. For example, a construction project becomes damaged because of a violent storm. Separately, rain water damages building materials, but heavy winds also caused damage. The materials at the project are equally ruined by both causes of loss. In other words, each individual cause would have caused damage alone to the project.

The following Exhibit 1 illustrates the distinctions between sequential causes of loss and concurrent causes of loss as discussed in the examples above.

Exhibit 1:

ILLUSTRATION OF SEQUENTIAL AND CONCURRENT CAUSES OF LOSS

Sequential Cause of Loss

A series of dependent and related acts or events.

Fire → Sprinkler Triggered → Water Damage → Mold → Damaged Sheetrock

Concurrent Cause of Loss (Type 1)

Two or more independent and unrelated events; all are required for damage to occur.

Exposed Materials + Rain = Damaged Materials

Covered Materials + Rain = No Damage

Exposed Materials + No Rain = No Damage

Concurrent Cause of Loss (Type 2)

Two or more independent and unrelated events; each is sufficient to cause the damage on its own.

Rain + No Wind = Damaged Materials

No Rain + Wind = Damaged Materials

Rain + Wind = Damaged Materials

II. SEQUENTIAL CAUSES OF LOSS: IS THE DAMAGE COVERED?

A. Efficient Proximate Cause Standard

When analyzing coverage for damages resulting from sequential causes of loss, an efficient proximate cause standard is generally the analytical framework applied. The efficient proximate cause standard requires an identification of the most significant, or dominant, cause of loss when looking at all contributing factors to a loss.[3] Once the efficient proximate cause is identified, coverage is determined based on whether that cause is covered or excluded.[4] Significantly, not all jurisdictions utilize the same meaning of "efficient proximate cause." It is important to identify the appropriate jurisdiction as it relates to a loss because it can be outcome determinative. The three primary interpretations are the first event in the chain of causation, the last event in the chain of causation, or the predominant cause, regardless of whether it is first or last.

1. **First Event:** The *first* event that sets others in motion;
   - Application: *Frontis v. Milwaukee Ins. Co.*, 242 A.2d 749 (Conn. 1969): A fire occurred at neighboring property of insured property. Because of the fire, the insured property became structurally compromised. In response, a building inspector ordered the owner of the insured property to remove third and fourth floors of the building. The property insurer denied claim because it determined the loss was directly or indirectly caused by order of a civil authority—an excluded cause of loss. The court disagreed with the insurer and found that the fire was the dominant, or efficient proximate, cause of loss. The court reasoned that the building was impaired by the fire, not the order of the building inspector, which was made only "in the interest of public safety [and] in recognition of a condition *already* in existence."[5]
2. **Last Event:** The *last* event in the chain of causation;
   - Application: *Album Realty Corp. v. American Home Assurance Co.*, 607 N.E.2d 804 (N.Y. 1992): Freezing temperatures caused a sprinkler head to rupture in basement of construction project that was insured by builder's risk policy. Upon rupturing, the sprinkler flooded basement resulting in water damage. The builders risk policy excluded "freezing" as a cause of loss but covered damage caused by water. The Court held that while damage would not have occurred without freezing, the water damage was the efficient proximate cause. The court reasoned that the "a reasonable and ordinary person" would find that the loss was "visibly occasioned by water damage," and would not look for alternate

[3] *Sabella v. Wisler*, 377 P.2d 889, 895 (Cal. 1963); *Ermentraut v. Girard Fire & Marine Ins. Co. of Philadelphia*, 65 N.W. 635, 636 (Minn. 1895).

[4] *McDonald v. State Farm Fire & Cas. Co.*, 837 P.2d 1000, 1004 (Wash. 1992).

[5] *Frontis*. 242 A.2d at 500. *See also*, *Krempl v. Unigard Sec. Ins. Co.*, 850 P.2d 533, 534 (Wash. App. 1993) (holding that there is no coverage available to the insured because the efficient proximate cause here, which set all other causes into motion, was an excluded cause).

causes.[6] The "mere fact that the presence of water can best be explained by the rupturing of a sprinkler head which had frozen" does not alter that analysis.[7]

3. **Predominant Event:** The predominant cause, regardless of when in the chain of events it occurs. Also referred to as "Appleman's Rule."
   - Application: *Franklin Pckg. Co. v. California Union Ins. Co.*, 408 A.2d 448 (N.J. Super. Ct. App. Div. 1979): Vandals broke into the warehouse, drove a truck into an air conditioning unit, and broke a valve, which created a constant flow of water. Separately, a burlap bag left by a contractor on the drain of the air conditioning unit by another party created a blockage for the water. This caused the water to back up and damage the insured's inventory in the warehouse. The fire insurer denied the claim based on the water exclusion. The court held that the efficient proximate cause was the vandalism and mischief, a covered cause of loss. Significantly, the court highlighted that the proximate cause is not necessarily the first or last "but the efficient or predominant cause which sets into motion the chain of events producing the loss."[8]

B. Distinguishing the Loss from the Cause

Another important factor in assessing coverage when dealing with sequential causes of loss is the impact of how the loss is characterized from either the perspective of the insurer or the insured. For example, a property develops mold due to water infiltration. The insured property owner makes a claim under its homeowner's policy, which contains an exclusion for loss caused by water. If the loss is characterized as mold, it likely would be excluded because it was caused by water. However, if the loss is characterized as damaged sheetrock and other material caused by mold, there is a potential that a court would find it covered. This difference in characterization is slight but can have a substantial impact one way or the other. To illustrate, in *Simonetti v. Selective Ins. Co.*, 859 A.2d 694 (N.J. Sup. Ct. App. Div. 2004), rain water infiltrated the insured's home leading to mold growth. The insured's homeowner's policy includes mold as an excluded cause of loss but did not exclude mold damage itself. The court held that the mold damage was covered because mold was the damage, not the *cause* of the damage. This distinction is critical to performing the right analysis – courts routinely confuse perils (the cause of loss) with damage (the loss itself).

III. CONCURRENT CAUSES OF LOSS: IS THE DAMAGE COVERED?

A. Efficient Proximate Cause Standard

The primary analytical framework applied to analyze coverage when damage is the result of concurrent causes is the efficient proximate cause standard as described above. In other words, when damage is the result of two or more independent, unrelated causes, insureds and insurers should compare the dominant cause of the loss against the exclusionary language of the policy. Again, what is deemed the "dominant" cause is highly dependent on the jurisdictionally adopted meaning of "efficient proximate cause" as detailed above. The majority of states follow

[6] *Album*, 607 N.E.2d at 805.
[7] *Id.*
[8] *Franklin*, 408 A.2d at 449, *quoting* 5 Appleman, Ins. Law & Practice, §309-311 (1970).

this approach. It should be noted that certain courts have refused to apply the efficient proximate cause standard where multiple causes of loss are equally significant.[9] These cases explain that it is impossible to determine a "dominant" cause and instead apply one of the other standards explained below.

- Application: *Metric Constr. Co. v. Allianz Global Risks U.S. Ins. Co.*, No. SC034886, 2005 WL 5715929 (Cal. Sup. Ct. Feb. 10, 2005), *affirmed*, No. B183628, 2006 WL 3008451 (Cal. App. Ct. Oct. 24, 2006): The roof of a warehouse construction project sustained damage during the project due to both faulty workmanship and deficient steel materials. The builder's risk policy excluded coverage for damage caused by faulty workmanship. The court found that the single proximate cause of the damage was faulty workmanship and concluded that there would be no coverage under the policy.[10]

B. "Partridge Rule" Standard

The Partridge Rule is a pro-policyholder standard established by the California Supreme Court in *State Farm Mut. Auto Ins. Co. v. Partridge*, 514 P.2d 123 (Cal. 1973), and is applied to assess coverage in cases where there are concurrent causes of loss. Under this standard, as long as there is one covered proximate cause of the loss, coverage exists, despite the existence of any other causes that might be excluded.[11] Partridge was decided under a third-party liability policy. A minority of jurisdictions have opted to extend the applicability of the rule to first party policies, such as commercial property, homeowner's, or builder's risk policies.[12]

- Application: *Sebo v. American Home Assur. Co., Inc.*, 208 So.3d 694 (Fla. 2016): The insured's home was damaged by both water intrusion and defective construction. The homeowner's policy insurer denied the claim based on the defective construction, which was an excluded cause of loss. The court, following the rationale of *Partridge*, found that there was coverage for the entire loss because the policy afforded coverage for damage caused by water.[13]

---

[9] *Sebo v. American Home Assur. Co., Inc.*, 208 So.3d 694, 700 (Fla. 2016); *Crete-Monee Sch. Dist. 21-U v. Indiana Ins. Co.*, No. 96 C 0275, 2000 WL 1222155, at *8 (N.D. Ill. Aug. 22, 2000).

[10] In first party property insurance actions, California courts apply the "predominant event" standard of efficient proximate cause. *Garvey v. State Farm Cas. Co.*, 770 P.2d 704, 710 (Cal. 1989).

[11] *Partridge*, 514 P.2d at 130-131 ("[C]overage under a liability insurance policy is equally available to an insured whenever an insured risk constitutes simply a concurrent proximate cause of the injuries. That multiple causes may have effectuated the loss does not negate any single cause; that multiple acts concurred in the infliction of injury does not nullify any single contributory act.").

[12] Note that, while California was the origin state for the Partridge Rule, California courts do not extend this application to first party insurance policies, such as homeowners and builder's risk policies. *Garvey*, 770 P.2d at 710 (applying, instead, the efficient proximate cause standard). Other jurisdictions take the same stance. *Port Auth. V. Affiliated FM Ins. Co.*, 245 F. Supp. 2d 563, 578 (D.N.J. 2001).

[13] *See also Paulucci v. Liberty Mut. Fire. Ins. Co.*, 190 F. Supp. 2d 1312, 1319 (M.D. Fl. 2002) (applying the Partridge Rule to a first-party property policy); *Wallach v. Rosenberg*, 527 So. 2d 1386 (Fla. Dist. Ct. App. 1988) (applying partridge rule to property damage loss as a result of storm water and improper maintenance, despite policy's exclusion for water).

C. Doctrine of Concurrent Causes Standard

Functioning as the pro-insurer standard, the doctrine of concurrent losses is applied in a minority of jurisdictions as well. With this standard, similar to the Partridge rule, where there are multiple causes of loss, as long as one is covered, there can be coverage. The distinction, however, lies in the amount of coverage available to the insured. In these states, the insured bears the burden of proof in distinguishing damage caused by covered and uncovered concurrent causes of loss and can only receive coverage for the damage caused by the covered cause of loss.[14] If the insured cannot isolate the damages, then the insured will receive no coverage at all.[15] The principle behind this standard is that insureds should only obtain the benefit of coverage for losses they have actually paid to insure, or the benefit they bargained for.[16] In reality, it sometimes works to provide no coverage to the insured as isolating the damage is impossible.

- Application: *Wallis v. United Servs. Auto Ass'n*, 2 S.W.3d 300 (Tx. App. Ct. 1999): The insured property owners discovered damage to the foundation of its home and filed a claim under their homeowner's policy. Insureds attributed the cause of damage to plumbing leaks, an arguably covered cause of loss. After investigation, it was determined that the damage was also caused by settlement, among other things, an excluded cause of loss under the "earth movement" language of the policy. The court applied the doctrine of concurrent causation and held that the insureds failed to demonstrate what damage was caused by the plumbing leaks and therefore no coverage was owed.[17]

IV. ENSUING LOSS PROVISIONS

Ensuing loss provisions afford coverage for losses that result (i.e. "ensue") from an excluded cause of loss. They operate to create an exception to a policy exclusion because they limit the scope of what is otherwise excluded.[18] Ensuing loss provisions are found in almost all property policies, including commercial, homeowner's, and builder's risk.

Ensuing loss provisions are typically found in two places in the policy: the preamble to an exclusions section or couched within an exclusion, providing more limited application. In a preamble, one example of an ensuing loss exclusion could read: "*We will not pay for loss caused by or resulting from the following. But if a loss from a Covered cause of Loss results, we will pay for the resulting loss."* An ensuing loss provision couched within another exclusion might read:

---

[14] *Lyons v. Miller Cas. Ins. Co*., 866 S.W.2d 597, 601 (Tex.1993).

[15] *Nat'l Union Fire Ins. v. Puget Plastics Corp*., 735 F.Supp.2d 650, 669 (S.D.Tex.2010).

[16] *Employers Cas.Co. v. Block*, 744 S.W.2d 940, 945 (Tex.1988) *overruled in part on other grounds*, 925 S.W.2d 696 (Tex.1996).

[17] *See also Hamilton Props. v. Am. Ins. Co*., No. 3:12-CV-5046-B, 2014 WL 3055801 (N.D. Tex. July 7, 2014) (granting motion for summary judgment in favor of insurer and against coverage because insured failed to provide any evidence to demonstrate the allocation of damage between a covered cause of loss—hailstorm—and uncovered causes of loss); *Brindley v. Firemen's Ins. Co. of Newark, N.J.*, 113 A.2d 53, 56-58 (N.J. App. Div. 1955) (finding no coverage where wind and rain were concurrent losses and insured failed to demonstrate the particular aspects of damage attributable to each cause).

[18] *McDonald v. State Farm Fire & Cas. Co.*, 837 P.2d 1000, 1005 (Wash. 1992).

"*The following is excluded . . . wind, rain, snow ... unless loss or damage from an insured Peril ensues and then only for such ensuing loss or damage*."[19]

These examples of ensuing loss provisions demonstrate that an ensuing loss must constitute a covered cause of loss under the policy.[20] The excluded cause of loss is never covered.[21] Take for example the following: As a result of defective construction, a home suffered leaks and, in turn, water damage. The water damage then proceeds to short an electrical circuit causing a fire. The policy contains a faulty workmanship exclusion, but covers losses caused by fire. The policy contains an ensuing loss provision. In this situation, the ensuing loss would constitute the fire damage and, since it is covered under the policy, it would be provided coverage under the ensuing loss exception, despite the existence of the faulty workmanship exclusion.[22]

In theory, ensuing loss provisions seem to have straightforward application, but in practical application, there is much confusion and debate about how these provisions are intended to function, even when drafted unambiguously. Further, the application of these provisions is wholly fact-dependent, resulting in diverging results from courts that purport to apply the same standards. When considering the application of an ensuing loss provision, it is strongly encouraged to focus on identifying the jurisdictional precedent in interpreting the prevision, the exact language of the ensuing loss provision, and, finally, the individual facts related to the claim, as most courts analyze some combination of these factors when assessing the applicability of an ensuing loss provision. There is an unpredictability that parties on either side must attempt to manage.

A. Separate, Independent Peril:

A primary issue of contention between insurers and insureds regarding ensuing loss is whether the ensuing loss is required to be a separate and independent peril.

1. Requirement of Separate and Independent Peril

The majority of jurisdictions purport to apply the "separate and independent peril" requirement in their ensuing loss analyses. These courts often look to apply the ensuing loss provision only when the chain of events is broken by "a new independent cause.[23] When a loss is "foreseeable" or a "natural consequence," it cannot possibly qualify as ensuing loss because it is simply a part of the excluded loss.[24] The principle behind this rationale is grounded in the fact that courts want to prevent attempts to "supersede the exclusion by disallowing coverage for ensuing loss is directly related to the original excluded risk.[25] In other words, courts do not want insureds to manufacture intervening causes of loss to escape the reach of an exclusion. Despite sharing similar principles related to this analytical framework, the result is not always the same.

---

[19] Note that these examples are two of many forms of ensuing loss provisions that take many forms.
[20] *McDonald*, 837 P. 2d at 1005.
[21] *Id.*
[22] *Cf. TMW Enter., Inc. v. Federal Ins. Co.*, 619 F.3d 574 (6th Cir. 2010).
[23] *TMW*, 619 F.3d at 579.
[24] *Friedberg v. Chubb Indem. Ins. Co.*, 691 F.3d 948 (8th Cir. 2012); *TMW*, 619 F.3d at 578-579.
[25] *Narob Dev. Corp. v. Ins. Co. of North America*, 219 A.D.2d 454 (N.Y. App. Div. 1995).

The following are examples of cases where a court applied the separate and independent peril requirement:

- *New London Cnty. Mut. Ins. Co. v. Karleen Zachem et al.*, 74 A.3d 525 (Conn. App. Ct. 2013): An intruder entered into the insured's home to steal copper pipes. Upon removing copper pipes, the intruder broke a propane gas line that ultimately exploded and caused a fire that destroyed the home. The homeowner's insurer denied the claim based on the exclusion for vandalism/theft. The policy contained an ensuing loss provision that the insured argued applied to the fire damage. The court denied coverage and explained that the losses were "proximately caused" by the theft, and the spark that set off the explosion does not constitute a separate and independent hazard.[26]
- *Vision One, LLC v. Philadelphia Indem. Ins. Co.*, 276 P.3d 300 (Wash. 2012): The insured subcontracted out shoring and concrete work for its condominium project. The shoring was installed defectively, leading to framing, rebar, and wet concrete to collapse. The builder's risk policy covered collapse but did not cover faulty workmanship. The faulty workmanship exclusion contained an ensuing loss exception that read, if "damage by a Covered Cause of Loss results, we will pay for the [damage] caused by that Covered Cause of Loss."[27] The court found that the framing, rebar, and wet concrete were separate from the improperly installed shoring, so the collapse was covered. The court emphasized that the "dispositive question in analyzing ensuing loss clauses is whether the los that ensues from the excluded event is covered or excluded."[28]
- *HoneyBaked Foods, Inc.* v. *Affiliated FM Ins. Co.*, 757 F. Supp. 2d 788 (N.D. Ohio 2010): The insured conducted and inspection of its food products and determined that bacteria was present. The Insured filed a claim and its "all risks" insurer denied the claim based on the contamination exclusion. The insured argued that resulting physical loss of bacteria qualified as an ensuing loss under the policy's ensuing loss clause. The court disagreed, explained that there was no independent "causation-in-fact-breaking link," and held that the loss was directly connected to the contamination.[29]

2. No Requirement of Separate and Independent Peril

Some jurisdictions do not impose the requirement that the ensuing loss must result from a separate and independent peril. In *Eckstein v. Cincinatti Ins. Co.*, 469 F. Supp. 2d 455, 462 (W.D. Ky. 2007), the court explained that there was "nothing in the policies to indicate that an ensuing loss must be the result of a separate cause from the excluded loss." In other words, as long as additional losses resulted from the excluded peril in the chain of causation, there should be coverage for the resulting loss.[30]

---

[26] *Zachem*, 74 A.3d at 531-533.
[27] *Vision One*, 276 P.3d at 303.
[28] *Id.* at 307.
[29] *HoneyBaked*, 757 F. Supp. 2d at 745-746.
[30] *Eckstein*, 469 F. Supp. 2d at 462.

- *Eckstein*: The insured. home experienced water damage due to faulty construction. That damaged turned into mold. The builder's risk and homeowner's policies both contained faulty workmanship exclusions with ensuing loss exceptions. The court found that the mold that resulted from the water damage that entered due to the faulty construction qualified as an ensuing loss and therefore was covered based on the ensuing loss exceptions.
- *Blaine Constr. Corp. v. Ins. Co. of North America*, 171 F. 3d 343 (6th Cir. 1999): Blaine, the additional insured on the policy, sought coverage for the replacement of insulation in the roofing insulation cavity. Blaine hired a subcontractor who incorrectly installed a vapor barrier in the cavity. This allowed condensation to build up and damage the insulation within the cavity. The court found that the faulty workmanship exclusion in the builder's risk policy applied to the replacement of the vapor barrier itself but the ensuing loss exception to the exclusion applied to provide coverage for the replacement of insulation because it constituted resulting damages from an excluded loss.

B. Common Scenarios Involving Ensuing Loss Complications

There are several common fact patterns that often result in a need for ensuing loss analyses. They include faulty workmanship losses generally, those that lead to mold and water damage,[31] and weather-related losses,[32] amongst others. It is important to note that despite similarities in these fact patterns, courts don't always come to the same result. Take *Vision One*, for example. In that case, the collapse of a floor resulted from faulty workmanship of shoring at the project. The court, utilizing the "separate and independent peril test" found that the collapse was a separate peril from the faulty workmanship. Thus, there was coverage based on the ensuing loss provision. In contrast, in *Sprague v. Safeco Ins. Co. of America*, 276 P.3d 1270, 1271-1273 (Wash. 2012), an insured sought coverage for damage to its deck related to rot. The rot was the result of faulty workmanship. The court found that the rot was not a separate and independent loss but was instead a loss caused by the faulty workmanship. These fact patterns have many parallels, but the courts in each instance came to a different result.

C. London Engineering Group Defect Exclusions

Closely related to ensuing loss provision, many builder's risk policies contain variations of the London Engineering Group defect exclusions, which eliminate various levels of coverage for damage arising from faulty workmanship. The London Engineering Group established these

[31] *See e.g. Friedberg*, 691 F.3d at 952 (finding no coverage under ensuing loss clause where faulty workmanship led to water infiltration which led to damage of beans in home because water damage was "a foreseeable and natural consequence" of faulty workmanship); *TMW*, 619 F.3d at 578-579 (holding that there was no coverage under ensuing loss clause where faulty workmanship led to water infiltration, corroding, and weakening structures because the water damage did not constitute an independent non-foreseeable loss).

[32] *Certain Interested Underwriters at Lloyd's v. Chabad Lubavitch of Greater Ft. Lauderdale, Inc.*, 65 So. 3d 67, 68 (Fla. Dist. Ct. App. 2011) (holding that there was no coverage for loss that occurred when crane fell into insured's building as a result of a windstorm because there was no intervening cause of loss other than gravity as would be required by the ensuing loss provision of the windstorm exclusion).

exclusions using a three-tiered approach—each tier providing progressively limiting the scope of the exclusion.[33] LEG exclusions operate similarly, although not identically to ensuing loss provisions, because, as the tiers increase, exceptions are carved out limiting the scope of the exclusion.

1. LEG 1: The Outright Exclusion

LEG 1 is the most restrictive of the LEG exclusions. The LEG 1 language reads, "The insurer(s) shall not be liable for: Loss or damages due to defects of material workmanship design plan or specification." This exclusion removes coverage for all losses or damage for faulty work and resulting loss.

2. LEG 2/96: The Consequence-Based Exclusion

LEG 2 excludes less than LEG 1. The LEG 2 exclusion states, in pertinent part:

> All costs rendered necessary by defects of material workmanship design plan or specification and should damage occur to any portion of the Insured Property containing any of the said defects the costs of replacement or rectification which is hereby excluded is that cost which would have been incurred if replacement or rectification of the Insured Property had been put in hand immediately prior to said damage.
>
> For purpose of this policy and not merely this exclusion it is understood and agreed that any portion of the Insured Property shall not be regarded as damaged solely by virtue of the existence of any defect of material workmanship[,] design plan or specification.

LEG 2 is interpreted to exclude only "that cost which would have been incurred if replacement or rectification of the Insured Property had been put in hand immediately prior to the said damage."[34] All other resulting costs, including the costs to rectify or replace the damage are still covered.[35]

3. LEG 3: The Full Defects Exclusion

LEG 3 limits has the highest limitation on excluded damage. It reads:

> "The Insurer(s) shall not be liable for
>
> All costs rendered necessary by defects of material workmanship design plan or specification and should damage occur to any portion of the Insured Property containing any of the said defects the cost of replacement or rectification which is

[33] *Will Builders Risk Get "LEGs?",* 2 Viewpoint 25 (2015).
[34] *Acciona Infrastructure Canada Inc. v. Allianz Global Risks US Ins. Co.,* 2014 BCSC 1568, at ¶ 221 (CanLII).
[35] *Id.*

> hereby excluded is that cost incurred to improve the original material workmanship design plan or specification.
>
> For the purpose of the policy and not merely this exclusion it is understood and agreed that any portion of the Insured Property shall not be regarded as damaged solely by virtue of the existence of any defect of material workmanship design plan or specification."

LEG 3 has been interpreted to only exclude coverage for the cost of improvements and costs associated with potential defects that have not yet produced damage. In other words, a LEG 3 exclusion provides coverage for the cost of resulting damage but also for the cost of fixing the defective work as well.

V. ANTI-CONCURRENT/ANTI-SEQUENTIAL Clauses

In response to the issues discussed within, some insurers have included anti-concurrent/anti-sequential clauses ("ACC clauses") in their policies. ACC clauses exclude coverage whenever a particular cause of loss is involved in a claim, regardless of the existence of any contributing covered causes of loss. A standard ACC clause states: "*We do not cover loss to any property resulting directly or indirectly from any of the following. Such loss is excluded even if another peril or event contributed concurrently or in any sequence to cause the loss*." ACC clauses are particular problematic in the wake of natural disasters, such as hurricanes, because many ACC clauses include flood or rain as an excluded loss. As a result, in a minority of jurisdictions, courts have found that ACC clauses are in violation of public policy.[36]

[36] *See e.g.*, *Howell v. State Farm Fire & Cas. Co.*, 267 Cal. Rptr. 708, 711-712 (Cal. Ct. App. 1990); *Safeco Ins. Co. v. Hirschmann*, 773 P.2d 413, 415-416 (Wash. 1989).

You Gotta Have Faith – Good Faith!

American College of Coverage Counsel
2019 Annual Meeting

Chicago, IL
May 8-10, 2019

Fred Cunningham
Domnick Cunningham & Whalen
West Palm Beach, Florida
fred@dcwlaw.com

Heather Sanderson
Sanderson Law
Calgary, Alberta, Canada
hasanderson@sanderson-law.com

John S. Vishneski III
ReedSmith LLP
Chicago, IL
JVishneski@reedsmith.com

Good Faith Limits on the Insurer's Rights to Administer & Settle Third Party Liability Claims. This perennial and thorny topic will be addressed in the context of four common scenarios, and will finish with a summary of current bad faith trends: (1) where liability is clear and damages are above limits: is tendering policy limits enough? (2) can an insurer refuse to hire experts to defend uninsured exposure?; (3) can an insurer refuse to settle weak reputation-harming claims?; (4) defending two insureds: can insurer pay a limits settlement for one?; and (5) Interesting bad faith trends: liability in excess of limits even in the absence of bad faith; individual liability for adjusters; and no bad faith failure to settle when there is a valid offer but no time is stated for acceptance.

(1) Where liability is clear and damages are above limits: is tendering policy limits enough?

In *Harvey v. GEICO General Insurance Co*. Florida's Supreme Court held that an insurer cannot evade bad faith liability by simply complying with a "checklist" of key obligations to its policyholder. No. SC17-85, 2018 WL 4496566 (Fla. Sept. 20, 2018). Accordingly, insurers may be held liable for bad faith despite advising policyholders of settlement opportunities, the probable outcome of underlying litigation, and the possibility of an excess judgment. The Court rejected the notion that "so long as a checkmark appeared next to each item [on the checklist of obligations owed by an insurer to its insured] bad faith may not be found."

Harvey involved a deadly automobile accident. Harvey, the policyholder, was found liable. His GEICO policy provided $100,000 in liability coverage. Three days after the accident, GEICO informed policyholder he likely faced liability in excess of policy limits. The attorney for the deceased motorist's estate asked GEICO's claims handler for a statement regarding Harvey's available assets, information regarding additional insurance, and whether he was acting in the

course and scope of his employment. GEICO's claims handler—who was handling 130 files at the time—refused the request, and failed to immediately communicate the request to Harvey or his attorney. Harvey and his attorney, once aware of the request, delayed providing it.

GEICO tendered policy limits to the estate's attorney within days of the accident, but the Estate returned the check and filed suit against Harvey. A jury found Harvey liable for more than $8 million in damages. Harvey sued GEICO for bad faith and won a jury verdict in excess of $9 million. The appeals court reversed finding insufficient evidence to establish bad faith and that Harvey's own action contributed in part to the excess verdict. Harvey appealed.

The Florida Supreme Court reversed reinstating the jury verdict against GEICO. In its 4-3 decision, the majority noted that "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 insured knew the insured faced significant financial exposure because of multiple survivors and low limits. The Court stated the insurer's obligations "are not a mere checklist. An insurer is not absolved of liability simply because it advises the insured of settlement opportunities, the probable outcome of the litigation, and the possibility of an excess judgment." Rather, the critical inquiry is "whether the insurer diligently, and with the same haste and precision as if it were in the insured's shoes, worked on the insured's behalf to avoid an excess judgment." The court reasoned that GEICO knew of its insured's fault, the potential for catastrophic damages, and "completely dropped the ball" by failing to use the same degree of care and diligence as a person of ordinary care and prudence should exercise in the management of his own business" and found that, under the totality of circumstances, GEICO failed to act as if the financial exposure to Harvey was "a ticking financial time bomb."

The Chief Justice filed a scathing dissent highlighting his concern about the majority's standard, which he characterized adopting a negligence standard for bad faith, "incentiviz[ing] a rush to the courthouse steps" by third-party claimants seeking to convert inadequate policy limits into a windfall. However, *Harvey* noted that negligence alone does not suffice to prove bad faith, but that "because the duty of good faith involves diligence and care in the investigation and evaluation of the claim against the insured, *negligence is relevant* to the question of good faith."

(2) Can an insurer refuse to hire experts to defend uninsured exposure?

One example is where the claim will exceed limits, and the insured, under a duty to defend policy without eroding limits, wishes to retain several expensive experts to control the uninsured exposure. The insurer states that it need only defend the claims to which the policy applies and refuses.

Expert fees, including those for investigation, constitute defense costs and are covered under the duty to defend, if they are reasonable and necessary. *General Accident Ins. Co. of America v. State, Dept. of Environmental Protection*, 143 N.J. 462, 672 A.2d 1154 (1996) (CGL policy); *Barratt American, Inc. v. Transcontinental Ins. Co*., 102 Cal.App.4th 848, 861, 125 Cal.Rptr.2d 852, 861 (App. 4th Dist. 2002) (investigative costs). Insurers can argue persuasively, particularly in states where the insurers are only required to defend those claims which potentially fall within the ambit of the policy or the many states where it is unclear, that the expert fees are not covered because they are part of uncovered claims. In states where insurers must defend all claims, whether covered or not, if there exist allegations of any covered acts, the policyholders have a stronger argument, at least where the experts are necessary. *Freedom Specialty Ins. Co. v. Platinum Mgmt. (NY), LLC*, 2017 BL 468437, 4 (Sup. Ct. Dec. 21, 2017) ("the Insureds argue

persuasively that they face irreparable harm without advancement of Defense Costs, and the balance of hardships tips decidedly in their favor. … the Insureds are in need of funds to pay for the expert witnesses and consultants that are essential to their defense.")

(3) Reputational Harm: can an insurer refuse to settle weak reputation-harming claims?

One example in which this instance may arises is where the insured, a private K-12 college preparatory school, is sued regarding allegations of sexual assault on its premises. The incident was reported to local police who investigated but filed no charges. The insurer under a duty to defend policy with rights to settle all tendered claims ("the insurer "may, at [its] discretion, … settle any claim or 'suit' that may result" from an "occurrence" or claim or "suit…"), agrees that the claim is covered. The insurer conducts an investigation and determines that there is a slim possibility of an adverse liability finding but that the demanded settlement amount is out of proportion to the claim. The insurer would like to press on with the case but the insured has requested an expedited settlement to avoid reputational harm. Can an insurer refuse to settle weak reputation-harming claims?

The answer is: it depends. Generally, insurers must give the interests of the insured at least as much consideration as it gives its own interests, including in the decision to settle. Generally, courts consider the reasonableness of the insurer's actions in determining bad faith, including "the strength of the injured claimant's case on the issues of liability and damages" *Clearwater v. State Farm Mut. Auto. Ins. Co*., 164 Ariz. 256, 792 P.2d 719, 722 (1990) (*en banc*). Frequently, when the insurer has just cause, a reasonable basis or excuse, of the claims are "fairly debatable" a denial does not constitute bad faith. Bad faith may require that settlement could have remained within policy limits. The duty to settle is limited in some states to occasions where the insurer's failure to settle exposed its insured to personal liability for a verdict in excess of limits. In several states bad

faith failure to settle requires liability be "reasonably clear." Or a determination that the insurer must indemnify the insured.

Insurers have many good arguments regarding the reasonableness of failing to settle weak claims, whether they harm the insured's reputation or not. Because the strength of the claim against its insured is considered in the reasonableness determination, where weak claims exist and the insured is likely to prevail, the duty to settle may never arise. This is particularly true where the failure to settle requires liability of the insured be reasonably clear. For reputation-harming claims, the claimant's demand may be excessively high. Where bad faith failure to settle requires that failure to expose the insured to personal liability for excess verdicts, the carrier has a strong argument that, because the claim is weak, failing to settle does not in fact expose the insured to any liability.

Policyholders can make strong arguments relying on the general "equal treatment" standard, because the insurer has a duty to treat the insured's interests equally with its own, and it is in the insured's best interest to settle the claim rather than have its reputation harmed. However, it is arguably in the insured's best interest to fight weak and untrue claims to prove there was no liability. Policyholders can also argue that settlement is reasonable, even for unsubstantiated claims, when the cost of settlement is less than the damage the publicity regarding this reputation-damaging claim

(4) Defending two insureds: can insurer pay a limits settlement for one?

When an Insured under a Multi-Insured Policy Grabs the Limits to Settle a Common Claim: Canadian Common Law on the "first to settle" or "first past the post" Principle

In common law Canada, the duty of a liability insurer to defend a given claim is founded upon the principle that if a liability insurer would be required to indemnify the insured against the

claim if it were proven be true, then that insurer has both the right and the duty to defend. That right and duty is founded upon the wording used in the policy. The often-acknowledged origin of this statement is the 1990 Supreme Court of Canada judgement, *Nichols* v. *American Home Assurance Co*., were the Chief Justice stated:

> The insurer's interest in defending a claim is related to the possibility that it may ultimately be called upon to indemnify the insured under the policy. It is in the insurer's interest that if liability is found, it be on a basis other than one falling under the policy. Requiring the insurer to defend claims which cannot fall within the policy puts the insurer in the position of having to defend claims which it is in its interest should succeed. The respondent suggested that this potential conflict could be avoided if the insured was able to retain his own lawyer, with the cost to be borne by the insurer. However, this would not end the difficulty. An insurer would be understandably reluctant to sign a "blank cheque", and cover whatever costs are borne by whatever lawyer is retained, no matter how expensive. Yet the insurer could not challenge any of these expenses without raising precisely the same conflict. For this reason, the practice is for the insurer to defend only those claims which potentially all under the policy, while calling upon the insured to obtain independent counsel with respect to those which clearly fall outside its terms.

The *Nichols* decision has been reaffirmed time and again by the Supreme Court of Canada as well as the Courts of Appeal of almost every Canadian province and territory. In the result, in common law Canada, it is generally recognized that there is an automatic conflict-of-interest between an insurer who is forced to defend, but has no obligation to indemnify, and an insured, who will ultimately bear 100% of any judgment or settlement generated by the action.

If after the defence of a claim is initiated by an insurer, the policy limits are exhausted through the payment of claims, then the insurer no longer has an obligation to indemnify. If there is no obligation to indemnify, then, in theory, the obligation to defend should terminate. The following passage from the 2004, Ontario trial level decision, *Boreal Insurance Inc*. v. *Lafarge Canada Inc*., [2004] O.J. 1571, supports that contention:

> In my view, it is not a reasonable expectation that the duty to defend would apply when the insurer does not have a duty to pay off claims, *unless the policy wording clearly provides for this*. In addition, one must read the entire policy in the context of the judicial statements about the relationship between the two duties, and

> whether one characterizes them as separate or inseparable, *the inexorable result is that the duty to defend terminates upon the exhaustion of the limits*. This is consistent with common sense, and the policy reasoning behind the judicial characterization of the two duties.

Therefore, in common law Canada, where the interests of multiple insureds under a policy are several, not joint, the insurer must proceed to fund each *fair and reasonable* settlement that is negotiated *in the best legal interests of an insured* in the order in which settlement occurs, independently of all other claims, thereby depleting the limits, even though the claims against other insureds, who have rights to call upon those limits, have not matured to either settlement or judgment, leaving them without insurance to either defend and indemnify them against the potential of future judgments. Those insureds whose claims remain in existence as the claims of other insureds are paid, do not have a cause of action in bad faith against the insurer: *Laidlaw Inc., Re* (2003), 46 C.C.L.I. (3d) 263 (Ont. S.C.J.) [Commercial List]) at p. 272;*Solway* v. *Lloyd's Underwriters*, [2005] O.J. No. 1331 (Ont. S.C.J.) at paragraphs 65, 69.; *Hollinger International Inc*. v. *American Home Assurance Co.,* [2006] O.J. No. 140 (S.C.J.), at para. 112-115;*Sun-Times Media Group Inc*. v. *Royal & SunAlliance*, 2007 CarswellOnt 7559.

The Alberta Court of Queen's Bench adopted this analysis and applied it to a commercial liability policy in:

Commerce & Industry Insurance Co. Canada Inc. v. *Singleton Associated Engineering Ltd*., 2005 ABQB 500:

> The *Hollinger* decision set out the test to declare that a settlement is to be declared fair, reasonable and in the best interests of the insured. That test will generally take into account factors such as:
>
> a) likelihood of recovery or likelihood of success;
>
> b) amount and nature of discovery, evidence or investigation;
>
> c) settlement terms and conditions;
>
> d) recommendation and experience of counsel;
>
> e) future expense and likely duration of litigation;

f) recommendation of neutral parties, if any;

g) number of objectors and nature of objections; and

h) the presence of arm's length bargaining and the absence of collusion.

The Court in the Hollinger case stated at para. 112:

> There simply is no basis for an insurer to refuse to pay a valid and determined claim that falls within coverage without the risk of exposure to a claim for bad faith.

The mere fact that other insureds have, or may have, claims that are not finally determined, cannot operate to prevent those otherwise entitled to indemnity from receiving it. Further, the fact that a judgment or settlement may deplete or even extinguish proceeds available to other insureds does not detract from the principle: see *Solway v. Lloyd's Underwriters*, [2005] O.J. No. 1331 (Ont. S.C.J.) at paragraphs 65, 69.

Consequently, finally determined claims will be paid as presented on a first come, first served basis. Subject to errant policy wording to the contrary, Canadian insurers in common law Canada are not obliged to consider claims or potential claims which have not been finally determined by judgment or settlement when determining whether to pay claims which, in contrast, have been finally determined. To impose a requirement upon insurers (and a corresponding restriction on an insured's direct right to have its resolved claim paid) which would oblige the insurer to defer payment (and the claimant collection) until such time as all claims and potential claims under the subject Policies are known and finally determined would constitute an unwarranted rewriting of most commercial liability policies.

Counsel for the insureds who are left without a defence and indemnity must distinguish this body of caselaw on the basis of the policy before them. They are likely to argue that the right to a defence to covered claims is a contractual right. There must be policy language to both initiate that right and, if the obligation to defend terminates upon exhaustion of the limits, there must be language in the policy to support that termination. In the *Boreal* case, there was support in the

wording of the policy to conclude that the duty to defend was subject to the availability of limits to pay the claims. That support was derived from the preamble to the primary policy which read, "…subject to the limits of liability . . . and other terms of the policy…". If the policy in question does not make it clear that the obligation to defend will terminate upon the exhaustion of limits, then the argument may have legs. Support for that position comes from a case from Quebec, that is not dependent upon Civil Code interpretation and therefore can be argued to apply in common-law Canada, that states that where the policy does not specifically state that the insurer's right and duty to defend terminates upon exhaustion of the limits; or, that the right and duty to defend is subject to the limits, that this duty to defend survives and continues, even if the limits are exhausted before the claim comes to an end: *Les Mines d'Amiante Bell Limitée v. Federal Insurance Company*, [1985] C.S. 1096.

The rebuttal to this contractual argument is that the obvious, insurmountable conflict between an insurer who no longer has an obligation to indemnify, but is compelled to defend, and an insured whose assets are now fully exposed to any judgment arising from the litigation, is so extreme, that it would take very, very compelling policy language to rebut the presumption that the duty to defend ends upon the exhaustion of the policy limits. Further, an insured that chose to manage its risk under a policy that provides it with coverage that is several, rather than joint, can have no reasonable expectation that an insurer will be obliged to continue to defend once its limits are depleted through the payment of claims.

U.S. Law

The insurer has issued a duty to defend policy to a corporate insured with an additional insured endorsement covering another entity under which the limits are shared. The insurer accepts that it must defend each of the insureds against a common claim and splits the administration of the defense of the claim internally. Additionally, the insurer appoints separate counsel for each

insured. One of the insureds receives an offer to settle for policy limits. What obligations does the insurer owe to each of its insureds?

Accepting a settlement offer that only releases one insured from liability may constitute bad faith. The states that find settlement as to one insured that does not release all insureds may constitute bad faith tend to utilize the following line of reasoning:

> courts considering this issue have held that requiring an insurer to settle a claim for policy limits, while leaving its insureds exposed to personal liability, presents an impossible Catch-22 for an insurer, exposing it to bad faith liability on either flank. In light of the conflicting duties owed by an insurer to its insureds and to third party claimants, courts have consistently held that an insurer's insistence on securing a release of its insureds before settling for policy limits does not constitute bad faith.

Gallagher v. Allstate Ins. Co., 74 F. Supp. 2d 652, 657 (N.D. W. Va. 1999). However, if the insurer can pay limits for one insured, while releasing liability for both insureds (for instance under an agency theory), the insurer may be able to settle for policy limits for one insured.

> **(5) Interesting Bad Faith Trends**: Liability in Excess of Limits Even in the Absence of Bad Faith; Individual Liability for Insurance Adjusters; and No Bad Faith Failure to Settle Within Policy Limits When There is a Valid Offer but No Time is Stated for Acceptance

a) Liability in Excess of Limits even in the Absence of Bad Faith

In *Century Surety Co. v. Andrew on Behalf of Pretner*, Nevada's highest court found an insurer can be held liable for consequential damages in excess of policy limits for breaching the duty to defend even when there is no bad faith. 134 Adv. Op. 100, 2018 WL 6609591 (Nev. 2018). In *Pretner*, the owner of a company negligently hit Pretner with a truck, causing severe brain injury. The insurer refused to defend under a commercial general liability policy following an investigation wherein it concluded the company owner was acting outside the scope of his employment at the time. The driver did not defend, defaulted, and assigned his insurance rights to Pretner pursuant to settlement. The district court entered an $18 million default judgment against

the driver and his company, and found that the driver was driving within the scope of his employment.

The Nevada Supreme Court rejected the majority rule that when an insurer breaches its duty to defend liability is capped at policy limits plus the policyholder's defense costs. Instead, it held, that insurers that breach their duty to defend may be held liable for consequential damages in excess of policy limit "even if the insurer did not act in bad faith." The court cited ALI's Restatement of the Law of Liability Insurance, which provides that recoverable damages for breach of a liability policy include consequential damages and concluded that the majority view placed an "artificial limit" on the insurer's liability within policy limits for breaching the duty to defend. The court.

The court reasoned that other jurisdictions, like California, hold insurers liable for losses flowing from a failure to defend even when there may be a dispute regarding coverage. The court emphasized that liability is not automatic and is subject to proof:

> we are not saying that an entire judgment is automatically a consequence of an insurer's breach of its duty to defend' rather, the insured is tasked with showing that the breach caused the excess judgment and is obligated to take all reasonable means to protect himself and mitigate his damages.

b) Individual Liability for Adjusters

In *Keodalah v. Allstate Insurance Co.*, the Washington State Court of Appeals held that an insurance adjuster can be held individually liable for bad faith and breaching consumer protection laws while handling claims in the regular course of employment. 413 P.3d 1059 (Wash. Ct. App. Mar. 26, 2018). Keodalah, the insured, tendered a claim to Allstate seeking Uninsured motorist coverage ("UIM") after a motorcyclist hit his truck. The police department, witnesses and accident reconstruction experts hired by Allstate indicated that the motorcyclist was at fault. Keodalah requested his $25,000 limit. Allstate refused, and Keodalah filed suit. Allstate's adjuster (also

Allstate's Rule 39(b)(6) corporate deponent) contradicted the findings of the police, witnesses and reconstruction expert at trial by testifying that Keodalah was 70% at fault because he ran a stop sign and was talking on his cell phone at the time of the accident. The jury, however, found the motorcyclist one hundred percent liable and awarded Keodalah more than $100,000.

Keodalah filed another suit against Allstate and Allstate's adjuster for bad faith and violating the Washington Consumer Protection Act. The Washington State Court of Appeals reversed the trial court's dismissal of the adjuster, holding that an insurance adjuster can be individually liable for bad faith and violating Washington's consumer protection statute while handling claims in the regular course of employment. Washington State has a regulation imposing a duty of good faith and fair dealing on "all persons engaged in the business of insurance…" (RCW 48.01.030.) Because an insurance adjuster is a "person", the appellate court found bad faith liability could be found against an adjuster. The Court of Appeals noted that Washington's bad faith statute did not "limit[] the duty of good faith to corporate insurance adjusters or relieve[] individual insurance adjusters from this duty," and reasoned that the duty of good faith "applies equally to individuals and corporations acting as insurance adjusters." This case has been accepted by the Washington Supreme Court. Other states permit bad faith against claims adjusters. *O'Fallon v. Farmers Insurance Exchange*, 859 P.2d 1008 (Mont. 1993); *Liberty Mutual Ins. Co. v. Garrison Contractors*, 966 S.W.2d 482 (Tex. 1998); *Taylor v. Nationwide Mut. Ins. Co*., 589 S.E.2d 55 (W.Va. 2003); *Tippett v. Ameriprise Ins. Co*, 2015 WL 1345442 (E.D. Penn. 2015).

c) No Bad Faith Failure to Settle Within Limits When There is a Valid Offer but No Time is Stated for Acceptance of Settlement Offer

In *First Acceptance Insurance Company of Georgia, Inc. v. Hughes* Georgia's highest court held "that an insurer's duty to settle arises only when the injured party presents a valid offer to settle within the insured's policy limits." (Case No.: S18G0517, Decided March 11, 2019). In

Hughes, the court found that, despite the fact that the claimant presented the insurer with a valid offer to settle within limits, because the offer failed to include a deadline, "the insurer did not act unreasonably in failing to accept the offer before it was withdrawn." The insurer's adjusters determined early on that the 2008 crash caused by its insured was covered, that the insured was liable for the loss, and that his exposure exceeded policy limits. Following some back and forth regarding settlement negotiations, counsel for two individuals hurt in the crash offered to settle for policy limits. There was no apparent time limit to respond, and the demand was inadvertently filed with some medical records. Approximately five-and-one-half weeks after offering to settle for limits, the two claimants revoked the settlement offer. At subsequent settlement negotiations, the insurer offered to settle for the $50,000 policy limit. The two claimants rejected this offer. A jury verdict was entered for $5.3 million. The administrator for the insured's estate filed against First Acceptance alleging negligence and bad faith for the failure to settle the claim within policy limits.

The court used general contract principals in determining whether the offer was valid. The court found there was no time limit for acceptance in the letters, as the offer to settle was presented as an alternative to these particular claimants participating in a global settlement conference. No time was set for the settlement conference. Because there was no set time for acceptance, the court used the contractual reasonable time standard.

The administrator "argue[d] that First Acceptance knew or should have known that [this claimant's] claim, in particular, was by far the most severe of the multiple bodily injury liability claims facing its insured, and that the evidence showed insurance industry custom and practice

required First Acceptance to resolve the most serious claim so as to limit its insured's exposure."[1]

The court found an insurer is not required to settle part of multiple claims. It reasoned that:

> [a] settlement of multiple claims that included [this] claim was in the insured's best interests as it would reduce the overall risk of excess exposure, and [these two claimants] had expressed their interest in attending a settlement conference with the other claimants. First Acceptance's failure to promptly accept [their] offer was reasonable as an ordinarily prudent insurer could not be expected to anticipate that, having specified no deadline for the acceptance of their offer, [these claimants] would abruptly withdraw their offer and refuse to participate in the settlement conference.

[1] Georgia's Court of Appeals permits liability insurers to, in good faith, settle part of numerous claims against its insured, even for policy limits. *Miller v. Ga. Interlocal Risk Mgmt. Agency*, 232 Ga. App. 231, 231 (1) (501 SE2d 589) (1998).

What We Talk About When We Talk About "Plain Meaning"

American College of Coverage Counsel
2019 Annual Meeting

Chicago, IL
May 8-10, 2019

Jeffrey W. Stempel
William S. Boyd School of Law
University of Nevada Law Vegas
jeff.stempel@unlv.edu

What We Talk About When We Talk About "Plain Meaning"

Jeffrey W. Stempel©
Doris S. & Theodore B. Lee Professor of Law
William S. Boyd School of Law
University of Nevada Las Vegas

Plain Meaning: Traditional, Dominant, Ubiquitous – But Still Under-Explained

The term "plain meaning," and its cousins "ordinary" meaning, "clear" text, "unambiguous language," and the like have been with for decades, perhaps even centuries and perhaps even from the earliest use of papyrus or other media to memorialize agreements. The concept has now acquired additional attention in the wake of the American Law Institute's Restatement of the Law of Liability Insurance ("RLLI"), which endorses a plain meaning approach to the interpretation of insurance contract policies – or not according to some critics. In the run-up to the final version of the RLLI section endorsing plain meaning, there was ample conflict between those favoring a more textualist approach to policy construction and those favoring a more contextualist methodology more receptive to extrinsic evidence.

In the end, the textualists won – although not to the satisfaction of more ardent textualists and insurer advocates. RLLI §3 is a victory for textualists, but with not as resounding a victory as they sought. However, even if the contextualists had prevailed in the RLLI, this would hardly have diminished the force of the plain meaning concept in existing and continuing caselaw. For example, a quick LEXIS search for judicial opinions issued just in January and February of 2019 using the term "plain meaning" or its equivalents (e.g., "plain-meaning") yields roughly 4,000 cases.1 Many of these are statutory interpretation opinions but even if statutory and contractual interpretation could be neatly separated (my thesis is that they should not be), it is clear that plain meaning is the dominant approach to construction of contracts (and probably for statutes and regulations as well). But is "plain meaning" really a meaningless venire placed upon an already decided result? Or is do courts coherently and consistently apply the concept?

[1] Any attempt to capture the historical prevalence of the term and trends in the popularity of plain meaning/textualist jurisprudence (which is a task for a braver soul) would need to proceed in increments because of the limits of even the LEXIS and WESTLAW computers – and these of course fail to capture the term's prevalence in ancient times predating the archives of the modern digital library.

Without doubt, the term plain meaning (I will mercifully stop putting the terms in quotation marks for the remainder of this manuscript) is hard-wired in American law (and UK law as well; it appears less dominant in continental legal systems). As presented in the Appendices to this paper, many states have statutes mandating a plain meaning approach and all states have leading – often controlling --contract construction cases extolling the virtues of an approach to contract construction that is not merely text-centered but strongly defers to text alone so long as its meaning is "plain" (pardon the quotation mark). Although precise classification of the states according to their embrace of plain meaning textualism is impossible due to variance in cases, court composition, and inconsistency in the invocation of the concept, there seems little doubt that most states follow a plain meaning concept or "rule," and reveal a clear majority of state courts identifying themselves as plain meaning states.

But identifying the supremacy of the plain meaning rule or its arguable increase in adherence begs the question of what exactly it means to take a plain meaning approach to the language of contract documents as well as the methodology used by courts in discerning plain meaning or its absence (in which case, extrinsic and contextual evidence is employed in resolving unclear text).

As discussed below, the short answer is that courts are depressingly tautological in applying the plain meaning rule/doctrine/approach. The meaning of insurance policies (and other documents, including statutes and regulations) is plain when the court says it is. And meaning is plain when a court is confident that its understanding of a term's meaning is the only reasonable one.

As a review of caselaw reflects, courts generally do not "unpack" their reasoning in reaching conclusions as to the plain meaning of text. Although judicial determinations are almost certainly influenced by sub silentio contextual factors such as the judge's background, experience, jurisprudence, ideology, and circumstances surrounding an insurance or other dispute, these factors almost never are specifically examined by courts applying a plain meaning rationale to decide a case.

Plain Meaning Synthesized – Sort Of

Deciphering Secondary Sources

As noted above, courts divide over their approach to contract interpretation and the role of extra-textual evidence of contract meaning. Even determining the prevailing rule in a particular jurisdiction can be difficult. For example, in Nevada, one can find precedent that seems consistent with the contextual approach of the Contracts Restatement[2] as well as precedent

[2] *See, e.g.*, Galardi v. Naples Polaris, LLL, 301 P.3d 364 (Nev. 2013)(even though contract text found to be unambiguous, trial court did not err by considering trade usage and industry custom in construing provision); Powell v. Liberty Mut. Fire Ins. Co., 252 P.3d 668 (Nev. 2011)(refusing to give broad or literal reading to earth movement exclusion in homeowner's policy and finding term ambiguous in light of context); Hilton Hotels Corp. v. Butch Lewis Prods., 808 P.2d 919 (Nev. 1991)(approving jury instruction permitting consideration of "all the circumstances leading to the contract, such as negotiations and statements to the parties"); Moore v. Prindle, 391 P.2d 352, 354 (Nev. 1964)(endorsing practical construction of contracts where the interpretation of the parties reflected by their conduct is "always persuasive, if not conclusive.")(citing Reno Club v. Young, discussed below in

that takes a more decidedly textualist approach resistant to consideration of information outside the four corners of the contract documents.[3]

Many commentators have summarized the plain meaning approach in ways that are essentially unified on the core concept but become increasingly less helpful when applied to particular cases in light of judicial variance (among jurisdictions) and inconsistency (within jurisdictions) regarding application of the concept.

Defining Plain Meaning Hindered by Co-Mingling With Other Concepts, Parol Evidence in Particular

The search for the meaning of plain meaning – in both secondary sources and in caselaw – is also complicated by the tendency of observers to co-mingle the concepts of ambiguity, context, extrinsic evidence, the parol evidence rule, along with the acceptable hierarchy and boundaries of the tools used for supplementing textual analysis.

For example, one leading treatise (my personal favorite that I assign in first-year Contracts) is informative but to a degree mashes its discussion of plain meaning into discussion of the parole evidence rule.[4] While not necessarily "wrong," neither is this combination and categorization required. My own view is that it is helpful to distinguish evidence of contact meaning in the parol evidence rule context from issues of extrinsic evidence when written

---

subsequent note). *See also* Gonski v. District Court, 245 P.3d 1164 (Nev. 2010)(adopting sliding scale approach to determining unenforceable contracts due to combination of procedural unconscionability and substantive unconscionability); Golden Road Motor Inn, Inc. v. Islam, 376 P.3d 151 (Nev. 2016)(invoking public policy concerns to strike down noncompete clause in casino worker's employment contract and refusing to modify or "blue pencil" clause to make it consistent with public policy on grounds this would encourage overly aggressive drafting of such clauses). Subsequent legislation partially overruled *Islam* by mandating blue penciling. See Kristopher Kalkowski, Note, *Recognizing an Overcorrection: A Proposal for Nevada's Policy on Non-Compete Agreements*, 18 NEV. L.J. 261 (2017).

[3] *See, e.g.*, William v. United Parcel Services, 302 P.3d 1144, 1147 (Nev. 2013)("When a statute is clear and unambiguous, we give effect to the plain and ordinary meaning of the words")(quoting Cromer v. Wilson, 225 P.3d 788, 790 (Nev. 2010)("In the absence of an ambiguity, we do not resort to other sources, such as legislative history."); Kaldi v. Farmers Ins. Exch., 21 P.3d 16, 21 (Nev. 2001)(where "a written contract is clear and unambiguous on its face, extraneous evidence cannot be introduced to explain its meaning.")(quoting Geo. B. Smith Chemical v. Simon, 555 P.2d 216, 216 (Nev. 1976); Siggelkow v. Phoenix Ins. Co., 846 P.2d 303, 304 (Nev. 1993)(contract terms should be "viewed in their plain, ordinary and popular sense."); Reno Club v. Young Inv. Co., 182 P.2d 1001, 1015-16 (Nev. 1947)(in the absence fo clear evidence of a different intention, words must be presumed to have been used in their ordinary sense, and given the meaning usually and ordinarily attributed to them; finding option agreement to be "in ordinary and plain language" with a "meaning [tha] seems clear." *See also* Nevada State Democratic Party v. Nevada Republican Party, 256 P.3d 1, 4 (Nev. 2011)("when a statute is facially clear, a court should not go beyond its language in determining its meaning."); Lowe Enters. Residential Ptnrs., L.P. v. District Court, 40 P.3d 405, 412 (Nev. 2002)(where statute's language is "plain and unambiguous" and "its meaning clear and unmistakable" there "is no room for construction" or consideration of material beyond the statutory language itself. But where a statute is ambiguous, the plain meaning rule has no application); Nevada Mining Ass'n v. Erdoes, 26 P.3d 753 (Nev. 2001)(using "clear statement of legislative intent" to resolve "any ambiguity inherent" in statutory language at issue regarding meaning of "120 calendar days" following commencement of legislative session for determining deadline for conclusion of session; adjusting for daylight savings time to conclude that two bills were acted upon before expiration of session).

[4] E. ALLAN FARNSWORTH, CONTRACTS §§7.6-7.13 (4th ed. 2004).

contract instruments do not purport to be sufficiently integrated for the parol evidence rule to apply.

Courts (and lawyers generally) tend to erroneously equate the terms "parol evidence," "extrinsic evidence," and "context" or "contextual evidence" or "information." Parol evidence, properly understood, refers only to evidence of pre-contract discussions proffered to vary the written terms of the contract documents ultimately accepted ("agreed" to) by the parties. The idea is that a party now dissatisfied with some aspect of the memorialized contract should not be able to avoid the written terms of the deal by arguing that they are inaccurate based on conversations that took place prior to finalization of the memorialization.

For example, a policyholder to a manuscript insurance policy that contains a clearly written pollution exclusion should not be able to avoid the exclusion by testifying that prior to signing the policy, the policyholder was assured that the exclusion would not apply to any liability stemming from belching smokestack at the old Pittsburgh plant that it was planning to retire in five years without investing in retrofitting.

Unless the policyholder can avoid the parol evidence rule through one of its recognized exceptions, this type of pre-memorialization discussion would not be admissible unless the exclusionary language is sufficiently facially ambiguous that the court can reasonably conclude that the conversational evidence is not contradicting the written instrument but rather is clarifying an ambiguity.

So understood, parol evidence is a relatively narrow doctrine as well as one rather easily avoided, perhaps because despite its venerability it is frequently criticized and because its rationale (that a silver-tongued liar or fabulist poses great danger of misleading lay jurors and that this risk is greatly controlled by limiting inquiry to the four corners of a contract instrument) is increasingly seen as flawed. The relative effectiveness of contract and commercial law in Europe and in international transactions in spite of the absence of a parole evidence rule in continental law as well as in the Convention on the International Sale of Goods (CISG) and in the UNIDROIT principles also undermines the parol evidence rule. An American may prefer Anglo-American contract law to these other bodies of law, but even the most ardent exceptionalist/chauvinist would have difficulty maintain (at least with a straight face) that these other bodies of law produce terrible results stemming from tribunals beguiled by false testimony.

Of course, outside the United States, lay juries are seldom involved in deciding contract disputes. Even in the jury-friendly United States, layperson opinion has limited impact on contrast construction because this is regarded as a matter of law for the judge rather than a matter of fact for the jury. In addition, U.S. law has for the past 30 years or so increasingly empowered judges to decide disputes without input from juries through doctrinal developments making summary judgment and motions to dismiss easier to obtain.

One might therefore, limit the term "parol evidence" to use of pre-memorialization discussions or communications of the parties that contradicts the written contract terms. "Extrinsic evidence" would then describe non-textual evidence bearing on meaning, which could include post-memorialization communications or conduct, including course or performance or

course of dealing regarding the transaction as well as "context," which can be understood either as its own category or a subset of extrinsic evidence providing background orientation that is helpful to understanding the purpose of a transaction, the objectives sought by the parties, the intent of the parties, and other factors that might reasonably bear upon interpretation. For example, what is the custom and practice of the industry/activity/field in question? Was the transaction made during peacetime or wartime? During a period of high inflation or deflation? During booms times or a recession?

Considering the many permutations of non-textual evidence should be helpful but perhaps provides too much data to be reliably and consistently processed by courts hoping to resolve questions as expeditiously as possible. Undoubtedly, this explains some of the attraction of a more textually oriented interpretative approach that limits the amount of information that must be processed by courts.

Treatise Treatment of Plain Meaning

Farnsworth

Allan Farnsworth, despite perhaps overly co-mingling the parol evidence and extrinsic evidence concepts, provides useful summary of the concept and opposing views of the concept.

> The essence of a plain meaning rule is that there are some instances in which the meaning of language, when taken in context, is so clear that evidence of prior negotiations cannot be used in its interpretation. If this is true, a court must make a preliminary determination that the meaning of the language in dispute falls short of that degree of clarity before admitting such evidence to interpret it. Can the meaning of language ever be that clear? Corbin thought not: "No parol evidence that is offered can be said to vary or contradict a writing unit by process of interpretation the meaning of the writing is determined.. On this view, the plain meaning rule should be discarded and evidence of prior negotiations freely admitted with no preliminary determination as to clarity.[5]

Farnsworth also noted the kinship between contract construction and statutory interpretation.

> In the field of statutory interpretation, the plain meaning rule, where it persists, bars the use of legislative history to interpret statutory language that is "clear on its face." To what extent is there an analogous rule that bars the use of prior negotiations to interpret contract language that is "clear on its face" To what extent, in other words, is there a plain meaning rule for contracts? Even the rule's opponents would have to admit that it appears to have retained more vitality in the field of contract interpretation than in the area of statutory interpretation. The explanation for this continued vitality may be that the analogy is far from perfect. If legislative history is used in statutory interpretation, it is documentary in form

[5] E. ALLAN FARNSWORTH, CONTRACTS 462 (4th ed. 2004).

> and its evaluation is in the hands of judges, but this is not the case if evidence of prior negotiations is used in contract interpretation. This has two consequences for contract interpretation. First, if evidence of prior negotiations is excluded, disputes can be disposed of more expeditiously: pre-trial discovery can be limited and summary judgment will be more available. A rule that excludes such evidence naturally finds favor with judges conscious of the burdens imposed on them by disputes over contact interpretation. Second, if evidence of prior negotiations is excluded, issues of contract interpretation will more often be left to judges as issues of "law" rather than "fact": issues to be addressed by the trial judge rather than a jury and to be reviewed on a plenary rather than a clearly erroneous basis. A rule that excludes such evidence has an obvious appeal to appellate judges confident of their own abilities in resolving issues of contract interpretation. In this respect, the rationale for excluding evidence of prior negotiations when it is offered to interpret language may differ form the rationale for excluding such evidence when it is offered to contradict or add to language.

E. ALLAN FARNSWORTH, CONTRACTS 462 (4th ed. 2004).

> The essence of a plain meaning rule is that there are some instances in which the meaning of language when taken in context is so clear that evidence of prior negotiations cannot be used in its interpretation. . . . Can the meaning of language ever be that clear? Corbin though not: "No parol evidence that is offered can be said to vary or contradict a writing until by process of interpretation the meaning of the writing is determined."[6] On this view, the plain meaning rule should be discarded and evidence of prior negotiations freely admitted with not preliminary determination as to clarity. The Supreme Court of Alaska)[7] has done just this by abandoning the rule "that resort to extrinsic evidence can take place only after a preliminary finding of ambiguity" on the ground that it is "artificial and unduly cumbersome" and "offers no such advantage over one which initially turns to extrinsic evidence for such light as it may shed on the reasonable expectations of the parties." A few other courts have shown sympathy for Corbin's view, but the overwhelming majority of courts retains some king of plain meaning rule.

E. ALLAN FARNSWORTH, CONTRACTS 463 (4th ed. 2004)(footnotes in original omitted).

> Under a plain meaning rule there is a two-stage process. In the first stage the court makes a preliminary determination of whether the language in dispute lacks the required degree of clarity before going on to the second stage, that of

[6] Arthur L. Corbin, *The Parol Evidence Rule*, 53 YALE L.J. 603, 622 (1944).

[7] Alyeska Pipline Srerv. Co. v. "O'Kelly, 645 P.2d 767, 771. N. 1 (Alaska 1982), which is still good law. See Mahan v. Mahan, 347 P.3d 91, 94-95 (Alaska 2015)(litigant "argues that extrinsic evidence may only be considered if the plain language of an agreement reveals ambiguity," [but] that is not the law in Alaska.")("We examine 'both the language of the [agreement] and extrinsic evidence to determine if the working of the [agreement] is ambiguous.'")(citations omitted). The court found the term "profit" did not on its face have a plain meaning of total revenue minus total expenditures but could also mean gross revenue or gross revenue minus some but not all expenses, requiring consideration of additional information.

> interpretation. Only if the court determines that the language lacks this required degree of clarity will evidence of prior negotiations be admitted during the second stage of the purpose of interpretation. A question than arises as to whether evidence of prior negotiations is admissible during the first stage to aid the court in its preliminary determination, and it is this question about which controversy has swirled. Can evidence of prior negotiations be used to show whether contract language lacks the required degree of clarity, whether it is "ambiguous" as opposed to "plain"?

E. ALLAN FARNSWORTH, CONTRACTS 464 (4th ed. 2004)

Speaking directly to interpretation of text unencumbered by the parol evidence issue, Farnsworth observed that courts

> Apply a standard of reasonableness in interpreting the contract language. The same general principles are applied to a wide variety of contracts, sometimes with variations for contracts of insurance or contracts creating secondary obligations. . . .
>
> Judge are fond of asserting that contract interpretation is a matter of "common sense" and that the "'plain and ordinary meaning' doctrine is at the heart of contract construction. In its search for that meaning, the court is free to look to all the relevant circumstances surrounding the transaction. This includes the state of the world, including the state of the law, at the time. It also includes all writings, oral statements, and other conduct by which the parties manifested their assent, together with any prior negotiations between them [subject to the parol evidence rule] and any applicable course of dealing, course of performance, or usage. The entire agreement, including all writings, should be read together in light of all the circumstances. Since the purpose of this inquiry is to ascertain the meaning to be given to the language, there should be no requirement that the language be ambiguous, vague, or otherwise uncertain before the inquiry is undertaken.
>
> Indeed, it is questionable whether a word has a meaning at all when divorced form the circumstances in which it is used. Dictionary definitions may be of help in showing the general use of words, but they are not necessarily dispositive. . . .[8] A word may be ambiguous, so that the dictionary gives both of the meanings asserted by the parties. Or a word may be vague, so that the application of the dictionary meaning to the particular case is uncertain. Furthermore, parties do not always used words in accordance with their dictionary definitions. Often the meaning attached to a word by the parties must be gleaned form its context, including all the circumstances of the transaction. Sometimes the nature of either

[8] As one might expect, Professor Farnsworth then quoted Learned Hand's famous dictum that "it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary." Cabell v. Markham, 148 F.2d 737, 739 (2d Cir.), aff'd, 326 U.S. 404 (1945). In the same vein, Judge Hand also observed that "[t]here is no surer way to misread any document than to read it literally." Giuseppi v. Walling, 144 F.2d 608 (2d Cir. 1944)(L. Hand, J., concurring).

> the parties or the subject matter shows that the contract was made with reference to a specialized vocabulary of technical terms or other words of art. And sometimes it can be demonstrated that the parties contracted with respect to a usage in their trade or even with respect to a restricted private convention or understanding.
>
> The significance of surrounding circumstances in interpreting contract language is reflected in a judicial emphasis on "purpose interpretation."
>
> * * *
>
> But even though a court may look at all the circumstances in the process of interpreting contract language, the language itself imposes a limit on how far the court will go in that process. . . . [But this is] another area in which judicial attitudes differ. [Case outcomes often] turn not only on the language of the contract and other relevant facts [but also] on the attitude of the particular court toward the authority of words and the sanctity of written language used in the contracting process and toward the protraction of the judicial process that results form entertaining such disputes over the meaning of language. But even though judicial attitudes differ considerably, some generally accepted rules in aid of interpretation can be distilled from the collective attitudes of judges as a body.

E. ALLAN FARNSWORTH, CONTRACTS 453-56 (4th ed. 2004). Outlining "Rules in Aid of Interpretation," Professor Farnsworth observed that

> When interpreting contract language, courts start with the assumption that the parties have used the language in a way that reasonable person ordinarily do and in such a way as to avoid absurdity. This assumption covers matters of grammar and syntax as well as the meaning of words. The process of interpretation therefore turns in good part on what the court regards as normal habits in the use of language, habits that would be expected of reasonable persons in the circumstances of the parties. Often an asserted meaning is challenged on the ground that, if the parties had intended this meaning, these habits would have led them to express it in a different way.[9]
>
> * * *
>
> Some of the assumptions that courts make as to normal habits in the use of language are so widely shared and so frequently articulated that they have come to be regarded as rules of contract interpretation. Some of these rules have been encapsulated in Latin maxims[10] that have a special ring of authority, albeit

[9] *See, e.g.*, George Backer Mgt. Corp. v. Acme Quilting Co., 385 N.E.2d 1062, 1065 (N.Y. 1978)(if particularized meaning is intended, "surely no problem of draftsmanship would have stood in the way of its being spelled out.").

[10] Otherwise known as canons of construction. For a summary of the major canons, including substantive policy canons (e.g., construing a statue to avoid unconstitutionality if possible), as well as canons of word meaning, *see* ANTONIN SCALIA & BRYAN GARNER, READING LAW (2012); WILLIAM N. ESKRIDGE, JR., ET AL., STATUTES,

sometimes a hollow one. None of these rules, however, has a validity beyond that of its underlying assumptions. There use in judicial opinions is often more ceremonial (as being decorative rationalizations of decisions already reached on other grounds) than persuasive (as moving the court toward a decision not yet reached). Judicial opinion on problems of contract interpretation sometimes resemble bouquets of such rationalizations, plucked from among many and arranged so as to harmonize with the result. Indeed, a court can often select from among pairs of opposing or countervailing rules that seem to conflict, although it should come as no surprise to lawyers that there are situations in which two sound policies argue for opposite results.

Many assumptions as to how words are sued are not limited to contract language but apply to language generally. The resulting rules have a universality that fits them for use, for example, in connection with statutes as well as contracts.

E. ALLAN FARNSWORTH, CONTRACTS 456-57 (4th ed. 2004)(footnotes omitted).

Calamari & Perillo

In the most recent edition of this venerable treatise, Professor Perillo observes that the

Plain Meaning Rule states that if a writing, or a term is plain and unambiguous on its face, its meaning must be determined from the four corners of the instrument without resort to extrinsic evidence of any kind. As stated by one court, "When the language of the contract is clear, the court will presume that the parties intended what they expressed, even if the expression differs from the parties' intentions at the time they created the contract." There are variations. Some plain-meaning jurisdictions allow evidence of surrounding circumstances.

Despite the dominance of the rule, there is a division of authority within jurisdictions that follow it. They divide on the question of whether extrinsic evidence is admissible to show that a term of the written agreement is ambiguous. Some admit such evidence. The more rigid approach is to bar evidence to demonstrate that what appears to be a plain meaning is actually ambiguous. Although many jurisdictions rule that evidence is inadmissible to show the existence of an ambiguity, the apparent rigidity of this approach is mitigated by allowing a proffer of evidence. Counsel is permitted to inform the court what the nature of the alleged ambiguity is and what evidence is available to show that court the actual intended meaning. Realistically viewed, such a proffer removes the blinder from the judge who is formally restricted to the four corners of the instrument. Another approach is to allow "objective" evidence to show that a writing that appears unambiguous is in fact susceptible to more than one meaning.

REGULATIONS, AND INTERPRETATION: LEGISLATION AND ADMINISTRATION IN THE REPUBLIC OF STATUTES (2014); Edwin Patterson, *The Interpretation and Construction of Contracts*, 64 COLUM. L. REV. 833 (1964).

> This approach bars "self-serving, unverifiable testimony" to show that an ambiguity exits.
>
> The plain meaning rule has been properly condemned because the meaning of words varies with the "verbal context and surrounding circumstances and purposes in view of the linguistic education and experience of their users and their hearers or readers (not excluding judges). Meaning may not be ascertained simply by reading the document. Although the Plain Meaning Rule has been condemned by the writers, the UCC, the Restatement (Second) and a number of courts, the great majority of jurisdictions still employ the rule. The dictionary is often used as a corroborating source. Some jurisdictions seem to have returned to a plain meaning approach after having adopted or flirted with more liberal approaches.

JOSEPH M. PERILLO, CALAMARI AND PERILLO ON CONTRACTS §3.10 at 136-37 (7th ed. 2014)(footnotes in original omitted).

Professor Perillo, in discussing use of extrinsic evidence to resolve facially ambiguous contract text notes that "[i]n earlier cases, courts would admit extrinsic evidence to clarify a latent ambiguity but not a patent ambiguity." *Id.* at 131 (footnote omitted). "These courts chose to decide what a patent ambiguity meant without the aid of extrinsic evidence." *Id.* at 138 (footnoted omitted). "Many of the modern cases, however, have abandoned the patent/latent distinction and hold that all relevant extrinsic evidence is admissible to clarify both types of ambiguities (*id.* at 138, footnoted omitted). Perillo also notes that "[e]ven a plain meaning jurisdiction will admit parol evidence to define terms of art that, even if unambiguous, are not generally understood. *Id.* at 138. He adds that "[e]ven in a plain meaning jurisdiction" if the

> term in question does not have a plain meaning it follows that the term is ambiguous, that is, it is susceptible to more than one meaning. Thus, whether the attacks on the World Trade Center were one insured "occurrence" is a question that cannot necessarily be determined solely form the four corners of an insurance binder that does not define the term.[11] It is for the court to say whether there is a "plain meaning" or whether an ambiguity exits. Mere disagreement by the parties as to the meaning of the contract at the time the dispute arises does not establish the existence of ambiguity. Even a disagreement in case law concerning the meaning of a standard term does not necessarily make its meaning ambiguous. Plain meaning judges dissent as to the plain meaning. Once it is found that an

[11] Here, of course, Professor Perillo is referring to SR Int'l Bus. Ins. v. World Trade Center Properties, 467 F.3d 107 (2d Cir. 2006)(applying New York law), which found that the binder used by insurance broker Willis did contain sufficiently clear language when it provided that the same "series of events" constituted one occurrence rather than the two occurrence-finding sought by the policyholder based on two separate terrorist-operated planes crashing into two separate buildings at different times, albeit only minutes apart. However, it was determined that some insurers not subject to the binder had sufficiently ambiguous language to require trial, which resulted in a finding of two occurrences.

A word of caution: the fact that a contract document contains a definition of a term does not necessarily result in a finding of plain meaning. The definition itself may be unclear.

> ambiguity exits, and conflicting extrinsic evidence is admitted, the jury determines the meaning.

JOSEPH M. PERILLO, CALAMARI & PERILLO ON CONTRACTS §3.10 at 137-38 (7th ed. 2014)(footnotes in original omitted).

Corbin

Corbin took that view that even in cases of "integrated" contracts subject to the parol evidence rule, that all relevant extrinsic evidence should be admissible regarding meaning, including evidence of subjective intent and any party communications or understandings regarding meaning. *See* 5 ARTHUR L. CORBIN, CORBIN ON CONTRACTS §24.7-24-9. Former St. John's Professor Kniffin, an updater of the Corbin treatise, takes a similar view. *See* Margaret Kniffin, *A New Trend in Contract Interpretation: The Search for Reality As Opposed to Virtual Reality*, 74 ORE. L. REV. 643 (1995).

Williston

In a Yin/Yang over-simplification, Corbin is often characterized as an extreme anti-textualist with little regard for contract text while Samuel Williston is caricatured as a rigid formalist taking a literalist view of contract text and resisting consideration of extrinsic evidence. The more nuanced reality is that Williston did not take a plain meaning/anti-extrinsic evidence attitude toward contract text unless the contract was fully integrated and subject to the parol evidence rule. *See* SAMUEL WILLISTON, CONTRACTS §§31:-31:13, 33:41.

In the case of integrated contracts, Williston did support barring use of extrinsic information while Corbin, as discussed above, welcomed such evidence, even if the contract text seems clear. This pronounced difference between them has accounts for the often overstated view that these two experts were polar opposites. The truth is that although Williston was at the margin more formalist while Corbin was more of a functionalist willing to subordinate contract text to contract purpose, the two had largely compatible views.

Ferriell

> Several reasons are usually advanced for adhering to the plain meaning of a written contract. Interpreting the document according to its plain meaning is said to minimize the ability of the court to rewrite the contract to mean something other than what it says. However, the plain-meaning approach is vulnerable to the criticism that it may rewrite the intent of the parties if that intent was poorly articulated in the written record. Thus, the plain meaning approach may detract from the principle of freedom of contract by imposing the general meaning of a term in place of that intended by the parties.
>
> [Regarding the parol evidence rule], parties who have taken the time to reduce their agreement to writing should be presumed to have drafted it carefully. To have selected their words with care, and course should not assume otherwise.

> However, this assumption is not always justified, particularly in the context of standard form contracts, which may have been well-crafted by one of the parties but not fully understood or even read by the other. Thus, the plain-meaning rule may be more appropriate in the context of written contracts that have been carefully negotiated by well represented, sophisticated parties. The strongest rationale in favor of the plain-meaning approach is that it enhances the parties ability to rely on the text of their written contract.

JEFFREY FERRIELL, UNDERSTANDING CONTRACTS 332-33 (4th ed. 2018).

The Department of Justice

In its manual addressing government contracts, the Justice Department appears to take a particularly textual approach.

> 72. Principles of Contract Interpretation
>
> Contract interpretation begins with the plain language of the contract. A court should first employ a "plain meaning analysis to any contract dispute.
>
> The intention of the parties to a contract controls its interpretation. In construing the terms of a contract, however, the parties' intent must be gathered from the instrument as a whole in an attempt to glean the meaning of terms within the contract's intended context. Contract interpretation requires examination first of the four corners of the written instrument to determine the intent of the parties. An interpretation will be rejected if it leaves portions of the contract language useless, inexplicable, inoperative, meaningless or superfluous.

UNITED STATES DEPARTMENT OF JUSTICE, CIVIL RESOURCE MANUAL, PRINCIPLES OF CONTRACT INTERPRETATION, https://www.justice.gov/jm/civil-resource-manual-72-principles-contract-interpretation (citations omitted).

> 73. Ambiguities
>
> A contract term is ambiguous "[i]f more than one meaning is reasonably consistent with the contract language."
>
> A patent ambiguity is "glaring"; it is so obvious from the face of the contract that it would place a reasonable contractor on notice of a discrepancy. Patent ambiguities raise an exception to the general rule of contra proferentem, which courts use to construe ambiguities against the drafter: a contractor is under a duty to attempt to resolve a patent ambiguity prior to bidding if the contractor subsequently wishes to rely upon the provision.

> A latent ambiguity, by contrast, exists where a contract is reasonably, but not obviously, susceptible of more than one interpretation. In the case of a latent ambiguity, the role of contra proferentem applies to construe the ambiguity against the drafter if the nondrafter's opinion is reasonable, and the nondrafter relied upon that interpretation. The reasonableness of an interpretation is determined by ordinary principles of contract interpretation.

UNITED STATES DEPARTMENT OF JUSTICE, CIVIL RESOURCE MANUAL, PRINCIPLES OF CONTRACT INTERPRETATION, https://www.justice.gov/jm/civil-resource-manual-73-Ambiguities (citations omitted).

The ALI Approach(es)

Despite a huge inventory of judicial decisions that are often if not usually unclear or tautological as to what constitutes plain meaning, observers have labored mightily in search of a workable definition of plain meaning and groundrules for applying the concept. Judging from the controversy surrounding the ALI's recently promulgated Restatement of the Law, Liability Insurance ("RLLI"), achieving even a vague consensus is more difficult than one might imagine.

Restatement of the Law Liability Insurance

Section 3 of the RLLI announces a "Plain-Meaning Rule"[12] for interpreting insurance policies, providing that

> The plain meaning of an insurance policy term is the single meaning to which the language of the term is reasonably susceptible when applied to facts of the claim at issue in the context of an entire insurance policy.
>
> If the insurance policy term has a plain meaning when applied to the facts of the claim at issue, the term is interpreted according to that meaning.
>
> An insurance policy is ambiguous if there is more than one meaning to which the language of the term is reasonably susceptible when applied to the facts of the claim at issue in the context of the entire insurance policy. An ambiguous term is interpreted as specified in §4.[13]

[12] When not discussing plain meaning in a quotation, this paper will continue to use two words rather than the needlessly hyphenated "plain-meaning" language used in the RLLI.

[13] AMERICAN LAW INSTITUTE, RESTATEMENT OF THE LAW OF LIABILITY INSURANCE §3 (Proposed Final Draft No. 2, April 13, 2018)(approved at May 2018 ALI Annual Meeting; formal publication pending)("RLLI" and "April 2018 Draft"). Comment f. to §3 defines an ambiguous term as one "that has at least two interpretations to which the language of the term is reasonably susceptible when applied to the facts of the claim in question." Section 4 sets forth the widely accepted rule that an ambiguous term is "interpreted against the party that supplied the term" but adds that this is not the case if the party authoring the unclear language "persuades the court that a reasonable person in the policyholder's position would not give the term that interpretation." *See* RLLI §4.

The RLLI argues that its proposed plain meaning approach "promotes consistency of interpretation of insurance policies using the same language in similar contests, giving the parties to standardized insurance policies greater confidence that they will be uniformly enforced."[14]

Notwithstanding that the RLLI endorses a plain meaning textual approach, which is generally preferred by insurers – and commercial entities in general -- to more contextual approaches,[15] this portion of the RLLI received substantial insurance industry criticism, albeit primarily directed toward earlier drafts that gave less emphasis to text and exhibited greater receptiveness to extrinsic evidence.[16] Insurer opposition to §3 (and to the RLLI generally) has continued, perhaps because the comments to the section continue to exhibit more receptiveness to extrinsic evidence than one would expect from the black letter of the Section.

> Generally accepted sources that courts consult when determining the plain meaning of an insurance policy term include: dictionaries, court decisions, statutes and regulations, and secondary legal authority such as treatises and law review articles. Such sources of meaning are not "extrinsic evidence" under any definition of that term. Rather, they are legal authorities that courts consult when determining the plain meaning of an insurance policy term, which is a legal question.[17]

Noting that "[m]any courts that follow a strict plain-meaning rule also consider custom, practice, and usage when determining the plain meaning of insurance policies" where this is "between parties who can reasonably be expected to have transacted with knowledge of that custom, practice, or usage."[18] Although this might sound like use of extrinsic evidence to a reasonable person, the RLLI finds this sufficiently within the plain meaning approach so long as "such sources of meaning can be discerned from public sources" through only "limited discovery."[19]

The RLLI notes that "[c]onsideration of custom, practice, and usage at the plain-meaning stage does not open the door to extrinsic evidence such as drafting history, course of dealing, or precontractual negotiations."[20] The comment adds that "it is important to note that the term

---

14 RLLI §3, *Comment a*., April 2018 Draft at 18. Although criticism of the plain meaning rule itself is beyond the scope of this paper, it should be noted that this justification for a more exclusively textual approach is not particularly persuasive in a world where different courts each purport to find insurance policy language clear but construed exactly the same language to mean different things. *See* JEFFREY W. STEMPEL, PETER S. SWISHER & ERIK S. KNUTSEN, PRINCIPLES OF INSURANCE LAW Ch. 11 (4th ed. 2011)(presenting examples from general liability insurance coverage decisions). *See, e.g*., *Hazen Paper Co. v. U.S. Fidelity & Guar. Co*., 555 N.E.2d 576 (Mass. 1990)(Administrative proceeding seeking environmental remediation a "suit" within the meaning of CGL policy); *Foster-Gardner, Inc. v. National Union Fire Ins. Co*., 959 P.2d 265 (Cal. 1998)(government action seeking remediation not a "suit" under CGL policy).

15 *See* Geoffrey Miller, *Bargains Bicoastal: New Light on Contract Theory*, 31CARDOZO L. REV. 1475 (2010).

16 *See* ALI Website, ali.org, Comments submitted regarding RLLI.

17 RLLI §3, *Comment b*., April 2018 Draft at 18.

18 RLLI §3, *Comment c*., April 2018 Draft at 18.

19 RLLI §3, *Comment c*., April 2018 Draft at 18. *Comment c* uses as an example of limited discovery proof "through an affidavit of an expert in the trade or business, who is subject to deposition, but without the need for extensive document requests." *Id*.

20 RLLI §3, *Comment c*., April 2018 Draft at 18.

'extrinsic evidence' does not include all sources of meaning that are extrinsic to the policy. [For example, the] facts of the claim at issue are extrinsic to the policy [but] all courts that follow the plain meaning rule permit consideration of claim facts and many of those courts also permit consideration of trade custom, practice, and usage when determining whether the term has a plain meaning and, if so, what that meaning is."[21]

Publication of the RLLI will not, of course, end debate about what constitutes extrinsic evidence. For example, lawyers and judges appear to divide on the question of whether use of a dictionary is use of extrinsic evidence. The literal answer must be "yes" in that the dictionary is evidence of word meaning outside the four corners of the insurance policy itself (whereas a resort to the Definitions section of a policy would not be use of extrinsic evidence, but merely part of the process of construing the policy as a whole).[22] In practice, however, many if not most courts appear not to regard consulting a dictionary as the use of extrinsic evidence.[23]

Restatement (Second) Contracts

In contrast to the RLLI – at least as portrayed by the RLLI – the ALI's Second Restatement of Contracts takes a "contextual approach" to contract interpretation in which "courts interpret insurance policy terms in light of all the circumstances surrounding the drafting, negotiation, and performance of the insurance policy,"[24] with the ALI's RLLI rejecting the ALI's Contract Restatement because the plain meaning approach is "typically followed in insurance law" with "courts interpret[ing] an insurance policy term on the basis of its plain meaning, if it has one."[25]

The Contracts Restatement does not enunciate a contextual approach in one particular section. Rather, the "Meaning of Agreements" topic in Chapter 9 ("The Scope of Contractual Obligations") sets forth an array of contract construction provisions in §§200-229 that are receptive to indicia of meaning in addition to contract text and sets forth a number of public policy considerations permitting courts to resolve uncertainty and fill gaps in order to reach reasonable results consistent with social policy and the purpose, function and operation of an

[21] RLLI §3, *Comment b*., April 2018 Draft at 18-19.
[22] Relatedly, one might ask: "If one needs a dictionary to be sure of the meaning of words in a contract document, then the text of the document is by definition insufficiently plain on its face.".
[23] *See, e.g.*, *Hartford Fire Ins. Co. v. T.A. Loving Co.*, 1995 U.S. Dist. LEXIS 13598, at *7–8 (E.D.N.C. Aug. 29, 1995) (referring to definitions of "waterborne" in *Webster's Third New International Dictionary*; noting multiple definitions and selecting the definition more favorable to policyholder "in the context of this case"); *Martin v. Allianz Life Ins. Co*., 573 N.W.2d 823, 825–26 (N.D. 1998) (giving literal enforcement to accident policy provision that loss of limb covered only if limb is "severed" within 90 days of event giving rise to injury and citing *American Heritage College Dictionary*).
[24] RLLI §3, *Comment a*., April 2018 Draft at 17.
[25] RLLI §3, Comment a., April 2018 Draft at 17. Elaborating, *Comment a*. states that the RLLI "does not follow [the Contracts Restatement] contextual rule because a substantial majority of courts in insurance cases have adopted a plain-meaning rule. Moreover, because of the mass market nature of liability insurance, there is value in a rule that rewards and encourages the drafting of insurance policy terms that have a plain meaning."

agreement,[26] including avoidance of unfair results or disproportionate forfeiture of contract benefits.[27]

Despite all this, the Contracts Restatement does not shed much light on what the law means by "plain meaning" and in its most direct discussion of the topic tends to comingle it with discussion of the parol evidence rule and integrated agreements.

> § 212 Interpretation of Integrated Agreement
>
> The interpretation of an integrated agreement is directed to the meaning of the terms of the writing or writings in light of the circumstances, in accordance with the rules stated in this Chapter
>
> A question of interpration of an integrated agreement is to be determined by the trier of fact if it depends on the credibility of extrinsic evidence or on a choice among reasonable inferences to be drawn form extrinsic evidenc. Otherwise a question of interpretation of an integrated agreement is to be determined as a question of law.

RESTATEMENT (SECOND), CONTRACTS §212. Elaborating, the ALI (in 1981) stated:

> It is sometimes said that extrinsic evidence cannot change the plain meaning of a writing, but meaning can almost never be plain except in a context. Accordingly, the rule stated in Subsection (1) is not limited to causes where it is determined that the language used is ambiguous. Any determination of meaning or ambiguity should only be made in the light of the relevant evidence of the situation and relations of the parties, the subject matter of the transaction, preliminary negotiations and statement made therein, usages of trade, and the course of dealing between the parties.

Id., Comment b.[28]

---

[26] *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS §§ 203 (preferring "reasonable" and "lawful" meaning); 204 (permitting court to supply "reasonable" terms to complete gaps in contract); 212 (permitting use of contextual evidence, even in cases of integrated agreements); 214 (permitting fairly liberal of parol evidence rule and use of prior or contemporaneous agreements or negotiations under more circumstances than many jurisdictions); 216 (permitting consistent additional terms to be implied as part of the contract); 219-223 (permitting consideration of custom, practice, usage in trade and course of dealing

[27] *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS §§ 205 (implying duty of good faith and fair dealing in all contracts), 208 (restricting enforcement of unconscionable terms); 211 (regarding interpretation of standardized agreements to avoid harsh results); 229 (permitting excuse of a condition to avoid disproportionate forfeiture).

[28] Courts have cited Comment b in following a contextual approach to contract meaning, but not all that frequently as compared to simple invocation of the plain meaning principle. See, e.g.,

> ***Comment b to § 212(1) of Restatement (Second) of Contracts*** (1981) reads thus: "*Plain meaning and extrinsic evidence*. It is sometimes said that extrinsic evidence cannot change the plain meaning of a writing, but meaning can almost never be plain except in a context. Accordingly, the rule stated in Subsection (1) is not limited to cases where it is determined that the language used is ambiguous. Any determination of meaning or ambiguity should only be made in the light of the relevant

> evidence of the situation and relations of the parties, the subject matter of the transaction, preliminary negotiations and statements made therein, usages of trade, and the course of dealing between the parties. See §§ 202, 219-23. But after the transaction has been shown in all its length and breadth, the words of an integrated agreement remain the most important evidence of intention. Standards of preference among reasonable meanings are stated in §§ 203, 206, 207."

City of Boston v. Professional Staff Ass'n, 807 N.E. 2d 229, 233, n. 5 (Mass. Ct. App. 2004)

> "The goal in interpreting any contract is to give effect to the reasonable expectations of the parties." *Neal & Co. v. Ass'n of Village Council Presidents Regional Housing Auth., 895 P.2d 497, 502 (Alaska 1995)* (internal citations and quotations omitted). "[W]hile extrinsic evidence should be consulted in determining the meaning of a written contract, nonetheless 'after the transaction has been shown in all its length and breadth, the words of an integrated agreement remain the most important evidence of intention.'" *Lower Kuskokwim Sch. Dist., 778 P.2d 581, 584* (citing *Restatement (Second) of Contracts, § 212 cmt. b* (1981)).

Brown v. J.W., 2007 U.S. App. LEXIS 21624 *2 (9th Cir. 2007).

> A statute is plain and unambiguous if 'virtually anyone competent to understand it, and desiring fairly and impartially to ascertain its signification, would attribute to the expression in its context a meaning such as the one we derive, rather than any other; and would consider any different meaning, by comparison, strained, or far-fetched, or unusual, or unlikely.'" *New England Med. Center, Inc. v. Commissioner of Rev., 381 Mass. 748, 750, 412 N.E.2d 351 (1980)*, quoting from *Hutton v. Phillips, 45 Del. 156, 160, 6 Terry 156, 70 A.2d 15 (1949)*. To the extent plain meaning depends upon context, compare ***Restatement (Second) of Contracts § 212(1) comment b*** (1981) (the "meaning [of a writing] can almost never be plain except in a context"), that context is here provided by the provisions of the enabling act in addition to the tax exemption, as set forth in note 1, *supra*, and discussed further, *infra*

Martha's Vineyard Land Bank Comm'n v. Board of Assessors, 814 N.E.2d 1147, 1150 n. 4 (Mass Ct. App. 2004).

> The Restatement of Contracts makes clear that a court need not close its eyes to all the circumstances of the transaction and rely solely on the agreement, even if that agreement is an integrated agreement. "The interpretation of an integrated agreement is directed to the meaning of the terms of the writing or writings in the light of the circumstances, in accordance with the rules stated in this Chapter." *Restatement (Second) Contracts § 212(1)* (1981). *Comment (b)* elaborates:
>
> > *Plain meaning and extrinsic evidence*. It is sometimes said that extrinsic evidence cannot change the plain meaning of a writing, but meaning can almost never be plain except in a context. **[*16]** Accordingly, the rule stated in subsection (1) is not limited to cases where it is determined that the language used is ambiguous. Any determination of meaning or ambiguity should only be made in the light of the relevant evidence of the situation and relations of the parties, the subject matter of the transaction, preliminary negotiations and statements made therein, usages of trade, and course of dealing between the parties. See §§ 202, 219-23. But after the transaction has been shown in all its length and breath, the words of an integrated agreement remain the most important evidence of intention.
>
> *Id. § 212 comment b* at 126. Moreover, "Agreements and negotiations prior to or contemporaneous with the adoption of a writing are admissible in evidence to establish . . . that the integrated agreement, if any, is completely or partially integrated [or] the meaning of the writing, whether or not integrated." *Id. § 214(b) & (c)*. With respect to interpretation of the *meaning* of an integrated agreement, the Restatement comments further explain, "Words, written or oral, cannot apply themselves to the subject matter. The expressions and general tenor of speech used in negotiations are admissible to show the *conditions existing when the writing* ***[*17]*** *was made, the application of*

Corpus Linguistics

This paper will say comparatively little about this because another paper by Prof. Thomas will explore at some length the concept and its implications for the plain meaning approach.

> In general terms, corpus linguistics may be thought of as a linguistic methodology that analyses language function and use by means of an electronic database called a corpus.
>
> * * *
>
> The data in the corpus are considered "natural" because they were not elicited for the purpose of study. That is, generally no one ask the speakers or writers whose words are represented in the corpus to speak or write for the purpose of subjecting their words to linguistic scrutiny. Instead, the architect of the corpus assembles her collection of speech and writing samples after the fact, from newspapers, books, transcripts of conversations, or interviews, etc.[29]

Writings in the area include DOUGLAS BIBER & RANDI REPPEN, THE CAMBRIDGE HANDBOOK OF ENGLISH CORPUS LINGUISTICS (2015); TONY MCENERY & ANDREW HARDIE, CORPUS LINGUISTICS: METHOD, THEORY AND PRACTICE (2012); TONY MCENERY & ANDREW WILSON, CORPUS LINGUISTICS: AN INTRODUCTION (2d ed. 2001); Thomas R. Lee & Stephen C. Mouritsen, *Judging Ordinary Meaning*, 127 YALE L.J. 788 (2018); Daniel Orner, *The Merciful Corpus: The Rule of Lenity, Ambiguity and Corpus Linguistics*, 25 B.U. PUB. INT. L.J. 101 (2016); Stephen Mouritsen, *Hard Cases and Hard Data: Assessing Corpus Linguistics as an Empirical Path to Plain Meaning*, 13 COLUM. SCI. & TECH. L. REV. 156 (2011); Douglas Biber, *Representativeness in Corpus Design*, 8 LITERARY AND LINGUISTIC COMPUTING 243 (1993). *See*

> *the words, and the meaning or meanings of the parties*." *Id. § 214 comment b* at 133. (emphasis added).

WHS Homes, Inc. v. Traditional Living, Inc., 2016 N.H. Super. LEXIS 2 at * 16-17 (Superior Ct., Merrimack Cty., Jan 15, 2016).

[29] Stephen C. Mouritsen, *The Dictionary is Not a Fortress: Definitional Fallacies and a Corpus-Based Approach to Plain Meaning*, 2010 BYU L. REV. 1915, 1954-55. One prominent linguist has posited five unifying traits of the corpus methodology, in particular that it: (1) is empirical and looks at patterns of use of natural text; (2) from a large and fairly assembled collection of natural texts (the "corpus"); (3) uses computer technology extensively, both to gather data and to interact with it; and (4) uses quantitative and qualitative techniques of data analysis. *See* Douglas Biber, *Corpus-based and Corpus-driven Analyses of Language Variation and Use* in THE OXFORD HANDBOOK OF LINGUISTIC ANALYSIS 159 (2009)(Bernd Heine & Heiko Narrog, eds.). *Accord*, PAUL BAKER ET AL., A GLOSSARY OF CORPUS LINGUISTICS (2006)(In linguistics, empiricism is the idea that the best way to find out about how language works is by analyzing real examples of language as it is actually used. Corpus Linguistics is therefore a sternly empirical methodology."). *See also* Mourtisen, 2010 BYU L. REV. at 1954-1966 (explaining mechanics and technique of corpus linguistics research); James C. Phillips & Jesse A. Egbert, *A Concise How-To Guide for Law and Corpus Linguistics: Importing Principles and Practices form Survey and Content-Analysis Methodologies to Improve Corpus Design and Analysis*, 2017 BYU L. REV. (same).

also Corpus of Historical American English ("COHA"). Brigham Young University, http://corpus.byu.edu/coha [http://perma.cc/N44U-NQ8T].30

For a friendly but thoughtful cautionary critique of the corpus linguistics approach, see Lawrence M. Solan & Tammy Gales, *Corpus Linguistics as a Tool in Legal Interpretation*, 2017 BYU L. REV. 1311. *See also* Lee & Mouritsen, 127 YALE L.J. at 865-76 (recognizing and responding to criticisms of corpus linguistics approach based on lack of "proficiency" of lawyers and judges with the tool, "propriety" of judicial research in databases, "practicality" concerns that assessing meaning via corpus linguistics will require inordinate investment of judicial resources; limitations on the observed data; and prospect of political opportunism.

Layperson Surveys

Related to but distinct form the Corpus Linguistics approach is use of survey research specifically directed at eliciting layperson meaning of a contractual provision, which may be seen as a variant of use of surveys in trademark/antitrust/consumer confusion cases. *See, e.g*, Omri Ben-Shahar & Lior Strahilevitz, *Interpreting Contracts via Surveys and Experiments*, 92 N.Y.U. L. REV. 1753 (2017). It differs in that it does not attempt to catch laypersons speaking "naturally" but instead asks them to interpret or construe terms. Respondents are presented with particular contract language and asked whether it does or does not have a particular meaning or compel a particularly result.

Erik Knutsen and I find this approach far less promising than corpus linguistics and even potentially pernicious to the extent it is used as anything other than a rough guide to lay perception of words in dispute in a given case. *See* Jeffrey W. Stempel & Erik S. Knutsen, *Turning Textualism Over to Amateurs: The Dangers of Contract Construction by Questionnaire* (Manuscript March 2019).

30

> The COHA is "the largest structured corpus of historical English." It contains "more than 400 million words of text form the 1810s-2000s (which makes it 50-100 times as large as other comparable historical corpa of English) and the corpus is balanced by genre decade by decade." Using data from the COHA, [interpreters] can gather linguistic information from the date that a statute was enacted, going back approximately 200 years.

Lee & Mouritsen, 127 YALE L.J. at 835 (citations omitted). *See also id.* at 835-36 (describing other corpa collecting textual usage).

The Thomas Drayage *Less Textual Approach Favoring Regularized Consideration of Extrinsic or Contextual Information*

Among the many famous opinions by California Supreme Court Justice Roger Traynor is *Pac. Gas & Elec. v. G.W. Thomas Drayage & Rigging Co*., 442 P.2d 641, 644–47 (Cal. 1968), a case remembered less for this holding than its pronouncements on the role of extrinsic evidence in contract construction. It is the case most associated with ushering in the "California Approach" receptive to use of extrinsic information as a means of determining even seemingly clear text (subsequent California cases have shown more rhetorical deference to text but the state remains more receptive to non-textual information regarding contract meaning than New York or other plain meaning states).

Thomas Drayage has had both its fans (arguably Farnsworth and supporters of the Second Contracts Restatement) and critics. *See, e.g*., *Trident Center v. Connecticut General Ins. Co*., 847 F.2d 564 (9th Cir. 1988)(applying California law)(in which now retired (and infamous) former judge Alex Kosinski excoriated the decision as having eliminated the parol evidence rule in the state and creating undue indeterminacy regarding commercial transactions) while purporting to "forced" to apply it via the *Erie* Doctrine); Val D. Ricks, *The Possibility of Plain Meaning: Wittgenstein and the Contract Precedents*, 56 CLEV. ST. L. REV. 767 (2008)(taking similar view, supporting plain meaning concept, and lamenting support for Traynor view).

> If words had absolute and constant referents, it might be possible to discovery contractual intention in the words themselves and in the manner in which they were arranged. Words, however, do not have absolute and constant referents. A word is a symbol of thought but has no arbitrary and fixed meaning like a symbol of algebra or chemistry. The meaning of particular words or groups of words varies with the verbal context and surrounding circumstances and purposes in view of the linguistic education and experience of their users and their hearers or readers (not excluding judges. A word has no meaning apart from these factors; much less does it have an objective meaning, one true meaning. Accordingly, the meaning of a writing can only be found by interpretation in the light of all the circumstances that reveal the essence in which the writer used the words.

442 P.2d at 643-45 (internal quotations and citations omitted). Professor Ricks, making a more nuanced (but considerably longer) defense of plain meaning than Judge Kosinski defines the plain meaning rule as one that

> Allows a judge, after finding unambiguous language (plain meaning) in a written contract, to refuse to look at other evidence of that language's meaning.
>
> The rule is heavily criticized, but claims against it have been exaggerated. One of these exaggerated claims is that plain meaning is impossible. This claim is found in the caselaw opinions that students are made to read [lamenting frequency with which Thomas Drayage is excerpted in law school casebooks]. * * * [but] plain meaning does not require that words have "inherent meaning" or "absolute and constant referents." Plain meaning is possible and occurs quite

> apart from reference or another theory of inherent meaning. Plain meaning rests instead on our unreflective, public, conventional language use. Most meaning is plain.[31]

The Rick critique of *Thomas Drayage* and defense of the plain meaning rule posits that word meaning is not inherently uncertain and is usually understandable to readers – but readers aware of the subject of the contract document. Although I may misunderstand or under-appreciate the Ricks defense of plain meaning, which invokes Wittgenstein's philosophical explorations,[32] it seems that Professor Ricks is at the end of the day suggesting that in context, contract text can be unambiguous – which is something less that hard-core textualism.

In commenting on the difference between the plain meaning approach and one more receptive to extrinsic evidence as in *Thomas Drayage*, Professor Eric Posner posed the question "Which rule is better?" and answered thus:

> It depends on how much one trusts judges to interpret extrinsic evidence properly. If judges are sophisticated enough, they may be able to read the evidence properly. If they are not, then it would be better to require them to rely on the writing. The logic of the argument is the same as in the controversy over the plain meaning rule.

ERIC A. POSNER, CONTRACT LAW AND THEORY §6.8 at 148 (2011)(also discussing parol evidence rule). *See also* JEFFREY FERRIELL, UNDERSTANDING CONTRACTS 331 (4th ed. 2018)(noting distinction between plain meaning states and what might be termed "*Thomas Drayage*" states).

What Dictionaries Say About Plain or Clear or Ordinary Meaning

Plain

"clearly" unequivocally"
"in a plain manner"
"without obscurity or ambiguity"
"clear or distinct to the eye or ear"
"conveying the meaning clearly and simply"
"easily understood"
"clear to the mind"
"evident"
"manifest"
"obvious"
"easy to understand"
"understandable"
"not complicated"

[31] 56 CLEV. ST. L. REV. at 767
32 56 CLEV. ST. L. REV. at 785-99.

“patent”
“definite”
“open-and-shut”

Ordinary

“of a common quality, rank or ability”
“of a kind to be expected in the normal order of events”
“routine”
“usual”
“average”
“common”
“commonplace”
“cut-and-dried”
“every day”
“garden-variety”
“normal”
“routine”
“run-of-the-mill”
“standard”
“standard-issue”
“usual”
“workday”
“unexceptional”
“unremarkable”

Clear

“in a clear manner”
“free from doubt”
“unqualified”
“absolute”
“transparent”
“crystalline”
“limpid”

Plain Meaning – A Rough/Tentative Scorecard: The California/New York Divide Regarding Parol Evidence

States Expressly Expressing Receptiveness to Extrinsic Evidence (often citing California cases) – meaning willingness to receive extra-textual material bearing on meaning even if the text appears to be clear on its face

Alaska[33]
Arizona[34]
Arkansas[35]
California[36]
Idaho[37]
Illinois[38]
Iowa[39]
Maine[40]
Maryland[41]
Montana[42]
New Jersey[43]
New Mexico[44]
Utah[45]
Vermont[46]
Washington[47]

[33] *See, e.g.*, Nautilus Marine Enterprises v. Exon Mobil Corp., 305 P.3d 309 (Alaska 2013)
[34] Taylor v. State Farm Mut. Auto Ins. Co., 854 P.2d 1134 (Ariz. 1993)(applying Contracts Restatement contextual approach)
[35] Hurt-Hoover Investments, LLC v. Fulmer, 433 S.W.3d 917 (Ark. 2014)(parol evidence rule does not prohibit introduction of extrinsic evdicne where this aids the court in interpretation).
[36] Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co., 442 P.2d 641 (Cal. 1968)(discussed in more detail, *infra*.)
[37] Anderson & Nafzier v. G.T. Newcomb, Inc., 595 P.2d 709 (Idaho 1979) (in sale of goods case governed by Uniform Commercial Code, court will consider material other than text of contract).
[38] Hessler v. Crystal Lake Chrysler-Plymouth, Inc., 788 N.E.2d 404 (Ill. 2003)(expressing support for Contracts Restatement and broad receptiveness to extrinsic evidence).
[39] Peak v. Adams, 799 N.W.2d 535 (Iowa 2011)(supporting Contracts Restatement approach)
[40] Rogers v. Jackson, 804 A.2d 379 (Me. 2002)
[41] Clendenin Bros. v. U.S. Fire Ins. Co., 889 A.2d 387 (Md. 2006)
[42] Mary J. Baker Revocable Trust v. Cenex Harvest States Cooperatives, Inc., 164 P.3d 851 (Mont.).
[43] Conway v. 287 Corporate Center Associates, 901 A.2d 341 (N.J. 2006)
[44] Sanders v. FedEx Ground Package System, Inc., 188 P.3d 1200 (N.M. 2008)
[45] Ward v. Intermountain Farmers Ass'n, 907 P.2d 264 (Utah 1995). See also Morris Evenson, What Is Happening to the Parol Evidence Rule? 67 Def. Counsel J. 209 (200)(discussing case).
[46] Madowitz v. Woods at Killington owners' Ass'n, 6 A.3d 1117 (Vt. 2010).
[47] Berg v. Hudsman, 802 P.2d 222 (Wash. 1990).

States Expressly Expressing Resistance to Extrinsic Evidence (often citing New York Precedent)

Alabama[48]
Colorado[49]
Connecticut[50]
Delaware[51]
Florida[52]
Georgia[53]
Hawaii[54]
Indiana[55]
Louisiana[56]
Nebraska[57]
New Hampshire[58]
New York[59]
North Dakota[60]
Oregon[61]
Pennsylvania[62]
Texas[63]
Virginia[64]
Wisconsin[65]

---

[48] Slaton v. Shell, 398 So.2d 311 (Ala. Civ. App. 1981)(articulating traditional rule that written instruments may not be varied parol evidence)

49 American Family Mut. Ins. Co. v. Hansen, 375 P.3d 115 (Colo. 2016); Montoya v. Cherry Creek Dodge, Inc., 708 P.2d 491 (Colo. App. 1985)(embracing traditional approach to parol evidence rule).

50 Heyman Associates No. 1 v. Insurance Co of the State of Pennsylvania, 653 A.2d 122 (Conn. 1999); Neiditz v. Housing Authority of City of Harford, 651 A.2d 1295 (Conn. 1994)(finding 10-year warehouse lease integrated and refusing to consider extrinsic evidence in construction). But see discussion, *infra*, regarding the Connecticut Supreme Court's 2003 move from a plain meaning approach to a contextual approach, with the legislature reinstating the plain meaning approach.

[51] Kellam Energy, Inc. v. Duncan, 668 F. Supp. 861 (D. Del. 1987)(rejecting extrinsic evidence seeking to vary text of price term of sales contract); Eagle Indus., Inc. v. DeVilbiss Health Care, Inc., 702 A.2d 1228 (Del . 1997).

[52] Dimmit Chevrolet, Inc. v. Southeastern Fid. Ins. Corp., 636 So. 2d 700 (Fla. 1993); Lakes Assoc., Ltd. V. Vargas, 881 So.2d 12 (Fla. Fourth Dist. Ct. App. 2004)(supporting traditional parol evidence rule but also entertaining inducement exception*). See also Deni Associates v. Carey*, So.2d (Fla. 1998)(taking broad textual approach to reading of CGL policy pollution exclusion and rejecting reasonable expectations analysis).

[53] Golden Peanut Co. v. Bass, 563 S.E.2d 116 (Ga. 2002)(taking restrictive view of consideration of usage in trade or course of dealing that may vary facially clear meaning of contract text).

[54] MPM Hawaiian, Inc. v. World Square, 666 P.2d 622 (Haw. App. 1983)(embracing traditional parol evidence rule)

[55] I.C.C. Protective Coatings, Inc. v. A.E. Staley Mfg. Co., 695 N.E.2d 1030 (Ind. App. 1998)(supporting traditional parol evidence rule).

[56] La. Civ. Code Ann. Art. 2046

[57] Henn v. Am. Family Mut. Ins. Co. 894 N.W.2d 179 (Neb. 2017)

[58] Bates v. Phenix Mut. Fire Ins. Co., 943 A.2d 750 (N.H. 2008)

[59] Selective Ins. Co. of Am. v. County of Rensselaer, 47 N.E.3d 458 (N.Y. 2016)

[60] Hanneman v. Continental W. Ins. Co., 575 N.W.2d 445 (N.D. 1998).

[61] North Pacific Ins. Co. v. Hamilton, 22 P.3d 739 (Or. 2001).

[62] National Union Fire Ins. Co. v. Shane & Shane Co., L.P.A., 605 N.E.2d (Ohio 1992).

[63] Kelley-Coppedge, Ins. v. Highlands Ins. Co., 980 S.W.2d 462 (Tex. 1998).

[64] Salzi v. Virginia Farm Bureau Mut. Ins. Co., 556 S.E.2d 758 (Va. 2002).

[65] Bethke v. Auto-Owners Ins. Co., 825 N.W.2d 482 (Wis. 2013).

Wyoming[66]

The "scorecard" here – and admittingly rough one that consume a J.S.D. candidate for years to verify/refute/expand in light of subtle differences in cases and precedents has 15 "California-like" or extrinsic evidence friendly jurisdictions and 19 "New York" or quite textualist plain meaning jurisdictions. In practice, however, California and its allies in modern cases seldom go as far down the extrinsic evidence road as did Justice Traynor in Thomas Drayage. And although roughly a third of the states resist categorization, they have plenty judicial rhetoric extolling plain meaning. So the dominance of a textual approach is probably stronger than reflected in this list.

State Statutes on Plain Meaning and Contract Interpretation

Appendix A presents a listing of the 11 states with statutes addressing contract interpretation. Many states also have statutes governing statutory interpretation methodology that could be pressed into service by counsel by analogy.[67] Of the states with contract interpretation statues, some (e.g., Iowa,[68] Nebraska[69]) are largely just codifications of the ambiguity approach[70] while others restate basic contract construction doctrine such as the norms that contracts be construed as a whole[71] with a preference for legality and avoidance of

[66] Colorado Cas. Ins. Co. v. Sammons, 157 P.3d 460 (Wyo. 2007).

[67] For example, in Duane Reade, Inc. v. Cardtronics, 54 A.D. 3d 137 (2008), the Appellate Division applied N.Y. Stat. Law §254 ("Relative or qualifying words of clauses in a statute ordinarily are to be applied to the words or phrases immediately preceding.") on construing a contract.

[68] Iowa Code Ann. §622.22 ("When the terms of an agreement have been intended in a different sense by the parties to it, that sense is to prevail against either party in which a party had reason to suppose the other understood it").

[69] Neb. Rev. State. §25-1217 ("When the terms of an agreement have been intended in a different sense by the parties to it, that sense is to prevail against either party in which he had reason to suppose the other understood it.")

[70] In states with more extensive contract interpretation statutes, codification of contra proferentem is also a common feature. *See, e.g.*, Cal. Civ. Code §1654 ("In cases of uncertainty not removed by the preceding rules, the language of a contract should be interpreted most strongly against the party who caused the uncertainty to exist."); Ga. Code Ann. §13-2-2(5)("If the construction is doubtful, that which goes most strongly against the party executing the instrument or undertaking the obligation is generally to be preferred."); 15 Okla. Stat. Ann. §170 ("In cases of uncertainty, not removed by the preceding rules, the language of a contract should be interpreted most strongly against the party who caused the uncertainty to exist. The promisor is presumed to be such party, except in a contract between a public officer or body, as such, and a private party, in which it is presumed that all uncertainty was caused by the private party.")(a mixture of the neutral rule of construing ambiguity against the drafter and the substantive policy rule of protecting government fisc and taxpayer dollars but slanting the contra proferentem rule against those contracting with the government).

[71] *See, e.g.*, Cal. Civ. Code §1641 ("The whole of a contract is to be taken together, so as to give effect to every part, if reasonably practicable, each clause helping to interpret the other"); Okla. Stat. Ann. §157 ("The whole of a contract is to be taken together, so as to give effect to every part, if reasonably practicable, each clause helping to interpret the others."); Mont. Code. Ann. §28-3-202 (same).

forfeiture.[72] The statutes may also include provisions regarding choice of law,[73] cannons of substantive law or policy[74] gap-fillers,[75] or custom and practice cum public policy.[76] They also tend to expressly recognize the importance of trade usage, industry custom, and course of dealing as helpful factors in contract construction.[77]

Regarding plain meaning, state statutes, like common law, often exhibit affinity for contract text[78] but are, perhaps unsurprisingly, also often as vague or conclusory as court decisions as to what constitute plain meaning,[79] reinforcing the cynic's view that plain meaning

---

[72] *See, e.g.*, Cal. Civ. Code §1643 ("A contract must receive such an interpretation as will make it lawful, operative, definite, reasonable, and capable of being carried into effect, if it can be done without violating the intention of the parties."); Ga. Code Ann. §13-2-2(4))"The construction which will uphold a contract in whole or in every part is to be preferred, and the whole contract should be looked to in arriving at the construction of any part"); Cal. Civ. Code §1642 ("Several contracts relating to the same matters, between the same parties, and made as parts of substantially one transaction, are to be taken together."); Mont. Code Ann. §28-3-201 ("A contract must receive such an interpretation as will make it lawful, operative, definite, reasonable, and capable of being carried into effect, if it can be done without violating the intention of the parties"); N.D. Cen. Code. §9-07-08 (same – in exactly the same language); 15 Okla. St. Ann. §166 ("Particular clauses of a contract are subordinate to its general intent."); 15 Okla. Stat. Ann. §168 ("Repugnancy in a contract must be reconciled, if possible, by such an interpretation as will give some effect to the repugnant clause, subordinate to the general intent and purposes of the whole contract."); 15 Okla. Stat. Ann. §159 ("A Contract must receive such an interpretation as will make it lawful, operative, definite, reasonable and capable of being carried into effect, if it can be done without violating the intention of the parties."); N.D. Cen. Code §9-07-07 ("Several contracts relating to the same matters between the same parties and made as parts of substantially one transaction shall be taken together");

[73] *See, e.g.*, 15 Okla. Stat. Ann. 162 ("A contract is to be interpreted according to the law and usage of the place where it is to be performed, or, if it does not indicate a place of performance, according to the law and usage of the place where it is made.").

[74] *See, e.g.*, Ga. Code Ann. §13-2-2(8)("Estates and grants by implication are not favored"); §13-2-2(9)("Time is not generally of the essence of a contract; but, by express stipulation or reasonable construction, it may become so"); 15 Okla. Stat. Ann. §174 ("Time is never considered of the essence of a contract, unless by its terms expressly so provided.")

[75] *See, e.g.*, 15 Okla. Stat. Ann. §173 ("Reasonable time allowed where not specified" in contract); §176 ("A promise made in the singular number, but executed by several persons, is presumed to be joint and several.").

[76] *See, e.g.*, Idaho Code §29-109 ("Where a contract is party written and partly printed, or where part of it is written or printed under the special directions of the parties, and with a special view to their intention, and the remainder is copied from a form originally prepared without special reference to the particular parties and the particular contract in question, the written parts control the printed parts, and the parts which are purely original control those which are copied from a form, and if the two are absolutely repugnant, the latter must be so far disregarded."); 15 Okla. Stat. Ann. §175 ("Promise presumed joint and several"); §178 ("Contracts designating former spouse as beneficiary or providing death benefits – Effect of divorce or annulment")(proving that in such circumstances, "all provisions in the contract in favor of the decedent's former spouse are thereby revoked.")(but listing six exceptions to general provision)..

[77] *See, e.g.*, Ga. Code. Ann. §13-2-2(3)("The custom of any business or trade shall be binding only when it is of such universal practice as to justify the conclusion that it became, by implication, a part of the contract . . . "). In addition, almost every state has enacted the portions of the Uniform Commercial Code that provided for consideration of usage in trade, course of dealing, and course of performance. These provisions are controlling in sale of goods disputes and other cases where the Code may be applicable. In addition, courts in common law contract cases often look to the UCC for guidance.

[78] *See, e.g.*, Okla. Stat. Ann. §155 ("When a contract is reduced to writing, the intention of the parties is to be ascertained from the writing alone, if possible, subject, however, to the other provisions of this article.").

[79] *See, e.g.*, Mont. Code Ann. §28-3-303 ("When a contract is reduced to writing, the intention of the parties is to be ascertained from the writing alone if possible, subject, however, to the other provisions of this Chapter.") and §38-3-401 (The language of a contract is to govern its interpretation if the language is clear and explicit and does not involve an absurdity."); Tenn. Code Ann. 47-50-112 ("All contracts . . . shall be prima facie evidence of the true

is not only in the eye of the beholder but, like Justice Potter Stewart's (in)famous aphorism about pornography, is something judges know when they see but can't quite describe.[80]

There are some attempts – none of which are very detailed -- at fleshing out the notion of plain, ordinary, clear or apparent meaning. California law, notwithstanding its reputation as an extrinsic evidence state, not only pays homage to text but attempts to provide guidance, as does Georgia,[81] North Dakota,[82] and Oklahoma[83] and other states.[84] New York does not address

---

intention of the parties, and shall be enforced as written.").

[80] *See* Jacobellis v. Ohio, 378 U.S. 184, **jump page** (1964)(Stewart, J.), concurring)("I shall note today attempt further to define the kinds of material I understand to be embraced within that shorthand description [of hard-core pornography]; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it, and the motion picture involved in this case [Carnal Knowledge] is not that.").

[81] *See, e.g.*, Ga. Code Ann. §13-2-2(2)("Words generally bear their usual and common signification; but technical words, words of art, or words used in a particular trade or business will be construed, generally, to be used in reference to this peculiar meaning. The local usage or understanding of a word may be provided in order to arrive at the meaning intended by the parties;"); Ga. Code Ann. §13-2-3 ("The cardinal rule of construction is to ascertain the intention of the parties. If that intention is clear and it contravenes no rule of law and sufficient words are used to arrive at the intention, it shall be enforced irrespective of all technical or arbitrary rules of construction.").

[82] *See, e.g.,* No. Dak. Cen. Code §9-07-09 ("The words of a contract are to be understood in their ordinary and popular sense rather than according to their strict legal meaning, unless used by the parties in a technical sense, or unless a special meaning is given them by usage, in which case the latter must be followed"); No. Dak. Cen. Code 9-07-10 ("Technical words are to be interpreted as usually understood by person in the profession or business to which they relate, unless clearly used in a different sense"); No. Dak. Cen. Code 9-07-12 ("A contract may be explained by reference to the circumstances under which it was made and the matter to which it relates"); No. Dak. Cen. Code §9-07-13 ("However broad may be the terms of a contact, it extends only to those things concerning which it appears that the parties intended to contract"); §9-07-14 ("If the terms of a promise in any respect are ambiguous or uncertain, it must be interpreted in the sense in which the promisor believed at the time of making it that the promise understood it."); No. Dak. Cen. Cod §9-07-15 ("Particular clauses of a contract are subordinate to its general intent"); No. Dak. Cen. Code §9-07-17 ("Repugnancy in a contract must be reconciled, if possible, by such an interpretation as weill give some effect to a repugnant clause subordinate to the general intent and purposes of the whole contract."); No. Dak. Cen. Code. §9-07-08 ("Words in a contract which are inconsistent with its nature or the main intention of the parties are to be rejected."); No. Dak. Cent. Cod §9-07-20 ("Stipulations which are necessary to make a contract reasonable or conformable to usage are implied in respect to matters concerning which the contract manifests no contrary intention."); No. Dak. Cen. Code §9-07-21 "All things that in law or usage are considered as incidental to a contract or as necessary to carry it into effect are implied therefrom, unless some of them are mentioned expressly therein. In such case, all other things of the same class are deemed to be excluded.").

[83] *See* 15 Okla. Stat. Ann. §160 ("The words of a contract are to be understood in their ordinary and popular sense, rather than their strict legal meaning, unless used by the parties in a technical sense, or unless a special meaning is given them by usage, in which case the latter must be followed."); 15 Okla. St. Ann. §161 ("Technical words are to be interpreted as usually understood by persons in the profession or business to which they relate, unless clearly used in a different sense.");

[84] *See, e.g.,* Mont. Code Ann. §28-3-204 ("Repugnancies in a contract must be reconciled, if possible, by such an interpretation as will give some effect to the repugnant clauses, subordinate to the general intent and purpose of the whole contract.") and §§28-3-304, 28-3-305, 28-3-306, 28-3-307, 28-3-402, 28-3-501, 28-3-502, 28-3-503, 28-3-601, 28-3-701, 28-3-702, 28-3-703 (all provisions with analogs in California statute discussed in text and accompanying notes 88-97); Ore. Rev. Stat. 42.220-42.280 (provisions similar to California regarding role of party intent, circumstances). Louisiana, despite having a civil law tradition, also has provisions similar to California and places significant emphasis on party intent and contract purpose. *See, e.g.,* La. Stat. Ann. Arts. 2045 ("Interpretation of a contract is the determination of the common intent of the parties."), 2051 ("Although a contract is worded in general terms, it must be interpreted to cover only those things it appears the parties intended to include."); Arts. 2047-2048, 2049, 2052, (provisions akin to California provisions) but also provides that "[w]hen the words of a contract are clear and explicit and lead to no absurd consequences, no further interpretation may be made in search of the parties' intent."). *See also* La. Stat. Ann. Arts. 2050, 2053, 2054, 2055, 2056 ("Each provision in a contract

contract construction in its statutes, its commitment to textualism a product of common law. Its statute on statutory interpretation is largely instruction on grammar.[85]

California provides that "[t]he language of a contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity"[86] and further provides that "[w]hen a contract is reduced to writing, the intention of the parties is to be ascertained from the writing alone, if possible [but] subject, however, to the other provisions" of the law.[87] This includes the command that "[a] contract must be so interpreted as to give effect to the mutual intention of the parties as it existed at the time of contracting, so far as the same is ascertainable and lawful."[88] In addition, "[w]hen, through fraud, mistake, or accident, a written contract fails to express the real intention of the parties, such intention is to be regarded, and the erroneous parts of the writing disregarded."[89] In words unsurprising to those familiar with *Thomas Drayage* and other Traynor Court of the 1960s, California law also provides that "[a] contract may be explained by reference to the circumstances under which it was made, and the matter to which it relates."[90] This contextual provision somewhere between *Thomas Drayage* and RLLI §3 is not a consequence of the Traynor Court however. The statute was enacted in 1872.

Regarding interpretation of contract text, California's statutory attempt to clarify the concept of clear contract text states:

> The words of a contract are to be understood in their ordinary and popular sense, rather than according to their strict legal meaning; unless used by the parties in a technical sense, or unless a special meaning is given them by usage, in which case the latter must be followed.[91]
>
> Technical words are to be interpreted as usually understood by persons in the profession or business to which they related, unless clearly used in a different sense.[92]
>
> However broad may be the terms of a contract, it extends only to those things concerning which it appears that the parties intended to contract.[93]

---

must be interpreted in light of the other provision so that each is given the meaning suggested by the contract as a whole.").

[85] *See, e.g.*, McKinney's Statutes §254 ("Relative or qualifying words of clauses in a statute ordinarily are to be applied to the words or phrases immediately proceeding, and are not to be construed as extending to others more remote, until the intent of the statute clearly indicates otherwise.");

[86] Cal. Civ. Code §1638.

[87] Cal. Civ. Code §1639.

[88] Cal. Civ. Code §1636.

[89] Cal. Civ. Code §1640.

[90] Cal. Civ. Code §1647. *See also* Cal. Civ. Code §1649 ("If the terms of a promise are in any respect ambiguous or uncertain, it must be interpreted in the sense in which the promisor believe, at the time of making it, that the promise understood it.").

[91] Cal. Civ. Code §1644.

[92] Cal. Civ. Code §1645.

[93] Cal. Civ. Code §1648.

> Particular clauses of a contract are subordinate to its general intent.[94]
>
> Repugnancy in a contract must be reconciled, if possible, by such an interpretation as will give some effect to the repugnant clauses, subordinate to the general intent and purpose of the whole contract.[95]
>
> Words in a contract which are wholly inconsistent with its nature, or with the main intention of the parties, are to be rejected.[96]
>
> Stipulations which are necessary to make a contract reasonable, or conformable to usage, are implied, in respect to matters concerning which the contract manifests no contrary intention.[97]
>
> All things that in law or usage are considered as incidental to a contract, or as necessary to carry it into effect, are implied therefrom, unless some of them are expressly mentioned therein, when all other things or the same class are deemed to be excluded.[98]
>
> If not time is specified for the performance of an act required to be performed, a reasonable time is allowed. If the act is in its nature capable of being done instantly – as, for example, if it consists in the payment of money only – it must be performed immediately upon the thing to be done being exactly ascertained.[99]
>
> Where all the parties who unite in a promise receive some benefit from the consideration, whether past or present, their promise is presumed to be joint and several.[100]

Although these attempts are not meaningless and in fact may be quite helpful in resolving contract disputes, they quickly veer from focus on text to interpretation methodology in the face of unclear or unspecified text, carrying with them substantive attitudes of law and policy rather than by enunciating in greater detail a methodology for determining when contract text is sufficiently clear or one that can assign meaning to text in the absence of context.

The state statutes regarding contract interpretation appear consistent with what might be termed the modern California approach or the RLLI approach in that they are not so much advocating admission of specific extrinsic evidence as endorsing an approach sufficiently contextual that it requires – or at least permits – contract text to be examine from the outset in light of all surrounding circumstances rather than solely on the basis of the court's reading of the face of the instrument.

---

[94] Cal. Civ. Code §1650.
[95] Cal. Civ. Code §1652.
[96] Cal. Civ. Code §1653.
[97] Cal. Civ. Code §1655.
[98] Cal. Civ. Code §1656.
[99] Cal. Civ. Code §1657.
[100] Cal. Civ. Code §1659. In addition, "[a] promise, made in the singular number, but executed by several persons, is presumed to be joint and several." Cal. Civ. Code §1660.

For example, Oklahoma provides that "[a] contract may be explained by reference to the circumstances under which it was made, and the matter to which it relates"[101] and also provides a potential avenue for evading literal text that a Traynor-like judge might drive a truck through: "[w]hen through fraud, mistake, accident, a written contract fails to express the real intention of the parties, such intention is to be regarded, and the erroneous parts of the writing disregarded."[102] Georgia both eschews punctuational literalism[103] and shows considerable concern for vindicating party intent and contract purpose,[104] as do Montana,[105] North Dakota,[106] and Oklahoma.[107]

Likewise, state statutes that speak to the issue tend to caution against elevating particular text over party intent or purpose. For example, Oklahoma law provides that "[w]ords in a contract which are wholly inconsistent with its nature, or with the main intention of the parties, are to be rejected"[108] and that "[s]tipulations which are necessary to make a contract reasonable and conformable to usage, are implied in respect to matters concerning which the contrary manifests no contrary intention."[109]

Judicial-Legislative Tension: The Connecticut Example

Courts in these same states, may, however, be less inclined to worry about party intent, contract purpose, or public policy and more inclined to scrutinize text. Or, conversely, a court that appears insufficiently deferential to text may run afoul of legislative sentiment (or powerful text-centric interests with legislative clout), a possibility reflected in Connecticut's experience with its statute concerning statutory interpretation. Connecticut Gen. Stat. §1-2z states that "[t]he meaning of a statute shall, in the first instance, be ascertained from the text of the statute itself and its relationship to other statues. If, after examining such text and considering such relationship, the meaning of such text is plain and unambiguous and does not yield absurd or

[101] 15 Okla. Stat. Ann. §163. Oklahoma also provides that "[h]owever broad may be the terms of a contract, it extends only to those things concerning which it appears that the parties intended to contract"(15 Okla. Stat. Ann. §164), which reads to me like an anti-literalism canon.
[102] 15 Okla. Stat. Ann. §156.
[103] *See, e.g.*, Ga. Code Ann. §13-2-2(6)("The rules of grammatical construction usually govern, but to effectuate the intention they may be disregarded; sentences and words may be transposed, and conjunctions substituted for each other. In extreme cases of ambiguity, where the instrument as it stands is without meaning, words may be supplied;").
[104] *See* note 79, *supra*.
[105] See Mont. Code Ann. §38-3-201 ("A contract must be so interpreted as to give effect to the mutual intention of the parties as it existed at the time of contracting, so far as the same is ascertainable and lawful."). Intent is to be determined according to "the rules given in this chapter." *See* Mont. Code. Ann. §28-3-302.
[106] *See* note 80, *supra.*
[107] *See* nn. 81 & 82, *supra*.
[108] 15 Okla. Stat. Ann. §169.
[109] 15 Okla. Stat. Ann. §171. Oklahoma also provides that "[a]ll things that in law or usage are considered as incidental to a contract, or as necessary to carry it into effect, are implied therefrom, unless some of them are expressly mentioned therein, when all other things of the same class are deemed to be excluded." 15 Okla. Stat. Ann. §172.

unworkable results, extratextual evidence of the meaning of the statute shall not be considered."[110]

The statute was passed after *State v. Courchesne*,[111] which self-consciously deviated from the professed plain meaning approach that had previously be applied, prompting many to see the statute as a legislative overruling of *Courchesne*.[112] But notwithstanding the statute, the Connecticut Supreme Court has continued to take the view that the "purpose or purposes" of legislation and "the context of [statutory] language, broadly understood, are directly relevant to the meaning of the language of the statute."[113]

Courchesne was perhaps controversial because it so openly and candidly departed from the textual orthodoxy of judicial ability to understand word meaning merely by seeing the word. But the extensive discussion of the Court in *Courchesne* may strike some (and certainly struck me) as the type of sophisticated and reflective (albeit lengthy) discussion of interpretation that one would appreciate seeing more frequently in judicial opinions. And although readers may recoil a bit, I present an extensive excerpt to provide a flavor of the opinion that triggered legislative reaction and "overruling" of its methodology.

> This claim presents a question of statutory interpretation. "The process of statutory interpretation involves a reasoned search for the intention of the legislature. In other words, we seek to determine, in a reasoned manner, the meaning of the statutory language as applied to the facts of this case, including the question of whether the language actually does apply. In seeking to determine that meaning, we look to the words of the statute itself, to the legislative history and circumstances surrounding its enactment, to the legislative policy it was designed to implement, and to its relationship to existing legislation and common law principles governing the same general subject matter.[114]
>
> * * *
>
> We now make explicit that our approach to the process of statutory interpretation is governed by the *Bender* formulation, as further explicated herein. The first two

[110] However, §1-2z applies only to "statutory language that is clear and unambiguous." The statute did not overrule the principle that ambiguous statutory language is not unconstitutionally vague if the legislative history establishes a clear meaning." *Gonzalez v. Surgeon*, 284 Conn. 573, 586. 937 A.2d 24 (Conn. 2007).

[111] 262 Conn. 537, 577-78, 816 A.2d 562 (Conn. 2003).
[112] *See Envirotest Sys. Corp. v. Comm'r of Motor Vehicles*, 293 Conn. 382, 978 A.2d 49 (Conn. 2009)(viewing statute as response to *Courchesne*).
[113] *Bell Atlantic Nynex Mobile, Inc. v. Comm'r of Revenue Servs*., 273 Conn. 240, 869 A.2d 611 (Conn. 2005).
[114] 816 A. 2d at 544 (citations omitted). *See also id.* at 546-48 (conducting extensive linguistic analysis of statute).

sentences of that formulation set forth the fundamental task of the court in engaging in the process of statutory interpretation, namely, engaging in a "reasoned search for the intention of the legislature," which we further defined as a reasoned search for "the meaning of the statutory language as applied to the facts of [the] case, including the question of whether the language actually does apply." (Internal quotation marks omitted.) Id. The rest of the formulation sets forth the range of sources that we will examine in order to determine that meaning. That formulation admonishes the court to consider all relevant sources of meaning of the language at issue--namely, the words of the statute, its legislative history and the circumstances surrounding its enactment, the legislative policy it was designed to implement, and its relationship to existing legislation and to common-law principles governing the same general subject matter. Id. We also now make explicit that we ordinarily will consider all of those sources beyond the language itself, without first having to cross any threshold of ambiguity of the language.

We emphasize, moreover, that the language of the statute is the most important factor to be considered, for three very fundamental reasons. First, the language of the statute is what the legislature enacted and the governor signed. It is, therefore, the law. Second, the process of interpretation is, in essence, the search for the meaning *of that language* as applied to the facts of the case, including the question of whether it does apply to those facts. Third, all language has limits, in the sense that we are not free to attribute to legislative language a meaning that it simply will not bear in the usage of the English language.

Therefore--and we make this explicit as well--we always *begin* the process of interpretation with a searching examination of that language, attempting to determine the range of plausible meanings that it may have in the context in which it appears and, if possible, narrowing that range down to those that appear most plausible. Thus, the statutory language is always the starting point of the interpretive inquiry. A significant point of the *Bender* formulation, however, is that we do not end the process with the language.

The reason for this, as we stated in *Frillici*, is that "the legislative process is purposive, and . . . the meaning of legislative language (indeed, of any particular use of our language) is best understood by viewing not only the language at issue, but by its context and by the purpose or purposes behind its use."

Thus, the purpose or purposes of the legislation, and the context of that legislative language, which includes the other sources noted in *Bender*, are directly relevant to its meaning as applied to the facts of the case before us. See L. Fuller, "Positivism and Fidelity to Law--A Reply to Professor Hart," 71 Harv. L. Rev. 630, 664 (1958) (it is not "possible to interpret a word in a statute without knowing the aim of the statute"); S. Breyer, "On the Uses of Legislative History in Interpreting Statutes," *65 S. Cal. L. Rev. 845, 853 (1992)* ("[a] court often needs to know the purpose a particular statutory word or phrase serves within the broader context of a

statutory scheme in order to decide properly whether a particular circumstance falls within the scope of that word or phrase"); F. Frankfurter, "Some Reflections on the Reading of Statutes," 47 Colum. L. Rev. 527, 538-39 (1947) ("Legislation has an aim; it seeks to obviate some mischief, to supply an inadequacy, to effect a change of policy, to formulate a plan of government. That aim, that policy is not drawn, like nitrogen, out of the air; it is evinced in the language of the statute, as read in the light of other external manifestations of purpose.").

Indeed, in our view, the concept of the context of statutory language should be broadly understood. That is, the context of statutory language necessarily includes the other language used in the statute or statutory scheme at issue, the language used in other relevant statutes, the general subject matter of the legislation at issue, the history or genealogy of the statute, as well as the other, extratextual sources identified by the *Bender* formulation. All of these sources, textual as well as contextual, are to be considered, along with the purpose or purposes of the legislation, in determining the meaning of the language of the statute as applied to the facts of the case.

B

This brings us to a discussion of what is commonly known as the "plain meaning rule." Although we have used many different formulations of the plain meaning rule, all of them have in common the fundamental premise, stated generally, that, where the statutory language is plain and unambiguous, the court must stop its interpretive process with that language; there is in such a case no room for interpretation; and, therefore, in such a case, the court must not go beyond that language.

It is useful to note that both the plain meaning rule and the *Bender* formulation have, as a general matter, their starting points in common: both begin by acknowledging that the task of the court is to ascertain the intent of the legislature in using the language that it chose to use, so as to determine its meaning in the context of the case.

Unlike the *Bender* formulation, under the plain meaning rule, there are certain cases in which that task must, as a matter of law, end with the statutory language. Thus, it is necessary to state precisely what the plain meaning rule means.

The plain meaning rule means that in a certain category of cases--namely, those in which the court first determines that the language at issue is plain and unambiguous--the court is *precluded as a matter of law* from going beyond the text of that language to consider any extratextual evidence of the meaning of that language, no matter how persuasive that evidence might be. Indeed, the rule even precludes reference to that evidence where that evidence, if consulted, would *support or confirm* that plain meaning. Furthermore, inherent in the plain meaning rule is the admonition that the courts are to seek the objective meaning of the language used by the legislature "not in what [the legislature] meant to say, but in

[the meaning of] what it did say." (Internal quotation marks omitted.) Another inherent part of the plainmeaning rule is the exception that the plain and unambiguous meaning is *not* to be applied if it would produce an unworkable or absurd result.

Thus, the plain meaning rule, at least as most commonly articulated in our jurisprudence, may be restated as follows: If the language of the statute is plain and unambiguous, and if the result yielded by that plain and unambiguous meaning is not absurd or unworkable, the court must not *interpret* the language (i.e., there is no room for construction); instead, the court's sole task is to apply that language literally to the facts of the case, and it is precluded as a matter of law from consulting any extratextual sources regarding the meaning of the language at issue. Furthermore, in deciding whether the language is plain and unambiguous, the court is confined to what may be regarded as the objective meaning of the language used by the legislature, and may not inquire into what the legislature may have intended the language to mean--that is, it may not inquire into the purpose or purposes for which the legislature used the language. Finally, the plain meaning rule sets forth a set of thresholds of ambiguity or uncertainty, and the court must surmount each of those thresholds in order to consult additional sources of meaning of the language of the statute. Thus, whatever may lie beyond any of those thresholds may in any given case be barred from consideration by the court, irrespective of its ultimate usefulness in ascertaining the meaning of the statutory language at issue.

We now make explicit what is implicit in what we have already said: in performing the process of statutory interpretation, we do not follow the plain meaning rule in whatever formulation it may appear. We disagree with the plain meaning rule as a useful rubric for the process of statutory interpretation for several reasons.

First, the rule is fundamentally inconsistent with the purposive and contextual nature of legislative language. Legislative language *is* purposive and contextual, and its meaning simply cannot be divorced from the purpose or purposes for which it was used and from its context. Put another way, it *does* matter, in determining that meaning, what purpose or purposes the legislature had in employing the language; it *does* matter what meaning the legislature intended the language to have.

Second, the plain meaning rule is inherently self- contradictory. It is a misnomer to say, as the plain meaning rule says, that, if the language is plain and unambiguous, there is no room for interpretation, because application of the statutory language to the facts of the case *is interpretation* of that language. In such a case, the task of interpretation may be a simple matter, but that does not mean that no interpretation is required.

The plain meaning rule is inherently self-contradictory in another way. That part of the rule that excepts from its application cases in which the plain language would yield an absurd or unworkable result is implicitly, but necessarily, premised on the process of going beyond the text of the statute to the legislature's intent in writing

that text. This is because the only plausible reason for that part of the rule is that the legislature could not have intended for its language to have a meaning that yielded such a result. Indeed, we have explicitly acknowledged as much. Thus, application of this aspect of the plain meaning rule requires an implicit inquiry into the legislature's intent or purpose, beyond the bare text, thus, in effect, permitting the court to *rule out* the plain meaning of the language because that meaning would produce an absurd or unworkable result. We see no persuasive reason for a rule of law that prohibits a court from similarly going beyond the bare text of the statute to *rule in* a *different* meaning that other sources of meaning might suggest in any given case. Yet such a prohibition is precisely what the plain meaning rule accomplishes.

Third, application of the plain meaning rule necessarily requires the court to engage in a threshold determination of whether the language is ambiguous. This requirement, in turn, has led this court into a number of declarations that are, in our view, intellectually and linguistically dubious, and risk leaving the court open to the criticism of being result-oriented in interpreting statutes. Thus, for example, we have stated that statutory language does not become ambiguous "merely because the parties contend for different meanings." Yet, if parties contend for different meanings, and each meaning is plausible, that is essentially what "ambiguity" ordinarily means in such a context in our language. See Webster's Third New International Dictionary, and Merriam- Webster's Collegiate Dictionary (10th Ed.), for the various meanings of "ambiguity" and "ambiguous" in this context. For example, in Merriam-Webster's Collegiate Dictionary, the most apt definition of "ambiguous" for this context is: "Capable of being understood in two or more possible senses or ways." We also have stated that, although the statutory language is clear on its face, it contains a "latent ambiguity" that is disclosed by its application to the facts of the case, or by reference to its legislative history and purpose. Statutory language, however, always requires some application to the facts of the case. Therefore, the notion of such a "latent ambiguity" as a predicate to resort to extratextual sources simply does not make sense. Moreover, we have stated that the plain meaning principle does not apply where the statutory language, although clear and unambiguous, is not "*absolutely* clear and unambiguous . . . ." (Emphasis in original.) The line of demarcation between clear and unambiguous language, on one hand, and *absolutely* clear and unambiguous language, on the other hand, however, eludes us. We have stated further that the court may go beyond the literal language of the statute when "a common sense interpretation leads to an ambiguous . . . result . . . .". It is similarly difficult to make sense of the notion of otherwise clear language becoming ambiguous because it leads to an "ambiguous . . . result . . . ." Id. Indeed, within the very same case: (1) we have stated that the language of the statute is clear and unambiguous and, therefore, "is not subject to construction"; and (2) nonetheless, "we *construed*" the statute so as to avoid a particular result that one of the parties had pointed out would otherwise come within that plain language. (Emphasis added.). Thus, in that case, in applying

the plain meaning rule, we directly violated it. We see little value in a rule of law that has led this court into such dubious distinctions. [29]

Eschewing the plain meaning rule does not mean, however, that we will not in any given case follow what may be regarded as the plain meaning of the language. Indeed, in most cases, that meaning will, once the extratextual sources of meaning contained in the *Bender* formulation *are* considered, prove to be the legislatively intended meaning of the language.

There are cases, however, in which the extratextual sources will indicate a different meaning strongly enough to lead the court to conclude that the legislature intended the language to have that different meaning. Importantly, and consistent with our admonition that the statutory language is the most important factor in this analysis, in applying the *Bender* formulation, we necessarily employ a kind of sliding scale: the more strongly the bare text of the language suggests a particular meaning, the more persuasive the extratextual sources will have to be in order for us to conclude that the legislature intended a different meaning. [31] Such a sliding scale, however, is easier to state than to apply. In any given case, it necessarily will come down to a judgmental weighing of all of the evidence bearing on the question.

The point of the *Bender* formulation, however, is that it requires the court, in *all* cases, to consider *all* of the relevant evidence bearing on the meaning of the language at issue. Thus, *Bender*'s underlying premise is that, the more such evidence the court considers, the more likely it is that the court will arrive at a proper conclusion regarding that meaning.

Moreover, despite the fact that, as we noted at the outset of this discussion, no other jurisdiction specifically has adopted the particular formulation for statutory interpretation that we now adopt, there is really nothing startlingly new about its core, namely, the idea that the court may look for the meaning of otherwise clear statutory language beyond its literal meaning, even when that meaning would not yield an absurd or unworkable result. It stretches back to the sixteenth century

The intent of the lawmakers is the soul of the statute, and the search for this intent we have held to be the guiding star of the court. It must prevail over the literal sense and the precise letter of the language of the statute. When one construction leads to public mischief which another construction will avoid, the latter is to be favored

---

[29] It is not the intention of the author of this majority opinion to avoid the charge of engaging in dubious distinctions and statements, since it should be noted that, with the exceptions of *Glastonbury Co. v. Gillies, supra, 209 Conn. 175*, and *State v. Delafose, supra, 185 Conn. 517*, the author either participated in or authored the opinions referred to in part II B of this opinion.

[31] Alaska has adopted a similar sliding scale approach. See *Wold v. Progressive Preferred Ins. Co., 52 P.3d 155, 161 (Alaska 2002)*.

unless the terms of the statute absolutely forbid. Sutherland on Statutory Construction [Ed. 1891] § 323 . . . .

In summary, we now restate the process by which we interpret statutes as follows: "The process of statutory interpretation involves a reasoned search for the intention of the legislature. In other words, we seek to determine, in a reasoned manner, the meaning of the statutory language as applied to the facts of [the] case, including the question of whether the language actually does apply. In seeking to determine that meaning, we look to the words of the statute itself, to the legislative history and circumstances surrounding its enactment, to the legislative policy it was designed to implement, and to its relationship to existing legislation and common law principles governing the same general subject matter." (Internal quotation marks omitted.) Thus, this process requires us to consider all relevant sources of the meaning of the language at issue, without having to cross any threshold or thresholds of ambiguity. Thus, we do not follow the plain meaning rule.

In performing this task, we begin with a searching examination of the language of the statute, because that is the most important factor to be considered. In doing so, we attempt to determine its range of plausible meanings and, if possible, narrow that range to those that appear most plausible. We do not, however, end with the language. We recognize, further, that the purpose or purposes of the legislation, and the context of the language, broadly understood, are directly relevant to the meaning of the language of the statute.

This does not mean, however, that we will not, in a given case, follow what may be regarded as the plain meaning of the language, namely, the meaning that, when the language is considered without reference to any extratextual sources of its meaning, appears to be *the* meaning and that appears to preclude any other likely meaning. In such a case, the more strongly the bare text supports such a meaning, the more persuasive the extratextual sources of meaning will have to be in order to yield a different meaning.

Before concluding this discussion, we respond to several of the main points of the dissent. The dissent takes issue with both the appropriateness and the reliability of ascertaining the purpose or purposes of the statute under consideration in determining its meaning. This point demonstrates a fundamental difference between our view and the dissent's view of the nature of legislation. We think that legislation is inherently purposive and that, therefore, it is not only appropriate, but necessary to consider the purpose or purposes of legislation in order to determine its meaning. Furthermore, the experience of this court demonstrates no particular difficulty in reliably ascertaining such purposes, based not on our own personal preferences but on both textual and extratextual sources. * * *

The dissent also suggests that judges, by employing a purposive approach to statutory interpretation rather than the plain meaning rule, will substitute our own notions of wise and intelligent policy for the policy of the legislature. We agree that

this may happen; any court *may* be intellectually dishonest in performing *any* judicial task, whether it be interpreting a statute or adjudicating a dispute involving only the common law. We suggest, however, that the risk of intellectual dishonesty is just as great, or as minimal, in employing the plain meaning rule as in employing the method of interpretation that we articulate. If a court is determined to be intellectually dishonest and reach the result that it *wants* the statute to mandate, rather than the result that an honest and objective appraisal of its meaning would yield, it will find a way to do so under any articulated rubric of statutory interpretation. Furthermore, by insisting that *all* evidence of meaning be considered and explained before the court arrives at the meaning of a statute, we think that the risk of intellectual dishonesty in performing that task will be minimized. Indeed, resort to and explanation of extratextual sources may provide a certain transparency to the court's analytical and interpretive process that could be lacking under the employment of the plain meaning rule. In sum, we have confidence in the ability of this court to ascertain, explain and apply the purpose or purposes of a statute in an intellectually honest manner.

The dissent also contends that the plain meaning rule is based on the constitutional doctrine of the separation of powers. Our only response to this assertion is that there is simply no basis for it. In our view, contrary to that of the dissent, there is nothing in either the federal or the Connecticut constitutional doctrine of the separation of powers that compels *any* particular method or rubric of statutory interpretation, that precludes a court from employing a purposive and contextual method of interpreting statutes, or that compels the judiciary to employ the plain meaning rule, in performing its judicial task of interpreting the meaning of legislative language. Simply put, the task of the legislative branch is to draft and enact statutes, and the task of the judicial branch is to interpret and apply them in the context of specific cases. The constitution says nothing about what type of language the legislature must employ in performing its tasks, and nothing about what method or methods the judiciary must employ in ascertaining the meaning of that language.

The dissent also makes the points that legislative history should be considered only if "the other tools of interpretation fail to produce a single, reasonable meaning," and that, in any event, it is an unreliable method of ascertaining legislative intent and facilitates "'decisions that are based upon the courts' policy preferences, rather than neutral principles of law.'" See A. Scalia, A Matter of Interpretation: Federal Courts and the Law (A. Gutmann ed., 1997) p. 35. Thus, the dissent regards the use of legislative history as unreliable evidence of legislative intent, and as insidious in the sense that it permits the court to interpret a statute to reach a meaning that the court *wants* it to have, based on the court's own policy preference, rather than that of the legislature. As a result, in the dissent's five step formulation of the plain meaning rule, consideration of legislative history is relegated to the fourth, or penultimate, step.

In response, we note first that it is difficult to understand why the dissent would consider the use of legislative history at all in its formulation, given that it regards such use as both unreliable and insidious. More importantly, it appears to us that,

> under the dissent's formulation, only the most difficult cases of statutory interpretation would reach the fourth step of its analysis. Thus, the dissent reserves what it regards as an unreliable and insidious source of statutory meaning to act as the tiebreaker in the most difficult cases of interpretation. This strikes us as a curiously important role for what the dissent regards so negatively as a source of the meaning of legislative language.
>
> On the merits of the use of legislative history, we simply disagree with the dissent's characterizations of it. The general experience of this court demonstrates to us that legislative history, when reviewed and employed in a responsible, discriminating and intellectually honest manner, can constitute reliable evidence of legislative intent. * * *
>
> As for the insidious nature of the use of such history, our response is the same as that we made to the same argument of the dissent regarding the general aim of ascertaining the purpose of a statute. If a court is determined to be intellectually dishonest and result-oriented in its decision-making, it does not need any particular stated rubric of interpretation--whether purposive, plain meaning, or some other method--to be so. Furthermore, we have confidence in this court's ability to employ legislative history in a responsible, discriminating and intellectually honest manner, so as to determine the legislature's purpose or purposes, and not our own. We think that our history in doing so bears this out, and we are confident that we can continue to do so.
>
> Ultimately, as Justice Cardozo acknowledged, the process of statutory interpretation requires "a choice between uncertainties. We must be content to choose the lesser." Furthermore, as Justice Frankfurter stated, in making those choices we cannot avoid "the anguish of judgment." F. Frankfurter, supra, 47 Colum. L. Rev. 527.[115]

One commentator, building on another empirical study, described the colloquoy between the Supreme Court and the Legislature.

> The situation in Connecticut involved the opposite ideological configuration, but nonetheless resulted in a similar judicial refusal to follow the rules of statutory interpretation that were codified by the legislature. This power struggle was initiated when the Connecticut Supreme Court announced in 2003 that it would no longer follow a plain meaning rule that precluded the consideration of extrinsic evidence of statutory meaning in the absence of textual ambiguity. In response to this decision, the state legislature promptly enacted a statute, which prohibits consideration of "extratextual evidence" of statutory meaning if the "text is plain and unambiguous and does not yield absurd or unworkable results."
>
> Despite the state legislature's rejection of the Connecticut Supreme Court's eclectic approach, Professor Gluck reports that "the Connecticut Supreme Court

[115] 816 A.2d at 578-90 (footnotes and case citations omitted).

has been very reluctant to apply the overruling statute." After examining all of the relevant cases, Gluck found that "as long as the parties are arguing over statutory meaning, as litigating parties are likely to do, the Connecticut Supreme Court finds the text ambiguous and holds [the state interpretive code] inapplicable." Moreover, she points out that because the court rarely finds the statute applicable, it has been able to avoid deciding "whether the statute unconstitutionally infringes on judicial authority, despite various hints in dicta that it might." Gluck therefore correctly concludes that "Connecticut's example underscores that resistance to legislated rules is not a textualist-only phenomenon," and that the state judiciary's approach "has meant that the legislated rule has had almost no practical effect." While Texas and Connecticut may provide especially stark examples, Gluck and other scholars have found that state courts, as well as courts in other countries, frequently ignore codified rules of statutory interpretation, and the conventional wisdom is therefore that "courts will find ways around legislated methodological rules they do not like, and that judges may be unwilling to relinquish authority over interpretive methodology."

Even if courts sincerely wanted to follow codified rules of statutory interpretation, they would have significant difficulty in doing so. Commentators have pointed out that the interpretive code must itself be interpreted, and codified rules of statutory interpretation will frequently be ambiguous about whether they apply to a particular case at hand. This "step zero" inquiry will necessarily turn on subsidiary questions that cannot be answered solely by reference to the interpretive code, such as (1) whether the interpretive code should be applied retroactively; (2) whether the interpretive code is intended to displace other widely accepted norms of statutory interpretation, especially when those norms are constitutionally motivated; (3) how courts should prioritize codified rules of statutory interpretation and other widely accepted interpretive principles; (4) what should be done if there are internal conflicts within an interpretive code; and (5) what should be done if there are conflicts between the results that would be generated by applying the interpretive code and the ascertainable intent of the legislature in a particular case. These kinds of questions necessarily recreate judicial discretion, and they have a tendency to counsel in favor of the narrow application of codified rules of statutory interpretation.[116]

The same might be said of legislative attempts to choreograph contract interpretation. Apart form arguable separation of powers issues, individual cases are sufficiently disparate and unique while courts are inclined to make their own decisions irrespective of legislative direction. But notwithstanding episodes like that of Connecticut, courts tend to be proponents of a text-centered, plain meaning approach to contract – at least in theory and rhetoric – perhaps more so than the legislatures that have enacted contract construction statutes.

[116] Glen Staszewski, *The Dumbing Down of Statutory Interpretation*, 95 B.U. L. REV. 209, 264-65 (2015). Although Professor Staszewski does not bluntly accuse the Connecticut legislature and its relatively common notion of the right approach to interpretation as a "dumbing down," that inference can be made of his general attack on seeking simpler or reductionist interpretative methodologies in the interests of achieving uniformity and consistency.

Judicial Discussion of Plain Meaning

Often Discussed in Tautology

As noted above, searching for court decisions using the term plain meaning provides an avalanche of cases too voluminous to wade through. Even limiting a LEXIS or WESTLAW search by year often yields thousands of cases. Limiting by month still typically produces hundreds of cases. Even a narrower search for use of the term only in insurance coverage disputes yields a rough average of ten cases each week in 2019 alone. For example, a February 2019 LEXIS search of this type produced 46 cases.

What these cases had to say about plain meaning was relatively unenlightening. Courts invoked the concept and in some cases gave some indication of what they meant by plain meaning. But they almost never explained how it was they discerned that meaning was plain – at least in the cases in which the court made this type of finding of sufficiently clear, unambiguous policy language. It was only in the cases where language was found not to be sufficiently plain that the courts offered some explanation of their lexical analysis.

Typical of the caselaw are statements such as the following:

> "unambiguous terms of an insurance policy require no construction, and the plain meaning of such terms must be given full effect . . . ."[117]
>
> an "unambiguous policy provision must be accorded its plain and ordinary meaning, and the court may not disregard the plain meaning of the policy's language in order to find an ambiguity where none exists."[118]
>
> "Courts must give full effect to the plain meaning of clear and unambiguous insurance policy contract provisions."[119]
>
> "Where the language in an insurance contract is plain and unambiguous, a court must interpret the policy in accordance with the plain meaning so as to give effect to the policy as written."[120]
>
> "[I]f contractual language is clear and explicit, it governs."[121]

[117] Continental Casualty Co. v. H.S.I. Financial Services, Inc., 466 S.E.2d 4, 5 (Ga. 1996). Quoted favorably in Auto-Owners Ins. Co. v. Cribb, 2019 U.S. Dist. LEXIS 17785 (N.D. Ga. Feb. 5, 2019) at *10-*11.
[118] Bassuk Bros. v. Utica First Ins. Co., 768 N.Y.S. 2d 479, 481 (N.Y. App. Div. 2003).
[119] Capitol Specialty Ins. Corp. v. Tayworsky LLC, 2019 U.S. LEXIS 12110 (S.D. W. Va., Jan. 25, 2019) at *7.
[120] Washington Nat. Ins. Corp. v. Ruderman, 117 So. 3d 943, 948 (Fla. 2013).
[121] Powerine Oil Co. v. Superior Court, 37 Cal. 4th 377, 390 (2005).

"[W[hen [policy] language 'is clear and unequivocal, [each] party will be bound by its plain meaning.'[122]

" 'Under Pennsylvania law, an insurance policy must be read as a whole and construed according to the plain meaning of its terms.'"[123]

"If the language of the policy is clear and unambiguous, then it will be given its ordinary and plain meaning."[124]

Some Explanation

Occasionally, a court's discussion of plain meaning and the plain meaning rule is a bit more expansive.

"[P]lain meaning is the one commonly understood in the context of insurance contracts."[125]

"Nuanced connotations may represent the plain meaning of a term in context even though those connotations result form tacit knowledge, accumulated experience, and common sense that are not reflected well – if at all – in dictionary definitions."[126]

Court looks at policy language "to ascertain its plain meaning or the meaning a layperson would ordinarily attach to it."[127]

Plain meaning is the meaning "a layperson would ascribe to contract language."[128]

---

[122] IDT Corp. v. United States Specialty Ins. Co., 2019 Del. Super. LEXIS 55 (Jan. 31, 2019) at *17 (source of quotation unclear).

[123] KA Together, Inc. v. Aspen Specialty Ins. Co., 2019 U.S. Dist. LEXIS 12184 (E.D. Pa. Jan. 24, 2019) at *11, quoting Selective Way Ins. v. Travelers Prop. Cas. Co. of Am., 724 F. Supp.2d 520, 5215 (E.D.Pa. 2010).

[124] Oldcastle Precast v. Concrete Accessories of Ga., 2019 U.S. Dist. LEXIS 16773 (D. Idaho Jan. 31, 2019) at *18.

[125] Oregon Mut. Ins. Co. v. Certain Underwriters at Lloyd's London, 2019 Ore. App. LEXIS 152 (Jan. 30, 2019)(determining that one of two automobile policies was excess and the other primary).

[126] State v. Gonzalez-Valenzuela, 365 P.3d 116, 121 (Ore. 2015).

[127] Waller v. Truck Ins. Exch., Inc. 11 Cal. 4th 1, 18 (1995).

[128] AIU Ins. Co. v. Superior Court, 51 Cal. 3d 807, 822 (1990). *See also* Whittaker Corp. v. AIG Specialty Ins. Co., 2019 U.S. Dist. LEXIS 23744 at *22 (C.D.Cal. Feb. 6, 2019)("When interpreting the language as a whole, one definition of the word 'accrue' makes sense: to come into existence as a legally enforceable claim"); In re Lair, 235 B.R. 1 (Bky. M.D. La. 1999)(plain meaning "does not mean 'simple to understand'' Several courts have used a plain meaning analysis to reach diametrically opposed interpretations of [11 U.S.C.] §521(2); United Nuclear Corp. v. Allstate Ins. Co., 252 P.3d 798, 810-14 (N.M. Ct. App. 2011)(using dictionary to interpret term "sudden" in qualified pollution exclusion but also buttressing construction by reference to the text of the entire policy and the context surrounding the issuance of the policy as well as examining precedent and noting division of authority on meaning of the qualified pollution exclusion). *But see* United Nuclear Corp. v. Allstate Ins. Co., 285 P.3d 644 (N.M. 2012)(reversing Court of Appeals)(finding meaning of "sudden" sufficiently ambiguous to permit consideration of extrinsic evidence and that ambiguity remained unresolved, requiring construction against

> [T]o determine the meaning of an ambiguous contract, the trier of fact must determine what a reasonable person would have understood the language to mean and the words used must be construed given their ordinary meaning."[129]

> "We rely on the plain meaning of the test as expressing legislative intent unless a different meaning is supplied by legislative definition or is apparent from the context, or the plain meaning leads to absurd results."[130]

When courts refuse to find plain meaning in a policy term, they are more likely to offer a substantive assessment of what constitutes plain meaning as opposed to ambiguity.

> Language is ambiguous if it is "reasonably susceptible of different constructions and capable of being understood in more than one sense."[131]

> "In addition to [dictionary] definitions, a plain meaning analysis must include reading words and phrases in context and construing them in accordance with the rules of grammar and common usage."[132]

> An ambiguous policy provision is one "reasonably susceptible of two different meanings or of such doubtful meaning that reasonable minds might be uncertain or disagree as to its meaning."[133]

> Court is "obligated to give an insurance contract that construction which comports with the reasonable expectations of the insured." "The standard is what a reasonable person standing in the shoes of the insured would expect the language to mean.").[134]

---

insurer as drafter of policy and in order to honor objectively reasonable expectations of the policyholder.); Moore v. State, 424 Md.129-30, 34 A.3d 513, 519 (Md. 2011)("When conducting a plain meaning analysis, we have observed that dictionary definitions 'provide a useful starting point for discerning what the legislature could have meant in using a particular term.")(citations omitted). *See also id*. at 130-35, 519-22 (also examining structure of statute and legislative history as guides to statutory meaning but referring to its methodology as a plain meaning approach). *But see* 424 Md. At 127-28, 34 A. 3d at 518 (where statutory language unambiguous, court should not examine extrinsic evidence). The *Moore* court concluded that a "firearm" could include an inoperable weapon and – notwithstanding the rule of lenity – affirmed conviction for possession of an unregistered, but inoperable, gun.

[129] Clark v. Prudential Prop. & Case. Ins. Co., 66 P.3d 242, 245 (Idaho 2003).

[130] Willacy Cty. Appraisal Dist. v. Sebastian Cotton & Grain, Ltd., 55 S.W.3d 29, 38 (Tex. 2018).

[131] Madison Constr. Co. v. Harleysville Mut. Ins. Co., 735 A. 2d 100, 106 (Pa. 1999).

[132] Lane v. State, 933 S.W.2d 504, 515 n.12 (Tex. Crim. App. 1996) *Accord*, Bingham v. State, 913 S.W.2d 208, 209-10 (Tex. Crim. App. 1995).

[133] Glen Falls Ins. Co. v. Smith, 617 S.E.2d 760 (W. Va. 2005), quoted approvingly in Capitol Specialty Ins. Corp. v. Tayworsky LLC, 2019 U.S. LEXIS 12110 (S.D. W. Va., Jan. 25, 2019) at *7.

[134] Burr v. Nationwide Mut. Ins. Co., 359 S.E.2d 626, 631 (W. Va. 1987).

> Refusing to consider dictionaries and precedent in text construction "would relegate plain meaning analysis of statutory language to the subjective impression of appellate judges with no standards to guide interpretation.[135]

More Pronounced Judicial Attempts to Articulate of the Concept

In Contracts Cases

> The interpretation of the purchase contract is a question of law re review de novo. The fundamental goal of contract interpretation is to determine the parties' intent. "[W]e interpret a contact as a whole, reading each provision in light of all the others to find their plain meaning. We afford the contract's terms the plain meaning that a reasonable person would give to them. "We employ common sense and 'ascribed the words with a rational and reasonable intent.'" "We consider the language in the context in which it was written, looking to the surrounding circumstances, the subject matter, and the purpose of the agreement to ascertain the intent of the parties at the time the agreement was made." "We presume each provision in a contact has a purpose, and we avoid interpreting a contract so as to find inconsistent provision or so as to render any provision meaningless."
>
> When the contract's provisions are clear and unambiguous, we look only to the "four corners" of the document to determine the parties' intent and we enforce the terms of the contract as written. "An ambiguous contract is one which either contains a double meaning or is obscure in its meaning because of indefiniteness of expression. Whether a contact is ambiguous is a matter of law, and the parties' disagreement as to a contract's meaning does not mean the contract is ambiguous. Because we use an objective approach to interpret contracts, evidence of the parties' subjective intent is not relevant or admissible in interpreting a contract."

Schell v. Scallon, 2019 Wyo. LEXIS 11 (Jan. 25, 2019) at **9-**10 (citations omitted). See also *id.* at **11 (using dictionary definitions form MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY (11th ed. 2003) to determine the meaning of an agreement that a seller would "complete a fully functional water well prior to closing").

The court concluded that "[u]nder the plain meaning of its terms, we conclude the well requirement is unambiguous and did not require Sellers to complete a well, before the date of closing, with any greater function than producing water." *Id.* at **11. The Court thus rejected the buyer's complaint that the well on the purchased property failed to comply with the provision

[135] Lane v. State, 933 S.W.2d 504, 515 n.12 (Tex. Crim. App. 1996). Common terms "are to be construed in their natural, plain and ordinary sense, and courts may inform their understanding of such words by consulting a dictionary." C.H. Heist Carib Corp. v. Am. Home Assur. Co., 640 F.2d 479, 481 (3d Cir. 2918); *See also* KA Together, Inc. v. Aspen Specialty Ins. Co., 2019 U.S. Dist. LEXIS 12184 (E.D. Pa. Jan. 24, 2019) at *13. Determining that the term "entrust" is a commonly sued term and that it means "to confer a trust on" or "to commit to another with confidence" based on a case (Grover Commercial Enters., Inc. v. Aspen Ins. UK, Ltd, 202 So.3d 877 (Fla. Dist. Ct. App. 2016), which made this determination on the basis of the Merriam-Webster Collegiate Dictionary (11th ed. 2005).

when it develop significant problems within months of the April 2015 closing and stopped working altogether/ran dry by June 2016.[136]

The court was unsympathetic, reasoning that "[t]he parties were free to define 'fully functional" or the requirement's other terms, but did not, and we will not write terms into a contract under the guise of contract interpretation." *Id.* at **11. The court then, however "bolstered" its linguistic analysis "in the context of the purpose" of the contract and discussed the context of the purchase at sufficient length (*Id*. at **11-**14) that one could be forgiven for viewing this as the equivalent of a California-like examination of extrinsic evidence. However, the court rejected the buyers' "request that we look outside the four corners of the contract and consider circumstances surrounding execution of the agreement" such as "industry standards and the State Engineer's minimum construction standards for water wells.[137]

One non-insurance case provides an extensive discussion of the concept and the extent to which arguably clear contract language may qualify as having a plain meaning. In *Mellon Bank, N.A. v. Aetna Business Credit, Inc*., 619 F.2d 1001 (3d Cir. 1980), the court reversed and remanded a trial court decision that had considered extrinsic evidence contradicting what the appellate court regarded as the plain meaning of a contract provision. Although not essential to the court's decision, its discussion of the plain meaning concept and consideration of extrinsic evidence is illustrative.

> In a world where semantics is a science instead of an art we might be able to read a contract and understand it without question. However, English is often a difficult and elusive language and certainly not uniform among all who use it. External indicia of the parties' intent other than written words are useful, and probably indispensable, in interpreting contract terms. If each judge simply

[136] This type of well failure seems severe enough that it would violate the implied warranty of merchantability if the house were a "good" within the meaning of the Uniform Commercial Code, making *Schnell v. Scallon* seem -- at least to me -- a harsh decision. But the opinion also notes other aspects of the transaction that can reasonably be read as the sale having something akin to an "as is" character – and the buyers did not inspect the well, which was at least nominally working at the time of closing, prior to purchase.

The case provides an interesting clash of two opposing concerns in disputes over a sale that has disappointed a party to the transaction. Which is the more "just" result – providing a remedy to the disappointed party? Or refraining from imposing liability on a party that appears not to have committed fraud or otherwise acted dishonorably but nonetheless provided an inferior product.

Schell v. Scallon is silent as to the purchase price of the property. I would argue that this is relevant to determining how broad or narrow a construction to give to the contract duty of the seller to "complete a fully functional well." If the home purchase was bargain basement, the Wyoming Supreme Court's analysis (in a unanimous opinion) seems correct. If the home was sold a price associated with homes that had no well problems, the result seems harsh and unjust for the buyers. An examination of such evidence, which is only partially extrinsic. The price presumably was on the face of the contract while the local real estate market is extrinsic information – but information capable of rather ready and accurate determination, almost in the manner of judicial notice pursuant to Fed. R. Evid. 202, through a look at local listings and recent comparable sales, which are normally available in government records and through real estate websites such as redfin.

[137] "Buyers arguments on this point are unconvincing for two reasons. First, the contract does not reference either set of standards. Second, Buyers have not shown that "fully functional" has a partricularized or technical meaning in the water well industry, or that, if it did, we should presume the parties intended "fully functional" to imply compliance with standards for an industry in which neither party participates." *Id.* at **15.

> applied his own linguistic background and experience to the words of a contract, contracting parties would live in a most uncertain environment.
>
> * * *
>
> It is the role of the judge to consider the words of the contract, the alternative meaning suggested by counsel, and the nature of the objective evidence to be offered in support of that meaning. The trial judge must then determine if a full evidentiary hearing is warranted. If a reasonable alternative interpretation is suggested, even though it may be alien to the judge's linguistic experience, objective evidence in support of that interpretation should be considered by the fact finder. *See Corbin on Contracts* § 542.

Id. at 1010–11 (footnote omitted).

> It is only by this approach that courts can achieve consistency in contract interpretation.
>
> > The strict "four-corners" doctrine allows a court to sit in an isolated position and decide if words are "clear" or "ambiguous." Judges today come from a variety of backgrounds private law practice, government service, business, academia and their fields of experience represent an even wider variance. The parties who appear before the court in these se times of complex commercial transactions come from a variety of specialized worlds of trade. It is the parties' linguistic reference that is relevant, not the judges'. The judge is in his or her linguistic field of expertise only when viewing words which lawyers have developed as terms of legal art. Even when the judge faces the need to interpret legal terms of art, extrinsic evidence and legal briefing are useful.
> >
> > For example, a contract might provide for a party to pay "$10,000 for 100 ounces of platinum." A judge might state that the quoted words are so clear and unambiguous that parol evidence is not admissible to vary their meaning. That judge might never learn that the parties have a consistent past practice of dealing only in Canadian dollars and follow a standard trade practice of measuring platinum in troy ounces (12 to the pound instead of 16). This is because that judge's linguistic frame of reference includes the dollars and the ounces he or she encounters in daily life. This is not the linguistic frame of reference of the commercial parties.
> >
> > There are many other examples which demonstrate the necessity of the approach we outline. A "pound" of caviar is always 14 ounces. One can readily see the difficulty counsel might have convincing a judge who never has eaten caviar that a "pound" can be 14 ounces. The case could also come before a judge who is a lifelong gourmet and consumer of caviar. To the gourmet judge it might be "clear and unambiguous" that a

> pound of caviar is 14 ounces. Similarly, in the lumber business a "two by four" is never really two inches by four inches, but somewhat smaller. The background of some judges might make them aware of this, the background of others might not. Following the approach we outline in this opinion a consistent result could be reached in each case the parties would be bound to the same meaning of the external signs of their intent. When the judge who knows only common usage is told that a specialized usage can be shown which is common to both parties, he will realize an ambiguity can exist and will admit evidence to determine the meaning by which the parties should be bound. Under a "four-corners" approach to the question of ambiguity, the result would depend on which judge heard the case.

Id. at 1011 n.12.

> But our approach does not authorize a trial judge to demote the written word to a reduced status in contract interpretation. Although extrinsic evidence may be considered under proper circumstances, the parties remain bound by the appropriate objective definition of the words they use to express their intent. Generally parties will be held to definitions given to words in specialized commercial and trade areas in which they deal. Similarly, certain words attain binding definition as legal terms of art. Dates, numbers and the like generally cannot be varied [(but noting that example of "two by four" lumber shows even this textual norm has exceptions)]. For example, extrinsic evidence may be used to show that "Ten Dollars paid on January 5, 1980," meant ten Canadian dollars, but it would not be allowed to show the parties meant twenty dollars. Trade terms, legal terms of art, numbers, common words of accepted usage and terms of a similar nature should be interpreted in accord with their specialized or accepted usage unless such an interpretation would produce irrational results or the contract documents are internally inconsistent.
>
> We have concluded that the district court here exceeded the permissible boundary of interpretation. We believe its [narrower] interpretation of insolvency [as the term was used in the contract] was improperly restrictive. Commercial parties entered a Buy-Sell Agreement using a well defined commercial term and legal term of art [in using the word] "insolvent."

Id. at 1013 (footnotes and citations omitted).

<u>In Criminal Cases -- Half a World Away From Insurance – and Distinguishable Because of the Rule of Lenity – but Does Criminal Law Application of the Plain Meaning Concept Provide Fodder for Insurer or Policyholder Briefs?</u>

In *United States v. Rodriguez*, 711 F.3d 541, 544 (5th Cir. 2013), the court stated that it would "adopt a plain-meaning approach to determining what constitutes a "crime of violence"

for purposes of enhancement of a criminal sentence because of defendant's prior conviction for "sexual abuse of a minor" and "statutory rape" and set forth the following protocol.

> First, we identify the undefined offense category that triggers the federal sentencing enhancement. We then evaluate whether the meaning of that offense category is clear from the language of the enhancement at issue or its applicable commentary. If not, we proceed to step two, and determine whether that undefined offence category is an offense category defined at common law, or an offense category that is not defined at common law. Third, if the offense category is a non-common-law offense category, then we derive its "generic, contemporary meaning" from its common usage as stated in legal and other well-accepted dictionaries. Fourth, we look to the elements of the state statute of conviction and evaluate whether those elements comport with the generic meaning of the enumerated offence category. This plain-meaning approach is faithful to the Supreme Court's decision in *Taylor v. United States*, [495 U.S. 575 (1990)] but does not impose a cumbersome methodological requirement on lower courts to conduct a nationwide survey and look to the majority of state courts – as well as the Model Penal Code, federal law, and criminal law treatises – when deriving the meaning of an undefined offense category enumerated in a federal sentencing enhancement.

711 F.3d at 544.

Rodriguez, like many cases discussing interpretative process at length, is of course a criminal case. Jorge Cabeccera Rodriguez was before the court on a guilty plea for illegal reentry into the United States after his deportation (a violation of 8 U.S.C. 1326) and received a 23-month sentence, that was enhanced because of prior convictions in Texas, where he had engaged in sex with a 16-year-old girl (sexual assault of a "child" in violation of Texas Penal Code 22.011(a)(2). To some extent, this is unsurprising because of the "rule of lenity" for statutory construction in criminal cases, which instructs the court to resolve unclear statutory language in favor of the defendant on the ground that a person should only be subjected to criminal punishment if the language of the statute is sufficiently clear.

Even if not dealing with criminal law, cases discussing the plain meaning approach or textual interpretation at length often involved statutes rather than contracts. Because statutes are both inherently textual and positive law of the sovereign rather than memorializations of private agreements as well as widely applicable, the stakes of statutory interpretation are perhaps considered sufficiently higher and therefore worth more extensive reflection and discussion by courts.

But even though statutes, particularly criminal statutes, differ form contract documents, the basic groundrules of interpretation should apply in all cases. Judicial analysis of statutory language can thus illuminate what courts do – or at least say they do – in resolving disputes over textual meaning.

Rodriguez, despite its methodical 4-step process, does not tell the reader much about how the judges of the en banc Fifth Circuit actually determined word meaning – but does identify sources of meaning consulted by the court. These include dictionaries,[138] judicial precedent, model laws, and treatises. For example the LaFave & Scott criminal law treatise enjoyed status as an authority on word meaning in criminal statutes.[139]

Defendant Rodriguez argued that there was a general national understanding that statutory rape and illegal sex with a child (the Rodriguez encounter was apparently consensual) this should be the yardstick – under age 16 and a four-year age difference between victim and perpetrator -- for determining whether federal sentencing enhancement was apt. Therefore, argued Rodriguez, it would be inappropriate to increase his sentence based on violation of the harsher Texas law that applied to victims under 17 and requires a three-year difference. (Rodriguez was 19 at the time of the infraction). The court rejected this argument.

Taylor v. United States involved the question of whether burglary constituted a "crime of violence" for purposes of sentence enhancement, with the Court taking the view that the term should be given its "generic" meaning rather than the particular meaning of the state law pursuant to which the defendant previously was convicted. 495 U.S. at 598. Based on this, the Fifth Circuit prior to *Rodriguez*, took the view that "lower courts [should] always look to the majority of state codes – as well as to other sources, including the Model Penal Code, federal law, and criminal law treatises" when assessing the "generic, contemporary meaning" of an offence category not specifically defined in federal criminal law. *Rodriguez*, 711 F.2d at 554. *See, e.g., U.S. v. Santiesteban-Hernandez*, 469 F.3d 376, 379 (5th Cir. 2006); *U.S. v. Munoz-Ortenza*, 563 F.3d 112, 114-115 (5th Cir. 2009); *U.S. v. Lopez-DeLeon*, 513 F.3d 472, 474-75 (5th Cir. 2007); *U.S. v. Mendez-Casarez*, 624 F.3d 233, 239 (5th Cir. 2010).[140]

---

[138] *See, e.g.*, OXFORD ENGLISH DICTIONARY (2d ed. 1989), MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY (11th ed. 2003); WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY (3d ed. 2002) as well as BLACK'S LAW DICTIONARY (9th ed. 2009), all cited in *Rodriguez*, 711 F.3d at 559-61.

[139] WAYNE LAFAVE, CRIMINAL LAW (5TH ED. 2010); WAYNE LAFAVE & AUSTIN SCOTT, SUBSTANTIVE CRIMINAL LAW (1986)(cited in Supreme Court's *U.S. v. Taylor* decision and several Fifth Circuit decisions regarding meaning of criminal statutes). *See also* WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND (1st American ed. 1772);

[140] But these seemingly sensible approaches to determining plain meaning "are no longer valid [Fifth Circuit] precedent to the extent they use approaches other than a plain-meaning approach to define the "generic, contemporary meaning" of the "statutory rape" and "sexual abuse of a minor" offense categories" of the sentencing guidelines. *Rodriguez*, 711 F.3d at , n. 6. Because of the unifying thread of federal law and a U.S. Supreme Court precedent in S., the Fifth Circuit is not alone in adopting a plain meaning approach to assessing sentence enhancement terminology. *See, e.g.*, Londono-Quintero, 289 F.3d at 153-54 (using Random House Webster's Unabridged Dictionary to define "sexual abuse of a minor"); Martinez-Carillo, 259 F.3d at 1104 (using Black's Law Dictionary to define generic meaning of "sexual abuse of a minor"); U.S. v. Graham, 982 F.2d 32155, 316 (8th Cir. 1992)(using Black's Law Dictionary to define "dwelling" and "burglary of a dwelling"); U.S. v. Romerio-Hernandez, 505 F.3d 1082, 1087-88 (10th Cir. 2007)(using Black's Law Dictionary to define "forcible sex offense"); U.S. v. Diaz-Ibarra, 522 F.3d 343, 348-49 (4th Cir. 2008)(using Webster's Third New International Dictionary to define "sexual abuse of a minor"); U.S. v. De Jesus-Ventura, 565 F.3d 870, 876-77 (D.C. Cir. 2009)(looking to definitions of terms in state codes, the Model Penal Code and federal law to determine meaning of "kidnapping'); U.S. v. Marrero, 677 F.3d 155, 165-66) (3d Cir. 2012)(using Model Penal Code, state laws, and criminal law treatises to determine meaning of "murder");U.S. v. McClenton, 54 F.3d 584, 587 (3d Cir. 1995)(using dictionary definitions of "dwelling").

"In the context of insurance policies, [a plain meaning approach] means that a judicial interpretation should conform to the plain meaning that reasonable insurers and insureds likely would have attributed to the words.

The search for this plain meaning does not myopically focus on a word here or a phrase there. Instead, it looks at a word in the context of a sentence, a sentence in the context of a paragraph, and a paragraph in the context of the entire agreement. The plain meaning of a word depends not merely on semantics and syntax but also on the holistic contact of the word within the instrument. Consequently, every word, clause, and provision of the policy 'should be considered and construed together and seemingly conflicting provisions harmonized when that can be reasonably done, so as to effectuate the intention of the parties as expressed therein.' If policy terms] 'are clear and unambiguous, their terms are to be taken in their plain, ordinary and popular sense.'[141]

Kwiecinski v. Ill Farmers Ins. Co., 2019 U.S. Dist. LEXIS 11511 (N.D. Ind. Jan. 22, 2019) at *4-5 (United States Postal Service vehicle that was driving on a daily mail delivery route for several years is a vehicle "furnished or available" within the plain meaning of the policy). Accord, Smith v. Allstate Ins. Co., 681 N.E.2d 2200, 23 (Ind. Ct. App. 1997)(employer-owned van provided for delivery of newspapers on route was "furnished for "regular use" as a matter of plain meaning); Estate of Kinser v. Ind. Ins. Co., 950 N.E.2d 23, 28 (In Ct. App. 2011)(vehicle furnished for regular use where delivery driver and employer had "mutual understanding that the driver would be given keys to access and permission to drive the vehicle to make deliveries").

But on closer scrutiny, these courts all use differing methodologies of determining plain meaning despite the uniformity enhancing aspects of the situation – uniformity enhancing aspects of law that are not present in insurance coverage disputes. Quite the contrary, insurance law is highly state-centered and only seldom is subject to a controlling federal statute or court decision. The leading federal statute on insurance, of course, is the McCarran-Ferguson Act, which might better be termed a disunifying statute in that it commits insurance regulation and insurance law generally to the states.

But a majority decision does not necessarily mean judicial consensus. Three judges in *Rodriguez* concurred, stating that they were "perplexed" by the majority's "decision to rely solely on dictionary definitions." First, these judges thought "that courts are just as capable as the authors of dictionaries of determining how statutes 'usually' define 'minor" Second, the concurring judges saw "inconsistencies in how the court applies the dictionary definitions." 711 F.3d at 563, 567 (Owen, J., joined by Haynes and Graves, concurring).

Another judge dissented, labeling the majority's plain meaning approach "novel" and "unprecedented" by focusing on the meaning of terms such as "statutory rape" based on the state law under which the defendant was previously convicted rather than upon broader national and historical connotations of a term. *See* 711 F.3d at 574, (Dennis, J., concurring).[140] *See also U.S. v. Rangel-Castaneda*, 709 F.3d 373 (4th Cir. 2013)(finding generic, contemporary meaning of statutory rape to place ages of consent at 16); *U.S. v. Rodriguez-Guzman*, 506 F.3d 738, 746 (9th Cir. 2007)(refusing to apply state law concept of age of consent as 18).

[141] Erie Ins. Exch. v. EPC MD 15, LLC, 2019 Va. LEXIS 2, 822 S.E.2d 351 (Jan 17, 2019) at *6, quoting Floyd v. Northern Neck Ins., 427 S.E.2d 193, 245 Va. 153, 158 (Va. 1993) and GEICO v. Moore, 266 Va. 155, 164, 580 S.E.2d 823 (Va. 2003), respectively)(reversing, on the basis of policy language found clear, lower court finding that coverage was extended to a policyholder's acquired entity).

Courts Labeling Problematic Policy Text Ambiguous as Avoiding The Seeming Meaning of Text Through Other Means

In cases that are (in my view) both numerous but not obvious,[142] courts may decline to enforce documentary language that many would regard as sufficiently clear to have a plain meaning. In many if not the majority of jurisdictions, a finding of textual ambiguity is a prerequisite to consideration many types of contextual evidence (e.g., usage in trade, course of dealing, the nature of the business or type of transaction involved, economic conditions, social conditions), especially what might be regarded as "hard core" extrinsic evidence (e.g., testimony or documents regarding party intent). This prompts some courts to find ambiguity (or at least profess for find ambiguity) in order to gain access to this additional information, particularly in cases where enforcement of seemingly clear contract document text cannot be avoided under the jurisdiction's prevailing law of unconscionability, illegality, or public policy or the "absurd result" exception to enforcement of clear contract text.[143] Even when not required by law, a court may be more comfortable declaring language ambiguous rather than admitting that it has consulted extrinsic information and used this to overcome seemingly clear policy text.

In a variant of this, a court may decline to give a broad reading to policy text because such a reading seems at odds with either a reading of the policy as a whole or an understanding of what the policy is designed to accomplish.[144] Related to this is some uncertainty about when arguably straight-forward construction of policy text is (a) giving effect to a uniformly accepted understanding of the term or (b) engaging in dictionary hyper-literalism that gives the language a construction that may be technically correct but is at odds with the way in which most laypersons use the language at issue in everyday speech.

A classic example of this definitional problem is application of the absolute pollution exclusion to claims alleging chemically-related injury that do not qualify as "pollution" as the term is commonly used. Is a court that applies the exclusion to bar coverage for carbon monoxide poisoning from a faulty furnace[145] giving the admittedly broad language of the

---

[142] Some of the difficulty in finding illustrative cases may also result because courts are deferring only partially to even clear text rather than being bound by the apparent single meaning of text

[143] *See, e.*g., *AstenJohnson, Inc. v. Columbia Cas. Co*., 562 F.3d 213, 220–22 (3d Cir. 2009)(but before declaring result of literal reading of text absurd, court considered extrinsic evidence to see if the information supported a non-absurd interpretation of policy language and, finding none, invoked the absurd result concept). *See id.* at 222.

[144] *See, e.g.*, *Groshong v. Mut. of Enumclaw Ins. Co*., 985 P.2d 1284, 1289–90 (Or. 1999) (finding no personal injury coverage for housing discrimination claim; ruling that policy text referring to coverage for claims alleging interference with "right of private occupancy" was not clear on its face, but in context applied only to claims of infringement on rights of existing property interests and not to claims of discriminatory failure to grant a property interest)(and stating that "[t]he meaning of a term is 'plain'—that is, unambiguous—if the term is susceptible to only one plausible interpretation."). As part of its contextual analysis, the *Groshong* Court referred to *Webster's Third New International Dictionary* and conducted a functional analysis, concluding that giving the phrase "right of private occupancy" a narrower meaning than sought by the policyholder would not result in illusory coverage. *See id*. at 1288–90.

[145] Or: bat guano in an attic; drifting smoke that obscures vision and leads to a collision; contaminated drinking water at a golf tournament; a direct hit by escaping fuel or insecticide that is confined to only one or a small group of victims in the immediate vicinity. In these types of cases, the courts have divided on coverage—as contrasted with

exclusion its "plain" meaning or engaging in over-literalism? When a court finds the language ambiguous as applied to something like lead poisoning, the court may claim that the language itself is unclear; but it might be more accurate to say that the language is linguistically clear standing alone but inconsistent with the intent, purpose, and function of the insurance policy once other evidence of meaning is considered.[146]

In addition, to the extent that the policy language at issue is an exclusion or operates in the nature of an exclusion, the "real" basis for a decision adverse to an insurer may be that although the language is quite favorable to the insurer, the language is not so indubitably clear as to reach the threshold of plain meaning—which the Restatement and most courts have defined as a textual presentation admitting to only a single meaning – in light of the canon of construction that exclusions are to be strictly construed and the burden of persuasion placed on insurers to demonstrate applicability of the exclusion.

Avoiding Seemingly Clear Policy Text Through Non-interpretative Legal Doctrine

Notwithstanding that many courts may be more comfortable finding textual ambiguity and considering contextual and extrinsic evidence in order to resolve disputes over policy meaning, courts are in some circumstances quite willing to refuse application of seemingly clear text based on consideration of other factors. Examples include:

> ***Anti-assignment clause cases that nonetheless permit the policyholder to assign policy protections after fortuitous loss has occurred if the insurer faces no increase of hazard from policyholder's assignment of rights after contingent risk has become a chose in action***. *See, e.g., Wehr Constructors, Inc. v. Assurance Co. of Am.*, 384 S.W.3d 680, 682–89 (Ky. 2012) (collecting cases on majority rule versus minority rule on this issue; using functional and purposive analysis that finesses the issue of the clarity of the policy text). *Accord N. River Ins. Co. v. Mine Safety Appliances Co.*, 105 A.3d 369 (Del. 2014). The anti-assignment clause on its face, however, would appear to clearly forbid all assignments. Although this could just as easily be viewed as an absurd result or an unconscionable penalty creating disproportionate forfeiture in the event of assignment, the majority rule on this point could also be viewed as judicial rejection of clear text after examination of non-textual factors affecting insurance policy construction.

---

cases of claims based on wider, more gradual contamination affecting a relatively larger group or area in which almost all courts have found the exclusion applicable.

[146] Cases that place reliance on legislative intent in construing statutes illustrate this reduced "deference light" to text. *See, e.g., Baker v. Hedstrom*, 309 P.3d 1047, 1050 (N.M. 2013) (stating that aim of statutory construction is to give effect to legislative intent, but court is to use "the plain language of the statute as the primary indicator of legislative intent" (quoting *State v. Willie*, 212 P.3d 369, 373 (N.M. 2009))). Contract and insurance coverage cases use similar approaches in at least acknowledging that contracting is about an agreement, but placing heavy reliance on text as the primary indicator of party intent. Because contracts normally lack the extensive background information surrounding statutes, this normally means that contract text prevails. Insurance is arguably a mix of the two in that widely used policy terms function as a type of private legislation that has a discernable drafting history or well-known purpose.

Pollution exclusion cases that refuse to give literal enforcement to the absolute or total pollution exclusion. *See, e.g., Pipefitters Welfare Educ. Fund v. Westchester Fire Ins. Co*., 976 F.2d 1037, 1043 (7th Cir. 1992) (applying Illinois law) ("Without some limiting principle, the [text of] the pollution exclusion clause would extend far beyond its intended scope, and lead to some absurd results."). *Accord Kent Farms, Inc. v. Zurich Ins. Co.*, 998 P.2d 292, 296 (Wash. 2000) (worker injured by spraying gas due to defective valve is not "polluted" as the exclusion was intended to be understood); *Am. States Ins. Co. v. Koloms*, 687 N.E.2d 72, 82 (Ill. 1997) (carbon monoxide poisoning from defective heater is injury due to vendor negligence rather than pollution). However, courts that refuse literal application of the pollution exclusion text tend to do so on grounds that the text is ambiguous, not that it is clear but inconsistent with the structure and function of the CGL. *See, e.g., Century Sur. Co. v. Casino W., Inc*., 329 P.3d 614, 618 (Nev. 2014).

Earth movement exclusion cases (some are actually found in liability policies) where the court refuses to read the exclusion literally or broadly, particularly an anti-concurrent causation clause, and limits excluded events to naturally occurring earth movement—such as an earthquake or mudslide rather than shifts in foundation due to broken pipe, equipment misuses, or inadequate stabilization by contractors. *See Powell v. Liberty Mut. Fire Ins. Co*., 252 P.3d 668, 672–74 (Nev. 2011)[147] (also collecting cases and concluding majority rule is to hold standard language earth movement exclusion applicable only to naturally caused earth movement despite its broad language but doing so largely on grounds of textual ambiguity); *United Nat'l Ins. Co. v. Assurance Co. of Am*., 2012 U.S. Dist. LEXIS 73630, at *13–15 (D. Nev. May 29, 2012) (taking similar approach to subsidence exclusion in general liability policy; expressly finding exclusion ambiguous, but also invoking reasonable expectations of builder policyholder and purpose of policy to provide protection to builders sued if faulty work causes injury to other property).

Refusal to require that a retention be paid out of pocket by the policyholder despite seemingly clear policy language to that effect so long as the insurer is not required to pay until covered losses exceed the amount of the retention. *See, e.g., Lasorte v. Certain Underwriters*, 995 F. Supp. 2d 1134, 1140 (D. Mont. 2014) (holding that SIR provided for in policy did not actually have to be paid to trigger insurer duty to provide payment; it was sufficient that policyholder had incurred liability in excess of SIR amount); *Intervest Constr. of Jax, Inc. v. Gen. Fid. Ins. Co.*, 133 So. 3d 494, 502–03 (Fla. 2014) (liability policy does not require SIR amount to be satisfied by payments made by policyholder; payment of

[147] I was also recently involved in an unreported case in which the state trial court ruled on summary judgment that an earth movement exclusion in a liability policy applied to only natural causes and therefore did not preclude coverage for a builder sued for poor subdivision design that exacerbated flooding when a canal overflowed. However, the decision was largely predicated on finding the language textually ambiguous and insufficient to preclude a duty to defend in view of the narrow construction normally afforded exclusions.

retention amount by other source sufficient to obligate insurer to provide coverage). *But see Lloyd's Syndicated No. 5820 v. AGCO Corp.*, 756 S.E.2d 520, 525 (Ga. 2014) (applying literal meaning of term "held legally liable" as measuring stick for insurer's responsibility to pay claim and refusing to construe term to trigger payment obligation merely because it had become apparent that policyholder was going to be found liable to third-party claimant).

Narrow construction of "use" of automobile provisions. *See, e.g.*, *Lancer Ins. Co. v. Garcia Holiday Tours*, 345 S.W.3d 50, 58 (Tex. 2011) (claims by passengers for exposure to tuberculosis due to infected bus driver did not "result from" use of motor vehicle). *Accord Imperium Ins. Co. v. Unigard Ins. Co*., 16 F. Supp. 3d 1104, 1122 (E.D. Cal. 2014) (liability for negligently unsecured gate across road did not arise out of vehicle use even though vehicle was used by workers leaving gate unsecured). Although these cases tend to narrow rather than expand coverage, I believe they fit the Section 3 model in terms of what the courts are doing even if not what the courts say they are doing. "Use" of an auto is a broad term. If applied in a literal fashion (and perhaps a plain meaning fashion as well), the bus driver with TB, the drive-by shooting, unloading a trunk, and CO poisoning from a defective heater would all qualify as auto use triggering coverage. But many and perhaps even most cases take a narrower approach, effectively treating these events as general liability exposures in spite of the broad text of use of an auto, arising out of use of an auto, or resulting from use of an auto language found in many policies. The situation is complicated in many states by statutes affecting the area, but I think it is correct to say that in these cases the courts do not apply facially clear textual meaning but instead consider a number of extrinsic factors to determine whether the incident in question should be treated as an auto liability policy matter.

Refusal to strictly enforce the "visible marks of entry" requirement in burglary cases (first party, I know), such as the classic reasonable expectations cases of *Atwater Creamery Co. v. Western National Mutual Insurance Co.*, 366 N.W.2d 271 (Minn. 1985), and *C&J Fertilizer, Inc. v. Allied Mutual Insurance Co.*, 227 N.W.2d 169 (Iowa 1975).

Narrow construction of the business pursuits exclusion. *See, e.g.*, *Springer v. Erie Ins. Exch.*, 94 A.3d 75, 87–91, (Md. 2014) (again a first party case) (business pursuits exclusion to liability coverage component of homeowner's insurance policy is construed to mean something other than mere minimum commercial activity or activity for which compensation is received; exclusion applies only where there is a continuity of the insured's alleged business interests and a profit motive).

Refusal to give literal enforcement to a requirement that circuit breakers be used in a building. *See Gold Mine Invs., Inc. v. Mount Vernon Fire Ins. Co.*, 300 P.3d 1113, 1118 (Kan. Ct. App. 2013) (finding that use of fuses satisfies the clause because this is the reading a reasonable policyholder would give the policy

text). But even without hyper-literalism, it would seem clear that a circuit breaker is not a fuse. The court's emphasis is on functional analysis, risks presented, and objectively reasonable expectations. But the court could have reached this result by acknowledging that the text appeared to have a plain meaning of requiring circuit breakers, but that application of this meaning would be inappropriate in light of the extrinsic evidence of policy purpose and objectives. Once again, however, we have a first-party illustration rather than a liability insurance illustration.

Refusal to give strict application to time limit conditions in policies. This is admittedly largely if not exclusively a facet of first-party coverage litigation, seen primarily in accident or health policies. *See, e.g., Strickland v. Gulf Life Ins. Co.*, 242 S.E.2d 148, 152 (Ga. 1978) (reversing literal application of 90-day requirement for amputation and remanding for consideration of functional analysis and consideration of public policy). However, this more functional and purposive approach may be the minority rule. *See, e.g., Martin v. Allianz Life Ins. Co.*, 573 N.W.2d 823, 827–28 (N.D. 1998) (in requiring severance of limb within 90 days for coverage, court reviews caselaw and finds its approach to be clear majority with cases like *Strickland* as a distinct minority). *See also Hawes v. Kan. Farm Bureau*, 710 P.2d 1312, 1316–17 (Kan. 1985) (collecting cases and

Conclusion

What exactly, then, is "plain" meaning? Everyone agrees on the concept in general but pronounced division of the legal community arises over what non-textual information, if any, may legitimately inform the determination of whether a contract term has a sufficiently plain or clear meaning. There are significant elements of the legal community, particularly the academic community, that reject narrow textualism and advocate rather extensive (but not boundless) consideration of extrinsic and contextual evidence.[148] Using New York and California law as

[148] As well as significant elements of the legal community favoring substantial modification of the traditional contract model, at least as respects insurance policies. The most obvious is support for a strong version of the reasonable expectations approach to policy construction in which a policyholders objectively reasonable expectations determine contract meaning even if contradicted by the literal language of the policy. *See* JEFFREY W. STEMPEL & ERIK S. KNUTSEN, STEMPEL & KNUTSEN ON INSURANCE COVERAGE, §4.11 (4th ed. 2016); Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961 (1970)(Part I). In practice, however, nearly all jurisdictions at least purport to require a showing of textual ambiguity before considering policyholder expectations as a guide to word meaning. *See* RANDY MANILOFF & JEFFREY STEMPEL, GENERAL LIABILITY INSURANCE COVERAGE: KEY ISSUES IN EVERY STATE Ch. 22 (3d ed. 2015). Because court decisions involving the reasonable expectations concept are so interwoven with the dispute in question rather than a broad state "rule" on reasonable expectations, the authors of the Treatise elected to eliminate this chapter in the Fourth Edition of the Treatise.

In addition, there is some support for viewing insurance policies as products and assessing them in light of their performance and fitness for the ostensible purpose rather than focusing on text alone. *See, e.g.*, Christopher C. French, *Understanding Insurance Policies as Non-Contracts: An Alternative Approach to Drafting and Construing These Unique Financial Instruments*, 89 TEMPLE L. REV. 535 (2017); Jeffrey W. Stempel, *The Insurance Contract as Thing*, 44 TORT, TRIAL & INS. L.J. 813 (2009); Daniel Schwarcz, *A Product Liability Theory for the Judicial Regulation of Insurance Coverage*, 48 WM. & MARY L. REV. 1389 (2007) along with less support for viewing

illustrative points on the text-context continuum, Professor Miller provided a useful summary assessment.

> The differences between New York and California contract law turn out to align with the formalist-contextualist distinction in contract theory. New York judges are formalists. Especially in commercial cases, they have little tolerance for attempts to re-write contracts to make them fairer or more equitable, and they look to the written agreement as the definitive source of interpretation. California judges, on the other hand, more willingly reform or reject contracts in the service of morality or public policy; they place less emphasis on the written agreement of the parties and seek instead to identify the contours of their commercial relationship within a broader context framed by principles of reason, equity, and substantial justice.[149]

This summary appears true as a general matter. But in addition to unduly minimizing the variance between judges in the same jurisdiction (an arguable ecological fallacy but also an occupational hazard whenever summarizing the law of a jurisdiction), this and other attempts to summarize different approaches to contract text do not really answer the question of what makes text sufficiently clear to the judge reading the text.

---

insurance policies as social instruments (*see* Jeffrey W. Stempel, *The Insurance Policy as Social Instrument and Social Institution*, 51 WM. & MARY L. REV. 1489 (2010)) or akin to legislation (*see* Jeffrey W. Stempel, *The Insurance Policy as Statute*, 41 MCGEORGE L. REV. 203 (2010)).

This is in addition to a rather large block of the academic community that, although adhering to a contract model of insurance policies, would prefer to de-emphasize textualism and increase contextualism beyond that approved in the Second Contracts Restatement. *See, e.g.*, Lawrence A. Cunningham, *Contract Interpretation 2.0: Not Winner-Take-All but Best-Tool-for-the-Job*, 85 GEO. WASH. L. REV. 1625 (2018)(arguing for avoidance of fundamentalist textualist approach and advocating more eclectic approach to contract construction); James A. Fischer, *Why Are Insurance Contracts Subject to Special Rules of Interpretation?? Text Versus Context*, 24 ARIZ. ST. L.J. 995 (1992)(supporting contextualist approach and finding it more prevalent in caselaw than commonly thought in view of judicial rhetoric supporting textual focus); Jeffrey W. Stempel & Erik S. Knutsen, *Rejecting Word Worship: Integrative Interpretation to Improve Judicial Construction of Insurance Policies* (Manuscript April 2018)(same regarding insurance policies). *See also* William Baude & Stephen E. Sachs, *The Law of Interpretation*, 130 HARV. L. REV. 1079 (2017)(taking less eclectic view more cabined by text but recognizing substantial non-textual factors operating widely in contract and statutory interpretation cases).

[149] Geoffrey P. Miller, *Bargains Bicoastal: New Light on Contract Theory*, 31 CARDOZO L. REV. 1475, 1478 (2010). Although stating that "[b]oth approaches to contract law are commendable" and "serve important social goals" as well as employing "sophisticated and well-reasoned doctrines in the service of these ends," in a victory for formalism fans, Professor Miller observed that

> contracting parties do date a position on this question [of which approach is better]. The testimony of the marketplace – the verdict of thousands of sophisticated parties whose incentives are to maximize the value of contract terms – is that New York's formalistic rules win out over California's contextualist approach. As predicted by theory, sophisticated parties prefer formalistic rules of contract law.

Id. at 1478. *See also* Theodore Eisenberg & Geoffrey P. Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies' Contracts*, 30 CARDOZO L. REV. 1457 (2009)(finding New York favored in choice of law clauses by roughly 2:1 margin in contracts involving commercial firms); Avery Weiner Katz, *The Economics of Form and Substance in Contract Interpretation*, 104 COLUM. L. REV. 496, 508-11 (2004)(positing that sophisticated contracting parties have the ability and motivation to choose the degree of formalism that best suits their needs of value maximization).

The perhaps uninspiring answer seems to be "whatever convinces the judge that the text is sufficiently understandable that further inquiry is unnecessary or unlikely to be worth the temporal, economic, social, or doctrinal cost." Contract meaning is plain when the judge is satisfied that it is clear – a determination that varies not only with the background, orientation, and linguistic preferences of the individual judge but also according to contextual factors and extrinsic evidence that is often unacknowledged.

Although trial judges making such a determination are affirmed more often than not, their findings of inarguably "plain" meaning as a matter of law are reversed with sufficient frequency (somewhere between a quarter and a third of the time in contract disputes, depending how one characterizes and counts)[150] that one can be forgiven for questioning the cosmic correctness of a court's determination that the meaning of a contract term is inarguably clear.[151]

Seen in this light, the RLLI version of Plain Meaning might be described as a fusion of the New York and California approaches as well as a reflection of what courts are "really" doing in contract cases. Recall that RLLI §3 defines the plain meaning of an insurance policy term as "the single meaning to which the term is reasonably susceptible when applied to facts of the claim at issue in the context of the entire insurance policy,"[152] a definition consistent with that of courts and treatise writers as well as with groundrule that contract terms should not be assessed in isolation.

If there is more than "one meaning to which the language of the term is reasonably susceptible *when applied to the facts of the claim at issue in the context of the entire insurance policy*,"[153] the term is ambiguous and extrinsic evidence of meaning may be presented, with the contra proferentem principle held in reserve as a tie breaker in the event meaning remains uncertain after analysis of non-textual indicia of meaning.[154]

Although the RLLI states that it is rejecting the contextual approach of the Second Contracts Restatement, an observer might be forgiven for thinking that the ALI protests too much.155 Although the RLLI does not embrace a full-throated contextual approach in the

---

[150] *See* Jeffrey W. Stempel, *Taking Cognitive Illiberalism Seriously: Judicial Humility, Aggregate Efficiency, and Acceptable Justice*, 43 LOYOLA L.J. 627 (2012)(noting that roughly a third of summary judgments appealed result in partial reversal or remand, undermining the efficiency claims of summary judgment).

[151] In addition, any single individual's conclusion that contract text is clear may be undermined by "false consensus bias," the tendency of human beings to believe that everyone would agree with there assessment of the "natural," "obvious," or "clear" meaning of a term. *See* Lawrence M. Solan, et al., *False Consensus Bias in Contract Interpretatio*n, 108 COLUM. L. REV.1268 (2008).

[152] *See* RLLI §3(1). Just in case it did not go without saying, RLLI §2 provides that "[i]f the insurance policy term has a plain meaning when applied to the facts of the claim at issue, the term is interpreted according to that meaning."

[153] *See* RLLI §3(3)(emphasis added).

[154] *See* RLLI §4.

[155] *See* WILLIAM. SHAKESPEARE, HAMLET, Act III, Scene II (originating now accepted saying to describe situation in which one makes representations inconsistent with or out of proportion to conduct, which correspondingly suggestions insincerity). The term "protest" in Shakespeare's time, generally meant to declare solemnly or to vow rather than the more modern usage of protest as implying dissent or visible disagreement. Labelling RLLI §3 insincere would be unfair and inaccurate – but it is fair to note that notwithstanding its embrace of plain meaning

manner of Corbin or Farnworth, neither is it taking a narrow textualist view in the manner of Justice Scalia addressing statutory language. The black letter of RLLI §3 itself nods significantly to context, stressing the "claim at issue" and the "context of the entire" policy as well adopting a lower threshold for finding ambiguity than many courts ("reasonable susceptibility" of language to more than one meaning rather than facial ambiguity, patent ambiguity, or the like).

The Comments and Reporters' Note to RLLI §3 makes its semi-contextual approach more apparent. Courts following the RLLI method may consider as "generally accepted sources of plain meaning" dictionaries, court decisions, statutes, regulations, treatises, law review articles and other secondary authority. The RLLI regards these not as extrinsic evidence but as "legal authorities that courts consult when determining the plain meaning of an insurance policy term, which is a legal question,"[156] as is contract construction generally. In addition RLLI §3 makes an ample place at the table for custom, practice, and usage, expressly approving introduction of expert affidavits and testimony (via deposition if not at trial or before a jury),[157] which begins to look a lot like extrinsic evidence. However, the RLLI draws a line excluding "extrinsic evidence such as drafting history, course of dealing, or precontractual negotiations"[158] unless the text as issue is deemed ambiguous.

No wonder strict textualists – and many elements of the insurance industry – are upset with RLLI §3. Entities with the bargaining power to draft contract document and who think (perhaps mistakenly) that they can do this consistently well and obtain absolute textual advantage will naturally be resistant to consideration of any information that might undermine their efforts or reduce these advantages. The become zealots for strict textualism, conveniently forgetting that when it is to their advantage, they are happy to seek the benefit of implied terms, the overall purpose of the instrument, public policy perhaps other extrinsic evidence as well.

Policyholders and their allies are at least equally justified in complaining about RLLI §3 in that it not only embraces the nomenclature and ideology of plain meaning but also places limits on consideration of non-textual indicia of meaning and gives short shrift to the reasonable expectations doctrine,[159] to say nothing of interpretative perspectives informed by the insurance

---

nomenclature, RLLI §3 does not endorse a narrow, crabbed, or unduly literal reading of policy text in a vacuum).

[156] RLLI §3, Comment b.

[157] RLLI §3, Comment c.

[158] RLLI §3, Comment c (but also emphasizing that the "facts of the claim," although extrinsic to the policy text, are not extrinsic evidence as the term is generally understood or should be understood.).

[159] Perhaps calling it "short shrift" is a bit unfair

> The rules stated in this Section and in§ 4 are broadly consistent with the principle that insurance policy terms are to be interpreted according to the reasonable expectations of the insured, provided that the understanding of what makes an expectation "reasonable" incorporates the concept of plain meaning. The term "reasonable expectations" is not used in the black letter of this or other Sections because of the wide variation in a way that courts have employed the term. By requiring that the meaning be one to which the words are reasonably susceptible, this Restatement does not follow the strong formulation of the reasonable-expectations doctrine, pursuant to which an insurance policy is to be interpreted according to the reasonable expectations of the insured even if the insurance policy language is to the contrary. So stated, the reasonable-expectations doctrine is not actually a rule of interpretation. Rather, it is a rule regarding the enforceability of terms that

policy's role as a product, private legislation, part of a regulated industry, governance, or a socioeconomic instrument.[160]

But love it or hate it, the RLLI does as good a job as any authority of capturing the approach most courts to contract and insurance policy text. Although professing to privilege party intent, the focus of the court is on documentary text out of a professed belief that the parties' intent is best reflected in that text – so much so that courts are wary (particularly if the parol evidence rule applies) of considering non-textual evidence unless the text is sufficiently unclear.

Even strongly textual courts implicitly surround their hermeneutic endeavors with at least some context, typically using a minimum of the factual setting of the case, the type of policy at issue (e.g., general liability, D&O, commercial property), dictionaries, precedent, and legal commentary, and perhaps custom and practice.

Likewise, strongly contextualist courts place strong emphasis on contract/policy text as determinative of meaning. Although these courts may be more receptive to extra-textual information than others, it requires very probative extra-textual evidence of meaning to displace the court's immediate reaction upon simply reading the text.

The resulting blend of eclectic interpretation may thus be the "silent majority" rule of contract construction – notwithstanding the rhetorical claims of the courts.

> are inconsistent with the reasonable expectations of the insured . . . the enforceability of insurance policy terms is governed by legal rules other than those regarding interpretation.

RLLI §3, Comment h.

[160] *See* Kenneth S. Abraham, *Four Conceptions of Insurance*, 161 U. PA. L. REV. 653 (2013)(noting in addition to contract and product perspectives, insurance can be analogies to regulated industry because of similarity of insurance, which is highly regulated regarding reserves, financial strength, policy forms, and pricing to utilities or other regulated industries; also noting insurance as a regulator or instrument of governance, which has similarities to insurance policies as statutes and as social instruments). *See also* RICHARD ERICHSON, ET AL., INSURANCE AS GOVERNANCE (2004)(noting degree to which availability of insurance and conditions regarding insurance impact social and economic behavior); Aviva Abramovsky, *Reinsurance: The Silent Regulator*, 15 CONN. INS. L.J. 345 (2009)(same regarding reinsurance).

Appendix A

STATE	STATUTE(S) Scripting the Manner in Which Contracts Should be Interpreted
Alabama	None
Alaska	None
Arizona	None
Arkansas	None
California	• **Cal. Civ. Code § 1635 et seq**
Colorado	None
Connecticut	None
Delaware	None
Florida	None
Georgia	• **Ga. Code. Ann. §§ 13-2-1 to 13-2-4**
Hawaii	None
Idaho	• **Idaho Code § 29-109**
Illinois	None
Indiana	None
Iowa	• **Iowa Code Ann. § 622.22**
Kansas	None
Kentucky	None
Louisiana	• **La. Civ. Code Ann. art. 2045 et seq**.
Maine	None
Maryland	None
Massachusetts	None
Michigan	None
Minnesota	None
Mississippi	None
Missouri	None
Montana	• **Mont. Code Ann. §§ 28-3-101 to 28-3-704**.
Nebraska	• **Neb. Rev. Stat. § 25-1217**.
Nevada	None
New Hampshire	None
New Jersey	None
New Mexico	None
New York	• NY does not have statutes governing the interpretation of contracts. Instead, it has statutes governing the interpretation of statutes (N.Y. Stat. Law §§ 72 to 262). ○ N.Y. Stat. Law § 254 contains the last antecedent doctrine ("Relative or qualifying words of clauses in a statute ordinarily are to be applied to the words or phrases immediately preceding…") ○ In *Duane Reade, Inc. v. Cardtronics*, 54 A.D.3d 137 (2008), the court applied this statutory construction tool to interpret a contract. (See the highlighted portion on page 4 of PDF).

North Carolina	None
North Dakota	• **N.D. Cent. Code §§ 9-07-01 to 9-07-23**
Ohio	None
Oklahoma	• **Okla. Stat. Ann. tit. 15, §§ 151 to 178**
Oregon	• **Or. Rev. Stat. §§ 42.210 to 42.300**
Pennsylvania	None
Rhode Island	None
South Carolina	None
South Dakota	None
Tennessee	• **Tenn. Code Ann. § 47-50-112(a)** states that all written contracts shall be prima facie evidence that the contract contains the true intention of the parties and shall be enforced as written in accordance with law.
Texas	None
Utah	None
Vermont	None
Virginia	None
Washington	None
West Virginia	None
Wisconsin	None
Wyoming	None

Appendix B

A Sampling of Legal Literature on Contract and Statutory Interpretation
(in chronological order)

Henry Hart, Jr. & Albert Sacks, THE LEGAL PROCESS: BASIC PROBLEMS IN THE MAKING AND APPLICATION OF LAW (Wiliam N. Eskridge, Jr. & Philip P. Frickey eds. 1994)(manuscript originally circulated in 1958).

Richard Posner, *Statutory Interpretation – in the Classroom and in the Courtroom*, 50 U. CHI. L. REV. 800, 808 (1983);

GUIDO CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES (1982)

RONALD DWORKIN, LAW'S EMPIRE (1986)

WILLIAM N. ESKRIDGE, JR., DYNAMIC STATUTORY INTERPRETATION, 135 U. PA. L. REV. 1479 (1987)

T. Alexander Aleinikoff, *Updating Statutory Interpretation*, 87 MICH. L. REV. 20 (1988)

Antonin Scalia, *The Rule of Law as a Law of Rules*, 56 U. CHI. L. REV. 1175 (1989);

Cass R. Sunstein, *Interpreting Statutes in the Regulatory State*, 103 HARV. L. REV. 405 (1989)

William N. Eskridge, Jr. *The New Textualism*, 37 UCLA L. REV. 621 (1990)

William N. Eskridge, Jr. & Philip P. Frickey, *Statutory Interpretation As Practical Reasoning*, 42 STAN. L. REV. 321 (1990).

Kathleen M. Sullivan, *The Supreme Court, 1991 Term – Foreword, The Justices of Rules and Standards*, 106 HARV. L. REV. 22 (1992)

ALEXANDRO DURANTI & CHARLES GOODWIN (EDS.), RETHINKING CONTEXT: LANGUAGE AS AN INTERACTIVE PHENOMENON (1992)

Lawrence Solan, *When Judges Use the Dictionary*, 68 AM. SPEECH 50 (1993)

Clark D. Cunningham, et al., *Plain Meaning and Hard Cases*, 103 YALE L.J. 1561 (1994)

WILLIAM N. ESRIDGE, JR. DYNAMIC STATUTORY INTERPRETATION (1994)

Cass R. Sunstein, *Problems with Rules*, 83 CAL. L. REV. 953 (1995)

Jane S. Schacter, *Metademocracy: The Changing Structure of Legitimacy in Statutory Interpretation*, 108 HARV. L. REV. 593 (1995)

John F. Manning, *Textualism as a Nondelegation Doctrine*, 97 COLUM. L. REV. 673 (1997).

Lawrence M. Solan, *Law, Language, and Lenity*, 40 WM. & MARY L. REV. 57 (1998);

William N. Eskridge, Jr., *Norms, Empiricism, and Canons in Statutory Interpretation*, 66 U. CHI. L. REV. 671 (1999).

Cass R. Sunstein, *Nondelegation Canons*, 67 U. CHI. L. REV. 315 (2000).

John F. Manning, *Textualism and the Equity of the Statute*, 101 COLUM. L. REV. 1 (2001)

Adrian Vermeule, *The Cycles of Statutory Interpretation*, 68 U. CHI. L. REV. 149 (2001).

Lawrence M. Solan, *Why Laws Work Pretty Well, but Not Great: Words and Rules in Legal Interpretation*, 26 L. & SOC. INQUIRY 243, 258 (2001);

Victoria F. Nourse & Jane S. Schacter, *The Politics of Legislative Drafting: A Congressional Case Study*, 77 N.Y.U. L. REV. 575 (2002).

Einer Elhauge, *Preference-Eliciting Statutory Default Rules*, 102 COLUM. L. REV. 2162 (2002)

Nicholas Quinn Rosenkranz, *Federal Rules of Statutory Interpretation*, 115 HARV. L. REV. 2085 (2002)

John F. Manning, *The Absurdity Doctrine*, 116 HARV. L. REV. 2387 (2003).

Ricki Sonpal, *Old Dictionaries and New Textualists*, 71 FORDHAM L. REV. 2177 (2003);

Lawrence M. Solan, *Pernicious Ambiguity in Contracts and Statutes*, 79 CHI.-KENT L. REV. 859 (2004)

Gary E. O'Conner, *Restatement (First) of Statutory Interpretation*, 7 N.Y.U. J. LEGIS. & PUB. POL'Y 33 (2004). *See also* Lawrence M. Solan, *Is It Time for a Restatement of statutory Interpretation?*, 79 BROOK L. REV. 733 (2014).

Philip P. Frickey, *Getting from Joe to Gene (McCarthy): The Avoidance Canon, Legal Process Theory, and Narrowing Statutory Interpretation in the Early Warren Court*, 93 CAL. L. REV. 397 (2005).

Lawrence M. Solan, *The New Textualists' New Text*, 38 LOY. L.A. L. REV. 2017 (2005);

John Manning, *What Divides Textualists form Purposivists?*, 106 COLUM. L. REV. 70 (2006).

William N. Eskridge, Jr., *No Frills Textualism*, 119 HARV. L. REV. 2041 (2006).

Jonathan T. Molot, *The Rise and Fall of Textualism*, 106 COLUM. L. REV. 1 (2006).

Jonathan R. Siegel, *Judicial Interpretation in the Cost-Benefit Crucible*, 92 MINN. L. REV. 387 (2007)

Adam Kilgarriff, *Googleology Is Bad Science*, 33 COMPUTATIONAL LINGUISTIC 147 (2007);

Sydney Foster, *Should Courts Give Stare Decisis Effect to Statutory Interpretation Methodology*, 96 GEO. L.J. 1863 (2008).

Val D. Ricks, *The Possibility of Plain Meaning: Wittgenstein and the Contract Precedents*, 56 CLEV. ST. L. REV. 767 (2008).

Michael Herz, *Purposivism and Institutional Competence in Statutory Interpretation*, 2009 MICH. ST. L. REV. 89.

Glen Staszewski, *Avoiding Absurdity*, 81 Ind. L.J. 1001, 1028-46 (2009).

Jonathan R. Siegel, *The Inexorable Radicalization of Textualism*, 158 U. PA. L. REV. 117 (2009);

RICHARD A. POSNER, HOW JUDGES THINK (2010)

Abbe R. Gluck, *The States as Laboratories of Statutory Interpretation: Methodological Consensus and the New Modified Textualism*, 199 YALE L.J. 1750 (2010)

Jacob Scott, *Codified Canons and the Common Law of Interpretation*, 98 GEO. L.J. 341 (2010);

Ward Farnsworth et al., *Ambiguity About Ambiguity: An Empirical Inquiry Into Legal Interpretation*, 2 J. LEGAL ANALYSIS 257 (2010).

Stephen C. Mouritsen, *The Dictionary Is Not a Fortress: Definitional Fallacies and a Corpus-Based Approach to Plain Meaning*, 2010 BYU L. REV. 1915;

Abbe R. Gluck, *Intersystemic Statutory Interpretation: Methodology as "Law" and the Erie Doctrine*, 120 YALE L.J. 1898 (2011).

John F. Manning, *The New Purposivism*, 2011 SUP. CT. REV. 113

ANTONIN SCALIA & BRYAN A. GARNER, READING LAW: THE INTERPRETATION OF LEGAL Texts (2012).

Aaron-Andrew P. Bruhl, *Hierarchy and Heterogeneity: How to Read a Statute in a Lower Court*, 97 CORNELL L. REV. 433 (2012).

WILLIAM N. ESKRIDGE, JR., ET AL., CASES AND MATERIALS ON STATUTORY INTERPRETATION (2012).

Aaron-Andrew P. Bruhl & Ethan J. Leib, *Elected Judges and Statutory Interpretation*, 79 U. CHI. L. REV. 1215 (2012).

Nicholas R. Parrillo, *Leviathan and Interpretative Revolution: The Administrative State, the Judiciary, and the Rise of Legislative History 1890-1950*, 123 YALE L.J. 266 (2013)(taking view that use of legislative history as interpretative device exploded in the New Deal years because of improved organization of and accessibility to legislative background materials).

Abbe R. Gluck & Lisa Schultz Bressman, *Statutory Interpretation From the Inside – An Empirical Study of Congressional Drafting, Delegation, and the Canons: Part I*, 65 STAN. L. REV. 901 (2013).

William N. Eskridge, Jr., *The New Textualism and Normative Canons*, 113 COLUM. L. REV. 531 (2013)(reviewing SCALIA & GARNER).

Lawrence B. Solum, *Communicative Content and Legal Content*, 89 NOTRE DAME L. REV. 479 (2013).

Janet W. Steverson, *I Mean What I Say, I Think: The Danger to Small Businesses of Entering Into Legally Enforceable Agreements That May Not Reflect Their Intentions*, 7 J. SMALL & EMERGING BUS. L. 283 (2003).

Richard H. Fallon, Jr., *The Meaning of Legal "Meaning" and Its Implications for Theories of Legal Interpretation*, 82 U. CHI. L. REV. 1235 (2015);

WILLIAM N. ESKRIDGE, JR. INTERPRETING LAW: A PRIMER ON HOW TO READ STATUTES AND THE CONSTITUTION (2016).

Lawrence M. Solan & Tammy Gales, *Finding Ordinary Meaning in Law: The Judge, the Dictionary or the Corpus*?, 1 INT'L J. LEGAL DISCOURSE 253, 263 (2016).

William Baude & Stphen E. Sachs, *The Law of Interpretation*, 130 HARV. L. REV. 1079, 1106 (2017)

William Baude & Ryan D. Doerfler, *The (Not So) Plain Meaning Rule*, 84 U.CHI. L. REV. 539 (2017)

Candor, Truthfulness and Conflicts of Interest: Ethics in Negotiations

American College of Coverage Counsel
2019 Annual Meeting

Chicago, IL
May 8-10, 2019

Neil B. Posner
Much Shelist, P.C.
Chicago, Illinois

No man can serve two masters: for either he will hate the one, and love the other; or else he will hold to the one, and despise the other. Ye cannot serve God and mammon.[1]

There are no conflicts above $5 million.[2]

I said, "there was a society of men among us, bred up from their youth in the art of proving, by words multiplied for the purpose, that white is black, and black is white, according as they are paid. To this society all the rest of the people are slaves. . . ."[3]

I. INTRODUCTION

We lawyers are trained to think of ourselves as "zealous advocates" while, at the same time, we are instructed to maintain a high standard of ethics. Not only are those concepts fraught with tension but also those concepts—zealous advocacy and high ethical standards—do not necessarily accurately describe our duties.

The purpose of this paper, therefore, is to explore what is expected of us, what conduct is permitted and what is forbidden, and whether those norms vary according to the situation at hand. To that end, this article will address the ABA Model Rules of Professional Conduct most applicable to these issues—namely Rules 1.7, 1.8, 3.3 and 4.1—and their interaction with other duties to clients (most particularly Rule 1.6), and attempt to provide some needed guidance for lawyers, especially in the context of negotiations.

The reader is reminded that this paper discusses the Model Rules. The rules in the reader's particular jurisdiction may differ and, accordingly, those rules and the comments, ethical opinions and cases interpreting them, should be consulted. This paper is for information purposes only and does not constitute legal advice. And, of course, the opinions expressed herein are those of the author and not necessarily those of his law firm or its clients.

II. ZEALOUS ADVOCACY, THEN AND NOW

In 1820, Lord Brougham described the lawyer's role thus:

> An advocate, in the discharge of his duty, knows but one person in all the world, and that person is his client. To save that client by all means and expedients, and at all hazards and costs to other persons, and amongst them, to himself, is his first and only duty; and in performing this duty he must not regard the alarm, the torments, the destruction, which he may bring upon others.[4]

[1] *Matthew* 6:24 (King James).

[2] Attributed to a "famous American lawyer (circa 1984)" in STEPHEN GILLERS, REGULATION OF LAWYERS: PROBLEMS OF LAW AND ETHICS 185 (9th ed. 2012).

[3] JONATHAN SWIFT, GULLIVER'S TRAVELS, Part 4, Chapter 5, Paragraph 11.

[4] 2 Trial of Queen Caroline 8, *as cited in* Sharon Dolovich, Ethical Lawyering and the Possibility of Integrity, 70 FORDHAM L. REV. 1629, 1687 n.9 (2002).

But when in 1983 the ABA adopted the Model Rules of Professional Conduct, which superseded the Model Code of Professional Responsibility, the term "zealous advocate" was removed.[5] In his excellent article on ethics in negotiations, Michael H. Rubin comments on the removal:

> In its place was a comment to [Model Rule] 1.3 that a "lawyer should act with commitment and dedication to the interests of the client and with zeal in advocacy upon the client's behalf." The Comment (although not the black-letter text of [Model Rule] 1.3 goes on to caution that a "lawyer is not bound to press for every advantage that might be realized for a client." This commentary has continued, almost verbatim, into the Ethics 2000 Commission's Revision to the Model Rules, adopted by the ABA in 2002 (E2K).[6]

Although the term persists in common usage, both by courts,[7] and by legal commentators,[8] the American Law Institute ("ALI"), in its Restatement of the Law Governing Lawyers, advises that zealous advocacy is not a synonym for hardball tactics and further cautions that that "term sets forth a traditional aspiration, but it should not be misunderstood to suggest that lawyers are legally required to function with a certain emotion or style of litigating, negotiating, or counseling.[9]

Thus, now that "zealous advocacy" has been removed from the Model Rules and is no longer normative behavior for lawyers, the question is begged as to what normative behavior is. Do the Model Rules require us to behave "ethically"? As we shall see in the next section, the answer is "not necessarily."

III. THE MODEL RULES ARE NOT ETHICAL RULES

---

[5] *Compare* ABA CANONS OF PROFESSIONAL ETHICS, Canon 15, *How Far a Lawyer May Go in Supporting a Client's Cause* ("The lawyer owes entire devotion to the interest of the client, warm zeal in the maintenance and defense of his rights and the exertion of his utmost learning and ability, to the end that nothing be taken or be withheld from him save by the rules of law, legally applied.") (*cited in* ABA COMPENDIUM OF PROFESSIONAL RESPONSIBILITY RULES AND STANDARDS 428 (2014 ed.) (hereinafter ABA COMPENDIUM) *with* ABA MODEL CODE OF PROFESSIONAL RESPONSIBILITY, Canon 7, *A Lawyer Should Represent a Client Zealously Within the Bounds of the Law*, Ethical Consideration EC 7-1 ("The duty of a lawyer, both to his client and to the legal system, is to represent his client zealously within the bounds of the law . . . .") (ABA COMPENDIUM 287) *with* ABA MODEL RULE OF PROFESSIONAL CONDUCT 1.3 ("A lawyer shall act with reasonable diligence and promptness in representing a client") *but see* Comment [1] to Rule 1.3 ("A lawyer must also act with commitment and dedication to the interests of the client and with zeal in advocacy upon the client's behalf. A lawyer is not bound, however, to press for every advantage that might be realized for a client.") (ABA COMPENDIUM 34-35).

[6] Michael H. Rubin, *The Ethical Negotiator: Ethical Dilemmas, Unhappy Clients, and Angry Third Parties*, 26 CONSTR. LAW. 12, 12 (Summer 2006). The author highly recommends this article to anyone who wishes to explore the history of the notions of zealous advocacy, professionalism and ethics. The article is well researched and the footnotes abundant.

[7] *See, e.g.*, Brown v. State, 110 Nev. 846, 877 P.2d 1071, 1073 (Nev. 1994) ("However much it may 'infuriate the jury,' a properly zealous advocate must do all he can to defend his client.").

[8] Rubin, *supra* note 7 at n.5, provides a nonexclusive list of law-review articles with one form or other of "zealous advocate" in the title: Katherine S. Broderick, *Understanding Lawyers' Ethics: Zealous Advocacy in a Time of Uncertainty*, 8 UDC/DCSL L. REV. 219 (2004); George A. Reimer, *Zealous Lawyers: Saints or Sinners?*, 59 OR. ST. B. BULL. 31 (1998); Raymond M. Brown, *A Plan to Preserve an Endangered Species: The Zealous Criminal Defense Lawyer*, 30 LOY. L.A. L. REV. 21 (1996); Marvin Ventrell, *The Child's Attorney: Understanding the Role of Zealous Advocate*, 17 FAM. ADVOC. 73 (Winter 1995); Robert G. Day, Note: *Administrative Watchdogs or Zealous Advocates? Implications for Legal Ethics in the Face of Expanded Attorney Liability*, 45 STAN. L. REV. 645 (1993).

[9] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 16 cmt. d. (2000).

The Model Rules replaced the Model Code of Professional Responsibility, which included "Ethical Considerations" and "Disciplinary Rules." The Model Rules dispense with these distinctions, focusing instead on what a lawyer "shall not" do, what a lawyer "shall" do, and what a lawyer "may" do.[10] As Rubin comments:

> "Ethics" is the term that is commonly applied to lectures about the ABA's Model Rules of Professional Conduct and its predecessor, the Model Code of Professional Responsibility. The 1983 Model Rules and the Ethics 2002 Model Rules, however, do not use the word "ethics" except in the scope section. That section notes that the rules "simply provide a framework for the ethical practice of law," but when one reads the rules, the concept of ethics is not otherwise mentioned.[11]

And it is not only the Model Rules that avoid mentioning ethics. The federal rules and statutes that purportedly regulate sanctionable conduct—Fed. R. Civ. P. 11, Fed. R. App. P. 38 and 28 U.S.C. § 1927—do not use the word either.[12]

Accordingly, the modern American lawyer operates in a world where she:

- must be competent (Model Rule ("M.R.") 1.1);
- must carry out the client's objectives (M.R. 1.2(a)) unless the lawyer knows the client intends to do something criminal or fraudulent (M.R. 1.2(d));
- must not breach any confidences (M.R. 1.6(a)) unless an exception applies (M.R. 1.6(b));
- must be loyal (M.R. 1.7 - 1.12) unless loyalty would result in a breach of other duties, such as to the court (M.R. 1.16);
- must keep track of who is the client and who is not when an organization is involved (M.R. 1.13; Sarbanes-Oxley Act[13]);

---

[10] See 1983 MODEL RULES OF PROFESSIONAL CONDUCT and the ETHICS 2000 MODEL RULES, *passim*.

[11] Rubin, *supra* note 7, at 13.

[12] *Id*.

[13] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745. See especially § 307 of the Act, 116 Stat. at 784, 15 U.S.C. § 7245, which mandates that the Security and Exchange Commission:

> issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including a rule—
>
> > (1) requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and
> >
> > (2) if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.

- must not allow the party paying for the lawyer's services—if that party is not the client—to interfere with her independence of professional judgment or with the client-lawyer relationship (M.R. 1.8(f)(2)), must obtain her client's consent to such an arrangement (M.R. 1.8(f)(1)) and must protect the client's confidential information as required by Rule 1.6 (M.R. 1.8(f)(3));

- must know when to withdraw when adherence to other rules render continuation of representation impossible or unreasonable (M.R. 1.16);

- must act with independence (M.R. 5.4) but may consider "moral, economic, social and political factors" (whatever they may be) in her representation (M.R. 2.1);

- must be candid toward a tribunal and take remedial measures if she knows that a person intends to engage in criminal or fraudulent conduct related to the proceeding (M.R. 3.3(a) and (b)) and must follow Model Rules 3.3(a) and (b) "even if compliance requires disclosure of information otherwise protected by Rule 1.6" (M.R. 3.3(c));

- but apparently may "puff," "bluff," "misdirect" or "bluster" in a nontribunal setting as long as she does not knowingly "make a false statement of material fact or law to a third person" or "fail to disclose a material fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6." (M.R. 4.1).

Although there is no *per se* rule about being ethical,

- she may not make a false or misleading statement about her services (M.R. 7.1);

- she may not solicit clients except as permitted by Rule 7.3; and

- she must report the misconduct of other lawyers (M.R. 8.3(a)) but, unlike Rule 3.3 but like Rule 4.1, does not have to disclose information protected by Rule 1.6 (M.R. 8.3(c)).

Finally, she, herself, must not commit any of the types of misconduct set forth in Model Rule 8.4, nor violate any of the local rules that may apply to her.

Thus, we are not necessarily "zealous advocates," at least in the traditional sense, nor are we bound by the ethical standards embodied in predecessors to the Model Rules. We operate, rather, in a system that says we "shall," we "shall not" and we "may." Whether we believe that this is an improvement is beside the point.[14] Our point is to explore whether a framework exists that can guide the practitioner. With that, we look first at the rules regarding negotiations.

---

15 U.S.C. § 7245.

[14] Many commentators, however, take opposing views on that question. See, e.g., Dolovich, *supra* note 5; Richard Wasserstrom, *Lawyers as Professionals: Some Moral Issues*, 5 HUM. RTS. Q. 1 (1975); Eleanor Holmes Norton, *Bargaining and the Ethics of Process*, 64 N.Y.U. L. REV. 493 (1989); Alvin B. Rubin, *A Causerie on Lawyers' Ethics in Negotiation*, 35 LA. L. REV. 577 (1965); James White, *Machiavelli and the Bar: Ethical Limitations on Lying in Negotiation*, AM. B. FOUND. RES. J. 926 (1980); Gerald B. Wetlaufer, *The Ethics of Lying in Negotiations*, 75 IOWA L. REV. 1219 (1990); Charles B. Craver, *Negotiation Ethics: How to Be Deceptive Without Being Dishonest/How to Be Assertive Without Being Offensive*, 38 S. TEX. L. REV. 713 (1997); Scott S. Dahl, *Ethics on the Table: Stretching the Truth in Negotiations*, 8 REV. LITIG. 173 (1989).

IV. TRUTH OR "TRUTHINESS[15]"?: MODEL RULE 4.1 IN THE LAND OF NEGOTIATIONS

Model Rule 4.1, "Truthfulness in Statements to Others," provides:

> In the course of representing a client a lawyer shall not knowingly:
>
> (a) make a false statement of material fact or law to a third person; or
>
> (b) fail to disclose a material fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.

This was not the language originally proposed. According to the drafting history, although the preamble was approved to include language referring to honest dealing with others,[16] proposed language for Model Rule 4.1 that explicitly would have required truthfulness in negotiations, even if it would have caused the lawyer to reveal client confidences, was rejected.[17] Accordingly, unless the lawyer is operating is a setting governed by Model Rule 3.3—that is, in a proceeding before a tribunal—what is required is that the lawyer make no false statements or fail to disclose a material fact when disclosure is necessary to avoid assisting the client in a criminal or fraudulent act. Except in the circumstances set forth in Model Rule 4.1, truthfulness is not required and "fair dealing" is not required.

Indeed, it would appear that the Model Rules permit at least some level of conduct that is not precisely truthful. Comment 2 to Model Rule 4.1, "Statements of Fact," provides in full:

> [2] This Rule refers to statements of fact. Whether a particular statement should be regarded as one of fact can depend on the circumstances. Under generally accepted conventions in negotiation, certain types of statements ordinarily are not taken as statements of material fact. Estimates of price or value placed on the subject of a transaction and a party's intentions as to an acceptable settlement of a claim are ordinarily in this category,

---

[15] *Truthiness* was named Word of the Year for 2005 by the American Dialect Society and for 2006 by Merriam-Webster. *See*, *e.g.*, http://www.americandialect.org/Words_of_the_Year_2005.pdf and http://www.merriam-webster.com/info/06words.htm, respectively. *And see* https://en.wikipedia.org/wiki/Truthiness, visited on 6 March 2019.

The Oxford English Dictionary defines *truthiness* thus:

> truthiness (noun) (informal): "The quality of seeming or being felt to be true, even if not necessarily true."

https://en.oxforddictionaries.com/definition/truthiness (visited on 6 March 2019). Dictionary.com defines it thus:

> *noun*
>
> **1**: the quality of seeming to be true according to one's intuition, opinion, or perception without regard to logic, factual evidence, or the lie:
>
> *the growing trend of truthiness as opposed to truth.*
>
> **2**: *Rare*. Truthfulness or faithfulness.

https://www.dictionary.com/browse/truthiness (last visited October 5, 2014).

[16] Paragraph 2 of the Preamble states in pertinent part, "As negotiator, a lawyer seeks a result advantageous to the client but consistent with requirements of honest dealing with others."

[17] The deleted sentence said, "The duties stated in this Rule apply even if compliance requires disclosure of information otherwise protected by Rule 1.6." See ABA CENTER FOR PROFESSIONAL RESPONSIBILITY, THE LEGISLATIVE HISTORY OF THE MODEL RULES OF PROFESSIONAL CONDUCT: THEIR DEVELOPMENT IN THE ABA HOUSE OF DELEGATES (1987).

> and so is the existence of an undisclosed principal except where nondisclosure of the principal would constitute fraud. Lawyers should be mindful of their obligations under applicable law to avoid criminal and tortious misrepresentation.[18]

Thus, in a negotiation, a lawyer essentially is free to do what she feels is necessary to achieve a satisfactory outcome for her client. She is not constrained, for example, by the notion that that outcome may not be one that is equitable to the other side. She need not reveal a client confidence (unless, after conferring with the client and obtaining his consent, she does so in order to facilitate a good outcome). She must not, however, make a false statement of material fact. And she must not engage in conduct that is fraudulent. Short of that, however, nearly everything else is negotiation strategy.

A. "Knowingly"; Not "Should Have Known"

The lead-in language to Model Rule 4.1 bars the lawyer from "knowingly" engaging in conduct prohibited by subsections (a) and (b). According to Model Rule 1.0(f), this requires "actual knowledge of the fact in question," which "may be inferred from circumstances."[19] This is not a "should have known" standard, and the case law tends to agree. For example, in *Brown v. County of Genesee*,[20] defense counsel did not know but only "believed it probable" that plaintiff and her lawyer were mistaken concerning the computation of damages in the employment discrimination case. Under these facts, the lawyer was under no "legal or ethical duty" to correct the factual error made during negotiations. Even more to the point, in *In re Tocco*,[21] the Arizona Supreme Court held that a violation of Arizona's Rules 1.2(d),[22] 3.3[23] and 4.1 requires knowledge, and that a mere showing that the lawyer reasonably should have known her conduct was in violation of the Rules, without more, is insufficient.

B. And the Fact Must Be "Material"

Comment [2] to Model Rule 4.1, set forth above, assumes away the meaning of "material." The "Materiality" Annotations to the Model Rules, provide the following critical guidance:

> A statement is material for purposes of Rule 4.1(a) if it could have influenced the hearer. See *In re Merkel*, 138 P.3d 847 (Or. 2006) (information is material if it "would or could have influenced the decision-making process significantly"). Whether it actually did influence the hearer is beside the point. See *In re Winthrop*, 848 N.E.2d 961 (Ill. 2006) (lawyer falsely told social service agency's lawyer that court order not required to freeze client's assets to protect them from client's malfeasing agent; not relevant that false statement had no effect on agency lawyer's conduct); *In re Warner*, 851 So. 2d 1029 (La. 2003)

---

[18] ANNOT. MODEL RULES OF PROFESSIONAL CONDUCT, at 429 (8th Ed. 2015) (hereinafter ANNOT. MRPC).

[19] ANNOT. MRPC 15.

[20] 872 F.2d 169 (6th Cir. 1989).

[21] 984 P.2d 539 (Ariz. 1999).

[22] Model Rule 1.2(d), *Scope of Representation and Allocation of Authority between Client and Lawyer*, provides:

> (d) A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.

ANNOT. MRPC 31.

[23] Discussed *infra* Section V.

(to avoid opening estate for client who just died, lawyer had client's daughter endorse settlement check in client's name; insurance adjuster's testimony that he would have made same settlement anyway was not relevant to Rule 4.1(a) violation); *In re Smith*, 236 P.3d 137 (Or. 2010) (lawyer's false statements to clinic employees that he had court order or letter from attorney general authorizing his client to physically take over clinic were material even though employees called policy anyway; reliance not part of materiality under Rule 4.1); see also *In re Carmick*, 48 P.3d 311 (Wash. 2002) (when lawyer's statement became material only because he was negotiating directly with obligee rather than her counsel, court would apply Rule 4.2 rather than Rule 4.1); *cf. Office of Disciplinary Counsel v. DiAngelus*, 907 A.2d 452 (Pa. 2006) (materiality of defense counsel's false statement that arresting officer agreed to withdrawal of one charge was established by prosecutor's reliance upon it; client's actual innocence of that charge not relevant).

Note that DR7-102(A)(5), the analogous provision of the predecessor Model Code, did not include a materiality requirement; many jurisdictions adopting Rule 4.1 retained this approach and omitted the materiality requirement. See http://ambar.org/MRPCStateCharts for the variations.[24]

The *Summer* case[25] is of particular interest. The facts—undisputed or established by clear and convincing evidence—that led to his troubles are as follows.

The "accused"[26] lawyer, Mr. Summer, became a member of the Oregon and Idaho bars in 1996 and, soon after, assumed a heavy caseload at a high-volume personal injury firm in Nampa, Idaho, while also working occasionally at his firm's Oregon office.[27] For each case, Summer relied on support staff to obtain medical records, provide him with summaries of them, and assemble pertinent records in support of demand letters that he drafted. When negotiating settlements with insurers, it was the practice of the firm as well as Summer "to instruct staff to withhold any medical records that might be adverse to a client's claim." On his cases, Summer retained final approval and authority over all demand letters and supporting documentation.[28]

One of Summer's first clients was Michael White, who was involved in two unrelated auto accidents within eleven days of each other. Neither accident was White's fault. The first accident, which occurred in Idaho, resulted in multiple injuries to White. State Farm insured the at-fault driver. The second accident occurred in Oregon but involved a truck and driver from an Idaho-based company, Boise Cascade, which was self-insured. Shortly after the second accident, White told Boise Cascade's adjuster that he had not been injured in the accident.[29]

---

[24] ANNOT. MRPC 431.

[25] In re Summer, 105 P.3d 848 (Or. 2005). This case was cited in the Eighth Edition of the ANNOT. MRPC at 432.

[26] While many states use the term "respondent" to refer to the lawyer under consideration for discipline, Oregon continues to use the term "accused"; that usage, perhaps, is enough to make Oregon lawyers think twice about their obligations under the Rules.

[27] *Summer*, 105 P.3d at 850 n.3. As the opinion notes, this case originally was tried under the Oregon Code of Professional Responsibility and not the Oregon Rules of Professional Conduct, which became effective on January 1, 2005. *Id.* at 849 n.1.

[28] *Id.* at 849-50.

[29] *Id.* at 850.

After Summer notified State Farm that he was representing White, State Farm learned about the second accident. State Farm conferred with Boise Cascade "more than once" about the second accident. In the meantime, Summer sent State Farm a demand letter describing White's injuries and ongoing pain and suffering, In support, Summer submitted White's emergency care, medical, dental, chiropractic and physical-therapy records. State Farm responded to Summer by inquiring about White's second accident. Summer asked White about the second accident and then wrote to State Farm stating that Summer was not aware of the second accident because White had not been injured in it. State Farm assessed the value of White's injuries and settled the claim for $10,500.00.[30]

A week after settling with State Farm, Summer sent a demand letter to Boise Cascade stating that, although White had been in an earlier accident, White "did not suffer any symptoms nor did he seek treatment until after the accident and injuries caused by [Boise Cascade]." Summer further claimed that Boise Cascade caused White "neck, back, and a laceration to [the] mouth" injuries, and demanded $9,081 to settle White's claim. Although Summer included, with this letter, some new medical records from White's orthopedist and internist, he also submitted *the same* physical therapy, chiropractic and dental records that he previously sent to State Farm.[31]

Because White previously had reported himself uninjured in the second accident to Boise Cascade's adjuster, and because many of the submitted records referenced the first accident as the source of White's injuries, Boise Cascade denied White's claim, alerted State Farm, and contacted Idaho's insurance fraud investigation department.[32] Although State Farm ultimately concluded that its settlement with White was appropriately valued, the State of Idaho saw other issues. The State criminally charged Summer and a jury found him guilty of attempted grand theft by deception.[33]

The disciplinary case against Summer turned on the following Oregon rules in force prior to January 1, 2005: DR 1-102(A)(2) ("[i]t is professional misconduct for a lawyer to * * * [c]ommit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness[,] or fitness to practice law";[34] DR 1-102(A)(3)

---

[30] *Id.*

[31] *Id.*

[32] *Id.* at 850-51.

[33] *Id.* at 851.

[34] *Id*. at 852. DR 1-102(A)(2) correlates to Model Rules 5.1(c), 5.3(b) and 8.4(a). ABA COMPENDIUM 201. Model Rule 5.1(c) states:

> (c) A lawyer shall be responsible for another lawyer's violation of the Rules of Professional Conduct if:
>
> (1) the lawyer orders or, with knowledge of the specific conduct, ratifies the conduct involved; or
>
> (2) the lawyer is a partner or has comparable managerial authority in the law firm in which the other lawyer practices, or has direct supervisory authority over the other lawyer, and knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action.

ANNOT. MRPC 479.

Model Rule 5.3(b) states: "With respect to a nonlawyer employed or retained by or associated with a lawyer: * * (b) lawyer having direct supervisory authority over the nonlawyer shall make reasonable efforts to ensure that the person's conduct is compatible with the professional obligations of the lawyer[.]" ANNOT. MRPC 491.

("[i]t is professional misconduct for a lawyer to * * * [e]ngage in conduct involving dishonesty, fraud, deceit[,] or misrepresentation";[35] and DR 7-102(A)(5) ("[i]n the lawyer's representation of a client * * *, a lawyer shall not * * * [k]nowingly make a false statement of law or fact."[36]

In attempting to persuade the court that he had not violated DR 1-102(A)(2), Summer argued that White had suffered injuries in both accidents and thus had legitimate claims against both insurers. He attempted to explain that White had suffered "no symptoms" after the second accident and, accordingly, Summer never falsely asserted White had been uninjured in that accident. The court rejected these arguments, stating:

> The accused's arguments are unconvincing. Resubmitting to Boise Cascade the same medical records previously sent to State Farm does not convey a belief that White had a legitimate claim against Boise Cascade. It conveys an intent to obtain a second recovery for the same injuries and take advantage of the timing of White's medical care. Further, the accused knew that he falsely attributed White's neck, back, and mouth injuries to the second accident. In testimony before the trial panel, the accused admitted that it was "not a completely true statement" to make such attributions. More to the point, the record is clear and convincing that the accused's statement was false.
>
> The accused also admitted in his testimony that he made a conscious effort not to disclose anything to insurers "that would be damning to [his] client" and that he had instructed staff to select supporting medical documentation accordingly. Consciously employing such tactics in this instance evinces a clear intention to deprive Boise Cascade of money wrongfully.
>
> Finally, even if this court were to accept the accused's distinction between symptoms and injuries, asserting to Boise Cascade that White suffered "no symptoms" after the first accident remains deceitful and untrue. White received extensive emergency room treatment after the first accident, which demonstrates the presence of both injuries and "symptoms."
>
> We conclude that the accused attempted to deceive Boise Cascade when he falsely attributed White's neck, back, and mouth injuries to the second accident and obscured their source. We further conclude that the accused bolstered his deceit by resubmitting medical records from White's first accident claim against State Farm. Finally, we conclude that the accused committed those acts with the intent to wrongfully deprive Boise Cascade of

---

Model Rule 8.4(a) states: "It is professional misconduct for a lawyer to: (a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another[.]" ANNOT. MRPC 669.

[35] 105 P.3d at 853. DR 1-102(A)(3) correlates to Model Rules 8.4(b) and (f). ABA COMPENDIUM 201. Model Rule 8.4(b) states: "It is professional misconduct for a lawyer to: * * * (b) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects[.]" Model Rule 8.4(f) states: "It is professional misconduct for a lawyer to: * * * (f) knowingly assist a judge or judicial officer in conduct that is a violation of applicable rules of judicial conduct or other law." ANNOT. MRPC 669.

[36] 105 P.3d at 853. DR 7-102(A)(5) correlates to Model Rule 3.3(a)(1) (discussed *infra* at Section V) and Model Rule 4.1. ABA COMPENDIUM 206.

> property. As such, the Bar established by clear and convincing evidence that the accused committed the criminal act of attempted theft by deception under Idaho law.[37]

In considering whether the false statements made by Summer were "material" for purposes of DR 1-102(A)(3) and whether he knowingly had made false statements of law or fact, the court stated that the "materiality" requirement "refers to information that, 'would or could significantly influence the hearer's decision-making process.'"[38] With respect to "misrepresentations by omission," the court explained such misrepresentations "involve information that the lawyer had in mind and failed to disclose and that the lawyer knows is material to the case at hand."[39] The court concluded that Summer violated both of these rules as well:

> Based on our analysis of DR 1-102(A)(2), we already have concluded that the accused engaged in conduct involving dishonesty and deceit, and did so intentionally to deprive Boise Cascade of money. Similarly, we conclude that the accused made both affirmative misrepresentations and misrepresentations by omission to Boise Cascade. White suffered "symptoms" after the first accident, received most of his medical treatment for those "symptoms," and never injured his mouth in the second accident. The accused misrepresented all those facts to Boise Cascade. The accused also failed to disclose to Boise Cascade that White had recovered from State Farm for the same or similar injuries.
>
> The accused made the above misrepresentations to Boise Cascade knowingly. The accused settled White's State Farm claim just one week before he sent his demand letter to Boise Cascade. Three weeks before that, the accused represented to State Farm that White had been uninjured in the Boise Cascade accident. We infer from those facts that the first accident was in the accused's mind when he made contrary representations to Boise Cascade and when he instructed his staff to select only those medical records that supported the purported second accident claim.
>
> Finally, the accused's knowing and false statements concerning whether and to what extent White was injured were material. And, contrary to the accused's arguments, Boise Cascade's ultimate denial of White's claim does not alter that conclusion. As noted, materiality is not limited to circumstances in which a misrepresentation successfully misleads, but to those that "would or could significantly influence the hearer's decision-making process." *Eadie*, 333 Or. at 53, 36 P.3d 468. Boise Cascade's claims manager testified before the trial panel that a lawyer's statements have such an influence because they can constitute "the entire basis for * * * negotiation." The accused's misrepresentations could have caused Boise Cascade to expend its resources investigating White's claim, analyzing its value, and negotiating settlement. Because the accused's statements could have influenced those decisions significantly, they were material.

---

[37] 105 P.3d at 852-53. The court noted further that its "finding is further supported by the Idaho jury's guilty verdict that the Idaho Supreme Court affirmed in State v. Summer, 139 Idaho 219, 76 P.3d 963 (2003)." 105 P.3d at 853 n.9.

[38] *Id.* at 853, citing *In re* Eadie, 333 Or. 42, 53, 36 P.3d 468 (2001).

[39] 105 P.3d at 853, citing *In re* Gustafson, 327 Or. 636, 648, 968 P.2d 367 (1998).

> By making false, knowing, and material misrepresentations to Boise Cascade, the accused violated DR 1-102(A)(3). Because the accused made knowing and false statements of fact in the course of White's representation, he also violated DR 7-102(A)(5).[40]

Needless to say, Mr. Summer was suspended from the Oregon Bar and suffered additional criminal penalties and disciplinary sanctions in Idaho.

C. Silence: The Problem with Omissions and Incomplete Statements

Salient in the *Summer* case is the notion of "omissions" as having the potential to violate Model Rule 4.1. The first comment to the Model Rule states:

> [1] A lawyer is required to be truthful when dealing with others on a client's behalf, but generally has no affirmative duty to inform an opposing party of relevant facts. A misrepresentation can occur if the lawyer incorporates or affirms a statement of another person that the lawyer knows is false. Misrepresentations can also occur by partially true but misleading statements or omissions that are the equivalent of affirmative false statements. For dishonest conduct that does not amount to a false statement or for misrepresentations by a lawyer other than in the course of representing a client, see Rule 8.4.[41]

The "Omissions That Mislead" Annotation to Model Rule 4.1 explains:

> Comment [1] explains that misrepresentations include "partially true but misleading statements or omissions that are the equivalent of affirmative false statements." This language was added in 2002 to replace the "vague" statement that "[m]isrepresentations can also occur by failure to act." American Bar Association, *A Legislative History: The Development of the ABA Model Rules of Professional Conduct, 1982-2013*, at 552 (2013); *see In re Summer*, 105 P.3d 848 (Or. 2005) ("misrepresentations by omission involve information that the lawyer had in mind and failed to disclose" though he knew it was material to case at hand). *But see* Neb. Ethics Op. 09-09 (n.d.) (lawyer for third-party defendant must comply with client's instructions not to volunteer that client is in hospice care).
>
> A misrepresentation by omission under Rule 4.1(a) is different from a violation of Rule 4.1(b)'s affirmative obligation to disclose; Rule 4.1(b) comes into play only if the lawyer would otherwise be assisting in a client's crime or fraud.[42]

Accordingly, silence or the making of partially true but misleading statements (or omissions), even in nontribunal settings, can result in serious discipline. In a 1986 informal opinion,[43] the ABA Commission on Ethics and Professional Responsibility considered a situation involving negotiations over a commercial contract, and set forth the following fact situation:

> A and B, with the assistance of their lawyers, have negotiated a commercial contract. After deliberation with counsel, A ultimately acquiesced in the final provision

[40] 105 P.3d at 853-54.

[41] ANNOT. MRPC 429.

[42] *Id.* at 399. Rule 4.1(b) provides: "In the course of representing a client a lawyer shall not knowingly: * * * (b) fail to disclose a material fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6." *Id.* at 432.

[43] ABA Comm. On Ethics and Professional Responsibility, Informal Op. 86-1518 (1986).

> insisted upon by B, previously in dispute between the parties and without which B would have refused to come to overall agreement. However, A's lawyer discovered that the final draft of the contract typed in the office of B's lawyer did not contain the provision which had been in dispute. The Committee has been asked to give its opinion as to the ethical duty of A's lawyer in that circumstance.[44]

Under this fact pattern, the Committee considered this to constitute a "scrivener's error, not an intentional change in position by the other party. A meeting of the minds has already occurred. The Committee concludes that the error is appropriate for correction between the lawyers without client consultation.[45] In fact, the Commission further states that it is not even necessary for A's lawyer to tell A about B's lawyer's error:

> A's lawyer does not have a duty to advise A of the error pursuant to any obligation of communication under Rule 1.4 of the ABA Model Rules of Professional Conduct (1983). "The guiding principle is that the lawyer should fulfill reasonable client expectations for information consistent with the duty to act in the client's best interests and the client's overall requirements as to the character of representation." Comment to Rule 1.4. In this circumstance there is no "informed decision," in the language of Rule 1.4, that A needs to make; the decision on the contract has already been made by the client. Furthermore, the Comment to Rule 1.2 points out that the lawyer may decide the "technical" means to be employed to carry out the objective of the representation, without consultation with the client.[46]

That said, A's lawyer may not assist A in taking *advantage* of B's lawyer's error, as the Commission explains:

> The client does not have a right to take unfair advantage of the error. The client's right pursuant to Rule 1.2[47] to expect committed and dedicated representation is not

---

[44] *Id.*

[45] *Id.* The Committee noted, however, that "[a]ssuming for purposes of discussion that the error is 'information relating to [the] representation,' under Rule 1.6 disclosure would be 'impliedly authorized in order to carry out the representation.' The Comment to Rule 1.6 points out that a lawyer has implied authority to make 'a disclosure that facilitates a satisfactory conclusion'—in this case completing the commercial contract already agreed upon and left to the lawyers to memorialize. We do not here reach the issue of the lawyer's duty if the client wishes to exploit the error." *Id.* at n.1. But, of course, the Rules would *not* permit the lawyer to assist the client in exploiting the error, as delved into further in the Informal Opinion.

[46] *Id.*

[47] Model Rule 1.2, *Scope of Representation and Allocation of Authority between Client and Lawyer*, provides in full:

> (a) Subject to paragraphs (c) and (d), a lawyer shall abide by a client's decisions concerning the objectives of representation and, as required by Rule 1.4, shall consult with the client as to the means by which they are to be pursued. A lawyer may take such action on behalf of the client as is impliedly authorized to carry out the representation. A lawyer shall abide by a client's decision whether to settle a matter. In a criminal case, the lawyer shall abide by the client's decision, after consultation with the lawyer, as to a plea to be entered, whether to waive jury trial and whether the client will testify.
>
> (b) A lawyer's representation of a client, including representation by appointment, does not constitute an endorsement of the client's political, economic, social or moral views or activities.
>
> (c) A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.

> unlimited. Indeed, for A's lawyer to suggest that A has an opportunity to capitalize on the clerical error, unrecognized by B and B's lawyer, might raise a serious question of the violation of the duty of A's lawyer under Rule 1.2(d) not to counsel the client to engage in, or assist the client in, conduct the lawyer knows is fraudulent. In addition, *Rule 4.1(b) admonishes the lawyer not knowingly to fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a fraudulent act by a client*, and Rule 8.4(c)[48] prohibits the lawyer from engaging in conduct involving dishonesty, fraud, deceit, or misrepresentation.[49]

Given the complexity of most contracts today, and the growing number of terms and provisions being negotiated, the possibility for error to creep into the finished policy is obvious. Under the Model Rules and the guidance above, it is clear that neither party may take advantage of the other in the event of a scrivener's error, their lawyers may not counsel them to do so, and they may not knowingly assist their clients in doing so.

What is less clear in the Model Rules is whether the passage of time would change the outcome. Although that question is beyond the scope of this article, the Model Rules do raise a fair question about a lawyer, who knows that the other party to a contract has failed to notice that an error has crept into it, nevertheless decides to say nothing and take advantage of the situation should it become an issue many years into the future. Indeed, as Informal Opinion 86-1518 states, "The duty of zealous representation in DR 7-101 is limited to lawful objectives. . . . Rule 1.2 evolved from DR 7-102(A)(7), which prohibits a lawyer from counseling or assisting the client in conduct known to be fraudulent. See also DR 1-102(A)(4), the precursor of Rule 8.4(c), prohibiting the lawyer from engaging in conduct involving dishonesty, fraud, deceit, or misrepresentation."[50]

Thus, in a nontribunal setting, lawyers should bear in mind that, while they may bluff, puff and misdirect, they may not make a misstatement of or an omission about a material fact, nor may they knowingly assist their clients in doing so.

In real time, the line between permissible and proscribed conduct in the negotiation setting may be hard to see. The Annotation to Model Rule 4.1 regarding negotiations, bluntly states: "A lawyer who makes a false statement in the course of negotiating may be subject to discipline under Rule 4.1(a)."[51] can do nothing to

---

> (d) A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.

ANNOT. MRPC 31.

[48] Model Rule 8.4, *Misconduct*, subsection (c) provides: "It is professional misconduct for a lawyer to: * * * (c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation[.]" ANNOT. MRPC 669.

[49] ABA Comm. on Ethics and Prof. Resp. Informal Op. 86-1518 (emphasis added).

[50] *Id.* The Informal Opinion concludes by stating that "[t]he delivery of the erroneous document is not a 'material development' of which the client should be informed under EC 9-2 of the Model Code of Professional Responsibility, *but the omission of the provision from the document is a "material fact" which under Rule 4.1(b) of the Model Rules of Professional Conduct must be disclosed to B's lawyer*." *Id.* n.2 (emphasis added).

[51] ANNOT. MRPC 434.

expand on or illustrate that comment other than to provide examples of lawyers being disciplined or referred to disciplinary authorities, as well as notable ethics opinions,[52] such as:

- Lawyer stated "untruths" in a letter he sent to opposing counsel proposing settlement terms;[53]

- Lawyer's misrepresentations leading insurance company to believe his deceased client was still alive (client's "brain wasn't working") or, later, had not died until after settlement, violated Rule 4.1;[54]

- Lawyer untruthful to opposing counsel about whether client died before or after settlement agreement reached;[55]

- In a case involving insurance, a personal injury plaintiff's lawyer negotiating release of hospital's lien on client's recovery had duty to tell hospital administrator that defendant had additional umbrella policy;[56]

- Lawyer failed to correct misrepresentation to lawyer for client's partner that certificate of deposit obtained for escrow had been established with liquidated partnership funds;[57]

- Lawyer for defendant in auto accident case under no duty to disclose client's death before serving any pleadings, but serving answer and amended answer on her behalf violated Rule 4.1;[58]

- Lawyer's concealment of intent to recover costs and failure to correct false impression that settlement agreement would resolve case violated Oregon Code provision analogous to Model Rule 4.1; court rejected argument that trial court's denial of motion to set aside on basis of misrepresentation had preclusive effect;[59]

- Lawyer whose personal injury client dies before accepting pending settlement offer must inform court and opposing counsel; failure to disclose is tantamount to making false statement of material fact within meaning of Rule 4.1(a);[60]

- "If opposing side relying upon false information in accepting settlement proposal, *and* if lawyer or his client supplied the false information, lawyer must correct it";[61] and

- Relying on the Michigan Code analogous to Michigan Rule 4.1, as well as to Model Rules 3.3 and 4.1, federal court vacated settlement that plaintiff's lawyer, who knew that defendant believed

---

[52] *Id.*

[53] Ausherman v. Bank of Am. Corp., 212 F. Supp. 2d 435 (D. Md. 2002).

[54] People v. Rosen, 198 P.3d 116 (Colo. 2008).

[55] *In re* Lyons, 780 N.W.2d 629 (Minn. 2010).

[56] State *ex rel.* Neb. State Bar Ass'n v. Addison, 412 N.W.2d 855 (Neb. 1987).

[57] Carpenito's Case, 651 A.2d 1 (N.H. 1994).

[58] *In re* Edison, 724 N.W.2d 579 (N.D. 2006).

[59] *In re* Eadie, 36 P.3d 468 (Or. 2001).

[60] ABA Formal Ethics Op. 95-397 (1995).

[61] N.Y. County Ethics Op. 731 (2003) (emphasis added).

plaintiff would make excellent trial witness, negotiated without disclosing that client had died;[62] *but*

- In a case illustrating the difference between holding back fact of client's death and question of client's life expectancy, one ethics commission opined that a lawyer need not disclose employee's one-year life expectancy when settling workers' compensation claim for equivalent of three years of benefits; unless lawyer determines that nondisclosure would work a fraud, Rule 4.1(a) was not implicated because no statement was made and no question was posed regarding life expectancy.[63]

The Annotation on Negotiation provides a nonexclusive list of scholarly sources as well.[64] The closing section of that Annotation—*Generally Accepted Conventions in Negotiation*—provides a final cautionary thought. In considering the sentence in Comment [2] to Model Rule 4.1 regarding "generally accepted conventions," the Annotation states:

> Comment [2] [to Rule 4.1] recognizes that certain statements ordinarily are not taken as statements of material fact "[u]nder generally accepted conventions in negotiation," and goes on to note that these include estimates of price or value and a party's intentions regarding acceptable settlement. This "defines the conduct that is permissible in negotiation by reference to local norms of negotiating behavior," according to James E. Moliterno, *Modeling the American Lawyer Regulation* System, 13 OR. REV. INT'L L. 47, 51 n.10 (2011) (noting culture-driven norms create opportunities for misunderstanding in cross-border negotiation). See Nelli Doroshkin, *Current Development, Candor and Integration: Codifying Collegial Truthfulness Requirements in* Europe, 25 GEO. J. LEGAL ETHICS 503 (Summer 2012) (norms of lawyer-to-lawyer interactions, which are often more culture-specific than those governing lawyers' relations with clients and judges, become more important as cross-border transactions increase; author calls upon Council of Bars and Law Societies of Europe (CCBE) to adopt negotiation provision that, like Rule 4.1, leaves space for cultural variances).

---

[62] Virzi v. Grand Trunk Warehouse & Cold Storage Co., 571 F. Supp. 507 (E.D. Mich. 1983).

[63] Pa. Ethics Op. 2001-26 (2001).

[64] ANNOT. MRPC at 435 cites the following: Don Peters, *When Lawyers Move Their Lips: Attorney Truthfulness in Mediation and a Modest Proposal*, 2007 J. DISP. RESOL. 119, 123 (most "actual regulation" of lawyer honesty in negotiation occurs through challenges to negotiated agreement by party who discovers facts were not as represented; citing Carrie Menkel-Meadow, *Ethics, Morality, and Professional Responsibility in Negotiation*, in DISPUTE RESOLUTION ETHICS, A COMPREHENSIVE GUIDE 139 (Phyllis Bernard & Bryant Garth eds., 2002); Charles B. Craver, *Negotiation Ethics for Real World Interactions*, 25 OHIO ST. J. ON DISP. RESOL. 299 (2010); Nathan M. Crystal, *The Lawyer's Duty to Disclose Material Facts in Contract or Settlement Negotiations*, 87 KY. L.J. 1055 (1999); Monroe H. Freedman, *In Praise of Overzealous Representation—Lying to Judges, Deceiving Third Parties, and Other Ethical Conduct*, 34 HOFSTRA L. REV. 771 (Spring 2006); James K. L. Lawrence, *Lying, Misrepresenting, Puffing and Bluffing: Legal, Ethical and Professional Standards for Negotiators and Mediation Advocates*, 29 OHIO ST. J. ON DISP. RESOL. 35 (2014); E. Cliff Martin & T. Karena Dees, *Current Development, The Truth about Truthfulness: The Proposed Commentary to Rule 4.1 of the Model Rules of Professional Conduct*, 15 GEO. J. LEGAL ETHICS 777 (Summer 2002); Peter Reilly, *Was Machiavelli Right? Lying in Negotiation and the Art of Defensive Self-Help*, 24 OHIO ST. J. ON DISP. RESOL. 481 (2009); Douglas R. Richmond, *Lawyers' Professional Responsibilities and Liabilities in Negotiations*, 22 GEO. J. LEGAL ETHICS 249 (Winter 2009); Barry R. Temkin, *Misrepresentation by Omission in Settlement Negotiations: Should There Be a Silent Safe Harbor?*, 19 GEO. J. LEGAL ETHICS 179 (Fall/Winter 2004); Daniel Walfish, *Making Lawyers Responsible for the Truth: The Influence of Marvin Frankel's Proposal for Reforming the Adversary System*, 35 SETON HALL L. REV. 613 (2005) (analyzing impact of 1975 argument that ethics rules should forbid material omissions and should affirmatively compel certain disclosures); Fred C. Zacharias & Bruce A. Green, *Reconceptualizing Advocacy Ethics*, 74 GEO. WASH. L. REV. 1 (Nov. 2005).

> The word "ordinarily" was added in 2002 to acknowledge that an estimate of price or value or a statement of intention regarding settlement could, under some circumstances, constitute a false statement of fact. American Bar Association, *A Legislative History: The Development of the ABA Model Rules of Professional Conduct, 1982-2013*, at 552 (2013); *see* ABA Formal Ethics Op. 06-439 (2006) (statements about party's negotiating goals or its willingness to compromise, as well as statements that can fairly be characterized as negotiation "puffing," ordinarily do not come within Rule 4.1(a)).[65]

This Annotation suggests, of course, that such statements might, perhaps, come within Rule 4.1(b), giving the practitioner added incentive to consider carefully where the line between "puffing" and "false statement of material fact or law" in the lawyer's jurisdiction really lies.

A recent trial-court decision,[66] provides the following:

> The New York Rules of Professional Conduct "do not specifically address the duty of truthfulness in the context of negotiations," and "[t]here is not a large body of New York case law or other ethics opinions on negotiations." David Keyko, *Ethics and Negotiating: Truth or Consequences?* N.Y.L.J. (Apr. 24, 2009), at 4. However, "[i]t is not unusual in a negotiation for a party, directly or through counsel, to make a statement in the course of communicating its position that is less than entirely forthcoming." ABA Comm. of Prof'l Ethics & Grievances, Formal Op. 06-439 (2006) (*Lawyer's Obligation of Truthfulness When Representing a Client in Negotiation: Application to Caucused Mediation*). [Footnote at this point provides, "The ABA Opinion concluded that "[u]nder Model Rule 4.1, in the context of a negotiation, including a caucused mediation, a lawyer representing a client may not make a false statement of material fact to a third person. However, statements regarding a party's negotiating goals or its willingness to compromise, as well as statements that can fairly be characterized as negotiation 'puffing,' ordinarily are not considered 'false statements of material fact' within the meaning of the Model Rules."] "A party in a negotiation also might exaggerate or emphasize the strengths, and minimize or deemphasize the weaknesses, of its factual or legal position." *Id.* Indeed, one commentator has observed that "consensual deception is the essence of caucused mediation." John W. Cooley, *Defining the Ethical Limits of Acceptable Deception in Mediation*, 4 PEPP. DISP. RESOL. L.J. 263, 264 (2004). [Footnote omitted.] Even so, a lawyer may not knowingly make a false statement of fact or law in a negotiation. N.Y. Rules of Prof'l Conduct 4.1. *See* Karen Wells Roby, *Ethics in Settlement: The Effect of Material Misrepresentation*, 59-AUG. FED. LAW. 42 (Aug. 2012) ("Even though a lawyer is not required to disclose weaknesses in his or her client's case, the lawyer is prohibited from knowingly making a false statement of fact or law to a third party—including opposing counsel, a witness, or a mediator.").[67]

In footnote 7 to the *Otto* decision, the court writes:

> Cooley cites to an article, now 30 years old but still timely, that "poignantly illustrates the differences of opinion and confusion among the experts regarding truthfulness standards in negotiation. Using four hypothetical negotiation situations, the author conducted a survey of [15] participants, which included eight law professors who had written on ethics and negotiation, or both; five experienced litigators, a federal circuit court judge, and a [federal]

[65] ANNOT. MRPC 435-36.

[66] Otto v. Hearst Communications, Inc., No. 17-CV-4712 (GHW) (JLC), 2019 WL 1034116 (S.D.N.Y. Mar. 5, 2019).

[67] *Otto*, 2019 WL 1034116, at *11.

[m]agistrate [judge]." 4 PEPP. DISP. RESOL. L.J. at 269. The four situations and how the 15 experts answered the ethical question posed by each of the situations are as follows:

> Situation 1: Your clients, the defendants, have told you that you are authorized to pay $750,000 to settle the case. In settlement negotiations after your offer of $650,000, the plaintiffs' attorney asks, "Are you authorized to settle for $750,000?" Can you say, "No I'm not?" Yes: Seven; No: Six; Qualified: Two
>
> Situation 2: You represent a plaintiff who claims to have suffered a serious knee injury. In settlement negotiations, can you say your client is "disabled" when you know she is out skiing? Yes: One; No: Fourteen; Qualified: None
>
> Situation 3: You are trying to negotiate a settlement on behalf of a couple who charge that the bank pulled their loan, ruining their business. Your clients are quite up-beat and deny suffering particularly severe emotional distress. Can you tell your opponent, nonetheless, that they did? Yes: Five; No: Eight; Qualified: Two
>
> Situation 4: In settlement talks over the couple's lender liability case, your opponent's comments make it clear that he thinks plaintiffs have gone out of business, although you didn't say that. In fact, the business is continuing and several important contracts are in the offing. You are on the verge of settlement; can you go ahead and settle without correcting your opponent's misimpression? Yes: Nine; No: Four; Qualified: Two

4 PEPP. DISP. RESOL. L.J. at 269 (citing Larry Lempert, *In Settlement Talks, Does Telling the Truth Have Its Limits?* 2 INSIDE LITIGATION 1, 15-18 (1988)).[68]

Of course, once a tribunal becomes involved, the playing field changes, as we shall see in the next section.

V. MODEL RULE 3.3: CANDOR TOWARD THE TRIBUNAL

It is in reading the "shall nots" of Model Rule 3.3 that the differences in permissible conduct and duties between negotiations and adjudicatory matters come into sharper focus. For example, in a negotiation, there is no requirement under Model Rule 4.1 that a lawyer disclose adverse authority to opposing counsel. Such an omission is not permissible under Model Rule 3.3. With that thought in mind, we turn to the rule itself.

Model Rule 3.3, "Candor Toward The Tribunal," provides:

> (a) A lawyer shall not knowingly:
>
> (1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer;
>
> (2) fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or
>
> (3) offer evidence that the lawyer knows to be false. If a lawyer, a lawyer's client, or a witness called by the lawyer, has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal. A lawyer may refuse to offer evidence, other than

[68] *Id.* n.7. *And see* Keith A. Call, *Is It Ethical To Be Dishonest In Negotiations?*, 29-APR UTAH B.J. 40 (March/April 2016); Yi He, *Free Reign or Strict Courtroom Courtesy? An Ethical Code for Business Negotiators*, 31 GEO. J. LEGAL ETHICS 657 (Fall 2018); James K.L. Lawrence, *Lying, Misrepresenting, Puffing and Bluffing: Legal, Ethical and Professional Standards for Negotiators and Mediation Advocates*, 29 OHIO ST. J. DISP. RESOL. 35 (2014).

the testimony of a defendant in a criminal matter, that the lawyer reasonably believes is false.

(b) A lawyer who represents a client in an adjudicative proceeding and who knows that a person intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal.

(c) The duties stated in paragraphs (a) and (b) continue to the conclusion of the proceeding, and apply even if compliance requires disclosure of information otherwise protected by Rule 1.6.

(d) In an ex parte proceeding, a lawyer shall inform the tribunal of all material facts known to the lawyer that will enable the tribunal to make an informed decision, whether or not the facts are adverse.[69]

A. Determining when the Matter is Before a Tribunal

Model Rule 1.0(m) provides that the term "Tribunal":

> denotes a court, an arbitrator in a binding arbitration proceeding or a legislative body, administrative agency or other body acting in an adjudicative capacity. A legislative body, administrative agency or other body acts in an adjudicative capacity when a neutral official, after the presentation of evidence or legal argument by a party or parties, will render a binding legal judgment directly affecting a party's interests in a particular matter.[70]

The Annotation, *"Tribunal,"* provides certain guidance as to when a matter is before a tribunal. The test appears to be whether the body is "acting in an adjudicative capacity" or whether it can "render a binding legal judgment directly affecting a party's interests in a particular matter."[71] Examples provided by the Annotation include:

- Lawyer who submitted fraudulent Criminal Justice Act voucher to court for payment violated District of Columbia Rule 3.3(a)(1); the Bar committee erred in holding that neither the accounting branch of the superior court nor the judge functioned as a "tribunal" when processing the voucher;[72]

- Oklahoma's Corporation Commission, charged with supervising public service corporations, was *not* exercising adjudicative powers by requiring change-of-ownership notification letter; lawyer's misrepresentations to it therefore did *not* violate Rule 3.3; and[73]

- In Social Security cases, disability hearings before administrative law judges constitute proceedings before a tribunal.[74]

Not included in the Annotation (although mentioned in the Sixth Edition of ANNOT. MRPC) are:

---

[69] ANNOT. MRPC 351.

[70] ANNOT. MRPC 16.

[71] ANNOT. MRPC 309.

[72] *In re* Cleaver-Bascombe, 892 A.2d 396 (D.C. Ct. App. 2006).

[73] State *ex rel.* Okla. Bar Ass'n v. Dobbs, 94 P.3d 31 (Okla. 2004).

[74] Ill. Ethics Op. 99-04 (1999).

- Court rejected lawyer's argument that false statements in pleading and supporting affidavit were not actually made to a tribunal because the lawsuit was dismissed before statement went to judge or jury; [75]

- Lawyer violated Kentucky's Rule 3.3 by sending letter to bar counsel containing false statements about someone else's pending disciplinary case and enclosing falsified supporting evidence;[76] and

- Lawyer violated South Carolina's Rule 3.3 by knowingly submitting false information on CLE compliance report filed with commission on continuing legal education.[77]

And please compare the previous two cases with the next two.

- Lawyer who lies to bar grievance committee *not* guilty of making false statement to "tribunal" for Florida's Rule 3.3 purposes;[78] and

- Court declined to find violation of Louisiana's Rule 3.3 for failure to make full disclosure to Office of Disciplinary Counsel when giving sworn statement; "while the ODC acts under the auspices of this court, it is not the type of 'tribunal' contemplated by the professional rules."[79]

Clearly, it pays to know the law in the controlling jurisdiction.

Notwithstanding the different interpretations as to whether certain bodies are "tribunals" (as the last four cited cases show), it is virtually axiomatic that a tribunal whose judgment will not be binding is not a tribunal for purposes of Model Rule 3.3. As the Annotation points out, in such cases:

> [T]he lawyer need only abide by Rule 4.1's requirement of truthfulness, rather than Rule 3.3's more rigorous requirement of candor. The major differences are that Rule 3.3 applies to *all* statements *regardless of materiality*, and can even require a lawyer to disclose information protected by Rule 1.6 (Confidentiality of Information).[80]

As to whether a deposition is a "matter before a tribunal," the Annotation states:

> The rule also applies to any "ancillary proceeding conducted pursuant to the tribunal's adjudicative authority, such as a deposition." Cmt. [1]; *see In re Michael*, 836 N.W.2d 753 (Minn. 2013) (lawyer lied at tribal court hearing on order to show cause why she should not be held in contempt); *In re Rodriguez*, 306 P.3d 893 (Wash. 2013) (lawyer lied at own deposition in own disciplinary investigation); N.Y. Cnty. Ethics Op. 741 (2010) (duties under Rule 3.3 apply to client's testimony at deposition).[81]

---

[75] Diaz v. Comm'n for Lawyer Discipline, 953 S.W.2d 435 (Tex. App. 1997).

[76] Andrews v. Ky. Bar Ass'n, 169 S.W.3d 862 (Ky. 2005).

[77] *In re* Diggs, 544 S.E.2d 628 (S.C. 2001).

[78] Fla. Bar v. Rotstein, 835 So. 2d 241 (Fla. 2002).

[79] *In re* Brigandi, 843 So. 2d 1083 (La. 2003).

[80] Annotation, "*Tribunal*," ANNOT. MRPC 355-56 (emphasis added).

[81] *Id.* at 355-56.

But as to *negotiations*, the Annotation says "no," while at least one commentator provides a "not so fast" caution:

> *[S]ee also* ABA Formal Ethics Op. 06-439 (2006) (Rule 3.3 does not apply to mediation except with respect to "statements made to a tribunal when the tribunal itself is participating in settlement negotiations, including court-sponsored mediation in which a judge participates"; criticized as "debatable" in Douglas R. Richmond, *Lawyers' Professional Responsibilities and Liabilities in Negotiations*, 22 GEO. J. LEGAL ETHICS 249 (Winter 2009) (suggesting some courts might hold Rule 3.3 (a)(1) applicable to "mediations conducted pursuant to the court's adjudicatory authority")).[82]

Overall, this Annotation raises an important question; namely: What is the difference between *truth* and *candor*? We shall explore that question in the next subsection.

B. "Truthfulness" vs. "Candor"

Nowhere in the Rules, the Comments or the Annotations is the distinction between "Model Rule 4.1's requirement of truthfulness" and "[Model] Rule 3.3's higher requirement of candor" explained. The closest we come to anything approaching an explanation is Comment [2] to Model Rule 3.3:

> [2] This Rule sets forth the special duties of lawyers as officers of the court to avoid conduct that undermines the integrity of the adjudicative process. A lawyer acting as an advocate in an adjudicative proceeding has an obligation to present the client's case with persuasive force. Performance of that duty while maintaining confidences of the client, however, is qualified by the advocate's duty of candor to the tribunal. Consequently, although a lawyer in an adversary proceeding is not required to present an impartial exposition of the law or to vouch for the evidence submitted in a cause, the lawyer must not allow the tribunal to be misled by false statements of law or fact or evidence that the lawyer knows to be false.[83]

The distinction between "truthfulness" and "candor" appears to turn on whether the integrity of the judicial system itself is imperiled by the conduct. A battle of wits with opposing counsel, with no one else around, over how much a case will settle for or how much settlement authority one has, does not appear to imperil the system's integrity. To tell one's opponent in negotiation that his case is worth *bubkes*[84] when deep down you know it's worth quite a bit more may constitute nothing more than bluster and, accordingly, violates no Model Rule. To say the same thing in a settlement conference to a judge who has seen the plaintiff's damages calculations, without producing countervailing evidence or support, may well be viewed as an attempt to mislead the court.

By comparison, being untruthful about a material fact is unacceptable under both Model Rules. If a defense lawyer *knows* that her opponent is under a complete misapprehension as to the available limits of the defendant's liability insurance where that amount would be considered a material fact under the facts and circumstances of the case, then allowing that misapprehension to go uncorrected likely would violate Model

---

[82] *Id.*

[83] ANNOT. MPRC 321-22.

[84] "**1**. Something trivial, worthless, insultingly disproportionate to expectations. 'I worked on it three hours—and what did he give me? *Bubkes!*'; **2**. Something absurd, foolish, nonsensical. 'I'll sum up his idea in one word: *bubkes!*' " LEO ROSTEN, THE JOYS OF YIDDISH 55 (1968).

Rule 4.1. And allowing a judge to adopt that misapprehension would certainly violate Model Rule 3.3 as well.

Accordingly, it is important to keep in mind that the language of Model Rule 3.3(a)(1) and Model Rule 4.1(a) is identical on the point that a lawyer "shall not knowingly make a false statement of material fact or law." But those Rules diverge on the question of statements about where the lawyer's settlement authority lies. Comment [2] to Model Rule 4.1 explains that statements about a party's intentions as to an acceptable settlement of a claim ordinarily do not constitute "statements of material fact" and are therefore ordinarily exempt from Model Rule 4.1(a). As Michael Rubin says, "apparently you can lie with impunity about your settlement authority."[85]

But there is no such exemption in the comments to Model Rule 3.3. Any lawyer attending a settlement conference with a judge is well advised to keep this distinction in mind. As Mr. Rubin suggests, "[a] lawyer who, during a settlement conference with a judge, misstates the client's intention as to an acceptable settlement undoubtedly acts at his or her peril."[86]

By way of example, one court admonished counsel for an insurance broker for asserting that the content of a particular conversation between the broker and the customer was an undisputed material fact when, in fact, it was not, eliciting the following threat from the bench:

> In addition, this Court finds it distasteful that [counsel for the insurance broker] listed the conversation with [the insurance agent] as an "undisputed material fact." This Court has noticed that this is part of an increasing habit among practicing attorneys in this district. Attorneys seem to be regularly asserting that certain facts are "undisputed material facts" when they are clearly in dispute. *See, e.g., Ransdell v. Heritage Enterprise*, Case No. 04-1209 (Order Denying Summary Judgment, November 14, 2006) (in which Magistrate Judge Gorman noted that it was wholly improper to characterize such facts as "undisputed"). Rule 3.3 of the Illinois Rules of Professional Conduct (which have been adopted by this Court under Local Rule 83.6) forbids an attorney from making a statement of material fact which the lawyer knows or reasonably should know is false. Asserting that a fact is undisputed when it is clearly in dispute is not only a violation of Rule 3.3, but it also undermines an attorney's credibility before the Court. Counselors practicing in this district need to take note and cease this distasteful habit.[87]

What might have been considered bluster in a negotiation could easily have resulted in disciplinary action against counsel making the false assertion.

C. Ancillary Proceedings Are Not Exempt

Just because a judge or other adjudicative body is not in the room does not mean that Rule 3.3 does not apply.

Comment [1] advises that Model Rule 3.3 "also applies when the lawyer is representing a client in an ancillary proceeding conducted pursuant to the tribunal's adjudicative authority, such as a deposition. Thus,

---

[85] Rubin, *supra* note 7, at 15.

[86] *Id.*

[87] Nat'l Union Fire Co. of Pittsburgh, Pa. v. Pontiac Flying Service, Inc., No. 03-cv-1288, 2006 WL 3422166 at *4 n.1 (C.D. Ill. Nov. 27, 2006).

for example, paragraph (a)(3) requires a lawyer to take reasonable remedial measures if the lawyer comes to know that a client who is testifying in a deposition has offered evidence that is false."[88]

The impact of this Comment is not to be measured by its brevity.

VI. THE IMPACT OF MODEL RULES 3.3 AND 4.1 ON THE DUTY OF CONFIDENTIALITY UNDER MODEL RULE 1.6

As discussed in Section IV., *supra*, proposed language for Model Rule 4.1 that explicitly would have required truthfulness in negotiations, even if it would have caused the lawyer to reveal client confidences, was rejected.[89] Not so with Model Rule 3.3(c), which explicitly states that "[t]he duties stated in paragraphs (a) and (b) . . . apply even if compliance requires disclosure of information otherwise protected by Rule 1.6."[90]

It may be helpful to compare the Annotations to the two Model Rules. The applicable Annotation to Model Rule 4.1 states:

> DISCLOSURE OF CONFIDENTIAL INFORMATION
>
> Rule 4.1(b) requires disclosure of a material fact to avoid assisting in a client's crime or fraud "unless disclosure is prohibited by Rule 1.6." Rule 1.6 generally bars lawyers from disclosing any "information relating to the representation of a client," but an exception in Rule 1.6(b) permits disclosure when a client is using the lawyer's services to further certain crimes or frauds. Although the language used in Rule 4.1(b) is not perfectly congruent with that used in Rule 1.6(b)(2) and (3), Rule 4.1(b) requires the disclosure if the conditions of both rules are met. *See* Pa. Ethics Op. 2002-3 (2002) (Rule 4.1(b) requires lawyer representing family before INS to disclose client's prior arrest; client's failure to disclose amounted to fraud in which he was using lawyer's services, thus triggering prevention/rectification exception to confidentiality rule); John A. Humbach, *Shifting Paradigms of Lawyer Honesty*, 76 TENN. L. REV. 993 (Summer 2009) ("Since Rule 4.1(b) requires its disclosures when Rule 1.6 permits them, a new and wide-ranging 'duty to warn' has emerged."); *cf*. ABA Formal Ethics Op. 07-446 (2007) (fact that lawyer gives behind-the-scenes help to pro se litigant is not material; failure to disclose—or ensure that litigant discloses—does not implicate Rule 4.1(b)). *See generally* Morgan Cloud, *Privileges Lost? Privileges Retained?*, 69 TENN. L. REV. 65 (Fall 2001) (many dilemmas created by "contradictory and far from self-explanatory commands" of Rules 1.2, 1.6, 1.16, 3.3, and 4.1 could be resolved by permitting disclosures to prevent or rectify harms to others resulting from client's crimes or frauds). For a discussion of the interplay between Rule 4.1(b) and Rule 1.6(b)(2) and 1.6(b)(3), see *ABA/BNA Lawyers' Manual on Professional Conduct*, "Obligations to Third Persons: Truthfulness in Statements to Others," pp. 71:201 *et seq*.[91]

[88] ANNOT. MRPC 351.

[89] *Supra* note 17 and accompanying text.

[90] ANNOT. MRPC 351.

[91] ANNOT. MRPC 436-37.

And the applicable Annotation to Model Rule 3.3 provides:

> ***Paragraph (b): When Lawyer Knows of Criminal or Fraudulent Conduct Relating to Proceeding***
>
> Until the rule was amended in 2002 this obligation (formerly found in Rule 3.3(a)(2)) was defined as a duty to take reasonable remedial measures necessary to avoid assisting the *client* in a criminal or fraudulent act. *See, e.g., In re Winthrop*, 848 N.E.2d 961 (Ill. 2006) (absent proof that lawyer represented client's agent as well as client, cannot discipline lawyer (under former Rule 3.3(a)(2)) for failing to tell court of agent's "suspicious" use of client's funds).
>
> The Rule, redesignated as Rule 3.3(b), now states that a lawyer "who knows that a *person* intends to engage, is engaging or has engaged in criminal or fraudulent conduct *related to the proceeding* shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal" (emphases added). The new wording reflects a "special obligation" on the part of lawyers "to protect a tribunal against criminal or fraudulent conduct that undermines the integrity of the adjudicative process." Cmt. [12]; *see also* American Bar Association, *A Legislative History: The Development of the ABA Model Rules of Professional Conduct, 1982-2013*, at 754 (2013) (amendment means obligation to avoid assisting in client crime or fraud "is replaced by a broader obligation to ensure the integrity of the adjudicative process").[92]

The pertinent Annotation under Model Rule 1.6, *Disclosure Required by Rule 3.3*, explains:

> When a matter is before a tribunal, a lawyer may be required by Rule 3.3 to reveal to the court otherwise protected under Rule 1.6 to avoid assisting a client in perpetrating a crime or fraud. For discussion of a lawyer's duty of candor to a tribunal, see the Annotation to Model Rule 3.3[93]

Examples of situations involving all three Rules are rare, although one ABA Formal Opinion takes on the challenge. In ABA Formal Opinion 93-375, the Committee on Ethics and Professional Responsibility addressed the following hypothetical situation:[94]

> A lawyer is outside counsel to a bank that is undergoing a routine examination by the banking agency that regulates it. In the course of the examination, an examiner from the agency identifies eight loans that he believes should be aggregated under the loan-to-one-borrower (LTOB) rules governing the bank. See 12 U.S.C. § 84(a)(1). If the eight loans in question are aggregated, the total loans to one person will exceed the 15 percent statutory limit and the bank will be in violation of the LTOB rules. An officer of the client bank believes that the bank has a powerful argument that one of the eight loans identified by the examiner ("Loan 8") should not be combined with the others, in which case the LTOB rules would not be violated. The officer asks the lawyer (who has not heretofore been involved in the bank examination) to review the bank's records and consider the issue before

[92] ANNOT. MRPC 365-66.

[93] ANNOT. MRPC 119.

[94] ABA Formal Op. 93-375 (Aug. 6, 1993). The Committee comments that this hypothetical is taken from the Report by the ABA Working Group on Lawyers' Representation of Regulated Clients (Discussion Draft, January 1993) at 169-175. ABA Formal Op. 93-375 at n.4.

> the officer meets with the examiner. The lawyer does so, and agrees that a substantial legal argument can be made that Loan 8 should not be aggregated. In the course of her review of the bank's records, however, the lawyer discovers another loan ("Loan 9") about which the examiner has not made any particular inquiry, that arguably should be aggregated with Loans 1 through 7, in which case also the LTOB rules would be violated. What are the lawyer's obligations under these circumstances? Do they change when the lawyer's role changes from that of a background advisor to that of a front-line representative of the client, articulating a position in behalf of the client or otherwise communicating and dealing directly with the bank examiner?[95]

The Committee proceeded from the following proposition; namely,

> that the banking regulations impose no separate duty of disclosure on a lawyer. Thus, it is the client and not the lawyer who has a duty to respond to the examining agency's inquiries, and the involvement of the lawyer neither increases nor decreases the client's obligations in this regard. Such obligations of disclosure as the lawyer may have rest solely on the rules governing lawyers' ethics. Where, as here, a lawyer is employed simply to advise the client about how the client should respond to the examining agency's inquiries, the duty to respond remains that of the client. Similarly, if the client simply asks the lawyer to represent him before the agency, the client's duty of disclosure does not ipso facto become that of the lawyer.[96]

Circumstances, however, could change, under which the lawyer's duties *might* change, and not for the better. As the Committee explains:

> However, a lawyer *may* put herself in a situation where she has assumed such obligations. When the lawyer is the only individual to deal directly with the bank examiners during the course of the examination, takes full responsibility for gathering factual information and preparing the client's submissions to the regulators, and cuts off the regulator from access the regulator otherwise might have to employees of the regulated entity, the lawyer may well have taken on the client's own obligation under the regulations to respond.[97]

In the hypothetical as set forth, however, no such heightened duty presents. Accordingly,

> the lawyer's involvement in the bank examination is indirect and attenuated; she is functioning solely as an advisor to the client, and her role is limited to reviewing facts and conclusions that cannot fairly be considered her own work product. The lawyer's duties thus derive *not* from any obligation that the client may have under applicable regulations to respond fully to the bank examiners' inquiries; rather, they derive from her obligations *under ethics rules applicable generally to the legal profession*. The duty to respond to the agency remains that of the client; the *lawyer's sole ethical obligation is not to mislead the agency*, and there is no duty to respond to the agency's inquiries to the client unless the lawyer has put herself in the position of offering, or vouching for, the client's responses.[98]

---

[95] *Id.*

[96] *Id.*

[97] *Id.* (emphasis added).

[98] *Id.* (emphases added).

The Committee analyzed this hypothetical under three Model Rules: 3.3, 3.9[99] and 4.1. As the Committee explained:

> Under all three of these provisions, it is clear that a lawyer may not tell a lie, whether or not it might be considered necessary to protect client confidences. See Rule 3.3(a)(1) and Rule 4.1(a) (a lawyer "shall not knowingly . . . make a false statement of material fact or law . . ."). See also Rule 3.9 (a lawyer "shall conform to the provisions of Rule 3.3(a) through (c) . . ."). This obligation of truthfulness is *unqualified*, applies on *all* occasions, and contains *no* exceptions.[100]

Recall, however, the ambiguity embedded in the hypothetical; namely, that there is a loan ("Loan 9") of which the examiner is unaware or hasn't thought about, but if she did know about it, might result in a violation of the LTOB rule. The Committee recognizes the lawyer's dilemma and addresses it thus:

> [I]t is somewhat less clear whether and to what extent a lawyer in a regulatory proceeding has an ethical obligation to be forthcoming. We do believe that a "false statement of material fact" includes a statement that the lawyer knows is misleading, whether or not it is intended to mislead. A *more difficult question* is *whether and to what extent a lawyer representing a client in a bank examination by a government regulatory agency has an affirmative obligation to come forward with information that is material to the purposes of the examination, the disclosure of which would be against the client's interests or otherwise violate her duty of confidentiality.* While Rules 3.3, 3.9 and 4.1 all impose a duty on a lawyer to disclose material facts when such disclosure is "necessary to avoid assisting a criminal or fraudulent act by a client," this duty overrides the duty to protect client confidences *only* under Rules 3.3 and 3.9. See Rule 3.3(b) ("The duties stated in paragraph (a) continue to the conclusion of the proceeding, and apply even if compliance requires disclosure of information otherwise protected by Rule 1.6"), incorporated by reference in Rule 3.9. *By contrast*, the analogous duty of disclosure to "third parties" in Rule 4.1(b) is *expressly qualified* by the lawyer's duty of confidentiality under Rule 1.6. See note 6, *supra*. Thus the duty to disclose takes precedence over the duty to keep client confidences *only* in the context of an "adjudicative proceeding" before a "tribunal" under Rule 3.3 or a "nonadjudicative proceeding" under Rule 3.9.[101]

The Committee queries and then concludes that a bank examination does *not* fall under either Rule 3.3 or 3.9 for purposes of determining whether disclosure may be required. Under this hypothetical, the lawyer's conduct falls under Rule 4.1. As the Committee explained:

> While a regulatory examination does not fit precisely into the category "negotiation or other bilateral transaction," it is more clearly suggested by these terms than it is by the terms "rule-making or policy-making." Accordingly, we conclude that the duty of

[99] As promulgated at that time, Model Rule 3.9, *Advocate in Nonadjudicative Proceedings*, provided: "A lawyer representing a client before a legislative or administrative tribunal in a nonadjudicative proceeding shall disclose that the appearance is in a representative capacity and shall conform to the provisions of Rule 3.3(a) through (c), 3.4(a) through (c), and 3.5." ABA Formal Op. 93-375 at n.6.

[100] *Id.* (emphases added).

[101] *Id.* (emphases added).

> disclosure applicable in the context of a bank examination is the qualified duty to "third parties" in Rule 4.1, and not the unqualified duty of disclosure in Rules 3.3 and 3.9.[102]

The question remaining, of course, is what the lawyer must do with respect to "Loan 9." On that point, the Committee states:

> Because of the importance the profession places on protecting client confidences, we also believe that the prohibition on disclosure of client confidences expressly stated in Rule 4.1 must be given effect in this context, *even if the result is to allow the client to engage in fraud*. On the other hand, we also believe that a lawyer faced with client fraud is required to conduct herself in such a way that she does not assist the fraud. Courses open to a lawyer in such circumstances include going up the corporate ladder under Model Rule 1.13, as well as withdrawal from the representation[103] so as to avoid giving assistance to the client's fraud.[104]

To explore further the lawyer's obligation when she learns of information damaging to her client's case, the Committee offers elaborations on the hypothetical and the following advice.

> *What if the lawyer believes that the client has a legal obligation under applicable banking regulations to volunteer the information about Loan 9?*

The lawyer's obligation is to counsel the client as to the lawyer's belief about the client's obligations. If the lawyer does so, she has discharged her duties. This begs the next question, of course, which is: What does the lawyer do if the client doesn't follow the lawyer's advice? As the Committee explained:

> At this point, the lawyer has fulfilled her obligations under the ethics rules by counseling the client as to his own legal obligations. She may continue to represent the client without doing more even if the client decides not to disclose. If the lawyer is of the view that Loan 9 is merely "arguably" aggregable, her own uncertainty about the implications of the client's failure to disclose substantially eliminates the possibility that her continuing to represent the client could be considered improper. Even if she *believes* Loan 9 *must* be aggregated, and that the client's refusal to disclose would be fraudulent, she herself has done *nothing* that could be regarded as assisting the client's fraud in violation of Rule 1.2(d). Given her limited involvement in the bank examination, she has *no obligation herself* to do anything more about the undisclosed Loan 9.[105]

---

[102] *Id.*

[103] The Committee's footnote at this point states: "Rule 1.16 ("Declining or Terminating Representation") provides in pertinent part that a lawyer "shall withdraw" from a representation if 'the representation will result in violation of the rules of professional conduct or other law.' See Rule 1.16(a)(1). It also provides that a lawyer 'may withdraw' if 'the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent . . . .' See Rule 1.16(b)(1)." ABA Formal Op. 93-375 at n.8.

[104] *Id.* The Committee's footnote at the end of this passage states: "While under these circumstances the lawyer may not make actual disclosure of client confidences, withdrawal may be required even if it has the collateral effect of inferentially revealing client confidences. See ABA Formal Opinion No. 92-366 . . . ." ABA Formal Op. 93-375 at n.9.

[105] ABA Formal Op. 93-375, § I, "Counseling the Client before the Exit Interview" (emphases added).

What if the lawyer is sure *that the loan must be aggregated and that the client's failure to report would be unlawful?*

In this elaboration on the hypothetical, the Committee posits that the lawyer has concluded that Loan 9 must be aggregated, that failure to report it to the examiners would be unlawful, and that she has so advised the client. Further, the client, against the lawyer's advice and in the lawyer's presence, makes an unequivocal representation to the bank examiners that there are no loans beyond those already known to them that even arguably should be aggregated. The Committee's opinion on what the lawyer should do is as follows:

> In the face of this clear misrepresentation by the client, and the client's apparent decision to commit a fraud in the lawyer's presence, the lawyer must act to disassociate herself from the client's intended course of action. She is undoubtedly obliged at the first private opportunity to urge the client to correct the falsehood and to consider the possible courses of action identified in Model Rule 1.13.[106]
>
> However, unless the lawyer knew in advance that the client intended to make such a misrepresentation, she herself to this point cannot be said to be a party to it and has violated no ethical duty. We therefore see no reason, in this context, why the lawyer should be required to do anything that would signal to the bank examiners her disapproval of the client's course of conduct. She is not required to jump to her feet and leave the premises upon hearing the client's false statement. Because she cannot yet be charged with knowledge that her services are being used by the client to assist the fraud, she is not required to terminate the representation on the spot or otherwise make a "noisy withdrawal" that would effectively disaffirm her involvement to date. And it is to everyone's benefit that she make a final effort to counsel the client, and take the opportunity to consider climbing the corporate ladder to persuade the bank to correct the falsehood.
>
> On the other hand, if the client refuses to correct his lie to the examiners about the existence of Loan 9, the lawyer may be required to consider whether or not to terminate the representation. See Rule 1.16(b)(1) * * *. In any event, she should not come to any subsequent meetings with the examiners if she knows the client intends to persist in the deception, since even her silent presence could make her a party to the client's fraud by conveying the impression that she believes the client's statements, now made a second time in her presence, are correct.[107]

What if it is the lawyer herself that makes the false statement to the examiner?

In this situation, the lawyer concludes that Loan 9 was made to the same borrower as Loans 1 through 8, but it is the lawyer *herself* who represents to the bank examiners that the client has made no other loans to that borrower. This is a clear violation of Rule 4.1(a), as further explained by the Committee:

> [T]he lawyer has violated the clear prohibition in Rule 4.1(a) against making false or misleading statements to third parties. It does not matter whether the false statement was volunteered by the lawyer, or whether the client directed her to offer it. Nor does it matter whether she made the statement in response to a specific question from the regulators. She

[106] The Committee's footnote at this point states: "Rule 1.13 ('Organization as Client') provides for consideration of consultation at higher levels of corporate management in the event a lawyer encounters contemplated fraud by a corporate official." ABA Formal Op. 93-375 at n.12.

[107] ABA Formal Op. 93-375, § II, "False Statement by Client in Presence of Lawyer."

> may not in any circumstances herself make a statement that she knows to be false and misleading. This may, of course, lead to some awkwardness where the client is adamant in his refusal to allow the lawyer to disclose the existence of Loan 9, and if the question is put directly to the lawyer by the bank examiner: in such a circumstance, the lawyer has *no permissible option* but to *decline* to respond, regardless of the inference that the examiner may draw. If the lawyer believes there is significant risk that she will be asked a question that she cannot ethically answer consistently with her client's instructions, she should so inform the client and give the client the choice whether she should attend before the meeting takes place.[108]

Of particular interest about this opinion is the point raised by the Committee concerning the lawyer's belief that "there is a significant risk that she will be asked a question that she cannot ethically answer consistently with her client's instructions." In this case, the lawyer must inform the client *in advance* of the meeting as to allow the client to consider his options. This is good practice and is consistent with the requirements of Model Rules 1.4 and 2.1.[109]

What if the lawyer makes a true *statement but* omits *other "material" information?*

In this elaboration, the lawyer does not mention Loan 9 but knows that, in the particular context, that omission is likely to mislead the bank examiners. The Committee finds this scenario troubling, as follows:

> Our conclusions respecting false statements by the lawyer extend to circumstances in which the lawyer omits mention of Loan 9, if the context is such that she knows the omission is likely to mislead the bank examiners. An omission may in a particular context be tantamount to an affirmative false statement. For example, if the lawyer knows that the examiners are unaware of Loan 9 and/or its implications for the LTOB rule, and if what she says to them affirmatively leads them to conclude that there is no such loan, or that it

---

[108] *Id.* § III, "False Statement by Lawyer" (emphases added).

[109] Model Rule 1.4, "Communication," provides:

> (a) A lawyer shall:
> (1) promptly inform the client of any decision or circumstance with respect to which the client's informed consent, as defined in Rule 1.0(e), is required by these Rules;
> (2) reasonably consult with the client about the means by which the client's objectives are to be accomplished;
> (3) keep the client reasonably informed about the status of the matter;
> (4) promptly comply with reasonable requests for information; and
> (5) consult with the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law.
> (b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

ANNOT. MRPC 57. Rule 1.0(e) provides that "informed consent" "denotes 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." ANNOT. MRPC 15.

Model Rule 2.1 provides:

> In representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client's situation.

ANNOT. MRPC 309.

> need not be aggregated, the lawyer may have violated her ethical obligation under Rule 4.1(a) not to mislead a third party. On the other hand, if the lawyer limits her statements to the question whether Loan 8 should be aggregated, and says nothing at all about any other loans, she cannot be faulted for failing to volunteer information about Loan 9 even if the examiners themselves make statements in the lawyer's presence to the effect that there are no other loans that need be aggregated. If Loan 9 has escaped the examiners' notice through no fault of the lawyer, the lawyer has no ethical obligation to dispel their erroneous impression that no such loan exists, and indeed is precluded from doing so by Rule 1.6.
>
> We stress that a lawyer's ethical obligation to disclose in this context depends upon the role she has herself played in creating any misimpression. As noted earlier, if the client does all of the talking during the examination, and the lawyer does not continue her participation in successive meetings with the examiners on these matters, she has no obligation to come forward to divulge the existence of Loan 9. *However, as the lawyer's role expands, so does her responsibility for making certain the examiners are not misled*. If she is speaking for the client, then her ethical obligations are substantially greater than if she is merely present when the client himself is speaking to the examiners.
>
> Our conclusion here does not depend upon a determination that the lawyer is acting as an "advocate" or as an "agent" for the client; rather, it is based on a purely practical analysis of what the lawyer does or says. We do not believe it helpful to make a lawyer's ethical obligation of disclosure depend upon how she or someone else may abstractly characterize her role in representing a client. Most people, including even lawyers themselves, will doubtless find it easier to decide what responsibility a lawyer had for making or reinforcing a misrepresentation by simply looking at what the lawyer said and did rather than determining what hat the lawyer was wearing when she said or did it.[110]

The key here is inquiring as to who is to blame for the examiner's erroneous assumption. The more the lawyer has to do with it, the higher the lawyer's risk.

> *What if the lawyer gave the client a written opinion and later learns that the client intends to turn it over the examiners?*

In this scenario, the lawyer had given the client a written opinion stating that the bank was not in violation of the LTOB rules. She later learns, however, that the bank plans to submit the opinion to the examiners. The Committee explains that "she would have an obligation to see that her opinion (in effect, her services) did not have the effect of assisting the client's fraudulent course of conduct." As the Committee explained:

> In ABA Formal Opinion No. 92-366, * * * the Committee expressed the view that a lawyer has an affirmative obligation to disaffirm her work product notwithstanding the dictates of Rule 1.6, if failure to do so would have the forbidden effect of lending assistance to the client's continuing or future fraud, even if such disaffirmance would have the collateral effect of inferentially revealing client confidences. However, the obligation to protect client confidences in Rule 1.6 always acts as a counterweight to the lawyer's obligation to disassociate herself from a client's fraud. Thus, before taking any steps to disaffirm the

[110] ABA Formal Op. 93-375 § IV, "True Statement by Lawyer but Omission of Other Material Information" (emphases added).

> misleading opinion, she should inform the client of her intention to do so, and give the client an opportunity not to use it.[111]

Thus, in this "nontribunal" situation, the principles underlying Rule 1.6 outweigh the lawyer's duties under Rule 4.1. This, of course, would *not* be the outcome under Rule 3.3, as the Committee expressed earlier in this Formal Opinion.[112]

> *What if the lawyer believes that Loan 9 need not be aggregated but also believes that the bank examiners would be of a contrary view?*

The Committee's opinion is that the lawyer has no ethical obligation under Rule 4.1, or any other provision of the rules, to bring the loan to the examiners' attention. As the Committee further explained:

> In deciding what her obligations may be under the ethics rules to disassociate herself from client fraud, the lawyer must be able to rely on her own informed judgment as to whether in fact such a fraud is occurring. If she has a reasonable basis for her legal conclusion, she should not be held liable for an ethical violation simply because the examiners may be of a different view. Nothing in the ethics rules requires a lawyer to bring to the attention of the examiners a violation by a client in which the lawyer has had no role. A fortiori, a lawyer has no obligation to bring to the attention of the examiners conduct the lawyer believes is not a violation, even if she has reason to believe that the examiners may be of a contrary view.[113]

VII. SPECIAL SITUATION: THE TRIPARTITE RELATIONSHIP

Litigation practitioners, regardless of whether they concentrate their practices in the area of Insurance Coverage, need to be aware of the applicability of the Model Rules and of the Restatement when there is a "third party" in the room. Such third party often is an insurance company, appearing by virtue of its defense obligations to one or more of the parties (typically, defendants), but may be a noninsurance-party indemnitor, or a surety, or other party with a stake in the outcome of the negotiations. Of special interest to practitioners in such situations, therefore, is the concern over how much, if any, control such third party can exert over how a lawyer, paid by the third party to represent one of the parties, conducts the defense of the underlying case. For convenience and ease of reading, we will assume that the tripartite relationship consists of a plaintiff (and plaintiff's counsel), the defendant insured (and its defense lawyer), and the insurer (who is paying the defense lawyer's bill).

The cases tend to divide among jurisdictions which hold that the defense lawyer has only one client—the insured—and those holding that the defense lawyer has two clients—the insured and the insurer. An example of the first is *Finley v. Home Insurance Company*, which held that "the modern view" is that "the sole client of the attorney is the insured."[114] But then there are cases referring to the insured as the "primary" client, thereby making the insurer a "secondary" client. For example, the Nevada Supreme Court held in *Nevada Yellow Cab Corporation v. Eighth Judicial District Court* that the insured was the "primary" client

[111] *Id.* § V, "The Lawyer's Written Opinion."

[112] *See supra* notes 97-102 and accompanying text.

[113] ABA Formal Op. 93-375 § VI, "The Regulators' Interpretation of the Law."

[114] Finley v. Home Ins. Co., 975 P.2d 1145 (Haw. 1998).

but the insurer also was a client as long as there was no conflict. The *Nevada Yellow Cab* court cited cases from six other jurisdictions and, on that basis, declared this rule to be the "majority rule"! [115]

In this paper, the author argues that it is irrelevant whether one practices in a so-called "one client" or "two client" jurisdiction. What matters are the applicable conflict rules in the jurisdiction, and an application of those rules to the specific facts and circumstances presented.

A. Applicability of Model Rules 1.7 and 1.8, and the Restatement § 134 to the Tripartite Relationship.

Model Rule 1.7 provides:

> (a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
>
> (1) the representation of one client will be directly adverse to another client; or
>
> (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.
>
> (b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:
>
> (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
>
> (2) the representation is not prohibited by law;
>
> (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
>
> (4) each affected client gives informed consent, confirmed in writing.[116]

Model Rule 1.8(f) provides:

> (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.[117]

Section 134 of the Restatement provides:

> (1) A lawyer may not represent a client if someone other than the client will wholly or partly compensate the lawyer for the representation, unless the client consents

[115] Nevada Yellow Cab Corp. v. Eighth Judicial Dist. Ct., 152 P.3d 737 (Nev. 2007).

[116] ANNOT. MRPC 133.

[117] ANNOT. MRPC 156.

under the limitations and conditions provided in § 122 and knows of the circumstances and conditions of the payment.

(2) A lawyer's professional conduct on behalf of a client may be directed by someone other than the client if:

(a) the direction does not interfere with the lawyer's independence of professional judgment;

(b) the direction is reasonable in scope and character, such as by reflecting obligations borne by the person directing the lawyer; and

(c) the client consents to the direction under the limitations and conditions provided in § 122.[118]

Let us consider the following hypothetical:

> Lawyer L is hired by an insurance company to defend its insured, a landlord whose tenant has slipped in a hallway and sustained injury. During preliminary investigation of the matter, L learns facts from the landlord that, if discovered by the tenant, would lead the plaintiff to amend her complaint to charge recklessness instead of negligence. Under the insurance policy there is no coverage for actions of the insured found to be reckless.[119]

And another:

> I do insurance defense work in a small northwestern city. A half dozen carriers hire me to represent insureds who get sued after auto accidents, injuries to guests in their homes, stuff like that. Almost always the insured couldn't care less about the case because the company is paying. They just care about if the premiums will go up. The policies require the insureds to cooperate, however, and they do. An insured I'll call Ed got sued when his car hit a

---

[118] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS (hereinafter RESTATEMENT) § 134 (2000). Section 122 of the RESTATEMENT provides:

> (1) A lawyer may represent a client notwithstanding a conflict of interest prohibited by § 121 if each affected client or former client gives informed consent to the lawyer's representation. Informed consent requires that the client or former client have reasonably adequate information about the material risks of such representation to that client or former client.
>
> (2) Notwithstanding the informed consent of each affected client or former client, a lawyer may not represent a client if:
>
> (a) the representation is prohibited by law;
>
> (b) one client will assert a claim against the other in the same litigation; or
>
> (c) in the circumstances, it is not reasonably likely that the lawyer will be able to provide adequate representation to one or more of the clients.

Section 121, to which Section 122 refers, provides:

> Unless all affected clients and other necessary persons consent to the representation under the limitations and conditions provided in § 122, a lawyer may not represent a client if the representation would involve a conflict of interest. A conflict of interest is involved if there is a substantial risk that the lawyer's representation of the client would be materially and adversely affected by the lawyer's own interests or by the lawyer's duties to another current client, a former client, or a third person.

[119] Hypothetical taken verbatim from GEOFFREY C. HAZARD & W. WILLIAM HODES, THE LAW OF LAWYERING § 12.14 at 12.43 (3d ed. 2004 Supp.) (hereinafter HAZARD & HODES).

> parked car, unfortunately, a high-end BMW, and caused more than $10,000 in damages. His policy is for $50,000. The company sent me the file. Then Ed told me that his daughter was driving, though he was in the car with her. No one was hurt. The thing is the daughter has no license and under the policy, the company is not liable if Ed lets an unlicensed person drive. Ed sure doesn't want the company to know what he told me. But the company hired me and has hired me for a dozen matters each year for seven or eight years now. What do I do?[120]

In both situations, the lawyer has a conflict arising out of the fact that someone other than the party being represented is the paymaster; namely, the insurer. Regardless of whether the law in the lawyer's jurisdiction regards the insurer as one of the lawyer's clients, the lawyer has a conflict.

In the first hypothetical, the conflict is a bit more subtle than in the second. In the first, the lawyer has learned from the insured client facts that might lead the plaintiff to amend her complaint to add a count for recklessness, either dropping the negligence count altogether or leaving it intact. At this juncture, however, the lawyer does not know what the plaintiff knows, and is under no duty to disclose those facts to the plaintiff. At this point, then, there is no conflict because all three parties to the tripartite relationship—the insured, the insurer, and the lawyer—share the same interest: defeat the tenant's claim. But if the tenant plaintiff does amend her complaint, then the insured landlord and the insurer's interest diverge because of the possibility of a verdict based on negligence versus recklessness. Professors Hazard and Hodes provide the following analysis of the problem:

> L [the lawyer], who has the most knowledge about the facts and also the best understanding of the significance of those facts, has no coherent way to choose a litigating tactic. The landlord is her client and deserves a defense that will minimize the risk that the plaintiff will prevail on a recklessness theory. The insurance company is either a co-client or at least a party with a special relationship to L and also has a contractual relationship with L that requires L's best efforts to protect the carrier. When coverage itself is at issue, the conflict of interest is so severe that may courts require the carrier to pay for separate counsel for the insured.[121, 122]

Professors Hazard and Hodes correctly identify the problem for the lawyer. Either the insurer is a co-client or has a "special relationship" to the lawyer. That problem is the precise reason why the question of whether the lawyer practices in a one-client or two-client jurisdiction is irrelevant.

---

[120] Hypothetical taken verbatim from STEPHEN GILLERS, REGULATION OF LAWYERS: PROBLEMS OF LAW AND ETHICS 270-71 (9th ed. 2012).

[121] HAZARD & HODES § 12.14 at 12-44. At this point in the referenced text, the editors offer the following at their footnote 1: "See, for example, Douglas Richmond, *Lost in the Eternal Triangle of Insurance Defense Ethics*, 9 GEO. J. LEGAL ETHICS 475 (1996), written by a practitioner specializing in insurance defense work. In Eric Holmes, *A Conflicts-of-Interest Roadmap for Insurance Defense Counsel: Walking an Ethical Tightrope Without a Net*, 26 WILLAMETTE L. REV. 1 (1989), the author discussed how the conflicts inherent in 'eternal triangle' situations manifest themselves at various stages of the typical third party insurance case. Professor Homes, co-author of a leading insurance law text, referred to the lawyer, the insurer, and the insured as a 'triumvirate.' "

[122] On the subject of the right of the insured to separate counsel, who gets to select such counsel, and how much the insurer may be required to pay for such counsel, *see* D. B. Applefeld, J. James Cooper, S. J. Field & R. Garcia, Jr., *Independent Defense Counsel: When Can The Policyholder Select Its Own Defense Lawyer and How Much Does the Insurer Have to Pay?: A 50-State Survey*, (2010, edited and revised by Neil B. Posner, 2013, 2014 and 2017), available from this paper's author.

According to the Professors, the conflict arises thus:

> Paradoxically, the situation can become analytically simpler if L *ignores* the potential interests of the insurer and fully accepts the proposition that the insured is her *only* client. She does the job she was paid to do, which is to defend the insured. If the defense is successful, the client is pleased, and the company is not hurt, for it has lost only the expenses of litigation, which it was contractually obligated to provide in any event. If the plaintiff is unable to show recklessness, but wins on a theory of simple negligence, the company still has not been hurt, and the insured has again received the contracted-for defense. If the plaintiff is able to show recklessness, the client has been adequately represented in a losing cause, and the insurer again has not been hurt, for it would have had to provide the insured with a defense in any event, and its liability under the policy remains to be determined.
>
> To carry through on this analysis, L must firmly put out of her mind the possibility that the insurance company will retaliate for her failure to disclose the possibility of noncoverage. She must be prepared to justify herself to the company, if necessary, on the ground that the company had no right to the information, for she was never *its* lawyer. This touchy point also accentuates the hidden conflict of interest that underlies all insurance defense cases: that lawyers in L's position will *not* properly represent the insured, because they are attempting to curry favor with the insurer, which is much more likely than the insured to be a "repeat player." This conflict (which is not triangular at all, but involves the lawyer and her client only) is so pervasive that it is the subject of one of the special purpose conflict rules—Rule 1.8(f).
>
> The case would be completely different, of course, if L concluded that the insured was trying to commit a fraud upon the insurance company by conniving with a friendly plaintiff or otherwise. In that event L could not represent the insured at all, for the representation would constitute aiding a fraud, which is prohibited by Rule 1.2(d) [internal citation omitted]. Whether L should then simply withdraw from representing the insured or should also make revelation to the intended victim of the fraud upon withdrawal are questions treated under Model Rules 1.6 (confidences) and 1.16 (withdrawal) [internal citations omitted].[123]

The Professors are correct: whether the insurer is a co-client or simply part of a "special relationship," the lawyer in the first hypothetical has a conflict of interest arising out of the possibility of a verdict based on a noncovered ground: recklessness. In such a case, the insurer wins if the lawyer's trial skills result in a defense verdict, but also wins if the plaintiff proves that the insured was reckless. Either way, the insurer only is liable for defense costs. And, in some jurisdictions, the insurer may even be able to recover defense costs if liability attaches on a noncovered ground.[124] In such a situation, the insured wins only if there is a verdict for the defense.

If the insurer is a client, then the two clients are directly adverse, thereby creating a concurrent conflict of interest under Model Rule 1.7(a)(1). If the insurer is not a client, then the fact that the lawyer has a "special relationship" with the insurer—by virtue of the simple fact that the insurer is more likely than the insured to be a "repeat player"—then Model Rule 1.7(a)(2) is implicated because there is a "significant risk that the

---

[123] HAZARD & HODES § 12.14 at 12-44 to 12-45 (emphases in original).

[124] *See*, *e.g.*, Buss v. Superior Court, 16 Cal. 4th 35, 939 P.2d 766, 65 Cal. Rptr. 2d 366 (1997) (insurer could seek reimbursement for costs incurred in defending those claims in underlying action that were not even potentially covered by its policy; insurer would be entitled to reimbursement if it could show by preponderance of the evidence that specific costs could be allocated solely to those claims). *Buss* is a controversial decision and is widely criticized.

representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer." Here, the "significant risk" arises from the lawyer's responsibilities to the insurer if the insurer is a co-client. But if the insurer is *not* a co-client, then the "significant risk" arises from the lawyer's responsibilities to a third person (the insurer) or by the lawyer's personal interest; namely, the desire to keep getting files from the insurer.

Further, the fact that the lawyer is paid by the insurer explicitly implicates Model Rule 1.8(f), which *prohibits* a lawyer from accepting compensation from a third party for representation of a client other than the payer of compensation *unless* all three of the rule's conditions are met: (1) that the client has given informed consent;[125] (2) the third-party payer does not interfere with the representation or with the client-lawyer relationship; and (3) the lawyer continues to observe the confidentiality rule provided for in Model Rule 1.6.

Thus, even if the insurer is a co-client, the lawyer cannot allow those of the insurer's interests that diverge from the insured's interests to interfere with the lawyer's obligations to the insured. If she does, she has violated Model Rules 1.7 and 1.8.

With respect to the second hypothetical—where the insured has disclosed to the lawyer that an uninsured driver was driving the car—there certainly is a conflict, but the lawyer's duties to avoid assisting a client in the perpetration of a fraud arguable supersedes the problem caused by the conflict. In the case of the second hypothetical, Model Rules 1.2(d), 1.6, and 1.16, at a minimum, come into play.

Model Rule 1.2(d) provides:

> A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.[126]

Model Rule 1.6(b) provides the following exceptions to the duty to protect a client's confidences, which may be implicated by this hypothetical:

> (b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:
>
> (1) to prevent reasonably certain death or substantial bodily harm;
>
> (2) to prevent the client from committing a crime or fraud that is 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;
>
> (3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services;
>
> (4) to secure legal advice about the lawyer's compliance with these Rules;
>
> (5) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim

[125] Model Rule 1.0(e) provides that " 'Informed consent' denotes 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." ANNOT. MRPC 15.

[126] ANNOT. MRPC 31.

against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client;

(6) to comply with other law or a court order; or

(7) to detect and resolve conflicts of interest arising from the lawyer's change of employment or from changes in the composition or ownership of a firm, but only if the revealed information would not compromise the attorney-client privilege or otherwise prejudice the client.[127]

And Model Rule 1.16 provides the grounds for mandatory and permissive withdrawal from a representation:

(a) Except as stated in paragraph (c), a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if:

(1) the representation will result in violation of the Rules of Professional Conduct or other law;

(2) the lawyer's physical or mental condition materially impairs the lawyer's ability to represent the client; or

(3) the lawyer is discharged.

(b) Except as stated in paragraph (c), a lawyer may withdraw from representing a client if:

(1) withdrawal can be accomplished without material adverse effect on the interests of the client;

(2) the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent;

(3) the client has used the lawyer's services to perpetrate a crime or fraud;

(4) the client insists upon taking action that the lawyer considers repugnant or with which the lawyer has a fundamental disagreement;

(5) the client fails substantially to fulfill an obligation to the lawyer regarding the lawyer's services and has been given reasonable warning that the lawyer will withdraw unless the obligation is fulfilled;

(6) the representation will result in an unreasonable financial burden on the lawyer or has been rendered unreasonably difficult by the client; or

(7) other good cause for withdrawal exists.

(c) A lawyer must comply with applicable law requiring notice to or permission of a tribunal when terminating a representation. When ordered to do so by a tribunal, a lawyer shall continue representation notwithstanding good cause for terminating the representation.

(d) Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client's interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled and refunding any advance payment of fee or expense that has not been earned or incurred. The lawyer may retain papers relating to the client to the extent permitted by other law.[128]

Thus, while Model Rule 1.2(d) would permit the lawyer to "discuss the legal consequences of any proposed course of conduct with [the] client," in the event the lawyer is unable to persuade the insured to tell the truth (that his unlicensed daughter was driving), then she would be required to withdraw under Model Rule

[127] ANNOT. MRPC 101.

[128] ANNOT. MRPC 273-74.

1.16(a)(1) as to avoid violating the law, or other of the Model Rules (such as the Model Rule regarding Candor Before a Tribunal).

A more vexing question for the lawyer might be this: Can she counsel the client about the client's duties to tell the truth while the lawyer is being paid by the insurance company, who certainly will benefit if the lawyer succeeds? Does that question alone give rise to a conflict of interest? If she were to withdraw at this juncture, what signal would that send to the insurance company? To the plaintiff? Once she learns about the unlicensed daughter, can her withdrawal be other than a "noisy" one? If the insurer already was aware of the potential for a verdict on noncovered grounds, the insurer could file a declaratory judgment action seeking a declaration of no duty to defend, or agree to defend under a reservation of rights. If the insurer chooses the second option, the laws of most jurisdictions would allow the insured to employ counsel of his choosing.

But, in this hypothetical, the insurer does *not* know; only the lawyer chosen by the insurance company knows! In that case, the lawyer already is in possession of information protected by Model Rule 1.6; she cannot disclose it, at least not before she tries to persuade the client to tell the truth. If the client fails to do so, can the lawyer withdraw at that point? What if she has doubts about the client's story? Is it possible that he really was the driver and is trying to shift the blame to his daughter for other reasons? Suppose the plaintiff never discovers, or even asks, who was driving the car? Would withdrawing at this point send a signal to the plaintiff that the plaintiff might never have thought about in the absence of the withdrawal?

These are the kinds of questions that render the "one client" versus "two client" distinction irrelevant. Regardless of jurisdiction, the analysis must always proceed under the Rules of Professional Conduct applicable in the lawyer's jurisdiction.

With respect to the first hypothetical, it has been suggested that Restatement § 134 provides a bit of a middle ground. As Professors Hazard and Hodes explain:

> Section 134(1) of the Restatement of the Law Governing Lawyers covers essentially the same ground as Model Rule 1.8(f) [internal citation omitted]. It permits a lawyer to accept compensation for representing a client from a third party, but only if the client has given informed consent. This is appropriately responsive to the undeniable risk that a lawyer might be tempted to tailor the representation to advance the interests of the payor rather than the one actually receiving the services. [Internal citations omitted].
>
> Recognizing the realities of practice, however, and especially the realities of liability insurance contracts, Restatement § 134(2) diverges from Rule 1.8(f) and permits the third party to "direct" the lawyer's conduct of the representation, if the direction is "reasonable in scope and character," and if the client consents a second time. So limited, this provision is not only realistic but sensible, because there are many situations in which the legitimate interests of the third party may be served *without* damage to the interests of the client. For example, a lawyer designated by a liability insurance carrier to represent a policyholder might be able to accept the carrier's directions to reduce defense costs by 20% in a matter, while still keeping any verdict or settlement within policy limits.
>
> As an added safeguard, the Restatement section was amended by the members of the American Law Institute to further limit the "directions" that a lawyer may accept from a nonclient payor, by resurrecting the language from Model Rule 1.8(f) respecting "interference with the lawyer's independence of professional judgment." This amendment was in response to critics who asserted that to allow the insurer to "direct" the lawyer in *any* way, as permitted by § 134 both before and after the last revision, would *necessarily* interfere

> with the lawyer's traditional concern for client interests. The drafters of § 134 insisted that they had already taken this concern into account, because any *acceptable* "direction" would *presuppose* that the lawyer was exercising independent professional judgment on behalf of the client-insured.[129]

It is difficult for this author to see how the Restatement provides much guidance to practicing lawyers, whether they are acting in the capacity of defense counsel or of coverage counsel. Firstly, the Restatement only has been cited in a small number of jurisdictions, so it hardly can be said to be controlling authority elsewhere.[130] Further, it is comment *f* to Section 134 that explicitly applies to the tripartite relationship, and it hardly can be said to provide support for an approach not otherwise provided for in the Model Rules, or under the Rules of Professional Conduct in the lawyer's particular jurisdiction:

> *f. Representing an insured*. A lawyer might be designated by an insurer to represent the insured under a liability-insurance policy in which the insurer undertakes to indemnify the insured and to provide a defense. The law governing the relationship between the insured and the insurer is, as stated in Comment *a*, beyond the scope of the Restatement. Certain practices of designated insurance-defense counsel have become customary and, in any event, involve primarily standardized protection afforded by a regulated entity in recurring situations. Thus a particular practice permissible for counsel representing an insured may not be permissible under this Section for a lawyer in noninsurance arrangements with significantly different characteristics.
>
> It is clear in an insurance situation that a lawyer designated to defend the insured has a client-lawyer relationship with the insured. The insurer is not, simply by the fact that it designates the lawyer, a client of the lawyer. Whether a client-lawyer relationship also exists between the lawyer and the insurer is determined under § 14. Whether or not such a relationship exists, communications between the lawyer and representatives of the insurer concerning such matters as progress reports, case evaluations, and settlement should be regarded as privileged and otherwise immune from discovery by the claimant or another party to the proceeding. Similarly, communications between counsel retained by an insurer to coordinate the efforts of multiple counsel for insureds in multiple suits and such coordinating counsel are subject to the privilege. Because and to the extent that the insurer is directly concerned in the matter financially, the insurer should be accorded standing to assert a claim for appropriate relief from the lawyer for financial loss proximately caused

---

[129] HAZARD & HODES § 12.15 at 12-45 to 12-46 (emphases in original).

[130] As of this writing, the cases citing Restatement § 134 are: U.S. v. Pizzonia, 415 F. Supp. 2d 168, 185 (E.D.N.Y. 2006) (subsection (1) quoted in discussion); State and County Mut. Fire Ins. Co. v. Young, 490 F. Supp. 2d 741, 747 (N.D. W. Va. 2007) (comment *f* quoted in case and in support, although § 134 is erroneously cited in the decision as "§ 14"); Zurich Am. Ins. Co. v. Super. Ct., 155 Cal. App. 4th 1485, 1500, 66 Cal. Rptr.3d 833, 843 (2007) (comment *f* quoted in support); Clukey v. Sweeney, 112 Conn. App. 534, 545, 963 A.2d 711, 717 (2009) (subsection (1) cited in discussion); *In re* Rules of Professional Conduct and Insurer Imposed Billing Rules and Procedures, 299 Mont. 321, 2 P.3d 806, 813, 814 (2000) (quoted in discussion, comment *f(5)* quoted in discussion; holding that any restrictions imposed by the insurer would constitute interference with the defense lawyer's duties in violation of the Rules of Professional Conduct); Unauthorized Practice of Law Committee v. Am. Home Assur. Co., Inc., 261 S.W.3d 24, 42 (Tex. 2008) (quoted in footnote); Juneau County Star-Times v. Juneau County, 345 Wis. 2d 122, 2013 WI 4, 824 N.W.2d 457, 466 (Wis. 2013) (comment *f* quoted in footnote); Armijo v. Flansas, No. 17-CV-665 WJ-JHR, 2017 WL 6001768, *5 (D.N.M. Dec. 4, 2017); Bell v. Ramirez, No. 13 Civ. 7916 (PKC)(HBP), 2017 WL 4296781, *2 (S.D.N.Y. Sept. 26, 2017); Hansen v. State Farm Mut. Auto. Ins. Co., No. 2:10-cv-014343-MMD-RJJ, 2012 WL 6205722, *8 (D. Nev. Dec. 12, 2012).

by professional negligence or other wrongful act of the lawyer. Compare § 51, Comment *g*.

The lawyer's acceptance of direction from the insurer is considered in Subsection (2) and Comment *d* hereto. With respect to client consent (see Comment *b* hereto) in insurance representations, when there appears to be no substantial risk that a claim against a client-insured will not be fully covered by an insurance policy pursuant to which the lawyer is appointed and is to be paid, consent in the form of the acquiescence of the client-insured to an informative letter to the client-insured at the outset of the representation should be all that is required. The lawyer should either withdraw or consult with the client-insured (see § 122) when a substantial risk that the client-insured will not be fully covered becomes apparent (see § 121, Comment *c(iii)*).

Illustration: 5. Insurer, a liability-insurance company, has issued a policy to Policyholder under which Insurer is to provide a defense and otherwise insure Policyholder against claims covered under the insurance policy. A suit filed against Policyholder alleges that Policyholder is liable for a covered act and for an amount within the policy's monetary limits. Pursuant to the policy's terms, Insurer designates Lawyer to defend Policyholder. Lawyer believes that doubling the number of depositions taken, at a cost of $5,000, would somewhat increase Policyholder's chances of prevailing and Lawyer so informs Insurer and Policyholder. If the insurance contract confers authority on Insurer to make such decisions about expense of defense, and Lawyer reasonably believes that the additional depositions can be forgone without violating the duty of competent representation owed by Lawyer to Policyholder (see § 52), Lawyer may comply with Insurer's direction that taking depositions would not be worth the cost.

Material divergence of interest might exist between a liability insurer and an insured, for example, when a claim substantially in excess of policy limits is asserted against an insured. If the lawyer knows or should be aware of such an excess claim, the lawyer may not follow directions of the insurer if doing so would put the insured at significantly increased risk of liability in excess of the policy coverage. Such occasions for conflict may exist at the outset of the representation or may be created by events that occur thereafter. The lawyer must address a conflict whenever presented. To the extent that such a conflict is subject to client consent (see § 122(2)(c)), the lawyer may proceed after obtaining client consent under the limitations and conditions stated in § 122.

When there is a question whether a claim against the insured is within the coverage of the policy, a lawyer designated to defend the insured may not reveal adverse confidential client information of the insured to the insurer concerning that question (see § 60) without explicit in-formed consent of the insured (see § 62). That follows whether or not the lawyer also represents the insurer as co-client and whether or not the insurer has asserted a "reservation of rights" with respect to its defense of the insured (compare § 60, Comment *l* (confidentiality in representation of co-clients in general)).

With respect to events or information that create a conflict of interest between insured and insurer, the lawyer must proceed in the best interests of the insured, consistent with the lawyer's duty not to assist client fraud (see § 94) and, if applicable, consistent with the lawyer's duties to the insurer as co-client (see § 60, Comment *l*). If the designated lawyer finds it impossible so to proceed, the lawyer must withdraw from representation of both clients as provided in § 32 (see also § 60, Comment *l*). The designated lawyer may be precluded by duties to the insurer from providing advice and other legal services to the insured

> concerning such matters as coverage under the policy, claims against other persons insured by the same insurer, and the advisability of asserting other claims against the insurer. In such instances, the lawyer must inform the insured in an adequate and timely manner of the limitation on the scope of the lawyer's services and the importance of obtaining assistance of other counsel with respect to such matters. Liability of the insurer with respect to such matters is regulated under statutory and common-law rules such as those governing liability for bad-faith refusal to defend or settle. Those rules are beyond the scope of this Restatement (see Comment *a* hereto).[131]

What comment *f* does support, however, is the irrelevance of the one-client/two-client distinction. In all cases, the lawyer's duties are to be governed by the Rules of Professional Conduct (and the cases and ethics opinions interpreting them) in the lawyer's particular jurisdiction.

VIII. CONCLUSION

The obligations imposed upon lawyers by the various Model Rules raises the stakes for lawyers engaging in negotiations, which is to say: Most Lawyers!

Determining first whether the situation is before a tribunal will help to clarify the analysis that must follow. In such situations, the higher duty of candor applies. What constitutes candor in a particular jurisdiction may require further research, but at least the lawyer is somewhat better informed as to the nature of the search.

In matters not before a tribunal and, therefore, subject to the murkier obligations under Rule 4.1, the questions become harder to articulate, let alone answer. Keeping in mind that it is never permissible to lie about a material fact, or to fail to speak up when not doing so would assist a client in committing a criminal or fraudulent act, are keys to lowering the risk of practicing in this arena.

Additionally, lawyers practicing in situations where a third-party payer (such as an insurance company) is involved, must give strong consideration to circumstances where the lawyer representing the client whose fees are being paid for by someone else, may have a conflict of interest between the client, whom she represents, and the "paymaster" who is paying her fee. All lawyers involved in such situations must analyze the Rules of Professional Conduct applicable in their jurisdictions that likely are to apply, especially Model Rules 1.7, 1.8, 1.2, 1.6, and 1.16, and the cases and ethics opinions interpreting them. To the extent that the Rules, cases and ethics opinion in the particular jurisdiction are not helpful, Restatement § 134, and comment *f* thereunder, should be consulted.

Finally, it is critical to remember that Model Rules 3.3 and 4.1 impact upon a lawyer's duties under Rule 1.6 differently and are certain to lead to different outcomes.

[131] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 134 cmt. *f*. (2000).

"Allocation—Is That a Thing?"—Navigating Disputes Over Allocation Between Covered and Uncovered Claims

American College of Coverage Counsel
2019 Annual Meeting

Chicago, IL
May 8-10, 2019

Franklin D. Cordell
Gordon Tilden Thomas & Cordell LLP
Seattle, WA

James W. Bryan
Nexsen Pruet
Greensboro, NC

Michael A. Hamilton
Goldberg Segalla
Philadelphia, PA

Suzan F. Charlton
Covington & Burling LLP
Washington, DC

I. Introduction—The Recurring Complication of Allocation Between Covered and Uncovered Claims

Policyholders who find themselves on the receiving end of a lawsuit universally have the same question for their lawyer: "Does our insurance cover this?" Coverage lawyers, whether on the policyholder or insurer side of the fence, know this question rarely has a simple "yes or no" answer. Many underlying lawsuits—particularly commercial litigation of any complexity—include some claims that are clearly covered and some that are not. Common fact patterns include:

- A lawsuit against a professional—lawyer, architect, or engineer—that asserts garden-variety claims of professional negligence, but also alleges overbilling and fraud.

- A consumer class action against a service provider that alleges potentially covered claims for negligence, but also seeks excluded punitive damages and damages that may fall within the "return of profit or advantage" exclusion from D&O coverage.

- A lawsuit against an insured corporation, along with co-defendants—individuals or affiliated businesses—that are not insureds. However, the interests of all the defendants are aligned and all are represented by the same counsel.

- An environmental contamination suit against an insured property owner, who then asserts counterclaims and third-party contribution claims against other neighbors and predecessor owners who contributed to the contamination.

Often, the uncovered nature of certain of the causes of action is not disputed; some claims, such as a claim for fraud that is tried to a plaintiff's verdict, simply are not covered. The source of frequent disputes in such "mixed" actions instead is over the practical effect of the presence of uncovered claims—that is, under what circumstances may costs be allocated to the uncovered claims, therefore to be borne by the insured? The conflict can arise both with respect to defense costs and liability resulting from a settlement agreement or judgment.

The law governing allocation between covered and uncovered claims or entities—including whether allocation is permitted at all, who bears the burden of proof if it is, and what methods insurers may use to seek allocation—varies substantially among the states. Further, in recent years insurers have increasingly introduced policy terms that expressly address allocation of coverage in mixed actions. This paper summarizes the competing approaches in the courts, examines the emerging policy terms addressing allocation, and discusses practical strategies for coverage counsel faced with allocation disputes

II. Allocation of Defense Costs

A. General Rule: No "Real-Time" Allocation of Defense Costs Between Covered and Uncovered Claims

Courts in most jurisdictions have adopted a *per se* rule that the insurer must provide a complete defense in a mixed action against the insured. *See First Newton Nat. Bank v. General Cas. Co. of Wisconsin*, 426 N.W.2d 618, 630 (Iowa 1988) ("We think the majority rule is the better one. It assures that the insured will have a coherent, coordinated defense aimed at defeating all of the claims, rather than separate defenses that might work at cross purposes, since the insurer will be interested primarily in defeating the covered claims."); *Presley Homes, Inc. v. American*

States Ins. Co., 90 Cal.App.4th 571, 575, 108 Cal.Rptr.2d 686 (4th Dist. 2001) ("It is settled that where an insurer has a duty to defend, the obligation generally applies to the entire action, even though the suit involves both covered and uncovered claims, or a single claim only partially covered by the policy."); *Fire Ins. Exch. v. Bentley*, 953 P.2d 1297, 1300 (Colo.App.1998) ("The insurer must defend against all claims as long as any one of them is arguably covered under the policy."); *Category 5 Mgmt. Group, LLC v. Companion Property and Cas. Ins. Co*., 76 So.3d 20, 23 (Fla. App. 2011) ("If the complaint alleges facts partially within and partially outside the coverage of the policy, the insurer is obligated to defend the entire suit."); 14 *Couch on Insurance* § 200:25, n.2 (3rd Ed. 2018) ("*Couch*") (collecting cases).

A small minority of jurisdictions give insurers at least a potential to allocate defense costs to uncovered claims, and thereby pay less than the full cost of the defense on an ongoing basis, *i.e*., during the pendency of the underlying claim. New Jersey law is the most insurer-friendly on this point. *Passaic Valley Sewerage Comm'rs v. St. Paul Fire and Marine Ins. Co.*, 206 N.J. 596, 21 A.3d 1151, 1162-63 (2011) ("When a complaint includes both covered and uncovered counts the carrier may refuse defense on the uncovered counts and dispute coverage."); *see also* 14 *Couch* § 200:25, n.3 (collecting cases).

The State of Washington theoretically allows insurers to provide less than a full defense in mixed actions. In *Bordeaux, Inc. v. American Safety Inc. Co.*, 145 Wn. App. 687, 186 P.3d 1188, 1193 & n.20 (2008), Washington's intermediate appellate court held that "[n]o right of allocation exists for the defense of non-covered claims that are reasonably related to the defense of covered claims." (Citation and internal quotations omitted.) However, the "reasonably related" test means the right rarely can actually be invoked. It is difficult to imagine a case in which the various causes of action against the insured are so varied or unrelated that the associated defense costs are not "reasonably related."

B. Not So Fast: Jurisdictions Requiring Full Defense of Mixed Actions, But Allowing Post-Claim Recoupment of Certain Defense Costs

The group of issues that has come to be identified by the term "allocation" is most often thought of as arising in "real time," that is, during the pendency of the underlying case. However, a number of jurisdictions—probably a narrow majority—have adopted a rule that permits allocation of defense costs, but shifts the timing of that allocation to after the conclusion of the underlying action. In these jurisdictions, the insurer must defend the entire mixed action, but retains a right to seek recoupment of defense costs associated with uncovered claims. This is essentially a compromise position:

- The policyholder gets the benefit of a full defense but may have to face a recoupment claim at the end of the underlying case;

- The insurer must defend even potentially uncovered claims, but retains a right to allocate to the policyholder at the end of the day (meaning the insurer "fronts" defense costs and faces the risk that the policyholder will be unable to repay any defense costs, no matter how strong the recoupment claim might be).

The seminal decision allowing recoupment of defense costs[1] is that of the Supreme Court of California in *Buss v. Superior Court*, 16 Cal.4th 35, 939 P.2d 766, 65 Cal.Rptr.2d 366 (1997). In *Buss*, the court attempted to strike a balance between preserving the value of the duty to defend, on the one hand, while avoiding imposing on the insurer an obligation that is absent from the insurance contract. The court first explained that the insurer's strict contractual obligation to defend does not extend to uncovered claims; rather, California's rule requiring the insurer to defend a mixed action in its entirety is extracontractual:

> We cannot justify the insurer's duty to defend the entire "mixed" action contractually, as an obligation arising out of the policy, and have never even attempted to do so. To purport to make such a justification would be to hold what we cannot—that the duty to defend exists, as it were, in thin air, without regard to whether or not the claims are at least potentially covered. As stated, the duty to defend goes to any action seeking damages for any covered claim. If it went to an action *simpliciter*, it could perhaps be taken to reach the action *in its entirety*. But it does not. Rather, it goes to an action *seeking damages for a covered claim*. It must therefore be read to embrace the action *to the extent that it seeks such damages*. So read, it accords with the general rule . . . that the insurer has a duty to defend as to the claims that are at least potentially covered, but not as to those that are not. . . .
>
> That being said, we can, and do, justify the insurer's duty to defend the entire "mixed" action prophylactically, as an obligation imposed by law in support of the policy. To defend meaningfully, the insurer must defend immediately. To defend immediately, it must defend entirely. It cannot parse the claims, dividing those that are at least potentially covered from those that are not. To do so would be time consuming. It might also be futile: The "plasticity of modern pleading" allows the transformation of claims that are at least potentially covered into claims that are not, and vice versa.

Buss, 16 Cal.4th at 48 (citations omitted; emphasis in original).

The court went on to balance this extracontractual benefit to the policyholder by granting the insurer a right to seek recoupment of defense costs after the conclusion of the case:

> As to the claims that are at least potentially covered, the insurer may not seek reimbursement for defense costs. . . . . As to the claims that are not even potentially covered, however, the insurer may indeed seek reimbursement for defense costs.
>
> The reason is this. Under the policy, the insurer does not have a duty to defend the insured as to the claims that are not even potentially covered. With regard to defense costs for these claims, the insurer has not been paid premiums by the insured. It

[1] The law under discussion in this section addresses whether an insurer may recoup defense costs where the insurance policy at issue contains no term expressly allowing recoupment. As discussed below, pp. 6-9, insurers are increasingly including such terms in D&O and other liability policies.

> did not bargain to bear these costs. To attempt to shift them would not upset the arrangement. The insurer therefore has a right of reimbursement that is implied in law as quasi-contractual, whether or not it has one that is implied in fact in the policy as contractual.

Id. at 50-51 (citations omitted).

The standard for determining what defense costs may be recouped has limited the practical impact of *Buss* recoupment claims. The court held that the insurer may recoup "[d]efense costs that can be allocated solely to the claims that are not even potentially covered." *Id.* at 52. The "solely" standard often will require a highly fact-driven analysis of defense tasks that may, in practice, have related to multiple claims in the mixed action. The insurer, as the party desiring relief, must carry the burden of proving which claims relate solely to claims that are not even potentially covered. *Id*. at 53.

Other jurisdictions, whether adopting the precise reasoning in *Buss* or otherwise, allow post-defense recoupment of defense costs. *See e.g., Cincinnati Ins. Co. v. Grand Pointe, LLC*, 501 F.Supp.2d 1145 (E.D.Tenn. 2007) (Tennessee law: reimbursement of defense costs permitted even though no policy provision allowed it where insurer's reservation of rights letter adequately reserved right to seek recoupment); *Hebela v. Healthcare Ins. Co*., 851 A.2d 75, 86 (N.J. App. Div. 2004) (right to recoup defense costs because policyholder would be unjustly enriched in benefiting by a defense for which it did not pay); *Sec. Ins. Co. of Hartford v Lumbermens Mut. Cas. Co*., 826 A.2d 107, 124 (Conn. 2003) (recoupment allowed in order to prevent policyholder from receiving a windfall); *Blue Ridge Ins. Co. v. Jacobsen*, 25 Cal.4th 489, 504 (2001) ("a reimbursement right is implicit in the policy terms which provide indemnification only for covered claims") (emphasis in original).

On the other hand, jurisdictions ruling in favor of the policyholder and denying recoupment typically cite some or all of the following grounds:

- Most policies contain no term specifically allowing reimbursement of defense costs.
- That being the case, as a matter of basic principles of contract, insurers cannot unilaterally modify and change policy terms in a reservation of rights letter.
- Recover in unjust enrichment is unwarranted because the insurer undertakes the defense of the insured to protect itself as much as it is protecting the insured.

See e.g., Westchester Fire Ins. Co. v. Wallerich, 563 F.3d 707 (8th Cir. 2009) (Minnesota law: recoupment of defense costs can only occur if such a right is expressly identified in the insurance policy; a reservation of rights can only retain defenses); *Perdue Farms, Inc. v. Travelers Cas. & Sur. Co. of America*, 448 F.3d 252 (4th Cir. 2006) (Maryland law: to allow recoupment would improperly narrow an insurer's broad duty to defend); *General Agents Ins. Co. of America, Inc. v. Midwest Sporting Goods Co*., 828 N.E.2d 1092 (Ill. 2005) (unilateral reservation of rights by insurer cannot create rights not contained in insurance policy; no unjust enrichment either because insurer defends to protect itself at least as much as it is protecting the insured); *Shoshone First Bank v. Pacific Employers Ins. Co*., 2 P.3d 510 (Wyo. 2000) ("no indication in the policy of any distinction to be made between covered and non-covered claims so far as the defense of those claims [are] concerned, and we will not permit the policy to be modified by subsequent letters from the insurer to the insured"); *National Surety Corp. v. Immunex Corp*, 176 Wn.2d 872, 884, 97 P.3d 688 (2013) ("Disallowing reimbursement is most

consistent with Washington cases regarding the duty to defend, which have squarely placed the risk of the defense decision on the insurer's shoulders.").

C. Allocation Between Covered and Uncovered Entities That Are Jointly Represented

Most of the case law on allocation of defense costs concerns actions involving covered and uncovered causes of action against a clearly insured defendant. However, a not-uncommon variant of the allocation debate can arise where an insured defendant has co-defendants that are not insured but share a common interest with the insured defendant and are represented by the same defense counsel as the insured defendant. In such cases, the policyholder will argue that no defense costs are allocable to the uncovered defendants.

The decision of the U.S. District Court for the Southern District of New York in *High Point Design, LLC v. LM Ins. Corp.*, 2016 WL 426594 (S.D.N.Y., Feb. 3, 2016), addressed this fact pattern, and the decision provides a useful survey of the applicable case law. The insured and insurer in that case agreed that defense costs that were incurred "solely in defense of" the uninsured parties were not covered (a concession that not all insured would make, depending upon the jurisdiction). The battleground in the case instead was over the category of defense costs that were not "solely" attributable to the non-insured defendants, but rather "redounded to the benefit of both" the insured and uninsured entities. *Highpoint Design*, 2016 WL 426594, *3. The insured argued that such costs were entirely covered, and the insurer argued that such costs should be allocated on a pro rata basis among the four benefitted parties (i.e., the insured defendant and the three non-insured co-defendants.) *Id.*

After surveying the case law in support of both positions, the court observed that the insured had "the support of more and better-reasoned case law." *Id.* The court held, first, that because the insured had made a prima facia showing that the costs in question were incurred, at least in part, to benefit the defense of the insured, the burden of allocation away from the insured fell on the insurer. *Id.* at *4. Second, the court rejected pro rata allocation, in favor of a fact-specific, "but for" analysis:

> [t]he amount that should be allocated to the non-covered parties, and thus not recouped from the insurer, are any additional expenses which would not have occurred but for the inclusion of the non-covered defendants. *Id.* at *4 (internal quotation and citation omitted.)

The court concluded by suggesting that the insurer might have a right of contribution against the non-insured entities or their insurers; any such claims would not reduce the coverage afforded to the insured party: "there is no support in precedent or logic by which an insurer's obligation to defend its insured is steadily diminished as the insured's opponent in the underlying action adds parties to the insured's side of the caption." *Id.*

D. Can the Costs of Related Counterclaims and Third-Party Claims Constitute Defense Costs? If Not, Are Such Costs Allocable to the Insured?

Another variant of the allocation debate involves situations in which the insured defendant seeks coverage for the costs of prosecuting affirmative claims, *i.e.*, counterclaims or third-party claims related to the original action. Insurers typically take the position that the costs of pursuing such affirmative claims are not covered because they are not, literally, the costs of defending against a claim. What appears to be a majority of the courts that have squarely considered the matter

have adopted this position. *See Mount Vernon Ins. Co. v. Visionaid, Inc.*, 477 Mass. 343, 76 N.E.3d 204, 209-10 (2017) (collecting cases); *Aldous v. Darwin National Assurance Co*., 851 F.3d 473, 483 (5th Cir. 2017) (applying Texas law) (holding no duty to prosecute helpful or inextricably intertwined affirmative claims); *Shoshone First Bank v. Pacific Employers Ins. Co*., 2 P.3d 510, 516 (Wyo. 2000) ("We accept the general premise that '[a]n insurer, being obligated to defend claims "against" the insured, is not required to bear the cost of prosecuting a counterclaim on behalf of the insured'")

On the other hand, policyholders counter that, in many cases, the assertion of counterclaims or third-party claims is fundamentally defensive in nature, in that its affirmative claims are related to the covered defense and designed to offset the original defendant's liability, which benefits the defense effort. Many courts have accepted that view. *See Visionaid*, 76 N.E.3d at 210 (citing cases). The rationale of such decisions is typified by that of the court in *Potomac Elec. Power Co. v. California Union Ins. Co*., 777 F. Supp. 980, 984 (D.D.C. 1991): the effective defense of covered claims often entails asserting counterclaims, and thus the duty to defend obligates the insurer to bring any claim that reasonable defense attorney would bring. *See also Great West Cas. Co. v. Marathon Oil Co*., 315 F. Supp. 2d 879, 882 (N.D. Ill. 2003) (applying Illinois law) (requiring insurer to fund, as cost of defense, affirmative counterclaims that would reduce insured's liability on underlying claim).

Because of the benefits of spreading the liability to co-parties, insurers sometimes agree to fund the cost of such affirmative claims for practical reasons, regardless of the state of the law. If no such agreement is reached, and the governing law does not require that the costs of affirmative claims be covered, the result is another type of mixed claim and, therefore, an allocation debate.

E. Policy Terms Expressly Addressing Apportionment of Defense Costs

The rules governing apportionment of defense costs by and large have been developed by the courts applying the plain language of the insuring agreement and "Supplementary Payments" term, and first principles. That is, insurers typically have not employed policy terms that expressly address allocation in mixed claims.

The principal exception has been D&O policy forms, most of which for many years have included a term expressly addressing allocation. A typical example is the following, from a form currently in use by Navigators Specialty Insurance Company:

> **C.** Solely with respect to all Liability Coverage Parts:
>
> If **Loss** is incurred that is partially covered and partially not covered by this Policy, either because a **Claim** made against the **Insureds** includes both covered and uncovered matters or because a **Claim** is made against both covered and uncovered parties, such **Loss** shall be allocated as follows:
>
> (1) 100% of **Costs of Defense** shall be allocated to covered **Loss**; and
>
> (2) **Loss** other than **Costs of Defense** shall be allocated between covered and non covered **Loss** based upon the relative legal exposure of the parties to such matters.

The Navigators term thus expressly requires full defense coverage of mixed claims but allows allocation of indemnity coverage, under a broad, "relative legal exposure" (aka "rough justice?") standard.

Over roughly the last decade, the authors have increasingly encountered policy terms that depart from this traditional distinction between defense and indemnity coverage for mixed claims. The following example comes from a D&O policy form in use by the ACE companies (in a form that defines "Loss" as including "Defense Costs"):

> XII. ALLOCATION
>
> A. If a Claim includes both Loss that is covered under this Policy and loss that is not covered under this Policy, either because the Claim is made against both Insureds and others, or the Claim includes both covered allegations and allegations that are not covered, the Insureds and the Insurer shall allocate such amount between covered Loss and loss that is not covered based upon the relative legal and financial exposures and the relative benefits obtained by the parties. The Insurer shall not be liable under this Policy for the portion of such amount allocated to non-covered Loss.
>
> B. If there is an agreement on an allocation of Defense Costs, the Insurer shall advance, on a quarterly basis, Defense Costs allocated to Loss. If there can be no agreement on an allocation of Defense Costs, the Insurer shall advance on a quarterly basis Defense Costs which the Insurer believes to be covered under this Policy until a different allocation is negotiated, arbitrated or judicially determined.
>
> C. Any negotiated, arbitrated or judicially determined allocation of Defense Costs on account of any Claim shall be applied retroactively to all Defense Costs on account of the Claim, notwithstanding any prior advancement to the contrary. Any allocation or advancement of Defense Costs on account of any Claim shall not apply to or create any presumption with respect to the allocation of other Loss on account of the Claim or any other Claim.

Similar terms, allowing allocation of defense costs in accordance with the relative exposure posed by the covered and uncovered claims, are increasingly common in D&O and Employment Practices Liability forms.

Further, insurers are beginning to introduce similar terms even into General Liability forms. In the wake of the decision of the Washington Supreme Court rejecting recoupment of defense costs,[2] several insurers began including the following endorsement in GL policies issued to Washington insureds:

[2] *National Surety Corp. v. Immunex Corp*., 176 Wn.2d 872, 297 P.3d 688 (2013) (rejecting *Buss*-type recoupment of defense costs under Washington law).

> WASHINGTON CHANGES – DEFENSE COSTS
>
> If we initially defend an insured or pay for an insured's defense but later determine that none of the claims, for which we provided a defense or defense costs, are covered under this insurance, we have the right to reimbursement for the defense costs we have incurred.

The insurer's ability to recoup defense costs at the conclusion of an underlying claim, under the rule established in the seminal California case *Buss v. Superior Court*, is closely related to the allocation issues that are the subject of this paper. Where an insurer is permitted to recoup costs paid in the defense of claims that are later determined to have been uncovered, the result essentially is a post-underlying claim allocation debate; the only difference is that the insurer will have advanced all of the defense costs, so that the insured need not bear any allocated share during the pendency of the underlying case.

In some jurisdictions, including Washington, the case law regarding the duty to defend suggests that the breadth and independence (from the duty to indemnify) of the duty to defend rises to the level of a matter of public policy. Such case law has given rise to policyholder arguments that policy terms requiring allocation of defense costs to uncovered claims, whether that allocation takes place "in real time" during the underlying case or afterward via *Buss*-style recoupment, are unenforceable as contrary to public policy. The above-quoted "Washington changes" endorsement recently survived a public policy challenge in federal court in Seattle, in *Massachusetts Bay Ins. Co. v. Walflor Industries, Inc.*, 2019 WL 1651659 (W.D. Wash., April 17, 2019). The policyholder will appeal that decision and is seeking to have the question certified to the Washington Supreme Court.

Regardless of the outcome of that rather rarified debate, policyholders would be well advised to be aware of what policy form they are purchasing. If they purchase a form that allows defense costs to be allocated—*i.e.*, not paid in full—they should do so with their eyes open, understanding that relatively modest savings of premium dollars may come at a hefty price in the event the insured becomes a defendant in a mixed claim.

F. Practical Strategies for Coverage Counsel

Counsel evaluating a mixed lawsuit asserted against his or her client should keep in mind the following practical points and strategies:

- Carefully review existing coverages for apportionment language. As discussed above, policies increasingly contain terms expressly addressing allocation, and for the most part, with respect to the duty to defend, allocation terms favor the insurer, particularly in jurisdictions with more policyholder-friendly common law. If allocation terms appear in the policy, counsel should evaluate whether the term is subject to challenge, on public policy or other grounds. Further, coverage counsel typically gets involved only after a dispute has arisen under an existing policy. However, the increasing use of policy terms expressly allowing allocation of defense costs presents an opportunity for counsel to add value at the time of placement or renewal. Policyholders should seek to strike such terms, or select one that expressly provides for a complete defense in mixed cases.

- If a claim arises, be aware that most sophisticated claims professionals recognize the importance of mounting an effective defense to the underlying case as a whole (and, in

many cases, that the insured might be unable to contribute meaningfully to the cost of the defense). Further, most insurers with a duty to defend, particularly under financial-lines coverages such as D&O, professional liability, and EPL, understand there is a strong presumption against allocation of defense costs to the insured. Policyholder counsel and underlying defense counsel therefore should ensure that the claims professional understands the relationship between the covered and uncovered claims, and understands how defense of the whole suit, including uncovered claims, may benefit the defense of the covered claims.

- For all these reasons, policyholder counsel should discourage or preempt requests by the insurer that defense counsel establish separate billing matters or otherwise attempt to allocate defense costs in a manner that would be contrary to the governing legal standard.

III. Allocation of Indemnity Costs

A. Legal Standard and Burden of Proof—Allocation of Settlements

1. General Rule: Insured Bears Burden of Proof

The general rule is that the policyholder bears the burden to apportion settlements that encompass a mix of claims/damages that are covered and not covered under the policy. For example, in *American Guaranty & Liability Insurance Co. v. U.S. Fire Insurance Co.*, 255 F. Supp. 3d 677 (S.D. Tex. 2017), the insured was a general contractor that was sued for damages involving faulty workmanship to a county courthouse. Some of the damages alleged against the insured were covered and others uncovered. The insured received settlement payments from subcontractors to resolve some of these claims and then turned to its insurers for the rest.

The insurers argued that the insured could "manufacture a covered loss through the internal bookkeeping maneuver of allocating the settlement money it received only to uncovered harms and then go after insurance coverage for the rest." *Am. Guar.*, 255 F. Supp. 3d at 684. Concerned for a double-recovery, the court held that the insured had the burden to show that the money it received from subcontractors "did not fully compensate" the covered damages alleged against it. Thus, the court required the insured to prove what portion of the settlement money it received was allocated to covered or non-covered damages. *Id.* at 689. *See also Uvino v. Harleysville Worcester Ins. Co.*, 2015 WL 925940 (S.D.N.Y. Mar. 4, 2015), *aff'd*, 2017 WL 4127538 (2d Cir. Sept. 19, 2017) (insured has the burden to prove entitlement to coverage, as well as covered damages); *Amerisure Ins. Co. v. The Auchter Co., et al*, No. 3:16-cv-407-J-39JRK, 2017 WL 4862194 at *12 (M.D. Fla. Sept. 27, 2017) ("[Florida law] requires the party seeking recovery under a judgment or settlement agreement to allocate the judgment or settlement amount between covered and uncovered claims. The inability to allocate precludes recovery").

Similarly, in *Executive Risk Indemnity, Inc. v. Cigna Corp.*, 74 A.3d 179 (Pa. Super. 2013), *appeal denied*, 89 A.3d 1285 (Pa. 2014), an insured settled a class action for breach of contract and RICO violations and submitted a claim to its excess professional liability carrier. In the ensuing coverage action, the insured argued that the insurer should prove which claims were excluded and outside of coverage, since the existence of some coverage was proven. The court, however, held that the insured had the burden to allocate because the insured was "the party that has access to the evidence and the parties' intent behind the settlement process."

Exec. Risk, 74 A.3d at 183. In addition, the court noted that the settlement was based on business records that the insured had in its possession, the insured and insurer were equally sophisticated entities, and the insured's attorneys prepared the settlement agreement. Importantly, while the insured controlled its defense in this case, the court also noted that the result "may have been different if there were evidence of [the insurer's] breach of a duty to [the insured]." *Id.* at 185 n. 7.

2. D&O-Specific Tests: "Relative Exposure" and "Larger Settlement" Rules

Most D&O policies contain language expressly addressing the apportionment of covered and non-covered matters. For example, a typical clause provides that:

> If both Loss covered under this policy and loss not covered under this policy are jointly incurred either because a Claim includes both covered and non-covered matters or covered and non-covered causes of action or because a Claim is made against both an Insured and any other parties not insured by this policy, then the Insured and the Insurer shall use their best efforts to fairly and reasonably allocate payment under this policy between covered Loss and non-covered loss based on the relative legal exposures of the parties with respect to covered and non-covered matters or covered and non-covered causes of action.

Courts generally apply one of two rules to address allocation under D&O policies in light of the policy language referenced above. The "relative exposure" rule requires the parties to allocate costs between the insured officers and directors and those attributable to uninsured parties such as the company. This rule originated from *PepsiCo, Inc. v. Cont'l Cas. Co.*, 640 F. Supp. 656 (S.D.N.Y. 1986). In that case, PepsiCo settled a number of claims involving a class-action suit naming it, its directors and officers, a former officer, and its accounting firm as defendants. PepsiCo sought complete indemnity under its D&O policy, which provided that: "Loss shall mean any amount which the Directors and Officers are legally obligated to pay for ... a claim or claims made against them for Wrongful Acts." The *PepsiCo* court held that this language required the parties to allocate the settlement costs between those attributable to the directors and officers (covered) and those attributable to PepsiCo and its accountants (uncovered). Thus, responsibility for the settlement were to be allocated based on the "relative exposures of the respective parties" to the action. *PepsiCo*. 640 F. Supp. at 662.

In contrast, the larger settlement rule provides that unless the uninsured corporation had some basis for liability independent of that of its directors and officers, the carrier must cover all of the defense and settlement costs for covered directors and officers, and their non-covered corporate entity. This rule originated from *Harbor Ins. Co. v. Cont'l Bank Corp.,* 922 F.2d 357 (7th Cir. 1990). In that case some Continental Bank investors filed securities fraud suits against Continental and the first suit, a class-action, named as defendants Continental, 25 directors and officers, and other employees. Continental settled the claims against it and sought indemnity from its insurers, which refused to pay. Although covered and non-covered parties were sued, the latter did not increase the liability of the former. Accordingly, the court held that the insurer must pay the entire loss. The court's opinion even went so far as to question why a covered loss should be allocated among covered and non-covered parties when the non-covered parties did not make things worse.

3. Exceptions

a. Breach of Duty to Defend

In *Harlor v. Amica Mut. Ins. Co*., 150 A.3d 793 (Me. 2016), the Supreme Court of Maine held that where the insurer had breached the duty to defend, the carrier did not lose the right to assert non-coverage as a defense to its duty to indemnify under Maine law. However, the court ruled that the insurer now has the burden to prove it had no duty to indemnify an underlying settlement by apportioning the covered and uncovered claims. Importantly, the court concluded that "[i]f the insurer cannot meet this burden of proof, it may be held liable for the entire settlement." *Harlor*, 150 A.3d at 802.

b. Failure to Adequately Notify Insured of Need to Allocate

Many jurisdictions recognize that in mixed actions, the insurer must take the appropriate steps to preserve the right to allocate between covered and non-covered claims. For example, in *Remodeling Dimensions, Inc. v. Integrity Mut. Ins. Co.*, 819 N.W.2d 602 (Minn. 2012), homeowners served an arbitration demand on their home remodeling contractor for faulty workmanship, and obtained a favorable general arbitration award. The insurer retained counsel to defend the contractor, but refused to pay for the award. The contractor paid the award and commenced a declaratory judgment action against its insurer.

The parties disputed whether the award included damages covered under the contractor's policy. The court held that when insurer defends under a reservation of rights that includes covered and non-covered claims, the insurer must defend and also disclose to the insured its interest in obtaining a description of the claims proven and potions of the award attributable to each. Although conditioned on such an allocation being available, the insurer's failure to notify the insured caused prejudice to the insured because insurer failed to advise it of its interest in obtaining a written allocation of any award. The court noted that the insurer should notify the insured "at or near the time the defense of the claim is accepted under a reservation of rights." *Remodeling Dimensions*, 819 N.W.2d at 618. Having failed to do so, the court concluded that the insurer must now prove that some part of the claim is uncovered.

B. Insurer's Ability to Intervene in Underlying Action to Aid Allocation, or Otherwise Compel Use of Special Interrogatories

One option potentially available to insurers is to intervene in the underlying action for the purpose of submitting jury interrogatories to aid in the allocation of covered and non-covered claims. Some courts are not receptive to these attempts by insurers. For example, in *J.T. Shannon Lumber Co. v. Gilco Lumber, Inc.,* 2008 WL 4553048 (N.D. Miss. Oct. 7, 2008), the insurer moved to intervene in the underlying case to submit special jury interrogatories to allocate any damages awarded. The court denied motion as untimely because it was 10 months after reservation of rights was issued. In addition, the court also held that the insurer lacked a "direct interest" in the case because no verdict had been rendered against the insured, and there had been no finding that any of the claims asserted against the insured were uncovered.

The *J.T. Shannon* court squarely cautions that intervention should be sought as soon as an insurer knows it has an interest in allocation. Moreover, diligence attempting intervention may be enough to put the burden on the party seeking coverage in a declaratory judgment action.

For example, in *Owners Ins. Co. v. Shep Jones Const., Inc.*, 2012 WL 1642169 (N.D. Ala. May 3, 2012), the underlying plaintiff obtained a general verdict against the insured contractor for damages involving faulty workmanship, among other things, and sought coverage from the contractor's insurer. The insurer sought, but was refused, intervention to underlying action to submit special jury interrogatories to allocate any damages awarded. Thereafter, the insurer sought a declaratory judgment that it had no duty to indemnify the verdict. The court held that party seeking coverage (here, the underlying plaintiff) has burden to allocate, unless insurer failed to make known the use and availability of a special verdict form. Since the insurer fulfilled this obligation by attempting intervention, the burden to allocate remained with the underlying plaintiff.

Some jurisdictions have strongly discouraged insurer intervention in the underlying action, to the point that insurers must think long and hard about even attempting to do so. It will not come a surprise to the practicing coverage lawyer that a leading example of this pro-inured approach comes from Washington State. In *Mutual of Enumclaw Ins. Co. v. Dan Paulson Construction, Inc*., 161 Wn.2d 903, 169 P.3d 1 (2007), the insured contractor had been sued for a variety of alleged construction defects. The underlying claims were mixed; some claims sought damage for covered property damage, but others likely fell within the "Your Work" and "Impaired Property" exclusions.

The underlying action was in arbitration rather than in court. The insured and underlying claimant, undoubtedly acting with an eye toward the ongoing allocation debate, agreed that the arbitrator would make any award on a lump-sum basis. This was contrary to "the arbitrator's usual practice of providing a detailed, itemized award," and the insurer "did not learn of the lump sum award agreement until after the arbitration hearing had begun." *Dan Paulson*, 169 P.3d at 6.

Upon learning of the agreement, and after the insured refused the insurer's request to participate in the arbitration in order to seek allocation of any award, the insurer filed a declaratory judgment action. The insurer, MOE, then "issued a subpoena duces tecum to the arbitrator, scheduling the arbitrator's deposition upon written questions after the arbitration was concluded. "In addition to making a comprehensive request for documents, the subpoena sought the arbitrator's thoughts regarding the arbitration. With the subpoena, MOE sent the arbitrator an *ex parte* cover letter explaining its coverage issues with [the insured]." *Id.* at 5-6. MOE later sent a second letter to the arbitrator, again explaining the dispute over the "Your Work" and related exclusions.

The insured demanded that MOE withdraw the subpoena, which the insurer later did. The insured and claimant later entered into a settlement agreement before the arbitrator rendered an award; the settlement agreement provide for a lump-sum payment and did not characterize or allocated the sum among the various alleged defects and property damage.

In the ensuing coverage litigation, the insured claimed that MOE's ex parte contact, via subpoena and two cover letters explaining the coverage issues, constituted bad faith and gave rise to coverage by estoppel. The Washington Supreme Court held for the insured:

> MOE did risk a bad faith claim if it litigated coverage issues with DPCI [the insured] prior to the arbitration hearing. While defending under a reservation of rights, an insurer acts in bad faith if it pursues a declaratory judgment that it has no duty to defend and that action might prejudice its insured's tort defense. MOE sought

> to establish which claimed defects were excluded from coverage because they resulted from work performed by DPCI. Simultaneously, DPCI was contesting liability for *any* defects in the underlying arbitration action. To the extent that MOE prevailed, it would have directly prejudiced DPCI's position in the arbitration, clearly an act of bad faith.
>
> However, MOE was not facing the alternative to pay the entire settlement amount regardless of whether it was based on covered claims. An insurer defending under a reservation of rights is not automatically liable to pay the entire settlement amount—provided the insurer acts in good faith. . . . Absent a successful bad faith claim and the resulting coverage by estoppel, the insured still has the burden of proving how much of the [settlement] should be allocated to covered claims." Thus, MOE was not forced as a last resort to choose a third option: the subpoena and cover letters to the arbitrator. In fact, MOE was not faced with the prospect of paying the entire amount, regardless of coverage, until its own conduct—its choice to pursue that third option—raised the possibility of a bad faith claim by DPCI.
>
> [W]e hold that MOE did not successfully rebut the presumption of harm that arose from its bad faith conduct. MOE did not prove that its subpoena and *ex parte* communications with the arbitrator prior to and during the arbitration hearing did not harm or prejudice DPCI. To the contrary, the record supports that MOE's conduct caused significant uncertainty and increased risk for DPCI's defense. MOE's bad faith conduct interfered in DPCI's final hearing preparation, interjected insurance coverage issues into the arbitration, and created uncertainty concerning potential prejudicing of the arbitrator and the effect of MOE's interference on the confirmability of the arbitration award.

Dan Paulson, 169 P.3 at 9-10, 11-12 (citatons, footnotes, and internal quotations omitted).

The court noted that MOE had chosen not to seek to formally intervene in the arbitration, as permitted, at the discretion of the arbitrator, under the governing AAA rules. However, the rationale of the court's bad-faith holding would seem to have applied equally to a formal request to intervene. Accordingly, insurers must be extraordinarily wary of seeking to intervene in Washington actions, whether in court or arbitration. One can question the fairness of this outcome, given the efforts of the insured and underlying claimant to obscure the basis of any arbitration award and the resulting settlement.

C. Policy Terms Addressing Apportionment of Covered and Non-Covered Claims

As discussed above, insurers are increasingly including policy terms that expressly provide for allocation of defense costs in mixed cases. While the extension of such terms to defense costs is relatively new, such terms have long been in use, mainly in D&O policies, with respect to indemnity coverage. The above-quoted Navigators term is representative of the approach taken by most such terms:

> Solely with respect to all Liability Coverage Parts:
>
> If **Loss** is incurred that is partially covered and partially not covered by this Policy, either because a **Claim** made against the **Insureds** includes both covered and uncovered matters or because a **Claim** is made against both covered and uncovered parties, such **Loss** shall be allocated as follows:
>
> (1) 100% of **Costs of Defense** shall be allocated to covered **Loss**; and
>
> (2) **Loss** other than **Costs of Defense** shall be allocated between covered and non covered **Loss** based upon the relative legal exposure of the parties to such matters.

The term provides only limited guidance as to how settlement or judgment liability should be allocated: "based upon the relative legal exposure of the parties to such matters." This leaves much room for case-specific advocacy concerning the facts and law governing the underlying claims.

D. Practical Strategies for Coverage Counsel

1. Recent Case Study: *UnitedHealth v. Executive Risk*

A recent decision from the Eighth Circuit presents a good roadmap of the various practical and strategy issues that counsel must consider when handling an allocation dispute, primarily involving the proof required. In *UnitedHealth Group, Inc. v. Executive Risk Specialty Insurance Co*., 870 F.3d 856 (8th Cir. 2017), the court considered a settlement that UnitedHealth Group ("UHG") had entered into to resolve claims from two previous lawsuits under a single agreement. *Id.* at 859. One of the settled lawsuits involved antitrust claims that were potentially covered by UHG's liability insurance policy. *Id.* The other lawsuit asserted ERISA claims that were not covered. *Id.* When UHG sought to collect on its liability insurance policy, its insurers refused to pay and UHG then sued them. *Id.* at 860.

The district court granted summary judgment in the insurers' favor and the Eighth Circuit affirmed, finding, *inter alia*, that UHG did not meet its burden to show how the settlement was allocated between the claims potentially covered by its insurance policy and those that were not. *Id.* at 863, 865-66. The Eighth Circuit noted that 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." *Id.* at 863. The burden to allocate the settlement between the covered claims and the non-covered claims must be met "with enough specificity to permit a reasoned judgment about liability." *Id.* Thus, the appellate court concluded, UHG was not able to prove its claim under the insurance policy because it was not able to identify a non-speculative basis upon which to allocate which portion of the settlement applied to the potentially insurable antitrust claims. *Id.* at 865-66 The court explained that the "allocation inquiry examines how a reasonable party in [the plaintiff's] position would have valued the covered and non-covered claims ... at the time of the settlement" and that in "complex lawsuits involving different legal claims and theories" a plaintiff must provide evidence about the relative strength and value of claims in order to properly allocate them. *Id.* at 863-64.

It is instructive to examine how the district court viewed the evidence needed to meet the

burden. *See UnitedHealth Grp., Inc. v. Columbia Cas. Co*., 47 F. Supp. 3d 863, 882-83 (D. Minn. 2014). The lower court noted that there were three kinds of evidence a party could introduce to a fact finder to convince them that a settlement was properly allocated between indemnifiable and non-indemnifiable claims: "(1) a party may introduce evidence of how the settling parties and their attorneys valued the claims at the time of settlement; (2) a party may introduce evidence of what was known to the parties and their attorneys at the time of settlement and ask the jury to assess the settlement value of each of the claims based on that information; or (3) a party may introduce expert testimony about the settlement value of the settled claims." *Id.* at 882. The court then added that the appropriate evidentiary approach turns on the complexity of the case. For instance, a lay jury may be able to deduce the proper allocation of a settlement from merely looking at the record available to the parties at the time of settlement if the underlying facts are "uncomplicated," such as in a "simple slip-and-fall case." *Id.* However, in a complex case like the one in UnitedHealth, "the jury would need the assistance of the expert testimony of an attorney who participated in litigating the underlying cases or an attorney who is hired to give expert testimony." *Id.* at 883. And if a party does not have an expert that can present testimony on this issue (which the plaintiff did not have in UnitedHealth), it cannot "fix this problem by handing the [evidence from the underlying record] to the jury and asking the jury to perform the [allocation] analysis that it failed to ask [its expert] to perform." *Id.* at 881. To do so would be to leave a "jury of farmers and mechanics and nurses and factory workers" to return a verdict "based on speculation." *Id.* at 883.

Then, in its affirmance, the Eighth Circuit elaborated further on the proof required: "To prove allocation, parties can present testimony from attorneys involved in the underlying lawsuits, evidence from those lawsuits, expert testimony evaluating the lawsuits, a review of the underlying transcripts, or other admissible evidence." *Id.* at 863. "Allocation require[s] either contemporaneous evidence of valuation or expert testimony on relative value to provide a reasonable foundation for a [fact-finder's] decision." *Id.* at 865. The court specifically noted that "[e]vents and circumstances happening after settlement are relevant only insofar as they inform how a reasonable party would have valued and allocated the claims at the time of settlement." *Id.* at 864.

2. Ensuing Battles on Motions in Limine and Over Expert Testimony

In the year since *UnitedHealth* was decided, several other noteworthy decisions have been handed down and offer some guidance on how the courts are handling the allocation issue. Motions in limine and motions to exclude expert testimony are two areas where the issue is decided:

- *Union Pacific Railroad Company v. Colony National Ins. Co.*, 2018 WL1054315 at *3 (D. Neb. Feb. 23, 2018). In ruling on a motion in limine concerning expert testimony on allocation of liability among potential tortfeasors in settled lawsuits, the court held:

> If [insured's trial lawyer expert] offers testimony as to what the law requires, allows, or prohibits; or testimony about what a court likely would decide on a question of law; his opinions will be subject to objection, as exceeding the province of an expert witness. If, however, he offers testimony as to how reasonable lawyers with expertise in Oklahoma tort litigation would evaluate claims, defenses, evidence, trial strategy, and settlement, relevant to the facts of this case, then his opinions may assist the Court in its fact-finding mission. His lack of experience in railroad crossing

> litigation likely will affect the weight given to his opinions, but will not preclude him from being called by [insured] as an expert witness.

- *Union Pacific Railroad Co. v. Colony National Ins. Co.*, 2018 WL 1247385 at *2 (D. Neb. March 9, 2018) (denying motion in limine concerning expert testimony on how much of settlement of underlying action is to be allocated to covered claims: "In the allocation trial, this Court must look to evidence of what the parties in the Underlying Action knew at the time of the settlement."; court rejected insurer's argument the court may not consider "information known to [expert] and shared with [insured] before the settlement, unless that information was known to the plaintiffs in the Underlying Action before the settlement.").

- *In re RFC and RESCAP Liquidating Trust Action*, 2018 W.L. 4489685, at *5 (D.Minn. September 19, 2018) (denial of motion to exclude expert testimony: "The Court finds that [indemnitee's expert's] breach rate methodology does not warrant the exclusion of the Allocated Breaching Loss Approach. … First, [indemnitors] fail to show that the supposed flaws in [expert's] methodology are so significant that they practically negate the value of the Allocated Breaching Loss Approach to the fact finder. Second, the Court is persuaded that [expert's] decision to sample from the At-Issue Loans makes good sense given that the purpose of his study is to allocate the bankruptcy claims among [indemnitors], and those claims are premised on losses to loans sold by [indemnitee]. Thus, conceptually, those damages would necessarily have flowed from the loans that actually experienced economic losses, i.e. the At-Issue Loans. Third, these arguments go to weight of the evidence.").

- One court denied summary judgment and allowed evidence on allocation to be presented to the jury. *See In re RFC and RESCAP Liquidating Trust Action*, 332 F.S.3d 1101, 1203-1204 (D. Minn. 2018) (indemnitor's summary judgment motion denied and indemnitee permitted to present to jury the allocated breaching loss approach: such approach offers a reasonably certain basis for assessing and allocating damages that is not speculative, remote, or conjectural. "First, the Settlements at issue here involved related claims in a single action whereas United Health predominantly involved unrelated ERISA and antitrust claims from two separate cases from different jurisdictions. Second, the claims at issue here are premised on very similar or even identical Trust Agreement contracts and, as one would expect given that commonality, investors raised similar types of arguments against [indemnitee]. Third, [indemnitee] has offered competent expert testimony to assess the relative value of the settled claims. In particular, Donald Hawthorne, a seasoned RMBS litigator with experience settling RMBS cases, offers his opinion as to the weight a reasonable party would assign to the different categories of claims that were asserted in the bankruptcy based on his assessment of [indemnitee's] exposure to those claims and their likelihood of succeeding.").

- Lastly, one court declined to declare any allocation so long as the underlying action has yet to be concluded. *See National Union Fire Insurance Co. of Pittsburgh v. Viracon, Inc.*, 2018 WL 3029054 (D. Minn. June 18, 2018) ("The Court cannot, however, determine on this record whether and to what extent the amount [insured] paid to settle the InterContinental lawsuit is excluded from coverage by the "your product" exclusion. There is no evidence before the Court on the terms of the settlement. [Insured] must establish what portion of the settlement is attributable to covered claims, and until that showing is made, no declaration regarding the settlement is appropriate. Similarly,

because the 12W [underlying] litigation is ongoing, the Court cannot determine whether [insured's] liability in that litigation is covered by [insurer's] policies. … Any declaration regarding indemnity for the InterContinental settlement or the 12W litigation must await further record development.").

3. Preserving the Right to Allocation

Once a mixed-claim action is asserted against an insured, the reservation of rights sets the stage to allocate claims. The reservation, however, must be specific. It requires stating that the insurer will rely on a particular policy provision as a ground to later disclaim coverage

The Supreme Court of South Carolina analyzed these issues in *Harleysville Grp. Ins. v. Heritage Communities, Inc*., 803 S.E.2d 288 (S.C. 2017). In *Heritage Communities*, the insurer defended its insureds under a reservation of rights against claims of faulty workmanship, but a general verdict was obtained against the insureds. The insurer then commenced a declaratory judgment action to contest that the general verdict had any covered damages. Under South Carolina law, "costs to repair faulty workmanship itself are not covered under a CGL policy but costs to repair resulting damage to otherwise non-defective components are covered."

The *Heritage Communities* court traced an insurer's duties on allocation back to its reservation of rights: "a reservation of rights letter must give fair notice to the insured that the insurer intends to assert defenses to coverage or to pursue a declaratory relief action at a later date." *Heritage Communities, Inc.*, 803 S.E.2d at 297. The court reasoned that an insurer has a better vantage point because it usually controls the insured's defense. Thus, where an insurer defends under a reservation of rights, it must inform the insured of the need for a verdict allocating covered versus non-covered damages.

Based on *Heritage Communities*, an insurer's control of the defense is balanced with heightened duties owed to the insured. Requesting special interrogatories for the jury is part of the insurer's "duty not to prejudice the insured's rights." In the words of the court: "If the burden of apportioning damages between covered and non-covered were to rest on the insured, who is not in control of the defense, the insurer could obtain for itself an escape from responsibility merely by failing to request a special verdict or special interrogatories." *Id* at 299 (citation omitted).

A critical error in the *Heritage Communities* reservation of rights was that it merely copied-and-pasted policy provisions. The insurer failed to state with particularity which provisions it would rely on to later defeat coverage. The court found that the insurer's "generic denials of coverage coupled with furnishing the insured with a verbatim recitation of all or most of the policy provisions (through a cut-and-paste method) is not sufficient."

Other courts have not taken such a strict view analysis of reservation of rights letters with respect to covered and uncovered claims, and rather generally look to see if the insurer adequately informed the insured of the potential issue. In *Phase II Transp., Inc. v. Carolina Cas. Ins. Co.*, 2017 WL 424903 (C.D. Cal. Jan. 19, 2017), the insurer sought reimbursement for part of a settlement that it paid under a reservation of rights for one of two underlying actions. One action alleged covered claims, but the other contained non-covered claims. The court specifically noted that the reservation of rights "adequately and timely" preserved the right to reimbursement. Thus, although settlement discussions involved covered claims with respect to the underlying action failing to assert a covered claim, the Court recognized that no covered claims were pled. Therefore, the insured could not show that the disputed portion of the

settlement included covered claims -- the burden did not shift to the insurer, and the insured was ordered to reimburse the insurer.

4. Role of Declaratory Judgment Actions

When there are disputes between apportionment of covered and uncovered claims, parties may contemplate filing a declaratory judgment action to get a declaration as to each party's payment obligations. The timing of a declaratory judgment action, and other procedural requirements, vary from jurisdiction to jurisdiction. For example, some courts will stay consideration of an insurer's potential duty to indemnify until resolution of the underlying matter. Other jurisdictions require all "interested" parties to be named, which may include the underlying claimants. Regardless of the procedural nuances, for insurers considering a motion to intervene in the underlying action to assist in the apportionment question, having a pending declaratory judgment action may help bolster a request for intervention by showing to the court that it is necessary to help resolve the pending coverage action.

Parties may be wary of filing declaratory judgment actions, fearing that the length of time it would take to resolve, as compared to the speed of the underlying case, would make such declaratory judgment actions impractical. However, practitioners should note that under Rule 57 of the Federal Rules of Civil Procedure, "[a] court may order a speedy hearing of a declaratory judgment action." Many state court rules of civil procedure are in accord with the federal rule. This rule provides a basis for counsel to argue, if necessary, that the declaratory judgment action must proceed expeditiously, considering its potential impact on the underlying litigation.

IV. Conclusion

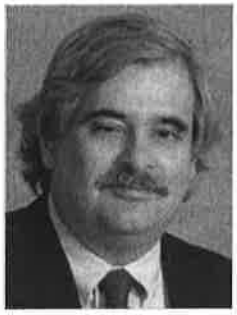
In an underlying case involving both covered and uncovered claims, the liability insurer’s initial coverage determination is only a starting point. The question of whether and how costs may be allocated between covered and uncovered claims can have a dramatic practical effect on the insurer’s obligation to pay. Allocation debates demand careful consideration of emerging policy terms, widely varying state law, and the underlying allegations and defense tasks, and therefore provide an opportunity for coverage counsel on both sides of the aisle to add value for their respective clients.

LAW360

Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

5 Key NJ Insurance Coverage Decisions From 2018

By **Robert Chesler and Christina Yousef**
January 30, 2019, 2:48 PM EST



Robert Chesler

Christina Yousef

From a policyholder's point of view, 2018 insurance coverage decisions in New Jersey left state law on insurance coverage matters scattered at best. Three decisions forged ahead, validating and expanding the rights of policyholders, while two other decisions took a step backward from established New Jersey law and reduced policyholders' protections.

The New Jersey Supreme Court decision in Cont'l Insurance Co. v. Honeywell Int'l Inc.,[1] upheld the application of the "unavailability rule" in New Jersey, just months after the New York Court of Appeals rejected it in KeySpan Gas E. Corp. v. Munich Reins. Am. Inc.[2] The unavailability rule comes into play when, pursuant to the continuous trigger, consecutive annual insurance policies are triggered, the more recent of which do not apply because of new exclusions placed into the policy by the insurance industry. In a typical instance in Honeywell, a worker may have been first exposed to asbestos in 1970, with a manifestation of asbestosis in 2010. In about 1986, the insurance industry inserted an absolute asbestos exclusion in the general liability policy, so that asbestos insurance coverage became unavailable in the marketplace. Thus, the issue is whether the policyholder or insurance companies that issued policies prior to 1986 are liable for the uncovered period between 1986 and 2010. The New Jersey Supreme Court held that the insurance companies were responsible for the uninsured years. In doing so, the court relied principally on public policy grounds, as set forth in Owens-Illinois Inc. v. United Insurance Co.[3]

The Third Circuit issued a major ruling in 2018 holding that New Jersey's Consumer Fraud Act applied not just to the sale of insurance but also to claims-handling.[4] In Alpizar-Fallas , the Third Circuit addressed extreme egregious misconduct by the insurance company. After an auto accident, the insurance company's representative visited the victim and had her sign paperwork, telling her that it would expedite the claim process. The representative did not reveal that the papers included a release of the other driver in the accident, who was insured by the same insurance company. On these facts, the Third Circuit found that the New Jersey Supreme Court would extend the reach of the Consumer Fraud Act to include claims handling. In view of New Jersey's weak law on bad faith, this is a major advance for New Jersey policyholders since the Consumer Fraud Act mandates treble damages and an award of attorneys' fees.

It is also noteworthy that in 2018 the New Jersey Senate passed an insurance bad faith bill that would apply to first party policies. The bill is currently before the Assembly.

Cooper Indus. LLC v. Columbia Cas. Co. is another valuable decision for policyholders.[5] The case concerned a policyholder that underwent corporate restructuring. The successor company was then sued by the United States Environmental Protection Agency. The insurance companies asserted that the bill of sale in the key corporate transaction was silent on the transfer of insurance rights, and that as a result, the parties did not transfer those rights. The insurance companies also argued that even if a transfer had occurred, the anti-assignment clause in the insurance policies foreclosed coverage. The Appellate Division ultimately rejected both of those arguments. Instead, the court relied on extrinsic evidence to find that the insured parties who effectuated the transfer believed that they were transferring insurance rights as well. The court also reaffirmed that the anti-assignment clause did not apply to post-loss transfers.

In two other cases, the Appellate Division ruled in favor of insurance companies. Wear v. Selective Insurance Co.[6] concerned an insurance company's duty to defend, an area in which New Jersey insurance law from a policyholder's point of view has lagged behind that of every other state. Importantly, Burd v. Sussex Mut. Insurance Co.[7] has bedeviled New Jersey policyholders for decades. There, the Supreme Court of New Jersey held that if a complaint asserted two causes of action, one potentially covered by insurance and the other not, and the underlying action would not resolve the factual dispute, the duty to defend, paying for defense bills as incurred could be converted to a duty to reimburse after the fact. Many commentators thought that in Flomerfelt v. Cardiello,[8] the New Jersey Supreme Court had limited the reach of Burd, if not extinguished it.

In Wear the underlying plaintiff alleged injury from both mold and other environmental factors. The insurance policy contained a mold exclusion, and also an anti-concurrent clause. The trial court ordered the insurance company to defend because of the allegations of injury from environmental factors in the complaint. The Appellate Division reversed the trial court's grant of summary judgment to the policyholder on the duty to defend, citing Burd, and other authority. Specifically, the Appellate Division held that "the duty to defend should be converted to a duty to reimburse pending resolution of the coverage action." In so holding, the court may have given new vitality to Burd, to the regret of New Jersey policyholders.

The Appellate Division's decision in Northfield Insurance Co. v. Mt. Hawley Insurance Co.[9] also represented a step backward for policyholders. In that case, Empress Properties Inc. hired CDA Roofing Consultants LLC to perform roof installation work on one of their hotels in Asbury Park, New Jersey. Once Sandy made landfall, however, the hotel sustained significant roof damage, which in turn caused water damage to the interior. CDA was insured by Northfield Insurance Company during the installation process and when Sandy hit. Empress Properties and its insurance company, Mt. Hawley, asserted a claim against CDA, and ultimately filed suit.

Northfield then advised its policyholder, CDA, that it was "disclaiming any obligation to indemnify", but, "[n]otwithstanding [a denial of coverage, it was] willing to provide [CDA] with a courtesy defense for this lawsuit." Northfield also expressly "reserve[d] any legal and policy defenses it may have in connection with these matters whether stated or not in this letter" and further "reserve[d] the right to modify its coverage position at any time upon receipt of additional information."

Six months later, Northfield filed suit against CDA, Empress and Mt. Hawley seeking a declaratory

judgment that it had no obligation to defend or indemnify CDA in Mt. Hawley and Empress's suit against CDA. Empress and Mt. Hawley filed a motion for summary judgment arguing that Northfield should be estopped from denying CDA coverage in the underlying action. The trial court granted Empress and Mt. Hawley's motion and found that Northfield's actions were in violation of Merchants Indemnity Corp. v. Eggleston.[10] Specifically, Northfield failed to expressly seek CDA's consent to its control of the defense and, therefore, Northfield could not properly disclaim coverage in the underlying action.

The Appellate Division reversed and found that Northfield's "willingness" to provide a "courtesy defense" could have been interpreted as an "offer of a defense, and not as the insurer's insistence on controlling the defense." The Appellate Division made clear that circumstances exist necessitating that the estoppel doctrine of Eggleston be inapplicable. Policyholders should, therefore, must be cautious in responding to such offers.

While 2018 presented advancements and setbacks for policyholders as far as New Jersey precedent is concerned, policyholders and insurance companies alike will likely see the effects of these decisions for years to come.

Robert D. Chesler is a shareholder and Christina Yousef is an attorney at Anderson Kill PC.

[1] 234 N.J. 23, 188 A.3d 297 (2018)

[2] 31 N.Y.3d 51, 73 N.Y.S.3d 113, 96 N.E.3d 209, 214-16 (N.Y. 2018)

[3] 138 N.J. 437, 478-79, 650 A.2d 974 (1994).

[4] Alpizar-Fallas, 908 F. 3d 910 (3d Cir. 2018).

[5] 2018 N.J. Super. Unpub. LEXIS 868 (App. Div. Apr. 13, 2018).

[6] 455 N.J. Super. 440, 190 A.3d 519 (App. Div. 2018)

[7] 56 N.J. 383, 267 A.2d 7 (1970)

[8] 202 N.J. 432, 997 A.2d 991 (2010)

[9] 454 N.J. Super. 135, 184 A.3d 517 (App. Div. 2018)

[10] 37 N.J. 114 (1962)

ANDERSON KILL
NEW JERSEY
ALERT

December 2018

Insurance Companies Behaving Badly

By Robert D. Chesler, Steven J. Pudell and Christina Yousef

The ability to win punitive damages or attorneys' fees as a result of insurance companies' wrongful conduct gives policyholders vital leverage in insurance coverage disputes. States vary widely in the extent to which such awards are obtainable. In three cases this past month, courts in New Jersey, Kansas and Illinois found that policyholders were entitled to extra-contractual relief because of their insurance companies' egregious failures in dealing with their policyholders.

A recent decision by the Third U.S. Circuit Court of Appeals, applying New Jersey law, is of particular interest to New Jersey policyholders. In *Alpizar-Fallas v. Favero*, No. 17-3837 (3d Cir. 2018), the policyholder, insured by Progressive Garden State Insurance Company (Progressive), was involved in a car accident. Allegedly, the Progressive claims-handler fraudulently induced the policyholder to enter into a release, which in fact released the other driver in the accident — who was also a Progressive policyholder.

The policyholder brought suit against Progressive under the New Jersey Consumer Fraud Act (CFA). The lower court dismissed her claim, holding that the CFA only applied to the sale or marketing of insurance policies. The Third Circuit reversed. It found that the law covers "fraud both in the initial sale (where the seller never intends to pay) and fraud in the subsequent performance (where the seller at some point elects not to fulfill its obligations)."

Alpizar-Fallas is a groundbreaking decision of the highest importance. The Consumer Fraud Act provides for an award of treble damages and attorneys' fees as remedies, providing policyholders with a potent weapon against bad faith behavior by insurance companies.

Another noteworthy case is *Gruber v. Marshall*, No. 2014-cv-00302 (Kan. Dist Ct. 2018), from the United States District Court for the District of Kansas. There, the policyholder was awarded approximately $11,600,000 on a $100,000 policy. The case involved an airplane crash resulting in the death of a passenger, and despite the policyholder's desire to settle the case early, the insurance company did not offer its policy limit of $100,000 for over a year. No coverage issues existed. The court found that had the insurance company offered its policy limit earlier, it would have protected the policyholder's estate from exposure to any further claims or suits brought by the victim's estate. As a result, the court found the insurance company liable for the entire verdict of $11,600,000.

ANDERSON KILL
1251 Avenue of the Americas
New York, NY 10020
(212) 278-1000

ANDERSON KILL
1600 Market Street, Suite 2500
Philadelphia, PA 19103
(267) 216-2700

ANDERSON KILL
1055 Washington Boulevard, Suite 510
Stamford, CT 06901
(203) 388-7950

ANDERSON KILL
1717 Pennsylvania Avenue, Suite 200
Washington, DC 20006
(202) 416-6500

ANDERSON KILL
One Gateway Center, Suite 1510
Newark, NJ 07102
(973) 642-5858

ANDERSON KILL
Wells Fargo Building
355 South Grand Avenue
Los Angeles, CA 90071
(213) 943-1444

www.andersonkill.com

who's who

Robert D. Chesler is a shareholder in Anderson Kill's New Jersey office. Bob represents policyholders in a broad variety of coverage claims against their insurers and advises companies with respect to their insurance programs.
rchesler@andersonkill.com
(973) 642-5864

Steven J. Pudell is the managing shareholder in Anderson Kill's New Jersey office. Steve regularly represents policyholders in insurance coverage matters and disputes.
spudell@andersonkill.com
(973) 642-5877

Christina Yousef is an attorney in Anderson Kill's New Jersey office. Christina's practice concentrates in insurance recovery, exclusively on behalf of policyholders, and in corporate and commercial litigation.
cyousef@andersonkill.com
(973) 642-5007

"Insurance Companies Behaving Badly" continued from p1

The Appellate Court of Illinois also awarded extra-contractual damages in *Charter Properties Inc. v. Rockford Mutual Insurance Co.*, 2018 Ill. App. LEXIS 829 (Ill. App. Ct. 2018). The policyholder was an owner of a commercial building that partially collapsed. The policyholder submitted a claim to its insurance company for the loss of the building and lost business income. While the insurance company made some payments, the claims were ultimately "held in abeyance" until further inspection. The insurance company did not explain why it denied certain damages, did not complete the property investigation, and failed to complete its liability determination. As a result, under the Illinois Insurance Code, the court awarded the policyholder, in addition to its damages, $27,692 for other costs, $48,784 for attorneys' fees, and $30,697 in statutory penalties.

These three cases establish that policyholders have available remedies when insurance companies act badly. In every insurance coverage case, policyholders must consider whether they have facts that support a viable extra-contractual claim. With the added deterrent of punitive damages, insurance companies may think twice before unnecessarily denying or limiting claims.

When Disaster Strikes: Coverage for Natural Disasters

American College of Coverage Counsel
2019 Annual Meeting

Chicago, IL
May 8-10, 2019

Andrew B. Downs
Bullivant Houser Bailey PC
San Francisco, California
Andy.Downs@bullivant.com

Susan B. Harwood
Kaplan Zeena LLP
Miami, Florida
Susan.Harwood@kaplanzeena.com

John D. Shugrue
ReedSmith LLP
Chicago, IL
JShugrue@reedsmith.com

The Authors acknowledge the assistance and contributions of Adrienne Kitchen, ReedSmith LLP, Chicago, Illinois, without whom this paper would not have been possible.
The views expressed in this paper are those of the authors alone, and are not those of their firms, their clients or the American College of Coverage Counsel.

Natural disasters can strike anywhere, any time and in a variety of forms. The last several years have witnessed catastrophic impacts from wildfires, tornadoes, hurricanes, and winter storms, from coast to coast and virtually all points in between. Natural disasters do and will continue to implicate many types of insurance coverage. In the commercial context the most important natural disaster coverages are for physical damage and time element (business interruption) losses. With natural disaster claims, the issue isn't so much whether the event is covered, but how much is due.

1) Physical damage and Related Costs:
   - Buildings/Real Property
   - Personal Property (of both the Policyholder and its Officers and Employees)
   - Property of Others in Policyholder's Custody
   - Accounts Receivable
   - Electronic Data/Programs/Software
   - Debris Removal
   - Decontamination Costs/Pollutant Removal
   - Demolition/Construction Costs
   - Valuable Papers/Records
   - Professional Fees (excluding attorneys, public adjusters)

2) Time Element Coverage

   - Business Interruption (BI) - Business Interruption Coverage covers actual loss of income/earnings due to suspension of operations caused by covered loss. Coverage continues through the period of restoration of operations (including Extended Coverage Period, if provided).

   - Contingent BI - Contingent Business Interruption Claims coverage is triggered where covered damage to suppliers, customers or "attractor properties" negatively affects the policyholder's business operations, even where policyholder's own property is not damaged. Covered Losses include: (1) additional expenses incurred to obtain supplies and raw materials; (2) diminished revenue because of losses suffered by customers; and (3) other expenses due to damage to suppliers or customers.

- Extra Expense - Covers necessary additional expenses incurred: (1) to avoid or minimize the interruption of business; and (2) to repair or replace property, systems, lost information or damaged valuable papers.

- Civil Authority

- Ingress/Egress - Applies when access to and exit from a policyholder's premises are blocked. Applies even if the policyholder's property has not been physically damaged but typically requires damage of the type covered under the policy to non-insured locations.

- Service Interruption - Covers loss of income or extra expense resulting from interruption of utility services (water, communications, power, gas and sewage) both on and off premises.

Although this paper focuses on commercial coverage, it is important to note that there are significant differences between homeowners and commercial policies. For instance, homeowners insurance generally excludes flooding and earthquakes, whereas some larger commercial policyholders purchase earthquake and flood coverage. However, in commercial coverage particular causes of damage – flooding, earthquake, named storm—typically are subject to specific sub limits. Moreover, there may be specific limits based on the location of the loss; coverage for flooding is less expansive in areas where flooding is common and coverage for named storms or hurricanes can be reduced in the states most often hit, such as Florida, or excluded altogether.

Several important issues arise regarding insurance for natural disasters, particularly under property and business income coverage:

I. Policy Interpretation Considerations

   a. General Considerations

   b. Causation and Anti-Concurrent Causation Language

II. Property Damage Considerations

a. Number of Events or Occurrences

b. Cost to Repair/Replace

III. Time Element Considerations

a. Period of Restoration

b. Loss of Market Exclusion

c. Civil Authority Provisions

d. Law and Ordinance Exclusion

IV. Practical Considerations for the Coverage Litigator

We consider each in turn.

I. Policy Interpretation Considerations

a. General Policy Interpretation Considerations

Policy language drives what policyholders may recover. Interpretation is a matter of state law, and differs, rendering choice of law important. Courts review the language and context of the policy, and in many jurisdictions ambiguity in policy language is construed in favor of the policyholder. *See, e.g.*, *Pierce v. Allstate Ins. Co*., 542 F. Supp.2d 495, 498 (E.D. La. 2008) ("When this provision is read in the context of the entire policy, … the endorsement issued by the Defendant is clear and unambiguous and must be enforced as written.") Policy language varies by insurer and policy, and many policies include manuscript language. Where standard language is used, it is frequently modified. Definitions, the use of language such as "directly and indirectly," or causation language create coverage issues, and are rife for arguments by both sides. Courts interpret insurance policies to determine if the language is ambiguous, and if not, they apply the

plain language rule, looking to definitions within the policy and, when those fail, to definitions in dictionaries—legal and otherwise—as well as definitions used by other courts. *See, e.g., Northrop Grumman Corp. v. Factory Mut. Ins. Co*., 563 F.3d 777, 784 (9th Cir. 2009) (finding the flood exclusion barred coverage based on the "plain language of the contract" and dictionary definitions).

Many of the best arguments attorneys on either side can make are based on the policy language. First and foremost, what does the policy say? Is the language clear and unambiguous? If there is ambiguity, frequently found when more than one definition exists, is extrinsic evidence involving the drafting and negotiation of policy relevant? If ambiguity exists, who prevails—keeping in mind that most courts will find in favor of coverage where there is ambiguity? Even when the language is clear, seemingly slight variations can affect coverage depending on the facts. Other arguments involve the policyholder's reasonable expectations, the existence of anti-concurrent causation language (addressed below), the specific facts of the losses, and how to characterize those losses. Loss categorization is one important way to determine if specific damage is covered or not and may drastically alter the amounts paid by the insurer.[1] Other common arguments revolve around other causes of loss that may be excluded: pollutants enter structures following natural disasters; mold may grow following water; theft and looting may occur following major storms; and the policyholder's own negligence regarding maintenance and mitigation.

[1] No coverage where the policyholders "conceded that they could not offer any evidence of entry through openings in the roof or walls caused by Hurricane Irene." *Florida Windstorm Underwriting v. Gajwani*, 934 So.2d 501, 506-507 (Fla. 3d DCA 2005).

b. Causation and Anti-Concurrent Causation Language

The policyholder bears the burden of proof on damages and their cause. *E.g. Loyola University v. Sun Underwriters Ins. Co. of New York*, 93 F. Supp. 186 (E.D. La. 1952) aff'd, 196 F. 2d 169 (5th Cir. 1952); *Tuepker v. State Farm Fire & Cas. Co.,* 507 F.3d 346 (5th Cir. 2001) (applying Mississippi law). There may be multiple coverages from different causes: (1) property damage; (2) business interruption; (3) contingent business interruption; (4) ingress/egress; and (5) service interruption. For each different allocations, deductibles and sublimits likely apply.

The state court's views of causation also create varying results. Some of the principle approaches are: concurrent causation; efficient proximate cause; and proximate or immediate cause. Concurrent causation broadly means that when damage is caused by covered and non-covered causes, all damage is covered. *See Sebo v. American Home Ins. Co*., 208 So. 3d 694 (Fla. 2016) ("it would not be feasible to apply the Efficient Proximate Cause doctrine because no efficient cause can be determined"; "'[w]here weather perils combine with human negligence to cause a loss, it seems logical and reasonable to find the loss covered by an all-risk policy even if one of the causes is excluded from coverage" (internal citation omitted)); *State Farm Fire & Casualty Co. v. Slade*, 747 So. 2d 293 (Ala. 1999). In many states, the efficient proximate cause rule is applied, which requires that if the insured peril is the dominant cause of the loss that sets other causes in motion coverage exists for the entire loss – other perils are not considered. *Garvey v. State Farm Fire and Cas. Co.*, 48 Cal.3d 395 (1989); *Flomerfelt v.* Cardiello, 202 N.J. 432 (N.J. 2010); Julian *v. Hartford Underwriters Ins. Co*., 35 Cal.4th 747 (2005); *Glen Falls Ins. Co. of Glen Falls, N.Y. v. Linwood Elevator*, 130 So.2d 262, 270 (1961). Some states take a conservative view of causation, finding no coverage when an excluded cause combines with a covered cause

to produce a loss, requiring the policyholder either to prove the entire loss was caused by a covered cause or specifically prove which damages resulted from that covered cause. *E.g. Travelers Indemnity Co. v. McKillip*, 469 S.W.2d 160, 162 (Tex. Sup. 1971) (holding that under the policy, when the insurer pled an exclusion, the burden was placed on the insured to establish either that the loss was not caused to any extent by the excluded peril, or to segregate the loss caused by windstorm, the covered peril, from the loss caused by the excluded peril, snow, and to secure a jury finding on the amount of damage caused by the windstorm); *Hahn v. United Fire & Cas. Co*., No. 6:15-CV-00218, 2017 WL 1289024 (W.D. Tex. Apr. 6, 2017); *Amish Connection, Inc. v. State Farm Fire & Cas. Co*., 861 N.W.2d 230 (Iowa 2015). Some courts use proximate/immediate causation to identify the single proximate or immediate cause of the loss and proceed from there without looking at any earlier cause that may have set the chain of events in motion. *Chemstrand Corp. v. Maryland Casualty Co.*, 98 So.2d 1, 5 (Ala. 1957) (recovery is allowed where an insured risk is the last step in the chain of causation set in motion by an uninsured peril).

Insurers responded to the growth of both efficient proximate cause and pure concurrent causation by inserting anti-concurrent causation clauses into the policy to avoid the need to determine which of several different governs. Anti-concurrent causation clauses generally provide that no portion of a loss caused by a combination of covered and uncovered causes is covered—even when a covered cause of loss contributes concurrently or in any sequence. The majority of courts enforce anti-concurrent causation clauses. *See JAW The Pointe, L.L.C. v. Lexington Ins. Co*., 460 S.W.3d 597, 608 (Tex. 2015); *Boazova v. Safety Ins. Co*., 462 Mass. 346 (Mass. 2012); *Lombardi v. Universal N. Am. Ins. Co*., 2015 Conn. Super. LEXIS 138 (Conn. Super.

Ct. Jan. 21, 2015) (collecting cases and finding an anti-concurrent causation clause enforceable in a dispute arising from Tropical Storm Irene); *Corban v. United Servs. Auto. Ass'n*, 20 So.3d 601 (Miss. 2009) (holding in a dispute arising due to damage from Hurricane Katrina that the clause applies only if two or more causes occur simultaneously to cause loss).

A smaller number of jurisdictions, led by California, have rejected this application. *Howell v. State Farm Fire & Cas. Co.*, 267 Cal.Rptr. 708 (Cal. App. 1990) (anti-concurrent causation language contrary to Cal. Ins. Code §§ 530 and 532); *Safeco Ins. Co. v. Hirschmann*, 773 P. 2d 413 (Wash. 1999) (*en banc*) (against public policy to contract around efficient proximate cause doctrine); *Murray v. State Farm Fire & Casualty Co.*, 203 W. Va. 477, 492, 509 S.E.2d 1, 16 (W. Va. 1998). Many of the cases which followed *Howell*, which is a statutory interpretation case, came from jurisdictions such as Washington and West Virginia that did not have a statute comparable to the California statutes interpreted in *Howell*. Those decisions (*Hirschman* and *Murray*) represent judicially created public policy, which may explain why the unenforceability view remains the minority view.

In some cases, damage stemming from natural disasters is caused by some combination of covered and uncovered causes. When this occurs, anti-concurrent causation language is implicated (at least where it exists). This causes significant issues when the cause cannot be separated. Policyholders, unsurprisingly, advocate that the damage was caused solely by a covered cause of loss, with no damage due to an uncovered cause. Insurers, on the other hand, may emphasize the loss from the excluded cause and rely on the anti-concurrent causation language.

For property damage, several issues arise: cause of loss; betterments; labor and material costs; and replacement cost vs. actual value. Coverage attorneys must first determine whether concurrent causation or a different rule applies. Next, they must consider how issues of causation will affect the outcome when there are two causes of loss one covered and one not. Some courts find there is coverage for all the damage, others find nothing is covered, and yet others find there is coverage for the loss arising from covered causes but no coverage for loss caused by causes excluded from the policy, placing the onus on the policyholder to prove the amount of damage resulting from a covered cause of loss. Even where the cause of loss is not excluded, often the policyholder must determine the amount of loss caused by each force because of the categories and sublimits in a policy.

V. Property Damage Considerations

a. Number of Events or Occurrences

The number of events or occurrences can be difficult to determine when a natural disaster hits. This arises particularly in the context of storms which make landfall in the same area more than once. Does the storm constitute a single event or occurrence because it results from the same storm or is it multiple occurrences because the storm made landfall, went back out to sea, and then returned? *SEACOR Holdings, Inc. v. Commonwealth Ins. Co*., 635 F.3d 675, 682-683 (5th Cir. 2011) (Louisiana law) ("An occurrence is defined as 'any one loss, disaster or casualty or series of losses, disasters or casualties arising out of one event.' Thus, each series of losses, even those stemming from different perils, arising from one event is adjusted separately. SEACOR may have experienced different casualties from Katrina's two perils, wind and rain, but under the policy, those losses arose out of one event — Katrina — and warrant only one deductible. … Katrina was

a single event requiring only the Named Windstorm deductible, even if the storm included multiple 'acts' of rain and wind."); *The Lynd Co. v. RSUI Indemnity Co*., 399 S.W.3d 197, 200 (Tex. App.-San Antonio 2012) ("It is undisputed that fifteen of Lynd's properties sustained damage from the same 'occurrence.' … 'a result of the single hurricane "occurrence."'") (citations omitted).

Complicating coverage issues is that some policies cover damage happening within a 72-hour period following a storm, and often the policyholder has the right to choose the start time. *The Lynd Co. v. RSUI Indemnity Co*., 399 S.W.3d 197, 200 (Tex. App.-San Antonio 2012) ("When the term "occurrence" applies to a loss or series of losses from the perils of tornado, cyclone, hurricane, windstorm, hail, flood, earthquake, volcanic eruption, riot, riot attending a strike, civil commotion and vandalism and malicious mischief, one event shall be construed to be all losses arising during a continuous period of 72 hours."); *ARM Props. Mgmt. Grp. v. RSUI Indem. Co.*, No. A–07–CA–718–SS, 2008 WL 5973220, *2 (W.D. Tex. Aug. 22, 2008) ("in the case of a hurricane, 'one event shall be construed to be all losses arising during a continuous period of 72 hours.' It is undisputed that each of the nine properties policyholder under this policy is a 'scheduled item of property.' The term 'loss' is defined as 'a loss or series of losses arising out of one event or occurrence.'")

Turning to the issue of multiple occurrences, must a policyholder exhaust its deductible for each occurrence before coverage is triggered? How do the limits on the number of occurrences affect coverage? This issue has arisen recently with Hurricanes Irma and Harvey. Generally, hurricanes hit an area once, then move on. Harvey, however, made several landfalls in the same locations, with breaks in between as it went out to sea. *ARM Props. Mgmt. Grp.*, No.

A–07–CA–718–SS, 2008 WL 5973220 ("It is undisputed that each of the nine properties policyholder under this policy is a 'scheduled item of property.' The term 'loss' is defined as 'a loss or series of losses arising out of one event or occurrence.'") Named storm coverage may have the 72-hour period time limit, but flood insurance generally has no such time limit. Hurricane Irma hit several islands, where policyholders owned multiple properties on different islands, all of which were covered by the same policy. Is this one occurrence or many? Does the 72-hour time limit apply? Different sublimits and deductibles?

b. Cost to Repair or Replace

A common issue in property damage coverage involves the scope of replacement cost coverage for older structures. It is common for policies to provide for replacement cost coverage, upon actual replacement, namely, paying the cost in excess of actual cash value that it actually costs to replace the policyholder property. Not all policies provide coverage for governmentally mandated upgrades to meet current building standards.

While a detailed discussion of the nuances of what is "replacement cost" under particular policy language and under the laws of various jurisdictions is beyond the scope of this paper, practitioners on either side need to be prepared to address the impact of Ordinance and Law exclusions (generally intended to eliminate coverage for governmentally mandated improvements, aka "code upgrades") and Ordinance and Law extensions of coverage (reversing those exclusions, but generally providing a limited additional amount of insurance, either within or in excess of the policy's limit of liability).

c. Ordinance and Law Exclusions

Given the catastrophic nature of natural disasters, many states enact laws and ordinances regarding methods of construction, material type, and various types of reinforcements to limit future damage caused by the more common natural disasters in their area, policyholder may want to strongly consider purchasing such coverage in an adequate amount. An issue can arise as to the scope of Ordinance and Law coverage as the Ordinance or Law exclusion can play a large role in coverage for natural disasters, impacting both the Period of Restoration and the Valuation following policyholder damage to property, leaving policyholders with no coverage for any code upgrades. Arguments regarding the Ordinance and Law exclusion often revolve around the appropriate period of restoration (for instance, the insurer arguing that all time for a permitting process is excluded and the policyholder claiming that permitting time is not excluded when other factors caused delay) and the definition of "enforcement" and "compliance."); *State Farm Fire & Casualty Co. v. Metro. Dade County*, 639 So. 2d 63, 66 (Fla. 3d DCA 1994) ("Enforcement is 'the act of enforcing: as a: compulsion especially by physical violence b: forcible urging or argument ... c: the compelling of the fulfillment (as of a law or order).' *Webster's Third New International Dictionary, Unabridged*, 751 (1986). … The threat of enforcement is the driving force behind compliance with building and construction codes and ordinances. Permits are required before construction and repairs commence. Failure to comply results in failure to receive necessary permits for further construction or occupancy."); *Haas v. Audubon Indemnity Co.*, 722 So. 2d 1022, 1029 (La. App. 3d Cir. 1998) ("compliance is not enforcement." "[I]t was the vandalism that caused damage to the Haas' building, not the enforcement of any ordinance or law. The costs of asbestos abatement were necessary because of the flooding which arose out of

the vandalism to the building."); *Hampton Foods, Inc. v. Aetna Cas. & Sur. Co.*, 787 F.2d 349, 353 (8th Cir. 1986) ("The condemnation decree did not cause or increase that loss. Construing the exclusion clause to preclude recovery here would violate the reasonable expectations of the layman who purchased the policy. … one would reasonably expect that if a building was severely damaged by a windstorm or snowstorm, rendering its collapse imminent and making access to the building extremely dangerous, this would constitute a loss not due to a subsequent condemnation of the structure.")

III. Time Element/Loss of Business Income

Generally, Business Income coverage is intended to compensate the policyholder for its actual loss of income during the "period of restoration." In the context of catastrophes, two issues are common: (1) the duration of the "period of restoration"; and (2) the degree to which wide scale disaster-induced economic changes are material to the calculation of the actual loss of business income.

a. Period of Restoration

Under most standard-form policies, the period of restoration is measured by the time it would take to repair or replace the policyholder property with reasonable diligence. This is a hypothetical period of time not necessarily governed by how long it actually takes the policyholder to repair or replace its property. *Hampton Foods, Inc. v. Aetna Cas. and Sur. Co.*, 843 F.2d 1140 (8th Cir. 1988); *Beautytuft, Inc. v. Factory Ins. Ass'n.*, 431 F.2d 1122 (6th Cir. 1970).

Major disasters, of course, can wreak havoc on construction efforts. Many insurers recognize this and take into account supply and demand issues for both contractors and building materials in calculating periods of restorations. Some jurisdictions, such as California, statutorily mandate

extensions for time element claims in personal lines policies for declared disasters. Cal. Ins. Code § 2051.5 (effective 2019).

b. Loss of Market Exclusion

Some Insurers may argue that there is no business income loss or reduced business income loss because business in the area ground to a halt due to disaster, triggering the "loss of market" exclusion found in some policies. Other policies contain express provisions intended to address the situation where there is a reduction in some types of commercial activity coupled with a surge in other types of commercial activity (such as contracting and insurance adjusting).

Courts are extremely reluctant to apply loss of market exclusions to circumstances where the cause of the market decline is the same casualty which caused the policyholder property damage. See, *Boyd Motors, Inc. v. Employers Ins. of Wausau*, 880 F.2d 270, 274 (10th Cir. 1989) ("taking the equation of 'loss of market' with 'loss of market value' to its logical conclusion would lead to the absurd result of the exclusion swallowing coverage whole. Since, as written, the loss of market exclusion is not qualified in any way so as to restrict its application solely to post-repair depreciation, accepting the identity of the two terms in question would appear to entail adoption of the indefensible position that all loss in value to the policyholder property (i.e., the entire covered risk) is excluded from coverage under the policy. "); *Duane Reade, Inc. v. St. Paul Fire & Marine Ins. Co*., 279 F. Supp. 2d 235 (S.D.N.Y. 2003); aff'd as modified, 411 F.3d 384, 398-399 (2d Cir. 2005) ("The loss of market exclusion relates to losses resulting from economic changes occasioned by, e.g., competition, shifts in demand, or the like; it does not bar recovery for loss of ordinary business caused by a physical destruction or other covered perils.")

c. Civil Authority Provisions

Civil authority provisions require access be prohibited due to a covered loss. It is often limited to a certain time period and specific geographic area. Often the prohibition of access must be specific to the policyholder's location (or a larger area encompassing the policyholder's location). Civil Authority Coverage for Business Interruption Claims may provide coverage when a government act prohibits access to covered property due to covered damage including closures, curfews and travel restrictions. This may be true even when there is no formal order. *Narricot Industries, Inc. v. Fireman's Fund Ins. Co*., 2002 WL 31247972, *4 (E.D. Pa. 2002) (holding that a Civil Authority Clause did not require a formal order or even a written order); *Kean, Miller, Hawthorne, D'Armond McCowan & Jarman, LLP v. Natl. Fire Ins. Co. of Hartford*, 2007 WL 2489711, *3 (M.D. La. Aug. 29, 2007) (the fact that the Governor declared a state of emergency and government officials asked and encouraged residents to stay off the streets "could be considered an 'action of civil authority' that would not have been given but for Hurricane Katrina."). However, Civil Authority coverage does require that access be prohibited due to property damage. *Kean*, 2007 WL 2489711, *3 (coverage not triggered where "the advisories and recommendations given did not actually 'prohibit access' to the policyholder premises.")

The specific prohibition element has been interpreted to preclude coverage where some general restriction on access elsewhere resulted in a reduction of business at a location outside the restricted area or where the restriction was less than total. Two examples are a reduction in business at a theater chain due to curfews imposed after the Rodney King riots in 1992 (*Syufy Enterprises v. Home Ins. Co. of Indiana*, 1995 WL 129229 (N.D. Cal. 1995)) and where vehicular, but not pedestrian, access to a building in lower Manhattan was restricted after 9/11. *Abner,*

Herrman & Brock, Inc. v. Great Northern Ins. Co., 308 F.Supp.2d 331 (S.D.N.Y. 2004)). Another example is where civil authority eliminated one of several modes of access (such as the grounding of all non-government aircraft for several days after 9/11) which resulted in a reduction of business for the policyholder hotel properties outside of New York. *Southern Hospitality, Inc. v. Zurich American Ins. Co.*, 393 F.3d 1137 (10th Cir. 2004) and *730 Bienville Partners, Ltd. v. Assurance Co. of America*, 2002 WL 31996014 (E.D. La. 2002)).

A government mandated evacuation may mean Business Income loss is not covered. *Dickie Brennan & Co., Inc. v. Lexington Ins. Co.*, 636 F.3d 683 (5th Cir. 2011) (holding that a mandatory evacuation ordered in anticipation of Hurricane Gustav did not trigger business income coverage because there was no nexus between the evacuation order and damage to property, "other than at the described premises," as required for coverage under the policy's civil authority provision.); *Jones, Walker, Waechter, Poitevent, Carrere & Denegre, LLP v. Chubb Corp*., CIV.A. 09-6057, 2010 WL 4026375, *3 (E.D. La. Oct. 11, 2010) (the prohibition of access "as a 'direct result of physical loss or damage to the property,'" requires a "direct nexus between the damage sustained and the [resultant] order.")

When anti-concurrent causation language is present, coverage may be barred when levees break or when a civil authority decides to open a dam to prevent further damage to one area but causes flooding in another.

IV. Practical Considerations for the Coverage Litigator

Coverage and bad faith litigation following a disaster arises in circumstances which counsel, whether for the policyholder or the insurer, ignores at the client's peril. First, even for business policyholders, there is a strong sense of victimization, which is often shared by the jury

pool in the jurisdiction. Second, the policyholder's conduct did not cause the loss – the policyholder simply was in the wrong place at the wrong time. Third, the insurer's claims handling resources are often stretched to or past their breaking point, depending on the scope of the catastrophe thereby possibly impacting the handling of the policyholder's claim. Fourth, government regulators (usually the state's Department of Insurance) are far more involved than they are in ordinary circumstances.[2] All of these circumstances need to be taken into account by counsel on both sides.

[2] For example consider the actions of California's elected Insurance Commissioners. http://www.insurance.ca.gov/01-consumers/140-catastrophes/WildfireResources.cfm

ONE MAN'S CEILING IS ANOTHER MAN'S FLOOR: MULTILAYER COVERAGE CHALLENGES ARISING FROM THE NUMBER OF "OCCURRENCES" AND "BATCHES"

American College of Coverage Counsel
2019 Annual Meeting

Chicago, IL
May 8-10, 2019

Marion B. Adler
Adler Law Practice, LLC
Chicago, Illinois
madler@adlerlawpractice.com

ONE MAN'S CEILING IS ANOTHER MAN'S FLOOR: MULTILAYER COVERAGE CHALLENGES ARISING FROM THE NUMBER OF "OCCURRENCES" OR "BATCHES"

MARION B. ADLER[1]
ADLER LAW PRACTICE, LLC
madler@adlerlawpractice.com
708-948-7391
www.adlerlawpractice.com

Imagine a series of claims against the manufacturer of a mass-produced product, each entailing potential damages in excess of $1 million, but for which the insured has strong defenses to liability. Then imagine two radically different insurance programs:

> **Scenario No. 1**: The insured carries a primary policy with $1 million per occurrence limits and $2 million aggregate limits, with a deductible of $10,000 per occurrence, with no aggregate deductible. The primary policy's duty to defend is not subject to the deductible and defense expenditures do not erode the primary policy limits. The retention of the first-layer excess policy matches the occurrence and aggregate limits of the primary layer. The excess policy carries limits of $5 million per occurrence and in the aggregate, which are eroded by defense costs. There are no higher-level excess policies.
>
> **Scenario No. 2**: The insured carries a primary policy with $1 million per occurrence limits, $2 million in the aggregate, which are eroded by defense expenditures. The primary policy sits over a $500,000 per occurrence self-insured retention, which is eroded by defense expenses (as wells as settlements or judgments) but has no aggregate cap. The primary insurer has no duty to defend until the self-insured retention is exhausted. Sitting above the primary policy are a series of excess layers, providing an additional $100 million in coverage, each of which carries identical occurrence and aggregate limits, and each of which is eroded by defense expenditures.

Without knowing anything else about the circumstances of these claims, it is a safe assumption that the policyholder in Scenario No. 1 will contend that the

[1] Marion Adler regularly represents commercial policyholders in coverage disputes. The views expressed in this paper are hers alone and do not necessarily represent the views her clients.

Credit for the title goes to the incomparable Paul Simon, "One Man's Ceiling is Another Man's Floor," *There Goes Rhymin' Simon* (Side 1, Cut No. 5) (1973).

claims entail multiple "occurrences" whereas, in Scenario No. 2, the policyholder will contend that each claim constitutes a single "occurrence," with the primary insurer taking the opposite sides of those arguments in both scenarios. And, if the policyholder and primary insurer in Scenario No. 2 compromise their dispute over the number of occurrences, without the concurrence of the excess insurer and without resolving all of the underlying suits, the excess insurer will likely argue that the underlying retention is not yet exhausted because the settlement is based on an understatement of the number of occurrences.

Of course, the self-interest of each party explains the diametric views of the policyholders and insurers in these hypotheticals. As advocates and advisors, however, coverage lawyers need to go beyond that cynical observation. We need to master the substantive law in this area, so as to present the best arguments possible for our client's position, advise clients of the strengths or weaknesses of their position, and, when possible, assist clients in minimizing the future risk arising from these conflicting interpretations of the term "occurrence," and similar problems when applying per "batch" clauses.

I.
Framework for Determining the Number of "Occurrences"

As with most questions of insurance coverage, the number of "occurrences" entailed in any coverage dispute is determined by the applicable policy language, as interpreted under state common law. For decades, the standard form definition of "occurrence" has been virtually identical throughout the industry – i.e., "an accident, *including continuous or repeated exposure to substantially the same general harmful conditions*." (Emphasis added.)[2]

Despite the uniform policy language, however, the states construing that language have developed three basic tests for counting the number of "occurrences" when multiple claims or injuries arise from the same or similar circumstances:

- **The "Cause" Test** is applied by the majority of jurisdictions. As described in *United States Gypsum Co. v. Admiral Insurance Co.*, this approach determines the number of "occurrences" "by referring to the cause or the causes of the damage … , as opposed to the number of individual claims or injuries." In *U.S. Gypsum*, the court concluded that claims of property

[2] See, e.g., ISO Form CG 00 01 10 01 at 14; ISO Form CG 00 01 12 07 at 14. See also Hartford Form 8117 at 2 (from a 1979 policy), defining "occurrence" in relevant part as "an accident, including continuous or repeated exposure to conditions."

damage brought against the manufacturer of asbestos-containing building products, asserted in eight separate lawsuits and encompassing 53 separate buildings, constituted a single "occurrence." The court reasoned that the "cause" of all of the claims "should be characterized as the continuing process of the manufacture and sale of asbestos containing products." As such, the insured only needed to pay a single "occurrence" deductible as to all of the claims.[3]

- **The "Effects" Test** is employed by a minority of jurisdictions. As explained by the Louisiana Supreme Court in *Lombard v. Sewage & Water Bd.,* the number of "occurrences" is counted "from the point of view of the many persons whose property was damaged" even when that damage has a single root cause. *Lombard* involved claims by 119 plaintiffs for damage to their buildings caused by a canal construction project. The project lasted more than one year, spanning two policy periods, each with "occurrence" limits of $50,000 and aggregate limits of $100,000. By deeming each plaintiff's claim a separate "occurrence," the court maximized the policy limits available to the insured.[4] Similarly, in *Kuhn's of Brownsville v. Bituminous Cas. Co.,* the Tennessee Supreme Court held that the collapse of two separate buildings, with different owners, constituted two separate "accidents" even though both were caused by a single excavation project.[5]

- **The "Unfortunate Events" Test** is a cousin of the "cause" test, which has been adopted most notably by New York. As explained in *Appalachian*

[3] 268 Ill. App. 3d 598, 607, 647-51, 643 N.E.2d 1226, 1232, 1257-60 (1994).

[4] 284 So. 2d 905, 915-16 (La. 1973).

[5] 197 Tenn. 60, 270 S.W.2d 358 (1954). *Kuhn's* involved a policy written on an "accident," not "occurrence" basis, and the term "accident" was not defined.

It is unclear that Tennessee would continue to adhere to the "effects" test if presented with a standard-form definition of "occurrence," as applied to the typical mass or serial tort claims – e.g., claims involving product liability, environmental injury, or negligent supervision of perpetrators of sexual molestation. The only recent Tennessee insurance case of which we are aware adhering to the "effects" test is *American Modern Select Insurance Co. v. Humphrey*, No. 3:11-CV-129, 2012 U.S. Dist. LEXIS 20800, 2012 WL 529576 (E.D. Tenn. Feb. 17, 2012). The dispute arose from a simultaneous attack upon the plaintiff by seven dogs, all owned by the same couple. The court held there was a single "occurrence" because there was a single victim but the same interpretation almost certainly would have been reached under the "cause" or "unfortunate event" test.

Insurance. Co. v. General Electric Co., this approach considers, not just to the root cause of the claim, but also:

> whether there is a close temporal and spatial relationship between the incidents giving rise to injury or loss, and whether the incidents can be viewed as part of the same causal continuum, without intervening agents or factors.

Appalachian v. GE held that each claimant alleging bodily injury from exposure to asbestos in turbines manufactured by the insured represented a separate "occurrence" because of the lack of "commonalities" in terms the time, place, and duration of the exposure.[6]

All three approaches are malleable and often result in unpredictable rulings. This unpredictability is exemplified by the contradictory decisions by differing courts, all purporting to apply the majority "cause" test or the closely-related "unfortunate event" test, when confronted with asbestos-related claims. As noted above, in *U.S. Gypsum*, the Illinois Appellate Court applied the "cause" test to conclude that the manufacturer's continued production and sale of its products over decades constituted a "single" occurrence, requiring the insured to pay only one deductible. That was the majority view among "cause" jurisdictions, when *U.S. Gypsum* issued in 1994.[7] One year later, in *Stonewall Insurance Co. v. Asbestos Claims Management Corp.*, the Second Circuit reached the opposite conclusion, holding that each separate installation of the insured's asbestos-containing products constituted a single "occurrence" under both New York's "unfortunate event" and Texas's "cause" tests.[8] The Second Circuit reached this conclusion by reversing the rationale of the Illinois Appellate Court: Whereas *U.S. Gypsum* held that a manufacturer's liability for the claims arose from the single, continued act of manufacturing the products, unlike an installer's multiple separate acts of installation,[9] the Second Circuit reasoned a manufacturer's liability results from "the presence of [asbestos-containing materials] each time the products were installed in the property of third parties."[10] The Wisconsin Supreme Court in *Plastics Engineering Co. v. Liberty Mutual Insurance Co.*,

[6] 8 N.Y.3d 162, 171-72, 174, 863 N.E.2d 994, 999, 1002 (2007).

[7] *See U.S. Gypsum*, 268 Ill. App. 3d at 649-50, 643 N.E.2d at 1258-59 (collecting cases).

[8] 73 F.3d 1178, 1212-14 (2d Cir. 1995).

[9] 268 Ill. App. 3d at 651, 643 N.E.2d at 1260.

[10] 73 F.3d at 1214.

applied the "cause" test to likewise hold that the claims of each separate plaintiff asserting asbestos-related bodily injury claims was a separate "occurrence."[11]

More recently, courts applying the "cause" test seem to have been influenced by the "unfortunate events" approach and focused more on the actual event(s) giving rise to the insured's liability, rather than in more remote "causes" of the claims. This is seen in product defect cases in which the courts consider the insured's place in the chain-of-distribution, treating claims against: (a) a manufacturer, whose liability arises from a design defect present in an entire product line, as a single "occurrence"; (b) a distributor or shipper as correlating to the number of discrete shipments of the product; and (c) a builder or installer as equaling the number of buildings or installations in which the product was incorporated.[12]

[11] 2009 WI 13 ¶¶ 29-43; 315 Wis. 2d 556, 571-78; 759 N.W.2d 613, 620-23.

[12] **Cases finding a single "occurrence" as to claims involving defective products against the manufacturer**: *United Conveyor Corp. v. Allstate Ins. Co.*, 2017 IL App (1st) 162314 ¶¶ 31-33, 92 N.E.3d 561, 569-70 (only single "occurrence" applied to thousands of bodily-injury asbestos-related claims against manufacturer of conveyor systems; therefore only a single "occurrence" limit of liability was available, rather than higher aggregate limits); *Westchester Supply Surplus Lines Ins. Co. v. Maverick Tube Corp.*, 722 F. Supp. 2d 787, 797-98 (S.D. Tex. 2010) (Mo. Law) (claims arising from defective drill casings incorporated into four gas wells were a single "occurrence" because "the property damage in the present case arose out of a single manufacturing defect and the manufacturer is the insured"); *E.I. du Pont de Nemours & Co. v. Stonewall Ins. Co.*, C.A. No. 99C-12-253 (JTV), 2009 WL 1915212 (Del. Super. June 30, 2009) (thousands of claims asserted against manufacturer of acetal resin used in plumbing systems constituted a single "occurrence"); *Nat'l Union Fire Ins. Co. v Puget Plastics Corp.*, 649 F. Supp. 2d 613, 628 (S.D. Tex. 2009) ("there is a single occurrence when multiple claims have arisen from the policyholder's manufacture and sale of the same product to many customers"); *Associated Indem. Corp. v. Dow Chemical Co.*, 814 F. Supp. 613 (E.D. Mich. 1993) (claims by 40+ rural co-ops for leaks in gas pipelines extruded from defective resin manufactured by the insured constituted a single occurrence under cause test). *But see Irving Materials, Inc. v. Zurich Amer. Ins. Co.,* 1:03-CV-361-SEB-JPG, 2007 WL 1035098 (S.D. Ind., March 30, 2007) (where insured manufactured ready-mix concrete on "as needed basis," using 12 "standard formulations" and "numerous specialty mixes," then "each contract between [the insured] and a third party requiring … deliver[y or] a specific formulation of concrete" was separate "occurrence").

Cases equating the number of shipments in claims against distributors and shippers: *Axis Ins. Co. v. Buffalo Marine Svcs., Inc.*, Civ. No. H–12–0178, 2013 WL 5231619 at *16 (S.D. Tex. Sept. 12, 2013) (in claims against barge operator, each

Some courts are candidly results-oriented, counting the number of "occurrences" differently, depending upon whether it favors the insured or insurer. In *Thebault v. American Home Assurance Co.*, the Louisiana Court of Appeal held there was only a single "occurrence" as applied to 41 claims arising from the failure of a back-up generator during Katrina; the policy had a $50,000 self-insured retention, with no aggregate retention.[13] The court offered two explanations for distinguishing the case from *Lombard*, which had applied the "effects" test such that each plaintiff's claim equaled a separate "occurrence": (a) unlike *Lombard*, which involved a "series of events occurring over a significant period," *Thebault* involved a "single, uninterrupted" loss of power, which, given the policy language, could not be viewed as giving rise to separate occurrences under the policy "occurrence" definition; and (2) if each claim were a separate "occurrence," then the insured would have no coverage at all, as none exceeded the $50,000 self-insured retention.[14] The second explanation seems closer to the court's real reasoning as the "occurrence" definition in *Lombard* was not that different.[15] *Thebault* may also reflect that Louisiana is in the process of substituting the "unfortunate events" test for the "effects" approach.

In contrast to *Thebault*, the Illinois Appellate Court in *United Conveyor Corp. v. Allstate Insurance Co.*, held that it was immaterial that prior case law involved the applicable deductible whereas the current dispute related to the policy limits. "[I]f an insured's conduct is a single occurrence for purposes of

shipment of contaminated petroleum was separate "occurrence"); *Michigan Chem. Corp. v. Am. Home Assur. Co.,* 728 F.2d 374, 382–83 (6th Cir.1984) (Ill. law) (each shipment to distributor of defective livestock feed was separate "occurrence" because manufacturer's liability did not arise until it shipped defective product to distributor).

Cases against installers or contractors, basing the number of "occurrences" on the number of buildings or installations: *Nicor, Inc. v. Associated Elec. & Gas Ins. Svcs. Ltd.*, 223 Ill. 2d 407, 431-32, 860 N.E.2d 280, 294 (2006) (in claims arising from removal and replacement of residential gas meters, which resulted in spillage of mercury, each separate job constituted separate "occurrence"); *Lennar Corp. v. Great Amer. Ins. Co.*, 200 S.W.3d 651, 682-83 (Tex. App. 2006) (as to claims against general contractor arising from installation of EIFs in homes, each home was a separate "occurrence"), *abrogated in part on other grds.*, *Gilbert Tex. Constr., L.P. v. Underwriters at Lloyds' London*, 327 S.W.2d 3d 118 (Tex. 2010).

[13] 195 So. 3d 113 (La. App. 2016).

[14] *Id.* at 118-19.

[15] *See* 214 So. 2d at 915 ("occurrence" definition included "repeated exposure to conditions" and that "[a]ll damages arising out of such exposure to substantially the same general conditions shall be considered as arising out of one concurrence").

establishing the applicable deductible, it should be the same for purposes of setting the limits of the insurer's liability."[16]

II.
Counting the Number of Occurrences in Multilayer Coverage Situations

Not unlike the conflicts addressed in Section I, in which policyholders and their primary insurer dispute the number of occurrences, the same conflicts arise between primary and excess insurers when asymmetric primary occurrence and aggregate limits are mirrored in the retained limits of the excess policy. Such a dispute arose in *Evanston Insurance Co. v. Mid-Continental Casualty Co.*, when a driver lost control of his truck, resulting in a series of collisions over a 10-minute period. The primary policy limits were $1 million per "accident," with "accident" defined similarly to the standard "occurrence" definition. The applicable Texas law uses the "cause" test, with a focus on the "immediate," not "overarching," cause of the claims. Predictably, the excess insurer contended that each collision was a separate "accident," while the primary insurer urged the contrary. The court agreed with the primary insurer because the cause of the entire series of events was the "continuous negligence" of the truck driver, who failed to apply the brakes, unbroken by any intervening cause of injury. This unbroken chain of proximate causation distinguished the case from, for example, negligent hiring and supervision claims arising from the insured's employee's molestation of multiple children, in which multiple occurrences were found because the overarching negligence of the employer was broken by the intervening intentional torts of the employee.[17]

Travelers Property Casualty Co. v. Continental Casualty Co. involved a more complex conflict between the primary and excess insurers as to the number of "occurrences." In that case, 19 plaintiffs, who sustained burns as a result of defective packaging of fuel gel, sued the manufacturer of the defective bottles, which had been distributed over a period of several years. Travelers, as primary insurer, had issued a series of five one-year liability policies, each with $950,000 "occurrence" limits and $5 million aggregate limits. The Travelers policies also

[16] 2017 IL App (1st) 162314 ¶ 32, 92 N.E.3d at 569-70. *See also Michigan Chem.* 28 F.2d at 380 n.7 (rejecting the argument that the number of "occurrences" depended on whether it applied to the deductible or policy limits) ("[O]nce courts establish a legal rule, such as how the number of occurrences is to be determined, any party is entitled to rely upon that rule in future litigation.").

[17] 909 F.3d 143 (5th Cir. 2018).

contained a "non-cumulation" clause that essentially restricted coverage to a single $950,000 "occurrence" limit as to claims for which injury spanned multiple Travelers policy periods. Sitting above each Travelers policy was a Continental excess policy with $25 million policy limits. After incurring $950,000 in settling some of the claims, Travelers tendered the remaining claims to Continental, on the ground that all of the claims constituted a single "occurrence," with recovery capped at $950,000 pursuant to the non-cumulation clauses. Applying Georgia's version of the "cause" test, the court agreed with Travelers that there was only a single "occurrence" because all of the claims arose from the same product defect.[18]

Evanston v. Mid-Continental and *Travelers v. Continental* are both instructive because of the policyholder's absence from the dispute. In *Evanston,* even before the coverage action was filed, the underlying suits were settled with the primary insurer contributing $1 million, consistent with its position that only a single "accident" had occurred, and the excess insurer funding the rest, thereby mooting any further exposure to the insured.[19] In *Travelers*, evidently the insured had sufficient excess policy limits – as well as the motivation of minimizing the size of its self-insured retention – that it was content to allow *Travelers* to urge that its primary policies were responsible for only $950,000 total rather than the $25 million in aggregate Travelers limits if multiple claims had been involved.

Resolution of these inter-layer disputes are often messier and the policyholder may get caught in the cross-hairs. The excess insurer may adhere to its objection that the primary policy limits have not been exhausted and decline to participate when a settlement opportunity presents itself. The primary insurer and policyholder then must assess whether to front the cost of the entire settlement, and pursue the excess insurer for sums they believe it owes. Where the primary policy limits are not eroded by defense costs, the primary insurer may decide to front the entire settlement costs, reserving its right to pursue the excess insurer for the sums above the single "occurrence" limit. The primary insurer's funding of the entire settlement in these circumstances is more likely when the primary insurer is persuaded that the insured's liability for the claims is strong and the underlying plaintiff's settlement demands are reasonable; it is notable that, in *Evanston v. Mid-Continental*, the truck driver's liability for the accident

[18] 226 F. Supp. 3d 1359 (N.D. Ga. 2017). Although not stated directly in the opinion, one presumes that the insured concurred in the primary insurer's position that there was a single occurrence. The policyholder's self-insured retention was $50,000 per occurrence for the first four Traveler policies, and $100,000 per occurrence for the last Travelers policy.

[19] *See* 909 F.3d at 146.

was evidently clear. If the primary policy limits are eroded by defense costs and/or the primary insurer does not perceive that the settlement demands are reasonable, the insured may find itself with the unenviable choice of contributing to the settlement itself or paying defense costs once the primary carrier declares its single "occurrence" limit exhausted, if the excess insurer refuses to assume responsibility for the claim.

Another distinguishing feature of *Evanston v. Mid-Continental*, compared to some of the hardest "real-world" examples, is that it involved a single incident resulting in immediate injury to a small number of individuals. As such, it was relatively easy for the policyholder and the insurers to form a relatively complete evaluation from the outset of both their potential exposure for the underlying claims and their preferred interpretation of the number of "accidents." And, even though the claims involved in *Travelers v. Continental* arose from defective bottles that were distributed over several years, the number of claims was known within a few years, as the defect resulted in explosion of the fuel and instant injury to the users, rather than an insidious latent injury.[20]

When long tail claims are involved, these evaluations are much more complex as the full scope of those claims only becomes understood over time. For example, in the early years of asbestos litigation, many insureds were most focused on reducing the amount paid in deductibles under their primary policies, because settlements were small and rarely exceeded those deductibles. What these policyholders did not appreciate was that: (a) as the plaintiff's bar became more adept, the size of the settlements and verdicts would increase, as would the number of claims;[21] (b) unlike the primary policies for which defense costs did not erode limits, defense costs would erode their excess limits; and (c) if there were only a single "occurrence," recovery might be diminished under excess policies with "non-cumulation" clauses and under multi-year excess policies with a single "occurrence" limit, even when they carried separate annual aggregate limits.[22]

[20] *See* 226 F. Supp.3d at 1361, 1368.

[21] *See generally* Francis E. McGovern, *Resolving Mass Tort Litigation*, 69 B.U.L. Rev. 659 (1989) (discussing the "maturation process" of mass tort litigation; in the early years it is difficult to measure the insured's exposure because the claims have not undergone a critical mass of discovery, verdicts, and appeals); Peter H. Schuck, *Mass Torts: An Institutional Evolutionist Perspective*, 80 Cornell L. Rev. 941, 948-50 & nn. 33-40 (May 1995) (discussing McGovern's theory of "maturation" of mass torts) ("Asbestos crossed a kind of developmental threshold in the early 1990s ….").

[22] *See, e.g., Liberty Mut. Ins. Co. v. Treesdale, Inc.*, 418 F.3d 330 (3rd Cir. 2005) (Pa. law) (Liberty issued 10 successive excess policies, each of which contained "non-

III.
Batch Clauses

A. What are "Batch" Clauses?

"Batch clauses" are endorsements typically added to liability policies for insureds in industries in which defective manufacture or storage may result in deviant "lots" or "batches" of a product. Manufacturers and distributors of food, drug, medical device, or chemical products are among the insureds most likely to have "batch clauses" endorsed on their policies. The gist of such clauses is to deem multiple injuries or claims arising from the same defective batch or lot of the product as constituting a single "occurrence." At least in theory, by using a batch clause, the policy creates greater certainty as to the number of "occurrences" rather than relying upon the judge-made common law under the "cause," "effect," or "unfortunate event" tests to determine the number of "occurrences."

There is no standard, industry-wide batch clause. Individual insurers may have their own standard form. Compare this batch clause from a primary policy issued by Travelers:

> The definition of "occurrence" in Section V - Definitions is amended to include the following:
>
> > All actual or alleged damages arising out of "bodily injury" or "property damage" to which this insurance applies, and which arises out of the same:
> > a. Lot or lots of "your product" manufactured, handled, sold, acquired or in any way distributed or disposed of by or for any insured; or
> > b. Supervision, recommendations, warnings, instructions or advice provided or which should have been provided in connection with "your product";
> > shall be considered as arising out of the same "occurrence."[23]

cumulation" clause that provided that, as to claims giving rise to injury in multiple policy periods, insured was restricted to recovering a single "occurrence" limit as to all of the years; pursuant to "cause" test, there was only a single "occurrence" as to thousands of asbestos bodily injury claims asserted against product manufacturer and therefore insured could not "stack" the policy limits of all 10 excess policies).

[23] *See Travelers v. Continental*, 226 F.3d at 1363.

with this batch clause from an AIG 2006 *umbrella* policy form:

> With respect to the **Products-Completed Operations Hazard,** all **Bodily Injury** or **Property Damage** *arising out of one* ***Lot or Batch*** of products prepared or acquired by you, shall be considered as arising out of one **Occurrence.** Such **Occurrence** shall be subject to the Each Occurrence and **Products-Completed Operations Hazard** Aggregate Limits of this policy show, in Item 3. of the Declarations.
>
> Notwithstanding the foregoing, it is understood and agreed that *nothing in this endorsement shall* be interpreted to:
>
> 1. *provide coverage for* ***Bodily Injury*** *or* ***Property Damage*** *which occurs outside of the* ***Policy Period*****;**
>
> 2. *recognize erosion of the limits of* ***Scheduled Underlying Insurance*** as a result of any underlying **Lot** or Batch provision which provides coverage *for Bodily Injury or Property Damage which occurs outside of the* ***Policy Period*** *of this policy;*
>
> 3. *provide* ***Lot or Batch*** *coverage which is broader than that provided under* ***Scheduled Underlying Insurance.***
>
>   *If applicable* ***Scheduled Underlying Insurance*** *defines the term* ***Lot or Batch,*** *the term shall have the meaning given to it under applicable* ***Scheduled Underlying Insurance.***
>
>   If **Scheduled Underlying Insurance** does not define **Lot or Batch**, the term will have the following meaning:
>
>   *Lot or Batch* means that quantity of a product *produced at a single production facility within a single manufacturing cycle and specifically marked with a date, distinctive combination of letters, numbers or symbols*, or any combination of any of the foregoing, from which it can be determined that an individual item of the product was produced during that cycle. *Lot* ***or Batch*** *includes*:
>
>   a.) the handling, selling, distribution, sharing or disposing of such quantity of products; and

b.) *the providing of or failure to provide warnings for such quantity of products.*

(NU Form 91003 (5/06); bold in original, referring to defined policy terms; italics added for emphasis.)[24]

Notably, the Travelers primary batch clause and AIG umbrella batch clause have very different language as applied to "duty to warn" claims. The Travelers policy language states that all claims relating to allegedly defective warnings, instructions, and the like are "considered as arising out of the same 'occurrence'" without regard to whether the products are from the same "lot." The AIG language is to the contrary; duty to warn claims are treated as pertaining to the same occurrence only if they relate to the same "lot" or "batch."

One other important feature of the AIG umbrella batch clause is the provision incorporating the definition of "batch" or "lot" contained in scheduled underlying insurance, if there is one. Imagine the confusion if an insured had primary coverage with the Travelers batch clause treating all duty-to-warn claims relating to the insured's "product" as arising from a single "occurrence," but the batch clause of the AIG umbrella, which counts each "lot" separately to determine the number of "occurrences" arising from duty-to-warn claims.

However, in our hypothetical of Travelers primary coverage and AIG umbrella coverage under the above-quoted batch clause provisions, there still is room for disputes as to whether and when the coverage under the AIG umbrella policy attaches. The AIG umbrella merely follows form to the definition of a "batch" or "lot," not the entirety of the underlying batch clause. As illustrated in the discussion of *National Union v. Donaldson*, below, batch clauses may also contain language that affects the trigger of coverage by pulling all claims arising from injuries occurring over multiple policy periods into the first triggered policy period. (See pp. 14-16, *infra*.) The language in paragraphs "1" and "2" of the AIG umbrella clause, quoted above, would seemingly prevent that sort of cumulation into a single policy period for the AIG umbrella policies, even when the underlying scheduled policy contained such language. In such circumstances, the policyholder could face a coverage gap between the deemed exhaustion of the primary coverage before the umbrella coverage attached.

Even when policies contain a batch clause, disputes arise as to whether it applies at all to a series of claims arising from defects in mass-produced products.

[24] *See* Amended Complaint, Ex. 14 in *Medline Indus., Inc. v. Landmark American Ins. Co.*, No. 12-cv-5464, Doc. No. 6-11, Page ID No. 755 (N.D. Ill. Sept. 13, 2012).

For example, in *Conagra Food, Inc. v. Lexington Insurance Co.*, Lexington's umbrella policy sat above a self-insured retention of $1 million. The insured faced thousands of bodily injury claims arising out of salmonella-tainted peanut butter. The policy contained a standard form occurrence definition, which was modified by a batch clause that defined a "lot" or "batch" as "a single production run at a single facility not to exceed a 7 day period." All of the peanut butter had been produced at a single plant, but the production run exceeded seven days. Arguing that the purpose of the batch clause had been to expand, not contract, coverage, the insured persuaded the court that the batch clause should be disregarded. The court instead relied upon the policy's basic "occurrence" definition. Under Delaware's "cause" test, this resulted in policyholder only needing to satisfy a single "occurrence" SIR. As collected in *Conagra*, there are many courts that have agreed with the position that the regular "occurrence" definition, rather than a batch clause, applies if application of the batch clause would result in reducing the amount of coverage available to the policyholder.[25]

B. Anatomy of a Multi-Layer "Batch Clause" Dispute: *National Union v. Donaldson*

A notable example of a batch clause dispute that ensnared the policyholder and both its primary and excess insurers is addressed in a series of decisions rendered by Judge Tunheim of the District of Minnesota in *National Union Fire Insurance Co. v. Donaldson Co.*[26] The underlying lawsuits involved a defectively designed plastic component that the insured manufactured at two different plants over the course of several years for incorporation into the air-intake system of diesel trucks; claims were asserted by approximately 15 individual truck purchasers and by a distributor, encompassing a total of approximately 100 trucks.[27] The policies consisted of (a) consecutive AIG primary policies issued from 1996 to 2002, each of which carried a $500,000 per-occurrence deductible and

[25] 21 A.3d 62, 69-72 (Del. 2011).

[26] See Civ. No. 104948, 2012 U.S. Dist. 44931 (D. Minn. March 30, 2012) ("*Donaldson I*"); 2015 U.S. Dist. LEXIS 35499, 2015 WL 1292561 (D. Minn. March 23, 2015) ("*Donaldson II*"); and 2017 U.S. Dist. LEXIS 201328, 2017 WL 6210915 (D. Minn. December 6, 2017) ("*Donaldson III*).

There were several other decisions rendered in *Donaldson* addressing questions not directly relating to the application of the "batch clause." *See, e.g., National Union v. Donaldson*, 272 F. Supp. 3d 1099 (D. Minn. 2017) (addressing insured's bad faith claims arising from primary insurer's changed positions as to the number of $500,000 deductibles the insured was required to pay).

[27] *See Donaldson I*, 2012 U.S. Dist. 44931 at *3-*5.

$1 million per-occurrence and aggregate limits:[28] and (b) first layer excess policies issued by Federal that sat immediately above and followed-form to each AIG primary policy.

The Batch clause in the AIG primary policies provided that the term "occurrence: was amended such that:

> [all] "property damage*" arising out of and attributable directly or indirectly to* the continuous, repeated or related exposure to *substantially the same general conditions affecting one lot of goods or products manufactured, sold, handled or distributed* by you or others trading under your name, shall be deemed to result from a single "occurrence." *Such "occurrence" will be deemed to occur with the first injury notified to you during the policy period.*

(Italics added.)[29] Thus, not only did the Batch clause treat claims arising from a single "batch" as constituting a single "occurrence," it also treated the injuries from all such claims from a single "batch" as occurring duing the policy period in which the policyholder received first notice of injury.

The underlying claims settled in two stages, consisting of approximately $214,000 paid to the various individual truck purchasers, followed by a $6 million settlement of the dealer's claims. The settlements were funded by the primary and excess insurers subject to a reservation of rights as to the amounts owed by each, and by the insured as deductible(s).[30]

The AIG primary policies did not define the term "lot." The court therefore relied upon dictionary definitions to construe "lot" as meaning ""each type of unique product as a distinct group, kind, or sort" wiithout any "arbitrary temporal limitation."[31] The insured and primary insurer urged that there was only a single

[28] The existence of $1 million aggregate limits in the AIG policies is inferred. None of the opinions states that AIG policies had any aggregate limits at all. But the court's ultimate determination that there were two "lots" – and hence two "occurrences" – obligating the insured to pay two deductibles but imposing merely a $1 million obligation on AIG makes sense only if the AIG primary policies had $1 million aggregate limits. *See Donaldson III*, 2017 U.S. Dist. LEXIS 201328 at *9-*10.

[29] *Donaldson I*, 2012 U.S. Dist. LEXIS 44931 at *10.

[30] *Donaldson III*, 2017 U.S. Dist. LEXIS 201328 at *3-*4.

[31] *Donaldson* I, 2012 U.S. Dist. LEXIS 44931 at *45-*46, quoted in *Donaldson II*, 2015 U.S. Dist. LEXIS 35499 at *28.

"lot" at issue because all of the claims arose out of a single design defect, whereas the excess insurer urged that there were 22 separate "lots," based upon the frequency of "break[s] in production" and the subsequent reassembly of the product molds "to continue production, even if the molds were the same and the product designs and materials were unchanged."[32]

Ultimately, the court concluded that there were two "lots" based upon "differences in their product numbers, specifications, and base materials [that] are significant enough to treat each as a distinct group, kind, or sort, and, therefore, a separate lot." This result was very much dependent on the actual wording of the batch clause (as it should be), which contained no temporal limitation as to the duration of manufacture of any single "lot."[33]

The parties also disputed the policy periods to which the claims should be assigned. The insured and primary carrier urged that they all should be assigned to the 1999-2000 policy period, relying upon the last sentence of the Batch Clause and the timing of the insured's first awareness of any claim; the court agreed.[34] Federal argued that the claims should be allocated to all six policy periods, which would have delayed the exhaustion of the underlying limits. Federal initially reasoned that the claims entailed a minimum of seven lots and that all six policy periods were triggered because the insured's first notice of claims needed to be separately determined as to each individual lot. After the court rejected Federal's contention as to the number of lots, Federal argued that all six policy periods were nonetheless involved because, even though its policies followed form to the AIG primary policies, the coverage could not be all lumped into Federal's 1999-2000 umbrella because of explicit langage in that policy requiring that "injury … takes

[32] *Donaldson II,* 2015 U.S. Dist. LEXIS 35499 at *26-*28. The description above glosses over significant disagreements between the insured and AIG over the course of the litigation as to the number of occurrences that existed for purposes of computing the number of $500,000 deductibles under the AIG policies. Although AIG had initially treated all of the claims as entailing only a single "occurrence," assigned to a single policy period for which only a single deductible was owed, AIG subsequently contended that the insured was required to pay a separate $500,000 deductible for each of the six policy periods – i.e., $3 million total. *See Donaldson I*, 2012 U.S. Dist. LEXIS 44931 at *11-*16.

[33] *Donaldson II*, 2015 U.S. Dist. LEXIS 35499 at *29-*30. Compare the batch clause in *Conagra*, quoted above, that limited the size of any "lot" to a seven-day production run. (See p. 13, *supra*.)

[34] *Id.* at *34-*35.

place during the Policy Period of this policy." The court rejected this argument too.[35]

The upshot of the court's rulings was that the insured owed two deductibles totalling $1million, AIG as primary insurer owed $1 million based on the $1 million aggregate limit of its 1999-2000 policy, and coverage for the remainder of the settlements was owed by Federal.[36]

IV.
Concluding Remarks

After reviewing the myriad coverage disputes that arise from uncertainty as to the number of "occurrences" or "batches," one might wonder why anyone buys insurance where the "occurrence" and "aggregate" limits are not identical, or that lack aggregate SIRs or deductibles. From a claims perspective, it would be much simpler to determine the scope of coverage if there never was asymmetry between the "occurrence" and "aggregate" limits, deductibles, or SIRs of any policy.

This observation would ignore the equally important underwriting perspective, however. Higher "occurrence" limits that match a policy's aggregate limit or an aggregate deductible/ SIR that capped the insured's deductible/ SIR may not be available except at a much higher premium. For insureds who manufacture or distribute a wide range of products, for example, the availability of multiple "occurrence" limits may have considerable value even if the full amount of their aggregate limits are not available to cover the totality of claims arising from defects in a specific product that is deemed a single "occurrence."

In the meantime, so long as policies are written with asymmetric "occurrence" and aggregate limits, deductibles, or SIRs, coverage lawyers for both policyholders and insurers can expect to continue to represent their clients in self-interested litigation designed to count the number of "occurrences" in a manner that benefits their respective clients.

[35] *Id.*; *Donaldson III*, 2017 U.S. Dist. LEXIS 201328 at *9-*10.

[36] *Donaldson III*, 2017 U.S. Dist. LEXIS 201328 at *8-9.

Draft 3/22/2019

Controlling The Defense: When Great Minds Don't Think Alike – The Dynamics Of Policyholder, Primary And Excess Insurer Interests In High Exposure Cases

Speakers:

Marion B. Adler – Adler Law Practice, LLC

Dominica C. Anderson – Duane Morris LLP

Douglas M. McIntosh – McIntosh, Sawran & Cartaya P.A.

Moderator:

Marcus B. Snowden – Snowden Law P.C.

Article Coordinator:

G. David Godwin – Squire Patton Boggs LLP

ACCC 2019 ANNUAL MEETING

Controlling The Defense: When Great Minds Don't Think Alike – The Dynamics of Policyholder, Primary and Excess Insurer Interests In High Exposure Cases

Introduction

High risk - high value third party liability claims pique the interest of all parties who share in that risk including the policyholder, primary insurer and umbrella[1] or excess insurer. All three have a unity of interest in defending the claim, but each has very different goals in its resolution.

The policyholder demands that the claim be defended and resolved without having to come out of pocket itself, at least nothing more than the applicable deductible or self-insured retention. The policyholder also wants to preserve its insurance assets, which could mean pressuring the primary insurer to mount an aggressive and costly defense and pay as little in settlement as possible. This assumes the primary insurer must pay defense costs in addition to the policy limit. Where the primary policy includes defense costs within the limit (aka a burning limits policy), the policyholder will likely pressure the primary insurer to resolve the case as quickly and inexpensively as possible to preserve some portion of the aggregate limit for the next claim.

The primary insurer who pays defense costs in addition to the policy limit strives to settle the claim as quickly as possible. If the claim is likely to exceed the primary insurer's limit of liability, the primary insurer will seek to tender its limit and pass the defense to the excess insurer. Tendering the limit to the excess insurer and passing the defense is more easily accomplished where the primary policy includes defense costs within the limit, since the maximum the primary insurer will pay is its limit of liability.

Finally, the excess insurer is motivated to monitor the claim and pressure the primary to mount an aggressive defense and settle the claim within the primary policy's limit. In this respect, the excess insurer's goals are aligned with the policyholder's. However, if the claim can be settled only with contribution from the excess insurer, the table turns and the primary insurer and policyholder team up to pressure the excess to contribute to resolve the claim or assume the defense.

[1] For purposes of this paper, we focus on the excess coverage provisions of umbrella policies, which provide insurance once the primary policy limit exhausts by payment of judgments or settlements. We utilize the terms "excess policy" and "excess insurance" to refer to both excess policies and the excess provisions of umbrella policies.

This paper explores the fundamental principles governing the control of the defense of high value claims including selection of counsel, who controls the defense, who controls whether to settle and selected issues causing conflicts between the parties.

I. Who Controls the Defense of High Exposure Third Party Lawsuits?

It is critical to have a clear understanding of which of the parties have defense obligations, when those obligations are triggered and whether payment of defense expenses erode policy limits, in order to determine the respective rights of the policyholder, primary insurer and excess insurer for high exposure claims. Although liability policies often utilize standard industry forms, the provisions defining each party's defense obligations are not uniform.

Some policyholders choose to retain a portion of the risk through self-insured retentions ("SIRs"), deductibles or retrospective premiums. A SIR refers to a specific sum or percentage of loss that must be paid by the policyholder before there is any coverage under the primary policy. Often, SIRs include the cost of defense as well as the damages payable to the third party. Deductibles generally only apply when there is a payment for damages, but this could affect who the decision-makers are for settlement purposes. Finally, retrospective premiums may include defense as well as indemnity costs. Each of these risk retention features could factor into the determination of whether the policyholder has some control over the defense and settlement of a claim.

Primary insurance policies typically include a duty to defend lawsuits that seek damages for bodily injury, property damage or personal injury.[2] The costs of defense are also typically in addition to the primary policy's limit of liability for any damages resulting from judgment or settlement of the claim.[3] Case law almost uniformly holds that such provisions give control of the defense and settlement of claims to the primary insurer, at least at the outset until the full extent of the risk is understood.

Some primary policies and many excess policy forms that cover defense costs expressly provide the payment of defense costs erode the available limit of liability.[4] Some excess policy

---

[2] The Insurance Services Office ("ISO") Commercial General Liability Coverage Form (CG 0001 04 13 [2012]) provides in pertinent part:

SECTION I – COVERAGES

COVERAGE A – BODILY INJURY AND PROPERTY DAMAGE LIABILITY

1. Insuring Agreement

   a. We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend the insured against any "suit" seeking those damages. However, we will have no duty to defend the insured against any "suit" seeking damages for "bodily injury" or "property damage" to which this insurance does not apply. We may, at our discretion, investigate any "occurrence" and settle any claim or "suit" that may result.

[3] *See e.g.*, Supplementary Payments – Coverages A and B.

[4] ISO Commercial Excess Liability Coverage Form (CX 00 01 04 13 [2012]) provides that defense costs are included as "ultimate net loss", which applies against the limit of liability, but only where the primary policy specifies that limits are reduced by defense expenses. *See* CX 00 01 04 13, Section IV Definition 6.

forms exclude the duty to defend but may or may not cover defense costs. Often such policies do not place control of the defense or settlement of claims with the insurer. However, they typically do require the consent of the insurer before any settlement or payment is agreed to by the policyholder.

Because of this variety in how defense obligations are treated, the first step in determining who controls the defense and settlement of claims is to map out the relevant policy language and analyze the applicable law construing those provisions. This will provide a foundation for advising the client on its rights and obligations through each stage of the claims, from notice to resolution. Some of the more common issues encountered for high exposure claims are addressed below.

A. Notice of the High Exposure Lawsuit

Once the policyholder receives a lawsuit, the provisions of a primary policy typically require prompt notice to the primary insurer.[5] Notice to the excess insurer is generally required if the lawsuit may result in a claim under the excess policy.[6] Providing notice is the contractual obligation of the policyholder. There is no privity of contract between the primary and excess insurer; however, courts have held that a primary insurer is obligated to keep the excess insurer informed of significant events concerning the claim including notice of the existence of the claim, at least where the identity of the excess insurer is known to the primary insurer.[7] The rationale supporting this obligation stems from the primary insurer's duty of good faith in defending and settling suits.[8]

Failure to provide prompt notice may provide grounds for the insurer to deny coverage. In most jurisdictions, an insurer is not obligated to provide coverage for any defense costs incurred prior to receipt of notice (commonly referred to as "pre-tender costs").[9] The majority of jurisdictions also require that the insurer establish it was prejudiced by the late notice, in

---

[5] Section IV of the ISO Commercial General Liability Coverage Form (CG 0001 04 13 [2012]) provides in pertinent part: "2. Duties In The Event Of Occurrence, Offense, Claim Or Suit a. You must see to it that we are notified as soon as practicable of an "occurrence" or an offense which may result in a claim."

[6] ISO Commercial Excess Liability Coverage Form (CX 00 01 04 13 [2012]) provides in pertinent part: "Section III – Conditions … 3. Duties In The Event Of An Event, Claim Or Suit a. You must see to it that we are notified as soon as practicable of an "event", regardless of the amount, which may result in a claim under this insurance."

[7] *See United States Fire Ins. Co. v. Am. Nat'l Fire Ins. Co.*, 2002 Phila. Ct. Com. Pl. LEXIS 43, *8 (Pa. Ct. Com. Pl., July 8, 2002).

[8] *See American Centennial Insurance Co. v. Warner-Lambert Co.*, 293 N.J. Super. 567, 681 A.2d 1241, 1245-46 (N.J. Super. Ct. Law Div. 1995); *Lemuel v. Admiral Ins. Co.*, 414 F. Supp. 2d 1037, 1057 (M.D. Ala. Jan. 24, 2006); *United States Fire Ins. Co. v. Am. Nat'l Fire Ins. Co.*, 2001 Pa. Dist. & Cnty. Dec. LEXIS 264 (Pa. D. & C., April 6, 2001); *Monarch Cortland v. Columbia Casualty Co.,* 165 Misc. 2d 98, 626 N.Y.S.2d 426, 431 (Sup. Ct. 1995) ("The court employs the [Guiding Principles for Insurers of Primary & Excess Coverage] as an indication of a practice or a goal of the insurance industry."), *aff'd as modified*, 224 A.D.2d 135, 646 N.Y.S.2d 904 (3d Dep't 1996); Couch on Insurance, § 186:1 (3d ed. 2005).

[9] A 50-State and Canada Survey on this subject is currently being compiled by the General Liability/Excess Committee.

order to avoid coverage altogether.[10] A minority, however, hold that an unreasonable delay in giving notice excuses the insurer from its coverage obligations regardless of whether the delay in notice resulted in prejudice to the insurer.[11] And even as to jurisdictions that usually follow the majority notice-prejudice rule, some hold that the failure to strictly comply with the notice provisions of claims-made policies voids coverage even without prejudice to the insurer.[12] A detailed discussion of the law concerning pre-tender costs and late notice are beyond the scope of this paper, but consideration must be given to these issues where there is any question of whether notice was untimely.

B. Selection of the Defending Insurer

Where the third party claim[13] implicates a single policy period or only one primary policy exists that potentially covers the claim, the issue of which primary insurer must defend is not in question. However, if the claim implicates multiple primary policies, the policyholder may demand a defense from all. A few courts allow an insured to select the policy from which it may receive a defense.[14] The application of this rule varies by jurisdiction, but it generally requires the selected insurer to provide a complete defense for the policyholder even where multiple primary policies are triggered by the claim. Whether the selected insurer is entitled to contribution from the other triggered policies also varies by jurisdiction.

C. Selection of Defense Counsel

Generally, the primary insurer with the duty to defend has the right to select defense counsel.[15] The exception to that rule may exist when a conflict of interest arises because the primary insurer has reserved its right to deny coverage. Some courts hold that any reservation requires independent counsel.[16] While others require that basis for the reservation involve a

---

[10] *See* Todd S. Schenk & Aon Hussain, *Late Notice and the Prejudice Requirement: A 50-State Survey* (Dec. 2016), *available at* https://www.tresslerllp.com/docs/default-source/Publication-Documents/chicago1--677316-v3-50_state_survey_late_notice_prejudice_update_klb.pdf?sfvrsn=0.

[11] *Id.*

[12] *See generally* Ellis I. Medoway, *The Notice-Prejudice Rule Debate in Claims-Made Policies*, COVERAGE (ABA Sept. 14, 2017), available at https://www.americanbar.org/groups/litigation/committees/insurance-coverage/articles/2017/winter2017-notice-prejudice-rule/.

[13] Most general liability primary policies limit the duty to defend to "suits." Our use of the term "claim" is not meant to imply that claims or demands short of a lawsuit implicate the duty to defend under such policies. Primary policies written on a claims-made basis – such as EPLI, D&O, and E&O policies – typically phrase the insurer's defense obligation in terms of "claims,"however, rather than "suits."

[14] *See Kajima Const. Services, Inc. v. St. Paul Fire and Marine Ins. Co.*, 858 N.E.2d 234 (Ill. 2006) (limited to concurrent primary policies); *Enumclaw Ins. Co. v. USF Ins. Co.*, 191 P.3d 866 (Wash. 2008); *Casualty Indem. Exchange Ins. Co. v. Libert Nat. Fire Ins. Co.*, 902 F.Supp. 1235 (D. Mont. 1995); *Cargill, Inc. v. ACE American Ins. Co.*, 766 N.W.2d 58 (Minn. App. 2009); *J.H. France Refractories Co. v. Allstate Ins. Co.*, 534 Pa. 29, 626 A.2d 502, 510 (Pa. 1993) (policyholder may select the primary insurer who must defend where the insurers could not agree on who should conduct the defense); *Keene Corp. v. Ins. Co. of N. Am.*, 667 F.2d 1034, 1051 (C.A.D.C. 1981).

[15] *See* New Appleman on Insurance Law Library Edition (Matthew Bender & Co. 2018) § 16.04, The Tripartite Relationship Among the Insured, the Insurer and Insurer-Directed Defense Counsel.

[16] *See* 1 General Liability Insurance Coverage § 6.01 (4th Ed. 2018), for a 50-State Survey.

fact or issue in dispute in the underlying litigation.[17] Where a reservation involves such facts or issues, courts find an actual conflict exists requiring counsel whose loyalties are to the policyholder, to avoid a conflict of interest.

When the policyholder has the right to independent counsel, generally the policyholder is entitled to counsel of its choice.[18] However, the policyholder does not always have that right. For example, an Oregon environmental statute provides that the insurer must appoint independent counsel when the primary insurer has reserved its rights or if there is a potential for liability in excess of the policy limits.[19]

Consequently, the policy, case law and applicable statute should be consulted in order to confirm whether the policyholder has any say in the selection of defense counsel.

D. Entitlement to Coordinating Counsel

The value of coordinating counsel in multi-jurisdictional or multi-claim scenarios is not a question for this presentation. Certainly, coordinating counsel may provide consistency to a policyholder's approach to legal and factual issues when faced with numerous claims involving, for example, a single product defect or mode of operation. But must an insurer defending a specific lawsuit pay the cost of coordinating counsel? There is little case law on this subject.

The policy provisions defining the defense obligation focus on the costs necessary to defend the suit in question. For this reason, an insurer may object to paying costs not directly associated with that defense. Courts that have addressed the issue analogize it to the situation where tasks are duplicated by more than one attorney or firm and hold that insurers must pay for legal work performed at a reasonable cost that is related to the defense of the policyholder regardless of whether that work is performed by a single law firm or allocated among national counsel and various local counsel.[20]

E. The Excess Insurer's Defense Obligations

1. When Must An Excess Insurer Defend?

Excess policies that either incorporate or contain provisions stating there is a duty to defend the policyholder are contingent upon the exhaustion of a predetermined amount of underlying insurance or a policyholder's retained limit.[21] Actual payment, as opposed to incurred but not paid, of the underlying limits is typically required. Where the policyholder has

---

[17] *See Elacqua v. Physicians' Reciprocal Insurers*, 860 N.Y.S.2d 229 (N.Y. App. Div. 2008); *Mut. Serv. Cas. Ins. Co. v. Luetmer*, 474 N.W.2d 365, 368 (Minn. App. 1991); Cal. Civ. Code § 2860.

[18] *See e.g. Armstrong Cleaners, Inc. v. Erie Ins. Exchange*, 364 F. Supp. 2d 797, 817 (S.D. Ind. 2005)

[19] 2017 O.R.S. 465.483

[20] *See e.g., Watts Water Techs., Inc. v. Fireman's Fund Ins. Co.,* 2007 Mass. Super. LEXIS 266 *22-24 (Super. Ct. Mass. July 10, 2007); *Viking Pump v. Century Indem. Co.*, 2014 Del. Super. LEXIS 2044 *8 (Super. Ct. Del. June 9, 2014) supplemental opinion and clarified by 2014 Del.Super.LEXIS 707 (insured required to reasonably allocate its national coordinating costs among the individual asbestos claims for payment).

[21] *See* Ostrager & Newman, *Handbook on Insurance Coverage Disputes* § 6.02[a] (19th ed. 2019).

paid some portion of the loss itself, it will argue that the payments fill any gaps not paid by the primary. Whether payment must be by the insurer is dependent on the policy language and applicable law.[22] An emerging coverage question is whether a court-determined reallocation of indemnity payments between insurers could qualify as a sort of "retroactive exhaustion" of limits, where a genuine dispute existed over contribution shares.[23] Either way, the policyholder will contend that both the primary and excess insurer must defend the claim and that inter-insurer disputes should not require the policyholder to defend itself. Consequently, both the primary and excess insurer are often faced with the decision of whether to defend the claim and seek reimbursement for costs paid after the court determines the date when the primary limit is exhausted.

2. Sharing of Defense Costs Between Primary and Excess Insurers

When a high exposure claim is likely to exceed the primary limit, the question arises whether the excess should share in the cost of defense. The answer again depends on the policy language and applicable law. Some excess policies expressly provide for an allocation of defense costs based on the proportion of indemnity (loss) paid under the excess policy as compared to that paid by the primary policy. Absent such express sharing provisions, courts have fashioned a number of solutions. The general rule is that the primary policy bears all costs of defense, until the limit is exhausted.[24] A few courts equitably allocate defense costs when it is apparent from the outset that the primary limits are inadequate.[25]

3. Right to Associate

Most excess policies provide an express right to associate in the defense of a claim that may implicate coverage under the excess policy. This right can exist even where the excess policy disclaims any duty to defend. Court's generally hold that the right to associate in the defense does not impose a duty to defend.[26]

II. Who Controls Whether and When to Settle High Exposure Third Party Lawsuits?

The primary insurer with a duty to defend generally has control over all aspects of the defense including settlement negotiations absent specific policy language to the contrary.[27] The primary insurer's duty to settle is based on the implied covenant of good faith, which

---

[22] *See Qualcomm, Inc. v. Certain Underwriters at Lloyd's, London,* 161 Cal. App. 4th 184 (2008) (payment by the insurer is required); *JP Morgan Chase & Co. v. Indian Harbor Insurance Co.*, 98 A.D.3d 18, 947 N.Y.S.2d 17, 21 (N.Y. App. Div. 2012); *Citigroup Inc. v. Federal Insurance Company*, 649 F.3d 367, 373 (5th Cir. 2011); *Trinity Homes, LLC v. Ohio Cas. Ins. Co.*, 7th Cir. 653, 658-69 (7th Cir. 2010) (where primary insurers paid at least 75% of their policy limits and policyholder paid the balance of those limits, the excess insurer's coverage obligations had matured); *Comerica Inc. v. Zurich American Insurance Co.*, 498 F. Supp. 2d 1019, 1029-30 (E.D. Mich. 2007).

[23] *See Certain Underwriters at Lloyds of London v. Illinois National Ins. Co.*, Case No. 09-CV-4418 (S.D.N.Y. Sept. 30, 2016).

[24] *See* Ostrager & Newman, *Handbook on Insurance Coverage Disputes* § 6.03 (19th ed. 2019).

[25] *See e.g.*, *Columbia Cas. Co. v. U.S. Fid. & Guar. Co.,* 178 Ariz. 104, 106, 870 P.2d 1200, 1202 (Ariz. Ct. App. 1994).

[26] *See* Ostrager & Newman, *Handbook on Insurance Coverage Disputes* § 6.03 [e] (19th ed. 2019).

[27] Professional malpractice coverage, for example, often requires the insured's consent to settlement.

requires it to consider the interests of the insured equally with its own and evaluate settlement proposals without regard to whether the underlying claim is covered.[28] A primary insurer that refuses a reasonable settlement demand[29] within policy limits may be liable for the entire settlement or judgment, unless the claim is not covered under the policy.[30]

The primary insurer's duty to settle may also be enforced by an excess insurer, under the theory of equitable subrogation. Specifically, where a primary insurer fails to accept a reasonable settlement offer within the limit of its policy, some courts recognize the excess insurer is subrogated to the policyholder's rights and may seek reimbursement of amounts paid to settle the suit.[31] A number of courts further allow an excess insurer to enforce a policyholder's claim for bad faith refusal to settle through equitable subrogation.[32] A few courts recognize the right of an excess insurer to bring a direct action for bad faith against the primary insurer for failure to settle.[33]

But what happens when a reasonable settlement demand is received that is within the combined limits of the primary and excess policies? California courts have held that under certain conditions, the primary insurer can enter into a settlement that invades the limit of the excess policy, without the consent of the excess insurer.[34] Alternatively, the primary insurer may be able to recover defense costs incurred after the settlement opportunity is lost due to the excess insurer's refusal to settle.[35]

---

[28] *See e.g., Johansen v. California State Auto. Assn. Inter-Ins. Bureau*, 15 Cal.3d 9, 16, 538 P.2d 744 (1975)*; N. Am. Van Lines, Inc. v. Lexington Ins. Co.,* 678 So. 2d 1325, 1332 (Fla. Ct. App. 1996).

[29] A few jurisdictions hold that an insurer has an affirmative duty to initiate settlement discussions. *See e.g. Fulton v. Woodford*, 545 P.2d 979, 984 (Ariz. Ct. App. 1976); *Goheagan v. Am. Vehicle Ins. Co.*, 107 So.3d 433, 438 (Fla. Dist. Ct. App. 2012); *Moratti v. Farmers Ins. Co. of Wash.*, 162 Wash.App. 495, 504, 254 P.3d 939 (2011), review denied, 173 Wash.2d 1022, 272 P.3d 850 (2012)

[30] *See* 1 New Appleman Insurance Bad Faith Litigation § 2.03.

[31] *See Nat'l Sur. Corp. v. Hartford Cas. Ins. Co.,* 493 F.3d 752, 756-57 n.2 (6th Cir. 2007) (collecting cases showing that the majority approach is followed in twenty-seven states)*; see also Twin City Fire Ins. Co. v. Superior Court*, 792 P.2d 758 (Ariz. 1990); *Fireman's Fund Ins. Co. v. Maryland Casualty Co.*, 21 Cal. App. 4th 1586, 26 Cal. Rptr. 2d 762, 771-72 (Cal. App. 1994); *Galen Health Care v. American Casualty Co.*, 913 F. Supp. 1525 M.D. Fla. Jan. 25, 1996); St. Paul Fire & Marine Ins. Co. v. Liberty Mut. Ins. Co., 135 Haw. 449, 455, 353 P.3d 991 (Haw. Sup. Ct. 2015); *United Heritage Prop. & Cas. Co. v. Farmers Alliance Mut. Ins. Co.*, 2011 U.S. Dist. LEXIS 160458 (D. Idaho, Sept. 22, 2011); *Great Southwest Fire Co. v. CNA Insurance Co.*, 547 So. 2d 1339 (La. App. 1989); *Hartford Casualty Insurance Co. v. New Hampshire Insurance Co.*, 417 Mass. 115, 628 N.E. 2d 14 (1994); *Commercial Union Insurance Co. v. Medical Protective Co.*, 426 Mich. 109, 393 N.W.2d 479 (1986); Continental Casualty Co. v. Reserve Ins. Co., 307 Minn. 5, 8-9, 238 N.W.2d 862 (Minn. Sup. Ct. 1976); *Phoenix Insurance Co. v. Florida Farm Bureau of Mutual*, 558 So. 2d 1048 (1990); *Ranger Insurance Co. v. Travelers Indemnity Co.*, 389 So. 2d 272 (1980); *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d 765, 774 (Tex. 2007); *American Centennial Insurance Co v. Canal Insurance Co.*, 843 S.W.2d 480 Tex. 1992).

[32] *See Scottsdale Ins. Co. v. Addison Ins. Co.*, 448 S.W.3d 818, 832, n.10 (Mo. 2014).

[33] *See* Ostrager & Newman, *Handbook on Insurance Coverage Disputes* § 13.07 (19th ed. 2019).

[34] *Fuller-Austin Insulation Co. v. Highlands Ins. Co.*, 135 Cal. App. 4th 958, 986-87 (Cal. Ct. App. 2006); *Diamond Heights Homeowners Assn. v. National American Ins. Co.*, 227 Cal. App. 3d 563, 580, 277 Cal. Rptr. 906 (Cal. Ct. App. 1991).

[35] *See e.g. Am. Alternative Ins. Corp. v. Hudson Specialty Ins. Co.,* 938 F. Supp. 2d 908 (C.D. Cal. April 3, 2013).

Likewise, some courts hold that when presented with a reasonable settlement offer in excess of the primary policy's limit of liability but within the excess policy's limit, the excess insurer owes a duty of good faith to the policyholder in considering whether to accept the demand.[36] To trigger this obligation, the primary insurer may have to tender its policy limit.[37] Those courts define the excess insurer's options to include: (1) approving the settlement and contributing its share, (2) rejecting the settlement and assuming the defense, or (3) refusing settlement thereby exposing itself to risk of liability in excess of the policy limit.[38]

III. Significant Issues Causing Conflicts

A. Horizontal or Vertical Exhaustion

High exposure claims that trigger multiple policy periods often result in a battle over whether the policyholder must exhaust all primary policies before seeking coverage under its excess insurance. This is commonly referred to as "horizontal exhaustion." In contrast, "vertical exhaustion" is where coverage attaches under an excess policy when the limit of a specifically scheduled underlying policy is exhausted.[39] Excess insurers will often claim that their policies afford no coverage unless and until all underlying primary policies have paid their limits for each occurrence. Courts that follow the horizontal exhaustion rule rely on various provisions of excess policies that require all other insurance to respond to the claim before coverage attaches under the excess policy. Where such provisions exist, the primary insurer may be required to defend the entire claim, even where its limit clearly is inadequate to resolve the claim.[40]

B. Number of Occurrences

A common point of conflict involves the number of occurrences at issue. The excess insurer may contend that a claim involves multiple occurrences such that the primary insurer remains obligated to defend until the limits applicable to all occurrences are exhausted. Conversely, the primary insurer may argue there is only a single occurrence or that the costs of defense can be segregated between occurrences, requiring the excess insurer to defend and pay for costs associated with the occurrence where the underlying limit has been fully paid. This situation is commonly associated with environmental claims, especially when they involve multiple contaminating events or sites; product liability and completed operations claims involving mass-produced products; and, in recent years, unfortunately, employer liability for

---

[36] *See e.g. State Farm Mut. Auto. Ins. Co. v. Mendoza*, 2006 U.S. Dist. LEXIS 709 *28-29 (D. Ariz. Jan. 5, 2006); *Keck v. National Union Fire Ins. Co.*, 20 S.W.3d 692, 701 (Tex. Sup. Ct. 2000).

[37] *See SRM, Inc. v. Great Am. Ins. Co.*, 798 F.3d 1322, 1329 (10th Cir. 2015); Ostrager & Newman, *Handbook on Insurance Coverage Disputes* § 13.04 (19th ed. 2019).

[38] *See Diamond Heights Homeowners Ass'n v. Nat'l Am. Ins. Co.*, 227 Cal. App. 3d 563, 277 Cal. Rptr. 906 (1991); *Teleflex Med. Inc. v. Nat'l Union Fire Ins. Co.*, 851 F.3d 976 (9th Cir. 2017) (applying the law of California);

[39] *See e.g., Community Redevelopment Agency v. Aetna Cas. & Sur. Co.*, 50 Cal. App. 4th 329, 57 Cal. Rprt. 2d 755 (1996).

[40] *See* Ostrager & Newman, *Handbook on Insurance Coverage Disputes* § 13.14 (19th ed. 2019); *State By State Survey: Horizontal and Vertical Exhaustion in the Additional Insured Context*, available at http://www.sdvlaw.com/docs/news.23.pdf.

negligent hiring or retention of employees engaged in sexual assault. This issue is dealt with in more detail in a companion paper for this presentation.[41]

C. Covered vs Non-Covered Damages

Finally, many high exposure claims include allegations of damages falling both within and outside the coverage provided by the policies. These claims are referred to as "mixed claims." Examples include punitive damages, equitable relief or economic losses associated with business operations. Courts generally require the primary insurer to defend the entire lawsuit, regardless of the existence of non-covered claims. Some jurisdictions permit the insurer to reserve the right to recoup costs solely related to the defense of the non-covered claim, but the burden is on the insurer to establish those costs.

When a reasonable settlement demand is received, the policyholder will call for its insurers to settle the matter without its contribution. Whether the insurer can demand participation by the policyholder varies by jurisdiction.[42] In California and certain other jurisdictions, the insurer may offer to settle a mixed claim under the reservation of the right to seek reimbursement from the insured for that portion related to non-covered claims.[43]

In the event the claim proceeds to judgment, whether the insurer must pay the full amount may be dependent on the form of judgment. If by general verdict, there will be no allocation between covered and non-covered claims. This raises the issue of whether the defending insurer may demand a special verdict or whether it is the insured's burden to demand a special verdict in order to prove the amount of covered damages.[44] Confounding this issue is whether one form of verdict is more beneficial to the overall defense of the claim. If so, the policyholder will demand that its defense strategy takes precedent over the coverage issue.

---

[41] *See* Marion B. Adler, *ONE MAN'S CEILING IS ANOTHER MAN'S FLOOR: MULTILAYER COVERAGE CHALLENGES ARISING FROM THE NUMBER OF "OCCURRENCES" AND "BATCHES".*

[42] Ostrager & Newman, *Handbook on Insurance Coverage Disputes* § 12.05 [g] (19th ed. 2019)

[43] *See Blue Ridge Ins. Co. v. Jacobsen,* 25 Cal. 4th 489, 106 Cal. Rptr. 2d 535, 22 P.3d 313 (Cal. 2001).

[44] *See* David A. Grossbaum & Meghan C. Moore, *USING SPECIAL VERDICT QUESTIONS TO DECIDE COVERAGE: Parties Should Consider Asking Special Jury Questions in the Underlying Case to Avoid Impairing Coverage Issues*, Presented at the ABA Section of Litigation Insurance Coverage Litigation Committee CLE Seminar, March 1-3, 2012.

Cyber Risks: Three Basic Structural Issues to Resolve

American College of Coverage Counsel
2019 Annual Meeting

Chicago, IL
May 8-10, 2019

Leo P. Martinez
University of California Hastings College of Law

Pre-publication version March 15, 2019
For discussion purposes only
Not to be cited without author's permission

Cyber Risks: Three Basic Structural Issues to Resolve

By Leo P. Martinez[1]

Abstract

The incidence of cyber liability and cyber losses, collectively cyber risks, have increased greatly over the last several years. To add to the problem, cyber risks also expose insureds to statutory liability.

The increasing number of incidents has given rise to an important question: "to what extent is liability for data breaches covered by a CGL or other sort of insurance policy?" Insurers have responded by including exclusions to mass data breaches in their CGL policies and offering separate plans (with high premiums) to cover such an event. However, insurers face a problem in drafting these policies because there is a lack of judicial information about how these policies will be interpreted by the courts. Without a thorough case history, insurers cannot confidently draft these policies to exclude (or price in) certain high-risk practices.

In this vacuum, several aspects of cyber liability require resolution. A short list of issues will illuminate the problem.

1. The definitional boundaries of exactly what is meant by cyber liability or loss is a basic systemic problem. The range of possible types of losses already seems daunting. It does not bode

[1] Albert Abramson Professor of Law, University of California, Hastings College of the Law. Comments regarding this paper can be directed to the author at martinez@uchastings.edu. I am grateful for the diligent and able research assistance of Paige Adaskaveg, Hastings class of 2019, Andrew Klair, Hastings class of 2020, and Michael (Jake) Winton, Hastings class of 2020. Errors are, of course, mine.

well if the insurance industry and policyholders face scores of coverage cases regarding cyber liability or loss coverage issues that seem only limited by human ingenuity.

2. Will exclusions for cyber liability or losses be effective? The insurance industry's odyssey with respect to the pollution exclusion suggests that a trial and error approach spanning 20 years is not a good idea.

3. Are coverage provisions regarding cyber liability and losses effective? If so, do they affect the basic duties to indemnify and defend?

This paper will address the three issues above with the idea of providing a framework for resolution.

Outline

Introduction

I. Range of Cyber Risks or What's Included/What's Excluded

II. Scope of Existing Coverage

A. Overview of Existing Coverage

B. The CGL policy

C. Specialty Policies, Endorsements, and Cyber Risk Exclusions

III. Everything Old Is New Again

A. Coverage for Cyber Risks Found

B. Coverage for Cyber Risks Denied

IV. Fixing It All

A. Resort to Cyber Security Firms

B. Consolidation of Cyber Perils

C. Risk Rating Mechanisms

Conclusion

Cyber Risks: Three Basic Structural Issues to Resolve

By Leo P. Martinez

Introduction

A staple of Silicon Valley lore is Moore's Law. Moore's Law posits that computer processor speeds will double every two years.[2] To the extent that firms' reliance on digital platforms is correlated to Moore's law, and to the extent malefactors' ability to cause mischief is likewise correlated to Moore's law, we can expect that Moore's Law will eventually apply the same geometric relationship to the incidence of cyber-losses by firms.[3]

In a 2016 study, the Ponemon Institute estimated the probability that any given company will experience a material data breach within 24 months is 26%.[4] The average total cost of such a data breach is estimated to be $4 million per incident, representing a 29% increase in the three years since 2013.[5] This represents costs incurred from network interruption, media liability,

---

[2] Benjamin Ostrander (2000) Chasing Moore's Law: Information Technology Policy in the United States. 5 J. High Tech. L. 5:1 (reviewing WILLIAM ASPRAY RALEIGH, 2004).

[3] Although this should be true, the empirical support for the proposition is weak. Perhaps there is a phase lag that reflects potential policyholder's lack of appreciation of the risk that is faced. For example, the prediction that the implementation of the European Union's General Data Policy Regulation would lead to an increased demand for cyber insurance also failed to materialize. Mengqi Sun, *Europe's Privacy Law Fails to Stoke Demand for Cyber Insurance*, WSJ at B10 (June 21, 2018).

[4] PONEMON INSTITUTE, 2016 COST OF DATA BREACH STUDY: GLOBAL ANALYSIS (2016), https://securityintelligence.com/media/2016-cost-data-breach-study/. Some of the material that follows paraphrases discussion in LEO P. MARTINEZ & DOUGLAS R. RICHMOND, INSURANCE LAW 500 (8TH ED. WEST PUBLISHING CO. 2018).

[5] PONEMON INSTITUTE, 2016 COST OF DATA BREACH STUDY: GLOBAL ANALYSIS (2016), https://securityintelligence.com/media/2016-cost-data-breach-study/. An ironic example of the cobbler's children going unshod is the observation that lawyers, who should be especially vigilant about clients cyber risk issues, are themselves often underinsured in this area. John F. Stephens & Michelle Worrall Tilton, *Lawyers Still Lag Behind in Network and Information Security Risk Management: Clients and Regulators Demand More*, 46 THE BRIEF, no. 4, Summer 2017, at 12 ("Only 17 percent of attorneys reported having a cyber insurance policy . . . .").

extortion liability, network security costs, reputational injury, and disclosure injury. Particularly vulnerable are medium-sized businesses that have large potential exposure to cyber risks but lack the sophisticated IT infrastructure necessary to deal with cyber-attack.[6] The problem of cyber loss is not a transitory one – it will only get worse and, as Moore's Law predicts, it will get worse at a rapidly increasing rate.[7]

This essay proceeds in a linear way. Part I begins with a working definition of cyber risks. Part II describes existing insurance coverage for cyber risks and deals with the difficulties of covering cyber risks. Part III describes the nearly complete lack of case law treatment of cyber risks either on the coverage side or the exclusion side. Finally, Part IV provides a general outline for possible solutions.

The discussion that follows includes both first-party and third-party cases. While I appreciate the distinction between the two, the relatively small number of cases dealing with cyber risks suggests that we should glean information from whatever sources are available.[8]

I. Range of Cyber Risks or What's Included/What's Excluded

"Cyber" has become insurance industry shorthand for a variety of information technology risks, including but not limited to: hardware, software, IT consulting, cloud services, and data

---

rate of cyber coverage among lawyers is marginally better than the 1/3 penetration rate among operating firms. Sasha Romanosky et at., *Content Analysis of Cyber Insurance Polices* 3 (Rand Corp., Working Paper WR-1208, 2017).

[6] John F. Stephens & Michelle Worrall Tilton, *Lawyers Still Lag Behind in Network and Information Security Risk Management: Clients and Regulators Demand More*, 46 THE BRIEF, no. 4, Summer 2017, at 12, 15.

[7] Erica J. Dominitz, *To Err is Human; To Insure, Divine: Shouldn't Cyber Insurance Cover Data Breach Losses Arising (in Whole or in Part) from Negligence?*, 46 The Brief, no. 4, Summer 2017, at 32, 33 (describing cyber losses as "not just a passing fad").

[8] See Robert H. Jerry, II and Michele L. Mekel, *Cybercoverage for Cyber-Risks: An Overview of Insurers' Responses to the Perils of E-Commerce*, 8 CONN. INS. L.J. 7, 11-17 (2001) (discussing first-party and third-party insurance). While used interchangeably in this piece, third-party cyber risk cases are difficult to assess because the duty to defend lowers an insurer's threshold obligations. OOIDA Risk Retention Grp., Inc. v. Griffin, 2016 U.S. Dist. LEXIS 57469 at p. 15 (E.D. Va. 2016) ("burden is not especially onerous as an insurer's duty to defend"); Moreover, it is the insurer who bears the burden of proof regarding exclusions. *Selective Way Ins. Co. v. Crawl Space Door Sys.*, 162 F. Supp. 3d 547, 551 (E.D. Va. 2016).

processing. It is in this very general sense that the term cyber is used in this essay. Because of the dearth of cases, issues involving first-party cyber losses and third-party cyber liability will be treated interchangeably under the rubric of "cyber risks."

The range of cyber risks today seems limited only by human ingenuity. The sheer number and variety of problems that exist make the creation of an effective and predictable exclusion a daunting task. The National Association of Insurance Commissioners (NAIC)[9] and the Insurance Information Institute have both identified long lists of potential cyber problems.[10]

---

[9] At the time *"Breaking Bad" in Cyberspace: A Challenge for the Insurance Industry* was written the list in footnote 10 was published on the NAIC website under the cybersecurity topics page. However, since 2014 the webpage has been updated and NAIC has removed the list below. NAIC's updates do not discount the validity of the list below, rather just that NAIC's focus on this topic has expanded. As of April 30, 2018, NAIC is considering creating a Cybersecurity Insurance Institute, demonstrating how this area of Insurance Law is expanding rapidly. For more information see, https://www.naic.org/cipr_topics/topic_cyber_risk.htm.

[10] *"Breaking Bad" in Cyberspace: A Challenge for the Insurance Industry*, 2015 Emerging Issues 7296 (2015).

The types of Coverage Identified by the National Association of Insurance Commissioners (NAIC) include the following:

- Liability for security or privacy breaches, including loss of confidential information by allowing, or failing to prevent, unauthorized access to computer systems;
- The costs associated with a privacy breach, such as consumer notification, customer support and costs of providing credit monitoring services to affected consumers;
- The costs associated with restoring, updating or replacing business assets stored electronically;
- Business interruption and extra expense related to a security or privacy breach;
- Liability associated with libel, slander, copyright infringement, product disparagement or reputational damage to others when the allegations involve a business website, social media or print media (for an in-depth discussion of specific risks arising from the use of social media, please see Carrie E. CopeCarrie E. Cope, Dirk E. Ehlers & Keith W. Mandell, *Social Media and Insurance: The Insider's Guide to Successful Risk Assessment and Management (2014)*);
- Expenses related to cyber extortion or cyber terrorism; and
- Coverage for expenses related to regulatory compliance for billing errors, physician self-referral proceedings and Emergency Medical Treatment and Active Labor Act proceedings. *"Breaking Bad" in Cyberspace: A Challenge for the Insurance Industry*, 2015 Emerging Issues 7296 (2015) AT P. 29.

The types of cyber risk liability identified by The Insurance Information Institute include an equally impressive listing:

- Loss / Corruption of Data – covers damage to, or destruction of, valuable information assets as a result of viruses, malicious code and Trojan horses;
- Business Interruption – covers loss of business income as a result of an attack on a company's network that limits its ability to conduct business, such as a denial-of-service computer attack--coverage also includes extra expenses, forensic expenses and dependent business interruption;

Other kinds of cyber risks apart from those compiled from the National Association of Insurance Commissioners (NAIC) and the Insurance Information Institute can be gleaned from various articles and secondary materials. These include systems restoration[11], forensic review[12], cost of substitute systems[13], third-party notification[14], interference with military operations,[15]

- Liability – covers defense costs, settlements, judgments and, sometimes, punitive damages incurred by a company as a result of:
- Breach of privacy due to theft of data (such as credit cards, financial or health related data);
- Transmission of a computer virus or other liabilities resulting from a computer attack, which causes financial loss to third parties;
- Failure of security which causes network systems to be unavailable to third parties;
- Rendering of Internet Professional Services; and
- Allegations of copyright or trademark infringement, libel, slander, defamation or other 'media' activities in the company's website, such as postings by visitors on bulletin boards and in chat rooms--this also covers liabilities associated with banner ads for other businesses located on the site;
- D&O / Management Liability – newly developed tailored D&O products provide broad all risks coverage, meaning that the risk is covered unless specifically excluded--all liability risks faced by directors, including cyber risks, are covered;
- Cyber Extortion – covers the 'settlement' of an extortion threat against a company's network, as well as the cost of hiring a security firm to track down and negotiate with blackmailers;
- Crisis Management – covers the costs to retain public relations assistance or advertising to rebuild a company's reputation after an incident--coverage is also available for the cost of notifying consumers of a release of private information, as well as the cost of providing credit-monitoring or other remediation services in the event of a covered incident;
- Criminal Rewards – covers the cost of posting a criminal reward fund for information leading to the arrest and conviction of a cybercriminal who has attacked a company's computer systems;
- Data Breach – covers the expenses and legal liability resulting from a data breach--policies may also provide access to services helping business owners to comply with regulatory requirements and to address customer concerns;
- Identity Theft – provides access to an identity theft call center in the event of stolen customer or employee personal information; and
- Social Media / Networking – insurers are looking to develop products that cover a company's social networking activities under one policy. Some cyber policies now provide coverage for certain social media liability exposures such as online defamation, advertising, libel and slander. Robert P Hartwig & Claire Wilkinson, Ins. Info. Inst., *Cyber Risks: The Growing Threat*, (2014) *available at* http://www.iii.org/sites/default/files/docs/pdf/paper_cyberrisk_2014.pdf; *"Breaking Bad" in Cyberspace: a Challenge for the Insurance* Industry, 2015 Emerging Issues 7296 (2015) AT P. 30-31.

[11] Sasha Romanosky et at., *Content Analysis of Cyber Insurance Polices* 14 (Rand Corp., Working Paper WR-1208, 2017) (mentioning systems restoration in addition to data recovery and data re-creation).
[12] *Id.*
[13] *Id.*
[14] John F. Stephens & Michelle Worrall Tilton, *Lawyers Still Lag Behind in Network and Information Security Risk Management: Clients and Regulators Demand More*, 46 THE BRIEF, no. 4, Summer 2017, at 15.
[15] Stephen A. Wood, et. al., *Aviation and Cybersecurity: An Introduction to the Problem and the Developing Law*, 46 THE BRIEF, no. 4, Summer 2017, at 38-39.

and disruption of infrastructure.[16]

II. Scope of Existing Coverage

As cyber risks have grown, insurance products that cover these risks have arisen in a sporadic and often contradictory way.[17] This section first analyzes the current state of coverage and then examines potential gaps that exist in CGL policies[18], specialty cyber policies, endorsements, and the gaps that exclusions can create in otherwise sound policies.

A. Overview of Existing Coverage

The long list of cyber risk possibilities has resulted in a wide array of insurance coverage products. This diversity in the market has led to several adverse results. First, the large number of insurance products and the lack of standard language has contributed to the lack of definitive case law that focuses on a small set of key concepts.[19] This problem is almost unbelievably basic. For example, some researchers point out that "[i]t is unclear if [mobile devices] are grouped into the standard 'computers, networks, and systems'" language found in many cyber

---

[16] Stephen A. Wood, et. al., *Aviation and Cybersecurity: An Introduction to the Problem and the Developing Law*, 46 THE BRIEF, no. 4, Summer 2017, at 38-39.

[17] John Buchanan, Dustin Cho & Patrick Rawsthorne, *When Things Get Hacked: Coverage for Cyber-Physical Risks*, *in* Hot Topics for ICLC's 40th – the Coverage Battles of 2028, (ABA Litigation Section, Insurance Coverage Litigation Committee, March 3, 2018); Latham & Watkins, *Cyber Insurance: A Last Line of Defense When Technology Fails* 7 (2014).

[18] While Directors and Officers Liability (D&O) policies and Errors and Omissions Liability (E&O) policies are distinct from Commercial General Liability (CGL) policies, the potential gaps in coverage appear to be similar. Latham & Watkins, *Cyber Insurance: A Last Line of Defense When Technology Fails* 7 (2014). Decisions on whether CGL, E&O, and D&O polices cover cyber risk events come down to subtle differences in policy language. The definitional problems described within this article creates the ambiguity of coverage for cyber risks. Jerry Oshinsky & Kenneth Lee, *Insurance Coverage for Cyber Crimes*, L.A. DAILY J., Apr. 14, 2010 *available at* https://jenner.com/system/assets/publications/435/original/Oshinsky_Lee_Coverage_for_Cyber_Crimes_LA_Daily_Journal.pdf?1313595662.

[19] Daniel Schwarcz, *Coverage Information in Insurance Law*, 101 MINN. L. REV. 1457, 1500-02 (2017); John G. Buchanan & Marialuisa S. Gallozzi, *Kicking the Tires on a New Cyber Policy: Top Tips and Traps*, American Bar Ass'n 1 (Jan. 22, 2018), https://www.americanbar.org/groups/litigation/committees/insurance-coverage/articles/2017/cyber-policy-tips-traps.html.

policies.[20] It is instructive that the first cyber risk case was decided in 1991[21] and there have been only on the order of two dozen cases in the time since.

Second, the proliferation of insurance products has also made the task of selecting adequate insurance protection that much more difficult.[22] As one prominent lawyer reasoned, "it takes both expertise and care to spot the traps or coverage gaps that may lurk in any cyber policy form."[23] Of course, the inclusion of non-lawyers as part of the team introduces even more moving parts into the equation including the complication of attorney-client privilege concerns.[24]

Third, and related to the previous point, insureds can face gaps in coverage because of cyber policies that are too narrowly tailored to meet actual needs.[25] This fine-tuning of cyber risk coverage needs to be addressed by the insurance industry. To begin, however, the coverage of cyber risks under standard CGL policies must be analyzed.

B. The CGL policy

The number of incidents involving cyber risks initially gave rise to an important threshold question: to what extent are cyber risks covered or excluded by general insurance policies? CGL insurance policies providing bodily injury, personal injury, and property damage

---

[20] Sasha Romanosky et at., *Content Analysis of Cyber Insurance Polices* 15 (Rand Corp., Working Paper WR-1208, 2017).
[21] *Retail Sys., Inc. v. CNA Ins. Cos.*, 469 N.W.2d 735 (Minn. Ct. App. 1991).
[22] Erica J. Dominitz, *To Err is Human; To Insure, Divine: Shouldn't Cyber Insurance Cover Data Breach Losses Arising (in Whole or in Part) from Negligence?*, 46 THE BRIEF, no. 4, Summer 2017, at 32 pp. 36-37. This may also explain the large variation in pricing among available cyber loss policies. Latham & Watkins, *Cyber Insurance: A Last Line of Defense When Technology Fails* 13 (2014).
[23] John G. Buchanan & Marialuisa S. Gallozzi, *Kicking the Tires on a New Cyber Policy: Top Tips and Traps*, American Bar Ass'n 3 (Jan. 22, 2018), https://www.americanbar.org/groups/litigation/committees/insurance-coverage/articles/2017/cyber-policy-tips-traps.html.
[24] *Id.*
[25] Michael E. Nitardy, *Fraud Involving a Computer is Not Automatically "Computer Fraud"*, 46 THE BRIEF, no. 4, Summer 2017, at 26 on p. 27; Latham & Watkins, *Cyber Insurance: A Last Line of Defense When Technology Fails* 7 (2014).

coverages do not directly address the combination of first and third party cyber exposures.[26]

The traditional kinds of physical losses contemplated under CGL policies are (1) physical injuries to tangible property, including the resulting loss of *use* of tangible property that is physically injured, and (2) loss of *use* of tangible property that is not physically injured.[27] Thus, the early cases involving cyber claims under CGL policies concluded that the CGL policies covered only physical losses – data losses were not the physical kind of losses contemplated by the policies.[28] When cyber risks threaten solely economic losses, or merely losses of data without damage to tangible property, CGL policies are unlikely to provide coverage.

For example, in *Ward General Insurance Services, Inc. v. Employers Fire Insurance Co.*, California's Fourth Appellate District concluded that the loss of a database and the resulting economic loss was not "direct physical loss" due to the absence of damage to tangible property.[29] Similarly, the Fourth Circuit concluded in *America Online, Inc. v. St. Paul Mercury Insurance Co.* that even though a storage method which "consists of the arrangement of 'hundreds of thousands of atoms' of 'cobalt, iron, and other magnetic materials' in a perceivable and unique pattern" is tangible property, the "data information, and instructions, which are codified in binary language for storage" are not.[30] The loss or damage solely to data itself does not fall within the purview of the CGL policy because data is intangible.[31]

---

[26] Latham & Watkins, *Cyber Insurance: A Last Line of Defense When Technology Fails* 7 (2014) (a similar lack characterizes Directors and Officers Liability (D&O) policies and Errors and Omissions Liability (E&O) policies).
[27] 20-129 Appleman on Insurance Law & Practice Archive § 129.2 (2nd 2011).
[28] *Ward General Ins. Services, Inc. v. Employers Fire Ins. Co.*, 114 Cal. App. 4th 548, 554 (2003) (data does not qualify as a "direct physical loss"); *America Online, Inc. v. St. Paul Mercury Ins. Co.*, 347 F.3d 89, 95 (4th Cir. 2003) (while a hard drive is tangible property, the data, information, and instructions, which are codified in a binary language for storage on the hard drive, are not tangible property); *Union Pump Co. v. Centrifugal Tech., Inc.*, 2009 U.S. Dist. LEXIS 86352 (W.D. La. 2009) (electronic data is not tangible property).
[29] *Ward General Ins. Services, Inc. v. Employers Fire Ins. Co.*, 114 Cal. App. 4th 548, 556 (2003).
[30] *America Online, Inc. v. St. Paul Mercury Ins. Co*., 346 F.3d 89, 95 (4th Cir. 2003).
[31] Id. at 96.

To be sure, there are a few cases where the courts held CGL policies to provide some coverage, but these could be seen as exceptions to the general approach.[32] One line of cases held that physical damage to tangible property caused by cyber risks fell squarely within the boundaries of the CGL.[33] Another line of cases held that the loss of use or the diminution of reliability of cyber property could be covered physical loss under a CGL policy.[34] One could easily argue that these few "exceptions" were not exceptions at all but rather attenuated permutations of the basic idea that the CGL policies covered physical loss.

Even in the face of physical loss limitations, policyholders saw some initial success. In a few clear-cut cases the cyber loss was occasioned by a real physical loss. For example, in *Anthem Electronics, Inc. v. Pacific Employers Insurance Company*, Anthem Electronics manufactured several defective circuit boards.[35] These circuit boards caused damage to the scanners they were installed in, and the Ninth Circuit held the loss to be a physical loss.[36] A few cases went further, revealing a willingness of courts to adopt a flexible view of physical loss. One short line of cases was based on the courts' reliance on language borrowed from the federal computer fraud statute and other criminal statutes which make it an offense to cause damage to a protected computer and define damage as "any impairment to the integrity or availability of data,

---

[32] *E.g. Ashland Hosp. Corp. v. Affiliated FM Ins. Co.*, 2013 U.S. Dist. LEXIS 114730 at 18-19 (E.D. Ky. 2013) (direct and physical loss can include loss of reliability); *Eyeblaster, Inc. v. Fed. Ins. Co.*, 613 F.3d 797, 802 (8th Cir. 2010) (loss of *use* of computer was a physical loss).

[33] *See, e.g., Retail Sys., Inc. v. CNA Ins. Cos.*, 469 N.W.2d 735 (Minn. Ct. App. 1991) (holding computer tapes were tangible property); *Centennial Ins. Co. v. Applied Health Care Sys., Inc.*, 710 F.2d 1288, 1290 (7th Cir. 1983) (a faulty controller in data processing system caused damage and a loss of customer data, court held insurer had a duty to defend under CGL as property damage); *Computer Corner, Inc. v. Fireman's Fund Ins. Co.*, 132 N.M. 264, 266 (N.M. Ct. App. 2002) (district court found computer data in case "was physical, had an actual physical location, occupied space and was capable of being physically damaged and destroyed.").

[34] *Ashland Hosp. Corp. v. Affiliated FM Ins. Co.*, 2013 U.S. Dist. LEXIS 114730 at 18-19 (E.D. Ky. 2013); *Eyeblaster, Inc. v. Fed. Ins. Co.*, 613 F.3d 797, 802 (8th Cir. 2010).

[35] *Anthem Elecs., Inc. v. Pac. Emplrs. Ins. Co.*, 302 F.3d 1049 1058-59 (9th Cir. 2002).

[36] *Id*.

a program, a system, or information."[37] This broader reading of loss was the key to recovery. Another case found that the loss of *use* of computer equipment could be a physical loss within the meaning of the policy language.[38]

The unlikely possibility of coverage for cyber risks under the standard CGL policy was reduced further yet by the Insurance Services Office (ISO).[39] The motivation for the change by the ISO seems to have been a desire to remove coverage for cyber risks from the CGL policy and isolate them in specialty policies.[40] Initially, the ISO CGL was ambiguous about whether damage to electronically stored data was covered, but a revision in 2001 to the general CGL policy removed coverage for damage to electronically stored data and a 2004 revision (Exclusion P) excluded damages resulting from loss of electronically stored data.[41] A further revision carved out bodily injury from Exclusion P, and two recent competing endorsements have added exclusions for any damages arising out of "[a]ny access to or disclosure of any person's or

---

[37] *American Guar. & Liab. Ins. Co. v. Ingram Micro, Inc.*, 2000 U.S. Dist. LEXIS 7299; 2000 WL 726789 at 7 (dealing with a property damage policy, which insured against specific business interruption and service interruption losses). In *Ingram Micro*, Ingram's computer systems became inoperable because of a power outage. *Id.* at 1. Ingram made a claim to American, which American denied based on its determination that a power outage did not cause "direct *physical loss* or damage from any cause, howsoever or wheresoever incurring" to Ingram's computer system. *Id.* at 2 (emphasis added). The Court rejected American's argument that the computer system and the matrix switch were not "physically damaged" because despite the loss of the programming information, the computers were able to perform their intended functions. *Id.* at 5. Instead, the Court agreed with Ingram and found that "physical damage" was "not restricted to the physical destruction or harm of computer circuitry but includes loss of access, loss of use, and loss of functionality." *Id.* at 6. In finding that there was the requisite physical loss, the court borrowed from the federal computer fraud statute and other criminal statutes, which make it an offense to cause damage to a protected computer and which define damage as "any impairment to the integrity or availability of data, a program, a system, or information." *Id.* at 7. A subsequent Tennessee decision followed the *Ingram Micro* analysis. *Southeast Mental Health Ctr., Inc. v. Pac. Ins. Co.*, 439 F. Supp. 2d 831, 838 (W.D. Tenn. 2006).

[38] *State Auto Property & Cas. Ins. Co. v. Midwest Computers & More*, 147 F. Supp. 2d 1113 (W.D. Okla. 2001) (while data was not tangible property, the loss of the use of the customer's computer was tangible property).

[39] John Buchanan, Dustin Cho & Patrick Rawsthorne, *When Things Get Hacked: Coverage for Cyber-Physical Risks*, *in* Hot Topics for ICLC's 40th – the Coverage Battles of 2028, (ABA Litigation Section, Insurance Coverage Litigation Committee, March 3, 2018).

[40] John Buchanan, Dustin Cho & Patrick Rawsthorne, *When Things Get Hacked: Coverage for Cyber-Physical Risks*, *in* Hot Topics for ICLC's 40th – the Coverage Battles of 2028, (ABA Litigation Section, Insurance Coverage Litigation Committee, March 3, 2018) at p. 8.

[41] *Id.* at 5.

organization's confidential or personal information. . . "[42] These revisions have effectively removed coverage for property damages stemming from cyber breaches under ISO CGL policies and leave insureds with little possibility of coverage outside of specialty policies.

The result is that, with the exception of some, perhaps not so exceptional cases discussed below, a policyholder seeking some insulation against risk is left with an outcome best described as uncertain. By the same token, insurers who are interested in profiting from the sale of protection against cyber risks are forgoing the opportunity to provide needed coverage and to generate revenue.

C. Specialty Policies, Endorsements, and Cyber Risk Exclusions

Because the CGL policies generally do not provide certainty of coverage for cyber risks, insurers and policyholders have resorted to stand-alone cyber policies or cyber endorsements to the extent they are available.[43] Newer coverage forms for cyber risks include cyber insurance policies, professional liability for technology firms, and products liability to name a few.[44] The problem is: as insurance policies and endorsements have become more nuanced, the coverage issues have multiplied. As evidenced below, even if the basic difficulties with the exclusions outlined above are overcome, insureds and insurers will still find a litany of challenges to crafting effective specialty policies for cyber-attacks.

Specialty policies are increasingly diverse and specific. There already exist over 60

[42] *Id.*, Insurance Services Office, Inc., *Exclusion — Access or Disclosure of Confidential or Personal Information and Data-Related Liability — With Limited Bodily Injury Exception, CG 21 06 05 14* (2013).
[43] Daniel Garrie & Michael Mann, *Cyber-Security Insurance: Navigating the Landscape of a Growing Field*, 31 J. MARSHAL J. INFO. TECH. & PRIVACY L. 379, 389-90 (2014).
[44] Barbara O'Donnel & Lisa A. Oonk, *Changes in Latitudes, Changes in Attitudes: Looking Back over 25 Years of Coverage Litigation*, 47 THE BRIEF, no. 1, Fall 2017, at 10-1 (citing broad array of available policy forms).

markets for cyber insurance and liability limits extend to $500 million.[45] These policies, however, are still "unaligned on pricing, retentions, and sublimits for first-party coverages, in particular, such as forensics, business interruption, and notification expenses."[46] The diversity in the market leads to challenges for insureds trying to find a policy that specifically targets their needs.[47] Additionally, these coverages often have their own exclusions (beyond the ones listed below) which further limit coverage. Increasingly, these exclusions reduce coverage for the insured's own negligence whether it arises from specific human error or computer glitches.[48] This complexity means insureds need to use considerable time and effort or hire a cyber insurance expert to determine exactly what coverage they need.[49] While specialty policies currently exist, and their use is increasing,[50] the variance and complexity of the market can lead to confusion and gaps in coverage for even sophisticated insureds.

Exclusions that limit insurers' exposure further limit the coverages offered by insurance policies crafted to deal with cyber risks.[51] As is the case with coverage, the range of exclusions suggests that the initial novelty of coverage is further complicated. However, as will be discussed in Section III, the problem of novelty and the accompanying complications may well be overstated.

Just as coverages seem to coalesce around a handful of problems, so too have exclusions

---

[45] John F. Stephens & Michelle Worrall Tilton, *Lawyers Still Lag Behind in Network and Information Security Risk Management: Clients and Regulators Demand More*, 46 THE BRIEF, no. 4, Summer 2017, at 18.
[46] *Id.*
[47] Erica J. Dominitz, *To Err is Human; To Insure, Divine: Shouldn't Cyber Insurance Cover Data Breach Losses Arising (in Whole or in Part) from Negligence?*, 46 THE BRIEF, no. 4, Summer 2017, at 33.
[48] *Id.*
[49] John F. Stephens & Michelle Worrall Tilton, *Lawyers Still Lag Behind in Network and Information Security Risk Management: Clients and Regulators Demand More*, 46 THE BRIEF, no. 4, Summer 2017, at 18.
[50] *Id.* at 15 ("Sixty percent of ALPS's insureds wisely retain the cyber coverage.").
[51] Daniel Garrie & Michael Mann, *Cyber-Security Insurance: Navigating the Landscape of a Growing Field*, 31 J. MARSHAL J. INFO. TECH. & PRIVACY L. 379, 389–90 (2014).

tended to focus on a small set of issues.[52] According to a Rand research paper, the most common ten exclusions are: fines, penalties, fees from affected institutions; seizure or destruction of systems by government; IP Theft; acts of God; acts of terrorism, war, and military action; contractual liability; bodily injury; loss to systems not owned or operated; and negligent disregard for computer security.[53]

A related potential exclusion not mentioned above that affects cyber risk is the war exclusion. Because a large majority of cyber-attacks are conducted by state actors – that is, independent countries –insureds suffering cyber damages often face challenges by insurers based on these war exclusions.[54] War exclusions generally negate coverage for cyber risks and, even for the diligent policyholder, present significant coverage issues.[55] War exclusions exist in virtually all policies, including both CGL and specialty policies.[56]

To date, only a few of these exclusions have even existed in cases addressed by the courts in the context of cyber risk. Even when cases arise that concern cyber risk exclusions, the resolution typically turns on interpretations or other exclusions that do not implicate any aspect of cyber risk. This is not a great state of affairs. Both insurers and insureds are better served with predictable results. Insurers face a problem in drafting these policies because there is a lack of

---

[52] Sasha Romanosky et at., *Content Analysis of Cyber Insurance Polices* 10 (Rand Corp., Working Paper WR-1208, 2017) (suggesting that 52% of exclusion types could be identified after an examination of only six policies).
[53] Sasha Romanosky et al., *Content Analysis of Cyber Insurance Polices* 14 (Rand Corp., Working Paper WR-1208, 2017).
[54] John Buchanan, Dustin Cho & Patrick Rawsthorne, *When Things Get Hacked: Coverage for Cyber-Physical Risks*, *in* Hot Topics for ICLC's 40th – the Coverage Battles of 2028, (ABA Litigation Section, Insurance Coverage Litigation Committee, March 3, 2018) at p. 14.
Even if a potential policyholder is aware of the war exclusions and the consequent effect on coverage of cyber losses, it is an open question whether it is possible for even the most sophisticated of policyholders to avoid the war exclusions. *Id.*
[55] *Id.*
[56] *Id.* The categorical statement in the text requires some qualification. There are as many as 13% of cyber policies that cover terrorism related losses. Sasha Romanosky et at., *Content Analysis of Cyber Insurance Polices* 14 (Rand Corp., Working Paper WR-1208, 2017).

judicial information about how these policies will be interpreted by the courts. Without a thorough case history, insurers cannot confidently draft these policies to exclude (or price in) certain high-risk practices.[57] The "friction" of litigation in this context is an unalloyed disadvantage; to the extent insurance policy terms unique to cyber risks are vetted we are all better off.

III. Everything Old Is New Again

What has transpired since the ISO revisions to the CGL is somewhat remarkable. As noted above, there are only roughly two dozen cyber risk cases that have been decided since 2000. Of these cases, the early ones dealt with the possibility of coverage of cyber risks under the standard CGL policy. After the ISO revisions, the cases involving cyber riskes have been decided based on principles that are well familiar to insurance practitioners.

While there is a dearth of defining case law governing cyber risks, and even basic terminology has not been well litigated, the reality is that legal principles particular to cyber risks have not been needed – at least they don't seem to have materialized since the ISO revisions.[58] A brief review of representative cases reveals this state of affairs regardless of whether coverage has been found or not.

A. Coverage for Cyber Risks Found

In *Travelers Indemnity Co. v. Portal Healthcare Solutions, LLC*,[59] Portal Healthcare was

---

[57] Daniel Schwarcz, *Coverage Information in Insurance Law*, 101 MINN. L. REV. 1457, 1500–02 (2017).
[58] Latham & Watkins, *Cyber Insurance: A Last Line of Defense When Technology Fails* 13 (2014); John G. Buchanan & Marialuisa S. Gallozzi, *Kicking the Tires on a New Cyber Policy: Top Tips and Traps*, American Bar Ass'n 1 (Jan. 22, 2018), https://www.americanbar.org/groups/litigation/committees/insurance-coverage/articles/2017/cyber-policy-tips-traps.html (adding the lack of "standardization among cyber policies' wordings," as a factor); Barbara O'Donnel & Lisa A. Oonk, *Changes in Latitudes, Changes in Attitudes: Looking Back over 25 Years of Coverage Litigation*, 47 THE BRIEF, no. 1, Fall 2017, at 10-1 (noting that the creation of new forms has added to the mass of untested language).
[59] 35 F. Supp. 3d 765 (E.D. Va. 2014), *aff'd per curiam*, 644 Fed. Appx. 245 (4th Cir. 2016).

facing a lawsuit after medical records were accidentally made available through a simple internet search. Portal had a CGL policy with Travelers that provided coverage for injury arising from the "electronic publication of material that . . . gives unreasonable publicity to a person's private life."[60] Travelers denied coverage arguing that Portal did not "publish" the records by simply making them available to be accessed. However, the court disagreed and held that this was a "publication" under the policy and Travelers must provide coverage.[61] In reaching this decision, the court did not dip into a well of tailor-made cyber insurance terms, but instead utilized the age-old plain meaning line of reasoning to apply a different definition to "publicity" than the definition Travelers argued for.[62]

A further sampling of exclusions and their efficacy well illustrates the conventional approach to the problem. Exclusions for losses related to "software, data or other information that is electronic in form" have been held ineffective to preclude coverage for loss of *use* of computers.[63] For example, in *Eyeblaster, Inc. v. Federal Insurance Company*, the court found that the plain meaning of tangible property includes computers.[64] Since a computer is a tangible property, a "loss of the use of a computer constitutes 'property damage' within the meaning" of CGL policies.[65] In the absence of evidence from the Insurer showing that the computer remained functional, the court concluded that the allegations were "within the scope of the General

[60] *Id.* at 767.
[61] *Id.* at 770.
[62] *Id.* at 772 ("That Portal's conduct falls within the broader and primary definition of "publicity" suffices to establish that Portal gave unreasonable publicity to patients' private lives when it posted their medical records online without security restriction.")
[63] *Eyeblaster, Inc. v. Fed. Ins. Co.*, 613 F.3d 797, 802 (8th Cir. 2010).
[64] Id.
[65] Id. (citing State Auto Prop. & Cas. Ins. Co. v. Midwest Computers & More, 147 F. Supp. 2d 1113, 1116 (W.D. Okla. 2001)).

Liability policy."[66]

A provision providing coverage against loss resulting from "the theft of any Insured property by Computer Fraud . . ." was deemed to cover third-party claims stemming from the electronic theft of customer credit card information in *Retail Ventures, Inc. v. National Union Fire Insurance Company*.[67] The loss was covered despite an exclusion which provided that "[c]overage does not apply to any loss of proprietary information, Trade Secrets, Confidential Processing Methods, or other confidential information of any kind" because the court held it did not preclude coverage for loss of nonproprietary customer information.[68] Specifically, the court found that reading the catchall term "information of any kind" to include all information not intended for disclosure "would swallow not only the other terms in [the] exclusion but also the coverage for computer fraud."[69]

In *First Bank of Delaware, Inc. v. Fidelity & Deposit Company of Maryland* the coverage provision read, "[t]he Insurer will pay on behalf of the Insured all loss resulting from any electronic risk claim first made against the Insured during the policy period or the extended reporting period, if applicable, (1) for an electronic publishing wrongful act or (2) that arises out of a loss event."[70] An exclusion provided the insurer shall not be liable for any claim against the insured "based upon or attributable to or arising from the actual or purported fraudulent use by any person or entity of any data or in any credit, debit, charge, access, convenience, customer identification or other card, including, but not limited to the card number."[71] Although the court

---

[66] Id.
[67] *Retail Ventures, Inc. v. Nat'l Union Fire Ins. Co.*, 691 F.3d 821, 824-26 (6th Cir. 2012).
[68] *Id.* at 832.
[69] *Id.* at 833.
[70] *First Bank of Del., Inc. v. Fid. & Deposit Co. of Md.*, 2013 Del. Super. LEXIS 465 at 5-7.
[71] *Id.* at 16.

found the coverage and exclusion unambiguous, the court nonetheless denied the exclusion effect on the basis that to enforce it would render the coverage illusory.[72] According to the court, "[t]he principle that a grant of coverage should not be rendered illusory protects the reasonable expectations of the purchaser."[73]

In gross, these cases show that the coverage for cyber risks is proceeding subject to already well-recognized rules. No special principle of cyber law seems to have emerged. The same seems to hold true for those cases that have resulted in a denial of coverage.

B. Coverage for Cyber Risks Denied

In *P.F. Chang's China Bistro, Inc. v. Federal Insurance Company*,[74] P.F. Chang's had a separate cyber liability policy which provided that "[Federal] shall pay for Loss on behalf of an Insured on account of any Claim first made against such Insured. . . for Injury."[75] The policy defined a "privacy injury" as an "injury sustained or allegedly sustained by a Person because of actual or potential unauthorized access to such Person's Record, or exposing access to such Person's Record."[76]

On June 10, 2014, P.F. Chang's learned that computer hackers had obtained 60,000 customer credit card numbers. Federal reimbursed P.F. Chang's more than $1.7 million from direct customer injuries, but when P.F. Chang's credit card servicer sought $1.9 million for costs incurred by their customers, Federal denied the claim. Federal argued that the credit card servicer did not itself sustain a Privacy Injury because it was not their records that were compromised during the data breach. The court agreed with Federal and held that they need not cover the loss.

---

[72] *Id.* at 25.
[73] *Id.*
[74] No. CV–15–01322–PHX-SMM, 2016 WL 3055111 (D. Ariz. May 31, 2016).
[75] *Id.* at 12.
[76] *Id.*

There is a class of cases in which a grant of coverage for cyber risks was denied not based on cyber exclusions but rather on the grounds of causation – that is, the cyber issue was not, in fact, the cause of the loss.[77] Concurrent causation and proximate cause have not disappeared simply because we have a new cause.[78]

In the same way, the insured's breach of its duty of cooperation or at least breach of the insured's obligation to obtain insurer consent to settlement has been held to preclude recovery for a settlement involving infectious malware.[79] Another familiar kind of resolution, temporal limits relating to restoration expenses, has been held to be sufficient to deny coverage for damages occurring outside of a "period of restoration."[80]

Again, the larger point is that no new body of law particular to cyber risks has emerged and it is not clear that a critical mass of decisions is required in order to make sense of this area. The field is yet too new for any trend to emerge. At the same time, it can be observed that the resort to familiar words is common. Thus, the appearance of familiar terms such as "use" and "proprietary" allows courts to fall back on the treatment of those terms in settled contexts for use in the cyber arena. Similarly, resort to familiar principles of illusory coverage as in *First Bank of Delaware, Inc. v. Fidelity & Deposit Company of Maryland* provides a means of resolution as

---

[77] *InComm Holdings Inc. v. Great Am. Ins. Co.*, 2017 U.S. Dist. LEXIS 38132; 2017 WL 1021749 at 23 (policy language providing coverage for "computer fraud" did not cover fraud on the part of those who used telephones to defraud the insured); *Apache Corp. v. Great American Ins. Co.*, 662 Fed. Appx. 252, 258-59 (5th Cir. 2016) (computer was not direct cause of loss and use of email was "merely incidental" and noting every fraud that uses email is not a computer fraud).

[78] Erica J. Dominitz, *To Err is Human; To Insure, Divine: Shouldn't Cyber Insurance Cover Data Breach Losses Arising (in Whole or in Part) from Negligence?*, 46 The Brief, no. 4, Summer 2017, at 34-35 (discussing causation issues).

[79] *First Commonwealth Bank v. St. Paul Mercury Ins. Co.*, 2014 U.S. Dist. LEXIS 141538; 2014 WL 4978383 at 10-11 (settlement with customer for damage caused to client by malware not covered because insured failed to obtain insurer consent).

[80] *WMS Indus. v. Fed. Ins. Co.*, 588 F. Supp. 2d 730, 733-34 (S.D. Miss. 2008) (potential network damage claim denied on the basis the claim was not within the time window specified in the policy – "during the period of restoration").

well. Still, with many questions yet to be addressed by the courts, we will likely see more incarnations of cyber liability policies.[81]

IV. Fixing It All

The issues raised by cyber risks present knotty problems, and easy solutions are elusive. One solution is for insurers to do nothing – not offer coverage at all, secure in the knowledge that CGL policies are unlikely to provide coverage. Another approach is to only offer policies with modest limits or sub-limits in an effort to limit risk.[82] Both of these approaches are unsatisfactory. First, there is need – insurance exists for a reason. Policyholders need to protect themselves against the risk of loss. Second, the money involved is significant – insurers are in business to make money, and insureds need protection. With this background, at least three approaches can be taken.

A. Resort to Cyber Security Firms

First, organizations can resort to various cyber security firms to head off problems before they occur.[83] Because each organization's system infrastructure and security posture is unique, cyber security firms often employ several vulnerability assessments which include simulated cyber attacks.[84] While these firms do provide accurate vulnerability assessments, their accuracy

---

[81] For an interesting discussion of whether exclusions for "acts of war" and "warlike activity" apply to state sponsored acts cyber-attacks, see Kevin R. Doherty, *The Art of (Cyber) War*, 29 No. 6 INTELL. PROP. & TECH. L.J. 16 (2017).

[82] There is ample evidence that the use of modest limits or sublimits is widespread. Sasha Romanosky et al., *Content Analysis of Cyber Insurance Polices* 11 (Rand Corp., Working Paper WR-1208, 2017); John G. Buchanan & Marialuisa S. Gallozzi, *Kicking the Tires on a New Cyber Policy: Top Tips and Traps*, American Bar Ass'n 1 (Jan. 22, 2018), https://www.americanbar.org/groups/litigation/committees/insurance-coverage/articles/2017/cyber-policy-tips-traps.html (suggesting that, in some cases, $100 million limits are far too low given the large potential losses. A more insidious observation is that modest limits or sublimits "are effectively exclusions masquerading as coverage grants . . . ." *Id*. at 2.

[83] John F. Stephens & Michelle Worrall Tilton, *Lawyers Still Lag Behind in Network and Information Security Risk Management: Clients and Regulators Demand More*, 46 THE BRIEF, no. 4, Summer 2017, at 12, 17.

[84] Olajide Enigbokan & Nurudeen Ajayi, *Managing Cybercrimes Through the Implementation of Security Measures*, 16 J. OF INFO. WARFARE 112, 114 (2017).

is immediately outdated as it is a point-in-time view of an organization's security posture.[85] The difficulty with security is that it is often very much an after-the-fact approach. The plans that emerge, almost by definition, are intricate and can address crucial aspects such as initial identification of a problem to response and recovery protocols.[86] While firms can guard against known risks, human ingenuity has so far been successful in circumventing security that is based solely on known risks.

B. Consolidation of Cyber Perils

Second, insurers could develop a small taxonomy of issues that can arise. By grouping issues under the umbrella of a defined rubric, effective and predictable exclusions might emerge.[87] So far, the experience with exclusions seems to show that this does not seem promising.

The long lists of cyber risks are destined to become longer yet, and our ability to predict the possibilities that can lead to a cyber loss is limited because cyber villains seem to have an ever-increasing repertoire. However, the possibilities can be managed by more generalist categories. While I resist any claim that the following is necessarily the best taxonomy, one has to start someplace, and my gentle suggestion is that the perfect taxonomy would contain significant elements of the categories below.

The first category of cyber risks would be those associated with conventional torts. These could include libel, defamation, and related torts committed using electronic means. This

[85] Robert Boyce, *Vulnerability Assessments: The Pro-active Steps to Secure Your Organization*, SANS Institute, https://www.sans.org/reading-room/whitepapers/threats/vulnerability-assessments-pro-active-steps-secure-organization-453 (last visited June 23, 2018).
[86] John F. Stephens & Michelle Worrall Tilton, *Lawyers Still Lag Behind in Network and Information Security Risk Management: Clients and Regulators Demand More*, 46 THE BRIEF, no. 4, Summer 2017, at 12 on p. 17.
[87] There is some indication that this is happening in a way. Researchers have discovered that six sample policies contained about 88% of the coverages available. Sasha Romanosky et al., *Content Analysis of Cyber Insurance Polices* 10 (Rand Corp., Working Paper WR-1208, 2017). This suggests that the insurance industry itself is consolidating the perils it is willing to cover.

list might also include the civil equivalent of the criminal list below.

The second category of cyber risks would be those associated with crime. This list might include extortion, identity theft (theft is theft whatever the means used to commit it), and terrorism. This category might also include criminal rewards connected to the cyber-crime involved.

A third category of cyber risk would be the costs associated with cyber risks. This might be the broadest, and newest, type of loss. These might include the costs associated with restoring and replacing data, regulatory compliance (mentioned as a fourth category below), professional services, corruption of data, crisis management, public relations expenses, and security malfunctions.

A final category might include cyber risks that are accompanied by some sort of statutory or regulatory liability. For instance, certain provisions of the Health Insurance Portability and Accountability Act (HIPAA) govern the collection and storage of medical records and provide statutory damages for the negligent handling of patients' personal information.[88] The states are also entering this arena. For example, last spring New York's Department of Financial Services issued cyber-security regulation 23 NYCRR 500.[89] The regulation requires companies to create a cybersecurity policy that fulfills statutory minimum standards to protect consumer information and information technology systems from cyber-attacks.[90] The large point is that federal and

[88] *See* 42 U.S.C. § 1320d–5.
[89] N.Y. Comp. Codes R. & Regs. tit. 23, § 500.00 (2017); John F. Stephens & Michelle Worrall Tilton, *Lawyers Still Lag Behind in Network and Information Security Risk Management: Clients and Regulators Demand More*, 46 THE BRIEF, no. 4, Summer 2017, at 12.
[90] N.Y. Comp. Codes R. & Regs. tit. 23, §§ 500.02-500.17 (2017) (These minimum standards include requirements for: penetration testing, vulnerability assessments, audit trail assessments, access privilege restrictions, application security, risk assessments, multi-factor authentication, limitations on data retention, training and monitoring requirements, incident response plans, encryption requirements, and specific notice to the superintendent of cyber events).

state government regulation in this area enlarges the range of cyber risks to include potential statutory liability.

The taxonomy above is harm-based while traditional insurance law has been peril-based. An argument can be made that the peril is so diffuse – given the different types of cyber risks – that the time has come to shed the peril-based approach and transition to a harm-based system. This transition is not as radical a proposal as it sounds. There is evidence that insurers base their premiums not on the insured's "attack surface" or technology/governance controls but rather on the insured's asset value.[91] If such is the case, the regime seems to have shifted to a harm-based system, and there may be little difference in moving to a pure harm-based system.

C. Risk Rating Mechanisms

Alternatively, insurers could use risk rating mechanisms. Similar to credit risk managers, the idea is to develop an overall cyber risk rating that insurers can use to assess risk and price the insurance product accordingly.[92] Risk rating firms accomplish this through evaluation of "publicly available data on security behaviors from collection points across the globe."[93] The data evaluated consists of compromised system reports, system configuration information, user behavior, and data breach events.[94] Risk rating firms then report risk ratings on a daily basis to security professionals, risk managers, and underwriters. This provides insureds with benchmarks for security performance, visibility into security risks posed by third parties, and real-time

---

[91] Sasha Romanosky et at., *Content Analysis of Cyber Insurance Polices* 19, 31 (Rand Corp., Working Paper WR-1208, 2017). Applications for insurance seem to require only rudimentary information. *Id*. at 19.
[92] BitSight, Inc., *Making Risk Management More Effective with Security Ratings*, https://cdn2.hubspot.net/hubfs/277648/White_Papers/Making%20Risk%20Management%20More%20Effective%20with%20Security%20Ratings.pdf?t=1529692882780&utm_campaign=resource-center&utm_source=hs_automation&utm_medium=email&utm_content=12350311&_hsenc=p2ANqtz-9Z69TfjcYiqDG1sxGgigc_ol5AWlkpr0LApLGvyMDKfq_aaYPVgOGwqRX8Cpn1KMQo_6dhpDNeAEHyiUlikfdjJ-zCqDcr0O8IwWW_V2SF6fL53K0&_hsmi=12350311 (last visited June 23, 2018).
[93] *Id*.
[94] *Id*.

awareness of security risk changes.[95] These firms strive to create systems that shed light on the risks an organization faces within a landscape of ever-changing threats. Having real-time awareness of security risks allows insurers to reduce loss ratios by: "addressing security events on their insured's network or extended ecosystem before the claim occurs"; "improve underwriter effectiveness" by "setting underwriter thresholds based on security ratings"; and allowing insurers to "identify and mitigate concentration risk[s]" across their portfolios.[96]

In order to work, the insurance policies would almost have to be "all risk" policies because of the definitional problems outlined above. This approach has merit, but the experience is lacking. Currently, one company reported it has 70% of the security rating market with over 1,000 customers[97], demonstrating there is some adoption in the market, but even this is a drop in the bucket of experience. In sum, much work and uncertainty remain.

Conclusion

Cyber risks raise the classic question of whether existing legal regimes are up to the task of dealing with new technologies. Initially, the expectation was that cyber loss coverage was going to be different. That does not seem to be the case. So far, case history suggests that conventional insurance law has been up to the task of dealing with cyber risks. A caveat is in order, however, as the courts so far have not had to deal with the intricacies of cyber coverage or cyber exclusions.[98]

The wilderness of insurance coverage has always necessitated vigilance by policyholders when assessing coverage. However, that wilderness has, by now, been tamed with settled judicial

---

[95] *Id*.
[96] BitSight Technologies, https://www.bitsighttech.com/security-ratings-cyber-insurance (last visited June 23, 2018).
[97] BitSight Technologies, https://www.bitsighttech.com/bitsight-vs-competitors (last visited June 23, 2018).
[98] Michael E. Nitardy, *Fraud Involving a Computer is Not Automatically "Computer Fraud"*, 46 THE BRIEF, no. 4, Summer 2017, at 26, 31 (questioning whether insurance law can evolve with technology).

interpretations and well-defined potential perils which policyholders use to accurately predict claim outcomes. Yet, with cyber risks, the paths are neither well-trod nor carefully maintained; there is no certainty of court-vetted terms or even a well-defined set of potential perils.[99] Until these paths emerge, the prescription to "understand the cyber-physical risks involved" and to "understand how all policy language will respond to those risks" cannot be overstated.[100]

Looking forward, while recognizing that the range of cyber risks will only increase, a solution that involves some combination of "all cyber risks" is worth exploring. Indeed, to the extent insurers are assessing risk based on asset value and using an "all risk" approach to rating mechanisms, this idea is not as radical as it seems. As noted above, the policyholders' needs are great, and insurers have before them an equally great opportunity. The solution to the cyber risk problem will not be simple, will not be conventional, and will not be obvious. But, if done right, cyber risk insurance can become a benefit to insureds and insurers alike.

---

[99] Robert H. Jerry, II and Michele L. Mekel, *Cybercoverage for Cyber-Risks: An Overview of Insurers' Responses to the Perils of E-Commerce*, 8 CONN. INS. L.J. 7, 30 (2001); Michael E. Nitardy, *Fraud Involving a Computer is Not Automatically "Computer Fraud"*, 46 THE BRIEF, no. 4, Summer 2017, at 26, 31; John G. Buchanan & Marialuisa S. Gallozzi, *Kicking the Tires on a New Cyber Policy: Top Tips and Traps*, American Bar Ass'n at p. 1 (Jan. 22, 2018), https://www.americanbar.org/groups/litigation/committees/insurance-coverage/articles/2017/cyber-policy-tips-traps.html.

[100] John Buchanan, Dustin Cho & Patrick Rawsthorne, *When Things Get Hacked: Coverage for Cyber-Physical Risks*, *in* Hot Topics for ICLC's 40th – the Coverage Battles of 2028, at p. 16 (ABA Litigation Section, Insurance Coverage Litigation Committee, March 3, 2018).

When Things Get Hacked: Insurance Coverage for IoT-Related Risks

American College of Coverage Counsel
2019 Annual Meeting

Chicago, IL
May 8-10, 2019

John Buchanan and Dustin Cho
Covington & Burling LLP
Washington, DC

When Things Get Hacked: Insurance Coverage for IoT-Related Risks[1]

John Buchanan and Dustin Cho[2]

I. Introduction

Hackers can do more than steal your data. When they access IoT-connected things—whether household appliances, smart wearables, medical devices, industrial control systems, smart grids, or smart cities—hackers and other bad actors can damage property and endanger lives. As one commentator has put it, "American officials are discovering that in a world in which almost everything is connected—phones, cars, electrical grids, and satellites—everything can be disrupted, if not destroyed."[3]

Reports in recent years highlight some disturbing threat scenarios. Russian government cyber actors have reportedly gained remote access to networks capable of disrupting critical U.S. infrastructure, including the energy sector and the power grid.[4] Cyber soldiers sitting behind

---

1. This paper was submitted as a conference paper for the American Bar Association (ABA) Section of Litigation's 2019 Insurance Coverage Litigation Committee CLE Seminar. It is adapted from Chapter 17 of *Internet of Things (IoT): Legal, Policy, and Practical Strategies*, an ABA publication released at the ABA Section of Science & Technology's Internet of Things (IoT) National Institute in March 2019.

2. The authors are lawyers in the Washington, D.C. office of Covington & Burling LLP, who represent policyholders exclusively in coverage litigation. The opinions stated in this chapter are those of the authors and should not be attributed either to their law firm or to its clients.

3 David E. Sanger, THE PERFECT WEAPON: WAR, SABOTAGE AND FEAR IN THE CYBER AGE xii (2018)

4. *See, e.g.*, Dep't of Homeland Security & Fed. Bureau of Investigation, Technical Alert 18-074A, "Russian Government Cyber Activity Targeting Energy and Other Critical Infrastructure Sectors," https://www.us-cert.gov/ncas/alerts/TA18-074A (rev. Mar. 16, 2018) (hereinafter DHS-FBI Alert); Rebecca Smith and Rob Barry, *America's Electric Grid Has a Vulnerable Back Door—and Russia Walked Through It*, WALL ST. J. (Jan. 10, 2019); *US Warns Public about Attacks on Energy, Industrial Firms*, BUS. INS. (Oct. 23, 2017, 12:30 PM), http://www.businessinsurance.com/article/20171023/NEWS06/912316709/US-warns-public-about-attacks-on-energy,-industrial-firms. These activities are not confined to U.S. infrastructure. *See, e.g., Germany sees big rise in security problems affecting infrastructure*, REUTERS (Feb. 17, 2019), [LINK] ("Germany had learned of 157 hacker attacks on critical infrastructure companies in the second half of 2018 compared to 145 attacks in the whole of the previous year.").

(continued…)

computers in Tehran could open the floodgates on a suburban Westchester County dam.[5] Or the threat could be as banal and close to home as bored teenagers down the street hijacking your "smart" home appliances,[6] or, more ominously, the city's trolley system.[7]

These novel threats arise from what the National Institute of Standards and Technology refers to as "cyber-physical" or "smart" systems, that is, the "co-engineered interacting networks of physical and computational components" that allow the real world and digital world to interact in unprecedented ways.[8] Unfortunately, the cyber-security defenses in many "smart" IoT-connected systems are often . . . not too smart. Hence the reports of hacks on a wide variety of networked IoT devices ranging from smart toilets[9] to drones[10] to medical devices.[11] The federal government's alerts and subsequent security briefings in 2018[12] have raised the general level of awareness of potentially massive physical losses from hacking the IoT or industrial IoT, including attacks on power grids or other networked critical infrastructure.

---

5. Joseph Berger, *A Dam, Small and Unsung, Is Caught Up in an Iranian Hacking Cas*e, N.Y. TIMES, (Mar. 23, 2016), https://www.nytimes.com/2016/03/26/nyregion/rye-brook-dam-caught-in-computer-hacking-case.html.

6. *See* Kashmir Hill, *Here's What It Looks Like When a 'Smart Toilet' Gets Hacked*, FORBES (Aug. 15, 2013), http://www.forbes.com/sites/kashmirhill/2013/08/15/heres-what-it-looks-like-when-a-smart-toilet-gets-hacked-video/.

7. *See* Graeme Baker, *Schoolboy Hacks into City's Tram System*, THE TELEGRAPH (Jan. 11, 2008), http://www.telegraph.co.uk/news/worldnews/1575293/Schoolboy-hacks-into-citys-tram-system.html.

8. Cyber-physical systems homepage, Nat'l Inst. of Standards & Tech., http://www.nist.gov/cps/ (last visited Jan. 7, 2018).

9. *See* Hill, *supra* note 6.

10. *See SkyJack: Hacker-Drone That Can Wirelessly Hijack & Control Other Drones*, RT NEWS (Dec. 6, 2013), https://www.rt.com/news/hacker-drone-aircraft-parrot-704/.

11. *See* Tarun Wadhwa, *Yes, You Can Hack a Pacemaker (and Other Medical Devices Too)*, FORBES (Dec. 6, 2012), http://www.forbes.com/sites/singularity/2012/12/06/yes-you-can-hack-a-pacemaker-and-other-medical-devices-too/.

12. DHS-FBI Alert, *supra* note 4; Awareness Briefings: Russian Activity Against Critical Infrastructure, Nat'l Cybersecurity & Commc'ns Integration Ctr (NCCIC), https://share.dhs.gov/p344qjbhqu03/.

(continued…)

These increased warnings of the risk of massive physical losses from cyberattacks naturally raise the question whether that risk can be mitigated by insurance. In fact, a 2015 report titled "Business Blackout," prepared by Lloyd's and Cambridge University, anticipated the types of IoT-related attacks on critical infrastructure that have been the subject of the 2018 federal government warnings, and it analyzed what insurance implications might flow from them.[13] Specifically, the report hypothesized a (now all too plausible) scenario, in which a cyberattack on a utility's industrial control systems disables or destroys multiple power generators in a "smart" grid, resulting in cascading losses throughout the blacked-out power grid and beyond.[14] Such losses could include first-party physical property damage and business-interruption loss for utilities and their customers, third-party property damage and bodily injuries arising from the grid shutdown, and even looting and other social unrest, with accompanying liabilities for the businesses affected.[15]

The cyber insurance market has exploded in recent years; dozens of insurers now offer some kind of cyber coverage.[16] Most cyber-related policies address the intangible losses that accompany network intrusions and data hacks—with a particular focus on privacy-related losses.[17] Thus, while coverage is subject, as always, to the specific (and widely variable)

---

13. Lloyd's Emerging Risk Report, *Business Blackout: The Insurance Implications of a Cyber Attack on the US Power Grid* (May 2015), *available at* http://www.lloyds.com/~/media/files/news%20and%20insight/risk%20insight/2015/business%20blackout/business%20blackout20150708.pdf.

14. *Id*. at 11–13.

15. *Id*. at 16–19.

16. *See, e.g.*, Julie Greenwald, *Cyber Insurance Comes of Age*, BUS. INS. (Nov. 6, 2017), http://www.businessinsurance.com/article/20171106/NEWS06/912317022/Cyber-insurance-comes-of-age.

17. *See* Richard S. Betterley, *The Betterley Report: Cyber/Privacy Insurance Market Survey 2018*, 42–69 (June 2018) (charting availability of coverage for various data privacy-related losses under 32 different cyber insurance forms).

(continued…)

wordings of these nonstandard policy forms, if an attack on IoT-connected devices involves conventional data privacy losses, then most available cyber policies can be expected to provide some protection.

But insurance protection for so called cyber-physical risk—the physical losses that may result from the cyber peril of an IoT-related attack—presents a more complex question under many commonly available insurance policies. In fact, most off-the-shelf cyber forms expressly *exclude* coverage for physical bodily injury and property damage.[18] Originally, insurers drafted such exclusions to prevent cyber policies from duplicating the coverage traditionally afforded by standard-form commercial general liability (CGL) and first-party property policies.[19]

But do conventional liability and property policies still clearly cover bodily injury or property damage when it arises from a cyberattack involving IoT devices? This chapter analyzes coverage issues that may arise under traditional CGL and property policies where cyber-physical risks are involved, including the arguments that insurers may raise to escape coverage under such policies and the arguments that policyholders may raise in rebuttal. It then discusses examples of the specialty insurance products that have started to emerge to provide coverage (at a price) for physical harms from cyber perils. It concludes with a few general observations and recommendations for insuring IoT-related risks.

18. *See id.* at 72–75, 88–90 (charting the availability both of first-party coverage for direct damage to equipment and of third-party coverage for bodily injury and property damage).

19. *See infra* note 20.

(continued…)

II. Commercial General Liability Insurance Coverage for Bodily Injury or Property Damage Caused by Cyber Attacks through the IoT

Cyber insurance is now widely available; but as stated above, most cyber policies currently exclude third-party liability coverage for bodily injury and property damage. The explanation commonly provided for this exclusion is that "such losses are covered under CGL . . . policies."[20] But in fact, most recent standard-form CGL policies now incorporate their own cyber-related exclusions—the scope of which is not always clear. This section discusses the evolution of those exclusions and the coverage issues they present in the context of IoT risks.

A. Cyber Exclusions in the CGL Form

Since the turn of this century, the Insurance Services Office (ISO) has repeatedly revised the standard CGL policy's bodily injury and property damage liability coverage part (titled "Coverage A") with respect to cyber-related risks. First, in 2001, the standard CGL policy was revised to state that damage to electronically stored data would not be considered damage to tangible property.[21] Next, in 2004, it was revised to exclude "[d]amages arising out of the loss of, loss of use of, damage to, corruption of, inability to access, or inability to manipulate electronic

---

20. Robert Bregman, *Cyber and Privacy Insurance Coverage*, 37(11) IRMI, THE RISK REPORT 1 (July 2015), ("The [cyber] policies exclude claims alleging bodily injury and property damage because such losses are covered under CGL/property insurance policies.").

21. The 2001 Insurance Services Office CGL policy form added the following two sentences to the definition of "property damage":

> For the purposes of this insurance, electronic data is not tangible property. As used in this definition, electronic data means information, facts or programs stored as or on, created or used on, or transmitted to or from computer software, including systems and applications software, hard or floppy disks, CD-ROMS, tapes, drives, cells, data processing devices or any other media which are used with electronically controlled equipment.

In this form "property damage" is defined as "[p]hysical injury to tangible property, including resulting loss of use of that property," and "[l]oss of use of tangible property that is not physically injured." *See* ISO Properties, Inc., *Commercial General Liability Coverage Form, CG 00 01 10 01* § V.17, at 15 (2000).

(continued…)

data." According to ISO, this new exclusion, "Exclusion p," removed coverage for damage to physical property caused by loss of electronic data.[22] In 2013, a sentence was added to Exclusion p that carved out from the exclusion any "liability for damages because of 'bodily injury.'"[23] That is to say, the new sentence expressly *preserved* coverage for bodily injury arising out of the loss of electronic data.

In May 2014, ISO published two versions of an endorsement that revises Exclusion p: one with a "limited bodily injury exception" and one without.[24] The latter endorsement, in part, reverts to the 2004 variant of Exclusion p—it excludes any damages arising out of the loss of electronic data, regardless of whether the damages are because of bodily injury or property damage.[25] The version with a "limited bodily injury exception" in part adheres to the 2013 edition of Exclusion p, which preserves coverage for damages because of bodily injury.[26]

---

22. *See* ISO Properties, Inc., *Commercial General Liability Coverage Form, CG 00 01 12 04* § I.A.2.p, at 5 (2003). The definition of "electronic data" used in this exclusion was the same as the definition of "electronic data" that the 2001 standard CGL policy had introduced in its definition of "property damage."

23. *See* Insurance Services Office, Inc., *Commercial General Liability Coverage Form, CG 00 01 04 13* § I.A.2.p, at 5 (2012).

24. ISO also published a third version that applies only to Coverage B, the coverage for "personal and advertising injury liability" (thus omitting the revisions to Exclusion p in Coverage A). *See* Insurance Services Office, Inc., *Exclusion—Access or Disclosure of Confidential or Personal Information (Coverage B Only), CG 21 08 05 14* (2013).

25. The "limited bodily injury exception not included" endorsement states in relevant part:

> This insurance does not apply to: . . . Damages arising out of: (1) Any access to or disclosure of any person's or organization's confidential or personal information, including patents, trade secrets, processing methods, customer lists, financial information, credit card information, health information or any other type of nonpublic information; or (2) The loss of, loss of use of, damage to, corruption of, inability to access, or inability to manipulate electronic data.

Insurance Services Office, Inc., *Exclusion—Access or Disclosure of Confidential or Personal Information and Data-Related Liability—Limited Bodily Injury Exception Not Included, CG 21 07 05 14* (2013).

26. The "limited bodily injury exception" endorsement states in relevant part:

> This insurance does not apply to: . . . Damages arising out of: (1) Any access to or disclosure of any person's or organization's confidential or personal information, including patents, trade secrets, processing methods, customer lists, financial information, credit card information, health

(continued…)

B. Exclusion p, ¶ (1): "Access to . . . Nonpublic Information"

What was new and identical in both 2014 endorsements was the addition of paragraph (1) of Exclusion p—an exclusion for all damages (whether because of bodily injury or not) arising out of "[a]ny access to or disclosure of any person's or organization's confidential or personal information, including patents, trade secrets, processing methods, customer lists, financial information, credit card information, health information or any other type of nonpublic information."[27]

In isolation, the undefined terms "access to" and "nonpublic information" are sufficiently vague that an aggressive insurer might argue, for example, that a hospital's or medical device manufacturer's liability for bodily injury caused by alteration of a patient's dialysis machine settings would constitute excluded damages because they arose out of "access to . . . any person's health information or any other type of nonpublic information"; or similarly, that liability for property damage or personal injuries resulting from a hacker's manipulation of the data regulating industrial control systems in a nuclear plant or power grid arose from "access to . . . nonpublic information" and thus is excluded.

In response, insureds would argue that this exclusion, read within its context, cannot reasonably encompass all traditional bodily injury and physical damage caused by hacking of industrial control systems, malicious or negligent alteration of medical device settings, or other

---

> information or any other type of nonpublic information; or (2) The loss of, loss of use of, damage to, corruption of, inability to access, or inability to manipulate electronic data. . . . However, unless paragraph (1) above applies, this exclusion does not apply to damages because of 'bodily injury.'

Insurance Services Office, Inc., *Exclusion—Access or Disclosure of Confidential or Personal Information and Data-Related Liability—with Limited Bodily Injury Exception, CG 21 06 05 14* (2013).

27. *See* notes 25 and 26.

types of access to nonpublic electronic data regulating networked "things" through the IoT, for at least the following reasons:

- **"Nonpublic Information."** The settings and controls of devices and machinery, though not necessarily accessible to the "public," are not reasonably construed as "any other type of nonpublic information" as contemplated by the exclusion. The interpretive canon of *ejusdem generis*[28] instructs that when a series of items in a list share a certain core characteristic, a "catch-all" term at the end of the list should not be read to stretch beyond what the specifically listed items have in common. In these endorsements, the specifically listed types of "nonpublic information" preceding the catch-all phrase are all traditionally confidential information whose confidentiality is recognized, and protected, by law.[29]

Networked device settings and machine instructions do not generally enjoy either legal or popular recognition as inherently private information. Such data are qualitatively different from the specific categories of protected information listed in paragraph (1) of Exclusion p: "trade secrets, processing methods, customer lists, financial information, credit card information, [and] health information." Under this interpretive principle, therefore, the catch-all term "and any other nonpublic information" in the exclusion endorsements would be read to include other categories of information whose confidentiality is recognized under and protected by the law; but it would not be stretched to encompass a qualitatively different type of "information"—the data regulating electronic control systems.

---

28. "Under the principle of *ejusdem generis*, when a general term follows a specific one, the general term should be understood as a reference to subjects akin to the one with specific enumeration." Norfolk & W. Ry. Co. v. Am. Train Dispatchers Ass'n, 499 U.S. 117, 129 (1991).

29. The exclusion's list of various types of "confidential information" arguably starts after the first term, "patents." While patents are publicly disclosed once granted, they share legal protections similar to those enjoyed by other enumerated types of information such as "trade secrets."

Reinforcing this reading, both endorsements specifically list examples of the damages to which the exclusion applies—all of which are damages associated specifically with data privacy breaches:

> This exclusion applies even if damages are claimed for notification costs, credit monitoring expenses, forensic expenses, public relations expenses or any other loss, cost or expense incurred by you or others arising out of that which is described in Paragraph (1) or (2) above.[30]

All of these types of expense relate to common responses to data breaches, and indeed it is difficult to conceive how the first two items in the list—notification costs and credit monitoring expenses—could arise in the event of traditional physical bodily injury or property damage. This clause's focus on privacy-breach damages reinforces the conclusion that the exclusion was intended only for privacy-related liabilities and not for physical harm that happens to have resulted from a malfunctioning electronic device.

- **"Access To."** Although manipulation of a machine's or device's settings may involve "access to" those settings, the scenarios of concern do not "aris[e] out of" the access to the data that comprises those settings (much less their "disclosure" to the public). Rather, they arise out of the overwriting or overriding of that data—whether intentionally (through hacking) or unintentionally (through user error or a programming bug). In context, damages "arising out of . . . [a]ny access to or disclosure of . . . nonpublic information" means damages arising out of *obtaining* nonpublic information—the damages that typically arise from privacy breaches. When the hacking of industrial control systems or networked devices results in physical harm, by

30. Insurance Services Office, Inc., *Exclusion—Access or Disclosure of Confidential or Personal Information and Data-Related Liability—Limited Bodily Injury Exception Not Included, CG 21 07 05 14* (2013); Insurance Services Office, Inc., *Exclusion—Access or Disclosure of Confidential or Personal Information and Data-Related Liability—with Limited Bodily Injury Exception, CG 21 06 05 14* (2013).

contrast, the cause is not the *obtaining* of nonpublic information: that is, the prior, correct settings for the machinery or devices in question. Rather, it is the introduction of new instructions that override the original settings. For example, a hacker could alter a dialysis machine's settings even if he could not read the "information" in those settings before he overwrote them. Likewise, a hacker could disrupt a digital signal that provides instructions to a networked device without necessarily receiving or decoding the original intended signal.

In other words, the types of hacking that affect the operations of networked devices do not typically arise out of accessing any *information*—what the exclusion requires. Instead, they arise from someone's access to the *system or location* where the information is stored. What causes the harm is the new, erroneous digital settings or instructions that replace the original settings or instructions. Whether or not those original, correct settings are considered "nonpublic information," the intruder's access to that information is beside the point: the harm arises from the newly introduced malicious information, not from access to the "nonpublic information" itself. Unless the insurer can provide compelling forensic evidence that the essential cause of physical loss was the *release* rather than the *alteration* of confidential information in device settings, the exclusion should not apply.[31]

---

[31] The insurance industry's contemporaneous explanations of Exclusion p are also consistent with a reading that confines the exclusion to data-related, not physical, harm. The memorandum that ISO submitted to regulators in 2013 explaining its adoption of these endorsements states that "damages related to *data breaches, and certain data-related liability*, are not intended to be covered under the abovementioned coverage part. These types of damages may be more appropriately covered under certain stand-alone policies including, for instance, an information security protection policy or a cyber liability policy." Insurance Services Offices, Inc., *Access or Disclosure of Confidential or Personal Information Exclusions Introduced*, Commercial Lines Forms Filing CL-2013-ODBFR, at 7, 8 (2013) (on file with authors) (emphasis added). ISO's statement is consistent with an ISO executive's explanation of the endorsements shortly after they were introduced: he identified other "standalone" ISO insurance products that were available "to provide certain coverage with respect to data breach and access to or disclosure of confidential or personal information," thus suggesting that the new exclusions were intended to dovetail with cyber policies. *See ISO Comments on CGL Endorsements for Data Breach Liability Exclusions*, INS. J. (July 18, 2014), *available at* http://www.insurancejournal.com/news/east/2014/07/18/332655.htm (quoting Ron Biederman, assistant (continued…)

C. Exclusion p, ¶ (2): "Loss of . . . Electronic Data"

Paragraph (2) of Exclusion p uses the same language used in CGL policies since 2004 to exclude damages arising out of "[t]he loss of, loss of use of, damage to, corruption of, inability to access, or inability to manipulate electronic data."[32] As noted earlier, since 2014 this exclusion comes in two different versions. The "limited bodily injury exception" version, like the 2013 standard CGL policy, expressly preserves coverage for bodily injury. The other version, like the 2004 standard CGL policy, contains no express carve-out for bodily injury. In both formulations, as with paragraph (1), insurers would likely face a difficult burden to prove that this paragraph (2) exclusion applies to the most common source of cyber-physical loss: physical harms arising from IoT hackers overwriting or overriding the controls of electronic devices.

In sum, Exclusion p in the standard CGL form appears to be aimed at the privacy risks covered under separate cyber policies. But its uncertain application in the context of IoT-related cyber-physical harm may well give rise to highly technical—and no doubt costly—coverage disputes, with the insurer bearing the burden of proving that this exclusion precludes coverage for harm from an IoT attack.

---

vice president, Commercial Casualty at ISO: "As the exposures to data breaches increased over time, standalone policies started to become available in the marketplace to provide certain coverage with respect to data breach and access to or disclosure of confidential or personal information. For instance, ISO Information Security Protection Policy EC 00 10 contains both first and third party coverage through eight separate insuring agreements which address data breach and other cyber-related exposures.").

32. Insurance Services Office, Inc., *Exclusion—Access or Disclosure of Confidential or Personal Information and Data-Related Liability—Limited Bodily Injury Exception Not Included, CG 21 07 05 14* (2013); Insurance Services Office, Inc., *Exclusion—Access or Disclosure of Confidential or Personal Information and Data-Related Liability—with Limited Bodily Injury Exception, CG 21 06 05 14* (2013).

(continued…)

III. First-Party Property Coverage

Many first-party property policies do not explicitly address coverage for physical harm from a cyberattack.[33] Some, like the ISO's standard "all risks" and "named perils" policies, may not mention cyber-related risks at all in their cause of loss forms.[34] Others may include cyber exclusions targeting only harm to intangible property.

If such a "cyber-silent" policy is an "all risks" policy, meaning it covers losses unless caused by a specifically excluded peril, then coverage for physical damage from a cyberattack should presumptively exist. As one commentator has observed, however, some in the insurance industry assert that standard all risks policies were not created with cyber perils in mind.[35] But an insurer's failure to anticipate a novel risk should not negate the core function of an "all risks" policy; it promises coverage unless an exclusion applies.[36] Without a cyber-specific exclusion to rely on, an insurer facing a claim for physical losses from a cyberattack would likely have to show that the attack fits within some non-cyber-specific exclusion to justify denying coverage.

If a cyber-silent policy is written on a "named perils" basis—meaning it covers only harms from expressly enumerated risks—coverage could still be found in many cases. Under the standard ISO policies, and most others, cyberattacks, as such, are not named perils. Still, they may sometimes fall within the scope of a named peril's definition. For example, the ISO policies

---

33. *See* Lloyd's Emerging Risk Report, *supra* note 13, at 37.

34. ISO Properties, Inc., *Commercial Property, Causes of Loss—Special Form, CP 10 30 09 17* (2016); ISO Properties, Inc., *Commercial Property, Causes of Loss—Broad Form, CP 10 20 10 12* (2011); ISO Properties, Inc., *Commercial Property, Causes of Loss—Basic Form, CP 10 10 10 12* (2011).

35. *See* Alex Lathrop, *Does Traditional Coverage Apply When Cyber Attacks Cause Physical Damage?*, PROPERTY CASUALTY 360, at 3 (Dec. 29, 2016, 3:00 AM), http://www.propertycasualty360.com/2016/12/29/does-traditional-coverage-apply-when-cyber-attacks?slreturn=1515084401&page=3.

36. *See id.*

(continued…)

name "vandalism" as a covered risk and define it as "willful and malicious damage to, or destruction of," insured property.[37] To be sure, some insurers may balk at coverage under such a provision, asserting that what they meant to cover was only the traditional forms of vandalism, like a brick through a window, not cyber-related perils. But the "vandalism" definition is silent on means and relates only to intent—and many IoT hackers "willfully" or "maliciously" destroy insured property.

Even if a cyberattack does not fit within a named peril's definition, it may result in such a peril—for example, a fire or explosion. In cases where hacking either counts as a named peril or creates such a peril, an insurer would again need to point to a non-cyber exclusion to justify a denial of coverage. This potential exposure to the risk of cyber-physical damage under garden-variety property policies and other traditional policies has been characterized as the "silent cyber risk" that many insurers must evaluate more carefully.[38]

Although many property policies are still silent on cyber risks, some insurers are attempting to exclude them through endorsements or otherwise. For instance, one London Market form common to energy, marine, and industrial property policies, the Institute Cyber Attack Exclusion (CL 380), excludes from coverage any damage "arising from the use or

---

37. *See* Alex Lathrop & Janine Stanisz, *Hackers Are After More Just Data: Will Your Company's Property Policies Respond When Cyber Attacks Cause Physical Damage and Shut Down Operations?*, 28 ENVTL. CL. J. 286 (2016) (raising the possibility that an attack might count as "vandalism" and analyzing coverage for physical damage from multiple, hypothetical cyberattacks under both all risks and named perils policies).

38. *See, e.g.*, Najiyya Budaly, *Insurers Still Exposed to 'Silent' Cyberrisk Cover, PRA Says*, LAW360 (Jan. 30, 2019) (U.K. Prudential Regulation Authority urges insurers to "review their so-called silent cyber insurance, which opens them up to the risk of acciddntally covering a policyholder against cyber attacks without explicitly agreeing to."), http://www.law360.com/articles/1123619/; Scott Stransky, *Uncovering Silent Cyber Risk*, PROPERTY CASUALTY 360 (July 27, 2017, 8:00 AM), http://www.propertycasualty360.com/2017/07/27/uncovering-silent-cyber-risk; *Insurers Grapple with Cyber-Attacks That Spill over into Physical Damage*, THE ECONOMIST (Dec. 1, 2016), https://www.economist.com/news/finance-and-economics/21711086-only-cyber-calamity-will-reveal-how-ready-industry-insurers-grapple.

(continued…)

operation, as a means for inflicting harm, of any computer, computer system, computer software programme, malicious code, computer virus or process or any other electronic system."[39] Another London Market form, LMA 3030, excludes from property terrorism insurance "[l]oss or damage by electronic means including but not limited to computer hacking or the introduction of any form of computer virus or corrupting or unauthorised instructions or code or the use of any electromagnetic weapon."[40] These exclusions remain untested in the courts; whether one of them would preclude coverage for the particular circumstances of any given IoT hack may both raise subtle interpretive questions and require a fact-intensive technical analysis.

As new, nonstandard policy wordings proliferate to address the emerging risk of physical property damage from hacking of networked devices, first-party property insurance buyers will increasingly need sharp eyes, and sophisticated coverage advice, to evaluate what protection their policies provide.

IV. Emerging Coverage Solutions

Given the potential for coverage disputes under traditional CGL and property policies, as well as the growing potential for cyber-physical exposures from IoT-connected things, many policyholders may seek purpose-built coverage for risks of physical harm from cyber perils. The market for such products, like the threats they cover, is still evolving. A 2018 market survey of

---

39. The International Underwriting Association of London, *Institute Cyber Attack Exclusion Clause*, CL 380 (Oct. 11, 2003), *available at* http://www.iuaclauses.co.uk/site/cms/contentDocumentLibraryView.asp?chapter=8&category=57.

40. Lloyd's Market Association, *Terrorism Insurance Physical Loss or Physical Damage Wording*, LMA 3030 (Sept. 1, 2006), *available at* http://www.lmalloyds.com/LMA/Wordings/lma3030.aspx.

(continued…)

cyber insurance products indicates that such coverage options are still confined to a relative handful of insurers.[41]

Nonetheless, the number of insurance products that explicitly cover physical damage from cyber risks can be expected to grow steadily over the next several years. Some signs are already pointing in this direction. As reported in the insurance trade press, FM Global has reported increased inquiries about its products offering cyber-physical coverage;[42] AIG announced in 2017 that it would include cyber coverage in its commercial casualty policies—a move that would likely eliminate Exclusion p and the accompanying coverage issues discussed earlier;[43] and Chubb has introduced an endorsement to address, in part, uncertainty over what happens when a cyber incident creates damage traditionally covered under a property policy.[44] In the United Kingdom, meanwhile, the government-backed terrorism reinsurer, Pool Re, announced in 2017 that it would offer coverage for physical damage from cyberterrorism, following a report on the issue that it produced with the University of Cambridge's Judge

41. *See* Betterley, *supra* note 17, at 88–90 ("Third-party Coverage: Bodily Injury and Property Damage" summary chart).

42. *See* Katie Dwyer, *Cyberattacks Reach the Physical Realm*, RISK & INSURANCE (July 27, 2017), http://riskandinsurance.com/cyberattacks-reach-physical-realm/.

43. *See, e.g.*, Suzanne Barlyn, *AIG to Include Cyber Coverage to Commercial Casualty Insurance*, REUTERS (Oct. 26, 2017), https://www.reuters.com/article/us-aig-cyber/aig-to-include-cyber-coverage-to-commercial-casualty-insurance-idUSKBN1CV2XE.

44. Judy Greenwald, 2017 Innovation Awards: Chubb Global Cyber Facility and Property and Casualty Endorsements, BUS. INS. (Oct. 2, 2017), http://www.businessinsurance.com/article/00010101/NEWS06/912316218/2017-Innovation-Awards-Chubb-Global-Cyber-Facility-and-Property-and-Casualty-En (quoting a Chubb executive as saying, "There are questions, for instance, as to what happens if a cyber incident leads to damage covered by traditional property policies. . . . We don't want uncertainty for our clients.").

(continued…)

Business School.[45] This reinsurance protection may motivate commercial insurers to offer coverage for cyber-physical risks that they may currently attempt to exclude.

These market developments are too numerous, and too fluid, to warrant a comprehensive survey that could become obsolete within a matter of months. But one relatively recent insurance product offers a glimpse into where the market may be heading in response to these novel risks. Global insurance broker Marsh has developed a broad proprietary policy wording, known as Cyber CAT 3.0, crafted to maximize coverage across a range of insurance coverage lines for evolving cyber risks.[46] Cyber CAT 3.0 is specifically promoted as providing "Internet of Things coverage for negligence in the design or manufacture of an IoT product and/or service," as well as coverage for "[p]roperty damage to tangible property caused by a cyber event" and "[b]odily injury and property damage liability resulting from a cyber event."[47]

Policyholders desiring greater contract certainty around cyber-physical risks should consider carefully these new policies and endorsements. Some, like the Marsh form, show promise to prevent the potential coverage disputes identified in this chapter. Over the next decade, as the risk of cyber-physical harm grows more salient, more and more specialty insurance products can be expected to respond to rising market demand for more secure protection against such harms.

---

45. *See* T. Evan, et al., *Cyber Terrorism: Assessment of the Threat to Insurance; Cambridge Risk Framework Series*, Centre for Risk Studies, University of Cambridge (Nov. 2017).

46. *See Cyber Cat 3.0 Fact Sheet*, MARSH, *available at* https://www.marsh.com/content/dam/marsh/Documents/PDF/US-en/Cyber%20CAT%203.0%20Fact%20Sheet%20Final%20Spring%202018.pdf.

47. *Id.* at 2.

V. Conclusions and Recommendations for Entities with IoT Risk Exposures

Both insurers and insureds are confronting a relatively novel set of risks: old-fashioned physical harms arising from newfangled cyber perils. Many insureds confronted with these cyber-physical losses will argue that they should be covered under their conventional all-risk general liability and first-party property policies. Some insurer-side claims handlers may look for reasons why these risks should fall outside the policy terms.

To address these new issues, insurance purchasers would be well advised to take the following steps:

- **Understand the cyber-physical risks involved.** This means surveying the industrial control systems and other networked "smart" devices that the insured either manufactures or uses in its own operations; hardening the cybersecurity of those systems and devices; and thinking through the potential consequences of a cybersecurity failure.

- **Understand how all policy language will respond to those risks.** This means at a minimum analyzing the policy terms under cyber, technology errors and omissions, general liability, property and any other potentially applicable lines of coverage, such as kidnap and ransom policies and even directors and officers policies. Do the "dovetailing" exclusions actually dovetail? Or do they leave gaps—whether because they contemplate protection from another line of coverage that in fact has a reciprocal exclusion, or merely because the coverage grant in one line fails to align intelligently with the exclusion in another?

- **If possible, plug the gaps and clarify the coverage grants.** To clarify coverage specifically for cyber-physical risks, insurance buyers may request changes in their existing lines of coverage or explore the purchase of specialty coverage solutions.

- **Expect disputes.** They are virtually inevitable at the claims stage with any previously unrecognized or underestimated risk. But attention to both the big picture and the nitty-gritty details at the underwriting stage should reduce the chances that IoT-related risks and cyber-physical losses will generate the next big wave of coverage litigation.

PRESENTATIONS

Emerging Liability & Coverage Issues Arising from the #MeToo Movement

2019 Annual Meeting
May 8-10, 2019
Chicago, IL

Nancy D. Adams, CPCU
Mintz

James Murray
Blank Rome

Rebecca R. Weinreich
Lewis Brisbois

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

1

INSURANCE COVERAGE FOR DECADES OLD CLAIMS

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

2

Statutes of Limitations

- Legislative Efforts
  - California
  - Delaware
  - Hawaii
  - Michigan
  - Minnesota
- Recent Legislative Efforts
  - New York
  - Pennsylvania

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

3

Coverage Issues Under CGL Policies

- Lost Policies
- Limits of Liability
- An Accident or "Occurrence"
- Potential Exclusions

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

4

Lost Policies

- Burden of Proof
  - Terms and Conditions
  - Exclusions
  - Limits of Liability
- The History of Insurance
  - Rating Bureaus
  - ISO
- Resources

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

5

Limits of Liability

- Annualization of Limits
  - Multiple Year Policies
  - Per Occurrence Limit
  - Aggregate Limit
- Aggregate Limits

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

6

Provisions Impacting Limits of Liability

- Number of Occurrences
  - Occurrence v. Trigger
  - Three Tests
    - Cause
    - Effect
    - Hybrid
- Non-Cumulation of Liability Provisions
- Look Back/First Encounter Provisions

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

7

Accident vs. Occurrence

- Accident
- Evolution of Occurrence
- Role of Intent

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

8

Potential Exclusions

- Expected/Intended
  - Objective vs. Subjective
  - Factual vs. Legal Issues
- Professional Services
- Sexual Molestation

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

9

Defamation: The Second Offense

Rebecca R. Weinreich
Lewis Brisbois Bisgaard & Smith LLP

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

10

11

Defamation

Publication of an unprivileged, false statement of fact which damages a person's reputation and causes injury to the subject of the statement

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

12

Defamation

No *per se* privilege for a statement of opinion

- Prefacing an otherwise defamatory statement with "In my opinion …" does not protect the speaker because it does not state the basis for the opinion
- The test is whether an assertion "is sufficiently factual to be susceptible of being proved true or false" rather than just evaluating whether it expresses an opinion

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

13

Defamation

Public figures must meet a higher standard to establish defamation

They must show that the statements were made knowing they were false or with reckless disregard for the truth

A private figure need only show that false connotations were made with some level of fault.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

14

Winds of Change?

Justice Clarence Thomas' concurrence in *McKee v. Cosby* (Feb. 2019) challenges as unconstitutional the higher standard for public figures.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

15

Defamation Coverage Analysis

Look at

- Choice of law
- Exclusions
- Republication

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

16

Choice of Law

In today's media climate, any statement can be instantly cyber-published nationally

Courts look to the law of the defamed person's state at the time of publication

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

17

Exclusions

Defamation claims in the #MeToo and Time's Up arena take at least two forms

- If the insured is the accuser, the accused can argue that being accused of sexual assault is defamatory
- If the insured is the accused and denies the allegations, the accuser can argue defamation for having been called a liar, an opportunist or the like

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

18

More Exclusions

- Expected or intended
- Sexual assault, abuse or misconduct
- Intent to cause personal injury
- Knowledge of falsity

19

Still More Exclusions

- Criminal act; and
- Business pursuits

Within the entertainment industry, accusers often allege that the sexual abuse was part of a *quid pro quo* wherein the accused offered the accuser career advancement, a plum role, access to powerbrokers and so forth in return for sex

20

Republication

Can affect

- the number of occurrences
- the statute of limitations

Differs state to state

21

Republication

Each statement (or re-statement) is generally an actionable event

An "offense" for purposes of insurance coverage includes each act by an insured which results in "personal injury" (*e.g.,* defamation)

22

Republication

Can be when the defendant edits and retransmits defamatory material intending to reach a new audience

May or may not extend the statute of limitations

The original publisher may only be liable for republications by a third party if the repetition was reasonably expected

23

Settlement Considerations

When the accused is high profile, wealthy or involved in and connected with the entertainment industry, settlement dynamics can be complicated

24

Competing cross claims for defamation
- One by the accused and, if he denies the allegations,
- One by the accuser

can complicate settlement efforts and call into question what comes within the scope of defense

Inextricably intertwined?

Effect of one suit on another?

25

Accusers may want a coverage denial

- An accused who has to fund his own defense (not to mention pay a settlement or judgment) may be weaker in the litigation and beyond
- A savvy attorney may take that into consideration in drafting a complaint in an effort to avoid covered allegations

A global settlement may be harder to achieve if the accuser is unwilling to waive his counterclaim

26

Valuing the defamation claim can be difficult

If the accuser is believed/believable, the accused's defamation claim may not be worth much but can hold the negotiations hostage

27

While a confidentiality provision may be included

- One or the other or both litigants may demand a press release as part of the settlement
- Because publicity can be generated by formal media outlets and through individual social media postings, drafting a mutually agreeable press release can consume considerable time and effort

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

28

Conclusion

- The private is increasingly public
- The personal is increasingly political
- #MeToo and Time's Up are changing how we think about and talk about workplace sexual assault

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

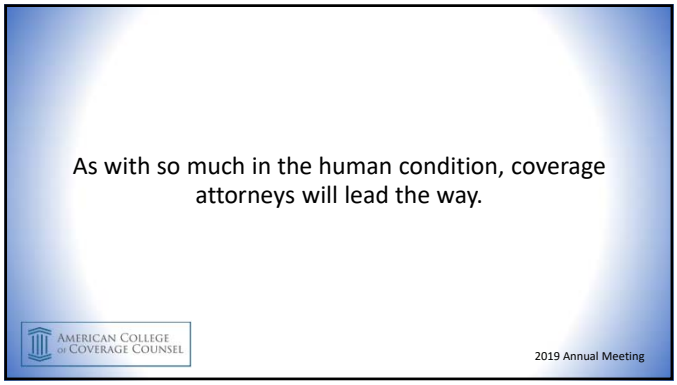
29

- Predictably, litigation and coverage disputes follow
- With social media dominating every conversation, some old law falls away and new nuances will arise
- This, in turn, leads to new policy language which, in time, will be disputed and adjudicated and …

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

30


As with so much in the human condition, coverage attorneys will lead the way.
American College of Coverage Counsel
2019 Annual Meeting

31

1

Tendering Policy Limits

Liability is clear / damages above limits:
Tender Limits?

American College of Coverage Counsel

2019 Annual Meeting

2

Crash:
Single Fatality

$100,000 limits:
Apparent Claim in Excess

American College of Coverage Counsel

2019 Annual Meeting

3

Estate asked insurer for:
policyholder assets,
insurance
acting in course & scope of his employment

Insurer did not immediately tell policyholder

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

4

Insurer tendered policy limits to Estate
days after the crash

Estate returned the check
Filed suit against policyholder

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

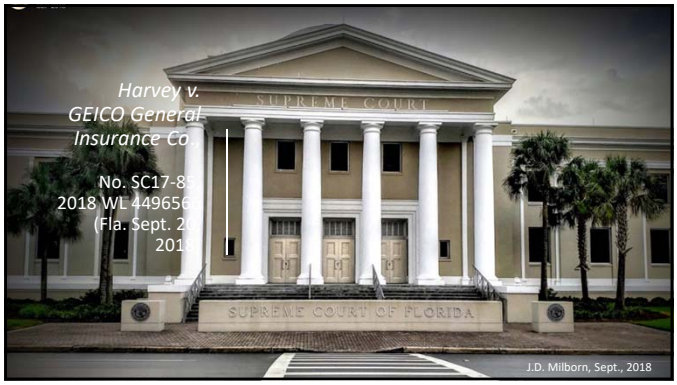
5

Policyholder found liable
for more than $8 million in damages

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

6



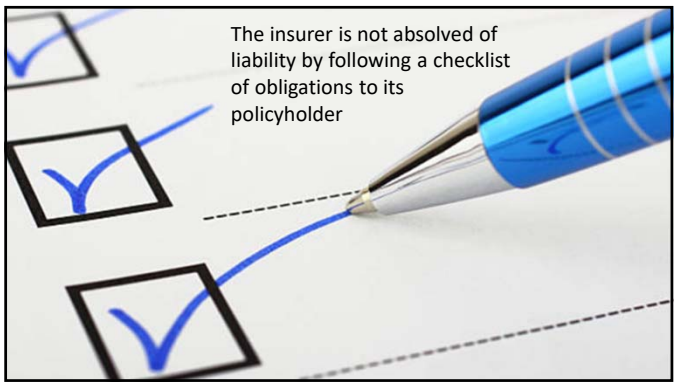
7

Majority found negligence is relevant to the question of good faith

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

8



9

Per Majority: critical question ….

Whether the insurer diligently,
and with the same haste and precision
as if it were in the insured's shoes, worked on the
insured's behalf
to avoid an excess judgment.

10

The insurer was liable in bad faith

11

The dissent …

"…the majority incentivizes a rush to the courthouse steps by third-party claimants whenever they see what they think is an opportunity to convert an insured's inadequate policy limits into a limitless policy…"

12

NOT retaining experts equals bad faith liability ?

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

13

Reasonable, necessary expert & investigation fees constitute defense costs and are covered under the duty to defend.

General Accident Ins. Co. of America v. State, Dept. of Environmental Protection, 143 N.J. 462, 672 A.2d 1154 (1996) (CGL policy);

Barratt American, Inc. v. Transcontinental Ins. Co., 102 Cal.App.4th 848, 861, 125 Cal.Rptr.2d 852, 861 (App. 4th Dist. 2002) (investigative costs).

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

14

In states where insurers only defend covered claims; or, in those states where it is unclear;

insurers are not obliged to fund experts to defend uncovered claims

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

15

In states where insurers must defend all claims,
whether covered or not,
if there are allegations of covered acts,
then, policyholders have a stronger argument
that the insurer must fund all necessary experts

Freedom Specialty Ins. Co. v. Platinum Mgmt. (NY), LLC, 2017 BL 468437, 4 (Sup. Ct. Dec. 21, 2017)

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

16

CGL policy covers trade dress allegations

Excludes patent infringement allegations

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

17

Insured has a good defence against patent allegations

- experts required
- Policyholder highly motivated.
- Insurer unconcerned

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

18

Must the insurer hire expensive experts to defend the patent infringement claim?

Assume in for a penny in for a pound
Patent infringement/Trade dress

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

19

Same result under the *Buss* rule?

Insurer has a duty to defend.
BUT
the insurer can be reimbursed for defending uninsured claims if it proves which costs were incurred for those claims.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

20

Reputational Harm

Can an insurer refuse to settle weak reputation claims?

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

21

When defending, insurers must give the interests of the insured at least as much consideration as it gives its own interests. That includes the decision to settle.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

22

Inconsistency across the United States as to the criteria for a bad faith, failure to settle case, but it is usually limited to cases where the insurer exposes the insured to liability.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

23

But can there be bad faith liability where a settlement within limits allegedly harms the insured's reputation?

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

24

Under a duty to defend policy, the insurer has the right to decide tactics, strategy and has the right to settle covered claims.

25

Allegations of sexual assault on the premises of a private K-12 preparatory school

School's employee the alleged perpetrator

Alleged negligent hiring, negligent supervision

High risk of reputational harm

26

Perpetrator likely liable BUT

- ❑ 20-year-old immigrant
- ❑ arrived in the United States three years ago
- ❑ Background check limited to U.S.
- ❑ Home country history sealed due to age

27

Insured wants to prove its case & clear its name but the insurer can settle for less than the budgeted cost to defend for a complete win.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

28

Insurer has the right to settle covered claims.

BUT, what about the equal treatment standard? What interest of the insurer outweighs that of the insured?

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

29

Settlement is reasonable, even for unsubstantiated claims, when cost of settlement is less than damage caused by negative publicity;

Within the insurer's contractual right to make that call.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

30

What if the settlement costs are slightly higher than the expected defense costs?

Interests are fairly equal, little basis to criticize the insurer if it chooses to settle.

31

Defending Multiple Insureds Under One Policy

32

Separation of Insureds
Common Limit
Duty to Defend Extinguished
when Limits are Paid

33

First Past the Post

Each fair, bona fide and reasonable finally determined settlement is funded as they are presented.

34

Those entitled to indemnity receive it, even if other insureds have, or may have, claims that are not finally determined.

Insureds whose claims remain following settlement have no bad faith cause of action against the insurer.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

35

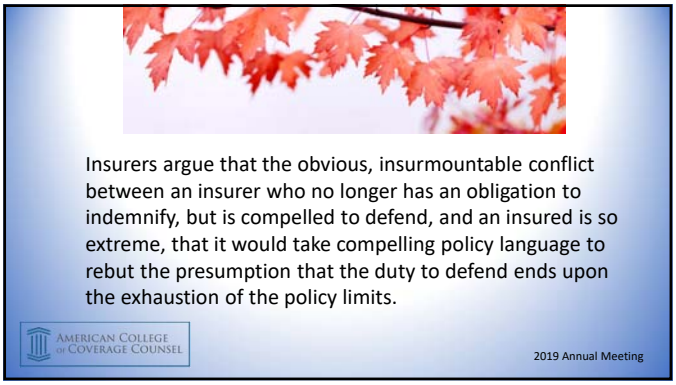
Policyholders are likely to argue that the right to a defence to covered claims is contractual.

There must be policy language to initiate that right and there must be policy language to terminate that right on exhaustion of limits.

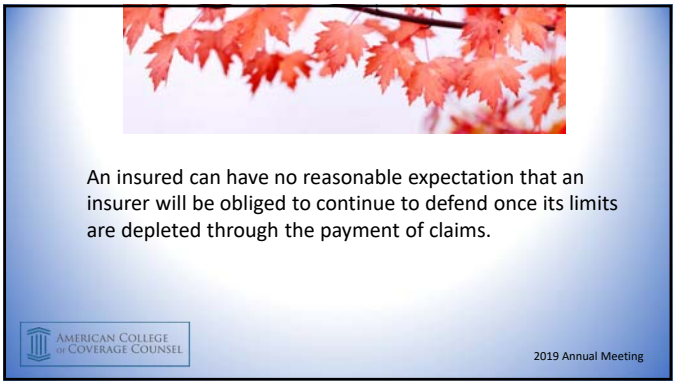
AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

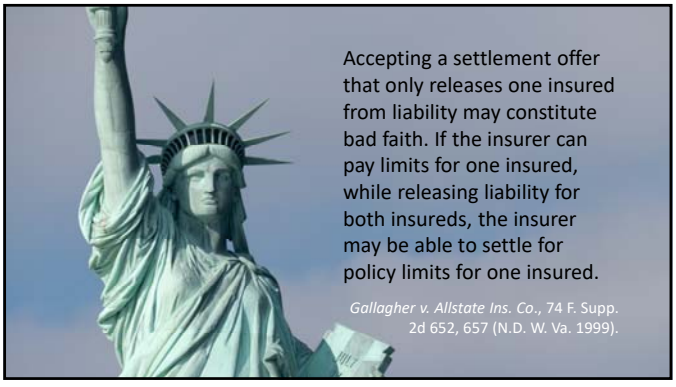
36


Insurers argue that the obvious, insurmountable conflict between an insurer who no longer has an obligation to indemnify, but is compelled to defend, and an insured is so extreme, that it would take compelling policy language to rebut the presumption that the duty to defend ends upon the exhaustion of the policy limits.
American College of Coverage Counsel
2019 Annual Meeting

37


An insured can have no reasonable expectation that an insurer will be obliged to continue to defend once its limits are depleted through the payment of claims.
American College of Coverage Counsel
2019 Annual Meeting

38


Accepting a settlement offer that only releases one insured from liability may constitute bad faith. If the insurer can pay limits for one insured, while releasing liability for both insureds, the insurer may be able to settle for policy limits for one insured.
Gallagher v. Allstate Ins. Co., 74 F. Supp. 2d 652, 657 (N.D. W. Va. 1999).

39

Homeowners of 1,000's of homes flooded with sewage sue:

- ❑ Manufacturer (internal files show manufacturer knew of defect but did not expect it to cause harm)
- ❑ Independent testing agency (that failed to find the defect, manufacturer deliberately withheld the incriminating files)

40

Both insureds sued at once

Testing agency has a good, less costly defense than the manufacturer

Testing agency has the first settlement opportunity – policy limits or nothing

41

What if the insurer talked to plaintiffs' attorneys and offered to settle on behalf of the testing agency?

42

Interesting Bad Faith Trends

Liability in Excess of Limits Even in the Absence of Bad Faith

Century Surety Co. v. Andrew on Behalf of Pretner, 134 Adv. Op. 100, 2018 WL 6609591 (Nev. 2018).

Held: an insurer can be held liable for consequential damages in excess of policy limits for breaching the duty to defend even when there is no bad faith.

"[W]e are not saying that an entire judgment is automatically a consequence of an insurer's breach of its duty to defend' rather, the insured is tasked with showing that the breach caused the excess judgment and is obligated to take all reasonable means to protect himself and mitigate his damages."

43

Interesting Bad Faith Trends

Individual Liability for Adjusters

Keodalah v. Allstate Insurance Co., 413 P.3d 1059 (Wash. Ct. App. Mar. 26, 2018).

Held: insurance adjusters can be held individually liable for bad faith and breaching consumer protection laws while handling claims in the regular course of employment.

Statute imposes a duty of good faith and fair dealing on "all persons engaged in the business of insurance" (RCW 48.01.030)

The adjuster contradicted the findings of the police, witnesses and a reconstruction expert by testifying that the policyholder was 70% at fault.

44

Interesting Bad Faith Trends

No Bad Faith Failure to Settle Within Limits When There is a Valid Offer but No Time is Stated for Acceptance of Settlement Offer

First Acceptance Insurance Company of Georgia, Inc. v. Hughes (Case No.: S18G0517, Decided March 11, 2019).

Held: Insurer's "failure to promptly accept [the] offer was reasonable as an ordinarily prudent insurer could not be expected to anticipate that, having specified no deadline for the acceptance of their offer, [these claimants] would abruptly withdraw their offer and refuse to participate in the settlement conference.

45

The Meaning of "Plain Meaning"

2019 Annual Meeting
May 8-10, 2019
Chicago, IL

Jeffrey E. Thomas – University of Missouri-Kansas City
Jeffrey W. Stempel – University of Nevada Las Vegas
Lorelie S. Masters, Hunton Andrews Kurth, Washington, D.C.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

1

Plain Meaning in Contracts

Calamari and Perillo The plain meaning rule "states that if a writing, or a term is plain and unambiguous on its face, its meaning must be determined from the four corners of the instrument without resort to extrinsic evidence of any kind. * * * CALAMARI & PERILLO, §3.10 at 136-37 (7th ed. 2014).

Farnsworth "The essence of a plain meaning rule is that there are some instances in which the meaning of language, *when taken in context*, is so clear that evidence of prior negotiations [or extrinsic evidence] cannot be used in its interpretation." E. ALLAN FARNSWORTH, CONTRACTS 462 (4th ed. 2004)(emphasis added)

Restatement of Contacts § 212(1) " The interpretation of an integrated agreement is directed to the meaning of the terms . . . in light of the circumstances. Comment b: "meaning can almost never be plain except in a context" such as "the situation and relations of the parties, the subject matter of the transaction, preliminary negotiations and statement made therein, usages of trade, and the course of dealing between the parties."

Construction Methodology Statutes 11 states have statutes, mostly consistent with common law rules, but occasional surprises

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

2

Contract Case Law on Plain Meaning

New York – California Divide: "differences between New York and California contract law turn out to align with the formalist-contextualist distinction in contract theory. New York judges are formalists, . . . they have little tolerance for attempts to re-write contracts to make them fairer or more equitable. . . . California judges, on the other hand, more willingly reform or reject contracts in the service of morality or public policy; they place less emphasis on the written agreement." Geoffrey P. Miller, *Bargains Bicostal*, 31 Cardozo L. Rev. 1475, 1478 (2010).

Formalist/Textualists 19 jurisdictions: Alabama, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Indiana, Louisiana, Nebraska, New Hampshire, New York, North Dakota, Oregon, Pennsylvania, Texas, Virginia, Wisconsin, Wyoming.

Functionalist/Contextual 15 jurisdictions: Alaska, Arizona, Arkansas, California, Idaho, Illinois, Iowa, Maine, Maryland, Montana, New Jersey, New Mexico, Utah, Vermont, Washington

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

3

Restatement, Liability Insurance

§3: "The plain meaning of an insurance policy term is the single meaning to which the language of the term is reasonably susceptible when applied to facts of the claim at issue in the context of an entire insurance policy."

Comment b: "Generally accepted sources that courts consult when determining the plain meaning of an insurance policy term include: dictionaries, court decisions, statutes and regulations, and secondary legal authority such as treatises and law review articles.

Many courts that follow a strict plain-meaning rule also consider custom, practice, and usage when determining the plain meaning."

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

4

RLLI on Ambiguity

§ 3(3) :An insurance policy term is ambiguous if there is more than one meaning to which the language of the term is reasonably susceptible when applied to the facts of the claim at issue in the context of the entire insurance policy."

§ 4 "When an insurance policy term is ambiguous as defined in §3(3), the term is interpreted against the party that supplied the term, unless that party persuades the court that a reasonable person in the policyholder's position would not give the term that interpretation."

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

5

RLLI that might have been: *Presumption* of plain meaning

§3(2) "An insurance-policy term is interpreted according to its plain meaning, if any, unless extrinsic evidence shows that a reasonable person in the policyholder's position would give the term a different meaning. The different meaning must be more reasonable than the plain meaning in light of extrinsic evidence, and it must be a meaning to which the language of the term is reasonably susceptible.

Comment b: "The rebuttable presumption has the potential to bring the legal rule more in line with the actual practice of interpretation even in jurisdictions with a very strict plain-meaning rule

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

6

Linguistics: the Science of Language

- Much of linguistics is intrinsically incorporated into "plain meaning" – definitions, grammar, syntax, usage, etc.
- A couple of linguistic concepts could be useful:
  1. **Core meaning**: words have core meaning with fuzzy margins
  2. **Context is instrumental**: listeners search for meaning and use context to disambiguate

Context:
"Visiting relatives can be annoying"

Core Meaning: "blue"

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

7

The Corpus Linguistics Movement: Promise or Peril?

- What is it? A linguistic methodology that uses a database of usage
- Why use it?
  - To address results-oriented use of plain meaning rule
  - To address false consensus bias about meanings
  - To help to explore the proper role of text
- How to use it? (work with a linguist)
  - Identify key terms or phrases
  - Run searches in the data base
  - Make arguments to the court (an issue of law)

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

8

Hypothetical 1: pollution exception

- **Text**: pollution damages are excluded unless the release was "sudden and accidental"
- **Facts**: leaking underground gasoline storage tank, leak was gradual and unexpected
- **What is the "plain meaning" of "sudden and accidental"?** Temporality or not? Ambiguous?

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

9

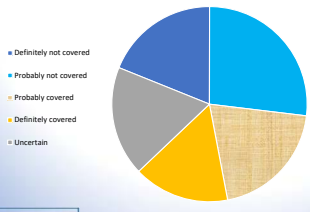
Hypothetical 2: territorial limitation

- **Text**: insurance applies "only to occurrences, accidents or losses which happen . . . Within the United States of America, its territories or possession, Canada or Mexico."
- **Facts**: plane traveling from NY to Puerto Rico crashed 25 miles west of Puerto Rico in international waters
- **What is the "plain meaning" of "within"?** Is a trip from the US to a US territory "within" the US or its territories?

See Vargas v. INA, 651 F.2d 838 (2nd Cir. 1981); Omri Ben-Shahar & Lior Jacob Strahilevitz, *Interpreting Contracts Via Surveys and Experiments*, 92 NYU L. Rev. 1753 (2017)

10

Hypo2: territorial limitation Survey



11

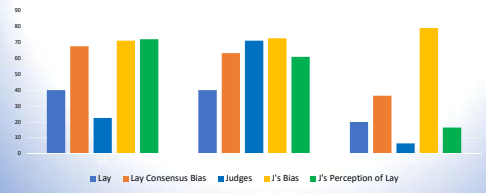
Hypothetical 3: earth movement

- **Text**: Property insurance does not apply to loss "caused by, resulting from, contributed to or aggravated by any earth movement, including, but not limited to earth sinking, rising, or shifting."
- **Facts**: Blasting by neighboring ski resort caused an underground concussion that caused serious structural damage
- **What is the "plain meaning" of "earth movement"?** Does it include an underground concussion?

See Lawrence Solan, Terri Rosenblatt, & Daniel Osherson, *False Consensus Bias in Contract Interpretation*, 108 Colum. L. Rev. 1268 (2008).

12

Hypo 3: earth movement survey



AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

13

Hypothetical 4: business pursuits

- **Text**: insurance "does not apply . . . To bodily injury or property damage arising out of business pursuits of any insured except activities therein which are ordinarily incident to nonbusiness pursuits."
- **Facts**: Insured was watching her own son and was paid by her neighbors to watch their son, who was accidentally injured by boiling water while in insured's care.
- **What is the "plain meaning" of "business pursuits"?** Does it include babysitting for the neighbor?

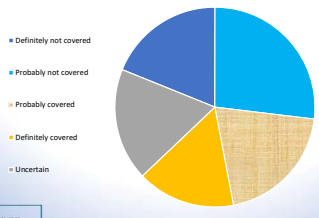
See State Farm & Casualty Co. v. Moore, 430 N.E.2d 641 (Ill. App. 1981); Omri Ben-Shahar & Lior Jacob Strahilevitz, *Interpreting Contracts Via Surveys and Experiments*, 92 NYU L. Rev. 1753 (2017).

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

14

Hypo 4: business pursuits survey



AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

15

Hypothetical 5: terrorism exclusion

- **Text**: "Terrorism" defined as "When one or both of the following applies:
  a. The effect is to intimidate or coerce a government or the civilian population or any segment thereof, or to disrupt any segment of the economy; or
  b. It appears that the intent is to intimidate or coerce a government, or to further political, ideological, religious, social or economic objectives or to express (or express opposition to) a philosophy or ideology."
- **Facts**: Suicide bombing at a Mosque; no known associations for bomber; no conclusive evidence of motive
- **What is the "plain meaning" of "terrorism"?** Is the target enough to make it terrorism?

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

16

Hypothetical 6: occupying a vehicle

- **Text**: an "insured" is any person "occupying an insured auto" and "occupying" is defined as "in, upon, getting into or getting out of."
- **Facts**: Claimant, sitting on a motorcycle, was hit by insured, and fell back onto insured's car; claimed UIM coverage under insured's policy as one "occupying" the vehicle
- **What is the "plain meaning" of "upon"?** Does it include claimant if he has no prior relationship to the vehicle?

Hahn v. GEICO Choice Ins. Co., 420 P.3d 1160 (Alaska 2018).

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

17

Questions and Comments

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

18

The Art of Negotiation and Mediation:
Are There Ethics In Poker?

2019 Annual Meeting
May 8-10, 2019
Chicago, IL

Neil Posner - Much Shelist, PC
John Bonnie – Weinberg, Wheeler, Hudgins, Gunn & Dial, LLC
Clifford Shapiro – Barnes & Thornburg LLP

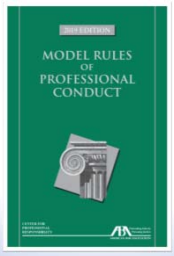
AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

1

Source Of Ethical Obligations In Negotiation

Adopted at least in part in all 50 states.



Two differing standards:

- Dealings with an opposing party;
- Dealings before a tribunal

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

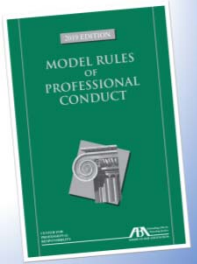
2

Harmonizing "Truthfulness" and "Candor"

Rule 4.1: Truthfulness in Statements to Others

Rule 8.4: Misconduct

Rule 3.3: Candor Toward the Tribunal



AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

3

Rules of Negotiation

Rule 4.1: Truthfulness in Statements to Others

Rule 4.1(b): A lawyer may not knowingly fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a fraudulent act by a client

Rule 8.4: Misconduct

Rule 8.4(c): A lawyer is prohibited from engaging in conduct involving dishonesty, fraud, deceit, or misrepresentation.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

4

Rules of Negotiation

Possibly Acceptable Conduct under Rule 4.1

- Puffing
- Bluffing
- Withholding material facts
- Other omissions

Statements of opinion and statements that merely reflect the speaker's state of mind, regardless of truth/basis

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

5

Contrast: Rules Before A Tribunal

Rule 3.3: Candor Toward the Tribunal

Rule 3.3(a) - A lawyer cannot knowingly (1) make a false statement of fact/law or fail to correct one previously made; (2) fail to disclose directly adverse, controlling legal authority; or (3) offer knowingly falls evidence.

Rule 3.3(d) - In an *ex parte* proceeding, a lawyer shall inform the tribunal of all material facts known to the lawyer that will enable the tribunal to make an informed decision, whether or not the facts are adverse.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

6

Efforts To Clarify And Harmonize The Rules

American Bar Association Section of Litigation
Ethical Guidelines for Settlement Negotiations
August 2002

American Bar Association Section of Dispute Resolution
Resolution On Good Faith Requirements For Mediators And Mediation Advocates in Court-Mandated Mediation Programs
August 2004

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

7

Criticism Of The Rules

". . . lying is not the province of a few 'unethical lawyers' who operate on the margins of the profession. It is a permanent feature of advocacy and thus of almost the entire province of law."

"The Model Rules contain no requirement of honest dealing."

"Conduct that is 'fraudulent' is forbidden, but all else is merely part of negotiating strategy."

"Model Rule 4.1 legitimizes some deceitful negotiation techniques . . ."

The "indeterminate" nature of the Model Rules render them "unhelpful".

"In negotiation, where there is only the sparest written guidance, the parties must decide for themselves what is legal, what is factual, and what is ethical."

"Consensual deception is the essence of caucused mediation."

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

8

A Scenario In The Extreme

Plaintiff injured in accident; serious injuries acknowledged.

IME requested by Defendants reveals life-threatening, undiagnosed aortic aneurism requiring immediate surgery. Plaintiff's counsel does not request/learn of findings of IME.

Whether the aneurism is related to the accident is unknown, but disclosing it to plaintiff almost certainly would increase the settlement value of the case.

Must *defense counsel reveal the IME despite damage to client's position?*

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

9

A Scenario In The Extreme

Spaulding v. Zimmerman, 263 Minn. 346, 116 N.W.2d 704 (1962)

"By reason of the *failure of plaintiff's counsel to use available rules of discovery*, plaintiff's doctor and all his representatives did not learn that defendants and their agents knew of its existence and possible serious consequences. "

"There is no doubt of the good faith of both defendants' counsel. . . [D]uring the course of the negotiations, when the parties were in an adversary relationship, no rule required or duty rested upon defendants or their representatives to disclose this knowledge."

"To hold that the concealment was not of such character as to result in an unconscionable advantage over plaintiff's ignorance or mistake, would be to penalize innocence and incompetence and reward less than full performance of an officer of the Court's duty to make full disclosure to the Court when applying for approval in minor settlement proceedings."

". . . no canon of ethics or legal obligation . . . required them to inform plaintiff. . . "

10

The Rules In Modern Practice

Scenarios

11

Scenario: Failure to disclose that client is dead

Representing that:

- already dead plaintiff "needed additional medical treatment"
- death of plaintiff occurred after, not before settlement

Failure to disclose:

- death of plaintiff at mediation
- death of defendant prior to suit
- death of defendant in answer
- death in settlement reached solely on belief plaintiff would have "made an excellent witness" at trial

12

Scenario: Failure to disclose that client is dead

Representing that already dead plaintiff "needed additional medical treatment"

In the Matter of Daniel R. Rosen, 198 P.3d 116 (Colo. 2008).

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

13

Scenario: Failure to disclose that client is dead

Representing that death of plaintiff occurred after, not before settlement

In re Lyons, 780 N.W.2d 629 (Minn. 2010).

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

14

Scenario: Failure to disclose that client is dead

Failure to disclose death of plaintiff at mediation

In re Rosenau, 132 A.3d 1174 (D.C. App. 2016)

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

15

Scenario: Failure to disclose that client is dead

Failure to disclose death of defendant prior to suit

In re Edison, 724 N.W.2d 579 (N.D. 2006).

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

16

Scenario: Failure to disclose that client is dead

Failure to disclose death of defendant in Answer to Complaint

In re Edison, 724 N.W.2d 579 (N.D. 2006).

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

17

Scenario: Failure to disclose that client is dead

Failure to disclose death when defendant settled solely on belief that plaintiff would "make an excellent witness" at trial

Virzi v. Grand Trunk Warehouse & Cold Storage Co., 571 F. Supp. 507 (E.D. Mich. 1983)

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

18

Scenario: Mischaracterization of physical ability
Scenario: Failure to disclose life expectancy

- Describing plaintiff in pre-suit settlement discussions as "an active man" despite two prior 5% disability ratings.
- Representing in pre-suit settlement discussions that plaintiff "could not participate in any activity which requires the slightest bit of physical exertion."
- Not disclosing fatal non-occupational disease and one year life expectancy in negotiating workers compensation settlement premised on the basis of three years of wages.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

19

Scenario: Mischaracterization of physical ability
Scenario: Failure to disclose life expectancy

Describing plaintiff in pre-suit settlement discussions as "an active man" despite two prior 5% disability ratings.

Statewide Grievance Committee v. Gillis, 2004 WL 423905 (Conn.Super.,2004)

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

20

Scenario: Mischaracterization of physical ability
Scenario: Failure to disclose life expectancy

Representing in pre-suit settlement discussions that plaintiff "could not participate in any activity which requires the slightest bit of physical exertion."

Statewide Grievance Committee v. Gillis, 2004 WL 423905 (Conn.Super.,2004)

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

21

Scenario: Mischaracterization of physical ability
Scenario: Failure to disclose life expectancy

Not disclosing fatal non-occupational disease and one year life expectancy in negotiating workers compensation settlement premised on the basis of three years of wages.

PA Eth. Op. No. 2001-26, 2001 WL 1744874.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

22

Scenario: Nondisclosure/Misrepresentation Of Will Or Estate

- Not disclosing existence of will
- Misrepresenting in mediation that estate funds would be included in settlement

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

23

Scenario: Nondisclosure/Misrepresentation Of Will Or Estate

Not disclosing existence of will

Jurek v. Kivell, 2011 WL 1587375 (Tex. App. April 21, 2011)

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

24

Scenario: Nondisclosure/Misrepresentation Of Will Or Estate

Misrepresenting in mediation that estate funds would be included in settlement

In re Potts, 336 Mont. 517, 158 P.3d 418 (2007)

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

25

Scenario: Insurance Limits Nondisclosures/Misrepresentations

- Not disclosing existence of other insurance.
- Misrepresenting the amount of the remaining policy limit.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

26

Scenario: Insurance Limits Nondisclosures/Misrepresentations

Not disclosing existence of excess insurance when settling hospital liens.

Nebraska State Bar Ass'n v. Addison, 226 Neb. 585, 412 N.W.2d 855 (1987)

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

27

Scenario: Insurance Limits Nondisclosures/Misrepresentations

Misrepresenting amount of remaining policy limit.

Statewide Grievance Committee v. Kennelly, 2005 WL 758055 (Conn.Super. 2005)

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

28

Scenario: Misrepresenting Amount of Settlement Agreement

- Misrepresenting amount of a settlement agreement prompting a third party to take a lesser fee for services provided to the lawyer's client.

AMERICAN COLLEGE OF COVERAGE COUNSEL

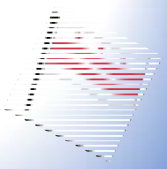
2019 Annual Meeting

29

Scenario: Misrepresenting Amount of Settlement Agreement

Misrepresenting amount of a settlement agreement prompting a third party to take a lesser fee for services provided to the lawyer's client.

In re Dargie, 172 A.3d 885 (D.C. App. 2017)



AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

30

Scenario: Lying In A Mediation
Scenario: Advocating Lying In Mediation

- Lying about *ex parte* conversations with opposing party outside presence of counsel
- Advocating on law firm website lying in school mediation proceedings

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

31

Scenario: Lying In A Mediation
Scenario: Advocating Lying In Mediation

Lying about *ex parte* conversations with opposing party outside presence of counsel

The Florida Bar v. Feinberg, 760 So.2d 933 (Fla. 2000)

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

32

Scenario: Lying In A Mediation
Scenario: Advocating Lying In Mediation

Advocating on law firm website lying in school mediation proceedings

In re Philpot, 820 N.E.2d 141 (Ind. 2005)

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

33

Scenario: Not Disclosing Existence of Successive Auto Accidents

Accident 1 occurs causing injury.

Accident 2 occurs causing injury.

Does the occurrence of one accident have to be disclosed in negotiating settlement of the other accident if the claimed injuries are different for each accident?

If the injuries are the same from the two accidents?

If no questions are asked in settlement negotiations implicating the other accident?

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

34

Scenario: Not Disclosing Existence of Successive Auto Accidents

In re: Summer, 338 Or. 29, 105 P.3d 848 (2005)

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

35

Scenario: Not Disclosing Existence of Successive Auto Accidents

Statewide Grievance Committee v. Gillis, 2004 WL 423905 (Conn.Super., 2004)

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

36

Other Scenarios

- Failing to correct misrepresentation to lawyer for client's partner that certificate of deposit obtained for escrow had been established with liquidated partnership funds. *In re Carpentio's Case,* 651 A.2d 1 (N.H. 1994).
- Concealment of intention to recover costs; failure to correct false impression settlement would resolve case. *In re Eadie*, 36 P.3d 468 (Or. 2001).
- Letter to opposing counsel proposing settlement terms contained "untruths". *Ausherman v. Banks of Am. Corp.*, 212 F. Supp.2d 435 (D. Md. 2002)
- Failure to disclose during settlement discussions ongoing dispute between client and its subcontractor. *Cedar Island Improvement Ass'n, Inc. v. Drake Associates, Inc.,* 2009 WL 415991 (Conn. Super Ct. 2009).

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

37

Other Tactics

- False Bottom Line
- False Evaluation
- The Torn Up Contract

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

38

What Are The Rules – In A Mediation

The Model Standards of Conduct for Mediators

Drafted by the AAA, the ABA Section of Dispute Resolution and the Society for Professionals in Dispute Resolution.

Section 4.1.1: "A mediator should promote honesty and candor between and among all participants, and a mediator **shall not knowingly misrepresent any material fact or circumstance in the course of the mediation**."

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

39

What Are The Rules – In A Mediation

Florida Rules for Certified and Court Appointed Mediators

Specifically prohibits mediator from intentionally or knowingly misrepresenting any material fact or circumstance. Fla. R. Med. 10.310(c).

- Further, Florida Supreme Court has held that mediator is an agent of the court carrying out an official court-ordered function.
- Court can/will invalidate any settlement agreement obtained through a violation of the judicially prescribed mediation procedure.
- But, most jurisdictions have not adopted such specific rules.

40

Mediation – Acceptable "Deceptive" Practices?

Confidential Information

The mediator is instructed to keep a material weakness in one party's case confidential; the other side is not aware

The mediator does not disclose or include the material weakness in caucus discussions

- This is accepted practice
- In fact, everyone agrees it is fundamental to the mediation process that the mediator keep the information confidential

41

Mediation – Acceptable "Deceptive" Practices?

Confidential Information (cont'd)

Example: An owner does not realize the contractor's lien claim is defective and the mediator is obligated not to disclose this information.

- Is the mediator engaging in deceptive conduct?
- How should the mediator handle this circumstance?

42

Mediation – Acceptable "Deceptive" Practices?

Confidential Information (cont'd)

Should the mediator try to obtain a "fair" result by finding another way to avoid the owner paying too much - while not disclosing the key confidential fact?

- Perhaps the mediator could focus the discussion with the contractor on other problems to reduce its demand?
- If the mediator overstates these other "problems" has the mediator engaged in "deceptive" conduct? Ethical?

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

43

Mediation – Acceptable "Deceptive" Practices?

Confidential Information (cont'd)

Insurance Coverage

A policyholder's claim against an insurance company could be barred by late notice but the carrier is not aware. The insurance company attorney asks the mediator, "How do you think the court will rule?"

- Is the mediator obligated to disclose the late notice defense?
- If the mediator offers an evaluation without including the late notice defense is the mediator being deceptive? Ethical?

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

44

Mediation – Acceptable "Deceptive" Practices?

Manipulating Offers

- Mediator makes up a proposal by one side to get the other side negotiating
- Mediator reframes an offer as his or her own idea to make it more palatable to the other side
- Mediator declines to offer a low-ball offer for fear of hurting the process

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

45

Mediation – Acceptable "Deceptive" Practices?

The Torn Up Contract

One attorney tells the mediator to "tell the other side" that the client considers the contract torn up, and proceeds to actually tear it up for full effect. The other side asks what the attorney said about the contract.

- If the mediator "soft sells" what was actually said, is this deceptive? Is it ethical?

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

46

"Allocation—Is That a Thing?"— Navigating Disputes Over Allocation Between Covered and Uncovered Claims

2019 Annual Meeting
May 8-10, 2019
Chicago, IL

Franklin D. Cordell
Gordon Tilden Thomas & Cordell LLP

James W. Bryan
Nexsen Pruet

Michael A. Hamilton
Goldberg Segalla LLP

Suzan F. Charton
Covington & Burling LLP

AMERICAN COLLEGE OF COVERAGE COUNSEL

1

The Recurring Complication: Allocation in Mixed Cases

AMERICAN COLLEGE OF COVERAGE COUNSEL

2

What is a "mixed" case?

- Covered and uncovered **claims**
- Covered and uncovered **parties**
- **Counterclaims** and **cross-claims** related to insured's defense

What coverage can be apportioned?

- Defense costs: Usually no
- Indemnity: Sometimes yes

3

Common "Mixed" Fact Patterns

- Professional liability lawsuit alleging ordinary negligence plus overbilling and fraud
- Consumer class action alleging negligence, plus punitive damages and restitution ("return of profit or advantage")
- Lawsuit against insured corporation, with co-defendants that are not insureds (added twist: defendants represented by same counsel)
- Environmental contribution lawsuit against insured property owner, who seeks to assert counterclaims and third-party claims to reduce potential liability

4

Defense Costs

American College of Coverage Counsel

2019 Annual Meeting

5

Defense Costs: No "Real Time" Allocation

- Nearly universal rule:
  - Insurer must defend entire mixed action — no "real-time" allocation for less than full defense
- Rationale:
  - Complete, real-time defense is necessary to preserve value of duty to defend
  - Full defense benefits both policyholder and insurer
- Exceptions:
  - New Jersey
  - Washington: "reasonably related" test

6

Not So Fast: *Post-Defense* Allocation of Costs

- *Narrow majority:*
  - After conclusion of underlying case, insurer may seek to recoup defense costs allocable to uncovered claims.

> ***Buss v. Superior Court***, 16 Cal.4th 35, 939 P.2d 766, 65 Cal.Rptr.2d 366 (1997).
>
> "As to the claims that are at least potentially covered, the insurer may not seek reimbursement for defense costs. . . . . As to the claims that are not even potentially covered, however, the insurer may indeed seek reimbursement for defense costs."

7

Not So Fast: Post-Defense Allocation of Costs

- Limitations on recoupment:
  - Insurer may recoup defense costs "that can be allocated ***solely*** to the claims that are ***not even potentially*** covered."
  - Burden is on **Insurer**, as the party desiring relief, to prove which claims relate solely to claims that are not even potentially covered.
  - Insurer bears insolvency risk

8

Not So Fast: Post-Defense Allocation of Costs

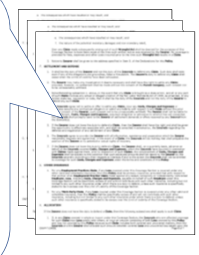
- Substantial minority of jurisdictions have rejected unilateral right of recoupment
  - "Unilateral": ROR letter
- But: Policy language?
  - Express policy provision for recoupment or real-time allocation?
  - Historically, Traditionally no terms expressly allow allocation or recoupment of defense costs

9

Policy Terms Providing for Allocation of Defense Costs

B. If there is an agreement on an allocation of Defense Costs, the Insurer shall advance, on a quarterly basis, Defense Costs allocated to Loss. If there can be no agreement on an allocation of Defense Costs, the Insurer shall advance on a quarterly basis Defense Costs which the Insurer believes to be covered under this Policy until a different allocation is negotiated, arbitrated or judicially determined.

C. Any negotiated, arbitrated or judicially determined allocation of Defense Costs on account of any Claim shall be applied retroactively to all Defense Costs on account of the Claim, notwithstanding any prior advancement to the contrary. Any allocation or advancement of Defense Costs on account of any Claim shall not apply to or create any presumption with respect to the allocation of other Loss on account of the Claim or any other Claim.



10

Insured and Uninsured Parties

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

11

Allocation Among Insured and Uninsured Entities

- Question arises where insured defendant and uninsured co-defendants are represented by same counsel
- Little case law
- *High Point Design, LLC v. LM Ins. Corp*., 2016 WL 426594 (S.D.N.Y., Feb. 3, 2016)
  - Court rejected pro-rata/per-capita allocation
  - Adopted "but for" test:
    - Recoupable costs are only those that would not have been incurred *but for* the presence of the uninsured entities

12

Related Affirmative Claims

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

13

Related Question: Affirmative Claims Within Duty to Defend?

- Narrow majority rule: "Duty to defend" strictly interpreted; affirmative claims not covered.
  - *Mount Vernon Ins. Co. v. Visionaid*, Inc., 477 Mass. 343, 76 N.E.3d 204, 209-10 (2017)
- Contrary view: Effective defense may entail asserting counterclaims; thus the duty to defend obligates the insurer to bring any claim that reasonable defense attorney would bring.
  - *PEPCo v. California Union Ins. Co.*, 777 F. Supp. 980, 984 (D.D.C. 1991)
- Potential area for pragmatism?

14

Indemnity Costs

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

15

Allocation of Indemnity Costs

- General Rule:
  Indemnity costs may be apportioned between claims/damages that are covered and not covered

16

Allocation of Indemnity Costs

- General Rule: Policyholder bears burden
  - E.g., *American Guaranty & Liability Insurance Co. v. U.S. Fire Insurance Co.,* 255 F. Supp. 3d 677 (S.D. Tex. 2017)
- Florida: Inability to allocate *precludes recovery*
  - *Amerisure Ins. Co. v. The Auchter Co., et al*, No. 3:16-cv-407-J-39JRK, 2017 WL 4862194 at *12 (M.D. Fla. Sept. 27, 2017)

17

Allocation of Indemnity Costs

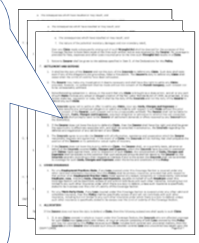
Factors that may affect burden of proof:

- Who was controlling the defense?
  - Whoever has access/control of evidence has burden to allocate
  - *Executive Risk Indemnity, Inc. v. Cigna Corp*., 74 A.3d 179 (Pa. Super. 2013), *app. denied*, 89 A.3d 1285 (Pa. 2014).
- Did insurer notify insured of need to allocate?
  - If failure to notify policyholder of need to allocate causes prejudice, insurer must prove part of claim that is uncovered.
  - *Remodeling Dimensions, Inc. v. Integrity Mut. Ins. Co.,* 819 N.W.2d 602 (Minn. 2012).

18

D&O Policy Terms on Allocation: Option 1

- "If both Loss covered under this policy and loss not covered under this policy are jointly incurred either because a Claim includes both covered and non-covered matters or covered and non-covered causes of action or because a Claim is made against both an Insured and any other parties not insured by this policy, then the Insured and the Insurer shall use their best efforts to fairly and reasonably allocate payment under this policy between covered Loss and non-covered loss based on the relative legal exposures of the parties with respect to covered and non-covered matters or covered and non-covered causes of action."

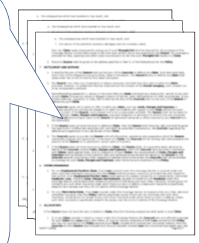


19

D&O Policy Terms on Allocation: Option 2

Solely with respect to all Liability Coverage Parts:
If **Loss** is incurred that is partially covered and partially not covered by this Policy, either because a **Claim** made against the **Insureds** includes both covered and uncovered matters or because a **Claim** is made against both covered and uncovered parties, such **Loss** shall be allocated as follows:

(1) 100% of **Costs of Defense** shall be allocated to covered **Loss**; and
(2) **Loss** other than **Costs of Defense** shall be allocated between covered and non covered **Loss** based upon the relative legal exposure of the parties to such matters.



20

Allocation of Indemnity Costs – D&O

<u>Court doctrines</u>

- "Relative Exposure" rule
  - Requires parties to allocate costs between insured Ds and Os and uninsured parties (such as the company)
- "Larger Settlement" rule
  - Unless the uninsured corporation had some basis for liability independent of that of its directors and officers, the carrier must cover all of the defense *and settlement costs* for covered directors and officers, and their non-covered corporate entity

21

Strategic Considerations

Intervention
Proof: Evidence and Experts
Reservations of Rights
Declaratory Judgment Actions

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

22

Strategic Considerations: Intervention/Use of Special Interrogatories

- Insurer may intervene in underlying action in order to submit jury interrogatories to aid in allocation of covered and non-covered claims.
- Not all courts approve.

23

Intervention/Use of Special Interrogatories

Cases not allowing intervention:

- *Owners Ins. Co. v. Shep Jones Const., Inc.,* 2012 WL 1642169 (N.D. Ala. May 3, 2012).
  - But court placed burden to allocate on policyholder
- *J.T. Shannon Lumber Co. v. Gilco Lumber, Inc*., 2008 WL 4553048 (N.D. Miss. Oct. 7, 2008)
  - Untimely (10 months after ROR); Insurer lacked "direct interest" in case (no verdict, no finding that claims were uncovered)
- *Mutual of Enumclaw Ins. Co. v. Dan Paulson Construction, Inc*., 161 Wn.2d 903, 169 P.3d 1 (2007)

24

Cautionary Tale: *Dan Paulson Construction*

- *Mutual of Enumclaw Ins. Co. v. Dan Paulson Construction, Inc.*, 161 Wn.2d 903, 169 P.3d 1 (2007)
  - In underlying arbitration, insured and underlying claimant agreed that the arbitrator would make any award on a lump-sum basis, contrary to "the arbitrator's usual practice of providing a detailed, itemized award."
  - Insurer attempted to intervene, was denied
  - Insurer filed DJ, then issued a subpoena to the arbitrator for deposition upon written questions after the arbitration was concluded.
  - Court agreed with insured that insurer's ex parte contact with arbitrator constituted **bad faith** and gave rise to **coverage by estoppel**

25

Proving Apportionment: Evidence and Experts

- Case Study:
  UnitedHealth Group, Inc. v. Executive Risk Specialty Insurance Co., 870 F.3d 856 (8th Cir. 2017)

26

UnitedHealth Group

"Allocation require[s] either contemporaneous evidence of valuation or expert testimony on relative value to provide a reasonable foundation for a [fact-finder's] decision."

- Evidence:
  - Testimony from underlying defense attorneys
  - Evidence from underlying lawsuits, including transcripts of testimony
  - Expert testimony evaluating lawsuits, testimony, documents, etc.

"Events and circumstances happening after settlement are relevant only insofar as they inform how a reasonable party would have valued and allocated the claims at the time of settlement."

27

Ensuing Battles on Motions in Limine and Expert Testimony

Since *UnitedHealth…*

- *In re RFC and RESCAP Liquidating Trust Action* (D. Minn. 2018)
  - Indemnitee's expert's breach rate methodology allowed
  - "arguments go to the weight of the evidence"
  - "reasonably certain basis for assessing and allocating damages that is not speculative, remote, or conjectural"
- *Union Pacific RR. Co.* (D. Neb. 2018)
  - Trial lawyer's opinions were on legal issues, exceeding province of expert witness.
  - Expert testimony allowed on information known to expert and shared with insured defendant before settlement, even though not known to plaintiffs before settlement.
- *Viracon, Inc.* (D. Minn. June 18, 2018)
  - Court declined to declare any allocation so long as the underlying action has yet to be concluded
  - No determination on portion of settlement amount attributable to "your product."

28

Reservations of Rights

- Reservations of rights do not always preserve the ability to allocate.
- *Harleysville Group Ins. v. Heritage Communities, Inc.* (S.C. 2017)
  - Where insurer defends under ROR, it must inform the insured of the need for a verdict allocating covered versus non-covered damages.
  - Insurer's "generic denials of coverage coupled with furnishing the insured with a verbatim recitation of all or most of the policy provisions (through a cut-and-paste method) is not sufficient."

29

Declaratory Judgment Actions

- Timing
  - Requirements vary by jurisdiction
    - Note potential for speedy hearing
    - FRCP Rule 57 and analogous state rules
  - Beware of statute of limitation issues
  - Impractical until verdict is allocated?
    - Tip for insurers: motion to intervene may be stronger if already pursuing a finding that some claims are uncovered
- Parties
  - Any insured
  - Consider other affected parties (e.g., underlying plaintiff)

30

Practical Tips for Counsel

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

31

Defense-Cost Allocation—Practical Tips for Counsel

- Wide variation among states—check prevailing law.
- Increasing chance that policy will address allocation or recoupment—read the policy!
  - Policyholders: reject such terms during placement.
- Policyholders: Reject requests to have defense counsel segregate tasks/fees.
- Have a conversation with claims professional—a full, effective defense benefits both parties.

32

10 CASES IN 45 MINUTES

2019 Annual Meeting

May 8-10, 2019

Chicago, IL

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

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

Anthony B. Leuin, Esq.
Partner
Shartsis Friese LLP
415-773-7227
aleuin@sflaw.com

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

1

Speaker

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

Robert D. Chesler is a shareholder in Anderson Kill's Newark office. Bob represents policyholders in a broad variety of coverage claims against their insurers and advises companies with respect to their insurance programs. Bob 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, Bob 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, and privacy insurance.

Bob 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 "*dominant force in coverage disputes*" and cites a client who calls him "*a dean of the insurance Bar; one of the brightest in writing about and analyzing insurance coverage.*"

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.

Bob 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.

2

Speaker

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

Suzanne Cocco Midlige is the Managing Partner and a founding member of Coughlin Duffy LLP. She is also a member of the Firm's 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. She has extensive experience representing multi-national companies involved in transnational disputes. Suzanne has extensive experience representing the interests of insurers and reinsurers in disputes relating to financial institutions, director and officer disputes, asbestos, pollution, health hazards, and the recent opioid litigation. Suzanne acted for multinational reinsurers in a series of corporate malfeasance claims and failed tax strategy claims, as well as coordinating counsel for a multinational reinsurer in relation to subprime and credit exposures. She has significant experience with asbestos coverage disputes, including the area of asbestos bankruptcy litigation. Significant cases include acting as counsel to 50 multinational insurers in a complex insurance and antitrust dispute involving US and Australian asbestos claims, as well as counsel to European insurers in asbestos coverage litigation filed in the US and London. Suzanne works closely with insurers in relation to the development and implementation of models to allocate losses across complex insurance programs, and in evaluating future loss projections and developing burn rate analyses.

Suzanne served as a judicial clerk to Hon. William G Bassler, Judge of the United States District Court for the District of New Jersey.

3

Speaker

Anthony Leuin, Esq.
Partner
Shartsis Friese LLP
415-773-7227
aleuin@sflaw.com

With over 35 years of practice, Tony Leuin is a senior litigation partner at Shartsis Friese in San Francisco, California. Although Tony has a broad background in civil disputes of all types, he has focused for more than two decades on representing policyholders in insurance coverage disputes. Tony litigates and evaluates coverage under a wide range of policies, including general liability, directors and officers, errors and omissions, property, cyber and mergers and acquisitions policies.

Tony has been a Contributing Editor to California Practice Guide: Insurance Litigation (The Rutter Group); has repeatedly been named a "Super Lawyer" in Insurance Coverage; currently sits on ACCC's Membership Committee; and frequently writes and speaks on coverage matters. Tony also chairs a Risk Purchasing Group through which over 2,000 lawyers at over 40 mid-size law firms around the country acquire professional liability coverage.

4

Unavailability Rule

- *Continental Ins. Co. v. Honeywell Int'l Inc.*, 234 N.J. 23 (2018)
- *KeySpan Gas E. Corp. v. Munich Reins. Am., Inc.*, 31 N.Y. 3d 113 (2018)
  - Issue – Continuous trigger period is 1970 to 2000. Absolute asbestos exclusion is added in 1986 and asbestos coverage is unavailable in the marketplace thereafter. Is insured or insurance company responsible for 1986-2000 period?
  - Honeywell (asbestos) – insured is not responsible based on public policy – purpose of seminal NJ trigger/allocation decision Owens-Illinois was to incentivize companies to buy insurance and penalize them for not buying.
  - KeySpan (environmental) – insured is responsible based on contract language.
  - Also, see Honeywell for choice of law analysis

5

Terminating the Duty to Defend

- *Fireman's Fund Ins. Co. v. Hyster-Yale Grp., Inc.* (Ohio 8th App. Dist. 2019):
  Insurer can withdraw from the defense of asbestos bodily injury claims when discovery in the underlying litigation reveals "indisputable, reliable evidence" that the claimant was not exposed to the insured's asbestos-containing product during the insurer's policy period.

  Original opinion (December 2018) reiterated Ohio Supreme Court ruling in *Preferred Risk Ins,. Co. v. Gill*, 507 N.E.2d 1118 (Ohio 1987) that where the duty to defend does not expressly include "groundless, false or fraudulent claims", existence of the duty must be decided based on the "true facts" underlying the complaint; however, revised opinion after reconsideration dropped the reference to *Preferred Risk*.

6

Occurrence

- ***Liberty Surplus Ins. Corp. v. Ledesma & Meyer Const. Co.*, 5 Cal.5th 216 (2018)**
  - Contractor's employee, working at school site, molests student.
  - Student's resulting suit names employer for negligent hiring, retention and supervision
  - Insurer contends there is no "accident" where employee acts intentionally
  - Held, employee's intentional act is an unexpected consequence or indirect cause of *insured employer's* independently tortious negligent in hiring, retention and supervision.
- ***Cf. Talley v. Mustafa*, 381 Wis.2d 393 (2018)** – No coverage when negligent supervision claim rests solely on an employee's intentional and unlawful act (punching customer in face) *without allegations of any specific separate acts by the insured that caused the injuries.*

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

7

Occurrence (cont'd)

- ***State Farm Fire & Cas. Co. v. Motta*, 356 F.Supp.3d 457 (E.D. Pa. 2018)**
  - Teenager commits suicide in face of classmate's savage cyberbullying
  - Family sues bully and bully's parents
  - State Farm acknowledges obligation to defend bully's parents, but challenges obligation to bully, asserting no "accident"
  - Held, State Farm must defend bully. Suicide was unforeseeable consequence of the bullying and complaint sounded in negligence, not intentional tort
  - Bully may have intended to insult or even cause emotional distress but from his perspective as an insured, classmate's death by suicide was an accident

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

8

Consumer Fraud Act

- *Alpizar-Fallas v. Favero*, 908 F. 3d 910 (3d Cir. 2018)
  - Auto accident. Progressive agent went to injured party, a Progressive customer, and told her to sign papers, telling her that it would expedite process. Agent did not tell her that papers included a release of the other driver, who was also a Progressive customer.
  - Third Circuit – New Jersey Consumer Fraud Act applied. The court predicted that the New Jersey Supreme Court would hold that the Act did not only apply to sale of insurance policies, but also to claim handling.
  - Consumer Fraud Act awards treble damages and attorneys' fees. Particularly important result because of weak New Jersey bad faith law.
  - Consumer Fraud Act – treble damages and attorneys' fees
  - Wait to see if Alpizar-Fallas is limited to extremely egregious facts or is applied more broadly.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

9

Damages Because of Bodily Injury or Property Damage

- *Acuity v. Masters Pharmaceuticals* , No. A1701985 (Ohio Com. Pls Hamilton Cnty Feb. 1, 2019):
  Insurer has no duty to defend or indemnify wholesale opioid distributor against governmental entity claims asserted in National Prescription Opioid MDL Actions because claimants do not seek damages "because of bodily injury."

  Damages sought are for governmental entities' economic losses, and "are not damages because of or for a '*bodily injury*'; an opiate addiction."

  See also, *Travelers Property Cas. Co. of Am. v. Anda*, 90 F.Supp.3d 1308 (S.D.Fla. 2015)(holding that State's claims for economic harm from opioid crisis not "bodily injury")

  But see, *Cincinnati Ins. Co. v. H.D. Smith* 829 F.3d 771 (7th Cir. 2016) (holding that damages sought by state against opioid manufacturer were damages because of bodily injury to opioid users for purposes of determining duty to defend)

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

10

Damages Because of Bodily Injury or Property Damage (cont'd)

- *Berry Plastics Corp. v. Illinois National Ins. Co. 903 F.3d 630* (7thCir. 2018):
  Foil laminate manufactured by policyholder (Berry) was defective, causing claimant's (Packgen) specialized container product to fail.

  Berry sought coverage for Packgen's claims for lost profits resulting from cancellation of orders and inability to make new sales.

  Were damages because of property damage or because of breach of warranties?

  Underlying verdict was based on breach of contract and warranties; policyholder failed to show any of the lost profits were the result of property damage.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

11

Computer Fraud: "Direct" Loss?

- ***Medidata Sols. Inc. v. Fed. Ins. Co.*, 729 Fed. Appx. 117 (2d Cir. 2018)** (spoofing, not hacking)
  - Email to employee purported to be from company president
  - Follow up call and email directed and induced employee to wire $4.7 million to fraudsters' account
  - Computer Fraud coverage for "direct" loss of money stemming from "entry of Data into" or "change to data elements or program logic of" a computer system
  - Spoofed email fell within this definition; Loss was "direct" under "proximate" cause analysis
- ***Am. Tooling Ctr., Inc. v. Travelers Cas. & Sur. Co. of Am.*, 895 F.3d 455 (6th Cir. 2018)** (spoofing, not hacking)
  - Fraudster intercepts invoicing email and posing as vendor successfully directs payment be made to "new" account
  - Coverage for "direct loss . . . directly caused by Computer Fraud"
  - Computer Fraud: "Use of any computer to fraudulently cause a transfer of Money…"
  - "Direct" loss means loss suffered by "immediate" OR "proximate cause"
  - Fraudulent email directly caused loss where it induced internal actions which led to the "point of no return"

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

12

Computer Fraud: "Direct" Loss? (cont'd)

- ***Interactive Communs. Int'l, Inc. v. Great Am. Ins. Co.*, 731 Fed. Appx. 929 (11th Cir. 2018)**
  - InComm sells "chits," credits "redeemed" by interactive voice response (IVR) computer system, then transferred to buyer's debit card
  - Fraudsters exploit IVR flaw enabling multiple redemptions of single chit, get $11.7 million
  - Policyholder has Computer Fraud coverage for loss "resulting *directly* from the use of any computer to fraudulently cause a transfer"
  - "Directly" means "immediately and without intervention or interruption" (*not* proximately)
  - Held, fraudsters' manipulation of IVR was use of computer and set in motion chain of events leading to loss, but did *not* "immediately" or "directly" cause the loss

Ambiguity

- *Siloam Springs Hotel, LLC v. Century Surety Company*, No. 17-6208 (10th Cir. 2018) – guests at hotel injured by carbon monoxide poisoning from indoor swimming pool.
  - exclusion for "qualities or characteristics of indoor air"
  - District court – unambiguously precluded coverage
  - Tenth Circuit – ambiguous. Exclusion could refer to (1) any substance found in the air, or (2) only an inherent feature or longer lasting trait of the air
  - Explosion of cases using ambiguity to find coverage:
  - *Allied Prop. & Cas. Ins. Co. v. Zenith Aviation, Inc.*, 336 F. Supp. 3d 607 (E.D. Va. 2018) ("smoke")

Ambiguity (cont'd)

- *Cochran v. State Farm Fire & Cas. Co.*, Civ. Act. No. 1:17-cv-0984-SCJ (N.D. Ga. 2018) ("contamination")
- *MTI, Inc. v. Employers Ins. Of Wausau*, 2019 U.S. App. LEXIS 2543 (10th Cir. 2019) ("that particular part")
- *Charter Oak Fire Ins. Co. v. Am. Capital*, 2019 U.S. App. Lexis (4th Cir. 2019) ("majority interest" clause)
- *My Left Foot Children' Therapy v. Certain Underwriters at Lloyds*, 2018 U.S. App. LEXIS 12269 (9th Cir. 2018) ("in addition")
- *AIG Property Casualty Co. v. Cosby* (3d Cir 2018) ("arising out of")
- Evanston Ins. Co. v. Xytex Tissue Services, CV-117-140 (S.D. Ga. 2019) (pollution exclusion and hazardous and toxic materials exclusion)
- Feenix Parkside LLC v. Berkley North Pacific, 2019 Wash. App. LEXIS 823 (Ct. App. 2019) ("decay")

Trying to Fit Crypto-Currencies Into Traditional Categories

- *Kimmelman v. Wayne Ins. Group No. 18-CV-1041* (Ohio Ct Com. Pl. Franklin Cnty Sept 25, 2018):
  $16K in Bitcoin stolen from policyholder's account. Insurer paid $200 sublimit for loss of "money". In case of first impression, Court held that Bitcoin was not "money" but "property".
- *SEC v. Blockvest LLC* No.18CV2297 (S.D.CA):
  November 2018: Court holds that initial coin offering (ICO) was not a offer of "securities", and therefore outside of SEC jurisdiction.
  February 2019, on motion to reconsider, Court reverses itself, holds ICO was an offer for securities to passive investors. Accord, *U.S. v. Zaslavskiy*, No. 17CR647 (E.D.N.Y. Sept. 11, 2018).

These cases represent the first trickle of what may become a stream of cases where courts try to fit crypto-currencies into traditional conceptual buckets in insurance and other disputes.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

16

Restatement

- ***Century Surety Co. v. Andrew*, 432 P.3d 180 (Nev. 2018)**
  - Business owner uses truck for business and personal purposes
  - Truck accident causes significant brain injury
  - CGL insurer investigates, concludes accident did not occur in course of insured business activity, refuses settlement demand, and refuses to defend
  - Injured party obtains default judgment in excess of policy, including finding driver was acting within scope of business
  - Can insurer be responsible for damages beyond policy limits?
  - Nevada: Yes. Adopts better, "minority" view: breach of duty to defend, like any breach of contract, subjects party to consequential damages
  - Relies on Restatement §48

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

17

Coverage for Investigations

- *Astellas US Holding, Inc. v. Starr Indem. & Liab. Co.*, No. 17 CV 8820, 2018 U.S. Dist. LEXIS 89725 (N.D. Ill. May 30, 2018)
  - Dept. of Justice issued document subpoenas to Astellas as part of industry-wide investigation
  - Failure to comply exposed Astellas to liability and punishment
  - Astellas gave notice to Starr
  - Starr denied claim because no written demand for relief, just request for documents
    - Court held that subpoena was "written demand for monetary, non-monetary or injunctive relief made against an insured"
    - Demand to appear and produce documents was non-monetary relief
  - 'Relief' not limited to 'legal remedy or redress'
  - 'Request' by government was in fact 'demand,' because reasonable to conclude that enforcement proceeding would follow non-compliance
  - D&O policies are not standardized and jurisdictions do not interpret similar provisions in uniform manner – critical to know your policy language

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

18

When Disaster Strikes: Coverage for Natural Disasters

2019 Annual Meeting
May 8-10, 2019
Chicago, IL

Andrew B. Downs, Bullivant Houser Bailey PC
Susan B. Harwood, Kaplan Zeena LLP
John D. Shugrue, ReedSmith LLP

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

1

Common Claims Following Natural Disasters

Physical Damage and Related Costs

- Property
- Debris Removal
- Decontamination Costs/Pollutant Removal
- Demolition/Construction Costs

Time Element Coverage

- Business Interruption (BI)/ Contingent BI
- Extra Expense
- Civil Authority

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

2

Important Issues

Policy Interpretation Considerations

- General Considerations
- Causation and Anti-Concurrent Causation Language

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

3

Policy Interpretation - Causation

Causation

May be multiple coverages from different causes, each with different allocations, deductibles and sublimits

- Varying views of causation

Anti-Concurrent Causation Language

- Generally enforced by courts
- Damage caused by combination of covered and uncovered causes, implicating anti-concurrent causation language
- Significant issues when cause is difficult to separate

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

4

Resolution of Causation Issues

Property Damage Issues

- Cause of loss
- Betterments
- Labor and material costs
- Replacement vs. actual value

- Coverage counsel must determine which causation rule applies and how that affects coverage
- Policyholder may have to prove the amount of damage resulting from a covered cause of loss

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

5

Property Damage Considerations

Number of Events or Occurrences

- Can be difficult to determine, particularly when storms make landfall in the same area more than once
- 72-hour period often permits policyholder to choose the start time

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

6

Property Damage Considerations

Multiple Occurrences

- Issues for storms making several landfalls
- Named storm coverage may have 72-hour limit, flood insurance generally does not

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

7

Property Damage Considerations

Cost to Repair or Replace

- Scope of replacement cost coverage for older structures
- Coverage for government-mandated upgrades?

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

8

Property Damage Considerations

Ordinance and Law Exclusion

- States enact laws and ordinances regarding methods of construction, material type and reinforcements to limit future damage
- Ordinance and Law exclusion can impact the Period of Restoration and Valuation
- Policyholders may lack coverage for any code upgrades
- Optional coverage often available

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

9

Time Element Considerations

- Period of Restoration
- Loss of Market Exclusion
- Civil Authority Provision
- Law and Ordinance Exclusion

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

10

Time Element Considerations

Period of Restoration

- Supply and demand issues arise following natural disasters
- Insurers frequently account for supply and demand issues for contractors and building materials
- Some jurisdictions, such as California, mandate extensions for time element claims in personal lines policies for declared disasters

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

11

Time Element/Loss of Business Income Considerations

Loss of Market Exclusion

- Policy language may reduce or eliminate BI loss because business ground to a halt after the disaster
- Some policies contain provisions to address a reduction in certain types of commercial activity coupled with surges in other types
- Courts reluctant to apply loss of market exclusion to circumstances where the market decline is caused by the same casualty which caused property damage

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

12

Time Element/Loss of Business Income Considerations

Civil Authority Provisions

- Requires access be prohibited due to a covered loss
- Often limited to certain time period and specific area
- May provide coverage when government act prohibits access due to closures, curfews and travel restrictions
- Government-mandated evacuation may preclude coverage for Business Income loss
- Anti-Concurrent Causation language may bar coverage for civil authorities opening dams to prevent damage in one area, causing flooding in another

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

13

Practical Considerations

- Strong sense of victimization for both policyholder and jury pool
- Policyholder's conduct did not cause the loss
- Claims handlers often stretched thin
- Government regulators more involved than usual

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

14

HOW GREAT MINDS CAN DIFFER: POLICYHOLDER, PRIMARY AND EXCESS INSURER INTERESTS IN MULTI-STATE LITIGATION

2019 Annual Meeting / May 8-10, 2019 /Chicago, IL

•Marion B. Adler (Adler Law Practice, LLC)
•Dominica Anderson (Duane Morris LLP)
•Doug McIntosh (McIntosh Sawran & Cartaya, P.A.)

•David Godwin / Paper Author (Squire Patton Boggs LLP)
•Marcus Snowden / Moderator (Snowden Law PC)

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

1

Multiple Occurrences, in Action

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

2

FACTS:

- Tractor trailer loaded with concrete pillars for construction project on I-595, takes a U-turn in front of oncoming cars headed west-bound.
- Canadian family on vacation crushed by pillars; mother and father killed instantly, 2 minor children in back seat severely injured.
- 3d vehicle behind Canadian family rental car travelling at posted 65MPH limit cannot avoid crash scene and collides with pile-up, killing 33 y.o. single mother of two minor children instantly.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

3

COVERAGE:

- Tractor Trailer- Primary Limits: $1M/acc. & $2M agg; $100K/acc. deductible. (Standard ISO Duty to defend, right to control defense).
- 1st Layer Excess: $10M/occ. & $15M agg. (follow-form, right to associate with defense, no duty to defend).
- 2nd Layer Excess: $20M/occ. & $30M agg. (follow-form, right to associate with defense, no duty to defend).
- When primary exhausts, defense costs erode 1st and 2nd Layer limits as "loss".

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

4

ACTIONS:

- Primary carrier desires to "pitch" limits, treating as two occurrences and makes "tender" of $2M, to first excess layer and victim claimants.
- First Excess layer avails its $10M limits to primary carrier to settle as many claims as possible, but contends there is only a single occurrence.
- Second layer excess affiliates panel counsel to appear for and co-defend with staff counsel appointed by primary insurer to defend.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

5

ACTIONS:

- Second defense firm analyzes case as within the $12M of availed offers (for global claims resolution).
- Demands: Canadian parents estates, and two minor children, "all available limits"; two minors of single mother, $10M each/$20M total.
- Jury Verdict: Canadian claimants: $32M; guardian for two minor survivors of single mom: $18M; punitive damages entitlement found for driver's gross negligence of tractor trailer and vicarious liability to employer/rig owner. Punitive damage trial set to commence on amount. Net worth of driver: $50,000; of rig owner: $50M.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

6

ISSUE 1

Selection of counsel/right to control defense and settlements.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

7

ISSUE 2

Rights/obligations of primary / middle layer excess / and top layer excess carriers.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

8

ISSUE 3

Resolving disagreements between the policyholder, Dewey Hurry & Howe and Tuff, Tuff & Tuffest on trial strategies, value assessments, and policyholder demands to settle for all available limits including aggregates.

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

9

ISSUE 4

Disputes about number of occurrences, and an exhaustion position taken by "We-Like-to-Exhaust", by virtue of its "tender" of all aggregate coverage for the event to the excess layers and the plaintiffs.

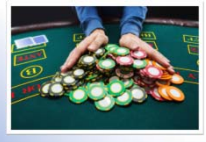
AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

10

ISSUE 5

Punitive damages coverage and exposure concerns of: policyholder; primary; and excess insurers.



AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

11

ISSUE 6

Is a dec action needed or appropriate?

AMERICAN COLLEGE OF COVERAGE COUNSEL

2019 Annual Meeting

12

SPEAKER BIOS

Nancy Adams
Mintz Levin Cohn Ferris Glovsky & Popeo PC

Nancy is a noted insurance coverage litigator with extensive experience representing primary and excess insurers on the business and legal implications of complex coverage issues involving commercial, transactional, and personal lines of insurance. Nancy serves as lead counsel in coverage litigation in state, bankruptcy, and federal courts across the country. With her vast knowledge of the insurance industry, she also advises companies on a wide range of risk management issues, frequently conducting exposure and risk analysis and assisting companies with implementing risk transfer mechanisms. Nancy frequently teaches, speaks, and writes on insurance-related topics.

Nancy has extensive experience representing and advising primary and excess insurers on the business and legal implications of a variety of complex coverage issues involving property and casualty and life insurance. Her experience includes representing insurers with respect to coverage disputes arising under directors and officers, professional liability, managed health care, life, aviation, fiduciary, financial institutions, crime, automobile, homeowners, and general liability policies. Nancy also has substantial experience advising clients with respect to potential coverage implications arising in the bankruptcy context. Her practice has involved representing insurers in state, bankruptcy, and federal courts across the country.

Nancy also has significant experience advising corporations and individuals in a wide range of risk management issues. Her experience includes conducting exposure and risk analysis and implementing insurance and other risk transfer mechanisms to address those exposures and risks. Nancy also regularly works with corporate boards preparing insurance program audits and reviews, drafting director/ officer indemnity agreements to complement the company's existing insurance program, identifying and addressing various insurance-related issues that arise in the road show and IPO context, and conducting insurance and indemnity due diligence for corporate transactions.

Marion B. Adler

Adler Law Practice, LLC

Marion Adler has represented businesses in all facets of commercial litigation for over 30 years. In addition to extensive experience in the state and federal courts in Illinois and other states, she has frequently represented clients in arbitrations and mediations.

Ms. Adler represents commercial policyholders in disputes over insurance coverage. Her experience includes claims arising under CGL, product liability, D&O, E&O, ERISA, intellectual property, fidelity, employment, environmental, commercial credit, civil rights, and assorted other commercial coverages. In addition to actively litigating coverage suits, Ms. Adler regularly counsels commercial policyholders and assists them in negotiated insurance recoveries without litigation.

She also has a breadth of experience in representing businesses in a wide variety of contractual and commercial disputes arising, for example, from distribution contracts, purchase agreements, licensing agreements, and partnership and LLC agreements.

Ms. Adler has considerable experience in defending individual and class claims asserted on behalf of consumers. She defends statutory actions arising under both state and federal consumer protection laws, such as the Uniform Commercial Code, Magnuson-Moss Warranty Act, the Illinois Consumer Fraud Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Equal Credit Opportunity Act, the federal Telephone Consumer Protection Act, as well as common law claims arising in tort, contract, or alleged fraud.

She also has tried cases and handled appeals involving enforcement of restrictive covenants, misappropriation of trade secrets, breaches of fiduciary duties, and related doctrines involving the departure of employees and break-up of businesses. Ms. Adler has defended employers in suits arising under federal employment discrimination statutes (including Title VII, the Equal Pay Act, and ADEA) both at the agency and court level, represented employers in wage and hour suits, and defended employment-related claims arising under common law doctrines, including claims for breach of contract, retaliatory discharge, infliction of emotional distress, and defamation.

Ms. Adler is experienced in representing businesses in arbitration proceedings, litigating motions to compel arbitration and to enforce arbitration awards, and representing clients in non-binding mediations.

2019 American College of Coverage Counsel Annual Meeting
Chicago Athletic Association
Chicago, IL
May 8-10, 2019

Dominica C. Anderson
Duane Morris

Dominica C. Anderson, managing partner of Duane Morris' Las Vegas office, practices in both the firm's Las Vegas and San Francisco offices. She is a member of the firm's Executive Committee, and vice-chair of the Duane Morris Women's Impact Network for Success Steering Committee.

Ms. Anderson has over 30 years of experience in high stakes commercial litigation, including representing insurance companies in complex insurance coverage cases, CGL and D&O throughout the U.S., and works with numerous clients to resolve issues abroad. Additionally, she represents businesses in complex contract disputes; unfair competition; business interference; false advertising; securities; antitrust; defamation; e-commerce and intellectual property issues. She is a member of Duane Morris' Insurance Practice Group and the firm's Commercial Litigation Group.

A member of the American Bar Association, Vice-Chair of the Professional Business Women of California, and a member of the National Association of Women Lawyers, Ms. Anderson is a 1986 *cum laude* graduate of the University of San Francisco Law School and a graduate, with high honors, of the University of California at Berkeley, where she was elected to Phi Beta Kappa. She has received numerous honors and awards over the years and has been on the California Super Lawyers list for over 10 years.

John C. Bonnie
Weinberg, Wheeler, Hudgins, Gunn & Dial, LLC

John Bonnie is a partner in the Atlanta office of Weinberg, Wheeler, Hudgins, Gunn & Dial, LLC. He is leader of the firm's Insurance Coverage Practice Group, concentrating on complex commercial disputes, litigation, arbitration and trial involving first and third party insurance obligations, alleged bad faith, and other forms of extra-contractual liability. His practice extends to all lines of coverage, including London market and Bermuda form policies; includes claims advice and counseling for insurers nationwide; and the representation of clients in matters involving written agreements to indemnify and other means of contractual risk transfer and allocation. He is the co-author of *Georgia Insurance Litigation*.

Mary E. Borja
Wiley Rein LLP

Mary represents clients in complex litigation and arbitration involving professional liability, general liability, cyber, crime, and property insurance coverage. She provides advice and counsel on a wide range of insurance issues, including legal malpractice and other errors and omissions claims, director and officer liability, bankruptcy, crime, construction defect, environmental liability, blockchain and other technology, and bad faith.

Mary is a certified Legal Lean Sigma Institute (LLSI) White Belt, and uses the LLSI process and project management approach to deliver increased value to clients.

James W. Bryan
Nexsen Pruet

James W. Bryan has been practicing law for 30 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. At law school, he was a member of the law review and moot court. He has held several leadership positions in the Defense Research Institute, and is a member of DRI's Insurance Law Committee, past chair of its first party property subcommittee, and program chair for its flagship coverage conference in December. Mr. Bryan also is the past chair of the Council of the Insurance Law Section of the North Carolina Bar Association and is a past president of the Greensboro Bar Association. He is also chair and master of the Guilford Inn of Court.

John G. Buchanan III
Senior Counsel, Covington & Burling LLP

John Buchanan, of Covington & Burling LLP in Washington, has represented insurance policyholders for over three decades. He contributed to one of the earliest publications on cyber insurance in 2001. Starting with the network intrusion discovered by TJX in 2006, he has represented multiple policyholders seeking coverage for historically major data breaches. John also advises policyholders in purchasing coverage for cyber- and IoT-related risks.

John teaches a graduate-level course on Insurance Litigation at U.Conn. Law School's Insurance Law Center. He speaks and writes frequently on topics relating to insurance, litigation and alternative dispute resolution, including in recent years on the insurance issues arising from the Internet of Things, artificial intelligence, autonomous vehicles, blockchain, drones, and spoofing fraud.

John has been active as an Adviser to the American Law Institute's Restatement of the Law of Liability Insurance and serves on the Members' Consultative Group for the ALI's Compliance, Enforcement, and Risk Management Principles project. Among other bar activities, he co-chairs the Cyber Risks and Data Privacy Subcommittee of the ABA Litigation Section's Insurance Coverage Litigation Committee, as well as the Cyber & Computer Crime Committee of the American College of Coverage Counsel, of which he is an elected fellow.

John is a graduate of Princeton, Oxford, and Harvard Law School; he clerked on the Third Circuit before joining Covington. *Chambers USA* ranks him Band 1, both in DC and nationally; Best Lawyers has named him DC Lawyer of the Year for Insurance; and he appears in *Best of the Best USA* and other peer reviewed lawyer listings.

Suzan F. Charlton
Covington & Burling LLP

Suzan Charlton has represented policyholders in insurance coverage disputes for more than 20 years. Clients trust her with coverage problems that demand creative solutions and zealous advocacy when litigation is called for. Her practice includes clients from a wide range of industries, including high-tech government contractors, oil and gas companies, energy utilities, industrial manufacturers, railroads, food and beverage companies, and hospitality businesses.
Ms. Charlton has handled all aspects of complex insurance coverage litigation, from filing a complaint through trial and appeal, and has successfully negotiated numerous substantial insurance coverage settlements.

Ms. Charlton lectures extensively on insurance and other topics in CLE programs, industry conferences, and at universities, including past service as an adjunct professor at the University of Maryland, University College, and as a guest lecturer at the University of Connecticut School of Law. Ms. Charlton is a Fellow of the American College of Coverage Counsel and has been recognized as a SuperLawyer since 2013.

Robert D. Chesler
Anderson Kill

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

Bob 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 "*dominant force in coverage disputes*" and cites a client who calls him "*a dean of the insurance Bar; one of the brightest in writing about and analyzing insurance coverage*." 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.

Bob 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.

Bob 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 coeditor in chief of the *Environmental Claims Journal*. Bob 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.

Frank Cordell
Gordon Tilden Thomas & Cordell LLP

Frank Cordell is Managing Partner of Seattle's Gordon Tilden Thomas & Cordell LLP and co-leader of the firm's Insurance Recovery practice. GTTC's track record places it among the top policyholder-side practices in the Northwest. The firm's work in the trial and appellate courts has played a major role in making Washington one of the most policyholder-friendly jurisdictions in the country.

Frank's clients range from multi-national corporations to small businesses and individuals. His substantive insurance experience is equally broad, ranging from the newest and most complex commercial coverage lines to high-stakes coverage disputes and bad-faith claims arising under personal-lines policies. He offers a special focus on complex "long tail" claims – securing coverage for environmental property damage and asbestos liabilities resulting from business operations occurring decades ago.

Frank frequently presents and writes on insurance coverage topics. He is the General Editor and chapter co-author of the LexisNexis publication *Practice Guide: Washington Insurance Litigation*, a practical, step-by-step book addressing all phases of insurance litigation in Washington.

Frank served as law clerk to the Hon. H. Emory Widener, Jr., of the U.S. Court of Appeals for the Fourth Circuit. Before relocating to Seattle to found GTTC in 1996, he was an associate with the nationally renowned insurance coverage practice of Covington & Burling in Washington, D.C. He became a name partner at GTTC in 2007.

Fred Cunningham
Domnick Cunningham & Whalen

Fred A. Cunningham is a Board Certified Civil Trial Lawyer and shareholder in the law firm of Domnick Cunningham & Whalen. He has a statewide and national practice devoted solely to trial work with a focus on litigating complex cases involving insurance company bad faith, insurance coverage, and catastrophic injuries. Many of Florida's best personal injury attorneys rely upon Mr. Cunningham to handle insurance bad faith claims arising out of their clients' personal injury claims. Mr. Cunningham has recovered close to 500 million dollars in settlements and verdicts for his clients.

Service to the legal profession is paramount to Mr. Cunningham. In 1997, he was elected by his peers to serve on the Board of Directors of the Florida Justice Association (FJA), a statewide organization of attorneys who fight to preserve the civil justice system. Over the past two decades, he has served on and chaired numerous FJA committees, and ultimately served as FJA President in 2012. His service has earned him numerous awards, including the President's Award for leadership in 2015 and the W. Mckinley Smiley Jr. award in 2018. In 2016, the FJA honored him with the Perry Nichols Award, the most prestigious award given by the organization, to an attorney whose "perseverance, commitment, and unmatched dedication to the civil justice system is at the forefront of their lives." In addition to the FJA, Fred has served on the Board of Directors and as President of both the North County Section of the Palm Beach County Bar and the Palm Beach County Justice Association.

Since 2001, Mr. Cunningham has been included in every issue of The Best Lawyers in America in the field of personal injury and insurance. In 2015, 2017 and 2018, Best Lawyers recognized him as the best insurance lawyer in Palm Beach County. Since 2006, he has been included in the Florida Trend "Legal Elite", as well as Florida "Super Lawyers", including being voted by his peers to be one of the "Top 100" lawyers in the state of Florida in 2012, 2013, and 2015. As a result of his courtroom success and professionalism, he is a sought-after lecturer on the topics of trial practice and insurance company bad faith.

Mr. Cunningham serves on the Board of Directors of the International Academy of Trial Lawyers, an esteemed, invitation-only privilege that is limited to 500 active trial lawyers in the United States and 100 trial lawyers outside the United States. Mr. Cunningham is also a Fellow of the American College of Coverage and Extracontractual Counsel and the International Society of Barristers. In 2016, he was inducted as a member of The Melvin M. Belli Society, a national organization whose stated purpose is to promote the international exchange of ideas among lawyers through meetings and education. In 2017, Mr. Cunningham was inducted as a member of The American Board of Trial Advocates, an invitation-only organization whose membership is extended only to trial lawyers with high personal character and an honorable reputation.

Andrew B. Downs
Bullivant Houser Bailey PC

Andy Downs is a shareholder in the San Francisco office of Bullivant Houser Bailey PC. Licensed in both California and Nevada, Andy represents insurers in complex coverage and extracontractual matters across multiple lines of insurance, with a focus on large first party property losses, professional liability, Directors & Officers, and marine.

Andy is a member of the Board of Regents of the American College of Coverage Counsel.
He is also a former Director of the Federation of Defense & Corporate Counsel.

Andy has been recognized since 2010 by Chambers USA for insurance law and is a Northern California SuperLawyer.

Outside the practice of law, Andy is a Nationally Certified Meet Official for United States Swimming.

David M. Halbreich
ReedSmith

David is the practice group leader of Reed Smith's Insurance Recovery Group, with more than 80 exclusively policyholder focused attorneys in offices throughout the United States, as well as around the world, including Europe and Singapore. He also represents clients in a variety of industries including manufacturing, oil and gas, financial services, real estate development, electronics, telecommunications, construction and others.

He is listed in *Chambers USA: America's Leading Lawyers for Business,* named one of the "leading lawyers nationwide," and awarded Band 1 (highest) rating for insurance in each of its 2004 through 2008 guides. In 2004, David was named California Lawyer of the Year ("CLAY") for Litigation in connection with the work done on behalf of Western Mac Arthur which led to settlements valued at approximately $2.2 billion.

David has represented policyholder clients seeking coverage for securities fraud claims, fiduciary liability claims, mortgage claims, asbestos and other toxic tort related claims, environmental/hazardous waste clean-up claims, product liability claims, first-party property claims, professional malpractice claims, construction defect claims, earthquake damage claims, claims by former employees, and patent infringement claims. He has also represented media and entertainment companies in a variety of recovery claims and litigation arising out of contract disputes.

His complex business litigation experience includes a class action against a major technology company under Business and Professions Code § 17200; a worldwide franchise dispute with a major soft drink company; several cases involving complex breach of fiduciary duty claims involving trade secret, copyright and unfair competition issues.

Michael A. Hamliton
Goldberg Segalla

Michael A. Hamilton is a partner in Goldberg Segalla's Global Insurance Services Practice Group and a leader of the GIS Pennsylvania team. Mike handles sophisticated and high-exposure insurance coverage claims and commercial litigation, and focuses his practice on environmental, professional liability, construction defect, transportation, and business torts/advertising injury claims. Mike has more than 25 years of experience handling insurance coverage claims and litigation on behalf of major insurers throughout the United States. He has an extensive background in environmental claims under commercial general liability policies and specialty environmental policies, and has assisted clients with claims involving the application of the pollution exclusion, surface and groundwater contamination, ground pollution, and hydro-fracking. Mike was also involved in two groundbreaking cases holding that claims for faulty workmanship in construction were not covered under CGL policies. He has represented insurance companies in bankruptcy court and has formulated strategies for carriers to best protect their rights when policyholders are in bankruptcy. He also has extensive appellate experience, arguing numerous appeals in state and federal courts across the country.

Mike currently serves as vice chair of former leaders of the Insurance and Reinsurance Committee of the International Association of Defense Counsel, after having recently served a two-year term as the committee's chair. He is also a frequent speaker and author on insurance litigation and emerging issues, and is a fellow of the American College of Coverage Counsel. He has an AV Preeminent rating from Martindale-Hubbell, is a ranked lawyer in Chambers USA for Pennsylvania – Insurance, and is designated in Best Lawyers in America - Insurance Law and Pennsylvania Super Lawyers, Insurance Coverage. Prior to law school, Mike received his bachelor's from Pennsylvania State University. He went on to earn his juris doctor from the Dickinson School of Law at Penn State, where he was a member of the Dickinson Law Review.

Rick Hammond
HeplerBroom, LLC

Rick Hammond focuses his practice in the area of insurance law. He serves as national counsel on matters relating to property insurance coverage, fire and explosion cases, and bad faith.

He is counsel to corporate executives, municipalities, and elected officials on high profile business litigation cases. He also serves as an expert witness on insurance law, bad faith, and coverage issues and is an Adjunct Professor on Insurance Law at the Loyola University-Chicago School of Law.

Previously Mr. Hammond was the Assistant Deputy Director of the Illinois Department of Insurance's Chicago office and held managerial positions in property claims and agency for two national insurance carriers. He also served as Executive Director and General Counsel for the Insurance Committee for Arson Control (a national insurance trade association).

Susan B. Harwood
Kaplan Zeena LLP

Susan has over 30 years of experience in insurance coverage (first and third party), bad faith/extra-contractual (first and third party) and general liability defense litigation. Throughout her career, she has also been active in a number of professional organizations that offer education, training and perspectives to the insurance industry. Through these same organizations, she has developed and maintained lifelong friends and had the benefit of their respective legal backgrounds and experiences.

Susan believes in community service. She currently serves a volunteer at the Hope CommUnity Center in Apopka, Florida where she assists immigrants prepare for their U.S. citizen interviews, and in the early years of her career, she served as a GAL or guardian ad litem for abused, neglected and abandoned children under the auspices of the Legal Aid Society of the Orange County Bar Association.

Michael W. Huddleston
Munsch, Hardt, Kopf & Harr

Michael W. Huddleston is an equity shareholder with Munsch, Hardt, Kopf & Harr, and leads the Insurance Recovery Practice Group, representing corporate and professional policyholders in insurance coverage and bad faith disputes. He also advises clients on a variety of risk management and insurance procurement issues arising in contracts in a wide variety of industries, including oil and gas, hospitality, construction, real estate, and cyber/technology. He is a former Chair and one of the founding officers in the Insurance Section of the State Bar. He was elected to the American College of Coverage Lawyers and was selected as the Texas Lawyer “Go-To” Lawyer in Insurance (2012), as Attorney of the Year in Insurance by Best Lawyer (2015 and 2019), selected a Top 100 Texas Super Lawyer by Texas Monthly (2018), and rated as a Band One Insurance Lawyer by Chambers.

Tony Leuin
Shartsis Friese LLP

Tony Leuin is a senior litigation partner at Shartsis Friese LLP in San Francisco. With broad background in civil disputes of all types, Tony has for decades represented policyholders in disputes with their insurers. He has litigated and resolved disputes involving CGL, D&O, Professional Liability, Employment Practices, Cyber, Crime, M&A and property coverages. He currently serves on ACCC's Membership Committee.

Hugh Lumpkin
Ver Ploeg & Lumpkin

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. Maintaining two offices in Florida, the firm nonetheless has a national practice, exclusive to limiting its practice to policyholder insurance work, including extra-contractual recoveries.

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 College of Coverage Counsel in 2014, where for several years he has served 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.

Leo Martinez
Albert Abramson Professor of Law
University of California Hastings College of the Law

Leo P. Martinez holds the Albert Abramson Professor of Law Chair at the University of California, Hastings College of the Law. He served as UC Hastings' Academic Dean for twelve years, he served as the Acting Chancellor and Dean of the College in the 2009-10 academic year, and he is currently serving as the UC Hastings Interim General Counsel.

Professor Martinez is a co-author of a leading insurance law casebook (now in its 8th edition), a co-editor of a four-volume insurance treatise, and the author of many articles on legal education, insurance law, and tax law that have appeared in journals ranging from the Stanford Law Review to the Tulane Law Review to the Yale Law and Policy Review to the China EU Law Journal. He has lectured on legal education, insurance law, and tax law throughout the United States, Europe, Asia, and South America.

Professor Martinez is a member of the Council of the Section on Legal Education and Admissions to the Bar for the American Bar Association (ABA)(the accrediting body for U.S. law schools). He is a past president of the Association of American Law Schools (AALS) for which he served both on the AALS Executive Committee and the Membership Review Committee. He is a current member of the American Law Institute (ALI) and he was one of the academic Advisers on the ALI's Restatement of the Law of Liability Insurance. He is an elected honorary fellow of the American College of Coverage Counsel. He has chaired or served on more than two-dozen ABA law school site evaluation visits and he has assisted more than ten law schools in their strategic planning. He was a member of the ABA Task Force on the Future of Legal Education.

Lorelie S. Masters
Hunton Andrews Kurth LLP

A nationally recognized insurance coverage litigator, Lorie handles all aspects of complex, commercial litigation and arbitration. Lorie has advised clients on a wide range of liability coverages, including insurance for environmental, employment, directors and officers, fiduciary, property damage, cyber, and other liabilities. She also handles various types of first-party property insurance claims, including claims under boiler and machinery, business-interruption, contingent business-interruption, extra expense and other related coverages.

Lorie has handled and tried cases in state and federal trial and appellate courts across the country and in arbitrations in the United States and abroad. At issue in these cases typically have been millions of dollars of insurance coverage for products and environmental liability, silicone gel breast implant claims, and other types of liability. Most recently, she obtained a settlement worth millions of dollars under D&O and E&O policies bought by a national nonprofit facing RICO and other high-stakes claims. She served as lead trial counsel for policyholder in an action enforcing CGL insurance coverage for the then-largest property damage class action settlement ever. The *National Law Journal* called that jury's verdict one of the "most significant jury verdicts" of the year. She has also handled many other matters in litigation, arbitration, and settlement negotiations, recovering, collectively, billions of dollars for her clients.

Lorie is co-author of *Insurance Coverage Litigation*, an in-depth legal treatise first published by Aspen Law & Business in 1997 and updated annually. She co-authored a second book, entitled *Liability Insurance in International Arbitration: The Bermuda Form*, which won the 2012 Book Prize from the British Insurance Law Association for "outstanding contributions to the literature on insurance," and is recognized as the seminal work on the issue of Bermuda Form arbitration. She was invited to serve as an Adviser to the American Law Institute's Restatement of the Law, Liability Insurance, a position she has held since 2010. A partner in the insurance coverage practice, Lorie's clients say she "is very good at explaining complicated issues, and then distilling them for commercial use," according to Chambers USA 2016, which ranks her in the upper echelons of her practice nationwide. She also was named a Top Ten Super Lawyer in DC for 2014 and 2015, among other recognitions.

Lorie writes and speaks extensively on insurance coverage, technology, and litigation. In addition to her legal practice, she is active in diversity and inclusion matters and has represented many individuals and groups pro bono, including policyholders denied health care coverage and victims of human trafficking. In 2007, she obtained one of the first money judgments in the country under the Trafficking Victims Protection Act, after a trial in the federal court in the District of Columbia.

Lorie currently serves on the Board of Governors of the American Bar Association (ABA) and as Treasurer of the DC Bar Foundation, the largest funder of legal services in the DC area. She is very proud of her service in 2008-2009 as President of the Women's Bar Association of the District of Columbia ("WBA") and her role in helping to organize the WBA's centennial celebrations in 2016-2017. She helped to found the American College of Coverage and Extracontractual Counsel and served as its second President in 2013-2014. She served as national Policyholder Chair of the Insurance Coverage Litigation Committee of the ABA Section of Litigation, 2000-2003.

Lorie is admitted to practice in the US Supreme Court, US Court of Appeals for the District of Columbia Circuit, US Court of Appeals for the Fourth Circuit, US District Court for the District of Columbia, US District Court for the District of Maryland, US District Court for the Eastern District of Michigan, US District Court for the Southern District of New York, the US District Court for the Northern District of Ohio, the US District Court for the Southern District of Ohio, and the US District Court for the Eastern District of Texas. She ran for attorney general in the District of Columbia's first-ever election for that position in 2014.

Jodi A. McDougall
Cozen O'Connor

Jodi represents insurers in complex insurance coverage disputes and maritime matters. She enjoys working together with her clients to help them avoid and solve problems. Jodi has extensive experience defending bad faith claims. She primarily practices in Washington and Oregon, two venues that are notoriously difficult for insurers to operate. She handles all types of coverage disputes including environmental, professional liability, maritime, and general liability. She has successfully litigated hundreds of cases, including two of the largest coverage cases in Washington state history.

Jodi is serving her second term on the board of directors for Cozen O'Connor and has been the managing partner of the Seattle office for the past 12 years. She is a fellow in the American College of Coverage Counsel and has been recognized as one of the top 50 women attorneys in Washington by Super Lawyers. She was named to the Best Lawyers in America list for commercial litigation and awarded the AV Preeminent rating by Martindale-Hubbell.

Jodi enjoys pro bono work and is involved in a wide array of matters. She recently obtained asylum for an African national based on persecution in his native country due to his sexual orientation. She has also represented asylum seekers who are fleeing their native country because of persecution for their democratic political beliefs. Jodi has represented numerous Holocaust survivors and obtained reparations for them from the German government. She actively participates in the firm's COVET project and has fought for veterans to obtain broader benefits. She is currently working with several women veterans to assist them in obtaining benefits for military sexual trauma that they have endured.

Jodi received her Bachelor of Arts, *magna cum laude*, in 1989 from the University of Southern California, where she was elected to Phi Beta Kappa. She earned her law degree, *cum laude*, in 1992 from the Seattle University School of Law. She studied the Law of the Sea and International Law at Cambridge University in England. Prior to joining private practice, Jodi worked as a prosecutor in both King and Pierce counties.

Douglas M. McIntosh
McIntosh, Sawran & Cartaya, P.A.

Founding Shareholder Douglas M. McIntosh has extensive experience in a wide range of areas: personal injury, product liability, commercial and professional negligence litigation, including legal, dental and medical malpractice defense, product liability and insurance coverage litigation. His current focus is on catastrophic damage claims, insurance coverage matters and bad faith litigation.

Mr. McIntosh has assisted insurance companies on bad faith, professional errors and omissions, general liability and all-risk policies of insurance issues for many years. He has also served as a testifying expert in state and federal courts in bad faith, primary and excess cases. He is a state qualified arbitrator and has served as selected mediator, panel and sole arbitrator, in a number of legal disputes, including bad faith and insurance coverage litigation.

He is admitted to practice in the state and federal courts in Florida and is admitted to practice before the United States Supreme Court. He speaks often on insurance law, professional ethics, and jury selection techniques, around the country. He presently co-chairs the ACCC Professionalism & Ethics Committee, and will co-chair the ACCC 2019 Symposium at Nova Southeastern University, Shepard Broad College of law in Fort Lauderdale, Florida.

Suzanne C. Midlige
Coughlin Duffy LLP

Suzanne Cocco Midlige is the Managing Partner and a founding member of Coughlin Duffy LLP. She is also a member of the Firm's 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. She has extensive experience representing multi-national companies involved in transnational disputes. Suzanne has extensive experience representing the interests of insurers and reinsurers in disputes relating to financial institutions, director and officer disputes, asbestos, pollution, health hazards, and the recent opioid litigation. Suzanne acted for multinational reinsurers in a series of corporate malfeasance claims and failed tax strategy claims, as well as coordinating counsel for a multinational reinsurer in relation to subprime and credit exposures. She has significant experience with asbestos coverage disputes, including the area of asbestos bankruptcy litigation. Significant cases include acting as counsel to 50 multinational insurers in a complex insurance and antitrust dispute involving US and Australian asbestos claims, as well as counsel to European insurers in asbestos coverage litigation filed in the US and London. Suzanne works closely with insurers in relation to the development and implementation of models to allocate losses across complex insurance programs, and in evaluating future loss projections and developing burn rate analyses.

Suzanne served as a judicial clerk to Hon. William G Bassler, Judge of the United States District Court for the District of New Jersey.

James R. Murray
Blank Rome

Jim Murray leads Blank Rome's policyholder-only insurance recovery practice, formerly the insurance practice of Dickstein Shapiro LLP. A nationally-recognized policyholder trial lawyer, Jim's work in high-profile, challenging cases across the country has earned him consistent praise from clients, opposing counsel, and jurors.

In 2017, the *National Law Journal* named Jim a "Plaintiffs' Lawyers Trailblazer" (one of 15 nationally in all practices areas). Also in 2017, the *National Law Journal* named Blank Rome as the D.C. Litigation Department of the Year for Insurance. In 2013 and 2011, *Law360* named Jim an MVP in Insurance Coverage.

Jim is a Fellow of the American College of Trial Lawyers and a member of the College's District of Columbia State Committee. Membership in the College is extended only by invitation, after extensive investigation, to those trial lawyers who have mastered the art of advocacy and whose professional careers have been marked by the highest standards of ethical conduct, professionalism, civility, and collegiality. He is also a Fellow of the American College of Coverage and Extracontractual Counsel and is listed in the *National Trial Lawyers*' "Top 100 Trial Lawyers" for the District of Columbia (Civil). He has litigated cases in 24 states for top-tier corporate clients, and has represented individuals and an array of religious institutions and governmental entities.

Jim was formerly a leader of the insurance coverage practice at an Am Law 200 firm and a partner in the litigation and insurance practices of an Am Law 100 firm where he served on the firm's Partnership Evaluation and Business Development Committees. From 1996 to 2007, he was a founding and managing partner of a trial practice boutique in Seattle, Washington.

He was a clerk for the Honorable James Hunter III of the U.S. Court of Appeals for the Third Circuit from 1981 to 1982 and was special assistant to William H. Webster, Director of the Federal Bureau of Investigation, from 1983 to 1985.

Neil B. Posner
Much Shelist, P.C.

Neil 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 is an elected Fellow of the American College of Coverage Counsel, the preeminent association of approximately 300 U.S. and Canadian lawyers who practice in the area of insurance coverage. Neil is one of approximately 150 Fellows who represent the interests of policyholders. He also currently serves as co-chair of the organization's Professionalism and Ethics Committee.

Neil assists clients in analyzing, negotiating and enhancing a wide range of insurance policies and plans.

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.

He regularly counsels boards of directors and officers of not-for-profit entities in matters of governance, fiduciary duty, strategic planning, leadership development and other matters. 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 he speaks and writes extensively on the subject.

Neil also has significant insurance and risk management experience in the construction industry. On the transactional side, Neil is well-versed in the full range of construction-related insurance policies, including CGL, workers' compensation, professional liability, wrap up (OCIP and CCIP), builder's risk, owner's protective, subcontractor default, project specific, green building, technology risk and cybersecurity. On the disputes side, he represents owners, contractors, subcontractors and other types of insureds in claims for

design errors, construction and engineering defects, catastrophic loss, and claims and losses directly or indirectly related to construction.

As a regular speaker at industry and legal seminars around the country—and author of articles and educational materials for dozens of conference training sessions—Neil has given presentations on issues as diverse as securities litigation, directors' and officers' insurance, change-of-control situations, errors and omissions insurance, non-traditional insurance options, cyber liability, the Sarbanes-Oxley Act, negotiating policy provisions and considerations, maximizing insurance coverage, recovering e-commerce and Internet claims, and directors' and officers' liability in consumer class action matters. Neil has also taught insurance law at Chicago-Kent College of Law.

While in law school, Neil earned awards for achieving highest grades in Legal Writing and Research, Federal Income Taxation of Corporations and Shareholders, and Business Bankruptcy. He also served as Lead Articles Editor for the *Marquette Law Review*.

Heather Sanderson
Sanderson Law

Heather Sanderson, the principal at Sanderson Law, has over 30 years of experience providing legal advice and direction on the investigation, defence and prosecution of commercial and personal lines claims and litigation.

In addition to being a skilled advocate, she has extensive experience with policy drafting, defending actions within the self-insured retention and bad faith actions.

Heather has appeared before the Supreme Court of Canada and all levels of Courts in Alberta, and was co-counsel on the longest civil trial in the history of the Northwest Territories. Heather has testified as an expert witness on insurance and civil litigation issues before the Alberta Court of Queen's Bench, the Ontario Superior Court of Justice and the Quebec Superior Court.

The two major works Heather has authored are standard industry reference materials and are on the required reading lists of several Canadian universities and community colleges. Both works have been cited in numerous insurance publications and by courts across Canada.

Heather is the Continuing Education Lead on the Insurance Committee of the Canadian Defence Lawyers Association and the Chair of the Canadian Law and Cross-Border Issues Sub-Committee of the Insurance Committee of the Defence Lawyers Institute.

In 2012 Heather received the Lee Samis Award, granted to those who in the opinion of the Canadian Defence Lawyers Association is deserving of national recognition for their contributions to Canadian insurance law and the community it supports.

Tracy Alan Saxe
Saxe Doernberger & Vita

Tracy Alan Saxe is one of the founding members of SDV as well as its President and Chief Executive Officer. He is a skilled commercial litigator with more than 30 years of trial experience. Tracy began his career handling a diverse array of general litigation matters, from a criminal court trial where his client was acquitted of murder to the representation of a certified class of independent book publishers in a bankruptcy court trial. Over time, his practice steadily narrowed to concentrate on more complicated and intellectually challenging areas and, since 1990, his focus has been on advocating for the rights of policyholders.

Tracy has litigated insurance coverage matters all over the country involving construction defects, completed operations, product liability, property damage and bodily injury claims related to mold and asbestos, “sick building” syndrome, environmental claims, business interruption, employment disputes, patent infringement, breach of fiduciary duty, and more. Tracy enjoys working in conjunction with sophisticated corporate clients and their brokers to create unique and customized strategies to resolve complex legal issues.

An active lecturer speaking on insurance coverage topics at seminars and conferences nationwide, Tracy is recognized as a pioneer and thought-leader in the insurance and risk/coverage industry. He has been selected as a New England Super Lawyer in 2016-2018, was the 2017 recipient of the IRMI Words of Wisdom Award presented at the 37th IRMI Construction Risk Conference and was the Finance Monthly Insurance & Risk Management Advisor of the Year in 2018. Tracy was also an Adjunct Professor at Quinnipiac University School of Law, where he taught courses on Insurance Law.

Tracy is the chair of the firm’s Executive Committee and also serves on the firm’s Diversity Committee. A lifelong resident of Orange, Connecticut, he is the founder and Chairman of the Board of Directors of Jiwanko Saathiharu: Jeremy Saxe Foundation of Education and Development, Inc., a charitable foundation whose mission is to provide educational opportunities for children in Nepal.

Clifford J. Shapiro
Barnes & Thornburg LLP

Clifford Shapiro, chair of the firm's Construction Law Practice Group, works every day to resolve construction claims and disputes. He resolves construction related disputes through negotiation and mediation and, when necessary, through arbitration or litigation. His in-depth knowledge of construction-related insurance coverage issues further enables him to help clients resolve claims.

With more than 35 years of experience, Clifford has been involved in virtually every kind of claim or dispute related to a construction project, including claims for termination, delay and/or disruption, extra work, construction defect, warranty, and professional liability. He has also handled virtually every kind of insurance coverage claim that arises in the construction claim context, including claims for defense and/or indemnity under commercial general liability policies, builder's risk policies, professional liability policies and "wrap" insurance programs.

In addition to being an experienced advocate, Clifford serves as a mediator and arbitrator in connection with construction and insurance claims. He is a formally trained mediator and arbitrator, and is listed on the American Arbitration Association's national roster of arbitrators for construction, insurance and commercial claims.

Clifford has published numerous articles and frequently speaks throughout the United States about how best to resolve construction claims and insurance related issues. Clifford's articles about insurance coverage for construction defect claims have appeared in several national publications, and have been cited in numerous court opinions (including several decisions issued by state supreme courts).

John D. Shugrue
Reed Smith LLP

John is a partner in the Insurance Recovery Group and affiliate member of the Energy and Natural Resources Group in Reed Smith's Chicago office. His practice focuses on representing policyholders in complex litigation and insurance coverage matters involving General and Excess Liability, OEE/Energy Package, D&O, Product Recall, First Party Property/Business Interruption, Pollution Liability, E&O, Cargo/Inland Transit and Crime/Fidelity coverage. In addition to wide experience with all major U.S. insurers, he is experienced in litigation, mediation and arbitration with Lloyd's and other London, European and Bermuda market insurers. His significant representations have encompassed major U.S. policyholders such as Anadarko Petroleum, Castleton Commodities International, Nicor Gas, International Game Technology, Tribune Company, Kraft Foods, and Republic Services and have involved claims throughout the U.S. and in Canada, the U.K., Italy, China, Brazil, Nicaragua, Japan, and West Africa.

After graduating with honors from the University of North Carolina School of Law in 1987, John began his legal career at Jenner & Block in Chicago, focusing on insurance coverage matters for policyholders. He was one of the principal attorneys involved in developing Jenner & Block's insurance recovery practice on behalf of policyholders, and became a partner at Jenner & Block in 1995. In 2000, he joined Zevnik Horton, a national policyholder firm, as a partner in its Chicago office and chair of its insurance recovery practice. In 2003, when Zevnik merged with Morgan Lewis & Bockius, he opened and became the Managing Partner of Morgan's Chicago office. In 2007, he was made co-chair of Morgan's Insurance Recovery Group.

John is recognized as one of the top policyholder insurance practitioners in the country by *Chambers USA*, *Best Lawyers in America*, *Legal 500* and *Who's Who Legal*. He co-authored the treatise *Insurance Coverage Disputes*, published by Law Journal Press. He writes and lectures often on insurance coverage topics, including business interruption claims, D&O liability insurance issues, environmental insurance coverage, coverage for onshore and offshore oil and gas E&P activities, and special issues relating to Lloyd's and the London insurance market.

John is a former co-chair of the American Bar Association Litigation Section's Insurance Coverage Litigation Committee. He twice co-chaired the Committee's annual meeting, and co-chaired a bi-partisan American Bar Association task force that prepared the *Manual for Complex Insurance Coverage Litigation*.

Marcus Snowden
Snowden Law P.C.

Marcus Snowden, panel moderator for "How Great Minds..." May 10, 2019, 10:15-11:15 a.m. session

A Fellow of the College since 2016, Marcus Snowden restricts his practice to opining on, strategic advice for, and litigating to trial and appeal coverage issues under primary CGL, D&O and E&O liability, and related excess and reinsurance programs along with commercial property insurance. His retainers include cases in underlying domestic and international cross-border and overseas litigation. He co-authors *Annotated Commercial General Liability Policy*, a loose-leaf text updated annually, Marcus holds membership in the Canadian Bar Association, Canadian Defence Lawyers Association, Federation of Defense & Corporate Counsel, Defense Research Institute, Inc. and American Bar Association.

Jeffrey W. Stempel
University of Nevada, Las Vegas

Jeffrey W. Stempel is the Doris S. & Theodore B. Lee Professor of Law at the William S. Boyd School of Law, University of Nevada Las Vegas where he teaches Insurance Law, Civil Procedure, Contracts, Professional Responsibility, and Evidence. Before joining the UNLV faculty in 1999, Prof. Stempel was the Fonvielle & Hinkle Professor of Litigation at Florida State University College of Law and Professor of Law at Brooklyn Law School. Prior to becoming a law teacher, he was a civil litigator.

In addition to being co-author (with Randy Maniloff) of *General Liability Insurance Coverage: Key Issues in Every State* (4th ed. 2018), Prof. Stempel is the author of *Stempel and Knutsen on Insurance Coverage* (4th ed. 2016)(with Prof. Erik Knutsen), originally published as *Interpretation of Insurance Contracts: Law and Strategy for Insurers and Policyholders* (1994) and Law of Insurance Contract Disputes (2d. ed. 1999) and *Stempel on Insurance Contracts* (3d ed. 2006), as well as co-author of *Principles of Insurance Law* (4th ed. 2011) and three books on civil procedure: *Learning Civil Procedure* (3d ed. 2018); *Fundamentals of Pretrial Litigation* (10th ed. 2016) and *Motion Practice* (7th ed. 2016), as well as authoring many articles on issues of insurance, civil procedure, federal statutes, arbitration, and the adversary system.

Prof. Stempel is a member of the American Law Institute, the European Law Institute, the Association of the Bar of the City of New York, the American Bar Association, the American Bar Foundation, the American Judicature Society, and the Law & Society Association. He received his B.A. degree from the University of Minnesota in 1977 and his J.D. degree from Yale Law School in 1981 and is admitted in Nevada and Minnesota.

Jeffrey E. Thomas
University of Missouri - Kansas City

Jeffrey E. Thomas is an Honorary Fellow of the American College of Coverage Counsel, and is the Daniel L. Brenner Faculty Scholar, Professor of Law, and Associate Dean for International Programs at the University of Missouri – Kansas City. He earned a Bachelor of Arts degree from Loyola Marymount University in 1983 (*magna cum laude*), and his Juris Doctor degree from University of California, Berkeley in 1986.

Insurance law is his primary research area. He served as the Editor-in-Chief of the New Appleman Library Edition, is co-author of the three-volume treatise Uninsured and Underinsured Motorist Insurance (with Alan Widiss), and his articles have been published in academic journals in the United States, China, Europe, India, Thailand, and the United Kingdom. He has served as President of the Asia Pacific Risk and Insurance Association, Chair of the Insurance Law Section of the Association of American Law Schools, a member of the Task Force on Federal Involvement in Insurance Regulation Modernization for the Tort Trial and Insurance Practice Section of the ABA, and as an Adviser to the American Law Institute's Restatement of the Law, Liability Insurance.

Professor Thomas practiced law with the firm of Irell & Manella before entering academia, where a significant portion of his practice involved insurance coverage and bad faith. He has served as an expert consultant and witness on insurance-related cases for policyholders, insurers and claimants. He is a member of the California Bar (inactive status).

Dean Thomas previously taught at the University of Chicago as Bigelow Teaching Fellow, at Loyola Law School (Los Angeles) as an adjunct, at University of Connecticut as a summer visitor, and is a two-time Fulbright Fellow to China (1999-2000) and to Russia (2010).

John S. Vishneski III
Reed Smith LLP

John focuses his practice on complex insurance coverage litigation. His experience is broad and includes coverage disputes concerning toxic torts liability, mortgage defaults, real property title defects, environmental liability, intellectual property liability, commercial property damage and business interruption. He is both a trial lawyer and an advisor.

John has litigated insurance coverage disputes involving diverse types of insurance, including First Party Property policies, Title Insurance policies, General Liability policies, Directors & Officers Liability policies, Mortgage Insurance policies, Credit Insurance policies and Employment Practices Liability policies and has extensive knowledge of insurance policy drafting history. John advises clients regarding negotiation of new and renewal policies with respect all coverages purchased by commercial businesses. He has represented clients in many jurisdictions, including the Supreme Court of Illinois and the Supreme Court of Connecticut. His practice is nationwide and also involves Lloyds and the London Market. John also acts as both neutral and party-appointed arbitrator in complex insurance coverage disputes.

Rebecca Weinreich
Lewis Brisbois Bisgaard & Smith

Rebecca Weinreich is a partner in the Los Angeles office of Lewis Brisbois Bisgaard & Smith, chairs the firm's national bad faith practice. Ms. Weinreich devotes her practice to coverage and bad faith litigation arising from first and third party policies, in both commercial and personal lines. She has represented insurers in a wide variety of complex, large exposure lawsuits brought by policy holders, has tried cases in both state and federal court and has lectured extensively on numerous topics within her field of expertise.


American College of Coverage Counsel
2019 Annual Meeting
May 8-10, 2019 | Chicago Athletic Association | Chicago, IL

ATTENDEES

Attendee List, as of May 6, 2019
Complete contact info for Fellows can be found in our online directory: americancollegecoverage.org

Nancy Adams
Mintz Levin Cohn Ferris Glovsky & Popeo PC
Boston, MA

Marion Adler
Adler Law Practice, LLC
Oak Park, IL

Leslie Ahari
Clyde & Co.
Washington, DC

Thomas Alleman
Dykema Gossett PLLC
Dallas, TX

Robert Allen
The Allen Law Group
Dallas, TX

Dominica Anderson
Duane Morris LLP
Las Vegas, NV

David Anderson
Anderson Coverage Group LLC
Chicago, IL

Walter Andrews
Hunton Andrews Kurth, LLP
Miami, FL

Samuel Arena, Jr.
Stradley Ronon
Philadelphia, PA

Lane Ashley
Lewis Brisbois Bisgaard & Smith LLP
Los Angeles, CA

Michael Aylward
Morrison Mahoney LLP
Boston, MA

H. Michael Bagley
Drew Eckl Farnham
Atlanta, GA

Michael Barnes
Dentons US LLP
San Francisco, CA

Jennifer Bentley
University of California, Hastings College of the Law

William Berk
Berk, Merchant & Sims PLC
Coral Gables, FL

Jill Berkeley
Neal, Gerber & Eisenberg LLP
Chicago, IL

Lyndon Bittle
Carrington Coleman
Dallas, TX

John Bonnie
Weinberg Wheeler Hudgins Gunn & Dial
Atlanta, GA

Mary Borja
Wiley Rein LLP
Washington, DC

Stacy Broman
Meagher & Geer PLLP
Minneapolis, MN

David Brown
Copeland & Rice LLP
Houston, TX

Lester Brown
Perkins Coie
Los Angeles, CA

Charles Browning
Plunkett Cooney, P.C.
Bloomfield Hills, MI

Thomas Brusstar
Hinkhouse Walsh Williams LLP
Chicago, IL

Attendee List, as of May 6, 2019
Complete contact info for Fellows can be found in our online directory: americancollegecoverage.org

Richard Bryan
Jackson & Campbell, PC
Washington, DC

James Bryan
Nexsen Pruet, PLLC
Greensboro, NC

John Buchanan III
Covington & Burling LLP
Washington, DC

Timothy Burns
Perkins Coie
Madison, WI

Bruce Celebrezze
Clyde & Co US LLP
San Francisco, CA

Suzan Charlton
Covington & Burling LLP
Washington, DC

Robert Chesler
Anderson Kill, P.C.
Newark, NJ

J. James Cooper
Reed Smith LLP
Houston, TX

William Corbett, Jr.
Coughlin Duffy LLP
Morristown, NJ

Franklin Cordell
Gordon Tilden Thomas Cordell LLP
Seattle, WA

Kevin Coughlin
Coughlin Duffy LLP
Morristown, NJ

Mary Craig Calkins
Kilpatrick Townsend & Stockton LLP
Beverly Hills, CA

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

Fred Cunningham
Domnick Cunningham & Whalen
Palm Beach Gardens, FL

Edward "Ned" Currie, Jr.
Currie, Johnson & Myers
Jackson, MS

James Davis
Reed Smith LLP
Chicago, IL

Scott DeVries
Winston & Strawn LLP
San Francisco, CA

Karen Dixon
Skarzynski Marick & Black LLP
Chicago, IL

Andrew Downs
Bullivant Houser Bailey PC
San Francisco, CA

Richard Dykstra
Friedman | Rubin PLLP
Seattle, WA

Angela Elbert
Neal Gerber & Eisenberg LLP
Chicago, IL

Shattuck Ely
Fellows LaBriola LLP
Atlanta, GA

Barry Fleishman
Pillsbury Winthrop Shaw & Pittman, LLP
Washington, DC

Laura Foggan
Crowell & Moring LLP
Washington, DC

Attendee List, as of May 6, 2019
Complete contact info for Fellows can be found in our online directory: americancollegecoverage.org

William Ford
COLLINS | FORD LLP
Tarzana, CA

Laura Frankel
JAMS

Troy Froderman
FR Law Group PLLC
Phoenix, AZ

Marialuisa Gallozzi
Covington & Burling LLP
Washington, DC

Arthur Garrett III
Keller and Heckman LLP
Washington, DC

Tyler Gerking
Farella Braun + Martel LLP
San Francisco, CA

Steven Gilford
JAMS
Chicago, IL

Stephen Goldman
Robinson & Cole LLP
Hartford, CT

David Goodwin
Covington & Burling LLP
San Francisco, CA

Reed Grimm
Taylor Day
Jacksonville, FL

Cary Hall III
Polsinelli PC
Phoenix, AZ

Michael Hamilton
Goldberg Segalla
Philadelphia, PA

Rick Hammond
HeplerBroom, LLC
Chicago, IL

Elizabeth Hanke Smith
KCIC

Laura Hanson
Meagher & Geer
Minneapolis, MN

Susan Harwood
Kaplan Zeena LLP
Miami, FL

Christine Haskett
Covington & Burling LLP
San Francisco, CA

Hon. Leslie Hayashi (ret.)
Honolulu, HI

Eric Hermanson
White and Williams LLP
Boston, MA

Michael Huddleston
Munsch Hardt Kopf & Harr, PC
Dallas, TX

Steven Janik
Janik LLP
Cleveland, OH

C. Michael Johnson
Hall Booth Smith, P.C.
Atlanta, GA

James Kallianis
Skarzynski Marick & Black LLP
Chicago, IL

Ronald Kammer
Hinshaw & Culbertson LLP
Coral Gables, FL

Attendee List, as of May 6, 2019
Complete contact info for Fellows can be found in our online directory: americancollegecoverage.org

Robert Katzenstein
Smith, Katzenstein & Jenkins LLP
Wilmington, DE

Courtenay Keller
Riley, Shane & Keller, P.A.
Albuquerque, NM

Robert Kelly
Jackson & Campbell, P.C.
Washington, DC

Philip King
Cozen O'Connor
Chicago, IL

Erik Knutsen
Queen's University Law School
Kingston, ON

Robert Kole
Choate Hall & Stewart LLP
Boston, MA

Dennis LaGory
Anderson Coverage Group. LLC
Chicago, IL

Seth Lamden
Neal, Gerber & Eisenberg LLP
Chicago, IL

Anthony Leuin
Shartsis Friese LLP
San Francisco, CA

Scott Lewis
Butler Snow LLP
Wilmington, NC

Daniel Litchfield
Litchfield Cavo LLP
Chicago, IL

Paula Litt
Honigman LLP
Chicago, IL

R. Hugh Lumpkin
Ver Ploeg & Lumpkin
Miami, FL

G. Andrew Lundberg
LundbergADR
Los Angeles, CA

Meghan Magruder
King & Spalding
Atlanta, GA

Michael Marick
Skarzynski Marick & Black LLP
Chicago, IL

Brian Martin
Thompson Coe
Houston, TX

Leo Martinez
University of California Hastings College of Law
San Francisco, CA

Lorelie Masters
Hunton Andrews Kurth LLP
Washington, DC

John Mathias, Jr.
Jenner & Block LLP
Chicago, IL

Ryan Maxwell
University at Buffalo School of Law

Lorraine Maxwell

Mary McCutcheon
Farella, Braun + Martel
San Francisco, CA

Jodi McDougall
Cozen O'Connor
Seattle, WA

Attendee List, as of May 6, 2019
Complete contact info for Fellows can be found in our online directory: americancollegecoverage.org

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

Ellis Medoway
Archer & Greiner, PC
Haddonfield, NJ

Helen Michael
Kilpatrick Townsend
Washington, DC

Suzanne Midlige
Coughlin Duffy LLP
Morristown, NJ

Julia Molander
Cozen O'Connor
San Francisco, CA

Christopher Monahan
KCIC

Joseph Monteleone
Weber Gallagher
Bedminster, NJ

Vince Morgan
Pillsbury Winthrop Shaw Pittman LLP
Houston, TX

Linda Morrison
Tressler LLP
Irvine, CA

Christopher Mosley
Sherman & Howard LLC
Denver, CO

Thomas Mulvihill
Boornazian, Jensen & Garthe
Oakland, CA

Brad Murlick
BDO
Chicago, IL

J.R. Murphy
Murphy & Grantland, P.A.
Columbia, SC

James Murray
Blank Rome LLP
Washington, DC

Andrew Nadolna
JAMS

Robert N. Naifeh, Jr.
Derryberry & Naifeh, LLP
Oklahoma City, OK

Hope Nightingale
Litchfield Cavo LLP
Chicago, IL

Lisa Pake
Haar & Woods, LLP
St. Louis, MO

Sherilyn Pastor
McCarter & English
Newark, NJ

Martin Pentz
Foley Hoag LLP
Boston, MA

Mark Plumer
Pillsbury Winthrop Shaw Pittman LLP
Washington, DC

Neil Posner
Much Shelist, P.C.
Chicago, IL

Alexander Potente
Clyde & Co.

Neil Rambin
Drinker Biddle
Dallas, TX

Attendee List, as of May 6, 2019
Complete contact info for Fellows can be found in our online directory: americancollegecoverage.org

Douglas Rawles
Reed Smith LLP
Los Angeles, CA

Peter Rosen
JAMS
Los Angeles, CA

Marc Rosenthal
Proskauer Rose LLP
Chicago, IL

Ed Rudloff Jr.
Foran Glennon Palandech Ponzi & Rudloff
Emoryville, CA

Amy Samberg
Foran Glennon Palandech Ponzi & Rudloff
Phoenix, AZ

Heather Sanderson
Sanderson Law
Calgary, AB

Tracy Saxe
Saxe Doernberger & Vita
Trumbull, CT

Thomas Segalla
Goldberg Segalla LLP
Buffalo, NY

Jay Sever
Phelps Dunbar LLP
New Orleans, LA

Clifford Shapiro
Barnes & Thornburg LLP
Chicago, IL

John Shugrue
Reed Smith LLP
Chicago, IL

Marcus Snowden
Snowden Law Professional Corporation
Toronto, ON

Jeffrey Stempel
University of Nevada, Las Vegas
Henderson, NV

Catalina Sugayan
Clyde & Co US LLP
Chicago, IL

Koorosh Talieh
Perkins Coie LLP
Washington, DC

Spence Taylor
Barze Taylor Noles Lowther LLC
Birmingham, AL

Wayne Taylor
Mozley, Finlayson & Loggins, LLP
Atlanta, GA

Jonathan Terrell
KCIC

Jeffrey Thomas
University of Missouri - Kansas City
Kansas City, MO

Sara Thorpe
Nicolaides Fink Thorpe Michaelides Sullivan LLP
San Francisco, CA

Rhonda Tobin
Robinson & Cole LLP
Hartford, CT

Alan Van Etten
Deeley King Pang & Van Etten
Honolulu, HI

Gregory Varga
Robinson & Cole LLP
Hartford, CT

Debra Varner
Varner & Van Volkenburg, PLLC
Clarksburg, WV

Attendee List, as of May 6, 2019
Complete contact info for Fellows can be found in our online directory: americancollegecoverage.org

James Varner, Sr.
Varner & VanVolkenburg, PLLC
Clarksburg, WV

Michael Velladao
Lewis Brisbois Bisgaard & Smith
Los Angeles, CA

Isabel Velladao
Los Angeles, CA

John Vishneski III
Reed Smith
Chicago, IL

Jeffrey Vita
Saxe Doernberger & Vita, PC
Trumbull, CT

Donna Vobornik
Dentons
Chicago, IL

Stuart Walker
University of Illinois College of Law

Brenda Wallrichs
Lederer Weston Craig
Cedar Rapids, IA

Rebecca Weinreich
Lewis Brisbois
Los Angeles, CA

Barron Weinstein
Weinstein & Numbers, LLP
Larkpsur, CA

Bryan Weiss
Murchison & Cumming LLP
San Francisco, CA

Lisa Weixelman
Polsinelli
Kansas City, MO

Christopher Yetka
Barnes & Thornburg LLP
Minneapolis, MN

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

Jared Zola
Blank Rome
New York, NY