"Is the Best Defense a Good Offense?" An Insurer Perspective

American College of Coverage Counsel
2020 Annual Meeting

Virtual Conference
September 10-11 & 24-25, 2020

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An Insurer Perspective: Introduction

Consistent with the approach of numerous courts across many jurisdictions, an insurer has no duty to prosecute affirmative counterclaims as part of its duty to defend. This rule is consistent with the policy language, the weight of authority, and the interests of both policyholders and insurers.

Under widely-used insurance contract terms, an insurer has no duty to a policyholder to prosecute a policyholder's counterclaims. The basic meaning of the duty to defend and the plain and ordinary meaning of the term "defense" compels the conclusion that the prosecution of counterclaims is not part of an insurer's defense obligations. Affirmative counterclaims are inherently offensive and prosecutorial, and not defensive. Expanding the duty to defend to include the prosecution of affirmative counterclaims would impermissibly expand the insurance policy beyond the contractual bargain.

The "in for one, in for all" rule followed in many jurisdictions does not compel a different result. That rule requires that an insurer provide a complete defense against a plaintiff's complaint. In light of the plain and ordinary meaning of "defense," the complete defense rule does not extend "defense" to encompass the prosecution of affirmative counterclaims.

Furthermore, there are strong public policy reasons to adhere to the majority view and refuse to embrace a murky exception for affirmative counterclaims that somehow are "inextricably intertwined" with the defense of an action. *See Spada v. Unigard Ins. Co.*, 232 F.

Supp. 2d 1155, 1163-64 (D. Or. 2002), *aff'd in part on affirmative counterclaim issue,* 80 F. App'x 27 (9th Cir. 2003) (noting that the "inextricably intertwined" test "has been repeatedly called into question, disagreed with, and not followed"). Recognizing the straightforward rule that there simply is no duty to prosecute affirmative counterclaims benefits the insurance system by promoting the certainty on which insurers depend in underwriting risk.

I. Under the weight of authority nationwide, an insurer has no duty to "defend" an affirmative counterclaim.

A. The duty-to-defend is a contractual duty to defend a policyholder for a claim made against it.

The rule that the defense obligation does not require prosecution of affirmative counterclaims is rooted in the basic meaning of the duty to defend: a contractual obligation and right by an insurer to defend a policyholder for a claim made against it.

The insurance contract requires the insurer to cover "Defense Costs," or the "reasonable and necessary legal fees and expenses incurred by [the insurer], or by any attorney designated by [the insurer] to defend [the insured], resulting from the investigation, adjustment, defense, and appeal of a Claim."[1] Nowhere is there any mention of an obligation to prosecute affirmative counterclaims. Imposing that result would impermissibly contort the duty to defend beyond what is provided for under the plain policy terms.

Widely-used insurance contract language provides that the insurer has a duty to defend

[1] The duty to defend is a contractual duty and right undertaken by an insurer. *See Herbert A. Sullivan, Inc. v. Utica Mut. Ins. Co.*, 439 Mass. 387, 397 (2003).

any "claim or suit, i.e., 'any proceeding initiated ***against*** [the insured]'" (emphasis added). Where the policy provides that the insurer has a "duty to defend any claim or suit," the policyholder is not entitled to reimbursement for legal fees incurred in the prosecution of affirmative counterclaims, because an "[insurer's] obligation [to the policyholder] stem[s] from the insurance policy, which provid[e]s for a legal defense." *See Goldberg v. Am. Home Assur. Co.*, 80 A.D.2d 409, 411 (N.Y. App. Div. 1981). The policy language does not include a promise to pay legal fees for claims asserted by the policyholder.

The duty to defend does not expand to include prosecution of counterclaims because a policyholder "bargained only for the insurer to pay for defending the insured against litigation[;] [it] did not bargain for legal representation where the insured is the plaintiff." *Red Head Brass, Inc. v. Buckeye Union Ins.* Co., 735 N.E.2d 48, 57 (Ohio Ct. App. 1999). *See also* Allan D. Windt, *Insurance Claims and Disputes*, § 4:41 (5th ed.) ("An insurer, being obligated only to defend claims brought 'against' the insured, is not required to bear the cost of prosecuting a counterclaim on behalf of the insured.").

B. An affirmative counterclaim is not a claim made against the policyholder.

In asserting a counterclaim, a defendant acts as a plaintiff. "A counterclaim is a 'claim for relief, just like a claim in the complaint." *See* Hon. Amy St. Eve & Michael A. Zuckerman, *The Forgotten Pleading*, 7 Fed. Cts. L. Rev. 152, 176 (2013). A claim brought by a policyholder is, at its core, offensive and prosecutorial, not defensive.

In federal actions, counterclaims are subject to the pleading requirements for all affirmative claims set by the federal rules and the Supreme Court in *Ashcroft v. Iqbal* and *Bell Atlantic Corp. v. Twombly. See id.; see also Tyco Fire Prods. LP v. Victavlic Co.*, 777 F. Supp. 2d 893, 904 (E.D. Pa. 2011) (discussing the pleading standards of affirmative counterclaims). Likewise, states' rules of civil procedure, modeled after the Federal Rules of Civil Procedure, generally construe counterclaims, whether compulsory or permissive, as offensive, prosecutorial claims. *See, e.g., Hermanson v. Szafarowicz,* 457 Mass. 39, 49 (2010) ("We generally follow the Federal courts' interpretation of Federal rules of civil procedure in construing our own identical rules.").

C. The duty to defend has a clear, unambiguous meaning: to deny or oppose the validity of the plaintiff's suit.

There is a basic, unambiguous meaning of "defense" in this context. To provide a "defense" is to deny or oppose the validity of the plaintiff's suit on behalf of the party being sued. *See, e.g., Red Head Brass, Inc.,* 735 N.E.2d at 57 (the "plain and ordinary meaning" of the terms "defend" and "defense" is "to deny or oppose the right of a plaintiff in regard to (a suit or wrong charged)[,]" or "the act of defending [as] opposed to attack[,]" and "a defendants denial, answer, or plea: opposing or denial of the truth or validity of the plaintiff's case;" "defend" "does not include prosecution of one's legal claim against another") (internal citations omitted).

Applying the plain and ordinary meaning of policy terms, like the term "defense," ensures that both insurers and policyholders understand the insurance contract and the available coverage. An affirmative counterclaim is not a proceeding initiated by a third•party against a

policyholder that implicates coverage under a policy. *Shoshone First Bank*, 2 P.3d at 516 (even where "duty to defend" and "claim" were undefined in the policy, holding that if an "insurance policy fails to specify coverage for prosecuting counterclaims, the policy language will not be 'tortured' to create an ambiguity" in order to provide coverage).

D. The weight of authority nationwide recognizes that a duty to defend is a contractual duty to defend a policyholder for a claim made against it.

The majority of courts that have considered the issue have held that an insurer has no duty to prosecute a policyholder's affirmative counterclaims. Commentators agree, noting the general rule that "[a]n insurer, being obligated only to defend claims brought 'against' the insured, is not required to bear the cost of prosecuting a counterclaim on behalf of the insured." Allan D. Windt, *Insurance Claims and Disputes*, § 4:41 (5th ed.).

Indeed, courts in numerous jurisdictions across the nation hold that the duty to defend does not encompass prosecution of affirmative counterclaims. *See, e.g.,* **California,** *James 3 Corp. v. Truck Ins. Exch.*, 111 Cal. Rptr. 2d 181, 188 (Cal. Ct. App. 2001) (no duty to prosecute counterclaims because "there is nothing in the policy that contractually obligates [the insurer] to fund and prosecute an insured's affirmative relief counterclaims or cross•complaints"); *Barney v. Aetna Cas.* & *Sur. Co*., 230 Cal. Rptr. 215, 219-20 (Cal. Ct. App. 1986) (no duty to prosecute counterclaims, noting that "[the insurer] had no duty under the policy to file a cross-complaint on [the insured's] behalf, for nothing in the policy provisions imposes upon the insurer the duty to prosecute claims of the insured against third parties"); *Silva* & *Hill Constr.* Co. *v. Emp'rs Nut.*

Liab. Ins. Co., 97 Cal. Rptr. 498, 506 (Cal. Ct. App. 1971) ("The duty to defend could not extend to requiring the insurer to take affirmative action [.]"); **Massachusetts,** *Mount Vernon Fire Insurance Company v. VisionAid, Inc.*, No. SJC-12142 (June 22, 2017) (finding no duty to defend counterclaim); **Ohio,** *Red Head Brass, Inc.*, 735 N. E. 2d at 57 (finding that under the "plain meaning to the words of the contract[,] . .. the contract did not require [the insurer] to pay for the prosecution of [the policyholder's] counterclaim"); **Oregon,** *Spada v. Unigard Ins. Co.*, 232 F. Supp. 2d 1155, 1164 (D. Or. 2002), *aff'd in part on affirmative counterclaim issue*, 80 F. App'x 27 (9th Cir. 2003) (finding chat "policy language 'to provide a defense' does not encompass a duty to prosecute affirmative counterclaims and cross-claims for relief"); **New Jersey,** *Morgan, Lewis* & *Bockius LLP v. Hanover Ins. Co.*, 929 F. Supp. 764, 773 (D.N.J. 1996) (no coverage for counterclaim filed by policyholder because "[t]he insurance policies do not cover affirmative claims asserted by the insured...."); **New York,** *Goldberg v. Am. Home Assur. Co.*, 80 A.D.2d at 410-11 (N.Y. App. Div. 1981) (insurer "was under no obligation to represent [the policyholder] in his counterclaim against [the claimant]..." because "[the insurer's] obligation to [the policyholder] stemmed from the insurance policy, which provided for a legal defense"); *Reynolds v. Hartford Acc.* & *Indem. Co.*, 278 Supp. 331, 333 (S.D.N.Y. 1967) ("As the insurance contract never contemplated the obligation to bring affirmative claims on behalf of its assured and the prosecution of counterclaims would no doubt entail extra expenditures on the part of the insurance carrier, to imply an obligation on its part to bring counterclaims would be manifestly unfair"); **Maine,** *Bennett v. St. Paul Fire* & *Marine Ins. Co.*, No. 04-cv-212-GNZ, 2006 WL 1313059, at *4, n.10 (D. Me. May 12, 2006) (citing *Carey v. Indian Rock Corp.*, 863

A.2d 289, 290 (Me. 2005) (Maine case law suggested that Maine courts would take the view that there is no duty to prosecute counterclaims as part of an insurer's duty to defend); **Minnesota,** *St. Paul Fire & Marine Ins. Co. v. Nat'l Computer Sys., Inc.*, 490 N.W.2d 626, 632 (Minn. Ct. App. 1992) (insurer not obligated to pay for the costs of a counterclaim raised by the policyholder in answering the complaint); **North Carolina,** *Duke Univ. v. St. Paul Mercury Ins. Co.*, 384 S.E.2d 36, 46 (N.C. Ct. App. 1989) ("An insurer, being obligated only to defend claims brought 'against' the insured, is not required to bear the cost of prosecuting a counterclaim on behalf of the insured."); **Wisconsin,** *Towne Realty, Inc. v. Zurich Ins. Co.*, 548 N.W.2d 64, 69 (Wis. 1996) (finding that even where the prosecution of a counterclaim is necessary to defend a suit, there is no duty to prosecute an affirmative counterclaim where "[t]he insurance contract simply does not establish an obligation on the part of [the insurer] to indemnify the Insureds for the pursuit of counterclaims"); **Wyoming,** *Shoshone First Bank v. Pac. Emp'rs Ins. Co.*, 2 P.3d 510, 516 (Wyo. 2000) ("We invoke our rule that if an insurance policy fails to specify coverage for prosecuting counterclaims, the policy language will not be 'tortured' to create an ambiguity."). These cases make clear the widespread agreement on this rule.

E. "In for One, In for All" is consistent with the rule that there is no duty to prosecute affirmative counterclaims.

Courts agree that the contractual duty to defend, under widely-used policy language and the usual and ordinary sense of the term "defense," does not include coverage for the prosecution of affirmative counterclaims, which are, by definition, offensive. Indeed, as the United States District Court for the District of Massachusetts in *Barletta Heavy Division, Inc. v. Travelers*

Insurance Co. explained, the duty to defend limits an insurer's duty to "defending against claims and does not encompass lawsuits launched offensively. "*Barletta Heavy Div., Inc. v. Travelers Ins. Co.*, No. 12-11193-DPW, 2013 WL 5797612, at *10 (D. Mass. Oct. 25, 2013) (internal quotations omitted). Counterclaims are claims for relief, like claims asserted in a complaint.

Further, the "in for one, in for all" or complete defense rule is fully consistent with the majority rule that counterclaims are not a "defense." The "in for one, in for all" rule requires that an insurer provide a defense for the entire complaint even if coverage is unavailable for certain causes of action asserted against the policyholder. *See GMAC Mortg., LLC v. First Am. Title Ins. Co.*, 464 Mass. 733, 739 (2013). While this rule may require a "complete defense" against the claimant's action, it does nothing to support an expansion of the duty to defend to include the prosecution of affirmative counterclaims, because such claims are inherently offensive.

Notably, the "in for one, in for all" rule is consistent with the approach of most jurisdictions across the country with respect to the duty to defend. *See generally,* Steven Plitt et al., *14 Couch on Insurance §* 200:19 (3d ed. 2016) ("A duty to defend any of the claims against an insured usually requires the insurer to defend the entire suit."). The weight of authority recognizing that there is no duty to prosecute affirmative counterclaims is fully consistent with this widely-accepted "complete defense" principle because, as discussed, the assertion of affirmative counterclaims is not part of a policyholder's defense.

F. Adopting the rule that there is no duty to prosecute affirmative counterclaims benefits both policyholders and insurers.

The assertion of counterclaims in civil litigation is ubiquitous. Both the Federal Rules of Civil Procedure and state rules of civil procedure allow defendants to plead any counterclaim in the answer to a complaint, in the same way a plaintiff would assert a claim. *See* Fed. R. Civ. P. 13(b). The liberal assertion of counterclaims is encouraged by the American judicial system as a means to promote judicial economy. *See* Douglas D. McFarland, *In Search of the Transaction or Occurrence: Counterclaims*, 40 Creighton L. Rev. 699, 732 (2007) (joinder devices such as counterclaims "permit as many controversies as possible to be settled in a single lawsuit, and joinder rules should promote judicial economy and efficiency").

The United States District Court for the District of Massachusetts in *Barletta Heavy Division, Inc. v. Travelers Insurance Co.* noted the problem of extending coverage to affirmative suits by policyholders. "Finally, there are good policy reasons for declining to extend the coverage of an insurer's duty to defend to voluntary suits initiated by the insured," it said. *Barletta Heavy Div.*, 2013 WL 5797612 at *10. The court recognized that:

> To do so would risk spawning marginal litigation; an insured would have every incentive-and little disincentive-to file suit, knowing that it could reap the benefits of success-however unlikely-while transferring the costs of an otherwise predictably unsuccessful suit onto its insurer.

Id.

If the defense duty were to be interpreted to encompass affirmative counterclaims, insurers would incur increased litigation costs that were not contemplated in the underwriting

process. Thus, expanding an insurer's duty to defend beyond the defense of claims asserted against a policyholder to affirmative counterclaims would create greater litigation risk and uncertainty for insurers long-run, this would not serve the interest of Massachusetts policyholders.

Insurance is a carefully defined, risk-for•premium exchange, calculated by an exacting actuarial science. *See N. River Ins.* Co. *v. Cy Thompson Transp. Agency, Inc.*, 840 F.2d 139, 142 (1st Cir. 1988) (recognizing that coverage is tailored to the risks defined in the insurance policy). Insurers price their policies based on an assumption of risk of claims asserted by third-parties against the policyholder. Coverage for affirmative counterclaims, and the high likelihood that they will be asserted, would negate the clear meaning of the policy's defense provisions, and add an additional factor in the underwriting process. As courts and commentators repeatedly have recognized, expanding insurers' coverage obligations beyond the explicit policy terms leaves "ordinary insureds to bear the expense of increased premiums necessitated by the erroneous expansion of their insurers' potential liabilities."[2]

II. Public policy supports adherence to the rule that the duty to defend only extends to claims asserted against a policyholder.

Adherence to the rule that defense does not include the prosecution of affirmative counterclaims is in accord with the basic meaning of the duty to defend. This rule is consistent with the policy language, the weight of authority, and the public interest. This longstanding rule

[2] *Garvey v. State Farm Fire* & *Cas. Co.*, 770 P.2d 704, 711 (Cal. 1989); *see also Moradi-Shalal v. Fireman's Fund Ins. Cos.*, 758 P.2d 58, 66 (Cal. 1988) (legal rules which increase insurance litigation costs will "result in higher premiums" to the general public) (internal citations omitted).

is a tested, straightforward standard for determining an insurer's defense duties.

An exception would undercut the straightforward rule that a defending insurer simply is not required to prosecute a counterclaim. In particular, the murky exception that a few courts have found to exist for affirmative counterclaims that somehow are "inextricably intertwined" with the defense of an action is suspect and undesirable. *See Spada*, 232 F. Supp. at 1163-64 (D. Or. 2002) (noting that *Safeguard Sci.'s, Inc. v. Liberty Mut. Ins. Co.*, 961 F.2d 209 (3d Cir. 1992), which advocates for the "inextricably intertwined" test "has been repeatedly called into question, disagreed with, and not followed"). An "inextricably intertwined" or similar carve-out would inject unnecessary and undesirable confusion into a clear rule. Requiring a defense of *some* counterclaims under such a rule would create undesirable ambiguity regarding an insurer's defense obligations. *See, e.g., Barletta Heavy Div.*, 2013 WL 5797612, at *10. It would unduly complicate the coverage analysis and encourage coverage disputes over whether a particular counterclaim is "inextricably intertwined" with the defense of the action.

Requiring insurers to pay for affirmative claims that would potentially benefit a policyholder would fundamentally alter an insurer's defense obligations under the policy.[3] It would negate the clear meaning of widely-used insurance policy terms and sweep in all kinds of unforeseeable activity. For instance, would defending a faulty workmanship case require an insurer to also prosecute suits for any amounts that customers have withheld due to complaints

[3] To the extent that the insured suggests that thebest defense to the claims against him is an affirmative counterclaim, it should be noted that there is already a pleading mechanism that allows a defendant to assert affirmative matters defeating claims against him - affirmative defenses.

about inadequate workmanship? Would an insurer defending a company in a wrongful termination case be required to finance counterclaims concerning alleged theft of trade secrets? Incorporating these types of obligations to pursue affirmative claims as part of a "defense" would go well beyond providing a policyholder a simple "collateral benefit."

Such obligations are not part of the insurer's contractual duty to provide a defense within the plain meaning of the term. *See Towne Realty, Inc.*, 48 N.W.2d at 69 (quoting dissent in lower court opinion that although "[i]t may be true that a good defense is a good offense, that does not create an obligation beyond the terms of the insurance policy. Courts should adhere to the settled rule, and refuse to introduce confusion into an insurer's duty to defend its policyholder in third-party suits brought against it.

Conclusion

An insurer does not owe a duty to prosecute an insured's counterclaim(s) for damages, or for affirmative counterclaims generally, as part of its duty to defend under the provisions of the insurance contract related to providing a defense or under an "in for one, in for all" rule.